International Journal of Innovation, Creativity and Change. www.ijicc.net
Volume 5, Issue 2, Special Edition, 2019

Financial Statement Effects of FRS Adoption in Malaysia

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This paper examines the impact of adopting Financial Reporting Standards (FRS) on listed companies in Malaysia. This study uses a sample of 100 top market capitalisation over a five-year period before and a five-year period after the adoption of FRS in Malaysia. It examines the quantitative effects by investigating whether the financial statements prepared under the post FRS period are more relevance as compared to the pre FRS period. The results reveal that most of the accounting figures have increased after the FRS adoption period. This indicates that adoption of FRS increase transparency and consequently the quality of financial reporting in Malaysia. The results of the study contribute to the existing literature in the field FRS adoption on accounting figures and financial ratio in Malaysia.

Key words: *Financial Reporting Standard, IFRS Adoption, Malaysia.*

Introduction

The globalization of financial markets had led to the need to have a common language for financial reporting that has become more widespread (Jeanjean & Stolowy, 2008). One of the ways to achieve this is to implement International Financial Reporting Standards (IFRS) issued by the International Accounting Standard Board (IASB) as a common language for financial reporting. During recent years, the adoption of IFRS has gained increased support from tinternational organisations and countries worldwide. Many countries have adopted IFRS or developed their local accounting standards based on IFRS. As of today, more than one hundred countries around the world have agreed to converge with the IFRS (IFRS Foundation, 2018). Since 2005, the member states of European Union (EU) and Australia have adopted IFRS. In recent years countries like China, India, Arab Saudi and Japan have also moved into IFRS convergence.

In Malaysia, starting from 1 January 2005, the Malaysian Accounting Standards Board (MASB) accounting standard was renamed to Financial Reporting Standards (FRS) to reflect Malaysia's commitment to align with global accounting standards. Companies in Malaysia are required to implement all the Financial Reporting Standards (FRS) issued by the MASB from 1 January 2006. IFRS supporters claim that a single accounting standard would increase transparency and consequently the quality of financial reports would be increased (Jeanjean & Stolowy, 2008). Lin, Ricardi and Wang (2017) stated that IFRS adoption will also increase financial statement comparability.

In recent years, several studies have examined whether the policy adoptions have achieved their main purpose, that is to give comparable and more transparent financial information (Harris, Lang & Moller, 1994; Niskanen, Kinnunem & Kasanem, 2000; Jermakowicz, 2004; Callao, Ferrer, Jarne & Lainez, 2007; Iatridis, 2010; Terzi , 2013). Previous studies, however, have produced mixed findings however most of the studies were researched in developed countries, for examples in the European Union (EU) countries, US and New Zealand. Thus, there is a need to conduct the study in a developing country like Malaysia.

In Malaysia, limited studies have been documented in the field of IFRS adoption. Among them are Tan, Lazar & Radiah (2007) and Sidik & Rahim (2012). However, these studies do not relate IFRS adoption with accounting figures and financial ratios. Kadri, Aziz & Muhd (2009) and Mohamad Sabri & Norman (2010), examined the value relevance of IFRS adoption in Malaysia. However, their studies are only limited to certain sectors and thus cannot be generalised to other sectors. To address the gap, we study the impact of the implementation of FRS on Malaysian public listed company financial reporting by focusing on companies that adopted FRS (between 2007 to 2011) and compare it with companies that adopt MASB accounting standards (between 2001 to 2005). In other words, this study examines a five-year period before and five-year period after the official adoption of FRS. The aim is to examine the financial statement effects of FRS adoption in Malaysia. The results are useful to the investors, accounting standard setters and regulators. It will provide them with evidence on the financial reporting quality. Apart from that, this paper will also contribute to the literature on the effects of IFRS adoption from the perspective of quantitative data i.e. the accounting figures and financial ratios.

The remainder of the paper is organized as follows. The next section presents the relevant previous literature review. Section 3 describes the sample, variables analysed, hypotheses to study and methodology. Section 4 discusses the results of the impact of IFRS on financial statements which concerns with the impact of IFRS on the relevance of financial information. Finally, in the last section, the conclusions of the study are presented.

Literature Review

IFRS Convergence

Currently, there is a worldwide trend towards converging local accounting standards with the IFRS that are issued by the IASB. These standards are now being used by various countries around the world. Emerging economies such as Korea, India and Canada have announced IFRS convergence by 2011 (Accountants Today, 2008). China, another example of an emerging economy has also substantially converged their national standards with IFRS (IFRS Foundation, 2018). Based on the survey by Deloitte Touche Tohmatsu (2012), more than one hundred countries around the world have either adopted or intend to adopt the IFRS for their domestic companies.

Several researchers (Goodrich, 1982; Nobes, 1992) have found a number of reasons that caused international differences in financial reporting systems by various jurisdictions. Among them are different legal systems, culture and funding sources. These differences are demonstrated through various accounting practices and reporting for items such as goodwill, depreciation, pensions and leases. Further, users and investors mqy find it difficult to compare the financial performance of companies in different countries around the world. Hence, a common set of accounting standards is needed for a better standardised reporting. As noted by Lazar, Tay & Othman (2006), a common set of reporting standards will allow more transparency, understanding, competitiveness and comparability of financial statements as presented by various jurisdictions.

The need for a global financial reporting language is also evident especially with the current explosion in the use of information and communication technology (ICT) which clearly reveals that nations around the world operate in a global village (Jacob & Madu, 2004). In addition, there has also been a rise in the number of regional trading blocks such as European Union (EU), NAFTA, etc. which has pushed international trade to a higher level. Multinationals and transnational corporations are also expanding their strategic alliances to suppliers outside their home countries especially in the areas of e-commerce and e-procurement (Jacob & Madu, 2004).

International Accounting Standards Committee (IASC) in its first 25 years of establishment had not made a significant impact in the area of the harmonisation of global corporate financial reporting. As highlighted by Jacob & Madu (2004), the old IASC structure was itself an impediment to the development of global accounting standards that would eventually be accepted by nations constituting the major capital markets around the world. IASC restructured itself into IASB in 2001 to challenge the production of a single set of global accounting standards known as IFRS by working together with the regulators and standard setters of other countries (Ahmed, Majid & Zin, 2016; Ali & Haseeb, 2019; Haseeb, Abidin, Hye, & Hartani, 2018; Haseeb., 2019; Suryanto, Haseeb, & Hartani, 2018)

In pursuit of its goal to produce a single set of global accounting standards, the IASB works in close cooperation with stakeholders around the world, including investors, national standard-setters, regulators, auditors, academics, and others who have an interest in the development of high-quality global standards. Progress toward this goal has been steady. All major economies have established time lines to converge with or adopt IFRSs in the future. The international convergence efforts of the organization are also supported by the Group of 20 Leaders (G20) who, at their September 2009 meeting in Pittsburgh, US, called on international accounting bodies to redouble their efforts to achieve this objective within the context of their independent standard-setting process. In particular, during the meeting, the G20 leaders had asked the IASB and the US FASB to complete their convergence project (IFRS Foundation, 2012; Asif,et.al 2018).

All member states of the EU are required to use IFRSs as adopted by the EU for listed companies since 2005. Australia has required the usage of IFRS for all private sector reporting entities and as the basis for public sector reporting since 2005. Canada has required all its listed entities to use IFRS in their preparation of financial statements from 1 January

2011. Private sector entities including not-for-profit organizations are also permitted to use IFRS in their preparation of financial statements in Canada (IFRS Foundation, 2012).

In Malaysia, MASB was established under the Financial Reporting Act 1997 and is the sole independent authority body that was given mandate to issue and develop accounting standards in Malaysia. Since 1997, companies have had to comply with the accounting standards issued locally by the MASB known as MASB standards. In 2005, MASB renamed and renumbered all the accounting standards as FRS to be in line with the accounting standards issued by the IASB. Lazar, Tay & Radiah (2006) commented that the move by MASB to adopt IFRS indicates that Malaysia's commitment to align with global accounting standards in order to converge to one common set of accounting standards for the entire developed world in this age of cross-border trading. As a result, starting from 1 January 2006, Malaysian companies are required to implement all the FRSs issued by the MASB.

IFRS Adoption and Its Impact

According to Eichhorst et al. (2002), changing accounting standards may not sound strategic, however it may change fundamentally the way that businesses are run, the way the business success is measured, and the information and records that companies need to maintain. The implementation of the FRS affects the business operations where the business organisations have to migrate from their existing accounting practices to a new set of standards (Cope & Clark, 2003). Accounting procedures and treatment, legal matters, information systems, human resources, taxation issues and investors relations are among the wide range of functions that are affected due to this convergence. Thus, the implementation of new FRS has significant impact on the financial reporting and the corporation itself.

Studies have shown that size, profitability and leverage are the most influential factors that influence the decision to provide voluntary IFRS-based disclosures (Dumontier & Raffournier, 1998; Glaum, 2000; Tarca, 2004). Gassen & Sellhorn (2006) on the other hand found that international exposure and dispersion of ownership were the motivating factors for the voluntary IFRS-based disclosures. Several prior studies from other countries have suggested that adoption of IFRS standards is usually related to several benefits. For example, Leuz & Verrecchia (2000) found that in Germany, the shift from local GAAP to IFRS reduces cost of capital. Leuz (2003) also suggested that potential long-term benefits of IFRS adoption may include lower cost of capital, positive valuation effect, increased shareholder base and trading volume.

According to the past Chairman of MASB, Dato' Zainal Abidin Putih (MASB, 2004), the change to IASB standards would enhance the quality of reporting thus results in greater reporting transparency in Malaysia. A study by Barth, Landsman & Lang (2005) in USA found out that IFRS adoption increases firms' financial reporting quality. In Malaysia, Tan et al., (2007) studied the level of adoption of FRS among Malaysian listed companies using questionnaires. Their findings revealed that only 71.6 percent of the companies listed in the Bursa Malaysia had fully adopted FRS in 2006. Due to this poor response rate, they suggested that future research should be generated through a study of the annual reports instead of using the questionnaire.

Aljifri & Khasharmeh (2006) examined the suitability of the implementation of IFRS) from the perspective of developers of major companies in United Arab Emirates (UAE). Their findings suggested that among the advantages of adoption of IFRS as stated by the respondents are "enhanced comparability of financial statements", "improved perception of accounting profession across the world" and "provision of better information for government economic planning". In Bahrain, Joshi, Bremser & Al-Ajmi (2008) found that most of the respondents who are accountants and auditors perceived that applying IFRS would lead to greater comparability of financial performance, followed by greater relevance, reliability and transparency of financial information of companies.

Adopting IFRS also improves access to foreign capital. El-Gazzar, Finn & Jacob (1999) suggested that firms voluntarily comply with IFRS in order to obtain greater exposure to new financial markets. Anticipation of improved communication with information users is also reported to be one of the motivations to use IFRS (Tarca, 2004). Findings based on Finnish data suggested that the predecessor of IFRS, International Accounting Standards (IAS) helped firms to supply information that met foreign investor's information needs (Kinnunen, Niskanen & Kasanen, 2000).

Bhattacharjee & Islam (2009) highlighted the vulnerability of small investors which has been a long time established problem and has been a big impediment for stock market development in Bangladesh. IFRS adoption which improves financial reporting quality helps small investors to compete better with informed professionals and hence reduces their trading risk. Several researchers have studied the effect of IFRS on accounting figures based on financial statements. Callao et al., (2007), analysed the impact of the European Union's adoption of IFRS on different aspects of Spain accounting models. They found 5 out of 16 balance sheet items and 6 out of 9 ratios changed significantly. Ormrod & Taylor (2004) studied UK companies' impact of the change to IFRS on companies' debt contracts. They found changes in reported profits and balance sheet amounts. Iatridis (2010) investigated the impact of the implementation of the IFRS on key financial measures of UK firms and the volatility effects of IFRS adoption. This finding suggested that the IFRS implementation has favourable effect on the financial performance (e.g. profitability and growth potential) of UK companies.

Callao et al. (2010) assess the quantitative impact of mandatory IFRS adoption on financial reports issued by first-time adopters and analyse whether IFRS make financial information more relevant for decision making in Spain and the UK. They found that the IFRS application for Spanish first-time adopters causes a higher value on assets and liabilities and a diminished financial position in reference to liquidity, solvency and indebtedness. As far as the UK is concerned, the financial statements of UK firms adopting IFRS causes increase in fixed and total assets, long- term liabilities, short-term liabilities, operating income, net income, indebtedness and return on equity while the current assets, equity and solvency decreases. In conclusion, the UK firms' financial statements display worse financial position in reference to solvency and indebtedness. However, the UK firms' profitability improved after IFRS adoption.

Iatridis & Rouvolis (2010) examined the impact of the adoption of IFRS on the financial performance of firms listed on the Athens Stock Exchange. Their study showed that firms tended to exhibit lower key accounting measures in the first year of adoption which was in 2005. However, firms displayed improved financial measures in the subsequent year. In addition, they also found that the scope for earnings management was significantly reduced in the post adoption period as compared to the pre adoption period. Their findings also showed that the use of IFRS appeared to lead to accounting measures with higher value relevancy.
Terzi et.al, (2013) studied the impact of IFRS adoption on listed companies in Turkey. They discovered that the financial statements prepared in accordance to local GAAP and IFRS were statistically different in terms of inventories, fixed assets, long term liabilities and shareholders' equity.

Studies also suggest capital market also benefits following adoption of IFRS, even in countries with strong investor protection and so-called high quality financial reporting and enforcement. Chalmers et al. (2011) report an increase in the value relevance and the persistence of earnings when IFRS were adopted in Australia. Bissessur & Hodgson (2012) observe a decrease in synchronicity in the Australian market in the first two years post IFRS (which became higher in 2007-2008). Bissessur & Hodgson (2012) and Cotter et al. (2012) find lower forecast error post IFRS in Australia. In India, Katta (2016) noted that the adoption of fair value accounting and strict requirement in following the accounting standards have strengthened the financial indicators and provided the users with a transparent, true and fair accounting information.

Cheong, Kim & Zurbruegg (2010) conclude that capitalisation of intangibles under IFRS provides value relevant information for companies from Australia, Hong Kong and New Zealand. Bayerlien & Farooque (2012) report greater comparability of policy choices for deferred tax and goodwill under IFRS for firms from Australia, the UK and Hong Kong. Brochet et al. (2011) also report improved comparability post IFRS for UK firms, based on the proposition that private information is reduced after IFRS adoption. Zéghal Chtourou & Sellami (2011) report use of IFRS is associated with less earnings management for French firms during the period 2003-2006, particularly for firms with higher corporate governance and more involvement in foreign financial markets. A study by Barth, Landsman & Lang (2008) examine whether application of IFRS is associated with higher accounting quality on firms in 21 countries. Their findings suggested less evidence of earnings management, more timely loss recognition and greater value relevance of accounting amounts. Lee & Fargher (2010) show IFRS adoption in Australia is associated with an increase in the level of investment in foreign equities by Australian investors.

Despite the benefits of adopting IFRS, the new FRS would result in greater volatility of company results (PWC Alert, 2005). This is due to the adoption of fair-value accounting in business combinations, share-based payments, assets held for sale and equity and debt investments in the new FRS regime. Thus, it will introduce significant volatility in the balance sheet and also in earnings. Iatridis (2010) found that following the fair value orientation of IFRS, the transition to IFRS appears to introduce volatility in income statement figures of the UK firms. Tan et al. (2007) commented that the transition to FRS represents one of the biggest challenges to Malaysia reporting entities. This is because adoption to FRS will mean adopting a new set of accounting standards (Cope & Clark, 2003). Apart from this, the preparers of the accounts will be the most affected as adoption of FRS will dramatically change the way financial statements are prepared (Ravlic, 2005).

In another study conducted in Belgium by the Belgian Commission of Banking, Finance and Insurance (CBFA, 2004) a survey of 73 listed Belgian companies, examined the difficulties and costs in relation to convergence with IFRS. Although a majority of the firms (62 per cent) stated that they have no problems in obtaining the necessary data to report under IFRS, the respondents find it costly to implement IFRS and the estimated costs of convergence for the BEL-20 companies ranged between 600 thousand and 6.2 million Euro. Moreover, only 22 per cent of the respondents stated that the value added of IFRS financial statements is positive for the majority of users of financial statements.

Research Hypothesis

This study examines the financial statement effects following the FRS implementation in Malaysia. This is done by assessing the effects of adoption on the key financial measures (Iatrisis, 2010). Previous studies (Callao et al., 2007; Callao et al., 2010; Iatridis & Rouvolis, 2010) found that the move to IFRS have a considerable impact on the accounting figures and financial ratios. Following that, the hypothesis is:
H1: The financial results reported under the FRS are significantly different than those reported under pre-FRS accounting standards.

Research Design
Sample Selection

The sample for this study is the companies that are listed in the Bursa Malaysia for the year 2001 to 2011. The basis of company selection is based on the 100 top market capitalization as at 31 December 2011. Accounting and financial data were collected from DataStream. Annual reports were also used when the researchers were unable to obtain data from the DataStream. To investigate the effect of FRS adoption on the company information environment, differences before and after FRS adoption were tested. The years 2001 to 2005 was chosen to represent the period for pre-adoption of FRS and the years 2007 till 2011 to represent the period of post-adoption of FRS. 2006 was excluded because it was the first year where companies in Malaysia were subjected to the adoption of FRS. Companies that provide financial services such banks, other financial institutions or insurance services were also exclude due to their specialised and regulated nature. This is in line with other previous studies on IFRS adoption (Mohamad Sabri & Norman, 2010; Iatridis, 2010). The selection of the final sample top 100 companies is shown in Table 1 below.

Table 1: Summary of sample selection procedure

Selection criteria	No of firm
Listed companies in Bursa Malaysia based on the 100 top market capitalization as at 31 December 2011	100
- Firms with incomplete data	(3)
- Firms that are in financial sector	(3)
	94
+ Next top 100 companies	6
Total number of companies used in the study	100

The Model

Models for Differences of Accounting Figures and Financial Ratios

The objective of our study is to analyse the impact of FRS on the financial reports issued by the firms in Malaysia. The significant differences in the values for each variable using relative impact were tested as has been used in Callao et al., (2010) study.

The formula is as follow:

$$\text{Relative Impact} = \frac{\text{Post Value} - \text{Pre Value}}{\text{Pre Value}}$$

where:

Post Value = Value for selected balance sheet items, income statement items, and the financial ratios during year 2001 to 2005

Pre Value = Value for selected balance sheet items, income statement items, and the financial ratios during year 2001 to 2005

The hypothesis is further tested using Wilcoxon signed-ranks test. Based on the number of positive and negative ranks, as well as the sum of ranks of each sign provided by the Wilcoxon signed-ranks test, we can determine the results.

Variables

For this study, several accounting figures that were obtained from the companies' financial statements i.e. the income statement and the statement of financial position were selected. The selected accounting figures and financial ratios were also used in the previous studies (Callao et al., 2010; Iatridis, 2010; Terzi et al., 2013; Hussain et al., 2018). In total, 11 selected variables are measured and are shown in Table 2 below.

Table 2: Accounting figures and Financial ratios

Definition	
Accounting figures	Source
Profit Before Interest and Tax (PBIT)	Income Statement
Total Asset (TA)	Statement of Financial Position
Fixed Assets (FA)	Statement of Financial Position
Current Assets (CA)	Statement of Financial Position
Current Liabilities (CL)	Statement of Financial Position
Long Term Liabilities (LTL)	Statement of Financial Position

Total Equity (TE)	Statement of Financial Position
Financial ratios	
Return on Capital Employed (ROCE)	Profitability
Current Ratio	Liquidity
Earnings Per Share (EPS)	Investment Returns
Total Debts to Equity	Solvency

Results and Discussion

This section will discuss the results of the study. Firstly the hypothesis result is presented followed by discussion.

Descriptive Analysis Statistics for Hypothesis

As stated in the previous section, the first aim of this study is to compare the effect of IFRS adoption in accounting figures and financial ratios of Malaysian companies. Results obtained related to this issue is explained in this section. The descriptive statistics as per Table 3 below presents the comparison between accounting figures and financial ratios for pre FRS adoption and post FRS adoption. Table 3 shows that most of the figures were higher during the post FRS adoption period except for current ratio, EPS and total debt to equity.

Table 3: Descriptive Statistics for Accounting Figures and Financial Ratios

Variable	*Panel A: Pre FRS Adoption (2001-2005)*			
	Min	Max	Mean	Std Dev
PBIT	-391634	2922580	271255.57	565786.124
TA	197553	59696640	4452685.70	9562551.631
FA	5076	51782820	2722484.55	7805431.561
CA	13269	8603020	1137282.73	1754027.276
LTL	0	27220960	1223674.70	4089147.646
CL	7612	6894620	848653.70	1415775.661
TE	131709	43860100	3280162.35	7138962.053
ROCE	-0.18	0.77	0.11	0.13
Current Ratio	.35	22.10	2.47	2.83
EPS	-2.45	2.38	0.14	0.41
Total Debt to Equity	.00	1.67	0.20	0.23

	Panel B: Post FRS Adoption (2007-1011)			
	Min	Max	Mean	Std Dev
PBIT	-152922	4054500	503000.78	757747.082
TA	256019	71507180	7285140.24	13040201.630
FA	2906	58141840	3673609.75	9313819.489
CA	65319	19273620	2315459.22	3432695.356
LTL	0	20106360	1669823.43	4202864.488
CL	9795	10639780	1568436.65	2434980.845
TE	185091	47702640	5139400.59	9300823.279
ROCE	-0.08	1.09	0.16	0.18
Current Ratio	.40	19.03	2.59	2.58
EPS	-0.34	2.62	0.34	0.36
Total Debt to Equity	.00	1.06	0.20	0.19

Results from Wilcoxon signed ranks test for the hypothesis are presented in Table 4 below. The hypothesis is rejected for 9 variables at 5 per cent level. All the accounting figures as contained in the income statement and statement for financial positions and also two financial ratios present statistically significantly differences. Among financial ratios, only current ratio and total debt to equity ratio do not display significant differences. Based on the ranks as provided by the Wilcoxon test, the financial statements of the Malaysian companies adopting FRS from 2007 to 2011 show higher level of net income, assets, liabilities and equities. This indicates that adopting FRS had significant impacts on the quality and comparability of financial reporting in Malaysia. The results are also consistent with the previous study (Callao et al., 2007; Iatridis, 2010 and Terzi et al., 2013).

Table 4: Results of Wilcoxon signed ranks test

Variables	Z statistics	Asymp. Sig (2 tailed)	
PBIT	-7.282	0.000*	
TA	-7.623	0.000*	
FA	-4.611	0.000*	
CA	-7.743	0.000*	
LTL	-3.986	0.000*	
CL	-7.179	0.000*	
TE	-7.358	0.000*	
ROCE	-5.549	0.000*	

Current Ratio	-1.626	0.104	
EPS	-7.915	0.000*	
Total Debt to Equity	-0.966	0.334	

Conclusion

In this study, we analysed the differences between pre and post adoption of FRS based on the financial statements of 100 companies listed on the Bursa Malaysia. The results revealed that most of the financial statement figures have increased in the post adoption period and the changes are statistically significant. This indicates that the move made by the MASB to adopt IFRS has improved financial reporting quality. This study however, is subject to several limitations. First, in the analysis only the first 100 companies that are listed in the Main Board are included and therefore, the sample size was limited as it covers only the public listed companies. Secondly, the impact of each FRS on the accounting figures and financial ratios was not investigated. Future studies should consider these issue by investigating the reasons behind the findings of this research.

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