

Goodwill Impairment Disclosures: A Test for IFRS Compliance in Malaysia

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Abstract

The application of FRS 136 – *Impairment of Assets* (Amended by Annual Improvements to IFRSs 2009) was mandatory for all companies listed in Bursa Malaysia from 1 January 2010. The highly prescriptive and technical provisions of Financial Reporting Standard (FRS) 136 – *Impairment of Assets* (FRS 136, 2009) therefore represent a very substantial variation from past practice. This in turn gives rise to questions about how Malaysian companies and their auditors have fared during the process of transition to a complex reporting regime and in consequence to the quality and consistency of reports produced pursuant to that new regime. Hence, this study examines the degree of technical compliance with the disclosure requirements of FRS 136 (Amended by Annual Improvements to IFRSs 2009) by a sample of 20 large Malaysian companies used as a proxy for audit quality. This research employed six analytical structures to distinguish audit quality among the Big 3 in an attempt to question the homogeneity of audit quality assumption. The evidence presented in this study suggests that there is no variation in audit quality among the Big 3 and contributes to the literature by providing at least preliminary evidence for the proposition that audit quality among the largest audit firms is homogenous, as has so often been assumed in previous studies. The findings will be of interest to investors, analysts, regulators and enforcers, not only in Malaysia but also in other jurisdictions undergoing transition to IFRS, in particular those whose reporting regimes portray similar features.

Keywords: Goodwill, FRS136, Impairment, Malaysia

1. Introduction

The positive relationship between audit firm size and audit quality has been well documented in previous studies. It is a long-held view that large audit firms provide higher quality audits and offer greater credibility to clients' financial statements than small audit firms (Lennox, 1999). This argument stems not just from the technical expertise and processes brought to bear by larger audit firms, but also because large audit firms enjoy better reputations, have higher brand equity and are likely to be highly motivated to protect these (DeAngelo, 1981). In addition, larger audit firms have generally been considered more independent of their clients (Dopuch, 1984). The extant literature on the subject shows that larger audit firms do indeed provide higher quality audit services, and the quality of audit services provided by large audit firms has been assumed to be or treated as homogenous.

The question of whether large audit firms effectively play a role in ensuring credible accounting information has received episodic attention over time. The spate of collapses in the early years of this century, exemplified by the Enron bankruptcy in 2001 and the related collapse of Arthur Andersen in 2002, triggered a bout of criticism of large audit firms, their processes and the quality of the audits being performed by them (Francis, 2004). These criticisms were particularly jarring given the traditional perceptions of the high quality of audits performed by large firms (Lam & Chang, 1994). Recently, a small number of studies have begun to investigate the question of audit quality by examining the possibility of quality differentials between large audit firms, rather than assuming that the problem is homogenous.

Thus, this study focuses on evidence relating to the quality of financial statement audits in the context of the transition to a new, complex regime. Specifically, the degree of technical compliance with the disclosure requirements of FRS 136 (Amended by Annual Improvements to IFRSs 2009) by a sample of 20 large Malaysian companies is used as a proxy for audit quality. The adoption of the new and revised FRS, modelled tightly on IFRS (though with some variations applicable in the transition phase) by

Malaysian companies, presents an interesting opportunity for research into the impact of expertise disruption on audit quality. FRS 136 presents great challenges for auditors of financial reports. In particular, a number of the new internationally compliant standards are substantially more complex in their configuration, in the nature and structure of reporting processes and disclosures that they require, and consequently on the demands associated with the production of audit services under their aegis. Six analytical structures are used to distinguish audit quality between the Big 3 and to question the homogeneity of audit quality assumptions. In investigating this theme, the remainder of this paper is structured as follows. Section 2 contains a brief review of some pertinent prior research literature. Section 3 sets out details of the sample, data and methodology employed. Section 4 sets out a discussion of key findings results, while section 5 contains some conclusions and suggests some potential avenues for future research.

2. Literature Review

In interpreting the audit quality literature and understanding its significance, it is important to recognise that the measurement of quality has both a relative and an absolute dimension. The estimation of audit quality on a relative basis tends to proceed via a process of comparing observed values for some posited proxy for quality between audit firms, while attempts to determine the absolute quality of an audit tend to examine the audit process itself, against unique engagement-specific benchmarks. The latter approach is costly, and usually requires researchers to be embedded with audit teams as they undertake their work, or to have direct access to audit working papers or peer review processes undertaken in relation to engagement work. There are published examples of such work (e.g. Colbert & Murray, 1998), but these are comparatively rare. On the other hand, work focused on relative measures of audit quality (via proxy), including literature citing evidence of fee differentials, litigation occurrence and resolution, earnings forecast accuracy, and earnings response coefficients, are more frequently represented in the published literature (e.g. Palmrose, 1988; Teoh & Wong, 1993; Lam & Chang, 1994).

One consequence of the manner in which the question of audit quality has predominantly been dealt with in the extant literature may be a failure to focus on situations where the most pertinent questions relating to quality relate not to the quality of one firm's offering versus another's, but rather the capacity to deliver an appropriate level of baseline assurance. As argued above, periods of regulatory transition represent risk inflexion points where skill sets and approaches to the conduct of work previously accumulated may be deeply diminished in their value. The adoption of IFRS is a case in point. Noted companies are expected to rely heavily on their auditors for advice regarding the adoption of IFRS and it is expected that there will be a positive relationship between auditor size and the extent and quality of disclosure. It has been widely discussed in the literature that large auditors are associated with improvement in compliance levels and disclosure quality.

An early study by Street & Gray (2001) examined the financial statements and footnotes of companies referring to the use of International Accounting Standards (IAS) and provided information about the factors associated with non-compliance. Using 1998 annual reports of 279 companies listed on Germany's New Market that claimed to comply with IFRS, post IAS 1 Revised, they found that compliance is positively associated with, and therefore higher for, companies audited by Big 5+2 firms. Glaum & Street (2003) examined compliance with both IAS and US GAAP for companies listed on Germany's New Market. Their sample was based on 100 firms that applied IAS and 100 that applied US GAAP in their year 2000 financial statements. The study found that compliance ranged from 100% to 41.6%, with an average of 83.7%, and provided evidence that compliance is positively related to audit firm size and that clients of non-Big 5 auditing firms exhibit, on average, significantly lower levels of compliance with IAS and US GAAP disclosures than companies audited by the Big 5.

A particularly challenging element of the IFRS framework is that which deals with the asset impairment phenomenon, especially as it pertains to goodwill. The need to adopt the IFRS framework for measuring and reporting on goodwill therefore represents a very substantial challenge to Malaysian reporting entities. The introduction of the new goodwill accounting and reporting regime has not resulted in profound changes to the format and nature of information recognised in the balance sheet, it has fundamentally changed the shape of note form disclosures supporting a financial statement user's understanding of the headline (recognised) balance sheet data pertaining to goodwill. Thus, while audit attention to the value ascribed to goodwill on the face of the balance sheet is still just as necessary as it was in the pre-IFRS reporting regime, the level of attention required to the note form disclosures

pertaining to goodwill and the assessment of its potential value impairment has increased substantially. From an auditor's perspective, the new IFRS requirements drive increases in disclosure and, therefore, required effort in the conduct of the audit (Hoogendoorn, 2006). However, it is not clear that enhanced disclosure challenges, particularly those with greatest impact in the notes to the accounts, are universally well dealt with in the context of financial statement audits.

The results of a recent study by Libby *et al.* (2006) indicate a far higher level of sensitivity on the part of Big 4 audit firm partners to adjustments impacting the balance sheet and/or profit and loss statements than those whose impact was limited to the notes only. In other words, auditors appear more willing to tolerate errors and discrepancies in note form disclosures than in recognised numbers on the primary financial statements. This suggests a hierarchy of vigilance on the part of auditors, in which the highest priority is accorded to minimising misstatements on the face of the profit and loss statement and balance sheet, with lower priority afforded to meticulous policing of information contained in the notes to the accounts. If these results are generalisable beyond the setting in which they were generated, then they suggest that the implementation of FRS 136, replete as it is with complex note form disclosure requirements, represents a useful focal point for research which may yield interesting insights into audit quality in the face of change and complexity.

Since the move to an IFRS-based regime for goodwill reporting has resulted in a framework with far more attention required to note form disclosures than had previously been the case, it is arguable that this very transformation may provide the opportunity for the acquisition of useful insights into audit quality differentials among auditors. Assuming that auditor competence is constant across the Big 4, it is nonetheless possible to entertain the possibility that, faced with a substantially increased detail burden in relation to required note form disclosures under IFRS, the same degree of vigilance exercised in relation to the data recognised in the primary financial statements may not consistently cascade down to the approach taken by audit firms in relation to note form disclosures. Yet this may impact audit quality, since the second key element of that construct is the willingness of auditors, having detected misstatements, to demand their correction. Thus this research examines the audited disclosures made during the two-year period (after the Amended by Annual Improvements to IFRSs 2009) under FRS 136 of a sample of 20 large Malaysian companies who engaged the Big 3, and attempts to question the homogeneity of audit quality assumption.

3. Methodology

This study focuses on data drawn from 20 large Malaysian Companies in 2010 and 2011. This two-year period represents a unique opportunity to examine the content of financial statements drawn up under the Amended by Annual Improvements to IFRSs 2009 of FRS136, with a view to gaining insights into the quality of financial reporting. The top 20 companies in 2010 and 2011 of this research sample were listed on Bursa Malaysia. Companies were included in the research sample if they had reported under IFRS in 2010 and 2011, had goodwill as a component of their asset base in in these years. Then, the audited disclosures made during this period under FRS 136 of a sample of large Malaysian *companies* who had each engaged Big 3 auditors in 2010 and 2011 were examined.

The study focuses on the extent to which clients of Big 3 audit firms strictly adhere to the complex technical provisions of a new reporting standard. The transition to FRS 136 has created more work for auditors, with the additional information pertaining to the disclosure of goodwill and the assessment of its potential value impairment requiring greater attention. In exploring this theme, six analytical structures were employed to distinguish audit quality among Big 3 audit firms and to attempt to question the homogeneity of audit quality assumptions (Carlin *et. al.*, 2009). First, companies in the research sample were sorted by audit firm according to the choice of method employed in estimating the recoverable amount of CGU assets. These include VIU, fair value or a combination of the two (that is, the use of VIU in some CGUs and the recourse to fair values in others). This data assisted with the development of insight into the level of compliance with basic disclosure requirements set out in FRS 136.

Second, the companies in the research sample were sorted by audit firm, according to whether they allocated all the value of goodwill to the CGUs for the purpose of impairment testing, or whether there was no meaningful information indicating how or if the value of goodwill was allocated to CGUs. Then, companies that allocated the total amount of goodwill to the defined CGU were categorised as 'compliant' and companies that did not meet this requirement were categorised as 'non-compliant'. This

data assisted with the development of insight into the level of compliance with basic disclosure requirements set out in FRS 136. Third, the companies in the research sample were sorted by audit firm according to the relationship between the number of operating segments they defined for reporting purposes and the number of CGUs defined for the purposes of goodwill impairment testing. Companies sorted by audit firm were grouped into one of four categories: where the number of defined CGUs was larger than the number of operating segments defined by the company; where the number of defined CGUs was equal to the operating segments defined; where the number of defined CGUs was smaller than the operating segments defined; or where there was no effective disclosure. This data provides evidence relating to the likelihood of CGU aggregation behaviour on the part of reporting entities.

Fourth, prior research has suggested that one key challenge faced in the context of FRS 136 is the manner in which goodwill is allocated between CGUs for the purposes of impairment testing. A particular risk relating to this process is known as the CGU aggregation problem (Carlin & Finch, 2010), where too few CGUs are defined and have goodwill allocated to them. This induces the risk that impairment charges which should occur are avoided, or at least inappropriately delayed. Therefore, a CGU to operating segment ratio was calculated for each of the sample companies, the results being displayed according to audit firm identity. This analysis builds upon the procedure described in step three (above) and also suggests the likelihood of CGU aggregation behaviour among reporting entities. Fifth, the companies in the research sample were sorted by audit firm according to the disclosure quality of discount rates used in the impairment testing process. A multi-classification taxonomy for data categorisation was applied, comprising four groupings. These were:

1. No effective disclosure;

Allocation of a company to the first category signified that the company provided inadequate disclosure regarding the discount rate and in consequence provided no meaningful information for external analysts relating to the impairment testing process. Companies in this category clearly breached a key element of the disclosure requirements stipulated under FRS 136.

2. a range of discount rates (where a company stipulated that the discount rates employed lay within a disclosed range but did not link any particular discount rate to any particular CGU);

Companies categorised as falling within the second category, 'range of discount rates', provided a degree of information regarding the process of impairment testing but given the lack of specificity of this data, it is questionable whether disclosure of this sort meets the requirements or objectives of FRS 136.

3. single explicit discount rate (where a single rate was used to discount the cash flows of all defined CGUs);

Companies in the third category, 'single explicit discount rate' disclosed the application of a single discount rate for recoverable amount modelling in each of their CGUs. While this treatment leaves financial statement users in no doubt as to the rate applied to the key task of future cash flow discounting, it nonetheless raises questions in relation to the appropriateness of the rates employed by these entities, given the need to shape discount rates to the risk characteristics of CGUs, and the likelihood that risk varies between CGUs.

4. multiple explicit discount rates (where a unique rate was used to discount the cashflows in each different CGU).

Companies in the fourth category appeared to fully comply with the requirements of FRS 136 in relation to discount rates by disclosing unique rates applicable to each of their various CGUs. This form of disclosure fully complies with the requirements of the Standard, but also provides a higher assurance of process quality through an explicit matching of applied rates to the individual risk characteristics of defined CGUs.

A very similar taxonomy was adopted for classifying growth assumption disclosures made by companies in the research sample. Companies in the sample were divided into four categories: multiple growth. The results of the analysis are reported in Section 4.

4. Results and Discussion

An overview of the research sample, broken down by, the ringgit value of goodwill for each company, goodwill as a percentage of total assets and the ringgit value of goodwill per CGUs is shown in Table 1.

At the date of sampling, companies included in the research sample controlled goodwill valued at RM 19,738 million in 2010 and RM 20,037 million in 2011. The amount of goodwill increased slightly by 1.5%, indicating that the data used for the purposes of analysis in this research were not primarily captive to large outlier movements.

In 2010, goodwill represented more than 5% of the total assets for six companies: Axiata (19.2%), KNM Group (22.7%), MMC Corporation (5.6%), Construction (8.75%), Parkson Holdings (18.5%), Wah Seong Corporation (5.5%), and YTL Power International (18.1%); whereas in 2011, for five companies – Axiata (18.1%), KNM Group (20.3%), MMC Corporation (5.6%), Construction (8.75%), Parkson Holdings (16.9%), and YTL Power International (18.4%) – goodwill represented more than 5% of their total assets. Providing an alternative overview of the research sample, Table 2 shows the number of companies audited by each of the Big 3. As Table 2 demonstrates, the distribution of large clients among the Big 3 is uneven. Ernst & Young and PwC dominates, having audited both by 40% in 2010 and 2011 followed by KPMG (20% in 2006 and 2007).

[insert Table 1 and 2 here]

The basic question contemplated in this research relates to the degree to which technical expertise survives periods of material regulatory inflexion sufficient to underpin quality financial reporting outcomes. The onset of change in regulatory arrangements impacts both preparers and auditors of financial statements. Consequently, the initial change period represents an ideal point at which to investigate the content of financial statements drawn up under new and complex standards, with a view to gaining insights into the quality of oversight offered by the audit profession.

The threshold question in understanding the process used by a reporting entity to test for the impairment of goodwill relates to the identity of the valuation method used to estimate the recoverable amount of the assets assigned to CGUs. Paragraph 18 of FRS 136 stipulates that either fair value (where appropriate market benchmarks exist) or VIU may be used as the basis for determining the recoverable amount. The frequency with which sample companies adopted fair value and VIU as a basis for the estimation of the recoverable amount of CGU assets is set out in Table 3.

The data demonstrate that the most common approach to the determination of the recoverable amount was that of VIU. A total of 17 companies (85%) in 2010 and 14 companies (70%) in 2011 used this method as the sole basis of determining the recoverable amount of CGU assets. In 2010, Ernst & Young and PwC clients adopted VIU methods most frequently, with 7 companies (88%); in 2011, Ernst & Young clients were the biggest adopters, with 7 companies (88%). An explanation for the use of VIU to the virtual exclusion of fair value may lie in the limited existence of active and liquid asset markets in Malaysia (Fah, 2006).

A further one company (5%) in 2010 and two companies (10%) in 2011 used fair value as the sole basis for determining the recoverable amount. One company (5%) in 2010 and two companies (10%) in 2011 reported that they had applied a combination of methods, as relevant to the differing characteristics of their CGUs. One company in 2010 and two companies in 2011 did not disclose any details of the method they used in determining the recoverable amount of CGU assets which were audited by PwC that failing this basic point of compliance. It is clearly shown that PwC clients were in breach of FRS 136 owing to their failure to disclose the information regarding the method employed to determine the recoverable amount. Other than that, this basic requirement does not suggest evidence of cross-sectional disclosure practice variation explicable by reference to audit firm identity.

[insert Table 3 here]

The next analytical procedure employed involved test checking the extent to which it was possible to reconcile the reported amount of goodwill on the consolidated balance sheets of the companies in the research sample with the sum of the amounts of goodwill allocated to those companies' CGUs. As set out in Table 4 below, 19 companies (95%) in 2010 and 18 companies (90%) in 2011 did produce disclosures which demonstrated full reconciliation between the quantum of balance sheet reported goodwill and the amount disclosed as having been allocated between the various CGUs defined by each, the remaining 1 companies (5%) in 2010 and 2 companies (10%) in 2011 failed to provide any meaningful disclosures (as required under Paragraph 80 of FRS 136) in relation to the association between components of total

company goodwill and CGUs. KPMG clients had non-compliance with the standard requirement in 2010 (1 company or 5%), whereas in 2011, KPMG and PwC clients had the highest rate of non-compliance (2 companies or 10%).

There is some possibility that 1 company in 2010 and 2 companies in 2011 may have taken the view that they had no need to comply with the requirement to disclose the amount of goodwill allocated to each CGU owing to the low materiality of goodwill on their balance sheets relative to total assets; in these cases goodwill represented less than 5% of total assets, a relatively small amount. However, this view is likely to have been erroneous given that the Standard clearly stipulates that the relevant materiality benchmark is total intangible assets, not total assets.¹ There can be no doubt that these companies failed to provide this basic disclosure were in breach of the Standard's requirements. It is not possible to construct a conclusion of variation based on audit firm identity alone.

[insert Table 4 here]

The next phase of the analysis was based on the preparation of evidence pertaining to the goodwill aggregation problem. The 'aggregation problem', where companies generate an internal 'portfolio diversification' effect by combining imperfectly correlated elements of their businesses which, in reality, can and do generate independent streams of cash flow and are subject to internal management reporting. In these situations, fewer CGUs than required will be defined, with the result that the chance of being forced to recognise impairment losses in weaker elements of the business is reduced. This subverts the requirement that goodwill be rigorously subjected to impairment testing and that the timing of goodwill impairment loss recognition be driven by the underlying economics of each of the independent cash flow streams that comprise the business, rather than by managerial discretion.

Table 5 suggests a greater tendency on the part of Ernst & Young and PwC clients define fewer CGUs or provide no meaningful data on CGU definition. The data reveals that in 2010, 30% of Ernst & Young clients and 35% of PwC clients and in 2011, 25% of Ernst & Young clients 35% of PwC clients defined fewer CGUs than operating segments or failed to provide meaningful disclosure about the identity of, and level of goodwill allocation to, CGUs. However, KPMG clients also showed a slightly high rate in defining fewer CGUs than operating segments (15% in 2010 and 15% in 2011 for KPMG clients). This suggests that there is still a risk factor of CGU aggregation for all clients of the Big 3.

[insert Table 5 here]

The same pattern emerges when the CGU to operating segment ratio for each sample company is calculated, stratified and sorted according to audit firm identity, as set out in Table 6, below. In instances where data pertaining to the existence and identity of CGUs is disclosed, the tendency is for fewer rather than more CGUs to be defined. With regard to more CGUs than operating segments being defined, only Ernst & Young clients reported the highest ratio (more than 1.01 CGUs per segment defined) at 10% in 2010 and 5% in 2011. None of the KPMG and PwC client discloses more than 1.01 CGUs per segment in 2010 and 2011.

Bearing in mind the expectation in the Standard that CGUs should be no larger than defined operating segments, it is anomalous to see many instances where fewer CGUs than segments exist. A possible interpretation of the data is that by 2011, companies became more attuned to the capacity to avoid undesired impairment charges via the aggregation of CGUs. The consequences of this type of activity could extend to overstatements of earnings and net assets, understatements of leverage and reduced reporting transparency. As a tentative conclusion, there does appear to be some evidence consistent with the risk of CGU aggregation and the magnitude of that risk does not appear to vary systematically according to audit firm identity.

[insert Table 6 here]

The final strands of the analysis undertaken relate to discount and growth rate disclosures made by the companies in the sample. Table 7 contains the results of the discount rate analysis. A theme that again emerges in this dataset is the Big 3 clients still not comply with the requirement in the standards in relation to the discount rates applied for the purposes of impairment testing. However, no evidence of variances explicable with reference to audit firm identity emerged between the qualities of disclosures

relating to discount rates made by sample companies. Ernst & Young and PwC clients provided the highest rate of no effective disclosure pertaining to discount rates with 2 companies (10.5%) in 2010 and 3 companies (16.6%) in 2010.

More often the practice was to define a multiple, which appears to be what is required in the standards. 10 companies (52.3%) in 2010 and 8 companies (44.4%) in 2011 had particularised discount rates specific to individual CGUs, as required. PwC clients disclosed the highest at 26.3% in 2010 and 22.2% in 2011. Ernst & Young and PwC client used to disclose single discount rate and apply this on a blanket basis to all CGUs (without apparent regard to risk variation between CGUs). Given that it is most unlikely that all CGUs within these companies have substantially the same risk profile, it appears defensible to conclude that inappropriate discount rates were being used in a substantial number of impairment testing procedures. PwC and Ernst & Young clients disclosed the highest in 2010 and 2011 at 15.7% (PwC) and 10.5% (Ernst & Young) in 2010 and 11.1% (PwC) and 16.6% (Ernst & Young) in 2011.

A further two (10.5% and 11%) companies in 2010 and 2011 provided details of a range of discount rates (generally not helpful in allowing detailed financial statement user insights into the robustness of the impairment testing process) which had been used in the value estimation exercise, but no details of specific discount rates used in relation to particular CGUs. Clients of Ernst & Young and KPMG disclosed the highest with two companies at 10.5% (KPMG) in 2010 and one company at 5.5% (Ernst & Young and KPMG) in 2011. Aside from the lack of consistent adherence to the disclosure framework for discount rates set out in FRS 136, it was apparent that anomalies existed with respect to the value chosen for the discount rate employed by some clients of the Big 3. The average discount rate applied by KPMG clients in modelling the CGU asset recoverable amount was acceptable with KPMG clients adopted a rate of 6.35% in 2010 and 2011.ⁱⁱ

[insert Table 7 here]

An inspection of data pertaining to growth rates used in recoverable amount modeling reveals slightly different pattern to that discernible in the data pertaining to discount rates. This data is set out in Table 8, below. Discounted cash flow models used as a basis for valuation typically consist of two components. The first is an explicit forecast period covered by the most recent budgets/forecasts; the second may be thought of as a terminal value component during which some form of constant growth (or steady state) assumption is made in relation to cash flows which emerge in the model from the year after the conclusion of the explicit forecast horizon through to perpetuity. Under FRS 136, companies are not required to publish details of their growth assumptions during the first of these two stages (that is, the explicit growth forecast horizon).ⁱⁱⁱ However, it is necessary for any growth assumptions pertaining to the terminal value component of the model to be made explicit. Thus, the observed growth rate data set out in Table 8 relates to assumptions expressed in relation to growth rates used to extrapolate beyond the budget/forecast period, being the terminal value to perpetuity element of valuation models used by companies.

Cursory inspection of this data immediately reveals the profound inadequacy of company growth rate disclosures, with in excess of 40% of the sample companies in both years apparently ignoring the clear requirement of FRS 136 that disclosures relating to growth rate assumptions applied in impairment testing be published. Clients of Ernst and KPMG were less likely to provide specific disclosures relating to growth rates applied in recoverable amount modeling which would assist financial statement users in independently assessing the validity of the goodwill impairment testing process. The rate of non-compliance was 36.7% in 2010 and 38.8% in 2011.

As set out in Table 8, in 2010 average assumed growth rates used by PwC clients were higher than the average assumed growth rates of other clients of Big 3 auditors; where as in 2011, average assumed growth rates used by Ernst & Young clients were higher than the average assumed growth rates of other clients of Big 3 auditors. A higher average assumed growth rate would, all things being equal, increase the estimated value of the recoverable amount of CGU assets, and lessen the chance of a goodwill impairment loss being recorded in any particular period. As will be evident, the mean and median values for assumed growth appear relatively conservative, given that the Malaysian long-run nominal GDP growth has been in excess of these levels and can likely be expected to remain so. However, it is notable that the explicit forecast horizons embedded in the valuation models of those organisations which made meaningful disclosures tended to be short (no longer than about five years). This raises the likelihood that

the bulk of model value lies in the terminal value component of the simulation, something generally regarded as risky and as reducing the robustness of the valuation modelling exercise.

[insert Table 8 here]

5. CONCLUSION

The research focused on evidence relating to the quality of financial statement audits in the context of the transition to a new, complex regime. Specifically, the degree of technical compliance with the disclosure requirements of FRS 136 by a sample of 20 large Malaysian listed companies was used as a proxy for audit quality. The adoption of the new and revised FRS modelled tightly on IFRS by Malaysian companies presents an interesting opportunity for research into the impact of expertise disruption on audit quality. Six analytical structures were used to distinguish audit quality among the Big 3, and in so doing the homogeneity of audit quality assumption were questioned. The audited disclosures made during the two-year period under FRS 136 (Amended by Annual Improvements to IFRSs 2009) of a sample of large Malaysian listed companies who had engaged Big 3 auditors was examined.

The evidence presented in this research suggests that there is no variation in audit quality among the Big 3 and contributes to the literature by providing at least preliminary evidence for the proposition that audit quality among the largest audit firms is homogenous, as has so often been assumed in previous studies. In addition, the result is troubling because, although the application of FRS 136 was mandatory for all of the companies included in the research sample, these companies systematically failed to comply with even the basic elements of the Standard in relation to goodwill impairment testing. This was even the case when all of the reports upon which this research was constructed had been subjected to audit by 'big brand' international audit franchises.

The findings will be of interest to investors, analysts, regulators and enforcers, not only in Malaysia but also in other jurisdictions undergoing transition to IFRS, in particular those whose reporting regimes portray similar features.

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ⁱ See Paragraph 134 of FRS 136

ⁱⁱ This judgment is proffered on the basis that long-run sovereign risk-free rates in jurisdictions such as the US have tended to manifest at levels in excess of 5%, and in Australia at 6%. It is therefore unusual that discount rates appropriate to risky enterprises in a less developed economic setting should be so low.

ⁱⁱⁱ Paragraph 134 d (iv) of FRS 136.

Table 1. Overview of Research Sample

Name of firms	Total Goodwill (RM Million)		Goodwill as % of Total Assets		% change in Goodwill	Goodwill per CGU (RM Million)	
	2010	2011	2010	2011		2010	2011
AIRASIA	5	7	1.6	0.1	28.6	5.0	7.0
AXIATA GROUP	7314	7333	19.2	18.1	0.3	2438.0	2444.3
BATU KAWAN	12	12	0.4	0.3	0.0	6.0	6.0
FRASER & NEAVE	46	46	1.5	1.9	0.0	23.0	23.0
IJM CORPORATION	70	69	0.6	0.5	-1.4	23.3	0.0
KNM GROUP	799	799	22.7	20.3	0.0	266.3	266.3
KUALA LUMPUR KEPONG	290	304	3.2	2.8	4.6	0.0	0.0
KULIM (MALAYSIA)	45	58	0.5	0.5	22.4	4.5	5.8
MISC	747	693	1.8	1.8	-7.8	249.0	173.3
MMC CORPORATION	2043	2043	5.6	5.6	0.0	681.0	681.0
NESTLE (MALAYSIA)	61	61	3.4	3.0	0.0	61.0	61.0
ORIENTAL HOLDINGS	31	56	0.6	0.9	44.6	7.8	11.2
PARKSON HOLDINGS	1244	1231	18.5	16.9	-1.1	622.0	410.3
SAPURACREST PETROLEUM	149	149	4.4	4.1	0.0	74.5	74.5
SIME DARBY	35.30	50	0.1	0.1	29.8	11.8	12.6
TELEKOM MALAYSIA	310	310	1.5	1.5	0.0	155.0	155.0
TOP GLOVE CORPORATION	20	20	1.5	1.4	0.0	6.7	6.7
UMW HOLDINGS	258	199	2.6	1.9	-29.6	51.6	39.8
WAH SEONG CORPORATION	110	113	5.5	4.9	2.7	36.7	37.7
YTL POWER INTERNATIONAL	6149	6484	18.1	18.4	5.2	2049.7	2161.3
Total	19738	20037	6.75	6.52	1.5	340.3	339.6

Table 2. Number of firms Audited by Big 3 Auditor

Name of Firms	Ernst and Young		KPMG		PricewaterhouseCoopers	
	2010	2011	2010	2011	2010	2011
AIRASIA					1	1
AXIATA GROUP					1	1
BATU KAWAN	1	1				
FRASER & NEAVE HOLDINGS	1	1				
IJM CORPORATION					1	1
KNM GROUP			1	1		
KUALA LUMPUR KEPONG			1	1		
KULIM (MALAYSIA)	1	1				
MISC	1	1				
MMC CORPORATION					1	1
NESTLE (MALAYSIA)			1	1		
ORIENTAL HOLDINGS			1	1		
PARKSON HOLDINGS	1	1				
SAPURACREST PETROLEUM	1	1				
SIME DARBY					1	1
TELEKOM MALAYSIA					1	1
TOP GLOVE CORPORATION	1	1				
UMW HOLDINGS	1	1				
WAH SEONG CORPORATION					1	1
YTL POWER INTERNATIONAL					1	1
TOTAL	8	8	4	4	8	8

Table 3. Method Employed by Firms to Determine Recoverable Amount

	Ernst & Young n=8		KPMG n=4		PricewaterhouseCoopers n=8	
	2010	2011	2010	2011	2010	2011
Fair value Method			1 (5%)	1 (5%)		1 (5%)
Value-in-Use Method	7 (35%)	7 (35%)	3 (15%)	3 (15%)	7 (35%)	4 (20%)
Combination of Methods	1 (5%)	1 (5%)				1 (5%)
No Effective Disclosure					1 (5%)	2 (10%)

Table 4. CGU Allocation Compliance by Auditor

	Ernst & Young n=8		KPMG n=4		PricewaterhouseCoopers n=8	
	2010	2011	2010	2011	2010	2011
Fully Compliant	8 (40%)	8 (40%)	3 (15%)	3 (15%)	8 (40%)	7 (35%)
Non-compliant	0	0	1 (5%)	1 (5%)	0	1 (5%)

Table 5. Operating Segments and CGU Aggregation by Auditor

	Ernst & Young n=8		KPMG n=4		PricewaterhouseCoopers n=8	
	2010	2011	2010	2011	2010	2011
No Effective Disclosure	1 (5%)	0	1 (5%)	1 (5%)	0	1 (5%)
CGUs < Segments	5 (25%)	5 (25%)	2 (10%)	2 (10%)	7 (35%)	6 (30%)
CGUs = Segments	1 (5%)	2 (10%)	1 (5%)	1 (5%)	1 (5%)	1 (5%)
CGUs > Segments	1 (5%)	1 (5%)	0	0	0	0
Proportion of Companies where CGUs < Segments or No Effective Disclosure	30%	25%	15%	15%	35%	35%

Table 6. Ratio of CGUs to Operating Segments

	Ernst & Young n=8		KPMG n=4		PricewaterhouseCoopers n=8	
	2010	2011	2010	2011	2010	2011
No Effective Disclosure	-	-	1	1	-	1
CGU : Segment is between 0.00 – 0.50	2	3	1	1	3	2
CGU : Segment is between 0.51 - 0.99	3	2	1	1	4	4
CGU : Segment is = 1	1	2	1	1	1	1
CGU : Segment is between 1.01 - 1.50	-	-	-	-	-	-
CGU : Segment is > 1.50	2	1	-	-	-	-
Mean CGU : Segment ratio	1.02	0.84	0.54	0.67	0.63	0.57
Median CGU : Segment ratio	0.75	0.68	0.58	0.67	0.60	0.59
Minimum CGU : Segment ratio	0.50	0.4	0.50	0.50	0.50	0.50
Maximum CGU : Segment ratio	2.00	2.0	1.00	1.00	1.00	1.00
% CGU : Segment ratio > 1.01	25%	13%	0%	0%	0%	0%

Table 7. Analysis of Discount Rates Used to Test Impairment (VIU and Mixed Method Companies Only)

	Ernst & Young n=8		KPMG n=3		PricewaterhouseCoopers n=8 n=7	
	2010	2011	2010	2011	2010	2011
No Effective Disclosure	2 (10.5%)	2 (11.1%)	0	0	0	1 (5.5%)
Range of Discount Rates	0	1 (5.5%)	2 (10.5%)	1 (5.5%)	0	0
Single Explicit Discount Rate	2 (10.5%)	3 (16.6%)	0	0	3 (15.7%)	2 (11.1%)
Multiple Explicit Rates	4 (21%)	2 (11.1%)	1 (5.2%)	2 (11.1%)	5 (26.3%)	4 (22.2%)
Minimum Discount Rate	2%	2%	5.2%	1.1%	5.5%	6.1%
Maximum Discount Rate	20%	18%	24%	22%	14%	15.7%
Median Discount Rate	11%	10%	14.6%	11.55%	9.75%	10.9%
Mean Discount Rate	6%	8.75%	6.35%	6.35%	13.33%	7.285%

Table 8. Analysis of Growth Rates Used to Test Impairment (VIU and Mixed Method Companies Only)

	Ernst & Young n=8		KPMG n=3		PricewaterhouseCoopers n=8 n=7	
	2010	2011	2010	2011	2010	2011
No Effective Disclosure	4 <i>(21%)</i>	4 <i>(22.2%)</i>	3 <i>(15.7%)</i>	3 <i>(16.6%)</i>	1 <i>(5.3%)</i>	1 <i>(5.5%)</i>
Range of Discount Rates	0	0	0	0	0	0
Single Explicit Discount Rate	2 <i>(10.5%)</i>	3 <i>(16.6%)</i>	0	0	3 <i>(15.7%)</i>	2 <i>(11.1%)</i>
Multiple Explicit Rates	2 <i>(10.5%)</i>	1 <i>(5.5%)</i>	0	0	4 <i>(21%)</i>	4 <i>(22.2%)</i>
Minimum Discount Rate	2%	2%			2%	-0.8%
Maximum Discount Rate	20%	50%			33.5%	8.5%
Median Discount Rate	11%	26%			16%	3.9%
Mean Discount Rate	6%	15%			16.5%	3.54%