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The Relationship Between Audit Committee Effectiveness and the Level of Corporate Risk Disclosure: The Relevance of Pre- and Post-Mccg 2012

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ABSTRACT

This study examined the relationship between audit committee effectiveness and the level of corporate risk disclosure amongst Malaysian listed companies pre- and post-Malaysian Code of Corporate Governance 2012. Content analysis was employed. A total of 122 firm-year observations was examined in order to measure the extent of risk disclosure against audit committee effectiveness. The findings reveal only audit committee size and diligence are significant in explaining the variations in corporate risk disclosure for pre- and post-MCCG 2012. This indicates that audit committee size does matter in assisting the revelation of corporate risk disclosure. It also signifies that audit committees are responsible and discharge their duties accordingly with reference to the higher number of audit committee meetings. An unexpected result was also found in this study where an inverse relationship was detected between audit committee independence and corporate risk disclosure. The result is contrary to the requirement of MCCG 2012 that emphasizes the importance of an independent director under its Principle 3.5. Further, the result also shows that the audit committee effectiveness have increasing in the post-MCCG 2012 period compared to pre-MCCG 2012 in determining the extent of risk disclosure of the sampled firms.

Keywords: *Corporate risk disclosure, audit committee characteristics, financial report, corporate governance*

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INTRODUCTION

Corporate governance issues have grabbed the world's attention with high profile corporate failures such as Enron and WorldCom in 2001 and 2002 respectively. Malaysia was also contaminated with the same problems and loopholes in corporate governance that surfaced when a number of corporate failures were recorded after the financial crisis in 1997/1998. This can be traced to the irregularities in financial reporting of Malaysian giant companies such as Transmiles, Malaysian Airline Systems and Port Klang Free Zone (Norwani et al., 2011; & Zainudian & Hashim, 2016). This situation led to a great public unease as stakeholders' lost their confidence on the financial statements of companies (Probohudono, Tower&Rusmin, 2013).

Several surveys had proved that Malaysia had issues with fraud, kickbacks and corruption. In 2014, Malaysia was ranked 50 by the Transparency International Secretariat Corruption Index with a score of 52. The problem was also growing at the organizational level in Malaysia as highlighted by KPMG Management & Risk Consulting Sdn Bhd (2014). Despite the efforts done by the government, the problems are still dominant in Malaysia. Industries that consistently score the top three highest rank in the KPMG survey are manufacturing (2013:26%, 2009:15%), consumer products (2013:18%, 2009:13%) and construction (2013:18%, 2009:14%).

Due to the sudden demise of several companies mentioned above, sufficient risk disclosure is highly needed for Malaysian companies. However, previous studies suggest that higher risk companies will disclose less information to the public as they believe that a higher level of risk disclosure will highlight their actual risk level (Anderson & Agarwal, 2011). According to Probohudono et al. (2013) a higher risk disclosure is found in firms with sound corporate governance systems. Therefore, this study will look into the effectiveness of corporate governance to monitor the extent of corporate risk disclosure by focusing on roles of the audit committee in financial reporting. Effectiveness of audit committees however depends on the active and collaborative participation from all parties including the board of directors, the management and the audit committee itself. It is important to understand which audit committee characteristics influence the risk management disclosure in Malaysian companies. Audit committee was

chosen because one of its duties is to assist in strengthening the operations and firm sustainability. Due to this reason, it is important to have a sound audit committee in an organization as they ensure the quality and credibility of financial reporting (Nelson & Devi, 2013).

The Government of Malaysia has also taken part in strengthening corporate governance by establishing the Malaysian Code and Corporate Governance (MCCG) in 2000 which was subsequently revised in 2007. The MCCG 2007 was then revised and substituted with MCCG 2012 which had few improvements and become effective starting from March 2012. Considering all the problems and the initiatives that have been taken by the Government of Malaysia, the study intended to determine whether MCCG 2012 had influenced the effectiveness of audit committees in monitoring the level of risk disclose by Malaysian public listed companies.

Therefore, the objectives of this study is twofold, 1) to provide a greater understanding on audit committee characteristics that may influence the compliance level of risk disclosure as stipulated by the Principle 6 (Recognise and manage risks) of the Malaysian Code on Corporate Governance 2012 (MCCG 2012), and; 2) to determine whether the revised MCCG 2012 increased the effectiveness of audit committees to monitor corporate risk disclosure. The results of this study will be very useful in understanding the factors that influence the revelation of risk information and the extent of risk disclosure in current reporting in Malaysian public listed companies.

LITERATURE REVIEW

The hypothetical relationship between audit committee and risk disclosure can be explained by the Agency Theory. Agency costs have been defined as costs arising from the likelihood that managers place personal interests ahead of shareholders' interest (Jensen & Meckling, 1976). Information asymmetry exists when management has more relevant information about the firm compared to shareholders subsequent to limitations caused by the intense competition in the market and the separation of ownership and control in firms. Due to information asymmetry, the principal is unable to determine whether the agent is performing the task for which he or she is

paid (adverse selection) or in doubt as to whether agents have done their work according to their ability (moral hazard) (Ashraf, Bandiera & Jack, 2014). Therefore, financial reporting and disclosure are crucially important for management to highlight firm performance and governance to the public (Leuz & Wysocki, 2016). High risk disclosure will lead firms to low information asymmetry and thus increase firm's credibility.

Previously, risk management was used to assist organizations from loss through avoiding downside risks. However, in today's world risk management has become an important aspect of firm's internal control, corporate governance and acts as a basic element in the business world (Domínguez & Gámez, 2014). Besides, risk management is also used in taking the upside (opportunities) while managing the downside (threat) risks. Risk management becomes an essential element in maximizing shareholders' wealth as it focusses on profit maximization while reducing the probability of financial failure (Stulz, 2015). In addition, the researcher found that institutional investors require individual and detailed risk reporting compared to general information of business risks as they find such reporting insufficient in helping their portfolio investment decision-making.

A study conducted by Linsley & Shrives (2005) showed the directors are seemed to be willing to discuss external risks where greater emphasize is stressed on good risks. They also prefer to focus more on past risks compared to future risks. The reasons for these types of disclosures are due to the nature of internal risks which cause the firm to incur higher proprietary costs of disclosure. Proprietary costs also cause mimicking behaviour to take place in the annual report disclosures as the directors are reluctant to voluntarily disclose information that other companies are unwilling to disclose (Anderson & Agarwal, 2011). The same problem on risk revelation occurred in South Africa where firms were largely focused on information which are non-financial (ie: operational, business and strategic), historical, good news and qualitative in nature (Ntim, Lindop, & Thomas, 2013).

A number of research have also been conducted on Malaysian public listed companies (Amran, Abdul Manaf & Che Haat, 2008; Atan, Sutan Maruhun, Wan Abdul Kadir & Jusoff, 2010; Ismail, Arshad, & Othman, 2014) in which most reported risks in the annual report are related to industry, competitors, plans and performance. It is due to the Bursa Malaysia

requirements for companies to disclose industry trends, development, group performance and material factors underlying results and financial position (Ali & Taylor, 2014). Another study showed that Malaysian companies are less transparent in risk disclosure whereby only 44.24% of risk information were released to the public in the annual report (Atan et. al., 2010). This is supported by results found in the research conducted by Ismail et. al., (2014) where they found the quality of voluntary disclosure in Malaysian companies is still at the average level in 2008 and 2009. This might be due to the lack of exposure to the importance of those information to shareholders and stakeholders in their investment decision making.

The audit committee has been widely accepted as a device that could assist in ensuring good quality corporate governance practices, mediating the disagreements between management and external auditors, synchronizing internal and external audit tasks as well as ensuring the quality of the firm's financial reporting (Adelopo, Jallow, & Scott, 2012; Lin, Xiao & Tang, 2008). It is also suggested that audit committee induces in balancing the power between accountability and audit relationships. Nevertheless, Cai, Hillier, Tian, & Wu (2015) contend that the existence of audit committee will only be worthwhile when benefits from their presence outweigh the expenses of not having them.

Hypotheses Development

Audit Committee Size

The audit committee is a subset of the main board. Therefore, from an agency theory perspective, the main board plays a vital role in determining audit committee structure in terms of size and composition. A bigger audit committee is also linked to a higher quality of financial reporting as they are able to enforce a better oversight function and improve the earning quality by lowering the chances of financial statements restatement (Adelopo et. al., 2012; Lin, Li, & Yang 2006). MCCG 2012 and Paragraph 15.10(1)(a) of the Listing Requirements of Bursa Malaysia Securities Berhad requires a listed firm to appoint an audit committee from amongst its directors and the composition of the audit committee must be not less than 3 members. Based on Adelopo et. al., (2012) and Lin, Li, & Yang (2006), the following hypothesis was developed:

H1: Audit committee size will significantly positively influence the level of corporate risk disclosure in the annual report of Malaysian public listed companies

Audit Committee Independence

Agency problems arise due to the conflicting interests between a manager and the shareholder (Fama & Jensen, 1983). According to the Agency Theory, higher accountability, independence and responsibility is associated to independent non-executive directors (INED) whereby they are more likely to be accountable to stakeholder concerns regarding revelation of risks. In addition, INED have the ability to put pressure on managers in disclosing high level risk disclosures (Domínguez & Gámez, 2014). Therefore, the composition of the board of directors play an important role in reducing agency problems and assist in increasing the effectiveness of a firm's corporate governance (Akhtaruddin, Hossain, Hossain, & Yao, 2009). The audit committee is regarded as independent when they do not have any personal or financial affiliation with the firm (Rainsbury, Bradbury & Cahan, 2009). Based on these arguments from the previous literature, it is hypothesized that:

H2: Audit committee independence will have a significant positive influence on the disclosure of corporate risks in the annual report of Malaysian public listed companies

Audit Committee Financial Expertise

Previous research suggests that the existence of financial experts on audit committees positively influence audit committee effectiveness in monitoring financial reporting quality. The higher proportion of accounting financial expertise on an audit committee is positively associated with financial reporting timeliness (Abernathy et. al, 2014), internal control effectiveness (Chen, Cao & Xia, 2014) and high quality accounting information disclosure. It is also suggested that directors with financial expertise are able to improve the quality of accounting information as they are well-versed and understand the complexity of financial information (Ran et. al., 2014).

Paragraph 15.10(1)(c) of the Listing Requirements of Bursa Malaysia Securities Berhad requires that at least one member of the audit committee

of public listed companies who is literate in financial matters sits in the audit committee. This indicate financial literacy is a vital element in audit committee characteristic as only members with financial literacy are able to comply with this principle. Therefore, the following hypothesis is posited:

H3a: Audit committee financial expertise with professional certifications (e.g. MIA, MICPA, ACCA, CIMA, etc.) will significantly positively influence the extent of risk disclosure in the annual report of Malaysian public listed companies

H3b: An audit committee chairman with financial expertise will significantly positively influence the extent of risk disclosure in the annual report of Malaysian public listed companies.

Audit Committee Financial Accounting Expert with Professional Certification (ACFINEX1) is measured by the proportion of audit committee members with professional certification in accounting to the total number of audit committee members (Yasin & Nelson, 2012; Lary & Taylor, 2012; Mohd Shatari, 2012). Audit committee is considered as financial accounting experts with professional certification if they are members of the Malaysian Institute of Accountants under Part II of the First Schedule of the Accountants Act, 1967.

Audit Committee Chairman with Financial Expertise (ACFINEX2) takes place when the chairman of an audit committee is an expert in financial accounting. The variable is awarded with a value of 1 if the audit committee chairman is a financial accounting expert and 0 for those who do not comply with the requirement which is consistent with the suggestion in Mohd Shatari (2012).

Audit Committee Diligence

Audit committee diligence is proxy by the audit committee's meeting frequency held in a particular financial year. Diligence is defined as the willingness of committee members to cooperate as expected to prepare, make inquiries, and seek answers when dealing with internal parties (i.e. management, internal auditors) and external parties (i.e. external auditors and other related constituents) (DeZoort et. al., 2002).

The MCCG 2012 does not specify the number of audit committee meetings to be held in a year. However, the Listing Requirements of Bursa Malaysia Securities Berhad requires a minimum of audit committee meetings to be held during a financial year, or more frequently as and when required. Higher number of meetings held by audit committee indicates that the audit committee is active in improving and monitoring to safeguard stakeholders' best interests (DeZoort et al., 2002). It also shows that audit committees are committed in discharging their duties and responsibilities. On the other hand, Kamarudian, Ismail & Alwi (2014) suggests that firms with less audit committee meetings were involved in fraudulent activities. Therefore, the following hypothesis was tested:

H4: Audit committee diligence will have a significant positive influence on the disclosure of corporate risks in the annual report of Malaysian public listed companies

Control Variables

Firm Size

Previous studies have proven that there is an association between firm size and risk disclosure (Linsley & Shrivess, 2005; Elshandidy et al., 2013). The Agency Theory predicts that agency costs arise due to firm size (Jensen & Meckling, 1976) and this can be controlled through the use of the financial reporting disclosure that helps in reducing information asymmetry (Shehata, 2014). As a firm becomes bigger, the number of stakeholders that are interested in the firm's affairs increase. Thus, risk disclosure becomes crucial in order to fulfill the needs of a prominent group of people (Amran et al., 2008) and to maintain corporate reputation (Oliveira, Lima Rodrigues, & Craig, 2011). Probahudono et al., (2013) suggests that bigger firms reveal more risk information as they have greater financial resources to absorb the cost of disclosure voluntarily compared to smaller firms. Based on the above arguments, it is expected that larger firms disclose more risk disclosures compared to the smaller firms.

Leverage

Oliveira et al. (2011) found that leverage has a significant influence on the level of risk disclosure. This is due to highly leveraged firms being associated with a higher level of agency costs and riskier as chances of shifting of possession from debtholders to stockholders may occur

(Domínguez & Gámez, 2014). Therefore, this type of firms are highly monitored by a greater power of debtholders. Thus, it is expected that firms with this characteristic have strong incentives to disclose a higher level of risk disclosure in order to justify and explain the condition of the firm to the debtholders (Amran et al., 2008). Based on the above arguments, it is expected that firms which are highly leveraged will disclose higher levels of risk disclosure compared to the smaller firms. Leverage is expected to be positively correlated with disclosure of risks. This is due to highly leveraged firms being closely monitored by a greater power of debtholders (Oliveira et al., 2011). Therefore, strong incentives to disclose higher levels of risk disclosure exist in order to justify and explain the condition of the firm to debtholders (Amran et al., 2008).

Profitability

According to the Agency Theory, managers of highly profitable firm tend to disclose more information to the public in order to prove their performance and obtain job security with higher levels of compensation. In addition, information disclosure is also used by managers as a signal to the market on the quality of their investment (Domínguez & Gámez, 2014). Besides, it also help managers to show their ability to identify and manage risks (Elshandidy et al., 2013). Therefore, it is expected that a highly profitable firm will disclose a higher level of risk disclosure as compared to the smaller firms. It is argued that managers of profitable firms release a higher level of risk disclosure to the market as a signal on the quality of their investment (Domínguez & Gámez, 2014). Besides, the disclosure is also used to show their ability to identify and manage risks (Elshandidy et al., 2013).

The Measurement of Risk Disclosure Index

For the dependent variable, risk disclosure index was calculated using content analysis. In the early stage of the research, an extensive review of the literature was undertaken to investigate the commonness across the subject area and to recognize items that are associated with risk disclosure. A Risk Disclosure Index was constructed based on the number of risk disclosure. Each risk disclosure reported was recorded and classified into 14 categories of voluntary risk disclosure (see Appendix 1) which were derived from the recommendation of previous studies (Anderson & Agarwal, 2011; Miihkinen, 2012 and Ntim et al., 2013). A score of “1” was given for each

of risk disclosure and a score of “0” was given for non-disclosure of risk management. Fourteen items were evaluated on the disclosure checklist, resulting in a maximum of 14 points (i.e. 100% disclosure) and a minimum of 0 point (0% disclosure). A disclosure index was calculated by dividing the total number of risk disclosure obtained by a company in the sample to the maximum score of risk disclosure.

The research framework for this study suggests that audit committee characteristics such as size, independence, financial accounting expertise and diligence have a certain influence on the extent of firm’s risk disclosure. Based on this premise the following model was developed in order to test the hypotheses:

$$CRD_{i,t} = \alpha_0 + \beta_1 ACSIZE_{i,t} + \beta_2 ACIND_{i,t} + \beta_3 ACFINEX1_{i,t} + \beta_4 ACFINEX2_{i,t} + \beta_5 ACDIL_{i,t} + \beta_6 SIZE_{i,t} + \beta_7 LEV_{i,t} + \beta_8 PROF_{i,t} + \varepsilon$$

Where:

- CRD_{i,t}** The extent of risk disclosure for firm *i* at time *t*.
- ACSIZE_{i,t}** Audit committee size measured by the number of board members on the audit committee at the end of financial year, for firm *i* at time *t*.
- ACIND_{i,t}** Audit committee independence measured by the proportion (i.e. percentage) of independent non-executive directors on the audit committee to the total number of directors on the audit committee at the end of the financial year, for firm *i* at time *t*.
- ACFINEX1_{i,t}** Audit committee financial expertise measured by proportion of audit committee members with professional certification (i.e. as stipulated under Part II of the First Schedule of Accountants Act, 1967) to the total number of audit committee members, for firm *i* at time *t*.
- ACFINEX2_{i,t}** Audit committee chairman with accounting financial expertise measured by a dummy variable given the value of “1” if the audit committee chairman is an accounting financial expert and “0” if otherwise, for firm *i* at time *t*.
- ACDIL_{i,t}** Audit committee diligence measured by the frequency of audit committee meetings held during a financial year, for firm *i* at time *t*.
- SIZE_{i,t}** Firm size measured by the function of natural logarithm of total assets for a particular financial year, for firm *i* at time *t*.
- LEV_{i,t}** Leverage measured by the total liabilities to total assets, for firm *i* at time *t*.
- PROF_{i,t}** Profitability measured by return on assets (i.e. operating income to total assets) for firm *i* at time *t*.
- A** Intercept
- β₁...β₈** The coefficients of audit committee variables
- ε** The error term

SAMPLING AND DATA COLLECTION

The annual report of Malaysian listed companies on Bursa Malaysia was used as the unit of analysis for this study. Previous studies suggests that company size and industry affects the level of risk disclosure (Elzahar & Hussainey, 2012; Zadeh & Eskandari, 2012). Thus, the sample was selected from the largest 10 companies from each of the selected industry based on market capitalization in order to control for size and industry (Ntim et al., 2013). The selection of the industry was made based on KPMG survey conducted in 2013 on fraud, bribery and corruption (KPMG Management & Risk Consulting Sdn Bhd, 2014). The findings of the survey suggest that the highest fraudulent activities were scored by firms from trading, consumer products, construction, properties, infrastructure and industrial products. This study excluded the finance sector from the population as they are regulated under different statutory requirements (Suffian & Sanusi, 2015). Only five companies were selected from infrastructure sector as there are limited companies listed on the Main Board under this category. Four companies were eliminated due to insufficient data. Therefore, the final sample were made up of 61 companies over two firm-years, resulting in a total of 122 firm-year observations from six industries. The study intended to focus on data from two financial year (FY); years 2011 and 2013 as effective date of the MCCG 2012 in Malaysia was on 31 December 2012. Therefore, it will help in identifying the level of risk disclosure prior to the implementation of MCCG 2012 (FY 2011) and after the implementation of MCCG 2012 (FY 2013).

Table 1: The Sample Firms According to Bursa Malaysia Listing Sectors

Sector	Number of firms	Number of firm-year	Percentage
Trading and Services	10	20	16.40
Consumer Products	9	18	14.75
Construction	9	18	14.75
Property	9	18	14.75
Infrastructure	5	10	8.20
Industrial Products	10	20	16.40
Plantation	9	18	14.75
Total	61	122	100.00

FINDINGS

Descriptive analysis for Dependent Variables

Table 2 presents the descriptive statistics for the extent of risk disclosure for the years 2011 and 2013.

Table 2: Descriptive Statistics for the Risk Disclosure Index for the Year 2011 and 2013

Year	Mean	Median	Std. Dev	Skewness	Kurtosis	Min	Max
2011	0.636	0.643	0.200	-0.408	0.017	0.143	1.000
2013	0.761	0.769	0.161	-0.136	-0.982	0.385	1.000

The extent of risk disclosures for 61 listed companies in the Main Board of Bursa Malaysia for 2011 ranged from 14.3 percent to 100 percent with a mean score of 63.6 percent and a standard deviation of 20 percent. The extent of risk disclosure in 2013 proved that there is an improvement in risk disclosure with a mean score of 76.1 percent and a standard deviation of 16.1 percent. As indicated in Table 3, the mean score for risk disclosure prior to the implementation of MCCG 2012 among firms was 63.6 percent. These results indicated that the disclosure level amongst top listed companies was still at low level and this is consistent with prior studies in Malaysia (Amran et. al., 2008; Ismail & Rahman, 2013). However, a slight improvement was found in the revelation of risk in 2013 by 12.5 percent compared to 2011 (2013:76.1%; 2011:63.6%). This indicates that firms have taken appropriate action to comply with the Principle 6 of MCCG 2012 – Recognize and Manage Risks whereby the board of directors is required to establish a sound risk management framework in managing risks. Further analysis discovered that results from individual types of risks were also consistent with the overall findings on risk disclosure as indicated in Table 3. A slight increase was found in operational risks (10.2%) and strategic risks (6.6%). The highest increase was recorded for risk management disclosure with 19 percent.

Table 3 Descriptive Statistics for the Types of Risk for the Year 2011 and 2013

Variables	Year	Mean	Med.	Std. Dev	Skewness	Kurtosis	Min	Max
Operational Risk	2011	0.741	0.800	0.277	-1.010	0.579	0.000	1.000
	2013	0.843	0.800	0.183	-1.253	1.645	0.200	1.000
Strategic Risk	2011	0.716	0.750	0.249	-0.824	0.698	0.000	1.000
	2013	0.782	0.750	0.236	-0.938	0.668	0.000	1.000
Risk Management	2011	0.469	0.400	0.301	0.113	-0.944	0.000	1.000
	2013	0.659	0.600	0.277	-0.242	-1.183	0.200	1.000

A number of companies have made an effort to make a transparent disclosure on risk management whereby the risk management policies, existence of a risk management committee and the availability of meetings conducted in a year were disclosed in a separate report under the “Statement on Risks and Internal Control” title.

Descriptive Analysis for Independent Variables

The descriptive analysis for audit committee effectiveness is presented in Table 4. The result indicates that companies do comply with the requirement of Paragraph 15.10(1)(a) of the Listing Requirements of Bursa Malaysia Securities Berhad which requires a listed firm to have an audit committee which must be comprised of a minimum of 3 members. The majority of the audit committee members in the sample data comprised of independent directors with the average audit committee independence (ACIND) of 88.7 percent for 2011 and 83.9 percent for 2013. This is in compliance with Paragraph 15.10(1)(b) of the Listing Requirements of Bursa Malaysia Securities Berhad which requires public listed companies to appoint a majority of its audit committee members from its independent directors. However, this result proved that non-compliance does exist (2011:11.3%; 2013:16.1%) as not all listed companies in the sample data complied with this requirement.

Table 4: Descriptive Statistics for the Audit Committee Effectiveness and Control Variables for the Year 2011 and 2013

Variables	Year	Mean	Med.	Std. Dev	Skewness	Kurtosis	Min	Max
ACSIZE	2011	3.520	3.000	0.721	1.565	2.857	3.000	6.000
	2013	3.620	3.000	0.820	1.185	0.697	3.000	6.000
ACIND	2011	0.887	1.000	0.153	-1.100	0.934	0.330	1.000
	2013	0.839	1.000	0.183	-0.765	-0.138	0.330	1.000
ACFINEX1	2011	0.364	0.333	0.150	0.914	0.746	0.000	0.750
	2013	0.389	0.333	0.171	0.108	1.937	0.000	1.000
ACFINEX2	2011	0.443	-	-	-	-	0.000	1.000
	2013	0.541	-	-	-	-	0.000	1.000
ACDIL	2011	5.150	5.000	2.032	2.086	9.325	0.000	15.00
	2013	5.520	5.000	1.858	2.167	6.474	4.000	14.00
SIZE	2011	9.161	9.322	0.844	0.762	0.123	7.218	10.684
	2013	9.209	9.374	0.893	-0.867	0.176	7.007	10.729
LEV	2011	0.404	0.376	0.227	0.351	-0.391	0.000	0.999
	2013	0.414	0.392	0.199	0.269	-0.770	0.056	0.824
PROF	2011	0.104	0.090	0.097	1.551	3.897	-0.100	0.460
	2013	0.093	0.063	0.096	3.038	12.724	-0.060	0.600

Notes: Variables are defined as follows: audit committee size (ACSIZE); audit committee independence (ACIND); audit committee with accounting financial expertise (ACFINEX1); chairman of audit committee with financial expertise (ACFINEX2); Audit committee diligence (ACDIL); firm size (SIZE); leverage (LEV); profitability (PROF)

Audit committee with financial expertise (ACFINEX1) scored a mean of 36.4 percent and 38.9 percent for 2011 and 2013 respectively which suggests a high number of non-compliance to Paragraph 15.10(1)(c) of the Listing Requirements of Bursa Malaysia Securities Berhad. More than half of the sample did not have at least one member of the audit committee who is financially literate. The result for audit committee meeting found in 2013 is consistent with the Listing Requirements of Bursa Malaysia Securities Berhad which requires the audit committee to hold at least four meetings during a financial year, or more frequently as and when required.

Correlation Analysis

Table 5 presents the correlation matrix for the dependent variables and independent variables employed in this study. The VIF result for all

variables ranged from 1.0 to 1.2 which indicates that no multicollinearity issues existed in this study as only VIF values of above 10 will violate the multicollinearity assumption (Pallant, 2013).

Table 5: Pearson Correlation of the Independent Variables and Risk Disclosure Index for Year 2011 and 2013

Correlation	CRD	ACSIZE	ACIND	ACFINEX1	ACFINEX2	ACDIL	PROF	LEV	SIZE
CRD	1.000	0.226*	-0.131	0.050	0.086	0.317**	-0.015	-0.003	0.045
ACSIZE	0.226*	1.000	-0.265**	-0.203*	0.098	0.124	-0.054	0.024	-0.128
ACIND	-0.131	-0.265**	1.000	0.012	0.017	0.156	-0.129	-0.001	0.064
ACFINEX1	0.050	-0.203*	0.012	1.000	0.216*	-0.039	0.193	0.036	-0.015
ACFINEX2	0.086	0.098	0.017	0.216*	1.000	0.049	0.052	0.031	-0.171
ACDIL	0.317**	0.124	0.156	-0.039	0.049	1.000	-0.159	-0.076	-0.256**
PROF	-0.015	-0.054	-0.129	0.193*	0.052	-0.159	1.000	-0.161	-0.048
LEV	-0.003	0.024	-0.001	0.036	0.031	-0.076	-0.161	1.000	0.222*
SIZE	0.045	-0.128	0.064	-0.015	-0.171	-0.256**	-0.048	0.222*	1.000

Notes: p-values in parantheses. Variables were defined as follows: audit committee size (ACSIZE); audit committee independence (ACIND); audit committee with accounting financial expertise (ACFINEX1); chairman of audit committee with financial expertise (ACFINEX2); audit committee diligence (ACDIL); profitability (PROF); leverage (LEV); firm size (SIZE).

*** Significant at the 1% level

** Significant at the 5% level

* Significant at the 10% level

Regression Analysis

Table 6 presents the Multiple Linear Regression Analysis which shows the relationship of audit committee effectiveness and the control variables on corporate risk disclosure for the research population (N=122). The regression results showed that the adjusted R Square (R^2) for the regression model to be 0.196. This implies that 19.6 percent of the total variation in corporate risk disclosure can be explained by the full model. However, a comparison between two sample periods showed that there was an increase in R^2 between year 2011 and 2013 with 21.3 percent and 26.3 percent respectively. This indicates that the ability of the independent variables to explain the changes in risk disclosure is greater in post-MCCG 2012 compared to pre-MCCG 2012.

Overall, audit committee size (ACSIZE) was significantly and positively correlated to corporate risk disclosure (CRD) at the 5 percent level. However, a higher percentage of average ACSIZE was recorded in 2011 compared to 2013. This indicates that an audit committee is one important factor that assists in increasing risk disclosure levels among Malaysian listed companies. Contrary to expectation of MCCG 2012, overall audit

committee independence (ACIND) was found to be negatively correlated to corporate risk disclosure with a non-significant relationship. This implies audit committee independence does not influence risk disclosure.

Table 6: Regression Analysis for Effects of Audit Committee Effectiveness and the Control Variables on Corporate Risk Disclosure for the Year 2011 and 2013

Year	(1) All	(2) 2011	(3) 2013
Intercept	0.063	-0.426	0.686
ACSIZE	0.177*	0.256*	0.045
ACIND	-0.154*	-0.043	-0.290**
ACFINEX1	0.087	0.078	0.101
ACFINEX2	0.067	-0.030	0.193
ACDIL	0.369***	0.355**	0.432**
PROF	0.019	0.106	-0.112
LEV	-0.024	0.025	-0.089
SIZE	0.191**	0.286*	0.016
R ²	0.196	0.210	0.257
Adjusted R ²	0.139	0.089	0.143
F-statistics	3.445**	1.732	2.252**
N	122	61	61

Notes: p-values in parantheses. Variables were defined as follows: audit committee size (ACSIZE); audit committee independence (ACIND); audit committee with accounting financial expertise (ACFINEX1); chairman of audit committee with financial expertise (ACFINEX2); audit committee diligence (ACDIL); profitability (PROF); leverage (LEV); firm size (SIZE).
 *** Significant at the 1% level
 ** Significant at the 5% level
 * Significant at the 10% level

Audit committee with accounting financial expertise (ACFINEX1) and chairman of audit committee with financial expertise (ACFINEX2) was insignificantly positively associated with risk disclosure. The results indicate that risk disclosure is insignificantly influenced by audit committee financial expertise. Audit committee diligence (ACDIL) which is proxy by the number of meetings held during a financial year had a significant positive correlation at the 1 percent level. Thus, the result implies that corporate risk disclosure is highly associated with audit committee diligence. Analysis on the control variables selected for this study (i.e. profitability (PROF),

showed that firm size (SIZE) is significantly and positively correlated to corporate risk disclosure (CRD) at the 5 percent level. However, leverage (LEV) and profitability (PROF) do not have a significant influence on corporate risk disclosure.

DISCUSSION

MCCG 2012 and Paragraph 15.10(1)(a) of the Listing Requirements of Bursa Malaysia Securities Berhad requires a listed firm to appoint an audit committee from amongst its directors with a minimum composition of three members. A larger board gives advantages to the firm as it offers variety for the selection of audit committee members. In addition, a larger board is associated with higher quality financial reporting as it is able to enforce a better oversight function and improve the earning quality by lowering the chances of financial statements restatement (Adelopo et. al., 2012; Lin et. al., 2006). On the other hand, a smaller board offers a limited option in selecting audit committee members and thus leads to limited skills which may impair the decision making process (Adelopo et al., 2012). However, the result of this study is consistent with the results from Yatim (2009) and Madi et. al., (2014). The findings suggest that audit committee size is positive and significantly correlated with financial reporting quality and internal control effectiveness. The result implies that audit committee size does matter in assisting the revelation of the corporate risk disclosure but it is not affected by the implementation of MCCG 2012.

Principle 3.5 of the MCCG 2012 and Paragraph 15.10(1)(b) of the Listing Requirements of Bursa Malaysia Securities Berhad requires a majority of independent directors if the chairman of the board is not an independent director. This implies that the proportion of independent directors in board of directors is crucial in ensuring a balance of power and authority. In addition, an audit committee should also possess independence of view, judgment and action to ensure that their existence is really effective. An inverse relationship between audit committee independence and corporate risk disclosure was found in this study. The result is consistent with previous studies that analyzed the association of audit committee independence with financial reporting quality in Malaysia (Abdullah et. al., 2010; Hamid et. al., 2015).

Paragraph 15.10(1)(c) of the Listing Requirements of Bursa Malaysia Securities Berhad requires that at least one member of the audit committee is a financial literate and any deviation to this requirement must be justified with reasons. The implicit assumption of having this requirement in the audit committee is to enhance the audit committee's oversight function on financial reporting. This is because an audit committee with financial expertise has the ability to ask the 'right questions' and identify any potential red flags in the company (Felo & Solieri, 2009) The results show that both an audit committee with financial expertise and chairman of audit committee with financial expertise are insignificantly positively associated with risk disclosure. However the results suggest that no guarantee can be provided that an audit committee with financial expertise will lead to a higher voluntary disclosure.

The MCGG 2012 does not specify the number of audit committee meetings to be held in a year. However, the Listing Requirements of Bursa Malaysia Securities Berhad requires the audit committee to hold at least four meetings during a financial year, or more frequently as and when required. A higher positive and significant association between audit committee diligence and the level of risk disclosure was found in 2013 compared to 2011. On average, the number of audit committee meetings conducted in 2011 and 2013 was five and six times respectively. Thus, the result implies that corporate risk disclosure is highly associated with audit committee diligence and MCGG 2012. This indicates that audit committee diligence has improved risk disclosure levels in the Malaysian listed companies with a higher number of meetings recorded after the implementation of MCGG 2012. The positive and significant result found indicates that the frequency of meetings is a crucial component for audit committee effectiveness in Malaysian listed companies as it signifies that the audit committees are responsible in discharging their duties. In addition, audit committee diligence will also enhance the level of oversight including those related to business operations, risk management and control activities.

CONCLUSIONS

The objective of this study was to identify audit committee effectiveness in monitoring the level of risk disclosure in Malaysian public listed companies

during pre and post implementation of the Malaysian Code on Corporate Governance 2012 (MCCG 2012). This study provided evidence that audit committee size and audit committee diligence do influence the extent of corporate risk disclosure. However, an unexpected result was detected on audit committee diligence whereby an inverse relationship was found between audit committee characteristics and corporate risk disclosure. On the other hand, no relationship was found between audit committee with financial expertise as well as audit committee chairman with financial expertise against risk disclosure. The results also provide evidence that the Revised MCCG 2012 did bring some positive impact on audit committee effectiveness as shown by an increase of R² for the post-MCCG 2012 sample firms. The results also suggest that it is important for Bursa Malaysia to enforce stringent rules for independent audit committee members and also audit committees with financial expertise in order to ensure that they are well equipped with knowledge and expertise as required to discharge their roles and responsibilities effectively. Therefore, mandatory accreditation programme, continuing education programmes and other suitable training should be made compulsory for audit committee members in order to enhance their competency in financial reporting.

The results should be interpreted with caution since this study suffers with several limitations. First of all, this study only employed non-financial firms in Malaysia and was limited to the Main Board of Bursa Malaysia. Therefore, generalization of the findings to all firms listed on the other boards of Bursa Malaysia is not possible due to the non-existence of other board samples. In addition, the sample data of this study only covered the years 2011 and 2013 which is pre- and post MCCG 2012 and thus the results may not be extended to other periods as the results may be different across different time periods. Finally, this study only investigated audit committee effectiveness and voluntary corporate risk disclosure. Therefore, future studies should consider a longer time series to capture the effects of the new MCCG 2012. This is important as new policies and procedures will take a longer period to be implemented and to reflect improvements.

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APPENDIX 1

Voluntary Risk Disclosures

1. Interest rate
2. Exchange rate
3. Commodity
4. Liquidity
5. Credit
6. Customer satisfaction
7. Product
8. Development
9. Efficiency and performance
10. Sourcing
11. Stock obsolescence and shrinkage
12. Product and service failure
13. Environmental, health and safety
14. Brand name erosion

