THE IMPORTANCE OF AUDIT COMMITTEE IN BOARD STRUCTURE IN MALAYSIA

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Abstract- Development of audit committee and effects of this section on review of performance and accuracy of financial statements and accounting systems around the world and by referring to studies on the linkage between audit committee and performance shows that there would be significant relations between them that help the organizations to improve profitability. In this part of corporate governance, many countries such as Malaysia have set up the regulation of Sarbanes-Oxley-Act after 2002 which consists of new rules and regulations on Audit committee to increase authority and responsibility of this committee. It has helped Malaysia to recover from the financial crisis in Asia. This recovery has caused investors to have more confidence and offer investments in Malaysia. A good structure and good management of corporate governance can provide a secure platform for investors invest more in Malaysia.

Index Terms- Corporate governance, Audit committee, performance, Malaysia

I. INTRODUCTION

According to Cadbury (1992), corporate governance is a general set of laws, habits, regulations, customs, process, policies and institutions. All of these mechanisms help to discipline administered and controlled organizations. The system of corporate governance is comprised of different institutions and practices includes accounting standards practices, financial disclosure, corporate boards and executive compensation, and also involves social, legal and economic institutions that protect interests of a corporation’s owners. As Morin and Jarrell (2001) claimed, corporate governance is a mechanism that controls the interest of the significant players in the markets; these players include shareholders, managers, employees, customers, executive managers, boards of directors and suppliers.

One of the most significant parties in corporate governance is the board of directors who play a key role in corporate governance and are responsible for the activities of the organization or company. The efficiency of the boards depends on the composition of the board, structure and procedures and also all the performance and functions that are related to the boards. For doing these functions, board of directors comprise of several sub-committees such as Audit committee, Remuneration committee, Nomination committee and etc. All of these sub-committees help discuss about certain issues with more details related to boards. Here, this study will describe the audit committee of the board that are today, one of the key fulcrum of any company.

Companies try to improve their operating committee known as the Audit committee (first approved audit committee concept in New York stock exchange) that is responsible for considering the annual financial statements and confirming them before submission to the board of directors. So, most of these countries are trying to strengthen their corporate governance and have also placed more emphasis on this subject. Some of the development after these events was the developments of codes of ethics in 2000 and in 2002 the role of the Audit committee became more empowered by including the text of the Sarbanes-Oxley Act (enacted July 30, 2002), especially in Malaysia to protect the investments of investors and to gain more confidence to invest in large companies. Based upon these considerations, this study is a brief survey to show the importance of audit committee role in board structure, in this article we are interested to describes the importance of audit committee role in board structure, in particular, it considers some criteria involving
sum requirements of audit committee, functions of audit committee, duties of audit committee, scope of audit committee, role and responsibilities of audit committee.

II. LITERATURE REVIEW

A. Audit Committee

Audit committee is a committee of the board of directors; one of the important roles of this committee is focuses on all aspects of financial reporting. The committee should have at least three members or directors they should be independent or non-executive directors. Results from some Audit committee meeting shows that a small group of audit committee better solve issues and problems and also dealing with issues are more effectively. In every meeting of audit committee other directors allowed to attend and also some directors that are not member of audit committee can attend. Evidence by Berlin & Bromilow (1993) shows that about 92% of audit committee meetings held at least four times a year and about 76% held more than four times in year, they also argue that in every meeting instead of discussion about financial report they have discussion that audit committee should have regularly meetings and must cover all committee duties and responsibilities and also they have more focus on more efficient meetings and must put sufficient time for more discussion on key problems and issues.

Study by Coopers & Lybrand (1994) shows that for having right financial report audit committee must have three or four times meeting during a year this frequent of meetings helps to committee to have more control on accountability of the company, usually the meetings held every quarter.

In Study by Raghunandan & McMullen (1996) empirical evidence shows that Audit committee plays an important role in improving quality of financial statement and reporting. They also concluded that 40 percent of firms without financial statement problem at least held meetings three times yearly and twenty three firms with financial problems met more than four times yearly.

In survey by Raghunandan & McMullen (1996) on Audit committee effectiveness between firms without and with financial reporting problems has found that problem firms were less expected to have Audit committee.

As determined in Malaysian code of corporate governance an Audit committee should have at least three members or directors, the majority of them are independent directors who have special duties and authority to do, usually the chairman of audit committee is an independent non-executive directors and one of the important mechanism of corporate governance is the appointment of independent non-executive directors the duties of them is to ensure that the financial statement of the company are properly, another role and duties of audit committee is to protect interest of shareholders. So these roles sometimes need the committee to approve a probing attitude or manner, questioning management’s decision.

Neal & Carnello (1999) found that when the percentage of outside audit committee is upper in financial crisis and distress percentage of modified audit committee reports is lower, this result shows that when outside directors in audit committee are higher have positive effect on financial reporting and performance of companies.

In study by Berlin & Bromlow (2005) shows that effectiveness of audit committee and they consider when Audit committee is smaller the effect of that is more than larger one.

In study by Dan & Vic Niker (2007) shows that when the member of audit committee are professional in three types of financial experts such as accounting, finance and supervisory then the probability of accuracy of financial statements are high and the quality of results are more accrue.
B. Sum of requirements of Audit committee

1- The number of members of this committee should be at least 3 person and directors maximum 6 person

2- About two –third of members of this committee should be non-executive directors

3- In every meeting of this committee one director in charge of finance should be attend but don’t have right to vote

4- Before submitted annual accounts to the board audit committee must consider and discuss about them

5- The board should order the committee’s provisions of reference in writing

C. Functions of the Audit committee

Some of the main functions of this committee include:

1- Review and assess financial reporting system

2- Provides appropriate direction and consider the operations of all audit functions

3- Fulfillment of internal control system

D. Duties of the Audit committee

1- Every year –end or quarterly this committee should review financial statements of bank or company and the major focus of this committee is particularly on:

   ▪ Every changes in accounting policies
   ▪ After complete audit this committee suggest significant adjustment
   ▪ This committee suggest related assumption
   ▪ Compliance with legal requirements and accounting standards

2- To review the management’s response and the letter of external auditor’s management

3- To discuss some problems and matters and reservations that will become clear after final audits

4- To assess the major findings of management’s response and internal investigation

5- To assess all topics that defined by the board

6- To assess any transactions that would be arise within the bank or company

7- Review all topics that are related to internal audit functions such as review of internal audit programs, review of internal audit process, review of any assessment or appraisal of actions of members of internal audit functions

E. Scope of Audit committee

The scope of audit committee has following five functional areas of management for review and consider of accounting functions and board’s auditing these areas includes:
**Internal auditing:** Types of internal audits that consider by this committee are: 1- risk audit 2- financial 3- operational 4- ethics 5- systems 6- compliance 7- review internal audit plans 8- review of organizational structure 9- review composition of internal audit department.

**External auditing:** The first role of external auditors is to state an attitude on whether an entity's financial statements are complimentary of material misstatements some of the matters that should be consider by external audit such as analytical review, audit plan, risk assessment, accounting auditing.

**Financial management:** Audit committee should review all information about members of financial management group of the bank or company.

**Legal process:** The committee also required to oversee some official functions such as: Industrial legislation, contracts, legislations, legal force, claim against the company and pending litigations.

F. **Role and responsibility of Audit Committee**

1. Increasing audit quality
2. Decrease a company’s illegal functions or irregularities
3. Preventing falsified financial reports
4. To make recommendations on the meeting and change of external auditor
5. To manage the internal audit structure and its performance
6. To organize the statement between external and internal auditors
7. To assess corporate accounting information
8. To evaluate internal control programs of the company

**References**


