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A Descriptive Study on Standalone Risk Management Committee Adoption among the Top 50 Malaysian Firms

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ABSTRACT

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In a modern business environment, business is considered more fragile as compared to the traditional business setting due to technology sophistication and global market uncertainty. Firms cannot run away from managing unique and complicated risk issues when exploring greater opportunities for a higher return in a competitive market. Realizing this, the Securities Commission of Malaysia had encouraged large, listed firms to form a separated Risk Management Committee to ensure better anticipation and responsiveness towards risk management issues. However, this practice is still voluntary among Malaysian listed firms most probably to allow internal coordination among different business atmospheres. Hence, this paper aims to describe the adoption level of the best practices to establish a standalone Risk Management Committee among the top 50 largest listed firms in Bursa Malaysia. Given the issuance of the Malaysian Code of Corporate Governance 2017 before the attributes of the Risk Management Committee were further explored. Secondary data were adopted, and information was gathered from the firms' annual reports in 2018 and 2019. It is available on the Bursa Malaysia website and each sampled firm's website. The results revealed that more than half of Malaysian listed firms had taken the initiative to establish a standalone Risk Management Committee following the best practices recommended by the Malaysian Code of Corporate Governance 2017. However, the composition of Risk Management Committee members is heavily tied to the Audit Committee. This current study provides insight into the risk governance structure among Malaysian listed firms after issuing the Malaysian Code of Corporate Governance 2017.

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1. INTRODUCTION

Governance mechanism is one of the pillars of good corporate governance. The focus is mainly on how the board of directors, as the agent to the stakeholders, undertake their stewardship function in fulfilling their public accountability (Ishak & Mohamad Nor, 2017). Unforeseen failure of corporate firms such as Enron, WorldCom and Lehman Brothers has changed stakeholder's perspective on the importance of mitigating risk within a business entity (Abdullah, Shukor, & Rahmat, 2017; Aldhamari, Nor, Boudiab, & Mas' ud, 2020; Larasati, Ratri, Nasih, & Harymawan, 2019; Rimin, Bujang, Wong Su Chu, & Said, 2021). Policymakers are finding ways to enhance governance rules to safeguard stakeholders' interests as the starting point to minimize principal risk.

In Malaysia, with the recent corporate failure of 1Malaysia Development Berhad, the Securities Commission (SC) had launched an improvised version of its corporate governance best practices with the issuance of the Malaysian Code of Corporate Governance (MCCG) 2017, which superseded its earlier version. This fourth version is seen to strengthen corporate governance culture in line with market and business needs. One of the recommendations made by the SC in the Step-Up Practice 9.3 of MCCG 2017 is the establishment of a standalone Risk Management Committee (RMC) which comprises a majority of an independent director to oversee the firm's risk management framework and policies. An independent director on board minimises agency problems (Fuzi, Halim, & Julizaerma, 2016).

With the evolving nature of risk associated with the sophisticated business environment, uncertainty in the industry, and global market phenomenon, the urgency for a specialized RMC is necessary to ensure risk identification and mitigation are adequately supervised (Securities Commission, 2017). Since the traditional ways of combining two primary key areas (audit and risk management) into one board raise the board's effectiveness in undertaking their responsibilities in an impactful manner. Moreover, the time commitment is also at a cost due to overwhelmed obligations (Aldhamari et al., 2020).

Previous studies reported the advantages of having a standalone RMC separated from the Audit Committee (AC). By focusing on how standalone RMC could contribute towards better financial performance (Aldhamari et al., 2020; Halim, Mustika, Sari, Anugerah, & Mohd-Sanusi, 2017; Jia & Bradbury, 2020; Rimin et al., 2021), higher audit quality (Larasati et al., 2019) and shorter audit report lag (Omer, Aljaaidi, & Al-Moataz, 2020). Standalone RMC is also proven to promote voluntary disclosure (Abdullah et al., 2017) and reduce financial fraud incidences (Abdullah & Said, 2019) within the entity. However, limited studies explore the characteristics of RMC itself that define its effectiveness (Jia & Bradbury, 2020) to bring better firm performance. Perhaps, because the practice of having a standalone RMC is still not mandated in many countries and at the same time, the governance guide on RMC is still silent.

Realizing the benefits brought by the existence of standalone RMC, this study wishes to investigate further the current practices by the top 50 Malaysian listed firms in Bursa Malaysia subsequently after the release of the MCCG 2017 to see the adoption of the best practice recommended by SC regarding the establishment of standalone RMC. It would be interesting to see how the large, listed firms react towards the encouragement made by SC subsequently after the guide is released on 26 April 2017. Further consideration would be given to the characteristics of RMC in ensuring strong corporate governance presents within the listed firm's board structure. The attributes of RMC may include the board independence, board size and whether RMC established is independent of the AC. All the governance structure of the main board should also be embedded in the RMC structure to avoid eye obscuring RMC established for the sake of complying with the best practice without properly undertaking their ultimate role seriously.

2. LITERATURE REVIEW

2.1 Agency Theory

The board of directors are the representative of shareholders has always rested within the agency theory concept. According to agency theory, board members appointed by the shareholder act as the agents who run the firm for the shareholder's best interest, known as the principal. A strong governance mechanism can monitor an agent’s behaviour in maximizing the principal’s return as the capital contributor (Rimin et al., 2021). One of the ways is by placing an internal supervision mechanism within the business operation (Halim et al., 2017), and RMC is one of the tools (Larasati et al., 2019; Nasution, 2019). RMC play a crucial role in resolving conflict of interest between shareholders and the board, subsequently increasing shareholder value. At the same time, it reduces information asymmetry due to the establishment of an independent board that causes higher integrity and promotes transparency in financial reporting (Aldhamari et al., 2020). Separate RMC will monitor various inherent risks with more focused risk oversight functions (Abdullah et al., 2017). A stronger governance mechanism exists with standalone RMC in place. It will increase the board’s effectiveness in dealing with risk management issues and align the principal and agent interest, thus reducing agency problems.

2.2 Evolution of Risk Management Guide in Malaysian Code of Corporate Governance

The importance of risk management and an effective internal control framework was first introduced in MCCG 2000. However, limited guidance was given on how the board should execute this responsibility. It is up to the board to design its structure (Ishak & Mohamad Nor, 2017). How a board of directors perceive risk management responsibilities should reflect how they organize their board structure (Tonello, 2012). Later, when the MCCG was revised in 2007, it required listed firms to form an internal audit committee that includes a risk management team in charge of managing risk effectively and ensuring internal control procedures are in place (Ghazali & Manab, 2013; Rimin et al., 2021).

The third version of MCCG, released in 2012, has provided a detailed governance principle and recommendation for the best practice related to risk management. At this point, it is recommended for the board to establish a sound risk management framework and internal control system, but it is still optional requiring the listed firm to disclose their option in the annual report (Abdullah & Said, 2019; Ishak & Mohamad Nor, 2017). In 2017, to enhance corporate governance even further, the SC has come up with Step Up 9.3 of MCCG 2017. It encourages the non-financial listed firm to incorporate a standalone RMC on its own, which comprises an independent director who focuses solely on overseeing risk management procedures, thus enhancing the quality of risk assessment and monitoring landscape. Table 1 summarizes the Evolution of Risk Management Guide in Malaysia.

Currently, the establishment of standalone RMC in Malaysia is compulsory for financial institutions. It is due to their business model that mainly deals with the high volatility caused by greater market risk, high credit risk and liquidity risk resulting from the changes in the global economic environment (Bursa Malaysia, 2017). This requirement was mandated in Standard 12.1(c) of Bank Negara Malaysia’s Policy Document on Corporate Governance. However, a separate RMC was not required for non-financial institutions. But with increasingly sophisticated changes in the corporate landscape caused by technology advancement, political intervention, changes in business model and global uncertainty, it is no longer the case. Large, listed firms, including non-financial firms, need a focused oversight risk board equipped with extensive skills to play an active role in minimizing all-rounded risk to guarantee business going concerned (Abdullah et al., 2017).

Table 1. Evolution of Risk Management Guide in Malaysia

MCCG 2000	MCCG 2007	MCCG 2012	MCCG 2017
The introduction of the Risk Management Concept place under the board of director's responsibility. It is to identify risk and mitigate the risk through an effective internal control framework.	Listed firms must form a structured internal audit committee that includes a risk management team in performing its risk management function. The Securities Commission defined three major areas of responsibilities by internal audit function, including evaluating risk management effectiveness, internal control system and firm's governance structure.	A more detailed guide was issued under eight broad principles. Risk management was highlighted under the Sixth Principle, whereby listed firms are encouraged to establish a sound risk management framework and internal control system. But adherence to this recommendation is still voluntary.	In moving towards enhancing governance structure, large, listed firms are encouraged to establish standalone RMC comprises independent directors that focus solely on overseeing risk management strategies.

Source: Series of Malaysian Code of Corporate Governance by Securities Commission

2.3 Combined Committee: Traditional Board Structure

Previously, the risk management function was not thought to be very important by the board in Malaysia (Aldhamari et al., 2020; Omer et al., 2020). Therefore, the risk management role was included within the AC's responsibilities, and most of the firms named this combined committee as Audit and Risk Management Committee. This traditional practice caused a great impact on the board's effectiveness in executing their responsibilities. Since the AC function itself is already overwhelmed with its role to oversee financial reporting process, supervise audit process, evaluate internal control procedures, review the financial report and dealing with external auditors for timely issuance of the audited financial report (Boudiab & Ishak, 2020; Abdullah & Said, 2019). This extensive job scope raises concern on how the AC executes its risk management duties carefully and adequately (Abdullah et al., 2017; Nasution, 2019).

This fact was also supported by a review made by Bursa Malaysia (2017), whereby AC was reported to be the most time-consuming committee, which held on average seven meetings in 2016 compared to other committees with four meetings held annually (Bursa Malaysia, 2017). Additionally, the requirement for an AC member to keep up to date with the recent development of accounting standards demand additional time and further commitment. As a result, the overburdened AC tends to overlook risk issues despite the fatal consequences that might happen in the absence of a comprehensive risk management team (Aldhamari et al., 2020; Halim et al., 2017). Hence, large firms should segregate the risk manager's role in today's sophisticated risk environment to ensure better delivery of board function in fulfilling their risk management responsibilities to avoid agency problems (Abdullah et al., 2017; Aldhamari et al., 2020).

2.4 Effectiveness of Standalone Risk Management Committee

Literature has provided empirical evidence on the effectiveness of RMC, mainly on firm financial performance in developing countries. One of the studies was conducted by Halim et al. (2017). He discovered firms with a standalone RMC are more effective in managing their financial risks thus have better financial performance. Having a separate RMC distinct from the AC allows the directors to focus and specialize on risk management efforts enabling them to dedicate more time and commitment for better risk monitoring to minimize firms' losses. Another study by Aldhamari et al. (2020) investigates the impact of RMC on financial performance among financial firms in Malaysia. They discovered financial performance is better for firms with effective RMC by enhancing transparency and integrity of financial reporting having a dedicated risk oversight team on board. In 2021, Rimin et al. conducted a study on consumer goods sector listed firms in Malaysia. They reported a positive relationship between separate RMC and financial performance measured by Tobin Q, implying firms with standalone RMC have better market valuation due to the risk monitoring mechanism.

The Risk Management Committee was also reported to bring benefits to non-financial aspects. Abdullah and Said (2019) uncovered a significant inverse relationship between standalone RMC and financial fraud incidences among Malaysian listed firms from 2001 to 2013. The existence of RMC separated from AC proved to be an effective tool in combating financial fraud by having an independent risk monitoring board whose responsibility is to mitigate risk within the business environment. In Indonesia, Larasati et al. (2019) drew samples from Indonesian listed firms that revealed that firms with separate RMC require higher audit coverage, thus affecting higher audit fees. Hence, positively improve audit quality. The result from prior studies on Malaysian non-financial firms demonstrated that the establishment of RMC could encourage better voluntary risk management disclosure in the financial report (Abdullah et al., 2017). With the information possessed by RMC through an effective monitoring role, firms are willingly disclosing their positive risk management information for better transparency.

2.5 Risk Management Committee Attributes

Given an extensive study on the effectiveness of RMC on financial and non-financial performance, studies on RMC attribute itself is limited due to RMC establishment remains voluntary in most countries, including Malaysia, Indonesia and Australia. Most of the existing studies focus on the main attributes, including committee size (Abubakar et al., 2018; Boudiab & Ishak, 2020), independence of members (Aldhamari et al., 2020; Jia & Bradbury, 2020; Ugwu, Ekwochi, & Ogbu, 2021), members knowledge and qualification (Aldhamari et al., 2020; Jia & Bradbury, 2020), number of meeting (Alkelani, Hussin, & Salim, 2020) and number of training attended by the members (Boudiab & Ishak, 2020). However, none of them had investigated if the RMC is independent of the AC after considering the work overload that AC members already have in hand.

3. METHOD

3.1 Research Design and Sample Selection

This study used a quantitative approach and descriptive research design to see the adoption level on the establishment of standalone RMC among the top 50 Malaysian largest listed firms. Then, attributes of RMC are analysed further to describe the governance structure of the established RMC. The population of this study is the listed firms in Bursa Malaysia, covering all sectors but excluding financial institutions. The sample selection of the top 50 largest firms by market capitalization according to the list provided by FBM KLCI is justified because larger firms are associated with high risk (Halim et al., 2017). Thus, it has more reasons to establish a separate RMC (Nasution, 2019), for instance, due to the high complexity of their economic