THE IMPACT OF AUDIT COMMITTEE CHARACTERISTICS ON THE EXTENT OF VOLUNTARY DISCLOSURE AMONG MALAYSIAN LISTED COMPANIES

BY

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ABSTRACT

Disclosing of corporate voluntary information endorses the economic development and the solvency of company problems. Voluntary disclosures is expected to minimise the information gap between managers and shareholders and all other parties (external or concerned). Hence, disclosing more voluntary information would make financial information more useful to shareholders and reduces the information asymmety. Thus, this research examines the extent of voluntary disclosure among Malaysian listed companies, in association with audit committee characteristics. 394 annual reports of non-financial publicly listed companies are collected from Bursa Malaysia for the years 2016 and 2017. Five hypotheses are formulated based on agency theory and resource dependence theory to explain the research framework of the current study. The result shows that the extent of voluntary disclosure in the annual reports of Malaysian public listed companies is significantly greater. Findings shows that the audit committee independence and audit committee industry expertise are significantly and positively, related to the extent of voluntary disclosure. Thus, based on agency theory, independent directors are more likely to monitor the managers' actions effectively to enhance disclosure and to minimise information asymmetry and agency problems. Hence, it may be suggested that audit committee plays a significant role in monitoring the financial reporting process. In light of this evidence, it will be useful to policy makers to enhance the role of audit committees in the financial reporting process.

خلاصة البحث

يدعم الإفصاحُ الطوعيُّ عن المعلومات الخاصة للشركة التنميةَ الاقتصادية ويمنع فيها مشاكل الملاءة المالية، ويحدُّ من الفجوة في المعلومات بين المديرين والمساهمين فيها، وكذا جميع الأطراف الأخرى الخارجية والداخلية، ومن شأنه أن يجعل المعلومات المالية أكثر فائدة لاتصالها بنقص تناسب المعلومات، وعليه؛ يتحقق هذا البحث من مدى الإفصاح الطوعي في الشركات الماليزية المسجلة ومدى تأثير لجنة التدقيق عليه من خلال الخصائص: المسمى، وحجم لجنة التدقيق، ومدى استقلالية اللجنة، ولجنة التدقيق الإدارية، ولجنة التدقيق المالية، ولجنة التدقيق المهنية، ومن ثم؛ فحص البحث تقارير سنوية في 394 شركة عامة غير مالية مدرجة في البورصة الماليزية في السوق الرئيس لعامي 2016-2017؛ لتحديد رؤية ذات معنى لتأثير خصائص لجنة التدقيق على مدى الإفصاح الطوعي، ويفترض البحث خمس فرضيات مبنية على نظرية "معضلة الوكالة" ونظرية "الاعتماد على الموارد"؛ لتفسير الإطار الخاص به، واستخدم البحث التحليل المتعدد للانحدار، وبين علاقة إيجابية مهمة بين استقلالية لجنة التدقيق ولجنة التدقيق المهنية وبين الإفصاح الطوعي، وأن توفُّر إدارة متعددة (من أكثر من جهة) لا يوثر إيجابيًّا، ولا علاقة له بالإفصاح الطوعي عن المعلومات، وأن حجم لجنة التدقيق ولجنة التدقيق المالية لا علاقة كبيرة لهما بالإفصاح الطوعي، وعلى الرغم من ذلك؛ ليس لحجم الشركة ونفوذها علاقة كبيرة بالإفصاح الطوعي، لكن للنسبة الربحية علاقة كبيرة بمستوى ١٪، ويتوقع أن تكون هذه النتائج مفيدة للهيئات التنظيمية الماليزية من مثل مفوضية الأوراق المالية وبورصة ماليزيا، والهدف تعزيز كفاءة عمليات مراقبة التقارير المالية، ذلك أن النتائج تقدم دلائل لصناع السياسات والمستثمرين وخبراء المحاسبة على مدى ارتباط خصائص لجنة التدقيق بكفاءة لجنة التدقيق في مراقبة عمليات إعداد تقارير الشركات.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a thesis for the degree of Master of Science (Accounting).

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DECLARATION

I hereby declare that this dissertation is my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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I dedicate this dissertation to my beloved mother, Aamino Ahmed Farah, and my brothers, Mohamed Nor Aden, Abdullahi Nor Aden and Abdikarin Nor Aden for their prayers, supporting, understanding, and endurance for all my life.

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LIST OF ABBREVIATIONS

AC	Audit Committee
BRC	Blue Ribbon Committee
ACFEXP	Audit Committee with Financial Expertise
ACIND	Audit Committee Independent
ACINDUEXP	Audit Committee with Industry Expertise
ACMD	Audit Committee with Multiple Directorships
ACSIZE	Audit Committee Size
LEV	Leverage
LOGASSET	Firm Size
MCCG	Malaysian Code of Corporate Governance
OECD	Organization for Economic Co-operation Development
PROF	Profitability
US	United States
VIF	Variance Inflation Factor

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

The global financial crisis of 2007-2008 that resulted in a loss of transparency and confidence of investors and individuals was mainly caused by the absence of proper corporate governance, as signalled by the Asian markets. As a result, Asian firms have been dynamically reviewing and improving their corporate governance framework to reassure firm transparency and increase information disclosure since the last decade. Nevertheless, simply adopting worldwide standards of accounting is not enough to eliminate the transparent problems in these nations, but shareholders must be satisfied with the disclosed information in the associations of the yearly company annual reports.

Disclosing of the basic information (mandatory disclosures) should be added with voluntary disclosures based on the regulatory suggestions. Moreover, using market incentives can change manager's behaviour to disclose information voluntarily regarding the apparent association between the related costs and benefits (Healy & Palepu, 2001; Gray, Radebaugh, & Roberts, 1990). As such, researchers have started to focus on the factors that determine voluntary disclosure of information items to enhance reporting quality. Most of the prior studies that examined the factors influencing the voluntarily corporate information disclosure were carried out on the developed countries, like the U.S (e.g. Lang & Lundholm, 1996; Malone, Fries, & Jones, 2014; Raffournier, 1995).

This study attempts to present empirical proof on how the characteristics of audit committee impact voluntary disclosure in the context of Malaysian companies. The study examines the annual reports of 394 listed companies on Bursa Malaysia main market; the firms were chosen depends on stratified random sampling. To have a clear and meaningful understanding of how the attributes of an audit committee (AC) influence voluntary disclosure, this research examines two data sets of 2016 and 2017. With these data sets, the study attempts to measure the extent (i.e., dichotomous basis) simultaneously. In addition, the research purposes of inspecting the impact of an AC attributes, such as AC size, AC financial expertise, multiple directorships, AC independence and AC industry expertise on the extent of voluntary disclosure for the Malaysian listed companies. The present study also measures the extent of voluntary disclosure of public listed companies in Malaysia. Hence, the result of this study is expected to fill the gap in the literature of voluntary disclosure, particularly from the context of Malaysian.

This chapter acts as the preliminary part of this study. Section 1.2 offers discussion on the background of the study; Section 1.3 covers the problem statement; Section 1.4 and Section 1.5 respectively highlight the research objectives and research questions; Sections 1.6 elaborates on the motivations for this study; Section 1.7 highlights the significance of the study; Section 1.8 presents the organisation of the study; and final section – Section 1.9 – summarizes this chapter.

1.2 BACKGROUND OF THE STUDY

The firms' annual reports usually contain voluntary and mandatory information. Mandatory disclosures are the items mandated by the accounting bodies or regulatory agencies, such as Bursa Malaysia to be disclosed in a firms' annual reports (Penman, 2013) whereas, information items about the firm's activities in the annual reports that are related to financial and others without regulatory requirements are referred to as voluntary disclosures (Alsaeed, 2006). Thus, understanding the usefulness of voluntary information by the internal and external users, such as accounting bodies, has attracted considerable attention of researchers (Naser, Al-khatib, & Karbhari, 2002).

Mandatory and voluntary disclosures are the only two dimensions of the corporate governance disclosures. The disclosures that are based on regulatory requirements, such as the financial statements, are called mandatory disclosures; while the disclosures that are included to satisfy the shareholders, such as the investment analysis to make better decisions for the annual reports' users, are voluntary disclosures. Voluntary disclosures are excess information to the financial statements, according to Meek, Roberts, & Gray (1995).

Various corporate governance variables that are broadly related to voluntary disclosure have been reported in the empirical studies. These variables include the audit committee, board size, the number of independent directors, members of the family in the board. Ever since the accounting bodies or Asian market regulators require that their publicly listed firms must disclose specific information believed to be essential for the enhancement of corporate reporting quality. Even with this requirement, some listed firms are still not complying to the efforts of the regulatory bodies to improve the extent of their disclosures (Abdullah & Ismail, 2008).

Besides, the disclosure of corporate information not only be improved by implementing international accounting standards on mandatory information, but it is also essential to consider the management's attitude to disclose further essential information as voluntarily to supplement the reporting quality (Ho & Wong, 2001). Hence, the need for voluntary disclosures has received considerable attention as it mitigates the agency problems (Fama & Jensen, 1983; Healy & Palepu, 2001), contributes to market liquidity (Kim & Verrecchia, 1994; Diamond & Verrecchia, 1991), and reduces the initial capital of the firms (Meek et al., 1995; Botosan, 1997).

Besides the studies of Leventis and Weetman, (2004); Hossain et al. (1995) and Makhija & Patton, (2004) investigate the determinants of voluntary disclosures, include company size, profitability and leverage.

Ghazali and Weetman, (2006) inspect the extent to which listed Malaysian firms disclose voluntary information by investigating various sort of data they have published in their yearly reports. This study used their 2001 annual reports and found that firm size and profitability have a positive association with voluntary financial and strategic information disclosures. Archambault and Archambault (2003) note that there is a distinction among countries on the degree of information disclosure, and even businesses in the same country, due to the difference in the accounting standards and regulatory requirements about information disclosure and the ability to comply with the requirements.

Hence, the difference in the contents of the reported information may negatively influence the stakeholders' investment decisions. Lakhal (2005) report that the vital role of full disclosure is to increase transparency and safeguard the shareholders' rights. As a result, accounting bodies and regulatory agencies have been making several attempts to promote good corporate governance to diminish the adverse selections and agency problems related to the information asymmetric. Thus, corporate governance is an essential instrument to solve disclosure problems and to enforce transparency and trust between agencies and principles, leading to excellent financial performance (Rogers, 2008).

After the breakdowns and concerns on corporate related issues, it is considered that the development of coordination committee can take a vital function for the prevention of fraudulent financial reporting activities and the reassuring of the partner's trust in the reported statements. Besides, the issues of the objectivity of auditors' independence have been subjected to intense discussion in the literature of accounting issues. For example, Arcay and Vazquez, (2005) report that auditor's independence for the payments of audit fees and unreturned recommendation services are mainly due to the establishment of an economic association in the relationship between clients and auditors.

Audit Committee (AC) is one of the most significant sub-committees in the corporate board whose primary responsibility is to ensure financial reporting quality and the firms' financial statement quality. To perform the audit committee activities effectively depends on their independence from the company's management. This is because managers rely on the reviewers to stay free from unnecessary pressures and interventions from corporate administrators who share common directorships among different committees within the board of directors and who also hired inside and outside inspectors to check the accuracy and reasonableness of the financial reporting (Abdul-Rahman et al., 2006).

1.3 PROBLEM STATEMENT

Disclosing corporate information voluntarily in annual reports is important to avoid inadequacy and information a symmetrically. Thus, it has been discussed that disclosing such information may promote potential economic development and solve company problems. Gul and Leung, (2004), Akhtaruddin et al. (2009) and Dhaliwal et al. (2012) report that Asian financial crisis would have been prevented if corporate information disclosures were sufficient and indicate the future direction to the investors and regulators. Moreover, inadequate disclosure signals the presence of misrepresentation in the financial statements and could lead to corporate failure, as managers can potentially provide misleading information (Abraham, Marston, & Jones, 2015; Al-janadi et al., 2012).

As a result, voluntary disclosures may minimise the information gap between managers and shareholders and other concerned parties (Barako et al., 2006). Corporate information disclosure covers all financial and other interim reports in the companies to the interested parties (Gallego-Alvarez & Quina-Custodio, 2016). Meanwhile, voluntary disclosure is a crucial source of information (Rouf et al., 2014). Annual reports provide vital information to the involved stakeholders, and corporate transparency is strengthened through disclosures (Mohamad & Sulong, 2010).

The disclosures in the firm's annual reports can be referred to as either voluntary or mandatory information. Hence, voluntary disclosures are related to additional information, either financial or other information, which are to the regulators' views facilitate stakeholders' decision-making process (Watson et al., 2002; Meek et al., 1995; Cooke, 1989).

For instance, disclosing information, such as company's research and development, potential strategies, and investment analysis, are referred to as voluntary disclosures; while disclosing information that are related to the firms' financial transactions in a year are known to be mandatory disclosures (Polinsky & Shavell, 2010; Adina & Ion, 2008). Also, the firm's disclosures are reflected its share prices and could considerably signal future performance (Bischof & Daske, 2013; Eng & Mark, 2003). For instance, a lower share price may specify higher risks towards the shareholders' capital.

Also, the disclosure of more voluntarily information can convince shareholders about the causes of weak financial performance and share prices (Healy & Palepu, 2001). Moreover, firms with financial difficulties or emerging into the market may disclose more information voluntarily than profitable or mature companies to reassure their shareholders. However, agency theory suggests that enhanced monitoring is required to reduce managers' self-interest behaviour and to be accountable for their responsibilities which can lead directors to disclose more data voluntarily in the firm's yearly report (Francis, Nanda, & Olsson, 2008). Hence, the audit committee is essential for transparency, particularly concerning information disclosures. The audit committee should comprise mainly competent individuals who can be trusted in monitoring and controlling a company's financial and non-financial information. Their activities should allow principal to be aware of what is going on in the company, though this will increase the agency costs related to the monitoring of the administration' activities.

With the previous discussion, the issue is that there is a dearth of literature on the influence of attributes of the audit committee and the extent of voluntary disclosure for the registered companies in Malaysia. Therefore, this study intends to explore the level of voluntary disclosures by the Malaysian listed companies and whether audit committee characteristics influence such disclosures.

1.4 OBJECTIVES OF THE STUDY

The main objective of this study is centred on determining the impact of audit committee characteristics and the extent of voluntary disclosure in Malaysian registered companies.

The specific objectives of this study are as follows:

1. To measure the extent of voluntary disclosure of Malaysian publicly listed firms with respect to 2016 and 2017 financial years.
2. To investigate the impacts of audit committee characteristics (i.e. AC size, multiple directorships, independence, and financial and industry expertise)

on the extent of voluntary disclosures of the Malaysian public listed companies.

1.5 RESEARCH QUESTIONS

The following are the research questions that this study intends to answer:

1. What is the extent of voluntary disclosure of publicly listed firms with respect to 2016 and 2017 financial years?
2. What are the impacts of audit committee characteristics (i.e. AC size, multiple directorships, independence, and financial and industry expertise) on the extent of voluntary disclosures of the Malaysian public listed companies?

1.6 MOTIVATION FOR THE STUDY

During the Asian financial crisis of 2007-2008, it was reported that more voluntary disclosures are needed to protect the investors' wealth. Meanwhile, the lack of effective corporate governance has been predictable as one of the crucial reasons for many corporate collapses and corporate scandals around the world, leading to impaired investors' confidence (Raffournier 1995). Thus, the following are among the motivations for this study. Firstly, this study efforts to comprehend the association among the attributes of the audit committee and the extent of voluntary disclosure. This information may encourage companies to add more items for disclosures on corporate governance in their annual reports. Therefore, it will help to enhance the degree of transparency on the part of companies and raise the level of confidence and reliability of investors and shareholders.

Secondly, the study is motivated by various studies on the extent of voluntary disclosure and audit committee characteristics. For example, the studies of Cooke (1989); Raffournier (1995); Depoers (2000); Persons (2009); Dhaliwal, Naiker, and Navissi (2010), and Banghoj and Plenborg (2008) have been conducted on developed countries. Also, the studies of Ho and Wang (2001)**;** Talpur et al. (2018) conducted on developing countries, like Malaysia, are among the studies that motivate this study. These studies claim that firms often use voluntary disclosures to reduce information asymmetry by releasing useful disclosures (Talpur et al., 2018). Thirdly, this research is predicted to contribute to the empirical improvement about the function of the AC on the voluntary disclosure by the Malaysian public listed companies. Lastly, this study intends to become a foundation for regulators listed companies that the expertise and qualifications of the individuals are vital for the selection of audit committee members. Therefore, the purpose is to achieve the assurance that the information submitted by the management to the public are trustworthy and fully transparent.

1.7 SIGNIFICANCE OF THE STUDY

This study emphasises on the issues of the attributes of the audit committee and the extent of voluntary disclosures. It investigates the influence of AC attributes (i.e. size, independence, multiple directorships, financial expertise, and industry expertise) on the extent of voluntary disclosure. This study contributes to the existing works on corporate governance, namely attributes of the audit committee, the effectiveness of corporate governance, and the extent of voluntary disclosure using Malaysian listed companies' recent data for 2016 and 2017 financial year. Thus, this study expects to further increase readers' understanding of audit committee attributes, and the extent of voluntary disclosure of the public registered companies in Malaysia.

Secondly, this study will benefit Malaysian listed companies to improve corporate governance systems based on the outcome of the relationship between audit committee characteristics and the extent of voluntary disclosure. Thirdly, the findings of this research will have significant implications for the regulators of Bursa Malaysia by providing evidence that the efficiency of the corporate governance system is due to better monitoring of management. Fourthly, the study contributes to knowledge sharing on the practices of voluntary disclosures in the growing capital markets, particularly for the developing countries, such as Malaysia, that are currently improving and amending their financial system of reporting to a reputable level. Hence, the researcher noticed that there are areas on the financial reporting system to be investigated that may assist the policymakers in setting new rules that can raise the transparency levels of corporate governance in Malaysia.

Lastly, this research contributes to the existing literature by means of exploring the impact of audit committee attributes on the extent of voluntary disclosure. This study expands the literature on voluntary disclosure by providing new empirical research. Besides, the study attempts to incorporate two new proxies of the audit committee, which are the industry expertise of the AC and multiple directorships. As for industry has make sense because AC with specific industry expertise may constrain voluntary disclosures to avoid proprietry costs like disclosure of comperative advantage. Ultimately, this dissertation has contributed to the existing literature on voluntary disclosures, specifically in the context of the Malaysian listed firms.