CHAPTER 1

INTRODUCTION

1.0 Introduction

The convergence with IFRS has gained steady support in the world. Today, IFRS is used by more than a hundred countries around the world. Since 2005, all member states of the European Union (EU) and Australia have adopted IFRS. In 2011, Korea, India and Canada have also moved into IFRS convergence (Deloitte Touche Tohmatsu, 2011). Significantly, the United States too has endorsed convergence setting 2014 as its agenda to move from US GAAP (generally accepted accounting principles) to IFRS and intend to complete few major convergence projects on certain standards. On 1 August 2008, the Financial Reporting Foundation (FRF) and Malaysian Accounting Standard Board (MASB) announced their plan to bring Malaysia to full IFRS convergence by 1 January 2012.

In view of this development of IFRS convergence, it is necessary for companies to be well prepared for full convergence with IFRS effective in year 2012 by assessing their existing financial reporting process, information systems, human capital and financial resources (The Malaysian Institute of Accountants, 2008). Hence, it is timely to study the responses of Malaysian public listed companies to the full convergence with IFRS by looking specifically at the key antecedents of IFRS adoption and internal barriers faced by companies.

This chapter provides an overview of the full convergence with IFRS in Malaysia. The discussion is organized as follows: Section 1.1 presents the background of this study. Section 1.2 discusses the research problems. Section 1.3 states the research objectives. Section 1.4 focuses on the motivations of study. Section 1.5 presents the contributions of study. Lastly, Section 1.6 summarizes organization of the study.

1.1 Background

In order to study the responses of companies to the full convergence with IFRS in Malaysia, it is crucial to understand the meaning of IFRS convergence and the current trend of convergence with IFRS in the global. Hence, five main areas will be discussed in this section that follows:

1. IFRS Convergence
2. Full Convergence with IFRS in Malaysia
3. The Impact of IFRS-compliant Framework in Malaysia
4. The Preparedness of Companies for IFRS Convergence

1.1.1 IFRS Convergence

International harmonization of financial accounting standards has been the goal of many countries throughout the world. Harmonization is defined as "a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation" (Nobes and Parker, 2010). This is a process that leads to the goal of achieving comparability of financial information across nations. Recently, the term "convergence" has been commonly used in the international harmonization of financial accounting standards. Convergence is a particular form of harmonization and refers to “the process of narrowing differences between IFRS and the accounting standards of countries that retain their own standards” (Ball, 2006). This is a process that country might gradually change their accounting standards towards to IFRS.

Generally, IFRS may not be implemented in full in some countries because of differences of political, economic, culture and institutional. Although national standards in most countries are now based on IFRS, national standard setters do make either an incremental or large modifications to their national standards (Pacter, 2005). This is the position for some countries that use different approaches to adopt IFRS with some modifications such as EU, Australia and Singapore (Deloitte Touche Tohmatsu, 2011). Since the IASB was established in 2001, it has a main goal to achieve “a single set of global financial reporting standards that will be both understandable and enforceable” (Pickard, 2007). Since then, IFRS convergence has gained steady support in the world in view of the advantages of single global accounting standards. Malaysia is also one of the countries moving toward full convergence with IFRS in 2012.

1.1.2 Full Convergence with IFRS in Malaysia

Looking at the recent context of accounting developments in Malaysia, accounting standards issued have been based on International Accounting Standards (IAS) since 1978. Before 1997, accounting standards which based on IAS issued by the MACPA and MIA were not enforceable on companies. Following the enactment of Financial Reporting Act 1997, accounting standards issued by the MASB become enforceable by

1997. All accounting standards issued by MASB had the prefix 'MASB'. Subsequently in 2005, the MASB renamed all issued standards as Financial Reporting Standards (FRS) that was in line with IFRS. Since 2006, Malaysian FRS standards have been identical to the respective IFRS. The difference lies in standards that Malaysia has not adopted. A new numbering system to its FRS and the interpretations was introduced by the MASB in 2007.

On 1 August 2008, the FRF and MASB announced their plan to move to full IFRS convergence by 1 January 2012. To facilitate a phased changeover to IFRS convergence, Malaysia has adopted FRS 139 Financial Instruments: Recognition and Measurement with the effective date of 1 January 2010. By 2012, all approved accounting standards applicable to entities other than private entities will converge fully with all IFRS issued by the IASB. Since then, the MASB has released the Exposure Draft, MASB ED75 in June 2011 which proposes to replace existing FRS in conjunction with the plan to convergence with IFRS in 2012. MASB ED 75 outlines the background of full convergence with IFRS and the impacts of IFRS to the financial statements.

Based on the MASB ED 75, full convergence with IFRS in Malaysia means full compliance with IFRS issued by the IASB as a basis for financial reporting in Malaysia. The existing FRS framework will be replaced by IFRS-compliant financial reporting framework in 2012. MASB ED 75 states that entities that meet the definition of publicly accountable entity are mandated to comply the IFRS-complaint FRS framework. On the other hand, private entity that does not fulfill the meanings of a publicly accountable entity has the option to either apply PERS or the IFRS-complaint FRS framework.

In November 2011, the MASB issued a new MASB approved accounting framework, the Malaysian Financial Reporting Standards (MFRS Framework). All entities other that private entities for annual periods beginning on or after 1 January 2012 are required to apply the MFRS Framework with the exception of entities that are subject to the application of MFRS 141 Agriculture and IC Interpretation 15 Agreements for Construction of Real Estate. Subsequently, full adoption of the MFRS Framework will be mandatory for annual periods beginning on or after 1 January 2013. In this regards, approximately one thousand public listed companies in Bursa Malaysia will be affected by full IFRS compliance in 2012. In this regards, approximately one thousand public listed companies in Bursa Malaysia will be affected by full IFRS compliance in 2012. The timeline of key events for changeover to IFRS framework is depicted in the Table 1.1.3.

Table 1.1.2: *Timeline of key events for changeover to IFRS framework*

Timeline	Key Events
October 2005	Renamed all issued MASB standards as FRS
February 2006	2-tier framework implemented: FRS and PERS
August 2008	Announcement of IFRS convergence
1 January 2010	Mandatory adoption of FRS 139 by non-private entities effective 2010
June 2011	Issuance of MASB ED 75
1 January 2012	Changeover from Malaysian FRS to MFRS framework. First year reporting under MFRS framework
31 December 2012	First annual financial statements prepared under MFRS framework
1 January 2013	Mandatory adoption of MFRS framework

(Adapted from MIA, 2008)

1.1.3 The Impact of IFRS-compliant Framework in Malaysia

IFAC (2004) acknowledges that IFRS adoption imposes challenges to countries. Malaysia is no exception in the move towards full convergence with IFRS in 2012. Currently, the existing FRS are already identical to IFRS except IAS 41 Agriculture and IC Interpretation 15 Agreements for the Construction of Real Estate (IC 15) that are yet to be adopted in Malaysia as well as different effective dates and additional transitional provisions in certain limited FRS. Based on the MASB ED 75, the industries that are most likely affected by the IFRS convergence in 2012 would be agriculture industry and possibly real estate industry and financial institutions.

Moving forward, IASB's future work plans on some other core standards would also affect Malaysian entities significantly after 2012. There are few IASB exposure drafts and discussion papers that are now going through due process and soon to be adopted including leases, revenue recognition, financial instruments, fair value measurement, insurance contracts and consolidated financial statements (MASB, 2011b). As a consequence of convergence, when IASB issues new or amended IFRS, Malaysia will adopt those standards expeditiously and entirely. Considering the impacts of IFRS-compliant framework, this study attempts to investigate the responses of companies to the IFRS convergence is crucial before the full convergence with IFRS due in 2012.

1.1.4 The Preparedness of Companies for IFRS Convergence

Although there has been widespread adoption of IFRS by countries throughout the world, the level of preparedness to adopt IFRS has varied widely between countries and companies. IFAC (2004) indicates that achieving IFRS convergence requires more than theoretical support. It requires reaching consensus to move towards IFRS convergence, determining how to facilitate the adoption of IFRS and, ultimately, taking the necessary plans to implement IFRS. Further, various surveys also reveal that adoption of new standards not only affects financial statements, but it will also has wide impacts to system, resources, planning, communication, tax and audit (CFERF, 2010). Thus, companies should view the IFRS convergence as a strategic management agenda and not just a mere technical financial accounting issue.

Prior researches in academic have focused mainly on the voluntary adoption of IFRS and had identified several circumstances influencing the voluntary adoption of IFRS: larger, more commercial internationalization and less capital intensive Swiss companies (Dumontier and Raffournier, 1998); companies listed in U.S. or foreign exchange listing audited by Big 4 audit firms (Street and Gray, 2002); and larger companies which have more foreign revenue and listed on one or more foreign exchange stock (Tarca, 2004). In summary, company's characteristics such as firm size, commercial internalization, foreign listing, audit type, profitability serve as pre-conditions for company to implement IFRS.

There are limited researches so far to explore the stage of preparedness of companies to adopt IFRS. In a survey conducted by Guerreioro et al. (2008) for IFRS adoption in Portugal, the level of preparedness of companies are measured based on the mode of assessment and process of conversion. The survey asked respondents whether the assessment process in placed to evaluate the accounting policy changes, system changes, scope of training, cost involved and reactions of stakeholders. Meanwhile, questions on the conversion process covers preparation for financial reporting system, training offered, collection of additional accounting information and other procedures initiated. The study also found that the level of preparedness for IFRS was significantly associated with company size, commercial internationalization, audit by a Big 4 accounting firm and profitability.

In the context of IFRS adoption guidelines, PricewaterhouseCoopers (2009) states that IFRS implementation goes beyond simple technical application in the finance or accounting function and it cuts across other business areas such as human resources, investor relations, IT department and other units. Several guidelines to smooth IFRS convergence are also suggested by IFAC (2004) and PricewaterhouseCoopers (2009) as follows:-

- To initiate IFRS convergence project management team
- To have an implementation action plan with timeline and actions taken
- To assess the impact of IFRS on business activities and planning
- To ensure adequate information derived from systems and operations or reconfigure system
- To integrate management reporting with new IFRS basis
- To communicate to key stakeholders
- To keep track of competitors in the industry

Therefore, companies should be adequately equipped and well prepared for IFRS convergence effective on 1 January 2012. To be ready for the IFRS transition process, company may need to emphasize on increasing awareness of IFRS, assessing the company's current capabilities and resources as well as planning for the implementation approach and training needs (Gannon, 2008).

To study the preparedness of companies for IFRS convergence, institutional theory is applied in this study. Specifically, this study aims to investigate the institutional isomorphism that influences the adoption of IFRS. There are three types of institutional isomorphism proposed by Dimaggio and Powell (1983) namely coercive, mimetic and normative isomorphism. These three sources of isomorphism form a powerful social framework that can influence the practices or behaviors of company in implementing IFRS. Coercive institutional pressures are represented by rules enforced in regulatory systems and can also include pressures from stakeholders. Normative pressures refer to organization norms that influenced by professionalization. Mimetic pressures refer to the modeling of successful organizational behavior by other organizations especially under uncertainty situation (DiMaggio & Powell, 1983). Thus, this study attempts to examine whether these key forms of institutional isomorphism drive companies to implement action plans for the IFRS convergence. Apart from the influences of institutional isomorphism, the degree of preparedness of companies for IFRS convergence may be affected by some extents of companies' internal barriers. In this regards, this study also investigate the influence of internal barriers from the lens of resource-based view.

1.2 Research Questions

The issue of IFRS implementation is considered complex and various considerations must take into account when studying the responses of Malaysian public listed companies to IFRS convergence: the present situation and features of financial reporting system, its historical development, the roles of accounting professions and regulators, the expectations of stakeholders of financial statements and the attitudes and characteristics of Malaysian companies. Thus, this study also attempts to understand these issues of IFRS implementation and the present accounting environment by adopting the institutional theory.

The full convergence with IFRS in Malaysia will cause implications and impact the financial position of companies if no proper preparation done to implement IFRS. In Malaysia, MASB has prepared tentative timelines to facilitate a phased changeover to IFRS. The adoption timeline may cause anxious for some industries such as property development industry. According to REHDA president, Datuk Seri Michael Yam, the property development industry is still not ready for a new accounting standard IC15 that recognizes revenue based on the completion stage of project, which is effective after 1 January 2012 (Lai, I, 2011). Despite the relatively long lead-time provided by MASB, there seems to be little appreciation or awareness of the complexity of works required to implement the IFRS properly (Nordin, 2009). A potential hurdles to adopt IFRS are lack of skills or knowledge, reporting system changes and financial resources (The Malaysian Institute of Accountants, 2008).

In view of these considerations, this study aims to identify the responses of Malaysian companies to the full convergence with IFRS as well as investigate the antecedents of IFRS adoption and challenges to implement IFRS. Therefore, research questions to be addressed in this study are as follow:

1. Do coercive forces from stakeholders influence the preparedness of companies for IFRS convergence?
2. Does imitation tendency of companies in organization field influence the preparedness of companies for full convergence with IFRS?
3. Does participation in accounting professional bodies influence the preparedness of companies for IFRS convergence?
4. Do internal barriers affect the preparedness of Malaysia companies for full convergence with IFRS?
5. Are these characteristics of companies such as types of industry types and auditor types influence the preparedness of Malaysian companies for full convergence with IFRS?

1.3 Research Objectives

The general objectives of the study are to study the responses of Malaysian public listed companies to full convergence with IFRS. This study also aims to investigate the following specific research objectives related to IFRS convergence as per the following:

1. To examine whether key drivers from institutional theory perspectives influence the preparedness of Malaysian public listed companies for full convergence with IFRS;
2. To investigate the internal barriers that affects the preparedness of Malaysian public listed companies for full convergence with IFRS; and
3. To identify whether there are significant variations between control variables (industry types and auditor types) and key drivers and internal barriers that

influence the preparedness of Malaysia public listed companies for full convergence with IFRS.

1.4 Motivations of Study

Despite the widespread adoption of IFRS, convergence with IFRS still presents a number of challenges for countries and companies involved. As such, it is necessary for companies to prepare thoroughly for IFRS convergence by assessing their existing financial reporting structure, information systems, human capabilities and financial resources. This study is both timely and significant as full convergence with IFRS is happening soon in Malaysia in 2012. In addition, there are very limited studies in Malaysia context has been conducted in this perspective. Since most of the past researches on IFRS adoption focus on advanced capital markets such as US, Europe and Australia, this study extends the literatures on IFRS adoption with survey information on the developing country.

Recently, some researches attempt to study the determinants or antecedents of IFRS convergence (e.g. Judge et al, 2010). This study joins this effort by investigating the constituents' preparedness for change in the process of IFRS convergence using institutional theory. The result of these findings may be relevant in assessing the likelihood that companies will comply with principles underpinning the IFRS once it is adopted.

Many past researches focus on the determinant factors of IFRS adoptions on the national level using institutional theory perspectives (Judge et al, 2010; Barbu and Baker, 2010; Irvine, 2008; Hassan, 2008; Mir and Rahaman, 2005; Touran, 2005). Therefore, it is possible to utilize institutional theory framework to investigate the isomorphism pressures that may influence the preparedness for IFRS convergence at organization field. It is also interesting to examine whether IFRS adoption process in organization is driven more by social legitimization pressures based on the institutional theory.

Additionally, this study also attempts to investigate the internal barriers to implement IFRS from the resource-based view as the lack of resources and capabilities of companies may constitute internal barriers that thwart the preparedness of companies for IFRS convergence. The outcome of this study will hopefully create awareness among financial statements preparers, standard setters and accounting regulators.

1.5 Contributions of Study

Findings of this study will help the accounting regulators such as the SC, accounting professional bodies like the MIA, standard setters like the MASB and other stakeholders such as accountants and auditors to understand the complex issues related to convergence with IFRS and the factors that affect or influence the diffusion of IFRS. As such, policy makers and accounting professional bodies can assess and even seek to influence the institutional pressures that may enhance or impede the adoption of IFRS.

Furthermore, the findings can be insightful to companies in the worldwide that required adopting IFRS as well as regulators and standard setters in promoting convergence with IFRS especially in the developing countries. National regulators and standard setters may find this study interesting and meaningful when considering various factors and barriers can influence the implementation of IFRS in different forms by entities in their respective jurisdictions.

This study also contributes to the research study's gap of inadequacy of exploration study on the IFRS adoption at organization field, especially in the developing countries context by using the institutional theory and resource-based view, hence providing a foundation background for future research.

1.6 Organization of Study

This study is structured into five chapters. The Chapter 1 introduces the study with the background of IFRS convergence and the full convergence with IFRS in the Malaysia context. The objectives of this study and research questions are also covered in this chapter. Lastly this introductory chapter also briefly discusses the motivation and contribution of the study.

Chapter 2 reviews the background of institutional theory and provides a thorough discussion on the influences of three isomorphism namely coercive, mimetic and normative isomorphism on the preparedness of companies for the IFRS convergence as well as the internal barriers to implement IFRS. The review on the control variables ends this chapter of literature reviews.

Chapter 3 describes the research methodology that begins with the research framework and hypotheses development. This chapter further elaborates the measurements of research variables, sampling design and data collection procedures, measurement development, administration of questionnaire and data analyses procedures that are used in this study.

Chapter 4 of research findings shows the statistical result and analyses of the findings. The testing of hypotheses is further discussed and the results of the findings are reported accordingly.

Chapter 5 of conclusion and recommendation provides the discussion on the results of the findings. The implications of the study are presented. Lastly, limitation and future research are also covered in this chapter.