Full Length Research Paper

Risk management disclosure in Malaysian public listed companies

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Accepted 17 April, 2013

The purpose of this study is to examine the risk management disclosure level among top 150 public listed companies in Malaysia. A score sheet checklist consists of mandatory and voluntary items have been developed to examine the disclosure level. Based on the total final sample of 122 listed companies for three years (2006 to 2008) the result show that risk management disclosure is relatively low irrespective of the importance of this information. This result indicates that further action must be taken by regulatory bodies to ensure more disclosure and information disclosed to the public.

Key words: Management, risk, public, Malaysia, companies.

INTRODUCTION

Corporate scandals and diminished confidence in financial reporting among investors and creditors have renewed corporate governance as a top priority for boards of directors, management, auditors and stakeholders (Raber, 2003). The annual report was seen to have weaknesses due to the lack of important information such as risk facing companies (Cabedo and Tirado, 2003). Such weaknesses have led to an increased demand for more disclosures, particularly in the non-financial segment of the annual report (Amran, Abdul Manaf and Che Haat, 2009) to ensure they are free from accounting fraud.

In Malaysia, many companies have collapsed during the Asian financial crisis in 1997 and the situation was even worst in world global crisis which driven by US subprime problems in 2007. Lack of corporate governance, weak internal control and risk management system were viewed as the roots of internal problems that eventuated companies to collapse.

In response to Asian Financial crisis, the government in Malaysia has quickly moved forward by establishing the Malaysian Code of Corporate Governance (MCCG) which was initiated in 2000 and was later revised in 2007. MCCG was formed to restructure the corporate governance guidelines as one effort in assisting the corporation to recover. The aim of MCCG is to set out principles and best practices as guidance for the companies in running their business operations towards achieving optimal governance framework. The development of MCCG is one of the major efforts that have influence Malaysian companies’ risk management system and disclosure level. Bursa (formerly known as KLSE) Revamp Listing Requirement 2007 has also shared the same view as MCCG on the importance of internal control and risk management. The listing requirement has consistently requested the board of directors to make disclosure in line with MCCG.

Therefore, the objective of this study is to examine the level of risk management disclosure in Malaysian public listed companies.

LITERATURE REVIEWS

Background of risk management

The importance of risk management was initiated when Cadbury Report in 1992 highlighted the code of best practiced requiring companies to establish audit committee and make disclosure on the effectiveness of internal control. The main issue being pointed out in the
report was on the need for a company to review their internal control system and reporting risk to their shareholders. The Hampel Report in 1998 further emphasised on the whole system of internal control which led to the requirement on risk management disclosure as part of the internal control in Combined Code (The London Stock Exchange Limited, 1998). The Turnbull Report in 1999 also responded in line with the Combined Code by emphasising the whole system of internal control that risk management should be around that system.

In 2002, the Risk Management Standard was published in UK to guide the companies on the terminology, process, organisation structure and objective for risk management. The standard defined risk as “the combination of the probability of an event and its consequences”. Solomon et al. (2000) defined risk as “the uncertainty associated with both potential gain and loss” (p.449). Linsley and Shrives (2006) provided more specific definition of risk disclosure as any information disclosed to reader on any opportunity, prospect, hazard, harm, threat or exposure that has already impacted or may give an impact upon the company or management in future. In general, risk refers to any uncertainty that faced by the organisation that could lead to gains or losses.

Finanial reporting standard disclosure in Malaysia

Malaysia Accounting Standard Board (MASB) is the responsible accounting body that sets the accounting standards in Malaysia. MASB was established under the Financial Reporting Act 1997 and act as an independent authority to develop and issue accounting and financial reporting standard in Malaysia. The objective of MASB is to develop and promote high quality accounting and reporting standard that are consistent with the international practices for the benefit of users, prepares, auditors and the public in Malaysia (MASB, 2005).

As for risk reporting, MASB had issued two main standards that require the company to provide disclosure. The two standards are Financial Reporting standard (FRS) 101: Presentation of Financial Statement and FRS 132: Financial Instruments: Disclosure and Presentation.

Under FRS 101: Presentation of Financial Statement, Paragraph 105 (d) (ii) requires a company to disclose notes to assist users in understanding the financial statement on non-financial disclosures such as entity’s financial risk management objectives and policies.

While under FRS 132: Financial Instruments: Disclosure and Presentation, Paragraph 52 requires a company to provide information to assist users of financial statements in assessing the extent of risk related to financial instruments. According to Paragraph 58, FRS 132, a company needs to describe its financial risk management objectives and policies, including its policy for hedging each main type of forecast transaction and its accounting treatment. Paragraph 58, FRS 132 has also specified the need to have a separate disclosure for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation (as defined in FRS 139) disclosed in the financial statement.

However, FRS 132 does not stipulate either the format of the information required to be disclosed or its location within the financial statements. The standard noted that a company could either present it on the face of financial statement or include it in the notes to the accounts. The reporting approach could also include a combination of narrative descriptions and quantified data, as appropriate to the nature of the instruments and their relative significance to the entity.

RESEARCH DESIGN

Sample selection

This study focuses on the disclosure made by companies listed on the Bursa Malaysia. Consistent with previous studies (Abdul Wahab, 2007; Che Haat et al., 2008 and Abdul Jalil, 2008) one hundred and fifty companies listed on the main board of Bursa Malaysia based on the market capitalisation ranking on 31 December 2007 (Bursa Malaysia Top Public Listed Companies by Market Capitalization, 2007) are chosen as the sample study. However, companies that are in the financial industry such as banking, insurance, trust, closed-end funds and securities are excluded from the sample due to their nature of business (Berretta and Bozzolan, 2004; Linsley and Shrives, 2006; Abraham and Cox, 2007) being governed by the additional regulation.

Consistent to previous studies, content analysis was performed in collecting and analysing the level of risk management disclosure in the annual reports (Lajili and Zeghal, 2005; Linsley and Shrives, 2006; Amran et al., 2009).

Risk management disclosure checklist

Three levels of risks to classify the extent of disclosure were used. This study used a 3-point scale to determine the extent of risk management disclosure. Such scale would provide more details on the extent of risk disclosure rather compared to using dichotomous measurement.

The score checklist covers two sections: mandatory disclosure and voluntary disclosure. The Mandatory Risk Disclosure which has been required by FRS 132: Financial Instruments: Disclosure and Presentation is divided into two main attributes:

i. Risk related to financial instrument
ii. Financial Risk Management Policies

On the other hand, voluntary disclosure score checklist consists of nine main attributes, namely, risk assessment, control environment, control activities, information and communication,
monitoring, operation risk, integrity risk, information processing technology and strategic risk. All these attributes were obtained from the Statement of Internal Control as well as recommendation by previous studies (Berreta and, 2004 and Linsley and Shrives, 2006).

RESULTS AND FINDINGS

As indicated in Table 1, the overall mean score for risk management disclosure among the public listed companies is 52.79%. Such results indicate that more efforts are needed to improve the level of risk disclosure in ensuring the stakeholders to have sufficient information about the risk facing companies. The results also show that the risk disclosure has slightly increased from year 2006 to 2008. Table 1 shows that the total risk management disclosure has a mean range from 52.71% to 53.85% indicating that the trend of providing risk disclosure among the companies is increasing. This finding implies that companies have started to perceive risk management disclosure as being important.

The result in Table 1 also shows that the highest and lowest percentage of total risk management disclosure is 78.57% and 32.14% respectively. Table 2 shows the top 5 companies that score the highest risk management disclosure.

Table 1 also shows the mean value for mandatory risk management disclosure. The results show that the mandatory risk disclosure is high (70.56%). Such results are expected due to the legal requirements by the accounting bodies whereby non-compliance of the legal requirements would lead to legal implication. The results indicates that there is a need for some standardised reporting format or guidelines from the standard setting and regulatory bodies to ensure compliance with the standards (Othman and Ameer, 2009). It is because the current guidelines just provide the general rules on risk reporting but do not provide the details of the item that should be disclosed by the company.

With regards to voluntary disclosure, the mean percentage of voluntary risk management disclosure is 50%. Such results are considered relatively low considering the importance of risk management to the users for decision-making. The results also show that the highest and lowest percentage of voluntary risk was 79.17% and 25% respectively. The highest disclosure was made by British America Tobacco Berhad and Tenaga Malaysia Berhad. The fact that the highest score companies have comprehensive risk management disclosure could be attributed by the establishment of the Enterprise Risk Management (ERM) which provides full review of risk information to the users.

Mandatory disclosure

Based on Table 3, the overall mean percentage results show that 62.90% of the risk disclosure was made by public listed companies is related to financial instrument. Such results are consistent with the result of Amran et al. (2009) where they found financial risk disclosure of 100 public listed companies at 64%. The results also indicate that overall, 78.36% disclosure was made in respect of risk management objectives and policies. This is considered quite high as most companies seem to comply with the requirement in FRS 132 to provide financial risk management objectives and policies.
The results show that the highest score is 84.51% for the interest rate risk. The results are consistent with the results shown in Othman and Ameer (2009). Othman and Ameer found that interest rate risk as the most highest type of market risk disclosed by top 500 companies in Bursa Malaysia. However, the recorded interest rate risk was shown at 37.06%. The main reason for the results variation between this study and Othman and Ameer’s (2009) study is that this study used top 150 companies listed on main board based on market capitalisation whereas their study used 500 companies listed in main board, second board and MESDAQ. Therefore, it could be argued that top companies have higher compliance level towards the requirement by the regulatory bodies since they are more likely to be subjected to public and regulatory scrutiny.

Furthermore, the results indicate that the lowest level of risk disclosure is represented by the price risk (33.15%). Based on the risk scoresheet, plantation industry was the most highest industry that disclosed the price risk. The possible explanation to such results of plantation industry is subjected to changes in the commodity price which exposed the companies to uncertain risk regarding their financial instrument. The existence of another market, Crude Palm Oil (CPO) that allows them to trade in their own market could reflect the changes in the global market prices. Therefore it is regarded important for the plantation companies to have assessment on the commodity price changes so that the companies are aware of the risk impact.

The second attribute of mandatory risk disclosure is the Risk Management policies. The two main areas examined are:

i. Financial risk management objectives and policies (Paragraph 56 of FRS 132)
ii. Discussion on financial instrument used (Paragraph 58 of FRS 132)

The results of the first area of risk management objective and policies show that disclosure is 97.54%. The results are consistent with the findings in Othman and Ameer (2009) where they found 329 out of 428 companies (76.89%) have provided the objectives and policies of risk management. Such findings indicate that most companies have complied the requirements in FRS 132. On the contrary, the second area related to disclosure on discussion on financial instrument, used only 49.18%. Such results are similar to Othman and Ameer (2009) whereby they found relatively low number of companies disclosed qualitative and quantitative disclosure on hedge instrument for each types of risk. One possible reason for such results is that many companies did not engage in any financial instrument associated with the risk.

<table>
<thead>
<tr>
<th>Companies</th>
<th>Risk score (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>British America Tobacco Berhad</td>
<td>78.57</td>
</tr>
<tr>
<td>Tenaga Nasional Berhad</td>
<td>78.57</td>
</tr>
<tr>
<td>Telekom Malaysia Berhad</td>
<td>75.00</td>
</tr>
<tr>
<td>Proton Holdings Berhad</td>
<td>75.00</td>
</tr>
<tr>
<td>Tanjong Public Limited Company</td>
<td>71.43</td>
</tr>
</tbody>
</table>

Table 2. Top 5 Companies based on risk management score.

<table>
<thead>
<tr>
<th>Mandatory risk management disclosure</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk related to financial instrument:</td>
<td>62.90</td>
</tr>
<tr>
<td>i. Currency risks</td>
<td>71.47</td>
</tr>
<tr>
<td>ii. Interest rate risks</td>
<td>84.5</td>
</tr>
<tr>
<td>iii. Price risks</td>
<td>33.15</td>
</tr>
<tr>
<td>iv. Credit risks</td>
<td>66.85</td>
</tr>
<tr>
<td>v. Liquidity risks</td>
<td>80.71</td>
</tr>
<tr>
<td>Financial risk management policies:</td>
<td>78.36</td>
</tr>
<tr>
<td>i. Financial risk management objectives and policies</td>
<td>97.54</td>
</tr>
<tr>
<td>ii. Discussion on financial instrument used</td>
<td>49.18</td>
</tr>
</tbody>
</table>

Table 3. Distribution Mean Percentage Scores for each Mandatory disclosure attributes from 2006 to 2008.
Table 4. Distribution Mean Percentage Scores for each voluntary disclosure attributes from 2006 to 2008

<table>
<thead>
<tr>
<th>Voluntary risk management disclosure</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk assessment</td>
<td>53.76</td>
</tr>
<tr>
<td>Control environment</td>
<td>64.85</td>
</tr>
<tr>
<td>Control activities</td>
<td>46.57</td>
</tr>
<tr>
<td>Communication</td>
<td>51.21</td>
</tr>
<tr>
<td>Monitoring</td>
<td>55.91</td>
</tr>
<tr>
<td>Operation risk</td>
<td>64.65</td>
</tr>
<tr>
<td>Technology risk</td>
<td>18.68</td>
</tr>
<tr>
<td>Integrity risk</td>
<td>10.75</td>
</tr>
<tr>
<td>Strategic risk</td>
<td>65.86</td>
</tr>
</tbody>
</table>

Voluntary disclosure

For voluntary disclosure, there are 9 main attributes examined in this study. Table 4 provides the results of these attributes. The results show that the highest attribute disclosed was “Strategic Risk” (65.86%), followed closely by “Operation Risk” (64.65%). Such results correspond with the findings of Linsley and Shrives (2006) and Amran et al. (2009) that reported strategic risk and operation risk as the most mentioned risks in the annual report. According to Amran et al. (2009), the reason behind this is due to the requirement of Bursa Malaysia requiring companies to discuss industry trends, development, group performance and the material factors underlying results and financial position in their annual report. Although there is no specific requirement for risk disclosure, most of the discussions presented the risks that are affecting the companies.

The least score is “Control Activities” (46.57%). One possible reason to such results could be due to the fact that this attribute focuses on the companies’ policies on the action and response to risk. Of consequence, most companies did not provide the details of their procedures and their ability to reduce the risk. The results are paralleled with the findings by Othman et al. (2009) in which they reported “Control activities” and “Risk response” as the least mentioned element of ERM.

DISCUSSION AND CONCLUSION

The growing number of irregularities incidents in the corporate world has received much attention from the public. Many parties have put the blame on the lack of corporate disclosure on the position of companies. The lack of important information such as risk information in the annual reports produced by the companies was a contributing factor to the irregularities (Cabedo and Tirado, 2003). Such scenario has led public demanding for more detailed corporate disclosure particularly on non-financial aspect (Amran et al., 2009). This is to ensure that the companies are free from accounting fraud. The corporate disclosure particularly on risk reporting is important because it provides information on the effects of risks on the firm’s future financial position.

The results from shows the overall score for risk management disclosure among public listed companies in Malaysia is 53%, demonstrating that there are more room for improvement on the level of risk disclosure. More critical findings show that the level of risk management disclosure in Malaysia from the year 2006 to 2008 are quite consistent each year suggesting that most of the companies perform the same level of risk management disclosure practices from year to year.

The risk disclosure index consists of two main sections (a) mandatory disclosure and (b) voluntary disclosure. For mandatory risk management disclosure, the disclosure is considered high (71.11%) whereas for voluntary risk management disclosure is only 49.98%. However, the results for mandatory disclosure are attributed by the legal requirement although there are still companies that did not comply with the regulatory requirement. There is a need for the regulatory bodies to identify the reasons for non-compliance since risk disclosure deems important for stakeholders. On the other hand, voluntary risk disclosure is relatively low considering the importance of risk management to the users’ decision-making.

This study is subject to several limitations. This study used a three-year period (2006-2008) to examine the risk disclosure level. Therefore, the findings of this study may not be generalised to other settings.

Furthermore, the final sample in this study consists of the top 122 companies listed on the main board of Bursa Malaysia. As such, the results of this study represent large and established companies which may
not be the same if other sample such as small companies are used.

The studies provide assistance in establishing a preliminary point to empirically examine the risk management disclosure level in Malaysia especially those which listed in Bursa Malaysia. Further research should be conducted to know the factors that affecting the disclosure level in Malaysia.

REFERENCES