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FINANCIAL ACCOUNTING APPLICATION AND ANALYSIS ON CONGLOMERATE COMPANY SIME DARBY

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ABSTRACT

The doctrine of financial reporting is embedded in a conceptual framework as an attempt to codify existing GAAP in order to reappraise current accounting standards and produce new standards. The IFRS shelters IASB Conceptual Framework that was revised in 2018. These theoretical principles provide the basis for the development of new accounting standards and the evaluation of those already in existence. The financial reporting process is concerned with providing information that is useful in the business and economic decision-making process. Therefore a conceptual framework forms theoretical basis for determining which events should be accounted for and how they should be measured and communicated to users. In this article, the researcher critically applies, analyses and evaluates with closing justifications on IFRS 15. Subsequently, an in-depth introspection on the need and type of financial statement disclosure with support of an example of a conglomerate company, Sime Darby, featured using its notes to financial statements.

Keywords: GAAP, IFRS, Disclosure, Financial Statements.

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OUESTION 1

Critically evaluate on the following areas:

*Explain the impact of the new standard replacing few old standards.

*What are the challenges for Malaysian accountants to be ready to adopt IFRS/MFRS 15?

*Suggest possible strategies company should prepare for the new standard.

(50 Marks)

1.0 IFRS 15 Revenue from Contracts with Customers

1.1 Introduction

According to K.Allen (2016), in May 2013, International Accounting Standards Board (IASB), US National Standard Setter and Financial Accounting Standards Board (FASB) issued a new standard pertaining to ‘revenue recognition’ to be applied as a common revenue standard for International Financial Reporting Standard (IFRS) and US Generally Accepted Accounting Principles (US GAAP). The new revenue standard was IFRS 15 or Accounting Standard Codification 606 (ASC 606), **“Revenue from Contracts with Customers”** which shall be effective at implementation in annual reports on or after January 1, 2017 and early adoption is acceptable. (EY, 2017)

1.2 Old Standards and its deficiencies

Based on K.Allen (2016), the development of IFRS 15 was performed to establish and clarify principles in recognizing revenue in terms of its amount, nature, timing and uncertainties rising from an entity’s contracts with customers. Thus, IFRS 15 is a combination of six revenue associated standards practiced previously- meaning IFRS replaces all the six standards namely:-

1) **IAS 11 Construction Contracts**
2) **IAS 18 Revenue**
3) **IFRIC 13 Customer Loyalty Programmes**
4) **IFRIC 15 Agreements for the Construction of Real Estate**
5) **IFRIC 18 Transfers of Assets from Customers; and**
6) **SIC-31 Revenue—Barter Transactions Involving Advertising Services**

***Note**: IAS: International Accounting Standards

: IFRIC: International Financial Reporting Interpretations Committee

: SIC: Standing Interpretations Committee.

According to Altman and Anderson (2016), this is because IASB and FASB realized that the previous revenue standards were difficult to be applied to multifaceted and composite accounting transactions and provided inadequate guidance in imperative accounting topics relating to revenue such as multiple element arrangements. Also, the US GAAP developed various requirements and concepts of recognizing revenue causing different standards being applied for merely the same transaction. This caused no standardization in recognizing revenue.

As a result, IASB and FASB developed a common revenue standard for both IFRS and GAAP to promote standardization. Indirectly, this concept addresses revenue issue through a robust methodology; eliminates discrepancies, weaknesses and problems associated with previous revenue standards, increases the usefulness of the information to financial statement users through distinct disclosures requirements; improves comparability for capital markets, entities and jurisdictions; and reduced the volume of requirements to be followed- thereby simplifying financial statement preparations. (Altman and Anderson, 2016)

Following all these achievements, it shows that IFRS 15 appears to be very different from the old revenue standards in terms of its principles and implementation. The following exhibit illustrates the basic change of old standards to new standards at a glance. (K.Allen, 2016)

Exhibit 1.0 Changes between old standard and IFRS 15

Current requirements		New requirements	
Revenue recognition		**Revenue from contracts with customers**	
IAS 11 IAS 18 IAS 18 IFRIC 15	Construction contracts Sales of goods Sales of services Real estate sales	IFRS 15	Point in time or over time
IAS 18	Royalties		New guidance on royalty revenue
IFRIC 13	Customer loyalty programmes		New guidance on options for additional goods and services and breakage
IFRIC 18 SIC 31	Transfers of assets from customers Advertising barter transactions		Guidance on non-cash consideration
	Previously little guidance on costs of obtaining and fulfilling a contract		New guidance on costs of obtaining and fulfilling a contract
Other revenue		**Other revenue**	
IAS 18 IAS 18	Interest Dividends	IAS 39 or IFRS 9	Interest Dividends

Source: K.Allen, 2016

1.3 The Core Principle and the Five Step Revenue Recognition Model

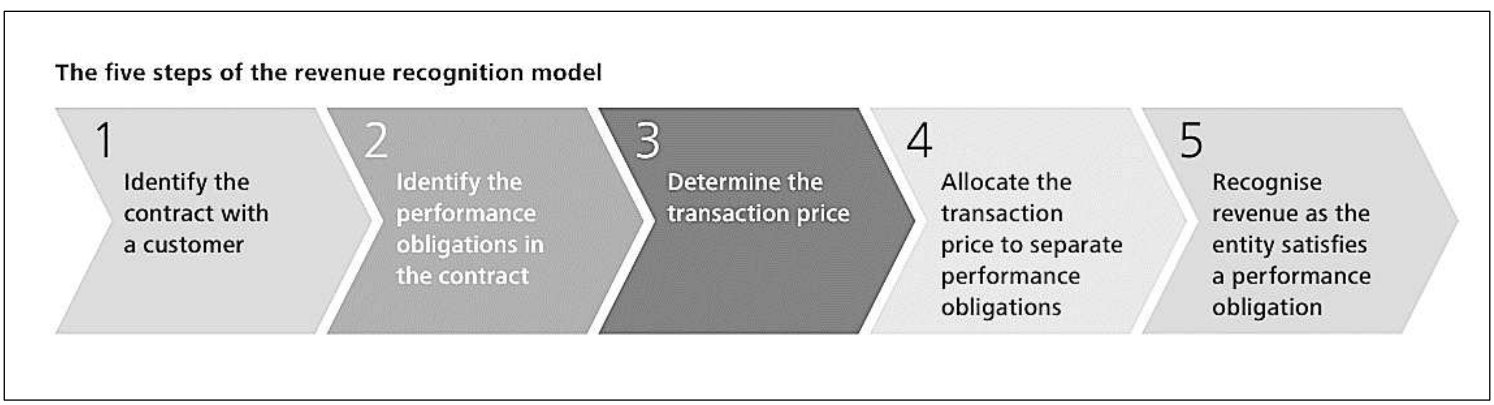
According to Kalavacherla, O'Donovan and Schurbohm (2016), the core principle under which IFRS 15 abides by the rule that an entity should recognize revenue in a way that clearly implies the transfer of promised goods or services to customers- where the amount the entity expects to receive in return for goods and services exchanged should distinctly reflect the amount considered. Therefore, to ensure that every entity correctly abides by this rule, IFRS 15 can be critically yet simply explained through a 'Five Step Model"-a model that must be followed to successfully recognize revenue according to IFRS 15.

The Five Step Revenue Recognition Model

- **Step 1 : Identification of the contract with the customer**
- **Step 2 : Identification and separation of the performance obligations in the contract**
- **Step 3 : Determination of the transaction price**
- **Step 4 : Allocation of the transaction price to the performance obligations**
- **Step 5 : Recognition of the revenue when the performance obligations are satisfied**

(Kalavacherla, O'Donovan and Schurbohm, 2016)

Exhibit 2.0 The Five Step Revenue Recognition Model

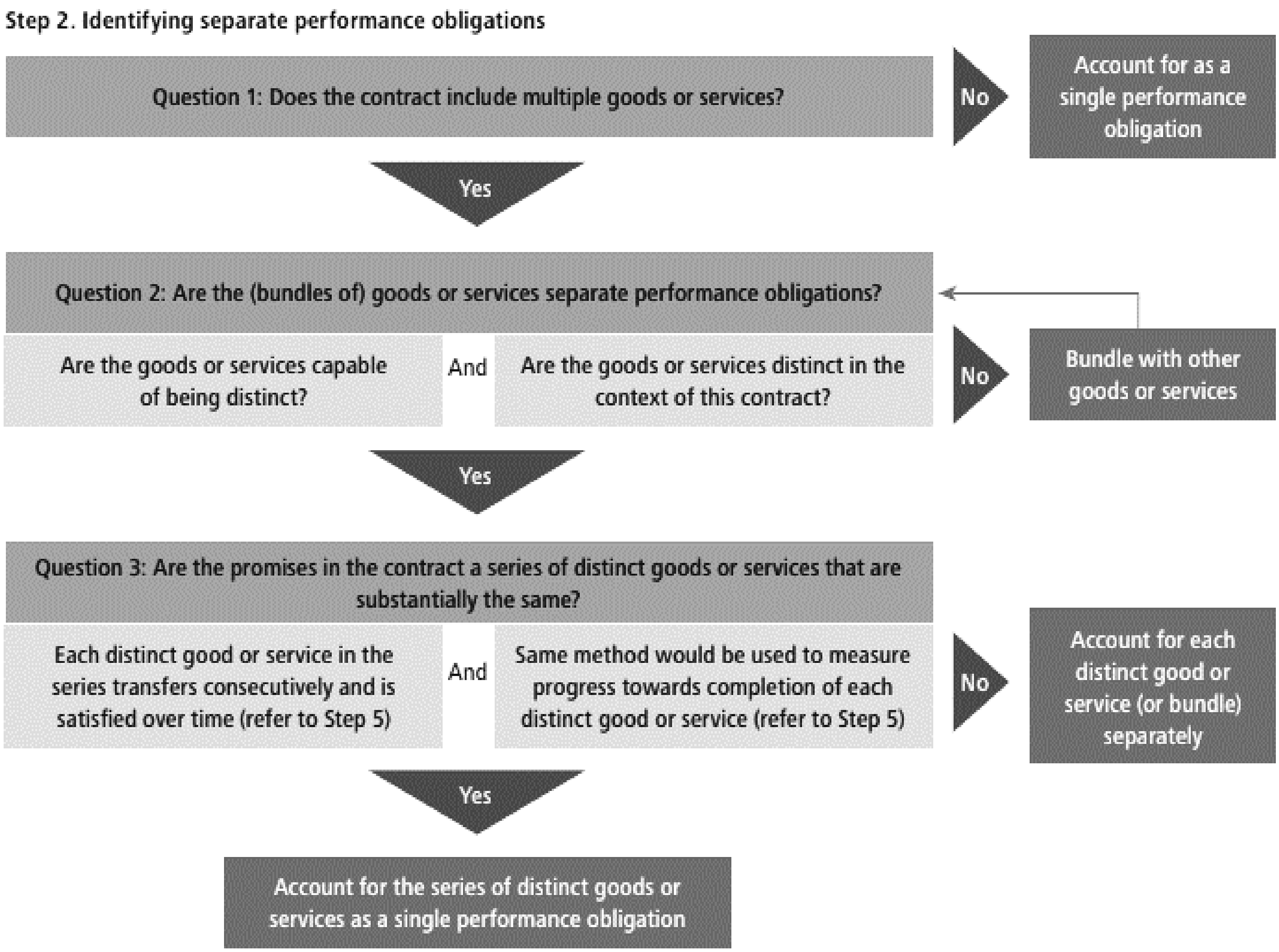


Source: K.Allen, 2016

First, **identify the contract(s) with customer**. IFRS 15 is only applicable when there is a contract depicting consensus between two or more parties binding to the enforceability of obligation- where in this case between the customer and entity. (Kalavacherla, O'Donovan and Schurbohm, 2016)

Second, **identify performance obligation in contract**. Following the contract formation, it includes the process of transferring goods or services to customer of which if the good is distinct- the promise of transferring goods is treated separately from other promises agreed in the contract. This is because distinct goods are depicted as goods that can be utilized by the customer by themselves or with the help of readily available resources. (Kalavacherla, O'Donovan and Schurbohm, 2016)

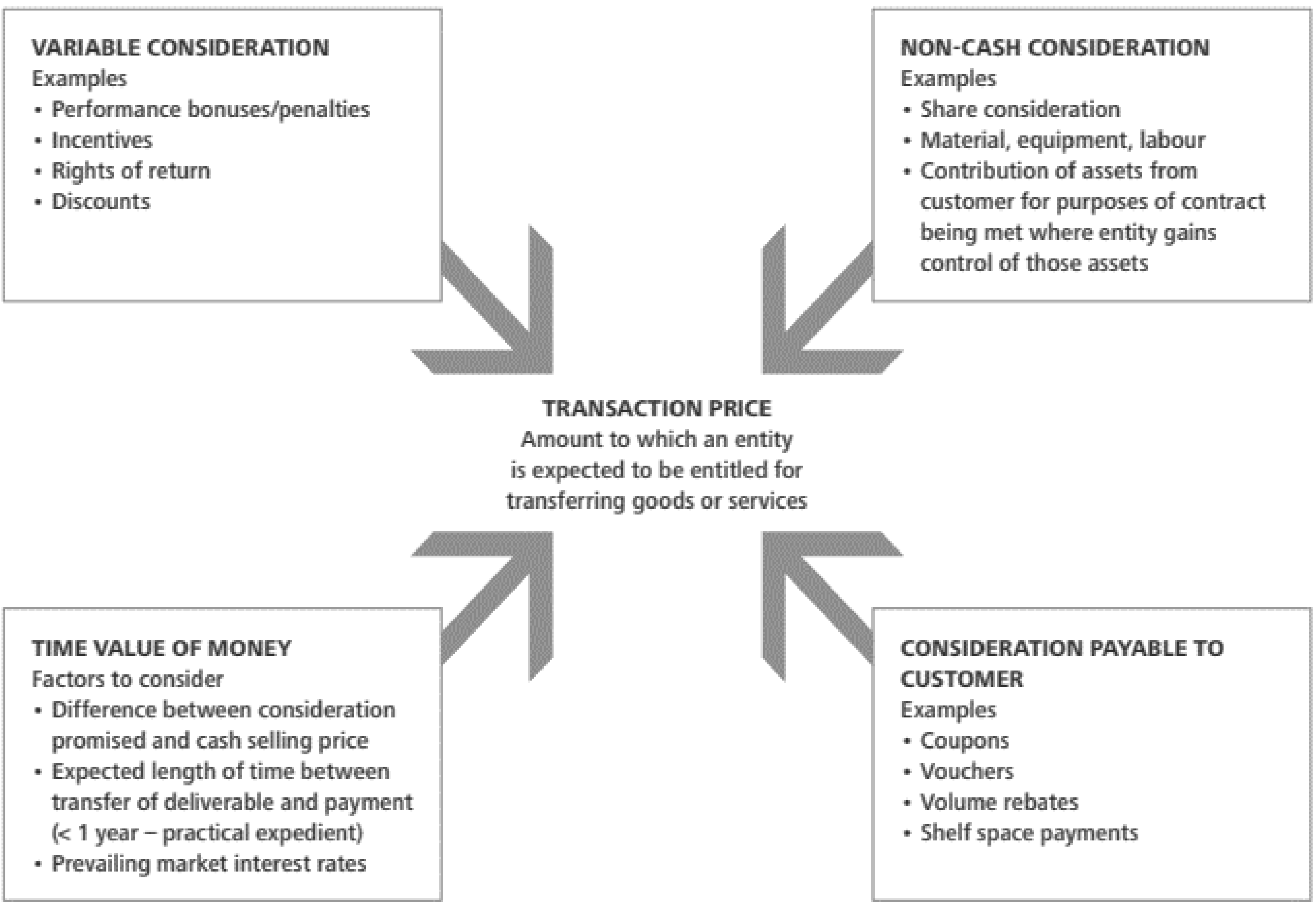
Exhibit 3.0: Identify performance obligation in contract



Source: K.Allen, 2016

Third, **determine the transaction price**. Since the modern world does not practice barter system, monetary value becomes the return to entity; following the exchange of good. This is the consideration in the contract which entity expects to be entitled. The transaction price is subject to changes due to customer consideration, variable consideration other than cash or even time value of money if the contract inherits financing component. However, if consideration is variable, an estimated amount shall only be included in the transaction price if resolution of uncertainty related to variable consideration does not cause significant cumulative revenue reversal. (Kalavacherla, O'Donovan and Schurbohm, 2016) and (IASB, 2014)

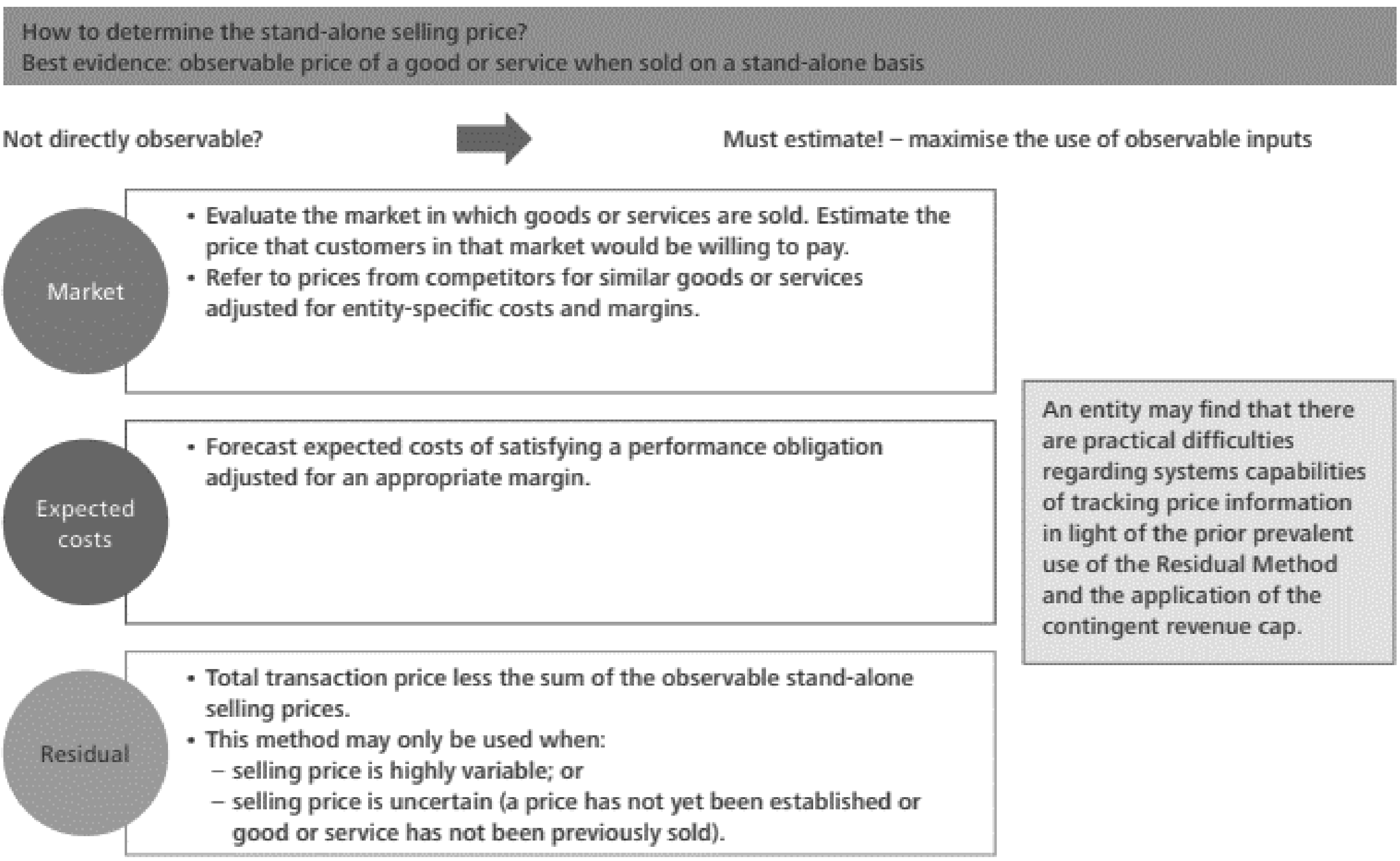
Exhibit 4.0: Determining the transaction price



Source: K.Allen, 2016

Fourth, **allocate the transaction price to separate performance obligations**. Based to the promised selling price of the goods, the entity decides the price for each performance obligation. However the price is exposed to estimation at intervals where selling price is not apparent and entity may include discounts based on the contractual agreements. (Kalavacherla, O'Donovan and Schurbohm, 2016)

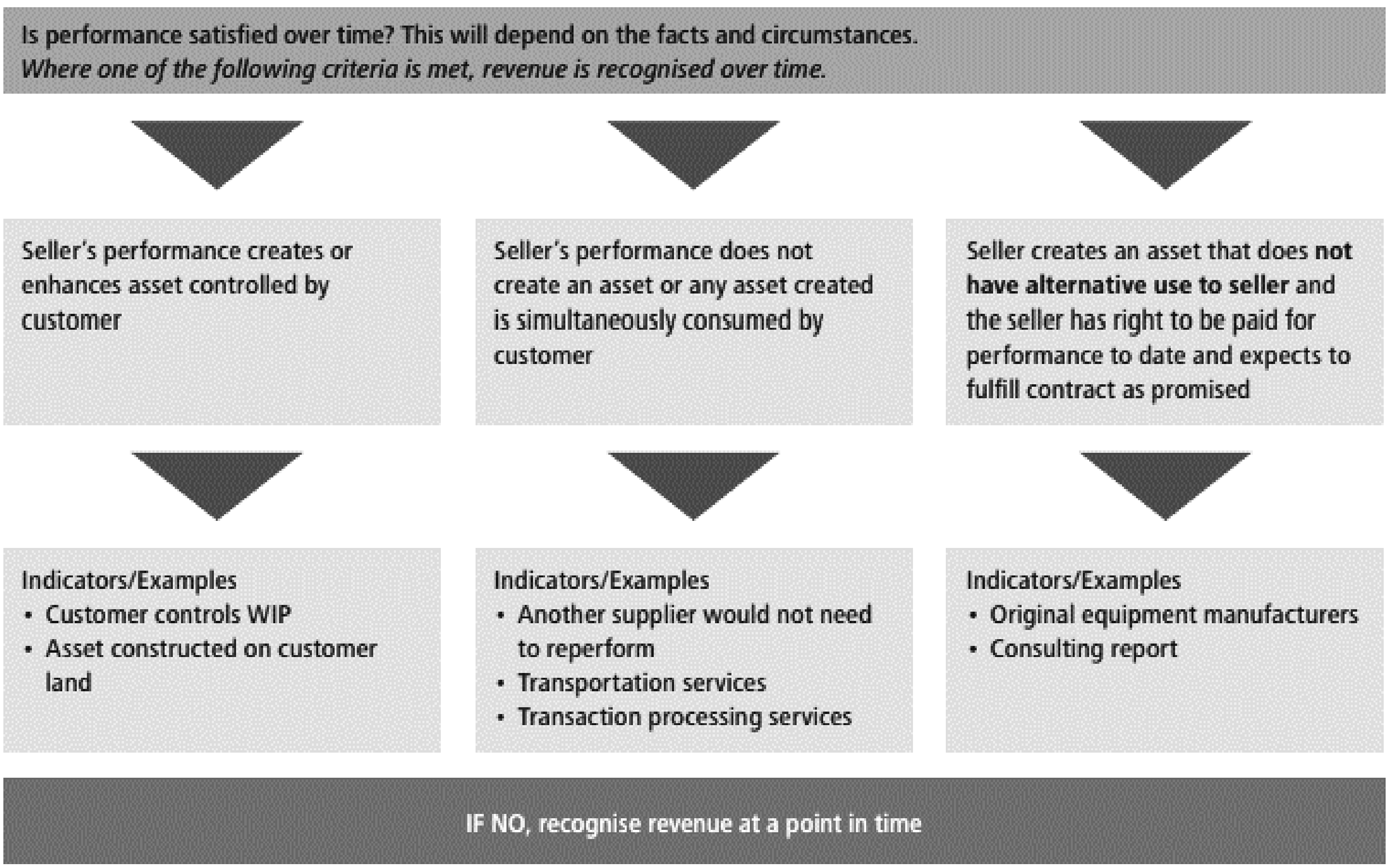
Exhibit 5.0: Allocating the transaction price to separate performance obligations



Source: K.Allen, 2016

Fifth, **recognize revenue as the entity satisfies performance obligations**. The revenue is recognized directly at the point when entity transfers goods to customer and that the customer is in control of it. This is when performance obligation is satisfied and revenue recognized according to allocation. The performance obligation can be satisfied ‘in time’ for transfer of goods and ‘over time’ for transfer of services- where revenue is recognized based on methods of measurements in order to accurately satisfy performance obligation. (IASB, 2014)

Exhibit 6.0: Recognizing revenue as the entity satisfies performance obligations.



Source: K.Allen, 2016

1.4 Impacts of New Standard Replacing Old Standards

Based on the 5 step Revenue Recognition model under IFRS 15, many companies are affected by the way they account for revenue as IFRS 15 can be very complex in terms of its implementation steps. Thus, there are many impacts of the new standard replacing the old standard.

First, **revenue recognition point 'in time' or 'over time'**. According to IAS 18, revenue recognition timing is based on the transfer of risks and rewards. However IFRS 15 focuses on control of goods transferred to customers.

Based on K.Allen, Kalavacherla and H. Munter (2016), thus, entities may be impacted in 'change of timing for revenue recognition'. IFRS 15 has illustrated three vital situations where revenue could be recognized 'over time' that is when, (i) upon seller's performance obligation, the customer obtains and consumes benefit; (ii) customer controlling work-in-progress assets that is still being developed by seller and (iii) the customer is obligated to pay for the work-in-progress asset up to the work-to-date as the asset could not be directed to another prospective customer.

Based on these three situations, if revenue is to be recognized over time, entities will have to be alert in analyzing all situations that happen at business and keep tract of any situations that happen to fall within these three scenarios.

This is because over time revenue recognition requires specific methods of measurements in order to accurately satisfy performance obligation. If entity does not monitor this, over time transactions will get recognized point in time causing inaccuracy in implementing IFRS 15. Thus, new standard changes impacts timing of revenue recognition. (K.Allen, Kalavacherla and H. Munter, 2016)

Second, **revenue recognition accelerated or deferred for transaction with variable and uncertain elements**. Certain contracts in entities pertaining to investments may include significant 'variable elements' such as rebates, refund, incentives, contingencies, penalties and performance bonuses which are payable based on net assets or upon meeting certain conditions.

However, IFRS 15 dictates that variable consideration shall only be included in the transaction price if it is highly probable that the resolution of uncertainty related to variable consideration does not cause significant cumulative revenue reversal out of subsequent re-estimation. (K.Allen, Kalavacherla and H. Munter, 2016)

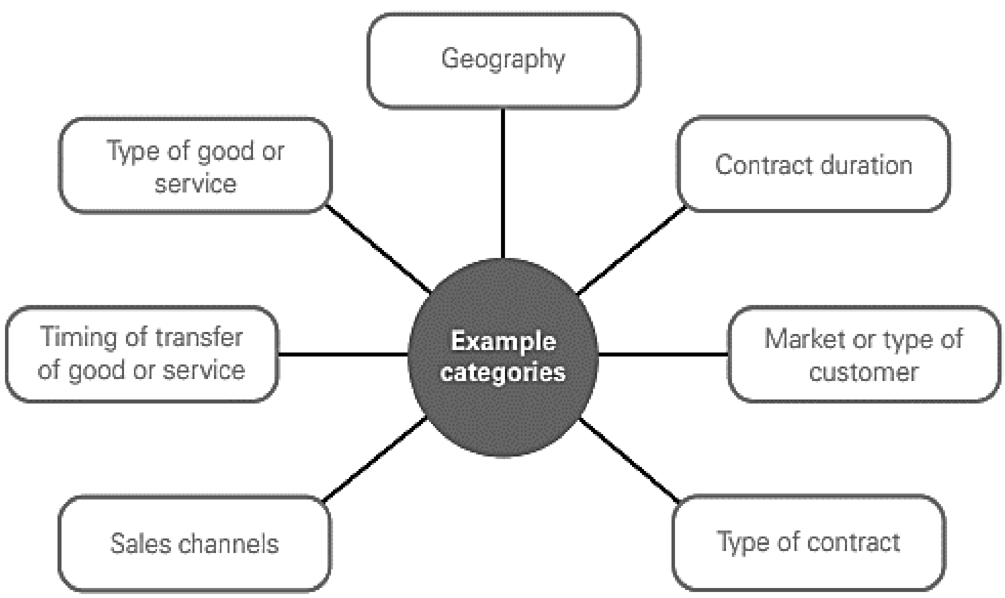
This impact entities as there is a need to adequately gauge on the amount of consideration that is required to be applied and that it may be arduous to judge the probability level of revenue not being subjected to future reversals.

Based on K.Allen, Kalavacherla and H. Munter (2016), this causes different entities performing revenue recognition for variable elements differently due to the uncertainty that revolves around 'probable' judgment- influencing financial ratios that affect financial analyst's prospects, seller's earn-outs and compensation procedures.

Third, **additional disclosures**. IFRS 15 has increased the volume of disclosure required to be disclosed in entities interim and annual reports- most of which were not disclosed by entities previously. This goes against adequate disclosure requirements. For example based on IAS 11 and IAS 18, K.Allen, Kalavacherla and H. Munter (2016) evaluates that disaggregated revenue was only disclosed by segment and significant category in accordance with IFRS 8 operating segments but IFRS 15 requires further disaggregation within segments in multiple categories. Also, disclosures regarding contract balances only disclosed potential Management Discussion and Analysis (MD&A) that depicted significant work-in-progress and deferred revenue but IFRS 15 requires added quantitative and prescriptive requirements for all contract balances and narrative discussions. (IASB, 2014) and (EY, 2015)

Thus, entities now have to consider applying qualitative and quantitative disclosure within all contracts with customers while declaring all judgments made or assets recognized when satisfying contracts under IFRS 15. Based on IASB (2014) and EY 2015), this negatively impacts businesses as they need intensive effort in understanding and capturing the information before illustrating disclosures and preparing new disclosures is comparatively time consuming. Also, many businesses may start providing irrelevant and immaterial disclosure if they fail to understand requirement of IFRS- which may dissatisfy potential financial statement users such as investors and credit providers. (K.Allen, Kalavacherla and H. Munter, 2016)

Exhibit 7.0 Disaggregation of revenue disclosure requirement



Source: K.Allen, 2016

Exhibit 8.0 Additional Disclosure Requirements

Source: K.Allen, 2016

Fourth, **involvement of IT**. Previously entities have programmed their IT and software systems to capture data based on old standard requirements. However, with IFRS 15 that requires various additional information for recording and disclosure purpose, entities need to introduce new system and processes that records data according to IFRS 15- especially data associated with revenue transaction estimates, cash cycles and disaggregation of revenue disclosures.

Incorporating the new system, entities may need to run records parallel for certain period of time in order to successfully implement the transition. Overall, entities shall incur additional cost for incorporating new software, inviting IT specialist making adjustment to system according to IFRS 15, replacing Excel and manual practices and training employees to learn the new revenue recognition technique- all of which entities shall be forced to finance, reducing short-term profitability. (Kalavacherla, O'Donovan and Schurbohm, 2016)

Fifth, **accounting processes, tax planning and stakeholder communication**. Following IFRS, sale operation, marketing, business development and executive management shall need to capture new information and document it accurately especially information relating to judgments and estimations. This is because, areas involving approximation attributes often run out of IRFS 15 paradigm due to different types of business dealing with different transactions and thereby recognizing revenue contrarily. (Kalavacherla, O'Donovan and Schurbohm, 2016)

Thus, based on IASB (2014), EY (2015) and Kalavacherla, O'Donovan and Schurbohm, (2016) entities are impacted by the need to maintain efficient internal controls to safeguard accuracy and completeness of information not collected previously. The understandability level of these accounting procedures shall impact tax planning. This is because timings and amount of revenue recognition causes tax changes- increasing need for businesses to cater revisions to tax planning.

Business are impacted with all these changes and at the same time shall need to communicate with stakeholders who are interested to understand IFRS 15 as changes in revenue recognition impact implementation costs, business practices, approach of transition and financial results- all of which resemble areas of stakeholder interests. Business need to ensure effective communication performed with stakeholders as lack of understandability may influence stakeholder decision making and so the overall entity's financial position. (K.Allen, 2016)

1.5 Challenges faced by Malaysian Accountants in adopting IFRS 15

Based on the impacts, there are many challenge faced by Malaysian accountants in adopting IFRS 15. The following paragraphs are designed based on areas or actions of a business (mainly from technology and consumer product industry) that may experience changes which may pose intense challenge for accountants.

First, **revenue allocation.** The main challenge accountants' face is utilizing judgment and estimation procedures to identify performance obligation- where they need to exactly know when performance obligation has been satisfied and that revenue can be recognized based on the transaction price set. This is because entities can no longer allocate revenue through billing practices as IFRS 15 is concerned in identifying performance obligation after binding contract is formed. (Altman and Anderson, 2016)

Altman and Anderson (2016) evaluates, this is difficult, for example in technology industries providing 'software license arrangements' where software often comes in a package bundled with myriads of services such as hosting, design, post-contract customer service and software upgrades. Each of these may have respective prices according to vendor-specific objective and multiple-element arrangements, however, accountants will need to create a stand-alone selling price.

This shows how accountants shall need to appropriately and accurately cater for change in allocation of transaction price, so that revenue can be recognized upon satisfying performance obligation.

Despite the change in transaction price, it is difficult to keep control of it as the data to perform calculation is in different systems- posing greater challenges for accountants to deduce stand-alone price in future. (Altman and Anderson, 2016)

Second, **license**. Accountants may experience a challenge when it comes to entity-consumer contracts involving licensing. This can be seen in consumer product industry where companies license intellectual property such as ‘company image’, ‘trademarks’, ‘inimitable slogans’, patents’, ‘copyright’ and ‘distinctive brand name’ to prevent other businesses or industries to imitate- but to authorize them with license for an agreed payment of royalty. Similar concept applies in technology industry where companies license software. (Altman and Anderson, 2016)

However, the difficulty builds when accounts have to decide whether the license is different from performance obligation or a right to use- as identifying this is imperative so that accountants can apply appropriate recognition in term of ‘over time’ or ‘in time’. Recognition is not only challenge, timing to recognize also becomes a challenge. (Altman and Anderson, 2016)

Third, **warranties**. In adopting IFRS 15, Malaysian accountants may face challenges in treating warranties. There are two types of warranties; one which guarantees customer that product complies description and specification while free from deficiencies, and, the other that do more than former- entitling customer to benefit from fixed period warranty above initial warranty.

The problem arises when accountants need to distinguish whether the warranty falls under cost-accrual basis or a distinct performance obligation. For example, in the consumer product industry, customers may have choice to buy it separately or receive upon agreed specifications- different businesses may apply warranty differently; causing accountants to reassess all warranties offered and accurately associate appropriate accounting treatment for its recognition. (Altman and Anderson, 2016)

Fourth**, Contract combinations and modifications**. Since the first requirement of IFRS 15 is ‘identifying a contract’, accountants will need to first ensure that a contract is formed binding entity-customer to the enforceability of obligation. Then, accountants need to investigate and deduce all the possible contracts entity had with same customer and the revenue reallocation practiced across contracts. (Altman and Anderson, 2016)

This becomes challenging when the accountant is obligated to perform this as in this lies the transaction pricing dependencies which the accountant needs to discover to counter check the transaction pricing against agreed pricing.

Not only that, the difficulty builds when accountants need to monitor contract modifications- where they have to be alert in recording constant adjustments made in the contract. If not, they may not be aware regarding changes in consensus pertaining to transaction price or performance obligation- causing inaccurate revenue recognition. (Altman and Anderson, 2016)

Fifth, **training, dividends and shareholders**. To adopt IFRS 15, companies need to modify and re-design IT and software systems to perform relevant and reliable reporting. Thus, the challenge is that accountants will need to get adequate training in understanding IFRS 15 so that they can draw up entity-customer contracts and successfully implement it through UBS, SAP, AXP and SQL accounting software. (Altman and Anderson, 2016)

Despite the training and adoption of IFRS 15, it is important to understand that the company is still running its operation and it is not that the companies have taken a break to implement IFRS 15. So, together with the transition, accountants will need to monitor if timing of revenue recognition influences profit recognition that could affect amount of dividends available for payment to shareholders. This is because shareholders are interest to maximize their wealth and are equally interested to know if the changes in IFRS 15 positively or negatively impacted financial statements. (Altman and Anderson, 2016)

Thus, it becomes difficult and challenging for Malaysian accountants as while getting trained and applying implementation, they are responsible to communicate status of financial position to shareholders with convincing explanation and update business plans accordingly so that the company does not lose existing and prospective investors.

1.6 Strategies companies should prepare for adopting IFRS15

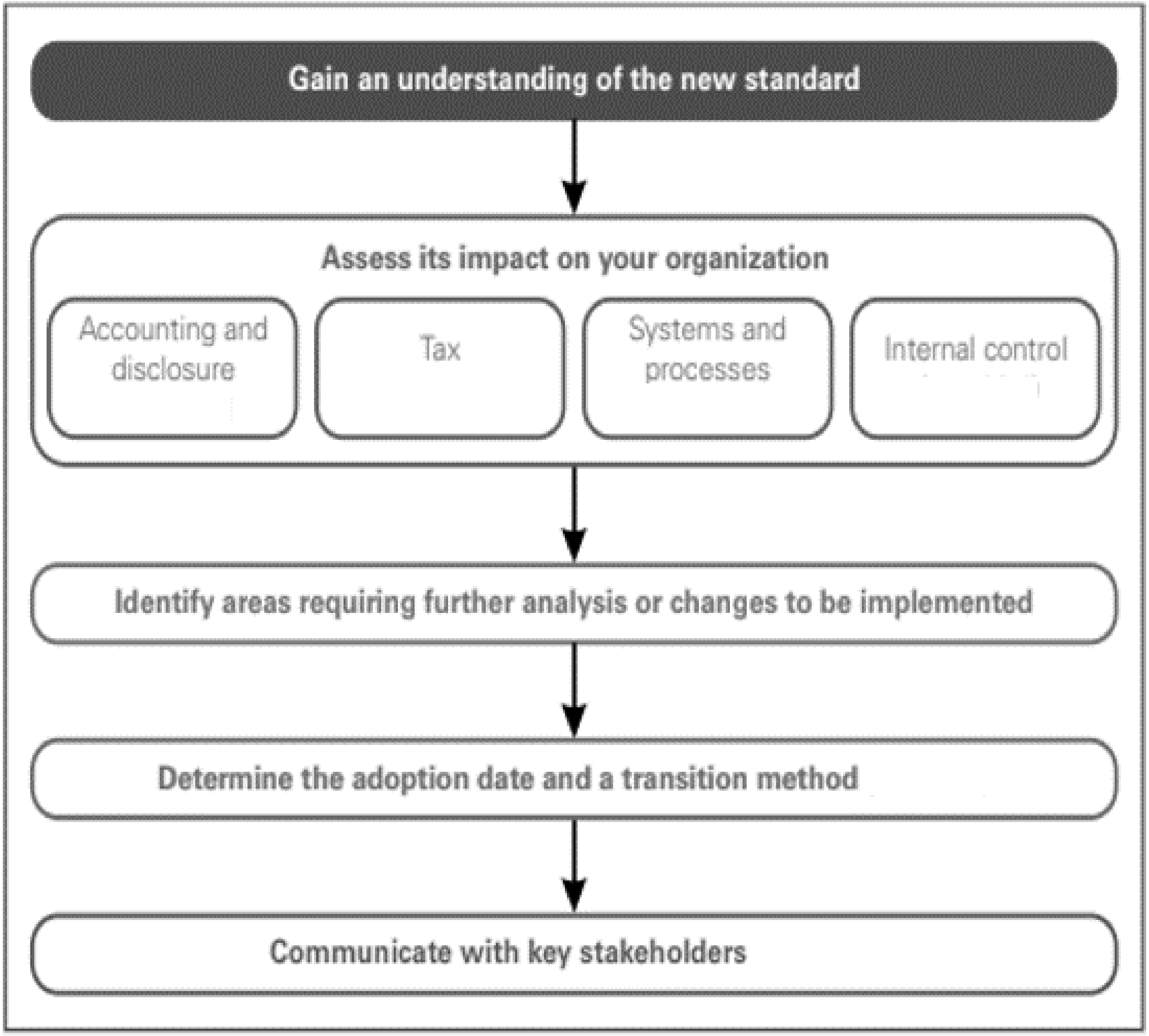
Based on the impacts and challenges faced by business and accountants following how IFRS 15 replaced old standards, there are many possible strategies that companies can and should prepare to implement new standard successfully. (Altman and Anderson, 2016)

First, **five step model and effective date and transition**. The very first strategy a business should consider is to understand IFRS 15 through the five step model that explicitly depicts in detail the minimum requirements a business should follow in order to proceed recognizing revenue from contract with customers according to IFRS 15.

Then, the business should evaluate the possible impacts and challenges accountants and entity shall face if IFRS 15 was implemented (as explained above) - but from the perspective of its business type be it from technology, telecommunication or consumer product industry it belongs to. (Altman and Anderson, 2016)

Finally the business should decide effective date and transition for IFRS 15 implementation. There are two ways to adopt IFRS15. First “retrospective approach’ where entity adopts IFRS15 as if it had been implemented. Second, ‘cumulative effective approach’ where IFRS15 shall be implemented directly on the required application date but shall disclose what would be the changes applying new standard. (Altman and Anderson, 2016)

Exhibit 9.0 Implementation Consideration Strategy



Source: K.Allen, 2016

Second, **accounting policies and disclosure**. Entities should identify and analyze all accounting policies that requires change and train accountants on additional disclosures needed to be showcased. To perform this, entity should consider several factors such as, ‘degree of variation based on type of good offered’; ‘contracts relating to numerous performance obligations, license and variable considerations’ and ‘revenue recognition patterns such as in-time” or over-time’. This way, entity will be able to implement changes in accounting policies and discover areas that need additional estimates, judgment and calculations. (Deloitte, 2018)

Third, **tax department representatives**. According to Kalavacherla, O’Donovan and Schurbohm, (2016), IFRS15 changes tax reporting and financial reporting for taxes. Thus, to efficiently approach this matter, entities can strategize by involving tax department personnel in their IFRS15 discussions; so that the entity can know and accommodate according types of tax resources needed to cater the implementation.

Also, changes in preparing tax computations for financial reporting can be critically reviewed and discussed as it may have cash tax implication, new short term differences and changes in federal tax accounting method- all of which is necessary to be identified, analyzed and monitored by carefully calculating it through systems and processes of tax provision so that it abides by the rules of new tax method. This allows tax representatives to prepare themselves in changing computation method. (Kalavacherla, O’Donovan and Schurbohm, 2016)

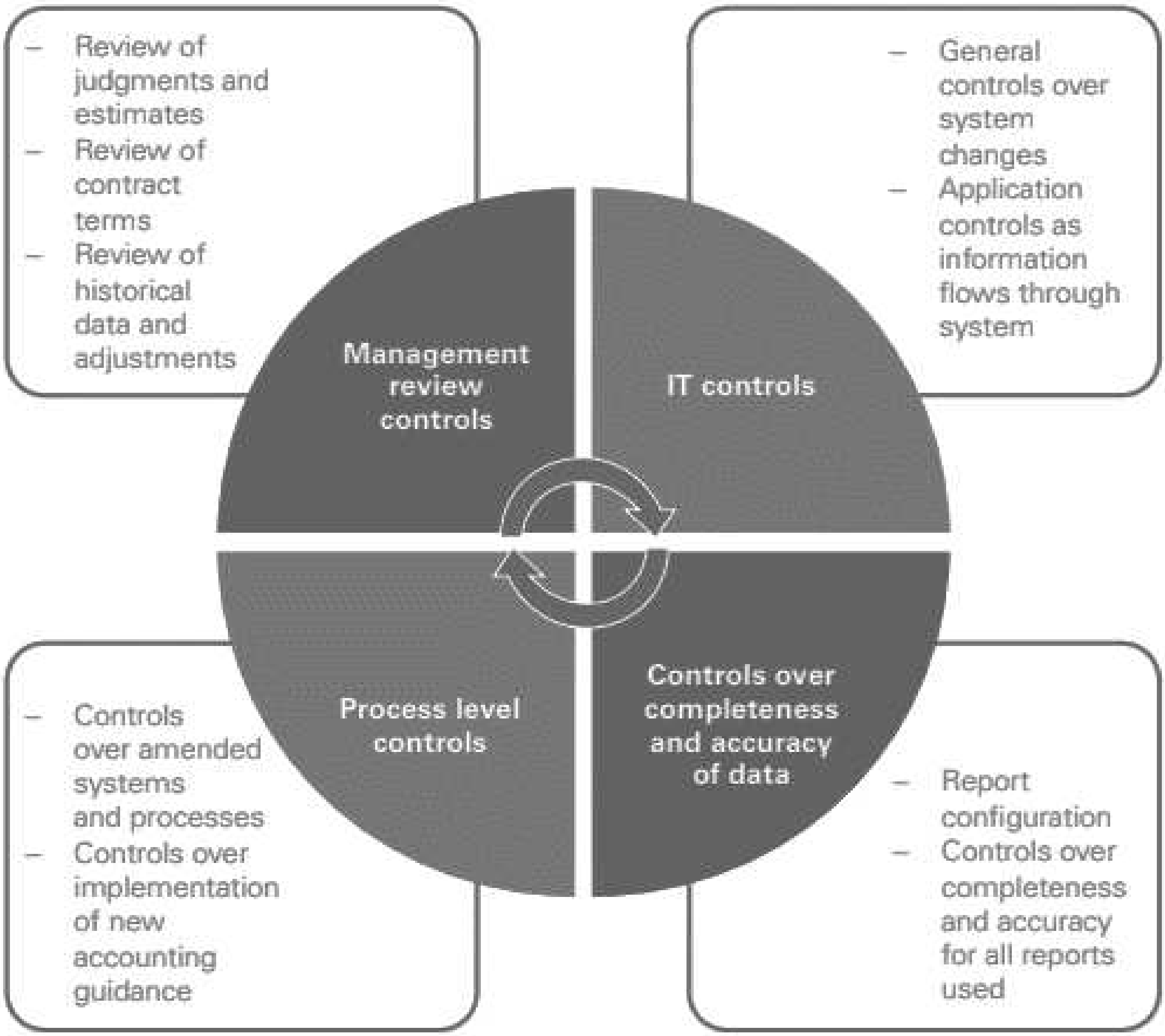
Fourth, **update IT systems and accounting processes**. Entities should undertake a cost effective strategy by considering types of new IT reporting software and packages available in order to record the additional data that needs to be disclosed. Also, Kalavacherla, O'Donovan and Schurbohm (2016) and K.Allen (2016) evaluate entities that generate financial reports through their existing accounting software should determine types of required additions and send their system for update accordingly- allowing instant changes towards reviewing contracts, preparing sales invoices and applying modifications following IFRS15.

Also, accounting policies and processes must be developed to ensure financial information is prepared according to managements relevant and applicable judgments. This is because, IFRS15 requires reporting of all historical information, for example costs incurred out of satisfying performance obligations and when binding entity-consumer contracts; for preparation of financial reports. (Kalavacherla, O'Donovan and Schurbohm, 2016)

Fifth, **internal control** of a business may range from 'management review control', 'IT control', process level control' and 'control over data accuracy and completeness. Thus, entities could strategize by designing and implementing new internal controls or modifying existing controls to encounter risks emerging out of judgments, estimates and processes.

This would strengthen internal control of a business towards new standard- ensuring accuracy and completeness of information at all times; especially if source of information id derived externally. Also, to incorporate this, entity can improve employee skill level through training- so that future modifications and amendments for controls can be upgraded by employees themselves. (Kalavacherla, O'Donovan and Schurbohm, 2016)

Exhibit 10.0 Internal Control



Source: K.Allen, 2016

QUESTION 2

*Explain the need for adequate disclosure in financial statements.

*Explain the types of information that must be disclosed.

*Elaborate one type of information.

(20 Marks)

2.0 Need for Adequate Disclosure and Types of Information

2.1 Disclosure and its Quality

According to Abadi and Janani (2014), in financial accounting, 'disclosure' depicts any additional information that must be provided in financial statements that has the capability to explain and justify all financial information embedded in financial report. Also, it means to disclose any information that may not be included in the financial statement. It can be simply dictated as presentation of financial information in financial report. (Frasca, 2016)

2.2 Adequate Disclosure Concept

There are three types of disclosures namely 'adequate', 'fair' and 'full' disclosure. However, the following paragraphs shall only concentrate on adequate disclosure.

Adequate disclosure can be implied as the minimum amount of information that is required to be disclosed- sufficient enough for respective financial statement users to indulge in decision making. The essence of adequacy is imperative as its objectives are to ensure financial statements carry full depiction of transactions, risk exposures and measurements, are not misleading and that they are presented in true and fair view. (Singh and J. Peters, 2018)

2.3 Adequate Disclosure Need and Audience

According to Abadi and Janani (2014), The need and mission to provide sufficient disclosure highly depends upon to whom the information is prepared for and who requires the information. This is because, what one reader of a financial statement considers important could be considered useless to another. Thus, companies see the need to provide sufficient disclosure depending on disclosure audience such as financial statement users- who are interested in making use of financial information. These users can be divided into two categories namely, **'primary users'**- who are investors and creditor providers and **'secondary users'** who are government, people employer and all other stakeholders.

2.4 Sufficient disclosure- Need and Importance

2.4.1 Adequate disclosure for investors.

Disclosure is seen as an **‘investment decision-making tool’** for people looking for investments that could help them grow their money, save for retirement, meet financial goals, send their children to college or even pay for a long-anticipated trip. This means investor’s decision to invest highly depends on disclosures that display the ability and potential of the company to maximize their wealth and meet their goals. So, adequate disclosure is important for investors as:-

First, it assists them develop basic awareness on company’s financial condition in terms of financial performance and financial stability- allowing them to get a basic overview on how company’s performance and wealth-generating processes contributes to the safety and profitability of investment. (Abadi and Janani, 2014)

Second, investors need to know past and present profit figures in the income statement and outstanding debt and equity components in the balance sheet to analyze and predict future profits and returns on investments. This allows them to gauge the short-term and long-term benefits and limitations of investing. (Abadi and Janani, 2014)

Third, investors are keen in analyzing current shareholders rate of ‘earnings per share’ to determine the stability and profitability of their rate of returns in future if they were to invest now. To achieve this, investors require adequate disclosure to know the amount of dividends proposed or declared before the financial statements were authorized for issue but which were not recognized as a distribution to owners during the period, and the related amount per share. Also, earnings per share rate may be influenced by retained earnings rate which serves importance to their investment decisions as high retained earnings shows higher availability of money to be paid to investors- increasing their confidence to invest. (Abadi and Janani, 2014)

Fourth, investors’ concern the ability of the entity to report cash flows from all sources because investors need to forecast future cash flows, evaluate the sustainability of the company’s business model, and assess its cash-generating ability- in order to analyze future changes in investment value.

Fifth, investors are interested with the security of their investment in terms of risks associated with their investment. For example securities such as bonds and preferred stock that offer fixed rate of return are exposed to interest rate risk- where an increase in interest rate reduces value of securities. Thus, investors need to know financial instruments and financial risk management of the company before they invest. (Abadi and Janani, 2014)

Therefore, from a prospective investor's perspective, it is vital for a company to reveal adequate disclosure that is sufficient enough to make an investment decision. This is because, if there is no information in addition to the general information revealed in financial statements, investors may not be able to get clear and comprehensive description of the company's financial position- diminishing their ability to understand and analyze financial statements as prices of securities, and even capital amounts assigned to a company, shall not reveal company's actual economic position. This not only demotivates investor to invest but puts company at disadvantage as it loses potential investor.

2.4.2 Adequate disclosure for credit providers.

Credit providers or lenders such as financial institutions (banks) require and utilize range of financial statement disclosures to decide whether the company is financially stable enough to take loans and whether the bank should extent credit. Thus, general information disclosed in the financial statement may not be sufficient for this decision making and that adequate disclosure beyond general disclosure is imperative for credit providers. This is because:-

First, banks are interested to analyze cash flows when granting, monitoring and renewing credits because banks are often reluctant to create credit if the company is experiencing poor cash flows due to higher outflows and lower inflows. Based on Abadi and Janani (2014), to analyze this, banks want additional information explaining cash flow statement to predict whether future cash flows of company would be able to repay loans. For example, repayment status of loans taken long ago may not affect the profit or loss of the business but would be evident in cash flow statements and that banks would be interested to know more about loan status. Thus adequate disclosure could help banks to carefully analyze how company uses cash resources and its ability to repay. (Panahi, 2012)

Second, banks want to know liquidity. Although the banks may be interested to know the profit figure, they want to know whether the borrower is able to settle the loan at points when business experiences losses- that is the ability to convert its assets to cash in order to repay loans. Thus, disclosures can further explain the liquidity risks of the business. (Panahi, 2012)

Third, banks are concern about company ability to service indebtedness. If the company has high debts and that poor cash flows, illiquidity and profits of business are not sufficient to repay the debts and other interest-bearing liabilities such as short term loans, then the banks are often interested to know the level of risks of company in failing to perform its obligations.

2.4.3 Adequate disclosure for external auditors.

According to Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing, external auditors are responsible to analyze the financial statements and present an independent opinion as to whether the preparation of financial statement has been performed in true and fair view without material misstatements. However, auditors are unable to generate audit evidence with inadequate information provided in addition to the general information recorded in the financial statement. Audit planning to sufficiently and appropriately obtain audit evidence highly requires the availability of adequate qualitative and quantitative disclosures in the notes to financial statement because:-

First, auditors are interested to know if the financial statements are prepared in material respects according to financial reporting standards. To achieve this, auditors need to perform risk assessment procedures to identify material misstatement risks in the financial statements. However, they need supportive explanation of each line material in order to successfully understand and audit account balances and transactions. Therefore, adequate disclosure that provides information about specific line item is imperative. (Abadi and Janani, 2014)

Second, auditors want to know if they company has provided additional explanation on all qualitative and quantitative information that is not part of general ledger system. This is so that auditors can examine the validity, completeness and accuracy of the information. For example, information outside accounting processes regarding financial instruments provided by company's treasury management must be adequately disclosed to audit its validity as it may have different system to accounting function that is exposed to higher audit risks. This increases need for adequate disclosure. (Abadi and Janani, 2014) and (Panahi, 2012)

Third, if the disclosures are inadequate and even draft disclosures are not available, then auditors may not be able to plan the audit. This causes high audit risks because there may be many sections in the financial statements that may be immaterial, omitted and not declared in true and fair view due to no supporting evidence. Thus, Frasca (2016) evaluates, audit procedures may not be successful as auditors may not be able to filter out the complexity and subjectivity of financial statements in terms of finding reasons why certain movements or changes may have happened. Therefore, adequate disclosure is needed.

In a nutshell, adequate disclosure accompanying entity's financial statements is high needed to ensure all users of financial statements are able to get a complete overview about company's financial condition.

The importance of providing adequate disclosure does not only limit to prospective investors, credit providers and external auditors but to all stakeholders of the company such as employees, suppliers, government and financial analysts.

This is because, the prime reasons to provide sufficient disclosure is to enable users understand transactions, avoid financial transactions and statements to be misleading and to maximize faithfulness and transparency of the statements. Also, disclosures communicate risk exposures and material information that is all important to allow different financial statement users to make respective decisions towards the company.

2.5 Types of Information that must be disclosed

There are many types of information that must be disclosed. However only 6 are identified.

First, **significant accounting policies**.

Second**, property, plant and equipment.**

Third, **earnings per share.**

Fourth, **board remuneration.**

Fifth, **equity, share ownership and related party transaction.**

Sixth, **credit facility.**

2.6 Elaborating one type of Information

Out of the many, these are the six types of information that must be disclosed. However, the following paragraphs shall only explain, elaborate and critically evaluate “Credit Facility” information.

Credit facility refers to all the borrowings of the company that must be disclosed in the statement of financial position under current and non-current liabilities depending if the borrowing is short term or long term in nature. The information regarding all borrowings must be adequately disclosed in the notes to financial statement- providing sufficient information regarding the repayments and outstanding values. It depicts the external finance taken by the company and is initially recognized at fair value and the difference between its proceeds and redemption shall be stated in income statement.

The explanation on borrowing is imperative for prospective investors and banks because they are interested to know if the company is utilizing the loans for purposes that can increase profitability of business maximizing shareholder wealth and at the same time whether it is capable to repay banks the principal and interest amounts.

The stability of business to repay from its profits creates confidence in investors and banks to invest and create credit- as the business showcases credit security. Also, the disclosure of borrowings shows the duration of repayment- in terms of whether the company made repayments within the time limit. It also shows if the companies have bank overdrafts. Thus, with all this information, banks and investors are able analyze and proceed with their decision making as they clearly understand the interest and concern company takes towards its credit financing.

QUESTION 3

* Obtain latest annual report of a non-financial institution company in Bursa Malaysia.

* Select THREE (3) items in the Notes to The Financial Statements

* Explain in details the importance of these items to people making decisions about investing in or extend credit

* Note: Attach a copy of the selected company's relevant pages of the Notes to The Financial Statements

(30 Marks)

3.0 Notes to Financial Statement Analysis

3.1 Introduction to Sime Darby Berhad

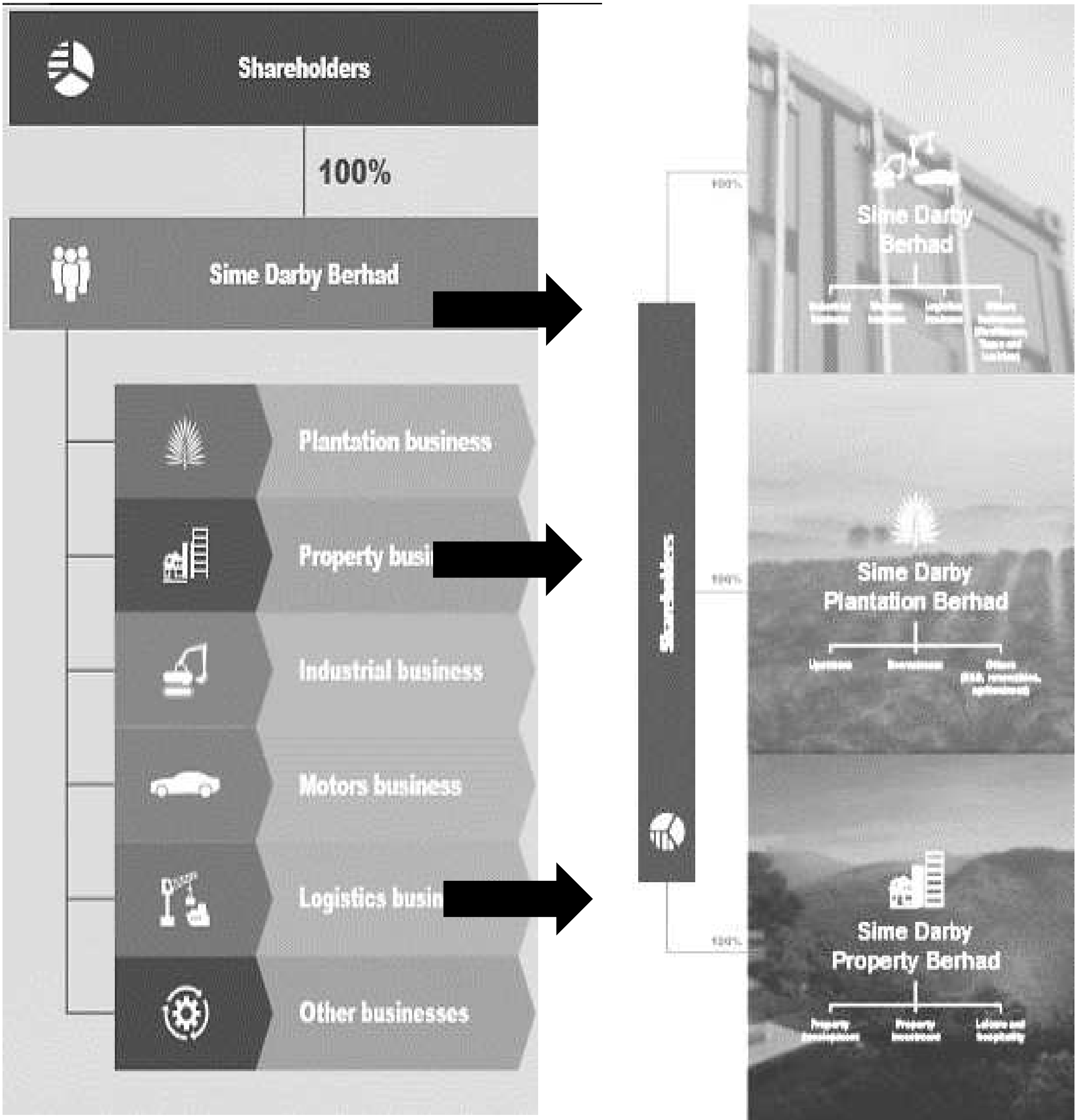
The non-financial institution chosen is “Sime Darby Berhad” and all the information explained in the following paragraphs under this section is based on Sime Darby’s latest annual report as of 2017.

Sime Darby represents one of the largest multinational companies listed on Bursa Malaysia with operations running in twenty-five countries and four territories. As of 30th June 2017, Sime Darby stands with market capitalization of RM64.6 billion (USD15.4 billion). As a result, it is an imperative player in the Malaysian economy. (Salleh, 2017)

Sime Darby operates through the process of diversification where it has its business in five important areas, namely, “Plantation”, “Property” and “Industrial Equipment”, “Motors” and “Logistics”. However, as of 2017, Sime Darby has divided itself into three separate and independent listed entities through the method of “Pure Play” such as “Sime Darby Berhad of Trading and Logisctics”, “Sime Darby Plantations Berhad” and “Sime Darby Property Berhad”- with each focusing on one distinct business. (Salleh, 2017)

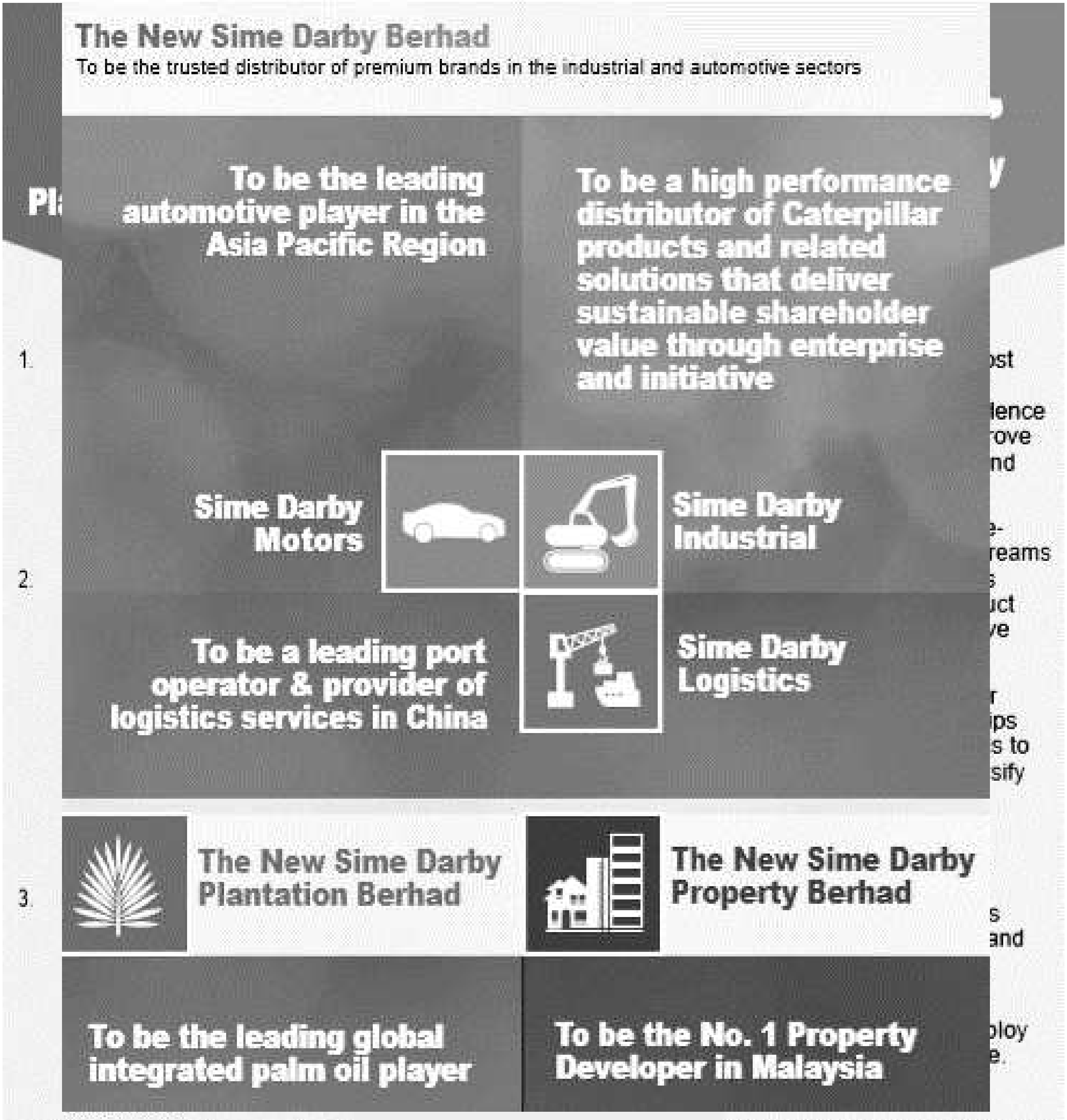
This pure play strategy is interested in boosting the performance of each individual business of Sime Darby in order to achieve the goal of developing an equitable balance between maximizing shareholder’s wealth and sustainable development.

Exhibit 11.0 Sime Darby Conglomerate change through Pure Play



Source: Salleh, 2017

Exhibit 12.0 Sime Darby Distinct Businesses



Source: Salleh, 2017

Exhibit 13.0 The New Sime Darby

Source: Salleh, 2017

3.2 Items from the Notes to Financial Statement

There are many items disclosed in Sime Darby's Notes to Financial Statement. However, only three items will be chosen.

First, **"Non-Current Asset: Property, Plant and Equipment". (Note 17, 21, 40 and 53)**

Second, **"Equity: Share Capital, Reserves and Retained Profits" (Note 18, 41 and 43)**

Third, **"Current and Non-Current Liabilities: Borrowings". (Note 46)**

Based on these items, the following paragraphs shall explain how the disclosure of these items are important in helping investors and credit providers in their respective decision making.

Note:

- *The items and its figures all refer to the "Sime Darby Group" and not "Sime Darby Company".*
- *All figures are in 'RM millions'.*
- *All 'Note' figures refer to Sime Darby "Notes to Financial Statement" number. Thus, for further details, the person concern may refer to the respective note extract provided in the appendix below.*

3.3 Importance of Items to Investors

3.3.1“Non-Current Asset: Property, Plant and Equipment (PPE)”.

- Note 17: Discontinuing operations
- Note 21: Property, Plant and equipment
- Note 40: Assets Held for sale and Liabilities Associated with Assets Held for sale
- Note 53: Disposals

Prospective investors are interested to know the transition of Sime Darby towards applying ‘pure play’ in creating three standalone listed entities, namely Sime Darby Plantation Berhad, Sime Darby Property Berhad and Sime Darby Berhad, in the plantation, property and trading and logistics sector. According to note 40, this transformation dictates developing equitable balance between maximizing shareholder’s wealth and sustainable development by presenting the property and plantation business as discontinuing operations in order to be distributed to the shareholders of the company. (Salleh, 2017)

Despite the idea and decision of the company to maximize shareholders wealth, prospective investors want to see the impact of this discontinuing operations.

According to note 21, it can be evaluated that PPE figures from 2016 to 2017 have declined from RM24, 456 to RM5624. This is a fall of RM18832- approximately a reduction of 77%. As a result, the overall non-current assets also reduced by 73% from RM39826 to RM 10853. This is highly due to the PPE that are allocated under ‘assets held for sale’ (note 40) due to company decisions of some PPE discontinuing operations. (see note 53 image at the bottom)

Thus, investors want to know the ability of these assets held for sale (held for distribution to owners of the company) to generate positive inflows over and above any borrowings to be made to support this procedure. This way, it can help investors decide whether this action of the company will earn them sufficient profits and cash flows to maximize earnings per share.

Exhibit 14: Disposals

53 Disposals

a. Disposal of subsidiaries

Subsidiaries disposed by the Group during the financial year ended 30 June 2017 are as follows:

Name of subsidiary	Disposal consideration	Group's effective interest disposed (%)	Effective disposal date
Property			
Sime Darby Property (Alexandra) Private Limited (SDPA)[1]	SDG83 million (equivalent to RM249 million)	100.0	29 September 2016
Logistics			
Weifang Sime Darby West Port Co Ltd (WSDWP)[2]	RMB39 million (equivalent to RM25 million)	50.0	6 April 2017

[1] SDPA was disposed to Aster Investment Holding Pte Ltd, a subsidiary of Sime Darby Real Estate Investment Trust 1, a joint venture of Sime Darby Property Singapore Limited.

[2] Following the completion of the disposal, the Group's interest in WSDWP has reduced from 99.9% to 50.0%. The remaining interest is accounted for as a joint venture and is recognised initially at fair value.

Source: Salleh, 2017

3.3.2 "Equity: Share Capital, Reserves and Retained Profits".

- Note 41 : Share Capital
- Note 43 : Reserves and Retained Profit
- Note 18: Earnings Per Share

The equity section of Sime Darby discloses share capital, reserves and retained profit- all of which investors are interested to investigate before making investment decision.

First, **share capital**. According to Note 41, it can be seen that the share capital has increased from RM3164 in 2016 to RM9229 in 2017- which is an increase of RM6135 or 194%. This is due to Sime Darby increasing its issued and paid up ordinary share capital. Thus, this information is imperative as investors want to evaluate the reason behind the increment in terms of proposed and actual utilization of additional share capital and the amount company has kept to be utilized. Also, investors want to know estimated time duration for the utilization showing if the business utilized the capital according to its need, out of issuing in emergency.

In the case of Sime Darby, according to note 41, the proceeds has been utilized for borrowings repayment, increasing working capital for day-to-day expenses, placement expenses and capital expenditure for plantation, motors and business property. This shows effective and efficient utilization to reduce debts and increase cash in hand for unexpected business circumstances. It also shows how Sime Darby is interested in obtaining and maintaining property and plantation lands for systematically expanding the business through ‘pure play’ so that investors can participate directly in the equity and growth of the plantation and property businesses.

Thus, the disclosure of this information positively assists investor in investment decision making as it can help them discover Sime Darby’s focus on capital management and growth strategies, and that if their money (to-be invested) would be used for the right purpose that could increase future rewards through business expansion. (Salleh, 2017)

Also, it allows investors unlock value and gain direct exposure to the Plantation and Property businesses to meet their individual investment preferences. They will also have a better insight into the business to help them analyses its performance.

Second, **reserves and retained profits**. Prospective investor are interested to investigate the sources and nature of reserves and retained profits in order to know the purpose of the company's collection of reserves and that to gauge if the reserves are sufficient enough to fund company's future expansion plans that can increase shareholder's wealth. Also, they want to know, if the reserves can pay investors their investments and dividends, if at all, expansion plans in future fail due to unforeseen and unexpected circumstances.

According to note 43, it can be evaluated that Sime Darby's reserves are increasing from RM623 in 2016 to RM1348 in 2017 which is an inclination of RM725- approximate increase by 116%. This is highly due to Sime Darby's implementation of 'pure play' that requires discontinuing operations which according to note 20, has positively impacted profits. This can be seen where profit for financial year before discontinuing operation were RM795 but drastically inclined to RM1886 in 2017- which is an increase of RM1092-approximately 137%.

Thus, through this, the investors are able to know if Sime Darby made the right decision to discontinue operations and that the increment in reserves particularly due to increase in profits form discontinuing operations is being retained from shareholders (without paying them dividends) for future investment and expansion plan. (Salleh, 2017)

This is because, although the profits are increasing with reserves, according to note 18, earnings per share of every shareholder is diminishing from RM38.5 to Rm36.7 from 2016 to 2017- which is reduction of 1.8- approximate fall of 5%.

Thus, this disclosure is important as often investors may be reluctant to invest if high retained earnings and reserves diminish earnings per share especially when company may or may not be on a journey to expand- as they are interested to maximize their wealth all times- better for short term than the uncertain long term.

3.3.3"Current and Non-Current Liabilities: Borrowings".

- Note 17: Borrowings

Prospective investors need to know the debt obligations of a company illustrated in the liabilities section of the balance sheet. Company's may be profitable and may have sufficient reserves but will not be able to fund expansion if its debts cancel out profits. This can reduced the value of shares- not allowing investors to benefit from high share price; which usually means losses for investors. (Salleh, 2017)

According to note 46, it can be evaluated that borrowings of Sime Darby has been decreasing from RM4419 in 2016 to RM1948 in 2017. This is a fall of 2471- approximately a reduction of 56%. This shows that Sime Darby has lesser dependence on external financing from financial institutions. Also, it shows, Sime Darby prioritizes and has the ability to repay debts.

As a result, according to note 46, Sime Darby discloses the opportunity to get refinanced with a three year loan facility beginning from 2017 due to full repayments of credit facility worth USD330 million. (Salleh, 2017)

This information serves great importance to investors as it gives them the confidence to invest as Sime Darby is not vulnerable to bankruptcy and is able to benefit from lower interest rate due to paying on time which increases overall profitability of business. (Salleh, 2017)

Also, this improves the credit rating of Sime Darby- where as of May 2017, 'Malaysian Rating Corporation Berhad' (MARC) has assigned a corporate credit rating of AAA to Sime Darby due to its steady outlook. This give all the reason for an investor to invest in Sime Darby.

3.4 Importance of Items to Credit Providers

In this context, the term ‘credit providers’ shall refer to financial institutions such as ‘prospective banks’.

3.4.1 “Non-Current Asset: Property, Plant and Equipment” (PPE).

- Note 17: Discontinuing operations
- Note 21: Property, Plant and equipment
- Note 40: Assets Held for sale and Liabilities Associated with Assets Held for sale
- Note 53: Disposals

It is important for banks to understand the idea of pure play and the decision of Sime Darby to record distribution of plantation and property business to shareholders as discontinuing operations (note 17) relating to PPE. Also, banks need to know the approval status of this proposal according to Securities Commission, Bursa Securities and company owners. (Salleh, 2017)

This can be seen in note 21 where PPE figures declined by 77% from RM24, 456 to RM5624 in 2016 to 2017- highly due to many PPE transferred under ‘assets held for sale’(note 40). Thus, banks are interested to know the ability of these assets to be converted into cash- where banks investigate the reconciliation of cash flow provided in note 21(f) regarding cash flows generated before and after discontinuing operations. (Salleh, 2017)

This is because banks want to know if the shareholders trusted Sime Darby’s investing activities and accepted the proposal- as this confirms that Sime Darby’s pure play, despite selling-off assets resources, has the ability to pursue growth strategies improving overall financial position; stable enough to make full repayment to banks within time.

PPE disclosure plays a key role in banks’ lending decision as it informs the banks how Sime Darby’s liquidity position is capable enough to repay banks if they were to lend in future.

3.4.2 “Equity: Share Capital, Reserves and Retained Profits”

- Note 41 : Share Capital
- Note 43 : Reserves and Retained Profit
- Note 18: Earnings Per Share

First, **share capital** in note 41 is important for credit provides as it informs how Sime Darby has increased issued and paid up ordinary shares to repay borrowings and fund capital expenditure. It also states the business plan to use this capital raised according to the banks' loan time frame provided- where Sime Darby aims to utlise the capital for repayment within 12 to 14 months from the listing shares date. (Salleh, 2017)

This shows Sime Darby's decision to raise more funds is to reduce liabilities and fun expansion so that can generate more profits. Also, it shows that Sime Darby is committed in ensuring borrowings are repaid on time.

Thus, banks become lesser reluctant to create credit when Sime Darrby needs funds to increase profitability for better financial position- which increases its capability and willingness to repay. (Salleh, 2017)

Second, **reserves and retained profits** in note 43 is vital for banks as it shows the ability of Sime Darby to support itself during times of crisis, bankruptcy and unexpected situations. It also shows the how strong is Sime Darby's foundation in making pure play a success through capital management in pursuing growth strategies. This can be seen according to the source of reserves such as from performance base employee scheme, fair value derivatives and even from available for-sale investment.

Also, banks may want to know the positive impact of profits generated from discontinuing operations on reserves and retained profits (see financial analysis in appendix). This is so that banks can decide whether Sime Darby shall be able to balance loan repayments and future investments in pari passu. (Salleh, 2017)

The entire section of equity in financial statements and their elaboration in the notes to financial statement is extremely important as it allows banks to calculate 'debt to equity ratios' which is a leverage ratio allowing banks to analyze Sime Darby's overall ability to make payments associated with long-term debts. The higher the ratio, it shows how company may be unable to generate sufficient cash to repay debt obligations and that lower ratio shows company not using its equity to finance debts. From this analysis, banks derive risks appetite of company.

3.4.3 "Current and Non-Current Liabilities: Borrowings".

- Note 17: Borrowings

Note 46 shall be the most vital area for any credit provider as it summarizes all Sime Darby's current and non-current secured and unsecured borrowings. It also discloses the status of the repayment duration where banks can predict the ability of the company to repay loans taken in 2017 based on analyzing the 2016 repayments. (Salleh, 2017)

Following note 46, Sime Darby has been repaying its loans and reducing the amount of borrowings by 56%. This shows how Sime Darby depends lesser on external financing and lesser prefers to be under debt obligations. Despite this, due to it concern in ensuring full repayments, Sime Darby received opportunity to get refinanced with a three year loan facility beginning from 2017 worth USD330 million. (Salleh, 2017)

Therefore, the disclosure of borrowings displays informative statements that may increase the confidence of prospective banks in always extending their credit to Sime Darby when needed as they are sure about Sime Darby's indebtness and security status.

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APPENDIX

SIME DARBY BERHAD

FINANCIAL ANALYSIS

SIME DARBY BERHAD

NOTES *to* FINANCIAL STATEMENTS

NOTES