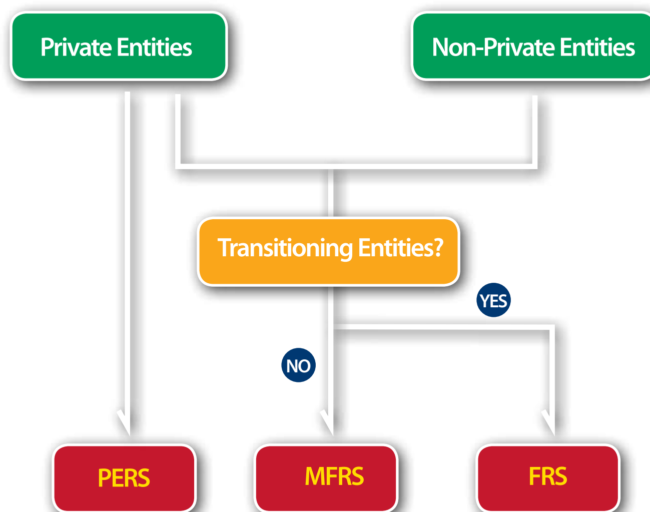
FIRST STEP TOWARDS IFRS convergence

MIA Professional Standards & Practices

Subsequent to the MASB's announcement in 2008 to bring Malaysia to fully converge with International Financial Reporting Standards (IFRS), much effort has been spent by stakeholders and authorities to ensure a smooth transition of convergence. The significance of the convergence was felt when the Malaysian Accounting Standards Board (MASB) issued a new accounting framework, named as the Malaysian Financial Reporting Standards (MFRS) framework which is a full IFRS-compliant framework on 19 November 2011. As quoted by the Chairman of the Financial Reporting Foundation, Datuk Ali Tan Sri Abdul Kadir, "this is the landmark achievement after a long haul and countless endeavours."

Effective from 1 January 2012, there will be three (3) sets of MASB approved accounting framework in Malaysia, namely MFRS framework, Financial Reporting Standards (FRS) framework and Private Entity Reporting Standards (PERS) framework. All entities other than private entities[1] are required to comply with MFRS framework for annual periods beginning on or after 1 January 2012. There is, however, an exception for entities that are within the scope of MFRS 141 "Agriculture" and IC Interpretation 15 "Agreements for Construction of Real Estate", including its parent, significant investor and venture (herein referred as "Transitioning Entities") to apply MFRS. Transitioning Entities have the option to select either the MFRS framework or FRS framework as their reporting framework for annual periods beginning on or after 1 January 2012. Nevertheless, this exception is only applicable for one year. Consequently, Transitioning Entities will be adopting the MFRS framework for annual periods beginning on or after 1 January 2013.

On the other hand, private entities could opt to comply with the PERS framework in its entirety or the MFRS framework in its entirety for annual periods beginning on or after 1 January 2012. Similar with non-private entities, private entities that choose to adopt the MFRS framework and fall within the scope of MFRS 141 and IC Interpretation 15 could select either MFRS or FRS as the basis of preparing their financial statements. In short, the applications of the accounting framework by different reporting entities are illustrated below:



[1] *Private entities are private companies, incorporated under the Companies Act 1965, that:*
- *are not itself required to prepare or lodge any financial statements under any law administered by the Securities Commission or Bank Negara Malaysia; and*
- *are not subsidiaries or associates of, or jointly controlled by, an entity which is required to prepare or lodge any financial statements under any law administered by the Securities Commission or Bank Negara Malaysia.*

MFRS 1 "FIRST-TIME ADOPTION OF MALAYSIAN FINANCIAL REPORTING STANDARDS"

i) Identify the date of transition to MFRS

As a starting point to prepare financial statements in accordance with MFRS, the entity shall apply MFRS 1 to ensure that an entity's first MFRS compliant financial statements and interim financial reports are comparable over all periods presented. Some may argue on the necessity to apply MFRS 1 since most of the existing FRSs are adopted by MASB from IFRSs. Indeed, Malaysian entities have not fully adopted IFRS 1 "First-time Adoption of International Financial Reporting Standards" previously leading to certain comparatives may not be restated based on the specific requirements of IFRS 1.

Many people may have a wrong perception that the date of transition to MFRS is 1 January 2012 and therefore only starting to prepare for convergence by then. The transition date, as defined in MFRS 1, is the beginning of the earliest period for which an entity presents full comparative information under MFRSs in its first MFRS financial statements. Moreover, MFRS 101 "Presentation of Financial Statements" requires entities to present three (3) statements of financial position, two (2) statements of comprehensive income, two (2) statements of cash flows and two (2) statements of changes in equity and related notes if entities apply an accounting policy retrospectively, make retrospective restatement or reclassify items in the financial statements. Hence, entities shall prepare the statement of financial position for its first MFRS interim report or annual report as at the beginning of the comparative financial year in accordance with MFRS.

It is crucial for entities to identify the date of transition to MFRS because it is the starting point for entities to prepare and present financial statements in accordance with MFRS. Entities which have common financial year end should take note of the following dates:

Financial year end	First MFRS annual reporting date	Transition date
31 December	31 December 2012	1 January 2011
31 March	31 March 2013	1 April 2011
30 June	30 June 2013	1 July 2011
30 September	30 September 2013	1 October 2011

ii) Identify the differences in accounting policy under previous GAAP and under MFRS and select accounting policies under MFRS

MFRS 1 basically requires a full retrospective application of all MFRSs, with certain exceptions and exemptions. Firstly, entities should understand the differences between the existing FRS or PERS with MFRS. They are recommended to undertake a detailed gap analysis to assess the differences and analyse its impact on application of MFRS 1.

Entities shall use accounting standards that are effective at the reporting date as the basis of preparation of financial statements. Management of entities needs to be thoughtful and strategic in selecting appropriate accounting policies, with a full understanding of its implications on the financial statements. Management could also consider applying any new accounting standards that are not yet effective but early application is permitted.

iii) Consider whether to apply optional exemptions from mandatory retrospective application

Despite the requirement on full retrospective application of MFRS under MFRS 1, the IASB grants limited exemptions from this requirement in certain areas, particularly where the cost of complying with them would be likely to exceed the benefits to users of financial statements and retrospective application would require judgements by management about past conditions after the outcome of a particular transaction was already known. The optional exemptions are as follows:

- Business combination
- Compound financial instruments
- Share-based payment transactions
- Severe hyperinflation
- Insurance contracts
- Fair value measurement of financial assets or financial liabilities at initial recognition
- Fair value as deemed cost
- Employee benefits
- Decommissioning liabilities included in the cost of property, plant and equipment
- Investments in subsidiaries, jointly controlled entities and associates
- Financial assets or intangible assets accounted for in accordance with IC Interpretaion 12 "Service Concession Agreement"
- Assets and liabilities of subsidiaries, associates and joint ventures
- Designation of previously recognised financial instruments
- Borrowing costs
- Extinguishing financial liabilities with equity instruments
- Transfers of assets from customers
- Cumulative translation differences
- Leases

This article attempts to discuss some of the optional exemptions that may have significant impact on Malaysian entities:

a) Business combination

MFRS 1 provides exemption to entities not to comply with MFRS 3 "Business Combinations" retrospectively for business combination that occurred before the transition date (past business combination). Entities which elect for this exemption shall consider the following:

- Classification of business combinations – The entity shall retain the same classification of business combination as previous GAAP.

If a subsidiary becomes first-time adopter at a date later than the parent company, the carrying amount of assets and liabilities in its financial statements at the transition date would be the carrying amounts that are included in the parent's consolidated financial statements based on the parent's date of transition to MFRSs or the carrying amounts based on the subsidiary's transition date.

- Recognition of assets acquired and liabilities assumed in the past business combination – The assets and liabilities acquired or assumed in the business combination are recognised in the entity's opening MFRS statement of financial position, unless the recognition is not permitted by MFRS.
- Measurement of assets acquired and liabilities assumed in the past business combination – Certain assets and liabilities that are required to be measured at fair value under MFRSs would be measured on the same basis in the opening MFRS statement of financial position. Any resulting changes in the carrying amount would be adjusted to retained earnings or other component of equity, if appropriate. Otherwise, the carrying amount of assets acquired and liabilities assumed immediately after the business combination under the previous GAAP are deemed cost in accordance with MFRS.
- Goodwill recognised in the past business combination – The carrying amount of goodwill recognised under previous GAAP at the transition date shall be the carrying amount of goodwill under MFRS after reclassification adjustments of intangible assets which do not qualify for recognition as asset under MFRS, recognition of intangible assets that was subsumed in goodwill under previous GAAP and recognition of impairment losses at the transition date, if any.

If an entity decides not to apply this exemption, it shall restate the business combination that occurred before the transition date in accordance with MFRS 3 and comply with MFRS 127 "Consolidated and Separate Financial Statements" concurrently.

b) Fair value as deemed cost

This exemption allows an entity to use the fair value of certain items in the statement of financial position as surrogate cost at a particular date. The common approaches to determine the fair value as deemed cost are as follows:

- Fair value at transition date - An entity could use the fair value for property, plant and equipment, investment property (cost model) or intangible assets, which meet both the recognition and revaluation criteria under MFRS 138 "Intangible Assets", at transition date as deemed cost.
- Revalued amount under previous GAAP - If the revaluation was broadly comparable to fair value or cost or depreciated cost adjusted for changes in a general or specific price index, the revalued amount of the items under previous GAAP could be used as deemed cost at the date of revaluation. Other than fair value at transition date, property, plant and equipment, investment property (cost model) or intangible assets that meet the criteria in MFRS 138 may also use the revalued amount under previous GAAP as deemed cost.
- Event-driven fair value - An entity may remeasure the fair value of its assets and liabilities at one particular date because of an event such as privatisation or initial public offering. Such event-driven fair value measurements could be used as deemed cost at the date of that measurement.

Where an entity selects cost model to measure property, plant and equipment, any subsequent depreciation is based on the deemed cost starting from the date on which the entity established the deemed cost. An entity that selects revaluation model to measure property, plant and equipment may use the deemed cost as a starting point to apply the revaluation model.

c) Designation of previously recognised financial instruments

Entities would have designated its financial instruments on initial recognition when MFRS 139 "Financial Instruments: Recognition and Measurement" became effective. MFRS 1 allows entities to re-assess classification of financial assets into available-for-sale designation at transition date or fair value through profit or loss designation at transition date, provided that the criteria in paragraph 9 (b) (i)-(ii) or 11A of MFRS 139 are met at that date. MFRS 1 provides exemption from retrospective application for the said designation of financial instruments.

d) Assets and liabilities of subsidiaries, associates and joint ventures

If a subsidiary becomes first-time adopter at a date later than the parent company, the carrying amount of assets and liabilities in its financial statements at the transition date would be the carrying amounts that are included in the parent's consolidated financial statements based on the parent's date of transition to MFRSs or the carrying amounts based on the subsidiary's transition date.

In the event that the parent adopts MFRSs at a date later than

its subsidiary, associate or joint venture, it will include the carrying amount of assets and liabilities in the subsidiary, associate or joint venture's book in its consolidated financial statements, taking into consideration the consolidation or equity method adjustments as required.

iv) Apply mandatory exceptions

MFRS 1 prohibits retrospective application on certain areas of MFRSs. These exceptions are as below:

a) Estimates

Estimates used in preparing opening statement of financial position at transition date shall be consistent with the estimates used under the previous GAAP (after adjusting the differences in accounting policy), unless there is objective evidence that those estimates were in error. Estimates that are made under MFRS, which were not required under previous GAAP, shall reflect the conditions that existed at the transition date, such as reflecting the market conditions for items like market prices, interest rates and foreign exchange rates.

b) Derecognition of financial assets and financial liabilities

Derecognition requirements in MFRS 139 shall be applied to transactions occurring on or after the transition date prospectively. However, entities are allowed to derecognise financial assets and financial liabilities retrospectively from the date of the entity's choosing, provided that the information required by MFRS 139 was obtained at the date of those transactions.

c) Non-controlling interests

The following requirements under MFRS 127 shall be applied by entities prospectively from the transition date:

- Total comprehensive income is attributed to the owners of the parent and to the non-controlling interest;
- Accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and
- Accounting for a loss of control over a subsidiary.

If an entity elects to apply MFRS 3 retrospectively to past business combination, it must also apply the above requirements from the date onwards.

d) Hedge accounting

Entities with hedge transactions should first consider whether their hedges under previous GAAP are of a type that qualifies for hedge accounting under MFRS 139. If the hedging relationship does not qualify for hedge accounting under MFRS 139, the entity should discontinue hedge accounting in accordance with MFRS 139. Entities that have designated a net position as a hedged item in accordance with previous GAAP are allowed to designate an individual item within that net position as a hedged item in accordance with MFRSs, provided that the designation is made by the transition date.

v) Prepare opening statement of financial position at the transition date

After selecting appropriate accounting policies and applying the chosen optional exemptions and mandatory exceptions, entities shall prepare and present a statement of financial position in accordance with MFRSs. Entities should recognise and measure all assets and liabilities required by MFRS. Entities are also required to reclassify items that were recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under MFRS. Assets and liabilities that are not permitted to be recognised under MFRS shall not be recognised.

vi) Present disclosures under the requirement of MFRS 1

Entities in Malaysia shall explain the impact of transition from previous GAAP to MFRS to their financial position, financial performance and cash flows. The first MFRS financial statements shall include:

- Reconciliation of equity from previous GAAP to MFRS at the transition date and at the end of the latest period presented in the entity's most recent annual financial statements in accordance with previous GAAP.
- Reconciliations of total comprehensive income from previous GAAP to MFRS for the latest period in the most recent annual financial statements in accordance with previous GAAP.
- Explanation of material adjustments to the statement of cash flows.

These reconciliations enable users of financial statements to understand the material adjustments to the statement of financial position and statement of comprehensive income and to distinguish changes in accounting policies from the correction of errors identified during transition.

The interim financial report for the comparable interim period of the immediately preceding financial year shall include:

- Reconciliation of equity from previous GAAP to MFRS at the end of that comparable interim period.
- Reconciliations of total comprehensive income from previous GAAP to MFRS for the comparable interim period (current and year to date).

Besides the reconciliations that explain the impact of transition to MFRS, entities are required to comply with other disclosure requirements stated in MFRS 1. Amongst others, entities are subject to disclosure requirements under MFRS 136 "Impairment of Assets" if they recognised or reversed impairment losses in their opening MFRS statement of financial position. Entities are therefore urged to perform a thorough and detailed study that the impact of MFRS transition will bring to the transactions and financial statements to ensure MFRS compliance. ■

A single control model for consolidation, involvement with other entities and fair value measurement

A review of IFRSs 10-13

PART 3

Tan Liong Tong

4. IFRS 13, FAIR VALUE MEASUREMENT

4.1 Reasons for issuing IFRS 13

Various IFRSs require or permit some assets, liabilities and equity instruments to be measured at fair value. These include IAS 41, *Agriculture*, IAS 40, *Investment Property*, IAS 39, *Financial Instruments: Recognition and Measurement*, and IAS 16, *Property, Plant and Equipment*. Fair value measurement is also required in a business combination accounted for as an acquisition under IFRS 3, *Business Combinations*, in valuing employee share options in share-based payment transactions under IFRS 2, *Share-based Payment*, and in performing impairment test under IAS 36, *Impairment of Assets*.

Although the fair value measurement basis has been used quite extensively to date, it has been added to IFRSs piecemeal over the years. As a result, the guidance on measuring fair value was dispersed across many IFRSs and they were not always consistent. Furthermore, the former guidance was incomplete as it provided neither a clear measurement objective nor a robust measurement framework.

The project on fair value measurement was initiated by the IASB in September 2005. A discussion paper on fair value measurement was issued in November 2006. The exposure draft was issued in May 2009, re-exposed in June 2010, before it was finalised as IFRS 13, *Fair Value Measurement*, in May 2011.

The rationale of this IFRS is to provide guidance on how to measure fair values of assets, liabilities and equity instruments, and specify the disclosures about fair value measurements.

4.2 THE SALIENT FEATURES OF IFRS 13

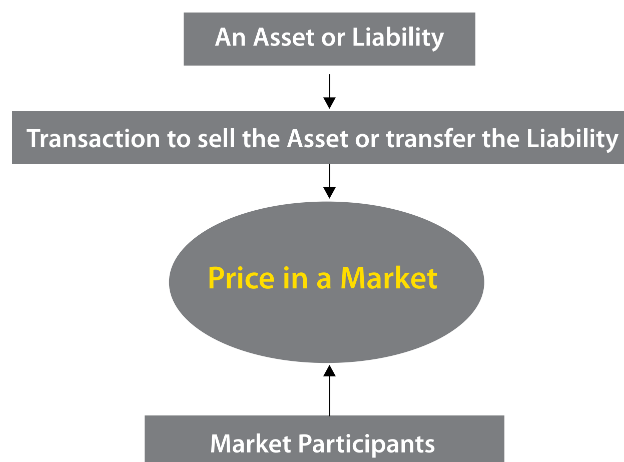
The IASB's objective of publishing the IFRS on fair value measurement are to:

i) define fair value,
ii) set out in a single IFRS a framework for measuring fair value; and
iii) require disclosures about fair value measurement (IFRS 13.1).

IFRS 13 explains how to measure fair value but does not require additional fair value measurements and does not change the measurement objectives in the existing IFRSs. It applies to IFRSs that require or permit fair value measurements or disclosures.

As the core principle to the fair value measurement, the Standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IFRS 13.9). This establishes the framework, which is based on an objective to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (i.e. the notion of an exit price from the perspective of a market participant that holds the asset or owes the liability at the measurement date). The definition emphasises that fair value is a market-based measurement, not an entity-specific measurement. Thus, an entity's intention to hold an asset or to settle a liability is not relevant when measuring fair value.

The Fair Value Measurement Framework can be portrayed by the diagram below:



THE ASSET OR LIABILITY

The fair value measurement in IFRS 13 is for a particular asset or liability. The asset or liability might be a standalone asset or liability (e.g. a financial instrument or an operating asset) or a group of assets or liabilities (e.g. a cash-generating unit or a business) depending on the unit of account prescribed by IFRSs applicable to the asset or liability or group of assets or liabilities.

The measurement shall consider the characteristics of the asset or liability (e.g. the condition and location of the asset and restrictions, if any, on its sale or use). For example, when measuring fair value of an investment property using prices of similar properties in other locations (observable market prices of similar properties), appropriate adjustments should be made to reflect the difference in price due to location. Similarly, when measuring fair value of a biological asset using market prices of similar biological assets in other locations, adjustments should be made to reflect the differences in age attribute (condition) and location (transport cost to get to the market).

THE TRANSACTION

A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

(a) in the principal market for the asset or liability; or
(b) in the absence of a principal market, in the most advantageous market for the asset or liability IFRS 13.16]

Principal market is defined in IFRS 13 as "the market with the greatest volume and level of activity for the asset or liability". The Standard clarifies that in the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market, in the absence of a principal market, the most advantageous market. The principal market is determined from the perspective of the entity, and thus different entities with different activities might have different principal markets.

THE PRICE IN A MARKET

The fair value is the exit price that would be received to sell an asset or paid to transfer a liability, regardless of whether that price is directly observable or estimated using another valuation technique. Although transaction costs are considered when determining the principal (or most advantageous) market, the price used to measure the fair value of the asset or liability shall not be adjusted for those costs. Transactions costs are not a characteristic of the asset or liability; rather, they are specific to the transaction and will differ depending on how an entity enters into a transaction for an asset or liability.

Transaction costs do not include the costs that would be incurred to transport an asset to or from its principal or most advantageous market. If location is a characteristic of the asset (for example, in the valuation of a commodity or an agricultural produce), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset to or from that market.

THE MARKET PARTICIPANTS

The fair value of the asset or liability shall be measured using the assumptions that market participants would use in pricing the asset or liability, assuming that market participants act in their economic best interest [IFRS 13.22]. In developing those assumptions, an entity need not identify specific market participants. Rather, the entity shall identify characteristics that distinguish market participants generally, considering factors specific to: (i) the asset or liability; (ii) the principal (or most advantageous) market; and (iii) market participants with whom the reporting entity would enter into a transaction in that market.

APPLICATION OF THE FAIR VALUE MEASUREMENT FRAMEWORK

A fair value measurement requires an entity to determine the following:

a) the particular asset or liability being measured;
b) for a non-financial asset, the highest and best use of the asset and whether the asset is used in combination with other assets or on a standalone basis;
c) the market in which an orderly transaction would take place for the asset or liability; and
d) the appropriate valuation technique(s) to use when measuring fair value.

APPLICATION TO NON-FINANCIAL ASSETS

The IFRS requires that a fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use (IFRS 13.27). The term "highest and best use" refers to the use of an asset by market participants that would maximise the value of the asset or group of assets and liabilities (e.g. a business) within which the asset would be used. The fair value of an asset reflects its highest and best use from the perspective of market participants, considering uses of the asset that are physically possible, legally permissible and financially feasible.

The highest and best use of a non-financial asset establishes the valuation premise used to measure the fair value of the asset, either in combination with other assets as a group or on a standalone basis.

APPLICATION TO LIABILITIES AND OWN EQUITY INSTRUMENTS

A fair value measurement assumes that a liability or an entity's own equity instrument (e.g. equity interests issued as consideration in a business combination) is transferred to a market participant at the measurement date. Thus, if there is a quoted price, the fair value of the liability or equity instrument is the quoted price.

When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available but the identical item is held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument from the perspective of a market participant that holds the identical item as an asset at the measurement date.

If a quoted price is not available (either directly or by reference to identical asset held by another party), the fair value is determined by another valuation technique (such as an income approach or a market approach). When a valuation technique is applied, the fair value of a liability reflects the effect of non-performance risk. Non-performance risk includes, but may not be limited to, an entity's own credit risk. Non-performance risk is assumed to be the same before and after the transfer of the liability.

IFRS 13 clarifies that when measuring the fair value of a liability or an entity's own equity instrument, an entity shall not include a separate input or an adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the item. The effect of a restriction that prevents the transfer is either implicitly or explicitly included in the other inputs to the fair value measurement. It further clarifies that the fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

IFRS 13 provides for an exception to the fair value measurement if an entity manages a group of financial assets and

financial liabilities on the basis of its net exposure to either market risks or credit risks. The exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions.

FAIR VALUE AT INITIAL RECOGNITION

The price paid (transaction price) to acquire an asset or to assume a liability is the entry price. In many cases, the transaction price will equal the fair value of the asset or liability, for example, when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold. For example, the price paid (entry price) to acquire a quoted equity share is the fair value of the equity share on initial recognition because that is the price in which the equity share would be sold (the exit price).

However, an entry price is not necessarily the same as the exit price and an entity does not necessarily sell an asset or transfer a liability at the price paid to acquire the asset or to assume the liability. Thus, transaction price might not represent the fair value of an asset or a liability at initial recognition. If another IFRS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognise the resulting gain or loss in profit or loss unless that IFRS specifies otherwise. For example, the price paid to acquire a "loan & receivable" asset might be different from the fair value determined using a discounted cash flow technique on the initial recognition. IAS 39 permits an entity to choose an accounting policy for recognising this difference in profit or loss.

VALUATION TECHNIQUES AND INPUTS

IFRS 13 requires that an entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. The Standard does not prescribe a particular technique but clarifies that the technique could be based on: (i) the market approach; (ii) the income approach; or (iii) the cost approach. Guidance is provided on estimating fair value using the present value techniques and these include the risk-adjusted discount rate method, the certainty equivalent cash flow method and the expected present value method.

The IFRS clarifies that in some cases, a single valuation technique to measure fair value will be appropriate. For example, when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities, a valuation technique using the market approach is sufficient. In other cases, multiple valuation techniques need to be applied (for example, when valuing a cash generating unit or a business). If multiple valuation techniques are applied to measure fair value, the results (i.e. the respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

Inputs are the assumptions used when pricing the asset or liability, including assumptions about risk. IFRS 13 requires that the valuation techniques used to measure fair value shall maximise the use of observable inputs (market-based data) and minimise the use of unobservable inputs (developed data).

IFRS 13 does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurement within a bid-ask spread.

If an asset or liability has a bid price and an ask price (e.g. an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorised within the fair value hierarchy. The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required. IFRS 13 does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurement within a bid-ask spread.

THE FAIR VALUE HIERARCHY

The Standard establishes a fair value hierarchy that prioritises into three levels the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

The fair value hierarchy prioritises the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a fair value measurement developed using a present value technique might be categorised within Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level in the fair value hierarchy within which those inputs are categorised. If observable inputs require significant adjustments using unobservable inputs, the resulting measurement is a Level 3 measurement.

For example, in measuring the fair value of an unquoted share option derivative, the observable inputs from the marketplace may include the market price of the underlying shares, the strike price, the time period to maturity, the current risk-free interest rate, the current dividend yield and a calculated volatility using past price movements of the underlying shares. The resulting valuation is a Level 2 measurement. In contrast, when measuring the fair value of an oil palm crop (a biological asset) using the discounted cash flow technique, the only observable input might be the market price of the fresh fruit bunches (the agricultural produce) whilst other inputs such as costs, margins, growth, yield, etc. are developed internally. The resulting valuation is a Level 3 measurement.

The fair value hierarchy to measurement of assets and liabilities shall be applied as follows:

a) If there is a quoted price in an active market for an identical asset or liability, an entity uses the quoted price (Level 1 input) for the fair value measurement (Level 1 measurement);
b) If there is no quoted price in an active market, an entity determines whether there are any observable inputs other than a quoted price in an active market for an identical asset or liability. If there are significant observable inputs (market-based data), the entity uses those inputs (Level 2 inputs) for the fair value measurement (Level 2 measurement).
c) If significant observable inputs are not available from the marketplace, the entity uses unobservable inputs, including developing internal data and assumptions, for the fair value measurement (Level 3 measurement).

DISCLOSURES

The primary focus of the disclosures in IFRS 13 is to provide information that help users of its financial statements assess both of the following:

(a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.

(b) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period [IFRS 13.91].

The Standard requires disclosures about the methods and inputs used to develop those measurements and, for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

An entity shall determine the appropriate classes of assets and liabilities on the basis of the following:

a) the nature, characteristics and risks of the asset or liability; and
b) the level of the fair value hierarchy within which the fair value measurement is categorised.

The number of classes may need to be greater for Level 3 measurements because they have a greater degree of uncertainty and subjectivity.

An entity shall disclose and consistently follow its policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred. The policy about the timing of recognising transfers shall be the same for transfers into the levels as for transfers out of the levels

For each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed, an entity shall disclose the level of the fair value hierarchy; for levels 2 and 3, the valuation technique(s), inputs and changes; and if highest and best use of a nonfinancial asset differs from its current use. However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in the Level 3 measurements. For such assets and liabilities, an entity does not need to provide the other disclosures required by IFRS 13. An entity shall present the quantitative discloses required by IFRS 13 in a tabular format unless another format is more appropriate.

4.3 IMPLICATIONS OF IFRS 13 ON PRACTICE

IFRS 13 applies to any IFRSs that require or permit fair value measurements or disclosures. It does not impose new fair value measurements or changes the measurement objectives in the IFRSs. It only serves as a reference point for fair value measurement in existing and future IFRSs.

The changes to the current accounting practice are likely to be in the processes and procedures of Level 3 fair value measurement. A reporting entity whose current fair value measurements are not in accordance with the fair value measurement framework needs to conform to the requirements of the Standard. The changes may include the approach, the valuation techniques and the inputs used in the valuation.

Disclosures about fair value measurements of financial instruments have already been incorporated in the Amendment to IFRS 7, *Financial Instruments: Disclosures*, for early application. The disclosure requirements are now extended to some other IFRSs and these include fair value measurements of:

a) biological assets and agricultural produce at point of harvest (IAS 41);
b) investment property (IAS 40);
c) property, plant and equipment (IAS 16) and intangible assets (IAS 38) carried at revalued amount;
d) assets acquired and liabilities assumed in a business combination (IFRS 3); and
e) share-based payment transactions (IFRS 2).

5. CONCLUSION

Unlike the former IFRSs, these new IFRSs are principle-based standards, focusing on articulating the accounting and reporting principles. There are no prescribed rules or specified bright lines. As such, reporting entities in Malaysia will need to apply judgements and assumptions by considering all the relevant facts and circumstances. For example, judgement is required when applying the new control model of IFRS 10 in deciding whether a reporting entity controls a structured entity or whether it is the dominant shareholder. The control test must also be applied in deciding whether control exists if a government holds a special or golden share in a privatised public vehicle, whether that special share has veto power and to what extent that veto power can be exercised or whether that share only has protective right that would not preclude the investor from having control.

In the current FRS regime in Malaysia, some FRSs provide for exceptions or exemptions to the fair value measurement if the fair value cannot be measured reliably. For example, unquoted equity instruments would be measured at cost in accordance with FRS 139, *Financial Instruments: Recognition and Measurement*, if their fair value cannot be measured reliably. Similarly, for FRS 141, *Agriculture*, an entity is permitted on initial recognition to rebut the presumption that the fair value of biological assets and agricultural produce at point of harvest can be measured reliably and thus avails the cost model. The exemptions may also be availed by the impracticability criterion in some other areas, such as in measuring fair value of bank licences or other intellectual property in a business combination.

The fair value model has been debated, researched and found to be more relevant to the decision-making needs of the existing and potential investors, lenders and other creditors i.e. the model is consistent with the Framework's objective of providing useful information to users of financial statements. For example, if a unit trust fund applies a cost-based model, profit is recognised only when an investment is sold. Changes in fair value are not recognised. This may lead to "cherry-picking" opportunities to manage reported results. There is only a fine line between realised and unrealised profits for investments of unit trust funds, the difference being merely a phone call to a broker. Can that phone call be so critical so as to make a difference in reporting profit? In contrast, the fair value model would report the performance of a unit trust fund in totality and is argued as more relevant to the existing and potential investors.

Those exemptions were justifiable in the past because there was insufficient guidance about fair value measurement in the FRSs. However, with this IFRS 13 in place, such exemptions may become invalid because the Standard provides guidance on how to measure fair value. It should be noted that the IASB has removed the cost exception for unquoted equity instruments in IFRS 9, *Financial Instruments*.

Unlike the former IFRSs, these new IFRSs are principle-based standards, focusing on articulating the accounting and reporting principles. There are no prescribed rules or specified bright lines. As such, reporting entities in Malaysia will need to apply judgements and assumptions by considering all the relevant facts and circumstances.

For agriculture accounting, the fair value model is applied "across the board" to all biological assets and agricultural produce at point of harvest. There are some who hold the view that the fair value model may not be useful in the reporting of long-term bearer biological assets (such as oil palm crop). The MASB has presented a paper at the international level articulating why this model is not useful and instead proposed that bearer biological assets should be accounted for under FRS 116, *Property, Plant and Equipment*. Pending an outcome of a decision by the IASB on this matter, a reporting entity in Malaysia would still need to prepare for compliance with FRS 141 by 1 January 2012.

Plantation companies that currently apply the cost-based models for their plantation crops will need to change to the fair value model unless bearer biological assets are scoped out of FRS 141 before 1 January 2012. However, for plantation companies that currently apply the capital maintenance method, a change of treatment is required by 1 January 2012 regardless of whether or not bearer biological assets are scoped out of FRS 141 by then. Accounting for bearer biological assets under FRS 116 means that if a plantation crop has a finite life, it must be depreciated in accordance with that standard. The previous notion of "permanent maintenance" does not hold in the new IFRS-compliant Reporting Framework. ■

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AUSTRALIA: Indigenous accountants in deficit

A university and a professional organisation have joined forces to recruit Aboriginal people into accounting and auditing, after their enquiries identified just 10 indigenous Australians among the country's 180,000 professional accountants. Deakin University and CPA Australia are urging Aboriginal people to consider accounting and auditing as careers and to see them as equally valuable to their communities as law, teaching and nursing. The initiative follows a national roundtable to address the issue, according to a report in the Deakin University publication.

"This goes beyond increasing the number of accountants; it's about creating people whose work will make a lasting impact on the position of their communities," said Wendy Brabham, director of Deakin's Institute of Koorie Education. The institute's chair of indigenous knowledge systems, Professor Mark Rose, said the involvement of Aboriginal people in business schools – particularly the accounting and auditing fields - was the next new frontier for Aboriginal communities seeking self-determination. Professor Rose said auditors and accountants played an important role in community affairs. "In our communities [they] are the people that control the money and ask about costs. They don't have a very good image but they have a lot of power.

"We can espouse all the political stuff we want to, but the auditors and accountants can shut us down." Accounting lecturer Luisa Lombardi said most accountants were white and perceived as the gatekeepers and finger pointers of misused finances. "They are also seen as elitist," she said. Lombardi said the lack of indigenous accountants meant there were few role models to act as mentors. "Understandably people want to work in and benefit their community, but that community has its own demands and value system," she said. Roundtable co-organiser Adrian Williams initiated the *IndigenousAccountantsRock.com.au* website as part of his own efforts to attract more Aboriginal people into the profession. ■

CHINA: Dezan Shira & Associates Hits 20 Years in China

Dezan Shira & Associates celebrates its 20th anniversary in China during 2012, making it one of the earliest foreign investment practices operating in China. In an interview published by *China Briefing*, the firm's founder Chris Devonshire-Ellis recalls its setting up in Shenzhen. "It was during the very early days, and only a handful of professional services firms were in China at the time. Coudert Brothers and Freshfields were the big blue chip law firms, and I don't think all of the Big Four had arrived in 1992 either," he said. At that time, he recalled that most firms were in Beijing and a few in Shanghai, and the majority of these were Hong Kong-based practices.

"China hadn't even liberalised their domestic legal and accounting industry at the time. Nearly all Chinese lawyers, accountants and auditors worked for the government; there was very little private enterprise in professional services back then," he said. Why did Dezan Shira & Associates choose to start its life in Shenzhen? On this, he said there were no other firms in the city, and he recognised the fact that the then-cheap SEZ tax rate (15 per cent) would be a magnet for foreign investors.

"It wasn't a fashionable choice, as most firms wanted to be in Beijing and Shanghai, but I'd put the business where the bulk of FDI was going – Guangdong Province. In hindsight it was a very shrewd move." "Over the years, the firm has developed in leaps and bounds – not least because the practice developed, somewhat uniquely, a publishing house to handle their marketing," he said. What started out as *China Briefing* – a four-page photocopied monthly print bulletin of some 500 copies – has now developed into *Asia Briefing Media*, with publications in five different languages covering six different investment destinations: China, India, Russia, Vietnam, Mongolia and Emerging Asia, he added.

"*China Briefing* and our other titles have definitely helped develop the firm. Now we have to employ editors, sub-editors and researchers. Before, it was just me and a basic computer typing away about legal and tax issues in China. There was no email and there were no websites, it was all print copies, sending faxes and distributing it to hotels, business centres, trade organisations, embassies, consulates and chambers of commerce. Now we're distributed globally by Springer (one of the world's largest academic publishers) and run numerous websites and mobile apps. It's been quite an evolution." The firm also joined the Leading Edge Alliance global accounting network several years ago, an organisation of several hundred international firms with a combined turnover in 2011 of some US$2.7 billion. ■

INDIA: Peer review for chartered accountants

The Institute of Chartered Accountants of India (ICAI) has taken it upon itself to ensure the quality of the working of its members through peer review. Peer review is review of the professional competence of one chartered accountant by another. Such an exercise ensures that the members of the institute comply with the requirements of the profession and that the quality of services rendered doesn't fall below the expected quality.

The ICAI selects from senior members with a standing of more than 10 years to function as peer reviewers, according to MV Kali Porasad, a Hydrabad-based chartered accountant, in an article that appeared in *The Hindu Business Line*. The peer reviewers (PR) scrutinise the records of the practising unit (PU) and send the report to the Institute. Peer review can be voluntary by the firms, or initiated by the ICAI. PU is given a choice to select the reviewer from among three names recommended by the ICAI, he wrote. ■

US: Prominent accounting and consulting firms agree to merge

Wipfli LLP and Eide Bailly LLP, two prominent accounting and consulting firms that rank among the largest in the US, announced plans to merge their professional practices. Pending regulatory approval, the two firms will officially combine on 1 June 2012. The combined firm will be named EB Wipfli LLP, and will rank among the nation's top 15 accounting firms, with annual revenue of more than US$314 million, it said in a joint release.

Combined, the new firm will serve more than 70,000 clients from 41 offices across the west-central United States and two offices in India. EB Wipfli will provide a comprehensive range of audit, tax, accounting, consulting, and professional advisory services to public and private companies across the country and internationally.

In a joint statement, Jerry Topp, Managing Partner/CEO of Eide Bailly, and Rick Dreher, Managing Partner/CEO of Wipfli, said, "Together, our firms will have the depth of resources necessary to help our clients meet their future challenges and leverage future opportunities. We are excited about what this merger will mean for our clients, our associates and our partners." ■

IFAC NEWS

THE IFAC UPDATE PROVIDES SUMMARIES OF IFAC DEVELOPMENTS OVER THE PAST MONTH.

ECONOMIC CONDITIONS CONTINUE TO CHALLENGE PREPARERS AND AUDITORS ALIKE; FOCUS MUST INCLUDE GOING CONCERN ASSUMPTION AND ADEQUACY OF DISCLOSURES

The global economy continues to experience difficult conditions as the effects of the financial crisis - for example, on corporate cash flows and access to credit - persist. Volatility in capital markets, and issues including measurement and disclosure of exposures to sovereign debt of distressed countries, continue to create uncertainty. The impact of these issues and uncertainty has wide-ranging financial reporting implications that often extend beyond national borders.

These and other current economic conditions present unique challenges for management of entities, those charged with governance, and auditors in meeting their responsibilities, including assessing an entity's ability to continue as a going concern and making relevant disclosures in the financial statements and, as appropriate, the auditor's report. In light of the current environment, the International Auditing and Assurance Standards Board (IAASB) reminds auditors of their important responsibilities under the International Standards on Auditing (ISAs) and that the appropriateness of management's use of the going concern assumption is a matter to be considered on every audit engagement. Prof. Arnold Schilder, Chairman of the IAASB, commented, "Difficult economic conditions give rise to many important audit considerations, but none more important - or more difficult - than evaluating management's assessment of an entity's ability to continue as a going concern and determining the appropriate auditor reporting in the circumstances."

"Auditors must remain alert throughout the audit for evidence of events or conditions that may cast significant doubt on an entity's ability to continue as a going concern. We cannot stress enough the importance of professional skepticism and judgement in evaluating financial statement disclosures and the implications for the auditor's report when a material uncertainty exists relating to events or conditions that, individually or collectively, may cast doubt on the entity's ability to continue as a going concern." The 2009 IAASB Staff Audit Practice Alert, "Audit Considerations in Respect of Going Concern in the Current Economic Environment," highlights matters relevant to the consideration of the going concern assumption in the preparation of financial statements. Among other matters, it addresses factors relevant to the assessment of going concern; the period of time considered in making a going concern assessment; financial statement disclosures; forming an opinion on the financial statements and the implications for the auditor's report.

"While this Audit Practice Alert was released in context of the 2008-2009 credit crisis, many of the matters addressed in it are equally relevant today. For example, an entity may be experiencing a decline in its financial health, or may have material uncertainties arising from direct or indirect exposures to sovereign debt of distressed countries. Auditors are therefore encouraged to review the Alert and, importantly, the relevant requirements in the ISAs," emphasised Prof. Schilder. ■

IAASB DISCLOSURES FEEDBACK STATEMENT; SHARES GLOBAL INSIGHTS TO SUPPORT ESSENTIAL COLLABORATION AND COOPERATION

The International Auditing and Assurance Standards Board (IAASB) released a Feedback Statement on the responses to its January 2011 Discussion Paper, The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications. The Discussion Paper solicited views and perspectives of different stakeholder groups on the challenges arising as financial reporting continues to evolve to meet the changing needs of users. Respondents from across the world, including regulators and oversight authorities, users and preparers, audit firms, and professional bodies provided thoughtful and informative input on issues around disclosures. The Feedback Statement provides an overview of the key messages heard and provides thoughts and recommendations on what can be done to address them.

"Disclosures have always been a critical component of financial reporting, but have become more so today as reporting increasingly incorporates fair value information, estimates involving judgement and complex measurements, and narrative disclosures of some of the risks and characteristics of companies and groups. Accordingly, investors and others look to disclosures for vital insights when making investment decisions," said Prof. Arnold Schilder, Chairman of the IAASB. "This underscores the importance of the IAASB's initiative to gain further knowledge and understanding of the issues and share what it has heard to stimulate further thinking and exploration in this area."

The Feedback Statement presents a summary of the range of views on some of the more significant challenges faced by participants across the entire financial reporting supply chain, including the impact of trends in financial reporting, applying materiality to disclosures, evaluating misstatements generated by disclosures, the availability of audit evidence to support disclosures, and work effort. To address some of the issues identified respondents have called for more auditing guidance in certain identified areas. However, the majority of the respondents were of the view that some of the more important issues could not be addressed by the IAASB on its own, but would require international collaboration and cooperation, particularly with both the accounting standard setters - including the International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB) - and regulators.

"Financial information that is reliable, understandable, and relevant is essential, as is the assurance on that information that auditors provide. We wholeheartedly agree with the respondents regarding the need for international collaboration and cooperation among standard setters; securities, audit, and prudential regulators; and other stakeholders. We must work together to develop effective responses to the issues being faced today," notes James Gunn, IAASB Technical Director. "Like others, the IAASB has a role in enhancing the public's confidence in disclosures as a priority - recognising that individual initiatives must be towards finding a collective solution." ■