Mandatory Corporate Disclosure and Regulatory Enforcement: The Case of Malaysia

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Abstract This study aims to know how the regulatory bodies in Malaysia monitor compliance with mandatory corporate disclosure for public listed companies. To achieve this objective, we use both primary and secondary data i.e. interviews and archive data. Our findings suggest that, although a set of mechanisms is in place to ensure companies comply with accounting standards, the activities of enforcement bodies are lax and insufficient. This study also highlights several weaknesses in the current regulatory enforcement in Malaysia.

Keywords Mandatory disclosure, Accounting Standards, Compliance, Enforcement

1. Introduction

Mandatory corporate disclosure is described in the literature as the presentation of the minimum amount of information in the annual report as required by laws, the stock exchange and the accounting standards setting body, which companies are obliged to follow if applicable to them ([9],[15]). The present study refers mandatory corporate disclosure as the disclosure requirements prescribed under the International Financial Reporting Standards (IFRS). IFRS are the principle-based standards issued by the International Accounting Standards Board (IASB), and the standards have been adopted by more than 100 countries since 2001. IFRS have been accepted in many countries because it offers more benefits compared to the local or national accounting standards such as increase comparability and transparency of financial reporting, increase market efficiency and reliability and decrease the cost of capital.

Following the adoption of IFRS by European countries in 2005, Malaysia has also taken steps to converge with IFRS whereby Malaysian accounting standards (i.e. MASB standards) have been made identical with IFRS on a per standard basis since 2006. In 2008, Malaysia declared to achieve full convergence with IFRS by 1 January 2012. However, it has been argued that the extent of IFRS benefits achieved in one country may also depend on the extent of compliance with IFRS, the presence of legal or regulatory backing for the standards, and the degree of compliance monitoring and enforcement ([3],[6]).

In Malaysia, compliance with IFRS is mandated by law and the enforcement of the accounting standards to public listed companies has been delegated to Securities Commission of Malaysia (SC). Additionally, the Malaysian Institute of Accountants (MIA) has also implemented self-regulatory enforcement to ensure the MIA members comply with IFRS in the preparation of financial statements. Given the presence of legal backing for accounting standards and the enforcement bodies to monitor compliance with IFRS in Malaysia, one may argue that the corporate reports of public listed companies in Malaysia are of high quality and transparent. However, this may not be the case because prior literatures (e.g. [13],[16]) argued that, although the regulations in Malaysia appear to be well written in the laws but they are ineffective in terms of enforcement. Moreover, a study by [7] showed that compliance with accounting standard i.e. FRS136-Impairment of Assets by Malaysian public listed companies in 2006 and 2007 was poor, at rates of 54.6 per cent and 49.4 per cent respectively. Her findings may suggest that the present regulatory enforcement is ineffective to curb non-compliance with IFRS in Malaysia.

In light of this, the present study aims to know how the regulatory bodies monitor and enforce compliance with IFRS in Malaysia. This study may benefit various parties such as investors, regulators and financial analyst given that the adoption of IFRS spreads in global capital markets. The findings of this study may assist regulators to improve and strengthen enforcement mechanisms in Malaysia. This study not only makes contribution to the practice but also to the extant literature on mandatory disclosure and regulation given the fact that there has been little research addressing the issue of enforcement of IFRS ([3]).

This paper is structured as follows. Section 2 provides an overview of Malaysia’s financial reporting. Section 3 explains the research methods use in the study. Section 4
presents the findings from archive search and interviews. Section 5 provides discussion and conclusion of the study.

2. Overview of Financial Reporting Regulation in Malaysia

Malaysia had its first formal financial reporting framework when the Financial Reporting Act 1997 (FRA 1997) was passed in July 1997 ([12]). Two bodies were established under the FRA 1997, namely the Financial Reporting Foundation (FRF) and the Malaysian Accounting Standards Board (MASB). The function of the FRF is basically to act as an oversight body of operations, activities and performance of the MASB, whereas the main function of the MASB is to issue legally binding accounting standards. The adoption of the MASB standards was effective for financial periods commencing on or after 1 July 1999. Under this reporting framework, the accounting standards are mandated by law and the enforcement of the standards were 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 to monitor compliance with accounting standards of public listed companies, the CCM monitors compliance to all registered companies and the Central Bank is responsible to finance and banking companies. Accordingly, 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. In 2005, the MASB standards were renamed as FRS (Financial Reporting Standards) and renumbered to coincide closely with the numbering of IFRS as an effort to converge with IFRS for example FRS1 refers to IFRS1 and FRS2 refers to IFRS2. Prior to this, the approved accounting standards were known as MASB standards. Since 2006, the FRSs have been made identical to IFRS on a per standard basis. Effective 1 January 2012, the FRS were renamed as MFRS (Malaysia Financial Reporting Standards).

3. Research Method

This study uses both primary and secondary data. First, we review the archive reports published by the regulatory bodies to understand how the monitoring enforcement is conducted in Malaysia. The archive search includes examining the regulators’ annual reports, public circulants on the website, newspapers and business magazines. Second, we interview the representatives from regulatory bodies to get better understanding on how monitoring and enforcement of compliance with accounting standards are conducted in Malaysia. This is because interview is the best approach to get information that is not documented or not available in public.

A semi-structured format was used in this study because it gives interviewer sufficient flexibility to adapt questions in response to different circumstances and perspectives. The interviews were conducted in person by the same interviewer between February 2010 and March 2010. The interviews lasted between 30 to 50 minutes. Each interview was recorded and subsequently transcribed for review. Six representatives from the regulatory bodies agreed to participate in the interviews i.e. two participants from the SC and four participants from the Malaysian Institute of Accountants (MIA). All interviewees have at least five years experience in monitoring compliance with accounting standards. At the request of interviewees, their actual words are not quoted in this paper.

4. Findings

This section presents the findings from archive search and interviews with representatives of regulatory bodies.

4.1. Monitoring and Enforcement by Securities Commission (SC)

The monitoring of compliance with accounting standards is undertaken by the Securities Commission through the formation of the Financial Reporting and Compliance Surveillance Department (FRSC) in 1998. Since 1999, the SC has been given broad powers under the Securities Industry (Compliance with Approved Accounting Standards) Regulation 1999 of the Securities Industry Act (SIA) 1983, to direct the company, its director or chief executive to take the necessary rectifying actions, or to make the necessary announcements with regard to the non-compliance or rectification required. The Director or Chief Executive Officer of companies can also be fined up to RM 1 million or given up to five years’ imprisonment, or both, if committing such offence ([1]).

According to interviewees, monitoring of compliance with accounting standards was based on referral i.e. when the cases are referred by MIA, Bursa Malaysia or public complaints. It is impossible for the FRSC to review all the public listed companies’ annual reports due to constraints in budget and manpower. In the review process, only selective accounting standards were checked for compliance by the SC. Priority was given to the revenue accounting standard because they believed that companies might have tendency to manipulate the accounting revenue or be involved in fraud. The findings of the FRSC are published on the SC website with the objective to educate and create awareness among public listed companies to comply with the approved accounting standard.

A review of the convicted cases published by the SC from 2002 to 2010 showed that only five cases were convicted of a breach of accounting standards, where the companies were reprimanded and directed to rectify and reissue the respective financial statements. The companies were also
required to make an announcement to the Bursa Malaysia with respect to the rectification and reissuance of financial statements. Facts of convicted cases, name of companies and directors involved in the cases were also disclosed on the SC webpage. The five cases and actions taken by the SC are presented in Table 1 below.

Table 1. Convicted Cases Relating to Breach of Accounting Standards by Securities Commission

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Facts of Convicted Cases</th>
<th>Actions Taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>MEMS Technology Bhd</td>
<td>Financial statements for FYE2007 and 2008 did not comply with FRS18-Revenue; later it was discovered that there were fictitious sales of RM30.17 million in the financial statements.</td>
<td>The company was asked by the SC to rectify and reissue financial statements FYE2007 and 2008. Later, in 2010, the director and CFO were compounded RM300,000 each for fictitious sales.</td>
</tr>
<tr>
<td>2009</td>
<td>Talam Corp. Bhd</td>
<td>Misleading information relating to reclassification of RM90 million debtor in 2006 and 2007 financial statements. The company is considered as breaching FRS101-Presentation of Financial Statements.</td>
<td>The company was asked to rectify and reissue 2006 and 2007 financial statements.</td>
</tr>
<tr>
<td>2005</td>
<td>Oliocorp Bhd</td>
<td>Breach of FRS108 and FRS133 in 2004 financial statements.</td>
<td>The company was reprimanded and made to rectify and reissue the financial statements.</td>
</tr>
<tr>
<td>2005</td>
<td>Goh Ban Huat Bhd</td>
<td>Breach of FRS27-Consolidated Financial Statements and investment in subsidiaries in 2004 quarterly financial reports.</td>
<td>The company was reprimanded and made to rectify and reissue the financial statements.</td>
</tr>
<tr>
<td>2005</td>
<td>Aktif Lifestyle Corp. Bhd</td>
<td>Breach of FRS22-Business Combination in 2004 financial statements.</td>
<td>The company was reprimanded and made to rectify and reissue the financial statements.</td>
</tr>
</tbody>
</table>

Source: Securities Commission’s webpage (Enforcement)

From these five non-compliance cases, it is found that none of companies’ auditors were penalised by the SC. A review of published reports also revealed that the SC emphasizes more on fraud or fictitious sales (i.e. related to revenue accounting standards) rather than compliance with other accounting standards. According to the interviewees, the SC could not penalize the auditors in non-compliance cases because this was not covered under the current SC’s regulations. In this case, the convicted auditors would be referred to MIA for disciplinary action. However, the interviewees believed that the situation might change when the Audit Oversight Board (AOB) came into effect on 1 April 2010 because the AOB was under the auspices of the SC, and that endowed the SC with more authority to oversee the auditors.

Given the constraints in resources, the interviewees claimed that the proactive approaches were more appealing than punitive action in handling non-compliance with accounting standards in Malaysia. Among the proactive approaches adopted by the SC to encourage compliance with accounting standards are through discussions and dialogues conducted with the listed companies.

4.2. Monitoring and Enforcement by Malaysian Institute of Accountants (MIA)

The Malaysian Institute of Accountants (MIA) was established under the Accountants Act 1967 as a statutory body to regulate and develop the accountancy profession in Malaysia. In Malaysia, the word ‘accountant’ is protected under the Accountants Act 1967 (section 22 and 23), where the Act strictly prohibits non-members of the MIA from referring to themselves or using the designation of ‘Accountant’. The monitoring of compliance with accounting standards is undertaken by MIA through the formation of the Financial Statement Review Committee (FSRC). The FSRC not only monitor 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 and also referral cases by the Investigation Committee of the MIA, the Securities Commission, the Bursa Malaysia and the Central Bank of Malaysia. However, due to constraint in resources, the number of companies reviewed by the FSRC was also small, an average 30 companies per year. Moreover, beginning 2007, the MIA had given priority to the referral cases.

The common findings of non-compliance with statutory requirements and the approved of accounting standards from the review are published on the MIA’s webpage and also in the MIA’s magazine ‘Accountants Today’. It is found that although common mistakes have been disclosed in the report, the names of companies, directors and auditors convicted of non-compliance with accounting standards are not disclosed by the MIA. According to interviewees, the MIA did not disclose the names of companies, preparers and auditors convicted of non-compliance because this would contradict their main objectives, which were to educate their members (i.e. preparers and auditors) and to create awareness regarding compliance issues. One of the interviewees was also of the opinion that it would be unfair to members if their names were disclosed if the objective was only to educate or create awareness about the issue.

There are three types of penalty tariffs introduced by the MIA to deal with non-compliance with the approved accounting standards ([8]). The first category applies to minimal non-compliance issues (e.g. housekeeping issues), where the minimum 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: (1) members are required to take the necessary corrective action; (2) members are given a warning letter; and/or (3) if 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 MIA or other regulatory bodies for appropriate action or giving a warning letter or reprimanded. The company’s financial statements could be put under surveillance by the FSRC for up to four consecutive years. Table 2 presents the number of cases reviewed and actions taken by the FSRC.

On the question of which approach is the best to monitor compliance issue, the interviewees claimed that an educational approach was more appealing than punitive action in handling non-compliance with accounting standards in Malaysia. According to interviewees, preparers are more receptive to learn and improve the financial reporting by an educational approach compared to punitive action. Therefore they believed that the approach will give lasting impact to preparers in Malaysia. Nonetheless, the interviewees also highlighted that they had limited authority to enforce compliance with accounting standards to all preparers because the MIA could only enforce MIA members. The MIA could not penalize preparers who were not members of MIA, in which case it would be referred to the SC for action.

Apart from the questions on monitoring and enforcement mechanisms used, interviewees were also asked their views regarding the extent of compliance with IFRS of public listed companies in Malaysia.

The interviewees believed that the level of compliance with IFRS in Malaysia was high for the following reasons. First, they argued that the previous Malaysian accounting standards (i.e. MASB standards) had been based on the IFRS since 1978. Therefore, they believed that the Malaysian listed companies were familiar with IFRS and supposedly did not face major difficulties in coping with the IFRS requirements compared with countries that were adopting the IFRS for the first time.

Second, they claimed that Malaysian listed companies would comply with the IFRS because this was mandated in law, and companies would be penalised if they did not comply with accounting standards. They also argued that there were cases where the listed companies were penalised for not complying with accounting standards and the convicted companies being announced on the SC webpage.

Generally, the findings suggest that all interviewees did not view compliance with IFRS as presenting a major problem in Malaysia.

5. Discussion and Conclusions

From the findings discussed above, several weaknesses are identified in monitoring and enforcement of compliance with accounting standards.

First, constraints in budget and manpower are the main limitations highlighted by interviewees. Because of these constraints, monitoring of compliance by the SC has been based on referrals and not all accounting standards are subject to review by the SC, whereby priority has been given to revenue accounting standard. Therefore, it is not surprising when we found only a few convicted cases with respect to non-compliance with accounting standards were reported from 2002 to 2010. On one hand, the findings may indicate that the enforcement of compliance with accounting standards or IFRS is lax in Malaysia. On the other hand, one may also argue that few convicted cases with respect to non-compliance with IFRS imply that the level of compliance with IFRS in Malaysia is high. However, the findings by prior studies ([2],[7]) perhaps may not support this second view because these studies showed that the level of compliance with certain IFRS by public listed companies in Malaysia were poor. Further, a study by[2] also showed that none of the examined companies received qualified audit opinion despite their significant non-compliance with IFRS disclosure requirements. These studies have demonstrated that even though compliance with accounting standards is mandated in law, it does not guarantee its compliance by listed companies.

Second, although the MIA has also conducted a regular review of financial statements of public listed companies, enforcement of compliance by MIA is restricted to their

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Cases Reviewed</th>
<th>No. of Convicted Cases</th>
<th>Actions Taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>28</td>
<td>6</td>
<td>4 cases were penalised whereby a warning letter was issued to preparers and auditors. 2 cases were referred to the Investigation Committee for further action.</td>
</tr>
<tr>
<td>2009</td>
<td>17</td>
<td>2</td>
<td>1 case was issued a warning letter. 1 case was referred to the Investigation Committee for further action.</td>
</tr>
<tr>
<td>2008</td>
<td>27</td>
<td>16</td>
<td>16 cases were referred to the Investigation Committee for further action.</td>
</tr>
<tr>
<td>2007</td>
<td>34</td>
<td>2</td>
<td>2 cases were referred to the Investigation Committee.</td>
</tr>
<tr>
<td>2006</td>
<td>29</td>
<td>7</td>
<td>7 cases were referred to the Investigation Committee.</td>
</tr>
</tbody>
</table>

Source: Annual Reports of MIA (2006-2010)

4.3. How do the Regulators Perceive Compliance with IFRS in Malaysia?
members only. Furthermore, the approach taken by MIA in not disclosing the names of members convicted for non-compliance cases casts doubt on whether it can effectively promote compliance with accounting standards. It is highly likely this approach provides less incentive for preparers to comply and for auditors to maintain their independence, knowing that the consequences of non-compliance remain invisible from the public.

Third, while the interviewees indicate that the constraint in resources has limited the regulators’ capabilities in monitoring compliance with accounting standards, it is also possible that their positive perceptions regarding the level of compliance in Malaysia also contribute to the lenient approach adopted by the regulators in monitoring compliance. This is because the way people perceive a certain issue would also influence their conduct on that issue ([5]). To assume that companies will comply with mandatory requirements may not necessarily true because in the lenient regulatory environment, companies are unlikely to comply if they perceive that the consequences of non-compliance are not serious ([14]).

In summary, the findings of this study suggest that, although compliance with accounting standards is mandated in laws, the activities of enforcement agencies to ensure full compliance with accounting standards are lax and insufficient. This study has also highlighted several weaknesses in the current regulatory enforcement that might provide insights for regulators and policy makers to improve the monitoring approach to ensure companies fully comply with IFRS.

Nevertheless, this study is not without limitation. The findings from interviews with regulators are limited by yielding only general information because of confidential issues that cannot be raised by the interviewees.

Findings could be more valid and of greater interest if the researchers could access and use internal information from the SC and MIA files, such as their working papers and correspondence.

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REFERENCES


