MALAYSIAN INSTITUTE OF ACCOUNTANTS

Driving Compliance Towards Better Communication in Financial Reporting

Financial Statements Review 2019/2020 Annual Report

About
Malaysian Institute of Accountants

Established under the Accountants Act 1967, MIA is the national accountancy body that regulates, develops, supports and enhances the integrity, status and interests of the profession in Malaysia. MIA accords the Chartered Accountant Malaysia or C.A. (M) designation to a professional in accountancy, business and finance with a recognised qualification and relevant work experience.

Working closely alongside businesses, MIA connects its membership to a wide range of information resources, events, professional development and networking opportunities. Presently, there are more than 36,500 members making their strides in businesses across all industries in Malaysia and around the world.

MIA's international outlook and connections are reflected in its membership of regional and international professional organisations such as the ASEAN Federation of Accountants (AFA), and the International Federation of Accountants (IFAC).

Purpose
To regulate and develop the accountancy profession to support economic growth and nation building

Vision
To be a globally recognised Professional Accountancy Organisation (PAO) in regulating and developing the profession for nation building

Values
Integrity, **M**utual Trust & Respect, **P**rofessionalism, **A**ccountability, **C**ommitment, **T**eamwork, **S**ustainability

MIA's Functions
Section 6 of the Accountants Act 1967 (the Act) states that the functions of the Institute shall be:

- To determine the qualifications of persons for admission as members;
- To provide for the training and education by the Institute or any other body, of persons practising or intending to practice the profession of accountancy;
- To approve the MIA Qualifying Examination (QE) and to regulate and supervise the conduct of that Examination;
- To regulate the practice of the profession of accountancy in Malaysia;
- To promote, in the manner it thinks fit, the interest of the profession of accountancy in Malaysia;
- To render pecuniary or other assistance to members or their dependents as it thinks fit with a view to protecting or promoting the welfare of members; and
- Generally, to do such acts as it thinks fit for the purpose of achieving any of the aforesaid objectives

Foreword from Chairman

Foong Mun Kong

Chairman of Financial Statements Review Committee(FSRC)

Dear stakeholders,

Over the years there has been an increasing awareness of the role and importance of annual reporting and the quality of information disclosed in financial statements. Each and every participant in the financial reporting ecosystem has a role to play in providing financial information that is useful to various stakeholders in making economic decisions.

In a competitive capital market, the need for annual reports that provide adequate relevant and reliable financial information is vital to enable investors to gauge the true value of a company and its potential for growth. This not only helps to foster the confidence of shareholders and investors in a company but also contributes to the enhancement of the company's good public image and reputation.

Adequate relevant and reliable financial information can be achieved through compliance with existing and new accounting and regulatory disclosure requirements, which continuously evolve in response to the changes in the business environment. This proves to be a challenge to those involved in the preparation of financial statements due to increased focus on compliance with the applicable requirements, transparency in reporting and the robustness of disclosure requirements in the financial statements.

In this regard, the Financial Statements Review Committee ("FSRC" or "the Committee") of the Institute have been sharing with members on good financial reporting practices through publication in the Institute's Accountants Today. The previous publications can be accessed through this link: https://www.mia.org.my/v2/surveillance/fsr/findings.aspx.

The period under review has seen three new standards come into effect, in which the FSRC will continue to monitor their application. We have also noted certain findings that are similar to the past, indicating that whilst common, these issues continue to be a challenge in the financial reporting practices.

Through this annual report, the FSRC intends to communicate its role in the financial reporting ecosystem, to continue sharing with members on good financial reporting practices and ultimately drive compliance towards better communication and improved quality of financial reporting in Malaysia. By advocating for compliance in financial reporting, the FSRC supports the Institute to regulate the practice and strengthen the credibility of the accountancy profession in Malaysia. This in turn protects the public interest and supports the Institute's overarching purpose of nation building.

CONTENTS

A. FINANCIAL STATEMENTS REVIEW COMMITTEE

The Financial Statements Review (FSR) function is one of the surveillance functions of the Institute set up to monitor and regulate the practice and strengthen the credibility of the accountancy profession in Malaysia.

Pursuant to Section 10(g) of the Accountants Act 1967, the Council of the Malaysian Institute of Accountants ("Institute") is empowered to appoint committees of the Institute for such purposes and with such powers as may be prescribed. The Council has authorised the FSRC of the Institute to review financial information and/or financial statements of any organisations on matters of public interest and provide constructive recommendations.

Members of the FSRC comprise representatives from the regulatory agencies (e.g. Bursa Malaysia), reputable audit firms, preparers of financial statements and academicians in the field of financial reporting (if any).

Objective

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

In addition, the FSRC seeks to enhance quality and promote excellence in financial reporting by sharing on good financial reporting practices based on common findings identified during the review process.

Scope of Financial Statements Review

In addition to random reviews, the FSRC is also responsible for reviewing the interim financial information and financial statements referred to the Committee by other regulatory bodies such as the Securities Commission Malaysia, Bursa Malaysia, Suruhanjaya Syarikat Malaysia, Bank Negara Malaysia, etc.

Besides that, the FSRC, if required, will also pursue reviews on matters of public interest reported in the press and/or in press releases issued by regulators or other relevant parties. Issues may relate to financial reporting of companies or conduct of MIA members.

The FSRC works closely with other regulators with an aim to promote high quality standards in financial reporting. The Committee also looks into matters referred to it by other regulators and may review those financial statements involving public interest issues.

In addition, the FSRC monitors the media as part of a proactive surveillance approach on potential accounting irregularities and reporting deficiencies in public-listed companies and public interest entities.

How the review is conducted

The FSRC conducts a desktop review of the selected financial statements. When a review indicates a potential non-compliance with the applicable accounting standards, the FSRC issues formal written correspondences to the member(s) concerned (either preparers and/or auditors of the entity's financial statements) and deliberates the replies received. This process continues until a decision is reached on the review, in which case, the degree of non-compliance and a corresponding penalty tariff is determined accordingly.

The matters raised in the enquiry letters mainly focus on financial reporting standards. However, the FSRC may look into the appropriateness of the audit opinion issued by the auditor if significant issues are identified.

Where necessary, should a member be found to have breached any by-laws and/or other statutory requirements in the preparation of and reporting on the financial statements, appropriate action will be taken. The action to be taken depends on the types of penalty tariff issued that are determined based on the findings of the reviewed financial statements.

Penalty tariff

The FSRC concludes each review by imposing a penalty tariff, which is divided into three categories. Categories of penalty tariff differentiate the severity of non-compliances as follows:

Category 1 prescribes the minimum action. This category relates to housekeeping issues, which require tidying up of the financial statements. It requires members who are responsible for the preparation of the financial statements to take necessary action on the financial statements and members who are responsible for reporting on them to be informed of the action.

Category 2 applies when there are substantial numbers of non-compliances with disclosure requirements of the applicable approved accounting standards. It requires members who are responsible for the preparation of the financial statements or for reporting on the financial statements to take the necessary corrective action. Members will be given a warning letter and will be informed that the financial statements of the company could be put under surveillance for up to two (2) consecutive years.

Category 3 applies when there are major non-compliances with the requirements of the approved accounting standards and auditing standards involving material reporting discrepancies and/or deficiencies, caused by the member's failure to discharge his/her professional responsibilities with diligence and due care and/or the company's/firm's weaknesses in the system of quality control.

Under category 3, action to be taken on members, who are responsible for the financial reporting and preparation of the financial statements, could include referring the member(s) to the Investigation Committee or Practice Review Committee of the Institute and/or other regulatory bodies for appropriate action or serving the members with warning letters or reprimands, or other appropriate measures. The financial statements of the company concerned could be put under surveillance for up to four (4) consecutive years.

B. FINDINGS

To ensure that members benefit from the FSRC reviews and to enhance the quality of financial reporting, the FSRC communicates the significant findings to members and highlights the common deficiencies arising from the review of financial statements of public listed entities for the review period from July 2019 to June 2020. The financial statements under review are those with financial years ended ranging from December 2018 to December 2019.

During the review period, there were new standards that came into effect, as follows:

STANDARD	TITLE	APPLICABLE FOR ANNUAL PERIODS BEGINNING ON OR AFTER
MFRS 9	Financial Instruments	1 Jan 2018
MFRS 15	Revenue from Contracts with Customers	1 Jan 2018
MFRS 16	Leases	1 Jan 2019

The issues below have been identified from our reviews so far:

(i) Application of new standards - MFRS 9 *Financial Instruments* (Disclosures)

The impairment model required by MFRS 9 is an expected loss model as compared to the incurred loss model under MFRS 139. Common issues identified during our reviews include the following:

- No disclosure of recognition and measurement of expected credit losses, including the methods, assumptions and information used to measure expected credit losses [Paragraph 35B(a) of MFRS 7 *Financial Instruments:* Disclosures];

- No disclosure of how an entity determines whether the credit risk of financial instruments has increased significantly since initial recognition [Paragraph 35F(a) of MFRS 7];

- No disclosure of the Group's definitions of default, including the reasons for selecting those definitions [Paragraph 35F(b) of MFRS 7];

- No disclosure of the inputs, assumptions and estimation techniques used to apply the requirements in Section 5.5 of MFRS 9 [Paragraph 35G of MFRS 7].

(ii) Application of new standards - MFRS 15 *Revenue from Contracts with Customers* (Disclosures)

Most of the financial statements reviewed stated that there are no material impacts resulting from the application of MFRS 15. However, common issues identified during our reviews include the following:

- No disclosure of information on the remaining performance obligations (i.e. amount of transaction price of the contract allocated to unsatisfied performance obligations) in accordance with Paragraph 120, unless applying practical expedient as in Paragraph 121 of MFRS 15;

- No disclosure of the judgements and the changes in the judgements made in applying MFRS 15 that significantly affect the determination of the amount and timing of revenue from contracts with customers in accordance with Paragraph 123 of MFRS 15;

- For performance obligations satisfied over time, no disclosure of both the methods used to recognise revenue (for example, a description of the output methods or input methods used and how those methods are applied) and an explanation of why the methods used provide a faithful depiction of the transfer of goods or services in accordance with Paragraph 124 of MFRS 15;

- For performance obligations satisfied at a point in time, no disclosure of the significant judgements made in evaluating when the customer obtains control of promised goods or services in accordance with Paragraph 125 of MFRS 15.

The FSRC will continue to monitor the application of MFRS 15 as well as the initial application of MFRS 16 in its next review cycle.

(iii) Impairment of non-financial assets

From our reviews, we raised several matters concerning the disclosure requirements relating to the impairment of non-financial assets in accordance with Paragraph 130 of MFRS 136 *Impairment of Assets.*

The following disclosures were often omitted:

- The events and circumstances that led to the recognition or reversal of the impairment loss [Paragraph 130(a) of MFRS 136].

- Whether the recoverable amount of the asset is its fair value less cost to sell or its value in use [Paragraph 130(e) of MFRS 136].

- If the recoverable amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market for an identical asset) [Paragraph 130(f) of MFRS 136].

- If the recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use [Paragraph 130(g) of MFRS 136].

Upon reviewing the replies relating to the above disclosure requirements, another issue commonly identified relates to the discount rate applied on the cash flow projections (if recoverable amount is the value in use) for impairment assessments. For example, there was a case whereby the Group is financed by equity and borrowings. However, the discount rate used in its value in use (VIU) computation was much lower than the Group's average borrowings rate and clearly below the industry average.

Paragraph 55 of MFRS 136 *Impairment of Assets* states that the discount rate shall be a pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the assets. Appendix A of MFRS 136 *Impairment of Assets* provides additional guidance on estimating the discount rate for VIU computation.

We also noted the adoption of key assumptions that were related to financing activities and therefore should not be incorporated in the VIU computation for impairment testing on property, plant and equipment. Paragraph 50(a) of MFRS 136 *Impairment of Assets* states that estimates of future cash flows shall not include cash inflows or outflows from financing activities.

(iv) Financial Guarantee Contracts (Disclosures)

A parent company may issue corporate guarantees to financial institutions to secure credit facilities extended to its subsidiary companies. These corporate guarantees are financial guarantee contracts (FGCs) that meet the definition of financial liabilities and shall be recognised and measured in accordance with MFRS 9 *Financial Instruments*.

Most of the reviewed financial statements have classified FGCs as financial liabilities, although there are still some that disclosed FGCs as contingent liabilities. Where it had been assessed that an outflow of cash is not probable, these FGCs were disclosed as contingent liabilities. MFRS 137 *Provisions, Contingent Liabilities and Contingent Assets* does not apply to financial instruments (including guarantees) that are within the scope of MFRS 9 *Financial Instruments* [Paragraph 2 of MFRS 137].

However, in cases where FGCs have been classified as financial liabilities, the following weaknesses were noted:

- No disclosures were noted in respect of FGCs that were not recognised in the Statement of Financial Position. As a good practice, in instances where FGCs have not been recognised due to the immateriality of their fair values, a disclosure reflecting this should be made in the financial statements.

- Weak or non-existent disclosures on the nature and extent of risks arising from FGCs. Typical risks arising from FGSs include liquidity risk and credit risk [MFRS 7.31-42]. Entities fail to provide the necessary disclosures citing that the risk of default is low. The Committee wishes to highlight that the entity is exposed to these risks, notwithstanding the low risk of default. Specifically, in addressing liquidity risk disclosures, the maximum amount of the guarantee is allocated to the earliest period in which it could be called [MFRS7.B11(c)].

C. COMMON FINDINGS

The following common findings on non–compliances with the applicable accounting standards were compiled from the reviews of the financial statements conducted by the FSRC from July 2019 to June 2020.

Table A: Common findings of FSRC for the Review Period from July 2019 to June 2020

No	Areas for improvement	FSRC findings
1	Cash and cash equivalents	Deposits with maturities exceeding three months classified as cash and cash equivalents [MFRS 107.7]. Although the three-month presumption is not a "bright line", it is pertinent and relevant to take into account this three-month presumption in considering whether the fixed deposit is held for the purpose of meeting short-term cash needs or for investment purposes. The longer the fixed deposits' original maturity period, the more likely the deposits are held for investment purposes.
2	Diluted earnings per share ("DEPS")	Non-disclosure of DEPS on the face of Statement of Comprehensive Income [MFRS 133.66]. There is no exemption for presentation of DEPS on the grounds of anti-dilution. However, to simplify presentation, basic earnings per share ("BEPS") and DEPS can be presented in the same line [MFRS 133.67].
3	Intercompany balances	Intercompany balances (receivables) are classified as current although repayment does not appear to be feasible within the entity's normal operating cycle. Balances shall be classified as current only if management expects to realise the balances within 12 months after the reporting period [MFRS 101.66]. In making this assessment, management should consider the expected realisation date of the balances instead of the stipulated contractual terms.
4	Investment in subsidiaries, associates and joint ventures	Non-disclosure of the principal place of business (and country of incorporation, if different) of those investees [MFRS 127.17(b)(ii), MFRS 101.138(a)]. Typically, most entities disclosed the country of incorporation and not the principal place of business.

5	Related party transactions	Non-disclosure of, amongst others, the amount of outstanding balances and the amount of transactions between related parties [MFRS 124.18].
6	Share capital	Non-disclosure of par value for each class of share capital. It is noted that the Companies Act 2016 abolished the concept of authorised share capital and par value of share capital. However, as per requirement of MFRS 101, if there is no par value, the Company shall state that the shares have no par value [MFRS 101.79(ii)].
7	Tax expense/(income) and/or deferred tax	Non-disclosure of deductible temporary differences, unutilised tax losses and unutilised tax credits of which no deferred assets are being recognised [MFRS 112.81(e)]. One should also be wary of the need to disclose the expiry date (if any) of the aforementioned items.

D. CONCLUSION

These are challenging times for those involved in the financial reporting process considering the ever-changing economic conditions, particularly the impacts of the unprecedented COVID'19 pandemic either direct or indirect. From a financial reporting standpoint, there are expectations that the financial statements should state clearly whether and how the entity's operations are being affected by the COVID'19 pandemic. In line with their respective responsibilities, those involved in the financial reporting process should work hand in hand to improve the quality of financial reporting and to provide users with balanced and useful information on the financials of an entity.

The FSRC wishes to reiterate that the responsibility for the preparation of financial statements under the Companies Act, 2016 lies with the entity's management and Board of Directors. Financial statements are to be accompanied by a statutory declaration made by the person primarily responsible for the financial management of the entity setting forth their opinion as to the correctness of the accompanying financial statements. [S251(b), Companies Act 2016].

Whilst auditors play an important role in enhancing the credibility of the financial statements, this role would be further enhanced with the entity's management and Board of Directors engaging with the auditors throughout the financial reporting process.

In responding to the FSRC's enquiries, parties concerned are encouraged to consider the following:

Order	Address all questions in the sequence provided.
Time	Provide responses within the given deadlines.
Consistent	Provide consistent facts and explanations.
Clear	Be clear in explaining the entity's circumstances and the substance of transactions.
Transparent	Be transparent in sharing the basis for management's judgements.
Tone	Be willing to consider different viewpoints

Whilst the FSRC continues to inform and educate members on good presentation and disclosure practices, its actions will be guided by its penalty tariff that depends on the severity of non-compliances. This comes back to its primary objective to monitor compliance in financial reporting, in supporting the Institute to regulate the practice and strengthen the credibility of the accountancy profession in Malaysia. This in turn protects the public interest and supports the Institute's overarching purpose of nation building.