

# LESSONS FROM Deficient Disclosure

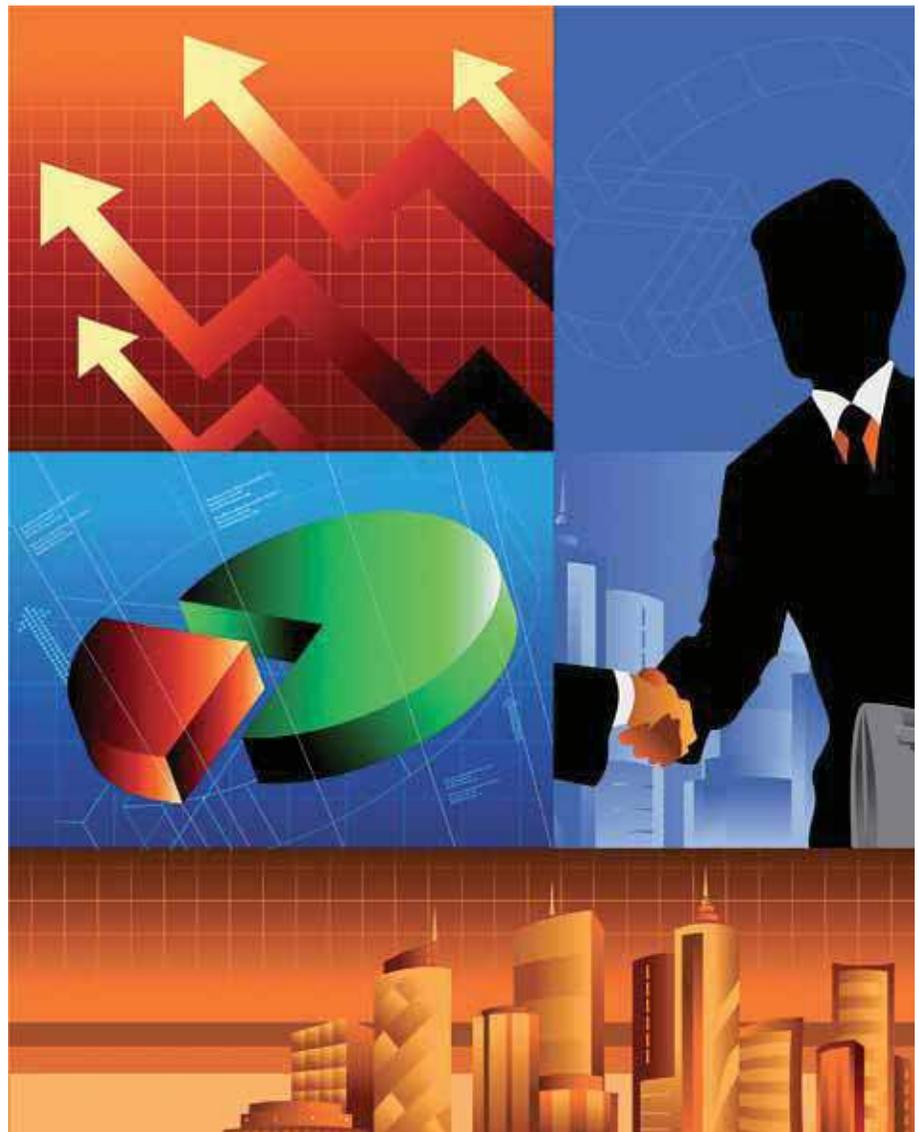
MIA'S FINANCIAL STATEMENTS REVIEW COMMITTEE SAYS THAT COMPANIES CAN LEARN FROM DEFICIENCIES IN RECENT FINANCIAL STATEMENTS AVAILABLE IN THE PUBLIC DOMAIN TO IMPROVE THE QUALITY OF THEIR OWN FINANCIAL REPORTING.

**M**alaysia's deadline for full convergence with International Financial Reporting Standards (IFRS) falls on 1 January 2012.

In the run-up to convergence, MASB has issued a number of new and amended Financial Reporting Standards (FRS) and Interpretations which would be effective for the financial periods beginning on or after 1 January 2010. With 2010 around the corner and with less than 2 years to full convergence, preparers, auditors and users of financial statements should by now be very conversant with the requirements of existing Standards and Interpretations.

Nevertheless, there are weaknesses as FRS users still strive to interpret and apply these standards.

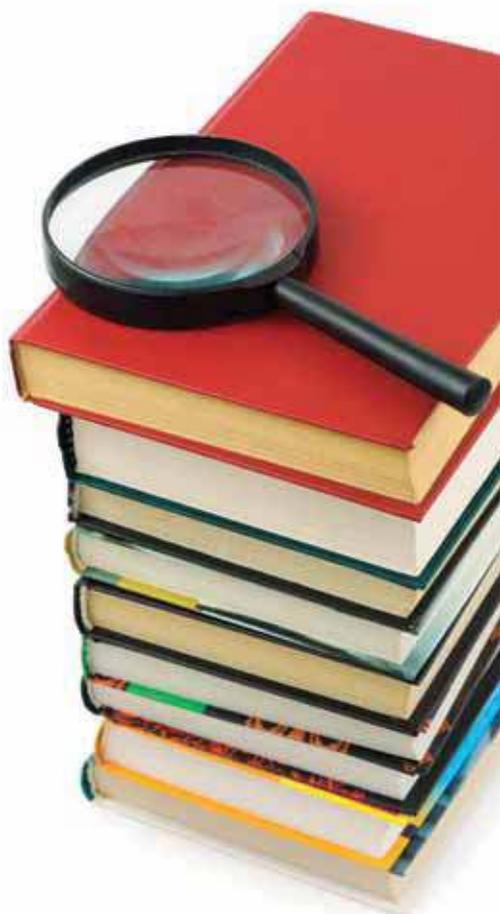
The Financial Statements Review Committee (FSRC) has identified and noted deficiencies in the financial statements of selected listed companies during the period from July 2008 until June 2009. By sharing these common findings, it is hoped that all parties interested in financial statements can learn from them and thus enhance the quality of financial disclosure.



**Table A: Findings Commonly noted by FSRC for Review Period from July 2008 to June 2009**

Areas for improvement	Findings noted
Going Concern	<ul style="list-style-type: none"> <li>• Questions raised on whether going concern assumption has been considered by the management and the auditors when the financial statements showed signs of deteriorating financial position. (FRS 101.23 and ISA 570)</li> <li>• Non-disclosure of material uncertainty on going concern. (FRS 101.23)</li> <li>• Inadequate disclosure on management's plan in dealing with material uncertainty on going concern. (FRS 101.23)</li> </ul>
Significant Accounting Policy	<ul style="list-style-type: none"> <li>• Significant accounting policy not disclosed. E.g. policy applied in accounting for increase or decrease in equity interest in an existing subsidiary company. (FRS 101.108)</li> <li>• Contradictory statements in its disclosure of accounting policies adopted. E.g. Policy on "Impairment of Assets" indicates "Review for indication of impairment is performed on the carrying amount of assets other than investment properties (IP)" whereas policy on IP indicates IP are measured subsequent to initial recognition at cost less accumulated depreciation and any accumulated impairment loss.</li> <li>• Accounting policy disclosed is not clear. E.g. policy on property, plant and equipment (PPE) indicates PPE is stated at cost or valuation, without indicating which category of PPE is using cost and which category is using valuation.</li> <li>• Accounting policy described is not reflective of accounting treatment. For example on revenue recognition, the accounting policy states that interest income is recognised on a receipt basis, but was actually recognised on accrual basis.</li> </ul>
Judgements in applying accounting policy and key sources of estimation uncertainty	<ul style="list-style-type: none"> <li>• Generic and did not reflect circumstances specific to the company. (FRS 101.116 and FRS 101.120)</li> <li>• Often bland and uninformative.</li> <li>• Significant judgement in applying policy not identified for disclosure. (FRS 101.113)</li> </ul>
Business Combinations	<ul style="list-style-type: none"> <li>• Non-disclosure of factors contributing to goodwill. (FRS 3.67(h))</li> <li>• Information on the nature and financial effect is disclosed for all the business combinations during the year instead of in respect of each business combination. (FRS 3.67)</li> <li>• Revenue and profit or loss of combined entity as though business combination effected at the beginning of the period not disclosed. (FRS 3.70)</li> <li>• Non-disclosure of nature and financial effect of business combination effected after the balance sheet date but before financial statements are authorised for issue. (FRS 3.66(b) and FRS 3.71)</li> </ul>
Investment in Subsidiaries	<ul style="list-style-type: none"> <li>• Impairment of subsidiary is not recognised "as there is no permanent diminution in value", instead of applying impairment testing per FRS 136. (FRS 136.4)</li> <li>• Impairment has not been considered on subsidiaries despite all PPE of subsidiary are impaired.</li> </ul>
Impairment	<ul style="list-style-type: none"> <li>• Questions raised over whether impairment of PPE, investment properties and other non-current assets was performed as there were impairment indicators such as gross loss position.</li> <li>• Inadequate disclosures when there is material impairment loss recognised. E.g. non-disclosure of whether the recoverable amount is fair value less costs to sell (FVLCTS) or value in use (VIU), basis of determining FVLCTS, discount rate(s) used in determining VIU. (FRS 136.130)</li> <li>• When impairment is being reversed, no disclosure of circumstances that led to reversal of impairment. (FRS 136.130)</li> </ul>
Segmental Reporting	<ul style="list-style-type: none"> <li>• Information disclosed incomplete in accordance with FRS 114 requirements. E.g. no reconciliation made to reconcile segment assets to the entity's assets as reported on the balance sheet.</li> <li>• Inclusion of borrowings as segment liabilities.</li> </ul>

Areas for improvement	Findings noted
Intangible Assets	<ul style="list-style-type: none"> <li>• Non-disclosure of reasons for supporting intangible assets as having indefinite useful life. (FRS 138.122(a))</li> <li>• Non-disclosure of information for each class of intangible assets. (FRS 138.118)</li> </ul>
Deferred Taxation	<ul style="list-style-type: none"> <li>• Non-disclosure of deductible temporary differences, unused tax losses and unused tax credits of which no deferred assets are being recognised. (FRS 112.81)</li> </ul>
Investment Properties	<ul style="list-style-type: none"> <li>• Non-disclosure of fair value when cost method is adopted. (FRS 140.79(e))</li> <li>• Incomplete disclosures. E.g. Non-disclosure of direct operating expenses arising from investment properties that generated or did not generate rental income. (FRS 140.75(f)(ii) &amp; (iii))</li> </ul>
Revenue	<ul style="list-style-type: none"> <li>• Non-disclosure of significant category of revenue. (FRS 118.35(b))</li> </ul>
Cash Flow Statements	<ul style="list-style-type: none"> <li>• Non-disclosure of gross cash receipts and gross cash payments separately. (FRS 107.22-24)</li> <li>• Movement in advances to/from subsidiaries disclosed as "operating cash flow", instead of "investing cash flow". (FRS 107.6)</li> </ul>
Presentation of Financial Statements	<ul style="list-style-type: none"> <li>• Nature of expenses not adequately analysed. (FRS 101.86 and FRS 101.93)</li> <li>• Additional line item for income and expenditure not presented on the face of income statement having considered the materiality, nature &amp; function e.g. material gain. (FRS 101.83-84)</li> </ul>



### FSRC's ROLE

The role of the FSRC is to monitor the quality of financial statements and reports that are prepared by or are the responsibility of members of MIA, for the purpose of determining compliance with statutory and other requirements, approved accounting standards and approved auditing standards in Malaysia.

For the period from July 2008 until June 2009, the FSRC was extremely busy. The FSRC closed 9 cases brought forward from the previous review period and selected another 19 financial statements of listed companies for review.

The financial year-ends of the selected financial statements ranged from 31 December 2006 to 31 August 2008. A total of 44 replies to queries raised by the Committee were deliberated during the period under review.

During the year under review, the FSRC referred one case to the Investigation Committee (IC) and categorised one case as Category 2 of the penalty tariff, whereby warning letters were issued to the preparers and auditor for numerous non-compliances with the requirements of FRS. The financial statements of such companies will also be monitored for up to two consecutive years.

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## OBSERVATIONS AND REMINDERS

Members should pay special attention to the following observations noted during FSRC's review:

### Incomplete and Inadequate Disclosure

In some cases, disclosures in the financial statements were not complete and adequate such that the FSRC had to probe further through query letters to seek more detailed information on certain matters disclosed (or not disclosed). Normally, clarifications provided by companies thereafter were sufficient for the FSRC to close the matters raised. Preparers of financial statements should strive to ensure fair presentation of the financial statements, which include providing additional disclosures when compliance with the specific requirements in FRSs is insufficient to enable users to understand the impact of particular transactions, events and conditions on the entity's financial position and financial performance (FRS 101.15(c)).

### Revealing Disclosures

Whilst the summary of findings in **Table A** may appear that the deficiencies relate to issues on presentation and disclosures, information disclosed (or not disclosed) in the financial statements is not merely an issue of non-compliance with disclosure requirements. The disclosures on financial statements actually reveal whether companies have applied appropriate accounting treatment on transactions that have occurred. For example, disclosing the factors contributing to goodwill arising on business combination might reveal that the acquirer had not appropriately recognised intangible assets of the acquiree separately from goodwill. In some cases, the FSRC noted that companies have not been using appropriate accounting treatment upon probing into the disclosures in the financial statements.



*“The FSRC will continue to discharge its role to monitor and provide guidance to members on good financial reporting practices but will also not hesitate to recommend that action be taken against members involved in the preparation or reporting on financial statements that contain material reporting discrepancies.”*

**Stephen Oong, FSRC Chairman**

### Correlating Accounting Treatments

Companies must consider how the accounting treatment of an item in the financial statements is correlated to accounting treatment of another item in the financial statements. For example, when the property, plant and equipment of the subsidiaries are impaired, companies should also consider reviewing the costs of investment in subsidiaries for impairment.

### Continuous Improvement

Members should use the matters raised as guidance to increase their awareness of the FRSs' requirements and to improve the applications of standards in the preparation, presentation and disclosures of financial statements in future.

### Conclusion

In some cases, where deemed appropriate, the FSRC extended the relevant accounting references to the members

when members acknowledged that they did not know where to look for guidance; and in other cases, the FSRC tried to assist by providing examples of what are considered good disclosures.

It is important that members continuously uphold quality in financial reporting. Such an attribute demands members to put in concerted effort and resolve to do so, as well as the desire to be up-to-date with the latest development in financial reporting. Given the rate at which financial reporting standards are being changed, revised and amended, continuous learning is one of the key success factors for members to remain relevant in the profession. “The FSRC will continue to discharge its role to monitor and provide guidance to members on good financial reporting practices but will also not hesitate to recommend that action be taken against members involved in the preparation or reporting on financial statements that contain material reporting discrepancies.” Stephen Oong, the Chairman of FSRC reminded. ■