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Revisited Note on Corporate Governance and Quality of Audit Committee: Malaysian Perspective

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Abstract

The issue of corporate governance has continued to gain widespread prominence in local and international business. Notably, audit committee is a key governance structure charged with oversight over financial reporting and disclosure that requires the audit committee members to be critically aware of and fully understand their oversight responsibilities. In recent years, interest in audit committees has increased dramatically, with a specific emphasis on member independence, experience and knowledge. This paper discusses on the corporate governance and audit committees' qualities and some reviews on the recent literature relating to the most cited audit committee qualities i.e. audit committee's composition and communications. Finally, this paper also identifies the suggestion made for the betterment of audit committee practices in Malaysia.

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Keywords: Audit committee; corporate governance; Malaysia

1. Introduction

The setting of corporate governance regulations and practices in Malaysia mostly is influenced by the developed countries such as the United Kingdom and the United States of America (Liew, 2007). The Malaysian Code on Corporate Governance (2012) defined corporate governance as: "The process and structure used to direct and

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manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interests of other stakeholders."

The economic crisis in 1997 had affected seriously the Malaysia's capital markets framework including its corporate governance regime (Zalailah & Jenny, 2012; Thomas, 2002; Mitton, 2002; Mat Zain & Subramaniam, 2007). In reaction to the issue occurred in 1997, the Malaysian Government had established a high level Finance Committee on Corporate Governance (FCCG) participated by almost all sectors across government bodies, private sectors, Central Bank of Malaysia, Malaysia Accounting Standard Board and association of banks. It is further expanded by the establishment of Capital Markets Strategic Committee in 1999. In 2000, the FCCG had issued the MCCG which required listed companies to disclose their level of compliance with its recommendations in view to provide a strong and facilitative regulatory regime including corporate accountability and high quality corporate governance mechanisms that would strengthen investor confidence (Securities Commission, 2001).

Alnasser (2012) noted that as compared to other Asian countries before the financial crisis hit Asia, Malaysia could be considered as the country which having strong governance guidelines. However, it did not help much from the crisis effects. Empirically, agency cost is identified as one of the factors that cause the weak of corporate governance practices in Malaysia. In addition, more voting rights of the external shareholders are also contributed to the weak board of trustee and market control. Therefore, the amended MCCG 2012 is aimed to generate an optimum level of positive relationship between stakeholder and the firm as well as to assure companies disclose relevant and necessary data in the annual report.

As one of the main components of corporate governance, audit committees provide critical oversight of companies' financial reporting and auditing processes (Salleh & Stewart, 2012; Cohen et al., 2007). The MCCG had recommended that the board of directors should establish an audit committee comprising at least three members, a majority of whom are independent plus all the members are non-executive directors. Written terms of reference which deal clearly with its authority and duties also need to be provided as references to committee. It is also suggested that the members of the audit committee are financially literate and at least one of them are members of an accounting association or body.

According to Vanasco (1994), in the United Kingdom, the audit committee role has been discussed since 1872 after the issuance of the Great Railway's audit committee report which the committee functioning as per today audit committee role. However, until 1987, due to large and expanding corporate size and corporate fraud, the Bank of England, the Confederation of British Industry, and other financial institutions urged public companies to adopt audit committees to promote awareness on the importance of the role of the non-executive or independent outside director. Due to Enron corporate scandal, the Sarbanes Oxley Act of 2002 was established as to strengthened corporate governance related to the improvement in audit committees through stricter composition, increased disclosures and expanded responsibilities. Based on the UK's Cadbury Committee Report, US's Tread way Commission Report and Canadian Macdonald Commission, audit committee has been regarded as an important element in corporate organization which operates as an oversight body in implementing appropriate corporate accountability.

2. Corporate governance and quality of audit committee

An effective audit committee plays an important role in upholding good corporate governance practices. Audit committees members in companies are appointed by the management and the Boards of Directors (BOD) to supervise the financial activities of the company and also to function as liaison between the board of directors, internal and external auditors. It is a common practice that, the audit committee is made up of majority external directors. The primary responsibilities of the audit committee involve assisting the BOD on issue concerning financial reporting and internal control and communicating with BOD financial management, the independent auditors and internal auditors.

Audit committee significant role portray the importance of audit committee function to ensure its corporate governance towards the shareholders. It is highlighted that the role of audit committee are to liaison with external auditor, appoint and terminate head of the internal audit department, monitor the reliability of financial statement and company's performance and review the effectiveness of internal control and risk management of the company.