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Risk Disclosure Practices among Malaysian Listed Firms

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ABSTRACT

This study discusses the development of risk disclosure policy in Malaysia after the 1997 financial crisis and provides evidence on the importance of risk disclosure over the recent years. Analysis on the trend of risk disclosure based on the new development was carried out through content analysis. The findings show positive trend of development in risk disclosure practices in Malaysia over the period of 2001-2011. In addition, risk disclosure sentences were found to be insufficient and should be rectified. There is a need to revisit the current regulations and standards to improve the risk disclosure practices and to follow internationally-based accounting policy.

Keywords: Risk Disclosure, Regulatory, Malaysia
JEL Classification: M40

1. INTRODUCTION

The identification, management and disclosure of risks have been the subject of recent legislation, directives and reporting standards issued across a number of international jurisdictions (Hill and Short, 2009). Risk reporting information has been disclosed based on certain regulatory framework. At the same time, some companies disclose extra information voluntarily. Risk management is a critical component in business; it incorporates identifying and measuring risks. Santomero (2007) suggested that implementing a sound risk management system in the organization requires inclusion of risk reporting in the organization's financial reports and presentation of the reports to shareholders and regulators. Raghavan (2003) added that it is necessary for organizations to disclose the right amount of risk information since it helps potential investors to examine the strategies adopted by the organizations. Institutions that set standards for risk reporting and disclosure in companies' annual reports have given considerable focus on risk reporting due to the critical nature of risk. However, it has been found that the availability of risk information is still inadequate in these reports (Abraham and Cox, 2007; Amran et al., 2009; Elzahar and Hussainey, 2012; Konishi and Ali, 2007; Lajili and Zéghal, 2005; Linsley and Shrives, 2006; Oliveira et al., 2011a; Woods and Reber, 2003). In fact, the users of the annual reports have increased their demand for availability of such information so that they can assess the organizations' risk profiles better (Linsley and Shrives, 2000; 2005; Rajab and Handley-Schachler, 2009; Solomon et al., 2000). Given the increased requests for more information about risk, regulators and other involved parties are playing a bigger role in introducing new policies that could enhance the risk reporting system (AICPA, 1994; ASB, 1993; 2003; 2006; CICA, 2002; ICAEW, 1997; 1999b; 2002).

In Malaysia, argument on risk management and its requirement for disclosure can be clearly established in the Financial Reporting Act 1997 and Bursa Malaysia listing requirements (Amran et al., 2009). The listing requirements suggest that listed firms are obligated to disclose their financial, operation and management information in their annual reports for a particular financial period to allow stakeholders and investors to assess the performance of the firm (Amran et al., 2009). This study explores the importance of risk disclosure in Malaysian context and investigates the trend of risk disclosure practices in Malaysia. The following section discusses on the importance of risk disclosure in Malaysia followed by methodology and content analysis. Subsequently, findings of the study are presented and conclusion is offered.

This study identifies the importance of risk disclosure over recent years in Malaysia. It looks at the development in risk disclosure policy in Malaysia after the 1997 financial crisis. Obligation for disclosure for companies in Malaysia has been established in the Financial Reporting Act 1997 and Bursa Malaysia listing requirements (Amran et al., 2009). Malaysian Accounting Standard Board and Security Commission are regulatory bodies which develop rules for disclosing more about companies' risks in order to bring market confidence. In addition, Malaysian Code of Corporate Governance clearly identifies the need to establish risk management committee and the importance of risk reporting practices. Figure 1 summarizes the regulatory development of risk disclosure in Malaysia after the 1997 financial crisis.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Many of the risk disclosure studies are derived from empirical research based on the UK, Dutch, French, German, and Anglo-Saxon nations (Abraham and Cox, 2007; Abraham and Shrives, 2013; Carlon et al., 2008; Deumes, 2008; Deumes and Knechel, 2008; Elshandidy et al., 2013; Elzahar and Hussainey, 2012; Kajüter, 2006; Lajili, 2007; Lajili and Zéghal, 2005; Linsley and Shrives, 2006), Latin nations (Beretta and Bozzolan, 2004; Combes-Thuélin et al., 2006; Oliveira et al., 2011a; Oliveira et al., 2011b), Arab nations (Hassan, 2009), and Asia-Pacific nations (Amran et al., 2009; Konishi and Ali, 2007; Mohobbot, 2005). In general, these studies show that the disclosure of risks is generic, vague, inadequate, backward looking, and qualitative in nature and does not meet the demands of the stakeholders (Oliveira et al., 2011a). In addition, researches on risk disclosure have focused on voluntary risk disclosure of the internal controls in annual reports (Deumes and Knechel, 2008), management discussion and analysis segments (Beretta and Bozzolan, 2004; Mohobbot, 2005), mandatory disclosure of risk in management reports (Kajüter, 2006) and mandatory and voluntary disclosure of risk in annual reports (Abraham and Cox, 2007; Amran et al., 2009; Hassan, 2009; Konishi and Ali, 2007; Lajili, 2007; Linsley and Shrives, 2006; Oliveira et al., 2006; Oliveira et al., 2011a; Rajab and Handley-Schachler, 2009; Taylor et al., 2010) and mandatory and voluntary disclosure of risk in interim reports (Elzahar and Hussainey, 2012).

Quite a few studies have highlighted the vagueness and inadequacy of risk disclosure (Oliveira et al., 2011a). It was found that among listed firms in Italy and Canada, voluntary risk disclosure was mainly concentrated on present and past risks and was qualitative in nature (Beretta and Bozzolan, 2004; Lajili and Zéghal, 2005). According to Linsley and Shrives (2006), risk disclosure among listed firms in the UK had future risk information but was qualitative in nature. Further, a study by Kajüter (2006) on German firms found that mandatory risk disclosure was very vague in their management reports in which only a few of the disclosures were detailed and accurate. Most disclosures were insufficient and the term of criticality was not easily identifiable.

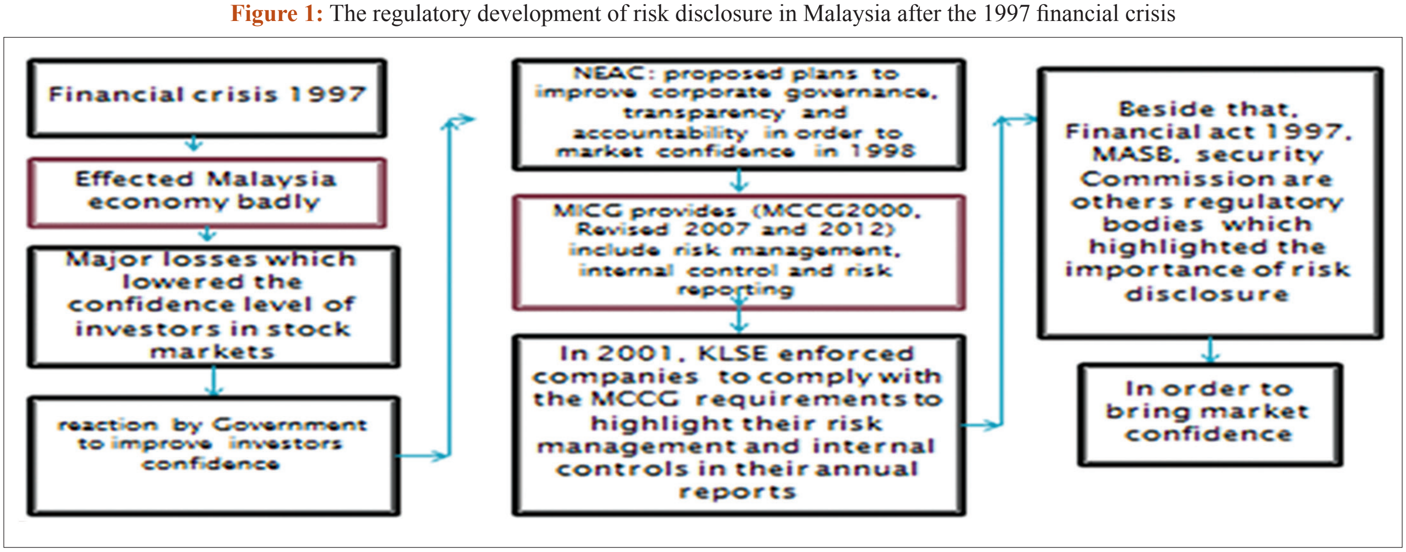
The exploratory study by Amran et al. (2009) found that risk disclosed information is very much less in Malaysia compared to a 2006 study done by Linsley and Shrives in the UK. According to the political costs theory, companies are required to meet any requirement from regulators in disclosing information which supports investors of the company for better decision making. It is expected that over the past few years, firms in Malaysia are reacting to the policies set out by SC, MCGG, and MASB and other regional events such as the Asian financial crisis by improving their risk disclosure levels (RDLs). The following hypothesis is developed based on political cost theory to figure out risk disclosure development over the period of 2001-2011 among Malaysian listed firm.

H_1: There is positive growth of RDL for the period of 2001-2011.

3. METHODOLOGY AND CONTENT ANALYSIS OF RISK DISCLOSURE

This study used content analysis to quantify risk disclosure. The specific measure was formulated from the categories used by

Figure 1: The regulatory development of risk disclosure in Malaysia after the 1997 financial crisis



Abraham and Cox (2007) and Oliveira et al. (2011a). There were three categories of disclosure namely financial risk (FR), non-FR (NFR) and risk management framework (RMFW). These categories were used to calculate the RDL for the following reasons. First, previous study in Malaysia by Amran et al. (2009) has adopted the risk categories based on Linsley and Shirves (2006). This category defined by ICAEW (1997) was more suitable for developed countries like UK and may not reflect the differences in economic situations (developing and developed countries). Second, there is less room for error when the idea of risk is limited to financial, non-financial and RMFW categories which can be applicable in any country or context and are not affected by researcher bias (Abraham and Cox, 2007; Oliveira et al., 2011a). Finally, these categories have assured the reliability of content analysis which is tested in emerging market by Oliveira et al. (2011a) and are suitable in the Malaysian context. This methodological gap will be clarified by choosing suitable risk categories as mentioned above.

This study also looked at the practices of Malaysian firms in improving their risk reporting and keeping in line with the regulators guidelines and meeting the requirements of the various accounting bodies in annual reports following the 1997 financial crisis. Staying in line with the study objective, the firms that constituted the sampling frame for the study were listed companies in the main board of Bursa Malaysia covering the period of 2001-2011. Of all the listed firms (data availability and active firms for this period) with 1155 firm-year observations, 105 firms were selected out. Data for the study were obtained from annual reports of the related firms. The data were analyzed through various statistical techniques; this entails descriptive statistic and Wilcoxon signed-rank test (non-parametric test).

Table 1: Mean value of risk disclosure - overall and based on categories

Year	N	$RDL = \sum_{i=0}^{sa} FR_{ij} + \sum_{i=0}^{sa} NFR_{ij} + \sum_{i=0}^{sa} RMFW_{ij}$			
		Mean			
		RDL	FR	NFR	RMFW
2001	105	12.914	4.657	5.666	2.590
2002	105	16.095	5.285	7.190	3.619
2003	105	18.761	6.133	8.552	4.076
2004	105	22.142	7.590	9.828	4.723
2005	105	25.780	10.276	9.904	5.601
2006	105	29.571	11.571	13.733	6.266
2007	105	34.800	12.885	14.628	7.285
2008	105	40.219	14.438	17.533	8.247
2009	105	46.066	16.447	20.161	9.457
2010	105	52.304	18.219	23.419	10.666
2011	105	58.180	21.809	24.895	11.476

RMFW: Risk management framework, RDL: Risk disclosure level, FR: Financial risk, NFR: Non-financial risk

4. FINDINGS

The results displayed in Table 1 and Figure 1 show a steady increase in mean disclosure over the period of 2001-2011. The graphical interpretation reveals the trends in total risk disclosure. This provides evidence that there is an upward trend in the average number of risk disclosure sentences being disclosed by the sample of companies, supporting its growing importance. The graphical interpretation reveals that risk disclosure increased from 12.914 to 22.142 (2001-2004), from 25.780 to 40.219 (2005-2008), and from 46.066 to 58.180 (2009-2011) over the 11 years. In addition, Table 2 (the Wilcoxon Signed-Rank Test (non-parametric)) shows that there are significant differences over the whole period which suggests that there is a significant increase in risk disclosure thus supporting the hypothesis H_1.

Table 1 and Figure 2 also show the differences in risk disclosure (mean value of risk disclosure sentences). There is an upward trend in disclosure which contributes to the total average of risk disclosure to differ between categories, and that there is more risk disclosure made by companies on NFR category in comparison to other two categories (FR disclosure and RMFW). Further, Table 2 and Figure 2 demonstrate that NFR disclosure dominates; reflecting its growing importance. Nevertheless, disclosure on FR and RMFW categories has also increased over the 11 year period, reflecting their significance.

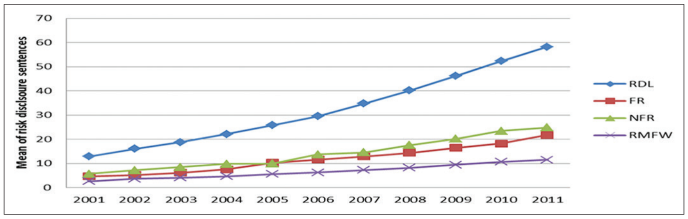
5. CONCLUSION

The findings from the content analysis show that there is some useful risk information disclosed by the firms in their annual reports. There is also positive trend of increasing amounts of RDL for the period of 2001-2011. An important conclusion is that the companies provide substantial but rather inadequate explanations in their annual reports. Disclosure regulations intend to deal with information gaps in the market so information becomes available to investors. In this study, the political cost theory was extended to discuss the need of increasing the disclosure in annual reports. It shows that narrative role of disclosure (including risk disclosure) is much more needed in imperfect market. The results suggest that accounting regulations, regulatory body and rules together with proposals issued by accounting organizations do influenced the increase in the level of risk information sentences disclosed but cannot ensure the sufficient level of disclosed information. This study also reveals that in order to meet various users' demand of annual reports information, there is a need to improve

Table 2: Result of Wilcoxon signed-rank test related to hypothesis H_1

	H_1: There is positive growth of RDL from 2001-2011											
	N	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2001-2011
Z	105	−8.170	−6.487	−7.085	−6.977	−7.659	−8.056	−8.058	−8.044	−7.827	−7.629	−8.898
Asymptotic significant (two-tailed)	105	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Figure 2: The trend of risk disclosure practices from 2001 to 2011



risk disclosure not only due to policies by regulatory bodies but also due to the increasing demands from various stakeholders especially after the 1997 financial crisis. Therefore, there is a need to revisit the current regulations and standards to improve the risk disclosure practices and to follow internationally-based accounting policy. While regulation is efficient in improving the level of risk disclosure, future researchers need to investigate the quality of information and to compare with international aspect. As this study is limited to large and non-financial firms through their annual reports, research can also include other sectors and other media of communications. Future research can also consider the determinants and consequences of risk disclosure. Thus, more effort on providing information would, therefore, further enhance the usefulness of risk disclosure.

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