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Audit Committee Reporting: Current Practices of Companies Listed on the Kuala Lumpur Stock Excange *(Bursa Malaysia)*

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Abstract

This study examines the disclosures contained in Audit Committee Reports (ACRs) and the level of compliance of current practices with the amended Kuala Lumpur Stock Exchange listing requirements after the adoption of various recommendations made by the High-Level of Finance Committee on Corporate Governance and the Malaysian Code on Corporate Governance (MCCG) in 1999 and 2000 respectively. All firms listed on the KLSE's main and second board, and MESDAQ counters were sampled. Consistent with the literature in developed markets, the findings reveal that very few companies provide more than what is expected by the ACRs in their listing requirements. Further, companies in finance, technology and IPC counters, and companies on the main board counter have greater initiative to provide value added (or termed as 'non-boiler plate') statements to information users.

Keywords: Audit Committee, Report, Corporate Governance, Bursa Malaysia, Directors

INTRODUCTION

It is an accepted fact that effectively functioning audit committees in the corporate sector will contribute towards the upkeep of good corporate governance and

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improve the quality of financial reporting. The Cadbury Committee (1992) in the UK, the Treadway Commission (1987) in the USA, and the MacDonald Commission (1988) in Canada have all clearly specified the vital role of audit committees in the development of the financial aspects of corporate governance, including financial reporting and auditing. To enhance the improvement of disclosure practices and transparency in financial reporting among listed firms, audit committees are responsible for overseeing and monitoring the management as well as the participation of independent auditors in the financial reporting process (Zulkarnain *etal*, 2001). In the UK, the idea of having audit committees as proposed by the Cadbury Committee is based on the following arguments: (1) audit committees have 'proved their worth' and become essential committees of the board in the US[1]; (2) there is enthusiasm for audit committees in an increasing number of UK companies which have formed them; (3) the list of benefits they can bring. However, Sommer (1991) suggests that the establishment of an audit committee does not necessarily mean that it will be effective in providing the benefits of improved financial reporting and auditing, and states that 'there is considerable anecdotal evidence that many, if not all audit committees fall short of doing what is generally perceived as being their duty. Menon and William (1994) provide evidence that companies that nominally formed an audit committee were often reluctant to rely upon it as they are established for the purposes of appearances rather than to enhance stockholders control of management. Conversely, Simnet *et al* (1993) found that audit committees (1) improve or at least maintain the quality of the financial reporting process, (2) aid the actual and perceived independence of internal and external auditors and (3) improve the confidence of financial statement users on the quality aspects of financial reports. There is therefore a critical need for Audit Committee Reports (ACRs) to improve the transparency of the committee's oversight of the financial reporting process, to

'The impetus of creating this committee cannot be traced clearly, but it is believed that this idea comes after large number of corporate failures such as the well-documented case inthe US of McKesson & Robbins in the 1930s. Since then, the adoption of audit committees became a common phenomenon in capital markets and in more recent times a large number of high-level committee were formed to discuss this issue worldwide such as BCA (1991) in Australia, TSE Committee (1994) in Canada, BRC (1999) in the USA, Cadbury Committee (1992) and Turnbull (1999).in the UK, and the high level Finance Committee on Corporate Governance (1998) in Malaysia.

provide additional motivation for committee members to effectively discharge their duties, and to promote investor confidence (Carcello *et al.,* 2002).

Overall, the idea to establish audit committees has received worldwide acceptance especially in developed countries such as the UK and the US long before other markets discovered them. The perceived reason underlying this phenomenon is that non-developed markets have a shorter history and relatively fewer problems which mandate the formation of such committees. Current corporate governance research focuses on the role, effectiveness, leadership, independence, communication and reporting of audit committees.

This paper investigates the disclosures contained in Audit Committee Reports (ACRs) and the level of compliance of current practices to the amended stock exchange (Bursa Malaysia berhad, or BMB) listing requirements after the adoption of various recommendations made by the High-Level of Finance Committee on Corporate Governance and the Malaysian Code on Corporate Governance (MCCG) in 1999 and 2000 respectively. Specific issues related to the dissemination of information on the audit committee's role, function and activities that is presented in the ACR of a company's annual report are discussed to provide insights to enhance efforts to improve audit committee performance.

The paper is organised into six sections. The following section provides the historical perspective of audit committee requirements in Malaysia. Section 3 discusses issues on good corporate governance. Section 4 outlines the data collection and research methodology. The fifth section presents the findings and discussion of the findings. Section six concludes the paper.

BACKGROUND TO THE AUDIT COMMITTEE REQUIREMENT IN MALAYSIA

Unlike developed countries that require the formation of audit committee as part of their long-term strategy to improve corporate governance practices in the corporate sector, the formation of audit committees in Malaysia is a reactive strategy following major economic failures. The Malaysian government initiated efforts for listed companies to have audit committees as a pre-emptive measure to mitigate any form of non-compliance to accepted corporate governance practices (for example corporate scandal and fraud) that can undermine investors confidence in our financial markets. The central bank (Bank Negara Malaysia or BNM) mooted the idea of setting up audit committees for financial institutions in 1985 but the constructive development of audit committees began in 1991. Prior to this, the Malaysian Institute of Accountants prepared a proposal on fraud prevention called "Fraud Prevention Measures" suggesting that the government require all public companies to establish an audit committee as an internal control mechanism to mitigate fraudulent activities.

In 1991, the Malaysian Institute of Accountants, jointly with the Malaysian Association of Certified Public Accountants (currently known as the Malaysian Institute of Certified Public Accountants) and the Institute of Internal Auditors, submitted a memorandum to the Registrar of Companies, the Capital Issues Commission (CIC) and the Kuala Lumpur Stock Exchange (KLSE now renamed as Bursa Malaysia Berhad) recommending that audit committees be made , mandatory for companies seeking listing on the KLSE. Beginning 1st August 1994 it become mandatory for all listed firms on the stock exchange to establish an audit committee. Section 344A of the stock exchange's listing requirements requires all companies seeking admission to the exchange to establish an audit committee comprising of a majority of independent directors.

In addition to global concern on good corporate governance, audit committee practices regained attention after the 1997 financial crisis. The high-level finance committee on corporate governance was established and it submitted recommendations in 1999 to establish and enforce the Malaysian Code on Corporate Governance in 2000. With the view of enhancing the capability of audit committees to better achieve their objectives and promote better corporate governance, transparency, efficiency in capital market activities, and to strengthen investor protection and confidence, the KLSE Listing Requirements were recently revised (KLSE, 2001). Provisions pertaining to the audit committee requirements took effect from 1'June 2001.

GOOD CORPORATE GOVERNANCE

The importance of maintaining good corporate governance

Audit committee is a subset of the corporate board of directors which constitutes an integral part of the corporate governance infrastructure. Audit committees are established to instill good corporate governance by providing an oversight of good financial reporting and auditing practices. Good corporate governance is also claimed to create better value for companies (Monks, 2002). This argument was substantiated by a survey on Malaysian firms by McKinsey & Co (2000) which suggested that foreign investors are prepared to pay a premium of about 25% for good corporate governance while local investors are willing to pay a premium of about 22%. Furthermore, Credit Lyonnais Securities Asia (CLSA) (2000) reveals that shares of companies with good governance in emerging markets significantly outperform those that do not comply with good governance practices. Hence, institutional investors prefer investing in companies with a record of good governance practices, as these companies are found to be more resilient during an economic downturn compared to companies that practice bad governance.

The idea of having audit committees to instil good governance has received much attention following the many corporate failures during the Asian Financial Crisis in 1997, and poor corporate governance has been frequently cited as a contributing factor to financial distress faced by listed firms during the crisis (A-Kadir, 2000, 2002). Despite rigorous efforts to encourage good corporate governance, A-Kadir (2002) highlighted that the May 1999 APEC Report on Strengthening Corporate Governance in the Asia-Pacific Economic Cooperation (APEC) Region identified that many boards and audit committees do not provide as effective an oversight as was expected and consequently contributed to the severity of the Asian crisis. This finding reflects the need to revise and update the series of reforms implemented, such as the shift from merit based to disclosure based regulatory system since 1996 and other relevant rules and regulations, to make them more effective in achieving the desired objectives.

AUDIT COMMITTEE REPORT CONTENT

Despite great attention received worldwide, in the last decade, on the idea of setting up audit committees, the frequency and intensity of corporate fraud and failures have been on the rise. Hence, are there any real benefits to having an audit committee? The activities of the audit committees during the financial year are not disclosed and are therefore not transparent. Consequently, stakeholders have to resort to the Auditor Committee Report in the annual report to find out about the audit committee's duties and activities. In fact, previous research by Zulkarnain *et al.* (2001) provides evidence that Malaysian audit committees only report their terms of reference (i.e. what they are expected to do) in the ACR and nothing was reported on what they actually do. Cook (1993) contended that most firms do not provide ACRs as they believe that such disclosures will become 'legalistic boilerplates'[2] that lack useful information. Turpin and DeZoort (1998) found that only 15% (5 cases) of their sample provided ACRs other than the 'legalistic boilerplates' variety and describe three of the five as follows:

> *Three of the five 'non-boilerplate' ACRs provided comments about the reported financial information. For example, one ACR stated that pursuant to the recommendation of the audit committee, the board of directors approved the financial section of the annual report. Another ACR indicated that stockholders are protected by appropriate accounting and auditing procedures. The third ACR stated that the audit committee reported with confidence to the full board that in its opinion, the corporations' accounting policies, reported financial information, and system of internal controls are appropriate to provide the assurances as to integrity and reliability of financial reporting that the board requires (Turpin and DeZoort, 1998, p.44*

It is, however, important to note that the ACR should extend beyond a mere description of activities and functions but should also include the audit committee's opinions regarding the completeness of the financial statements in terms of consistency and appropriateness with accounting principles.

The audit committee does not prepare financial statements or engage in the myriad decisions relating to the preparation of these statements. It just monitors the actions of those responsible for preparing the statements, namely the senior management, and internal and external auditors (Zulkarnain *et al.*, 2001). The objective is to increase public confidence on the credibility and objectivity of published financial information whilst assisting directors to meet responsibilities relating to financial reporting and strengthening the independence of external

[2]The term of 'legalistic boilerplate' has been used in Turpin and DeZoort (1998) to describe the phenomenon where most of the audit committee in their sample only provide their report in the form of following recommended reports that provide a description of activities and functions.

auditors through the ability to communicate with non-executive directors. The audit committee report is therefore expected to encourage audit committees to fulfil their stated obligations and responsibilities and to assure capital market participants that they have at least undertaken certain measures to perform their monitoring duties. Price Waterhouse (1993), in a joint study with the Institute of Internal Auditors, noted that requiring ACRs would clarify the role and responsibilities of the committee in each company and would help ensure that the committee meets its responsibilities by focusing the committee's attention on those responsibilities.

In the United States, for example, the Treadway Commission (1987) suggested that US firms provide separate management reports and ACRs in their annual reports called 'letter from the chairman of the audit committee that describes the committee's activities', which outline their purposes, objectives, and responsibilities and would be signed by the committee chairman (see Table 1).

Table 1 Audit Committee Chairman's Letter (Treadway Commission)

The audit committee of the board of _____________ directors is composed of independent directors. The members of the audit committee are: John Doe, Chairman, __________, and __________. The committee held meetings during fiscal year __________.

The audit committee oversees the company's financial reporting process on behalf of the board of directors. In fulfilling its responsibility, the committee recommended to the board of directors, subject to shareholder approval, the selection of the company's independent public accountant. The audit committee discussed with the internal auditor and the independent public accountant the overall scope and specific plans for their respective audits. The committee also discussed the company's consolidated financial statements and the adequacy of the company's internal controls. The committee met regularly with the company's internal auditor and independent public accountant, without management present, to discuss the results of their examinations, their evaluations of the company's internal controls, and the overall quality of the company's financial reporting. The meetings were also designed to facilitate any private communication with the committee desired by the internal auditor or independent public accountant.

John Doe, Chairman
Audit Committee

Source: Treadway Commission (1987)

Rittenberg and Nair (1993) recommended that the extent of the Treadway Commission's model report be expanded (as provided in Table 2) as a result of their study on audit committee members, internal auditors and external auditors. Their suggested report includes information on fees paid to audit committee members, important relationships with the company and explanation of activities.

Contrary to expectations, previous research in developed countries show that a majority of publicly traded companies opt not to include an ACR in their annual report (Kintzele *et a!*, 1993; Price Waterhouse, 1993; Rezaee and Farmer, 1994) and suggests that such additional information creates additional liability exposure for directors.

Table 2 Expanded Audit Committee Report

The major responsibility of the audit committee is to ensure the integrity of financial reporting by the company. To meet this responsibility the membership of the board is independent of management while possessing experience and expertise in accounting, legal, and regulatory issues as well as knowledge of company operations. During the last fiscal year we met x times; the total fees paid by the company to each member of the audit committee or organizations to which they belong wasere $x. The audit committee has explicit authority to investigate any matters that may affect the integrity of financial reports or the internal controls of the company, has access to resources to conduct these investigations, and has full access to all information. The audit committee meets regularly with the external auditors, the head of internal audit, and the company legal counsel, without other members of management present, to discuss all issues of concern to them, including a discussion of their disputes with management. The committee also attempts to ensure that those with a knowledge of breakdowns in internal control, illegal acts, or management fraud have private access to the audit committee.The major activities of the audit committee during the last fiscal year included making recommendations on the selection of the external auditor and the audit fee; discussion of the nature and scope of the audit plan and any problems or reservations arising from the audit; review of the quarterly and annual financial statements and of keyjudgments and estimates underlying those statements; review of the selection of significant accounting principles and of any material or unusual transactions and payments and associated accounting, reporting, legal, and regulatory issues. We also reviewed the internal audit plan and significant investigations, including compliance with laws and regulations. We reviewed recommendations for the improvement of internal controls and instructed the internal audit function to monitor the implementations of those controls and to report back to us on the effectiveness of the implementations of the improvements by management. The committee also conducts ongoing reviews to assess the company compliance with its code of conduct and reports its findings to the board of directors.
Source: Rittenberg and Nair (1993)

In the amended version of the Kuala Lumpur Stock Exchange Listing Requirements, audit committees of Malaysian public listed firms are required to prepare the audit committee report and clearly distinguish it in the annual report. As a minimum requirement, this report should provide information on; (i) the composition of the audit committee, including the name, designation (indicating chairman) and directorship of the members (indicating whether the directors are independent or otherwise); (ii) the terms ofreference of the audit committee, (iii) the number of audit committee meetings held during the financial year and details of attendance of each audit committee member, (iv) a summary of the activities of the audit committee in the discharge of its functions and duties for that financial Year of the listed firm, and (v) the existence of an internal audit function or activity and a summary of the activities undertaken (KLSE 's Listing Requirements 2001).

The information on the composition of the audit committee and their directorships will describe the credibility and independence of the committee. The directorship ofits members will reveal the independence of the committee members. The benefit is that if the audit committee is independent of management than it is more likely to mitigate any pressure on the auditors, by the management, to issue an unqualified report and therefore make them more objective and effective in their oversight role. Pincus *etal.* (1989) suggest that the presence of outside directors on the board could increase the quality of monitoring because they are 'not affiliated With the company as officers or employees, and are thus independent representatives of the shareholders' interests'. The terms of reference of the committee help readers identify the scope of work and responsibilities t be accomplished and stakeholders can predict the achievements of the committee through the frequency of meetings and summary of activities undertaken during the year. It is expected that a more active committee would perform a better role than a less active committee. Audit committee members are expected to be thorough in their oversight role and to deal objectively with the management in carrying out their responsibilities.

METHODOLOGY

Information on audit committee reports was collected from the KLSE web page Where all listed companies are required to post their annual reports for public

Table 3 Description Sample used in this study

	Number of companies
Initial sample of the KLSE listed companies for the period from 1 January 2002 to 31 December 2002	
Main board	562
Second board	294
MESDAQ	12
Total listed companies as at 31 December 2002	868
Missing annual reports	(50)
Final Sample	818

viewing. The initial sample contains all firms listed on the KLSE's main and second board; and MESDAQ counters. However, only 94% of the companies actually posted their annual reports and 48 companies failed to provide such reports. All audit committee reports (8I8 ACRs) were analyzed in the context of the issues discussed earlier.

The audit committee reports analyzed cover the financial year January 2002 to December 2002. This cut-off period was selected due to the following reasons: (1) the amended KLSE Listing Requirements that cover audit committee requirements took effect from 15[1] June 2001 and some of the requirements took effect from 31 July 2001, (2) as an extension to Zulkarnain *et al* (2001) study of audit committee reporting for the period prior to the adoption of the MCCG, and (3) to investigate the impact of audit committee related recommendations made by the Malaysian Code of Corporate Governance in March 2000.

This paper investigates the ACRs oflisted companies to ascertain the level of compliance with the stock exchange's requirements on audit committees. The ACRs were also scrutinized for 'non-boiler plate' reports or any additional assurances or information over and above the requirements of good corporate governance practices.

FINDINGS

Based on published Audit Committee Reports (ACR) in the company's annual report, analyses was conducted on listed firms in the main and second board of the exchange and MESDAQ counters. Eight items required under the KLSE Listing requirements on ACRs were investigated namely; (l) the composition of the audit committee, including names and designation (termed as Composition), (2) directorship of the members (termed as Directorship), (3) the terms of reference of the audit committee (termed as Term of Reference), (4) the number of audit committee meetings held during the financial year (termed as Meeting), (5) details of attendance of each audit committee member (termed as Detail of Meeting), (6) a summary of the activities of the audit committee in the discharge of its functions anct duties for that financial year of the listed company (termed as Summary of Activities), (7) the existence of an internal audit function or activity (termed as Existence of Internal Audit), and (8) where there is such a function or activity, a summary of the activities of the function or activity (termed as Summary oflnternal Audit).

The sampled ACRs were also analyzed for disclosures or wording that differ from the requirements which could give further assurance on the corporate governance practices of the company or what is referred to as 'non-boiler plate' type disclosures (termed as value added statement).

A total of 532 main board, 285-second board and lO MESDAQ companies Were included in this analysis (see Table 4). All of the sampled companies complied With the requirement to disclose the composition of the audit committee except for 2 main board companies that completely did not provide their ACRs. Table 5 summarizes the findings based on industry classification and shows that both the

labie 4 Disclosures Frequency in the Main Board, Second Board and MESDAQ Counters

	MB		**SB**		**MESDAQ**	
'fype of Disclosures	n=532	%	n=285	%	n=lO	%
Composition	530	99.6%	285	100.0%	10	100.0%
Directorship	516	97.0%	281	98.6%	9	90.0%
Term of Reference	528	99.2%	285	100.0%	10	100.0%
Meeting	517	97.2%	279	97.9%	8	80.0%
Detail of Meeting	513	96.4%	273	95.8%	8	80.0%
Summary of Activities	512	96.2%	272	95.4%	5	50.0%
Existence of Internal Audit	463	87.0%	218	76.5%	4	40.0%
Summary of Internal Audit	460	86.5%	218	76.5%	4	40.0%
Value Added Statement	72	13.5%	19	6.7%	0	0.0%

Table 5 Frequency of Disclosures in Audit Committee Reports

Type of Disclosure	Technology SB n=3	Technology MB N=l6	Consumer SB n=59	Consumer MB n=61	Industrial SB n=l19	Industrial MB n=l14	Construction SB n=20	Construction MB n=34	Trading/Svs SB· n=67	Trading/Svs MB n=l16	Properties SB n=4	Properties MB n=83
Composition	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Directorship	100.0%	100.0%	100.0%	96.7%	99.2%	96.5%	100.0%	100.0%	95.5%	97.4%	100.0%	97.6%
Term of Reference	100.0%	100.0%	100.0%	100.0%	100.0%	99.1%	100.0%	100.0%	100.0%	99.1%	100.0%	100.0%
Meeting	100.0%	100.0%	100.0%	100.0%	97.5%	96.5%	100.0%	100.0%	98.5%	96.6%	100.0%	96.4%
Detail of Meeting	100.0%	100.0%	98.3%	100.0%	94.1%	96.5%	100.0%	97.1%	98.5%	97.4%	100.0%	95.2%
Summary of Activities	100.0%	93.8%	98.3%	93.4%	96.6%	95.6%	100.0%	100.0%	95.5%	95.7%	100.0%	98.8%
Existence of Internal Audit	100.0%	93.8%	76.3%	85.2%	79.0%	84.2%	70.0%	88.2%	79.1%	88.8%	75.0%	89.2%
Summary of Internal Audit	100.0%	93.8%	76.3%	85.2%	79.0%	84.2%	70.0%	88.2%	79.1%	87.9%	75.0%	89.2%
Value Added Statement	0.0%	25.0%	5.1%	9.8%	7.6%	11.4%	0.0%	11.8%	10.4%	13.8%	0.0%	12.0%

Type of Disclosure	Plantation SB n=3	Plantation MB n=37	Finance SB n.a.	Finance MB n=51	IPC SB n.a;	IPC MB n=7	Hotel SB n.a.	Hotel MB n=6	Mining SB n.a	Mining MB n=4	MESDAQ Counter n=lO
Composition	100.0%	100.0%		98.0%		100.0%		100.0%		100.0%	100.0%
Directorship	100.0%	97.3%		98.0%		100.0%		83.3%		100.0%	90.0%
Term of Reference	100.0%	100.0%		98.0%		100.0%		100.0%		100.0%	00.0%
Meeting	100.0%	97.3%		96.1%		100.0%		100.0%		00.0%	80.0%
Detail of Meeting	66.7%	97.3%		96.1%		100.0%		100.0%		50.0%	80.0%
Summary of Activities	100.0%	97.3%		96.1%		100.0%		100.0%		100.0%	50.0%
Existence of Internal Audit	66.7%	81.1%		90.2%		85.7%		83.3%		100.0%	40.0%
Summary of Internal Audit	66.7%	81.1%		88.2%		71.4%		83.3%		100.0%	40.0%
Value A.dded Statement	0.0%	5.4%		27.5%		28.6%		16.7%		0.0%	0.0%

companies that did not comply with the ACR requirement were from the finance industry. The common disclosures in the composition section are the name of audit committee members and designation of the members (whether chairman or lllember of the committee).

The non-compliance rate for the disclosure of directorship of audit committee lllembers was 3% for the main board and I% for second board companies. The incidence ofnon-compliance arises in the consumer (main board counter), industrial (both counters), trading and services (both counters), property (main board counter), Plantation (main board counter), finance (main board counter) and hotel (main board counter) sectors. These companies either did not provide the status of the lllember or only disclosed whether the member is an executive or non-executive director instead of independent or non-independent director. The independence status of the director is a common disclosure under this section. The non-compliance of directorship disclosure requirement could mislead stakeholders on the independence status of the committee and consequently violate the KLSE Listing Requirement that requires two-third of the committee members to be independent. Conversely, some of the non-compliance companies did provide the independence status of audit committee members in another part of the Annual Report that did not constitute as a part of the ACR. It should be noted that the KLSE listing requirements explicitly states that the disclosure of directorship of audit committee lllernbers must be part of the ACR. All of the listed firms provide the term of reference or what is expected from the audit committee except for 4 main board companies. Table 5 shows that the incidence of non-compliance comes from 3 industries namely the industrial, trading and services and finance industry. This section outlines the duties, responsibilities and conduct of the committee. Almost an of the listed companies provided their term of reference in great detail and most Of the reported information seems to have similar word\ngs. However, it should be noted that the term of reference only lists out the expected functions of the committee and not the actual activities performed by the committee. The requirement on the disclosure of the term of reference should be revised to give more emphasis on Concurrently reporting on the actual activities performed by the audit committees to reflect the responsibilities of the committee for the benefit of stakeholders and the general public.

Almost all (97%) of the main and second board companies disclose the number of meetings held and the attendance of audit committee members in these meetings. The ratio of attendance by the members to total meetings held, summarized in Table 5, shows that six industries, namely the industrial, trading and services, property, plantation, finance, mining sectors and MESDAQ counter, did not achieve 100% compliance. Except for the mining sector (50%) and the MESDAQ counter (20%) the percentage of non-compliance reported is insignificant. However, the number of companies in these counters is small and the level of non-compliance is considered insignificant (2 out of 10 companies in the MESDAQ counter and 2 out of 4 in the mining sector). In spite of this, some of the companies provide further information in this section which increases the value of the report where the wording used differs from most of the sampled companies. For example, the extracted section of an ACR in sample 1describes the conduct of a meeting without the presence of the executive member of the committee to ensure a free flow of communication within the company. Clearly , the ACR trys to show that the committee's meeting was properly conducted and independent of any management influence.

Sample 1

Crest Petroleum Berhad
Audit Committee Meeting Attendance Section

In accordance with the recommendations under the Code, and as stipulated by its own Terms of Reference, at the Audit Committee Meeting held on 20 November 2002, the executive member, namely Encik Razman Ariffin left the meeting to enable the meeting to continue just between the external auditors and the remaining members of the Audit Committee. This was done to facilitate a free flow of discussion between the external auditors and the Audit Committee that might have been hampered with the presence of an executive member.

Sample 2 highlights the depth of discussions at the meetings where the audit committee not only relied on submitted reports but also feedback from the branch level which emphasised the importance oflocality in business. Such disclosure is very important to information users to assess whether the conduct of the audit committee is proper in overseeing the various aspects of business operations.

Sample 2

Tenaga Nasional Berhad
Introduction Section
Some of the BAC (Board Audit Committee) meetings were held at regional offices so that local issues and problems could be understood better, and to ensure prompt attention by local management and corrective actions are taken on issues raised by internal audit.

Finally, sample 3 illustrates how the company deals with the internal control issues faced by the company and preventive actions taken to overcome the Weaknesses identified. This type of disclosure provides assurance to the reader that the company is making continuous efforts to improve its internal controls and adequate mechanisms exist to improve any weaknesses. Information users are therefore,more confident of the system ofinternal control and the financial reporting Process.

Sample 3

Puncak Niaga Holdings Berhad
Meetings of the Audit Committee Section
During the Audit Committee Meetings, IAD tabled its internal audit reports to the Audit Committee for deliberation and direction. Weaknesses of procedures were identified and the respective Heads of Departments were asked to take the necessary actions to rectify those weaknesses and improve on procedures and control mechanisms to prevent future occurrences of a similar nature

Furthermore, the KLSE Listing Requirement requiress the audit committee to disclose their activities during the year in summary form in the ACR. This requirement is an improvement on the previous requirement and is seen as an indicator of whether the committee discharged their duties during the year. Table 4 shows that 96% of the main board, 95% of the second board and 50% of the MESDAQ companies complied with the requirements. However, the incidence of non-compliance is considered insignificant comprising approximately 5% in all industries except the MESDAQ counter as reported in Table 5. It is found that the wording used in this section is similar almost across the board or that it only briefly describes the activities to comply with this requirement. Half of the MESDAQ companies failed to comply with this requirement and it is believed that more time is needed for these companies to learn how to effectively conduct their audit committee functions. However, some of the sampled companies do provide further description of the activities actually performed to enhance good corporate governance. Five samples (sample 4 to 9) presented below show the summary of activities carried out by audit committees. In sample 4, the committee assured the ACR readers that good internal control exists within the company and of the reliability of the information in the quarterly report. Stakeholders will find that the disclosure provides additional assurance on the effectiveness of internal control, hence, the reliability of information provided by the company is assured.

Sample 4

Ancom Berhad
Summary of Activities Section

.....The Audit Committee was satisfied that there was no major breakdown in the internal control of the Group during the year. The Audit Committee also approved the auditors' remuneration for the year ended 31 May 2001.

......During the year, the Audit Committee commissioned Ernst & Young ("E&Y"), the internal auditors, to conduct a review of the Group's Interim Accounts Closing Process in order to obtain assurance that the Group's quarterly results announcements are reliable and would not contain material misstatement. Based on the review, E&Y reported that the Internal control elements in the Group's Interim Accounts Closing Process were in order to produce reliable quarterly results announcements.

Similar to the above extract from the ACR, sample 5 describes the meetings and review ofaudit reports conducted during the year. It provides assurance of the good corporate governance in practice by the company by ensuring greater transparency. Investors and stakeholders are more interested in this type of information disclosure rather than the 'legalistic boilerplate' type of reports.

Sample 5

C.I. Holdings Berhad
Summary of Audit Committee Activities Section

During the financial year, five (5) Audit Committee meetings were held. The Audit Committee reviewed a total of twenty-two (22) audit reports. The Audit Committee reviews all internal audit reports with an emphasis on significant issues and critical risk areas affecting the overall performance of the Group. In order to ensure greater transparency and good corporate governance within the Group, the Audit Committee discusses in detail the adequacy of each company's internal control systems in addition to organisational and operational controls. The Audit Committee further emphasises actions to be taken to rectify and improve the effectiveness and efficiency of operations of the subsidiary concerned.

The extract of the ACR in sample 6 discusses the review of risks faced by the company and the details ofrisk areas, providing assurance on the level of internal control practiced by the company. Moreover, users may find the report useful Where it describes the training undertaken by the committee members -to ensure they effectively discharge their duties. It seems that the audit committee in sample 6 received appropriate training to enhance their ability to discharge their duties Properly.

Sample 6

Tenaga Nasional Berhad
Member of BAC Section

For the financial year under review, twenty four (24) audit reports were submitted to the Board Audit Committee for its review. The reports that were submitted highlighted critical and high-risk areas that have significant and material impact on the Group's performance. In addition, the reports addressed routine financial activities with specific emphasis on the system of internal control within the group. Specifically, the reports covered the following areas:

- Operational efficiency
- Operational expenditure and cost saving opportunities

- System of Internal Control
- Metering, billing and revenue collection
- Safety and environmental audit
- Fuel procurement
- Treasury management
- Budgeting and control
- Major projects and contracts
- Manufacturing and other non-core subsidiaries
- IT projects

••••Members of the audit committee conducted a study tour to two utilities in Japan -Tokyo Electric Power Company -to obtain an insight into the functions of their audit committees, particularly in the areas of:

- Audit organisational set-up
- Corporate governance
- Risk management
- Distribution business
- Power plant performance

The extract of the ACR in sample 7 shows that related party transactions have been reviewed according to the required procedure. This type of disclosure will overcome the doubts of stakeholders about efforts to address risk areas. It is very rare to find ACRs that provide information that give proper assurance on related party transactions in public listed companies.

Sample7

Asia Pacific Land Berhad
Summary of Activities Section

Related party transactions between the Group and its·directors and any other person connected with the directors of the Group are also reviewed by the Audit Committee in accordance to the review procedure established by the Group.

Value-added statements contained in the summary of activities section of the ACRs illustrated above will help information users assess the level of safeguards; threats and corporate governance practices within the company and will add value to the ACR beyond merely as a mandatory requirement. In general, most of the

ACRs provided minimum information in compliance with the listing requirements and this needs to be revised by regulators to widen the scope of information reported in compliance with the disclosure based corporate environment.

The listing requirement on internal audit functions in Table 4 show that 87% of the main board, 77% of the second board and 40% of the MESDAQ companies provide disclosure of their internal audit functions and activities during the year. This finding requires policy makers to revise the requirements to encourage companies to comply with the requirement, as there is a substantial cost to incorporate or outsource internal audit functions.

Effective enforcement requires coordinated efforts among the regulatory authorities such as the KLSE, Securities Commission (SC) and Companies Commission of Malaysia (CCM). A holistic approach needs to be pursued to effectively enforce the required measures as it involves multiple parties. It is believed that the incidence of non-compliance arises either due to the company not having internal audit functions or simply due to companies trying to hide the weaknesses of their organisation. Provided below are 4 samples of extracts from the Internal Audit Function section of the ACR which elaborates further on their activities during the year which differ from the 'legalistic boilerplate' type of ACRs.

Sample 8 outlines the activities of the internal audit fm;1ction and identification of critical and high-risk areas within the company which gives additional assurance to the user that the internal audit department is functioning properly. The company also highlights the areas reviewed by the department.

Sample 8

Damansara Realty Berhad
Internal Audit Function Section

Throughout the financial year under review a number of audit assignments and follow-up audits were carried out on the Company's business units/operations and a subsidiary company. These assignments were carried out in accordance with the Annual Audit Plan or as special ad-hoc audit at Management's request. The resulting reports of the audits undertaken were presented to the Audit Committee for its review which highlighted critical and

high-risk areas that have significant and material impact on the Group's performance. In addition, the reports addressed routine financial activities with specific emphasis on the system of internal control within the Group. Specifically, the internal audit exercise during the financial year under review covered the following areas:

- Group cash flow
- Property management operation undertaken by an associated company
- Inter-company transaction and reconciliation
- Investigation on the alleged misconduct of technical/ maintenance personnel

The extract of the Internal Audit Function section in sample 9 describes their technique in auditing internal controls of the company and provides assurance that there is no breakdown of internal control within the company

Sample 9

Advance Synergy Capital Berhad
Internal Audit Function Section

The Audit Committee has adopted a top down, risk based approach to the implementation and monitoring of internal controls in the Group. This was achieved via the critical and in depth review and deliberation of the management reports and relevant issues presented during the regular Audit Committee meetings held. This top down, risk based approach will enable the Audit Committee to identify any major breakdown in the risk management and internal controls in the Group and to take necessary steps to address the issues.

The Company in sample 10 reveals that the audit committee has evaluated and identified the currency risk faced by the company and provides further assurance that the risk did not warrant any further disclosure. Investors can make a more objective investment decision with transparent and timely disclosed information especially about risks faced by the·company.

Sample 10

CNLT (Far East) Berhad
Internal Audit Function Section

The Internal Audit observations and findings highlighted variances in the expected and actual results of the systems implemented for management of significant risks. Italso identified possible new risks of currency fluctuation for the forthcoming years. However these do not result in any contingencies that would need disclosure in the Groups annual report.

The extract from the ACR in sample 11 describes the Internal Audit Function of the company. The disclosure illustrates the compliance level, risks faced by the company and recommendations made during the year.

Sample 11

Puncak Niaga Holdings Berhad

••.••For year 2002, IAD initially planned its audit on departmental basis by reviewing the level of each Department's compliance with policy and procedures, statutory requirements, good industry practices, etc. and identifying risks, which were peculiar to the respective Departments under review. However, in the second half of 2002, with the Audit Committee's consent, IAD focused on the enterprise-wide risks i.e. risks that were identified during the brainstorming sessions of the Risk Management Scorecard Working Group (comprising Executive Directors and Senior Management). The enterprise-wide risks identified are risks facing the Group as a whole and the controls implemented to manage by one or more departments in the Company•

••.••Set out below are some recommendations and assurances provided by IAD for year 2002:-

1. Inventory and Storage System at the SSP2 Water Treatment Plant Storehouse.
2. Increasing Receivables.
3. Inadequate Raw Water Quantity and Poor Raw Water Quality.

/The report further e/a/Jorates in detail on each of the recommendations/

In addition to disclosures in compliance with the KLSE Listing requirement as discussed above, some companies provide additional information unique to the company and industry. The extract of the ACR in sample 12 discusses the strategies adopted by the company to counter the money laundering issues faced by the finance sector.

Sample 12

CIMB

Anti Money Laundering Activities Section

The Directors and Management of the Group fully support the new Anti Money Laundering Act 2002 (AMLA) and have taken active steps to ensure that the group has appropriate controls in place to circumvent any Money Laundering Activities from happening. Some of the steps that have been taken include:-

- Group wide internal training on the AMLA requirements and best practices for prevention of money laundering activities
- Nomination of a compliance officer internally to be the liaison between the Group and the regulators on all money laundering matters
- Review of internal requirements for "Know Your Customer" policy
- Drafting an internal checklist on AMLA requirements

And, sample 13 provides assurance that the audit committee has discharged their functions consistent with the terms of reference.

Sample 13

Ancom Berhad

Conclusion section

Based on the above, the Audit Committee is of the opinion that it has discharged its function effectively in accordance with the terms of reference established above.

The findings also indicate that only 14% of the main board, 7% of the second board companies and none from the MESDAQ counter provide additional wording or disclosures other than those of the 'legalistic boilerplate' type in the ACRs. This implies that the listed companies provide ACRs simply to comply with the requirements, and only a small number of the ACRs expressed the audit committees' view on the appropriateness of the financial statements and internal controls. The incidence of procedural compliance discussed above is consistent with the findings of Zulkarnain *et al.* (2001) which examined audit committee disclosures for the Period 1994 to 1999. The findings imply that although audit committees have been in existence for almost a decade, there is not much improvement except for minimum compliance to the additional listing requirements. The procedural compliance in practice does not ensure quality of work discharged by the committee members and only of avoidance of fines by the regulatory authorities for non-compliance. It is expected that in future, ACRs should extend beyond a mere description of activities and functions to include communication by the audit committee regarding its belief that the financial statements are complete, consistent, and reflect appropriate accounting principles (Urbancic, 1996).

CONCLUSION

This paper investigates the level of compliance with KLSE Listing Requirements on audit committee reporting. This paper provides evidence on audit committee reporting in the Malaysian corporate environment. Consistent with literature in developed markets, the findings reveal that very few companies provide more than what is expected by the listing requirements in their ACRs. Also companies in finance, technology and IPC counters, and companies on the main board counter have greater initiative to provide value added (or termed as 'non-boiler plate') statements to information users.

The requirement to include ACRs in the annual report will provide financial statement users an understanding of the roles, functions and activities undertaken by the audit committee during its financial year. This disclosure will provide some form of assurance on the depth of corporate governance practices among the listed firms. The inclusion of the ACR in the annual report also signals to the stakeholders that there is an attempt towards good corporate governance practice and will Positively reflect on the firm's credibility and quality of financial reporting. Bowever, the ACR should not be a 'legalistic boilerplate' type and should provide as much information as possible on the oversight functions undertaken.

Consistent with the stakeholders' expectations on the use of ACRs to evaluate the effectiveness of the audit committee in discharging their duties, the findings in this paper suggest a further look into the usefulness of ACRs among stakeholders such as bankers and institutional investors. This would provide added value to the ACRs despite the fact that it is a mandatory requirement for listed companies. Furthermore, there is still a lack of evidence on the issue of preparation and approval of the decision to provide 'non-legalistic boilerplate' type of ACRs. The investigation should focus on variables like inside ownership, leverage, proportion of outside directors, size, complexity, board listed and profitability. The findings could shed further light on the ACR's ability to create a firm's value or improve perceptions of a firm's credibility.

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