

# Technical e-Newsletter

OCTOBER 2005 ISSUE

*A Monthly e-Newsletter published by the Technical Support Unit of AXP Solutions Sdn. Bhd. (693866-X)*

## A New Beginning

### Financial Reporting Standards

Treating SMEs Differently?

### Auditing

Reporting on Going Concern Uncertainty

Malaysian Approved Standard on Auditing:  
A Proposal for Comments

### A Peek into Common Issues Of Interest To IRB

## The Advent of the AXP Technical e-Newsletter

We are pleased to introduce to you the all-new AXP Technical *e-Newsletter*! What's this? This Technical *e-Newsletter* is aimed at establishing a platform for the practitioners to discuss and understand the latest development of the **Financial Reporting Standards (FRS)** and **other current issues**.

Since the issuance of 20 revised Malaysian FRS to date, MASB is expected to further issue additional revised FRS by end of year 2005. The revised FRS will be effective for the financial year ending on or after 1 January 2006. Practically, the audit practitioners will be commencing the audit engagements for financial statements prepared under the revised FRS in early or middle of year 2007. Compliance with the FRS is required under the Financial Reporting Act, and it has always been a concern and a time consuming task to correctly interpret and apply the FRS.

What's more? From 1 January 2007 onwards, when the **Goods and Services Tax (GST)** law comes into effect, the financial reporting regime is expected to take an even more drastic turn. The financial statements are required to be completed within a short timeframe so as to ensure timely GST returns and submission, while all net input taxes are claimed back accordingly. In addition, apart from the need to have better procedures on cash flow management and credit control in addressing the risk of having excessive cash being tied up in GST payment, the introduction of many other critical measures is equally important.

**It has been said that these emerging rules are a "Tsunami" to the accounting profession as they will change entirely the financial reporting practices. Is the accounting profession ready to face this "Tsunami"? Nobody seems to have the definite answer for now .....**

With this in mind, we hope that our review and interpretation of the FRS and other current issues will be of help to the practitioners. Boggled down not with the tsunami but remain focused on achieving greater efficiency and effectiveness, delivering more value added services to clients for that cutting edge.

**To kick off our Technical e-Newsletter, in this issue, we shall analyze the pros and cons of having a separate FRS for Small and Medium Enterprises and some "tips" to better prepare ourselves for tax audit or investigation by the Inland Revenue Board.**

AXP Technical *e-Newsletter* Editorial Board welcomes your contributions to this *e-Newsletter*. We also wish to hear from you your comments and suggestions that would enable us to further meet your professional needs.

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AXP Technical *e-Newsletter*

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AXP Technical e-Newsletter is published by the Technical Support Unit of AXP Solutions Sdn. Bhd. (693866-X) and distributed to its clients and selected accounting and audit practitioners. The views in this e-Newsletter do not necessarily represent those of AXP's.

## Contributions & Comments

AXP Technical e-Newsletter welcomes your contributions on contemporary issues encountered by the profession. We also wish to hear from you on how this e-Newsletter can be improved for more timely and useful information. Your contributions or comments may be sent directly at:

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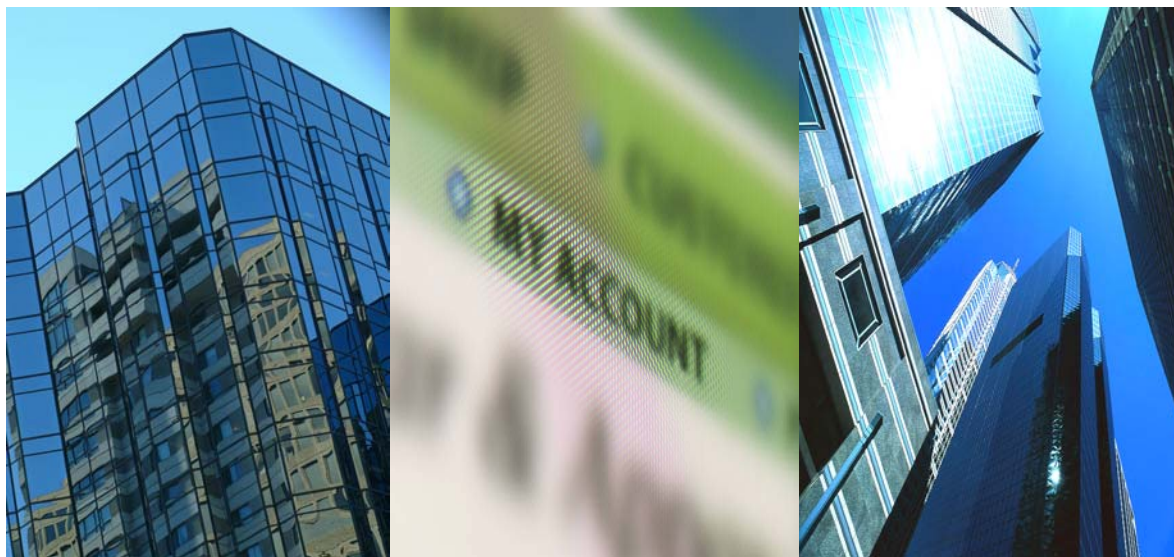
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## IS A SEPARATE SET OF ACCOUNTING STANDARDS REQUIRED FOR **SMALL AND MEDIUM ENTERPRISES**?



### *Current Approach.....*

Malaysian revised Financial Reporting Standards (FRS) will be effective for the financial period beginning on or after 1 January 2006.

Although the business operations are vastly different, there is only one set of standards for the preparation of financial statements throughout. At one extreme end are those companies listed on the Stock Exchange which require comprehensive financial reporting rules for better reporting of their financial statements, in terms of accuracy and transparency, to all stakeholders. At the other end are Small and Medium Enterprises (SME), comprising primarily proprietor-managed companies with a nominal value in share capital, which represent approximately 90% of the business establishments in Malaysia.

Based on the existing FRS, all companies are required to comply with the same set of financial reporting rules. Additional requirements for Public Listed Companies are minimal, such as segmental reporting and earnings per share, and other requirements under the Listing Requirements.

*In this issue, we focus on the pros and cons of having different standards for SMEs.*

## ***Advocates of SME Standards***

The advocates of SME Standards put forth that different reporting for SMEs is required, at least, for the following reasons:-

### ***1. Different User Needs***

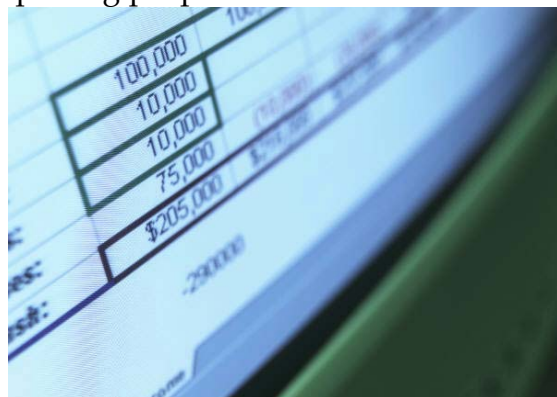
For SMEs, the main objective of the financial statements is to show the financial results and positions. Apart from the owners, government agencies (such as tax authorities) and creditors are likely to be the only other interested users of SME financial statements. As such, the general purpose financial statements need not be as complicated as those of the Public Listed Companies as certain provisions in the revised FRS are obviously irrelevant to these users, be it in decision-making or otherwise. Furthermore, they may be vested with the power to seek for additional information beyond the financial statements at any one time. A simplified set of reporting requirements is thus sufficient to satisfy the general needs and interests.

### ***2. Cost-Benefit Trade Off***

Many FRS requirements are either irrelevant to or too complex for SMEs. As the financial statements of SMEs are circulated to a limited number of users only, questions are raised as to whether it is appropriate to impose statutory burdens on the SMEs with the full compliance requirements. In addition, since the users of the financial statements are primarily those manager-owners, the costs of complying with such requirements are believed to exceed the benefits to the users, if any at all.

One obvious example is the adoption of fair value accounting in place of the historical cost accounting. [Do the users of SME financial statements require such complex accounting data?](#)

It is apparent that it may not be justifiable, on the cost-benefit ground alone, for SMEs to adopt the fair value accounting as the historical cost measurement basis is already sufficient for general financial reporting purposes.



## *Opposition of SME Standards*

There are arguments that there should not be any separate accounting rules for the preparation of financial statements for SMEs:

1. There will be a lack of uniformity, consistency, transparency, comparison, benchmarking and clarity for the contents of the financial statements.
2. Some SMEs may have complex transactions which may not be addressed by the simplified SME standards.
3. SMEs are a major component of the Malaysian economy. Therefore, the effect of the adoption of the SME standards may have significant implications, both direct and indirect.
4. When SMEs expand and need to access to the capital markets, for instance Initial Public Offering, the transitional compliance from the SME standards to full FRS requirements may be more costly than adopting full FRS requirements from the beginning.
5. Separate sets of FRS would be more costly for auditors (keeping two types of audit programmes), accountants (mastering two sets of standards), academics (instilling two sets of standards in their students) and standard setters.
6. It is difficult to define the SMEs that fall within the ambit of the simplified standards. If the size is to be considered as one aspect, what about the other qualitative aspects, such as subsidiaries of public listed companies which are SMEs. Complexity may arise out of circumstances where two sets of standards are applicable to one single group of companies. What about a company that qualifies for SME this year, but not the following year?



It has been further suggested that instead of setting a new set of SME standards, there should be provisions for modifications and exemptions on certain FRS for SMEs' reporting purposes.

## *Initiations of HKICPA and IASB.....*

*Hong Kong Institute of Certified Public Accountants has issued the Small and Medium-sized Entity Financial Reporting Framework (SME-FRF) and Financial Reporting Standard (SME-FRS). These standards will be effective for financial period beginning on or after 1 January 2005. These standards have simplified the disclosure and recognition requirements currently found in the FRS, for instance, the abolishment of the disclosure of statement of changes in equity and cash flow statement.*

*International Accounting Standards Board has in mid of year 2005 expanded its working group on Accounting Standards for SME to develop a set of financial reporting standards suitable for SME, which might include simplified standards from full International FRS.*

Accounting rules comprise disclosure, recognition and measurement requirements. There is view that SME standards could only require less disclosure. No modifications should be made to recognition and measurement principles as the figures reported by SMEs should not be any different as the accounting principles should be applied universally.

In this respect, however, there have been differences between a few standards world-wide. A more obvious example would be the differences between FRS and US GAAP. The objective of the FRS is thus to adopt harmonized standards throughout the world. **As such, is the adoption of SME standards a move backward from this objective?**



## ***Moving Forward.....***



All interested parties are waiting for the exposure draft of the SME standards to be released, to see what modifications and how extensive the differences will be.

We expect that only those disclosure, recognition and measurement requirements that meet the needs of the users of the SME financial statements will be included in the proposed standards.

MASB has the tendency to harmonize its FRS with IFRS. Thus, the emergence of the SME standards by IASB will definitely have a significant impact on the development of the Malaysian FRS.



## MALAYSIAN INSTITUTE OF ACCOUNTANTS (MIA) ISSUED RPG 4 - SAMPLES OF AUDITORS' REPORTS IN RESPECT OF GOING CONCERN UNCERTAINTY

The following are the extracts of the RPG 4, the full text can be obtained from the MIA Web-site.

### Model 1(c): Adequate Disclosure on Going Concern - **Emphasis of Matter** (paragraph 33 of ISA 570)

Without qualifying our opinion, we draw attention to Note... to the financial statements. The company incurred a net loss of.....during the year ended 31 December 20xx and, as of that date, the Company's current liabilities exceeded its current assets (or total assets) by ..... These conditions, along with other matters as set forth in Note..... to the financial statements, indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern.

*Note: In extreme cases, such as situations involving multiple material uncertainties that are significant to the financial statements, the auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.*

### Model 1(d): Inadequate Disclosure on Going Concern - **except for** (paragraph 34 of ISA 570)

The Company's financing arrangements expire and amounts outstanding are payable on <date>. The Company has been unable to renegotiate or obtain alternative financing. The financial statements (and notes thereto) do not disclose this fact. In our opinion, except for the omission of the information included in the preceding paragraph:

Model 1(e) : Inadequate Disclosure on Going Concern - **Adverse**  
(paragraph 34 of ISA 570)

The Company's financing arrangements expired and the amount outstanding was payable on <date>. The company has been unable to renegotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty which may cast significant doubt on the Company's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business.

In our opinion:

- a) because of the omission of the information mentioned in the preceding paragraph, the financial statements have not been properly drawn up in accordance with the provisions of the Companies Act, 1965 and MASB approved accounting standards and do not give a true and fair view of:-

Model 1(f) : Limitation of scope - **Disclaimer of opinion**

The Company's financing arrangements expire and amounts outstanding are payable on <date>. The company has been unable to renegotiate or obtain replacement financing. We are not able to confirm or dispel, in the absence of management's assessment, the existence of plans management has put in place to address the above. In view of the significance of the matters discussed in the preceding paragraph, we are unable to form an opinion as to whether the financial statements have been properly drawn up in accordance with the provisions of the Companies Act, 1965 and MASB approved accounting standards so as to give a true and fair view of:

**An appropriate audit  
opinion will safeguard  
your interest**

## **PROPOSED MALAYSIAN APPROVED STANDARD ON AUDITING AVAILABLE FOR COMMENTS**

MIA has recently issued the following Proposed Malaysian Approved Standard on Auditing for comments by members, professional accountancy bodies, regulators and other interested parties before **31 December 2005**:-

1. International Framework For Assurance Engagements;
2. Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services;
3. Assurance Engagements Other Than Audits or Reviews of Historical Financial Information; and
4. Planning an Audit of Financial Statements.

This is the chance for the audit practitioners to raise their views and concern before the auditing standards become enforceable.

In our next issue, we will have a study on the expected impacts of some of these proposed auditing standards on the audit approaches of the small and medium audit practitioners (SMP), and practically, how the SMP should get prepared to comply with these proposed auditing standards.

Feedbacks from the audit practitioners are most welcomed for a wide variety of views of different sizes of practices.

## WHAT ARE THE “COMMON ISSUES” TARGETED BY INLAND REVENUE BOARD?



In any tax audit or tax investigation, Inland Revenue Board (IRB) may focus on “sensitive” accounts, the following are some of the common accounts that IRB will raise questions on, and some of the counter measures that taxpayers can do:-

- **Cash purchases** vs credit purchases. Try to avoid “cash purchases” without proper invoices issued by the suppliers.
- **Directors’ accounts** including payments made on behalf, loans to or from directors, claims for the Company’s expenses which might include domestic expenses, and so on.....
- **Audit adjustments** or year-end adjustments by taxpayers.
- **Related parties transactions.** Are the transactions at arms-lengths or are they genuine? Have there any supporting documents for the determination of an arms-lengths price?
- **Allowance for doubtful debts.** Try to issue genuine credit notes if there are dispute with the customers?
- **Entertainment, gifts and gratuities.** To open and allocate these expenses into a few accounts instead of lumping into one account. For instance, entertainment for staff, customers, promotional expenses, etc.
- **Traveling expenses.** If these expenses include those of domestic, do open a new account for these expenses and add back voluntarily.
- **Upkeep expenses.** Are these expenses justifiable against the property, plant and equipment?
- **Payments to non-residents.** Has withholding tax been complied with?
- **Benefits-in-kind.** Have the “arms-lengths” rules been observed for benefits available to staff and directors?
- **Subscriptions fee.** Are these business related expenses?
- **Interest expenses,** for example has interest restriction been added back? Have considerations been made for the results of the latest case law on the deductibility of interest expenses and the taxability of interest income?