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PwC Alert

Malaysian Financial Reporting Standards: The new IFRS-compliant framework effective 2012

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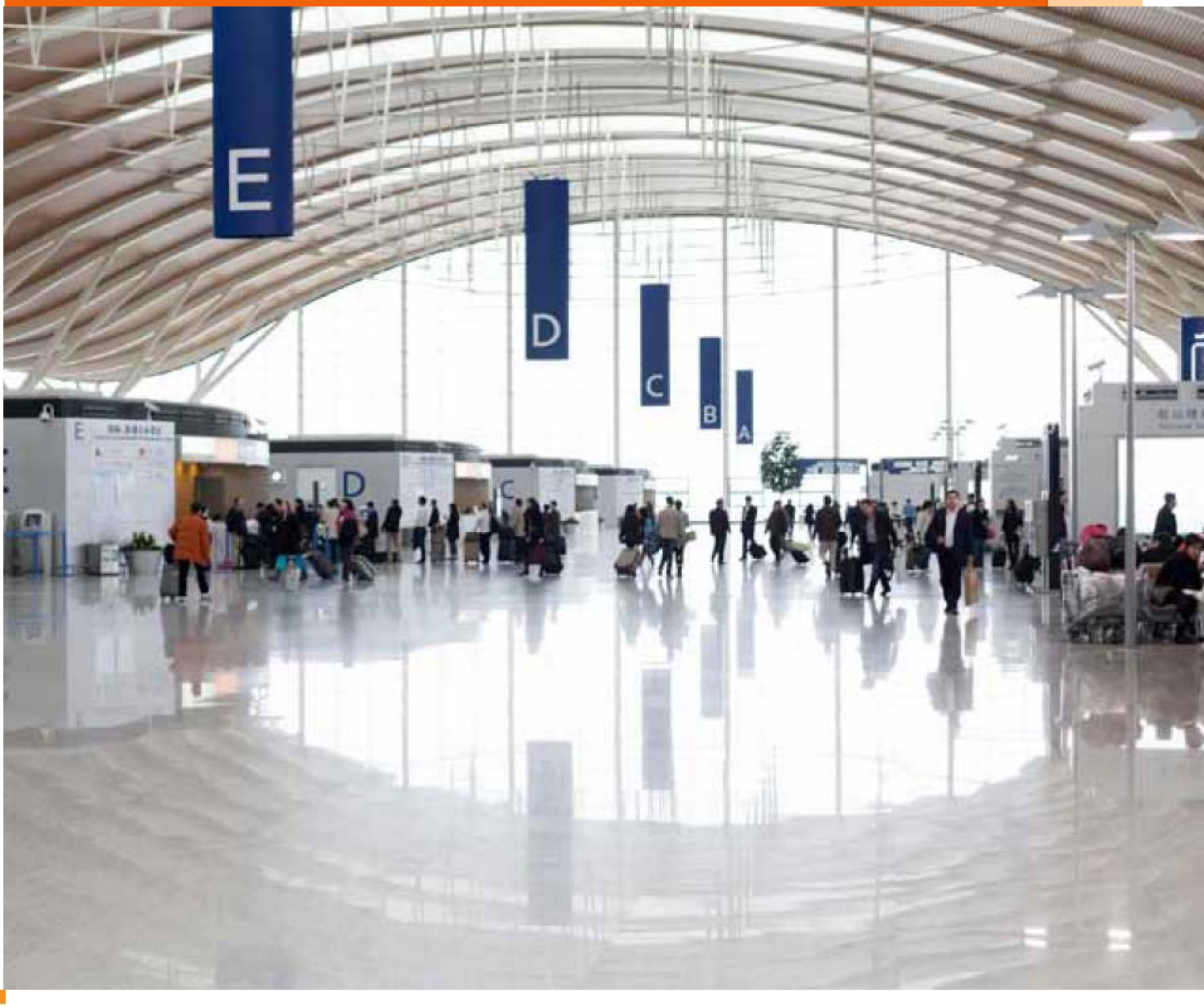
In this issue:



1 January 2012 marked the beginning of a new calendar year. It was also the day when the Malaysian Financial Reporting Standards (MFRS) fully converged with the International Financial Reporting Standards (IFRS). Essentially, apart from the names of the various standards, the MFRS is identical to the IFRS.

The IFRS-compliant framework will give Malaysian companies a higher competitive edge with international players, increasing the creditability of these companies and the nation as a whole.

Applicability of MFRS framework

The Malaysian Accounting Standards Board (MASB) issued the MFRS framework on 19 November 2011. This IFRS-compliant framework applies to all non-private entities (except Transitioning Entities (TE)) for annual periods beginning on or after 1 January 2012. TE may defer adoption of the MFRS framework by one year.

TE are non-private entities within the scope of MFRS 141 "Agriculture" and IC Interpretation 15 "Agreements for Construction of Real Estate", including their parent, significant investor and venturer. Therefore, if a parent company chooses to continue with the existing Financial Reporting Standards (FRS), this doesn't mean that all its subsidiaries can continue to use FRS in their own statutory financial statements for the annual period beginning on or after 1 January 2012. Panels 1 and 2 illustrate this option.

FRS framework allowed for one more year

The option for TE to defer adoption of the MFRS framework to 2013 is in view of potential changes on the international arena that may affect the current accounting treatment for agriculture and real estate sales. The MASB appears to allow only a year's grace period for these changes to take place. One wonders whether it will defer this timeline further if changes on the international scene take longer to complete or if the changes are not in line with expectations.

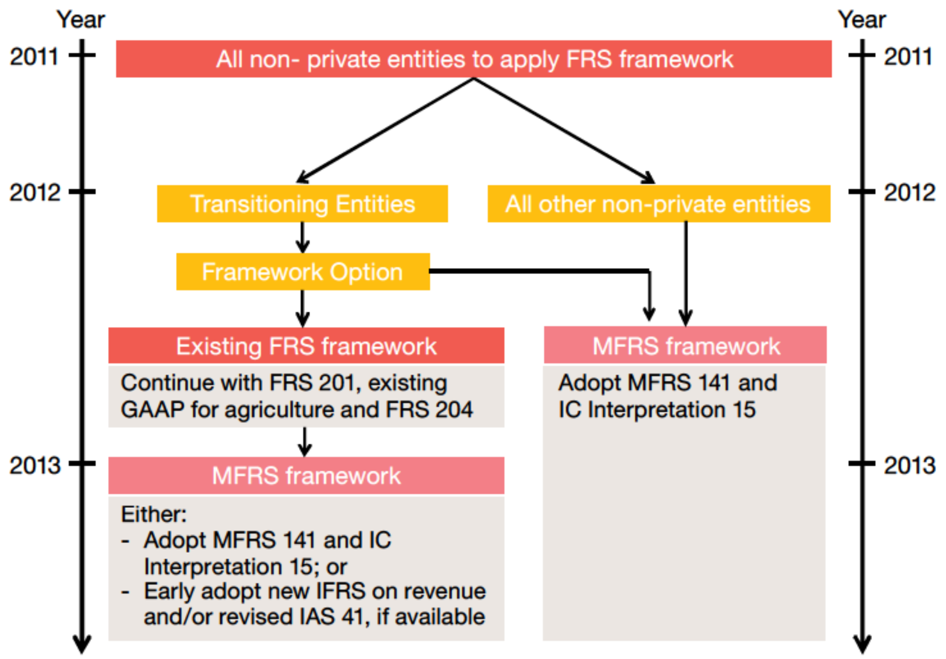
On accounting for agriculture, the MASB is of the view that the requirements in IAS 41 (equivalent of MFRS 141) can be further improved for bearer biological assets. It has submitted Issues Papers for the consideration of International Accounting Standards Board (IASB). Subsequently, the IASB has included the proposed amendment of IAS 41 as one of the proposed agendas in its public consultation to seek input on its future direction and overall balance of its future work programme.

On revenue recognition for real estate sales, the IASB has issued a revised exposure draft on Revenue from Contracts with Customers in November 2011. When finalised, this revision will supersede IFRIC 15 (the equivalent of IC Interpretation 15). Deliberations are ongoing on whether the concerns of the real estate industry will be addressed and if the changes will be the preferred approach of the industry.

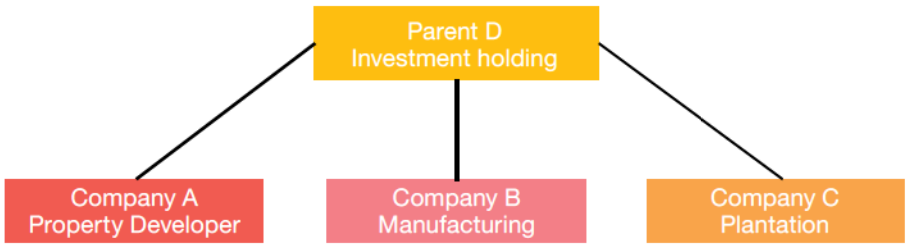
TE that opt to apply the existing FRS framework in 2012 will continue to apply FRS 201 "Property Development Activities" or the existing Generally Accepted Accounting Principles (GAAP) for agriculture and FRS 204 "Accounting for Aquaculture".

FRS 201 requires percentage of completion to be applied to housing units under construction for which a sale and purchase agreement has been signed. Existing GAAP for agriculture is on a cost basis while IAS 41 applies fair value accounting.

Panel 1: Option available to Transitioning Entities in 2012



Panel 2: An illustrative example of the choice of frameworks in 2012 only



Company	Transitioning Entity?	If Parent D adopts FRS		If Parent D adopts MFRS	
		Filing with Registrar of Companies	Reporting to Parent D	Filing with Registrar of Companies	Reporting to Parent D
A	√	MFRS or FRS	FRS	MFRS or FRS	MFRS
B	x	MFRS	FRS	MFRS	MFRS
C	√	MFRS or FRS	FRS	MFRS or FRS	MFRS

Some key considerations

Subsidiaries, associates and jointly controlled entities which are not TE do not have the option of applying the existing FRS framework. Accordingly, in situations where the reporting group has a mixture of subsidiaries, associates and jointly controlled entities that are TE and non-TE, the reporting group must decide which framework to use in 2012, based on the reporting group's activities.

To illustrate: a TE Parent elects to continue with the existing FRS framework in its consolidated financial statements (and therefore doesn't apply international standards for agriculture and property developers). However, its subsidiaries which aren't TE must use the MFRS framework. This means non-TE subsidiaries will need to maintain accounting records under two frameworks – one using MFRS for its own filing of financial statements lodged with the Registrar of Companies and one using FRS for reporting to the TE Parent for its consolidation. This is further illustrated in Panel 2.

There are many aspects management must take into consideration for a smooth transition to the new MFRS framework. These include the following:

<table>
<tr><th colspan="2">Key considerations</th></tr>
<tr><td>a) To determine which entities in your group are considered TE</td><td>TE that choose to use the FRS framework will have to disclose that fact in their financial statements and also the reasons for not adopting the MFRS framework in 2012.</td></tr>
<tr><td>b) For the TE, to assess cost-benefit of deferring MFRS for one year in order to decide which financial reporting framework (i.e. FRS or MFRS) to be adopted in 2012</td><td>There are both possible pros and cons of delaying adoption of the MFRS for another year.
<table>
<tr><th>Pros</th><th>Cons</th></tr>
<tr><td>TE have more time to evaluate the impact of the MFRS framework.
TE can continue to apply FRS 201 and the existing accounting treatment for agriculture.</td><td>If your group of companies has entities applying both the FRS and MFRS frameworks, a separate set of accounting entries have to be maintained for consolidation adjustments to be made for group entities with a framework different from that of the parent. Pages 13 and 14 of this Alert contains an illustration of MFRS 1 applications where entities in a reporting group adopt MFRS in different financial year.
Benefits forgone and reputational risks for not being able to assert compliance with IFRS to the entity's stakeholders.</td></tr>
</table></td></tr>
<tr><td>c) To assess the impact of full convergence with IFRS including the adoption of MFRS 1</td><td>In order for entities to assert that their financial statements are in full compliance with MFRS and IFRS, they are required to apply MFRS 1 "First-time Adoption of Malaysian Financial Reporting Standards".

MFRS 1 contains various mandatory exceptions from retrospective application and optional exemptions from respective MFRS on first-time adoption. Pages 7 to 14 of this Alert highlight some areas of the MFRS 1 application.</td></tr>
<tr><td>d) To assess and disclose impact of new standards</td><td>For both the new MFRS framework and existing FRS framework, the MASB has also issued many new MFRS/FRS effective on or after 1 January 2012. Many of these new standards have been issued following the recommendation of the Group of Twenty (G20) Finance Ministers and Central Governors to improve financial reporting after the global financial crisis. Panel 3 contains a list of the new standards effective after 1 January 2012.

It is critical that companies should start mapping out a strategy in addressing requirements of this new wave of accounting standards.

In the coming 2011 financial statements, entities are required to disclose the implications of these standards issued.

In addition, it's useful for entities to indicate the impacts of adopting the MFRS framework (whether in 2012 or 2013).</td></tr>
<tr><td>e) To consider impact on stakeholders, contracts and bank covenants, and to manage these issues accordingly</td><td>All non-private entities should educate its stakeholders (bankers, investors, etc.) on the impact of the new MFRS framework (whether adopted in 2012 or 2013) and the impact of new standards (which are introduced to both frameworks). They should also be informed about the possible outcome of MFRS 141 and requirements of the new revenue exposure draft.</td></tr>
</table>

Time is running out

There's not much time left - entities applying MFRS in 2012 have to assess the impact of MFRS 1 in time for their first affected quarter (see table below). Therefore, management needs to begin now to address the implications of the conversion to the new MFRS framework.

	December year end companies	June year end companies
Opening MFRS statement of financial position	1 January 2011	1 July 2011
First MFRS quarterly announcement by public listed companies	31 March 2012	30 September 2012
First MFRS financial statements	31 December 2012	30 June 2013

Panel 3: List of MFRS / FRS effective after 1 January 2012

MFRS	Title	FRS
MFRS 9*	Financial Instruments	FRS 9
MFRS 10	Consolidated Financial Statements	FRS 10
MFRS 11	Joint Arrangements	FRS 11
MFRS 12	Disclosures of Interests in Other Entities	FRS 12
MFRS 13	Fair Value Measurement	FRS 13
MFRS 119	Employee Benefits (IAS 19 as amended by IASB in June 2011)	FRS 119
MFRS 127	Separate Financial Statements (IAS 27 as amended by IASB in May 2011)	FRS 127
MFRS 128	Investments in Associates and Joint Ventures (IAS 28 as amended by IASB in May 2011)	FRS 128
Amendments to MFRS 101	Presentation of Items of Other Comprehensive Income	Amendments to FRS 101
IC Interpretation 20	Stripping Costs in the Production Phase of a Surface Mine	IC Interpretation 20

** The IASB amended IFRS 9 (equivalent of MFRS 9) in December 2011 to delay the effective date to 1 January 2015. This amendment is not yet adopted by MASB.*

Highlights of MFRS 1 applications

Entities moving from FRS to MFRS reporting framework must apply MFRS 1 in its first MFRS financial statements. MFRS 1 requires an entity to prepare an opening MFRS statement of financial position at the date of transition to MFRS. Date of transition is the beginning of the earliest period for which an entity presents full comparative information under MFRS in its first MFRS financial statements.

The date of transition of a December year end entity for which MFRS is effective on 1 January 2012 would be 1 January 2011. This serves as the starting point for accounting under MFRSs.

This section of the alert highlights the key principles in MFRS 1 and some exemptions that may be beneficial to entities that wish to minimise differences between FRS and MFRS on first time adoption. This alert is not intended to cover all aspects of MFRSs or MFRS 1 and is not a substitute for reading the relevant MFRSs.

An overview of MFRS 1

- **Full retrospective application**

  All transition guidance related to first time adoption of MFRS is contained within MFRS 1. So, the transitional provisions in the individual MFRS are not applicable.

  The general principle underlying MFRS 1 is that standards effective at the reporting date of an entity's first MFRS financial statements should be applied retrospectively as if MFRS had been used for an entity's accounting since its inception, except for the mandatory exceptions and the optional exemptions selected. Some key exceptions and exemptions are discussed below.

- **Mandatory exceptions**

  MFRS 1 prohibits retrospective application of MFRSs in the following areas:

  a) Using hindsight to revise estimates or make new estimates. Estimates included in the opening MFRS balance sheet should be consistent with estimates made on the same date under previous FRSs, unless there is an objective evidence of error.
  b) Application of the derecognition rules in MFRS 139 Financial instruments: Recognition and Measurement to financial assets and liabilities that have been derecognised, except under certain conditions.
  c) Designating transactions entered into before the date of transition that do not qualify for hedge accounting in accordance with MFRS 139 as hedging relationships.
  d) Attributing losses to the non-controlling interests even if this results in non-controlling interests having a deficit balance.
  e) Accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control as equity transactions.

- **Optional exemptions**

  Entities may elect to apply any, all or none of the optional exemptions from full retrospective application of MFRSs to facilitate transitioning to MFRS. The IASB believes that these exemptions cover standards where retrospective application could prove too difficult or could result in a cost likely to exceed any benefits to users. Some of these exemptions are:

  - business combinations
  - deemed cost
  - share-based payment transactions
  - leases
  - employee benefits
  - compound financial instruments.

Some of these are discussed below.

Some optional exemptions and how these are useful to existing FRS reporters

- **Deemed cost exemption for property, plant and equipment, investment property and limited number of intangible assets**

  Entities that elect to apply this exemption are allowed to use the following measures as deemed cost:

  a) fair value at the date of transition as deemed cost on date of transition; or

  b) revalued amount recorded in the FRS financial statements as deemed cost at the date of valuation if on the date of revaluation, the revaluation was broadly comparable to fair value or depreciated cost, adjusted to reflect changes in price index. The deemed cost should then be depreciated up to the date of transition.

Panel 4: Illustration of deemed cost exemption applied to property, plant and equipment

1 January 1976	- Company A acquired a building for RM100,000 - Estimated useful life: 50 years - Depreciation per year: RM2,000
1 January 1996	- Company A revalued the building to RM600,000 in conjunction with its listing exercise, resulting in revaluation surplus of RM540,000 - No change in estimated useful life - Depreciation per year: RM20,000
31 December 2010	- Carrying amount of the building in FRS financial statements: RM300,000. (Note: Company A had applied the MASB's IAS 16 transitional provision and treated the revalued amount as deemed cost in 1998)
1 January 2011	- Fair value of the building at the date of transition to MFRS: RM500,000

Company A has three options as at date of transition to MFRS if it continues to apply cost model:

	(1)	(2)	(3)
	Fair value as deemed cost	Revalued amount at previous revaluation date as deemed cost	If company chooses not to apply the deemed cost exemption in MFRS 1
Carrying amount of building on date of transition	500,000	300,000	30,000 (100,000 – 2,000 x 35 years)
Impact to net assets	+200,000	-	-270,000
Impact to depreciation expense per annum from 2011	+13,333 (33,333 – 20,000)	-	-18,000 (2,000 – 20,000)

Applying the revalued amount as deemed cost exemption would remove the difference between FRS and MFRS and therefore no impact to net assets and depreciation upon transition to MFRS.

Practical applications

1) Entities that have recorded their property, plant and equipment at the revalued amounts and treated these as deemed cost under the transitional provision when MASB first adopted IAS 16 in 1998 can apply the deemed cost exemption upon adoption of MFRS. See illustration in Panel 4.

   If an entity chooses not to apply this exemption, the carrying amounts of these property, plant and equipment shall be re-measured at cost less accumulated depreciation retrospectively.

2) Entities that have adopted the cost model can uplift the carrying amount of its property, plant and equipment to fair value at date of transition on a one off basis and use it as deemed cost from that date without having to change to a revaluation model.

3) Entities that have adopted the revaluation model can switch to the cost model from date of transition by applying the deemed cost exemption discussed above.

This exemption does not apply to leasehold land held as operating leases. Entities that have treated the revalued amount as deemed cost under FRS 117 must re-measure the leasehold land (prepaid lease rental) at cost less accumulated amortisation retrospectively.

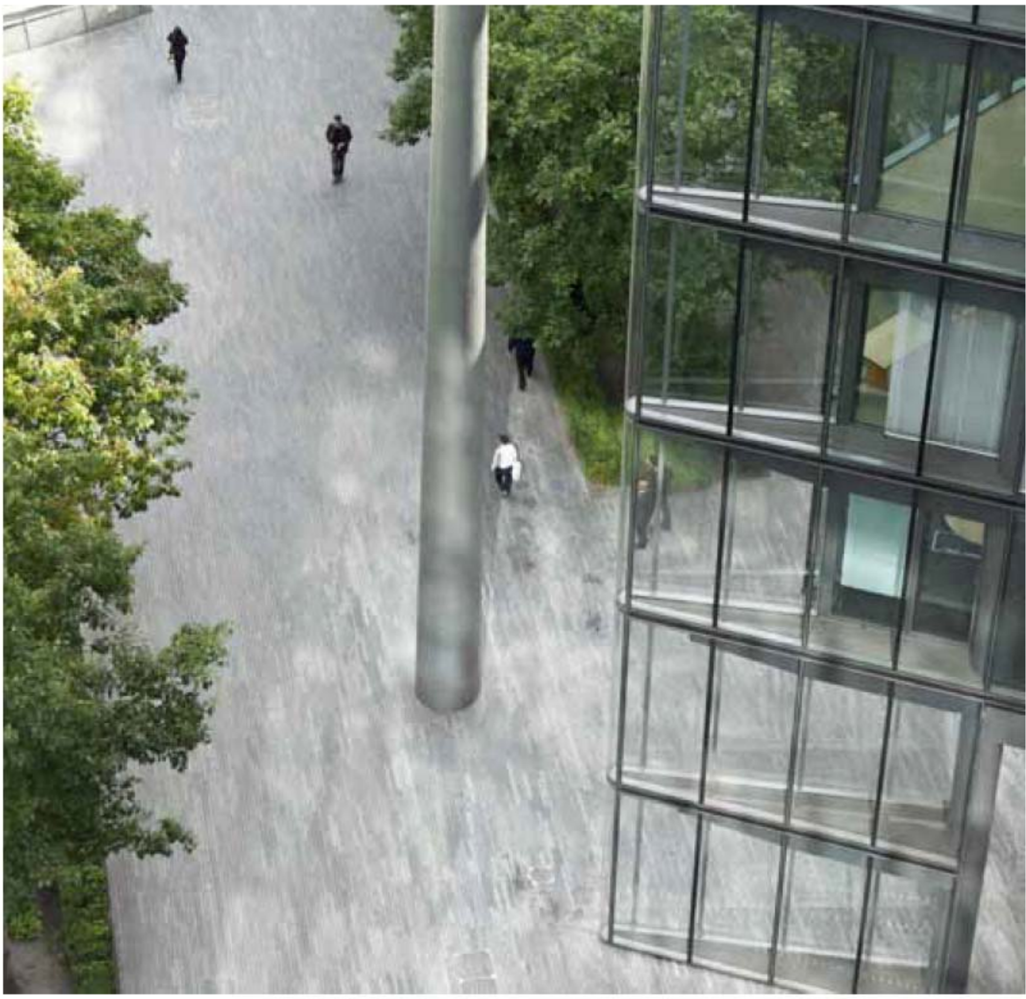
- **Deemed cost exemption for investment in subsidiaries, jointly controlled entities and associates**

  Entities that elect to apply this exemption can use the following measures as deemed cost for the investment in each subsidiary, jointly controlled entity or associate:

  a) fair value at the date of transition; or
  b) carrying amount under FRS at the date of transition

  Practical applications

  Entities that had previously taken pre-acquisition dividends from subsidiaries to cost of investment can elect to measure these investments at the fair value or carrying amount under FRS as its deemed cost at the date of transition. If this exemption is not applied, entities would have to re-measure the cost of these investments by excluding all pre-acquisition dividends. This is because MFRS 127 requires all dividends to be recognised as income and not as reduction to cost of investment. The transitional provision in MFRS 127 which requires prospective application of the pre-acquisition dividends is not applicable to a first time adopter of MFRS. See illustration in Panel 5.



Panel 5: Illustration of deemed cost exemption applied to cost of investment in subsidiary

The carrying amount of Company B's investment in subsidiary S on 31 December 2010 in accordance with FRS is RM450,000, derived as follows:

	RM
Original cost of investment	1,000,000
Total pre-acquisition dividends	(550,000)
Carrying amount	450,000

Fair value at the date of transition on 1 January 2011 is RM 400,000. (Company B has assessed the investment for impairment and has determined that the carrying amount is supported by value-in-use cash flows.)

Upon transition to MFRS, Company B can elect to measure the cost of its investment in subsidiary S at RM450,00 (based on carrying amount under FRS) or RM400,000 (based on fair value at date of transition) or RM1,000,000 (based on historical cost). Using the carrying amount under FRS as deemed cost exemption would remove the difference between FRS and MFRS.

- **Goodwill and fair value adjustments arising from business combinations involving foreign operations**

  MFRS 1 allows entities not to apply the requirements in MFRS 121 to treat goodwill and fair value adjustments arising in business combinations as assets and liabilities of the foreign operations retrospectively to business combinations that occurred before date of transition.

  If such exemption is applied, MFRS 1 requires entities to reset the cumulative translation differences for all foreign operations to zero on the date of transition to MFRS. Accordingly, future gains or losses on subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition, but include later translation differences.

Practical applications

Entities that applied the transitional provisions in FRS 121 and treated goodwill and fair value adjustments arising from business combinations that occurred before 1 January 2006 as assets and liabilities of the parent (hence, translated at historical rate) can elect to apply this exemption. This allows entities to avoid full retrospective adjustments to goodwill and fair value adjustments arising from business combinations that occurred before 1 January 2006 which may be too costly to restate.

Applying this exemption however, means translation gains/losses relating to periods prior to date of transition cannot be reclassified to profit or loss upon subsequent disposal of the foreign operations. If this exemption is elected, it must be applied to all foreign operations.

- **Assets and liabilities of subsidiaries, associates and joint ventures**

  If a subsidiary becomes a first time MFRS adopter later than its parent, the subsidiary can choose to measure its assets and liabilities at the carrying amounts that would be included in the parent's consolidated MFRS financial statements (before any consolidation adjustments such as fair value adjustments arising from a business combination, inter-company eliminations or alignment of accounting policies). These should be measured based on the parent's date of transition to MFRS. This exemption also applies to associates and joint ventures.

  On the other hand, if a parent becomes a first time adopter later than its subsidiary (or associate or joint venture), it has no choice but to measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the MFRS financial statements of the subsidiary (or associate or joint venture). However, it should make the necessary consolidation adjustments.

What does this mean for a reporting group with Transitioning Entities?

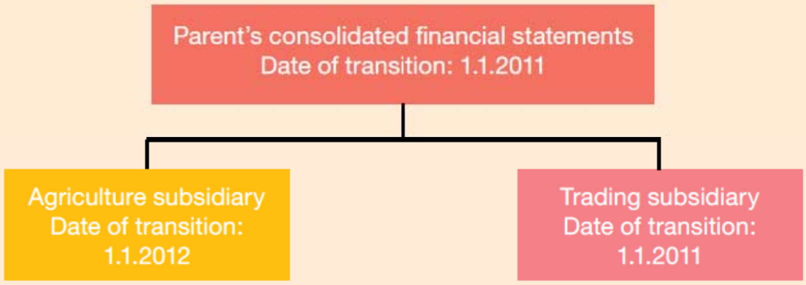
A parent, joint venturer or investor with subsidiaries, jointly controlled entities and associates that are transitioning entities (as discussed in page 3 of this alert) has a choice of:

- adopting MFRS as the reporting framework for its consolidated financial statements, or
- continuing to use the FRS framework for one more year prior to the mandatory adoption of MFRS for the annual period beginning on or after 1 January 2013.

Panel 6 illustrates how these exemptions can be applied in a reporting group with different MFRS adoption date.

Panel 6: Illustration of reporting group with different MFRS adoption date

Scenario (1): Parent adopts MFRS in 2012 & Transitioning subsidiary adopts MFRS in 2013



Upon transition to MFRS, the Parent elects to apply the fair value as deemed cost exemption. The adjustments required for the Agriculture subsidiary's buildings included in the Parent's consolidated financial statements are as follows:

	1.1.2011	31.12.2011	31.12.2012
Included in Agriculture subsidiary's FRS financial statements			
Cost	200	200	200
Less: Accumulated depreciation (based on RM10 per annum)	(50)	(60)	(70)
Carrying amount	150	140	130
Included in Parent's consolidated MFRS financial statements			
Fair value as deemed cost	450	450	450
Less: Accumulated depreciation (based on RM30 per annum)	0	(30)	(60)
Carrying amount	450	420	390

MFRS 1 allows Agriculture subsidiary to use this in its opening MFRS statement of financial position as at 1.1.2012

Due to different timing on adoption of MFRS, the Agriculture subsidiary will have to produce two sets of financial information for the year ending 31 December 2012:

- one for its own financial reporting under FRS; and
- one under MFRS for group reporting to its Parent.

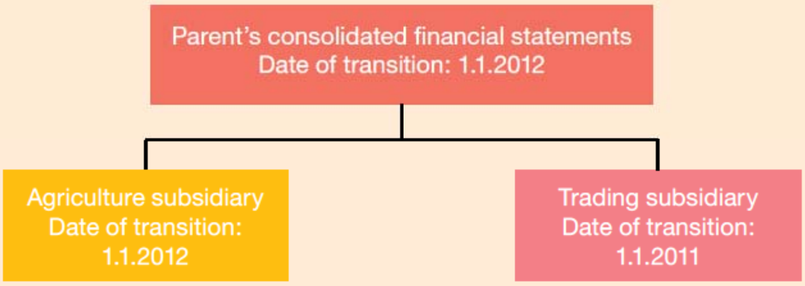
When the Agriculture subsidiary prepares its first MFRS financial statements for the year ending 31 December 2013, it has two options for its opening statement of financial position as at 1 January 2012 (date of transition):

a) measure its assets and liabilities based on the carrying amounts in the Parent's consolidated MFRS statement of financial position as at 1 January 2012, before consolidation adjustments as allowed under MFRS 1. This exemption is useful as similar assumptions, exemption and figures can be used by the Agriculture subsidiary when it adopts MFRS in 2013; or

b) measure its assets and liabilities based on the subsidiary's date of transition to MFRS. This could result in figures that differ from (a) and therefore, the Agriculture subsidiary would need to maintain two sets of financial statements in subsequent years.

Panel 6: Illustration of reporting group with different MFRS adoption date (continued)

Scenario (2): Parent adopts MFRS in 2013



When the Parent prepares its first consolidated MFRS financial statements later than its subsidiary, e.g. year ending 31 December 2013, the Parent has no option but to:

- measure the assets and liabilities of its Trading subsidiary based on the carrying amounts in the latter's MFRS financial statements as at 1 January 2012, and
- adjust for consolidation adjustments in its opening statement of financial position as at 1 January 2012 (date of transition for the Parent's consolidated financial statements).

See illustration below:

	1.1.2011	31.12.2011	31.12.2012
Included in Trading subsidiary's MFRS financial statements			
Fair value as deemed cost	750	750	750
Less: Accumulated depreciation (based on RM100 per annum)	0	(100)	(200)
Carrying amount	750	650	550

MFRS 1 requires the Parent to use this in its opening consolidated statement of financial position as at 1.1.2012

In conclusion

As part of the preparation to transit to the new MFRS framework ,companies must carefully analyse the nature and impact of both the exceptions and the exemptions in MFRS 1. It is also important to take into account not just the conversion process itself, but issues relating to risks, stakeholder relations, financial reporting, and internal controls which will be triggered by the transition.

If you have any specific enquiries, please contact any PwC team that you are accustomed to dealing with. Otherwise, email pwcmsia.info@my.pwc.com with the subject "PwC Alert Issue 93".

PricewaterhouseCoopers
Level 10, 1 Sentral, Kuala Lumpur Sentral
PO Box 10192, 50706 Kuala Lumpur
Malaysia

Phone: +60 (3) 2173 1188
Fax: + 60 (3) 2173 1288

pwc.com/my

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