The Role of Companies' Characteristics in Influencing the Malaysian Companies' Compliance under the FRS 136 Requirements: Goodwill Case

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ABSTRACT

The adoption of International Financial Reporting Standards (IFRS) makes the annual reports of companies more credible and transparent. However, many companies in different countries still failed to comply with the IAS 36Assets Impairment. This paper investigates the factors that may affect companies' compliance with the FRS 136 Assets Impairment among the Malaysian listed companies. Based on a review of the prior literature, this paper proposes a conceptual framework to investigate the relationship between company characteristics (company size, goodwill intensity, company leverage and company profit) and the level of goodwill disclosure compliance with the FRS 136 among Malaysian listed companies. Evidence from previous studies suggested that the company's characteristics namely company size, goodwill intensity, profitability, company and company leverage positively impact the companies' compliance with the FRS 136. It is argued that the characteristics of a company are considered as important variables to explain the difference in company disclosure.

Keywords: IFRS; IAS 36; FRS 136; Asset Impairment; Goodwill; company characteristics; financial disclosure.

Introduction

In order to follow the development in economics and keep its standards effectively, the International Accounting Standard Board (IASB) always reviews and updates these standards by revising the current standard or even replacing the old standard with the new one. Indeed, the relevant information which is disclosed by companies plays an important role in the decision making process by stakeholders. This is because when these stakeholders adopt any decision, it would be based on this information, to make appropriate and accurate decisions (Ferrer & Ferrer, 2011).

Therefore, the IASB exerts efforts and publishes standards in order to improve both the financial accounting and financial reporting which attracts the interest of financial analysts, auditors and users of financial statements (Mangena&Tauringana, 2007), as well as the goodwill is considered as a big asset. This is in line with Kavicic et al. (2013) Goodwill represents a significant amount in a company's balance sheet. Goodwill on average is 10.7% and in the median is 6.6% of the company's total assets. Therefore, in 2004 the IASB had revised the IAS 36 *Assets Impairment* (AbuGhazaleh et al., 2012). Accordingly, the newly issued standard abolished the amortization method and replaced it with the impairment regime. Thus, the goodwill is no longer amortized as a straight line but it is subject to impairment test at least once annually or more if there are any indicators implying the occurrence of impairment in a goodwill value (Carlin et al., 2009).

As known, goodwill is a controversial asset and the new treatment continues to receive criticisms from the academics and practitioners because they see the impairment regime based on the discretion of management (Abu Ghazaleh et al., 2011). Further, the new IAS 36 requires many things, and requires companies to provide more disclosure (ESMA, 2013). Thus, it is considered as a complex standard (Linda & LeMaster, 2007) and has some ambiguous requirements (Mollik & Bepari, 2011). Therefore many companies around the world failed to comply with the IAS 36 requirement of disclosure regarding goodwill for instance, Singapore (Kharil et al., 2013), 17 European countries (Glaum et al., 2013), Australia (Carlin et al., 2009) and Malaysia (Carlin et al., 2009). Thus it is considered as a challenge for companies when preparing their financial reporting (Wines, et al 2009).

It is widely believed that accounting information provides relevant and useful information to investors and other decision makers. Without disclosure, the comparability of financial statement of companies will reduce and in turn leading to substantial variation between companies (Matthews and Rusinko, 2010). Disclosure of company impacts capital market decision and decision investment of companies (Kanodia , 2006). Thus, the company characteristics have recently become of prominent importance in governing the companies' decisions; due to considering them as important variables explaining the difference in company disclosure (Naser et al., 2002).Moreover, the level of company's compliance under IFRS is impacted by the company specifics (Alanezi et al., 2012).

This paper proposes a conceptual framework to investigate the impact of companies' characteristics (company size, goodwill intensity, company leverage, and company profit) on goodwill disclosure complying with the paragraph 134 requirements according to the FRS 136 *Assets Impairment* among the Malaysian companies listed on Bursa Malaysia. The remainder of the paper is organized as follows: Section 2 introduces the background of the study; Section 3 highlights the literature review; Section 4 presents the conceptual framework and hypothesis development; Section 5 summarizes and concludes this paper.

Background

The treatment of goodwill remained different among Malaysian companies until 2006 and this is attributed to the absence of a true standard which governs goodwill accounting (Carlin et al., 2009). In particular, some companies used capitalized goodwill and amortization while some companies used capitalization but the goodwill was subjected to impairment review, whereas another group used capitalized goodwill and kept it as permanent asset (Abdul Majid, 2013).

The Malaysia Accounting Standard Board (MASB) adopted the International Financial Reporting Standards (IFRS) and became effective in 2006. Hence, the Malaysian companies were forced to prepare and present their annual reports according to the IFRS (Carlin et al., 2009). Thus, the MASB changed their treatment regarding goodwill and issued the FRS 136 impairment of assets. The FRS 136 is equivalent to the IAS 36 Impairment of Assets, so any entities need to apply the FRS 136 thereby complying with the IAS 36. According to the new treatment, the amortization against goodwill was abolished and goodwill became subject to an annual impairment test or more if there are any indicators implying that any impairment in goodwill value took place, as well as, the impairment loss will not be retrieved. Also, the goodwill that was generated internally was no longer recognized (MFRS 136, 2012).

Thus, In view of the fact that the Malaysian recently adopted the FRS 136, and by reason of the lack of studies about goodwill disclosure compliance in Malaysia, this study intends to investigate the impact of the company characteristics in constraining goodwill disclosure.

Literature review

Recently, most global countries have adopted the International Financial Reporting Standards (IFRS), and as reported by Bova and Pereira (2012) and Khiril et al. (2013), more than100 countries have changed their domestic standards to the IFRS. Indeed the IFRS have superior merits when compared to same domestic standards of accounting (Hail et al., 2010). Aside from that, the IFRS offer more convergence and harmonization in accounting treatment around the world (Ferrer & Ferrer, 2011). Furthermore the standards increased financial information in local and foreign corporations (Chen et al., 2013). Thus, the companies' financial statement could achieve more transparency and credibility (Godfrey et al., 2009). Therefore, these benefits will decrease the information asymmetry between the companies' management and shareholders (Eiler, 2009). Aside from that, the company's investment efficiency will also be improved (Chen, et al, 2013).

According to Godfrey et al. (2010), financial information basically demands two intentions: steward and decision making. With respect to the agency theory, it focused on the steward intention because the separation between ownership and management leads to a divergence of interests between managers and shareholders, thus, the agency cost will increase (Jensen &Meckling, 1976). As such, monitoring managerial decisions becomes essential for shareholders to assure that their interests are protected (Fama & Jensen, 1983) as well as for ensuring credible and reliable financial reporting. Therefore, financial disclosures will reduce the agency costs which arise from the conflict between shareholders as principals and managers as agents (Abe & Chung, 2009), as well as will reduce the information asymmetry (Leuz &Verrecchia, 2000).

Financial disclosure is the information released by companies to the public and may be financial or non-financial, numerical or qualitative, mandatory or voluntary, and through formal or informal methods (Gibbins et al., 1990). Meanwhile, mandatory disclosure is the information released by companies in order to meet the standards' requirements (Hassan & Marston, 2010), whereas voluntary disclosure is the information released by companies exceeding the mandatory requirements and it is considered as optional to provide this relevant information for users of annual report (Al-Janadi et al., 2011).

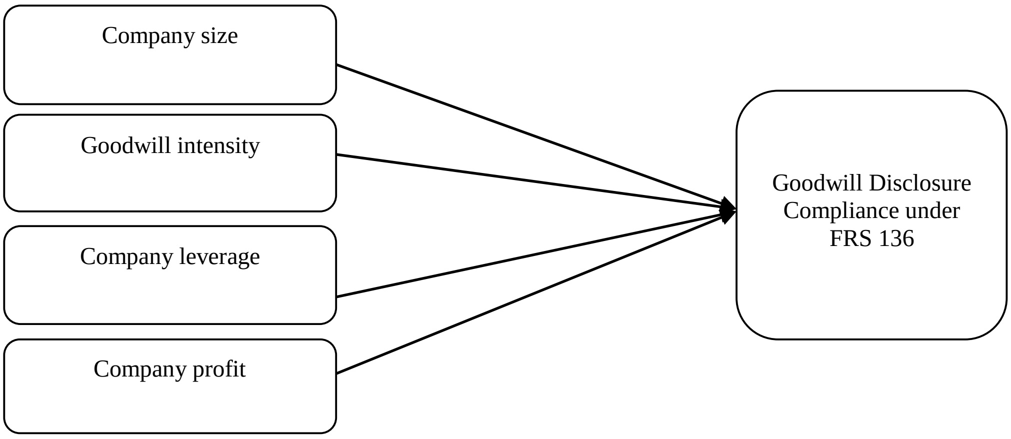
Previous literatures have seen that financial disclosure is an effective way to decrease the agency cost (Abe & Chung, 2009), and decrease the information asymmetry between managers and shareholders and among shareholders itself. Additionally, it is considered as a basic source for decision making (Ferrer & Ferrer, 2011; Bova & Pereira, 2012).Therefore, the company's characteristics should play an important role in constraining the level of financial disclosure. In relation to this, the prior studies such as those from Alsaed (2006) and Alanezi et al. (2012) suggested that the characteristics of companies have an impact on the International Accounting Standards' (IAS) adherence. Thus it is reasonable to hypothesize that the company's characteristics will enhance the goodwill disclosure compliance under the FRS 136 among the Malaysian listed companies.

In the following section, company's characteristics such as company size, goodwill intensity, leverage and profitability, are discussed for their impacts on financial disclosure in literature review.

The Conceptual Framework and Hypothesis Development

The company's characteristics and their relation with goodwill disclosure are integrated in one conceptual framework. Figure (1) explains the proposed framework. In this conceptual framework, company's characteristics are the independent variables and goodwill disclosure is the dependent variable. The current study thus attempts to bridge the gap by providing the basis for discerning the impact of company's characteristics on goodwill disclosure compliance. Then, sections 4.1- 4.4 will discuss the hypotheses that are developed from the conceptual framework.

Figure (1): Company's Characteristics and Goodwill Disclosure



Company's Characteristics

Company size

Many studies provide evidence that company size has a significant positive relation with the level of company disclosure (Buzby, 1975; Wallace, 1994; Raffournier, 1995;Feket, 2008; Singh, 2013).According to the agency theory, the size of companies is an important factor, because it relates to the level of capital that needs to increase due to shareholders' wishes and pressure. The reason for this is that, they need to maximize their wealth as the shareholder theory stated (Cooke, 1996).

Indeed, the size of company is considered a factor in deciding the level of finance, where when the size is increased, the cost will also increase. Thus, the big companies need more finance in order to operate, and they find this finance in stock exchange, but in order to get this benefit, the companies are forced to disclose more information in their annual report (Ahmed & Nacholls, 1994). As for the small companies, if they need to get more finance via the stock market, they would change their strategy of disclosure by providing more information than they did in the previous year's report (Firth, 1980).

In addition, the public appear to pay more attention to large companies than they do to small companies (Cook, 1989b). Therefore, the big companies provide more information in annual report in order to attract more interest from investors and the public (Embong et al., 2012). This means that the advantage gained from disclosure is not same for small and large companies (Diamond &Verrecchia, 1991) albeit the fact that both big and small companies are subject to the same regulations of disclosure (Pierce, 1992).On the contrary, the small companies' disclosure is more important for investors, providing that, more financial information is included in their annual reports (Aljifri et al, 2014).

Thus, based on the aforementioned discussion, it is argued that there is a potential relationship between company size and goodwill disclosure. Thus, the following hypothesis is developed:

H1: Company size has a significant positive impact on the level of compliance under the FRS 136 *Assets Impairment* among the Malaysian listed companies.

Goodwill intensity

In recent years, the notion of goodwill has become more important than other assets of companies (Kavcicet al., 2013). Thereby, the investors hope to get more financial information that has more credibility and transparency in order to able to compare, so that they could make their decision with less uncertainty, as well as control the management's actions (Glaum et al., 2013). In addition, the investors look at goodwill information with more attention because they consider it to have more value relevance for investment decision (Wyatt, 2008).

Over time, goodwill has been defined in several ways such as: "Goodwill is the difference between the cost of a purchased company and the net fair value of that company's identifiable assets; identifiable assets includes tangible assets and intangible assets," (Hall, 2002).The standard regulators are aware of the needs of goodwill information and issued the IAS 36 *Asset Impairment* and the IFRS 3 *Business Combination*, and require the application of the two standards in an effective manner (Glaumet al., 2013). Indeed, the companies display large amount of goodwill in their annual report, and this means that they should make more impairment test of goodwill. Then, if the test result shows that the goodwill has been impaired, then, the position of these companies will be more likely to be impacted (Guthrie and Pang, 2013). Therefore, standards setters require the application of the IAS 36 and IFRS 3 in an effective manner so that the pertinent parties would be provided with information that is more transparent and credible and this will consequently fulfill the needs of different parties (Glaum et al., 2013).

Studies that address goodwill intensity with compliance level are very limited. Nonetheless, it has been reported that the increase in goodwill is associated with the increased level of compliance under the IAS 36 and IFRS 3 requirements (Glaum et al., 2013). In addition, the magnitude of goodwill in a company's financial statement has a positive relation with the value of equity market (Godfrey &Koh, 2001).

Thus, based on the aforementioned discussion, it is argued that there is a potential relationship between goodwill intensity and goodwill disclosure. Thus, the following hypothesis is developed:

H2; Goodwill intensity has a positive impact on the level of disclosure compliance under the FRS 136 *Assets Impairment* among the Malaysian listed companies.

Profitability

The notion of profitability has been addressed by researchers because they think that the managers in companies with high profits have incentives to increase the capital of their companies. Therefore, they promote their companies by providing additional disclosure (Singh, 2013).

The agency theory says that the manager of companies should provide sufficient information about their companies' profit, as they would feel proud when their companies achieved a good profit (Ferrer & Ferrer, 2011). Of course, more disclosure regarding a good news especially news on high profit encourages the confidence of investor, thereby, the manager's compensation will rise (Ahmed &Courtis,1999). In addition, the managers of the companies that have greater profit need to exploit this benefit by promoting themselves and obtaining more compensation (Giner, 1997). Thus, if a company obtains high profit, it is more likely that its manager will disclose more information (Wallace &Naser, 1995).

Indeed, the standards demand companies to disclose more information about their earning source. Interestingly, companies with high profit appear to adhere to the requirements and provide more information compared to the companies with bad performance and bad profit (Agyei-Mensah, 2012). As indicated by Williams (1992), when a company has poor performance, obtains low profit or even loss, its managers will also suffer from pressure as well as threat and thus, they will try to disclose less information in order to hide the bad news. There are many studies which have addressed the association between company profit and disclosure, and these studies showed positive evidence on the companies' financial disclosure such as the studies from Agyei-Mensah (2012), Kolsi (2012), Rouf (2011) and Naser et al. (2002).

Thus, based on the aforementioned discussion, it is argued that there is a potential relationship between company profit and goodwill disclosure. Thus, the following hypothesis is developed

H3: Company's profit has a significant positive influence on the level of compliance under the FRS 136 *Assets Impairment* among the Malaysian listed companies.

Company leverage

The agency theory stipulated that the external capital holders are considered as the principal and the agent is the manager. As such, the agency cost will rise in companies that have higher level of debt in their capital structure (Leftwich et al., 1981) because the concept of principal and agent in the agency theory in a situation of higher leverage changes wealth by shifting it to the shareholder from the bondholder (Myers, 1977). As such, agency conflict will arise and lead to increased agency costs (Donalson & Davis, 1991). Therefore, transparent disclosure allows stakeholders including debt holders to control the action of the company's management as well as to reduce agency costs (Anantharaman, 2009).

Indeed, the high rate of leverage places the companies under the creditor's conditions, and this raises concern (McRobert, 2009). This is because the leverage means the way a company follows for financing their operations, assets and liabilities (Ferrer, et al., 2011). Additionally, the rate of financial resource which is adopted by a company has an important impact on the strategy decision and the way of implementation that will be followed by this company (Brammer & Pavelin, 2006).

Of course, the amount of information that is required from the shareholder is different from that required from the debt holder (Rahman, 2003).Further, the level of debt equity is more likely to encourage the companies with a high level of debt to provide a lot of information in their financial statements for satisfying the needs of their creditors. Also, companies with high level of debt equity are under pressure and are being monitored by financial institutions more than companies with less level of debt equity (Agyei-Mensah, 2012). This means that, the companies that do comply with disclosure requirement are not necessarily small companies, rather, it is likely because they have little need for outside financial assistance. On the contrary, having low level of debt makes the companies prouder. Also, companies with less debt need to inform the public about their independency and level of ability, and thus, they provide more information than would their counterparts with high debt level (Gallego et al., 2009). Further, many studies reveal that the relationship between company leverage and the level of disclosure is positive such as the studies by Alsaeed (2006), Kolsi (2012) and Ramadan and Majdalany (2013).

Thus, based on the aforementioned discussion, it is argued that there is a potential relationship between company leverage and goodwill disclosure. Thus, the following hypothesis is developed:

H4: Company leverage has a significant positive influence on the level of compliance under the FRS 136 *Assets Impairment* among the Malaysian listed companies.

Summary and Conclusion

The adoption of the IFRS makes the annual report of companies more credible and transparent, and they offer a lot of information to different users. However, most companies in different countries failed to comply with the FRS 136 requirements. Therefore, this study aimed to investigate the factors that influence the Malaysian companies to comply with the FRS 136 by proposing a model that includes four company characteristics that might affect the Malaysian companies in complying with the paragraph 134 requirements according to the FRS 136.These proposed four characteristics are company size, goodwill intensity, company leverage and company profit. In turn, four hypotheses are developed and to validate the hypothesis, a survey research will be undertaken. Based on previous literature, the proposed model shows that company's characteristics play an important role in improving companies complies with FRS 136 *Assets Impairment*, where the size of company, goodwill intensity, company profit and company leverage are positively impact the level of compliance with FRS 136 .

The present research paper is limited to Malaysian companies compliance under FRS 136 due to lack of studies that have been carried out on compliance with FRS 136. The results of this research paper may be generalized to all companies listed in Bursa Malaysia.

The proposed model concludes and gathered the important factors that influence the companies compliance with FRS 136, which will help future researchers conduct further studies on compliance with accounting standards.

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