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Some Observations on Mandatory Disclosure Practices of Malaysian Public Listed Companies

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Abstract: This study investigates the mandatory disclosure practices evident in the annual reports of Malaysian public listed companies. Our findings show that none of the examined companies fully met the mandatory disclosure requirements even though the companies' management had declared that the financial statements were prepared in accordance with the approved accounting standards. We also observed an inappropriate usage of 'boilerplate' practice in the preparation of financial statements, whereby the companies disclosed certain information that was irrelevant to their circumstances. This study has shown that to assume that companies will fully comply with mandatory disclosure requirements may not be necessarily true and, second, merely adopting International Financial Reporting Standards may not automatically lead to increased transparency.

Key words: Mandatory Disclosure · Accounting Standards · Boilerplate

INTRODUCTION

The main objective of this study is to investigate the mandatory disclosure practices evident in the annual reports of Malaysian public listed companies. An annual report is the most common medium used by the management of companies to disseminate information about their companies to various stakeholders. We focus on the presentation of mandatory disclosure because we expect that not all companies will fully comply with mandatory disclosure requirements due to weak institutional features, such as an inadequate regulatory framework, ineffective enforcement mechanisms and a shortage of qualified accountants [1-4]. Although prior studies have found evidence of non-compliance with mandatory disclosure requirements in companies' annual reports in both developed and developing countries for example [5-8], there is scant literature on mandatory disclosure practices in Malaysia. Therefore, the present study aims to contribute to the extant literature on mandatory disclosure. Additionally, a study on mandatory disclosure may provide some useful insights about the extent of compliance and the effectiveness of independent auditors and enforcement bodies in the countries studied [9].

The findings of the present study show that none of the examined companies fully disclosed the mandatory disclosure items as prescribed in the accounting standards. Surprisingly, the companies still received clean audit reports despite significant non-compliance with mandatory disclosure requirements. In addition, an inappropriate usage of 'boilerplate' practice among the companies was also observed and this might lead to users of financial statements receiving misleading information.

The findings of this study should be of interest not only to preparers of financial statements and auditors but also to investors, policy-makers and regulatory bodies. This study informs preparers and auditors of the reporting aspects that should be improved in the preparation of financial statements in order to improve the quality of financial reporting. The findings also suggest that investors and regulators should be vigilant about the quality of disclosure in companies' annual reports, even if the reports have been audited and certified by auditors.

This paper is organised as follows. Section 2 presents an overview of financial reporting regulations in Malaysia. Section 3 presents a literature review on mandatory disclosure. Section 4 describes the research method and Section 5 discusses the findings, followed by the conclusion in Section 6.

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Overview of Financial Reporting Regulations in Malaysia: Malaysia had its first formal financial reporting framework when the Financial Reporting Act 1997 (FRA 1997) was passed in July 1997 [10]. Under this reporting framework, the accounting standards issued and adopted by the Malaysian Accounting Standards Board (MASB) became mandated by law and the enforcement of the standards was entrusted to the three regulatory agencies, namely the Securities Commission (SC), the Central Bank of Malaysia (Bank Negara) and the Companies Commission of Malaysia (CCM). The SC is responsible for monitoring compliance with accounting standards by public listed companies, the CCM monitors compliance by all registered companies and the Central Bank is responsible for monitoring compliance by financial and banking institutions. The Companies Act 1965 was also amended in September 1998, requiring all companies incorporated in Malaysia to comply with the approved accounting standards. The amended Companies Act 1965 requires directors to ensure that their company's accounts are prepared in accordance with the approved accounting standards. The Act also requires directors to declare that the financial statements comply with the accounting standards and that they give a true and fair view of the financial position and performance of the company.

Prior to 2005, the approved accounting standards in Malaysia were known as MASB standards. Following the worldwide convergence with International Financial Reporting Standards (IFRS)[2], particularly the adoption of IFRS by European countries in 2005, the Malaysian Accounting Standards Board (MASB) renamed the MASB standards as Financial Reporting Standards (FRS) and renumbered the standards to coincide closely with the numbering of IFRS. For example, FRS1 refers to IFRS1 and FRS2 refers to IFRS2. This was an initial step taken by the MASB to show its efforts toward convergence with IFRS. Since 2006, the FRS have been made identical to IFRS on a per standard basis and in 2008, the MASB declared the aim to achieve full convergence with IFRS by 1 January, 2012. Effective from 1 January, 2012, the FRS were renamed Malaysian Financial Reporting Standards (MFRS). Essentially, the MFRS are identical, word-for-word, with IFRS.

Additionally, the Malaysian Institute of Accountants (MIA) has also implemented self-regulatory enforcement to ensure that MIA members comply with the MFRS in the preparation of financial statements for their companies. The MIA was established under the Accountants Act 1967 as a statutory body to regulate and develop the accountancy profession in Malaysia. To monitor the quality of financial statements prepared by the members of the MIA, the MIA has formed the Financial Statement Review Committee (FSRC). The FSRC not only monitors compliance with accounting standards but also compliance with statutory and other requirements and approved auditing standards in Malaysia. The review process by the FSRC is based on random sampling, as well as cases referred by the Investigation Committee of the MIA, the Securities Commission, the Bursa Malaysia and the Central Bank of Malaysia. The FSRC may also review specific companies' financial statements when there are public interest issues involved. The FSRC publishes the findings of their review on the MIA's webpage and also in the MIA's magazine 'Accountants Today', with the objective to inform and educate MIA members about good presentation and disclosure practices and consequently to improve the quality of financial reporting by companies. However, non-disclosure of names of companies, directors and auditors convicted of non-compliance with accounting standards may benefit the convicted entities because they can avoid negative publicity that could tarnish their reputation and image.

Three types of penalty tariffs have been introduced by the MIA to deal with non-compliance with the approved accounting standards. The first category applies to minimal non-compliance issues (e.g. housekeeping issues), where minimal action will be taken against the members, such as requiring them to tidy up their financial statements. The second category applies if there are substantial instances of non-compliance with disclosure requirements of the approved accounting standards. Several actions can be taken against members in this category, such as: (1) members are required to take the necessary corrective action; (2) members are given a warning letter; and/or (3) the company's financial statements are placed under surveillance by the FSRC for up to two consecutive years. The third category involves major non-compliance with the requirements of the approved accounting standards. Under this category, members would be referred to the Investigation Committee of the MIA or other regulatory bodies for

[2]International Financial Reporting Standards (IFRS) are accounting standards issued by the International Accounting Standards Board (IASB) since 1973. Among the objectives of IFRS are to increase the transparency, comparability and reliability of financial statements.

appropriate action, given a warning letter or reprimanded. The company's financial statements could be put under surveillance by the FSRC for up to four consecutive years.

Literature Review: Mandatory disclosure is defined in the literature as the presentation of the minimum amount of information as required by law, the stock exchange and the accounting standards setting body, which is enforced for applicable companies [11]. Therefore, disclosure of mandatory information is vital to assist potential investors or users of financial statements in making economic decisions. Despite their importance in decision making process, prior studies have documented evidence of non-compliance with accounting standards or mandatory disclosure requirements among companies in both developed and developing countries. For example, [12] examined 49 major companies from twelve countries that claimed to have complied with IFRS in their 1996 annual reports. Interestingly, they found that there was significant non-compliance with IFRS in many aspects. The main areas of non-compliance were observed in IAS2-Inventory, IAS8-Net Profit or Loss for the Period, IAS9-Research and Development Costs, IAS16-Property, Plant and Equipment, IAS18-Revenue, IAS19-Retirement Benefit Costs, IAS21-The Effect of Changes in Foreign Exchange Rates, IAS29-Hyper Inflationary Economies, IAS22-Business Combination and IAS23-Borrowing Costs.

[13] extended the work of [12] by examining the annual reports of 82 companies from seventeen countries for the year 1998. They also observed some degree of non-compliance with respect to IFRS, though the companies claimed that they had complied with IFRS. They observed that compliance with IFRS was problematic in some areas, including: IAS8-Net Profit or Loss for the Period, IAS14-Segment Reporting, IAS17-Leases, IAS19-Employee Benefit, IAS23-Borrowing Cost, IAS29-Financial Reporting in Hyperinflationary Economies and IAS31-Joint Ventures. A study by [8] on the extent of compliance with IFRS by 279 companies claiming to have complied with IFRS in their annual reports for the year 1998 documented that the extent of compliance with each standard varied and none of the companies achieved 100 per cent compliance. In another study, [14] assessed a sample of 165 companies that had adopted IFRS in their 1999-2000 financial statements. He revealed that 29% of the surveyed companies had practiced 'implied IFRS lite', which means companies claimed to have used IFRS but in fact had not complied fully with the requirements of the standards. He also identified problematic accounting standards, including IAS12-Income Taxes, IAS14-Segment Reporting and IAS35-Discontinuing Operations. He also observed that some auditors issued unqualified audit reports for companies that did not comply with IFRS. A study by [7] has also examined the extent of compliance with both IASs and US GAAP for companies listed on the Germany New Market. The study found that compliance with IFRS was problematic with regard to disclosures associated with pensions, leasing, financial instruments, earnings per share, research and development and provisions and contingencies. [5] examined 153 Greek listed companies' compliance with all IFRS mandatory disclosures during 2005. His study showed a relatively low average level of compliance with IFRS mandatory disclosures by Greek listed companies.

In sum, the above studies suggest that the adoption of high-quality accounting standards such as IFRS does not automatically lead to high-quality financial reporting or an increase in transparency. This scenario is particularly relevant to countries with weak institutional features, such as an inadequate regulatory framework, ineffective enforcement mechanisms and a shortage of qualified accountants.

MATERIALS AND METHODS

This study used a sample of 225 companies listed on Bursa Malaysia. The companies were randomly selected after excluding finance companies and companies that did not publish their annual reports on the Bursa website as of 30 May, 2009. Information disclosed in the companies' financial statements was checked against the disclosure checklist prepared by one of the researchers. A self-constructed disclosure checklist contained 295 mandatory disclosure items, which were derived from twelve accounting standards, i.e. FRS2-Share Based Payment, FRS3-Business Combination, FRS5-Non-current Assets Held for Sale and Discontinued Operations, FRS101-Presentation of Financial Statements, FRS114-Segment Reporting, FRS116-Property, Plant and Equipment, FRS117-Leases, FRS119-Employee Benefits, FRS132-Financial Instruments: Disclosure and Presentation, FRS136-Impairment of Assets, FRS138-Intangible Assets and FRS140-Investment Property. These accounting standards were chosen to be examined in this study because they were enacted in 2006 and are 100 per cent identical with IFRS disclosure requirements. In developing the disclosure checklist, we also consulted the checklist prepared by [15] and Pricewaterhouse Coopers to ensure that the prepared checklist items were conformed with IFRS disclosure requirements.

Similar with the approach used by prior studies, the initially constructed disclosure checklist used in the present study was reviewed by two chartered accountants to ensure its validity in measuring compliance with IFRS disclosure requirements. Any ambiguity raised was referred to another independent person with in-depth experience of IFRS. After taking into account all suggestions and comments from these three referees, the final disclosure checklist, containing 295 items, was prepared. To ensure the reliability of the disclosure checklist, a pilot study was carried out whereby the researcher and another independent person with IFRS knowledge examined and scored the financial statements of twelve companies. The compliance score results from the researcher and the independent person were then compared and analysed. The results showed that there was substantial agreement between the scores, which indicated minimal subjectivity in the scoring process; thus, the disclosure checklist used in this study is considered reliable. A similar approach was used by [11, 2] to test the reliability of their scoring instrument.

The scoring process involves the subjective judgement of the researcher [16]; thus, it is likely that a company will be penalised for non-disclosure of an item which in fact is not applicable to the company [11]. To mitigate this problem, the present study follows the practice of prior research, where the entire annual report is read at least twice to understand the nature and complexity of each company's operation before any decision is made. Then the unweighted disclosure index is used to score the disclosure checklist, because under this approach all disclosure items are assumed to be equally important to all users of annual reports. [11] also notes that the unweighted index may provide more independent analysis because no particular user group's perceptions are involved. The most common unweighted disclosure index used in prior studies is the 'dichotomous' method, where an item is scored one if disclosed, zero if not disclosed, or not applicable (NA) if the item is not relevant to the company [2]. Under this method, a company will not be penalised for not disclosing items that are not relevant to that company [11]. The dichotomous disclosure index is computed as the ratio of the total items disclosed to the maximum possible number of items applicable to the company, which can be stated in the formula below.

$$CS_j = \frac{T = \sum_{i=1}^{m} d_i}{M = \sum_{i=1}^{n} d_i}$$

where CS_j is the total compliance score for each company and $0 \le CS_j \le 1$; T is the total number of items disclosed (d_i) by company j and $m \le n$; and M is the maximum number of applicable items that the company j is expected to disclose, i.e. $n \le 295$.

RESULTS

Our analysis shows that the extent of mandatory disclosure varied among the accounting standards. As shown in Table 1, the highest average mandatory disclosure score was for FRS101-Presentation of Financial Statements (95.5%), followed by FRS5-Non-current Assets Held for Sale and Discontinued Operations (94.3%) and FRS116-Property, Plant and Equipment (92.7%). This means that the majority of the examined companies met almost all mandatory disclosure requirements prescribed under these three accounting standards. The highest disclosure scores were for FRS101, possibly due to the following reasons; first, FRS101 is easy to comply with by the majority of companies because the standard deals with basic disclosure requirements (e.g. name and description of entities, the key items to be included in the financial statements) and second, complying with this standard does not lead to high proprietary costs [15]. Other accounting standards (except for FRS132 and FRS2) had average disclosure scores below 80%, where the lowest scores were for FRS136-Impairment of Assets (71.7%), followed by FRS117-Leases (73.5%) and FRS119-Employee Benefit (75.7%). Further analysis in Table 2 shows that a considerable number of companies had compliance scores below 70% for FRS119, FRS117 and FRS136, i.e. 84 companies, 74 companies and 60 companies respectively. These findings suggest that compliance with mandatory disclosure requirements is problematic in Malaysia and the majority of Malaysian companies have difficulty in complying with FRS119, FRS117 and FRS136. We also found that there were companies that did not provide any of the information required by specific standards even though the standards are relevant to them. This is shown in Table 1 - refer to Minimum Disclosure column.

Table 1: Mandatory Disclosure Scores for Each Accounting Standard

FRS	Average Disclosure (%)	Minimum Disclosure (%)	Maximum Disclosure (%)
FRS101-Presentation of Financial Statements	95.5	86.5	100
FRS 5-Non-current Assets Held for Sale and Discontinued Operations	94.3	33.3	100
FRS116-Property, Plant and Equipment	92.7	45.5	100
FRS114-Segment Reporting	92.6	0.0	100
FRS132-Financial Instrument Disclosure	89.0	3.0	100
FRS2-Share Based Payment	82.7	0.0	100
FRS138-Intangible Assets	78.9	28.6	100
FRS140-Investment Property	77.8	4.0	100
FRS3-Business Combination	77.1	12.5	100
FRS119-Employee Benefit	75.7	0.0	100
FRS117-Leases	73.5	0.0	100
FRS136-Impairment of Assets	71.7	0.0	100

Table 2: Range of Disclosure Scores for Each Standard

	≥ 90%		80-89.9%		70- 79.9%		60-69.9%		50-59.9%		< 50%	
Range	N	%	N	%	N	%	N	%	N	%	N	%
FRS101	214	95.1	11	4.9	-	-	-	-	-	-	-	-
FRS5	60	81.1	4	5.4	-	-	9	12.2	-	-	1	1.4
FRS116	159	70.7	32	14.2	25	11.1	7	3.1	1	0.4	1	0.4
FRS114	141	77.5	25	13.7	9	4.9	-	-	1	0.5	6	3.3
FRS132	124	55.6	59	26.5	27	12.1	9	4.0	3	1.3	1	0.4
FRS2	30	32.6	29	31.5	24	26.1	5	5.4	1	1.1	3	3.3
FRS138	32	36.0	31	34.8	2	2.2	4	4.5	6	6.7	14	15.8
FRS140	18	15.7	58	50.4	16	13.9	15	13.0	3	2.6	5	4.3
FRS3	27	37.5	16	22.2	11	9.7	7	9.7	7	9.7	4	5.6
FRS119	103	45.8	11	4.9	25	5.3	12	5.3	53	23.6	21	9.4
FRS117	50	26.7	22	11.8	51	16.1	30	16.0	11	5.9	23	12.3
FRS136	26	16.8	50	32.3	19	18.1	28	18.1	10	6.5	22	14.2

N= number of companies

Item by item analysis for each standard revealed that there were several parts of the standards received less compliance from the majority of companies. The frequent non-disclosure mandatory items are provided in Table 3. For example, the majority of the examined companies did not disclose events and circumstances that led to recognition or reversal of the impairment loss, as required under FRS136. The majority of the companies that engaged with operating lease also did not provide information regarding the total future minimum lease payments under non-cancellable operating leases for each of the following periods; (i) not later than 1 year; (ii) later than 1 year and not later than 5 years; and (iii) later than 5 years.

Apart from these frequent undisclosed items, we also observed some poor reporting practices by some companies. These companies had disclosed in the notes to financial statements certain information irrelevant to the nature and activities of those companies. For example, the companies had reported in their accounting policies that they had segment reporting and investment property. However, after detailed reading and examination of their annual reports, we found that the disclosed information was irrelevant to such companies. We believe that these companies had used the disclosure template prepared by auditors (i.e. boilerplate practice) to assist them in complying with mandatory disclosure requirements. Although the boilerplate practice can assist preparers in complying with IFRS, the practice may become destructive when the disclosure of irrelevant information will mislead the readers of annual reports [17]. This boilerplate practice indeed may encourage preparers to merely comply by ticking boxes rather than taking the initiative to fully comprehend the requirements of IFRS. As a result, the readers or users of financial statements may be supplied with information that is irrelevant or not useful in their decision-making.

Table 3: Frequent Non-Disclosure Items in the Financial Statements

	Non-disclosure items/information
FRS136-Impairment of Assets	•Events and circumstances that led to recognition or reversal of the impairment loss. •Information of whether the recoverable amount of the asset (cash generating unit) is its fair value less costs to sell or its value in use. •Basis used to determine fair value less costs to sell •Discount rate(s) used in the current estimate and previous estimate •The period over which management has projected cash flows; the growth rate used and the discount rate applied to the cash flow projections. •A description of each key assumption on determination of fair value less costs to sell (if it is not determined using an observable market price for the unit); and approached used to determine the values.
FRS117-Leases	LESSEE/ OPERATING LEASE •Total of future minimum lease payments under non-cancellable operating leases for each of the following periods; (I) not later than 1 year; (ii) later than 1 year and not later than 5 years; and (iii) later than 5 years. •A general description of the lessee's material arrangements (e.g. the existence and terms of renewal or purchase options and restriction imposed by lease arrangement)
	LESSEE/ FINANCE LEASE •A reconciliation between the total of future minimum lease payments (MLP) at the balance sheet date and their present value (PV); and disclose the total of future MLP at the balance sheet data and their PV for each of the following period: (i) not later than one year; (ii) later than one year and not later than five years; (iii) later than 5 years. •A general descriptions of the lessee's material leasing arrangements (e.g. the existence and terms of renewal or purchase options and restriction imposed by lease arrangement)
FRS119-Employee Benefit	•Information about contributions to defined contribution plans for key management personnel. •A reconciliation of opening and closing balances of the present value of the defined benefit obligations •A reconciliation of the opening and closing balances of the fair value •Actual return on plan assets
FRS3- Business Combination	•A description of the factors that contributed to the cost that results in the recognition of goodwill
FRS140-Investment Property	•Methods and significant assumptions applied in determining the fair value of investment property •The extent to which the fair value of investment property is based on valuation by an independent valuer who holds a recognized and relevant professional qualification. If there has been no such valuation by independent valuer, the fact should be disclosed. •Direct operating expenses that generated or did not generate rental income. •Contractual obligations to purchase, construct or develop investment property for repairs, maintenance or enhancements. •If the entity applies the cost model, it should disclose the fair value of investment property. When the fair value cannot be determined reliably it shall disclose a description of the investment property and explain why it cannot be determined reliably.
FRS138- Intangible Assets	•Information of whether the useful lives are indefinite or finite; and if finite, the useful lives or the amortization rates used. •Amortization methods used for intangible assets with finite useful lives. •Carrying amount of intangible asset and the reasons supporting the assessment of an indefinite useful life. •A description of the carrying amount and remaining amortization period of any individual intangible asset that is material to the entity's financial statements.
FRS2-Share based payment	•Range of exercise prices and weighted average remaining contractual life. •Weighted average fair value of those options at the measurement date and information on how that fair value was measured, including (i) option pricing model used and the inputs to that model, (ii) how expected volatility was determined, (iii) whether and how any other features of the option grant were incorporated.
FRS132- Financial Instruments	•Amount of maximum credit risk exposure at the balance sheet date. •Significant concentrations of credit risk. •Fair value for each class of financial assets or liabilities. •Whether fair values of financial assets or liabilities are determined directly, in full or in part, by reference to published price quotations in an active market or are estimated using a valuation technique.
FRS114-Segmental Reporting	•Segment revenue from external customers •Basis of pricing inter-segment transfer and any change there in.
FRS116- Property, Plant and Equipment (PPE)	•Effective date of revaluation; •Methods and significant assumptions applied in estimating the items' fair values •The extent to which the items' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques.
FRS5- Non-current Assets Held for Sale and Discontinued Operations	•A description of the facts and circumstances of the sale, or leading to the expected disposal and the expected manner and timing of that disposal.
FRS101-Presentation of Financial Statements	•A description of nature and purpose of reserve in within equity. •Entities classifying expenses by function shall disclose additional information on the nature of expenses. •Management judgments in applying accounting policies. •Key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet data- assets and liabilities carrying amount as at the balance sheet date (in the notes)

CONCLUSION

The main objective of this study is to investigate the mandatory disclosure practices of Malaysian public listed companies. The findings show that the extent of mandatory disclosure in annual reports varies among companies. Even though compliance with mandatory disclosure requirements in Malaysia is mandated by law and the companies acknowledged that they complied with the approved accounting standards, we found that none of the companies met all mandatory disclosure requirements relevant to them. Therefore, the adoption of high-quality accounting standards like IFRS will not automatically lead to increased transparency, given that the financial reporting practices in a specific country are much influenced by the institutional structures and culture of that country [18-20].

We also observed that the inappropriate usage of boilerplate practice among Malaysian public listed companies and this practice might result in misleading information given to the readers or users of annual reports. The users or potential investors are therefore advised to be more vigilant when inspecting annual reports. It is important to highlight that among the objectives of IFRS is to increase the transparency and comparability of financial statements. However, it seems that the aims of IFRS will not be achieved if the companies choose not to provide all the relevant mandatory disclosure requirements. Hence, based on these findings, regulators, policy-makers and professional accounting bodies should be concerned about the quality of mandatory disclosure by Malaysian companies. The problematic accounting standards and the frequent non-disclosed items reported in this study may help regulators to focus on monitoring compliance with the accounting standards. The frequently non-disclosed items documented in this study may also assist users or potential investors in their decision-making regarding the companies. If necessary action is not taken when the rules are breached, it is highly likely that the rules will remain only on paper [21]. The companies may also treat mandatory disclosure in the same way as voluntary disclosure if stringent enforcement mechanisms are not in place [6].

Despite these important findings, the limitations of this study are also acknowledged. The results of this study are based on twelve accounting standards and the annual reports for the year 2008 only. Therefore, the findings could be more interesting and broader if the study could examine all the IFRS and cover more than one year.

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