

Conceptual Framework Related to the Impact of Coronavirus Disease 2019 (Covid-19) on Malaysian Private Entity Reporting Standard (MPERS) adoption by Small and Medium Enterprises (SMEs) in Malaysia

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Abstract

Malaysian Private Entity Reporting Standard (MPERS) serves as a new reporting framework to private entities and significant milestones to the capital market. This enables the entities to assert the financial statements with full compliance with the International Financial Reporting Standard (IFRS). Thus, the focus of this paper is to discuss the conceptual framework on the impact of external pressure and environmental uncertainty on the quality of financial reporting by Small and Medium Enterprises (SMEs) in Malaysia. The effect of the Covid-19 pandemic on environmental uncertainty has an impact on the quality of financial reporting. It is expected that the Malaysia's authority and regulator will anticipate the impact of the Covid-19 pandemic, given the outbreak has created disruption in all business chains including the SMEs in Malaysia.

Keywords: *Malaysian Private Entity Reporting Standard (MPERS), Small and Medium Enterprises (SMEs), Coronavirus Disease 2019 (Covid-19), External Pressure and Environmental Uncertainty*

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1.0 Introduction

In February 2014, Malaysian Accounting Standard Board (MASB) issued Malaysian Private Entities Reporting Standard (MPERS) and it set new accountability for the financial reporting standard of the private entity in Malaysia. MPERS based on International Accounting Standard Board (IASB), International Financial Reporting Standard for Small and Medium Enterprises (IFRS for SMEs) examines in May 2015. All private entities, including Small and Medium Enterprises (SMEs), were required to apply MPERS for annual periods beginning on or after 1st January 2016 in preparation of their financial statements (MASB, 2014). This implementation has resulted in various responses among market players including business owners, accounting bodies, and also the government.

The MPERS applies to private entities only. Based on Malaysia's jurisdiction, private entity defined as the private company, incorporated under the Companies Act 1965, which is not itself required to prepare or lodge any financial statement under any law by the Securities Commission or the Bank Negara Malaysia. The private entity also is not subsidiary or associate of, or jointly controlled by, an entity that is required to prepare or lodge any financial statements under any law administered by the Securities Commission or Bank Negara Malaysia. Alternatively, a private entity that decides not to adopt MPERS could choose to apply the Malaysian Financial Reporting Standard (MFRS). All private entities which adopt whether the MFRS framework or the MPERS framework, must ensure to adopt the framework entirely (PWC, 2015).

Currently, SMEs have a choice between continuing the existing Private Entity Reporting Standards (PERS) framework or apply the Malaysian Financial Reporting Standards (MFRS) framework (mandatory for non-private entities except transitioning entities), or beginning 1st January 2016, SMEs mandatory migration to the new MPERS framework. Since the requirement for the first-time adoption of MPERS is respectively, it is important that SMEs to prepare in advance if they have to move to MPERS or drift to MFRS in the future. The MPERS is seen to bring opportunity for businesses as it is an international accounting standard. Moreover, the basis of the standard, IFRS for SMEs is widely adopted by 73 countries including the United Kingdom, Australia, Hong Kong, Singapore, and another 14 countries are considering opting to use the standard. Hence, with a little bit of customization to the Malaysian business environment, MPERS actually could ensure the convergence and comparability of local business with international business.

The adoption of MPERS is an important step towards preparing private entities or the SMEs to globalization. SMEs will able to create opportunities and SMEs could be facing enormous challenges through globalization. It is really important and relevant that the SMEs in Malaysia adopted a global financing reporting language that is not only up-to-date but also has been adopted by other 73 countries around the world (MASB, 2014). In Malaysia, SMEs have performed remarkably well, with the growth exceeding that of the overall economy. SMEs is important because currently, over 7 million jobs provided by SMEs to 66.2% of Malaysia's workforce in 2018. From all business establishment in

Malaysia, 98.5% are SMEs and in 2019, SMEs sector contributed 38.3% to overall nation's gross domestic product (GDP) and 17.3% of total exports (SME Annual Report, 2018/2019).

At the end of 2019, the world was shocked by the transmission of a new virus known as Coronavirus Disease 2019 which known as Covid-19. On 24 January 2020, the first case of Covid-19 was detected in Malaysia where the first case involved a 63-year-old Chinese man and a 41-year-old Malaysian from Selangor. Due to the increasing transmission of Covid-19, the Malaysian government announced a movement control order from 18 March 2020 to 9 June 2020. This has huge implications for SMEs that adopt MPERS.

The structure of this paper is arranged as follows; section 1 introduces the paper; section 2 briefly describes the background of MPERS in Malaysia. Section 3 briefly illustrate the background of SMEs in Malaysia. Section 4 discusses the Covid-19 implication for SMEs, while section 5 briefly explains quality of financial reporting. Section 6 represent the external pressure, while section 7 discusses the environmental uncertainty. Section 8 will discuss the conceptual framework and hypotheses. Then, Section 9 concludes the paper.

2.0 An Overview of the Malaysian Private Entity Reporting Standard (MPERS) as a New Private Entity's Financial Reporting Standard in Malaysia.

The Malaysian Accounting Standards Board (MASB) has issued a new financial reporting framework for private entities, the Malaysian Private Entities Reporting Standard (MPERS), and it has amended several standards for non-private entities. All private companies apply the MPERS to their financial statements beginning 1st January 2016, or after that. The MPERS is word-for-word the International Financial Reporting Standard (IFRS) issued by the International Accounting Standards Board (IASB) in July 2009 for Small and Medium Enterprises (SMEs), except for the requirements for income tax and property development activities. To date, over 80 countries have adopted or declared plans to do so on the IFRS for SMEs.

In February 2014, the MASB issued the Malaysian Private Entities Reporting Standard (MPERS), which sets a new landmark in Malaysia's financial reporting for private entities. MPERS is primarily based on the International Financial Reporting Standard for Small and Medium Enterprises (IFRS for SMEs) issued by the IASB in July 2009. The new reporting framework, known as the MPERS framework, applies to financial statements that begin on or after January 1st, 2016, with early implementation enabled.

As of 1st January 2016, all private entities, including SMEs, were required to apply the MPERS when preparing their financial statements. Malaysia's private entities have three ways to use the accounting standard or implement it. They may choose to adopt the Private Entity Reporting Standard (PERS), Malaysian Private Entities Reporting Standard (MPERS), or Malaysian Financial Reporting Standards (MFRS). They have the option to proceed with the current framework for PERS or to adopt the MFRS framework

(mandatory for non-private entities, excluding transitional entities), or mandatory migration to the new MPERS Framework by 1st January 2016. Those who want to adopt PERS and MPERS must follow these standards beginning or ending on 1st January 2016 and ending on or after 1st January 2012 for annual MFRS (Salin, 2017). Considering that the requirement for the first implementation of MPERS is retrospective, private entities must plan if they expect to move to the MPERS framework or the MFRS framework in the immediate future.

3.0 Small and Medium Enterprises (SMEs) in Malaysia

According to Small and Medium Industries Development Corporation (SMIDEC), an enterprise is regarded as an SME in each of the representative sectors based on the annual sales turnover or the number of full-time employees. Small and Medium Enterprises (SMEs) are divided into two sectors which is; manufacturing, manufacturing related services and agriculture industries; and services (including ICT) and primary agriculture (Muhammad, Zakiah & Yaso'a, 2010).

There is no specific definition of Small and Medium Enterprises (SMEs) in Malaysia. Every company defines SMEs based on their criteria and usually based on annual sales turnover and the number of full-time employees. A business will categorize as SMEs if it meets either one of the two specific qualifying criteria, which is sales turnover or full-time employees, whichever is lower (SME Corp. Malaysia, 2013). The new definition of Small and Medium Enterprises (SMEs) in Malaysia by the size of the operation as follows:

Table 1: Category of Small and Medium Enterprises (SMEs)

Category	Micro	Small	Medium
Manufacturing	Sales turnover of less than RM300,000 <u>OR</u> less than 5 full-time employees	Sales turnover from RM300,000 to less than RM15 mil <u>OR</u> full-time employees from 5 to less than 75	Sales turnover from RM15 mil to not exceeding RM50 mil <u>OR</u> full-time employees from 75 to not exceeding 200
Services and Others Sectors	Sales turnover of less than RM300,000 <u>OR</u> less than 5 full-time employees	Sales turnover from RM300,000 to less than RM3 mil <u>OR</u> full-time employees from 5 to less than	Sales turnover from RM3 mil to not exceeding RM20 mil <u>OR</u> full-time employees from 30 to not

But, if the business meets either one specific qualifying criterion across the different sizes of operation, so the smaller size will be applicable.

4.0 Coronavirus Disease 2019 (Covid-19) Implication for Small and Medium Enterprises (SMEs)

The emergence of Coronavirus Disease 2019 (Covid-19) became a business risk that are not expected by many entrepreneurs. The Movement Control Order (MCO) period was followed by the Conditional Movement Control Order (CMCO) and Recovery Movement Control Order (RMCO) to curb the spread of the pandemic, resulting in the temporary suspension of several business sectors.

For business owners, one of the objectives to be achieved during the hibernation period is to ensure that business status can be maintained even if business operations are disrupted. Among the big challenges are the need to pay supplier debt and rent premises as well as fulfill the responsibility of retaining employees.

SMEs have faced many implications because of spreading the Covid-19 in Malaysia and also global. According to SME Corp Malaysia, this type of enterprise can be distinguished by the annual sales volume and the number of employees. It is not appropriate if a flat approach is made to this business because the level of difficulty for issues, problems, and challenges is not the same.

In the principle of accounting, it is a must for business owners to make an assessment and report on financial position as if the business will continue forever. If before MCO, budget planning was done, now all types of enterprises regardless of category need to re-evaluate the ability of the business to continue operations.

Covid-19 has implications for SMEs where business operations are slowing down resulting in declining production. Because this is why Malaysia is facing an economic recession. According to the Department of Statistics Malaysia, more than 40 percent of business firms need more than six months to restore operations affected by the Covid-19 pandemic. Head of Statistics Malaysia, Datuk Seri Dr. Mohd Uzir Mahidin said although this pandemic is coming to an end, the country will see reduced costs, declining demand, and disruption to the supply chain.

If a business is temporarily suspended because of Covid-19, the cash inflows of the business will certainly stop, but not for cash outflows. The business sector affected by the Covid-19 pandemic is already experiencing tighter cash flows as well as slower demand (Bank Negara Malaysia, 2020). There is still a lot of expenses to be borne by entrepreneurs. The Malaysian capital market has also been affected by uncertainty, but can still survive and operate in an orderly manner supported by strong liquidity and strong infrastructure.

Indirectly, Covid-19 puts pressure on the labor market in terms of lower job demand than labor supply and impacts daily life. Many have lost their source of income due to layoffs and have increased unemployment in this country. Economists estimate that in the short term, about 2.4 million people will lose their jobs in various forms (Mansur & Kasim, 2020). This has directly affected the daily life of society as a whole. Entrepreneurs also face the implication of retaining employees. They struggle with a sense of responsibility to retain employees who are most likely unable to make ends meet if service is terminated.

SMEs need to persevere and always pray that the crisis due to COVID-19 ends immediately. It is possible that the facilities and assistance offered will continue to increase after this. Therefore, SMEs should be wise to take the opportunity to overcome financial challenges better.

5.0 Quality of Financial Reporting

In a study which set out the determined quality of financial reporting, covers both financial and non-financial information that is useful for making decisions included in the financial reports (Akeju & Babatunde, 2017). According to International Accounting Standard Board (IASB), the essential principle of assessing the quality of financial reporting is related to the faithfulness of the objectives and the quality of the disclosed information in the financial reports of a company. Such qualitative characteristics improve the facilitation of evaluating the value of financial reports, which will also contribute to a high-quality standard. Gajevszky (2015) highlights the financial report must be a comparable, faithful representation, verifiable, timely, and understandable to achieve this standard. The focus is therefore on transparent financial reporting and not deceptive financial reporting to users; not to mention the significance of accuracy and predictability as measures of high-quality financial reporting.

The higher the financial report's information usefulness, the higher the financial report's quality and vice versa. The quality of financial reporting is determined by the quality of accounting standards and the subsequent regulatory implementation of standards, the accounting system used by management, and the judgment and estimates of management when applying the chosen substitutes.

International accounting bodies such as the International Accounting Standard Board (IASB), the International Federation of Accountants (IFAC) and the Financial Accounting Standard Board (FASB) have developed a conceptual measurement of the

qualitative characteristics of the financial reports. This calculation primarily provides a systematic viewpoint for the evaluation of the full spectrum of the financial report's qualitative features. In 2015, IFAC report that to define the qualitative attributes according to the literature, various dimensions have been adopted by all of this. Accordingly, qualitative attributes or characteristics such as contextual relevance definition, faithful representation, understandability, comparability, and timeliness are considered as potential qualitative factors defining financial reporting quality.

Hence, in 2014, MASB reported the qualitative characteristics of information in financial statements of MPERS to involve understandability, relevance, materiality, reliability, substance over form, prudence, completeness, comparability, timeless, and balance between benefit and cost. Here, five (5) qualitative characteristic further explanations:

5.1 Relevance

Relevance is closely related to the term's usefulness and materiality. In an analysis of financial reporting quality, BPP (2014) found relevance reflects the users' capability to make decisions. Relevant information can make a significant difference in the user's decision making. Its nature and materiality influence the relevance of the information. One study by Ezelibe et al. (2017) reported information is only useful if it applies to user-focused issues. Information can make a difference in decision making when it has predictive value, confirmatory value, or both.

According to Herath & Albarqi (2017) who published a paper in which they described the information provided in the financial statements must be relevant to users' needs for decision-making. When information found in financial reports affects users in their economic decisions, it is said that this information has the relevant quality. It is also useful as this information allows users to analyze, correct, and validate current and past events. As note by MASB (2014), information has the quality of relevance because it can affect users' economic decisions by helping them evaluate past, current, or future events or by confirming or correcting their past evaluations.

5.2 Timeliness

In an analysis of financial reporting quality, Herath & Albarqi (2017) and Beest et al. (2009) reported timeliness illustrates that information needs to be made available to decision-makers before they lose their powerful and good influence. When evaluating the quality of reporting in an annual report, timeliness is evaluated using the period between the end of the year and the issuance date of the auditor's report the period of days it took for the auditor to sign the report after the end of the fiscal year.

According to MASB (2014), timeliness requires presenting the details within the time frame of the decision. If the reporting of information is undue delay it could lose its relevance. Management would need to balance the relative benefits of timely reporting and reliable information delivery. The overriding consideration in achieving a balance between relevance and reliability is how best to satisfy the users' needs in making economic decisions.

5.3 Comparability

Herath & Albarqi (2017) identify comparability is the concept whereby users may compare financial statements to determine an entity's financial position, cash flow, and performance of an entity. Information is equivalent if it can be compared for another period or date with similar information about other entities and similar information about the same entity. This comparison helps users to compare through time, and in the same period, with other companies.

MASB (2014) mentions users must be able to compare an entity's financial statements across time to recognize trends in its cash flow and an entity's performance in its financial position. Users must also be able to compare the different entities' financial statements to determine their relative financial position, performance, and cash flows. Accordingly, the measure and presentation of the financial effects of like transactions and other occurrences and conditions for that entity must be carried out consistently throughout an entity and over time, and consistently throughout entities. Furthermore, users must be aware of the accounting policies used in the preparation of the financial statements, any adjustments in those policies, and the consequences of those changes.

5.4 Understandability

According to Herath & Albarqi (2017), several studies have found that understandability in financial reports is one of the important qualities of information. It is through effective communication that we achieve the quality of understandability. Thus, the better the users' understanding of the information, the higher the quality achieved. Understandability is the principle of presenting financial information so that users can understand it easily. It assumes users have reasonable business knowledge but do not need advanced business knowledge to achieve a high level of understanding. Adhering to a fair level of understandability would preclude a company from deliberately obfuscating financial information to mislead users of its financial statements.

Understandability is one of the enhancing qualitative characteristics, which will increase when information is clearly and sufficiently presented and classified. Users can understand what their needs are when annual reports are well organized. The information provided in the financial statements should be interpreted in a way that makes it comprehensible to users who have a fair knowledge of business and economic practices and accounting and a willingness to study the information with reasonable care. Nonetheless, the need for understandability may not allow relevant information to be excluded because certain users may consider it too difficult to understand (MASB, 2014).

5.5 Reliability

Reliability is also another important factor in the consistency of financial statements. In an analysis of reliability, Tontiset & Kaiwinit (2015) reported several studies have found that reliability in financial reporting is characterized as the published financial statements,

which are accurately prepared to provide users with useful information when making economic decisions. To be useful, information must be of the quality of reliability in financial reporting. This quality is achieved when information based on users is free of bias and material errors. In an analysis of financial reporting quality, Cheung et al. (2010) found based on the qualities of faithful, verifiable, and neutral information, reliability is evaluated. Romney & Steinbart (2017) reported that reliability encompasses honesty, verification, and impartiality

MASB (2014) mentions that financial statements must contain reliable information. Information is reliable when free from material error and bias and faithfully reflects what it is either intended to represent or may fairly be expected to represent. Financial statements are not bias-free if they are intended to affect the making of a decision or judgment by choosing or presenting information to obtain a predetermined result or outcome.

6.0 External Pressure

Institutional theories expect that organizations will become more similar due either to coercive, normative and mimetic pressures. Coercive isomorphism is always correlated with everything around the organization that relates to the organizations. Coercive isomorphism is the consequence of formal and informal interference from other organizations, where the organization relies on the culture norms of a society in which the organization conducts its functions. DiMaggio & Powell (1983) note that coercive isomorphism arises from the need for authority and political power. Coercive power is an external pressure to follow mechanisms or processes provided by governments, legislation or other institutions (Ashworth, 2009). There are guidelines designed to better practice of the organizing. Otherwise, the coercive force of a rule may contribute to an organizational propensity to gain or correct legitimacy (legitimate coercion) (Scott, 1987), thus it merely highlights positive aspects for the organization to look good by outside parties of the Organization.

Frumkin & Galaskiewicz (2004) noted that the level of governance capacity could be adversely affected by external pressures, especially those associated with enforcing a policy or procedure. The activities listed in this study are specific to the implementation of a financial quality reporting. The advantage of anticipating external pressure is linked to the degree of regional independence in its administrative operations, where local governments can further maximize their territorial capacity.

In this scenario, the external pressure measures refer to input such as legislation, political considerations, executives and societies. (1) Legislation enforcing requirements provided for in Article 70 of Legislation No 171 / PMK of the Minister of Finance. 05/2007 The Minister of Finance, as Treasurer General of the State, prepared the Financial Report of the State General Treasurer on the accounting system and the financial report of the Central Government. (2) Politics is a process of shaping and sharing power in the society where the decision-making process is taking place, in particular in the country. Politics is defined as art and science in order to acquire successful, constitutional, and non-

constitutional power. Political pressure on financial reporting arises when state financial statements are disclosing. 3) The society is a group of people who form a semi-enclosed or semi-open structure, the majority of whom associate with individuals who reside within the group.

7.0 Environmental Uncertainty

The instability of the mimetic environment is an organizational propensity to model itself in the actions of other organizations (DiMaggio & Powell, 1983), behaving to a certain standard as a reaction to uncertainty (Mizruchi & Fein, 1999). Mimetic isomorphism requires the recognition and benchmarking of best practices in the field (Tuttle & Dillard 2007). Uncertainty may be caused by a number of factors outside the organizations, such as rapid changes in a period, the interaction with one another of different regulations. Uncertainty has caused an organization to adjust its procedures and structures.

Syahputra & Saraswati (2020) stated the environmental uncertainty environment which is (1) Modifying the regulation or amending the regulation is a regulation which amends other rules that existed earlier. In general, regulatory changes with the modified rules are released to regulatory level in the hierarchy. (2) Mutations in genetic material are mutations found either at gene level or at chromosome level. Mutations at the stage of the gene are termed point mutations while the chromosomal mutations are typically considered aberrations. Gene mutations can contribute to the creation of new methods and the foundations for new species variations. Mutations in nature at low frequencies, generally inferior to 1:10,000. (3) The process of self-adjustment is how individuals reach a life-balance to meet the needs of a suitable environment. Self-adjustment is more of a life-long process, and people actively try to discover and resolve the pressures and difficulties of living to achieve a healthier individual.

8.0 Conceptual Frameworks and Hypotheses

The relationship between each of the variables that the organizational change's external pressure centered on the coercive powers would cause the company to seek more political power rather than technical (Ashworth, 2009). More political influenced organizational changes would result in activities taking place within the organization, especially with regard to enforcing the quality of financial reporting, just formality aimed at obtaining the credibility and quality of the financial statements. Organizational transition is no simple thing either to the mechanism or to the organizational framework in response to environmental instability. Unprepared organization of a regulatory framework can contribute to a low level of organizational understanding for translation into new regulations. In an uncertain situation, the leader of the organization will decide on the best solution that the organization will have by imitating the organization that they consider to be successful.

H1a: External pressures have a significant relationship to the quality of financial reporting

The uncertainty of the items recognized and measured in the financial statements affects reliability (Intakhan & Ussahawanitchakit, 2009). Yet, the Company will present the structured formal of the accounts that can be received (acceptable account) for each organizational operation (Meyer & Rowan, 1977) to meet society's standards. The quality would also require the organization to reveal the full details on the financial reporting process and procedures in order to meet the requirement for the reliability quality of the financial reporting.

H1b: Environmental uncertainty has a significant influence on the quality of financial reporting

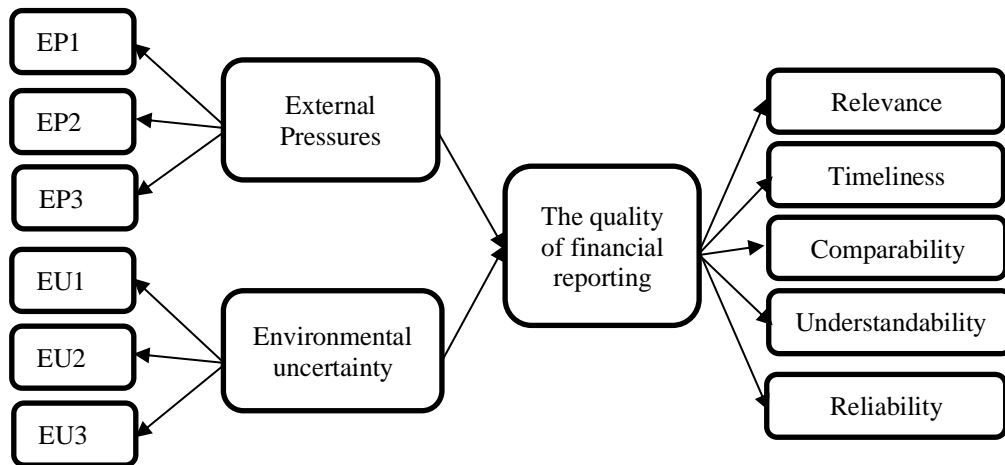


Figure 1: Conceptual frameworks

9.0 Conclusion

MPERS was introduced to enhance the harmony of reporting standards to SMEs and also to replace PERS which has not been updated for a long time. MPERS play an important role for SMEs when preparing their financial statements. On the other hand, SMEs play an important role in the economic growth of the country. There is a 907,065 establishment of SMEs in Malaysia. But due to Covid-19, it has made the national economy vulnerable to unfavorable events or crises, even more leading to losses since the MCO, CMCO and RMCO. A large number of countries experience economic recession as business slows down, production declines, unemployment rates rise, capital markets decline. Malaysia suffers from similar symptoms and SMEs are severely affected by Covid-19 transmission. SMEs, which are small in their assets, working capital, skilled manpower, are affected to a greater extent especially those involved in the trade and supply of products or services to other businesses. Low cash flow and limited financing are the main implications faced by SMEs during this downturn.

Nevertheless, the government recognizes the importance of SMEs for the economy and needs to implement various policies, plans, actions, and programs to assist SMEs in these difficult situations. Therefore, the government needs to take appropriate measures so that SMEs can be defended and strengthened when Covid-19 hits.

External pressures increased financial reporting quality, Ridha & Basuki's findings (2012) note that external factors are impacting the implementation of quality financial reporting. Because of the effects of the Covid-19 pandemic around the world, the growing countries have resulted in the global economic situation getting worse. Some organizations also forecast the global economy, such as the International Monetary Fund (IMF), which aims to minimize global economy growth by 3%. It later shows the external pressure on the quality of the financial reporting for the country. Local governments must prevent the impact of the Covid-19 pandemic immediately, given that the outbreak in Malaysia only began to spread in the third of March 2020.

Environmental uncertainty thus increases the quality of the financial reporting. This is because usually the organization first forecasts and responds to the circumstances of the surrounding environment. In individuals participating in financial reporting the ability to forecast future conditions of low external pressure often exists to make it easier to obtain information from subordinates. Therefore, by establishing good cooperation between the leadership and the members, it should benefit the organization in financial reporting. Ridha and Basuki (2012) who found external pressures that have no impact on financial reporting results environmental uncertainty due to pandemic case Covid-19. In particular, Prime Minister Malaysia's performance of 'Pakej Rangsangan Ekonomi (PRE) PRIHATIN' was announced on 27 March 2020 and was also affected by other factors, such as the effects of the Covid-19 pandemic in Malaysia's capital city and various regions. The performance of 'Pakej Rangsangan Ekonomi (PRE) PRIHATIN' distribution in the region has therefore been affected, as the central and local governments are still concentrating on managing the effects of the Covid-19. Circumstances that certainly can definitely impact the quality of financial reporting.

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