



Yet another blow

IT'S getting to be a tough year for SMEs and private limited companies. Even as they try to cope with the effects of the Goods and Services Tax (GST), a slowing economy, weak ringgit, new minimum wage and increased foreign worker levy, they now have to comply with a new financial reporting standard.



by Galyn Yap



by Ho Chung Teng

That compliance will result in additional costs such as staff training, increased audit fees and additional valuation fees to revalue some of their assets and liabilities. Their current accounting systems may also require upgrades.

It is difficult to estimate what the extra costs would be to the some 645,000 SMEs and thousands

of other smaller companies but they can expect audit fees to go up by at least 10%.

The new standard is called the Malaysian Private Entities Reporting Standard (MPERS). The framework, which is effective this year, was issued by the Malaysian Accounting Standards Board (MASB) on Feb 14, 2014, to replace

the outdated Private Entity Reporting Standards (PERS), which had been in force since 1998.

Private limited companies, however, have a choice of complying with MPERS or the full Malaysian Financial Reporting Standards (MFRS) – typically the domain of listed companies – but migration from PERS is mandatory.

However, its timing could not have been worse. According to the SME Association of Malaysia, these companies comprise 98.5% or 645,136 of the total number of business establishments in the country and a significant number have reported a 30-50% drop in sales in the past year.

Industry players and experts in the financial services industry, however, say MPERS is bringing about necessary change as it is a step in the right direction to improve financial reporting by private entities.

This will ensure local businesses can stand shoulder-to-shoulder with their

peers in regional and global markets in terms of comparable financial statements, which will also open up more financing opportunities outside the country.

Those familiar with the industry say there are inevitable costs in compliance. It is believed there will be minimal effect on smaller companies, with medium-sized ones bearing most of the impact. The impact will vary depending on the size and complexity of the transactions undertaken by these private limited entities.

EY Malaysia partner **Stephen Oong** says transactions undertaken by most micro-enterprises are relatively straightforward and they do not enter into complex contractual agreements. Thus, for these businesses, accounting treatment for such transactions and contracts would normally be the same whether under MPERS or PERS.

Compared to MFRS, Oong believes disclosure requirements under MPERS are significantly less comprehensive, with fewer accounting policy choices and disclosures. This should go down well with SMEs.

That said, MPERS could result in a change in an SME's accounting policies, especially in areas where there are no equivalent requirements under PERS. These changes range from presentation



Ngo says one of the changes is in the presentation of financial statements



Ko says there will also be extra costs from the domino effect on business operations

of financial statements to effecting judgments for financial impacts arising from the transition, say Deloitte Malaysia audit partner **Cheong Thoong Farn** and audit technical director **Winston Ngo**.

The Association of Chartered Certified Accountants (ACCA) Malaysia technical and policy manager **Vivian Ko** says there will likely be additional costs for medium-sized companies, such as training staff and a potential increase in audit consultation fees. "They may also need to incur additional valuation fees to revalue some of their assets and liabilities."

Moreover, many private entities today rely heavily on accounting systems or enterprise resource planning (ERP) systems, which may potentially require

A significant impact

THE Malaysian Private Entities Reporting Standard (MPERS) has exemption provisions for undue costs which should ease its implementation compared to the Private Entities Reporting Standard (PERS) which does not.

Malaysian Accounting Standards Board (MASB) executive director **Tan Bee Leng** explains: "In areas where fair value measurement is relevant, for example in the case of investment property and biological assets, fair value is required only when such assets can be measured reliably without undue cost or effort."

Further, the framework also introduces a hierarchy to determine and measure fair value and does not require the use of a professional valuer, say Deloitte Malaysia audit

partner **Cheong Thoong Farn** and audit technical director **Winston Ngo**.

In terms of specific industries, EY Malaysia partner **Stephen Oong** notes property developers and plantation companies will be the most affected. This is due to the significant differences between PERS and MPERS, with the latter requiring non-capitalisation of both the borrowing and development costs, but the impact of the change will depend on the business transactions.

He says: "Under MPERS, SMEs have a choice of [adopting] either capitalised or expensed borrowing costs. If a property developer borrows significant amounts to acquire land and fund development activities, its bottom line will be significantly affected."

Borrowing cost is defined as cost directly attributable to the acquisition, construction or production of a "qualifying asset" which includes: interest

expense, finance charges and exchange differences arising from foreign currency borrowings.

It is also not uncommon for companies to take loans for the construction of factories and buildings, he notes.

However, the new reporting standard states that all interest costs incurred need to be expensed and cannot be capitalised as part of the costs of these assets under construction.

For property players with significant investment properties, Oong says MPERS can be an expensive compliance requirement. He explains that SMEs will likely have to engage the services of professional valuers to determine the fair values of their investment properties. Compared to listed companies, they have an accounting policy choice of measuring their investment properties at cost or fair value. SMEs do not have the choice.

Plantation companies will be required

Tan says fair value is required only when the assets can be measured reliably without undue cost or effort



SMEs by sector

Sector	Micro	Small	Medium	Total no. of SMEs	SMEs in sector	Number of large firms	Total no. of establishments
	Number of establishments				% share		
Manufacturing	21,619	13,934	2,308	37,861	5.9	1,808	39,669
Services	462,420	106,061	12,504	580,985	90.0	10,898	591,883
Agriculture	3,775	1,941	992	6,708	1.0	2,121	8,829
Construction	8,587	6,725	3,971	19,283	3.0	2,857	22,140
Mining and quarrying	57	126	116	299	0.1	119	418
Total no. of SMEs	496,458	128,787	19,891	645,136	100.0	17,803	662,939

Source: SME Annual Report 2014/15

“Private entities would do well to realise that the shift to MPERS does not only impact the disclosure portion of the financial statement, but also the day-to-day operations and way of capturing financial data as well.”

— Ko

changes or upgrades, says PricewaterhouseCoopers Malaysia (PwC) senior executive director **Siew Kar Wai**.

She points to accounting systems where the functional currency is not set in ringgit as an example of systems that require changes to record transactions in its functional currency under MPERS. This is in contrast with PERS' relatively straightforward stance, where all transactions are measured in ringgit regardless of the primary economic environment of the private entity. Functional currency means the currency of the primary economic environment in which a business operates.

With the implementation of MPERS, SMEs are allowed to translate only their foreign operations based on “closing rate translation method”. Under this method, translation of foreign operations are made at the end of a period.

ACCA's Ko says additional costs will come not only from MPERS' implementation, but also from the domino effect on business operations.

She adds: “Private entities would do



Oong says most micro-enterprises have relatively straightforward transactions



Siew says MPERS requires transactions to be recorded in the functional currency

well to realise that the shift to MPERS does not only impact the disclosure portion of the financial statement, but also the day-to-day operations and way of capturing financial data as well.”

Compliance with MPERS is just one of the many problems faced by SMEs in recent years. It was perhaps the announcement of the minimum wage in 2012 that marked the start of the toughest time SMEs would face.

Effective Jan 1, 2013, SMEs with more than five employees had to pay a minimum wage of RM900 and RM800 per month in the peninsula, and Sabah and Sarawak, respectively. However, SMEs were given blanket deferment of the minimum wage implementation for foreign workers until Dec 31 of the same year.

Feeling the pinch

In early 2014, smaller companies felt the full impact of the minimum wage. The Malaysian Employers Federation said SMEs' labour costs increased by 40-60% and overall costs by as much as 10%.

The year that followed was not much better. Peppered with higher overheads in the form of increased electricity tariffs, transportation and raw material costs as well as subsidy cuts, they had to contend with a new challenge looming over the horizon: GST.

First mooted in 2009, the GST, which replaced the sales and service tax (SST), was scheduled to be implemented in 2011 but was repeatedly put off until April last year. An uncertain implementation timeline, confusion on the mechanics of the tax system, and the lack of knowledge on necessary GST processes hampered adoption among SMEs, with a large number adopting a wait-and-see approach.

A necessary move but timing's off

MPERS is derived from the International Financial Reporting Standards (IFRS) for SMEs which was first issued by the International Accounting Standards Board (IASB) in 2009. IFRS for SMEs is a self-contained accounting standard designed to meet the needs and capabilities of small and medium entities compared to the full IFRS which is adopted by Malaysian Financial Reporting Standards or MFRS.

MPERS defines SMEs as private entities, excluding sole proprietorships and partnerships. It also covers unlisted companies that are not a financial institution and where the parent company is also not listed and not a financial institution.

MPERS, intended to bring SMEs up-to-date with regional and global accounting practices, is yet another measure admittedly long overdue.

From the perspective of smaller companies, however, it is blow-after-blow in a continuous series of reforms that many feel would have been better introduced over a longer period of time, in order for them to cope.

Compliance with MPERS comes into effect for financial statements from Jan 1, 2016. The timing couldn't have been worse. Dampened business and consumer sentiments have negatively impacted sales of SMEs.

Struggling to make ends meet, smaller companies grappled with ensuring sufficient time and resources to meet compliance costs, specifically in replacing outdated technology with the right software and training employees to understand the new processes.

Then other issues cropped up that created multiple shocks for the economy, including a sharp dip in commodity prices with crude oil prices falling to US\$30 per barrel. Added to that were weak external and internal demand owing to global economic uncertainties,

➤ See next page

to measure all their biological assets at fair value for each reporting date, with fair value changes taken to profit or loss. This is a problem, he says, as Malaysian companies are generally adverse to the idea of measuring their oil palm trees, rubber trees, fish, prawns and chickens at fair value.

“The irony is listed plantation companies applying MFRS do not have to fair value their bearer biological assets such as oil palm trees. Instead, they are required to measure such trees at cost or at valuation. The cost model option is not available to SMEs. From this perspective, SMEs are placed in a more onerous situation than listed plantation companies,” Oong shares.

Furthermore, SMEs with significant amounts of intangible assets or goodwill will also be affected by the change, as these will normally have to be amortised over 10 years and can be a nightmare to



Above: Deloitte Malaysia audit partner Cheong Thoong Farn



KPMG audit partner Thong Foo Vung

their bottom line. Amortisation is a routine decrease in the value of an intangible asset or the process of paying off a debt through regular payments.

The adoption of new standards involves a lot of work within the first year, especially so with MPERS, which dictates a new way of doing things owing to its requirements.

Issues on the ground

KPMG's audit partner **Thong Foo Vung** feels strongly that the debate on the practicality and necessity of MPERS is already history and it is a mandatory migration for private entities, especially SMEs. He adds the move to a more up-to-date and acceptable financial reporting framework is encouraging but recognising implementation issues and managing them upfront will help ensure a smoother transition.

Technical issues may arise, opines

EY's Oong and it will be a big challenge to ensure financial statements are comparable among SMEs as there must be consistency in application and implementation of MPERS' requirements.

Deloitte's Cheong and Ngo echo Oong's views that the “undue cost or effort” exemption in determining fair value in the framework may bring new problems, as judgment on what constitutes “undue cost or effort” may differ from one entity to another.

Association of Chartered Certified Accountants (ACCA) Malaysia technical and policy manager **Vivian Ko** says a smooth transition is not expected, owing to a lack of preparation by private entities. While the framework came into effect last month, it requires companies to have retrospective prior-year figures for comparison.

She adds: “The implication here is

➤ See next page

Tough times but SMEs determined to show they're resilient

► From previous page
volatility in global financial markets, and political developments.

Another concern affecting SMEs' bottom lines and narrowing profit margins was the depreciation of the ringgit, as the majority of these companies operate almost exclusively in the domestic market. Not many SMEs export extensively, but those that do tend to import raw materials, impacting input costs despite higher returns due to an favourable exchange rate.

The latter half of last year saw subdued domestic consumer sentiment and a halt in expansion or capacity building plans for SMEs amidst global and regional trade slowdowns, further eroding external demand. Still reeling from the effects of the GST, companies were greeted with another shock in the form of a further hike in minimum wages.

The 2016 Budget announced that minimum wages for workers in the private sector will be increased from July to RM1,000 in the peninsula, and RM920 in Sabah, Sarawak and Labuan. The current minimum wages are RM900 and RM800, respectively.

The wage ceiling for mandatory contribution to the Social Security Organisation (Socso) was also raised to RM4,000 from RM3,000.

Another major blow was when the government announced recently steep increases in foreign workers' levy. One reason given is that it is meant to reduce dependence on foreign labour and encourage SMEs to restructure their



Low says Vision Animation's medium-term outlook is better as foreign sales will start in the second half

businesses and invest in automation. It would bring in an estimated RM2.5 bil to the government's coffers. Following protests, the levy hike has been put on hold pending discussions with employers. A final decision will be made soon and it seems inevitable that there will be an increase in the cost of doing business.

The government had proposed that employers pay RM2,500 per foreign worker in the manufacturing, construction and services sectors, and RM1,500 per worker in the plantation and agriculture sectors (from RM1,250 for manufacturing and construction, RM590 for plantation, RM410 for agriculture and RM1,850 for services). The levy for foreign domestic workers remains at RM410.

Battle for survival

It is undeniable this year would be a challenging one for SMEs, and in the battle for survival in today's tough economic environment, inevitably the weaker companies will fall.

Being resilient, many SMEs are determined to weather the storm and grow further despite these challenges.

Animation studio Vision Animation Sdn Bhd CEO **Low Huoi Seong** says the ringgit's depreciation works in his company's favour as it generates most of its income from licensing royalties from foreign sources.

However, the weak ringgit is a big blow to businesses such as biotech



Syed Isa laments the foreign labour levy hike will be another burden for manufacturers

company Algaetech International. Its founder and CEO **Datuk Paduka Syed Isa Syed Alwi** says the increase in the exchange rate of the US\$ by almost RM1 from RM3.30 to RM4.30 last year means an almost 30% hike in the prices of all materials and equipment needed. This, he points out, is on top of the GST impact on procurement pricing.

"The other sad part is that all grants, loans and so on are in US\$ and pegged at RM3.30, meaning a cost increase of 30% to 35% overall on all new purchases and in honouring old payments. Agencies don't care if the ringgit has depreciated so much and will only base it on the current value," he adds.

Saying the cost of doing business has increased, Vision Animation's Low says: "Some of my budgeted costs do go up, especially those incurred offshore. Locally, we had to increase salaries to help employees cover the rising cost of living. So, in the short term, our costs have increased, but the medium-term outlook is better when foreign sales start in the second half of this year."

Syed Isa further states the new foreign labour levy will be another burden that will increase costs, especially for smaller manufacturers such as Algaetech.

Malaysian Footwear Manufacturers Association president **Tony Ting** says the government has to be in tune with businesses and consult them on important business issues such as the levy hike.



Ting believes only the most competitive and cost-efficient shoe manufacturers will survive

On MPERS, Syed Isa says: "Accounting standards have been something that people like me, who are not accountants, are left boggled on how it is done. As it is, I find it stringent. MPERS will definitely make an impact in terms of costing at the end of the day, and as such will be an additional burden to beginners like us."

Also rising is the cost of electricity, which he says is a major cost contributor in most industries. In manufacturing, for example, power constitutes about 60% of overall costs.

While SMEs in general are pushing on with perseverance, business sentiment is bleak. "At the rate it's going now, many will sink, with many more to follow and only the fittest will survive," says Syed Isa.

Ting echoes his sentiments, specifically for the footwear industry, saying only the most competitive and cost-efficient companies will survive.

He adds: "Small and medium footwear companies will definitely suffer. Some local brands will be phased out in the face of the cut-throat price war by foreign and international licensed brands. There is no room for second best as businesses simply cannot afford to misallocate resources in a globalised economy."

Ting suggests the government initiates a national campaign to promote local brands and products, and encourage all government agencies to use only local goods and services. **FocusM**

Most firms not ready for MPERS

► From previous page
that they will need to convert 2015 figures in accordance to MPERS to enable this comparison for 2016's financial statement. Hence, the urgency for private entities to prepare for MPERS early. To start now would in fact be a little delayed [late], but they must begin the transition now."

The issue of implementation is further complicated by the mindset of private entities, which she says may not be acknowledging the urgency to start the transition process and may even disregard the Jan 1 enforcement date as they think there is still one year to go until Dec 31, 2016.

SME Association president **Michael Kang** says it will be a big impact on companies in light of the rapid changes in the local and global economic environment. He adds the change to the new reporting standard is a minimum requirement for doing business moving forward.

He stresses: "If you want to compete in the Asean market, it's something that's necessary. You need to have the proper

systems in place – be it management, accounting systems or standards – to grow bigger and move to the next level."

That said, Kang admits that for the majority of SMEs, they are just not ready for MPERS. This explains why the association, with support from the government, has embarked on a nationwide programme to educate SMEs on MPERS since last month.

Similarly, the Malaysian Institute of Accountants (MIA) has implemented initiatives to boost awareness, as well as training and support to its members to ease implementation woes. "We have outreach programmes to help SMEs implement MPERS. Such programmes will teach participants what are the key requirements of MPERS, the changes and differences with the current PERS, as well as the implementation and application issues. We have conducted this in six states – Perak, Negeri Sembilan, Melaka, Pahang, Sarawak and Kedah," says its CEO **Ho Foong Moi**.

Ho spoke of MIA's outreach programmes to help SMEs implement MPERS



She adds MIA will organise more training programmes on MPERS. It has already conducted 38 such programmes nationwide.

Despite initial costs, Deloitte's Cheong and Ngo say private entities should not shy away from MPERS as it allows them to be relevant and competitive and their financial information to be comparable to that of others in the global marketplace.

Opening up opportunities

It is important for SMEs to apply accounting standards that will help them reduce their compliance costs and remove uncertainties that affect their cost of capital, says MASB's Tan. This is because it will make cross-border trade, investment and capital allocation easier.

With the adoption of MPERS, the financial statements of private entities will meet international standards, and owing to the similarities between MPERS and IFRS for SMEs – except the requirements on property development – these statements will be comparable

with financial statements of their peers in at least 73 jurisdictions.

The comparability is vital for private entities looking to reach beyond Malaysia's borders, as financial institutions and venture capital firms are typically multinational operations which rely on financial statements in making lending decisions, and establishing terms and interest rates.

Owing to IFRS for SMEs being an internationally recognised framework for the preparation of financial statements, and that MPERS is almost identical, it intends to ensure that lenders, investors and other stakeholders receive high quality financial information to help them make these decisions.

"It is important and relevant for private entities in Malaysia to adopt a global financial reporting language that is up-to-date and has been adopted by other countries to gain access to a wider market for their financing needs," says PwC's Siew.

MASB's Tan adds: "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."