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The Impact of Risk Management Committee Characteristics on Corporate Voluntary Disclosure in Malaysia

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Abstract

This study establishes a conceptual framework for the relationship between the characteristics of risk management committees (RMCs) and voluntary disclosure. It underlines the significance of distinguishing between the tasks and responsibilities of an audit committee (AC) and a risk management committee (RMC). Furthermore, auditors and RMC members should not be in any way entangled to provide an objective assessment of all risk management responsibilities. Following the Malaysia Code of Corporate Governance 2017, the board shall form an RMC, consisting of a majority of independent directors, to supervise the firm's RM framework and rules, as well as their implementation.

Keywords: Corporate Governance, Voluntary Disclosure, Risk Management Committee, Malaysia

1. Introduction

Unexpected corporate failures around the world have resulted in rising prices, as well as a loss of trust in board members, an unstable financial system, and a drop-in economic activity (Halim et al., 2017; Ng, Chong, & Ismail, 2012). Various factors may have contributed to these failures, but high risk-taking may have been one of the most significant factors (Ng et al., 2012). Meanwhile, the lack of an RMC may have contributed to the instability that gripped many significant institutions during the global financial crisis of 2008 in various ways (Fajembola, Rahman, & Rus, 2018; Amoozegar, Pukthuanthong, & Walker, 2017; Hines & Peters, 2015). This is in line with Malaysia CCG 2017, which stated that the board of directors forms an RMC, consisting of a majority of independent directors, to supervise the firm's risk management (RM) framework and policies. According to CCG 2017, set the risk appetite within which the board expects management to function, and ensure that a suitable RM framework is in place to identify, analyze, evaluate, manage, and monitor critical financial and non-financial risks.

According to Abdullah, Janor, Hamid, and Yatim (2017), risk management is an important aspect of corporate governance. They go on to say that companies should protect the shareholders' interests. Furthermore, it is recognized that a strong corporate governance culture influences management practices and decision-making processes, particularly those related to the development of a special oversight committee to review the firm's risk management process (Badriyah, Sari, & Basri, 2015; Kakanda, Salim, & Chandren, 2017). To reduce these risks, management must work with the Board of Directors (BoD) to form a specialist committee to supervise the RM processes. Furthermore, numerous corporate stakeholders are increasing their demands for public businesses to establish RM frameworks as well as a separate RMC. This will reduce risks while also improving transparency (Kakanda, Salim, & Chandren, 2018). Essentially, an RMC's continuous evaluation of the organization's risk management system is a critical initial step in supporting the AC in achieving its purpose of ensuring that financial reports are of acceptable quality (Jia, 2019). In addition, the RMC oversees the implementation of risk rules and advises the management and board on effective RM (Fajembola et al., 2018).

Furthermore, RM is critical for a company's long-term existence (Abdullah, Shukor, & Rahmat, 2017). The increased global focus on RM practices has sparked considerable legislative revisions around the world. According to Ng et al. (2012), organizations in Malaysia should be able to detect, control, and monitor risks that may impair their operations. As a result, all listed companies in Malaysia need to implement an independent enterprise risk management system (Halim et al., 2017; MCCG, 2017; HABTOOR, et al., 2020). Therefore, poor risk monitoring by various firms has resulted in the firms suffering substantial losses which lowers performance. When a company loses money due to a high-risk situation, the RMC members are likely to be replaced (Kallamu, 2015).

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RMC incorporates the risks associated with the firm's contacts with the external environment, such as marketing risk and competitive risk, in addition to AC expertise on the firm's internal control system and financial statements (Ishak & Yusof, 2013; Kakanda, et al., 2017). As a result, forming a separate RMC that focuses solely on the firm's risk-related issues will aid in risk management and improve firm performance (Badriyah et al., 2015; Liew, Mat Zain, & Jaffar, 2012).

Risk management functions (RMF) are essential for increasing institutional disclosure and dealing with shareholder litigation. Following recent corporate scandals, corporate voluntary disclosure (VD), an important component of capital market dynamics, has gotten a lot of attention. Furthermore, To improve openness and restore confidence in the financial markets, several reforms and standards of best governance practices have been enacted around the world (Barros, Boubaker, & Hamrouni, 2013). Academics have long emphasized the need for high-quality disclosure. Voluntary disclosure is thought to be vital for the efficient operation of the capital market since it informs shareholders and potential investors about corporate voluntary disclosure and governance, boosting their confidence. In a landmark work, According to Jensen and Meckling (1976), a good company voluntary disclosure approach reduces agency costs and mitigates information asymmetry between management and shareholders. According to Lobo and Zhou (2001), the agency theory proposes that firms increase corporate voluntary disclosure to resolve conflicts between principals (shareholders) and agents (managers). Companies who seek to increase their firm's value may consider boosting corporate voluntary disclosure.

In a similar line, Diamond and Verrecchia (1991) claim that the amount of information given by major transactions is smaller for firms that provide more data about their operations, implying that voluntary disclosure reduces investor information asymmetry. The technique to help management control and the attainment of firm value maximization is a basic concept in all governance systems. It is critical to have an RMC in place to supervise the management and decrease information asymmetry between shareholders and management. Given the significance of RMC in monitoring, it is reasonable to assume that firms with better RMCs will boost management incentives to reveal more corporate information to their stakeholders.

2. Stand-Alone Risk Management Committee

The Malaysian Securities Commission strongly favors the creation of an RMC through the Malaysian Corporate Governance Code (MCGC). In a similar vein, as part of their listing criteria, Bursa Malaysia requires corporations to provide a statement about their risk management and internal control affairs. The requirement for a separate RMC is clearly stated in the 2017 amended code of corporate governance, which requires significant corporations to establish an RMC to monitor risk management policies and practices. It should be emphasized., However, because they have different roles and responsibilities inside the business, the corporation should keep this group separate from the audit committee. The board of directors, as the highest authority in the corporate structure, is solely accountable for risk management actions within the company, according to the MCGC. As a result, the board of directors must start and/or organize a separate committee dedicated solely to risk management in their company. To protect its shareholders, the corporation established this committee to define its risk tolerance as well as identify and assess major risk factors (Aldhamari, Nor, Boudiab, & Mas' ud, 2020).

In addition, the RMC is a sub-committee of the board that handles RM oversight. Companies with a high degree of corporate governance are more likely to provide a high level of corporate transparency, according to research (Jia, Li, & Munro, 2019; Kiliç and Kuzey, 2018). Risk management committees, raising risk enterprise management expertise within businesses, according to Mohd-Sanusi, Motjaba-Nia, Roosle, Sari, and Harjitok (2017), boosts the firm's market value. This is predicated on the idea that ineffective resource management can deplete a company's resources, resulting in a loss of shareholder capital. RMC is also expected to increase risk monitoring as a risk monitoring method, resulting in lower agency costs and less information asymmetry (Jensen and Meckling, 1976). An RMC can increase the quality of internal monitoring of a firm's risk profile, according to Ishak and Yusof (2014). Furthermore, one of an RMC's responsibilities is to provide investors with appropriate and relevant risk information, thereby lowering the danger of the firm's devaluation by investors. We believe that a stand-alone RMC will improve disclosure quality based on these reasons. Meanwhile, Halim pointed out that RMC is a company's strength, allowing it to meet its business goals, improve financial reporting quality to protect the company's reputation, and improve performance. Because the RMC is in charge of inspecting, monitoring, and evaluating the company's principles, policies, strategies, processes, and RM controls, this will result in a better RM process, reducing, if not eliminating, the company's risks and, as a result, influencing the improvement of corporate voluntary disclosure.

3. Risk Management Committee Diligence

The frequency with which RMCs meet is a good indicator of their thoroughness (Malik, Zaman, & Buckby, 2020). Despite RMC's role in managing risk and its impact on a company's disclosure through a robust risk framework. When it comes to RMC efficacy, however, board members' engagement is the most crucial component (Boudiab & Ishak, 2020; Ng, Chong, & Ismail, 2012). The RMC's key agenda item is to arrange frequent meetings that will allow board members to engage and share useful ideas for improving the firm's efficiency. Regular meetings and checks and balances guarantee

that no issue goes unnoticed (Fajembola, Rahman, & Rus, 2018). More RMC meetings are intended to signify improved governance (Hines & Peters, 2015). Furthermore, a continual sequence of meetings plays an essential function in determining the RMC board members' efficacy (Yatim, 2009).

Meetings are intended to increase organizational value since they allow for more contact and sharing of ideas. It also allows for frequent monitoring (Fajembola et al., 2018). More RMC meetings are expected to demonstrate diligence (Hines, Masli, Mauldin, & Peters, 2015). Additionally, the frequency with which members meet is an important factor in determining its efficacy (Kakanda et al., 2018; Yatim, 2009; HABTOOR etal., 2020). In addition, an inactive RMC may be ineffective, affecting the organization's control process (Malik et al., 2020). Previous research has revealed evidence that frequent committee meetings suggest efforts to achieve the committee's objectives and that members are willing to execute their roles in supporting effective control (Abbott & Parker, 2000; Ellul & Yerramilli, 2013).

RMC members can easily communicate, discuss, and reach a common goal by holding meetings to discuss RM concerns (Kakanda et al., 2018; Ng et al., 2012). Additionally, frequent meetings help members to be informed about the organization's risk (Kakanda et al., 2018; Ng et al., 2012; Yatim, 2009). Regular meetings are expected to ensure that the decision-making monitoring process runs smoothly and efficiently (Ng et al., 2012). Furthermore, RMC members who are watchful in their oversight obligations, particularly RM activities, improve communication amongst themselves and boost the board's monitoring function, according to Yatim (2010).

Further, MCCG 2000 mandates that the board meet regularly. The number of meetings held annually, as well as the details of those meetings, should be made public by the corporation. Aside from that, the board should have a set agenda. In addition, the MCCG 2007 recommends that the board meet at least four times per year. Attending board meetings regularly will improve communication between directors and internal control organs like the RMC. It will also guarantee that the board improves its ability to carry out its statutory responsibilities (Fajembola et al., 2018). Moreover, holding regular meetings stimulates free conversation and increases communication among the members of the board of directors (Ishak & Mohamad Nor, 2017; Yatim, 2010). As a result, more meetings are expected to keep members up to date on current information and understanding about the firm's state, particularly with RM and concerns that may affect their supervisory responsibilities (Halim et al., 2017). As a result, more vigilant boards may strengthen their RM framework, which includes establishing an RMC to aid in the firm's internal control. Additionally, more frequent meetings have been linked to fewer financial reporting errors/frauds and have been found to improve external audit quality. As a result, more frequent board meetings harm corporate voluntary disclosure.

4. Risk Management Committee Size

The majority of RMC members should be independent directors, according to MCGC 2017. While the question of who should be chosen for the RMC and his responsibilities is straightforward, the question of how many members the RMC should have is more complicated. Unfortunately, neither the MCGC nor the Listing Requirements address issues related to membership size. When it comes to audit committee size, at least three members must be appointed, and all members must be independent (Securities Commission, 2017). Similarly, the presence of a risk management committee may be related to the size of the board. The presence of a large board size provides more options to find directors with the necessary competence to create and lead a risk management subcommittee (Abubakar, Ado, Mohamed, & Mustapha, 2018; Yatim, 2009). Furthermore, the size of the RMC is regarded as an indicator of a corporation's readiness to spend board money to boost the prestige of clients and the committee's strength (Fali, Philomena, Ibrahim, & Amos, 2020).

The size of an RMC can be defined as the total number of members on the committee at the end of a fiscal year (Ishak, 2016). Furthermore, the RMC size is used as a proxy for an organization's willingness to commit board-level resources to improve its ERM operations (Malik et al., 2020). The RMC's size is a crucial aspect (Kakanda et al., 2018; Ng et al., 2012). The size of the committee has a significant impact on its ability to perform (Elamer & Benyazid, 2018). A larger RMC is expected to focus on risk issues with greater determination and efficiency (Ng et al., 2012). Companies with larger boards are more likely to attract directors with the necessary expertise to participate in and harmonize with the RM sub-committee (Blessy & Taddesse, 2014). Additionally, Malik et al. (2020) claim that a large RMC may improve its ERM effectiveness since it is more likely to match the essential characteristics, such as more independence, director knowledge, gender diversity, and so on. Similarly, large committees might have a diversified membership, which can provide additional resources for success. Moreover, RMC size is important because it is likely to be diversified, which may attract competent and skilled personnel, resulting in an increased corporate voluntary disclosure.

A larger committee may have access to a wider range of knowledge and skills required for RM (Blessy & Taddesse, 2014). A smaller RMC, on the other hand, is expected to be more efficient for directors' monitoring functions and have a lower probability of failure (Ishak, 2016).

Theoretically, because the purpose of agency theory is to solve the problem of the principal-agent relationship (Eisenhardt, 1989), which reduces the high costs associated with agency issues (Fama & Jensen, 1983), a larger board will thwart the CEO's dominance of the board because directors will be in a more upright position to exercise their powers and rights in governing the firm, thereby improving corporate voluntary disclosure. For this reason, agency theory predicts that a moderate RMC size will be more successful in improving firm disclosure.

The MCCG 2017 mandates that the board form an RMC comprised mostly of independent directors to oversee the organization's risk management structure and policies. The minimal number of committee members, however, is not specified in the code. Bursa Malaysia, on the other hand, is required by Section 22 of the "Capital Markets and Services Act 2007" to have a minimum of four members.

5. Risk Management Committee Independence

The presence of an independent director on the RMC is a critical aspect in determining the committee's objectivity. Most RMC members should be independent directors, according to paragraph 9.3 of the MCGC 2017. (Securities Commission, 2017). Similarly, a board's ability to supervise is dependent on its independence from management. The presence of a substantial number of non-executive directors on the board is widely seen as a good indicator of the board's independence from management (Abubakar, Ado, Mohamed, & Mustapha, 2018).

An effective risk governance team, according to Battaglia and Gallo (2015), should be made up of independent individuals. One of the conditions for effective risk mitigation in business organizations is the formation of such a committee. Fajembola and colleagues (2018) It is anticipated that members who can do their jobs without interference will be more objective and effective, allowing them to restrict management from acting in ways that could harm the organization. Independent RMCs have been found to lower risk through better monitoring and oversight in previous studies. Non-executive directors play a critical part in managerial functions, as the agency theory suggests (Azam, Usmani & Abassi, 2011; Fuzi, Halim & Julizaerma, 2016; HABTOOR, et al., 2020). It is expected that boards with more non-executive directors will be able to successfully carry out their responsibilities and make better decisions than boards with fewer (Kakanda et al., 2016). Similarly, a significant number of independent directors provide neutral perspectives, fresh ideas, problem-solving skills, and critical judgment that executive directors may lack (Amran, 2016). The board's makeup is a critical component in determining how well management is supervised in an organization (Malik et al., 2020).

As a result, an RMC may be ineffective if there are not enough independent directors with the proper knowledge and experience of a given industry and its unique hazards. The pillar of effective risk oversight, according to regulators, practitioners, and scholars, is independence (Hines et al., 2015). This is because greater RMC independence indicates better governance. Independent directors in the subcommittees, likewise, must have specified abilities and knowledge to be considered for these posts (Méndez, Pathan, & Garca, 2015). Moreover, According to Kakanda et al. (2018), the impact of management choices decreases as committee members appear to be more autonomous.

Similarly, Hooy and Tee (2009) suggest that sovereign directors in Malaysian Government-Linked Companies have failed to fulfill their endogenous monitoring duty (GLCs). Furthermore, as suggested by Johari, Saleh, Jaffar, and Hassan, the MCCG's minimum composition of the sovereign director may not be appropriate for inefficiently overseeing management (2009). The MCCG 2017 mandates that the RMC include more independent directors to supervise the company's RM in Malaysia.

In general, the presence of non-executive directors on a board is critical to its performance (Fuzi, Halim & Julizaerma, 2016). As a result, it is not surprising that the board of directors of any firm should be dominated by non-executives, who are presumed to be independent of management (Kang, Cheng, & Gray, 2007). It is thought that when a board has a small number of non-executive directors, the board will be dominated by executive members and will be unable to criticize the executives' actions (Fuzi et al., 2016). Again, where the board chairman is an executive director, the majority of the board must be independent, and the board should audit its independence ratio every year, according to Malaysia's code of corporate governance (2012). Furthermore, in Malaysia, the majority of businesses have a one-tier board. As a result, Bursa Malaysia mandated that non-executive directors make up at least one-third of the overall board for it to function effectively and serve the interests of shareholders. Furthermore, if the company is classified as large, MCCG 2017 advised that the board report whether half of the board members are independent directors every year.

6. Theoretical Background

It has been pointed out that the challenge in adopting "excellent" corporate governance currently stems from the potentially tense association between the board of directors and shareholders. Agency theory has addressed this issue (Donaldson & Davis, 1991).

6.1. Agency Theory

The agency theory describes the interplay between managers (agents) and shareholders (principals) (Donaldson & Davis, 1991). Its goal is to resolve conflicts between the organization's management and its owners by outlining procedures for resolving them, such as delegating decision-making to project managers.

According to the agency hypothesis, businesses are made up of contracts between owners and managers who are responsible for how they use the company's resources (Jensen & Meckling, 1976). According to the theory, managers have more information about firms than owners, and this information asymmetry hinders the principal's capacity to adequately oversee whether or not their interests are being served by the agent. It would be difficult and expensive for the

principal to monitor the acts of the agent, and as a result, the former cannot be certain that the latter has carried out his responsibilities properly. The principal-agent relationship and the adoption of governance systems as monitoring mechanisms that reduce agency difficulties and costs by ensuring that the principal and agent's interests are aligned is the theory's basic premise. Why does the agency problem contribute to corporate governance concerns? Lubatkin, Schulze, Ling, and Dino (2005) showed why. They claimed that at its most fundamental level, agency theory is concerned with issues resulting from cooperative exchanges in which the principal contracts with the agent to make decisions on the latter's behalf. Nonetheless, contracts tend to be incomplete and vulnerable to risks due to human nature, such as self-interest, bounded rationality, and risk aversion; organizational nature, such as goal conflict among organizational members; and information asymmetry, all of which make it difficult and costly for principals to keep up with actual accomplishments.

The agents are blamed for the emergence of agency difficulties because they hide facts or act in their self-serving interests. Principals are motivated to invest in monitoring and provide rewards to managers as a result of this. The agency hypothesis, according to Jensen and Meckling (1976), tries to avoid or lessen the agency cost caused by a conflict of interests between managers and owners. The aggregate bonding costs and the residual cost are the agency costs. The salaries and expenses paid by owners to measure, control, and observe the agent's performance are known as monitoring costs. Despite the above-mentioned clarifications of the agency theory and difficulties, the concentrated ownership structure still creates a conflict of interest. This is a difficulty that both external investors and company executives face. Internal and external monitoring methods could be linked to fixing the agency dilemma, but these techniques come at a cost to the agency.

According to Jensen and Meckling, providing information can be a strategy to reduce agency costs (1976). Increased earnings quality (EQ) is thought to lead to more corporate voluntary disclosure, and so transparency is a strategy to lower the information asymmetry between owners and agents, minority and majority shareholders, and, as a result, reduce agency costs. According to the agency theory, EQ is a method for corporate voluntary disclosure that decreases costs associated with management-shareholder disputes, minority-majority shareholder conflicts, and firm-creditor conflicts (Jensen & Meckling, 1976).

6.2. Proposed Conceptual Framework

Even if empirical findings are inconsistent, the relevance of effective corporate governance practice in promoting corporate voluntary disclosure has been examined in a variety of publications. In Malaysia, the empirical literature on RMC is also quite scarce. In light of this, it is necessary to determine the RMC characteristics that drive firm disclosure in Malaysia proposed conceptual framework used agency theory as an appropriate conceptual linkage to explain why managers of Malaysian listed companies do not act in ways that are consistent with shareholders' goals, especially in a developing country like Malaysia were developing corporate governance principles and enforcing them is difficult. According to the agency hypothesis, in listed businesses with a concentrated ownership structure, there is an agency problem between minority shareholders and majority shareholders, who, due to their controlling power, will try to expropriate smaller shareholders (Fama & Jensen, 1983; Jensen & Meckling, 1976).

The argument above demonstrates that RMC and corporate voluntary disclosure are linked. As a result, this research contributes to a better understanding of the impact of RMC features on business voluntary disclosure. This study will provide useful information to accounting standard-setting authorities, investors, analysts, and researchers to better understand how RMC can improve company voluntary disclosure. Furthermore, provides a conceptual model that elucidates the link between RMC features and firm disclosure. This is illustrated in figure 1 below:

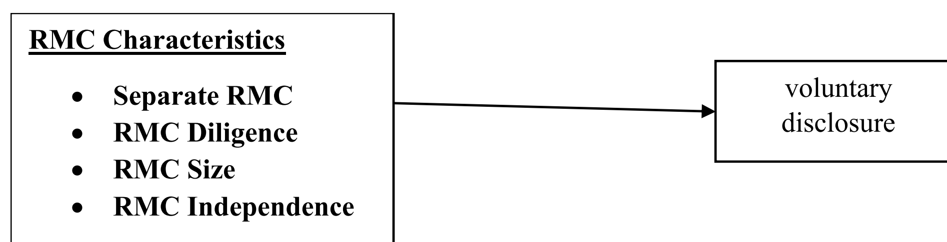

Fig. 1. Conceptual Framework of the Study

7. Conclusion

Financial crises, corporate failures, the competitive climate, and globalization are all putting pressure on businesses' ability to survive. As a result, continual risk monitoring and assessment have become a top priority in corporate

management and public policy implementation to maintain corporate accountability and improve operating performance. With these, the RMC has proven to be a very important metric for most businesses.

This study's proposed conceptual framework makes theoretical, contextual, and policy contributions. It defines the function of RMC features in increasing corporate voluntary disclosure. While there are many studies on corporate governance and disclosure, the impact of RMC and company voluntary disclosure has been overlooked in these studies.

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