

# Financial Statements Review Committee (FSRC) Key Observations

THE MALAYSIAN INSTITUTE OF ACCOUNTANTS' FINANCIAL STATEMENTS REVIEW (FSR) FUNCTION SERVES TO ENSURE THAT THE QUALITY OF FINANCIAL INFORMATION PRESENTED WITHIN FINANCIAL REPORTING MEETS WITH REQUIRED STANDARDS.

**U**nder this function, MIA monitors compliance with statutory and other requirements, approved accounting standards and approved auditing standards in Malaysia in relation to financial reporting and shares with members of MIA financial reporting best practices based on common findings identified during the review process.

The review is carried out by MIA's Financial Statements Review Committee (FSRC). The FSRC hereby shares with readers the results of the review by highlighting the common findings which have been noted arising from its review of the financial statements of selected listed companies during the period from July 2009 until June 2010.

## Statistics

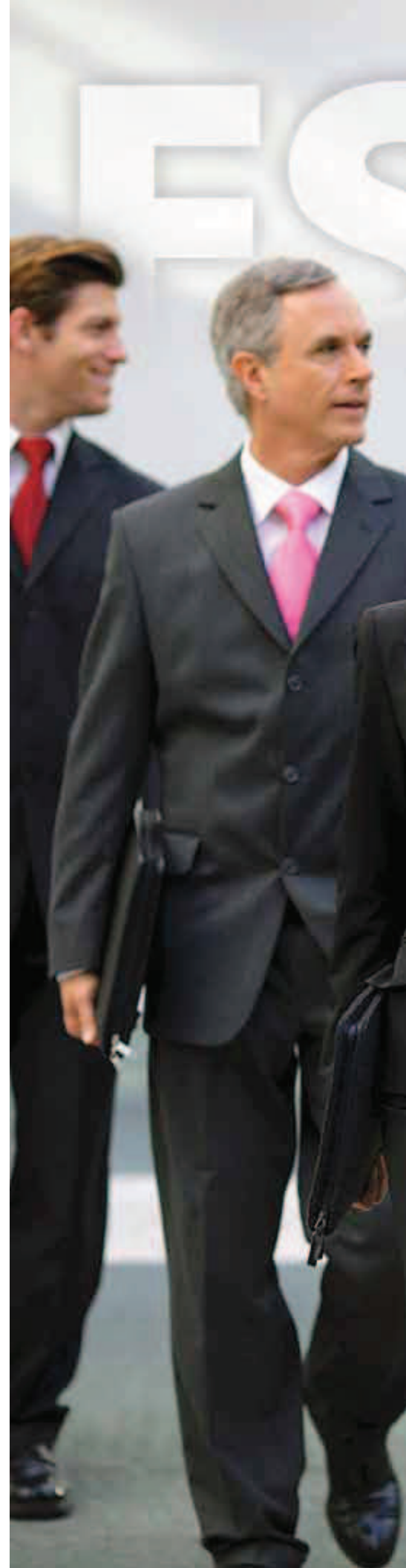
For the period from July 2009 until June 2010, the FSRC closed 11 cases brought forward from the previous review period and selected another 19 financial statements of listed companies for review. The

financial year-ends of the relevant financial statements ranged from 31 December 2007 to 30 June 2009. A total of 48 replies to queries raised by the Committee were deliberated during the period under review. The FSRC also looked at seven public interest cases.

During the year under review, the FSRC referred two cases to the Investigation Committee (IC); and has categorised four cases as Category 2 of the penalty tariff, whereby warning letters were issued to the respective preparers and auditors for non-compliance with the requirements of FRS. The financial statements of such companies will also be monitored for up to two consecutive years.

## Observations

A summary of the findings noted by the FSRC during the period under review is in **Table A**. It should be noted that this summary only tabulated those deficiencies that are more commonly noted by the Committee during the review process.



**THE FSRC DRAWS PARTICULAR ATTENTION TO THE FOLLOWING:**

- **DISCLOSURE OF MANAGEMENT JUDGEMENTS AND KEY ESTIMATION UNCERTAINTIES**
  - Objective of the disclosure required by FRS 101 “Presentation of Financial Statements” is that the information disclosed must help users of financial statements to understand the judgements made by management when there is estimation uncertainty.
  - Disclosures that are boiler-plate and limited provide little insight into the impact of reasonably possible alternative assumptions on the entity’s financial position.
  - The FSRC observed that disclosure that should be made which include items such as sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity are often omitted.
  - Directors are encouraged to be more candid about the key sources of the uncertainties they encountered and identify the specific consequences to the financial position.
  
- **CLASSIFICATION OF CASH FLOW MOVEMENT**
  - The FSRC noted in many instances, advances given to subsidiary companies for their working capital purposes have been erroneously disclosed as changes in working capital in the company’s cash flow statement.
  - The nature of the amount due from/(to) subsidiaries or other related companies should be analysed from the Company’s perspective and not how the other entity utilises the advances given.
  - If the transaction is non-trade in nature, then the cash movement should be reflected as investing or financing activities accordingly in the cash flow statements of the parent, instead of reporting the net movement as working capital changes.
  - Similarly, in the respective financial statements of the subsidiaries, the advances to the parent or related company should be evaluated from the subsidiaries’ perspective in determining the classification in the subsidiaries’ cash flow statements.





● **ANALYSIS OF NATURE OF EXPENSES**

- Nature of all expenses should be analysed and disclosed, despite companies having chosen to present classification of expenses by function in the income statement.
- Analysis of expenses by nature requires disclosure of expenses by the type of costs incurred, not the activity the cost supports. For example, disclosure of “cost of sales” or “property development costs” by itself, is not sufficient.
- Examples of nature of expenses that could be considered for disclosure include raw materials and consumables used, subcontract costs, upkeep and repairs of assets, utilities and telecommunication expenses, advertisement expenses etc.
- Classification and selection of the nature of expenses for disclosure is judgemental and dependent on the activities and operation of each entity; and judgement is required in the process to determine a disclosure that best suit the entity.

● **BUSINESS COMBINATIONS**

- The FSRC reminds that there is a need to identify “business combinations”, before the method of accounting in FRS 3 “Business Combinations” is applied.
  - A business combination is the bringing together of separate entities or businesses into one reporting entity; i.e. the coverage is wider than acquisition of a Sdn Bhd or Berhad
  - The definition of “business” must be met. A busi-

ness is defined in FRS 3 as an integrated set of activities and assets conducted and managed for the purpose of providing a return to investors; or lower costs or other economic benefits directly and proportionately to policyholders or participants.

- If an entity obtains control of one or more entities that are not businesses, the bringing together of those entities is not a business combination. Examples include acquisition of a company which owns a land bank with no development activities may not be a business combination under FRS 3.
- FRS 3 requires the acquirer to allocate the cost of a business combination by recognising the acquiree’s identifiable assets, liabilities and contingent liabilities at their fair values at acquisition date.
  - The process includes identifying and recognising intangible assets of the acquiree, separately from goodwill, at the acquisition date when it meets the definition of an intangible asset in FRS 138 “Intangible Assets” and its fair value can be measured reliably; despite the acquiree not having recognised such intangible assets. Examples include acquiree’s customer contracts.
  - Estimates may be required to measure the fair value of intangible assets, and there could be a range of possible outcomes with different probabilities for the fair value. Paragraph 35 of FRS 138 states that this does not demonstrate an inability to measure

Areas for improvement	Findings noted
Going Concern	<p>Queries were raised on whether going concern assumption has been considered by the management and the auditors when the financial statements showed signs of deteriorating financial position. (FRS 101.23 and ISA 570)</p> <p>Non-disclosure of material uncertainty on going concern. (FRS 101.23)</p> <p>Inadequate disclosure on management's plan in dealing with material uncertainty on going concern. (FRS 101.23)</p>
Judgements in applying accounting policy and key sources of estimation uncertainty	<p>Key sources of estimation uncertainty is generic and did not reflect circumstances specific to the company. (FRS 101.116 and FRS 101.120)</p> <p>Often bland and uninformative.</p> <p>Significant judgement in applying policy not identified for disclosure. (FRS 101.113)</p> <p>Sensitivity analysis not provided. (FRS 101.120)</p>
Business Combinations	<p>Did not fair value acquiree's identifiable assets, liabilities and contingent liabilities at acquisition date. (FRS 3.36)</p> <p>Non-disclosure of factors contributing to goodwill. (FRS 3.67(h))</p> <p>Non-disclosure of both amounts recognised at acquisition date of acquiree's assets, liabilities, contingent liabilities and carrying amounts, in accordance with FRS, immediately before the combination. (FRS 3.67(f))</p> <p>Revenue and profit or loss of combined entity as though business combination effected at the beginning of the period not disclosed. (FRS 3.70)</p> <p>Information on the nature and financial effect is disclosed for all the business combinations during the year instead of in respect of each business combination. (FRS 3.67)</p>
Impairment of investments in subsidiary company/associated company/other investment/goodwill/intangible assets	<p>Inadequate disclosures when there is material impairment loss recognised. E.g. non-disclosure of whether the recoverable amount is fair value less costs to sell (FVLCTS) or value in use (VIU), basis of determining FVLCTS, discount rate(s) used in determining VIU. (FRS 136.130 (d) – (g))</p> <p>When impairment is being recognised or reversed, no disclosure of circumstances that led to the recognition or reversal of impairment. (FRS 136.130(a) and FRS 136.131(b))</p> <p>Cost of investment in subsidiary company or associated company was impaired, but recoverability of amounts due from these companies not carefully evaluated.</p> <p>Disclosure of estimates (e.g. assumptions, growth rate etc) used to measure recoverable amounts and the impact of a reasonably possible change in a key assumption has been omitted. (FRS 136.134(d)-(f)).</p> <p>Disclosure of estimates used to measure recoverable amounts of cash generating units (CGU) containing goodwill or intangible assets with indefinite useful lives is generic and not specific to the specific CGU. (FRS 136.134)</p> <p>Impairment of quoted investment classified as current assets not reversed despite market value improved and the accounting policy is to account for such investments at lower of cost and market value. (FRS 125.46(b)) Beginning from 1 January 2010, FRS 139 "Financial Instruments: Recognition and Measurement" will be effective. Hence, the measurement principles in accordance with FRS 139 would be applicable in place of FRS 125.</p>
Intangible Assets	<p>Non-disclosure of reasons for supporting intangible assets as having indefinite useful life. (FRS 138.122(a))</p>
Deferred Taxation	<p>Non-disclosure of deductible temporary differences, unused tax losses and unused tax credits of which no deferred assets are being recognised. (FRS 112.81(e))</p> <p>Non-disclosure of nature of evidence supporting recognition of deferred tax assets. (FRS 112.82)</p>
Cash flow statements	<p>Non-disclosure of major classes of gross cash receipts and gross cash payments separately that arose from investing and financing activities. (FRS 107.21)</p> <p>Movement in advances to/from subsidiaries disclosed as "operating cash flow" in the parent's cash flow statement, instead of "investing/financing cash flow". (FRS 107.6, FRS 107.16 &amp; FRS 107.17)</p>
Presentation of financial statements	<p>Nature of expenses not adequately analysed, particularly the nature of expenses included in the cost of sales. (FRS 101.93 and FRS 101.94)</p> <p>Material components included within other receivables and other payables are not disclosed. (FRS 101.74)</p> <p>Nature and purpose of each reserve within equity are not disclosed. (FRS 101.76)</p>
Employee Benefits	<p>Defined benefit plan being disclosed as defined contribution plan despite criteria of defined contribution plan not met. (FRS 119.25-27)</p> <p>ESOS expenses relating to subsidiaries not allocated to subsidiaries, but absorbed wholly by the parent company.</p>
Fair Value Disclosure	<p>Fair value of each class of financial assets and financial liabilities, for example corporate guarantees given for credit facilities granted to subsidiary, is not disclosed. (FRS 132.86)</p>

Table A: Common Findings of FSRC for Review Period from July 2009 – June 2010



the fair value reliably. Instead, the uncertainty enters into the measurement of the asset's fair value. For example, for a customer contract where the price of the raw material is not stable, the fair value could still be measured reliably using, for instance, estimates of a range of raw material prices or weighted average of expected outcome.

- Only when the intangible assets arises from legal or other contractual rights, and is not separable or has not been transacted before, it might not be possible to measure reliably the fair value of an intangible asset acquired in a business combination. (FRS 138.38)
- Guidance on application of the above could be obtained from

- \* *Paragraphs B16 and B17 of Appendix B of FRS 3 which provide guidance on determining the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities for the purpose of allocating the cost of a business combination; and*
- \* *Illustrative Examples to the International Financial Reporting Standards (IFRS) 3 "Business Combinations" which provides some examples of items acquired in a business combination that meet the definition of an intangible asset and may be recognised separately from goodwill. FRS 3 is identical to IFRS 3.*

It shall be noted that FRS 3 (revised) which is effective on or after 1 July 2010 introduced some changes to accounting for business combinations. This

includes requiring all identifiable assets and liabilities be recognised, and there is no requirement for an asset or liability to be reliably measurable before it could be recognised. This is because the criterion for reliable measurement is part of the overall recognition criterion in the Framework. Probability is reflected in the fair value measurement. As a result, paragraph 35 of FRS 138 is amended and paragraph 38 of FRS 138 is deleted.

- The FSRC reminds that any significant assumptions made and key sources of estimation in determining fair value shall be disclosed (FRS 101.116).

## Conclusion

The Committee wishes to highlight that disclosure of adequate and relevant information is important to help users of financial statements to understand the financial statements better. Presenting a proper picture of a company's performance and financial health is a fundamental duty that directors owe to shareholders; and financial statements are a tool to assist directors in discharging this duty.

The Committee also reminds that many FRSs and IC Interpretations have been issued and are effective from 1 January 2010. Those who are involved in the financial reporting chain, including the finance team, Chairman of Audit Committees and auditors, are urged to anticipate in advance the implication of the changes on recognition and measurement principles, as well as the presentation and disclosures required in the financial statements. ■