CORPORATE GOVERNANCE FAILURE AND ITS IMPACT ON FINANCIAL REPORTING
WITHIN SELECTED COMPANIES

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Abstract
This paper was produced with regards to corporate governance and financial reporting issues. It specifically discussed on the failure of corporate governance that led to failure in financial reporting. Few cases had been explored in this paper to prove the influence of corporate governance in financial reporting such as Perwaja Steel, Technology Resources Industries (TRI), Transmile, Megan, Malaysian Airlines System (MAS), Port Klang Free Zone (PKFZ), Enron and WorldCom (WC). This paper also highlighted the challenges and recommendations that need to be improved. Enforcement and monitoring became the main hurdles in establishing the good corporate governance. Transparency in financial reporting coupled with minority shareholder involvement was foreseen to give a helping hand pertaining to this topic. The accountability of auditors was recommended to ease the corporate governance and financial reporting matter.

Keywords: corporate governance, financial reporting, Perwaja Steel, Technology Resources Industries (TRI), Transmile, Megan, Malaysian Airlines System (MAS), Port Klang Free Zone (PKFZ), and WorldCom (WC)

1.0 Overview of Corporate Governance and Financial Reporting
Corporate governance has drawn world attention when the big companies such as Enron in United Kingdom and WorldCom in United States collapse in 2001 and 2002 respectively. With regards to this matter, researchers began to explore the corporate governance field from many perspectives and authorities started to implement rules and regulations to overcome this issue. Countries all around the world setting the best practice as a guideline; Cadbury Report was produced in United Kingdom, Sarbanes Oxley in United States, The Dey Report in Canada, the Vienot Report in France, the Olivencia Report in Spain, the King’s Report in South Africa, Principles and Guidelines on Corporate Governance in New Zealand and the Cromme Code in Germany. The goal of most of this regulation was to improve firm’s corporate governance environments (Bhagat & Bolton, 2009).

Review has been done from time to time to iron up the massive governance issue and to come out with good corporate governance. Good corporate governance is a corporate set up leads to maximize the value of the shareholders legally, ethically and on a sustainable basis, while ensuring equity and transparency to every stakeholder: the company’s customers, employees, investors, vendor-partners, the government of the land and the community (Murthy, 2006). Today, corporate governance became a determinant to many subjects in identifying company’s strengths and functions. One of the most important functions that corporate governance can play is in ensuring the quality of the financial reporting process (Cohen, Krishnamoorthy & Wright, 2004). The question is how confident we are that corporate governance can ensure the quality of the financial reporting? Thus, let’s explore the journey of corporate governance and financial reporting that specifically discussed in this paper.
This paper is organized as follows. The first section will briefly explain the development of corporate governance in Malaysia. The second section will reveal the relationship between corporate governance and financial reporting, and determine how corporate governance failure leads to financial reporting failure. The failure of corporate governance at company level inside and outside Malaysia, and at national level will be explored in the following section. This paper will be continued with recommendation to improve the corporate governance and financial reporting. Finally conclusions will be made at the end.

2.0 Development of Corporate Governance in Malaysia

Likewise other countries, Malaysia can’t hide from facing the corporate governance problem. After the East Asian crisis in 1997, Malaysia saw the need to improve corporate governance in firms to regain investor’s confidence (Lai, 2004). This Asian Financial Crisis introduced the term of corporate governance and drew attention of the public about the weaknesses of Malaysian corporate governance practice (Nor Azizah Zainal Abidin & Halimah @ Nasibah Ahmad, 2007). In addition the irregularities in Renong Berhad, the Bumiputera Malaysia Finance (BMF) scandal, the Perwaja fiasco, the downfall of Sime Bank, the corporate misconduct of Technology Resources Industries (TRI) Berhad and the massive trouble of Malaysian Airline Systems (MAS) forced government to enhance corporate governance regulations.

In 2001, Malaysia’s capital market experienced two events regarding corporate governance reform (Abdul Wahab, How & Verhoeven, 2008). The first was the introduction of Malaysian Code on Corporate Governance (MCCG) as part of the Bursa Malaysia Securities (formerly known as Kuala Lumpur Stock Exchange) Listing Rules, and the second was the establishment of the Minority Shareholder Watchdog Group (MSWG), a watchdog group primarily set up to enhance shareholder activism by institutional investors (Abdul Wahab, How & Verhoeven, 2008). Since 1998, government and private sector had chosen to enhance the corporate law in order to improve the level of corporate governance in the country (Nor Azizah Zainal Abidin & Halimah @ Nasibah Ahmad, 2007). The regulatory framework on corporate governance has undergone tremendous change to further strengthen the financial and capital market.

3.0 Definition of Corporate Governance

Many agree that corporate governance is the main factor in producing the financial reporting. The corporate governance became the starting point for preparation of financial reporting. But, what is corporate governance? According to Report on the Observance of Standard and Codes (The World Bank, 2005:2) “Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders. The European Central Bank has almost the same perspective in describing the corporate governance whereby it mentioned that corporate governance is the “Procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making” (European Central Bank, 2004).

Back in Malaysia, The Malaysian High Level Finance Committee on Corporate Governance (Securities Commission, 2007:52) define it as “the process and structure used to direct and manage the business and affairs of the company towards enhancing the business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholders value, whilst taking into account the interests of other stakeholders”. From all the definition given, the similarities are that the corporate governance involved the process of directing the organization. Good corporate governance is aimed at enhancing business prosperity and at the same time accountability. The argument is how to determine effective corporate governance and distinguish them with governance failure? In actual fact there is no specific model or rules that organization should practically adhere to have effective corporate governance. However the US Blue Ribbon Committee did list out three non-negotiable components of quality corporate governance which are the Board of Directors including the audit committee, financial management includes the internal auditors and the external auditor. The core element of each of them should be independence and become the “three-legged stool” that supports responsible financial reporting.

4.0 Financial Reporting

The next key word in this paper is financial reporting.
Working paper prepared by Beest, Broom and Boelens (2009) stated that the primary objective of financial reporting is to provide high-quality financial reporting information concerning economic entities, primarily financial in nature, useful for economic decision making (FASB, 1999). In fact no one can ignore the importance of financial reporting. Providing high quality financial reporting information is important because it will positively influence capital providers and other stakeholders in making investment, credit, and similar resource allocation decisions enhancing overall market efficiency. Financial reporting should be prepared with integrity. It should be easily understood by the whole nation and clearly define the numbers arose. The backbone of preparation this financial reporting is corporate governance.

5.0 Relationship between Corporate Governance and Financial Reporting

Now let’s see how this corporate governance link to financial reporting. Financial reporting connected the people that involved in corporate governance such as the management including the board of directors, auditors, information distributors, analyst and shareholders. It is the bridge that communicates the company with the external parties and will be the measurement to determine the performance or outcome of the company. According Sloan (2001) the financial information is the first source of independent and true, communication about the performance of company managers. This relevance makes the financial reporting as the main attraction to management influence. The integrity of financial reporting is highly dependent on the performance and conduct of those involved in the financial reporting ecosystems, particularly directors, management and auditors (Mohd Hassan Che Haat, Rashidah Abdul Rahman & Mahenthiran, S. 2008; Nik Mohd Hasyudeen Yusoff, 2010). In other words, the integrity of financial reporting relies on corporate governance. The Board of Directors has a primary responsibility of overseeing the firm’s financial reporting process (Yatim, Kent & Clarkson, 2006). Those board of directors together with management will try to produce a financial statement that shows the company achieved a recommendable profit. The independence person that reviews the corporate reporting is the auditors. They need to follow the auditing standard with competence, diligence and integrity. They suppose to give their opinion for the reported information.

In communicating the corporate reporting to the user, there are information distributors who are basically the group that provides an important communication channel for financial information. They will include comments on the financial information as an added material for shareholders to make decision. Third party analyst such as the credit-rating agencies, financial analysts, investment banks, internal lawyers and external lawyers evaluate the financial statements to provide additional information. The shareholders and other stakeholders will look into the reporting to determine the return on their investment and make decision. Basically when the corporate governance fails it will lead the company to reporting failure whereby most of them manipulated their financial statement. The governance failure that occurred at organization or national level invited the pressure to report about their performance. In order to show that the company’s performance is in line with expectation, they produce a false accounting, aggressive earnings management and other reporting failure whereby no transparency, accountability and integrity exist. As corporate governance reflects the process how the organization or the nation managed, no doubt that the failure in governance itself will result in reporting failure as well. Further, academic research has found an association between weaknesses in governance and poor financial reporting quality, earnings manipulation, financial statement fraud, and weaker internal controls (Beasley, 1996; Beasley, Carcello & Hermanson, 1999; Beasley & Frigo (2007); Carcello & Neal 2000; Dechow, Sloan & Sweeney, 1996; Klein 2002; McMullen & Raghunandan, 1996).

6.0 Corporate Governance Failure That Leads to Financial Reporting Failure

The corporate governance environment varies from country to country and the characteristics of corporate governance vary from firm to firm (Huang & Chen, 2009). Many cases can be referred as an example in discussing the corporate governance failure. In this paper, the highlight will be on corporate governance failure that leads to the financial reporting failure.

7.0 Corporate Governance Failure That Leads to Financial Reporting Failure at Company Level Inside Malaysia

Corporate scandals that happen today is not unique. It is continuous from previous episode that posed threats to the nation. Below are the corporate governance failures at company level in Malaysia:
7.1 Perwaja Steel Sdn. Bhd.

One of the well known corporate governance failures in Malaysia is the scandal of Perwaja Steel Sdn. Bhd. Perwaja was established in 1982 by HICOM Bhd., a company owned by the government in collaboration with a Japanese company, Nippon Steel Corporation to fulfill the government's mission in implementing the heavy industrial policy (Nur Azizah Zainal Abidin & Halimah @ Najibah Ahmad, 2007). The corporate governance of Perwaja was collapse due to misconduct in the directorship. The director has paid RM74.6 million to Japan’s NKK Corporation without getting approval from board of directors or tender committees. Later it was revealed that the payment was made via Hong Kong based firm. No qualification of accounts was made by the external auditors during the period 1992 to 1995 with respect to Perwaja’s accumulated losses. Investigation revealed that there was an alarming lack of an internal control system within Perwaja (Jeyasingam, 2004). There are inaccurate records and hundreds of millions ringgit in apparently unauthorized and one-sided contracts between Perwaja and both local and foreign companies. This demonstrated a failure of corporate governance, in which internal control mechanisms were short-circuited by conflicts of interest that enriched certain directors and has an impact on the reporting failure.

7.2 Technology Resources Industries Berhad (TRI)

Another example of corporate governance failure in Malaysia is the corporate misconduct at Technology Resources Industries Berhad (TRI). The problem began in 1993 when TRI acquired Celcom from Telekom Malaysia Berhad. TRI had placed foreign debt to raise the fund needed in acquiring Celcom. TRI faced millions of foreign exchange loss and high cost of borrowing when the Asian Financial Crisis happened in 1997. TRI made an internal restructuring and debt refinancing to settle the borrowing. The governance failure occurred when the major shareholder of Celcom and executive chairman was the same person which is Tan Sri Tajuddin Ramli. He was also the major shareholder of TRI but was removed in July 2002 when Telekom purchased a large block of TRI shares from Danaharta. In August 2002, Celcom has made legal proceeding with regards to the payment of RM55.8 million paid to three previous directors of Celcom which they claim as unauthorized payments. According to Lee, A Md Ali and Gloeck (2009), TRI was discovered to have issued fictitious invoices totaling nearly RM260 million in 1998 and 1999 (Krishnan, 2011). Those fictitious invoices misleading the financial statement whereby it reflect that the company has derived high revenue.

7.3 Transmile

Transmile was another organization that faced the governance failure. The company was alleged to have overstated its revenue by a total of RM522 million in financial years 2004, 2005 and 2006. In addition, RM341 million in its property, plant and equipment account appear to have been fabricated as the amount was little supported by documents (Abdullah Zaimee, 2007). In another occasion, Lim Guan Eng in his press release mentioned that “accounting scandals in Transmile group where revenue and profits are falsified through creative accounting indicates 3 structural failures in regulatory oversight and full disclosure of our capital markets, unreliability of financial statements and poor corporate governance in Malaysia”.

7.4 Megan Media

Few other companies that fail in their governance and resulted to reporting failure are Scan Associates Bhd. under the directorship of Datuk Aminuddin Baki Esa, Megan Media and many others. For Megan Media the governance failure began when it two subsidiaries namely Memory Tech and MJC Pte Ltd. defaulted on a RM47 million payment to bondholders. This failure drove to reporting failure whereby a preliminary report found that “substantial irregularities” and financial position of the company’s financial position had been misstated and RM211 million deposits for 13 production lines was fictitious. Consequently it resulted to the receivables amounting RM334.3 million. On top of that the payments made to creditors were actually made to other parties in a move to channel cash out of Memory Tech. In April 2007, the loss of Megan Media reported amounting to RM1.3 billion compared to a profit of RM60 million in the previous year.

8.0 Corporate Governance and Financial Reporting Failure at National Level Inside Malaysia

Numerous corporate governance failures also occurred at national level in Malaysia. It is just another dimension of corporate misconduct that messes up the nation credibility.

8.1 Malaysia Airline Systems (MAS)

For Malaysia Airline Systems (MAS), the governance failure occurred when Tan Sri Tajuddin Ramli via Naluri Berhad who is the single largest shareholder in MAS and held both chairman and Chief Executive Officer position entered into unprofitable business activities whereby he had over expansion the flight destination.
The capital expenditure increased due to placing many orders on planes. The company was in accumulated loss from 1998 to 2001. In the financial reporting, it was simply a mismatch between earnings and expenditure whereby earnings was mostly in ringgit while expenditure (jet fuel, aircraft maintenance and others) was in US dollar. When MAS made new aircraft orders in 1995 the costing was based on RM2.50 but it ended up paying RM3.80. MAS was then re-purchased by the government for RM8 per share which was more than double of the market price. In fact the net tangible assets were only RM1.74 per share. This situation shows that corporate governance failure not only occurred at organization level but at national level as well. The question was why an audit was not conducted before the government’s buyback which would have a very important bearing on the proper price of the government buyout.

8.2 Port Klang Free Zone (PKFZ)

Another example of governance failure at national level is the Port Klang Free Zone (PKFZ) project. The main players in this project are the ministers or former ministers that supposed to carry out their duties with adequate care but instead they failed to do so. The governance failure started when Port Klang Authority (PKA) bought the land from Kuala Dimensi Sdn. Bhd. (KDSB) for the price of RM1.09 billion whereby KDSB bought it for only RM95 million in late ‘90. KDSB is 70% owned by Datuk Tiong King Sing. Major decisions on the project were made without prior approval from PKA board and without seeking advice from the government authorities. Series of mismanagement and inadequate governance transparency occurred when the cost to develop this project turned up very high. The contract to develop the project was given to KDSB without open tenders and additional development works contracts might not been tabled either in the Parliament or Cabinet but received formal approval directly from Prime Minister. This governance failure was then driven to reporting failure whereby the RM3 million PriceWaterhouseCooper audit reports was falls under audit opinion “limited in scope” as many issues had been cover up.

9.0 Corporate Governance Failure Leads to Financial Reporting Outside Malaysia

Country outside Malaysia also not spared from the crisis of corporate governance failure. Below is the case of Enron and WorldCom.

9.1 Enron

When talk about corporate governance, many researchers quote Enron as the influence in establishing corporate governance rules. Here’s the story of Enron. Enron is natural gas pipe line company formed by Kenneth Lay, which then turn into online trading model called EnronOnline. In an attempt to achieve further growth, Enron pursued a diversification strategy. By 2001, Enron had become a conglomerate that both owned and operated gas pipelines, pulp and paper plants, broadband assets, electricity plants, and water plants internationally. After Jeffrey Skilling was hired, he developed a staff of executives that, through the use of accounting loopholes, special purpose entities, and poor financial reporting were able to hide billions in debt from failed deals and projects. The failure of corporate governance in Enron was using Special Purpose Entities (SPE); which is limited partnerships or companies created to fulfill a temporary or specific purpose, to fund or manage risks associated with specific assets. Enron had over 3,000 SPEs, many times more than any other company (Cunningham & Harris, 2006). Three major sets of transactions in which Enron created SPEs is to hold assets, borrow money, and hedge fluctuations in the value of its investment activities. What they did wrong was that they apparently tried to manufacture earnings by manipulating the capital structure of the SPEs; did not have independent outside partners that prevented full disclosure in their financial statements.

The SPEs always had complex structures with interlocking ownership and with Enron sometimes holding an equity interest. The CFO of Enron and/or other employees held equity interests. Senior executives or other employees of Enron managed and operated the activities of the SPE while being paid salaries by Enron. Subsequently, they were able to control both sides of transactions and enrich themselves. This invites the conflicts of interest. The rules came in that ownership percentage of the off balance sheet entity should be higher than 3% and the outside investors should not be controlled or affiliated with the parent. The financial reporting failure occurred when Enron's understated its liabilities, overstated its equity and its earnings. By the end of 1999, according to company estimates, it had moved $27 billion of its total $60 billion in assets off balance sheet. Over the four years from 1997 through 2000, Enron overstated reported net income in total by $1.58 billion and overstated reported stockholder’s equity in total by $2.59 billion. Although Enron declared bankruptcy prior to year-end 2001, reports indicated that its quarterly reports for 2001 overstated net income and shareholder’s equity by $545 million and $828 million respectively.
The collapse of Enron has implications for the functioning of business and capital markets far beyond financial reporting standards and accountants’ responsibilities. In particular, it raises questions regarding the oversight responsibilities of Enron’s board of directors, the financial advisers that assisted the company in structuring its SPEs, the banks and other lenders that provided ‘off balance sheet’ financing, and the brokers, analysts, and other investment advisers that ignored the warning signs of trouble apparent in Enron’s financial reports. All of these parties actively assisted Enron’s management in its efforts to distort fair presentation of the company’s financial condition. The failure of Enron, initially attributed to accounting and reporting inadequacies, continues to raise broader issues of corporate governance and regulation.

9.2 WorldCom (WC)

WorldCom (WC) is another company that synonym with corporate governance failure. It is a global leader in telecommunications industry that provide package for communication services (voice, data and internet) to business and consumers. It achieved its position through the successful of 65 acquisitions. Two of these acquisitions were MFS Communications (MFS) that enabled WC to obtain UUNet, a major supplier of Internet services combining long distance, local services and data communications to business, and MCI Communications (MCI) that gave WC one of the largest providers of business and consumer telephone service. Those acquisitions lead WC into trouble whereby the management can’t face the challenge of integrating new and old organizations into single function business. Customers and accounts were not handled efficiently as there is conflict in merging all the acquisition companies. Dozens of conflicting computer systems remained, local systems were repetitive and failed to work together and billing systems were not coordinated. The corporate governance failure occurred when the Chief Executive Officer, Bernie Ebbers who was the person in charge with all the acquisition granted by the board with $341 million loan to settle his personal business activities that is not related to WC. The absence of internal control was obvious when there is lack of transparency between senior management and Board of Directors. It appears that the Board did not even raise questions, much less do anything to attempt to persuade Mr Ebbers to divest himself of his other business or otherwise limit his non-WC business activities (Moberg, 2006). In addition the Board failed to devise a work plan with internal and outside auditors.

The company faced US$28 billion in loans and yet Bernie Ebbers who ran the company was given a loan of US$366 million (Banyard, 2002). Looking into financial reporting perspective, the acquisition of MCI gave WorldCom accounting opportunity. While reducing the book value of some MCI assets by several billion dollars, the company increased the value of "goodwill". The net result was WC's able to cut annual expenses, acknowledge all MCI revenue and boost profits from the acquisition. Another factor that misled financial reporting in WC is the pressure to keep stock price high. In year 2000, a proposed merger with Sprint was disapproved by the government and the telecommunications boom came to an end, WC earnings began to slip. Management use aggressive accounting techniques to shore up its eroding financial picture. When these were exhausted, management resorted to simple false entries to generate what could masquerade as genuine earnings and enable them to meet Wall Street’s earnings targets. Thus the Company consistently reported that it met those targets which actually should have reported loss. From another point of view, WC lack of internal control drive the Company to mislead its financial reporting. WC decided to lease large amounts of network capacity and these lease call is fixed rental payment without regards to message volume. In other word, WC needs to pay the same amount of rent even though its customers are not sending much traffic through the networks. Rental payment combined with lower message volume should produce an increase in line cost, but it didn’t appear in WC financial reporting. Instead WC improperly “transferred” $3.8 billion of these costs from income statement back to the balance sheet where they were shown as an asset. This practice clearly proved the financial reporting failure.

10.0 Challenges and Recommendations

A veritable industry has developed around the need and desire for improved corporate governance: accounting firms offer corporate governance compliance services, business schools integrate corporate governance into their courses and lawyers, the investment and financial industries and the popular media take up the cause (Stein, 2008). But still the challenges for incorporated good corporate governance exist. Several actions need to be taken to overcome this issue.

10.1 Enforcement and Monitoring

Mentioned elsewhere in this paper, all the countries around the world have their regulation in guiding the corporate governance issue.
These sets of rules and regulations, whether international, national or company, are all remarkably similar (Bobirca & Miclaus, 2007). As a common denominator, they aim at shaping comprehensive standards of good governance (Bobirca & Miclaus, 2007; Shil, 2008). However, having all the good rules on paper only is not enough; it must be supported practically by efficient enforcement and monitoring. Looking into Malaysia scenario, this country always overlooked on those two items. Even if Bursa Malaysia made it mandatory to disclose the corporate governance in financial reporting, still the issues of corporate governance failure will occur if the enforcement bias to certain parties and lack of monitoring. The challenging hurdle is to enforce the rules and regulation to everybody without looking into their political influence, national position or personal credibility such as the class of elite. Research done by Azham (2006) on “Phantasmagoric Accounting In Malaysia – A Case Study Of The Triumph of Hope Over Experience?” mentioned that the financial reporting system is purposely made to be weak so that for this elite to maintain secrecy for their own gain. Zalanga (2004) in his article title “Indigenous Capitalists: The Development of the Indigenous Investment Companies in Relation to Class, Ethnicity, and the State in Malaysia and Fiji” explore the elite effect.

He stated that the transformative ruling elite coalition has national development as its main agenda; consequently, it creates effective state bureaucratic organizations that will ensure the realization of such a goal. On the other hand, destructive ruling elite coalition is primarily concerned with using the state to accumulate wealth, power and prestige for personal uses. Those elite persons have a strong relation with the powerful person in the country. Netto (2007) wrote that “…you may have all the best measures to prevent corruption and unethical practice, but the crucial question is: will the authorities act against a top-ranking Cabinet member, well-connected firm or prominent tycoon suspected of fraud or corruption?” Just look into judgement over the various governance failures in Malaysia and from there we know that not much action taken. Therefore, to overcome this challenge, the enforcement and monitoring should be practised to all Malaysian in order to smooth the agenda in improving corporate governance in this country.

10.2 Transparency in Financial Reporting

Transparency is a very important component of financial reporting (Mc Gee & Yuan, 2008). Accounting researchers have concerned themselves with mechanisms of transparency (particularly financial reporting) which seek to align the interests of management and shareholders, and with mechanisms of accountability such as audit committees, internal audit and risk management as assurances of the quality of financial reporting (Brennan & Solomon, 2008). In addition, delivery of information regarding company activities and their results to shareholders is the most important factor that ensures effectiveness of decisions taken by shareholders (Dogan, Coskun & Celik, 2007). The quantity of information, voluntary items disclosed in the annual reports and the time the information to be released, are influenced by the board of directors. Thus, when the board of directors are independent and observe their responsibility to be accountable to the shareholders or stakeholders, they will be transparent in disclosing all the relevant information in their financial reporting. The challenging part is to have the sincere governance. For this we need to develop a human capital with good values.

10.3 Minority Shareholder Involvement

Another area that can be improved for corporate governance in Malaysia is on the minority interest rights in capital market. Although Minority Shareholder Watchdog Group (MSWG) has been established, the minority interest welfare still left behind. Minority shareholders are handicapped to a certain extent as most of them are not aware of their rights under the Companies Act 1965 in protecting their interest (Hua & Mat Zin, 2007). In addition, the main shareholders in public listed corporations in Malaysia are either related due to family owned-corporation that has been listed or state agencies that have invested in Government Link Companies. The shareholdings of individuals in these corporations are miniscule compared to those held by state investment bodies. Since it is normal for institutional shareholders to appoint their own candidates of directors, it is not too far-fetched to assume that the candidates are selected by virtue of political influence over the state investment agencies. With that minority shareholder will not take action if the board abuses its power as it is not only perceived as challenging the directors but also the politician who appoint them (Satkunasingam & Shanmugam, 2006). Compare to Australia, minority shareholder took action against GIO when the corporation forecast a big profit and advised them against selling their stock to AMP as the latter’s was too low (Satkunasingam & Shanmugam, 2006). Thus, in Malaysia the minority shareholders, in actual fact does not have the power to voice out if there is any misleading or aggressive financial reporting done by the majority shareholders. It is recommended to have minority shareholder statement in the financial reporting in order to conform the good corporate governance have been practice in that particular company.
10.4 Accountability of Auditor

Audit is an important element of efficient equity markets, because audits can enhance the credibility of financial information, directly support better corporate governance practices through transparent financial reporting (Francis, LaFond & Schipper, 2003; Sloan, 2001) and therefore ultimately influences the allocation of resources (SEC, 2000). This is because an effective and objective of audit is an essential part of corporate governance (Low, 2002). Auditors are given power to detect the company’s wrongdoing and accountable on the financial reporting prepared by governance of the Company. Far too often, though, the partners of audit firms develop a cozy relationship with their clients. Auditors rely for their income on audit and consultancy fees paid by their clients. In these circumstances, the auditors will be in difficult position if one of their major clients decide to “massage” the figures and indulge in “creative accounting” (Netto, 2007). Thus, the most common question asked whenever there has been a financial scandal is, whether the auditors carried out their duties and obligations properly (Reilly, 2006) and the reliability of financial reporting (Holm & Laursen, 2007). Therefore, to improve corporate governance, it is necessary to include the accountability of auditor as they play an important role in determining the reliability of the financial reporting.

11.0 Conclusion

Corporate governance became important when most of big companies collapse. The failure in corporate governance forced rules and regulation to be enacted. Countries around the world find the best solution to battle the corporate governance issues. Malaysia too, does the necessary reforms to prevent the disease in corporate governance. Phase by phase implementation has been done to build up the good reputation for corporate governance in this country. The relationship between corporate governance and financial reporting can’t be denied. The failure in corporate governance could lead to the failure in financial reporting. This has been proven with many cases happen in Malaysia and outside Malaysia. It happened not only at company level but also at national level. Few cases have been discussed in this paper including MAS, TRI, Perwaja Steel, Megan Media, Transmile, Enron and World Com. Most of governance failure manipulate their financial reporting to show that they achieve a commendable performance. Although the world tried the best to act against corporate governance failure, there are several hurdles need to be passed. The enforcement and monitoring should be practiced ethically to enhance the existing rules and regulation. In addition the transparency in financial reporting would support the good governance practice. Beside that the involvement of minority shareholder in preparation of financial reporting would be an added value to improve the corporate governance. Finally the accountability of auditors’ plays an important instrument in carrying the corporate governance agenda towards a better financial reporting.

References


