

Financial Instruments Disclosure Practices: Evidence from Malaysian Listed Firms

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ABSTRACT

The current changes in business settings have directed companies to conduct businesses at the international level which requires the use of financial instruments. The mandatory MFRS 7, an adoption of IFRS 7 standard has been implemented for entities to disclose their involvement with financial instruments. Thus, the aim of this study is to investigate the financial instruments disclosure practices (FID) among Malaysian listed companies; specifically, on the level of compliance with MFRS 7. The overall results indicate that companies complied with MFRS 7, though there are several requirements omitted by companies. Furthermore, with the revision of Malaysian Code of Corporate Governance (MCCG) in 2012, this study examines the association of corporate governance mechanisms (board expertise, audit committee independence, audit fee, external and internal audit functions) with the extent of FID among companies. Based on a total sample of 319 Malaysian public listed companies for financial year end 2012, the analysis reveals that FID is significantly and positively associated with audit committee independence and external audit functions, while internal audit is negatively associated. Hence, it suggests that effective corporate governance is crucial as this is likely to have some influence on the extent of disclosure level among companies.

Keywords: MFRS 7; financial instruments; financial instrument disclosure practice; corporate governance

INTRODUCTION

In recent years, there have been significant developments of more complex and innovative financial instruments to cater for the needs of current business world (Zadeh & Eskandari 2012; Hunziker 2013). Financial instruments, either equity-based (*i.e.* shares) or debt-based (*i.e.* derivatives) are widely used by companies as a medium to raise more capital (Ismail & Rahman 2011). New risk management techniques and concepts have evolved for identifying, evaluating, and managing the exposure of risk arising from the financial instruments. Thus, there is a need for more relevant information on and greater transparency of an entity's exposure in managing and controlling those risks (Zaluki & Hussin 2009). Potential stakeholders, particularly investors, are demanding such high quality information in order to make more informed decisions.

For this reason, in August 2005, the International Accounting Standards Board (IASB) issued International Financial Reporting Standards (IFRS) 7 on financial instruments to provide guidelines to the extent of the disclosure required for entities involved with financial instruments. Previously, financial instruments disclosure was catered for under either IAS 30 Disclosure in the Financial Statements of Banks and similar Financial Institutions or IAS 32 Financial Instruments: Disclosure and Presentation. However, the IASB removed these duplicated disclosures as part of their revision, and simplified them to a single concentration standard known as IFRS 7. IFRS 7 defines a financial instrument as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

In line with international developments on this matter, Malaysian companies are also required to adhere to the regulation set by the Malaysian Accounting Standards Board (MASB). The MASB is the sole authority dealing with accounting standards in Malaysia. It has issued Malaysian Financial Reporting Standards (MFRS), fully IFRS-compliant standards, in order to be aligned with global accounting standardisation efforts. The full convergence process came into effect on 1 January 2012 and is to be applied by all Entities Other Than Private Entities (MASB 2011). The convergence with IFRS, although challenging, will place Malaysian companies and the capital market at par with other international economies and markets (The Accountant 2008). Thus, firms that comply with MFRS standards would be expected to produce high quality accounting information, as numerous studies (Liu, Yao, Hu & Liu Olive 2011; Aubert & Grudnitski 2012) have shown that, by adopting IFRS, the overall financial reporting prepared by firms improves significantly.

The MASB introduced MFRS 7 *Financial Instruments: Disclosure* and the requirement to use it came into force on 1st January 2012. It acts as a new standard to deal with the disclosure of financial instruments which was previously covered by FRS 132 *Financial Instruments: Disclosure and Presentation*. The decision to defer the implementation was made to give Malaysia a grace period to learn from other countries' experiences (MASB 2005) as well as to provide a sufficient interval for companies to make necessary adjustments to their financial reporting (Zadeh & Eskandari 2012). Generally, MFRS 7 provides two main disclosures that cater the need to disclose the significant level of the

financial instruments to the entities; and the qualitative and quantitative information on the exposure of risk faced to the entities' financial statements. Additionally, MFRS 7 has enhanced the disclosure on fair value measurements and liquidity risk to address the application issues as well as to provide sufficient information to users. The MFRS 7 standard is a complementary to both other MFRS standards which are, MFRS 139 Financial Instruments: *Recognition and Measurement* and MFRS 132 Financial Instruments: *Presentation*. However, for the purpose of this study, we will only focus on MFRS 7.

The aim of this study is to examine the MFRS 7 disclosure practices among Malaysian listed companies and their compliance level to MFRS 7. Unlike many prior studies, FID was examined either by using the prior standards such as MASB 24 (Hassan & Salleh 2010) and FRS 132 (Othman & Ameer 2009; Zadeh & Eskandari 2012), or by focusing on voluntary disclosure (Bamber & McMeeking 2010; Ismail & Rahman, 2011). This study extends prior research by focusing on MFRS 7, the current globally-accepted accounting standard. In addition, this study complements a study conducted by Amran et al. (2009) which examined the factors associated with overall risk reporting, but did not cover the corporate governance elements. Thus, this study provides additional empirical evidence to the existing literature by investigating the relationship between corporate governance using several revised MCGC code in 2012, and the extent of a firm's level of compliance with the MFRS 7. This paper is organised as follows: the subsequent section contains reviews of related literature and hypotheses development. Next, the research method is deliberately explained, followed by analysis of results and discussion. The final area will briefly explain the implication and conclusion of this study.

REVIEW OF RELATED LITERATURE AND HYPOTHESES DEVELOPMENT

The pressure of business transactions and the rapid development of international market have increased the demand for more relevant information and greater transparency in financial reporting disclosure (Bischof 2009; Savvides & Savvidou 2012; Elzahar & Hussainey 2012). The risk exposure from financial instruments and how they are being managed are among the key elements needed. This detailed information is crucial to ensure financial statements are prepared to reflect the true financial position of the firms, and to assist users i.e. investors to make more informed judgement. Further, MFRS 7 has been initiated to provide such information to enable users to evaluate the nature, extent of risks and the significance of the financial instruments to the entity's financial position. Prior literature has examined the financial instruments disclosure practices particularly on risk-related disclosure covering mandatory, voluntary, or combination of both types of risk-related disclosure. Findings indicate that companies tend to comply with the accounting standards mandated by the respective countries

(Bischof 2009; Hassan & Salleh, 2010; Probohudono, Tower & Rusmin 2013), while some studies show that extra disclosure is required to meet the additional rules and regulation (Bamber & McMeeking 2010). However, it is also documented that companies tend to partially comply, by omitting certain requirements in the standards (Othman & Ameer 2009; Savvides & Savvidou 2012; Zadeh & Eskandari 2012); and the disclosure practices vary in terms of type of the risk information disclosed, and the in-depth details of such information in the financial reporting (Ismail & Rahman 2011; Oliveira, Rodrigues & Craig 2011).

Empirically, prior studies show that disclosure practices vary with respect to different settings across countries. This was due to different responses coming from various level of economic development (Probohudono, 2013), the acceptability of each country on risk information (Bischof 2009; Othman & Ameer 2009; Savvides & Savvidou 2012) as well as different level of enforcements and interpretation of the standards itself (Bischof 2009). Besides, prior studies suggest that the level of risk disclosure is associated with corporate governance characteristics (Taylor et al. 2008; Oliveira et al. 2011), where firms with strong CG structure are more likely to be more effective in financial risk management, hence promote better transparency in financial reporting. Similarly, Alanezi and Albuloushi (2011) revealed that Kuwaiti firms with high level of compliance with the IFRS-mandatory disclosure are more likely to have good CG structure.

In Malaysia, Hassan and Salleh (2010) examined the disclosure quality using a self-developed disclosure index based on MASB 24 requirements; while, Othman and Ameer (2009) and Zadeh and Eskandari (2012) employed FRS 132. In general, there are no major areas and differences between these two standards; as the MASB standard was just renumbered and renamed (Lazar, Tay and Othman 2006) to FRS for international convergence purpose. However, results indicate that there are variation in the disclosure practices among companies on the nature and level of compliance to the standard; eventhough the convergence efforts to align Malaysian accounting standards to international standards already took place in 2006. Thus, it is hoped that the adoption of IFRS into MFRS is able to enhance the compliance level among Malaysian companies as Malaysian Accounting Standards Board (MASB) has no power to exempt anyone (i.e. Malaysian public listed firms) from MFRS. To strengthen the quality of financial reporting, the recently-revised MCGC is expected to enhance the quality of information provided by the firms, which includes the need for better transparency of financial reporting and disclosure.

While there is a wide range of studies (Oliveira et al. 2011; Elzahar & Hussainey 2012; Probohudono et al. 2013) concerning the relationship between CG mechanism and financial reporting, very little research has directly investigated or explored the link of CG with financial instruments disclosure. Hence, the current study expands existing risk-related literature by investigating the association of corporate governance mechanism with FID

practices among Malaysian companies. At the same time, this study contributes to the current literature by examining the MFRS 7 disclosure practices among companies. Agency theory provides a powerful theoretical framework in the study as financial reporting disclosure is among the cost-effective monitoring tools in principle-agent relationship. It explains how information asymmetry between the shareholders (principles) and managers (agents) is mitigated through monitoring mechanism (Oliveira et al. 2011). Furthermore, compliance with IFRS promulgated by the IASB is among the recommended practices to improve the principal-agent relationship as similar information would be transmitted to all parties (MASB 2005).

In this study, monitoring mechanism covers the four dimensions of corporate governance structure (Cohen, Krishnamoorthy & Wright 2004) which are comprised of the board, audit committee, external auditor and internal audit functions. The variables used are represented as board expertise (BEXP), audit committee independence (ACNED), external audit functions (EA), audit fees (AF), and internal audit functions (IA), which are consistent with prior studies (*see* Taylor et al. 2008; Oliveira et al. 2011; Elzahar & Hussainey, 2012; Probohudono et al. 2013). Control variables are useful in a research to take into consideration other relevant factors that might influence the variables of interests. Prior studies suggest that control variables are related to oversight mechanisms, in association with the level of disclosure, such as firm-specific characteristics. Therefore, firm size, firm leverage and firm complexity were used for the purposes of this study.

BOARD EXPERTISE (BEXP)

Prior literature recommends that board size affects board effectiveness in the sense of a larger board being more likely to have more knowledge and skills (Ismail and Rahman 2011; Elzahar and Hussainey 2012), but without an appropriate level of expertise among the board members, it will be a cost instead of a benefit to the firm. Further, Sulaiman (2013) suggests that the lack of relevant expertise among the board member could lead to a failure of a board to exercise its oversight duty, resulting in loss or damages to the company. Specifically, Sulaiman (2013) highlights the relevance of financial literacy or expertise among the board as it could improve board's effectiveness. There is still a limited number of studies (Sulaiman 2013) that focus on board expertise, hence, this study extends the literature by including board expertise as the board has a role in ensuring corporate disclosure policies are in place. Consistently, the study predicts that firms with greater number of board members with accounting or finance expertise would enable them to better understand the financial reporting elements associated with better compliance with financial reporting standards. More specifically, the board with accounting or finance backgrounds, who by definition would have greater understanding on financial reporting requirements, would be motivated to ensure the firm is in compliance with the

mandatory MFRS standards imposed. Similar with past studies (*see* Yatim, Kent & Clarkson 2006; Nelson 2010; Yasin & Nelson 2012), a positive association between board expertise and the level of compliance with MFRS 7 is assumed, resulting in the following hypothesis:

H₁: There is a positive association between the level of a firm's compliance with MFRS 7 and board expertise

AUDIT COMMITTEE INDEPENDENCE (ACNED)

Given the diversification and complex nature of company, the board needs to delegate some of its monitoring responsibilities to another party within the firm, who can support and provide secondary control over the company operations (Oliveira et al. 2011). The board generally delegates financial reporting responsibilities to the audit committee and hence the audit committee is the mechanism most likely to provide shareholders with the greatest protection in maintaining the quality of a company's financial statements and ensuring the entity complies with mandatory disclosures (Palmer 2008; Akhtaruddin & Haron 2010; MCCG 2012). Consistent with MCCG (2007) requirements, an effective audit committee needs to be in place and prior research indicates that the effectiveness of an audit committee is related to the extent to which the committee is independent (Oliveira et al. 2011; Elzahar & Hussainey 2011; Probohudono et al. 2013). The results of past studies reveal that a higher proportion of independent directors sitting in the audit committee would lead to greater monitoring over the board. The greater monitoring over board includes high compliance with the applicable standards and regulations imposed on the company (Palmer, 2008; Akhtaruddin & Haron, 2010; Oliveira et al. 2011; Elzahar & Hussainey 2011). Akhtaruddin and Haron, (2010) also suggest that higher level of compliance with the IFRS-required disclosures is found among companies with higher proportion of non-executive directors serving on their audit committee. Therefore, it is assumed that companies with a higher proportion of independent directors sitting in the audit committee would lead to a higher level of compliance with MFRS 7. Hence, the following hypothesis is proposed:

H₂: There is a positive association between audit committee independence and the level of a firm's compliance with MFRS 7.

EXTERNAL AUDIT FUNCTIONS (EA)

External auditors have a major role in ensuring that their clients comply with accounting standards and other regulations. Some audit committee and board members are likely to be unaware of all reporting requirements given the increasing complexity of accounting regulation in recent years (Palmer 2008). Thus, the external auditor is in a position to ensure that companies comply with applicable financial reporting requirements. Larger audit

firms (i.e. the Big Four) typically have more resources and expertise (Chen, Hsu, Huang & Yang 2013) as well as being more familiar with the applicable reporting requirements (Palmer 2008); hence engaging with Big Four audit firms could ensure high compliance with accounting standards and other regulations. In addition, agency theory predicts that the larger the company, the more complicated the organisational structure, and the higher the agency cost (Jensen & Meckling 1976); thus companies with high agency costs would tend to engage Big Four international auditing firms due to the higher quality offered (Chen et al. 2013). Subsequently, these large and well-known auditing firms (the Big Four) ensure high compliance with applicable financial reporting standards in order to maintain the audit firm's reputation (Oliveira et al. 2011) and avoid reputational costs borne by them (George, Ferguson & Spear 2013). Consistent with the above findings, this study predicts that firms that engage with Big Four audit firms would tend to have greater compliance with MFRS 7 disclosure requirements than those firms with non-Big Four audit services. Therefore, to test the impact of external audit functions on the level of a firm's disclosure practice, the following hypothesis is developed:

H₃: There is a positive association between firms audited by Big-Four audit firms and a firm's level of compliance with MFRS 7

AUDIT FEES (AF)

Agency theory states that shareholders need to incur monitoring costs (Jensen & Meckling 1976), such as the cost of hiring the external auditor. This cost is better known as audit fees and is in place to minimise the agency cost (Cohen et al. 2004). Moreover, prior studies show that there is association between fees received by audit firms and the auditor's independence, which will indirectly impact on the financial reporting decision (i.e. the extent of disclosure in annual reports). It is argued that a higher amount of audit fees indicates that auditors provide more thorough and efficient audit services (Yatim et al. 2006). Hence, more reliable information and a high level of compliance with accounting standards and other regulations are expected. Furthermore, George et al. (2013) found a significant increase in audit cost due to the IFRS adoption by the client companies. The increase in audit fees is attributed to an increase in auditing work, as additional effort is needed by the auditors. They further state that the additional cost incurred is to mitigate the risk of IFRS adoption such as the possibility of financial statements being materially misstated or not complying with applicable accounting standards. In addition, the auditors need to familiarise themselves with the applicable reporting requirements (Palmer 2008) and become knowledgeable about the new IFRS standards (George et al. 2013). This is a cost to the audit firms which contributes to higher fees charged to the clients. Therefore, consistent with above findings, this

study predicts that higher audit fees are associated with a higher level of compliance with MFRS 7 among listed companies. The following hypothesis is developed to test this association.

H₄: There is a positive association between audit fees and the level of a firm's compliance with MFRS 7.

INTERNAL AUDIT FUNCTIONS (IA)

Consistent with the revised MCCG (2012), past studies (Cohen et al. 2004; Christopher, Sarens & Leung 2009; Kueppers & Sullivan 2013; Johl, Johl, Subramaniam & Cooper 2013) indicate that the independence of internal audit function is crucial to ensure the internal auditors are carrying out their function accordingly as well as to ensure that internal controls are operating effectively. In addition, the greater the independence level of internal audit functions, the greater the likelihood that the internal auditors can exercise their professional skepticism and remain objective (Christopher et al. 2009; Kueppers & Sullivan 2013). Therefore, this suggests that effective internal audit functions will lead to a high level of compliance with accounting standards and other regulations. Further, it is argued that firms that outsource their internal audit functions are less likely to be independent in comparison to companies that have their own in-house internal audit functions. This is because they may not be fully aware of the overall operation of the firms, hence, there is a tendency to internal influence by the management of the firm (Abdolmohammadi 2013), particularly if the internal auditor is new or has a conflict of interest, such as in a politically connected firm (Johl et al. 2013). Moreover, the level of independence could be impaired as they (the outsourced internal audit function) are being employed and paid directly by the company. However, prior studies also indicate that there are cases where outsourcing the internal audit functions provide more benefits to firms. As normally, firms would outsource their internal audit functions to a professional service provider, who can provide specialised resources, and thus be able to strengthen the internal control of the firms. Similarly, a study by Desai, Gerard and Tripathy (2011) found that external auditors assess the quality of outsourced IAF to be higher than the quality of an in-house IAF and thus are more willing to rely (to a greater extent) on outsourced IAF than in-house IAF. Accordingly, the study predicts that firms that outsource their internal audit functions are more likely to comply with MFRS requirements, given firms would outsource their internal audit functions to a professional service provider (i.e. accounting or auditing firms), who are more familiar with IFRS/MFRS standards and other financial reporting requirements. The following association is hypothesized.

H₅: There is a negative association between firms that have their own internal audit functions (in-house) and the level of the firms' compliance with MFRS 7

RESEARCH METHODOLOGY

Although year 2012 marked the year for full adoption of MFRS by all public listed companies but there was an exception granted for several companies such as those entities that are within the scope of MFRS 141 Agriculture (MFRS 141) and IC Interpretation 15 Agreements for Construction of Real Estate (IC 15). In this case, these transitioning entities will be excluded in the sample as they are allowed to defer the adoption for another 2 years. Moreover, consistent with prior studies (Bamber & McMeeking 2010; Ismail & Rahman 2011; Elzahar & Hussainey 2012), the sample also excludes financial industry due to different regulation attached to this sector, thus, the final sample consists of 319 companies. Data was hand collected from available annual reports on Bursa Malaysia website. This study employed the unweighted index or dichotomous scores whereby all information was equally valued regardless of the number of words, sentences, or the length of pages. The Financial Instrument Disclosure Checklist (FID) contains a total of 25 checklist items, which was self-developed based on the MFRS 7 requirements. The items disclosed are coded as '1' if a particular item is included in the checklist while '0' is coded if not disclosed, consistent with prior studies (*see* Taylor et al. 2008; Othman and Ameer 2009; Savvides and Savvodiou 2012; Probohudono et al. 2013). The variables of measurements used are based on prior academic literature or relevant regulatory requirements (i.e., the MCGG code). Table 1 below represents the summary of the operationalisation of variables used in this study. They have been categorised into three types, which are dependent variables, independent variables and control variables.

RESULTS AND FINDINGS

Table 2 shows the overall mean score for FID is 80.76%, with the minimum and maximum score of 14% and 100% respectively. The results show that the disclosure level of

Malaysian companies has slightly increased compared to prior studies by Othman and Ameer (2009) and Zadeh and Eskandari (2012). For the independent variables, they are mainly categorised into two sections, Panel A reports those for continuous variables, which includes the values of the mean, minimum, maximum and standard deviation values of the variables, while, Panel B represents the frequency of dichotomous variables.

The revised MCGG code (MCGG 2012) focuses on strengthening the roles and responsibilities of the board by having the appropriate composition of board members with the relevant expertise. In addition, in a dynamic and complex business environment, it is crucial for the directors in the board to have a certain level of accounting-related knowledge and to enhance their skills through appropriate continuing education programmers. This will enable the board to serve and sustain their active participation in board deliberations effectively (MCGG 2012). The data collected in this study have shown that on average, 28% of the board members have an accounting background and/or accounting-related experience. The maximum and minimum percentages of board members with an accounting background or accounting-related experience are 80% and 0%, respectively.

Furthermore, it is a recommended practice under the MCGG 2007 for Malaysian companies to establish an audit committee, of which a portion comprises the directors in the board and the majority of the members need to be independent non-executive directors. The role of the audit committee is to provide further support to the board; hence, its members should be independent in order to discharge their functions effectively. The finding reveals one company failed to comply with the MCGG (2007) recommendations, given the minimum amount of 0 obtained from the ACNED variable results. This company mentioned in their annual report that they had not established any audit committee team but would rather outsource it to their parent company. However, it is permissible not to have audit committee for

TABLE 1. Summary of Variables

	Operational Measures	Acronym
Independent Variable		
Board Expertise	The proportion of board members with accounting background or accounting related experience	BEXP
Audit Committee Independence	The proportion of independent non-executive directors (INED) in the audit committee team;	ACNED
External Auditor	Assigned as 1 for firm's audited by Big-Four and 0 for firm's audited by non-Big Four	EA
External Audit Fee	Natural log of total value of audit fees paid to the external auditors by the firms	AF
Internal Audit Functions	Assigned as 1 for in-house internal audit functions and 0 for outsourced internal audit functions	IA
Control Variables		
Firm Size	Natural log of firm size based on market capitalisation	FSIZE
Firm Leverage	Total value of debt to total assets	FLEV
Firm Complexity	Number of direct subsidiaries	FCOMPLEX

TABLE 2. Descriptive analysis for all variables

	Min	Max	Mean	Std. Deviation
<i>DEPENDENT VARIABLE</i>				
MFRS Disclosure Index (FID)	3 (14%)	25 (100%)	20.19 (80.76%)	
<i>INDEPENDENT VARIABLES</i>				
<i>Panel A- Continuous Variable</i>				
BEXP(%)	0.00	0.80	0.28	0.14
ACNED	0.00	1.00	0.86	0.17
AF	8000	5,274,000	381,373.57	675,230.61
FSIZE	1,949,700	56,069,660,672	1,851,707,432	6,947,662,596
FLEV	0.03	1.69	0.40	0.23
FCOMPLEX	0	101	9.93	12.99
<i>Panel B- Dichotomous Variable</i>				
EA	Freq (Big 4) 173	% 54.20	Freq (Non-Big 4) 146	% 45.8
IA	Freq (In-house) 163	% 51.10	Freq (Outsource) 155	% 48.60

this type of company as it falls under real estate investment trust; hence, audit committees are not applicable (Bursa Malaysia, 2013). On the other hands, the maximum of 100% for ACNED indicates that all members sitting on the audit committee functions are independent non-executive directors, but, on average, the result obtained is 86%.

With regard to external auditors, on average 54.20% of the companies, or a total of 173 companies, engaged the services of one of the Big Four audit firms, while the rest (45.80%) engaged a non-Big Four audit firm. In addition, to provide assurance to the board that the internal controls are operating effectively, the MCG 2012 further enhances the governance practices which outline the need to establish internal audit functions reporting directly to the audit committee. However, based on the findings obtained, only 51.10% or a total of 163 from the total sample, have in-house internal audit functions while the rest outsource their internal audit functions to the outsiders.

For control variables, the mean for firm size is RM 1,851,707,432, which is proxied by market capitalisation, with a minimum amount of RM 1,949,700 and a maximum amount of RM 56,069,660,672. The next variable used is firm leverage. Firm leverage is computed based on total liabilities over total assets; the mean obtained is 0.4%, while the maximum and minimum amounts are 1.69% and 0.03% respectively. Finally, the number of direct subsidiaries ranges from 0 to 101, with a mean of 9.93.

In Table 3, the correlation analysis indicates that there is no evidence of high collinearity among the variables. The overall correlation analysis between dependent and independent variables suggests that MFRS 7 on financial instruments disclosure (FID) is positively and significantly correlated with external audit (EA) and audit fees (AF) at 0.177 and 0.297, respectively, while it is insignificant with the rest of independent variables which include board expertise (BEXP), audit committee independence (ACIND) and internal audit functions (IA). This result suggests that external auditors play a major role in ensuring high

compliance among companies as they (external auditors) are expected to be more familiar with the reporting requirements. Some clients are likely to be unaware of all reporting requirements given the increasing complexity of accounting regulations in recent years (Palmer 2008). Hence, the external auditors are in a position to provide reasonable assurance that the financial statement is prepared in accordance with the applicable MFRS standards and other regulations. Specifically, the finding indicates that firms that engage Big Four audit firms or, to some extent, firms with high audit fees tend to comply with MFRS 7 disclosure requirements, as compared to firms that employ non-Big Four audit services or ones which charge a lower audit fee. Further, the correlation table provides the correlation analysis between the dependent variable and the control variables. The result signifies that each of the control variables (FSIZE, FLEV and FCOMPLEX) is positively and significantly correlates with MFRS 7 on financial instrument disclosure (FID)

On the other hand, the highest level of correlation among the independent variables (at 1% level) exists between external auditor (EA) and audit committee independence (-0.204), between audit fees (AF) and EA (0.424), and between internal audit functions (IA) with EA and AF, which represent 0.187 and 0.323 respectively. There is a significant relationship between all the independent variables and firm size (audit independence at -0.273; external audit functions at 0.454; audit fees at 0.618 and internal audit functions at 0.323) except for board expertise (-0.095). Similarly, for firm's complexity, which is proxied by the number of direct subsidiaries, the result indicates that there is a significant correlation with all independent variables except board expertise (-0.009) and audit committee independence (-0.081). The figures are 0.163 for external audit functions, 0.530 for audit fees and 0.253 for internal audit functions. Moreover, only audit fee (0.287) is found to be highly correlated to the firm's leverage, while the rest of independent variables are found to be insignificant.

TABLE 3. Results of Correlation Analysis

	FID (%)	BEXP	ACNED	EA	AF	IA	FSIZE	FLEV	FCOMPLEX
FID(%)	1	-0.079	0.059	0.177**	0.297**	-0.004	0.198**	0.180**	0.201**
BEXP		1	-0.028	-0.087	0.011	-0.094	-0.095	0.052	-0.009
ACNED			1	-0.204**	-0.135*	-0.052	-0.273**	-0.055	-0.081
EA				1	0.424**	0.187**	0.454**	0.003	0.163**
AF					1	0.323**	0.618**	0.287**	0.530**
IA						1	0.323**	0.094	0.253**
FSIZE							1	0.029	0.353**
FLEV								1	0.180**
FCOMPLEX									1

**, * Correlation is significant level at 1% and 5 % respectively level (2-tailed)

Note: FID= The percentage of MFRS 7 financial instruments disclosure items BEXP= The proportion of board members with accounting background or accounting related experience; ACNED: The proportion of independent non-executive directors (INED) in the audit committee team; AF: Natural log of total value of audit fees paid to the external auditors by the firms; EA: Assigned as 1 for firm's audited by Big Four and 0 for firm's audited by non-Big Four; IA: Assigned as 1 for in-house internal audit functions and 0 for outsourced internal audit functions; FSIZE: Natural log of firm size based on market capitalisation; FLEV: Total value of debt to total assets; FCOMPLEX: Number of direct subsidiaries

Table 4 provides a summary analysis of the multiple regression results obtained for this study. The F-value of the data is 6.698 and is statistically significant at 1% level, with the p-value of 0.000. Further, the explanatory power of the entire set of variables for this study is estimated by the adjusted R² figures. The R² value is the coefficient of determination; in this case, the R² is represented by 15.4%. It indicates that 15.4% of variation in the dependent variable is explained by the variation in the independent variables. In other words, it measures the degree of predictive accuracy of the regression model in explaining the variation in the dependent variable. Although the R² is reported as having a low value, this seems consistent with prior studies in this financial reporting disclosure area, such as Hassan, Saleh and Rahman (2008), Said, Zainuddin and Haron (2009) and Akhtaruddin and Haron (2010). The R² values for all these studies are reported at 15.67%, 13% and 12.2 % respectively

The overall regression results show that two variables which are audit committee independence (ACNED) and external audit (EA) are significant and positively associated, while, internal audit (IA) is found to be negatively associated with the extent of MFRS 7 disclosure practices among the selected sample. For the rest of the independent variables and control variables, they are found to be insignificant in this study. External audit functions (EA) is the only variable that is strongly supported since it also shows a significant positive correlation in the correlation analysis, while the other two variables (ACNED and IA) are not significantly correlated with the extent of MFRS 7 disclosure practices.

The largest beta coefficient in this study is 0.276, which represents the external audit (EA) variables. This indicates that external audit function makes the strongest contribution in explaining the dependent variable (FID). Consistently, the p-value for EA shows a significant value at 1% level, which indicates the selection of external audit functions (Big Four or non-Big Four audit firms) is found to

be positively associated with the firm's level of compliance with MFRS 7. Thus, H₄ is supported. The result is consistent with prior studies (*see* Oliveira et al. 2011; George et al. 2013; Chen et al. 2013). External auditors play a valuable role in monitoring the contractual relationship between the entity and its stakeholders, as the auditor's verification provides greater assurance about companies' annual reports (KPMG 2012), and hence, reduces the information asymmetry in the agency relationship. Further, some audit committee and board members are likely to be unaware of all reporting requirements given the increasing complexity of accounting regulation in recent years (Palmer 2008). Thus, the external auditor is in a position to provide independent advice and ensure that companies comply with applicable financial reporting requirements (Palmer 2008). Hence, external auditors are expected to be independent, qualified and competent to carry out their duties in order to maintain the quality of audit services offered. Based on the findings, Big Four audit firms are more likely to ensure high compliance with applicable accounting standards among their clients as compared to non-Big Four firms, as they are internationally recognised, and have more resources and expertise (Chen et al. 2013).

Similarly, the finding is consistent with agency theory prediction in which the larger the company, the more complicated the organisational structure, and the higher the agency cost. Thus, companies (with higher agency costs) would tend to engage Big Four auditing firms due to the higher quality of service offered (Jensen & Meckling 1976). Subsequently, these large and well-known auditing firms (the Big Four) will ensure high compliance with applicable financial reporting standards among their clients in order to maintain the audit firm's reputation (Oliveira et al. 2011) and avoid reputational costs borne by them (George et al. 2013). Therefore, firms that engage Big Four audit firms would have a greater tendency to comply with MFRS 7 disclosure requirements than firms with a non-Big Four audit service

TABLE 4. Multivariate Regression Analysis
 $FID = \beta_0 + \beta_1 BEXP + \beta_2 ACNED + \beta_3 EA + \beta_4 AF + \beta_5 IA + \beta_6 FSIZE + \beta_7 FLEV + \beta_8 FCOMPLEX + \varepsilon$

	Variable	Beta/ Coefficients	Significant (t-stat)	(p-value)
Independent Variables	(Constant)		5.042	.000
	BEXP	-0.056	-1.030	0.304
	ACNED	0.121	2.146	0.033**
	EA	0.276	3.289	0.001***
	AF	0.076	1.214	0.226
	IA	-0.176	-3.011	0.003***
Control Variables	FSIZE	0.053	0.699	0.485
	FLEV	0.090	1.557	0.121
	FCOMPLEX	0.067	0.067	0.067
R ²	0.154			
Adjusted R ²	0.131			
F-value	6.698			
p-value	0.000***			
N	319			

***, **significant at 1% and 5% respectively.

Note: FID= The percentage of MFRS 7 financial instruments disclosure items BEXP= The proportion of board members with accounting background or accounting related experience; ACNED: The proportion of independent non-executive directors (INED) in the audit committee team; AF: Natural log of total value of audit fees paid to the external auditors by the firms; EA: Assigned as 1 for firm's audited by Big Four and 0 for firm's audited by non-Big Four; IA: Assigned as 1 for in-house internal audit functions and 0 for outsourced internal audit functions; FSIZE: Natural log of firm size based on market capitalisation; FLEV: Total value of debt to total assets; FCOMPLEX: Number of direct subsidiaries

The MCCG (2007, 2012) highlights the need for an internal audit function to be independent, reliable and functioning in a timely manner. Consistently, the regression results obtained from the study suggest that the internal audit function (IA) appears to be able to influence the extent of firm's disclosure practices, although, the correlation analysis shows an insignificant correlation between internal audit functions (IA) and firm's disclosure practices (FID). The p-value and t-stat value for the internal audit (IA) variable are 0.003 and -3.011 respectively, hence, it shows a negative association at 1% level. Previously, the correlation analysis shows insignificant results as it is based on a linear relationship between the two variables (IA and FID only), while the regression analysis allows a more sophisticated exploration by taking into consideration the interrelationship among the set of other dependent variables (i.e. BEXP, ACNED, EA, AF) within the study. For that reason, regression results are considered more absolute and ideal as they take into consideration the complexity of business by providing information about the model as a whole and the relative contribution of each variable used to make up the model. In view of this, H₅ is supported, as the regression results suggest that firms that outsource their internal audit functions to a professional service provider (i.e. an auditing or accounting firm) tends to comply more with MFRS 7 as compared to firms that have their own in-house internal audit functions. This is consistent with prior studies (see Desai et al. 2011; Abdolmohammadi 2013) but contradicts with the revised MCCG (2012) recommendations. The revised MCCG (2012) states that companies should establish an internal audit function

as one of the mechanisms to recognise and manage the risk. Hence, the regulators or standard setters would benefit from these findings as they shall consider the practicality of recommending an in-house internal audit function. Based on the findings from the study, it shows that firms that outsource their internal audit functions to a professional service provider are more likely to comply with MFRS 7 as compared to firms with in-house internal audit functions. In other words, outsourced internal audit functions provide better monitoring control as compared to in-house internal audit functions

Furthermore, several past studies (Christopher et al. 2009; Kueppers & Sullivan 2013) have empirically proved that the outsourced internal audit function is more likely to be independent as compared to the in-house internal audit function. The internal audit function needs to be independent to ensure the internal controls are operating effectively. The greater the independence level of the internal audit functions, the greater the likelihood that the internal auditors can exercise their professional skepticism and remain objective (Christopher et al. 2009; Kueppers & Sullivan 2013). Moreover, firms would outsource their internal audit functions to a professional service provider, who can provide specialised resources, such as an auditing or accounting firm (Desai et al. 2011; Abdolmohammadi 2013). Thus, they should have the relevant qualification and appropriate experience that enable them to provide assurance to their clients that the internal controls are operating effectively. Effective internal controls include ensuring the financial reporting process (MCCG 2012) is in place, subsequently contributing to a high level of compliance with the applicable standards in the company.

Similarly, the correlation analysis found a non-significant relationship with audit committee independence, and this is supported in regression analysis. Therefore, H_2 is supported. This posits that audit committee independence (ACNED) is not a stand-alone variable as it has a positive and significant association with the extent of firms' disclosure at 5% level after taking into consideration other dependent variables in the regression model. Audit committee independence is proxied by the proportion of independent non-executive directors (INED) on the audit committee team. Hence, it indicates that the higher the proportion of independent non-executives directors in the audit committee, the higher the probability of firms' compliance with MFRS 7 disclosure requirements. This is consistent with the recommendation of the MCGG (2007), that every public company should establish an audit committee comprising at least three members, the majority of whom are independent directors. Moreover, prior studies (*see* Oliveira et al. 2011; Akhtaruddin & Haron 2010; Probohudono et al. 2013) suggest that when there are more independent directors on the audit committee, it is likely that there will be more effective board monitoring. Hence, this would lead to a higher level of disclosure and indirectly contribute to a higher level of MFRS 7 compliance in companies.

Moreover, among the aims of the revised MCGG (2012) is to strengthen the board structure and its composition, which includes having qualified and competent board members to manage the business operation effectively. An appropriate level of knowledge and adequate experience in accounting and finance are viewed as among the essential elements for the board members (Nelson 2010). However, the regression result in this study rejects H_1 , as it indicates that no significant association exists between board expertise and the extent of MFRS 7 disclosure. This is consistent with Yasin and Nelson (2012) and could possibly be attributed to the minimal recommendation in the MCGG already being sufficient for Malaysian companies. The MCGG code recommends only that all members of the audit committee to be financially literate and that at least one should be a member of an accounting association or body. Therefore, the findings would be useful for regulators and companies to ensure the balanced structure of a board, as any excess or deficiency is a cost rather than a benefit to the firm. In contrast to the correlation results, the regression results found an insignificant relationship between the audit fee and the extent of MFRS 7 disclosure; thus H_4 is rejected. H_4 predicted that the higher the amount of audit fees, the more thorough and efficient the audit services offered by the external auditors. In other words, there is a positive association between audit fee and the level of a firm's disclosure. However, the result in this study reveals a weak association between these variables. The result contradicts with George and Ferguson (2013), who claim that there has been a significant increase in audit fees due to the new IFRS implementation as more auditing works are needed. This contrasting result could be due to auditing fees having a minimal impact on the level of disclosure and that there are other relevant factors influencing the level of disclosure,

which should be considered by companies. Moreover, this study suggests that companies should consider a reasonable audit fee to ensure the balance of cost and benefit received by companies.

Nevertheless, the regression and the correlation analysis for the control variables (FSIZE, FLEV and FCOMPEX) show inconsistent results. The initial correlation results indicate that all the control variables are correlated with the dependent variable (FID), but, in the regression analysis, none of the control variables shows a significant relationship. Therefore, this signifies that although each control variable correlates to the firm's disclosure practice, the impact is minimal and insignificant to the overall regression model. This is consistent with several prior studies (Hassan 2009; Oliveira et al. 2011; Miihkinen 2012; Elzahar & Hussainey 2012).

CONCLUSION

The study provides recent empirical evidence on the MFRS 7 disclosure practices among Malaysian listed companies. In general, most Malaysian companies comply with MFRS 7, though some requirements are omitted such as hedge accounting information. This is consistent with Othman and Ameer (2009) who documented low level of hedge information due to the less involvement with hedging activities among Malaysian companies. The adoption of agency theory in this study suggests that mandatory disclosure is needed but will be effective only with the establishment of effective corporate governance and proper enforcement in place. Effective corporate governance (agents) is required to ensure adequate disclosures are made, resulting in the overall quality of financial reporting and ultimately protecting the interest of the shareholders (principals). Specifically, the results indicate that internal and external audit functions play a vital role in supporting the audit committee to ensure a high level of compliance and greater transparency of financial reporting disclosures. The findings are consistent with MCGG recommendations, which propose that audit committee members need to be independent in order to discharge their duties effectively and to strengthen the role of the auditing function within the firm. This study could be useful to regulators, standard setters, companies and market players in general as it empirically examines the impact of new MFRS adoption on the disclosure practices of Malaysian companies as well as highlighting the role of corporate governance in enhancing the level of corporate reporting disclosure. However, this study is subject to several limitations, such as the exclusion of the finance-related industry, and the limited data and research methods used which could be extended in future research.

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APPENDIX

Item No	MFRS 7 on Financial Instruments Disclosure (FID) checklists	Score
A) Overview of MFRS 7		
1	Disclosure of relevant scope of MFRS standards used for financial instruments	1
<u>Classes of financial instruments and level of disclosure</u>		
2	- Categorisation of each financial instrument based on its nature & characteristics	1
3	- Initial recognition and measurements of each financial instruments	1
4	- Subsequent recognitions and measurements	1
B) Significance of financial instruments for financial position and performance		
<u>Financial Position</u>		
5	a) Categories of financial assets and financial liabilities	1
6	b) The extent and nature of each underlying financial instrument,	1
7	c) Significant terms and conditions that may affect the financial instruments	1
8	d) Accounting policies and method adopted, including criteria for recognition and basis of measurement applied	1
9	a) Disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes.	1
<u>Other Disclosures</u>		
	a) Disclose each type of hedge described in MFRS 139, their fair values at the end of reporting period and the nature of the risks being hedged	
10	Type of hedge as described in MFRS 139	1
11	Fair Values of hedge accounting at the end of reporting period	1
12	Describe the nature of the risk being hedged	1
	b) Disclose the fair values measurements using a fair value hierarchy; including the methods used, valuation techniques as well as the assumptions applied in determining the fair values of each financial instruments	
13	Fair value measurements using a fair value hierarchy	1
14	Method and valuation techniques used	1
15	Assumptions applied in determining the fair value	1
C) Nature and extent of risks arising from financial instruments		
<u>Qualitative Disclosures</u>		
Credit Risk		
16	a) the exposure to the risk and how it arises;	1
17	b) its objectives, policies and process for managing the risk and the method used to measure the risk; and any changes from the previous period	1
Liquidity risk		
18	a) the exposure to the risk and how it arises;	1
19	b) its objectives, policies and process for managing the risk and the method used to measure the risk; and any changes from the previous period	1
Market Risk		
20	a) the exposure to the risk and how it arises;	1
21	b) its objectives, policies and process for managing the risk and the method used to measure the risk; and any changes from the previous period	1
<u>Quantitative Disclosures</u>		
Credit risk information		
22	The amount that best represents financial instruments' maximum credit risk exposure	1
23	Significance concentrations of credit risks for each class of financial instruments	1
Liquidity risk information		
24	Maturity analysis for derivative and non-derivative financial liabilities including financial guarantee contracts; and description of how it manages the liquidity risk.	1
Market risk information		
25	Sensitivity analysis for each type of market risk, the methods and assumption used, as well as any changes from prior period, with the asons for such changes	1