

# A Descriptive Study on Standalone Risk Management Committee Adoption among the Top 50 Malaysian Firms

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## ABSTRACT

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*In a modern business environment, business is considered more fragile as compared to the traditional business setting due to technology sophistication and global market uncertainty. Firms cannot run away from managing unique and complicated risk issues when exploring greater opportunities for a higher return in a competitive market. Realizing this, the Securities Commission of Malaysia had encouraged large, listed firms to form a separated Risk Management Committee to ensure better anticipation and responsiveness towards risk management issues. However, this practice is still voluntary among Malaysian listed firms most probably to allow internal coordination among different business atmospheres. Hence, this paper aims to describe the adoption level of the best practices to establish a standalone Risk Management Committee among the top 50 largest listed firms in Bursa Malaysia. Given the issuance of the Malaysian Code of Corporate Governance 2017 before the attributes of the Risk Management Committee were further explored. Secondary data were adopted, and information was gathered from the firms' annual reports in 2018 and 2019. It is available on the Bursa Malaysia website and each sampled firm's website. The results revealed that more than half of Malaysian listed firms had taken the initiative to establish a standalone Risk Management Committee following the best practices recommended by the Malaysian Code of Corporate Governance 2017. However, the composition of Risk Management Committee members is heavily tied to the Audit Committee. This current study provides insight into the risk governance structure among Malaysian listed firms after issuing the Malaysian Code of Corporate Governance 2017.*

## 1. INTRODUCTION

Governance mechanism is one of the pillars of good corporate governance. The focus is mainly on how the board of directors, as the agent to the stakeholders, undertake their stewardship function in fulfilling their public accountability (Ishak & Mohamad Nor, 2017). Unforeseen failure of corporate firms such as Enron, WorldCom and Lehman Brothers has changed stakeholder's perspective on the importance of mitigating risk within a business entity (Abdullah, Shukor, & Rahmat, 2017; Aldhamari, Nor, Boudiab, & Mas' ud, 2020; Larasati, Ratri, Nasih, & Harymawan, 2019; Rimin, Bujang, Wong Su Chu, & Said, 2021). Policymakers are finding ways to enhance governance rules to safeguard stakeholders' interests as the starting point to minimize principal risk.

In Malaysia, with the recent corporate failure of 1Malaysia Development Berhad, the Securities Commission (SC) had launched an improvised version of its corporate governance best practices with the issuance of the Malaysian Code of Corporate Governance (MCCG) 2017, which superseded its earlier version. This fourth version is seen to strengthen corporate governance culture in line with market and business needs. One of the recommendations made by the SC in the Step-Up Practice 9.3 of MCCG 2017 is the establishment of a standalone Risk Management Committee (RMC) which comprises a majority of an independent director to oversee the firm's risk management framework and policies. An independent director on board minimises agency problems (Fuzi, Halim, & Julizaerma, 2016).

With the evolving nature of risk associated with the sophisticated business environment, uncertainty in the industry, and global market phenomenon, the urgency for a specialized RMC is necessary to ensure risk identification and mitigation are adequately supervised (Securities Commission, 2017). Since the traditional ways of combining two primary key areas (audit and risk management) into one board raise the board's effectiveness in undertaking their responsibilities in an impactful manner. Moreover, the time commitment is also at a cost due to overwhelmed obligations (Aldhamari et al., 2020).

Previous studies reported the advantages of having a standalone RMC separated from the Audit Committee (AC). By focusing on how standalone RMC could contribute towards better financial performance (Aldhamari et al., 2020; Halim, Mustika, Sari, Anugerah, & Mohd-Sanusi, 2017; Jia & Bradbury, 2020; Rimin et al., 2021), higher audit quality (Larasati et al., 2019) and shorter audit report lag (Omer, Aljaaidi, & Al-Moataz, 2020). Standalone RMC is also proven to promote voluntary disclosure (Abdullah et al., 2017) and reduce financial fraud incidences (Abdullah & Said, 2019) within the entity. However, limited studies explore the characteristics of RMC itself that define its effectiveness (Jia & Bradbury, 2020) to bring better firm performance. Perhaps, because the practice of having a standalone RMC is still not mandated in many countries and at the same time, the governance guide on RMC is still silent.

Realizing the benefits brought by the existence of standalone RMC, this study wishes to investigate further the current practices by the top 50 Malaysian listed firms in Bursa Malaysia subsequently after the release of the MCCG 2017 to see the adoption of the best practice recommended by SC regarding the establishment of standalone RMC. It would be interesting to see how the large, listed firms react towards the encouragement made by SC subsequently after the guide is released on 26 April 2017. Further consideration would be given to the characteristics of RMC in ensuring strong corporate governance presents within the listed firm's board structure. The attributes of RMC may include the board independence, board size and whether RMC established is independent of the AC. All the governance structure of the main board should also be embedded in the RMC structure to avoid eye obscuring RMC established

for the sake of complying with the best practice without properly undertaking their ultimate role seriously.

## **2. LITERATURE REVIEW**

### ***2.1 Agency Theory***

The board of directors are the representative of shareholders has always rested within the agency theory concept. According to agency theory, board members appointed by the shareholder act as the agents who run the firm for the shareholder's best interest, known as the principal. A strong governance mechanism can monitor an agent's behaviour in maximizing the principal's return as the capital contributor (Rimin et al., 2021). One of the ways is by placing an internal supervision mechanism within the business operation (Halim et al., 2017), and RMC is one of the tools (Larasati et al., 2019; Nasution, 2019). RMC play a crucial role in resolving conflict of interest between shareholders and the board, subsequently increasing shareholder value. At the same time, it reduces information asymmetry due to the establishment of an independent board that causes higher integrity and promotes transparency in financial reporting (Aldhamari et al., 2020). Separate RMC will monitor various inherent risks with more focused risk oversight functions (Abdullah et al., 2017). A stronger governance mechanism exists with standalone RMC in place. It will increase the board's effectiveness in dealing with risk management issues and align the principal and agent interest, thus reducing agency problems.

### ***2.2 Evolution of Risk Management Guide in Malaysian Code of Corporate Governance***

The importance of risk management and an effective internal control framework was first introduced in MCCG 2000. However, limited guidance was given on how the board should execute this responsibility. It is up to the board to design its structure (Ishak & Mohamad Nor, 2017). How a board of directors perceive risk management responsibilities should reflect how they organize their board structure (Tonello, 2012). Later, when the MCCG was revised in 2007, it required listed firms to form an internal audit committee that includes a risk management team in charge of managing risk effectively and ensuring internal control procedures are in place (Ghazali & Manab, 2013; Rimin et al., 2021).

The third version of MCCG, released in 2012, has provided a detailed governance principle and recommendation for the best practice related to risk management. At this point, it is recommended for the board to establish a sound risk management framework and internal control system, but it is still optional requiring the listed firm to disclose their option in the annual report (Abdullah & Said, 2019; Ishak & Mohamad Nor, 2017). In 2017, to enhance corporate governance even further, the SC has come up with Step Up 9.3 of MCCG 2017. It encourages the non-financial listed firm to incorporate a standalone RMC on its own, which comprises an independent director who focuses solely on overseeing risk management procedures, thus enhancing the quality of risk assessment and monitoring landscape. Table 1 summarizes the Evolution of Risk Management Guide in Malaysia.

Currently, the establishment of standalone RMC in Malaysia is compulsory for financial institutions. It is due to their business model that mainly deals with the high volatility caused by greater market risk, high credit risk and liquidity risk resulting from the changes in the global economic environment (Bursa Malaysia, 2017). This requirement was mandated in Standard 12.1(c) of Bank Negara Malaysia's Policy Document on Corporate Governance. However, a separate RMC was not required for non-financial institutions. But with increasingly

sophisticated changes in the corporate landscape caused by technology advancement, political intervention, changes in business model and global uncertainty, it is no longer the case. Large, listed firms, including non-financial firms, need a focused oversight risk board equipped with extensive skills to play an active role in minimizing all-rounded risk to guarantee business going concerned (Abdullah et al., 2017).

Table 1. Evolution of Risk Management Guide in Malaysia

MCCG 2000	MCCG 2007	MCCG 2012	MCCG 2017
The introduction of the Risk Management Concept place under the board of director's responsibility. It is to identify risk and mitigate the risk through an effective internal control framework.	Listed firms must form a structured internal audit committee that includes a risk management team in performing its risk management function. The Securities Commission defined three major areas of responsibilities by internal audit function, including evaluating risk management effectiveness, internal control system and firm's governance structure.	A more detailed guide was issued under eight broad principles. Risk management was highlighted under the Sixth Principle, whereby listed firms are encouraged to establish a sound risk management framework and internal control system. But adherence to this recommendation is still voluntary.	In moving towards enhancing governance structure, large, listed firms are encouraged to establish standalone RMC comprises independent directors that focus solely on overseeing risk management strategies.

Source: Series of Malaysian Code of Corporate Governance by Securities Commission

### 2.3 Combined Committee: Traditional Board Structure

Previously, the risk management function was not thought to be very important by the board in Malaysia (Aldhamari et al., 2020; Omer et al., 2020). Therefore, the risk management role was included within the AC's responsibilities, and most of the firms named this combined committee as Audit and Risk Management Committee. This traditional practice caused a great impact on the board's effectiveness in executing their responsibilities. Since the AC function itself is already overwhelmed with its role to oversee financial reporting process, supervise audit process, evaluate internal control procedures, review the financial report and dealing with external auditors for timely issuance of the audited financial report (Boudiab & Ishak, 2020; Abdullah & Said, 2019). This extensive job scope raises concern on how the AC executes its risk management duties carefully and adequately (Abdullah et al., 2017; Nasution, 2019).

This fact was also supported by a review made by Bursa Malaysia (2017), whereby AC was reported to be the most time-consuming committee, which held on average seven meetings in 2016 compared to other committees with four meetings held annually (Bursa Malaysia, 2017). Additionally, the requirement for an AC member to keep up to date with the recent development of accounting standards demand additional time and further commitment. As a result, the overburdened AC tends to overlook risk issues despite the fatal consequences that might happen in the absence of a comprehensive risk management team (Aldhamari et al., 2020; Halim et al., 2017). Hence, large firms should segregate the risk manager's role in today's sophisticated risk environment to ensure better delivery of board function in fulfilling their risk management responsibilities to avoid agency problems (Abdullah et al., 2017; Aldhamari et al., 2020).

### 2.4 Effectiveness of Standalone Risk Management Committee

Literature has provided empirical evidence on the effectiveness of RMC, mainly on firm financial performance in developing countries. One of the studies was conducted by Halim et

al. (2017). He discovered firms with a standalone RMC are more effective in managing their financial risks thus have better financial performance. Having a separate RMC distinct from the AC allows the directors to focus and specialize on risk management efforts enabling them to dedicate more time and commitment for better risk monitoring to minimize firms' losses. Another study by Aldhamari et al. (2020) investigates the impact of RMC on financial performance among financial firms in Malaysia. They discovered financial performance is better for firms with effective RMC by enhancing transparency and integrity of financial reporting having a dedicated risk oversight team on board. In 2021, Rimin et al. conducted a study on consumer goods sector listed firms in Malaysia. They reported a positive relationship between separate RMC and financial performance measured by Tobin Q, implying firms with standalone RMC have better market valuation due to the risk monitoring mechanism.

The Risk Management Committee was also reported to bring benefits to non-financial aspects. Abdullah and Said (2019) uncovered a significant inverse relationship between standalone RMC and financial fraud incidences among Malaysian listed firms from 2001 to 2013. The existence of RMC separated from AC proved to be an effective tool in combating financial fraud by having an independent risk monitoring board whose responsibility is to mitigate risk within the business environment. In Indonesia, Larasati et al. (2019) drew samples from Indonesian listed firms that revealed that firms with separate RMC require higher audit coverage, thus affecting higher audit fees. Hence, positively improve audit quality. The result from prior studies on Malaysian non-financial firms demonstrated that the establishment of RMC could encourage better voluntary risk management disclosure in the financial report (Abdullah et al., 2017). With the information possessed by RMC through an effective monitoring role, firms are willingly disclosing their positive risk management information for better transparency.

### ***2.5 Risk Management Committee Attributes***

Given an extensive study on the effectiveness of RMC on financial and non-financial performance, studies on RMC attribute itself is limited due to RMC establishment remains voluntary in most countries, including Malaysia, Indonesia and Australia. Most of the existing studies focus on the main attributes, including committee size (Abubakar et al., 2018; Boudiab & Ishak, 2020), independence of members (Aldhamari et al., 2020; Jia & Bradbury, 2020; Ugwu, Ekwochi, & Ogbu, 2021), members knowledge and qualification (Aldhamari et al., 2020; Jia & Bradbury, 2020), number of meeting (Alkelani, Hussin, & Salim, 2020) and number of training attended by the members (Boudiab & Ishak, 2020). However, none of them had investigated if the RMC is independent of the AC after considering the work overload that AC members already have in hand.

## **3. METHOD**

### ***3.1 Research Design and Sample Selection***

This study used a quantitative approach and descriptive research design to see the adoption level on the establishment of standalone RMC among the top 50 Malaysian largest listed firms. Then, attributes of RMC are analysed further to describe the governance structure of the established RMC. The population of this study is the listed firms in Bursa Malaysia, covering all sectors but excluding financial institutions. The sample selection of the top 50 largest firms by market capitalization according to the list provided by FBM KLCI is justified because larger firms are associated with high risk (Halim et al., 2017). Thus, it has more reasons to establish a separate RMC (Nasution, 2019), for instance, due to the high complexity of their economic

environment and higher leverage. Therefore, the recommendation made by the SC is, particularly for large, listed firms. Perhaps this purposive sampling method will help draw a better insight into the adoption level of the best practice to establish a standalone RMC among the top 50 Malaysian listed firms. The sample size of 50 companies is then multiplied with two consecutive years (2018 and 2019) to make up 100 observations. Both years were selected as the latest year after the issuance of the MCCG 2017.

### 3.2 Data Collection and Data Analysis

The data in this current study was collected from annual reports taken from Bursa Malaysia's official website and sampled firm's websites. They are considered secondary data. Content analysis was performed to gather information about the characteristics of each firm's board of directors on the establishment of standalone RMC apart from the AC and its attributes. Table 2 shows the definition of the variables selected in this study.

Table 2. Variables Definition

Variables	Definition
Combined committee	Combination of audit and risk management function in a single committee
Standalone RMC	Board established a separate RMC apart from AC
Size of RMC	Number of members on RMC
Independence of RMC members	The proportion of independent directors on RMC to total RMC members
Dual chairmanship	The chairman of RMC also chairs AC
Mutual membership	If the chairman of RMC does not chair AC, at least 1 mutual member is also in AC
Independent RMC from AC	RMC has its chairman with different members from AC

The data were obtained primarily from a few specific sections of the firms' annual reports, including firm Governance Framework, Corporate Governance Overview Statement, Board of Director Profile, Audit Committee Report, Risk Committee Report and Statement on Risk Management and Internal Control. Upon completion of data collection, the frequency and percentage were computed on all variables. The analysis was performed using Microsoft Excel 365 function in generating figures and tables to facilitate the presentation of data for discussion purposes.

## 4. RESULTS AND DISCUSSION

### 4.1 The Adoption Level of Risk Management Committee Establishment

Table 3. Adoption of Risk Management Committee Establishment

	2018 (N=50)		2019 (N=50)		Entire sample (N=100)	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
Combined committee	25	50	21	42	46	46
Standalone RMC	25	50	29	58	54	54
Total	50	100	50	100	100	100

Step-Up Practice 9.3 of MCCG 2017, encourages large, listed firms to establish a standalone RMC to improve the corporate governance culture of public listed firms by sharpening risk management strategy and focus. Table 3 demonstrates the adoption level of RMC establishment among the top 50 largest listed firms in 2018 and 2019.

Overall, the majority (54%) of the firms take a step further in enhancing the effectiveness of their risk management strategy by forming a standalone RMC. When the data is accessed separately by year, there is an increased number of firms with standalone RMC in 2019 (58%) compared to 2018 (50%). Indicating the level of adoption of this step-up practice is better in the second year after revision of MCGG for the fourth time in 2017. It was anticipated that firms need time to restructure their board for better management and coordination. Some of the firms also grouped the function of risk oversight with sustainability roles. They named it Sustainability and Risk Management Committee, most probably because the board sees the linkages between these two crucial functions for firm continuity.

#### **4.2 Attributes of Risk Management Committee**

This study further analyses the attributes of RMC established by reference to prior literature on good corporate governance structure. In general, the average number of members on RMC is 4, whereby 4.20 in 2018 and 4.03 in 2019 and the majority are independent. There is no specific number of RMC members required by the SC or Bursa Malaysia to date, but the ideal minimum size would be three as practised by the busiest committee, the AC. Moreover, the majority of members must be independent. Independent directors are seen as a mechanism of good corporate governance (Ishak & Mohamad Nor, 2017; Kweha et al., 2019). By being independent, the board that has no interest in the firms will act diligently to provide effective monitoring to the manager without the influence of any party (Fuji et al., 2016; Karim, Manab, & Ismail, 2020). The exact requirement was also found under general board composition in Practice 4.1 of MCGG 2017.

Table 4. Attributes of Risk Management Committee

	2018 (N=25)		2019 (N=29)		Entire sample (N=54)	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
Independent RMC from AC	2	8	3	10	5	9
Dual chairmanship	6	24	8	28	14	26
Mutual membership	17	68	18	62	35	65
Total	25	100	29	100	54	100

The expectation is that when a firm establishes a standalone RMC, it should employ distinct members to serve the committee. However, the finding tells a different story. Based on Table 4, observation on whether RMC is independent, the AC uncovered only 5 out of 54 firms with standalone RMC has a risk committee that has nothing to do with the AC. It represents only nine percent out of the total observation for the two years. It shows that even though the majority of sampled firms adapted the best practice to have a standalone RMC on board, they decided to utilize the same talent to take advantage of the synergies provided by having the similar person on different board committee regardless of the issue of the overburdened committee and poor execution of their responsibilities (Abdullah et al., 2017; Aldhamari et al., 2020). There was not much difference in whether the firms have a combined committee that has been practising in the traditional board structure or opt for a standalone RMC following the recommended best practice. The fact was supported by further finding that 26% of firms with standalone RMC have a chairman who also chairs the AC. But the most normal practice among these largest listed firms is that although the chairman of RMC does not chair the AC, at least one mutual member exists in both the RMC and AC who carries out these dual functions, which amount to 65%.

Corporate Governance Guide by Bursa Malaysia, there is no harm for the chairman of the AC to chair another board committee, including the RMC, as the risks are insignificant (Bursa Malaysia, 2017). However, prior literature had argued that overwhelmed job scope of AC members should be given a severe thought of organizing the board structure. To ensure the quality of work performed can be maintained at a high level and prevent inadequate attention on risk management issues (Abdullah & Said, 2019; Aldhamari et al., 2020; Omer et al., 2020). This issue is prone for large, listed firms expected to deal with the greater risk profile and complex business model (Tonello, 2012). Having the same members on these two separate committees will impair the efficiency and effectiveness of audit and risk management mechanisms caused by disability to devote sufficient time and attention to a specific affair.

However, as the board of directors can organize its structure, they should know their operation and business model better in maximizing shareholder's interest. The board should critically consider several factors in deciding its operational oversight function to ensure risk issues are satisfactorily tackled and appropriately mitigated. The board should recognize the risk coupled with the business model, product and market in entirety to enable them to come out with the appropriate risk management mechanism (Ishak & Mohamad Nor, 2017). Having either a combined or standalone RMC requires proper synchronization with the other subcommittee in building up an all-rounded risk-ready culture to protect the stakeholder interest. The board of directors has the final say about this yet; careful consideration is a must since it has a fatal effect on the firm survivability.

## **5. CONCLUSION**

The RMC establishment as a standing committee is some strength of the firm that will aid in a proactive risk management system and consequently create a risk awareness culture within the organization. Having a focused committee responsible for risk identification and mitigating issues would encourage an all-rounded risk management effort that would lead to business sustainability and growing concern. Findings from the current study revealed encouraging results that most large, listed firms in Malaysia have adopted this best practice by forming a standalone RMC following the Step-Up Practice 9.3 of MCCG 2017. However, small essential details about the attributes of this governance mechanism should be given serious consideration to avoid public confusion and eye obscuring committee that stand on its name without its real substance. For instance, the study found Malaysian listed firms with standalone RMC are heavily tied to the AC in terms of their mutual member on board and the same director chairs both committees. Utilizing the synergies behind this "separated but combined" board structure, overwhelmed duties of AC members should not be ignored. The board of directors should carefully organize and coordinate the committee's structure on board, especially on RMC establishment, with caution thought by analysing the pros and cons of each available option to avoid sudden corporate failure that highly relies on risk management mechanisms.

This descriptive study has contributed to the body of literature by providing insights into the governance structure of Malaysian listed firms' RMC from its operationalization aspect and its detailed characteristics after the issuance of MCCG 2017. It creates awareness among listed firms on the importance of a focused, standalone RMC in an effective risk management strategy. Moreover, it provides ideas on possible future research that could be conducted. Future research should consider investigating a significant difference in firms' performance if firms establish a standalone RMC or stick to a combined committee. However, this study comes with several limitations. Due to time constraints, small sample size was used with a short observation period of two years. The focus of this study is on the separation of the AC and RMC. Thus, other essential attributes of RMC are ignored, for example, members' knowledge



and qualification and the number of meetings held per year. Therefore, future research should incorporate these limitations in deriving a better result representation.

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