

Reformation of Corporate Governance in Malaysia

Do changes in audit and accountability practices increase institutional performance?

R Arshad and Z Abas
University of Utara Malaysia

ABSTRACT

Following a sequence of financial crises around the world, a series of corporate governance codes were issued concerning best practice with regard to corporate governance reformation. Central to these codes was the aim of the government to create investor confidence, to raise the standard, drive corporate governance reforms and use as a benchmark monitoring and implementing as corporate governance practices and policies at the corporate company level. The Malaysian government is committed to ensure that corporate companies demonstrate a track record of good governance in order to attract and retain long-term investors. Therefore, after seven years, the first Malaysian Code on Corporate governance (MCCG) was introduced in 2000, while the revised MCCG was introduced in 2007. The amendments of MCCG 2000 involved the components of audit committees and board of directors. It was aimed to improve the quality of audit committees and board of director's functions among Publically Listed Companies (PLCs) in promoting accountability and high levels of protection for the investor. This article aims to examine the effect of the Malaysian Code on Corporate governance on audit and accountability practices by comparing practices prior to, and after the implementation of the Code. Furthermore, the relationship between changes in audit and accountability practices and institutional performance in terms of corporate governance reformation is also examined.

INTRODUCTION

It is believed that the development of corporate governance can lead to better supervision and guidance of corporate behaviour (Iyengar, Williams & Zampelli 2005; Jensen & Meckling 1976). Enhanced governance is a result of an improvement of the internal corporate governance mechanisms carried out by the board of directors, audit committees, internal

auditors, control and risk management, external mechanisms and external auditors (Hasnah 2009). A large number of studies state that corporate governance can be used to improve the companies responsibility, accountability and transparency which in turn will increase their long term investment and credibility (Armitage & Marston 2008; Holder-Webb, Cohen, Nath, & Wood 2008; Jongsureyapart 2006; Koh, Laplante & Tong 2007; Luo 2005; Rueda-Sabater 2000). Corporate governance has become a very important concept that requires many countries to concentrate on its reformation. Globalisation of markets, open markets competition, and international business has generated awareness of the significance of enhancing corporate governance practices. International flow of investment and business requires countries to decide whether they will be involved in creating governance regulations or be governed in line with international requirements. Corporate governance has become an international agenda item that affects the business world in order to inculcate good governance.

Corporate regulation in Malaysia was established prior to the Asian financial crisis in 1997/1998 (Hirschey, John and Makhija 2005). However, in response to the economic collapse and corporate governance reforms throughout the East Asian countries, (a year after the Asian financial crisis in 1997), Malaysia established the *High Level Finance Committee on Corporate Governance* (FCCG) responsible for formulating a corporate governance framework for corporate companies. The High Level Finance Committee on Corporate Governance published its report in 1999 (Report on Corporate Governance 1999). In March 2000, the Malaysian Code of Corporate Governance (MCCG) was officially released by the Ministry of Finance Malaysia and compliance with the Code was implemented in January 2001 through the Bursa Malaysia¹ Listing Requirements (Chapter 15). In 2007, the Code was revised but still based on the MCCG principles and practices, which required minor changes in some of the clauses. Through the Code, the Malaysian government had set out principles and best practices for PLCs to follow. It was believed that the Code would improve and maintain high standards of corporate governance in Malaysia (Hirschey et al. 2005).

It had been debated since the 1980s that in order to maintain improved corporate governance practices, an audit committee be appointed to serve on the board in order to uphold integrity in financial reporting (Chen & Jaggi 2000). The combination of audit and accountability as an internal control is believed to enhance the effectiveness of a checks and balances system of a company. It also relates to improved monitoring of management decisions and activities by corporate boards (Fama 1980).

It can be inferred that an investigation into the modifications of the audit and accountability practices and transformation in company performance, could provide a better understanding of the importance of the Code in improving corporate governance practices and its relationship with a company's performance. Therefore, further investigation into the relationship between these changes in corporate governance practices' and in a company's performance could shed light on the reasons for the importance of focusing on the audit and accountability practices in the corporate firm. The aim is to understand the important roles of the MCCG which was introduced by the Malaysian government to innovate corporate governance practices in terms of audit and accountability practices among the PLCs and to examine whether the change in audit and accountability is feasible or even desirable, especially in view of recent efforts to meet international benchmark for policy



makers, investors, corporations and other stakeholders worldwide. The Code could result in improved corporate governance practices.

ACCOUNTABILITY AND AUDIT

In Malaysia, the effects of the MCCG on the audit committee can be identified as an important monitoring mechanism that can minimise agency problems. All Malaysian PLCs are required to establish an audit committee with at least three independent directors as prescribed by the KLSE listing requirements (Kuala Lumpur Stock Exchange 1995). The existence of independent directors on the audit committee provide independent judgment and improved monitoring for the external and internal auditor (refer to audit committee functions as stated above; FCCG 2000). This condition is expected to improve monitoring in the PLCs and alignment of agent and principal interests as well as improve performance and reduce agency problems.

The audit function has been widely researched in a variety of studies. Abbott, Park and Parker (2000) analysed whether two key audit committee characteristics: 1) activity; and, 2) independence, in combination, reduced the fraudulent or aggressive financial statement actions. They found that firms with audit committees composed of independent directors, and meeting at least twice per year, are less likely to be sanctioned for fraudulent or misleading financial reporting. Furthermore, this study undertook research on the association between corporate governance characteristics and financial miss-statements (Abbott *et al.* 2000).

The role of the audit committee is to ensure the independence of external audit firms and the quality of financial reports as well as monitor company management (Klein 2002). An effective audit committee was identified as an important element in ensuring effective corporate governance and reliable financial reporting (Raghunandan, Rama & Scarbrough 1998). Furthermore, an effective audit committee can provide an assurance of the accounting information and services to the shareholders and enhance monitoring functions and reduce agency costs (Jensen & Meckling 1976b; Kuhlemeyer, Collins & Black 2000). The importance of an audit committee is also expressed in terms of increasing the quality of the audit committee in providing accurate assurances to the shareholders or investors with regard to the financial background of the company (Iyengar & Zampelli 2008; Mohamed Nazri & Zauwiyah 2004). Consequently, many countries have recommended that all companies should establish audit committees (for example: Cadbury Committee Report 1992; FCCG 1999; OECD 2004).

Klein (2002) examined whether a company's audit committee and board characteristics are related to earnings management. They found that negative associations existed between board or audit committee independence and abnormal accruals. They added that strong results were found when the audit committee had fewer members than the majority of independent directors. Frankel, Johnson and Nelson (2002) examined whether auditor fees are associated with earning management and market reaction to the disclosure of auditor fees. The result revealed that non-audit fees are positively associated with small earnings and the magnitude of discretionary accruals, while audit fees are negatively associated with earnings management indicators.

Cotter and Silvester (2003) examined the association between board and monitoring committee independence, the impact of other mechanisms used to control agency conflicts on that independence, and the impact of independence on firm value. They found that audit committee independence is inversely associated with leverage and concluded that reduced monitoring mechanisms appear to be compensated for with higher levels of board and audit committee independence. Jaggi and Leung (2007) examined whether the establishment of audit committees by Hong Kong firms would constrain earnings management, especially in firms with family-dominated corporate boards of 523 firms for the period 1999 to 2000. The documented results revealed that audit committees play a significant role in constraining earnings management even in the business environment of higher ownership concentration.

Anderson, Mansi and Reeb (2004) found that fully independent audit committees, audit committee size and the number of audit committee meetings were negatively associated with the cost of debt financing. The results suggested that audit variables are an important element in providing greater monitoring of the financial accounting process to the creditors and shareholders. Davidson, Goodwin-Stewart and Kent (2005) investigated the role of an institutional internal governance structure and earning management with a sample of 434 listed Australian institutions in 2000. The institution's internal governance measured the board of directors, the audit committee, internal audit function and the identified external auditor. Their findings revealed that the audit committee is significantly associated with earnings management as measured by the absolute level of discretionary accruals. They also found that the voluntary establishment of an internal audit function and the choice of auditor are insignificantly related to a reduction in the level of discretionary accruals. Fan and Wong (2005) examined whether external independent auditors are employed as monitors or as bonding mechanisms, or both, to alleviate agency problems by using a broad sample from eight East Asian economies. The results revealed that institutions with agency problems embedded in the ownership structures are more likely to employ Big Five auditors.

Koh, Laplante and Tong (2007) investigated the twin roles of accountability and value enhancement of corporate governance in the context of financial reporting by differentiating between governance mechanisms that have direct roles in the financial reporting process (audit related) from mechanisms that have indirect roles (board related). Their findings showed that independent and active audit committees and independent boards are important governance attributes for financial reporting. In a recent study, Iyengar and Zampelli (2008) investigated whether compensation committees actively intervene to adjust accounting performance-based incentive schemes for the real, or perceived, reduced earnings credibility signalled by the purchase of non-audit services. Using a nonlinear, two-stage least-squares method that accounts for the executive salary, institutional performance and non-audit fees, they found a significant negative relationship existed between the non-audit fees and the sensitivity of the chief executive officer's (CEO) salary to the institutional performance.

From an agency theory perspective, the audit function represents another important corporate governance mechanism that assists shareholders in monitoring and controlling company management (Solomon and Solomon 2004). It helps to disclose the company's financial statements credible and increases trustworthiness among shareholders (Rezaee, Olibe & Minmier 2003). Klein (2002) and Anderson, Mansi and Reeb (2004) extend this



argument by suggesting that an independent audit committee plays an important role as an active overseer of the financial accounting process, which reduces the information asymmetry and provides relevant and credible information to the shareholders and stakeholders. For example, Klein (2002) found a negative association between board audit committee independence and abnormal accruals. Anderson, Mansi and Reeb (2004) noted that fully independent audit committees, audit committee size and the number of audit committee meetings were significantly negatively associated with the cost of debt financing. The results suggest that audit variables are an important element in providing greater monitoring of the financial accounting process to the creditors and shareholders. If the audit variables provide reliable accounting information and monitor the accounting process, then this study expects the introduction of the MCCG, with the requirement for the establishment of audit and accountability elements, will increase corporate governance practices. In accordance with the above discussion and prior literature, the following hypotheses are proposed:

H1 = There is a significant difference in compliance between audit and accountability prior to, and after the MCCG.

H2 = Changes in audit and accountability as a result of compliance with the MCCG are positively associated with changes in firm performance.

METHODOLOGY

This study focuses on the audit and accountability structure and firm performance of the publicly listed companies on the Main and Second Board of Bursa Malaysia (KLSE) in 1996 to 2005. A Pearson correlation analysis, t-test, and multivariate regression analysis was conducted to empirically test the formulated hypothesis. The population of the research involved the 'Main Board' and the 'Second Board' of the Publicly Listed Companies (PLCs) ² in the Bursa Malaysia (formerly known as the Kuala Lumpur Stock Exchange), with the exception of the companies listed in the MESDAQ Market. The target sample data of this ranged from 1996 to 2005 and companies that were included in the samples with 10 consecutive years of annual reports for independent non-executive directors on the board and 11 consecutive years of financial data of the institutions performance. Non-probability convenience sampling was employed in this research because the nature of the study required only companies that availed information about each director of the company. A total of 237 companies were identified which met the criteria.

For accounting based measures, earning per share (denoted as EPS), return on assets (denoted as ROA) and return on equity (denoted as ROE) are used alternatively. EPS is calculated as earnings based on average common shares for the 12 months ended the last financial year, which is generated from DataStream. ROA and ROE are purely accounting based measures (profit ratios) and were computed from company financial statement data. The ROA is a useful measurement to indicate the profit of the company relative to total assets (Jong 2003). ROA rationally indicates management's/company's effectiveness in utilising the assets entrusted to them and does not depend on the alternative uses of debt versus equity to fund such assets (Robinson 1998). Similar to ROA, ROE indicates management's

effectiveness in generating a return on the funds invested by the common shareholders, to whom management is ultimately responsible and accountable. For this study, the ROA and ROE were generated from DataStream data. The ROA and ROE were calculated based on the following formula:

$$ROA = \frac{(\text{After tax profit})_t}{(\text{Total assets})_{t-1}}$$

$$ROA = \frac{(\text{Net income before preferred dividends})_t - (\text{Preferred dividend requirement})_t}{(\text{Common equity})_{t-1}}$$

Where,

Preferred dividend requirement = Actual cash dividend payment on preferred stock or the provision for preferred dividends, if in arrears. It also includes accretion on preferred stock.

Audit and accountability is measured based on eight variables as follows: 1) number of directors on the audit committee (ACSZ); 2) proportion of non-executive directors on the audit committee (ACNEX); 3) proportion of independent non-executive directors on the audit committee (ACINEX); 4) disclosure about whether the Chairman of the audit committee is independent non-executive director (ACCHINEX); 5) disclosure about the audit committee duty and authority (ACDUTY); 6) number of audit committee meetings held in a year (ACMEET); 7) disclosure about the audit committee meetings with external auditors and the advice received from them (ACMTEAD); and 8) disclosure about the audit committee review of internal audit functions (ACIAD).

Multivariate regression models

Hypothesis 1 proposed that there is a significant difference in compliance between audit and accountability prior to, and after the MCCG 2000. Hypothesis 2 proposed an association between changes in firm performance and changes in audit and accountability as a result of compliance with MCCG 2000. Therefore, to test this hypothesis, the following regression model for changes in the institutions performance was estimated for all companies "i" in the sample with changes in the accountability and audit variables. The regression model was as follows:

$$\Delta FP_i = \beta_0 + \beta_1 \Delta ACSZ_i + \beta_2 \Delta ACNEX_i + \beta_3 \Delta ACINEX_i + \beta_4 \Delta ACMEET_i + \beta_5 \Delta ACCHINEX_i + \beta_6 \Delta ACDUTY_i + \beta_7 \Delta ACMTEAD_i + \beta_8 \Delta ACIAD_i + \epsilon_i$$

Where,

- ΔFP_i = The change in firm performance calculated (EPS, ROE, ROA, RET and RETadj)
- $\Delta ACSZ$ = Change in the mean number of directors on the audit committee.
- $\Delta ACNEX$ = Change in the mean proportion of non-executive directors on the audit committee.
- $\Delta ACINEX$ = Change in the mean proportion of non-executive directors on the audit committee.
- $\Delta ACMEET$ = Change in the mean number of audit committee meetings held each year.
- $\Delta ACCHINEX$ = Change in the mean of disclosure about chairman of audit committee is independent non-executive director.
- $\Delta ACDUTY$ = Change in the mean of disclosure about audit committee duties and responsibilities.
- $\Delta ACMTEAD$ = Change in the mean of disclosure about audit committee meetings with external auditors and receive advices from them.
- $\Delta ACIAD$ = Change in the mean of disclosure about audit committee reviews internal audit function.
- * $\Delta LOGTA$ = Change in the mean of total assets.
- * $\Delta LOGTS$ = Change in the mean of net sales.

Notes: * Control variables



RESULTS

Regression analysis was used to test the hypothesis of independence board-performance relationship to determine whether the change of audit and accountability by comparing prior to and after the Code had a significant impact on the institutions performance. Table 1 shows that the result of Paired sample t-test and Wilcoxon signed rank test is significant at the 0.01 level for the number of directors on audit committee (ACSZ). This result indicated that there is a significant difference between ACSZ prior to, and after the Code and the mean ACSZ after is higher than prior to the Code. Furthermore, the effect size of the difference is large at Eta square of 0.05, which indicates a medium effect size. For the proportion of non-executive directors on the audit committee (ACNEX), the Paired sample t-test and Wilcoxon signed rank test revealed that the mean for ACNEX prior to be less than the mean for ACNEX after the Code and the difference in the means was significant at the 0.01 level. This result suggests that the mean proportion of ACNEX is significantly higher than ACNEXPRO1. The Eta squared statistic is 0.08, which indicated that the Code had a medium effect size on the changes in the mean proportion of ACNEXPRO when comparing prior to, and after, the introduction of the Code.

For the number of audit committee meetings held a year (ACMEET), both Paired sample t-test and Wilcoxon signed rank test show that the difference between the mean of ACMEET prior to, and after the MCCG 2000 is significant at the 0.01 level. The result suggested that the mean ACMEET prior to was lower than the mean ACMEET after the MCCG 2000. This result indicated that there might have been ACMEETs prior to MCCG 2000, but PLCs did not disclose this in their annual report. This was due to the guidelines of ACMEET which was provided by the KLSE LRs (1994) not specifying a specific number for ACMEET. Therefore, this result reflected that the Code had increased the PLCs to comply with the Code requirement.

In Panel B of Table 1, by using Chi-square, this study found that disclosure about whether the Chairman of the audit committee was an independent non-executive director (ACCHINEX) by comparing prior to, and after the Code was insignificant at the 0.01 level. The result revealed that the introduction of Code did not affect PLC disclosure of their ACCHINEX. This result was likely to be influenced by the requirement of KLSE LRs (1994) that required PLCs to have ACCHINEX.

For disclosure about audit committee duties and responsibilities (ACDUTY), the Chi-square test for the difference in the mean of ACDUTY prior to, and after MCCG 2000 was significant at the 0.01 level. This suggested that the mean ACDUTY after is higher than prior to the Code. For disclosure about audit committee meetings with external auditors and advice received from them (ACMTEAD), the Chi-square test indicated that the difference between the mean ACMTEAD prior to, and after the Code was significant at the 0.01 level. The disclosure about audit committee reviews internal audit function (ACIAD) also indicated that the mean difference between ACIAD prior to, and after the Code is significant at the 0.01 level. This result revealed that the mean ACIAD after MCCG 2000 was significantly higher than ACIAD prior to. Overall, out of eight, seven audit and accountability variables provided support for hypothesis 1 that there was a significant difference by comparing prior to, and after the Code.

The independent variables' capturing changes in accountability and audit and the empirical model was used to test hypothesis 2. The Pearson correlation coefficients

Table 1 Paired sample t-test, Wilcoxon signed ranks test and Chi-square tests comparing board structure variables prior to, and after the MCCG 2000

Panel A	N	Mean	S. Deviation	t-value	z-score	
ACSZ1	237	3.5333	0.7448	-7.669 (p=0.000)	-7.5911 (p=0.000)	
ACSZ2	237	3.7249	0.7832			
ACNEX1	237	73.38	15.778	-10.299 (p=0.000)	-9.932 (p=0.000)	
ACNEX2	237	78.24	16.371			
ACINEX1	237	65.53	14.874	-7.448 (p=0.000)	-7.508 (p=0.000)	
ACINEX2	237	69.07	14.210			
ACMEET1	237	0.2321	1.0280	-63.122 (p=0.000)	-28.452 (P=0.000)	
ACMEET2	237	4.3316	2.0760			
Panel B	N	Frequency		Percentage		z-score
		YES	NO	YES (%)	NO (%)	
ACHINEX1	237	237	0	100	0	0.000* (p=1.000)
ACHINEX2	237	237	0	100	0	
ACDUTY1	237	226	11	95.4	4.6	123.811 (p=0.000)
ACDUTY2	237	236	1	99.4	0.6	
ACMTEAD1	237	156	81	65.8	34.2	19.583 (p=0.000)
ACMTEAD2	237	233	4	98.6	1.1	
ACIAD1	237	75	162	31.6	68.4	4.741 (p=0.029)
ACIAD2	237	228	9	96.3	3.7	

*No statistics are computed because ACHINEX1 and ACHINEX2 are constants.

- ACSZ1 = Number of directors on the audit committee prior to the MCCG 2000.
 ACSZ2 = Number of directors on the audit committee after the MCCG 2000.
 ACNEX1 = Proportion of non-executive directors on the audit committee prior to the MCCG 2000.
 ACNEX2 = Proportion of non-executive directors on the audit committee after the MCCG 2000.
 ACINEX1 = Proportion of independent non-executive directors on the audit committee prior to the MCCG 2000.
 ACINEX2 = Proportion of independent non-executive directors on the audit committee after the MCCG 2000.
 ACMEET1 = Number of audit committee meetings held a year prior to the MCCG 2000.
 ACMEET2 = Number of audit committee meetings held a year after the MCCG 2000.
 ACHINEX1 = 1 = Disclosed that the Chairman of the audit committee is independent non-executive director in the annual report; otherwise = 0, prior to the MCCG 2000.

- ACHINEX2 = 1 = Disclosed that the Chairman of the audit committee is independent non-executive director in the annual report; otherwise = 0, after the MCCG 2000.
- ACDUTY1 = 1 = Disclosed audit committee authority and duties in the annual report; otherwise = 0, prior to the MCCG 2000.
- ACDUTY2 = 1 = Disclosed audit committee authority and duties in the annual report; otherwise = 0, after the MCCG 2000.
- ACMTEAD1 = 1 = Disclosed the statement of audit committee meeting and got advice from external auditors in the annual report; otherwise = 0, prior to the MCCG 2000.
- ACMTEAD2 = 1 = Disclosed the statement of audit committee meeting and got advice from external auditors in the annual report; otherwise = 0, after the MCCG 2000.
- ACIAD1 = 1 = Disclosed the statement of audit committee reviews of internal audit function in the annual report; otherwise = 0, prior to the MCCG 2000.
- ACIAD2 = 1 = Disclosed the statement of audit committee reviews of internal audit function in the annual report; otherwise = 0, after the MCCG 2000. Performance variables are as defined in Table 6.6.

Table 2 Correlation coefficients and regression estimates for changes in audit and accountability variables and changes in firm performance for 237 PLCs.

	Δ EPS	Δ ROE	Δ ROA
Panel A – Pearson correlations			
Δ ACSZ	0.011 (0.863)	-0.044 (0.501)	-0.044 (0.504)
Δ ACNEX	-0.006 (0.932)	-0.088 (0.175)	-0.099 (0.128)
Δ ACINEX	-0.124 (0.057)	0.012 (0.852)	0.017 (0.797)
Δ ACDUTY	-0.022 (0.732)	-0.160* (0.014)	-0.095 (0.145)
Δ ACMEET	0.046 (0.477)	0.116 (0.074)	0.132* (0.042)
Δ ACMTEAD	0.022 (0.739)	0.016 (0.802)	0.011 (0.867)
Δ ACIAD	-0.152* (0.019)	0.101 (0.120)	-0.009 (0.890)
Δ LOGTS	0.188** (0.004)	0.022 (0.733)	0.097 (0.136)
Δ LOGTA	0.044 (0.496)	0.012 (0.858)	0.023 (0.730)
Panel B – Spearman correlations			
Δ ACSZ	0.031 (0.635)	-0.027 (0.684)	-0.004 (0.954)
Δ ACNEX	-0.038 (0.564)	-0.094 (0.149)	-0.113 (0.083)
Δ ACINEX	-0.046 (0.480)	-0.062 (0.342)	-0.033 (0.608)
Δ ACDUTY	-0.063 (0.336)	-0.129* (0.047)	-0.017 (0.799)

	Δ EPS	Δ ROE	Δ ROA
Δ ACMEET	0.024 (0.708)	0.101 (0.122)	0.138* (0.034)
Δ ACMTEAD	-0.009 (0.890)	-0.031 (0.636)	0.007 (0.909)
Δ ACIAD	-0.191** (0.003)	0.054 (0.407)	0.019 (0.775)
Δ LOGTS	0.324** (0.000)	0.089 (0.174)	0.150* (0.020)
Δ LOGTA	0.210** (0.001)	-0.031 (0.640)	0.028 (0.671)

	Model 2a		Model 2b		Model 2c	
	β	t-value	β	t-value	β	t-value

Panel C – Ordinary Least Squares Regressions

(Constant)	-0.401	(0.689)	-1.438	(0.152)	-2.533	(0.012)
Δ ACSZ	-0.631	(0.529)	-0.846	(0.399)	-0.901	(0.368)
Δ ACNEX	1.161	(0.247)	-1.729	(0.085)	-2.038	(0.043)
Δ ACINEX	-2.284	(0.023)	0.820	(0.413)	1.057	(0.292)
Δ ACDUTY	-0.406	(0.685)	-2.140	(0.033)	-0.940	(0.348)
Δ ACMEET	0.168	(0.866)	1.759	(0.080)	2.149	(0.033)
Δ ACMTEAD	1.484	(0.139)	-0.471	(0.638)	0.053	(0.958)
Δ ACIAD	-2.762	(0.006)	1.714	(0.088)	-0.102	(0.919)
Δ LOGTS	2.617	(0.009)	0.316	0.752	1.341	0.181
Δ LOGTA	0.145	(0.885)	-0.657	0.512	-0.705	0.481
Adjusted R	0.049		0.026		0.016	
F statistic	2.358		1.708		1.430	

* significant at the 0.05 level

** significant at the 0.01 level

- Δ ACSZ = Change in the mean extent of disclosure about the number of directors on the audit committee.
- Δ ACNEX = Change in the mean extent of disclosure about the proportion of non-executive directors on the audit committee.
- Δ ACINEX = Change in the mean extent of disclosure about the proportion of non-executive directors on the audit committee.
- Δ ACDUTY = Change in the mean extent of disclosure about audit committee duties and responsibilities.
- Δ ACMEET = Change in the mean extent of disclosure about the number of audit committee meetings held each year.
- Δ ACMTEAD = Change in the mean extent of disclosure about the audit committee meetings and receive advice from external auditors.
- Δ ACIAD = Change in the mean extent of disclosure about the audit committee reviews internal audit function.
- Δ LOGTS = Change in the mean total sales.
- Δ LOGTA = Change in the mean total assets.

in Panel A, Table 2 show that among all the variables, five significant correlations exist. Two variables are significantly positively associated at the 0.05 and 0.01 level as follows: 1) Δ ACMEET and Δ ROE ($r=0.132$); and 2) Δ LOGTS and Δ EPS ($r=0.188$), another two variables are significantly negatively associated at the 0.05 and 0.01 levels as follows: 1) Δ ACIAD and Δ EPS ($r=-0.152$); and 2) Δ ACDUTY and Δ ROE ($r=-0.160$). The positive correlations provide limited evidence that an increase in the number of directors on the audit committee (ACSZ), the number of audit committee meetings held each year (ACMEET), and firm size (LOGTS) are associated with an increase in the particular measure of firm performance. However, the negative association does not provide support that an increase in disclosure about audit committee reviews internal audit function (ACIAD) and disclosure about audit committee duties and responsibilities (ACDUTY) are associated with changes in the particular measure of firm performance.

Panel B shows the Spearman correlation coefficients. Four (4) significant correlations exist, whereby seven variables are positively correlated at the 0.01 or 0.05 level as follows: 1) Δ ACMEET and Δ ROE ($r=0.138$); 2) Δ LOGTS and Δ EPS ($r=0.324$); 3) Δ LOGTS and Δ ROA ($r=0.150$); and 4) Δ LOGTA and Δ EPS ($r=0.210$). These results provide additional support for the notion that an increase in the number of directors on the audit committee (ACSZ), the number of audit committee meeting (ACMEET), firm size (LOGTS and LOGTA) are associated with an increase in the particular measure of firm performance. Two variables are negatively correlated at the 0.05 or 0.01 level as follow: 1) Δ ACDUTY and Δ ROE ($r=-0.129$); and 2) Δ ACIAD and Δ EPS ($r=-0.191$). These results provide no support that an increase in the number of directors on the audit committee (ACSZ) and increase in disclosure about audit committee duties and responsibilities are associated with an increase in the particular measure of firm performance.

Panel C shows the results obtained from regressing changes in firm performance on changes in audit and accountability variables. The results indicate that none of the models (8a, 8b, 8c, 8d, or 8e) are significant. Overall, the correlation and regression results provide limited support for the hypothesis 8. The results indicate that among all accountability and audit variables, there are seven variables are significantly associated with changes in firm performance. Four variables are positively associated at the 0.05 or 0.01 level as follows: 1) Δ ACMEET ($t=2.149$) and Δ ROA; and 2) Δ LOGTS ($t=2.617$) and Δ EPS. These results provide additional support for a positive relationship between changes in the number of directors on the audit committee (ACSZ), the number of audit committee meetings held per year (ACMEET) and institutional size (LOGTS) that increases compliance with the MCCG 2000 and changes for the particular institutional performance (accounting based measures (ROA and EPS). Meanwhile, three variables are negatively associated at the 0.05 and 0.01 levels as follows: 1) Δ ACNEX ($t=-2.038$) and Δ ROA; 2) Δ ACDUTY ($t=-2.140$) and Δ ROE; and 3) Δ ACIAD ($t=2.762$) and Δ EPS. These results do not provide support for the relationship between changes in disclosure about the proportion of non-executive directors on the audit committee (ACNEX), disclosure about the audit committee duties and responsibilities (ACDUTY), and disclosure about the audit committee reviews internal audit function (ACIAD) that increase compliance with the MCCG 2000 and changes for the particular measure of firm performance (accounting based measure (EPS, ROE and ROA). Therefore, the correlation and regression results do not provide strong support for hypothesis 2.

Overall, the correlation and regression results provide limited support for hypothesis 2. Only some changes in audit and accountability (ACSZ, ACMEET and LOGTS) that increase compliance with the MCCG 2000 are significantly associated with changes in firm performance. The results also provide consistent support for a significant positive relationship between changes in the number of directors on the audit committee, changes in the number of audit committee meetings and in institutional size with changes in accounting based measures (EPS and ROA) and market based measures (RET and RETadj) of firm performance. Further, the result also provided a consistent outcome for a negative relationship between changes in disclosure about the audit committee duties and responsibilities (ACDUTY), and disclosure about the audit committee reviews internal audit function (ACIAD) that increased compliance with the MCCG 2000 and changes for the particular measure of accounting based measures (EPS and ROE), results neither provide support for the relationship between changes in ACDUTY and ACIAD nor increased compliance with the MCCG 2000 and changes for the particular accounting based measures (EPS and ROE).

CONCLUSION

The MCCG made a number of recommendations relating to improve corporate governance practices in Malaysia. The introduction and the development of the Code was aligned with other international Codes of Corporate Governance (for example see Cadbury Report 1992, Greenbury Committee Report 1995; Hampel 1998; Turnbull Report 1999; Smith Report 2003; Higgs Report 2003, in Britain, OECD Report 2004, Singapore Code on Corporate Governance 2001 and Hong Kong Corporate Governance Code Conclusions, 2004). The main objective of the Code was to enhance corporate governance reformation through the changes in audit and accountability structure by promoting a fair and balanced monitoring function among the PLCs.

The primary finding of this study revealed that the reformation of corporate governance practices through the MCCG compliance by the PLCs was very high, which was possibly due to the requirements by other rules and regulations prior to MCCG 2000. In the context of agency theory, these results suggest that audit and accountability had provided better monitoring and controlling mechanisms of the company management in reducing the agency problems. It also indicated the importance of transparency and adequate disclosure of accounting information to the shareholders, improve their confidence and ensure that better corporate accountability is practiced by the company (Anderson *et al.* 2004; Klein 2002; Rezaee *et al.* 2003; Teoh & Lim 1996). Furthermore, the audit committee comprised mainly independent and non-executive directors. This result confirms previous studies by Vinten and Lee (1993), Rezaee *et al.* (2003), and Mohamed Nazri and Zauwiyah (2004) that the independent audit committee also plays an important role in providing a perfect assurance over corporate governance, financial reporting process, internal control structures, internal audit functions and external audit activities of the company. In this study, it related to the means of exercising corporate accountability by ensuring that the information delegated to the management was guaranteed. Empirically, the result failed to provide support for the association between changes in firm performance and audit and accountability. Apparently, the potential control and monitoring benefit from audit and accountability structure



appeared to have no association with changes in institutional performance. This finding was aligned with Baxter (2007) and Vafeas (2005), who found the same result. Therefore, the representation of audit and accountability that beliefs can increase monitoring and as an internal control of the corporate institution does not have any relationship with the institutions performance.

NOTES

- 1 Prior to 2004, Bursa Malaysia is formerly known as Kuala Lumpur Stock Exchange (KLSE).
- 2 Companies been listed in the Bursa Malaysia are either listed on 1) Bursa Malaysia Securities Main Board for larger capitalised companies, 2) the Second Board for the medium sized companies, or 3) the MESDAQ Market for high growth and technology companies.

REFERENCES

- Abbott, L.J., Park, Y. and Parker, S. 2000. The Effects of Audit Committee Activity and Independence on Corporate Fraud. *Managerial Finance*, 26(11).
- Abbott, L.J., Park, Y. and Parker, S. 2000. The Effects of Audit Committee Activity and Independence on Corporate Fraud. *Managerial Finance*, 26(11).
- Abdul Hadi, Z., Fazilah, A.S. and Md. Ishak, I. 2005. Corporate governance in Malaysia (Publication. Retrieved 20.10.2005, from Malaysian Institute of Corporate Governance: <http://www.micg.net/research/CORPORATE%20GOVERNANCE%20IN%20MALAYSIA%20-%20MICG.pdf>.
- Act of Parliament 1983, *Securities Industry Act 1983 (Incorporating all ammendments up to 5 January 2004)*, Malaysian Government, viewed August 2006: <http://www.sc.com.my/eng/htm/resources/guidelines/siasireg98.pdf>.
- Agrawal, A. and Knoeber, C.R. 1996. Firm perfomance and mechanisms to control agency problems between managers and shareholders. *Journal of Financial and Quantitative Analysis*, 31(3):377–397.
- Allen, J.W. 2000. Code Convergence in Asia: smoke or fire? (Publication. Retrieved 20.10.2008, from Asian Corporate Governance Association: http://www.acga-asia.org/loadfile.cfm?SITE_FILE_ID=25.
- Anderson, C.W. and Campbell, T.L. 2004. Corporate governance of Japanese banks. *Journal of Corporate Finance*, 10(3):327–354.
- Anderson, R.C., Mansi, S.A. and Reeb, D.M. 2004. Board characteristics, accounting report integrity, and the cost of debt. *Journal of Accounting and Economics*, 37(3):315–342.
- Antle, R. 1984. Auditor Independence. *Journal of Accounting Research*, 22(1):1–20.
- Antle, R. 1984. Auditor Independence. *Journal of Accounting Research*, 22(1):1–20.
- Armitage, S. and Marston, C. 2008. Corporate disclosure, cost of capital and reputation: Evidence from finance directors. *The British Accounting Review*, 40(4):314–336.
- Armitage, S. and Marston, C. 2008. Corporate disclosure, cost of capital and reputation: Evidence from finance directors. *The British Accounting Review*, 40(4):314–336.
- Arthur, N. 2001. Board composition as the outcome of an internal bargaining process: empirical evidence. *Journal of Corporate Finance*, 7(3):307–340.
- Barton, D. and Wong, S.C. 2006. *Improving board performance in emerging markets* 26-10-2008. The pressure keeps growing for companies to tackle a range of governance issues.

- Basu, S., Hwang, L., Mitsudome, T. and Weintrop, J. 2007. Corporate governance, top executive compensation and firm performance in Japan. *Pacific-Basin Finance Journal*, 15:56–79.
- Basu, S., Hwang, L.-S., Mitsudome, T., and Weintrop, J. 2007. Corporate governance, top executive compensation and firm performance in Japan. *Pacific-Basin Finance Journal*, 15(1):56–79.
- Bauguess, S.W., Moeller, S.B., Schlingemann, F.P. and Zutter, C.J. 2009. Ownership structure and target returns. *Journal of Corporate Finance*, 15(1):48–65.
- Baxter, P. 2007. *Audit committees and financial reporting quality*. University of Southern Queensland, Toowoomba.
- Baxter, P.J. 2007. *Audit committees and financial reporting quality*. University of Southern Queensland, Toowoomba.
- Baxter, P.J. 2007. Audit committees and financial reporting quality. Unpublished Ph.D research, University of Southern Queensland, Queensland, Australia.
- Bozec, R. 2005. Boards of directors, market discipline and firm performance. *Journal of Business Finance & Accounting*, 32(9/10):1921–1960.
- Bozec, R. and Dia, M. 2007. Board structure and firm technical efficiency: Evidence from Canadian state-owned enterprises. *European Journal of Operational Research*, 177(3):1734–1750.
- Bushman, R., Chen, Q., Engel, E. and Smith, A. 2004. Financial accounting information, organizational complexity and corporate governance systems. *Journal of Accounting and Economics*, 37(2):167–201.
- Chang, J. and Shin, H. 2007. Family ownership and performance of Korean conglomerates. *Pacific-Basin Finance Journal*, in press, corrected proof, pp. 1–24.
- Che-Ahmad, A. and Houghton, K.A. 1996. Audit fee premiums of big eight firms: Evidence from the market for medium-size U.K. auditees. *Journal of International Accounting, Auditing and Taxation*, 5(1):53–72.
- Chen, C.J.P. and Jaggi, B. 2000. Association between independent non-executive directors, family control and financial disclosures in Hong Kong. *Journal of Accounting and Public Policy*, 19(4–5):285–310.
- Claessens, S., Djankov, S. and Lang, L.H.P. 1999. *Expropriation of minority shareholders: evidence from East Asia*, World Bank, 20 August 2005, World Bank Policy Research Paper no. 2088: http://www.worldbank.org/research/interest/prr_stuff/working_paper/2088.pdf.
- Cohen, J., Cohen, P., West, S. and Aiken, L. 2003. *Applied Multiple regression/correlation analysis for the behavioral sciences* (3 ed.). New Jersey: Lawrence Erlbaum Associates.
- Collier, P.A. 1993. Audit committees in major UK companies. *Managerial Auditing Journal*, 8(3):25–30.
- Company Act 1965*, ACT 125 C.F.R. (2008).
- Coram, P., Ferguson, C. and Moroney, R. 2008. Internal audit, alternative internal audit structures and the level of misappropriation of assets fraud. *Accounting and Finance*, 48.
- Davidson, R., Goodwin-Stewart, J. and Kent, P. 2005. Internal governance structures and earning management. *Accounting and Finance*, 45:241–267.
- De Angelo, L.E. 1981. Auditor size and audit quality. *Journal of Accounting and Economics*, 3(3):183–199.
- Dedman, E. 2002. The Cadbury Committee recommendations on corporate governance: a review of compliance and performance impacts. *International Journal of Management Reviews*, 4(4):335–352.
- De Fond, M.L. and Subramanyam, K.R. 1998. Auditor changes and discretionary accruals. *Journal of Accounting and Economics*, 25(1):35–67.
- Devi, S. 2003. Corporate governance as an evolutionary process: a Malaysian perspective. Paper presented at the United Nations Conference on Trade and Development. from <https://unp.un.org/details.aspx?pid=11261>.
- Engel, E., Hayes, R.M. and Wang, X. 2010. Audit committee compensation and the demand for monitoring of the financial reporting process. *Journal of Accounting and Economics*, 49(1–2):136–154.

- Fama, E. 1980. Agency problems and theory of the firm. *Journal of Political Economy*, 88:288–307.
- Fama, E. 1980. Agency problems and theory of the firm. *Journal of Political Economy*, 88:288–307.
- Fan, J.P.H. and Wong, T.J. 2005. Do External Auditors Perform a Corporate Governance Role in Emerging Markets? Evidence from East Asia. *Journal of Accounting Research*, 43(1):35–72.
- Global Corporate Governance Forum. 2005. *Tool Kit 2: Developing corporate governance codes of best practice*. Washington: The World Bank.
- Green, D.L. 1994. Canadian audit committees and their contribution to corporate governance. *Journal of International Accounting, Auditing and Taxation*, 3(2):135–151.
- Hasnah, H. 2009. *Corporate governance failure: How would effective internal and external monitoring mechanisms help?* Pulau Pinang: Penerbit Universiti Sains Malaysia.
- Healy, P. and Lys, T. 1986. Auditor changes following big eight mergers with non-big eight audit firms. *Journal of Accounting and Public Policy*, 5(4):251–265.
- Hirschey, M., John, K. and Makhija, A.K. 2005. *Advances in Financial Economics Volume 11. Corporate governance: a global perspective*. Retrieved 20 September 2008, from <http://library.books24x7.com.ezproxy.usq.edu.au/books.asp?task=search&userbinsize=10>.
- Iyengar, R.J. and Zampelli, E.M. 2008. Auditor independence, executive pay and firm performance. *Accounting & Finance*, 48(2):259–278.
- Iyengar, R.J., Williams, H.J. and Zampelli, E.M. 2005. Sensitivity of executive pay to accounting performance measures in all-equity firms. *Accounting and Finance*, 45:577–595.
- Jensen, M. and Meckling, W. 1976a. Theory of the firm: managerial behaviour, agency cost and ownership structure. *Journal of Financial Economics*, 3:305–360.
- Jensen, M. and Meckling, W. 1976b. Theory of the firm: managerial behaviour, agency cost and ownership structure. *Journal of Financial Economics*, 3:305–360.
- Jongsureyapart, C. 2006. Factors that determine corporate governance in Thailand. Unpublished Research Ph.D, Victoria University, Melbourne.
- Kaplan, S.E. and Mauldin, E.G. 2008. Auditor rotation and the appearance of independence: Evidence from non-professional investors. *Journal of Accounting and Public Policy*, 27(2):177–192.
- Klein, A. 2002. Audit committee, board of director characteristics, and earnings management. *Journal of Accounting and Economics*, 33(3):375–400.
- Klein, A. 2002. Economic determinants of audit committee independence. *The Accounting and Review*, 77(2):435–452.
- Koh, P.-S., Laplante, S.K. and Tong, Y.H. 2007. Accountability and value enhancement roles of corporate governance. *Accounting & Finance*, 47:1–29.
- Leedy, P.D. and Ormrod, J.E. 2005. *Practical Research: Planning and Design* (3rd ed.). New Jersey: Pearson.
- Lowensohn, S., Johnson, L.E., Elder, R.J. and Davies, S.P. 2007. Auditor specialization, perceived audit quality, and audit fees in the local government audit market. *Journal of Accounting and Public Policy*, 26(6):705–732.
- Mohamed Nazri, F. and Zauwiyah, A. 2004. Audit expectation gap: The case of Malaysia. *Managerial Auditing Journal*, 19(7):897–915.
- Muhammad Fadzly, N. and Zauwiyah, A. 2004. Audit expectation gap: the case of Malaysia. *Managerial Auditing Journal*, 19(7):897–915.
- Raghunandan, K., Rama, D.V. and Scarbrough, D.P. 1998. Accounting and auditing knowledge level of Canadian audit committees: Some empirical evidence. *Journal of International Accounting, Auditing and Taxation*, 7(2):181–194.

- Rezaee, Z., Olibe, K.O. and Minnier, G. 2003. Improving corporate governance: the role of audit committee disclosure. *Managerial Auditing Journal*, 18.
- Rueda-Sabater, E.J. 2000. Corporate governance and the bargaining power of developing countries to attract foreign investment. *Corporate Governance*, 8(2):117–124.
- Solomon, J. and Solomon, A. 2004. *Corporate governance and accountability*. West Sussex: John Wiley & Sons Ltd.
- Tabachnick, B.G. and Fidell, L. S. 2007. *Using Multivariate Statistics* (5th ed.). Boston: Allyn and Bacon.
- Vafeas, N. 2005. Audit committees, board and the quality of reported earnings. *Contemporary Accounting Research*, 22(4):1094–1122.
- Vander Bauwhede, H., Willekens, M. and Gaeremynck, A. 2003. Audit firm size, public ownership, and firms' discretionary accruals management. *The International Journal of Accounting*, 38(1):1–22.
- Vinten, G. and Lee, C. 1993. Audit committee and corporate control. *Managerial Auditing Journal*, 8(3):11–28.
- Zhang, Y., Zhou, J. and Zhou, N. 2007. Audit committee quality, auditor independence, and internal control weaknesses. *Journal of Accounting and Public Policy*, 26(3):300–327.