Adoption of IFRS: What the Audit Committee Needs to Know

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In this article, MASB staff highlight areas Audit Committee members should consider as their company implements Malaysian Financial Reporting Standards (MFRS) - a verbatim adoption of International Financial Reporting Standards (IFRS).

Introduction

The full adoption of IFRS by Malaysia on 1 January 2012 through the issuance of MFRS was a necessary milestone in making Malaysia an attractive investment destination. By adopting MFRS, companies in Malaysia can now join companies in over 120 countries who prepare financial statements under an IFRS Framework[1]. As companies finalise their 2012 financial statements, it is important that the Audit Committees of Publically Accountable Entities reflect on what the adoption of the IFRS Framework means going forward.

Role of the Audit Committee in financial reporting

In addition to the global push by regulators towards using a common accounting standard framework such as IFRS, the public is pushing for more accountability for financial reporting by Audit Committees. For example, the United States (US) Sarbanes Oxley Act[2] and the Audit Committee Guidance for European Companies[3]

[1] "AICPA IFRS Resources." *IFRS FAQs*. N.p., 2012. Web. 26 Nov. 2012. <http://www.ifrs.com/ifrs_faqs.html>.
[2] Sarbanes-Oxley Act. Pub. L. 107-204. 116 Stat. 745. July 30, 2002. Print.

require Audit Committees to provide strong oversight on a company's financial reporting and internal controls. Similar to regulators in the US and Europe, Malaysia's regulators have also published Audit Committees guidelines. For example, Chapter 15 of BURSA Malaysia's Listing Requirements[4] outlines the structure and functions of the Audit Committee, lists Audit Committee procedures, and details Audit Committee reporting requirements. Similarly, the Securities Commission Malaysia (SC) discusses the role of the Audit Committee within its Corporate Governance Blueprint 2012[5]. Chiefly the SC believes the role of the Audit Committee centres around upholding the integrity of financial reporting - principally through examining and monitoring the continued suitability and independence of external auditors, developing and supporting a strong internal audit function, and ensuring the financial statements comply with applicable reporting standards.

Audit Committees must understand the responsibilities associated with their role. One guidance is to be found in a recent Australian case, where directors of Centro Properties Group were found guilty of issuing misleading financial reports, which resulted in hefty fines[6]. While some Audit Committees have been punished for breach of duties, others, such as Dell Inc.'s, have played an instrumental role in investigating and correcting accounting misconduct: in 2007 Dell's Audit Committee worked to ensure the company's restated financial statements corrected any prior 'errors and irregularities'[7].

It is imperative that Audit Committees fulfil the expectations placed on them; including taking an active role in their company's accounting framework convergence initiatives. Furthermore, their accountability to external stakeholders (including investors, creditors and regulators) presents an opportunity to create an environment that supports continual compliance with IFRS.

[3] European Confederation of Directors' Associations. Aug. 2001. Web. 19 Nov. 2012. < http://www.ecoda.org/Publications.html>.

[4] "Listing Requirements." Bursa Malaysia, Web. 19 Nov. 2012. <http://www.bursamalaysia.com/market/regulation/rules/listing-requirements/main-market/listing-requirements>.

[5]"Corporate Governance Blueprint 2012." Securities Commission Malaysia, Web. 19 Nov. 2012. <http://www.sc.com.my/eng/html/cg/cg2012.pdf>

[6] "Centro Civil Penalty Proceedings." Australian Securities and Investments Commission, 31 Aug. 2011. Web. 26 Nov. 2012. <http://www.asic.gov.au/asic/asic.nsf/byHeadline/11-188MR%20Centro%20civil%20penalty%20proceedings?opendocument>.

[7] "Dell Audit Committee: Company Did Not Maintain Effective Control Environment." Nashville Business Journal, 24 Aug. 2007. Web. 19 Nov. 2012. <http://www.bizjournals.com/nashville/stories/2007/08/20/daily40.html>.

What IFRS compliance really means

Companies that follow MFRS will have to faithfully keep to the obligation of being IFRS compliant. The main draw of IFRS is having a particular transaction accounted for similarly, regardless of industry and consistently between the jurisdictions that use IFRS.

In order to state that the financial statements are ‘IFRS-compliant’, an entity needs to adhere to both IFRS standards and IFRS Interpretations Committee (IFRIC) interpretations. This means following IFRS to the letter – i.e., Malaysian-specific interpretations are not permitted. As such, management and the Audit Committee need to ensure they are aware of how IFRS is applied worldwide, reading the latest publications detailing concerns and challenges related to IFRS and have a process in place for their accounting function to keep up to-date.

Working with management

The most apparent impact of adoption will be on an entity’s finance function. The Audit Committee should ensure the financial reporting team not only identifies the relevant IFRS standards and interpretations but also has the technical expertise to apply the guidance to company-specific transactions. As accounting standards are not static, the Audit Committee should regularly brainstorm with management how significant developments could impact the financial statements they oversee. Professional judgement is required to adequately apply IFRS. Assessments should extend far beyond a ‘cut and paste’ of accounting methodology. Management must be able to think critically - understanding both the substance and form of transactions - to determine the most appropriate accounting treatment.

The Audit Committee should help identify and develop ‘internal experts’ who will drive the MFRS Initiatives. In addition to the financial reporting team, the tax department should be brought in to consider any related tax implications. Another key department is legal as they need to be aware of changes to accounting standards that may affect their views on legal matters such as on joint ventures and entities with minority interest. Once these personnel are identified, the Audit Committee should determine if the company’s training strategy provides a platform for continued learning as IFRS evolves, setting IFRS-specific education goals not only for the staff but for themselves as well.

The Audit Committee should also determine if its information systems are capable of capturing and transmitting all the relevant data necessary to fulfil IFRS and regulatory reporting requirements. Questions to consider include how automated the company wants to make financial reporting, as well as what changes to information systems are needed, if any, to support compliance going forward. One recent development worth being aware of is the move for financial reporting to use the XBRL reporting format locally.

It is clear therefore that the Audit Committee must be clear how the various parts of management are kept appraised of accounting standard changes and keep in compliance of the accounting standards, which is much more of an issue for the company as a whole and not just a problem for the Finance department to deal with.

Working with auditors

External auditors can be a valuable source of IFRS knowledge and expertise, educating the company on their firm's 'house view' on IFRS applications relevant to the company. Understanding why certain views are preferred, and not just what those views of the auditors are, can even serve as a foundation for developing internal expertise.

Tension can develop between auditors and management, especially when high levels of professional judgement are needed. Therefore, the Audit Committee must be made aware of such circumstance and may have to act as mediator to determine which position is more appropriate.

Creating a collaborative environment

The move towards MFRS can be used as a catalyst to implement a culture of collaboration among management, the external auditors and the Audit Committee. The Audit Committee can establish protocols that require management to brief them on major accounting decisions, accounting policy elections and significant accounting estimates. The Audit Committees can encourage roundtables with their external auditors to learn more about accounting matters relevant to the company.

In addition to working with its management and external auditors, the Audit Committee should consider its responsibilities towards the company's investors. In this regard, the Audit Committee should discuss internally what the best approach is to keep investors informed of any changes resulting from the implementation of IFRS and adoption of new standards.

Conclusion

Continued compliance with IFRS is not easy, but a well-equipped Audit Committee can provide valuable oversight and counsel to help an entity successfully report under an internationally-recognised accounting framework. Fully adopting IFRS raises the status of the company - providing a globally accepted accounting framework that investors around the world can interpret and understand. Thus, migrating to the MFRS Framework should be viewed as an opportunity instead of just a challenge, with the Audit Committee playing a vital role.