The Evolution of GAPSE in Malta: A Qualitative Approach to Establish the Basis for Conclusions and Beyond

By

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Abstract

In 1995 the new Companies Act was introduced in Malta. This effectively meant that all companies in Malta had an obligation to prepare IFRS based financial statements. However, several people felt that these standards fail to cater for the needs of local SMEs. After years of research to find a solution to this situation, an accounting framework that is more focused on the needs of local SMEs has been developed. This means that for financial reporting periods ending in 2009, SMEs may opt to apply GAPSE in the preparation of financial statements.

The purpose of this study is to document the decision making process in reaching the conclusions of GAPSE and to include the views and perspectives of the individuals involved in this process. This was mainly achieved through the interviews held with members of the SMERTF in order to find out the reasons behind the decisions taken.

The study reveals the main thoughts on issues raised before the ED was published. It also delves into the comments received during the exposure period and the reasons why they have been transposed into GAPSE or why they were not. As regards the future of GAPSE, it is important that it is regularly updated and reviewed and that adequate education and training is provided.

Keywords: financial reporting, small firms, accounting standards.

Statement of Authenticity

I, the undersigned, hereby declare that the work contained in this dissertation is my own original work and any conclusions or statements contained therein are mine, unless otherwise stated.

Daniel Borg

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List of Abbreviations

ASB	Accounting Standards Board (UK)
BC	Basis for Conclusions on the IFRS for SMEs ED
CCAB	Consultative Committee of Accountancy Bodies
ED	Exposure Draft
EU	European Union
FRSSE	Financial Reporting Standards for Smaller Entities
GAPSE	General Accounting Principles for Smaller Entities
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IRD	Inland Revenue Department
MIA	Malta Institute of Accountants
NPAE	Non-Publicly Accountable Entities
PE	Private Entities
SBPC	Small Business Practitioners Committee
SME	Small and Medium Sized Entities
SMERTF	MIA SME Reporting Task Force
SSAP	Statements of Standard Accounting Practice
UK	United Kingdom

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Chapter 1: Introduction

‘There is a long history of questions about financial reporting standards and the needs of small entities, the users of their financial statements, and the professionals who serve those entities.’

(SPBC 2002, p.6)

1.0 Background information

The Accountancy Profession is recognised as one that contributes to every sector and aspect of the economy. Thus, it is essential to have an appropriate legal system so that the profession will be organised. In Malta, prior to the introduction of the Companies Act of 1995 there were no set of accounting standards which the law required to be followed in the preparation of financial statements. Research by Micallef (1993) explains how this caused preparers of financial statements to apply either IASs or SSAPs or a combination of both. Francalanza (1988) contends that this situation of applying different accounting frameworks for similar events and transactions reduces the value of accounting for decision makers because it would be difficult for them to make comparisons.

The new Companies Act of 1995 obliged all companies in Malta to apply IASs in the preparation of their financial statements. This was one of the most important developments for the local Accountancy Profession. However, these standards are large in terms of detail and seem to be designed for huge multinational companies. As shown by Camilleri (2000), this caused several people to show concern about whether the reporting requirements of these standards are beneficial or an unnecessary burden for SMEs.

SMEs dominate the Maltese economy and are thus economically significant. It was felt that accounting and financial reporting requirements of SMEs could be scaled down to ensure that they are more relevant, understandable and sensible to the SME scenario. However, although there seemed to be a consensus that SMEs need an alternative accounting framework, the solution to this problem was not so easily forthcoming.

One of the first initiatives as regards SME reporting in Malta occurred when the Accountancy Board requested the MIA to express its views on the subject of a '*Proposal to Introduce Special Accounting Standards for Small Firms'* way back in 2001 (SBPC, 2002). Subsequently, the MIA recommended that the SBPC investigates the subject. Eventually the SBPC appointed two members of this committee to prepare a report on the matter which they finalised by June 2002.

The report (SBPC, 2002) highlighted the major initiatives issued by standards setters and international organisations as well as an overview of alternative reporting regimes adopted by other countries such as Canada and New Zealand. It also focused on surveys and studies carried out on the UK FRSSE.

Following this report, a number of alternatives were studied by the SMERTF in order to arrive at the best solution for local SMEs as regards financial reporting. Initially, the Third and Fourth Schedule to the Companies Act were looked at carefully in order to make recommendations on any necessary enhancements and form an SME accounting framework. Another project consisted of looking into the provisions of the FRSSE and the staff draft of the IASB's project for SMEs and assess their local applicability. However, these two options did not seem to achieve the desired simplified accounting framework for SMEs. A third option taken into consideration was to use the UK FRSSE as a model on which to develop a reasonable alternative to IFRSs for the local SMEs. Several advantages were identified in the FRSSE and this latter alternative was accepted.

This was followed by the issuing of an ED for a two-month period of public consultation. After this period was over, the comments received were reviewed, considered, discussed and decided upon in six meetings. Following these meetings a seventh and final meeting was held in order to assure that all the suggestions that were adopted were reflected in GAPSE. This was followed by the publishing of the final form of GAPSE which came into force on the 24th February 2009 through Legal Notice 51 of 2009.

1.1 Objectives of the dissertation

The objective of this study is to gather the views and perspectives of the individuals that were involved in the development of GAPSE as well as to collect the feedback and reactions attained during the exposure period in order to identify the basis for conclusions of this new accounting framework. Barth (2008, p. 1159) states that:

> ‘the basis for conclusions explains how the standard-setter thought through the issues, applied the conceptual framework, weighed the pros and cons of available alternatives, and reached the decisions in the standard.’

This study intends to present a formal documentation of the decision making process in order to enhance the level of transparency and accountability.

1.2 Structure of the dissertation

The dissertation is divided into five chapters. Chapter 1, *Introduction* presents a brief overview of the difficulties encountered by local SMEs in meeting their financial reporting requirements and stating the objectives of the study. Chapter 2, *Literature Review* highlights the main routes that were considered to provide a solution for these difficulties and the final outcome. Chapter 3, *Research Methodology* lays down the research method chosen to achieve the objectives of the study. Chapter 4, *Findings and Discussions Thereof* presents the basis for conclusions of this new accounting framework. Chapter 5, *Conclusions and Recommendations* puts forward the conclusions emerging from the research carried out and proposes suitable recommendations for further research.

1.3 Limitations of the dissertation

There were two main limitations in carrying out my research:

1. The first limitation was that on commencement of this research some sections of the framework were still in progress and the final decisions were still not taken. This created difficulty in keeping track of the ongoing changes. However, after the final version was published, this difficulty was overcome and it was possible to make the necessary analysis.

2. A second limitation was that due to the word limit of the dissertation the basis for conclusions were limited to the sections where significant changes occurred and where explanations were mostly required.

Chapter 2: Literature Review

‘The principal aim when developing accounting standards for small to medium-sized enterprises (SMEs) is to provide a framework that generates relevant, reliable, and useful information. The result should be a high quality and understandable set of accounting standards suitable for SMEs.’

(Goh and Holt 2006, p.46)

2.0 Introduction

The following chapter will delve into the literature available on the options considered during the past years which led to a new set of accounting standards for local SMEs. The following are the three main alternatives which were taken into account (Dingli, 2008):

1. To upgrade the current requirements laid down in the Third and Fourth Schedules to the Companies Act 1995 as subsequently amended.
2. The IASB's proposed accounting standards for SMEs (IASB 2007a).
3. The FRSSE – Financial Reporting Standards for Smaller Entities developed in the UK (ASB 2008).

This will be followed by an analysis of the selected differences between the FRSSE and the IASB's proposed standards for SMEs. Finally, an overview of GAPSE will be given.

2.1 The Third and Fourth Schedules to the local Companies Act

The Third Schedule to the local Companies Act 1995 is intended to set out the minimum requirements as regards the form and content of the balance sheet and profit and loss account as well as additional information required to be included in the notes to the accounts of a company. This schedule mainly sets out some areas and classes of transactions that would feature in an accounting framework for the preparation of general purpose financial statements.

Dingli (2008) explains that the Third Schedule to the Companies Act 1995 is based on the EU Fourth Council Directive (78/660/EEC) on the annual accounts of certain types of companies (Council of the European Communities, 1978). SCADplus (2007) identifies the following as the main aims of Directive 78/660/EEC:

- The establishing of the minimum legal requirements as regards the extent of financial information that should be made available to the public;
- The prescribing of a mandatory layout for the balance sheet and the profit and loss account in a format which would be acceptable to all parties concerned;
- The regulation of the minimum information which must be displayed by way of notes to the accounts in order to satisfy the required legal standards and principles on which it is based.

- The coordination of the different methods of valuation of assets and liabilities to the extent necessary to ensure that annual accounts disclose comparable and equivalent information in respect of the various companies operating in different sectors.

Moreover, Directive 78/660/EEC applies less stringent requirements for small and medium sized companies which on their balance sheet dates do not exceed two of the three criteria laid down in article 11 (for small companies) and in article 27 (for medium sized companies). Table 2.1 presents these criteria.

Table 2.1: Company Criteria

Company Size	Criteria		
	Balance Sheet Total (EUR)	Net Turnover (EUR)	Average number of employees during the financial year
Small	4, 400, 000	8, 800, 000	50
Medium	17, 500, 000	35, 000, 000	250

On the other hand, the Fourth Schedule to the local Companies Act 1995 lays down what should be included by way of form and content in the consolidated balance sheet and profit and loss account as well as the notes to such accounts.

It also contains several accounting rules that should be adhered to in the preparation of consolidated financial accounts which apply equally both to SMEs as well as to large companies. The basis of this schedule is the EU Seventh Council Directive (83/349/EEC) on consolidated accounts of companies with limited liability (Council of the European Communities, 1983).

The MIA noted that these schedules lacked numerous provisions and had concluded that they cannot form a suitable basis on which an SME financial reporting framework could be drawn up and therefore started actively looking at the staff draft of the IFRS for SMEs and the FRSSE (Dingli, 2008).

2.2 The IASB's proposed accounting standards for SMEs

> 'The IFRS for SMEs is a courageous attempt by the IASB to simplify accounting rules and disclosures for all publicly accountable entities'
>
> (McQuaid 2008, p.25)

Buttigieg (2006) noted that although the IASB never stated that its standards are aimed solely at large companies, the IASB recognises the fact that the majority of SMEs find the IASs difficult to implement. Soon after it was set up in 2001, the IASB launched a project to develop accounting standards for small and medium sized entities. From July 2003 the IASB deliberated the issues during thirty-one board meetings until the ED was issued for comments on 15th February 2007 (IASB, 2007a).

The IASB gave a reasoned account of its decisions and the issues it considered in a separate document entitled '*Basis for conclusions on Exposure Draft'* (IASB 2007b). As noted by McQuaid (2008, p.18), the aim of this document is to convey 'transparency of the highest order.' It includes a list of topics omitted from full IFRSs, recognition and measurement simplifications and simplifications considered but not adopted.

The published ED was followed by a field testing programme to ensure the best outcome possible. One hundred and sixteen entities from twenty different countries participated in this programme by restating their most recent annual financial statements and reporting any problems encountered. The findings of the comments and field tests were presented to the IASB in April 2008 (IASB, 2008a).

Subsequently, the IASB started to review the main issues raised. One of which is the name of the standard which was changed to *IFRS for PEs* in May 2008 from the previous *IFRS for SMEs.* In January 2009 the name was re-changed to *IFRS for NPAEs* since it was deemed to give a better description of entities having no public accountability (IASB, 2009). The IASB has decided to update its standard every two years (Pacter, 2006).

2.3 The FRSSE

> 'The Board hopes that the proposed FRSSE will be of real assistance to those concerned with preparing the accounts of our very many small companies.'
>
> (Tweedie 1997, p.37)

In the UK, the first serious step towards the application of accounting standards for smaller companies occurred in July 1993 when the ASB set up a working party to the CCAB. The aim was to reduce the administrative burden on such enterprises by providing exemption from a number of accounting standards, and thereby reducing the reporting requirements.

In 1994, the working party produced a consultative document entitled *'Exemptions from Standards on the Grounds of Size or Public Interest'*, which proposed that small companies should not be required to comply in full with all accounting standards (ASB, 2008).

Subsequently, the FRSSE was issued by way of recognition of the fact that the accounting and disclosure requirements for large and small companies were sharply diverging (Charles, 2002). The FRSSE has been adopted in the UK since November 1997 and presents considerable simplifications when compared to the locally applicable IFRSs.

On the issue of the first version of the FRSSE, the ASB had stated its intention to review how the FRSSE, as a whole, was working in practice after two full years of operation. Since then, the ASB has continued to update the FRSSE on a regular basis to reflect changes in accounting standards. The most updated version has been issued on the 12th of June 2008. This update to the FRSSE was made to recognise the changes made by virtue of the UK Companies Act 2006 (Collings, 2008a).

2.4 Differences between the IFRS for SMEs ED and FRSSE

The IFRS for SMEs ED differs from FRSSE in a number of circumstances. The following are selected differences:

2.4.1 The scope

The IASB defines an SME as an entity with no public accountability. In an interview held in November 2006, Dr. Paul Pacter, IASB Director of Standards for NPAEs, stated that, 'in short, entities without public accountability (SMEs) are unquoted companies that are not financial institutions' (Pacter 2006, p. 31). However, in deciding on the content of its SME standards, the IASB has focused on a typical SME with about 50 employees. Still, the IASB has concluded not to specify quantified size tests and left this decision in the hands of jurisdictions (IASB, 2007b).

On the other hand, the FRSSE sets specific size levels to define an optional programme of modified standards for SMEs. As stated in the scope section:

> 'The FRSSE may be applied to...small companies or small groups as defined in companies legislation preparing Companies Act individual or group accounts...'
>
> (ASB 2008, pp. 10-11)

According to the UK Companies Act 2006 a company can qualify as small if it does not exceed two or more of the following criteria: Annual turnover - £6.5 million; balance sheet totals - £3.26 million; number of employees - 50. However these criteria do not apply across the board and primarily for reasons of public interest, certain companies are not allowed to use the FRSSE even though they meet the qualification criteria. These include public companies, banks, building societies and insurance companies.

2.4.2 The extent to which the documents operate on a standalone basis

The FRSSE is derived from the full UK accounting standards. The ASB has presented derivation information in the form of tables, which cross-referenced the FRSSE to its mainstream standard equivalents. Collings (2008b) points out that this shows that FRSSE is not meant to be a substitute for the mainstream standards themselves and this is in view of the fact that reference has to be made to UK Financial Reporting Standards.

On the other hand, the IASB's SME project is meant to be a single self-contained standard. This means that the accountant can rely solely on the rules prescribed in this document in preparing a set of financial statements although there are also a number of cross-references to the main IFRS (Edwards, 2007). However, this should only occur occasionally in the following three situations:

1. If a particular transaction or event is not covered by the IFRS for SMEs.
2. If an SME elects to use a complex option that is omitted from the IFRS for SMEs.
3. If the IFRS for SMEs does not address a transaction, event or condition, or provide an explicit cross-reference back to IFRS.

In the third situation the preparer should apply the treatment which is deemed to give a true and fair view. In making that selection, an SME should consider, first, whether the appropriate accounting can be determined from the principles in the IFRS for SMEs. If that does not provide guidance, the SME must consult the full text of IFRSs (Pacter, 2006).

2.4.3 The cash flow statement

Another important characteristic of the FRSSE is that it omits the requirement for the cash flow statement. The debate regarding this statement started when the ASB requested the CCAB to set up a Working Party to help in reducing the reporting requirements for SMEs. Although the latter had proposed the requirement for a cash flow statement, the ASB maintained that it was not convinced by the comments received by the CCAB Working Party. As a result the ASB's exposure draft excluded the cash flow statement although it still believed that a case could be made for its inclusion, and so invited comments to this effect. Instead, it included a 'voluntary disclosures' section, recommending, but not requiring, the provision of a simplified cash flow statement (Reid & Smith, 2008).

Only a minority of respondents to the FRSSE ED stated that a cash flow statement was in fact important. Although the ASB held the same opinion as the minority, it recognised the difficulty in mandating this statement and therefore did not include the cash flow statement as part of the mandatory requirements (ASB, 2008).

In contrast, The IASB (2007b) was of the opinion that the cash flow statement is critical to users, especially lenders, in making economic decisions and in determining how the entity generates and spends cash, as this would undoubtedly weight in whatever decision the user would be asked to take in respect of the enterprise concerned.

In addition, it also noted that once an entity would have drawn up an income statement and a balance sheet with amounts for the beginning and the end of the reporting period, then the preparation of the cash flow statement would be comparatively simple to compile.

2.4.4 The treatment of goodwill

The FRSSE requires that positive purchased goodwill shall be capitalised and depreciated on a straight line basis over its useful economic life which shall not be in excess of twenty years. Furthermore, the FRSSE prohibits the revaluation of goodwill (SwatUK, 2007). On the contrary, the IFRS for SMEs ED does not permit goodwill to be amortised but is instead tested for impairment. It requires that goodwill in a business combination after initial recognition should be recognised at cost less any impairment losses (IASB, 2007a).

2.4.5 Other differences

There are several other differences between these two frameworks, especially in the terminology used. (Collings, 2008b) The FRSSE also differs from the IFRS for SMEs in that it does not require the presentation of consolidated financial statements (SwatUK, 2007).

Another difference lies in the measurement options and disclosure requirements of investments, associates and intangible assets. With regards to financial instruments, while the proposed IFRS for SMEs focuses on cost versus fair value measurement as well as giving significant attention to hedge accounting, the FRSSE tends to focus on the classification and cost measurement (McQuaid, 2008).

2.5 The new local accounting standard: GAPSE

After delving into the frameworks described in the previous sections as regards financial reporting requirements for SMEs, the MIA felt that although Malta has implemented full IFRS as from 1995, the staff draft of an IFRS for SMEs ‘did not achieve the objective of simplified accounting and disclosure for local and small entities’ (Dingli 2008, p.8). Eventually, the MIA recommended that a set of local accounting principles for smaller entities using FRSSE as a model would be the best solution since the latter framework has been tested in a reputable economy for more than ten years and contains a number of simplifications. However, this did not mean that IFRSs were to be disregarded in the formation of this new framework. The MIA noted that in building GAPSE, the knowledge and experience gained through the applicability of IFRS throughout the past was widely used (Flynn, 2008).

Thus, after an 18 month process of deliberation, on the 17 December 2007 the GAPSE ED was launched during a press conference held at the Malta Stock Exchange. According to Hon. Tonio Fenech, Minister of Finance, the Economy and Investment, this new standard will achieve a win-win situation. GAPSE will aid SMEs to dedicate more time to their business rather than focus on compliance to IFRSs. In addition, it will also help accountants focus on more important work such as international financial business, where accountants are lacking (The Times Business, 2007).

Chapter 3: Research Methodology

‘Semi-structured interviews are particularly useful for understanding social movement mobilization from the perspective of movement actors or audiences’

(Klandermans and Staggenborg 2002, p.92)

3.0 Introduction

After identifying the objectives of the study and providing a critical review of the literature available, this chapter will give an overview of the research methodology employed which best suits the objectives of the study at hand. The research was conducted in order to obtain evidence with regards to the conclusions reached in completing this new accounting framework.

Initially, the research consisted of a number of preliminary interviews to gain background information. The information thus acquired then served as a basis in order to be able to identify which questions would be required in order to discover how the individuals that were involved in the development of GAPSE tackled matters, assessed the advantages and disadvantages of alternatives and finally how they have actually arrived at the final decisions.

3.1 Preliminary research

Initially, an extensive review of the FRSSE and the IASB project for SMEs was carried out at an early stage in order to acquire the requisite knowledge on the subject. However, as it turned out this was not enough to obtain information on the development, updates and critics of these standards as years went by. In view of this, a review of a number of books, journal articles and past dissertations at the University of Malta library and its depository for older articles was also carried out. I have also reviewed the comment letters received during the exposure period as well as the minutes of the first six meetings of the SMERTF. I also attended the seventh and final meeting. This provided sufficient material which pointed towards the type of questions which were eventually asked during the interviews which were in fact held.

3.2 Choosing the research method

This dissertation falls within the phenomenological research paradigm. One of the most commonly accepted definitions of paradigm is the one written by Kuhn (1962, p.10). He states that a paradigm consists of a set of beliefs shared by a group of scientists about how problems should be understood and eventually addressed. Burrel and Morgan (1979, p.22) identify four paradigmatic positions in business research: Functionalist, interpretative, racial humanist and radical structuralist.

This study concerns the interpretive paradigm. In this regard, Haralambos and Holborn (2004 p.871) state that interpretive sociologists believe that the only way social actions can be understood is by interpreting the meanings and motives on which they are based. According to Bryman and Bell (2007 p.16) one of the main intellectual traditions that have been responsible for the interpretive approach is phenomenology. Welman and Kruger (cited in Groenewald 1999) contend that phenomenologists are concerned with understanding issues from the perspectives of the people involved. In this thesis the phenomenon is the reasons which led to the decisions taken in building this new framework.

Due to its nature, phenomenology is often linked to qualitative research since this type of research is concerned with words as opposed to quantitative research, which is more concerned with data in a numerical form. According to Haralambos and Holborn (2004, p.873) this fact is why qualitative data is usually portrayed as presenting a more truthful picture of people's experiences and their beliefs.

In most cases phenomenological analysis is conducted using semi-structured interviews as they enable the person carrying out the research to provide more detail than would be possible using a quantitative research tool (Smith, 2008). Hence, the main research tool used to collect the data was the semi-structured interviews. Each interview was taped and transcribed in order to extract the main arguments brought forward by the interviewees.

This technique is used to collect qualitative data by setting up an interview that allows respondents to reveal their opinions on a particular subject. This data collection method was chosen because it allows the person being interviewed to explain in detail complex issues and at the same time allow the interviewer to ask for clarification.

This method is one of the most effective methods for conducting qualitative research because although the interviewer designs a number of questions beforehand, it allows the latter to pose probing questions, brought up from the answers of the person being interviewed, as the discussion develops.

This definitely cannot happen when a questionnaire is the research tool used for data collection and is the main reason why the semi-structured interview method was preferred in this study. Another reason is that under a questionnaire the participant cannot clarify the questions being posed. A scenario could easily arise when a particular question is not fully understood, thus resulting in unwarranted responses.

Moreover, respondents who may choose the same response may not necessarily mean the same thing. In addition, the level of detail obtained from a questionnaire is much more limited, since the participant often has fixed choices to choose from. Haralambos and Holborn (2004 p.873) state that as a result, phenomenologists tend to look at data produced using questionnaires as an artificial creation of the researcher, based on false assumptions.

3.3 Selecting the questions and the participants

For the purpose of this dissertation two main sets of interview schedules have been drawn up. The first set of questions (refer to Appendix 1) were aimed at obtaining information relating to general issues on GAPSE. The second interview schedule (refer to Appendix 2) addressed specific sections on GAPSE and how decisions were taken in the building up of these sections. These were addressed to purposely selected members from the SMERTF as well as the Accountancy Board. In addition, a third set of questions (refer to Appendix 3) was asked to the two major local banks as well as the IRD in order to gather further information.

In the second interview schedule, reference is made to the IASB's project for SMEs. The interviews were conducted during the months of December 2008 and January 2009 and therefore do not reflect changes made to the IASB's project for SMEs after December 2008.

3.4 The participants

The following is a list of the individuals interviewed:

- Mr. Simon Flynn, *MIA President.*
- Mr. Jonathan Dingli, *MIA Technical Director.*
- Mr. Fabio Axisa, *SMERTF Member.*

- Mr. Hilary Galea-Lauri, *SMERTF Member.*
- Mr. William Spiteri-Bailey, *SMERTF Member.*
- Mr. Bernard Scicluna, *Accountancy Board Member.*
- Mr. Paul Borg, *Reviewer, Quality Assurance Unit, Accountancy Board.*
- Ms. Suzanne Stafrace, *Relationship Manager, HSBC Bank Malta p.l.c.*
- Ms. Elvia George, *Chief Officer Finance, BOV p.l.c.*
- Mr. Mario Borg, *Director of Operations, IRD.*

3.5 Limitations

Although semi-structured interviews tend to be very effective in qualitative research, there are some problems associated with this research method. A disadvantage connected with semi-structured interviews is that different respondents may be asked different questions due to the different arguments brought up by different respondents. This may cause the data obtained from different interviews to be difficult to generalise and compare.

Another difficulty is that the interviewer has no way to confirm that the respondent is saying the truth. There is potential for respondents to reply in the manner they feel is expected rather than of their true personal opinion. This may result in unreliable and invalid data. However, this disadvantage can be counteracted if the interviewer has the necessary skills and is nondirective. This in effect means that the interviewer should refrain from offering opinions and avoid expressions of approval or disapproval (Haralambos and Holborn, 2004, p.907).

Chapter 4: Findings and Discussions Thereof

'It is very important to remember that a set of financial statements prepared under GAPSE are not a set of abridged or limited disclosure financial statements. They are, on the contrary, financial statements which are pitched to give an appropriate but not excessive or overcomplicated level of information to their users.'

(Flynn cited in The Times Business 2007, p.3)

4.0 Introduction

This chapter will present in detail the main thoughts of those involved in the development process behind this new alternative accounting framework. The first section deals with an analysis of the main commentators during the exposure period. The other sections will delve into the most important decisions taken in the formation of the GAPSE ED, the issues and suggestions raised during the period for public comments, their analysis during the subsequent meetings and the basis upon which suggestions were accepted or rejected.

4.1 Comments received during the public consultation period

Most of the comments received were positive and supported the development of this new accounting framework. The main participants of this exercise were the larger audit firms which presented a detailed analysis and recommendations on what they considered to be the main issues in GAPSE. Although more comments were expected to be received from smaller practitioners and preparers, one can understand that these have limited resources to review in depth such a detailed framework.

However, the interviewees stated that they received several positive informal comments from preparers and sole practitioners although some expected less rigid regulations in certain sections. These included not requiring a cash flow statement as well as exempting deferred taxation.

4.2 Defining the entities eligible to apply GAPSE

4.2.1 The criteria

The SMERTF recognised that size should not be the only principal characteristic in defining entities eligible to apply GAPSE, because public interest and accountability need not necessarily be only related to size. In view of this, in determining which entities can qualify to apply GAPSE, the SMERTF set both qualitative as well as quantitative size criteria and hence it listed types of entities that are not eligible to apply GAPSE. The latter includes public companies and entities whose securities are listed on a regulated market.

Despite this, the SMERTF felt that including only qualitative criteria, in similarity to the IASB’s project for SMEs, would not achieve the objective of ensuring that certain entities, for which application of an easier and less stringent framework is not desirable, will continue to comply with full IFRS requirements. Moreover, in paragraphs BC 43 and BC 44 of the BC, it is provided that the decision not to include quantitative criteria was taken since it would not be feasible to develop quantified size tests for all those countries that use IFRS. It is also said that the decision to which entities the framework shall apply will lie within national jurisdictions and standard setters.

4.2.2 The increase in the quantified size criteria

Initially at the ED stage, GAPSE was an option for SMEs and could be applied to entities that satisfy two of the following three criteria:

- The balance sheet total must be less than €500,000
- Total revenue must be less than €1,000,000
- Average number of employees during the reporting period: 10

Against these criteria, GAPSE was therefore meant to target merely the needs of micro entities. However, some expressed the view that GAPSE could also serve as a tool used by larger companies within the SME population in view of the fact that GAPSE is a high quality accounting framework. They claimed that the application of GAPSE would also present an appropriate set of financial statements for the larger segment of SMEs. Thus, extending the scope of GAPSE will give the opportunity to more companies to apply an accounting framework which was easy to follow.

After due consideration and appropriate amendments to a number of sections in GAPSE, the SMERTF decided to extend its scope. This was achieved by significantly increasing the quantitative thresholds set out in the GAPSE ED to those that define a medium company in accordance with article 27 of the EU Directive 78/660/EEC, which are presented in Table 2.1 of this dissertation. However, the SMERTF decided that due to this substantial increase in the thresholds, an entity would not be eligible to apply GAPSE even if it exceeds the limits of *one* criterion. It is important to note that these criteria do not apply to state owned entities[1].

In view of their application of, and reliance on, direct and indirect financing from the public in general, the SMERTF was of the view that state-owned entities attract a higher level of public interest and should therefore comply, to a practicable extent, to more stringent financial reporting rules. For this reason state-owned entities can apply GAPSE only if they satisfy the criteria of a small company in accordance with article 11 of the EU Directive (78/660/EEC) which are laid down in Table 2.1 of the literature review.

The SMERTF noted that these new limits regulating the application of GAPSE achieve a careful balance between the need for a simplified accounting framework, the maintenance of IFRS knowledge within the local

[1] A state owned entity is defined under GAPSE as: (a) an organ of the government; (b) any public authority or corporation established by the law; or (c) an entity in which the government holds, directly or indirectly, not less than fifty per cent of the voting rights of the entity.

Accountancy Profession and the needs of the various users of SME financial statements.

4.3 Simplifications considered but not adopted

4.3.1 Optional presentation of a cash flow statement

During the initial development stages, the SMERTF considered the possibility of making the presentation of a cash flow statement optional for the preparer of the financial statements, similar to the FRSSE. Various individuals were consulted in this regard. Some were in favour of this simplification, questioning its benefit and recognising the difficulty in the preparation of such a statement. Others maintained that various users regard this statement as important. One of the consultants was Dr. Paul Pacter, who questioned the credibility of GAPSE without requiring a cash flow statement. He stated that several users ‘prefer the cash flow statement to the income statement because of lack of transparency of some accruals in the income statement’ (Refer to Appendix 6).

The SMERTF decided to include the requirement of the cash flow statement in the GAPSE ED using either of the direct and indirect methods. During the exposure period further suggestions were put forward. One of these suggested the exemption of the cash flow statement for relatively inactive companies by introducing a further level of thresholds in this regard. Another comment questioned the need for subsidiaries preparing a cash flow statement when the cash flow management decisions are taken further up in the group and are therefore beyond their control.

The SMERTF noted that it had already considered the possibility of removing the requirement of the cash flow statement and after due consideration of the comments received, retained its decision in the ED to require the presentation of a cash flow statement in the final version of GAPSE. In arriving at its decision the SMERTF recognised that the cash flow statement is an important part of the financial statements for small businesses. The SMERTF also noted that locally, lenders rely heavily on this statement in assessing the liquidity of entities. This fact also emerged from interviews conducted with the two major local banks. Moreover, the SMERTF disagreed with those that held the view that it is complex to prepare and thought that if it were to re-introduce this exemption, the credibility of GAPSE as a complete framework might be prejudiced.

4.3.2 Including the revaluation model for intangible assets

As regards measurement after recognition for intangible assets the SMERTF decided that the option to apply the revaluation model should not be permitted. The two main reasons for the prohibition of this model are the costs related with adopting this model and also because there seems to be a lack of active markets locally for a number of intangible assets. The latter decision emerges from paragraph 81 of IAS 38 which prohibits the use of the revaluation model unless there is an active market for the intangible asset in question.

One of the commentators during the exposure draft period expressed agreement to this prohibition and there were no comments to the contrary. As a result, the SMERTF retained its position in the ED and required that after recognition all intangible assets are measured at cost less accumulated amortisation and accumulated impairment losses.

4.3.3 Including proportionate consolidation in accounting for joint ventures

The SMERTF felt that for the sake of simplicity joint ventures should be accounted for using either the cost method or the equity method, subsequent to initial recognition. The SMERTF concluded that proportionate consolidation is not an appropriate method of accounting for jointly controlled entities.

In arriving at this conclusion, the SMERTF recognised that in September 2007 the IASB published for public comment a proposal to improve the accounting for joint arrangements in which it proposed that proportionate consolidation should be eliminated. On the basis for conclusions to this proposal the IASB states that when a party accounts for its interest in a jointly controlled entity under this method:

> '...it recognises as assets and liabilities a proportion of items that it does not control or for which it has no obligation. These supposed assets and liabilities do not meet the definition of assets and liabilities in the Framework.'
>
> (IASB 2007c, p.5)

The SMERTF was in agreement with the IASB's proposals which it endorsed by not adopting proportionate consolidation as one of the methods to account for joint ventures.

4.3.4 Inclusion of the fair value through profit or loss option for associates and joint ventures

It was noted that on paragraph BC 83 of the BC it is stated that associates and joint ventures can be subsequently accounted for at fair value through profit or loss in recognition of the fact that SMEs face problems in applying the equity method and proportionate consolidation and also in view of the relevance of fair values to lenders. However, the SMERTF was of the opinion that the fair value of an investment in practice is difficult to understand and also that this option could lead to an income statement which is heavily affected by items which are not the core business of the entity in question.

4.4 Simplifications

4.4.1 Separate sections for intangible assets and goodwill

One of the comment letters recommended that due to the different nature of the underlying issues relating to intangible assets and goodwill, the two should be dealt with in separate sections as is the case in the IFRS for SMEs ED. The SMERTF agreed with this comment and the section entitled *Intangible assets and Goodwill* in the ED has been replaced by two sections.

The first deals with *Business Combinations and Goodwill.* This section applies only for consolidated financial statements prepared by a parent company in accounting for its investments in subsidiaries, associates and joint ventures. The second section deals with *Intangible assets other than Goodwill.*

4.4.2 Finite lives for goodwill and intangible assets

Goodwill is only recognised if it is acquired in a business combination. It is initially measured at cost, which is defined as any difference between the purchase price and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Subsequently, it is carried at its cost less any accumulated amortisation and any accumulated impairment losses. The residual value assigned to goodwill is zero and the amortisation period may not exceed twenty years.

In taking the above decision, the SMERTF noted that many expressed the view that annual impairment testing of goodwill is a burdensome requirement because it means that the recoverable amount of the group of assets to which goodwill pertains has to be calculated on a yearly basis. Apart from the costs involved, a high level of specialised knowledge is arguably required.

One of the respondents suggested that instead of amortising goodwill over a finite life, it should be tested for impairment only when there are internal or external indicators that it has been impaired. However, the SMERTF disagreed with this respondent because it is of the opinion that goodwill should be amortised over a finite life for cost-benefit reasons and also in line with a convenient and pragmatic approach as proposed by GAPSE.

In addition, the SMERTF believes that amortising goodwill over a finite life is an approach which is in line with the prudence concept in that it addresses concerns over the potential recognition and measurement of an element of goodwill in perpetuity.

Similarly, the same treatment adopted for goodwill was also adopted for intangible assets. This in effect means that intangible assets are prohibited from having an indefinite useful life since every intangible asset should be amortised over its finite life.

4.4.3 Fair value through equity option for investment property

The GAPSE ED required that an entity shall initially recognise its investment property[2] at cost. After recognition, investment property had to be measured at cost less any accumulated depreciation and any accumulated impairment losses in accordance with the cost model presented in the section relating to property plant and equipment. This accounting treatment emerged as a consequence of the fact that small entities usually tend to lack the sophistication required to report fair value fluctuations within current year results.

In view of this, GAPSE always gives the option to use historical cost in determining the carrying amount of its assets and liabilities. For investment property, the SMERTF noted that following the cost model would be a simpler requirement for measurement after recognition. However, the majority of the respondents criticised this treatment and proposed several alterations to the subsequent measurement of investment property.

One of the commentators stated that GAPSE should also allow the fair value as an option for subsequent recognition of investment property, while another contended that the fair value option should also be removed form the

[2] Investment property is defined under GAPSE as property (land or a building, part of a building or both) held by the owner or by the lessee under a finance lease to earn rentals, for capital appreciation or both.

property, plant and equipment section. The main concern behind these arguments was inconsistency on the treatment of what are intrinsically similar assets. One comment letter was in agreement with the proposed accounting treatment in the GAPSE ED.

Although the SMERTF agreed with the main concern of the respondents, it noted the fact that permitting fair value measurement with fair value changes recognised in the profit or loss would not be consistent with the objectives of a simpler accounting treatment and may be conducive to volatility in the income statement. It noted that this option can have a huge effect on the income statement of an entity and can create confusion amongst shareholders in understanding this volatility from one year to the next.

After due consideration to the different arguments, the SMERTF felt that the solution to this problem would be to permit fair value measurement after recognition with changes in the fair value being recognised in equity. The SMERTF disagreed with a respondent that criticised this treatment on the basis that it is inconsistent with IFRS principles, different from the current practice and that it will cause non-comparability of financial information in the local market.

4.4.4 Non-distinction between pre-acquisition and post-acquisition profits for investment in subsidiaries, associates and joint ventures.

In one of the meetings held after the period for public comment, the SMERTF decided to amend part of the cost method section for investment in subsidiaries, associates and joint ventures. The GAPSE ED required an entity to recognise income received from an investment only to the extent that it was distributed from post-acquisition profits. Distributions out of pre-acquisition profits, on the other hand, had to be credited against the cost of the investment rather than recognised as income.

The IASB has voiced its concern that to comply with this requirement an entity would need to measure the fair value of the consideration at the date of acquisition and to determine whether dividends received were made out of pre-acquisition profits or of post-acquisition profits. It noted that such an exercise can be costly, difficult or even impossible especially when such an investment has been held for many years.

In May 2008 the IASB amended IAS 27 in an attempt to mitigate this problem. The SMERTF was in agreement with the new simplified requirements which state that the investor:

> 'shall recognise a dividend from a subsidiary, jointly controlled entity or associate in profit or loss in its seperate financial statements when the right to receive the dividend is established.'
>
> (IASB 2008b, p.8)

Thus, the SMERTF has reflected these new requirements into GAPSE. In this manner the requirement to distinguish between pre-acquisition profits and post-acquisition profits has been removed.

4.4.5 Recognition of derivatives

Initially, for simplicity's sake the SMERTF was of the opinion that derivatives would be one of the topics not to be included in GAPSE. However, it was noted that article 42d (c)[3] of EU directive 78/660/EEC requires that information regarding derivatives should be at least disclosed in the notes to the accounts. In view if this, the GAPSE ED did not require derivatives to be recognised on an entity's balance sheet but required a number of disclosures in satisfaction of the EU directive requirements.

Eventually, in view of the significantly increased thresholds, which effectively meant that companies at the macro end of SMEs would be eligible to apply GAPSE, the SMERTF deemed it appropriate to give entities the option to recognise derivatives at fair value with changes in future periods recognised

[3] Article 42d (c) states: 'Where valuation at fair value of financial instruments has been applied, the notes on the accounts shall disclose for each class of derivative financial instruments, information about the extent and the nature of the instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows.'

in profit or loss. The main reason for this decision was that with the new thresholds, permitting adoption of GAPSE by relatively larger and more sophisticated entities, non-recognition of material derivatives might prejudice the true and fair view of those financial statements. Moreover, disclosure in the notes would entail the same trailing and calculation effort as recognition.

4.4.6 Investments

In the ED investments[4] were initially measured at cost. Subsequent to initial recognition, different measurement rules applied to current, non-current and held-for-trading investments. The SMERTF noted that this approach did not take into account the underlying nature of investments. As a result, the SMERTF decided to mandate different measurement rules to different classes of investments (rather than to different maturities) and to give examples of such classes. These examples included quoted instruments, unquoted instruments and debt or equity securities. This approach would give flexibility to an entity to classify its investments in accordance with their nature.

The unquoted instruments class is meant to capture those investments that are not permitted to be measured at fair value under article 42a (4)(a) and

[4] GAPSE defines an investment as a financial asset which is held by an entity for the accretion of wealth through distribution (such as interest, royalties and dividends), for capital appreciation or for other benefits to the investing entity.

(b)[5] of EU directive 78/660/EEC and hence should be subsequently measured using the cost model. On the other hand, investments that fall under the quoted instruments category may be measured using the fair value through equity model, in line with the principles laid down in EU directive 78/660/EEC as well as those found in IAS 39. As regards investments that fall under the held-for-trading category, these are allowed to use the fair value through profit or loss model for subsequent measurement purposes in line with the requirement of article 42a (3)(a) of directive 78/660/EEC which states that for investments held as part of a trading portfolio, valuation at fair value should be permitted.

4.4.7 The amortised cost approach for financial assets and financial liabilities (other than derivatives)

Financial instruments other than derivatives should initially be measured at cost. Subsequently, entities are encouraged to use the amortised cost approach, whereby any difference between the initial and maturity amounts is amortised over the term of the instrument. This approach was encouraged, rather than required, because although amortising the difference between the two amounts remains a key principle in accounting, entities should nonetheless have the option not to amortise the difference between the initial

[5] Article 42a (4) (a) states: ‘to non-derivative financial instruments held to maturity’ and (b) ‘ to loans and receivables originated by the company and not held for trading purposes’

and maturity amounts, especially when such a difference is not significant. The SMERTF however noted that materiality considerations should always be considered in that respect.

In addition, in view of the fact that an entity can measure financial assets and liabilities at cost or amortised cost, the SMERTF decided to clarify paragraph 18.13 of the GAPSE ED which relates to how an impairment loss should be measured in each of the situations. Reference is made to the asset's recoverable amount in section (b) of this paragraph. The recoverable amount in this situation refers to the total undiscounted estimated future cash flows.

4.5 GAPSE ED simplifications, not adopted

4.5.1 Property, plant and equipment at a fixed quantity and value

One of the comment letters was concerned with the permission to include property, plant and equipment at a fixed quantity and value, when:

- It is constantly being replaced.
- Its value is not material to assess the entity's state of affairs.
- Its quantity, value and composition are not subject to material variation.

The comment pointed out the fact that this treatment reflects outdated practice. The SMERTF agreed to this comment and also noted that this is in conflict with IFRS requirements. In view of these facts, this option was withdrawn.

4.5.2 Optional recognition of deferred tax when an entity carries all its assets and liabilities at cost

An item on the original SMERTF simplification list was recognition of deferred tax. The IRD pointed out that deferred tax is merely an accounting measure that is used to smoothen out the tax effects of transactions on accounting principles in order to produce less distorted results, and as such it has no effect for tax purposes. The IRD remarked that it is current tax which is more important to cater for its needs rather than deferred tax.

The GAPSE ED therefore encouraged but did not require an entity to recognise deferred tax provided that it carried all its assets and liabilities at cost. However, during the period for public comments some expressed the view that deferred tax is important and should become mandatory for GAPSE to be considered a reliable framework modelled on the accruals basis and other related fundamental accounting concepts. Some argued that deferred tax is a tool used for converting accounting for tax from a cash basis to an accruals basis.

In view of the newly significantly increased thresholds, the SMERTF noted that while there were sufficient grounds to relax recognition of deferred tax for micro entities, deferred tax should become mandatory subject to the overriding principle of materiality. The SMERTF noted that deferred tax is very important for the truth and fairness of the financial statements especially when there are fair value measurements and material temporary differences. Moreover, deferred tax liabilities may result in huge cash outflows in the near future.

It was also pointed out that paragraph BC 85 of the BC states that the IASB SME project adopts a timing differences[6] approach on the basis that many SMEs and their auditors indicated that this approach is not so burdensome, the SMERTF replied that introducing a concept with which users and preparers are not familiar with would complicate matters rather than achieve a simplistic approach.

[6] Timing differences are defined as income or expenses that are recognised in profit or loss in one period but, under tax laws or regulations, are included in taxable income in a different period. (IASB 2007a, p. 251)

4.5.3 Accounting policies for investments in subsidiaries, associates and joint ventures

Section 10 of GAPSE deals with investments in associates, subsidiaries and joint ventures in individual financial statements. These investments are initially accounted for at cost and subsequently using either of:

1. The cost method - At cost less any accumulated impairment losses or;
2. The equity method - Increasing or decreasing the carrying amount to recognise the investor's share of the profit or loss.

Under the GAPSE ED, the choice of the above methods for subsequent measurement depended on the class of investments. This meant that an entity could, for example, account for an investment in associate under the equity method while accounting for a subsidiary under the cost method. The SMERTF noted that such a situation can prejudice the relevance of the financial statements.

Thus, it agreed that while retaining the choice between cost and equity accounting, the accounting policy chosen would then apply to *all* investments in subsidiaries, associates and jointly controlled entities held by a reporting entity. The SMERTF also decided that guidelines should be included to ensure uniform accounting policies for like transactions and events in similar circumstances under the equity method.

4.6 Changes in the GAPSE ED to ensure consistency with IFRS principles

Respondents observed that there are certain issues in the GAPSE ED which are not in line with the terminology used under IFRS. After analysing these suggestions, the SMERTF felt that since preparers and users are more familiar with IFRS concepts, wherever possible these should be utilised in order to avoid misunderstandings and misconceptions. This can be viewed as a step towards making the most of the experience gained through the application of IFRS in the past as well as the maintenance of IFRS knowledge within the local Accountancy Profession.

4.6.1 The concept of current value

The GAPSE ED states that property, plant and equipment should be measured after initial recognition using either the cost model, being cost less any accumulated depreciation and any accumulated impairment losses, or the revaluation model. Under the latter model the carrying amount would be the market value less accumulated depreciation. Alternatively, the current value could be used when the market value would not be deemed to be an appropriate basis.

One respondent pointed out that the concept of *current value* is unfamiliar with users as it is not consistent with IFRS requirements. The SMERTF agreed with this statement and concluded that the carrying amount under the revaluation model shall instead be the *fair value* at the date of revaluation less any subsequent accumulated depreciation and any subsequent accumulated impairment losses.

4.6.2 The treatment of revaluation gains and losses on property, plant and equipment

The same respondent that was concerned about the current value also raised a similar issue of misunderstanding as regards the treatment of revaluation gains and losses of property plant and equipment in paragraphs 16.15 and 16.16 of the GAPSE ED. The commentator noted that the wording of these paragraphs were not in line with IFRS concepts. The SMERTF also agreed with this decision and reworded the paragraph concerning such treatment in line with paragraphs 39 and 40 of IAS 16.

4.6.3 Defining a valuer for property, plant and equipment

The SMERTF also received a comment stating that the definition of the *valuer* who values property plant and equipment should be amended to the definition used under paragraph 32 of IAS 16. As a result, the SMERTF changed the definition from ‘an experienced valuer who has recognised and relevant recent professional experience, and sufficient knowledge of the state of the market, in the location and category of the asset being valued' to 'a professionally qualified valuer.'

One could argue that the latter definition may increase the expense for entities adopting GAPSE because the *valuer* has to be in possession of an appropriate qualification. Under the previous definition such valuations could also be done by certain other individuals such as real estate agents. However, the SMERTF felt that the fact that the *valuer* is required to be professionally qualified would ensure reliability of the valuation being obtained.

Moreover, the new definition makes the choice of the *valuer* less restrictive in that, under the GAPSE ED's wording, a *valuer* had to have recent experience in the location and category of the asset. A *valuer* having all these characteristics may not always be easy to find in a market of a limited size.

4.6.4 The concept of useful life

One of the respondents pointed out that IAS 16 refers to the concept of *useful life* rather than the *useful economic life* as referred to in the ED. The latter is the term used under the FRSSE. Under IAS 16 the *useful life* of an asset is defined as 'the period over which an asset is expected to be available for use by an entity while the FRSSE defines the *useful economic life* as 'the period over which the entity expects to derive economic benefit from the asset.'

The respondent noted that these two definitions might not necessarily result in the same duration because an entity might adopt an asset management policy whereby it disposes of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. The SMERTF evaluated the possible confusion that could be created and decided to adopt the suggestion to replace the concept of *useful economic life* with the concept of *useful life*.

4.6.5 The carrying amount for investments in subsidiaries, associates and joint ventures

The SMERTF noted that paragraph 20.12 of the GAPSE ED, dealing with the situation where an investor's share of losses equals or exceeds the carrying amount of the investment under the equity method, should be amended to be more in line with IFRS concepts. As a result, the SMERTF decided that this paragraph should make reference to the *interest* in the equity accounted entity rather than the *carrying amount* in line with paragraph 29 of IAS 28.

4.7 Conclusion

This chapter presented the findings that emerged from the interviews together with an analysis. This should give the users an overview of the development process of GAPSE and the final decisions reached. The following chapter will highlight the main conclusions and future recommendations regarding this new reporting framework.

Chapter 5: Conclusions and Recommendations

'...there must be a set of simple, definitive rules for the accounting for smaller entities that must be followed if a true and fair view has to be presented by the accounts of the reporting entity.'

(Murphy, 2006)

5.0 General conclusions

The previous chapter documents the rationale behind the requirements of the major sections of GAPSE by disclosing the decision making process in a comprehensive manner. In addition, it also provides additional information in order to help readers in understanding this new financial reporting standard in more detail and with a higher level of clarity. Moreover, the findings and discussion show that although the new standard is based on the FRSSE and has utilised IFRS knowledge, the decisions were taken in light of the applicability to the local SME scenario. This is the reason why certain requirements of GAPSE are unique, such as the measurement option for investment property described in section 4.4.3 of this study.

The study also shows that throughout the development process of GAPSE detailed discussions took place. Discussions commenced when the need for an alternative SME reporting framework was identified in an attempt to find the best possible solution. Once the decision to build up local accounting principles for smaller entities was taken, detailed meetings continued until the ED was published.

Discussions were put on hold during the exposure period in which the public at large was invited to comment and resumed after this period was over in order to analyse the feedback from the comment letters received. The proposals from the public were then transposed into the standard where relevant, before GAPSE was finalised.

This process demonstrates the effort that has been put into this project which makes the case for the ability of GAPSE to reach its goal. Moreover, the fact that this study documents the decisions reached and their reasoned explanations increases the level of accountability and transparency in the decision-making process. The documentation of the reasoning of decisions will also enable users to obtain a complete picture of GAPSE before putting forward questions and make further suggestions.

5.1 Recommendations

Recommendations with regards to the future of GAPSE and SME financial reporting in Malta include the following:

5.1.1 To incorporate the relevant requirements of the local Companies Act

GAPSE can be considered to be a completely independent framework in that there are no cross-references to other standards as is the case in the FRSSE and the IASB project for SMEs. This implies that the preparer does not have to consult other standards in the preparation of GAPSE based financial statements. However, although GAPSE can be considered to be a standalone framework as regards accounting standards it would be helpful if GAPSE were to be a ‘one-stop shop’ accounting framework that would incorporate both the accounting requirements emerging from the current sections of GAPSE as well as the relevant legal requirements emerging from the local Companies Act and which have an effect on the financial statements.

Currently, in its present form GAPSE seems to omit certain required disclosures by the local Companies Act. One example of such omissions is the relatively new requirement under article 156(5) which emerges from EU Directive 2006/43/EC (European Parliament and the Council of the European Union, 2006). This article requires certain companies to disclose separately fees paid in respect of audit services, other assurance services, tax advisory services and other non-audit services. This requirement has been transposed into the local Companies Act through the enactment of Act No. IX of 2008 in August 2008.

Collating the accounting requirements of GAPSE with those of the Companies Act 1995 would be most helpful to the preparers of financial statements for smaller entities since they would only need to refer to one document in order to keep track of the changes in financial reporting requirements. However, it is important to note that this exercise can result in difficulties to keep GAPSE up to date. This is because there might be requirements that do not apply to all entities that are applying GAPSE and therefore the entities to which the requirements have regard to must be identified.

5.1.2 To review and update GAPSE periodically

Now that the final version of GAPSE has been published, GAPSE should be reviewed and updated periodically in order to make the most of this new accounting standard. As pointed out in the literature review, the FRSSE has been reviewed after two years of its publication and is regularly updated. In the same manner, the IASB intends to review its SME project every two years. Given the potential difficulties that may arise initially, a first review in my opinion should occur after the first sets of financial statements based on GAPSE are published.

Thereafter, GAPSE should be reviewed and updated every two years. Any major problems should be identified and addressed instantly through further simplification and increased education. Resolving issues without undue delay should not prove to be a difficult task given that members of the SMERTF reside locally. The reasons behind any changes in the requirements of the standard should always be documented so that all interested parties may keep track of decisions and policies over time. This documentation will also aid in retaining the credibility of GAPSE.

5.1.3 To monitor future changes in accounting standards

In the current conditions of globalisation, where international transactions are on the increase, the need for comparable financial statements arises. In 2002, the two major accounting standard setters, the IASB and the FASB, agreed to harmonise the current accounting regulations where possible and to work together in the development of new accounting standards. In light of these conditions, it is recommended that the MIA should monitor the changes in the standards that this process of convergence inevitably creates in order to reflect these changes into GAPSE.

5.1.4 To organise educational and training activities

All parties concerned should be consulted, informed and educated about GAPSE. The MIA should develop implementation and training activities such as the provision of models of GAPSE based accounts that would assist entities and accountants in applying this new accounting framework. Activities may take the form of seminars, conferences or short courses and included as part of the Continuing Professional Educational Program offered by the MIA. Moreover, internal training within accountancy firms should also be provided to employees.

Ideally, directors of companies will be directly involved in this process of education and training since ultimately the decision to adopt GAPSE lies within the board of directors. Training directed towards directors may involve the provision of practical courses in order to supply them with the necessary information as to how and why they might wish to adopt GAPSE.

However, several directors will probably need the specialised assistance of those charged with the preparation of their accounts in complying with the requirements of GAPSE. As a result, the directors may channel this decision towards those assisting them in the preparation of financial statements.

5.2 Areas for further research

5.2.1 The basis for conclusions of other topics

This study has identified the basis for conclusions of issues relating to the following topics in GAPSE:

1. Scope
2. Cash Flow Statement
3. Property, Plant and Equipment
4. Investment Property
5. Investments

6. Investments in subsidiaries, associates and joint ventures
7. Intangible assets other than goodwill
8. Income taxes
9. Financial assets, financial liabilities and equity
10. Business combinations and goodwill

Further research can delve into the basis for conclusions to the sections of GAPSE to which this study has not discussed.

5.2.2 The perception of the public and user needs

After a number of years, the MIA should seek the views of the public on whether GAPSE has been a success and achieved its original objective of scaling down the financial reporting requirements of SMEs. A period of five years is suggested in order to enable the commentators to become familiar with GAPSE and consequently being capable of analysing it in detail. Following this exercise of public consultation a study can take place whereby the various opinions brought up by the respondents would be classified under different categories in order to identify the general perception of GAPSE.

A further study that could be carried out from the analysis of the comment letters received would entail the investigation of whether the needs of entities, their accountants and users are being met. As regards users, one should particularly asses the level of clarity of financial information provided by GAPSE.

5.2.3 Behavioural implications

Further research may delve into the level of acceptance of the new framework by identifying the level of use of GAPSE by accounting preparers, given that the latter will probably decide whether an entity should switch to GAPSE or not. In this study, one would identify the entities that have adopted GAPSE and the motivating factors that lead to the adoption. On the other hand, one must also identify those entities that were eligible to apply GAPSE but retained the presentation of financial statements in accordance with full IFRSs as adopted by the EU. The reasons that led to this decision should also be pointed out.

5.2.4 A cost/benefit analysis

Another study may involve a quantitative assessment on whether the less onerous requirements of GAPSE outweigh the additional costs that may be involved to prepare GAPSE based accounts. Although there will always be costs involved in complying with accounting standards, one should keep in mind that small entities have limited resources and therefore must rely on outside professionals. Additional costs involved in the application of GAPSE may be related to updates of accounting software, additional training and explanation of changes to users. The resulting cost/benefit ratio of adopters of GAPSE can then be compared to the same ratio experienced by those that opted not to adopt GAPSE.

5.3 Conclusion

The suggested recommendations and areas for further research are aimed at providing evidence as to whether GAPSE will fulfil its original intentions. Now that a new simplified accounting framework has been enacted as a means of reducing the reporting requirements for smaller entities, one would be eager to see its implementation take place. SMEs will hope that they will experience a reduction in the burden associated with compliance with full IFRSs to which they have been subjected to since 1995. However, although GAPSE can be considered to be a huge step forward, research in areas related to financial reporting of smaller firms in Malta, which are so diverse in their needs, should continue to seek ways for improvement.

One of these areas relates to owner-managed company reporting. Some argue that companies where ownership and management are not separate should benefit from further measurement simplifications. However, this argument is questionable given that these companies elect to benefit from limited liability and it is therefore necessary that they are accountable. Moreover, when considering the fact that every section of GAPSE gives the option of measurement at historical cost, further simplification might diminish the truth and fairness of owner-managed company accounts.

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Appendices

Appendix 1 – Sample interview schedule regarding general issues on GAPSE

1. What are the main objectives behind the increase in the thresholds?

2. GAPSE does not differentiate between owner managed companies and the remaining SME population. One might argue that this is unfair on owner managers. Do you agree?

3. How was the feedback received during the exposure period? How did the comments affect you?

4. Do you think that GAPSE should have been re-exposed for the public in view of the new thresholds?

5. GAPSE establishes quantitative criteria (size) in order to assess which entities are allowed to use a simplified accounting framework. In your opinion, are there any qualitative criteria?

6. Do you think that financial statements prepared under GAPSE report a true and fair view?

7. GAPSE was written using FRSSE as its basis. However its look and feel was changed to make it look like IFRS. Do you think that this will help or confuse users?

8. One might argue that introducing GAPSE will continue to hinder comparability of SME accounts within the EU. To what extent do you agree or disagree?

9. Is any training planned for financial reporting under GAPSE such as the provision of practical courses aimed at educating potential users of the standard as to how and why they might wish to adopt it?

Appendix 2 – Sample interview schedule regarding specific sections of GAPSE

1. **Financial assets, liabilities and equity.**

The committee decided that derivatives should be allowed to be recognised at fair value through profit and loss rather than keeping their fair value movements exclusively off balance sheet as proposed in the exposure draft. Can you explain this decision?

Why was ‘amortised cost’ introduced and encouraged for subsequent measurement of other financial assets and liabilities?

2. **Investments in associates, subsidiaries and joint ventures**

Subsequent measurement for investments in associates, subsidiaries and joint ventures under GAPSE should follow either the cost model or the equity method. However, I wish to hightlight that under the IASB’s SME project an investor can measure its investments under fair value through profit or loss. Moreover, joint ventures can also be measured by proportionate consolidation. What is the reason behind the omission of these two options?

3. Investment Property

The exposure draft required the use of the cost model for subsequent measurement. However, after lengthy discussions the committee eventually decided to re-introduce the fair value model (modified). What was the reason behind re-introducing a fair value option and for requiring fair value changes to go through equity rather than in the P/L as in IAS 40?

A comment letter recommended that the fair value option should only be available when the fair value is determined by a professionally qualified valuer. Why was this recommendation not adopted?

4. Property, Plant and Equipment

For valuations of property, plant and equipment the exposure draft (paragraph 6.14) requires an experienced valuer ‘who has recognised and relevant recent professional experience, and sufficient knowledge of the state of the market, in the location and category of the asset being valued.’ However, eventually the SMERTF decided to require valuations of property, plant and equipment to be performed by professionally qualified valuers. Why has there been this shift?

The SMERTF decided to replace the concept of useful economic life with the concept of useful life. What is the difference between the two concepts and their impact on property, plant and equipment?

5. Business combinations and goodwill

IFRS principles do not permit goodwill to be amortised but only to be tested for impairment annually. What was the reason behind the amortisation requirement in GAPSE?

6. Intangible assets other than goodwill

Under IAS 38 certain intangible assets are deemed to have a finite life while others may have an indefinite life. The latter should be tested for impairment on an annual basis. However under GAPSE *all* intangible assets are deemed to have a finite life. Why?

Why was the revaluation model prohibited for measurement after recognition of intangible assets?

7. Investments

The SMERTF agreed that investments should be measured according to their class of investments rather than by whether they are current or non-current investments. Why?

8. Deferred tax

While in the exposure draft deferred tax was optional for an entity that carries all its assets and liabilities at cost, it has now become mandatory. What is the reason for this change?

Appendix 3 – Sample interview schedule addressed to the two local major banks and the IRD

1. Banks/IRD in Malta rank/s amongst the highest users of SME financial statements. In your opinion, how will banks be affected by the introduction of GAPSE?

2. Will financial statements prepared under GAPSE provide the necessary information required by banks/the IRD?

3. From your experience (as a banker and also) as a CPA, which component of the financial statements do you consider to be the most important? Why?

4. Do you think that banks/the IRD were/was involved during the development process of GAPSE in order to assess their needs as users of SME financial statements?

Appendix 4 – Letter presented to interviewees

L-UNIVERSITÀ TA' MALTA
Msida MSD 2080 - Malta
DIPARTIMENT TA' L-ACCOUNTANCY

UNIVERSITY OF MALTA
Msida MSD 2080 - Malta
DEPARTMENT OF ACCOUNTANCY

20th November 2008

Dear Madame/Sir,

Mr Daniel Borg is a Bachelor of Accountancy (Hons) student reading through the last year of his course. As part of his academic studies and assessment, he is preparing a dissertation concerning 'The Evolution of GAPSE in Malta: A Qualitative Approach to Establish the Basis for Conclusions and Beyond'.

As part of his dissertation project, he is required to carry out a number of interviews and this is the purpose of this letter. You are kindly being asked to help Mr Borg and provide him with any information that you can offer.

The Faculty of Economics, Management and Accountancy of the University of Malta would be very pleased with your collaboration. All information and responses will be treated with the strictest confidentiality.

Yours sincerely,

Mr Ivan Grixti
Dissertation Supervisor

TEL: (+356) 2340 2714 / 2700 DIRECT: (+356) 2133 3997 FAX: (+356) 2131 7782

Appendix 5 – Sample e-mail submitted to the interviewees

Dear Mr. Axisa

I am a 5th year Bachelor of Accountancy (Hons.) student. As partial fulfilment of my studies I am preparing a dissertation relating to the basis for conclusions of the new set of financial reporting principles for SMEs: The General Accounting Principles for Smaller Entities (GAPSE). I was present during the final meeting of the MIA SME Reporting Task Force.

I would be grateful if we can set up a meeting at your convenience in order to get to know your views on the decisions taken on certain sections of GAPSE.

Thank you in advance for your help.

Regards,

Daniel Borg

Appendix 6 – Correspondence by e-mail with Dr. Paul Pacter

E-mail sent:

From: Daniel Borg [daniel.borg@onvol.net]
Sent: 10 March 2009 13:24
To: Paul Pacter
Subject: The Cash Flow Statement and GAPSE

Dear Dr. Pacter,

I am a 5th year student at the University of Malta reading through the Bachelor of Accountancy (Hons.) degree. In partial fulfilment of my studies I am preparing a dissertation, a considerable part of which will be documenting the basis for conclusions of the new set of accounting and financial reporting principles for SMEs in Malta: The General Accounting Principles for Smaller Entities (GAPSE).

Mr. Jonathan Dingli, Technical Director of the Malta Institute of Accountants (MIA), informed me that, during an informal discussion which I understand was held at the Institute in October 2007, you had strongly argued in favour of requiring a cash flow statement to be prepared by SMEs in view of the usefulness of such a statement for users of SME financial statements. As you are certainly aware, your recommendation was taken on board and GAPSE requires a cash flow statement to be presented in the annual financial statements.

I would be grateful if you could kindly let me have some more detail in this regard, such as the main reasons for your proposal and any other information you think might be relevant.

Thank you in advance for your help.

Regards,

Daniel Borg

E-mail received:

From: Paul Pacter
Sent: 11 March 2009 10:14
To: Daniel Borg [daniel.borg@onvol.net]
Subject: The Cash Flow Statement and GAPSE

The IASB makes its case for the cash flow statement in paragraphs BC95 and BC96 of the Basis for Conclusions that accompanied the exposure draft.

I might amplify the last sentence of BC96 (users want the cash flow statement) to add that a number of users of SME financial statements have told us that they prefer the cash flow statement to the income statement because of lack of transparency of some accruals in the income statement.

Paul Pacter