Issues and Challenges of Adoption of IFRS for SMEs in Malaysia

Vicky Vendy*, Diarany Sucahyati

Universitas Pembangunan Nasional “Veteran” Jawa Timur, Surabaya 60294, Indonesia

*Corresponding author: E-mail: vicky.vendy.ak@upnjatim.ac.id

ABSTRACT

The purpose of this research is to look into issues and challenges associated with the adoption of International Financial Reporting Standards for Small and Medium Enterprises (IFRS for SMEs) or so-called MPERS (Malaysian Private Entity Reporting System). Using keywords like “IFRS for SMEs,” “MPERS in Malaysia,” and so on, this study examines existing literature in the form of articles in the Emerald database, as well as press releases and publications published by the Malaysian Institute of Accountants (MIA). The MPERS version of IFRS is a shortened version of the complete IFRS. It reduces the substance of the whole IFRS by about 85%. Certain topics are excluded because they are not normally relevant to SMEs. SMEs, on the other hand, still consider IFRS for SMEs to be excessively complicated. MPERS is a performance-based standard, not a cost-based one. Almost everything must be of reasonable value. As a result, businesses owning investment properties or biological assets will have to pay extra for the valuation of these assets at fair value. For preparers, there are two major obstacles to overcome. Constant changes in standards, as well as a scarcity of skilled accountants, are also issues. Some data suggests that the decision usefulness model is inappropriate for smaller businesses. SMEs have a small number of account users, lack accounting competence to deal with complexity, and are managed by their owners. Furthermore, for SMEs, a reporting approach focused on stewardship and employing simplified historical cost accounting would be more appropriate.

Keywords: IFRS for SMEs, MPERS, Malaysia

Introduction

Malaysia has announced the adoption of MPERS (Malaysian Private Entity Reporting System), a set of International Financial Reporting Standards for Small and Medium Enterprises (IFRS for SMEs) with minor modifications on income tax and property development activities, which will take effect on January 1, 2016 (IFRS Foundation, 2017). It’s not unexpected that Malaysia, as a reasonably rich country with stock exchanges and widespread usage of English in business, has accepted the standard. Malaysia is ranked sixth in the “Ease of Doing Business in 2014” rankings, indicating that the country is in good shape to foster entrepreneurship and is ready to adopt global accounting standards (Samujh & Devi, 2015). The adoption of MPERS will ensure that local enterprises are comparable to their international competitors (MIA, 2016).

The application of International Financial Reporting Standards for Small and Medium Enterprises has both advantages and disadvantages (IFRS for SMEs). There is a lot of discussion about how important it is for SMEs to adopt IFRS. Proponents of IFRS for SMEs argue that by converting to IFRS, countries will be able to attract Foreign Direct Investment (FDI) and contribute to raising...
the standard of living of their citizens through sustained growth. However, whether there is a genuine link between IFRS convergence and FDI has long been a source of controversy and dispute (Mustafa & Singh, 2012).

Low accountability, according to the United Nations Conference on Trade and Development (UNCTAD), is one factor contributing to financial instability, which discourages FDI and prevents assistance donors from lending (Samujh & Devi, 2015). Many government programs, such as credit guarantee schemes and start-up loans, require entrepreneurs to provide financial reports to be held accountable for the funds they receive. Furthermore, aid recipients must meet certain financial accountability requirements set by organizations like the World Bank and the Asian Development Bank (ADB).

Compliance with MPERS provides major benefits to SMEs. Because the MPERS framework necessitates extensive disclosures, adoption of the standard will improve private entity accountability, hence boosting investor and banker confidence. As a result, SMEs will be able to compete in regional and worldwide markets, as they will be able to inform decisions that are in line with global norms (MIA, 2016). Meanwhile, SMEs tend to prioritize cash flow and operations above financial reporting, putting them at a disadvantage when it comes to obtaining financing and accessing markets. As a result of implementing MPERS, they will be able to prioritize financial reporting and disclosure to differentiate themselves in regional and worldwide markets (MIA, 2016).

Many developing economies in Asia adopted IFRS after the World Bank and the International Monetary Fund (IMF) advocated it. According to the IASB, 73 nations already utilize IFRS for SMEs, with 14 more contemplating it, according to Accountant’s Today Magazine (MIA, 2016). This means that Malaysian private organizations, the majority of which are SMEs, would be able to compare their financial statements to those of SMEs in at least 73 countries, including the United Kingdom, Australia, Hong Kong, and Singapore. When it comes to money, bankers and venture investors can readily make comparisons. It will make it easier for international investors to invest in SMEs (MIA, 2016). However, the implementation of IFRS for SMEs may continue to be a contentious issue. As a result of the adoption, some objections have surfaced. Institutional forces forced the majority of developing economies to commit to convergence (Samujh & Devi, 2015).

Other developing economies, such as Bahrain, Zimbabwe, Bangladesh, and Egypt, are encouraged to embrace IFRS. It is believed that the IASB’s path toward a single set of IFRS is more about political and social elements than about the economic benefits of IFRS convergence (Samujh & Devi, 2015). According to Samujh and Devi (2015), there is no benefit to using IFRS for SMEs for firms that operate locally. They are uninterested in international trade, and their accounting reports typically cite the national revenue authorities as a source of information. Compliance with IFRS for SMEs may necessitate unnecessary accounting reporting for many SMEs, particularly the smallest.

Furthermore, extra regulation has been demonstrated to hurt rising economies, as it creates additional barriers for entrepreneurs and reduces the number of enterprises registered. Then adopting the International Financial Reporting Standards (IFRS) for SMEs for all small companies could be counterproductive by putting an undue financial reporting burden on entrepreneurs, leading to more informed business (Samujh & Devi, 2015).

The possibility of increased foreign direct investment (FDI) is one of the most commonly perceived benefits of convergence to IFRS, but according to a 2010 report on the most attractive FDI destinations, the world’s highest FDI receivers are China, the United States of America, and India, none of which have converged to IFRS (Mustafa & Singh, 2012). As a result, the concept that IFRS convergence will attract FDI is false, and this ostensible benefit cannot be used to persuade countries to adopt IFRS for their financial reporting.

Before the IFRS set standards for SMEs, the IASB must understand the cultural and historical backdrop of accounting in developing economies, notably in Southeast Asia. As a result, the IFRS
for SMEs could help small enterprises strengthen their financial records and support entrepreneurs in their efforts to stay in business. This article attempts to clarify several difficulties concerning the adoption and implementation of IFRS for SMEs in developing economies, particularly in Malaysia. This paper will begin by defining SMEs and the International Financial Reporting Standards (IFRS) for SMEs. The discussion then shifts to concerns surrounding the adoption of IFRS for SMEs, such as the implications of fair value, the significance of issues addressed in IFRS for SMEs, the option of using IFRS for SMEs or earlier standards, and the issue of IFRS for SMEs’ aim. Finally, a conclusion will be formed when the conversation has been displayed.

Literature Review

Defining SMEs

Small and medium businesses (SMEs) are more concerned with surviving than with growing and profiting (Samujh & Devi, 2015). As a result, they are more prone to focus on historical stewardship rather than future-oriented stewardship. For small and medium-sized businesses, the IASB established two criteria. For starters, the corporation is not accountable to the public. It means that the entity’s debt or equity instruments are not traded in a public market, or that the entity is not in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange, or an over-the-counter market, including local and regional markets), or that the entity’s primary business is not holding assets in a fiduciary capacity for a large group of outsiders. Banks, credit unions, insurance businesses, securities brokers/dealers, mutual funds, and investment banks are all examples of this. Regarding its principal operation (e.g., receiving payment in advance of delivery of products or services), the entity can hold the assets of its clients and consumers (Vasek, 2011). Second, for external users, the entity provides general-purpose financial statements. Owners who are not involved in the management of the business, existing and future creditors, and credit rating organizations are examples of external users (Vasek, 2011). However, the majority of SMEs do not participate in the capital markets, and their activities are primarily local and self-funded (Samujh & Devi, 2015).

In defining an SME, the CPA Australia-Corporate Governance & Financial Reporting Centre (2007) looked at key quantitative measures such as turnover, total gross assets, and the number of workers. The majority of survey respondents chose a turnover and total assets criterion of US$10 million or less as the quantitative metric for designating an SME. Less than 50 full-time employees were likewise chosen as the suitable workforce measure for an SME by the respondents.

IFRS for SMEs

The IFRS for SMEs was derived from the entire IFRSs, with various simplifications made to facilitate SME financial statement users and cost-benefit analysis. The following are five major changes to the IFRS for SMEs that make it easier to understand than the whole set of IFRS (Kiliç et al., 2016):

1. Subjects that are irrelevant to private entities have been removed.
2. In contrast to full IFRS, which provides multiple accounting treatment options in a given situation, SMEs only have one.
3. The fundamentals of asset, liability, income, and expense recognition and measurement have been simplified.
4. The entire IFRS disclosures had been removed, and the required presentation had been simplified; and
5. The entire body of standards has been rewritten in plain English to improve clarity.

Private entities could utilize either the MFRS Framework (which is similar to IFRS Standards) or the MASB’s Private Entity Reporting Standard (PERS) until December 31, 2015. PERS will be phased down on January 1, 2016, and replaced by the Malaysian Private Entities Reporting Standard (MPERS) (IFRS, 2017). On February 14, 2014, the MASB released MPERS.
The MASB published Amendments to MPERS on October 28, 2015. Section 29 on income taxes has been amended to reflect the requirements for income taxes outlined in the Amendments to the IFRS for SMEs Standard published in May 2015. As a result, save for the criteria for property development activities and minor language modifications, the MPERS (including the Amendments to MPERS) is essentially the IFRS for SMEs Standard (including the Amendments to IFRS for SMEs Standard).

The MPERS has been updated, for example, Section 1 Small and Medium-sized Entities has been modified to dictate the MPERS' application in the Malaysian context. In this regard, the terms 'SMEs' and 'public accountability have been substituted in Sections 1-35 by the phrase 'private entities.' Section 9 Consolidated and Separate Financial Statements require the ultimate Malaysian parent to prepare consolidated financial statements regardless of whether the ultimate parent is incorporated in Malaysia. The accounting for property development operations in Malaysia has been clarified by amending Section 34 Specialised Activities (IFRS, 2017).

Material and Methods

The existing literature on the experiences of SMEs adopting and implementing the International Financial Reporting Standards (IFRS) is evaluated, both in Malaysia and in other countries. Articles are found using keywords like "IFRS for SMEs," "MPERS in Malaysia," and so on in Emerald and Google. Press announcements and magazines from professional bodies, such as accountants, which are now administered by MIA (Malaysian Institute of Accountants), are also analyzed to gain insight into MPERS' progress in Malaysia.

Results and Discussion

The use of Fair value in transaction measurement

Unlike PERS, MPERS is nearly identical to IFRS for SMEs, an IASB-issued worldwide accounting standard. There are numerous important distinctions between MPERS and PERS requirements. Many accounting policies found in PERS are not available under MPERS because it is similar to simplified MFRS (or IFRS). Some changes can be found below, taken from accountants today Magazines (2016), which is published under the auspices of the Malaysian Institute of Accountants (MIA).

1. Borrowing costs on a qualifying asset can be expensed as they are incurred or capitalized as part of the cost of the qualifying asset under PERS. Borrowing costs, on the other hand, must be expensed as they are incurred under MPERS.
2. Investment properties can be valued using either the cost model or the revaluation approach under PERS. Investment properties can only be measured using the fair value model under MPERS.
3. The concept of functional currency does not exist in PERS. All financial statements prepared under MPERS are in the reporting currency.
4. Certain intangible assets and goodwill are considered to have infinite useful lives under PERS, and as a result, they do not need to be amortized and are instead subject to a yearly impairment test. All intangible assets and goodwill must be amortized under MPERS since they have a finite life. If the preparer is unable to identify the lifetimes of intangible assets and goodwill, MPERS assumes that they have a ten-year finite life.
5. Furthermore, MPERS has accounting standards in place for business combinations, share-based payments, service concession arrangements, agriculture, government grants, financial instruments, and related party transactions, whereas PERS does not.

The adoption of IFRS for SMEs in a country with rule-based standards necessitates a shift in thinking among those affected. Both preparers and users must learn to value the judgments required to generate financial reports, especially if fair value metrics are used (Samujh & Devi, 2015). MPERS is a performance-based standard, not a cost-based one. Almost everything must be evaluated fairly (MIA, 2016). In many cases, MPERS allows a preparer to opt-out of a requirement
if it is too costly or time-consuming. For example, biological assets do not have to be valued at fair value if doing so would be prohibitively expensive or time-consuming. What constitutes excessive expenditure or effort is very subjective and impossible to quantify. As a result, financial statements from different companies will not be comparable. When compared to PERS or MFRS, certain areas are more complex and costly to implement, such as biological assets and investment properties, which must be valued at fair value. As a result, many organizations with investment properties or biological assets may have to bear additional costs related to the fair value valuation of those assets (MIA, 2016). For example, under MPERS, all trees in a plantation must be valued at fair market value, something most plantation businesses have been attempting to avoid (MIA, 2016).

While it is possible to make claims of excessive cost, there is currently no consensus on what constitutes excessive cost. It can only be implemented on a case-by-case basis and is usually described as unnecessary costs incurred in the process of preparing the accounting. Preparers and auditors are likely to disagree over what constitutes an excessive expense. Fair value, on the other hand, does not have to be exact. It’s always meant to be a rough estimate. It is unquestionably a difficult task for planners. Due to a lack of historical data, they are unable to claim disproportionate costs (MIA, 2016).

**Certain issues in the IFRS for SMEs might not be relevant to SMEs**

According to Aboagye-otchere and Ageibor (2012), who conducted research in Ghana, not all of the concerns addressed by the IFRS for SMEs apply to SMEs in Ghana. 19 of the 27 issues addressed by the IFRS for SMEs are of no relevance to small businesses in Ghana, such as paying for goods or services with own shares, preparing financial statements in a foreign currency, lending or borrowing money in a foreign currency, selling an asset and leasing the same asset back from the buyer, and so on. It indicates that just eight of the IFRS for SMEs concerns are relevant to SMEs. Finally, because SMEs do not engage in complicated transactions, the IFRS for SMEs in its current form is not the accounting standard of choice for them. Because Malaysian authorities have adopted IFRS for SMEs verbatim, the findings in Ghana will likely be comparable to those in Malaysia.

The IFRS for SMEs is a simplified version of the entire IFRS. It reduces the substance of the whole IFRS by about 85%. Because the IASB feels that most SMEs are unlikely to meet such transactions or conditions, certain items that are not normally relevant to SMEs are excluded. SMEs, on the other hand, still consider IFRS for SMEs to be excessively complicated (Van Wyk & Rossouw, 2009). Looking at the UK's experience, the UK accounting regulatory regime has long emphasized a "think small first" approach, as all businesses were required to submit GAAP-compliant financial statements. The decision to implement IFRS across the EU has flipped this on its head, resulting in a "top-down strategy." The UK’s introduction of IFRS for SMEs raises a dilemma: how to maintain the UK’s accounting position in global markets while also shielding millions of non-listed enterprises from over-regulation (Fearnley & Hines, 2007).

**Option to use IFRS for SMEs or the old standards (MASB standards)**

According to the two countries in the Asia-Pacific area (Australia and New Zealand), the IFRS for SMEs is not being considered for adoption. The introduction of the Financial Reporting Act 2013 [2] in New Zealand reduced compliance expenses for smaller domestic firms. Australia conveyed a more deliberate (political) approach by stating that it is monitoring developments but is not actively exploring adoption. As a result, many SMEs in Australia and New Zealand may produce special purpose financial reports to suit the needs of end-users such as taxes authorities, financiers, or management. Furthermore, these countries may set the trend by providing options and support to other economies that believe the International Financial Reporting Standards for SMEs do not satisfy the standards (Samujh & Devi, 2015).
In the case of Malaysia, it appears that it is too late to determine whether or not to support MPERS [3]. MPERS have already been issued and are in use. SMEs are being advised to accept the fact that, by 2016, private entities will no longer be able to prepare financial statements using PERS. If a small business wants to expand internationally, it must have comparable financial accounts.

Private entities are not required to switch from PERS to MPERS. Changing from PERS to MFRS, on the other hand, maybe a superior solution in some cases (MIA, 2016). As a result, preparers should use this time to carefully examine if switching from PERS to MFRS is a preferable alternative. Before deciding whether to switch to MPERS or MFRS, there are numerous factors to consider. Property developers, for example, are unlikely to use MPERS because it requires all borrowing costs to be expensed. Similarly, if a company has a lot of intangible assets or goodwill, MPERS may not be for them because all of those assets and goodwill will have to be amortized over ten years and expensed to profit or loss. Plantation firms will also have to measure all of their trees at fair value under MPERS (MIA, 2016).

Nonetheless, preparers of financial reports based on IFRS for SMEs face two important problems. To begin with, there is constant change. To stay up, preparers must learn to be agile and adaptive. Even before implementation, there were 55 IFRS modifications, and the IASB (International Accounting Standards Board) is still accepting views on its Conceptual Framework Exposure Draft. It's complicated enough as it is, but another modification gets added even before one topic is fully comprehended. The Conceptual Framework looks to be changing all the time. If preparers are constantly assaulted with revisions, understanding and executing the rules will be more challenging (MIA, 2016). Second, there is talent scarcity. It exacerbates the difficulties of transitioning to MPERS. The lack of quality and number of accountants who can generate financial reports based on MPERS is an issue. This is exacerbated by the fact that SMEs vary greatly in size. Some SMEs can afford competent accounting services, while others cannot (MIA, 2016).

Objectives of financial reporting for SMEs
As opposed to huge corporations, SMEs have different goals and accounting requirements (Samujh & Devi, 2015). Financial statements do not improve relationships with bankers in countries where bankers are the primary corporate financiers. Bankers, according to Van Wyk and Rossouw (2009), do not require large and sophisticated information. According to Wyk and Rossouw (2009), 90% of unlisted companies prepare financial reports for only three types of users: owners, banks, and tax authorities.

Fair value accounting is a component of the decision usefulness model of financial reporting suggested by the two standard-setters in their joint conceptual framework (IASB and FASB). Non-listed entities with no publicly traded shares have little in common with the listed corporation accounting model. There is a lot of evidence that the decision usefulness model isn't appropriate for small businesses. They have a small number of users (Van Wyk & Rossouw, 2009), but they lack the accounting ability to deal with complexity [3], and they are possibly owner-managed. For SMEs, a reporting methodology focused on the concept of stewardship and employing simplified historical cost accounting would appear to be more appropriate (Fearnley & Hines, 2007).

Conclusion
SMEs' compliance with MPERS has a lot of potential benefits. It would strengthen the openness of private firms as well as the confidence of investors and bankers. As a result, SMEs will be able to compete in regional and global markets, as well as attract foreign investment. Some contend, however, that following IFRS for SMEs has little benefit for local firms. Because SMEs do not engage in international trade, and their accounting reports are largely used by owners, bankers, and tax officials, they are not subject to international accounting standards.

MPERS is a performance-based standard, not a cost-based one. Almost everything must be of reasonable value. As a result, businesses owning investment properties or biological assets will
have to pay extra for the valuation of these assets at fair value. The IFRS for SMEs is a simplified version of the entire IFRS. It reduces the substance of the whole IFRS by about 85%. Furthermore, certain topics that are not relevant to SMEs are excluded. SMEs, on the other hand, still consider IFRS for SMEs to be excessively complicated.

In the case of Malaysia, it appears that it is too late to determine whether or not to support MPERS. MPERS have already been issued and implemented. Nonetheless, there are two major obstacles for planners to overcome. Constant changes in standards, as well as a scarcity of skilled accountants, are also issues. There is a lot of evidence that the decision usefulness model isn’t appropriate for small businesses. SMEs have a small number of account users, lack accounting competence to deal with complexity, and are often run by their owners. For SMEs, a reporting methodology focused on the concept of stewardship and employing simplified historical cost accounting would be more appropriate.

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