Flat cargo berhad essay sample

Finance

Flat Cargo Berhad (FCB) was one of the largest air freight companies in Malaysia, servicing several government linked companies including Freight Malaysia Berhad, and had Kencana & Associates served as its auditors. In 2006, during a routine financial audit, the auditors identified several suspicious findings that resulted in a delay in finalising the auditor's report. The case presented an auditor's dilemma involving the possibility of fraud in a financial audit engagement. Keywords: fraud, auditors, professional scepticism

INTRODUCTION

It was 5 February 2006 and Mr Chuah Mun Soong had just finished a meeting with his audit team. He was silently enraged. " Not another Media Com or Blue Vital. Could there be a fraud in Flat Cargo too?" he wondered. His firm, Kencana & Associates, could not deal with another client scandal. He had just been informed by his subordinates that there had been inconsistencies in the accounts of Flat Cargo Berhad (FCB). His team was to report to the audit committee of FCB in two weeks. His boss, Mr Keong Chee Wah, the managing partner of Kencana & Associates, had to be informed immediately of the situation.. Taking time to calm himself down, Mr Chuah decided to work through the company's information to assess the possibility of fraud. He needed the information to help him explain the situation to Mr Keong.

COMPANY BACKGROUND

FCB was a listed company operating primarily as an air cargo carrier. It was registered as an investment holding company with several subsidiaries. The principal activities of FCB subsidiaries included air freight services and aircraft ground handling services. FCB's wholly owned subsidiaries included

FC Spare Sdn Bhd, Cargo Management Sdn Bhd, FCB (SPV), Cargo Air Services Sdn Bhd and FC Air Ltd. The company's head office was located in Selangor. FCB started operations in 1997 with two aircrafts: a Boeing 737-200F and a Cessna Grand Caravan. FCB's maiden flight in November 1997 had been an overnight air express transport service for Freight Malaysia Berhad to Singapore. Flat Cargo Group obtained listing in Bursa Malaysia1 on 15 September 2001.

FCB's major shareholder in 1997 had been Bangor Berhad, which was part of a diversified international family owned conglomerate, the Miri Group. The Miri Group had a China based company called Miri Logistics Ltd which owned logistic businesses extensively in the Asian region. In 2004, the Miri Group2 bought a controlling interest of 55. 2 million shares or 26. 5% of FCB from the founders, Lim Loon Sim and Ali Bin Ahmad, via an off market deal. The fast growing intra-Asian air express market fuelled FCB's expansion plans between 2001 to 2004. With the extensive growth in e-business activities, the demand for express transportation services increased. FCB aimed to maintain their niche position in the Asia Pacific region by delivering best quality customer service and satisfying customer demands.

The corporate structure of FCB is seen in Figure 1.

Figure 1 Flat Cargo Group Berhad's corporate structure

Main Activities

FCB was the only dedicated Intra-Asian overnight express cargo operator based in Malaysia. Its core business was to provide air freight transportation, which included aircraft charter and leasing.

FCB's prompt handling of large shipments to meet customer demands was attributed to its expansion in freighter fleet size for its Boeing 737s, 727s, MD11s. In addition, it had access to an international cargo complex covering 24-hour custom facilities at the Sultan Abdul Aziz Shah Airport in Subang. If it had not been for the scandal, FCB would have likely remained as the nation's leading air cargo carrier.

With an array of landing rights in the Asia Pacific region, FCB was in the ideal niche position to offer express air services to international integrators, freight forwarders and major airlines within the Asian region. It managed to secure major landing rights in various countries in Asia including China, Japan, Thailand, Singapore, India, Indonesia, Taiwan, Sri Lanka, the Philippines, Korea, Myanmar and Cambodia.

FCB Customers

Up to 2005, FCB secured agreements with well-established companies such as Worldwide Express, United Parcel Services (UPS), Nationwide Express, Citylink, Bax Global and Nippon Express. Cargo Malaysia Services and Bangor Berhad, being FCB major shareholders, also used FCB's air freight forwarding services. FCB offered regular flights to fast growing countries like China, Thailand and India. Other destinations in the region included major cities in the Asia Pacific region.

Governance Structure in FCB

The Chairman of FCB was Dato' Ibrahim Samad who was also an independent non-executive director of the company. He was the former

Director General for the Ministry of Transportation. He was also Malaysian Chamber of Commerce's former President.

The top management team comprised of Mr Lim Loon Sim as the Chief Executive Officer, Mr Ali Bin Ahmad as the Executive Director, and Mr Kim Boon Chok as the Chief Financial Officer. Mr Lim Loon Sim was the founder for FCB and had been a board member since 1997. As at 31 December 2006, he owned 6. 5 million shares in FCB, worth approximately RM97. 5 million valued at RM15 per share. Mr Ali Bin Ahmad, who had been a board member since 1999, held 30, 000 shares in the company. He was also the chairman of the company's Audit Committee and a member of its Employee Share Option Scheme Committee. As shown on Appendix D, the Board of Directors comprised of two independent non-executive directors and six non-independent directors, of which three were executive directors and the remaining non-executive directors. The composition of the Board of Directors was in adherence to the Malaysian Code of Corporate Governance (See Appendix E). The Audit Committee of FCB consisted of three members.

Asian Journal of Case Research (AJCR)

The director shareholdings of the company by 31 December 2005 were as follows:

Directors

Number of ordinary shares of

RM1 each as at 31/12/2005

Lim Loon Sim

Ali Bin Ahmad

Lee Guan Choi

Miri Kim Chen

Dato' Ibrahim Samad

65, 500, 000

30, 550, 000

10, 550, 000

120, 750, 000

6, 187, 000

FCB Financial Growth

In 2005, FCB's counter was ranked 4th in terms of capital gains and dividends to shareholders. Its share price at 31 December 2001 had been RM1. 89, but by end of 2005, the share price surged to RM10. 60 per share. It was reported that FCB had been able to pay dividends at a steady 3% per annum for over 4 years. Turnover for 2005 was RM550 million, which is more than 1½ times than that for 2004 (see Appendix A). Analysts were expecting FCB's revenue to increase for the next year by a further 54% to RM809 million because of its major capacity expansion in 2005 despite the rising fuel prices. FCB also acquired several new aircrafts, namely MD-11s and two B727s, and projected to secure additional landings rights in China.

Despite the rave reviews made by various investments houses, FCB's high gearing, nevertheless, posed serious concerns. Rating Agency Malaysia (RAM) rated FCB's RM150 million Commercial Papers or Medium Term Notes to AA3/ P1 and downgraded the company's long term rating from stable to negative. The rating was due to the company's high gearing ratio and weak debt servicing ability.

Excerpts from FCB's Audit Working Papers for 2005

Audit working papers for 2006 revealed the following:

• The auditors were unable to verify the aircrafts claimed to have been purchased by FCB in 2005. The audit team found a non-functional rundown aircraft barely worth RM231 million in a hangar.

• Several debtors' confirmation letters were returned because the addressees had changed their mailing addresses.

• A large sum of sales transactions was found with no supporting documents. Most of these transactions involved small clients.

Flat Cargo Berhad: An Auditor's Conundrum

• A loan received from a Hong Kong based company was found to be incorrectly recorded in the debtors' account.

• Several abnormal transactions involving the purchase of aircrafts by FCB and offsetting the debtors' accounts were found in FCB's books.

THE AIR CARGO INDUSTRY

The industry is described as highly competitive with low profit margin. There are about 85 operators servicing all over Malaysia and the Asia Pacific region. The major players in Malaysia include MAS Cargo Sdn Bhd, a subsidiary of Malaysia Airlines Bhd, Malaysia's national carrier.

The growth rate for the air cargo industry had been about 21. 3% per year from 1991 to 2003. However, the International Air Transport Association (IATA) reported that there was to be a mere 3% growth for the international freight traffic in the Asia Pacific region for 2005.

In 2005, an international crisis occurred with the exceptional increase in oil prices. The hike started in mid-2004 at US$40 per barrel but eventually, the increase continued to stages of US$50, US$60, US$65, US$70 and US$80 per barrel. The price hike in fuel surcharges drastically affected the freight forwarding industry significantly because of its reliance on fuel for operations.

CONCLUSION

Mr Chuah decided to consult his firm’s legal department for advice as he was not willing to risk his firm’s reputation because of a client. The report prepared by his audit team was going to be presented to FCB’s audit committee in a few days. Meanwhile, he convinced himself that FCB was a reputable company with a good business model and the possibility of irregular activities in FCB was remote.

REFERENCES

Business News (2005, November 5). Asia’s Air Cargo Industry Struggles with Continued Fuel Surcharges, Retrieved October 15, 2010 from http://www. prweb. com/ releases/2005/11/prweb306197. htm