RMP PUBLICATIONS Research Malaysia Publications

International Journal of Business and Management 5 (5): 01-09, 2021
e-ISSN: 2590-3721
© RMP Publications, 2021
DOI: 10.26666/rmp.ijbm.2021.5.1

CEO and Audit Committee Competencies towards Enhancing Financial Disclosure Transparency: Evidence from Malaysian Government Linked Companies

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Abstract: Transparency through financial disclosure is crucial, especially in a society that demands for real-time information. In this regard, it is believed that competencies enhance the effectiveness of audit committees along with the CEO and, to some extents, the transparency of financial disclosure. Many studies did not explore the role of the CEO and audit committee competencies in depth as they simply used the experience as a proxy to measure competencies. Therefore, the purpose of this study is to empirically investigate the extent of financial disclosure transparency of the annual reports of listed GLCs in Malaysia for the year 2012 until 2017, and whether an association exists between several competencies characteristics namely experience, advanced academic qualification, training and multiple directorships towards the level of financial disclosure transparency. This study also controlled the variables suggested in prior research as significant contributors to financial disclosure transparency. The control variables included are firm performance, firm financial leverage and firm size. The hypotheses were tested using a sample of GLCs listed on the Bursa Malaysia which are also involved in the GLC Transformation Program (GLCT). The final 10 listed GLCs were analysed. The Ordinary Least Squares (OLS) is employed to examine the relationship between CEO and audit committee competencies with financial disclosure transparency. The findings that the CEO and audit committee accounting financial experts and finance experts have a significant impact on financial disclosure transparency. Findings of this study are of interests to the Malaysian government, the board of directors, policy makers and investors as they provide a useful basis for assessing and enhancing corporate disclosure transparency.

Keywords: competencies; financial disclosure transparency; GLC; audit committee; CEO

1. Introduction

The presence of an effective CEO and audit committee as the foundation of good corporate governance (CG) has become a prevalent agenda globally, including in emerging economies such as Malaysia. The need for sound CG practices, including transparency and full disclosure started as a response to the Asian financial conflicts in 1997 which caused the collapse of several corporations (Alzeban & Sawan, 2015). According to by an analysis of transparency in corporate reporting

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conducted on top 100 public listed companies (PLCs) by the Malaysian Institute of Corporate Governance in 2017, disclosure practices and levels of transparency among corporations are still below satisfactory level and far below the expected standards. The report revealed that only 15 companies scored 50% or more in all criteria, including organisational transparency. Furthermore, financial reporting improprieties and corporate collapses have put the CEO and audit committees under continuous enquiry on their role as a monitoring mechanism. Researchers have also focused on the attributes of an effective CEO and audit committee, such as determiners of competencies.

In the meantime, the Malaysian Government has a direct controlling stake in GLCs through its proxies, namely Government-linked Investment Companies (GLICs) that allow the government to exercise control over aspects including the appointment of board members (Nasir, 2017). This significant government ownership in PLCs reflects the strong involvement of the government in the corporate level. This may explain why improvement on corporate and financial disclosure transparency, especially in GLCs, does not appear to be a priority (Elfeky, 2017). Apart from that, according to Megginson, Nash & Randeborgh (1994), the position of directors in GLCs are frequently occupied by high-ranked government servants or politically-affiliated individuals who may not possess sufficient competencies to run a business entity. This is evident in the recent the political tussle and financial failures in several Malaysian GLCs, including Felda Global Ventures Holdings Berhad (FGV). It was reported that FGV is facing difficulties due to the heavy political presence on its boards (The Star, 2017). This goes against the GLCs' transformation program and other good governance practices which calls for board positions or audit committee members particularly to be nominated and selected according to the specified competencies. Therefore, this study was conducted to provide a thorough understanding regarding CEO and the audit committee competencies in enhancing financial disclosure transparency in Malaysian GLCs.

2. Literature Review

2.1 Transparency and Disclosure

Corporate disclosure transparency can be translated as the availability of relevant information particularly on specific firm information to internal or external users (Han, Kang & Yoo, 2012). As the terms quality and transparency are used jointly and alternatively, Salehi, Moradi & Paiydarmanesh, (p. 35, 2017) interpreted disclosure quality as "the degree of reliability, relevancy and correctness of the information disclosed that increased by independent audit". Moreover, in assessing the quality of financial reporting, transparency has been described as a direct and observable approach (Han et al., 2012). Transparency in financial disclosure is important to different users to assist them in making judgements and decisions about a company (Rahman, 1998). Alfraih & Almutawa (2017), described the importance of financial disclosure to ensure the functioning of efficient stock markets. Financial disclosure also plays a pivotal role in fulfilling the rights and interests of outside investors and market participants in general as the adequacy of reported information by the company could direct the decisions makers towards the right and logical decisions (Salehi et al., 2017). The failure to provide transparent financial reporting would mislead and has an adverse effect towards to the wealth of investors and other stakeholders (Salehi et al., 2017). In Malaysia, financial reporting and disclosure is governed by the relevant sections of the amended Companies Act, 2016, the revised Bursa Malaysia Listing Requirement (BMLR) and the accounting standards approved by the Malaysian Accounting Standard Board (MASB).

2.2 CEO and Audit Committee Experience with Financial Disclosure Transparency

Kusnadi, Leong, Suwardy & Wang (2016), highlighted the importance of having boards and audit committee members with adequate experience as an effective

means to monitor management's financial reporting practices in order to produce more transparent corporate disclosure. Normally, one's experience highly depends on the proportion of the board and audit committee who have accounting and/or finance expertise as they are more capable to detect anomalies in corporate reporting compared to members without such expertise (Appuhami & Tashakor, 2017). On the other hand, the supervisory experts may not fully grasp and understand the accounting complexities, but they possess industry specific business knowledge which could promote better financial disclosure transparency (Cohen, Hoitash, Krishnamoorthy & Wright, 2013). Hence, the CEO and audit committee experience can be decomposed into three specific categories in this study, namely accounting financial experts and non-accounting financial experts, which are further divided into finance experts and supervisory experts.

In regard to the non-accounting financial experts, Ghafran & Sullivan (2017), found that the proportion of non-accounting financial experts are linked to higher audit quality, due to their role in improving the transparency of financial reporting, especially in the case of smaller listed firms. Goh (2009), indicated that the role of non-accounting financial experts as a valuable component of the governance expertise of the boards and audit committee members. However, some studies revealed that the presence of finance or supervisory experts have no significant impact on quality of disclosure. For example, it was reported that such expertise does not lead to better accruals quality (Kusnadi et al., 2016). Therefore, this study formulated these hypotheses:

H1: CEO and audit committee accounting financial expertise is positively associated with financial disclosure transparency.

H2: CEO and audit committee finance expertise is positively associated with financial disclosure transparency.

H3: CEO and audit committee supervisory expertise is positively associated with financial disclosure transparency.

2.3 CEO and Audit Committee Advanced Academic Qualification with Financial Disclosure Transparency

The current literature, specifically in education, support in using academic qualification as one of the measures for CEO and audit committee competencies. Higher education qualification allows directors to have broader views and develop a greater understanding (Post, Rahman & Rubow, 2011). Anderson, Mansi & Reeb (2004), elucidated that independent-audit committee and board of directors members who have higher academic qualification will help them gain a superior oversight of the financial accounting processes and ultimately leads to the improvement in the transparency and reliability of financial reporting. Francis, Hasan & Wu (2016), documented that academic directors who sit on audit committees exert a positive impact on earnings quality and information quality. Therefore, this study postulates that CEOs and audit committee members with higher academic qualification are effective monitors and as a result, their presence can lead to a more transparent financial disclosure. Accordingly, this study proposes the following hypothesis:

H4: CEO and audit committee advanced academic qualification is positively associated with financial disclosure transparency.

2.4 CEO and Audit Committee Training with Financial Disclosure Transparency

The revised BMLR, the MCCG 2017 and the Blueprint 2011 have emphasised the need for CEOs and audit committee members to undertake continuous training as one of the initiatives to improve transparency of information disclosed in annual reports. In this light, although there are no studies that directly linked the relationship between CEO and audit committee training and financial disclosure transparency, there are some studies that have investigated on the impact of training on other areas, such as level of firm performance, audit fees and board or audit committee effectiveness.

Focusing on determining the 'effective board characteristics', a recent study by Borlea, Achim & mare (2017), found that there is no significant relationship between training the member's competences and financial performances for Romanian companies represented either by Tobin's Q or Return on Assets (ROA). The study argued that the more the training provided to the CEO and audit committee members, the more competent these members are in monitoring the management's financial reporting practices which lead to a higher transparency of financial disclosure in GLCs. Accordingly, the following hypothesis is conjectured:

H5: Training received by the CEO and audit committee members is positively associated with financial disclosure transparency.

2.5 CEO and Audit Committee Multiple Directorships with Financial Disclosure Transparency

According to Hundal (2017), directors who serve on other corporate boards may add valuable resources within an organisation in the form of human capital (education, experience, skills, reputation) and relational capital (a network of ties to other firms, external organisations and external contingencies). In this context, the CEO and audit committee members who are also a board or committee member, may gain additional contextual knowledge which could be useful in helping them perform their monitoring responsibilities. This subsequently, will affect the transparency of corporate disclosure (Madi, Ishak & Manaf, 2014). Empirical evidence from Malaysia has consistently support this notion; Madi et al., (2014), reported that multiple directorship of audit committee is associated with corporate voluntary disclosure. In addition, Hanifa & Cooke (2002), documented the positive impact of multiple directorships in enhancing the financial disclosure practices. Hence, the next hypothesis was formulated as follows:

H6: CEO and audit committee multiple directorships are positively associated with financial disclosure transparency.

3. Research Methodology

3.1 The Presentation of the Sample

The sample of this study is limited to GLCs that are fully listed on the Bursa Malaysia and involved in the GLC Transformation Program (GLCT). The list of companies involved in the GLCT was obtained from Menon (2017). The list originally comprised of top 20 listed GLCs, known as G20. However, in the wake of mergers, demergers and other corporate restructuring exercises, G20 is now a group of 17 GLCs. Out of 17, two GLCs which do not have complete data were excluded from the study sample. Further, five GLCs in financial industry were also removed from the population as they are governed by special regulations and under close supervision from the Central Bank of Malaysia. Accordingly, the final 10 listed GLCs for the year 2012 until 2017 were analysed. Year 2012 was chosen because the Malaysian Code on Corporate Governance (MCCG) was revised on the 26th April 2012, while year 2017 is considered as the most recent annual report available online.

3.2 Development of a Financial Disclosure Index (Dependent Variable)

A starting point in developing the disclosure index is the selection of reliable items which could be expected to be disclosed in all annual reports. As such, a detailed review of a set of indices from the previous studies by Elfeky (2017), Elfraih et al., (2017), Haniffa et al., (2002) and Akhtharuddin & Harun (2010), was performed. To make it more relevant in the Malaysian context, some modifications were carried out to the list of information items obtained from these studies. In total, 95 items for the final financial disclosure index were identified. To further enhance the validity of this disclosure index, it was reviewed by two professional accountants from Ernst & Young. The level of financial disclosure was identified and calculated based on disclosure score index. An unweighted approach was

employed on a basis that each item in the disclosure index is considered equally important, thus given the same scores. The items of information are numerically scored on a dichotomous basis either by assigning one (1) score if an item is present in the annual report or zero (0) score if it is not disclosed. If a particular item is not relevant to a sample company, a non-applicable (NA) score is given. Once the scores for financial disclosure items were identified, the total financial disclosure transparency index score (FIDTRA) for each company was calculated. It represents the ratio of the total actual scores to the maximum expected disclosure scores. This approach has been adopted in several prior studies Akhtarudin et al., and Sellami & Fendri (2017), and the equation is as follows:

$$FIDTRA = ACTD / MXTD \quad (1)$$

Where:

FIDTRA = The value of the financial disclosure transparency for each firm.

ACTD = The number of items each firm actually disclosed.

MXTD = The expected maximum number of items disclosed by each firm (= 95).

3.3 Measurement of Independent Variables

The data on CEO and audit committee competencies were collected from the profile of directors and audit committee report section in the annual report. First, the CEO and audit committee experience were classified into three different categories, namely, the CEO and audit committee with accounting financial experts (ACCEX), finance experts (FINEX) and supervisory experts (SUPEX). The proxies used for all three different categories are the proportion of the CEO and audit committee members with their respective experiences to total number of members. Consistent with studies by Ghafran et al., (2017), the ACCEX was referred to as those who have previously held or currently have work experience as CPA, CFO, CAO, auditors, vice presidents of finance, financial controller or any other major positions either in accounting or auditing field. It also included those who have been a member of any professional accounting body (such as MICPA, MIA, etc.). Meanwhile, the criteria of FINEX as proposed by Ghafran et al., (2017), was referred to those members with prior work experience as an investment banker, chief investment officer, financial analyst or any other corporate finance role. Similar to Ghafran et al., (2017), the members are classified as SUPEX if he or she has any past or current work experience as a CEO, general partner, managing directors, COO or chairman of the board in a for-profit corporation.

Second, the higher academic qualification of the CEO and audit committee qualification (ADVAQ) was measured based on the proportion of members with tertiary education academic qualification (master's degree or doctorates) to the total number of members. The measurement is consistent with Nelson & Devi (2013). Third, the training experienced by the CEO and audit committee (TRAIN) was identified by calculating the average of all trainings attended during the financial year. This is consistent with the previous research by Azmi, Samat & Zakaria (2013). Lastly, the CEO and audit committee with multiple directorships (MULDI) was measured as the average number of outside directorships held in other corporations which is in line with measurement employed by Sun, Lan & Liu (2014).

There are control variables included in this study which could affect a firms' disclosure behaviour . These variables are firm performance (FIRPE), firm financial leverage (FILEV) and firm size (FISIZ). This study also used the return on assets (ROA) as a measure of FIRPE by Appuhami et al., (2017) while the FILEV was based on the ratio of total liabilities and total assets Appuhami et al., (2017), and FISIZ was measured as the natural logarithm of book value of total assets Sellami et al., (2017).

3.4 The Models Employed

The Ordinary Least Squares (OLS) was employed to

examine the relationship between CEO and audit committee competencies with financial disclosure transparency. The following regression equation is estimated for this study:

FIDTRA = β0 + β1ACCEX + β2FINEX + β3SUPEX + β4ADVAQ + β5TRAIN + β6MULDI + β7FIRPE + β8FILEV + β9FISIZ + ε (2)

4. Findings

Table 1 presents the descriptive statistics for the sample firms. The results for financial disclosure transparency (FIDTRA) indicate the highest score achieved by a firm is 89.4% and the lowest score is 69.9%, with the standard deviation of 4.8%. The overall level of financial disclosure scores is generally high, which is 81.7% out of the 95 items, indicating most of the GLCs complied with the requirements of financial reporting and disclosure practice. The mean score for accounting financial experts (ACCEX) and finance experts (FINEX) are 36.6% and 18.4%, respectively. These companies complied with the requirement set in the revised BMLR, revised MCCG and the Green Book to have CEO and audit committee member with financially literate. Meanwhile, the mean score for the supervisory experts (SUPEX) is 64.1%, which indicates that a significant number of CEO and audit committee members have supervisory expertise. Next, the mean value for advanced academic qualification (ADVAQ) is 0.363, which asserts that there is 36.3%, on average, of the sample firms that have CEO and audit committee with advanced academic qualification. The average training (TRAIN) attended by CEO and the audit committee members is 8 with maximum and minimum training attended are 19 and 1, respectively. The total multiple directorships (MULDI) held by the CEO and audit committee members ranged from 1 to 5 directorships, with an average of 2.21, suggesting full compliance with the recommendation of the BMLR to hold and serve of less than five directorships. The percentage of firm performance (FIRPE) control variables is between -13.4% and 15.9% with a mean of only 5.2. The percentage of firm financial leverage (FILEV) ranged from 22.5% to 75%, with the average of 55.2%, while the firm size (FISIZ) has the mean value of 10.2% and ranged between 8.9% to 11.5%.

Table 1: Descriptive Statistics for All Variables

Variable	**Mean**	**Standard Deviation**	**Minimum**	**Maximum**
FIDTRA	0.817	0.048	0.699	0.894
ACCEX	0.366	0.161	0.167	0.750
FINEX	0.184	0.188	0.000	0.750
SUPEX	0.641	0.199	0.250	1.000
ADVAQ	0.363	0.202	0.000	0.750
TRAIN	7.597	4.388	1.000	19.000
MULDI	2.208	0.909	0.600	4.600
FIRPE	0.052	0.039	-0.134	0.159
FILEV	0.552	0.096	0.225	0.750
FISIZ	10.214	0.568	8.935	11.452

The variation inflation factor (VIF) scores, as presented in Table 2 are reviewed to test the presence of multicollinearity. It shows that all values are below the threshold level of 10 (Alias, p. 87, 2011), confirming that there is no multicollinearity issue. The multiple regression results of the association between financial disclosure transparency and the experimental variables, as well as the control variables are presented in Table 2.

The results indicate the F-statistic of 10.079 (p=0.0001) which support that the estimated model is statistically significant. Moreover, the R-square of 64.5% and the adjusted R-square of 58.1% suggest that a significant percentage of the variation in financial disclosure transparency can be explained by the variations in the whole set of independent variables.

Table 2: OLS Regression Results

	Coefficient	**Standard Error**	**Beta t values**	**Significance**	**VIF**
Intercept	-1.121	0.266	-4.210	0.000	
ACCEX	0.245	0.108	2.275	0.027	2.228
FINEX	0.196	0.085	2.308	0.025	1.905
SUPEX	-0.002	0.062	-0.037	0.971	1.126
ADVAQ	-0.007	0.066	-0.107	0.915	1.321
TRAIN	0.004	0.003	1.290	0.203	1.432
MULDI	-0.040	0.016	-2.503	0.016	1.597
FIRPE	-0.071	0.315	-0.227	0.822	1.137
FILEV	-0.273	0.131	-2.090	0.042	1.179
FISIZ	0.184	0.024	7.515	0.000	1.444
R^2 = 0.645 Adjusted R^2 = 0.581 F = 10.079 Sig = 0.0001					

In respect of competency variables, the results show that the CEO and audit committee members with accounting financial expertise is significantly and positively associated with financial disclosure transparency. Hence, the H1 is supported. This is consistent with Kusnadi et al., (2016). In this respect, it can be argued that the CEO and audit committee are effective in detecting anomalies in financial reporting. This could enhance the financial disclosure transparency. Based on the finding, the CEO and audit committee members with finance expertise significantly and positively correlated to the extent of financial disclosure transparency. Therefore, the H2 is supported. This is in line with the previous studies from Ghafran et al., (2017). The existence of finance expertise is consistent with Resource Dependence Theory that highlights this kind of expertise as an external resource to the firm. However, the rest of the variables namely supervisory experts, advanced academic qualification, training and multiple directorships are not significantly associated with financial disclosure transparency, thus rejecting their respective hypotheses. In terms of the control variables, the statistical result shows that large companies, as represented by their total assets, have significant association with financial disclosure transparency. Meanwhile, firm performance and firm financial leverage show an insignificant influence on financial disclosure transparency.

5. Conclusion

This paper assesses the role of CEO and audit committee in enhancing corporate financial disclosure transparency in the annual reports of GLCs in Malaysia. Specifically, this paper investigates the relationship between the CEO and audit committee competencies and financial disclosure transparency. This study also

controls for the variables suggested in previous literature as significant contributors to financial disclosure transparency. The results obtained stipulate that the presence of CEO and audit committee who are accounting, financial experts and finance experts have significant impact on financial disclosure transparency. This study also demonstrates the agency theory and resource dependence theory are useful towards enhancing the effectiveness of the CEO and audit committee. The findings of this study will be useful for the Malaysian government, board of directors, policy makers and investors as they provide a useful basis for assessing and enhancing corporate disclosure transparency. The findings also add to the existing literature by contributing to the understanding of CEO and audit committee role in corporate disclosure practices. This study has several limitations. First, the sample of this study is limited to only the top listed GLCs in Malaysia. The results may not extend across the other firms in Malaysia. Second, this study only considered the annual reports in order to collect the relevant data without investigating the other useful medium. Thus, the results of this study put forward several suggestions for possible further research; first, studies in this issue can be extended by using a newly updated list of GLCs in Malaysia. Moreover, future researchers may focus on all GLCs regardless on whether they are listed or non-listed companies in Bursa Malaysia. In addition, future researchers are encouraged to investigate the extent of financial disclosure transparency published in quarterly financial reports or information provided though the GLCs websites.

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