BOARD OF DIRECTORS AND RISK INFORMATION DISCLOSURE: A CONCEPTUAL PAPER

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BOARD OF DIRECTORS AND RISK INFORMATION DISCLOSURE: A CONCEPTUAL PAPER

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ABSTRACT

The need for vibrant risk management and high quality of risk information disclosure through sound corporate governance is significant to the government in order to overcome the global financial crisis and past accounting scandals that occur in every country including Malaysia. This paper aims to examine the impact of corporate governance mechanisms in risk information disclosure in terms of board of directors (BOD) characteristics namely gender diversity, professional membership, and board tenure. Besides that, this study aims to measure the level of risk management information disclosure in the annual reports. This study is expected to give benefits to others researchers who especially interested in corporate disclosure area namely the professional bodies and standard setters so that they can keep updating on the new variables or factors that might affect the risk management disclosure among public listed companies (PLC) in Malaysia.

KEYWORDS: Corporate Governance, Agency Theory, Risk Information Disclosure, Public Listed Companies

1. INTRODUCTION

Corporate Governance (CG) is one of the mechanisms that significant in protecting the stakeholders' interest. Promoting sound and comprehensive of corporate governance principle has become a global issue or problem for advancing governance and performance of private and public businesses (Mustafa, Berisha and Liaci, 2018). According to Alkurdi, Hussainey, Tahat and Aladwan (2019), the approach to protect interest of stakeholders is with introducing and strengthening business rules and regulations in terms of enhancing of accountability, integrity and transparency which it can mitigate the agency problem among shareholder and management. Besides that, CG is gaining attention worldwide because the aspects such as mismanagement, fraudulence, corruption, and breach of trust have great impact to the financial scandals and corporate failures (Shan, Ab Razak and Ismail @Ali, 2018).

One of the most powerful CG mechanisms are board of directors (BOD). BOD is responsible to enhance a company's alignment with its stakeholders, to control and supervise a firm's progress and improve the quality of disclosure by monitoring and controlling the management's activities. Besides that, BOD also perform many functions namely to ensure the business comply with rules and regulations, safeguarding the public interest and also guarantying stakeholders' protection (Alkurdi, Hussainey, Tahat and Aladwan, 2019). The efficiency of BOD can balance the relationship between a company's returns and risks. According to Al Attar (2016), the efficiency of BOD enables the entities get benefits from managing of resources with effectively. Corporate governance mechanism can be used a monitoring instrument to company in order to help investor specially to make a rational decision by disclosing the risk information (Rosli, Mohammed and Sanusi, 2017). A review of prior literature on corporate governance in Malaysia suggests that corporate governance mechanisms such as gender diversity, professional membership and audit tenure of BOD are worthy to be investigated further in relation to the disclosure of annual report.

1.1 Background of the study

Risk management (RM) is a component that important to for every companies in their business activities and business operations. Lark (2015) found that RM is a serious task need to be implemented by companies if they want to accomplish their business aims and objectives. Previous studies have shown that in reducing the risk of corporation, the company should disclose more relevant information about risk. The effectiveness risk management enable to reduce fraud, control possible threat, and use of resource with efficient (Hashim and Koon, 2015). The information that relate with the ability of companies to control the risk is significant to existing and potential investors to make a rational decision. The companies that are refusing in disclosing information about risk will be problematic to access capital. BOD need risk information to enable them in considering, understanding, and managing risk efficiently. Besides, it shows that the shareholders need to know the impact of risk to the financial position of company in the future. According to Mohamad, Norizan, Rosly and Ahmad (2019), a few methods of risk management have developed for companies in making the risk disclosure of corporate information. Indirectly, these methods are significant in controlling and communicating the different type of risks information disclosure.

1.2 Problem Statement

In recent year, demand for more corporate information disclosure of companies is significant aspects that stakeholders should receive. According to Musa, Ali and Harun (2018), the stakeholders need the companies to disclose information with timely, clear and relevant in terms of business operation and financial performance especially risk information disclosure. Elshandidy and Neri (2015) examined the relationship between risk disclosure and CG and reported that there is strong relationship which the governed firms were more responsible to provide more important risk information especially to their investors as compared to weakly governed firms. It shows that the importance of BOD in providing risk information disclosure. While Allini et al. (2016) reported that the effectiveness of CG within risk disclosure information is largely depend on the composition of the board of directors.

Risk management disclosure information is the significant element to the shareholders to obtain the relevant and appropriate information in making the decision. This is important to shareholders in understanding the risk profile that arise from the company that invest into (Mohamad, Norizan, Rosly and Ahmad, 2019). As investors, they should aware and careful to the risks that are taken because it will impact to the risk disclosure of information. According to Ahmad, Abdullah, Jamel and Omar (2015), every company should be responsible to comply in disclosing a greater risk information for the benefit of the company as whole. Thus, risk management information disclosure is regarded as vital element in the annual report. The government especially should be responsible to ensure to the enhancement of governance mechanism. One of the methods that the government can act is improving and enhancing principles and guidelines for listed firms (Ahmad, Abdullah, Jamel and Omar, 2015). In MCCG 2017, the appointment of BOD is vital in risk management information disclosure because companies need the better establishment of board in making a sound decision.

According to Mustapha, Berisha and Liaci (2018), companies with better establishment of BOD will show the better performance in terms of aspects such as sales, investment and exports compared to companies that do not have the better establishment of BOD. The BOD plays a greater function in a company's governance structure because they are responsible in ensuring sound corporate governance. According to Freihat, Farhan and Shanikat (2019), BOD is one of the major aspects in the governance mechanism and good corporate governance is urgently needed in many companies. This is because corporate governance and corporate risk management are rising intertwined which is focusing the importance of aspects such as interdependencies and mutual impacts of corporate governance mechanisms into corporate risk information disclosure and risk disclosure is no exception. Therefore, this study was endeavored to fill the academic gap by investigating the relationship of gender diversity, professional membership and audit tenure with the level of risk information disclosure among PLC in Bursa Malaysia for five (5) years period (2015 to 2019).

1.3 Purpose of the study

In order to achieve the main aim of the study, several objectives were outlined as follows:

RO1: To investigate the relationship between the gender diversity of BOD and the level of risk information disclosure.
RO2: To investigate the relationship between the professional membership of BOD and level of risk information disclosure.
RO3: To investigate the relationship between tenure of BOD and level of corporate risk information disclosure.

1.4 Research questions

This study is engaged to answer the following research questions:

RQ1: Does the gender diversity of BOD has a direct relationship with the level of risk information disclosure?
RQ2: Does the professional membership of BOD has a direct relationship with the level of risk information disclosure?
RQ3: Does the tenure of BOD has a direct relationship with the level of risk information disclosure?

1.5 Significance of the study

This paper is expected to contribute to theories pertaining to the impact of CG mechanisms into corporate risk information disclosure i.e., a competent BOD as proposed by MCCG 2017 on the level of risk disclosure information in the annual report. Additionally, the findings of this study will be beneficial to the regulators in making policies on problems related to corporate governance to determine the direction of future governance rules and guidelines for Malaysian companies. This study is also anticipated to contribute to the body of knowledge in terms of aspects such as accounting, the increasing empirical literature in the country, boosts more research in the future about the corporate governance mechanisms that give a huge impact to the risk information disclosures because risk disclosure information is still in early stages especially in developing country like Malaysia.

2. LITERATURE REVIEW

Previous literature discussed that corporate governance attributes can mitigate or minimize risk exposure by enhancing transparency and disclosure quality, protecting shareholders' interest and monitoring management (Allini et al., 2016; Elshandidy & Neri, 2015; Al-Maghzom et al., 2016; Taylor et al., 2010).

2.1 Agency Theory

This research uses an agency theory (AT) framework to examine the impact of corporate governance mechanisms i.e., board of directors in presenting the interest of corporate owners as a counter to the potential self-interest of management. According to Berle and Means (1932), Ross (1973) and Jensen and Meckling (1976), the renowned 'agency problem' arises due to the separation of ownership and control that resulting to inability of the owners to observe the actions of management. They defined the managers of the company as the 'agents' and the shareholders as the principal. The shareholder, who is the owner or 'principal' of the company are unable to engage in management of the company, delegate the responsibility to the board of directors (agents) to represent their interests in the company. The agency conflict arises when the agents may not always act in the principals' best interest (Fama & Jensen, 1983; Jensen & Meckling, 1976). The principals' interests can be compromised if the directors are able to maximize their self-interest at the expense of organizational profitability. Since both parties are utility maximisers; thus, there is no substantial reason to believe that the board of directors will always act in the shareholders' best interest. Risk management disclosure information is the significant element to the shareholders to obtain the relevant and appropriate information in making the decision. Therefore, board of directors must ensure that shareholders received sufficient risk information to enable them to make informed decisions

2.2 Board of Director Characteristic

BOD characteristics have a main consequence to the companies namely corporate financial and risk decision making practices. BOD plays a vital role in the governance of companies and hence an understanding of how the characteristics and effectiveness of the board affect the governance of firms is very important, not least because agency theory states that the role of the board of directors is to ensure that the resolutions made by the rulers of a company are in the interest of investors (Deschênes et al., 2014). The board of directors is one of the major factors in the governance mechanism and good corporate governance is urgently needed in many enterprises. One of the essential benefits of establishing good corporate governance practices is that they help companies to access international capital markets. Therefore, BOD characteristics including gender diversity, professional membership and audit tenure are explained under the following sub-headings.

2.2.1 Gender Diversity

The gender diversity is one of the significant factors that influence risk management disclosure of the companies. In Malaysia, nowadays the trend of women holding higher positions compared to men in a company that involved in decision making process in public and private sectors has grown its momentum (Shan, Ab Razak and Ismail @ Ali, 2018). In recent years, regulators around the world have attempted to increase the numbers of women on corporate boards. Shan, Ab Razak and Ismail @ Ali (2018) stated that, the government has introduced a rules and procedures that women must include no less than 30% on board and senior management positions by 2016 for public and limited liability companies with more than 250 employees in order to get gender equality. The first country that legislated gender quotas in the boardroom was Norway. In 2003, Norway passed legislation that required 40% female representation on corporate boards by 2008. Spain adopted the same regulation and mandated 40% female representation on the boards by 2015. Other European countries that imposed gender quota include France (40% by 2016), Italy (33.3% by 2015), and the Netherlands (30% by 2016). Malaysia is with no exception. Securities Commission Malaysia has introduced the third Corporate Governance Code in 2012, known as MCCG 2012. Among others the code recommended improving the representation of women directors on the board. This is further recommended in MCCG 2017 that the board of large companies will need to comprise at least 30% women directors. The MCCG 2017 also encourages companies in general to include women participation not only at board level but also in senior management.

Boards of directors is facing increased expectations regarding their roles in efficient risk management (MCCG, 2017). Research on women behavior indicates that women appear less sensitive to probabilities and more pessimistic towards gains than men. According to Schubert (2006), women have better multi- tasking skills, risk management and communicative abilities as compared to their male counterparts. Women also have an ability to exert stronger monitoring effort towards business risk and uncertainty (Adams and Fereira, 2009). According to Bayazitova and Shivdasani (2012) female directors are likely to be more risk averse than their male counterparts, which might lead to a decrease in financial distress costs and systemic risk. Therefore, it is expected that more women on board will positively contribute towards efficient risk management and extensive risk information disclosed in the annual report.

Women directors make less risky choices (Perryman, Fernando and Tripathy, 2016) Women are more meticulous when making decision related to risk. Women made decision based on extensive information. Therefore, it can be assumed that informative risk information disclosure is affected by gender diversity considering their less appetite towards risks. Hence the current study aims to answer the research questions related to the potential role of gender diversity in improving risk management information disclosure in annual report. Therefore, it is expected that the increasing of gender diversity will further increase the level of risk information disclosure, hence, the following hypothesis is posited:

H1: There is a relationship between the gender diversity of BOD and level of risk information disclosure.

2.2.2 Professional Membership

Professional membership of BOD is vital element in the risk disclosure information. Board members who have professional qualification and are associated with professional bodies such as the Association of Chartered Certified Accountants (ACCA), The Institute of Chartered Accountants in England and Wales (ICAEW) and Chartered Institute of Management Accountants (CIMA) is categorized as board professionalism. There have been many ongoing debates in the previous studies regarding the influence of board demographic characteristics towards the risk disclosure. A study done by Farag and Mallin (2016) using survey data from 892 Initial Public Offerings (IPOs) floated in both the Shanghai and Shenzen Stock Exchangs, indicated that Chief Executive Officers (CEO) which have postgraduate qualifications tendency to consider corporate risk-taking. Al-Hadi, Hasan and Amp; Habib (2016) suggested that market risk disclosures can be influenced by the risk committee qualifications and size. This is due to the capability of understanding in complexity of business environment among board who have professional qualification together with their experience, expertise and skills in dealing with the multiple stakeholders. In addition, the determinants of corporate risk disclosure can be depending on the education level received and required specialized skills developed through the experience. This can make them more awareness and think consequences of certain practices such as non-compliance with risk disclosure requirements. This can be seen on a study at listed Finnish companies found that the board of directors' capability of understanding the relevance information-rich risk information that is more useful to the stakeholders is significant correlated with the higher education received (Juha, Troberg, Martikainen, & Miihkinen, 2015).

The relevant qualification and experience of board will make the market risk exposure can be disclosed enough in the report. Moreover, lack of knowledge in financial literacy also may leads the shortages of such disclosure. According to GCC Board Directors Institute (BDI) (2011) stated that the barriers of the effectiveness of boards among GCC is due to the shortage qualified and financially literate as they do not require the directors to have academic or professional qualifications. Therefore, in order to ensure high-quality risk management and risk reporting, it requires the directors with financial expertise and auditing knowledge can more likely to make expert judgements especially in the financial disclosure process (DeZoort and Salterio, 2001, and Naiker and Navissi, 2010). This is in line with Krishnan (2005) and Dionne et al. (2015) indicated that education in finance and accounting will give positive impact on the effectiveness of risk management. The Malaysian Code of Corporate Governance (MCCG) (2007) suggested that the process of corporate reporting including risk management reporting can be presented well if there is financially literate audit committee member.

However, Buckby, Gallery and Ma (2016) analyzed the risk management disclosures in the annual reports of top 300 ASX-listed companies by analyzing risk management disclosure and developing a code and categorise risk management disclosures made in the annual according to the disclosure categories specified in

ASX Corporate Governance Principles and Recommendation (CGPR). The study found that audit committee who are financially literate and qualified accountant do not seem to impact the level of risk management disclosure in the Australia context. Prior research supports their negative association between board members having professional qualification and risk disclosure (Allini, Rossi and Hussainey, 2015; Abdullah, Shukor and Rahmat, 2017). This is maybe due to some of boards might be more cautious on the disclosure of risk management and preferable to withhold this information (Allini, Rossi and Hussainey, 2015). The level of competence and professional membership of board members are appropriately required to ensure a better position in order to identify the relevant risks issues and disclose in annual reports properly. Hasan, Salleh and Ibrahim (2020) also indicate that the existence of board professional membership diversity was found to significantly increase the reporting disclosure. This study also consistent with a study done by Okaro, Okafor, Nwanna and Igbinovia (2017). The study on the 18 micro finance banks operating in Nigeria found that lack of knowledge and access to relevant information among internal audit may lead to poor risk management disclosure. Accordingly, based on these arguments, formulated the second hypothesis of the study as follows:

H2: There is a relationship between professional membership of BOD and level of risk information disclosure.

2.2.3 Board of Director Tenure

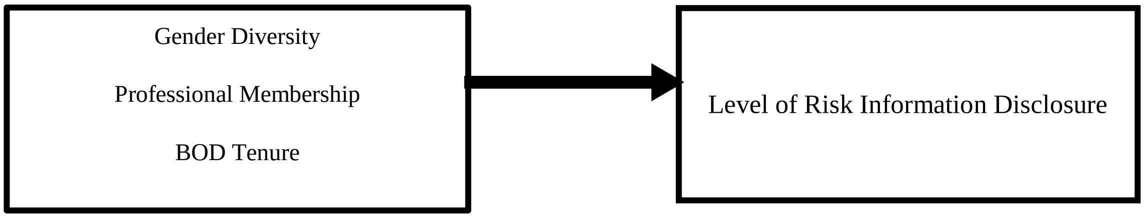
According to MCCG (2012), the board of directors is responsible in managing all risks involved in the business and ensuring an effective system to monitor and manage the risks. The responsibilities held by the board of directors include determining the company's level of risk tolerance and actively identify, assess and monitor key business risks to safeguard shareholders' investments and the company's assets, and ensure that their risk management system is viable and robust (Securities Commission, 2012). The board's duty is to serve the interest of shareholders as well as make the company known to the outside environment through disclosure (M. Akhtaruddin & Haron, 2010). The rationale for the existence of director ownership is to make the directors have the perspectives of real owners of the company in which they are expected to provide a strategic leadership that aligns with the company's interest (Chatterjee, 2009). The decisions on disclosure are in the boards' hands (M. Akhtaruddin & Haron, 2010).Furthermore, companies with better establishment of BOD will show the better performance in terms of aspects such as sales, investment and exports compared to companies that do not have the better establishment of BOD (Mustapha, Berisha and Liaci, 2018). According to Na Li and Wahid (2018), the BOD plays a greater function in a company's governance structure because they are responsible in ensuring sound corporate governance. Meanwhile, Freihat, Farhan and Shanikat (2019), BOD is one of the major aspects in the governance mechanism and good corporate governance is urgently needed in many companies. This is because corporate governance and corporate risk management are rising intertwined which is focusing the importance of aspects such as interdependencies and mutual impacts of corporate governance mechanisms into corporate risk information disclosure and risk disclosure is no exception.

On one hand, firms and regulators acknowledge that there are benefits of long tenure, including knowledge continuity and boardroom collegiality. Even so, governance experts have recently raised concerns about the potential costs of longer board tenure. These costs may include a loss of independence and the lack of agility and adaptability. Board renewal (PwC Center for Board Governance, Fall 2011). According to Johnson et al (2013), board tenure reflects the likelihood that board members' control over the monitoring of executives will increase as the average tenure period increases. Board with longer tenure would logically accumulate more firm-specific knowledge while sitting on the board. Meanwhile, director tenure should be able to enhance a board's ability both to monitor and provide resources to the firm, and by so doing, reduce its risk of financial distress (Na Li & Wahid, 2018). Prior studies indicate that experienced directors can provide better knowledge about the firm and be more efficient in decision making (Hillman and Dalziel, 2003).

In this study, topic has been carried out seek to identify by mean of associations between the board tenure with the level of risk information disclosure. The risk information disclosure would be quantifying the impact of an event is assumed to provide more useful information and it would be desirable that companies disclose risks in quantified manner. This is important to shareholders in understanding the risk profile that arise from the company that invest into (Mohamad, Norizan, Rosly and Ahmad, 2019). Furthermore, as investors, they should aware and careful to the risks that are taken because it will impact to the risk disclosure of information. On the other hand, Ahmad, Abdullah, Jamel and Omar (2015), every company should be responsible to comply in disclosing a greater risk information for the benefit of the company as whole. Thus, risk management information disclosure is regarded as vital element in the annual report. Therefore, it is expected that board tenure will further increase the level of risk information disclosure, hence, the following hypothesis is posited:

H3: There is a relationship between the board tenure and level of risk information disclosure.

3. THEORETICAL FRAMEWORK



Independent Variable **Dependent Variable**

4. SUGGESTION FOR FUTURE RESEARCH

Based on the findings of this paper, it is necessary to test the model in various settings especially in developing countries such as Malaysia where risk information disclosure is still at infancy stage. Furthermore, it is strongly encouraged to conduct more research on this matter as the literature regarding risk information disclosure is still scarce and limited in Malaysia context. The theoretical framework also needs to be empirically tested to assess the reliability of corporate governance mechanisms in particular, the board of directors in determining the quality of risk management disclosure, as investors will likely to invest in a firm that discloses investment related information including the risk management practices.

5. CONCLUSION

In conclusion, this study is aimed to explore the implications of corporate governance in disclosure of risk information by looking at BOD characteristics namely gender diversity, professional membership and BOD audit tenure. According to Schubert (2006), women have better multi-tasking skills, risk management and communicative abilities as compared to their male counterparts. Women also have an ability to engage in stronger monitoring effort towards risk management and business uncertainty (Adams and Fereira, 2009). Therefore, it is expected that more women on board will positively contribute towards a more systematic and efficient risk management and extensive risk information disclosure in the annual report. Professional membership also plays an important role in the information risk disclosure. Professional membership means Board members who have professional qualification and are associated with professional bodies such as the Association of Chartered Certified Accountants (ACCA), The Institute of Chartered Accountants in England and Wales (ICAEW) and Chartered Institute of Management Accountants (CIMA) are among qualified professional bodies categorized as board professionalism. According to the GCC Board Directors Institute (BDI) (2011) stated that the barriers of the effectiveness among the GCC Board members are due to the shortage of qualified and financially literate as they do not require the directors to have academic or professional qualifications. Therefore, in order to ensure high-quality risk management and risk reporting, it recommends the directors with financial expertise and auditing knowledge will more likely to make expert judgments especially in the financial disclosure process (DeZoort & Salterio, 2001; Naiker & Navissi, 2010). Companies with better establishment of BOD will show better performance in terms of sales, investments and exports as compared to companies that do not have better establishment of BOD (Mustapha, Berisha & Liaci, 2018). On the other hand, a study by Ahmad et al. (2015) stated that every company should be responsible to comply in disclosing a greater risk information for the benefit of the company as a whole. Board with longer audit tenure would logically accumulate more firm-specific information while sitting on the board. Meanwhile, the longer audit tenure should be able to enhance a board of director's ability in both monitoring and providing resources to the firm, and by so doing, reduce its risk of financial distress (Na Li & Wahid, 2018). The findings of this study have indicated that is a correlation between gender diversity, professional membership and board tenure with risk information disclosure.

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