

1MDB: A disaster unfolding before our very eyes

Kinibiz.com

Apr 23, 2014

By P. Gunasegaram

Many a talk has this and other Tigers had about that so-called strategic fund of ours, yes, 1Malaysia Development Berhad (1MDB). But the snowball just gets larger and larger as it barrels down the hill completely out of control. And no one seems to care.

Tiger warned that when accounts are delayed, it means dire things. And it was not far wrong. While the picture painted was one of a fund which continued to make profits, they were as illusory as El Dorado and arose purely because of unjustified revaluation of investment property.

But the signs are ominous — of a problem much bigger than unearned profits and of a situation which is rapidly spiralling out of control and may eventually see much bigger losses in the offing.

According to the delayed annual report, the land held for the Bandar Malaysia and Tun Abdul Razak Exchange or TRX projects were classified as investment properties in accordance to the Malaysian Financial Reporting Standards (MFRS) which 1MDB adopted for FY13 in lieu of the previous Financial Reporting Standards (FRS). The classification was made because the blueprints for both developments had not been finalised.

The new standards stipulate that fair value gains from investment properties are to be recognised in profit and loss, implying that the RM2.73 billion in revaluation gains were only recognised in 1MDB's profit and loss statement because the fund had not finalised the blueprints for both projects.

Imagine that, the revaluation gain would not have arisen if the blueprints had been finalised. And 1MDB was going to eventually finalise them anyway but found it convenient and expedient to classify it as investment property meantime, pushing the envelope in a very wrong way.

Let Tiger repeat: the only reason 1MDB is making profits for the last three years is because of consecutive property revaluations. It merely obtained property at giveaway prices from the government and then revalued them.

Essentially, 1MDB is not operationally profitable, the accounts show beyond a shadow of a doubt. But much more concerning is the amount of money that 1MDB is playing with. Already assets are reaching RM45 billion and of these liquid assets amount to more than half that at over RM23 billion. Liabilities, including borrowings of RM36 billion amount to some RM42 billion.

Of the over RM23 billion in liquid assets over RM7 billion are invested in Cayman Islands. The 1MDB board says it has no control over these RM7 billion funds and is now looking to sell it.

Imagine that. 1MDB has put money in investments it can't control!

The question that goes a-begging is why there is a need for 1MDB to borrow over RM36 billion and then put a substantial portion of RM23 billion in liquid assets. Even if its acquisitions are alright — they are not — the loan amount necessary is RM13 billion (36 - 23) but instead it is RM36 billion. Why?

On top of that 1MDB has a history of mispricing its loans and has already lost RM4 billion through this with at least a further loss of RM1 billion following other loans obtained later. Is that the reason for pursuing with the loans and then finding assets to buy after the fact?

Any prudent strategic fund worth its salt will make a careful assessment of assets it wants to acquire, make a decision, then come up with financing. But 1MDB has got it backwards — get the loans first and then find the assets. Do you take a housing loan first and then look for a proper house to buy? Obviously not but 1MDB does it.

Meantime, 1MDB pays expensive rates for its loans even if most of them are guaranteed by the government and then puts the excess money in assets such as deposits and dubious investments in the Cayman Islands with lesser returns.

Some RM23 billion are in near-cash investments, nearly two-thirds of total loans. How dumb, how incompetent or how sinister! Take your pick. 1MDB's liquidity management is in total shambles.

So far, the only assets it has bought which could contribute to future earnings quickly are the power assets but these would still not be enough to cover huge financing costs of over RM1.6 billion from its massive loans.

But the immediate impact of the power assets has been negative with 1MDB reporting an impairment loss of RM1.2 billion directly as a result of acquiring the power assets for some RM10.9 billion. That loss is more than 10% of the purchase price and comes less than a year after the acquisitions.

Despite, this, 1MDB had the gall to say that the power acquisitions enabled it to make a successful bid for project 3B, the 2,000MW coal-fired plant contract that it won and will build for RM11 billion.

What kind of strategy is that? Overpay for power assets to get the expertise to bid for the power project? It could have just bought the expertise for a few million ringgit instead of wasting billions.

The annual accounts for the year ended Mar 31, 2013 involve quite a bit of massaging and the notes involved explanations with 1MDB's latest auditors Deloitte, the third in its

short life, highlighting a long list of critical accounting judgements and estimation uncertainty.

These include areas such as the Cayman Islands investments, investment properties, arrangements relating to various power purchase agreements including renewals, its fund investments, fair value measurements and valuation processes — in short over substantially all of 1MDB's businesses.

1MDB's delayed annual report for the year ended Mar 31, 2013 is an indictment of the so-called strategic investment fund and all that it has done so far and is clear indication that it could well become the country's worst single case of misuse of public funds.

Now if only someone will sit up and take notice.

GRRR!

Copyright © 1999-2012 Mkini Dotcom Sdn. Bhd

Source: <http://www.kinibiz.com/story/tigertalk/82747/1mdb-a-disaster-unfolding-before-our-very-eyes.html>