

## **First Time FRS Adoption among Top Malaysian Public Listed Companies**

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### **Abstract**

Globalization has led to greater demand for more uniform accounting standards throughout the world. A single global standard is vital for the investors who look for the best capital markets in which to invest, based on the financial reports available across the boundaries. International Accounting Standard Board (IASB) has taken an aggressive initiative to bring further convergence between local Generally Accepted Accounting Principles (GAAP) and international standards with the amendments of some existing standards and adopted certain new standards in the name of the International Financial Reporting Standards (IFRS). Nevertheless, the complexity on the issue of convergence with a single standard has been raised by many parties (Hoogendoorn, 2006; Bernhut, 2008). Similarly, the Malaysian's accounting bodies have also raised their anxiety as to whether the public listed companies are ready to encounter the major accounting transition. Therefore, this study tries to investigate the extent of FRS adoption among the Malaysian's top 100 listed companies. Using sample of 57 companies to represent the first annual reports to adopt 18 new or revised FRSs, this study reveals that all largest companies have promptly adhered to the FRS transition. Nevertheless, the level of adoption differs between the sample companies.

**Keywords:** *FRS, First Time Adoption, Malaysia, Public Listed Companies, FTSE Bursa Malaysia 100*

## **1. INTRODUCTION**

Convergence, formerly known as harmonization, is the process enhancing comparability between international accounting standards and national standards. It is not a process to achieve identical standards, but targets generally comparable standards that become analogous over time (Thomas, 2009). The main motivation of convergence is to increase the quality of accounting standards (Zeff, 2007) and enhance the compatibility of accounting practice with a limited degree of variation (Smith, 2008). IASC was the most well-known standard setting body of International Accounting Standards (IAS). It was formed in June 1973 in order promote a single accounting standards that can be applied worldwide. IASC existed for 27 years until it was restructured and changed its name to International Accounting Standard Board (IASB) on 1<sup>st</sup> April 2001. IASB has amended some existing standards and adopted certain new standards in the series of name called International Financial Reporting Standards (IFRS). The first IFRS was issued in June 2003 that is IFRS 1: First-time Adoption of International Financial Reporting Standards.

It is global phenomenon nowadays for the convergence with IFRS and the trend is escalating further. The IFRS have been accepted as a mandatory transition in the European Union (EU), Australia, New Zealand, Russia, Africa, Bahrain, the US, Hong Kong, South Africa, Singapore and Malaysia (Bebbington and Song, 2007; Jacob and Madu, 2009). Mintz (2011) stated that at the beginning of 2011, almost 120 countries have accepted the transition to IFRS. The European countries embarked their IFRS convergence beginning 1 January 2005, which is also parallel to Australia (Jones and Higgs, 2006; Daske and Gebhardt, 2006). New Zealand started their IFRS transition since 1 January 2007, while Canada set an

effective deadline for convergence of 1 January 2011. In addition, 1 April 2011 is the target date for IFRS adoption by Indian companies, and Japan and Korea have also agreed to comply with IFRS by 2011 (Thomas, 2009). Recently, the Securities and Exchange Commission (SEC) completed its roadmap and decided to mandate IFRS transition in the US by 2015 (Aguilar, 2011).

Similarly, the Malaysian Accounting Standards Board (MASB) made a decision to adopt 21 IFRS beginning 1 January 2006. This endeavour by MASB aimed to close the gap between the local standards and a single international standard. IFRS in Malaysia is branded as Financial Reporting Standards (FRS). In enhancing the transparency of financial statements, these universal standards demand for more meaningful presentation of financial statements and detailed disclosure requirements. The issues of full and partial convergence have received considerable comments and debates from business entities, professional bodies and academic interest (Jones and Higgis, 2006). Most of the concerns are on the pros and cons of IFRS adoption in their countries, for instance, in European Union (Jones, Rahman and Wolnizer, 2004; Daske and Gebhart, 2006), Australia (Jones and Higgis, 2006) and Bahrain (Joshi, Bremser and Al-Ajmi, 2008). The question of whether benefits of adopting IFRS outweigh costs of implementation becomes crucial (Jones and Higgins, 2006) to the entities especially for small business entities. The compliance costs include training costs of accountants to comply with fair value accounting and increase in external auditors' costs as they are required to put more effort in verifying complicated items.

Therefore, the primary objective of the present study is to investigate the readiness and extent of FRS adoption using sample from top Malaysian's Public Listed Companies that first adopted in the annual financial statements ended 31 December 2006. Further, the attributes of first time adoption companies are discussed. The paper is set out as follows. Section 2 discusses a brief overview of accounting standards in Malaysia. Section 3 comprises the data and methodology. The discussion of the results is contained in Section 4. The last section points out key conclusions and policy implications.

### **1.1 Overview of Malaysian Accounting Standards**

In Malaysia, the development of accounting standards began in 1957 with the formation of the Malaysian Institute of Certified Public Accountants (MICPA).<sup>1</sup> In earlier years, the development of accounting profession was under British influence (Zulkarnain and Shamsher, 2008). In 1977, MICPA started to issue Approved Accounting Standards in line with International Accounting Standards (IAS) and Malaysia Accounting Standards (MAS) (Susela, 1999). Malaysia and Singapore are considered the earliest ASEAN countries to adopt IAS together with the support on IASC's efforts (Saudagaran and Diga, 2000). In 1997, under the Financial Reporting Act 1997, MASB and the Financial Reporting Foundation (FRF) were formed. The main objective of MASB is to enhance the quality of accounting standards in Malaysia and to contribute to the development of international accounting standards. At the same time, the FRF acts as an overseeing body for the operating activities of MASB. MASB has been given the responsibility to issue accounting standards, issue statement of principles, develop a conceptual framework and continue the work that was done prior to 1997. Initially, 24 IAS and MAS were adopted with the status of approved accounting standards. In addition, the Company Act 1965 was amended to require companies to comply with approved accounting standards.

Up to January 2005, 32 MASB standards have been issued and adopted. The standards issued by MASB were referred to as MASB 1, MASB 2 and so on. Nevertheless, beginning January 2005, all MASB standards had been renamed to Financial Reporting Standards

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<sup>1</sup> On 6<sup>th</sup> July 1964, MICPA changed its name to the Malayan Association of Certified Public Accountants (MACPA). Later, on 6 July 2002, MACPA was renamed as MICPA again (MICPA, 2011).

(FRS). The main reason for the change of name was to converge with IFRS. At the same time, the number assigned was renumbered to match with the IFRS. For instance, MASB 1 Presentation of Financial Statements was renumbered FRS 101, IFRS 1 is known as FRS 1, IFRS 138 is FRS 138 and so forth. As at January 2006, MASB had adopted 21 new IFRS with the effective date for the use of these new standards being 1 January 2006. Compliance with IFRS is legislated under the Financial Reporting Act 1997. It is important to note that two standards, FRS 117 and FRS 124, would only come into effect from accounting period beginning 1 October 2006. In addition, MASB had deferred the convergence with FRS 139 to 1 January 2010.

## **2. DATA AND METHODOLOGY**

The data in this study consist of publicly available information mainly obtained from annual reports for companies listed on Bursa Malaysia. The annual reports were downloaded from Bursa Malaysia Company Announcement Webpage. The initial sample was developed by obtaining the list of FTSE Bursa Malaysia 100 companies as at 31 December 2006. Since the 18 new and revised FRSs would come into effect from accounting period beginning on or after 1 January 2006, thus all companies with accounting year-end 31 December 2006 would be the first financial statements to comply with FRS (Carlin, Finch and Laili, 2009). For this reason, 43 companies are excluded due to the reporting period other than 31 December 2006. The remaining 57 companies represented the final sample for this study.

In order to determine whether the sample companies firstly adopted FRS in their annual reports, the 'basis of preparation' section in the notes to accounts was verified. The section normally contained the statement of compliance with FRS and the specific FRS that were applicable and adopted by the respective company. Thus, the extent or level of FRS adoption during the first year could be measured. Subsequently, several attributes of first-time FRS adopted companies were discussed. The characteristics include industry distribution, types of auditors and distribution of Big 4 auditors in Malaysia. This study utilized descriptive statistical test and data was analyzed using SPSS Statistic Software 17.0.

## **3. RESULTS AND DISCUSSIONS**

### **3.1 The adoption of FRS**

This analysis shows that all 57 companies from the final sample complied with the requirement to adopt FRS in the financial statements ended 31 December 2006. The results revealed that the Malaysian's public companies with 31 December 2006 were ready to adhere to the new or revised FRS requirement. The result, perhaps, was attributable from the early announcement made by the MASB. Thus, the Malaysian companies have ample time to understand the new standards and changes required on existing standards, train their staffs and communicate the transition. Besides that, Malaysia has greater influence from common law (Callao, Jarne and Lainez, 2007) and Anglo-American culture. A study by Zeghal and Mhedhbi (2006) provided evidence that developing countries under Anglo-American culture was one of the most influential factors to adopt universal accounting standards such as FRS.

### **3.2 The extent/level of FRS adoption**

Table 1 presents the number of FRS adopted out of 18 new or revised FRS during the first year of adoption. The FRS adoption ranges between the minimum of 11 standards to the full adoption of 18 FRSs. There were 42 companies (73.7%) complied with full adoption of 18 FRSs in their annual reports while only one (1) company (1.8%) adopted a minimum of 11 standards.

Table 1: The Level of FRS Adoption

| FRS Adoption | Frequency | Percentage |
|--------------|-----------|------------|
| 11           | 1         | 1.8        |
| 13           | 1         | 1.8        |
| 14           | 2         | 3.5        |
| 15           | 2         | 3.5        |
| 16           | 3         | 5.3        |
| 17           | 6         | 10.5       |
| 18           | 42        | 73.7       |
| Total        | 57        | 100        |

### **3.3 The attributes of first year FRS adoption companies**

#### *3.3.1 The influence of sectors on FRS adoption*

Table 2 presents the classification of sample companies according to the sectors. There were eight (8) sectors that represented the companies studied. Trading and services sector covered 35.1% of the sample companies, 15.8% for finance and industrial products; plantation of 12.3%, consumer products represented 8.8%, 5.3% for infrastructure projects while both construction and property covered 3.5% of the FRS adoption companies at 31 December 2006.

Table 2: Distribution of FRS Adoption Companies According to Sectors

| Sector                  | Frequency | Percentage |
|-------------------------|-----------|------------|
| Construction            | 2         | 3.5        |
| Consumer products       | 5         | 8.8        |
| Finance                 | 9         | 15.8       |
| Industrial Products     | 9         | 15.8       |
| Infrastructure Projects | 3         | 5.3        |
| Plantation              | 7         | 12.3       |
| Property                | 2         | 3.5        |
| Trading and Services    | 20        | 35.1       |
| Total                   | 57        | 100        |

#### *3.3.2 The influence of auditor's type on FRS adoption*

Table 3 shows the portion of auditor's type engaged by the large public listed companies in Malaysia. Big 4 auditors audited majority (96.5%) of the sample companies while only 2 (3.5%) companies appointed non-big 4 firms in their audit engagement. The result is consistent with brand name theory introduced by Klein and Laffler (1981) in which the researchers describe how the brand name premium acts as a guarantor for the quality services provided and how incentives are created by firms to fulfill the implicit contract. In auditing, brand name reputation is commonly connected to large, higher quality, well-known, more famous clients (Moizer, Garcia Benau, Humphrey and Martinez, 2004) and well capitalized international accounting firms. Majority of auditors' reputation research claim that larger auditors serve a greater monitoring to the clients and provide superior information quality and more credible (see for example: DeAngelo, 1981; Beatty, 1989).

Table 3: Distribution of Auditor' Types

| Types of Auditor   | Frequency | Percentage |
|--------------------|-----------|------------|
| Non-Big 4 Auditors | 2         | 3.5        |
| Big 4 Auditors     | 55        | 96.5       |
| Total              | 57        | 100        |

### 3.3.3 The Big 4 auditors

From the total of 55 auditees companies being audited by Big Firms, Table 4 details out the analysis according to the four international affiliated auditors in Malaysia. From, the descriptive statistic results, Ernst & Young dominated 43.6% of the top Malaysian top public listed companies with 31 December as accounting year-end. It was followed by KPMG and PricewaterhouseCoopers which audited 25.5% of the sample. Only 5.5% of the big firms' clients being audited by Delloite & Touche/Delloite KassimChan.

Table 4: Distribution of Big 4 Auditors

| Big 4 Auditor                         | Frequency | Percentage |
|---------------------------------------|-----------|------------|
| Delloite & Touche/Delloite KassimChan | 3         | 5.5        |
| Ernst & Young                         | 24        | 43.6       |
| KPMG/ KPMG Desa Megat & Co.           | 14        | 25.5       |
| PricewaterhouseCoopers                | 14        | 25.5       |
| Total                                 | 55        | 100        |

## 4. CONCLUDING REMARKS

Started from the date MASB announced to converge with IFRS effectively 1 January 2006, which was a year behind Singapore, Australia and New Zealand, much questions raised on the readiness to adopt the 1<sup>st</sup> phase of 18 FRS. The focal issue was whether Malaysian public listed companies were prepared in terms of technical fitness and staffs proficiency. Therefore, this study aimed to assess the enthusiasm of the top Malaysian public listed companies to adopt FRS in their financial statements at 31 December 2006. From 100 FTSE constituent companies, 57 companies met the sample requirement. The descriptive statistics analysis discovered that all the final sample adhere to the mandatory transition to FRS. This study disapproved the early prediction made by the Association of Chartered Certified Accountants (ACCA) FRS trainer, that even some public listed companies were not somewhat ready to adopt new FRS. Nevertheless, sample for this study is limited to top public listed companies and the results might be different compare to the medium size companies.

This research is useful to the policy makers, regulatory bodies, the accounting and auditing professions such as the Malaysia Institute of Accountant (MIA), the Bursa Malaysia and the Securities Commission (SC) to educate and guide companies and auditors to take serious actions in facing full convergence by 2012. The accounting and auditing bodies can take preliminary actions before reaching full transition phase such as aggressively organizing seminars or discussion groups. In addition, special committee might be set up to make assessments and get feedbacks or comments from preparers of financial statements especially with the adoption of most complex standard namely FRS 139. Similarly, public listed companies in Malaysia must be well prepared in term of having enough expertise, willing to increase their compliance costs and sufficiently update their accounting systems. With all these attempts, everybody will have a clear mind setting and able to cope with more challenges ahead in producing high quality financial statements.

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