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The Association Between Committees Responsible for Risk Management and the Disclosure Level of Financial Instruments Information Among Listed Companies in Malaysia

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ABSTRACT

Low-level disclosure of financial instruments information may lead to information asymmetry between managers and investors, and subsequently mislead investors when making their decisions and also raise agency problems. This thesis investigates the disclosure level of financial instruments information of companies which are listed on the main board of Bursa Malaysia (Malaysian Stock Exchange). The purpose of the thesis is, from an agency theory perspective, to explore the association between Committees Responsible for Risk Management (CRfRM) and the disclosure level of financial instruments information. The study mainly focuses on three committees responsible for risk management: Risk Management Committees (RMC), Internal Audit (IA), and Outsourced Internal Audit (OIA). In this study, we measure the disclosure level based on an index that developed based on *FRS 132 Financial Instruments: Presentation and Disclosure*. The results indicate that, on average, the disclosure level of financial instruments information in 2008 was low, as it has slightly decreased compared to 2003. The results also indicate that the effectiveness of CRfRM among companies in Malaysia can still be questioned.

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LIST OF ABBREVIATIONS

AR	Annual Report
CFO	Chief Financial Officer
e.g.	<i>(exempligratia)</i> ; for example
et al.	<i>(et alia)</i> ; and others
FRS	Financial Reporting Standard
IASB	International Accounting Standards Board
JPK1	(In Malay: Jawatankuasa Pengurusan Korporat) The Working Group on Best Practices in Corporate Governance
KLSE	Kuala Lumpur Stock Exchange
MASB	Malaysian Accounting Standards Board
NACD	National Association of Corporate Directors
NYSE	New York Stock Exchange
OECD	Organization for Economic Co-operation and Development
SEC	Securities and Exchange Commission
viz.	as follows, namely

TABLE OF CONTENTS

1.	Introduction	1
2.	Problem Statement.....	2
3.	Research Objectives.....	4
4.	Frame of Reference.....	4
4.1	Agency Theory.....	4
4.2	Disclosure Level of Financial Instruments Information	5
4.3	Corporate Governance.....	9
4.3.1	The Code on Corporate Governance in Malaysia	11
4.4	Committees Responsible for Risk Management (CRfRM) & Hypothesis Development	12
4.4.1	Enterprise Risk Management (ERM)	12
4.4.2	Risk Management Committee (RMC)	13
4.4.3	Internal Audit (IA).....	14
4.4.4	Outsourced Internal Audit (OIA)	16
5.	Methodology.....	17
5.1	Sample Selection & Data Collection.....	17
5.1.1	Data Collection Procedure	18
5.2	Measurement of Variables & Data Analysis	26
6.	Findings	27
6.1	Disclosure Level of Financial Instruments Information	27
6.2	Committees Responsible for Risk Management (CRfRM)	30
6.3	The Association between CRfRM and Disclosure Level of Financial Instruments Information	31
7.	Conclusions	37
8.	Limitations and Future Research	38
9.	References	39
10.	Appendices.....	44
	Appendix 1: Financial Instruments Information Disclosure Index.....	44
	Appendix 2: The Malaysian Code on Corporate Governance	48

LIST OF FIGURES:

Figure 1: Descriptive statistic of disclosure level of financial instruments information in 2008.....	28
Figure 2: Disclosure level for the year of 1999, 2000, 2002, 2003 and 2008	28
Figure 3:The trend of disclosure level of financial instruments	29
Figure 4:The average of FI information disclosure level (by components)	30
Figure 5:The total number of companies use IA as CRfRM	31
Figure 6:The total number of companies use OIA as CRfRM.....	31
Figure 7:The total number of companies use RMC as CRfRM	31
Figure 8:Mann-Whitney U Test.....	32
Figure 9:Pearson Correlation Matrix.....	34

1. Introduction

Asian financial crisis in 1997 and 1998 has brought a huge impact on the systems, regulations and governance worldwide. RekaPacific Berhad was one of Malaysian companies that were reported to have significant impact from the crisis. The company began to step in problem when fraud and wrongdoings were committed by its former director and former solicitor in 1997. The advent of the crisis in 1997 then led the existing agency problem to be worst and the company had to bare massive losses due to the severe stock market downfall. In 2001, the company has been de-listed by KLSE (now known as Bursa Malaysia) from the official list. Even though there was no big disruption reported in Malaysia, however the effect is indeed suffered by most Malaysian industry. Therefore, many parties in business society started to realize the importance of taking preventive actions and increase their awareness of risk management to avoid corporate disaster and unexpected business failure (Yatim, 2009).

Preventive actions, like enforcing regulations and rules, issuing high-quality accounting standards and strengthening corporate governance within companies, have been taken as a way to remedy the negative impact from financial crisis and agency problem. Furthermore, many parties in business society started to pay more attention on how to promote information transparency (Patel et al. 2002) as information transparency may reduce information asymmetry between management and principal and eventually evade the company from disaster, loss and risk exposure.

In Malaysia, in order to promote information transparency, regulation bodies like the Malaysian Securities of Commission (SC) has issued various statutory legislations and non-legislative rules, such as The Bursa Malaysia Listing Requirements. The Bursa Malaysia Listing Requirements mandate all listed companies to disclose their compliance with The Code on Corporate Governance in the annual reports. This action is profoundly significant to strengthen the effectiveness of internal governance while effective governance is synonym with promoting transparency in a company (Bhimani, 2009; Haniffa & Cooke, 2002; Dechow et al., 1996).

Moreover, best practices of corporate governance are more proactive and employed structured approach to identify, measure and manage risk within a company. Rising corporate governance focus in risk management issues leads to higher risk management awareness among board committees such as finance, risk management and audit (Yatim, 2009).

Therefore, this study explores the association between committees which are assigned to help the Board in managing risk, hereafter refer as Committees Responsible for Risk Management (CRfRM), and the disclosure level of financial instruments information from an agency theory perspective. This study mainly focus on three committees comprise of Risk Management Committees (RMC), Internal Audit (IA), and Outsourced Internal Audit (OIA). We measure the disclosure level based on an index developed from *FRS 132 Financial Instruments: Presentation and Disclosure*. Besides, this study also provides evidence on disclosure level of financial instruments information after the adoption of FRS 132, and compares it with previous study by Hassan et al. (2008). Apart from that, it shows a picture of corporate governance practices adopted by Malaysian listed companies. Thus, this study makes significant contributions to the corporate governance and financial reporting literature.

The remaining sections of this study are organized as follows: Section two and three explain our problem statement and research objectives respectively. Section four develops literature references used in this study. Section five describes the methodology undertaken and research findings are presented in section six. Section seven and eight show our conclusions and limitation as well as future research respectively.

2. Problem Statement

The Asian financial crisis in 1997 and 1998 has taught business society about the key to survive in fluctuate global business environment through establishing an effective corporate governance and risk management (Francis & Anthony, 1999). Effective corporate governance is even more crucial nowadays due to agency problem which increases the gap of information between management and principal that tends to expose the principal to make wrong decisions.

Following the crisis, the first issuance of The Code on Corporate Governance (The Code) in 2000 and later revised version in 2007 are actually regarded as an effort to remedy the main problem of many Malaysian companies during the crisis *viz.* poor governance (Norman et al, 2005) and low transparency of company (Aghevli, 1999).

The Code states as principle that the board of directors should maintain a sound system of internal control and the need for proper risk management as its critical element (Bursa Malaysia, 2000). The board of directors as stated on The Code also should identify principal risks and ensure the implementation of appropriate system to manage risk. In order to have proper risk management, The Code recommends the board to establish RMC (Yatim, 2009) or any committees that would be responsible on risk management. As the companies are given a leeway to choose committees that responsible for risk management, therefore we found there are varieties of CRfRM have been assigned by companies in practice such as RMC, IA and OIA. The function of these committees are not only to help the board to identify, measure and manage the risk (Francis & Anthony, 1999) but also need to inform and channel the relevant information to the governing bodies (the Board and audit committee) to be disclosed in the annual report.

Patel et al. (2002) and Hassan (2004) emphasize the significance of financial information disclosure to mitigate agency problem and avoid companies from high risk exposure. Adopting their findings, we assume any kind of information related to financial risk is the most significant to be disclosed and hence motivates us to examine the disclosure level of financial instruments information. The research by Patel et al. (2002) motivates us even more to investigate on how to strengthen the effectiveness of corporate governance. Besides, what appeals most is when its result shows that in spite of increasing attention on corporate governance after the Asian crisis, the level of disclosure in emerging markets at the end of 2000 in Asian countries include Malaysia was still low. Hassan et al. (2008) also confirms the low disclosure by illustrating the result of disclosure quality of financial instruments from 1999 to 2003 among listed companies in Malaysia, which was on average only 33.49%. This low disclosure level demonstrates the

importance of this study to be conducted, thus contribute this knowledge in relevant research area which is still quite scarce in Malaysia.

Considering all the situations and problems that we mentioned, the issue is “does the chosen CRfRM is an effective corporate governance mechanism to increase the disclosure/transparency of financial instruments information of the company?” Hence, this study will answer this issue and anticipate that, to large extent, it is relevant to the external governance (e.g. Law/Regulations setting bodies) and to the internal governance (e.g. The Boards of Directors) in Malaysia.

3. Research Objectives

The research question in our study is defined as, **“What is the association between Committees Responsible for Risk Management (CRfRM) and the disclosure level of financial instruments information in Malaysia?”**

To further investigate the question, two research objectives are going to be addressed in the paper: first, to determine the disclosure level of financial instruments information among listed companies in Malaysia in 2008; second, to investigate the association between Committees Responsible for Risk Management (CRfRM) and the disclosure level of financial instruments information.

In other words, we are going to look into the effect of the chosen CRfRM approach on the disclosure level of financial instruments which subsequently enhance the transparency among listed companies.

4. Frame of Reference

4.1 Agency Theory

Agency theory is a model that suggests a direct link between performance and board compositions. As a result of information asymmetries and self-interest, principals barely trust their agents and will seek to resolve these concerns by putting in governance mechanisms to align the interests of agents with principals and to reduce the scope for information

asymmetries and opportunistic behavior. An agency relationship is created when shareholders authorize managers to delegate decision-making. In an agency relationship, agency problems exist when the principal and the agent have conflicting goals. In the research, Verrecchia (2001) summarized three main solutions for the agency problem, and here we only consider one of them, which association-based actions are taken by the principal (corporate governance) to reduce the agency costs.

Patel et al. (2002) linked the transparency with the agency problem and declared that financial literatures have analyzed the agency problems arising from the asymmetric information between a firm's management and financial stakeholders for over 75 years, with an increasing focus over the last 25 years. The attention on transparency and disclosure has been attracted since the wake of the Asian crisis in the latter half of 1997 and it continues with the recent discussions in the US equity markets.

Patel et al. (2002) also asserted that the agency problem in corporate governance can be mitigated in practice by timely and adequate disclosure of financial information. Since the disclosure is very essential, and therefore, our study is interested to measure the disclosure of financial instruments information among listed companies in Malaysia in 2008, which is more or less ten years after the Asian Crisis and link it to the corporate governance issue.

4.2 Disclosure Level of Financial Instruments Information

Numerous researches which have been done in the disclosure area use term of "disclosure quality" to refer how much information has been disclosed by companies to stakeholders (Lambert et al., 2007; Patel et al., 2002; Brown & Hillgeist, 2006; Hassan, Percy & Goodwin, 2004), While some other research use "disclosure level" in their studies (Botosan, 1997; Poshakwale & Courtis, 2005; Jensen, 2002).

As disclosure quality is quite subjective and very difficult to assess (Beattie et al., 2004; Botosan, 1997), therefore we prefer to use the term of 'disclosure level' instead of 'disclosure quality' to reflect how much information has been disclosed by the company. Whatever term is

used, both either disclosure level or disclosure quality is always allied with information transparency while the transparency is integral to corporate governance (Patel et al., 2002).

Previous research (Poshakwale & Courtis, 2005; Brown & Hillgeist, 2006; Lambert et al., 2007; Laidroo, 2008) agree that greater disclosure is associated with lower information asymmetry and accordingly mitigates the agency problem in corporate governance (Patel et al., 2002).

In addition, the higher level of disclosure, the lower investor's uncertainty and the lower uncertainty will result to lower dividend payouts which can be accepted by investors. A lower dividend stream would decrease the cost of equity capital because of a lower risk premium expected by the investors (Poshakwale & Courtis, 2005).

In order to measure the level of disclosure, we will use the same model that has been used by Hassan et al. (2006) which investigates the disclosure of derivative by Australian Firms in the extractive industries. They have developed a disclosure index based on Australian Accounting standard namely *AASB 1033 Presentation and Disclosure of Financial Instruments* and assumes that each item of disclosure is equally important (Cooke, 1991). The paper examined the disclosure based on all the information disclosed in the annual reports and adopted a dichotomous procedure where a score of 1 is given for disclosed items, and 0 otherwise.

For the purpose of conducting this study, we adopt their index and make an adaptation to develop an appropriate index which based on information required by the *FRS 132 Financial Instruments: Presentation and Disclosure*. We use the FRS 132 to build the index because all listed companies must comply with this standard regarding disclosure of financial instrument information and this standard is issued to increase the transparency and international comparability of the companies in Malaysia. In addition, the FRS 132 is assumed to be a "high quality" disclosure standard (Hassan et al., 2008) since it is based on the standard issued by the IASB and therefore the disclosure index is relevant to be used as a checklist in order to measure how much information that disclosed by the listed companies. The index focuses on six components: disclosure of risk management policies information; terms, conditions and accounting policies disclosure; interest rate risk information; credit risk information; fair value information; and other disclosures information. We use a simple binary coding scheme

whereby the presence or absence of an item is recorded (Beattie et al., 2004). The procedure for measuring the disclosed item is explained in later part.

4.2.1 Accounting Standards : MASB 24 vs. FRS 132

In our thesis, the index we use is based on *FRS 132 Financial Instruments: Presentation and Disclosure* (which started to be effective on 1st January 2006). Comparing to its former standard *MASB 24 Financial Instruments: Disclosure and Presentation* (which started to be effective on 1st January 2002), there are some differences between these two standards.

Generally, MASB 24 prescribes certain requirements for presentation of on-balance sheet financial instruments and identifies the information that should be disclosed about on-balance sheet (recognized) and off-balance sheet (unrecognized) financial instruments. It does not deal with the recognition and measurement issues concerning financial instruments, as these will be dealt with in a separate MASB standard. Disclosure requirements deal with information about risk management policies information; accounting policies information; interest rate risk information; credit risk information; fair value information, hedge information and other disclosures. However, FRS 132 provides information to enhance understanding of the significance of financial instruments to an entity's financial position, performance and cash flows, and assist in assessing the amounts, timing and certainty of future cash flows associated with those instruments. Based on our revision on the both standards, we found that requirements in FRS 132 are almost the same with MASB 24, except as depicted as follows:

- **Disclosure of Risk Management Policies information**

FRS 132 describes deeper about hedges information that should be disclosed by companies compared with MASB 24. FRS 132 requires companies to disclose more in-depth about designated fair value hedges, cash flow hedges and hedges of net investment in a foreign operation. Apart from requires description about hedge information, it also requires companies to disclose about the nature of the risks being hedged, a description of any forecast transaction for which hedge accounting had previously been used but which no longer expected to occur and others that

stated in paragraph 58 and 59. While MASB 24 only requires firm to disclose policies for hedging each major type of forecasted transactions generally.

- **Fair Value Information**

In MASB 24, it was stated that if the fair value cannot be measured practically then companies should disclose the fact with information about the principal characteristics of the underlying financial instruments that are pertinent to its fair value. However, FRS 132 requires companies to disclose more than that like the description of financial instruments that cannot be measured reliably includes their carrying amount and the reason of why fair value cannot be measured reliably. Then, if those financial assets are sold, FRS 132 requires companies to disclose the fact, the carrying amount at the time of sale and amount of gain and loss recognized (if any). Plus, when possible, companies may indicate their opinion on the relationship between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value reliably. Standards setter requires greater disclosure in FRS 132 as many companies make use of the loopholes in MASB 24 by disclosing such limitations even though the fair values of the financial instruments can be estimated (Accountant today, 2007).

- **Other Disclosures**

FRS 132 describes more information about other disclosures that need to be disclosed by companies such as information regarding derecognition, collateral, compound financial instruments with multiple embedded derivatives, financial assets and financial liabilities at fair value through profit and loss, reclassification, information about available for sale assets, impairment and default and breaches. According to Malaysian Accounting Standard Board, there is several disclosure requirements have been added in FRS 132 which are illustrated as follows:

- Information about assets retained in transactions that do not qualify for derecognition in their entirety (paragraph 94 (a))

- The existence of, and specified information about, issued compound financial instruments with multiple embedded derivative features that have interdependent values (paragraph 94 (d))
- The carrying amounts of financial assets and financial liabilities that are classified as held for trading and those designated by the entity upon initial recognition as financial assets and financial liabilities at fair value through profit or loss (paragraph 94 (e))
- The amount of the change in fair value of a financial liability designated as at fair value through profit or loss that is not attributable to changes in a benchmark interest rate (paragraph 94 (h))
- Information about any defaults by the entity on loans payable and other breaches of loan agreements (paragraph 94 (m))

Previously, in MASB 24 paragraph 97 stated a requirement to disclose separate information about financial assets carried at an amount in excess of fair value, but in FRS 132, it has been eliminated because it is redundant. This is because FRS 132 requires the disclosure of fair value information to be given in a way that permits comparison with financial assets' carrying amounts.

4.3 Corporate Governance

Corporate governance (CG) issue is not a new issue as numerous research have been conducted in this area and there are more than 3,500 hits containing term of "corporate governance" can be found in Social Science Research Networks (Gillan, 2006). As CG becomes very common in business society nowadays, so it is generally defined as a mean or a system to manage and control a company. However, CG can be defined specifically as:

"...the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on

corporate affairs. By doing this, it also provides the structure through which the company's objectives are set, and the means of attaining those objectives and monitoring performance." (OECD, April 1999)

While the Former President of World Bank, J. Wolfensohn defines it as:

"Corporate governance is about promoting corporate fairness, transparency and accountability." (Quoted in Financial Times, June 21st 1999)

Above definitions reveal the importance of CG and these definitions are not contradict with the definition brought by Shleifer & Vishny (1997) which defined "corporate governance as the approaches which are used by investors of the corporations to assure themselves of getting a return on their investment" and definition by The Australian Stock Exchange which regarded CG as "the system by which companies are directed and managed, it influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimized" (Dickhart, 2008). The mentioned definitions revolve around agency theory which emphasizes the importance of an effective CG as a mechanism to solve agency problem (Verrecchia, 2001).

According to Gillan (2006), he divides corporate governance mechanisms into two main groups viz. internal governance and external governance. Internal governance comprises 1).The Board of Director 2).Managerial Incentive 3).Capital structure 4).Bylaw and Charter Provision and 5).Internal control systems, while external corporate governance comprises 1).Law and regulations 2).Market 3).Capital market information 4).Accounting, Financial and Legal Services 5).Private Sources of External Oversight. Considering his view, our study is related to both internal and external governance. For internal governance, this study covers both The Board of Director and internal control system as this study investigates on the effect of chosen CRfRM to promote transparency. While for external governance, this study covers law and regulations as a mechanism to strengthen corporate governance in company. In Malaysia, regulations such as The Code on Corporate Governance play a very important role in improving the effectiveness of corporate governance.

4.3.1 The Code on Corporate Governance in Malaysia

In order to promote the monitoring function of corporate governance mechanisms in Malaysia, the Code on Corporate Governance was approved by the Ministry of Finance (Norman et al, 2005) and it was released by The Securities Commission and enforced by The Stock Exchange Requirement. In 2007, the Code has been revised to further strengthen corporate governance practices in line with development in the domestic and international capital markets. The Code was developed by the Working Group on Best Practices in Corporate Governance (JPK1) and subsequently approved by the High Level Finance Committee on Corporate Governance. JPK1 was chaired by the Chairman of the Federation of Public Listed Companies. The members of JPK1 comprised a mix of private and public sector participation.

It codified the principles and best practices of good governance and described optimal corporate governance structures and internal processes. The role of the Code is to guide boards by clarifying their responsibilities and providing prescriptions, thereby strengthening the control exercised by boards over their companies.

Paragraph 15.26 under the Listing Requirements of Bursa Malaysia stated that listed companies are compulsory to present in their annual report a narrative statement of how they use the principles that set out in Part 1 (see Appendix 2) and a statement on the extent of compliance with the Best Practices in Corporate Governance set out in Part 2. They are also required to identify and give reasons for things that do not comply with the code, together with alternative practices used, if any. And paragraph 15.27 under the Listing requirement requires listed companies to disclose additional statements by the board of directors about (a) a statement explaining the board of directors' responsibility for preparing the annual audited accounts; and (b) a statement about the state of internal control of the listed companies.

In other words, the listed companies in any case must apply the principles (part 1) that set out in the code but they have option to apply or not the best practices that suggested in the part 2. Nevertheless, they must explain in the annual reports both to what extent they apply the part 2 and another approach of corporate governance practices in their company (if any). If the listed

company fails to disclose the matters in its annual report, Bursa Malaysia can take action against the company or its directors.

4.4 Committees Responsible for Risk Management (CRfRM) & Hypothesis Development

4.4.1 Enterprise Risk Management (ERM)

The underestimation or mismanagement of risk has been widely acknowledged as one of the causes in the current economic crisis. With the past far-reaching corporate reporting scandals and the recent global financial meltdown, Enterprise Risk Management (ERM) is regarded as “an effective approach to identifying, assessing and monitoring risks across organizations and establishing communication protocols to efficiently share this risk information quickly across the entity” (Steffee S., 2009). Relevant researches about ERM had been published in 2001, and the result showed that companies that had adopted ERM were not facing a global economic crisis, but instead were attempting to “create, protect and enhance shareholder value (Barton et al., 2009).” In 2004, COSO defined ERM as follows:

“Enterprise Risk Management is a process, affected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.” (COSO as quoted by Beasley et al., 2009)

According to related surveys, Crowe Horwath found that more than 65 percent of CFOs and 70 percent of audit committee members cite managing enterprise risk as their organization’s biggest challenge (Cain A, 2008, pp.14).

It is important for companies to know much more about the risks they face, the more they know, the better they can manage. And it is also crucial for companies to be able to identify changes in risk as quickly as possible. “To manage such changes effectively, companies should have disciplined processes to examine enterprise risk. More importantly, those processes should be ongoing to allow for effective identification of new and emerging risks.” (Steffee S., 2009, pp.48).

In Malaysia, the board usually assigns Risk Management Committee (RMC), Internal Audit department (IA) or Outsourced Internal Audit (OIA) to carry out the risk management role to drive the risk management processes in identifying principal business risks and ensure the implementation of appropriate systems to manage these risks.

4.4.2 Risk Management Committee (RMC)

The RMC is supposed to be an effective mechanism of corporate governance in order to increase the effectiveness of role in managing, assessing and disclosing risk, especially risk related to financial instruments. The main roles of risk committees are to identify, evaluate, assess, control and monitor the risks (Ruin, 2003). In practice, it has been stated in numerous annual reports that the CRfRM are not only assigned to manage risks, but also to help top management by providing information which is supposed to be disclosed. Hence, we assume that RMC plays an important role in promoting higher quality disclosure of financial instruments information.

Since the risk management process is quite subjective, so it is difficult to objectively quantify the effectiveness of a RMC, but there is some evidence that implies such a committee could benefit the board. Based on the NACD Public Company Governance Survey in 2008, 79 percent of boards with a stand-alone RMC declared that they are effective in handling risk. Moreover, some corporate governance observers have noted that there is a trend toward stand-alone RMC that they expect will gain momentum (Bates & Leclerc, 2009). In their research, Bates & Leclerc (2009) have described four benefits of a stand-alone RMC which may promote a company's risk management practice:

“1. Relief of Audit Committee---A risk committee may promote the focused oversight of a company's risk by relieving the burdened audit committee of direct oversight of non-financial risk management.

2. Broader risk focus than audit committee---while audit committee members are often selected based upon their skills and experience related to financial reporting and accounting, risk management is a much broader concept that encompasses all areas of a company's operations and the risks associated with such operations.

3. Ability to react to trends and events---By shifting discussions about risk to a smaller, more nimble group of directors, a risk committee may provide a board with greater

flexibility in its ability to react to trends and events and report these developments to the full board.

4. Cross-Committee Synergies---A risk committee can foster cross-committee dialogues that create risk management synergies.” (Bates & Leclerc , 2009, pp.16).

Although we do believe that RMC is an effective approach for companies to manage their risk, but it is not an optimal approach for all companies. Some companies do not have RMC, because the potential drawbacks of RMC: qualified members and full board oversight (Bates & Leclerc, 2009).

In Malaysia, one unpublished working paper by Hassan et al. (2008) has agreed the establishment of RMC associate with higher disclosure quality of financial instruments. However, that article used old data, which was taken from 1999 to 2003 and during that time, The Code in 2000 did not emphasize the function of internal audit for risk management except only for control. However, in the revised code in 2007, the role of internal audit is broadening to include risk management and governance process. Consequently, after 2007, the role of risk management is transferring to internal audit department but some companies still use RMC approach to manage the risk. Different with Hassan et al. (2008), we collect the latest data that represent the situation after the revised code in 2007 and we also use current accounting standard (FRS 132, instead of MASB 24 that used in Hassan et al. (2008)). Our study tries to seek knowledge the affect of RMC to disclosure level of financial instruments information in 2008 and thus, our first hypotheses is:

H1: The use of Risk Management Committee as Committee Responsible for Risk Management (CRfRM) affects disclosure level of financial instruments information.

4.4.3 Internal Audit (IA)

The Institute of Internal Auditors (IIA) defines internal auditing as:

“..An independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process “(IIA, 1999)

From above definition it is understandable that the role of internal audit is widening from control to managing risk and also corporate governance (Walker et al., 2003). Walker et al. (2003, pp. 52) declare that internal audit can “help organizations identify and evaluate risks, moving the profession into the front line of risk management”. By this Goodwin & Kent (2006) anticipate that there are a link between the use of internal audit and the company’s commitment to sound risk management.

Besides that, internal audit also plays a significant monitoring role in assuring the quality of financial reporting and corporate accountability (Carcello & Neal, 2000). In addition, Deborah et al. (2008) considered the need for an internal audit report (IAR) to increase governance transparency to external stakeholders. Thus, it is relevant to say, due to the information asymmetry between management and external stakeholders, internal audit is an important mechanism for the external stakeholders to collect relevant information and to make decisions. Karamanou & Vafeas (2005) found that in companies with more effective board and internal audit function, managers are more likely to make or update earnings forecast, and their forecast is more accurate, and it elicits a more favorable market response.

Owing to the essential role that played by internal audit, some countries seemingly started to mandate company to establish internal audit department. For instance, the NYSE has endorsed the proposals of its Corporate Accountability and Listing Standards Committee (NYSE, 2002) that all companies listed on the NYSE should be compulsory to establish their own internal audit function within their company (Goodwin & Kent, 2006).

However, some countries like Australia, despite a commitment to strong corporate governance by regulators; many listed companies do not appear to engage in internal audit activities (Carey et al., 2000a). This shows that even though internal audit function has obliged by regulators but in practice, not all companies readily to have internal audit in their companies. In Malaysia, the revised code requires all public listed companies to carry out their own internal audit functions but it is not mandatory requirement even though the code insists the importance of internal audit function.

Thus, our study is conducted to provide information on this issue in a voluntary setting in Malaysia. As study in internal audit is still scarce in Malaysia so our study makes an important contribution on this growing body of literature. Based on above illustrated literatures, we anticipate there is association between internal audit and higher transparency of company and thus, our second hypotheses is:

H2: *The use of Internal Audit as Committee Responsible for Risk Management (CRfRM) affects disclosure level of financial instruments information.*

4.4.4 Outsourced Internal Audit (OIA)

Willenkens et al. (2005) found that companies with stronger corporate governance systems disclose more financial and non-financial performance information and one of the characteristics for “good” corporate governance is the existence of internal and external audit department. Due to the importance of internal audit (Carcello & Neal, 2000; Deborah et al., 2008) besides external audit, some companies nowadays started to establish internal audit department in their companies (Arena & Azzone, 2007) while some found the outsourcing is an efficient approach for providing internal audit within companies (Carey et al. 2000b).

A large number of research articles about the outsourced internal audit (OIA) show the recent trend towards the outsourcing of internal audit services to the public accounting profession. The outsourcing of internal audit services is regarded as “a way to add value to a business” (Andersen, 1995), because companies can manage their capacity more efficiently and enhance their flexibility by outsourcing non-core competencies to an external, professional workforce and focusing on the core areas of the business that create and sustain competitive (Rittenberg & Covaleski, 2001). Through the outsourcing services, companies can achieve a reduction in costs, such as employment and administrative costs (the high costs of recruiting, training and paying an internal employee). In addition, outsourcing also may increase a company’s flexibility in dealing with changing market conditions and organizational requirements (Davis-Blake & Uzzi, 1993).

As the internal audit function is implemented by an external expert, more information of the company is needed, so other organizations, stakeholders and investors may gain access to a wider range of publicly available information thus increasing the disclosure transparency and quality, though it may also “leak” some proprietary information which impacts its competitive advantage (Rittenberg & Covaleski, 2001).

Additionally, the advantages of OIA are “knowledge” and “independence” which external consulting firms can offer more than internal audit department and finally lead to higher disclosure and transparency. This anticipation is based on some studies such as Matusik & Hill (1998) who pointed out that acquirement of knowledge is the key in outsourcing internal audit function to external professionals and experts; and Lynda (2007) mentioned that outsourcing to the external committee can improve the independence of the internal audit function, gain access to skilled auditors with specialized knowledge in information technology (IT), fraud, and other specific risk areas. Due to the advantages that can be benefited from outsourced internal audit thus, our third hypothesis is:

H3: Outsourced internal audit (OIA) as Committee Responsible for Risk Management (CRfRM) affects disclosure level of financial instruments information.

5. Methodology

5.1 Sample Selection & Data Collection

Our sample comprises 63 companies that are listed on the main board of Bursa Malaysia in 2008. The sample represents 10% of 634 listed companies in 2008. As Hassan et al. (2008) pointed out that companies’ size is correlated to disclosure quality of financial instruments information, and we assume that large companies usually engage in large numbers of transactions, which requires them to disclose more information than small companies, therefore, we choose those companies that have large size, which are sorted by their total assets in 2003. However, we collect data from annual reports in 2008, instead of those in 2003, due to the consideration from both the issuance of FRS 132 and the revision of Malaysian Code of Corporate Governance, which started to take effect in 2006 and 2007 respectively.

Furthermore, annual reports of 2008 are the latest annual reports that are available to be downloaded from the official website of Bursa Malaysia.

This study considers all relevant industries except for financial institutions because financial institutions in Malaysia should comply with different statutory requirements (need to comply with requirements from the central bank of Malaysia). Data will be collected from annual reports from the respective companies. The reasons why we collect the data from annual reports are: firstly, the disclosure level of financial instruments information that will be measured is based on an index which is built from *FRS 132 Financial Instruments: Disclosure* (see Appendix 1). Secondly, since all listed companies are required to explain in annual report about their best practices of corporate governance in their companies (para 15.26 & para 15.27 the listing requirement of Bursa Malaysia), therefore we believe that information about corporate governance practices and especially about CRfRM can easily be obtained from the annual report.

5.1.1 Data Collection Procedures

In order to ensure more reliable, consistent and accurate data that are used in this research, we apply the following procedures in the process of data collection.

5.1.1.1 Disclosure level of financial instruments information

To prevent the same thing happened to Tonkin (1989) which had been criticized by Cooke & Wallace (1989) for failing to provide evidence that his measurements of disclosure are valid and reliable (Marston & Shrives, 1991), we take a preliminary action by providing rules/instructions pertaining to the measurements of disclosure. Marston & Shrives (1991), which provides an excellent review of the use of disclosure indices in accounting research (Beattie et al., 2004), has declared that the index scores awarded to companies can be considered to be reliable if the results can be replicated by another researcher. Since the scores are extracted from annual reports which remain constant over time, there is no obstacle to repetition.

Marston & Shrives (1991) mentioned that researchers in previous years did experience a number of practical problems in awarding scores, but researchers can mitigate this problem by

providing clear instructions for measuring the disclosed and non-disclosed information like Buzby (1974) and Cooke (1989) did in their papers.

For that reason, we adopt an index which is already used by Hassan et al. (2006) and make an adaptation to develop an appropriate index which is based on *FRS 132 Financial Instruments: Disclosure and Presentation*. This index is considered reliable and valid because the results can be replicated by another researcher as it provides clear rules on how to give scores to disclosed and non-disclosed items. The scoring rules are: 1 will be allocated for each item if it is disclosed in the company's annual report, and 0 will be given if the required item is not disclosed by the company. However, if the item is not relevant to the company, researchers will not penalize them by giving 0, instead giving N (which means the information is not relevant to the company and should be removed) and accordingly deduct the score from the company's total possible disclosure score. Then the level of disclosure will be measured through dividing a company's actual total score by its total possible score. Below is the formula that we adopt from Hassan et al. (2006) & Hassan et al. (2008) to measure the disclosure level of financial instruments information:

$$\text{Disclosure Level} = \frac{\text{Company's actual disclosure score}}{\text{Company's total possible disclosure score}}$$

To make it more understandable, we bring some examples on how we give scores based on this rule.

Example 1:

Based on the index, the first component that need to be evaluated is regarding to the **“Disclosure of Risk Management Policies Information”**. Under this component, the first item that should be revealed by a company is about “company's financial risk management objective

& policies". According to annual report of Amway Berhad, it has disclosed this information by saying:

Financial risk management objectives and policies

"The Group's financial risk management policy seeks to ensure that adequate financial resources are available for the development of the Group's businesses whilst managing its interest rate risks (both fair value and cash flow), foreign currency risk, liquidity risk and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarized below. It is, and has been throughout the year under review, the Group And Company's policy that no trading in derivative financial instruments shall be undertaken." (Extracted from AR of Amway Berhad, 2008, p. 80)

As it discloses such information explicitly in the annual report, hence, according to the rule, score of 1 is awarded for the item.

Example 2:

The next item which should be disclosed is regarding "the policy for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation". According to the annual report of Jotech Holding Berhad, it was written as below:

"The Group and Company are also exposed to foreign currency risk in respect of their investment in foreign subsidiaries. The Group does not hedge this exposure by having foreign currency borrowings but keeps this policy under review and will take necessary action to minimise the exposure of the risk.

The Group and Company's income and operating cash flows are substantially independent of changes in market interest rates. Interest rate exposure from the Group's borrowings is managed through the use of fixed and floating rate borrowings. The Group does not use derivative financial instruments to hedge its borrowings obligations (extracted from AR of Jotech Holding Berhad, 2008 p. 82)

Since this company clearly declared that it did not use any derivative financial instruments in 2008, therefore, any information about hedge and derivative is not relevant to this company. Hence, we should give points of N, instead of 0, and deduct the total possible score of that component accordingly.

Example 3:

For the next item, a company needs to disclose detailed information about hedges (if there is any hedge existed in the financial activities of a company). The company can be awarded maximum 4 points for the second item when it discloses all the following conditions in the AR:

- a) description of the hedge;
- b) a description of the financial instruments designated as hedging instruments and their fair value at the balance date;
- c) the nature of the risks being hedged; and
- d) For cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss, and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur.

According to the information from the AR of Ann Joo Resources Berhad,

“The Group is exposed to foreign currency exchange risk as a result of entering into sales and purchase transactions denominated in foreign currencies. The foreign currency transactions are mainly denominated in US Dollars. The Group enters into foreign currency forward contracts to hedge the exposure to specific risks relating to material foreign currency transactions.” (Ann Joo Resources Berhad, 2008, p.98)

“Foreign currency forward contracts are entered into by the Group in currencies other than its functional currency to hedge against fluctuations in foreign currency exchange rates on specific transactions”.(Ann Joo Resources Berhad, 2008, p.99)

“As at the balance sheet date, the net unrecognized gain on open contracts that hedge anticipated future foreign currency purchase/sales amounted to RM1,247,859 (2007 : NIL) whilst the unrecognized gain on open contracts that hedge anticipated future foreign currency sales amounted to RM NIL (2007:RM435,196).” (Ann Joo Resources Berhad, 2008, p.100).

It had designated fair value hedges in Ann Joo Resources Berhad, and the first three conditions were satisfied, so we give 3 points in this item.

Example 4:

The third component is about interest rate risk information. Company should disclose information about contractual reprising or maturity dates of interest rate risk as well as

effective interest rate. From AR of Esthetics International Group, we found following information:

Effective interest rates and reprising analysis

In respect of interest-earning financial assets, the following table indicates their average effective interest rates at the balance sheet date and the periods in which they mature, or if earlier, reprise.

	<u>2008</u>		<u>2007</u>						
	Effective interest rate	Total	Within 1 year	1-5 years	Effective interest rate	Total	1 year	Within 1-5 years	
	%	RM'000	RM'000	RM'000	%	RM'000	RM'000	RM'000	
Group									
Financial assets									
Deposits placed with									
Licensed banks	2.1	3,400	3,400	–	2.2	1,740	1,740	–	
Amount due from									
Associate	6.5	999	–	999	8.5	1,719	1,199	520	

(Extracted from AR of Esthetics International Group, 2008, p. 77)

Based on the information above, we will give 2 as scoring for the third component: 1 is given for information about reprising analysis and 1 is for effective interest rate.

Example 5:

Another component that needs to be disclosed based on the index is about credit risk information. Company should disclose the amount that best represents its maximum credit risk exposure at the balance sheet date and significant concentrations of credit risk. According to AR of Keck Seng (Malaysia) Berhad, we found the company disclosed such information as following:

“Credit risks, or the risk of counterparties defaulting, are controlled by the application of credit approvals, limits and monitoring procedures. Credit risks are minimized and monitored by limiting the Group’s associations to business partners with high creditworthiness. Trade receivables are monitored on an ongoing basis via Group management reporting procedures. The Group does not have any significant exposure to any individual customer or counterparty nor does it have any major concentration of

credit risk related to any financial instruments". (AR of Keck Seng (M) Berhad, 2008, p. 83 & 84)

Based on the cited information, we found that the company did not disclose information about the amount that best represents its maximum credit risk exposure at the balance sheet date and thus, we give 0 points. However, for the second information, which pertaining to significant concentrations of credit risk, we give N, because the company did not have any major concentration of credit risk related to any financial instruments.

Hence, we will apply the same way to give score on each item of the index and accordingly the company's actual score and total possible score will be calculated to measure the disclosure level of financial instruments information.

5.1.1.2 Committees responsible for risk management (CRfRM)

To collect the data regarding CRfRM, we will use a well-established method in the social science research namely content analysis (Beattie et al., 2004). Content analysis is a technique based on the manual or automated coding of transcripts, documents, audio and video material (Bloomberg et al., 2008). Bloomberg et al. (2008) describe two steps of content analysis process. Firstly, they suggest a researcher to define the source used for the content analysis; and secondly, to define the coding procedure.

As all listed companies in Malaysia are required by the listing requirements of Bursa Malaysia to clarify their best practices of corporate governance in their annual reports, we define the source of our content analysis is from annual reports (AR) of listed companies in 2008. Furthermore, Botosan (1997) has mentioned that annual reports are generally considered to be one of the most important sources of corporate information, hence, we believe it is relevant to gather all data based on annual reports.

And the second step is to define the coding procedure, which is of utmost importance for validity of the study, because through the coding text, elements are categorized to make inferences. Valid inferences require that the classification procedure is reliable in the sense of consistency. Thus, different people should code a text in the same way (Bloomberg et al., 2008;

Weber, 1985). In addition, Weber (1985) explained the classification procedure must also be valid which means the variables generated from the classification procedure represent what the researcher intended it to represent.

Therefore, in this analysis we will use the procedure that suggested by Boyatzis (1998) and Weber (1985) which provides useful discussions regarding how to develop a coding scheme (Beattie et al., 2004). This procedure needs to be applied in order to achieve reliability and validity in our research. To do so, they suggest a researcher firstly define the recording unit (e.g. word or phrase) and secondly define the categories.

The recording unit used in this study is the phrase of '*risk management*' or the phrases which give the same meaning like '*managing risk*'. We then define 3 categories of CRfRM viz. Risk Management Committee (RMC), internal audit (IA) and outsourced Internal audit (OIA) which also represent our independent variables. In order to make classification of which category of CRfRM that company has, we will follow below procedure:

- a. If it is written the phrase of "Risk Management Committee", so consider the company has assigned the RMC.
- b. If it is written the phrase of "Internal audit" or "internal audit department" or "internal audit function", so consider the company has assigned the IA.
- c. If it is written the phrase of "Internal audit" or "internal audit function" and written together the word "outsourced" or "appointed a consulting firm" or "appointed an independent firm" so consider the company has assigned the OIA.

To make it easier to understand, we bring three examples to show how we apply the procedure during the data collection.

Example 1:

"The Board confirms that there is an underlying and ongoing process in the Group for the identification, evaluation and mitigation of its significant risks. The processes under the Group's Enterprise <Risk Management> Framework have been in place at all relevant time in 2008. In accordance with the Framework, a Risk Management Committee was established to drive the <risk

management> processes in identifying principal business risks and ensures the implementation of appropriate systems to **<manage these risks>**” (Extracted from AR of Engtex Group Berhad, 2008 pg 25)

Explanation: We highlight the phrase of “risk management” and “manage these risks” and accordingly we read the next sentence and also the previous sentence in order to make inference which category of CRfRM the company has. As it is written Risk Management Committee, then we consider this company has assigned RMC to play role in risk management.

Example 2:

*“The role of the internal audit function is to assist the Audit Committee and the Board of Directors in monitoring and **<managing risks>** and internal controls of the Group. A systematic and disciplined approach is used to evaluate and improve the effectiveness of **<risk management>**, operational and internal controls, and compliance with laws and regulations. The internal audit function adopts a risk based approach to monitor and implement an effective internal control system for the Group. The monitoring process forms the basis for continuous improvement to the **<risk management>** process of the Group in meeting its overall objectives”.* (Extracted from AR of I berhad, 2008 pg 19)

Explanation: We highlight the phrase of “risk management” and “managing risk” and accordingly we read the next sentence and also the previous sentence in order to make inference which category of CRfRM the company has. As it is written internal audit function, then we consider this company has assigned IA to take role of managing risks.

Example 3:

*“The group’s internal audit functions are outsourced to, CGRM Infocomm Sdn Bhd, an external independent professional internal audit and **<risk management>** consulting firm, which reports to the Audit Committee and assists the Board of Directors in monitoring and **<managing risks>** and internal controls”.* (Extracted from AR of Kamdar Group Berhad, 2008 pg 19)

Explanation: We highlight the phrase of “risk management” and “managing risk” and accordingly we read the next sentence and also the previous sentence in order to make inference which category of CRfRM the company has. As it is written “Internal audit functions” together with the words of “outsourced” and “independent consulting firm”, then we consider this company has assigned OIA to take role of managing risks.

By applying this procedure, we believe we can get a valid and reliable data so that this research will generate more accurate and valid result.

5.2 Measurement of Variables & Data Analysis

Disclosure level (DL) is a dependent variable (DV) and we will examine disclosure based on all information in annual reports and adopt dichotomous procedure. A score of 1 is given for each item based on the detailed information provided, both qualitative and quantitative, and a zero amount is allocated if firms failed to provide any information required. The disclosure level of each component will be summed and the maximum and minimum points will be 1 and 0 respectively.

The results of disclosure level will be presented descriptively in tables and followed by explanations. As there are six components of information on the index, we therefore will present the result of disclosure level by each component as well so that reader can understand how much information on each component has been disclosed by companies. While for the independent variables, for example, we will code 1 if the company uses IA as the committee responsible for risk management, otherwise 0 will be given. The same method will be applied on other two variables (RMC and OIA). We will present the results of independent variables by percentage. The percentage of companies which uses IA, RMC and OIA will be measured and shown on tables.

We will examine the association of the independent variables and the disclosure level (DL) mainly by using Mann-Whitney U Test. Based on the statistical test we will either find the statistic result support our hypothesis or the other way around. As we use statistical computer program such as SPSS, the results of statistical tests always reported as probability values (P-values). The P-value is the probability of observing a sample value as extreme as, or more extreme than, the value actually observed, given that the null hypothesis is true. The P-value is compared to the significance level, and on this basis the null hypothesis is either rejected or not rejected. If the P-value is less than the significance level, the null hypothesis is rejected (if P-

value $< \alpha$, reject null). If P is greater than or equal to the significance level, the null hypothesis is not rejected (if P-value $> \alpha$, don't reject null) (Bloomberg et al., 2008).

6. Findings

6.1 Disclosure Level of Financial Instruments Information

Our study focuses on the disclosure level of financial instruments information in 2008 and its result is depicted in Figure 1 below. However, in order to understand the trend of the disclosure level better, we combined our results (disclosure level in 2008) with the results from Hassan et al. (2008) which studied the disclosure quality of financial instruments information among listed companies in 1999, 2000, 2002 and 2003. Even though Hassan et al. (2008) used the term of "disclosure quality" instead of "disclosure level", it is still relevant to make comparison here as we use the same method of calculating the disclosure level of financial instruments information.

Besides that, according to our research in the annual reports, it is necessary to highlight one interesting point regarding the distinction between "disclosure level" and "disclosure quality". Although Hassan et al. (2008) used "disclosure quality" because of the "standard compliance", but as an outsider, we found it is hard to measure the quality of disclosure as we can not reach as much information as insiders. For instance, it is very perplexing to know either a company does not disclose one item required by FRS 132 on purpose or it is actually not involved in such business transactions during the accounting year. Hence, considering the complexity of measuring disclosure quality, we think it is more appropriate to use "disclosure level" in this paper.

	N	Minimum	Maximum	Mean	Std. Deviation
1. Disclosure of Risk Management Policies Information (C1)	63	.000	1.000	.74444	.287665
2. Terms, Conditions and Accounting Policies Information (C2)	63	1.000	1.000	1.00000	.000000
3. Interest Rate Risk Information (C3)	63	.500	1.000	.98413	.088366
4. Credit Risk Information (C4)	63	.000	1.000	.52381	.478814
5. Fair Value Information (C5)	63	.333	1.000	.79453	.209215
6. Other disclosures (C6)	63	.000	.625	.24746	.160431
Disclosure Level	63	.407	.727	.56005	.080271
Valid N (listwise)	63				

Figure 1: Descriptive statistic of disclosure level of financial instruments information in 2008

	1999	2000	2002	2003	2008
Average	0.2567	0.2925	0.4837	0.5888	0.5600
Highest	0.5000	0.5857	0.9429	0.9714	0.7270
Lowest	0.0357	0.0357	0.1357	0.3071	0.4070

Figure 2: Disclosure level of financial instruments information for the year of 1999, 2000, 2002, 2003 and 2008

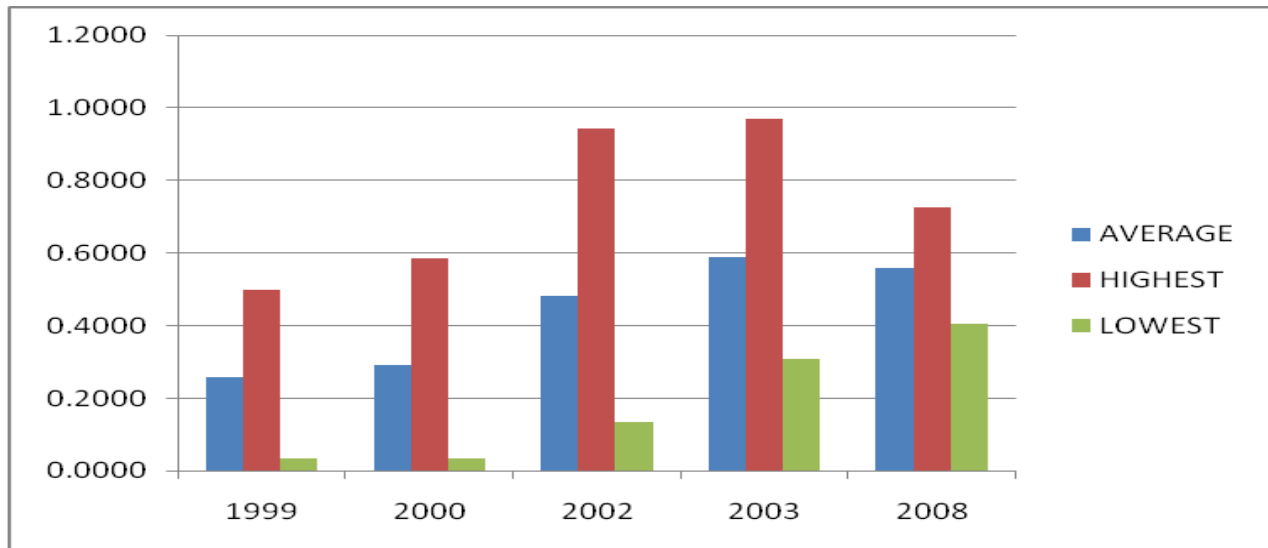


Figure 3: The trend of disclosure level of financial instruments information for the year of 1999, 2000, 2002, 2003 and 2008

Based on Figure 2, we found that the highest, average and lowest score among those listed companies in 2008 are 0.7270, 0.5600 and 0.407 respectively. While Figure 3 shows the disclosure level score increases from 1999 to 2003, but in 2008 it decreases slightly. The decreased trend is probably due to the lack of disclosure in one component of information, *viz.* “Other Disclosure Information”. Previously, MASB 24 only required listed companies to disclose three items in the component of “Other Disclosure Information”, which accumulate only 5 total possible scores (refer to the index of Hassan et al., 2008). But, since 2006, FRS 132 has required more information in the same component, such as derecognition, default, compound financial instruments with multiple embedded derivatives and others, which accumulate 33 total possible scores altogether.

The average disclosure level of financial instruments (by components) is illustrated in Figure 4. It is clear to see that almost each component increases during the period, except “Other Disclosure Information” which decreases about 0.009 from 2003 to 2008.

	1999	2000	2002	2003	2008
	←	Sample (n = 121)	→		Sample (n=63)
1. Disclosure of Risk Management Policies Information	0.0289	0.0455	0.5372	0.6405	0.7444
2. Terms, Conditions and Accounting Policies Information	0.8430	0.9008	0.9174	0.9855	1.000
3. Interest Rate Risk Information	0.7397	0.8512	0.9132	0.9793	0.9841
4. Credit Risk Information	0.0000	0.0289	0.2975	0.4256	0.5238
5. Fair Value Information	0.1640	0.1634	0.5072	0.6824	0.7945
6. Hedge of Anticipated Transaction	0.0198	0.0281	0.1339	0.1521	NIL
7. Other disclosures	0.0017	0.0298	0.0793	0.2562	0.2475

Figure 4: The average of FI information disclosure level (by components) of the listed companies in Malaysia for the period of 1999, 2000, 2002, 2003 and 2008

6.2 Committees Responsible for Risk Management (CRfRM)

Figures below show information about CRfRM that are used among the listed companies in Malaysia in 2008. We find that most of the companies use Risk Management Committee (RMC) as CRfRM (approximately 57.1%), 15 companies use Internal Audit (IA) (approximately 20.3 %), and the rest companies uses Outsourced Internal Audit (OIA) (approximately 16.2%).

Figure 5: The total number of companies use IA as CRfRM

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	.000	48	64.9	76.2	76.2
	1.000	15	20.3	23.8	100.0
	Total	63	85.1	100.0	
Missing	System	11	14.9		
Total		74	100.0		

Figure 6: The total number of companies use OIA as CRfRM

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	.000	51	68.9	81.0	81.0
	1.000	12	16.2	19.0	100.0
	Total	63	85.1	100.0	
Missing	System	11	14.9		
Total		74	100.0		

Figure 7: The total number of companies use RMC as CRfRM

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	.000	27	36.5	42.9	42.9
	1.000	36	48.6	57.1	100.0
	Total	63	85.1	100.0	
Missing	System	11	14.9		
Total		74	100.0		

6.3 The Association between CRfRM and Disclosure Level of Financial Instruments Information

The results reflected in Figure 8 show that there are no significant relationships between Disclosure Level (DL) and Risk Management Committee (RMC) as well as Internal Audit (IA), but there is association existed between DL and Outsourced Internal Audit (OIA). Through Mann-Whitney U test (at the 0.05 level of significance) the hypothesis that the distribution of DL is the same across categories of OIA is rejected, while the hypotheses that the distribution of DL is the

same across categories of RMC and IA are retained. In addition, Pearson Correlation Matrix shown in Figure 9 also suggests the same results.

Figure 8: Mann-Whitney U Test (DL and RMC, non-RMC, IA, OIA)

Hypothesis Test Summary

	Null Hypothesis	Test	Sig.	Decision
1	The distribution of DL is the same across categories of RMC.	Independent-Samples Mann-Whitney U Test	.156	Retain the null hypothesis.

Asymptotic significances are displayed. The significance level is .05.

Hypothesis Test Summary

	Null Hypothesis	Test	Sig.	Decision
1	The distribution of DL is the same across categories of NON RMC.	Independent-Samples Mann-Whitney U Test	.156	Retain the null hypothesis.

Asymptotic significances are displayed. The significance level is .05.

Hypothesis Test Summary

	Null Hypothesis	Test	Sig.	Decision
1	The distribution of DL is the same across categories of IA.	Independent-Samples Mann-Whitney U Test	.846	Retain the null hypothesis.

Asymptotic significances are displayed. The significance level is .05.

Hypothesis Test Summary

	Null Hypothesis	Test	Sig.	Decision
1	The distribution of DL is the same across categories of OSA.	Independent-Samples Mann-Whitney U Test	.046	Reject the null hypothesis.

Asymptotic significances are displayed. The significance level is .05.

Hypothesis 1, which states that the use of RMC as CRfRM affects disclosure level of financial instruments information, is not supported. The result is inconsistent with the findings established by Hassan et al (2008), which found that RMC is significantly associated with disclosure quality of financial instruments information. Thus, a possible explanation of this result is that while RMC as CRfRM takes a large percentage among listed companies in Malaysia and it aims to ensure that the company has complied with disclosure requirements, it is still not

actively pressing the company to disclose such information, as it is under the control of The Board of Directors.

Besides, there are doubts about the independence and effectiveness of RMC in the company. In Malaysia, RMC is established by the board in the company, and it is not only required to report relevant information to both The Board of Directors and Audit Committee (AC), but also needs to be overseen by them (The IIA, 2005). Thus, since the ultimate power is under the governing bodies (The Board and AC), then we believe that the interaction between RMC and the board as well as AC may affect the independence and effectiveness of RMC, and finally influence the disclosure level.

Even though there are two research that have been conducted by Yatim (2009) which showed companies with more independent The Board of Director and the ones with more independent, expert, and diligent audit committees are likely to set up a stand-alone RMC in Malaysia which demonstrates their commitment to and awareness of improved internal control environment (Yatim, 2009), but as far as we know, there is no research in Malaysia proves that the independence of the board can influence the effectiveness of RMC and consequently may affect the disclosure level of financial information in the company.

Moreover, according to our research, most of the directors play many different roles among The Board of Directors, RMC and AC in the sample companies. Therefore, the mixed role played by RMC members may weaken the committee's function, especially its independence and effectiveness. Hence, RMC compositions probably influence, directly or indirectly, the disclosure level of financial instruments information. In addition, we also find that there is no association between using Non-RMC and DL, which means no matter which one to be used as CRfRM, RMC or Non-RMC, it will not affect DL at all.

Hypothesis 2, which states that the use of IA as CRfRM affects disclosure level of financial instruments information, is rejected as well. There is no association between DL and IA. In Malaysia, internal auditing may enhance CG in a company, but considering the ERM framework in a company, IA is not involved in determining the level of disclosure (The IIA, 2004), and as for to what extent IA actively influence the level of disclosure with respect to the financial

instruments information in the corporate annual reports is still questionable. IA not only plays a role as a communicator between the AC and the operational level in a company, it is also regarded as a comfort provider to the AC by Sarens et.al (2009), which found that the more the audit committee is aware of risk management and internal control issues and its own monitoring responsibilities in this regard, the more its members tend to deal with these issues and, consequently, the more they seek comfort from internal audit department (Sarens et.al, 2009), as IA members can provide general knowledge as well as more company-specific and practical knowledge on risk management to AC. While IA is an independent department which is to identify and manage risk, there is no evidence that IA has an influence on disclosure level of financial information in annual reports; it is probably because IA plays a vital role in giving assurance on risk management processes and making sure that risks are correctly evaluated (The IIA, 2004), which means that IA is mainly used to assist the board or AC, and the level of financial information disclosed is finally decided by The Board of Directors or AC.

Hypothesis 3 states that OIA as CRfRM affects disclosure level of financial instruments information. Mann-Whitney U Test shows that there is a significant association between OIA and DL (P-value=0.046), besides that, Pearson Correlation (Figure 9) also proves a significant negative association between OIA and DL, in particular, OIA has negative relationship with C6 (other disclosure information).

Figure 9: Pearson Correlation Matrix

	C1	C2	C3	C4	C5	C6	DL	IA	OIA	RMC
C1	1.0000									
C2	1.000	1.000								
C3	.345**	1.000	1.000							
C4	.098	1.000	.009	1.000						
C5	-.139	1.000	-.179	.085	1.000					
C6	.034	1.000	.107	-.046	-.073	1.000				
DL	.355**	1.000	.210*	.187	.343**	.748**	1.000			
IA	.083	1.000	.101	.050	.025	.029	.021	1.000		
OIA	-.026	1.000	.088	-.024	-.039	-.239*	-.246*	-.271*	1.000	

RMC	-.051	1.000	-.157	-.024	.010	.164	.177	-.645**	-.560**	1.000
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** . Correlation is significant at the 0.01 level (1-tailed).

* . Correlation is significant at the 0.05 level (1-tailed).

The results show the use of OIA is associated with low DL of financial instruments information and hence convince us to accept the dark side of using the OIA. Even though some research (Davis-Blake & Uzzi (1993), and Matusik & Hill (1998)) agreed that outsourcing of internal audit function can give many advantages, but focus of those researches are more on the good side of OIA from economic and management’s view.

Whereas, from accounting’s perspective, there are arguments about the recent trend towards outsourcing of internal audit services to the public accounting profession which may impair the independence of the auditor. According to Watts & Zimmerman (1983)(1986), auditor independence is defined as the probability that the auditor will disclose a discovered breach in the financial report and therefore, managers have incentives to reduce agency cost by hiring independent auditors (Watts & Zimmerman, 1983), which means auditor’s independence is very essential to reduce information asymmetry between principal and agent.

Thus, if the same accounting firm performs the function of internal and external audit at the same time, their independence can be questioned as Levitt (1996) assert that:

“... auditors cannot participate in management activities of audit clients and they cannot sell services that leave them auditing their own work.”

Moreover, The IIA also has the same position with regards to this issue that total outsourcing of the internal audit function to a company’s external auditor will impairs the [CPA] firm’s independence besides internal auditing is a key management function that conflicts with the public accountants’ responsibilities to be independent of management.

Internal audit’s core role in relation to ERM should be to provide assurance to management and to the board on the effectiveness of risk management (The IIA, 2004). And The IIA put emphasis on internal auditors' independence and objectivity as it is likely to improve the organization's risk management, control, and governance processes. Hence, when a company decides to outsource internal audit function, the first thing that needs to be considered is external

auditors' independence and objectivity. However, as outsourced internal auditors, one main problem that they face is to access the company-specific knowledge, which could be finally influence the auditing outcomes. As Carey et.al (2006) mentioned, an in-house internal audit function has leverage over an external service provider through its in-depth firm-specific knowledge (pp.12). As employees of the company, internal auditors have some advantages that outsourced internal auditors do not have, for instance, "have commitments to the long-term well-being of the organization" (Carey et.al, 2006, pp.12). And Pearson Correlation that shows OIA is negatively associated with Other Disclosure Information (C6) may supports our assumption that there is a border line exists between the company and appointed OIA, which mitigates OIA to access some information of the company besides the complexity of managing financial risk underlies in financial instruments (IASB, 2008 pp.4), especially the information that are required in the C6.

Besides that, from another publication by The IIA (29th Sep.2004), entitled "The Role of Internal Auditing in Enterprise-wide Risk Management (ERM)", it states that:

"The Institute emphasizes that organizations should fully understand that management remains responsible for risk management" (pp. 2).

Based on that, the primary responsibility for identifying and managing risks lies with management. Although OIA is used as CRfRM, the ultimate authority is in governing bodies' hand (e.g. Audit Committee and The Board), while OIA is selected as the way to obtain internal audit services, the governing body plays a vital role in the oversight process, and the level of active oversight should be considered as well. And it has been affirmed by the IIA:

"The IIA believes that oversight and responsibility for the internal audit activity cannot be outsourced."

This is in line with the attention of the U.S. Congress, the SEC, and the major stock exchanges that focus on corporate boards as primary vehicles for improving the quality of financial information provided by companies. Moreover, Xie et al. (2003) also noted that audit committee has the responsibility to oversee internal controls over financial reporting, communicating with management, internal and external auditors, and the board of directors to

assure that appropriate controls are in place and reporting processes are effective (Hoitas et al.,2009).

Hence, we believe that the board and AC may influence the effectiveness of OIA in risk management, and consequently may affect the disclosure level of financial instruments information.

Overall, the results indicate that the disclosure level of financial instruments information does not be influenced by RMC as well as IA, as both of them are controlled by governing bodies directly, they are not involved in determining the level of disclosure and are not actively pressing the company to disclose relevant information. However, we find that OIA negatively affects the disclosure level of financial instruments information, which is due to the dark side of outsourcing internal audit function.

7. Conclusions

This paper provides an initial attempt to look into the association between DL of financial instruments information and CRfRM among listed companies in Malaysia. This research is conducted to seek knowledge whether or not the current practice that considered as “the best practices” employed by the listed companies in Malaysia is an effective CG mechanism to promote the transparency of the company. Hypotheses are developed based on the premise that CRfRM is not only assigned to manage, evaluate and assess risks, but also to help the board and management by providing information which is supposed to be disclosed in annual reports. Our research shows that even though OIA, IA and RMC as CG mechanisms, to some extent, help governing bodies in collecting significant information, they are still not really effective to remedy the poor governance and low disclosure in Malaysia, and this suggest for companies (particularly The Board of Director) and regulation bodies to think more about how to strengthen CG effectiveness as current regulations and practices are still not sufficient.

8. Limitations and Future Research

Even though this study makes an important contribution on the governance and internal control debates especially in Malaysia, but there is one main of limitations inherent in this study viz. the use of small sample size which is 10% out of the total number of listed companies in Bursa Malaysia. Therefore, future research is needed to overcome this limitation. Besides that, since The Board and AC have influence on CRfRM activities, so further concerns about the interaction among The Board, AC and CRfRM in DL issue are needed in the future. Moreover, researches on the roles of CRfRM composition are also essential to be conducted in the future as an effort to strengthen the effectiveness of CG mechanism especially in Malaysia.

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10. Appendices

Appendix 1: Financial Instruments Information Disclosure Index

Component of Financial Instruments Information Disclosure index based on FRS 132			
Item	Information	Reference	Score
1	<i>Disclosure of Risk Management Policies Information</i> # Describe firm's financial risk management objective & policies #The use of financial instruments, associated risks, policies for controlling risks	Para 56 &57	1
2	# for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation a) description of the hedge b) a description of the financial instruments designated as hedging instruments and their fair values at the balance sheet date; c) the nature of the risks being hedged; and d) for cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss, and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur	Para 58 (a)-(d)	4*
3	# When a gain or loss on a hedging instrument in a cash flow hedge has been recognized directly in equity, through the statement of changes in equity: (a) the amount that was so recognized in equity during the period; (b) the amount that was removed from equity and included in profit or loss for the period; and (c) the amount that was removed from equity during the period and included in the initial measurement of the acquisition cost or other carrying amount of a non-financial asset or non-financial liability in a hedged highly probable forecast transaction.	Para 59 (a)-(c)	3*
Component Score			8
4	<i>Terms, Conditions and Accounting Policies Information</i> (a) a) Extent and nature of the underlying financial instruments, b) including significant terms and conditions that may affect the amount, timing, and certainty of future cash flows.	Para 60 (a)	2
5	(b) a) Accounting policies and method adopted, b) including criteria for recognition and the basis of measurement applied	Para 60 (b)	2
Component Score			4
6	<i>Interest Rate Risk Information</i> # Contractual reprising or maturity dates for interest rate risk	Para 67 (a)	1
7	# Effective interest rates	Para 67 (b)	1

	Component Score	2
	Credit Risk Information	
8	(a) the amount that best represents its maximum credit risk exposure at the balance sheet date, without taking account of the fair value of any collateral, in the event of other parties failing to perform their obligations under financial instruments	Para 76 (a) 1
9	(b) significant concentrations of credit risk	Para 76 (b) 1
	Component Score	2
	Fair Value Information	
10	# Fair value information for each class of financial asset and financial liability (Except as set out in paragraph 90 and 91A)	Para 86 1
11	# When fair value cannot be measured reliably that fact shall be disclosed together with (a) a description of the financial instruments, (b) their carrying amount, (c) an explanation of why fair value cannot be measured reliably	Para 90 3*
12	# if financial assets whose fair value previously could not be reliably measured are sold, (a) that fact, (b) the carrying amount of such financial assets at the time of sale and (c) the amount of gain or loss recognized shall be disclosed	3*
13	# Some financial assets and financial liabilities contain a discretionary participation feature as described in IFRS 4 Insurance Contracts. If an entity cannot measure reliably the fair value of that feature, the entity shall disclose (a) that fact together with a description of the contract, (b) its carrying amount, (c) an explanation of why fair value cannot be measured reliably	Para 91A 3*
14	# a) Method adopted and b) any significant assumptions made in determining fair value	Para 92 2
	Component Score	12
	Other disclosures	
15	Derecognition (a) for each class of financial asset, (i) the nature of the assets; (ii) the nature of the risks and rewards of ownership to which the entity remains exposed (iii) when the entity continues to recognize all of the asset, the carrying amounts of the asset and of the associated liability (iv) when the entity continues to recognize the asset to the extent of its continuing involvement, the total amount of the asset, the amount of the asset that the entity continues to recognize and the carrying amount of the associated liability	Para 94 (a) 4*
16 (a)	Collateral (i) the carrying amount of financial assets pledged as collateral for liabilities, (ii) for contingent liabilities, (iii) any material terms and conditions relating to assets pledged as collateral	Para 94 (b) 3*
16 (b)	When an entity has accepted collateral that it is permitted to sell or repledge in the absence of default by the owner of the collateral (i) the fair value of the collateral accepted (financial and non-financial assets); (ii) the fair value of any such collateral sold or repledged and	Para 94 (c) 3*

	<p>whether the entity has an obligation to return it</p> <p>(ii) any material terms and conditions associated with its use of this collateral</p>		
17 a	<p>Compound financial instruments with multiple embedded derivatives</p> <p>If an entity has issued an instrument that contains both a liability and an equity component and the instrument has multiple embedded derivative features whose values are interdependent it shall disclose</p> <p>(i) the existence of those features and</p> <p>(ii) the effective interest rate on the liability component (excluding any embedded derivatives that are accounted for separately).</p>	Para 94 (d)	2*
17 b	<p>Financial assets and financial liabilities at fair value through profit or loss</p> <p>(e) disclose the carrying amounts of: (i) financial assets that are classified as held for trading</p> <p>(ii) financial liabilities that are classified as held for trading</p> <p>(iii) those that are not financial assets classified as held for trading</p> <p>(iv) those that are not financial liabilities classified as held for trading</p>	Para 94 (e)	4*
17 c	(f) disclose separately net gains or net losses on financial assets or financial liabilities		1*
17 d	<p>(g) If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through profit or loss</p> <p>(i) the maximum exposure to credit risk at the reporting date of the loan or receivable (or group of loans or receivables)</p> <p>(ii) the amount by which any related credit derivative or similar instrument mitigates that maximum exposure to credit risk</p> <p>(iii) the amount of change during the period and cumulatively in the fair value of the loan or receivables that is attributable to changes in credit risk</p> <p>(iv) the amount of change in the fair value of any related credit derivative or similar instrument that has occurred during the period and cumulatively since the loan or receivable was designated</p>		4*
17 e	<p>(h) If the entity has designated a financial liability as at fair value through profit or loss</p> <p>(i) the amount of change during the period and cumulatively in the fair value of the financial liability that is attributable to changes in credit risk</p> <p>(ii) the difference between the carrying amount of the financial liability and the amount the entity would be contractually required to pay at maturity</p>		2*
17 f	<p>(i) (i) the methods used to comply with the requirement in (g)(iii) and (h)(i)</p> <p>(ii) the reasons and relevant factors for consideration that the disclosure it has given to comply with the requirements in (g)(iii) or (h)(i) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in credit risk</p>		2*
18	<p>Reclassification</p> <p>(j) the reason for reclassification</p>		1*
19	<p>Income statement and equity</p> <p>(k) (i) total interest income and total interest expense (calculated using the effective interest method) for financial assets and financial liabilities that are not at fair value through profit or loss</p> <p>(ii) for available-for-sale financial assets, the amount of any gain or</p>		3*

	<p>loss recognized directly in equity during the period and the amount that was removed from equity and recognized in profit or loss for the period</p> <p>(iii) the amount of interest income accrued on impaired financial assets</p>	
20	<p>Impairment</p> <p>(l) the nature and amount of any impairment loss recognized in profit or loss for a financial asset, separately for each significant class of financial asset</p>	1*
21	<p>Defaults and breaches</p> <p>(m) any defaults of principal, interest, sinking fund or redemption provisions during the period on loans payable recognized as at the balance sheet date and any other breaches during the period of loan agreements when those breaches can permit the lender to demand repayment</p> <p>(i) details of those breaches</p> <p>(ii) the amount recognized as at the balance sheet date in respect of the loans payable on which the breaches occurred</p> <p>(iii) with respect to amounts disclosed under (ii), whether the default has been remedied or the terms of the loans payable renegotiated</p> <p>before the date the financial statements were authorized for issue.</p>	3*
Component Score		33

#A score of one is allocated for each item discloses in the notes to the financial statements

* Information that may be not relevant to firm. If the firm discloses, 1 will be given to each item, but if the information is not relevant and not related to firm's transaction, N will be given. Otherwise, give 0.

Appendix 2: The Malaysian Code on Corporate Governance

PART 1

PRINCIPLES OF CORPORATE GOVERNANCE

A DIRECTORS

I The Board

Every listed company should be headed by an effective board which should lead and control the company.

II Board Balance

The board should include a balance of executive directors and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision making.

III Supply of Information

The board should be supplied in a timely fashion with information in a form and of a quality appropriate to enable it to discharge its duties.

IV Appointments to the Board

There should be a formal and transparent procedure for the appointment of new directors to the board.

V Re-election

All directors should be required to submit themselves for re-election at regular intervals and at least every three years.

B DIRECTORS' REMUNERATION

I The Level and Make-up of Remuneration

Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully. The component parts of remuneration should be structured so as to link rewards to corporate and individual performance, in the case of executive directors. In the case of non-executive directors, the level of remuneration should reflect the experience and level of responsibilities undertaken by the particular non-executive concerned.

II Procedure

Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors.

III Disclosure

The company's annual report should contain details of the remuneration of each director.

C SHAREHOLDERS

I Dialogue Between Companies and Investors

Companies and institutional shareholders should each be ready, where practicable, to enter into a dialogue based on the mutual understanding of objectives.

II The AGM

Companies should use the AGM to communicate with private investors and encourage their participation.

D ACCOUNTABILITY AND AUDIT

I Financial Reporting

The board should present a balanced and understandable assessment on the company's position and prospects.

II Internal Control

The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

III Relationship with Auditors

The board should establish formal and transparent arrangements for maintaining an appropriate relationship with the company's auditors.