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Hedging Activities Information and Risk Management Committee Effectiveness: Malaysian evidence

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Abstract

This study examines the extent of information about hedging activities disclosures within the annual reports of Main Market companies listed on Bursa Malaysia. The extent of hedging activities disclosures is captured through a 32-item-template, which consists of a mandatory and voluntary disclosure scores. The results of this study indicate that the extent of information on hedging activities disclosure is still insufficient among the sampled companies even though the disclosure scored is quite high. This study also examines the relationship between the existence of risk management committee (RMC), its characteristics and the extent of information on hedging activities disclosure in two separate statistical models. The regression results imply that the existence of RMC is positive but does not significantly influence the extent of information on hedging activities disclosure. However its characteristics (i.e. RMC independence and RMC meeting) have a significant influence. The findings may provide some meaningful insights to regulators, policymakers and researchers, towards the establishment of RMC as a part of the internal corporate governance mechanisms. In addition to its existence, the effectiveness of RMC also needs to be emphasized.

Key words: *Derivatives; Disclosure Index; Financial Instruments; Hedging Activities; Risk Management Committee (RMC)*

1.0 INTRODUCTION

Previous studies explained that derivatives may be used for three reasons; risk management, income generation, and financial engineering. Although derivatives may have different roles, many research have reported that companies frequently employ derivatives as an instrument for corporate risk management (e.g. Ameer, 2010; Grant and Marshall, 1997; Mallin et al., 2001). In other words, derivatives are used as a mechanism to offset financial risk exposure caused by business activities (Stulz, 2004). According to Chung and Fung (1995), although derivatives are able to offset companies' financial risk exposure, improper and weak internal policies towards the use of derivatives may lead companies to suffer huge losses. As previously indicated, financial risks associated with hedge arrangements contributed to the collapse of several prominent corporate companies such as Enron and PLC. With regard to these corporate failures, several studies have urged for more information about risks from hedge activities, particularly from the use of derivatives (see Birt et al., 2013; Hassan et al., 2012; Taylor et al., 2008). It was claimed that users of financial statements must understand and have enhanced information in evaluating companies' use of derivatives.

Ameer (2010) argued that a need exists for users (especially investors) to understand the risk exposure and risk management activities carried out by companies including the hedging objective and its cost and relate their descriptions of risk management to disclosures of quantitative information. According to Papa and Peter (2013), insufficient derivative disclosures or limited transparency (i.e. either designated or non-designated for hedging) can result in an investor undervaluing the risk of reporting entities and lead to flawed investment decisions as being involved in derivatives can increase a company's risk exposure.

The International Accounting Standard Board (IASB) has introduced a new accounting standard to improve derivative information sharing and enable users to reach more informed investment conclusions. In Malaysia, IFRS 7 (*Financial Instruments: Disclosures*) became in effect on January 1, 2010 and was renamed MFRS 7 (*Financial Instruments: Disclosures*). However, while business entities have just relatively applied MFRS 7 in Malaysia, several studies in other countries have raised concerns regarding the extent and quality of the disclosure companies provide in meeting this accounting standard (e.g. Birt et al., 2013;

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Hassan et al., 2006; Lopes and Rodrigues, 2007; Wei and Taylor, 2009). One concern is related to information about derivative and hedge activities, which some have claimed to be less useful and subject to management discretion (Bamber and Meeking, 2010; Hassan et al., 2012; Hausin et al., 2008; Papa and Peter, 2013). This is because the accounting standard offers an optional requirement for hedge accounting to be applied by companies.

Previous studies (i.e. Abdullah and Chen, 2010; Birt et al., 2013; Hassan et al., 2012) have proposed that the establishment of a Risk Management Committee (RMC) could influence the level of transparency and quality of disclosure of financial instruments. Since there is mixed evidence to support this assertion, this study further queries about the effectiveness of RMC in doing so particularly on the information about derivatives and hedge activities. It is argued that the mere existence of RMC is insufficient and its effectiveness should be of more concern and emphasized to justify the quality of such disclosures. To examine its effectiveness, the present study uses the characteristics (i.e. size, independence, diligence, diversity and expertise) of RMC as a proxy for its effectiveness. Hence, the objectives of this study are to examine the extent of hedging activities information and the influence of the risk management committee and its characteristics to the level of hedging activities information disclosure in annual reports of selected Malaysian-listed companies. The paper is organized as follows. Section 2.0 outlines the prior research on financial instruments disclosure. Section 3.0 discusses the research hypotheses, while chapter 4.0 discusses the research design. Section 5.0 presents the results on the extent of hedging activities disclosure as well as the results of hypothesis testing. The last section of this paper presents the conclusions and future research opportunities.

2.0 LITERATURE REVIEW

2.1. Studies on Financial Instruments Disclosures

Although many studies have examined reporting practices on financial instruments, only a limited number of studies have specifically addressed the disclosure of information on derivatives. As information on derivatives and hedge activities is part of financial instrument disclosure, this section reviews related past studies on the disclosure of financial instruments, emphasizing disclosure of information on derivatives and hedging activities. In general, studies prior to the existence of regulations showed that the disclosure of financial instruments including information on derivatives was unsatisfactory as many companies

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under study limited the amount of their disclosure. However, a higher level of disclosures was reported after regulations were created but the information provided was not always useful. Several factors could help explain the level of financial instruments disclosure. Studies conducted before the issuance of accounting standards showed that the level of financial instruments disclosure was associated with several specific characteristics. Chalmers and Godfrey (2004) provided evidence on some drivers that help in voluntary financial instruments disclosure. These factors are companies' affiliations with professional bodies, company size, type of industry and the extent of its media attention. Similarly, Lopes and Rodriguez (2007) provided evidence that company size, type of industry and auditor listing status were significantly related to the extent of disclosure among Portuguese-listed companies. In contrast, Hassan et al. (2006) gave a different view on this matter. They reported that large companies and companies with high price-earnings ratios and debt-to-equity ratios provided more transparent and higher quality financial instrument disclosures. Wei and Taylor (2009) showed that the strength of corporate governance and leverage were significant factors that positively influenced the disclosure of fair value information on financial instruments. Similarly, Taylor et al. (2008) reported that the level of financial instruments disclosure, including information on hedging activities, was positively associated with leverage and strength of corporate governance. In another study, Birt et al. (2013) showed that the extent of disclosure of financial instruments was significantly associated with profitability, leverage, the type of audit firm, company size and the existence of a risk management committee. They found that a large profitable company with high leverage and audited by a Big 4 auditor was likely to provide more extensive disclosure of financial instruments. In contrast to Birt et al. (2013), Nejad et al., (2013) found no relationship between a risk management committee and the level of financial instruments disclosure among companies listed on the Tehran Stock Exchange.

In Malaysia, limited studies have addressed disclosure of financial instruments information. Hafiz (2003), as cited in Hassan et al. (2012), was the earliest study found. Hafiz (2003) provided evidence relating to the relationship between the extent of derivative financial instruments disclosure and two specific company characteristics: company size and the level of foreign activities. A disclosure index, based on MASB's ED 24 (*Financial Instruments: Disclosure and Presentations*), was used to measure the level of voluntary derivative disclosures. The study found that the level of voluntary disclosures among companies with

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a high percentage of foreign subsidiaries was low when compared to companies with a low percentage of foreign subsidiaries. Furthermore, there was no difference in the level of voluntary disclosures of derivative financial instruments with regard to companies with substantial foreign sales as opposed to those with a low percentage of foreign sales; nor did an observed difference exist between companies with large assets and those with small assets. The argument has been made that this outcome resulted from conflicts of interest between the management and stakeholders.

Hassan et al. (2012) extended the study by examining the disclosure quality among listed companies in Malaysia prior to and after MASB 24 was issued. Their findings suggested that the existence of a risk management committee, company size and profitability were associated with high quality financial instruments information. The study provided useful insight on the disclosure quality of financial instruments in Malaysia after the issuance of MASB 24 including disclosure of derivatives used for hedging activities. However, it could be argued that the results of this study might be out-dated because the study was conducted during the period when revised accounting standards for financial instruments were absent. Abdullah and Chen (2010) further examined the level of financial instruments disclosure under FRS 132 (*Financial Instruments: Presentation and Disclosure*). They reported that, on average, the disclosure level of financial instruments information in Malaysia was still low. Their study revealed that the existence of RMC had no relationship with the extent of financial instruments disclosure due to the lack of an independent or effective RMC. In addition, a few other studies have investigated other specific aspects of financial instruments disclosure in Malaysia. By emphasizing market risk disclosure, Othman and Ameer (2009) claimed that a large number of companies have complied with the requirement of FRS 132 (*Financial Instruments: Presentation and Disclosure*). However, they claimed that most of the Malaysian companies did not engage in hedging any type of market risk. Ismail and Abdul Rahman (2011) also presented high compliance of risk disclosure in accordance to mandatory accounting standards (i.e. FRS 132). They also reported that a significant relationship existed between corporate governance mechanisms and risk disclosure (including risk on hedging activities).

3.0 HYPOTHESES DEVELOPMENT

3.1 The existence of RMC

According to Yatim (2009), RMC was established to support the internal audit function of board committees (i.e. BODs and audit committee) as well as to increase risk management effectiveness in companies. Its main role is to ensure that management of companies is closely monitored and not too involved in high risk activities. In addition, it ensures that firms provide high quality of financial instruments information in their annual reports, including hedging activities information (Hassan et al., 2012). Based on the agency theory, this study argues that the establishment of RMC will be able to safeguard the investors'/shareholders' interests through its supervising responsibilities on the management's actions on the use of derivatives for hedging. The presence of RMC as one of the internal control mechanisms on behalf of the investors/ shareholders can be seen as important to promote higher quality information and disclosure (Abdullah and Chen 2010; Birt et al., 2013). More reliable and relevant information can be expected with regards to information on hedging activities, both discretionary and mandatory. Hence, this study hypothesizes that:

H1: *The extent of hedging activities information disclosure is positively associated with the existence of RMC.*

3.2 RMC size

To perform its function, a board committee should be supported with adequate resources and authority (DeZoort et al., 2002; Ika and Ghazali, 2012). Previous studies have suggested that committee size impacts financial reporting and disclosure of information. A large committee is recommended in order to create a good intensity level and to be capable of providing a diversity of opinions and expertise (Bedard et al., 2004). This is because a larger committee size could offer more skills, knowledge, controls and various experiences (see Rashid et al., 2012; Xie et al., 2003). However, arguably, a larger committee would be more likely to promote a free rider problem (Karamanou and Vafeas, 2005). Additionally, having a large number of committee members may result in a lack of focus, and the committee members might tend to be less active (Dalton et al., 1999). A smaller board is claimed to be more effective in monitoring managerial practices and amending corporate disclosure practices than is a larger one. However, mixed evidence exists about this matter (for example, see

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Cerbioni and Parbonetti, 2007; Htay et al., 2011; Raheja 2005; Said et al., 2013). In view of these studies, the number of members in RMC seems related to the quality of risk management as well as to disclosure of hedge activities information. Therefore, it is hypothesized that:

H2: *The extent of hedging activities information disclosure is positively associated with RMC size.*

3.3 RMC independence

Board composition is an important element in creating boards that are effective in monitoring risks and disclosing relevant information (Ng et al., 2013; Yatim, 2009). RMC is seen to be more effective and efficient if the membership comprises outside or independent members. This is because they can preserve the company's best interests without promoting the interests of a particular class of shareholders over another or neglecting the interests of some stakeholders (Jensen and Meckling, 1976; Nicholson and Kiel, 2007). Therefore, the expectation is that the involvement of independent directors in RMC can serve a control mechanism to enhance the committee's effectiveness. For this reason, if the RMC is independent and plays an accountability and transparency role for the stakeholders, more and relevant information on hedging activities could be expected. This means that the risk management committee is valued for its expertise and independence. Independent directors will not be intimidated by the CEO's power and will provide information directly to the board committee that will make decisions and implement company policy. Although the involvement of independent directors might influence the extent of hedge activities information disclosure, some evidence in many disclosure studies has demonstrated its significance (for example, see Leung and Horwitz 2004; Adznan and Puat Nelson, 2014). With regard to these facts, this study hypothesizes that:

H3: *The extent of hedging activities information disclosure is positively associated with RMC independence.*

3.4 RMC diligence

To perform an oversight function on behalf of the BOD and audit committees, RMCs should be competent in order to ensure that the management (the agent) does not pursue opportunistic behaviour. A RMC that acts on behalf of the principals can ensure diligent, relevant and faithful disclosure if more meetings are conducted. This is because the RMC

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can regularly serve as a check-and-balance on management activities and report any issues and conflicts that arise. Additionally, frequent meetings among RMC members can serve as a platform to share knowledge, information and produce a pool of expertise to provide high quality information (see Allegrini and Greco, 2013; Saleh et al., 2007). Laksmana (2008) supports this view. His study indicated that meeting frequency of the board and the compensation committee was positively associated with greater disclosure about executive compensation practices. Karamanou and Vafeas (2005) found that the frequency of audit committee meetings was positively associated with management decisions to issue an earnings forecast. O'Sullivan et al. (2008) found that audit quality, measured also by the frequency of meetings of the audit committee, was positively associated with the decision to disclose forward-looking information in the annual report. It may therefore be said that the higher the number of RMC meetings, the more diligent RMC members will be to discuss issues relating to the risk management on hedging activities and more disclosure can be expected. Hence, the next hypothesis that will be tested is:

H4: *The extent of hedging activities information disclosure is positively associated with the number of RMC meetings.*

3.5 RMC gender diversity

The board oversight function of RMC is seen to be more effective and efficient if the membership includes female directors. The argument is that involvement of female directors in RMC will increase board independence. This is because female membership can lead to improvement in the intensity of board monitoring and consequently result in the alignment of the management's and the shareholders' interests (Fama and Jensen 1983). Kang et al. (2007) study supported this view, positing that the presence of female directors helps increase board independence and provides the potential for a company to increase its level of information disclosure. Therefore, having female directors as members of a company's RMC can be expected to enhance RMC's effectiveness, and consequently has the potential to increase the level of disclosure on hedge activities information. It is also argued that RMCs with female members increase efficiency and effectiveness in the decision-making process and results in higher participation (see Adams and Ferreira, 2004; Ibrahim and Angelidis 1994). Involvement of female directors is said to increase board effectiveness because they are more committed, diligent, well prepared, able to give different views during discussions and give more attention to audit, risk and oversight controls (Huse and Solberg,

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2006; Stephenson, 2004). Several studies have shown that having female directors on the board has a positive effect on disclosure and company performance with respect to financial and non-financial information (e.g., Adams et al., 2005; Abdullah and Ku Ismail, 2013; Rao et al., 2012). As female directors possess special personal qualities such as high commitment, high participation, and good preparation, they are able to participate in complex debates and decisions about the hedging activities of the company. Hence, the present study hypothesizes that:

H5: *The extent of hedging activities information disclosure is positively associated with the proportion of female directors on RMC.*

3.6 RMC expert

Several pieces of evidence have shown that qualification is one of the important elements for board effectiveness (Akhtaruddin and Haron, 2010; Francis et al., 2012; Ismail and Abdul Rahman, 2011). It is argued that the possession of an academic background, such as accounting and finance or industry-specific knowledge by board members, would improve the quality of financial reporting disclosure. In particular, it is able to reduce the information asymmetry (Akhtaruddin and Haron, 2010). One of the reasons is that qualified members can easily understand their company issues and problems as well as enhance the effectiveness of the committee (Roberts, et al., 2005). Hence, this study expects that the inclusion of more expert directors in RMC will improve the quality of financial reporting, particularly on hedging activities information. A study by Md Yusof (2010) supported this argument, whereby his finding showed that board committees with higher proportion of financial experts could enhance the quality of financial reporting. According to Lorsch (1995), the ability to govern also depends on the knowledge and skills owned by the board members. This claim is supported by Pettigrew and McNulty (1995) who asserted that to be effective in monitoring strategic decisions, directors should be individuals with relevant knowledge and expertise. The Bursa Malaysia Listing Requirement (Paragraph 15.09) also mandates that at least one board member of the audit committee must be a member of the Malaysian Institute of Accountants (MIA). Therefore, it is expected that RMC members with finance and accounting background would give more information regarding risk identification on hedging activities. This has led the study to generate the following hypothesis:

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H6: *RMC members' qualification is positively associated with the extent of hedging activities information disclosure*

4.0 RESEARCH METHODOLOGY

This study investigates the extent of hedging activities disclosure and examines the influence of RMC and its effectiveness in two separate models of statistical test. The first model initially examines the extent of hedging activities disclosure and the existence of RMC. The second model involves analysing the relationships between the effectiveness of RMC (i.e. characteristics) and the extent of hedging activities information disclosure. Section 4.1 discusses the data sources and sample while sections 4.2 and 4.3 outline the variables measured and models used in both statistical tests respectively.

4.1 Data and Sample Selection

This study uses secondary data collected from two separate sources: DataStream and annual reports of companies listed on Bursa Malaysia. Financial data (i.e. ROA, total asset and leverage) were obtained from Datastream, and data on RMC was gathered from annual reports. In the case where the RMC was established through an Audit Committee (AC), this study selected RMC characteristics based on AC characteristics. This process was assumed to be valid as the RMCs through ACs perform similar functions (see Birt et al., 2013). The sample comprises 300 large companies listed in 2013 on the main board of Bursa Malaysia based on their total assets¹. This sample size was assumed to be sufficient because many previous financial instruments disclosure studies had shown that the number of companies drawn as sample is not based on any single rule (for example, see Abdullah and Chen, 2010; Lopes and Rodrigues, 2007; Taylor et al., 2008). However, the original sample of 300 was reduced because not all the companies from the original sample used derivatives to hedge their financial risk exposure or did not have a RMC (see Table 1). The 2013 financial year was chosen because this was the third year in which Malaysian Accounting Standard Board (MASB) fully adopted accounting standards for financial instruments and made them mandatory for all Bursa Malaysia listed companies to follow. Thus, the time can be considered sufficient for companies to adopt the standard.

¹ Companies in the financial industry such as banking, insurance, trust, closed-end funds and securities were excluded from the sample due to their nature of business and because they were governed via additional regulations (see Abdullah and Ku Ismail 2008; Beretta and Bozzolan, 2004)

Table 1

Summary of sample selection procedure

Selection Criteria	No. of companies
Total sample companies	300
Companies which use derivatives for hedging	162
Less: companies not having a RMC	(45)
Companies which use derivatives and have a RMC	117

4.2 Measurement of Variables

4.2.1 Dependent variable

The dependent variable in the study is the extent of hedging activities information disclosure (EHAD). To measure this variable, a disclosure index was prepared as the proxy for the extensiveness of hedging activities information. The amount of hedging activities information captured was based on a 32-item template comprising a mandatory and discretionary disclosure score. The index was calculated by adding up all items disclosed divided by the total maximum number of disclosures determined. The formulation can be described as follows:

$$EHAD_j = \frac{\text{total number of hedging activities information disclosed}}{\text{total possible hedging activities information disclosures (32) - (non-applicable items)}}$$

Note: Where $EHAD_j$ = the extent of hedging activities disclosure for firm j

Mandated disclosures on derivatives and hedging activities information were directly derived from MFRS 7 (*Financial Instruments: Disclosure*). Such disclosure items include all hedge accounting in MFRS 7 (paragraph 22-24) and other related hedging activities disclosure requirements. Discretionary (i.e. voluntary) hedging activities information disclosure on the use of derivatives was extracted and developed from the accounting literature. In this regard, three classes of relevant hedging activity information index were developed, comprising disclosure of *Risk Management and Accounting Policy of Hedging Activities*, *Disclosure Effect of Hedging Activities on Financial Statement* and *Disclosure of*

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Risks Related to Hedge Activities. To avoid unsystematic evaluation processes and increase the reliability of the design disclosure checklist, this study further crosschecked the mandatory disclosure items with the PWC's *IFRS Presentation and Disclosure Checklist 2012*. The assumption of this study was that this checklist could be counted upon to be a good metric for measuring the level of disclosing hedging activities information as the checklist presents a practically tested auditing tool. The present study recognizes that the MFRS 7 standard's requirements and the PWC's *Disclosure Checklist 2012* are identical. Many other researchers have used a similar procedure to study the extent of financial instruments disclosure and other financial reporting disclosures (e.g. Birt et al., 2013; Rahman et al., 2012; Taylor et al., 2008).

4.2.2 Independent variables

There are two separate independent variable measurements in this study: 1) the existence of RMC; and 2) the effectiveness of RMC. To measure the existence of RMC, this study gives a score of '1' if a company established a RMC, otherwise '0'. With respect to the effectiveness of RMC, the measurements are based on the characteristics of RMC in terms of size, independence, diligence, gender diversity and training. To measure RMC size, this study used the total number of RMC's members active in the committee until the end of the financial year. This study considers someone to be a RMC's member if the appointment as member was at least six months and above. Several previous studies have used the same rationale (e.g. Farinha and Viana, 2009; Ng et al., 2013). RMC independence refers to the number of independent non-executive members on the RMC. The number of independent non-executive members will be divided by the total number of RMC's members to generate a proportion (see Ismail and Abdul Rahman, 2011; Lopes and Rodriguez, 2007; Mangena and Pike, 2005; Ng et al., 2013). With regard to RMC diligence, this study uses the number of RMC meetings held throughout the financial year. To measure the gender diversity of the RMC, this study will operationalize a dummy variable to distinguish the existence of one or more female director/s from those that have none in the committee. A score of 1 will be awarded if the RMC has female directors as members of the RMC, and 0 otherwise. With regard to RMC expert, this study uses the proportion of RMC qualification based on the total number of RMC members with qualification divided by the total number of members sitting on the RMC (see Ismail and Abdul Rahman, 2011; Yatim, 2009).

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This study identified four control variables that have been found to be related to disclosure of financial instruments in previous work, namely, company size, profitability leverage and auditor quality. Prior researchers have shown that that size of a company positively influenced the level of financial instruments disclosure (see Birt et al., 2013; Chalmer and Godfrey 2004; Hassan et al., 2012; Lopes and Rodriquez 2007; Taylor et al., 2008). They argued that large companies are expected to disclose more information on financial instruments. Hence, the present study expects that the larger the company size, the greater will the level of hedging activities information disclosure be. Following the example of Hassan et al. (2012), this study uses the natural logarithm of total assets to control the size effect on the extent of hedging activities information disclosure.

With regard to profitability, Return on Asset (ROA) is used as a proxy to measure the profitability. This measurement has been used by several previous studies on financial instruments disclosure studies (for example, see Hassan et al., 2006; Wei and Taylor 2009). It is expected that the higher the profitability the greater the hedge activities information disclosure. The argument is that companies with high profitability tend to disclose more information in order to disseminate good news regarding their position and reputation as well as to increase management compensation. Several recent studies on financial instruments disclosure such as those of Hassan et al. (2012) and Birt et al. (2013) also suggested that leverage could also possibly influence the extent of financial instruments disclosure and the evidence suggests that leverage is positively associated with the extent of disclosure. Similar to their studies, Debt to Total Asset Ratio is used in this study as a proxy for leverage. Moreover, previous studies on financial instruments disclosure have also showed positive relationships between the size of audit firms and the quality of financial instruments disclosure (see Birt et al., 2013; Hassan et al., 2012; Lopes and Rodriquez, 2007). They argued that reputations of large audit firms are diminished if their clients provide low-quality annual reports and do not comply with the accounting standards (Chalmers and Godfrey, 2004). Therefore, this current study also expects that larger audit firms tend to influence their clients to provide more and higher quality information particularly on hedging activities.

4.3 Model Specification

To examine the association between the extent of hedging activities disclosure (EHAD), the existence of RMC and the effectiveness of RMC, this current study employs separate multiple linear regression models. The first model is to test the relationships between EHAD and the existence of RMC. The model is constructed as follows:

$$EHAD_i = \alpha + \beta_1 REXIST_i + \beta_2 CSIZE_i + \beta_3 PROF_i + \beta_4 LEV_i + \beta_5 AUDITOR_i + \varepsilon_i$$

With regard to the effectiveness of RMC, the second regression model in this study tests the relationship between RMC characteristics and the extent of hedging activities information disclosure. The model is constructed as follows:

$$EHAD_i = \alpha + \beta_1 RSIZE_i + \beta_2 RINDE_i + \beta_3 RDILI_i + \beta_4 RDIVER_i + \beta_5 REXPERT_i + \beta_6 CSIZE_i + \beta_7 PROF_i + \beta_8 LEV_i + \beta_9 AUDITOR_i + \varepsilon_i$$

Table 2
Computation of Variables

Variable	Composition of variables
EHAD	: Total Score of information on hedging activities disclosure = company's actual disclosure score/company's total possible disclosure score
REXIST	: Dichotomous variable, 1 for company with RMC, 0 otherwise
RSIZE	: Number of RMC members at financial year-end
RINDE	: Proportion of independent non-executive members on the RMC
RDILI	: Number of RMC meetings during the financial year
RDIVER	: Dichotomous variable, 1 indicates the existence of female members in RMC, 0 otherwise.
REXPERT	: Proportion of RMC members with accounting or finance qualification.
CSIZE	: Log of total assets
PROF	: Return on assets (ROA)
LEV	: Debt to total assets ratio
AUDITOR	: Dichotomous variable, 1 if audited by Big 4, 0 otherwise
ε	: Error term

5.0 RESULTS AND DISCUSSION

5.1 Descriptive Results

Descriptive results for the extent of hedging activities disclosure are shown in Table 3 below. As can be seen from the table, variation in the disclosure of hedging activities information existed among non-financial Bursa Malaysia listed companies. The mean scale for the extent of hedging activities information disclosure index was 0.7729 with a minimum value of 0.44 and maximum value of 0.98. The results show that the extent of hedging activities information disclosure was quite high, and most companies seemed to comply with the requirement in MFRS accounting standards for derivatives and hedging activities disclosure. Although the score is quite high, it should be observed that only 48 out of 162 of the sampled companies chose to apply hedge accounting which reflects the overall disclosure scored on hedging activities information. This is because many of the sampled companies were affected by 'Not-Applicable' disclosure requirements. In this respect, we perceive that the richness of the information on hedging activities can still be considered insufficient. However, these findings compared favourably with the results of several previous studies on Malaysian financial instruments disclosure (e.g., Abdullah and Chen 2010; Hassan et al., 2012; Ismail and Abdul Rahman, 2011). On average, these studies reported that the percentage of the disclosure score ranged from 64 per cent to 78 per cent.

Table 3 below also indicates the largest level of disclosures were mandatory disclosure on 'policy notes' and 'risk related to hedging activities', where companies disclosed, on average, 97 per cent and 74 per cent respectively. The mandatory disclosure means score of 'Disclosure Effect of Hedging Activities on Financial Statement' was only 31 per cent. On the other hand, Table 3 also shows that the discretionary (i.e. Voluntary) amount of hedging activities information disclosure was still low for each disclosure category. However, 60 per cent of the companies voluntarily disclosed the impact of hedging activities on the statement of cash flow. In a broader view, this study demonstrates room for improvement in the disclosure of hedging activities information. This is because such voluntary disclosures tended to be inconsistent across the companies, and this inconsistency can make it challenging for users of financial statements to compare derivatives usage for hedging, risk exposure, and risk management practices across companies.

Table 3

Descriptive Statistics: Hedging activities information disclosure (Panels A and B)

Panel A: Adoption of Hedge Accounting (N=162)							
						No of Firms	%
Those that apply hedge accounting						48	30
Those that do not apply hedge accounting						114	70
Panel B: Disclosure of Hedging activities information (N=162)							
	<i>Risk Management and Accounting Policy of Hedging Activities</i>		<i>Disclosure Effect of Hedging Activities on Financial Statement</i>		<i>Disclosure of Risks Related to Hedging Activities</i>		Total disclosure score (EHAD)
	Mandatory	Voluntary	Mandatory	Voluntary	Mandatory	Voluntary	
Mean	.9658	.3750	.3079	.6015	.7415	.3162	.7729
Std. Deviation	.09230	.23938	.45590	.41350	.31815	.24246	.15226
Minimum	.50	.00	.00	.00	.00	.00	.44
Maximum	1.00	.83	1.00	1.00	1.00	.80	.98

Table 4 below shows the descriptive statistics for the independent variables in this study. As seen in Table 4, *Panel A* shows that 72 percent out of 162 companies that used derivatives had established a RMC. Compared to a study conducted by Hassan et al. (2012), it can be noted that many Malaysian companies were concerned about having a RMC as part of their internal control mechanisms although its establishment is still voluntary in Malaysia, especially for non-financial companies. *Panel B* exhibits the descriptive results of the attributes of RMC effectiveness. The RSIZE had a mean of 3.83 members (approximately 4) and had a standard deviation of 1.132. The largest RMC had 9 members and the lowest was 2. The mean 0.7082 for RINDE indicated that, on average, the number of independent directors in RMC was slightly higher than non-independent directors. In other words, RMCs in Malaysia have a balanced composition in general, although such balance is voluntary in nature. Based on the sample, the highest RMC comprised all independent directors, while the lowest was 0. On average, RMCs conducted meetings four times yearly; however, one company did not conduct any RMC meeting at all. The highest number of meetings among the sampled companies was 12 times. It also can be observed the presence of female directors in RMC is about 0.32 per cent (i.e. RDIVER), meanwhile the mean for REXPERT is 0.61 percent, representing the proportion of RMC members with accounting or finance qualification.

Table 4
Descriptive Statistics: Independent variables

Panel A: Descriptive statistics on the existence of RMC (N=162)				
Categorical variables		Frequency	No. of Companies	Percentage (%)
REXIST	Yes		117	72
	No		45	28
AUDITOR	Yes		121	75
	No		41	25
Continuous Variables	Mean	Std. Deviation	Min.	Max.
CSIZE	14.5456	1.41529	12.43	18.41
PROF	2.4904	1.07581	.50	7.76
LEV	4.7880	1.75123	.10	7.87
Panel B: Descriptive statistics on the effectiveness of RMC (N=117)				
Categorical variables		Frequency	No. of Companies	Percentage (%)
AUDITOR	Yes		91	78
	No		26	22
RDIVER	Yes		37	32
	No		80	68
Continuous Variables	Mean	Std. Deviation	Min.	Max.
RSIZE	3.83	1.132	2	9
RINDE	0.7082	.34945	0.00	1.00
RDILI	4.01	1.887	0	12
REXPRT	0.6109	.23028	.00	1.00
CSIZE	14.8927	1.43135	12.43	18.41
PROF	2.3559	1.16062	0.49	7.76
LEV	4.8722	1.70329	0.10	7.65

5.2 Regression Results

Table 5 below exhibits the results of regression analysis between the disclosure of hedging activities information and the existence of RMC. The results show that the existence of RMC is positive, but does not significantly influence the extent of hedging activities information disclosure. Consistent with Abdullah and Chen (2010), the existence of RMC can be presumed as not actively pressing the company to disclose related information on hedging activities and this may be due to a lack of committee effectiveness. According to Birt et al. (2013), most of the companies established RMC through Audit committee (i.e. sub-committee). Therefore, the mixed role played by RMC members may weaken the committee's function because they performed similar function. Since RMC is commonly established by the board in the company and voluntary in Malaysia (see Hassan et al.,

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2012;Yatim, 2009), we believe that the interaction between RMC and the board as well as the Audit Committee may affect the effectiveness of RMC, and eventually influence the disclosure level. This is because the ultimate power of management decision is still under their dominance.

Table 5

Summary of the multiple regression results- The existence of RMC

Model 1	Predicted Sign	Coeff.	SE	t	Sig.	VIF
(Constant)		-0.397	0.169	-2.351	0.020	
REXIST	+	0.050	0.037	1.361	0.175	1.172
<u>Control Variables</u>						
CSIZE		0.059	0.012	4.832	0.000***	1.265
PROF		0.006	0.015	0.411	0.681	1.058
LEV		0.016	0.009	1.749	0.082*	1.083
AUDITOR		0.016	0.036	0.447	0.655	1.079
R²	0.228	P value	0.000			
Adjusted R²	0.203	N	162			
F statistic	9.217					

Note: ***Significant at 0.01 level, **significant at 0.05 level, *significant at 0.1 level.

Table 6 below presents the outcomes of the regression analysis between the disclosure of hedging activities information and the effectiveness of RMC (i.e. characteristics). Table 6 shows that RINDE (t value = -1.887) had a significant and negative relationship with the extent of hedging activities disclosure, at $p < 0.1$. This finding indicates that independent directors in RMC do not influence the extent of hedging activities information disclosure. It seems that independent directors did not contribute their experience, skills and knowledge towards increasing the information on hedging activities. As hinted by the literature, an independent director does not always play an active role in supervising the management as directors often rely on the management for information due to their busy schedules and commitment to other activities (Ismail and Abdul Rahman, 2011). Another possible explanation is that the independent directors may have a relationship with the management connected with their appointments as a director and long period of experience in the company. As a result, their decision-making may be influenced by the management because their appointment as director was due to their relationship with the company.

Table 6
Summary of the multiple regression results- RMC characteristics

Model 2	Predicted Sign	Coeff.	SE	t	Sig.	VIF
(Constant)		-0.437	0.200	-2.181	0.031	
RSIZE	+	0.016	0.016	0.997	0.321	1.087
RINDE	+	-0.108	0.057	-1.877	0.063*	1.289
RDILI	+	0.030	0.010	2.976	0.004***	1.121
RDIVER	+	-0.047	0.040	-1.178	0.241	1.092
REXPRT	+	-0.021	0.087	-0.242	0.810	1.267
Control Variables						
CSIZE		0.054	0.014	3.960	0.000***	1.238
PROF		0.017	0.019	0.915	0.362	1.111
LEV		0.022	0.011	2.032	0.045**	1.111
AUDITOR		0.037	0.044	0.835	0.405	1.083
R²	0.273	P value	0.000			
Adjusted R²	0.212	N	117			
F statistic	4.470					

Note: ***Significant at 0.01 level, **significant at 0.05 level, *significant at 0.1 level.

Even though the results of this study support the hypothesis that the presence of more independent directors in RMC does not influence the level of hedging activities disclosure, this result should be viewed with caution given the small number of non-financial listed companies having a standalone RMC in the sample. Moreover, results from Table 6 also show that RDILI had a significant and positive relationship with the extent of hedging activities information disclosure, at $P < 0.01$. This indicates that infrequent RMC meetings are likely to be related to a low level of hedging activities disclosure. However, RSIZE, RDIVER, and REXPRT were found to be insignificant in this study.

Consistent with prior research (e.g. Hassan et al., 2012; Ismail and Abdul Rahman, 2011; Lopes and Rodrigues, 2007; Taylor et al., 2008; Wei and Taylor, 2009), company size (CSIZE) was found to be related to the extent of hedging activities information disclosure. Based on agency theory, this finding may be due to the fact that large firms incur lower information-processing costs as well as higher political costs than do small firms, thereby encouraging large firms to disclose more information. For example, Ng et al. (2012) claimed that large companies are more likely to operate internationally and therefore be subjected to market risks associated with foreign currency and interest rate fluctuations, resulting in the

need to deal with such disclosure. The results of this study provide limited support for the notion that company performance (PROF) has an impact ($p < 0.1$ in the positive direction). One factor that could help explain this is that the impact of global systemic economic crisis. The recovery planning after the crisis may have affected the performance of the sampled companies during the period of this study. The prediction that disclosure of hedging activities information was positively related to financial risk (i.e. leverage) was supported for both models. The result is consistent with some previous studies (e.g. Birt et al., 2013; Hassan et al., 2012; Taylor et al., 2008; Wei and Taylor, 2009), which found that the level of fair value, financial instruments and risk management disclosures, under a mandatory regime pursuant to IAS32, were related to leverage levels. The extent of disclosure increases with increasing financial risk, wherein companies with higher leverage increase disclosure to reduce potential agency costs associated with external funding and their asset replacements. With regard to audit quality (AUDITOR), the present study found that the use of Big 4 audit firms did not significantly influence the extent of hedging activities disclosure on both models.

The Variance Inflation Factor (VIF) statistics indicate that multi collinearity did not exist in both models because tolerance values were close to 1 and VIF values were less than 10. The hypothesised RMC existence, its characteristics and control variables (i.e., company performance (PROF), financial risk (LEV) and auditor quality (Big 4), explain for about 20 percent of the variation in the level of hedging activities information disclosure in both models, which are relatively low. Although the adjusted R^2 in both models is low, these findings are consistent with previous studies, which pointed out that a low R^2 is common in corporate governance research (for example, see Adznan and Puat Nelson 2014; Birt et al., 2013; Ng et al., 2013; Ismail and Abdul Rahman, 2011).

6.0 CONCLUSION

This paper examines the extent of hedging activities information disclosure on the use of derivatives of Bursa Malaysia Main Market listed companies. In general, the descriptive results show that the extent of hedging activities information disclosure was quite high, which indicates that companies tend to comply with the MFRS accounting standards for financial instruments. Although the majority of the companies comply with the MFRS

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accounting standards, this study only found approximately 30 per cent of the companies' sampled chose to apply hedge accounting. One potential reason for this is perhaps that the application of hedge accounting is optional in nature according to the MFRS accounting standards for financial instruments, which leads Malaysian companies to accept choices. Due to this, this study perceives that the transparency and richness of the information regarding the utilization of derivatives on hedging activities is still insufficient. As a consequence, users of the financial statements (especially investors) may be misled and cannot fully analyse, understand or assess the character and impact of the companies using derivatives for hedging their financial risk exposure (see Ameer et al., 2011; Papa and Peter 2013). However, there are some space and ways for an improvement of voluntary hedging activities information disclosure among Malaysian companies as to enhance the quality information.

This study also examines the relationships between the existence of RMCs and the extent of hedging activities disclosure. The analysis indicates that the presence of RMC appears to be linked positively to the extent of hedging activities information disclosure as a corporate governance internal control mechanism. However, it is not significant. This study also analysed the effectiveness of RMC (i.e. Characteristics) in terms of its size, independence, diligence, diversity and expertise. Based on the results of the analysis, the composition of independent directors in RMC negatively affects the level of hedging activities disclosure while the number of meetings conducted positively affects the level of hedging activities information disclosure. Consistent with some previous studies (e.g. Abdullah and Chen 2010, Birt et al., 2013), the results reveal that the mere presence of RMC is not enough to explain more disclosure towards financial instruments information particularly on hedging activities. Its effectiveness is something that needs to be considered and emphasized especially in incorporating RMC as part of the corporate governance mechanism. Although, the findings of this study may provide some meaningful insights to regulators and policymakers, especially towards the presence of RMC and its characteristics, the evidence provided by this study may be considered to be small, at least from an international perspective. Therefore, future studies may be extended to cover more companies or other companies in emerging economies to fill the knowledge gap and create a more thorough analysis.

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