STATEMENT OF INTENT – SFRS FOR SMALL ENTITIES

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Comments to be received before 18 August 2010

This Statement of Intent is issued by the Accounting Standards Council (ASC) for comments from the public, stakeholders and interested parties.

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explain the issue and provide suggestions with supporting reasoning.

Comments should be submitted early, so as to be received before 18 August 2010, via email to:

MOF_Feedback_ASC@mof.gov.sg

STATEMENT OF INTENT - SINGAPORE FINANCIAL REPORTING STANDARD FOR SMALL ENTITIES

A EXECUTIVE SUMMARY

This Statement of Intent sets out the reasons behind the intention of the Singapore Accounting Standards Council (ASC) to adopt the International Accounting Standards Board (IASB)'s final standard on International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) as the **Singapore Financial Reporting Standard for Small Entities (SFRS for Small Entities)**. The SFRS for Small Entities would be a reporting option for entities in Singapore which have no public accountability and satisfy certain criteria.

2. An entity is eligible to use the SFRS for Small Entities if: (I) it is not publicly accountable; and (II) it qualifies as a small entity by virtue of it satisfying two out of the three threshold criteria as prescribed by the ASC.

(I) An entity is deemed to be publicly accountable if:

(a) Its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (such as a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(b) It is a deposit-taking entity and/or holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, insurance companies, securities brokers/dealers, mutual funds and investment banks[1], or

(c) It is a public company defined under the Singapore Companies Act, or

(d) It is a charity defined under the Charities Act, or

(e) It is a credit society defined under the Co-operative Societies Act or a society deemed to be a credit society under the Co-operative Societies (Amendment) Act 2008.

(II) An entity qualifies as a small entity if it satisfies two of the following three criteria (determined on a consolidated basis):

(a) Total annual revenue of not more than S$10 mil;

(b) Total gross assets of not more than S$10 mil; and

[1] For the avoidance of doubt, all regulated or exempt financial institutions are not permitted to use the SFRS for Small Entities, except for money changers, financial advisers, insurance brokers, captive insurers and Lloyds Asia Scheme service companies. These entities may elect to use the SFRS for Small Entities only if they meet the qualifying criteria as prescribed by the ASC.

(c) Number of employees not more than 50.

3. The ASC intends to provide **transitional relief for "marginal entities"** that fall in and out of the eligibility threshold criteria due to year-on-year fluctuation in financial / operational results, by requiring the preparation of financial statements under the full SFRS only if the entity fails to satisfy the prescribed threshold criteria for two consecutive years[2]. Likewise, an entity that prepares financial statements based on the full SFRS is eligible to apply the SFRS for Small Entities only if it has satisfied the prescribed threshold criteria for two consecutive years.

4. The ASC believes that the IFRS for SMEs is a robust and comprehensive standard that is suitable for use by small entities in Singapore and hence proposes that the IFRS for SMEs be **adopted without modification** as the SFRS for Small Entities. The SFRS for Small Entities would be available for eligible entities to apply for **financial periods beginning on or after 1 Jan 2011**.

B BACKGROUND

5. Singapore, unlike jurisdictions such as EU, Hong Kong, Japan and the UK, does not currently have in place a differential reporting framework for small entities. All companies incorporated in Singapore, regardless of size or the level of public interest in them, are required under the Companies Act to comply with the Singapore Financial Reporting Standards (SFRS), which are largely aligned to the IFRS.

6. The ASC has received feedback that the application of SFRS on all companies imposes a reporting burden on many small private companies, given that the users of those financial statements often do not require the level and extent of disclosure that comes with the SFRS[3]. The ASC also received feedback that most banks tend to place greater reliance on the personal guarantees/collateral provided by the directors and/or shareholders of these companies, rather than the financial statements when considering whether to extend loans to them. The ASC also observed that many jurisdictions which adopt IFRSs limit their application to listed companies only.

C ASC SME TASKFORCE PROPOSALS

7. In 2008, the ASC formed a dedicated taskforce to consider the possibility of allowing differential reporting for SMEs in Singapore. Taking into consideration the feedback received by the ASC, the ASC SME Taskforce is of the view that there should be a differential reporting framework for SMEs in Singapore that are not publicly accountable. This is in line with the practices in the other jurisdictions such as Australia, Canada, the European Union (EU), Hong Kong, Japan and New Zealand. The ASC SME Taskforce believes that this will help to reduce the compliance burden for small entities in Singapore, based on its analysis of the objectives the financial statements of these entities are supposed to achieve.

[2] In other words, an entity may continue to use the standard in the first year that the entity does not fulfill the conditions.

[3] In particular, it was highlighted to the ASC that since most small private companies are owner-managed, shareholders have on-going access to financial information without having to rely on the financial statements.

8. A public consultation was conducted from 12 May to 30 June 2008 on the applicability of a differential reporting framework for SMEs in Singapore and the criteria that an entity needs to satisfy in order to qualify for differential reporting[4]. The ASC SME Taskforce received diverse feedback on its proposal, including those from the accounting profession, academia, banks, and professional bodies. A summary of the responses received is attached as ANNEX.

9. At the same time, the ASC SME Taskforce noted that on the corporate regulatory front, a high level review committee, i.e. the Steering Committee for Rewriting the Companies Act, is also embarking on an initiative to reduce the regulatory costs for smaller companies through the introduction of a differential statutory financial reporting requirements framework in the Companies Act. Specifically the Steering Committee proposed, in its focus group discussion document, that a company should be considered as "small" if it is a private company and it fulfills two of the following three criteria, namely,

(a) Total annual income of not more than S$10 mil;

(b) Total gross assets of not more than S$10 mil; and

(c) Number of employees not more than 50.

10. The ASC SME Taskforce, taking into consideration the feedback received and the review currently undertaken by the Steering Committee for Rewriting the Companies Act, proposed to align the qualifying criteria for the application of the IFRS for SMEs to the Steering Committee's proposed definition of a small company. This is because a single consistent definition both for the purposes of providing relief in terms of regulatory compliance requirements and financial reporting requirements will help to avoid confusion amongst companies. Furthermore having a single set of criteria for accounting standards and auditing exemptions would then mean that audit firms will need to be proficient only in one accounting framework (i.e. the full SFRS) and avoids implementation costs (e.g. training / need for separate sets of audit procedures for each framework).

D ASC'S TENTATIVE DECISION

11. The ASC has considered the proposals of the ASC SME Taskforce and concurs that there are advantages to have in place a differential reporting framework for small entities in Singapore. The ASC believes that the adoption of the IFRS for SMEs would benefit the smaller entities in Singapore by reducing undue financial reporting burden arising from the considerable number of recognition and measurement bases and detailed disclosures requirements.

[4] For the purpose of the public consultation in 2008, the ASC SME Taskforce had initially proposed that an entity would qualify as an SME if it satisfies two of the following three criteria: (a) net assets not more than S$15 million; (b) annual turnover not more than S$15 million; and (c) average number of employees not more than 200.

12. Given that the issue of comparability would be more relevant for companies that are on the cusp of transitioning to listed status, the ASC conducted a focus group discussion with selected companies[5] in Mar 2010 to seek feedback on what size threshold criteria would best manage and contain the impact. Based on the comments received, the ASC believes that the proposed threshold criteria as indicated in paragraph 2(II) is an appropriate cutoff which would minimize the issue of non-comparability while allowing at least 80% of companies in Singapore to be eligible for the use of the SFRS for Small Entities[6]. If necessary, the ASC would review the threshold criteria after the IASB completes its first comprehensive review of the IFRS for SMEs in 2011 / 2012.

13. This Statement of Intent is issued with the objective of informing the public on the likely issuance of the SFRS for Small Entities in Singapore. Members of the public and relevant stakeholders are welcome to submit comments on the ASC's intent as set out above to the ASC in writing, supported by specific reasoning, by **18 August 2010**. The SFRS for Small Entities would be uploaded onto the ASC website once the ASC finalises its adoption. The IFRS for SMEs can be found at the link as provided below:

http://www.iasb.org/IFRS+for+SMEs/IFRS+for+SMEs+and+related+material/IFRS+for+SMEs+and+related+material.htm

[5] The companies are selected based on the size of their annual revenue, which are in the range of S$10 million to S$100 million.

[6] Statistics are estimated based on company records filed with ACRA for financial year 2007.

PUBLIC FEEDBACK ON THE DIFFERENTIAL REPORTING PROPOSAL

A) Should Singapore adopt a differential reporting framework for SMEs?

1 All but one of the respondents supported the proposal of having a differential reporting framework for SMEs. The respondents agreed that users of financial statements of SMEs often have different informational needs compared to the users of financial statements of publicly accountable entities. For example, given that SMEs often either obtain capital from shareholders/directors or receive bank financing based on the collateral put up by the shareholders/directors, disclosures of related party transactions may thus be more relevant in the case of SMEs.

2 The respondents were also of the view that since the shareholders of most SMEs are either closely involved in the management of these entities or are represented on the Board; they are unlikely to obtain any additional benefits from financial statements prepared in accordance with the full SFRS. That being the case, on a pure cost and benefit analysis, it is thus reasonable to apply a differential reporting framework on SMEs so that they would be able to save on the costs that they would otherwise have to incur if they had adopted the full SFRS, e.g. putting in place a fair value reporting/valuation model etc.

B) Should the differential reporting framework only be applicable to an entity that is not publicly accountable[7] and satisfies the size criteria to be regarded as an SME?

3 The majority of the respondents, while supportive of the proposal, asked that greater clarity be given to the definition of "public accountability" so as to avoid confusion and ambiguity. Two respondents were however of the view that instead of having a differential reporting framework for just SMEs, this should be extended to all entities without public accountability.

C) Should an entity be deemed as an SME if it satisfies any two of the following criteria: net assets not exceeding $15 mil, annual turnover not exceeding $15 mil and employs less than 200 employees?

4 Most respondents were supportive of the proposal that an entity should be deemed as an SME if it satisfies any two of the three criteria stated above. On the use of assets as a criterion, the responses were mixed, with some respondents preferring the use of *total* assets over the use of *net* assets, on the ground that net assets can be distorted by excessive gearing. On the use of number of employees as a criterion, a respondent commented that this may not be a good gauge given that a lot of companies are now out-sourcing a substantial part of their internal functions, while another opined that a reduced threshold of 50 employees may be more appropriate instead.

[7] An entity is deemed **not** to be publicly accountable if it does not issue shares or debts in a public market and does not hold assets in a fiduciary capacity for others.

D) *Should one of the qualifying criteria for an entity applying the differential reporting framework be that all of its owners must be members of the entity's governing body, or that there should be unanimous consent from all its owners?*

5 The responses were mixed as some of the respondents were of the view that there should not be any additional qualifying criteria beyond the public accountability and size threshold test, as this would be unduly onerous. The respondents that were in favour felt that this would help to protect the rights of minority shareholders who may not be involved in the management of the SME.

E) *Should we adopt the UK's system of allowing the exemption to continue for the first year that the company does not fulfill the size criteria?*

6 Majority of the respondents were agreeable to adopting the UK system as the one year grace period would give those companies that have grown in size, the time to prepare themselves for compliance with the full SFRS. This would also address the potential volatility of the assets and turnover figure for a reporting entity.

F) *Should an entity that qualifies under the differential framework be given a choice to either follow the SME-IFRS in its entirety or the SFRS?*

7 All respondents agreed that an entity that qualifies as an SME should be given the choice to either adopt the SME-IFRS or the SFRS.