

Malaysia Risk Reporting Environment: Understanding of the Study

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ABSTRACT

In today volatile business environment, the need for transparent information is arguably more needed than before. The internationalisation of company financial flows has caused risk reporting is becoming more important and recently become one of the most significant issues in financial markets. In Malaysia, past accounting scandals of Transmile and Port Klang Free Zone and the global financial crisis in 2007 – 2009 has triggered the market to pay special attention to company annual report especially their risk report. Due to pressure from professional bodies and government, the management and standard setters are working continuously to enhance company risk disclosure practice. The previous study also suggested despite the effort given by the responsible party to enhance disclosure practice, it was argued that current corporate disclosure is rather insufficient and yet to achieve a satisfactory level. Therefore, the objective of this study is to extend the current disclosure literature by discussing the problems of risk disclosure practice among listed companies in Malaysia. In addition, the study also intends to highlight the research questions and objective formulation.

INTRODUCTION

In this globalisation era, organisations are not only facing financial risk, but also a non-financial risk which is arguably emphasised the need for the proper risk management system

(ICAEW, 1997). Risk management arguable is the critical tools in business operation where one of their primary function is to identify and measure the risk associated with the companies. In order to implement a good risk management system in the companies, it was suggested to comprise risk report in the company annual report and present to shareholders and regulators (Zadeh, 2015). It also stated that companies are encouraged to disclose comprehensive risk information to the market as it would assist investors to assess the strategies adopted by companies to mitigate the risk and make an inform decision (Raghavan, 2003).

One of the primary functions of the annual report is to channel information to market to assist current and potential shareholders to make an informed decision. To describe the real situation of the company, an annual report of the company should not only emphasise on the financial information but also focus on disclosing non-financial information (Johansson & Thörnberg, 2011). It was argued that a comprehensive disclosure is important to fulfil the information demands by shareholders, creditors, suppliers, customers and competitors to make their own relevant decisions (Smith, 2006; FAR, 2006). It also stated that the information embedded in the annual report must be reliable and truthful to avoid market failure (Johansson & Thörnberg, 2011). Therefore, to ensure the information disclose in the annual report is reliable, a system must be implemented to control and guide the content of the annual report (Flower, 1999). It was highlighted, in the era of globalisations and integration of capital market, the need for risk reporting is rather important than before due to the internationalisation purpose especially in the fulfillment of accounting rules.

Disclosure according to accounting literature can be defined as the acting from the management for informing the market the positive performance of their company through the annual report (Mohammadi,

2017). In other definitions, the disclosure also can be defined as disclosure of economic information, either quantitative or qualitative, or financial or non-financial (Owusu-Ansah, 1998). In another word, information disclosure is series of activities including the activity standard need to comply the company who intend to publicise certain information to the market such as the process of issuing stock, listing on the market, stock exchange and rules of securities administrative (Tian & Chen, 2009). It was stated that the main purpose of disclosing financial information is to channel useful and valid information to the public, potential investor outside of the companies (Bolo & Hosseini, 2007; Salehi & Azary, 2008). One of the objectives of corporate financial disclosure is to provide important data to shareholders to evaluate the function and the ability of an economic agent to generate profit (Salehi & Abedini, 2008). To ensure the information disclose is capable to assist the shareholders, the information discloses must be comprehensive and capable to be used as the predictor of future economic activities to generate profit (Talebnia et al., 2011). By acknowledging the importance of high-quality information as the mechanism to improve economic agencies functions, prior studies highlighted that high-quality information disclosure could promote company performance by attracting foreign capital (Lambert et al., 2007; Albu et. al., 2014). The study also found that investors especially foreigner investors are reluctant to invest particularly in emerging countries market due to high information asymmetry and lack of compliance with international standards (Mohammadi, 2017).

Cheung et al. (2010) documented that disclosure can be classified into voluntary and mandatory. According to Meek et al. (1995), mandatory disclosure can be defined as the information discloses by the company by abiding one country rules and regulations (Smith & Taffler, 2000). It was argued that mandatory disclosure for listed companies

is quite complicated and demanding. These include an obligation to prepare transparent accounting, financial and operational information (Cheung et al., 2010). While voluntary disclosure can be referred as an owner will action from top management who disclosing extra information in the form of narrative information, tables and graphs to the market, beyond what been required by the regulations (Meek et al., 1995; Smith & Taffler, 2000). In addition, there is no standard format to be followed by voluntary information as the information is included based on the capacity of the management (Clatworthy & Jones, 2001). As the users' number of corporate voluntary disclosure is increasing, the need for voluntary disclosure from companies also significantly increase (Tusin & Hasan, 2014). In addition, it was argued that the level of voluntary disclosure of one company is determined through the culture of society, economic situations and the practice of the management itself. Moreover, Mohammadi (2017) also stated that the information who discloses by the management at their own risk is referred to as corporate voluntary disclosure. It was noted that the effect of voluntary disclosure can be classified into past, current and future impact depending on the situation of the company.

It was argued that due to the critical nature of risk, the authorities who responded to govern and oversee risk reporting and disclosure in companies' annual report have given a considerable amount of focus to the content in the risk reporting (Zadeh, 2015). However, despite the effort given by the authorities, it was found that risk information readiness in the annual report is still inadequate and vague in nature (Linsley, Shrides, & Crumpton, 2006; Abraham & Cox, 2007; Azlan, Rosli, & Hassan, 2009; Oliveira, Lima Rodrigues, & Craig, 2011). As a result, to cope with insufficient risk information embedded in the annual report, users have increased their demand on the availability of risk information embedded in the annual reports to assist them

in making an inform decision (Linsley & Shrides, 2000, 2005; Solomon et al., 2000). In response to an increased demand for comprehensive risk information, regulators and other professional bodies have continuously governed the risk regulations to keep align with the current trend of risk associated by the companies and demand from users (CICA, 2002; ICAEW, 1999, 2002). In Malaysia, the need for risk management and disclosure of the information is clearly published in the Financial Reporting Act 1997 and Bursa Listing Requirement (Azlan et al., 2009). The listing requirement clearly suggested that all listed companies in Malaysia should disclose their financial, operation and management information in their annual reports for the period of time to assist stakeholders and potential investor to examine the company performance (Zadeh, 2015). Therefore, it is expected that by practising a satisfactory level of risk disclosure, it will enhance the performance of the company due to inform decision made by the investors.

PROBLEM STATEMENTS

In relation to 1997 Asian Financial Crisis, the need for a comprehensive and high quality of risk disclosure is significant than before, driving the governments to improve the current policies to keep align with current economic situations and user demands on risk information (Piaw & Jais, 2014; Zadeh, 2015). This has led to the introduction of the National Economic Council (NEAC) in an effort to strengthen the economic growth in Malaysia (Mohd Ghazali & Weetman, 2006). Among NEAC objective plan is to enhance company corporate governance practice, accountability and reduce information asymmetry to attract market investors (Mohd Ghazali & Weetman, 2006).

To evaluate the existing practice of corporate governance in Malaysia and to make an improvement for the practice, NEAC has

announced a high-level finance committee in 1998. In 1999, the Malaysian Code on Corporate Governance (MCCG) was introduced as a guideline for corporate governance best practices. It was argued that in the first stage of introduction of MCCG in 1999, complying with the guideline is rather an option than mandatory (Zadeh, 2015). However, Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange) in 2001 has obligated all listed companies in Malaysia to comply with MCCG requirement by associating risk management and internal control section in companies annual report (Mohd Ghazali & Weetman, 2006). Following the introduction of MCCG in 1999, there is a series of refinements of MCCG practice in 2007, 2012 and latest in 2017.

Further refinement of MCCG in 2017 is arguably bringing a positive impact to the risk disclosure practice in Malaysia. It was clearly suggested in MCCG report 2017 that board of directors should include discussions of key risk in the annual report and disclose whether the adopted risk management framework is in compliance with international standards (MCCG, 2017). It is to note that the present guideline, however, fails to state type of risk framework that should be employed by listed companies in Malaysia to align with international standards when Malaysia still missing their own risk framework. This is opposite with disclosure practice in several countries like US, UK, Germany and Canada whereby their accounting bodies (AICPA, ICAEW, GAS5 and CICA) has clearly stated the treatment for risk information through the established risk framework (Beretta & Bozzolan, 2004). Despite the critics of risk framework for being insufficient and inconsistent due to different institutional context employed (Lajili & Zéghal, 2005; Miihkinen, 2013) it was argued that the presence of guideline itself (whether it is mandatory or voluntary) will enhance the risk management practice among the companies (Lajili & Zéghal, 2005; Zadeh, 2015). Therefore, it is expected that by complying with risk framework, it will bring greater result

to listed companies but at the same time, the possibility for the adopted international standards to incompatible with one country economic environment may exist.

It was stated that the disclosure of risk information is crucial for the company as it does not only lower the information asymmetry, but it also works as a tool to enhance the shareholder's confidence by lowering their uncertainty on company future cash flow (Al-Maghzom, Hussainey, & Aly, 2016). In addition, it by enhancing shareholder confidence on the company performance, it will allow the company to obtain external fund at a cost of capital, which contributes to rapid capital market activities (Kothari, Lu, & Short, 2009). Therefore, to improve transparency and information asymmetry, it is argued that company should not only focus on reporting their business activities, but also reporting the risk they associated or may encounter together with a mitigation plan to reduce the risks (Al-Maghzom, Hussainey, & Aly, 2016).

The previous study reported that a company annual report is suffered from insufficiency and vagueness in term of risk information content (Cabedo & Tirado, 2004). It was highlighted that one of the factors who contributes to the global financial crisis in 2008 is the unavailability of risk disclosure information to investors (Al-Maghzom, Hussainey, & Aly, 2016). Rahman (1998) stated that companies who reluctant to disclose information may restrict the investors to gain sufficient and reliable information to inform decisions. This is supported through study (Solomon et al., 2000) who found that risk reporting among UK listed companies is poor. This, as a result, will impair the ability of the investor to make proper risk judgement due to insufficient risk information discloses who limit the investor's capability to assess company risk profile (Linsley et al., 2008). Inadequate and inconsistency of nature of risk information being disclosed by companies in the annual report have triggered this study to further

examine the factors who might contribute to lower disclosure practice by companies, especially in emerging countries, like Malaysia.

Study conducted by Azlan et al. (2009) and Zadeh (2015) revealed that most of the listed companies in Malaysia tend to disclose risk information at non-financial section of annual report such as chairman statements or 'operation review and management' section whereby this is contradicted of what being issued by MCCG report in 2017 who required all the risk information to be discussed in the SORMIC (Statement of Risk Management and Internal Control). MCCG in their latest guideline (2017) has emphasised the importance of risk management as a mechanism to identify the threat and opportunities and internal control who act as a tool to reduce the threats and secure opportunities (MCCG, 2017). It was argued that the company with sound risk management and internal control is capable of assisting the company to determine the level of risk acceptance and plan necessary mitigation tools to achieve the objectives set. In addition, aside from responsible to govern company risk management and internal control systems, the board of directors also responsible to ensure that the systems are running effectively and capable to mitigate the risk associated. Thus, this study intends to examine whether under the refinement guideline, there is improvement in term of risk disclosure practice by Malaysian listed companies.

In addition, Bursa Malaysia in their current amendment of 2016, has highlighted the importance of disclosing sufficient risk information, particularly the non-financial information such as future information (Bursa Malaysia, 2016). However, it was found that the current practice of disclosure among listed companies in Malaysia is contradicting with the guidelines. In a study conducted by (Zadeh et al., 2016), it was revealed that despite the greater amount of non-financial information being disclosed by Malaysian listed companies, most of the information disclose is vague and

backwards-looking in nature. In addition, it is also observed that there is not much difference in terms of the amount of disclosure between financial and non-financial information among listed companies in Malaysia. For example, Zadeh et al. (2016) recorded that of a mean of 21.809 for financial information and 24.895 for non-financial information.

It also highlighted that failure of corporate governance in monitoring the management also contributed to the poor information asymmetry between shareholders and the management (Norwani, Mohamad, & Chek, 2011). It was stated that one of the main contributors to the failure of 1997 financial crisis and 2008 global financial stress is the poor practice of corporate governance (Mitton, 2002; Akhtaruddin et al., 2009) and dysfunctional of company risk management system (Breitenfellner & Wagner, 2010; Iatridis, 2011). It was documented that this financial crisis not only affects the performance of the companies worldwide, but it rather affects the investor confidence to invest in the market (Akhtaruddin et al., 2009). Following the Financial Crisis Asia in 1997 (Lai, 2004) and recent Global Financial Crisis in 2008 has triggered the Malaysian professional bodies on the importance of having sound governance practice in Malaysian listed companies as it was argued that company value is largely influenced by company governance practice and disclosure policy (Akhtaruddin et al., 2009). It was suggested for companies who wish to enhance their value, it was recommended for the company to start practising high-quality information as investors are willing to burden higher disclosure cost (Mitton, 2002).

Rajab and Schachler (2009) noted that there is less study who focusses on investigating the trend of risk disclosure. It was found that the difference in term of level of risk employed by companies might be contributed by the difference in term of risk regulations practices in each country (Zadeh, 2015). Therefore, it is crucial to examine the trend of risk disclosure

as it is arguably beneficial for the need of the investor in determining the type of risk being disclosed by the companies and come with a mitigation plan (Zadeh, 2015). To the extent of researcher knowledge, there is less study focusing on the trend of risk disclosure especially in emerging countries like Malaysia. Hence, this study intends to investigate the trend of risk disclosure practice in Malaysian listed companies for 10 years and intends to ensure whether the annual reports presented by the companies are align with the mandated guidelines. Zadeh (2015) argued that the need for reviewing disclosure practices is indeed important to ensure the practices are following guidelines set by policies, rules and standard setters.

Schipper (1991, 2007) highlighted that annual report information disclosure could be used as tools to improve shareholders monitoring cost and reduce agency cost as a whole. Moreover, the annual report may act as a mechanism used by the management to convince the shareholders that the company is performing well and reliable. Mohammadi (2017) argued that the company tends to employ disclosure as a medium to reduce agency cost as it is mentioned that disclosure could improve investor confidence and company transparency. Agency theory suggests that agency cost may vary depending on the company corporate governance practices. In addition, future risk information disclosed by the companies will allow the users to understand the associated risk and come up with a mitigation plan to lower the risk effect (Zadeh, 2015). Despite the importance of risk disclosure, it has been noticed that most of the previous risk disclosure studies were conducted in developed countries with strong regulations which could be explained by the positive result attained by those studies (Linsley & Shives, 2005, 2006; Abraham & Cox, 2007; Elshandidy, Fraser, & Hussainey, 2015). This study, however, intent to study risk disclosure from the perspective of a developing country like Malaysia to determine factors who might affect the company disclosure practice.

Zadeh (2015) stated that risk disclosure studies in Malaysia are still under-researched. Mohd Ghazali (2012) analysed the impact of associated risk and ability of risk management system in reducing the problem, while Azlan et al. (2009) employed companies characteristics (industry, leverage, size) to determine their effect with risk disclosure practice among listed companies in Malaysia. Zadeh et al. (2016) in other ways around only examined the level of risk disclosure in Malaysia for a one-year period. It is to note that, past risk disclosure studies in Malaysia showed inconsistency in term of variables choose by the researchers to establish a significant relationship with the company disclosure levels. For example, a study conducted by Azlan et al. (2009), Zadeh and Eskandari (2012) and Zadeh et al. (2016) employed company characteristics in explaining the disclosure levels among listed companies in Malaysia. While, other researchers attempt to explain the disclosure levels by examining both the corporate governance and company characteristics and their relationship with risk disclosure level (Abraham & Cox, 2007; Rajab & Schachler, 2009). This study somehow will solely focus on the effect of corporate governance to risk disclosure practice in Malaysia.

Contradicting with study conducted by Greco (2012) who focusing on developing new risk framework in conjunction to new mandated risk regulation, this study will employ existing risk framework who developed by Lima, Craig and Oliveira (2011) and already being tested in emerging market such as Malaysia and India (Zadeh, 2015; Saggat & Singh, 2017). The risk framework by Lima, Craig and Oliveira, (2011) comprises of three main components, namely; financial, non-financial and risk management whereby each of these risk categories will capture different risk information discloses by the company. It was noted that most of the existing risk disclosure studies tend to employ risk framework developed by Linsley and Shives (2006) and Abraham and Cox (2007) where most of the studies

were conducted in developed countries with perfect market conditions. In addition, it also documented that risk who associated in developing countries may be different from one associated in the developed countries. For instance, study conducted by Linsley and Shrivs (2006) and Elzahr and Hussainey (2012) has divided risk information of UK listed companies into 6 different categories (Financial, Operation, Empowerment, Integrity, Strategic and Information and Technology risk) and documented that integrity risk is one of the highest risk being disclosed by UK listed companies while in the similar study by Azlan et al. (2009) for Malaysian context found that integrity risk is the least risk disclose by the Malaysian listed companies. This has created the need to further investigate the type of risk being disclosed by companies in emerging countries as a risk who may associate by companies in developing countries may not associate in developing countries.

In attempted to further investigate risk disclosure practices in Malaysia, this study aims to clarify the following stated issues:

- a. Incomprehensive and poor-risk information in the annual report of companies may lead the investors to make uninformed decision
- b. Multi-location of risk information and poor future risk information in the annual report of Malaysian listed companies is arguably contributing to lower disclosure by the companies.
- c. Failure of corporate governance is not only decreasing the value of the company and loss of investor confidence, but it also affects company disclosure practice.
- d. Empirical findings of risk disclosure studies mostly focused on identifying the types of risk information disclosed, but studies who focussed on examining the trend of risk disclosure among companies are scant.

RESEARCH QUESTIONS

It was stated by Fraenkel and Wallen (2009) that good research questions should comprise of three criteria namely; concise, understandable and meaningful. It was argued that plausible research questions will lead to a credible hypothesis, resulting in practical and beneficial studies (Salkind, 2009). Through proper generated research questions, the researcher should be able to plan a proper study in an attempt to answer the research questions. To answer the research objectives in the following section, two research questions have been developed as follows:

1. What is the trend of risk disclosure practices among Malaysian listed companies for the last 10 years?
2. Do corporate governance determinants employed by listed companies in Malaysia affect the risk disclosure level?

RESEARCH OBJECTIVES

The stated research objectives are aimed to be answered in this study:

1. To assess the risk disclosure trend in the annual report of Malaysian listed companies from 2008 to 2017;
2. To determine whether corporate governance determinants influence the level of disclosure in the annual report of listed companies in Malaysia.

SIGNIFICANCE OF STUDY

This study intends to explore the level of risk disclosure among listed companies in Malaysia, by examining the amount of risk being disclosed by the companies and the determinants of corporate governance who may affect the disclosure level. Therefore, it is expected that the outcome of this study is capable to explain the following issues;

1. The risk disclosure trend among listed companies in Malaysia.

2. Possible determinants who might affect the level of disclosure among listed companies in Malaysia. It is arguably important as this study intends to explain the variable who rarely employed by the previous studies.

It is expected that the outcome of this study will contribute to the risk disclosure literature align with the first objective of this study who intends to examine the trend of risk disclosure. To the best researcher capacity, there are fewer studies who ventured in examining the risk disclosure trend, particularly in a longitudinal study. Among the objectives of the study is to determine whether there is an improvement in risk disclosure practice among listed companies in Malaysia in the last ten years post the global financial crisis in 2008. Besides, the researcher also intends to investigate the level and the nature of risk information disclosed by the companies (Ali, 2013). Whilst most of the past studies focusing on the relationship between determinants and risk disclosure level among listed companies in developed countries (Deumes, 2008; Hill & Short, 2009; Taylor, Tower, & Neilson, 2010), it is to noted that there are fewer risk studies conducted in developing countries (Azlan et al., 2009; Abdallah & Hassan, 2013). It is expected that at the end of this study, the researcher will be able to develop a risk framework who arguably suitable for Malaysian business environment.

This study also enhances previous disclosure studies by improving the understanding of the risk characteristics. This could be achieved through a deep understanding of risk profiles, the potential determinants and extensive review of the evolution of risk disclosure policies by regulatory and professional bodies for Malaysian listed companies. In addition, this study aims to fulfil the users' demand for risk information by improving company risk management systems (Zadeh, 2015). It was highlighted that the need for high-quality risk

information is not only due to fulfilment of new regulations but it also a reflection to the 1997 Asian Financial Crisis (Azlan et al., 2009; Yunos, 2011; Ali, 2013).

In addition, this study also aims to determine the effect of corporate governance on the level of risk disclosure practices by listed companies in Malaysia. It was noted that the agency theory in this study is explaining the corporate governance (board independence, the board size, board gender, auditor independence, audit tenure, audit committee independence, and audit committee expertise) while another element is explained by signalling theory (level of risk disclosure).

CONCLUSION

It is arguably important for shareholders and potential stakeholders to attain relevant risk information such as risk mitigation plan to allow them to correctly assess the company risk profile for an informed decision. It was stated that public disclosure will train the company to be more selective in disclosing information and intolerance with company unacceptable risk profiles. Therefore, transparency is arguable will improve company corporate governance.

It also suggested that risk information should not be provided through an annual report and it is rather appropriate for the risk information to be found in corporate website as it will increase the timeliness for the information to be disclosed. One of the reasons for a company to keep use annual report as the medium to channel information is due to the public acceptance of the annual report as an important public document. If the annual report keeps continuing to be the primary place for the company to channel information, therefore, an improvement in risk reporting is necessary. At present, risk information embedded in the annual report is incomprehensive and rather vague in nature. It was not denied that some useful information

is provided through an annual report but yet, the information must be supplemented with another additional information for the information disclosed to be useful to their own characteristics. Therefore, it was arguably crucial for the company to improve transparency to allow the market to correctly assess the company risk profile and come up with a mitigation plan when needed.

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