

## AUDIT COMMITTEE OF COOPERATIVES IN MALAYSIA: LEVEL OF COMPETENCY

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### Abstract

This study investigated the level of competency amongst audit committees (ACs) of Malaysian cooperatives (coops). AC competency (with proxies of educational background and accounting knowledge) has emerged as a significant theme in corporate governance debates. AC that possesses accounting knowledge is associated with effective monitoring. As such, this study employed 384 AC members as respondents representing large-, medium-, and small-sized coops. As a result, this study revealed that only 12.7 % of ACs held first degree, while almost half of them only possessed secondary level of education. In terms of accounting knowledge, only 10.1 % of the AC members possessed professional knowledge related to the abilities of analysing and issuing opinions on financial reporting, as well as providing added value to coops. Besides, only 5.2 % of the ACs fell under the technical level, which is associated with the ability to prepare and to understand financial reports, but not to the extent of analysing them. Meanwhile, 29.7% of the AC members had intermediate knowledge linked with the capability of preparing reports in accordance to specific format without the ability to comprehend them. Surprisingly, 23.4 % of the AC members were novice, hence lacked knowledge in accounting.

**Keywords:** Audit Committee, Education, Accounting Knowledge, Cooperatives

### 1.0 INTRODUCTION TO AUDIT COMMITTEE (AC)

The ACs in the cooperative sector are composed of shareholders appointed by its Board of Directors according to Section 42A, Co-operative Societies Act 1993 and Guidelines 4 (2009) regulated by Malaysia Cooperative Societies Commission (MCC). Some essential functions of AC include enhancing financial reporting credibility, ascertaining effective internal control, as well as monitoring the operations of its business activities (Carcello, Klein, & Neal, 2008). These ensure that shareholders can gain accurate information before committing into economic activities (Saleh, Iskandar, & Rahmat, 2007).

Nevertheless, Utusan Malaysia (2012) reported that after three years of implementing Guidelines 4 (2009), the ACs appear to be still inept and ineffective when dealing with issues pertaining to financial reporting. Based on the report, appointed ACs seem to have failed to respond accordingly towards audit findings and thus, doubts have been raised on the competency level of these appointed ACs. Weak governance structure and the absence of good governance contribute to the inefficient performance of coops in Malaysia (Mohamad, Othman, & Mohamed, 2013). In fact, several cases related to the poor governance in coops

have been highlighted. The first instance refers to the inability of the AC to identify financial fraud engaged by the board members of Koperasi Pekebun Kecil Getah Nasional (NARSCO) in 2006, which resulted to a loss of RM20 million. The second instance is a case that happened in 2010, in which Koperasi Kakitangan Kerajaan Selangor dan Wilayah Persekutuan (KOSWIP) misappropriated tenders and inflicted a loss of RM1.5 million. These scandals point out the weaknesses of ACs in identifying early threats or red flags of misappropriation of assets, breach of trust among the management, and fraudulent financial activities that lead to losses suffered by the shareholders.

## 2.0 BACKGROUND OF THE COOPERATIVE SECTOR IN MALAYSIA

The term ‘cooperative’ is a direct translation from the word ‘co-operation’, which originates from the Latin word, ‘co-operari’ that consists of two syllables; ‘co’ referring to together, while ‘operari’ means working (Novkovic, 2008). Coop reflects a business entity that was initially developed in rural areas. The primary objective of the establishment during earlier days was to resolve debt crisis faced by the locals in Tanah Melayu.

Upon enacting the cooperative law on 28<sup>th</sup> June 1922, the first credit-based coop was registered under the name ‘The Federated Malay States Posts and Telegraphs Co-operative Thrift and Loan Society Limited’ on 21<sup>st</sup> July 1922 (Othman & Kari, 2008). The cooperative sector in Malaysia is rather significant as based on record<sup>1</sup>, 25% of Malaysians have share interests in coops, and therefore, constitute as significant contributors of the country’s income in terms of direct tax.

Coops in Malaysia can be classified into nine functioning segments, which are: banking, credit, agriculture, housing, industrial, consumer, construction, transportation, and service. Table 1 presents the performance of coops in 2016.

**Table 1. Cooperative Economic Performance Report 2016**

No	Function	No of Coop	No of Members	Capital (RM Million)	Asset (RM Million)	Revenue (RM Million)
1	Banking	2	971,613	3,328.58	101,499.38	28,716.40
2	Credit	590	1,317,256	6,181.41	14,119.57	5,401.39
3	Agriculture	2,891	738,800	656.96	2,849.54	1,185.11
4	Housing	286	156,879	199.74	1,035.10	224.86
5	Industrial	332	19,806	13.41	78.72	36.37
6	Consumer	5,238	2,586,528	437.40	1,980.00	1,340.07
7	Construction	238	98,681	35.23	330.11	58.23
8	Transportation	479	147,233	70.93	332.41	605.51
9	Service	3,372	1,029,426	3,068.18	8,515.86	2,096.69

(Source: Malaysian Cooperative Performance Report, 2016)

In 2016, the development of cooperative sector has significantly boosted Malaysia’s economy. A total of RM40 billion had been contributed to Gross Domestic Product (GDP) (Sinar Harian, 2018). The present performance also indicates a positive trend from year to year. The Cooperative Economic Performance Report 2010-2016, which was published on MCC official website, reported increment for the numbers of registered coops, coop members, asset, and revenues by 39.3%, 6.6%, 45.1%, and 75.9%, respectively.

<sup>1</sup> The statistics on [www.skm.gov.my](http://www.skm.gov.my) is based on year 2016.

Coop performance in Malaysia has exhibited promising development within five years since the launching of National Cooperative Policy (NCP) 2011-2020. The reasons for establishing NCP are to enhance coop economic development; strengthen control, supervision, and governance; and finally, to improve public confidence in coop movement towards becoming a significant contributor towards GDP.

Despite of the positive progress within the cooperative sector in Malaysia, doubts regarding cooperative governance are frequently raised and debated due to countless misappropriated assets, fraudulent financial activities, and breach of trust among Cooperative Board Members. According to the 2017 MCC official report, Koperasi Telekom Malaysia Berhad (Kota Mas) suffered losses up to RM23 million due to fraudulent activities by its Board Members, which is currently under investigation by the Malaysian Anti-Corruption Commission (MACC). This is among the reasons that have sparked doubts and questions over the governance and credibility of AC within the cooperative sector.

### 3.0 EDUCATION AND KNOWLEDGE LEVEL AMONG AC MEMBERS

The AC, which serves as an internal governance mechanism, is responsible in overseeing the process of financial reporting, among others are: (i) to assess the suitability of management's selection regarding accounting policies and disclosures in compliance with financial reporting standards; (ii) to review significant and unusual transactions and accounting estimates; as well as (iii) to assess if the financial report present a true and fair view of the company's financial position and performance and if it complies with the regulatory requirements (Bursa Malaysia Corporate Governance Guide, 2012). The education level amongst the AC members is pivotal in ascertaining the effectiveness of AC (Ika & Ghazali, 2012). An AC who possesses knowledge in accounting is expected to have a significant role in mitigating fraudulent financial activities. Prior studies have indicated that education level among AC members in non-problematic companies is higher than their counterparts (McMullen & Raghunandan, 1996; Mohd Mohid Rahmat, Takiyah Mohd Iskandar, & Norman Mohd Salleh, 2009).

Knowledge of AC members pertaining to accounting, auditing, and finance is beneficial in lowering risks of fraudulent financial activities (Hasnan, Rahman, & Mahenthiran, 2013). Such knowledge aids ACs to further comprehend reporting requirements, which subsequently improves supervision and monitoring functions. ACs with high competency in financial education can restrict a management from acting impulsively and recklessly in managing resources, as well as disclosing business information to a third party (Nelson & Devi, 2013).

Table 2 presents the summary of past studies concerning accounting knowledge and education amidst AC members. In particular, Sultana, Singh, and Van der Zahn (2015) revealed that accounting knowledge and education are essential in ensuring that financial reporting is prepared in accordance to approved accounting standards. Meanwhile, another strand of studies displays that AC members with accounting education can identify risks in misappropriation and fraudulent activities (Saat, Karbhari, Xiao, & Heravi, 2012). All in all, these studies signify that fraudulent activities and misappropriation of assets in organizations can be minimised if the AC members possess sufficient accounting knowledge.

In a similar vein, this study postulates that AC members with high education background and accounting knowledge are more likely to mitigate fraudulent financial reporting and asset misappropriation. This is important because AC competency, in which education background and accounting knowledge serve as proxies, is linked with the ability to identify threats or red flags related to assets misappropriation and fraudulent financial activities. The impact of assets misappropriation, fraudulent activities, and fraudulent financial reporting are disastrous and detrimental to the interest of shareholders. As such, the primary

objective of this study is to determine the level of education and accounting knowledge amongst selected AC members of Malaysian coops.

**Table 2. Education and Knowledge of AC Members**

Author	Research Samples	Findings
DeZoort, Hermanson, Archambeault, & Reed (2002) Accounting, Organization Society	A sample of 87 AC members of public listed companies in US Stock Exchange.	Accounting knowledge is pivotal and influences professional opinions of AC members in mitigation of misappropriation and fraudulent activities.
Saat, Karbhari, Xiao, & Heravi (2012) World Review Business Research	The study data were based on financial reports of public listed companies in Bursa Malaysia. A total of 221 companies were analysed to determine the characteristics of AC and their level of compliance.	AC members with accounting background are significant to be at the compliance level. AC members with accounting education can identify risks in misappropriation and fraudulent activities.
Iyer, Bamber, & Griffin (2012) Managerial Auditing Journal	A study that looked into 118 AC members with accounting education, as well as 49 members with accounting knowledge and experience.	AC members with accounting background indicate positive relationship with mitigation of fraudulent activities.
Aldamen, Duncan, Kelly, McNamara, & Nagel (2012) Accounting & Finance Journal	A study on 300 companies during global financial crisis.	AC members with finance and accounting knowledge have a positive correlation with companies' performance and are able to detect fraudulent activities at early phase.
Sultana, Singh, & Van der Zahn (2015) International Journal of Auditing	494 public listed companies in Australia to determine the characteristics of AC and the level of financial reporting compliance.	Companies with accounting, auditing, and finance-based AC members are free from financial reporting manipulation.

#### 4.0 METHODOLOGY

According to Guidelines 4 (2009), every cooperative is required to appoint a minimum 3 to 5 members of AC members among the shareholders. Krejcie and Morgan (1970) stated that 384 respondents are required for infinite sampling. According to a report published in 2016, a total of 17,900 AC members were involved in Malaysian coops. Therefore, 384 AC members, which represent 35% of large- and medium-sized cooperatives each, as well as 30% of small-sized cooperatives, were selected for this study.

In this study, the response rate was for 41% (158 respondents), which exceeded the threshold of 30%, as suggested by Frohlich (2002). The questionnaire employed in this study was adopted from Ika and Ghazali (2012) as it focuses only on demographic profile.

#### 5.0 FINDINGS AND DISCUSSION

A total of 110 (69.6%) respondents from this study were males, while the remaining were females. Their age ranged between 25 and 56. More than one third of the AC members fell in the age range of 46 to 56, whereas 14.6% of the respondents were within the age range of 25-35 years old.

**Table 3. Accounting Education and Knowledge level of AC Members**

<b>Education Level</b>	<b>No.</b>	<b>%</b>
Post Degree	17	10.8
Professional	1	0.6
First Degree	20	12.7
Diploma / STPM	46	29.1
SPM	74	46.8
<b>Total</b>	<b>158</b>	<b>100</b>
<b>Knowledge Level</b>	<b>No.</b>	<b>%</b>
Professional	16	10.1
Technical	8	5.2
Intermediate	47	29.7
Basic	50	31.6
Novice	37	23.4
<b>Total</b>	<b>158</b>	<b>100</b>

Table 3 shows that 46.8% of coop AC members had secondary level of education, while 24.1% claimed to have studied until tertiary level, and 29.1% had diploma certificates. As for knowledge level, only 10.1% possessed professional knowledge to analyse and issue opinions concerning financial reporting, including providing added value to coop business. Those with technical and intermediate level of knowledge only constituted 34.9%. Technical knowledge refers to the ability of preparing and understanding financial reports, but not to the extent of analysing them. Intermediate knowledge, on the other hand, refers to those who are only able to prepare the report based on the given format without the ability to comprehend the report. Next, 31.6% had only the basic knowledge, while 23.4% were novice and were clueless about accounting.

Based on the above findings, 46.8% of AC members possessed intermediate education level, while 55.0% had basic knowledge or had no accounting or finance knowledge but were appointed as AC members of Malaysian coops.

## 6.0 CONCLUSION

This paper documents the descriptive analysis of competency exerted by AC members based on their education background and accounting knowledge. The study outcomes conclude that both education background and accounting knowledge of the AC members among Malaysian coop are relatively low. This finding offers a basis for further investigation on whether AC members who lack accounting knowledge are less likely to detect early threats or red flags related to assets misappropriation and deficiencies in financial reports of coops.

It is recommended that MCC should introduce Continuous Development Program (CPD) to AC members in order to increase and to update both skills and knowledge to keep up with advancement in technology and education. The syllabus for CPD can be developed with help sought from professional bodies, such as the Malaysian Institute of Accountants (MIA), and the Institute of Internal Auditors (IIAM) to improve accounting knowledge.

Additionally, Maktab Kerjasama Malaysia (MKM) should be empowered by updating their modules based on the current technological development. MKM, hence, should introduce Computerized Auditing Technique (CAT) in detecting unhealthy activities that may disrupt cooperative progression.

Future studies may examine the association between the level of AC competency and the financial reporting quality of coops in Malaysia

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