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AUDIT COMMITTEE EXPERTS AND MANDATORY DISCLOSURE TRANSPARENCY OF MALAYSIAN GOVERNMENT LINKED COMPANIES

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Abstract

Transparency has been acknowledged as one of the approaches which is more direct and observable to assess financial reporting quality. Underlying this is a belief that different areas of expertise enhance the effectiveness of audit committee and, by extension, the mandatory disclosure transparency. Hitherto, many studies did not specifically examine the composition of audit committee expertise in depth as they simply used working experience as a proxy to measure expertise. This study primarily investigates the association between audit committee experts and mandatory disclosure transparency of Malaysian GLCs. Three fundamental types of expertise examined in details are experience, advanced academic qualification and training. Regarding experience, it is further categorised into accounting financial experts, finance experts and supervisory experts. To achieve this objective, a quantitative-positivist approach has been employed in this study wherein the mandatory disclosure index has been developed and corporate reports of 10 GLCs for the period of 2009-2017 have been analysed. Using multiple regression analysis on data collected, the results show that accounting financial experts, finance experts, supervisory experts and advanced academic qualification have a significant positive influence on the mandatory disclosure transparency. However, there is no evidence that training affects mandatory disclosure transparency. This study is important as it provides additional knowledge about the impact of having audit committee experts in enhancing mandatory disclosure transparency. It offers an ample scope for further improvement for the Malaysian government and regulators to revise and incorporate this study's outputs into the current standards and policies.

Keywords: Audit committee, expertise, mandatory disclosure transparency, disclosure index, GLCs, Malaysia.

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1. Introduction

The role of audit committee has dramatically increased due to the propagation of corporate collapses in recent years as well as the occurrence of the Asian financial turbulence in 1997/1998. These incidences have revealed severe shortcomings in corporate governance as well as in transparency and disclosure practices. In particular, the lack of transparent financial reporting with inexpert audit committee as a hawk-eyed on financial reporting processes are a global phenomenon, whose need to be enhanced exponentially (Sallehuddin et al., 2017). Accordingly, the governments and regulators around the world should spearhead an initiative on finding a more effective and efficient governance mechanism. Malaysia being no exception. Generally, the audit committee that consists of expert directors could be a valuable form of monitoring in promoting corporate disclosure transparency (Madi et al., 2014).

The corporate disclosure transparency is one of the tools that has been evolved to reduce information asymmetry between managers and shareholders, thus lowers the agency costs (Akhtaruddin & Haron, 2010). Alanezi and Albuloushi (2010) further elucidated that the formation of audit committee has been suggested as a feature in explaining variations in the extent to which disclosure is required. In other words, the audit committee acts as a mechanism to diminish agency costs by inducing managers to disseminate more corporate information. Basically, corporate disclosure transparency can be translated as the availability of relevant information particularly on firm specific information, which can be grouped into two parts, namely, mandatory disclosure and voluntary disclosure (Fathi, 2013). There are several disclosure vehicles used by the companies to furnish corporate information to various stakeholders such as annual reports, conference calls, analyst presentations, investor relations, interim and quarterly reports, prospectuses, press releases and websites.

However, the scope of this study is only focused on aspects of mandatory disclosure in the annual reports of Government Linked Companies (GLCs) in Malaysia. Hence, the present study refers corporate disclosure transparency as the mandatory disclosure that prescribed by laws, the stock exchange and accounting standards (Abdullah et al., 2013). The annual report is the most important medium of external disclosure including mandatory disclosure and it becomes the focus of disclosure index, where a wide range of mandatory disclosure items might be found therein. As such, the characteristics of inexpert audit committee may be reflected in companies where the event of departure from the mandatory disclosure requirements or the lower level of mandatory disclosure are occurred. This relationship is assumed to be established as one of the distinctive responsibilities of the audit committee is monitoring the compliance with the mandatory disclosure requirements (Alanezi & Albuloushi, 2010).

The outcomes of this study may assist the Malaysian government and regulators to monitor and strengthen enforcement mechanisms in Malaysia. They may impose penalties for those companies contravene the reporting requirements. Further, it would also give them a signal to acknowledge other relevant audit committee expertise as a prerequisite for audit committee memberships. This paper is structured in sequence order. The next section discusses problem statement. Section 3 presents research questions followed by section 4 on purpose of the study. Section 5 describes the research methods, while section 6 presents the findings. Finally, section 7 concludes the paper.

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2. Problem Statement

In 2017, a report undertaken by Malaysian Institute of Corporate Governance revealed that the transparency in corporate reporting among Malaysia's top 100 public listed companies are still below satisfactory level and far reaching from the expected standards. Such outcomes are supported by a robust evidence by Abdullah et al. (2013) which argued that the activities of enforcement bodies are lax and insufficient, although the mandatory disclosure requirements in Malaysia appear to be well written in the laws. It contradicts with the mandatory disclosure requirements that upholds the notion that disclosure transparency is essential element to facilitate users' decision-making process. Besides, Menozzi et al. (2010) highlighted on the presence of politicians on the boards, which found to be pervasive in larger firms. To be specific, the significant government ownership in GLCs would give the government a power to appoint the board members, hence explaining on the existence of inexpert and politically-affiliated audit committee members on GLCs board. Consequently, the intermingle between the role of political powers and business powers would beget serious repercussions on corporate decision-making.

As far as the present study is concerned, there is a scant literature on mandatory disclosure practices in Malaysia. Moreover, there is a remarkable gap in prior literature when none of the studies conducted in Malaysia has considered and focused specifically in the context of the GLCs. Indeed, the GLCs have its own unique characteristics of its government ownership. Meanwhile, pertaining to audit committee expertise, most prior research generally did not explore the areas of expertise in details. In fact, they simply used working experience in accounting or finance as a proxy to measure audit committee expertise (see Appuhami & Tashakor, 2017; Salleh et al., 2017). Thus, the existing definition and measurement of expertise may need to be revised and analysed as merely having working experience may be inadequate to be categorised as expert directors. Perhaps defining expertise may need to be expanded rather than solely relying on working experience.

3. Research Questions

The aforementioned issues have led to the formation of the following research questions:

1. What is the level of mandatory disclosure transparency in Malaysian GLCs?
2. Do the audit committee experts affect the mandatory disclosure transparency in Malaysian GLCs?

4. Purpose of the Study

The purpose of this study is twofold. First, to investigate the level of mandatory disclosure transparency in the annual reports of Malaysian GLCs over a period of nine years. It has been measured by referring to the established mandatory index purposely to see on how these companies comply with mandatory disclosure requirements as codified in the laws, the stock exchange and accounting standards. Second, to examine the relationship between audit committee experts and mandatory disclosure transparency of Malaysian GLCs. There are three main proxies of expertise that have been examined in

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details, namely, experience, advanced academic qualification and training. Regarding experience, it is further categorised into accounting financial experts, finance experts and supervisory experts.

5. Research Methods

5.1. Literature Review and Hypotheses Development

Transparency has been described as one of the approaches which is more direct and observable to assess the quality of financial reporting. The stakeholders and a firm would gain benefits from enhanced transparency as it will act as a panacea in eradicating the information gap between both parties. From agency theory perspective, audit committees serve as an intermediary between both parties of which effective aud committees would lead to transparency of mandatory disclosure (Eyenubo et al., 2017). The inclusion of audit committees seems beneficial as they possess two characteristics that allow them to perform their monitoring function effectively, namely expertise and independence (Islam et al., 2010).

However, it is critical to formulate the right combination of audit committee expertise as most of the studies simply measured the expertise as those who have working experience either in accounting or finance (see Salleh et al., 2017). Hence, the new measures on expertise have been introduced, namely academic qualification (see Nelson & Devi, 2013) and training (see Azmi et al., 2013). Regarding experience, a broader definition is employed by concentrating on accounting financial experts, finance experts and supervisory experts (see Kusnadi et al., 2016).

5.1.1. Audit Committee Experience

Audit committee experience has been given considerable attention in the prior research as it is effective in performing vigilant monitoring in order to produce more transparent corporate disclosure. Some researchers have investigated the influence of three types of audit committee experience on financial reporting quality. Pertaining to accounting financial experts, Sellami and Fendri (2017) found that this expertise is associated with mandatory disclosure. Regarding the non-accounting financial experts, Ghafran and O'Sullivan (2017) documented that audit committee with finance expertise and supervisory expertise are associated with higher audit quality, due to their role in improving the transparency of financial reporting. Therefore, this study postulates that the audit committee with experience either in accounting or non-accounting would provide substantive monitoring which would lead to more transparent corporate disclosure. Accordingly, the following hypotheses are formulated:

H1: There is a significant and positive relationship between audit committee accounting financial expertise and mandatory disclosure transparency.

H2: There is a significant and positive relationship between audit committee finance expertise and mandatory disclosure transparency.

H3: There is a significant and positive relationship between audit committee supervisory expertise and mandatory disclosure transparency.

5.1.2. Audit Committee Advanced Academic Qualification

Prior literature specifically in education lends support in using academic qualification as one of the measures of audit committee expertise (Nelson & Devi, 2013). The directors would be potentially unique

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in their capacity for knowledge, availability and independence. Yasin and Nelson (2012) postulated that this expertise is associated with financial reporting quality. Further, Francis, Hasan and Wu (2016) documented that the audit committees with academic qualification exert a positive impact financial reporting quality. Therefore, this study postulates that the audit committee with advanced academic qualification would provide superior oversight on the financial accounting processes, ultimately lead to improvement in transparency of corporate reporting. Accordingly, this study proposes the following hypothesis:

H4: There is a significant and positive relationship between audit committee advanced academic qualification and mandatory disclosure transparency.

5.1.3. Audit Committee Training

The revised Bursa Malaysia Listing Requirements (BMLR) have emphasised on the need of audit committee members to undertake continuous training to keep abreast of developments in relevant accounting and auditing knowledge. Although there is no study that directly links the association between audit committee training and mandatory disclosure transparency, there are some studies that have examined the effect of training on the other areas. A recent study by Borlea et al. (2017) reported that no significant relationship between board training and financial performances of Romanian companies. Wu (2013) reported that board training is positively related to financial performances of Taiwanese companies. Besides, under the Malaysian context, Azmi et al. (2013) showed that the audit committee training could have an impact on the lower audit fees. Therefore, this study argues that substantial trainings provided to the audit committee members would expose them to accounting knowledge and other skills commensurate with the complexities of the firms which could lead to a higher transparency of corporate disclosure. By extrapolating these arguments into the relationship between audit committee training and mandatory disclosure transparency, the following hypothesis is conjectured:

H5: There is a significant and positive relationship between audit committee training and mandatory disclosure transparency.

5.2. Population, Sample and Data Collection

A quantitative-positivist research philosophy has been adopted to answer the research questions. Data of this study is based on the GLCs listed on the Bursa Malaysia and involved in GLC Transformation Program (GLCT), which is known as G20. Currently, G20 is a group of 17 GLCs. After eliminating two delisted companies and five GLCs in the finance industry, the final sample of 10 listed GLCs for the year 2009 until 2017 are analysed. The panel data technique is applied, resulting a total of 90 firm-year observations. In the process of collecting data, this study used secondary data from the corporate reports, consisting of annual reports, integrated annual reports and sustainability reports.

5.3. Development of Mandatory Disclosure Index

The development of mandatory disclosure index begins with the selection of reliable mandatory items, by referring to the existing disclosure indices from the previous studies (see Akhtaruddin, 2005; Hossain, 2008) as well as the established checklist instrument from a Big-4 accounting firm (Ernst & Young

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and KPMG) and legal requirements from BMLR and Companies Act 2016. The selection of items covers the whole content of the corporate reports by considering the availability and relevancy of information. In total, a complete list of 110 mandatory items is identified. Table 01 shows the distribution of 110 mandatory items across the corporate reports.

Table 01. Distribution of Mandatory Disclosure Index Items

Category Title	No. of Item	Percentage (%)
(A) General corporate disclosure	11	10
(B) Statement of financial position information	35	32
(C) Statement of profit and loss information	19	17
(D) Corporate governance	30	27
(E) Accounting policies	15	14
Grand Total	**110**	**100**

*The disclosure index is available upon request from the corresponding author.

The items of information are numerically scored on an unweighted and a dichotomous basis. The unweighted approach is employed based on the assumption that each item is considered equally important, thus given the same scores (Akhtaruddin, 2005). The items of information are numerically scored on a dichotomous basis either by assigning one (1) score if disclosed in the corporate reports, or zero (0) score if otherwise. If a particular item is irrelevant to a sample company, a non-applicable (NA) score is given. Next, disclosure scores for each sample firm is calculated as follows and it is expressed in ratio:

$$\mathbf{MADTRA = ACTD / MXTD}$$

Where:

MADTRA = The value of the mandatory disclosure transparency score for each firm.
ACTD = The number of items each firm actually disclosed.
MXTD = The expected maximum number of items disclosed by each firm.

5.4. Regression Model and Variables Defined

The Ordinary Least Squares (OLS) regression model is employed to investigate the relationship between audit committee experts and mandatory disclosure transparency. The following regression equation is estimated for this study:

$$MADTRA = \beta_0 + \beta_1 ACCEX + \beta_2 FINEX + \beta_3 SUPEX + \beta_4 ADVAQ + \beta_5 TRAIN + \beta_6 INDEP + \beta_7 ACSIZ + \beta_8 TNURE + \beta_9 FIRPE + \beta_{10} FILEV + \beta_{11} FISIZ + \varepsilon$$

Table 02 summarises all variables used in the model above.

Table 02. Measurement of Variables

Variable (Notation)	Measurement of Variable
Dependent Variable Mandatory disclosure transparency score (MADTRA)	The ratio of the total actual disclosure scores to the maximum expected disclosure scores.

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Independent Variables Audit committee accounting financial experts (ACCEX)	The proportion of audit committee members who are accounting financial experts (has working experience as Certified Public Accountant (CPA), Chief Financial Officer (CFO), Chief Accounting Officer (CAO), auditors, vice presidents of finance, financial controller or any other positions in accounting or auditing field, or a member of professional accounting body) to total number of audit committee members.
Audit committee finance experts (FINEX)	The proportion of audit committee members who are finance experts (has working experience as an investment banker, chief investment officer, financial analyst or any other corporate finance role) to total number of audit committee members.
Audit committee supervisory experts (SUPEX)	The proportion of audit committee members who are supervisory experts (has working experience as the CEO, general partner, managing directors, COO or chairman of the board in a for-profit corporation) to total number of audit committee members.
Audit committee advance academic qualification (ADVAQ)	The proportion of audit committee members with advanced academic qualification (has master's degree or doctorates) to total numbers of audit committee members.
Audit committee training (TRAIN)	The average of all trainings attended during the financial year by audit committee members.
Control Variables Audit committee independence (INDEP)	The proportion of independent directors that occupy positions on the audit committee to total numbers of audit committee members.
Audit committee size (ACSIZ)	The number of directors on the audit committee.
Audit committee tenure (TNURE)	The average length of tenure of independent audit committee members.
Firm performance (FIRPE)	ROA, the ratio of earnings before interest and taxes to total assets.
Firm financial leverage (FILEV)	The ratio of total liabilities to total assets.
Firm size (FISIZ)	The natural logarithm of book value of total assets.

6. Findings

6.1. Descriptive Statistics and Correlations

Table 03 displays the descriptive statistics for all variables. The results for mandatory disclosure transparency score indicate the highest score achieved by a firm is 97.3% and the lowest score is 86.9%. The mean of mandatory disclosure transparency score is reasonably high, which is 93.4% out of the 110 items. In spite of this achievement, this value poses the question as to why the GLCs' mandatory disclosure transparency score is yet to achieve a full score, where Malaysia is apparently under a regulated reporting environment. Several clarifications are possible. First, it may be due to inadequate enforcement mechanisms (Abdullah et al., 2013). Second, some companies may have disclosed items by using other media such as company's website and/or press releases, where these media do not form part of this study's data collection.

Table 03. Descriptive Statistics for All Variables

Variable	Mean	Minimum	Maximum
MADTRA	0.934	0.869	0.973
ACCEX	0.431	0.200	0.800
FINEX	0.199	0.000	0.000

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SUPEX	0.562	0.000	1.000
ADVAQ	0.346	0.000	1.000
TRAIN	7.663	0.000	20.000
INDEP	0.810	0.667	1.000
ACSIZ	3.744	3.000	6.000
TNURE	5.871	1.000	21.000
FIRPE	0.059	-0.134	0.159
FILEV	0.544	0.225	0.779
FISIZ	10.148	8.935	11.452

On average, 43.0% and 20.0% of audit committee members have accounting financial expertise and finance expertise, respectively. The results reflect that the GLCs comply with the requirements of the BMLR and revised MCCG on having audit committee member with relevant accounting or finance qualifications and expertise. Meanwhile, the average score for the supervisory experts is 56.0%, which stipulates that a significant number of audit committee members have supervisory expertise. Next, the mean value of 34.6 % for advanced academic qualification asserts that the audit committee have either a master's degree or doctorates. For training, the average number of trainings attended is eight, thereby indicating that the GLCs follow the revised MCCG's recommendations on the need to undertake continuous training.

For control variables, the vast majority of the sample firms is composed with independent directors, with the mean value of 81.0%. The average of audit committee size is 4 members, ranging from 3 to 6 members. The average audit committee tenure is around 6 years, thus fulfilling the revised MCCG's recommendation to have a cumulative term of up to 9 years. Next, the mean value for the firm performance is 5.2%, ranging from -13.4% to 15.9%. The financial leverage ranged from 22.5% to 77.9%, averaging 54.4%, whilst the firm size which calculated by the natural log of total assets, it ranges from 8.94 to 11.45 with an average score of 10.15.

Table 04. Pearson Correlation Analysis Results

Variable	1	2	3	4	5	6	7	8	9	10	11	12
1. ACCEX	1											
2. FINEX	.400**	1										
3. SUPEX	.124	-.019	1									
4. ADVAQ	-.109	.181	.207	1								
5. TRAIN	.231*	-.177	-.145	.144	1							
6. INDEP	-.301**	-.352**	.387**	.037	-.016	1						
7. ACSIZ	.189	-.040	.339**	.027	.238*	.250*	1					
8. TNURE	-.228*	-.368**	-.509**	-.478**	-.122	-.244*	-.347**	1				
9. FIRPE	.080	.063	-.120	.040	-.056	-.141	-.136	-.077	1			
10. FILEV	-.020	-.099	.022	-.053	.012	.046	.141	.120	-.398**	1		
11. FISIZ	.197	-.078	.125	-.162	.054	-.046	.360**	.069	.062	-.004	1	
12. MADTRA	.375**	.496**	.365**	.096	-.281**	-.124	.148	-.146	.058	.068	.406**	1

Notes: The sign * and ** represent significance levels (two-tailed) at 5 percent and 1 percent, respectively.

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Table 04 presents the results of the correlation analysis. The MADTRA is positively and significantly correlated with four variables *p* < 0.01 (ACCEX, FINEX, SUPEX, FISIZ). Four variables are positively correlated with MADTRA, but not significant *p* > 0.05 (ADVAQ, ACSIZ, FIRPE, FILEV). Meanwhile, three variables (TRAIN, INDEP, TNURE) have a negative association with MADTRA.

6.2. Regression Results

Table 05 presents the results of OLS regression analysis examining on the association between audit committee experts and mandatory disclosure transparency. It is apparent that the F-value is 14.218 (P=0.000), which indicates that the model estimate fits the data at an acceptable level. The R-square of 66.7% and the adjusted R-square of 62.0% suggest the variations in mandatory disclosure transparency score explained by all variables are quite moderate.

Table 05. OLS Regression Results

	Coefficient	Standard Error	Beta t values	Significance	VIF
Intercept	-0.668	0.266	-2.512	0.014	
ACCEX (+)	0.193	0.094	2.061	0.043**	1.826
FINEX (+)	0.460	0.076	6.029	0.000***	2.084
SUPEX (+)	0.266	0.059	0.415	0.000***	2.012
ADVAQ (+)	0.129	0.056	2.312	0.023**	1.566
TRAIN (+)	-0.005	0.003	-1.920	0.059*	1.599
INDEP	0.106	0.116	0.910	0.366	1.715
ACSIZ	0.000	0.023	0.018	0.986	1.642
TNURE	0.015	0.004	3.436	0.001***	2.773
FIRPE	0.520	0.357	1.456	0.149	1.310
FILEV	0.221	0.127	1.744	0.085*	1.236
FISIZ	0.118	0.024	4.959	0.000***	1.324
R-Squared	0.667				
Adjusted R-Squared	0.620				
F	14.218				
Sig	0.000				

Notes: The expected signs for each of the independent variables are presented in parentheses. Unstandardised coefficients are reported. The sign *, ** and *** represent significance levels at 10 percent, 5 percent and 1 percent, respectively.

As the study is concerned with the individual effect of explanatory variables on the mandatory disclosure transparency, the presence of multicollinearity is observed by using the correlation matrix and variation inflation factor (VIF). Based on the Pearson correlation analysis in Table 04, none of the variables are found to be exceeding the critical level of 0.90 (Appuhami & Tashakor, 2017). Likewise, the VIF scores as depicted in Table 05 are found to be below the threshold value of 10 (Madi et al., 2014). Thus, these results support the lack of presence of multicollinearity. Consequently, the results from the regression analysis can be interpreted with a high degree of confidence.

In respect of expertise variables, the results show that the audit committee accounting financial experts is significantly and positively associated with mandatory disclosure transparency. Hence, the H1 is supported. This is in line with the findings by Kusnadi et al. (2016). In this respect, it can be argued that

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the audit committees are effective in recognising potentially misleading transactions and detecting anomalies in corporate reporting, which could enhance the corporate transparency. The findings also indicate that the audit committee finance experts is found to be significantly and positively correlated to the extent of mandatory disclosure transparency. Therefore, the H2 is supported. This result reinforces the findings from Ghafran and O'Sullivan (2017). Although finance experts normally have inadequate understanding of accounting matters, they may assist in deciding whether the accounting methods truly reflects the economic substance of transactions.

With regard to audit committee supervisory experts, the results show that it is positively associated with mandatory disclosure transparency. Thus, the H3 is supported. This result corroborates the findings in Ghafran and O'Sullivan (2017). The derivation of such expertise via experience on supervising financial reporting responsibilities and overseeing the performance of companies may motivate the corporate management to adhere with mandatory disclosure requirements. The regression results also indicate a significant and positive association between audit committee advanced academic qualification and mandatory disclosure transparency, thus supporting H4. This finding is in agreement with Yasin and Nelson (2012). In detail, the result is consistent with the agency theory argument that this expertise is an effective corporate governance mechanism that could enhance mandatory disclosure transparency.

On the other hand, the audit committee training is significantly associated with mandatory disclosure transparency, but the sign of the coefficient is not as predicted. Hence the H5 could not be supported. In terms of the control variables, the statistical result shows that audit committee tenure, firm financial leverage and firm size have significant association with mandatory disclosure transparency. Meanwhile, audit committee independence, audit committee size and firm performance show an insignificant influence on mandatory disclosure transparency.

7. Conclusion

This paper investigates the relationship between audit committee experts and mandatory disclosure transparency in the corporate reports of Malaysian GLCs. Three fundamental types of expertise examined in this study are experience, advanced academic qualification and training. Furthermore, this study also controls for the variables as suggested in previous literature in order to avoid a spurious relationship between dependent variable and independent variables. This study has developed the mandatory disclosure index that contains 110 mandatory items purposely to measure the mandatory disclosure transparency score on a sample of 10 Malaysian GLCs for the period of nine years, beginning 2009 until 2017.

The results obtained stipulate that the audit committee accounting financial experts, audit committee finance experts, audit committee supervisory experts and audit committee advanced academic qualification have significant impact on mandatory disclosure transparency. Consistent with the existing studies, these results support the agency theory. This study is important as it provides additional knowledge about the impact of having audit committee experts in enhancing mandatory disclosure transparency, and it offers an ample scope for further improvement, where the Malaysian government and regulators may consider on the necessity to revise and incorporate this study's outputs into the current standards and policies.

This study has a number of limitations as well. First, this study is limited to G20 companies that listed on the Bursa Malaysia. The results may not extend across the other firms in Malaysia. Second, this

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study only considered the corporate reports and the other useful media have been omitted. Therefore, the aforementioned limitations identified could become the basis for future studies. First, future researchers may focus on all GLCs regardless whether they are grouped under listed or non-listed in Bursa Malaysia. In addition, future researchers are encouraged to investigate the extent of corporate disclosure transparency published in other media such as quarterly financial reports or information provided though the GLCs' websites.

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