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Financial instruments disclosure practices: Evidence from Malaysian listed firms

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Abstract

The current changes in business settings have directed companies to conduct businesses at the international level which requires the use of financial instruments. The-mandatory MFRS 7, an adoption of IFRS 7 standard has been implemented for entities to disclose their involvement with financial instruments. Thus, the aimed of this study is to investigate the financial instruments disclosure practices (FID) among Malaysian listed companies; specifically, on the level of compliance with MFRS 7. The overall results indicate that companies complied with MFRS 7, though there are several requirements omitted by companies. Furthermore, with the revised of MCCG in 2012, this study examines the association of corporate governance mechanisms with the extent of FID among companies. Based on sample of 319 companies, result indicates that audit committee independence, internal audit independence (out-source) and audit fees are positive and significantly associated with FID. Hence, it suggests that effective corporate governance may have some influence on the extent of disclosure level among companies.

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Keywords: MFRS 7; financial instruments; financial instrument disclosure practice; corporate governance

1. Introduction

2012 marked the-first year of the Malaysian Financial Reporting Standards (MFRS), an adoption of International Financial Reporting Standards (IFRS) among Malaysian Listed companies. Consequently, it

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enhances better transparency and promotes comparability in financial reporting among Malaysian companies. These changes are expected to provide more information to be disclosed in the annual report with respect to the risk faced by companies arising from financial instrument (Bischof, 2009; Savvides and Savvidou, 2012; Elzahar and Hussainey, 2012). Financial instruments either equity -based (i.e. shares) or debt-based (i.e.: derivatives) are widely being used by companies as a medium to raise more capital (Ismail and Rahman, 2011). Hence, the MFRS 7, an-equivalent to IFRS 7 on financial instruments disclosure (FID) is in place to outline the extent of disclosure required for entities involved in financial instruments.

Generally, MFRS 7 provides two main disclosures that cater the need to disclose the significant level of the financial instruments to the entities; and the qualitative and quantitative information on the exposure of risk faced to the entities' financial statements. Additionally, MFRS 7 has enhanced the disclosure on fair value measurements and liquidity risk to address the application issues as well as provide sufficient information to users. The MFRS 7 standard is a complementary to both other MFRS standards which are, MFRS 139 Financial Instruments: *Recognition and Measurement* and MFRS 132 Financial Instruments: *Presentation*. However, this study will only focused on MFRS 7,

The aim of this study is to examine the MFRS 7 disclosure practices among Malaysian listed companies and their compliance level to MFRS 7. Unlike many prior studies, FID were examined either using the prior standards such as MASB 24 (Hassan and Salleh, 2010) and FRS 132 (Othman and Ameer, 2009; Zadeh and Eskandari, 2012), or focused on voluntarily disclosure (Bamber and McMeeking, 2010; Ismail and Rahman, 2011). Hence, current study will focus on the current-globally accepted standard to determine the MFRS 7 disclosure practices of Malaysian companies. Moreover, with the recent revision of Malaysian Code of Corporate Governance (MCCG) in 2012, this study examines the relationship between the MFRS 7 disclosure practices with corporate governance mechanism. The overall finding reveals that corporate governance structure is likely to influence firm's disclosure practices.

This paper is organized as follow: the subsequent section reviews of related literature and hypotheses development. Next, the research method is deliberately explained, followed by analysis of results and discussion. The final area will briefly explain the implication and conclusion of this study.

2. Review of related literature and hypotheses development

The pressure of business transactions and the rapid development of international market have increased the demand for more relevant information and greater transparency in financial reporting disclosure (Bischof, 2009; Savvides & Savvidou, 2012; Elzahar & Hussainey, 2012). The risk exposure from financial instruments and how they are being managed are among the key elements needed. This detailed information is crucial to ensure financial statements are prepared to reflect the true financial position of the firms, and assist users i.e. investors to make more informed judgement. Further, MFRS 7 has been initiated to provide such information to enable users to evaluate the nature, extent of risks and the significant of the financial instruments to the entity's financial position.

Prior literatures have examined the financial instruments disclosure practices particularly on risk-related disclosure covering mandatory, voluntary or combination of both types of risk-related disclosure. Findings indicate that companies tend to comply with the accounting standards mandated by the respective countries (Bischof, 2009; Hassan & Salleh, 2010; Probohudono, 2013), while some studies show that extra disclosure is required to meet the additional rules and regulation (Bamber & McMeeking, 2010). However, it is also documented that companies tend to partially complied, by omitting certain requirements in the standards (Othman & Ameer; 2009; Savvides & Savvidou, 2012; Zadeh & Eskandari, 2012); and the disclosure practices varies in terms of type of the risk information disclosed, and the in-depth details of such information in the financial reporting (Ismail & Rahman, 2011; Oliveira et al., 2011).

Empirically, prior studies showed that disclosure practices vary with respect to different settings across countries. This was due to different responses coming from various level of economic development (Probohudono, 2013), the acceptability of each country on risk information (Bischof, 2009; Othman & Ameer, 2009; Savvides & Savvidou, 2012) as well as different level of enforcements and interpretation of the standards itself (Bischof, 2009). Besides, prior studies suggest that the level of risk disclosure is associated with corporate governance characteristics (Taylor et al., 2010; Oliverira et al., 2011), where firms with strong CG structure are more likely to be more effective in financial risk management, hence promote better transparency in financial reporting. Similarly, Alanezi & Albuloushi (2011) revealed that Kuwaiti firms with high level of compliance with the IFRS-mandatory disclosure are more likely to have good CG structure.

In Malaysia, Hassan and Salleh (2010) examined the disclosure quality using a self-developed disclosure index based on MASB 24 requirements; while, Othman and Ameer (2009) and Zadeh and Eskandari (2012) employs FRS 132. In general, there were no major areas and differences between these two standards; as the MASB standard were just renumbered and renamed (Lazar et al., 2006) to FRS for international convergence purpose. However, results indicate that there are variation in the disclosure practices among companies on the nature and level of compliance to the standard; even though the convergence efforts to align Malaysian accounting standards to international standards already took place in 2006. Thus, it is hope that the adoption of IFRS into MFRS is able to enhance the compliance level among Malaysian companies as Malaysian Accounting Standards Board (MASB) has no power to exempt anyone (i.e. Malaysian public listed firms) from MFRS. To strengthen further the quality of financial reporting, the recent revised MCCG is expected to enhance the quality of information provided by the firms, which includes the need for better transparency of financial reporting and disclosure.

While there is a wide range of studies (Oliveira et al., 2011; Elzahar & Hussainey, 2012; Probohudono et al., 2013) concerning the relationship between CG mechanism and financial reporting, very little research has directly investigated or explored the link of CG with financial instruments disclosure. Hence, the current study expands existing risk-related literature by investigating the association of corporate governance mechanism with FID practices among Malaysian companies. At the same time, contributes to the current literature by examining the MFRS 7 disclosure practices among companies. Agency theory provides a powerful theoretical framework in the study as financial reporting disclosure is among the cost-effective monitoring tools in principle-agent relationship. It explains how information asymmetry between the shareholders (principles) and managers (agents) are mitigated through monitoring mechanism (Oliveira et al., 2011). In this study, monitoring mechanism such as board structure, audit committee, external and internal audit function are represented as board independence (BINED), board expertise (BEXPERT), audit committee independence (ACINED), internal audit function (in-house or outsource), IA fees (IAF), audit fee (EAF) and external audit function (firms audited by big 4 or non-big 4 audit firms), which is consistent with prior studies (see Taylor et al., 2010; Oliveira et al., 2011; Elzahar & Hussainey, 2012; Probohudono et al., 2013). The study expects that firms with good CG have a positive association with the extent of MFRS 7 disclosure. Hence, the following hypotheses are proposed:

H1- There is a positive association between the extent of MFRS 7disclosure and board independence

H2- There is a positive association between the extent of MFRS 7disclosure and board expertise

H3- There is a positive association between the extent of MFRS 7disclosure and audit committee independence

H4- There is a positive association between the extent of MFRS 7disclosure and internal audit function

H5- There is a positive association between the extent of MFRS 7disclosure and internal audit fees

H6- There is a positive association between the extent of MFRS 7disclosure and audit fees

H7- There is a positive association between the extent of MFRS 7disclosure and external audit function

3. Research methodology

Although year 2012 marked the-year for full adoption of MFRS by all public listed companies but there was exception granted for several companies such as those entities that are within the scope of MFRS 141 Agriculture (MFRS 141) and IC Interpretation 15 Agreements for Construction of Real Estate (IC 15). In this case, these transitioning entities will be excluded in the sample as they are allowed to defer the adoption for another 2 years Moreover, consistent with prior studies (Bamber & McMeeking, 2010; Ismail & Rahman, 2011; Elzahar & Hussainey, 2012), the sample also exclude financial industry due to different regulation attached to this sectors, thus, the final sample consist of 319 companies. Data was hand collected from available annual reports on Bursa Malaysia website. This study employed the unweighted index or dichotomous scores whereby all information was equally valued regardless of the number of words, sentences or the length of pages. The Financial Instrument Disclosure Checklist (FID) contains a total of 25 checklist items, which was self-developed based on the MFRS 7 requirements. The items disclosed were coded as '1' if a particular item is included in the checklist while '0' is coded if not disclosed, consistent with prior studies (see Taylor et al., 2008; Othman and Ameer, 2009; Savvides and Savvodiu, 2012; Probohudono et al., 2013).

4. Results and findings

Table 1 shows the overall mean score for FID is 80.76%, with the minimum and maximum score of 14% and 100% respectively. The results show that the disclosure level of Malaysian companies has slightly increased compared to prior studies by Othman and Ameer (2009) and Zadeh and Eskandari (2012). Besides, Table 2 provides the results of correlation analysis between FID and other independent variables. The analysis revealed that FID is positively correlated to several CG factors which include firms that were audited by big-4 audit firm (EA), audit fees (EAF) and internal audit fee (IAF). However, the results of the regression analysis in Table 3 indicate that, audit committee independence (ACINED), firms that outsourced their internal audit function (IA), and external audit fee (EAF) are found to have a significant association with FID at 5 % level, while the remaining variables are found to be insignificant. Thus, H3, H5 and H6 are supported and the rest of the hypotheses (H1, H2, H4 and H7) are not supported. The results are consistent with several prior studies conducted by Taylor et al. (2008), Oliveira et al. (2011) and Elzahar and Hussainey (2012). Further, it appears from the results that there are vital role of internal and external audit functions in supporting the audit committee to ensure the transparency of financial reporting disclosure. Besides, the findings is consistent with MCCG recommendations, which proposed that the audit committee members need to be independence to effectively discharge their duties and to strengthen the role of auditing function within the firm. The adjusted R^2 from the model used is 11.5 %.

Table 1. Descriptive Analysis

	Min	Max	Mean	
DEPENDENT VARIABLE				
MFRS Disclosure Index (FID)	3 (14%)	25 (100%)	20.19 (80.76%)	
INDEPENDENT VARIABLES				
Panel A- Continuous Variable				
BINED (%)	0.17	0.88	0.12	
BEXPERT	0.00	0.80	0.14	
ACINED	0.00	1.00	0.17	
EAF	3.90	6.72	0.45	
IAF	3.67	7.00	0.64	
Panel B- Dichotomous Variable				
EA	**Freq (Big 4)**	**%**	**Freq (Non-Big 4)**	**%**
	173	54.20	146	45.8
IA	**Freq (In-house)**	**%**	**Freq (Outsource)**	**%**
	163	51.10	155	48.60

Table 2. Results of Correlation Analysis

	FID(%)	BINED	BEXPERT	ACINED	EA	IA	EAF	IAF
FID(%)	1	-0.050	-0.079	0.059	0.177**	-0.004	0.297**	0.190**
BINED		1	0.162**	0.373**	-0.137*	-0.008	-0.098	-0.152*
BEXPERT			1	-0.028	-0.087	-0.094	0.011	-0.014
ACINED				1	-0.204**	-0.052	-0.135*	-0.255**
EA					1	0.187**	0.424**	0.429**
IA						1	0.323**	0.543**
EAF							1	0.736**
IAF								1

Table 3. Multivariate Regression Analysis

FID=β0 + β1 BINED + β2 BEXPERT + β3 ACINED + β4EA + β5 IA + β6 EAF + β7 IAF+ ε

Variables	Coefficients	t-stat	(p-value)
CONSTANT	-0.084	5.728	0.000***
BINED	-0.069	-1.274	0.204
BEXPERT	0.171	-1.134	0.258
ACINED	0.076	2.548	0.011**
EA	-0.169	1.126	0.261
IA	0.204	-2.357	0.019**
EAF	0.134	2.284	0.023**
IAF		1.344	0.180
R square			0.115
Adjusted R square			0.091
Sig. F change			0.000***

***, * *, *Correlation is significant level at 1%, 5 % and 10% respectively level (2-tailed)

Note: Dependent Variable: **FID**= The percentage of MFRS 7 financial instruments disclosure items;
Independent Variables: **BINED**: Proportion of independent non executives directors in the board; **BEXP**= The proportion of board members with accounting background or accounting related experience; **ACNED**: The proportion of independent non-executives directors (INED) in the audit committee team; **EA**: Assigned as1for firm's audited by Big-4 and 0 for firm's audited by Non-Big 4; **IA**: Assigned as 1 for in-house internal audit function and 0 for outsourced internal audit function ; **EAF**: Natural log of total value of audit fees paid to the external auditors by the firms; **IAF**: Natural log of cost incurred for internal audit function.

5. Conclusion

The study provides recent empirical evidence on the MFRS 7 disclosure practices among Malaysian listed companies. In general, most Malaysian companies complied with MFRS 7, though some requirements were omitted such as hedge accounting information. This is consistent with Othman and Ameer (2009) whom documented low level of hedge information due to the less involvement with hedging activities among Malaysian companies. This study is useful to the regulators, companies and market players in general as it empirically examined the impact of new MFRS 7 disclosure practices among Malaysian companies, and highlighted the role of corporate governance in enhancing the level of corporate reporting disclosure. Hence, legislators or policy makers (i.e. Securities Commission) may provide strict enforcement to public listed companies to incorporate good governance practices as the findings suggest that strong corporate governance affects the extent of firm's disclosure level, thus, improve the financial reporting quality. There are several limitations to this study. First, due to the different regulations for financial industry, this research was unable to include financial institutions. Thus, future research might consider expanding the research to include wider capital market. Next, the amount and type of data available might be limited since the study is based on secondary data (i.e. annual reports) and focusing on companies that adopted the MFRS standards only. Alternative research methods, such as interviews or surveys with key stakeholders, for example audit committee, internal or external auditors could strengthen the findings of this study.

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