Malaysian Institute Of Accountants

Articles Of Merit Award On PAIB 2008

ISBN 978-983-40841-4-1

MALAYSIAN INSTITUTE OF ACCOUNTANTS

Publication Information

PUBLISHED BY
Malaysian Institute of Accountants
Dewan Akauntan,
No.2, Jalan Tun Sambanthan 3,
Brickfields, 50470 Kuala Lumpur

DATE OF PUBLICATION
10th July 2009

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FOREWORD by MIA PRESIDENT

Nik Mohd Hasyudeen Yusoff

We are pleased to extend to you this e-book, which features a compilation of the winning articles of the inaugural Malaysian Institute of Accountants (MIA)'s Articles of Merit Award on Professional Accountants in Business 2008.

A majority of our membership is made up of accountants in business. Towards this end, we believe that it is very important for us to continue to engage members and propel them towards enhancing their professional knowledge and skills. This is done by providing a channel for exchange of information on important issues that shape the profession and facilitating the adoption and development of best practices with the purpose of promoting the value of professional accountants in business.

As much as member development is a key concern to us, we are also equally committed towards recognizing the contributions of members of our profession.

It is with these objectives in mind that the Articles of Merit initiative was conceptualized. Apart from offering insights into latest developments in the profession, it is also meant to recognize the authors of outstanding articles that are judged to make a distinct and valuable contribution to the development of the roles and domain of the professional accountants in business.

In October 2008, the competition was opened to professionals, academicians and students from the accountancy and business fraternity. Following an adjudication process, eight winning articles were chosen and they are featured in this e-book. The articles are current, of high quality, and are applicable to today's vibrant business environment and we certainly hope will offer much value to those who are reading them.

Congratulations to the winners of the competition! It is hoped more articles of this nature will be put forth in times to come and challenge the intellect of the practitioners of the profession. That said, I wish you the good reader a pleasant and interesting time reading these articles.

Thank you.

Nik Mohd Hasyudeen Yusoff
MIA President

FOREWORD by PAIB COMMITTEE CHAIRMAN

Yeo Tek Ling

On behalf of the PAIB Committee of the Malaysian Institute of Accountants (MIA), it gives me great privilege to extend to you this e-book featuring a compilation of the winning articles of the inaugural MIA's Articles of Merit Award on Professional Accountants in Business 2008.

The International Federation of Accountants (IFAC), the global organization for the accountancy profession, has defined a professional accountant in business as:

"A professional accountant employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service, the public sector, education, the non-profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities."

The PAIB Committee functions by assisting MIA members in enhancing their professional skills and knowledge by providing a channel for exchange of information on important issues that shapes the profession. The Committee also strives to facilitate the adoption and development of best practices with the purpose of promoting the value of professional accountants in business.

One of the PAIB Committee's primary goal is studying and reviewing suitable publications issued by the Professional Accountants in Business Committee of IFAC and/or other relevant sources and to promote the publications to members and the public at large. The production of this e-book further testifies MIA's commitment in realizing this goal.

The competition was opened to professionals, academicians and students from the accountancy and business fraternity in October 2008. Out of the many articles sent and reviewed by our panel of judges, the winning articles were chosen. The articles were chosen based on the stringent criteria in line with the conditions of the contest. As a result from this endeavour, the winning articles were identified as being current, of high quality, and are applicable to today's vibrant business environment.

Apart from offering insights into latest developments in the profession, the production of this on line publication is a move to give due recognition to the authors of these remarkable articles. All in all, the articles present significant contribution to the forward evolution of the roles and domain of the professional accountants in business.

Kudos to the authors of the winning articles. It is my sincere wish that the readers will be thoroughly engaged by these literary offerings that are very much in line with the progressive and dynamic nature of the profession. Judging from the contents of the articles myself, it wouldn't be an overstatement to say that you will be inspired and challenged by the views and ideas included in these writings.

Last but not the least I wish to record my sincere appreciation to the President, Council members, Judges, PAIB Committee members and Management staff for their valuable advice and contribution in making this project a success.

Thank you.

Yeo Tek Ling

Professional Accountants in Business (PAIB) Committee Chairman

ACKNOWLEDGEMENT

We hope you find these articles interesting and insightful. We wish to record our appreciation to the parties that have made this Award and the publication of the e-book possible namely the Panel of Judges comprising En. Mustapa Kamal Mohd Razali (Chairperson), Assoc. Prof. Dr. A Thillaisundaram, En Ahmad Fuaad Kenali, En. Gazali Jaafar, Prof. Dr. Ibrahim Kamal Abdul Rahman, Dr. Steven Liew.

We also wish to thank the PAIB Committee members for their guidance and the MIA PAIB Department Management team for their hard work in this Award.

To the authors who participated and contributed their time and effort in submitting their articles, we thank you.

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Abstract

Motivation of Study and Research Objectives

A review of literature from some developed and developing countries provides insight that tax audits pose enormous challenges to taxpayers, tax authorities and tax practitioners. However, published scholarly studies on Malaysian tax practitioners and tax audit are scant. At the time of the study, little is known about Malaysian tax practitioners' experience and compliance complexities faced in tax audits since the issuance of the 'Tax Audit Framework' in January 2007. Therefore, instigated by the growing concern on tax audits and the lack of empirical studies, this study aims (i) to find out the Malaysian tax practitioners' experience when representing clients in tax audits after the issuance of the 'Tax Audit Framework'; and (ii) to examine the compliance complexities faced by tax practitioners in tax audits.

Research Methodology

The target subjects were professional accountants in tax practice. In view of the fact that research on tax matters is usually considered personal and confidential; to preserve anonymity of respondents, a questionnaire was used to collect data. Questionnaires were administered to participants who attended the "Budget 2008 Tax Seminars" in the months of September and October 2007 organized by the Malaysian Institute of Accountants in Peninsular Malaysia. Only responses from tax practitioners were collected. In total, 208 usable questionnaires were collected for data analysis.

Main Findings and Conclusion

Out of the 208 respondents, 66.5% of them indicated that when conducting tax audits, some tax auditors had the intention or aimed to find fault to impose penalties for incorrect returns or understatement of income. A majority of the respondents (55.9%) felt that the tax audit process was not transparent and took too long to finalize. About 53% of them indicated that some tax auditors were not happy with the explanation provided by clients. Nearly 49% indicated that tax auditors checked beyond the scope of tax audits as stated in the letter of notification for tax audit. Just 21% of respondents indicated that their clients accepted tax audits as a normal course of activity under the self-assessment system. At a 99% confidence level, a majority of the respondents strongly disagreed that

the Inland Revenue Board of Malaysia (IRBM) should consider taking legal action against the company auditors who failed to detect material underreporting of profits or penalize tax practitioners for tax evasion detected in tax audits. Overall, this study is current and timely, and the findings provide important insights to the IRBM on the need to improve the tax audit process, approach in tax audits and quality of tax auditors in order to encourage and intensify voluntary tax compliance.

Introduction

The IRBM had implemented the self-assessment system (SAS) on companies effective from year of assessment (YA) 2001; subsequently, the IRBM extended the SAS on other taxpayers in YA 2004. The SAS relies on the full cooperation of taxpayers to disclose their taxable income honestly, correctly and promptly. In SAS, the onus to assess tax liability is now rested on taxpayers, as the tax return form submitted is deemed to be the notice of assessment. To ensure voluntary tax compliance, the IRBM is intensifying tax audits (desk audit and field audit) to examine taxpayers' returns to make sure that the tax liability is correctly reported in accordance with the Income Tax Act (ITA) and Public Rulings.

Under the traditional assessment system, tax audit will only be initiated upon suspicion of tax evasion or when the tax officers had reason to believe that the tax return was incorrect. However, under SAS, the IRBM neither needs any reason to initiate a tax field audit nor is required to provide any reason to the taxpayers. In SAS, tax field audit has become a primary and routine activity. Notably, tax audits are arduous and costly to both taxpayers and tax collectors (Kent, 2005; Rhoades, 1997). In practice, studies found that the tax audit process is weighted heavily against the taxpayer under review (Alm and Mckee, 2006; Rhoades, 1997; Turner, Smith and Gurd, 1998). Hence, in fear of tax penalties, many taxpayers seek professional accountants' (i.e. tax practitioners or tax preparers) assistance for tax filing and to represent them for tax audits. Extant study of Mckerchar (2005) found that since the implementation of SAS, tax practitioners in Australia are having bigger roles to play in tax compliance, tax audits and tax enforcement processes.

A review of literature from some developed and developing countries provides insight that tax audits pose enormous challenges to taxpayers, tax authorities and tax practitioners. However, at the time of the study, published scholarly studies on Malaysian tax practitioners and tax audit are scant. Except for the study by Choong and Lai (2008), which had attempted to study Malaysian taxpayers' views on tax audits; little is known about Malaysian tax practitioners' experience and compliance complexities in tax audits since the issuance of the 'Tax Audit Framework' in January 2007. Therefore, a lack of the existence of empirical studies had motivated the researchers to conduct this study.

Research Objectives

This study aims (i) to find out about Malaysian tax practitioners' experience when representing clients in tax audits after the issuance of the 'Tax Audit Framework'; and (ii) to examine compliance complexities faced by tax practitioners in tax audits.

Literature Review

In some developed and developing countries like Australia, Bangladesh, Canada, Korea, Hong Kong, New Zealand, United Kingdom (UK), the United States (US), Spain and Taiwan; several studies have been conducted to examine tax audits. Some of the findings are presented below.

In the US, Pentland and Carlile (1996) found that the tax audit process is an example of an "expression game", whereby the taxpayers attempt to be honest and tax compliant, whilst the tax auditors attempt to maintain a front as fair, competent professionals in carrying out tax audits. Pentland and Carlie (1996) also noted that the initial interview sets the tone for the rest of the audit process and tax auditors form impression about what to expect from the taxpayers. At the interview stage, the interaction between taxpayers and tax auditors will determine how the tax audit will proceed further. Rhoades (1997) argued that tax auditing is costly to taxpayers and is an imperfect audit that produces false detection and excessively increases the burden of honest taxpayers. When using a laboratory experiment to examine the response of individuals to audit rates and productivity, Alm and McKee (2006) found that an announcement about the probability and productivity in advance of a tax audit increases the compliance while those who were not informed reduces compliance.

In Australia, Marshall et al. (1997) found a number of factors that influenced the ethical judgment and shaped the behaviour of tax practitioners. Among the few factors included are the probability of audit detection (audit risk), client pressure on tax practitioner to act unethically and the revenue contribution of a client to tax practice. Golding and Hansford (2002) argued that the outcomes of tax audits always caused an inappropriate amount of extra work to tax practitioners and caused worry to clients in the UK. Hasseldine and Hansford (2003) discovered strong differing attitudes between tax auditors and tax practitioners on three key stages of the tax auditing process, i.e., the initial interview, data gathering and "selling" the adjustments in the final interview with taxpayers.

In Russia, the Moscow Times (2004) reported that taxpayers had problems with the audit time frame, and taxpayers complained that the tax auditors requested too many documents that were often not used, and sometimes requested for old documents that were difficult to trace. Larina (2005) noted that dealing with tax audit is a particular problem for businesses in Russia, as injustice exists in both the selection criteria and the procedure for tax audits; often, in some cases, tax audits may last as long as the tax authorities wish.

In Hong Kong, based on a review on tax evasion cases over a six-year period from 1992 to 1997, Ho and Lau (1999) discovered that tax representatives had handled a large number of tax evasion cases detected by field audit teams. However, they found that the Inland Revenue Department (IRD) had not taken any enforcement steps or imposed penalties on tax representatives. Ho and Lau (1999) suggested that "in order to ensure that tax preparers have properly advised taxpayers in a professional manner and hence filed tax returns of good quality, the IRD should penalize both the tax preparer and the taxpayer for tax evasion detected by field audit teams" (p.68). In a similar vein, Arenas del Buey Torres (2004) stated that in Spain, 56.4% percent of accounting and tax professionals surveyed had the opinion that the financial auditor is the one that should be responsible for a fiscal fraud if he/she is hiding information about it deliberately.

Tax Audit in Malaysia: Practical Challenges

In Malaysia, tax audits cases are on the increase. In 2005, the IRBM reported that they finalized 2,303 audit cases involving companies with additional tax of Ringgit Malaysia (RM) 442 million being raised as the settlement amount after tax audits. This represented an increase of 40.2% in the amount of additional tax compared to 2004 in which only 1,635 audit cases were solved with a settlement amount of RM315 million. In 2005, taxes and penalties imposed through tax audits totalled RM635.40 million, compared to RM429.31 million in 2004; representing an increase of 69.48% (The IRBM, 2005). The Ernst and Young (EY) Annual Tax Survey (2006) revealed that 45% of the Chief Executive Officers (CEOs) surveyed had the opinion that the tax auditors were aggressive when conducting tax audits.

On 14 December 2006, the IRBM held a tax dialogue with tax representatives from professional accounting bodies to discuss issues related to tax audits. The tax representatives were members of the Malaysian Institute of Accountants, Malaysian Institute of Taxation, Malaysian Institute of Certified Public Accountants, The Malaysian Institute of Chartered Secretaries and Administrators and Malaysian Association of Tax Accountants (The IRBM, 2007a). In the tax dialogue, tax representatives raised their concerns on the approach to tax audits. They found that the tax audit processes lack transparency and consistency, as some tax auditors did not carry out tax audits in a professional manner, whereby they performed tax audits with a preconceived mindset that the taxpayers are guilty and the field visit is to confirm the offences.

Another issue raised by tax representatives in the tax dialogue was about tax auditors. Tax representatives found that tax auditors lack accounting and business knowledge. Some tax auditors adopt different treatments on the same subject matter. In some cases, tax auditors refused to accept commercial justification even though supporting documents were provided; and some tax auditors were unable to provide convincing rationale for tax audit adjustments (The IRBM, 2007a).

As stipulated in the tax audit guide, the time frame for a tax audit should be 3 months from the date of commencement of the tax audit, but in practice, that was not the case. In the tax dialogue, tax representatives complained that tax audit processes took a longer time than expected; notably, some audit cases took more than 1 year to finalize. Whilst some audit cases were hurriedly closed to meet the 3 months deadline (The IRBM, 2007a). As a result, notice of additional assessment was raised on dubious grounds, and taxpayers have to lodge an appeal against the additional assessment. Concern was also raised about the letter of notification, as tax representatives pointed out that some of their clients were only given a short notice prior to the tax field audit. Hence, taxpayers faced difficulties in preparing the documents required for a tax audit. In some cases, after the field audit, tax auditors called the taxpayers by phone and asked them to deliver or post the accounting documents to the tax office. There were cases where tax auditors refused to issue a 'letter of clearance' after the field audit, thus causing psychological costs and worry to the taxpayers. There were cases when tax auditors advised taxpayers not to ask a tax agent to represent them for the tax audit (The IRBM, 2007a).

Later, in response to a call for a more transparent and efficient tax audit, in January 2007, the IRBM issued the 'Tax Audit Framework' to guide taxpayers, tax audit officers and tax agent/representatives. Among others, the 'Tax Audit Framework' clearly states, "the main objective of tax audit is to encourage voluntary compliance with the tax laws and regulations and to ensure that a higher tax compliance rate is achieved under the SAS" (The IRBM, 2007b, p.3). It also spelled out that for the purpose of achieving voluntary compliance, "the tax audit activity is one of the measures undertaken by IRBM to educate and create awareness among taxpayers towards their rights and responsibilities under the provisions of the Income Tax Act" (The IRBM, 2007b, p.4). Although the 'Tax Audit Framework' serves to guide tax auditors, taxpayers and tax practitioners; it does not discuss practical and administrative issues which may arise when applying these guidelines in practice. The application and usefulness of the 'Tax Audit Framework' still remains unknown. In essence, literature review provides insights that it is important to find out the tax practitioners' experience in tax audits after the issuance of the 'Tax Audit Framework'. The research methodology is presented next.

Research Methodology

The target subjects were professional accountants in tax practice (or tax practitioners). Research on tax matters is usually considered personal and confidential; Gardner and Stewart (1993) suggested that in relation to tax research techniques, if the field study involves attitudinal and/or preferential studies, a questionnaire survey based on carefully selected statistical samples is essential. Hence, a questionnaire was used to collect data. Questionnaires were administered to participants who attended the "Budget 2008 Tax Seminars" in the months of September and October 2007 organized by the Malaysian Institute of Accountants in Kuala Lumpur, Johor Bahru, Penang and Ipoh. Only responses from those working in tax practice were collected. In total, 208 usable questionnaires were collected.

Data Analysis And Findings

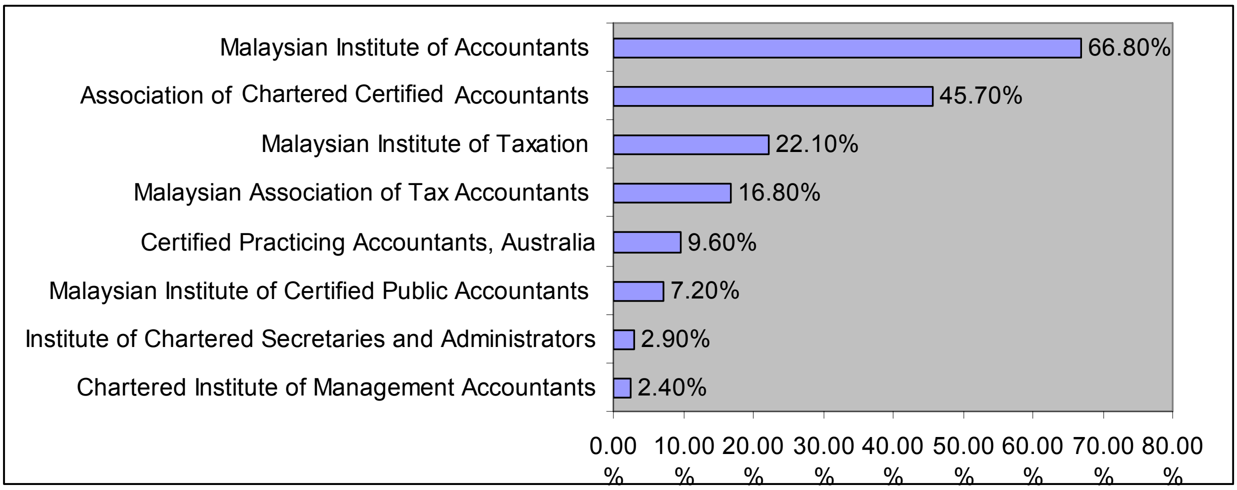
The respondents' profile is presented in Table 1. Notably, the respondents were holding various job positions in tax practice, ranging from tax proprietor/director/partner (46%), tax manager (26%), tax supervisor (15%) and tax assistant (13%). About 38% of the survey respondents had 1 to 5 years experience in preparation of tax returns for companies and tax related matters; 30% (6 to 10 years) and 32% (10 years or more). Of the 208 survey respondents, a majority of them (62.5%) were from Kuala Lumpur, 14% from Ipoh, 12% from Penang and 11.5% from Johor Bahru. In terms of ethnicity, the Chinese were the most notable respondents, making up about 91%, which reflects the reality that in Malaysia, the Chinese dominate the tax profession. A majority of the survey respondents were females (57.7%) and aged between 25 and 34 years old (45.7%). More than 69% of the respondents possessed professional qualifications and 24% had bachelor degrees. Most of them (70.2%) worked in a small-size audit firm or firm with a single office. Only 2.9% of the respondents worked for the 'Big 4' firms, while the remaining (26.9%) worked in medium-sized firms.

Table 1: The Respondents' Profile

		Frequency	Percentage (%)
Job Positions:	Tax proprietor/director/partners	96	46.2
	Tax manager	54	25.9
	Tax supervisor	31	14.9
	Tax assistant	27	13.0
Tax working experience:	1-5 years	80	38.5
	6-10 years	62	29.8
	> 10 years	66	31.7
Location of tax firm:	Kuala Lumpur	130	62.5
	Ipoh	29	14.0
	Penang	25	12.0
	Johore Bahru	24	11.5
Ethnic Group:	Chinese	190	91.3
	Malay	13	6.3
	Indian	5	2.4
Gender:	Male	88	42.3
	Female	120	57.7
Age:	25–34 years	95	45.7
	35-44 years	75	36.0
	45-54 years	22	10.6
	55 and above	16	7.7
Highest Qualification:	Bachelor Degree	50	24.0
	Masters	2	1.0
	Professional	144	69.2
	Others	12	5.8
Size of tax firm:	Big 4	6	2.9
	Firm with single office	145	70.2
	Firm with multiple offices in state	10	4.8
	Firm with offices in more than one state	46	22.1
Total		208	100

Figure 1 shows that most of the respondents were members of the local and foreign professional accounting bodies, such as the Malaysian Institute of Accountants (66.8%), the Association of Chartered Certified Accountants (45.7%), Malaysian Institute of Taxation (22.1%), Malaysian Association of Tax Accountants (16.8%), Certified Practicing Accountants, Australia (9.6%), Malaysian Institute of Certified Public Accountants (7.2%), The Malaysian Institute of Chartered Secretaries and Administrators (2.9%) and Chartered Institute of Management Accountants (2.4%). Overall, the respondents' profiles indicate that they had vast experience in tax practice and hence could provide useful information on tax audits.

Figure 1: Professional Membership*



* Some of the respondents hold membership of more than one professional body; as such the total did not add up to 100%

Tax Practitioners and Tax Audit

At the outset, the tax practitioners surveyed were asked if they have read the ‘Tax Audit Framework’ issued by the IRBM in January 2007. The findings show that only 63% of the respondents had read the ‘Tax Audit Framework’, the remaining 37% of the tax practitioners had not (see Table 2, row 2). Alm and McKee (2006) asserted that awareness of the tax audit guidelines and processes helps to improve tax compliance, hence, the fact that 37% of the tax practitioners had not read the “Tax Audit Framework’ is not a positive sign. It could be due to a lack of awareness on the part of tax practitioners or sufficient publicity had not been carried out by the IRBM. When asked if they were concerned if their clients may be selected for a tax audit, 89% of the tax practitioners indicated that they were concerned with the prospect of tax audits, whilst about 11% were not (see Table 2, row 3). The plausible explanation for this finding is that the tax authority selects taxpayers for a tax audit at random, Hence, some tax practitioners perceived that the probability of their clients being selected for audits is relatively small. In turn, when asked if they had any clients selected for tax field audits, more than 86% of respondents indicated that their clients had been audited (see Table 2, row 4).

To further probe the tax audit issue, respondents were asked if they were present during tax field audits. The survey found that only 16% of the respondents indicated that they were present all the time during the tax field audit, and 70% of tax practitioners indicated that they were present during the tax field audit only upon request by their clients, and 14% of the respondents indicated that they never attended any tax field audit (see Table 2, row 5). It is worth noting here that Nichols and Price (2004) found that in the US, the final tax assessment was significantly less for taxpayers who were represented by tax practitioners. This suggests that the presence of tax practitioners during the tax field audit is essential as they might influence the amount of the final tax assessment. However, in tax practice, to represent clients for tax field audit, tax practitioners will charge extra fees, hence not all clients would seek a tax agent's assistance in view of the additional fees.

Table 2: Tax Practitioners and Tax Audit

		Frequency	Percentage %
1	Have you read the 'Tax Audit Framework' issued by the IRBM in January 2007? Yes No	 130 78	 62.5 37.5
2	Are you concerned about your clients being selected for tax field audit? Yes No	 185 23	 88.9 11.1
3	Do you have any clients being selected for tax field audit? Yes No	 179 29	 86.1 13.9
4	Were you present during the tax field audit process? All the time Upon client's request Never	 34 145 29	 16.2 69.8 14.0

Next, when asked about how they prepare clients for tax audits; Figure 2 shows that 99.4% of respondents made sure that their clients maintained proper records and documentation. About 55.3% of the respondents indicated that they would educate their clients on the "dos" and "don'ts" during tax audits. About 40.9% of respondents taught their clients how to answer questions that might be raised by tax auditors, and 29.8% of them indicated that they would handle tax queries on behalf of their clients. The remainder (1.9%) would advise their clients to be co-operative and courteous to the tax auditors.

Figure 2: How Do You Prepare Your Clients For Tax Field Audit?

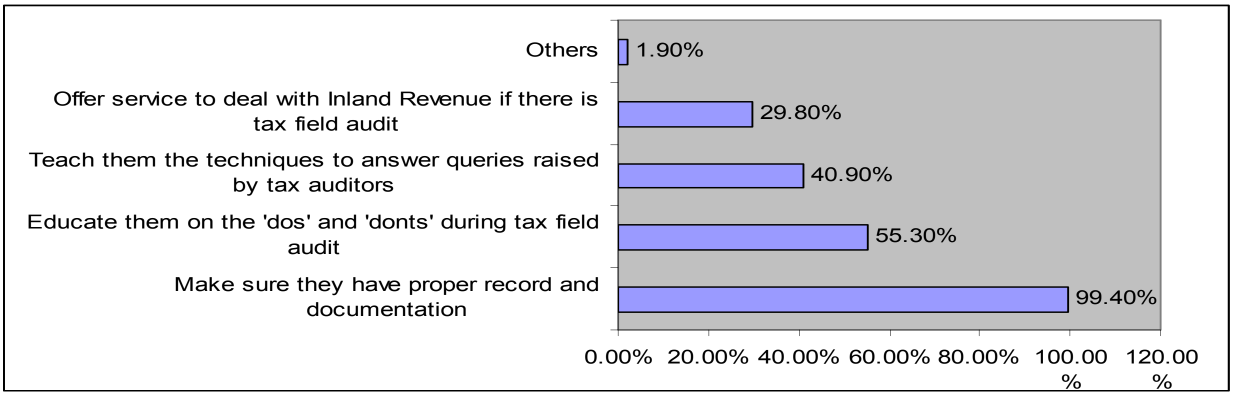


Figure 3: Tax Practitioners' Opinions About Tax Auditors

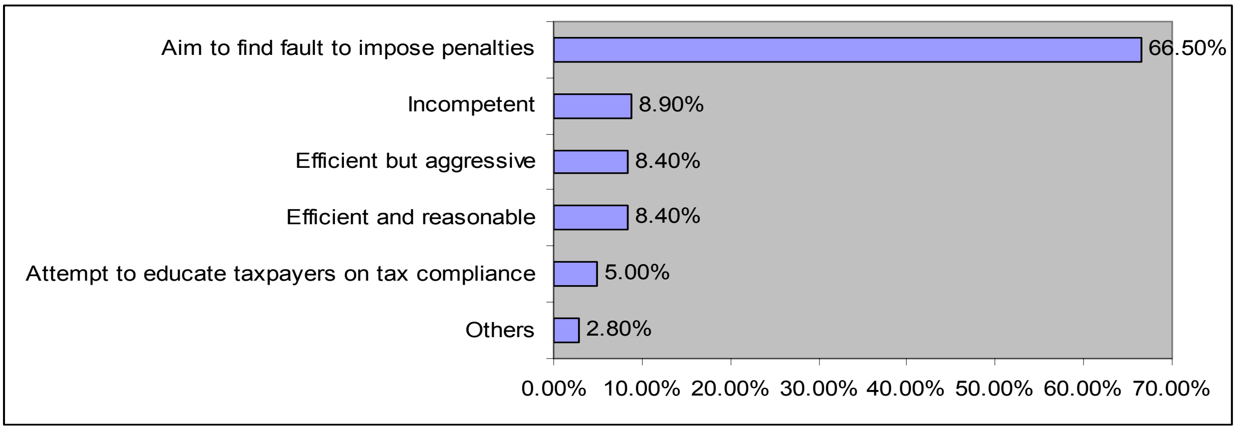
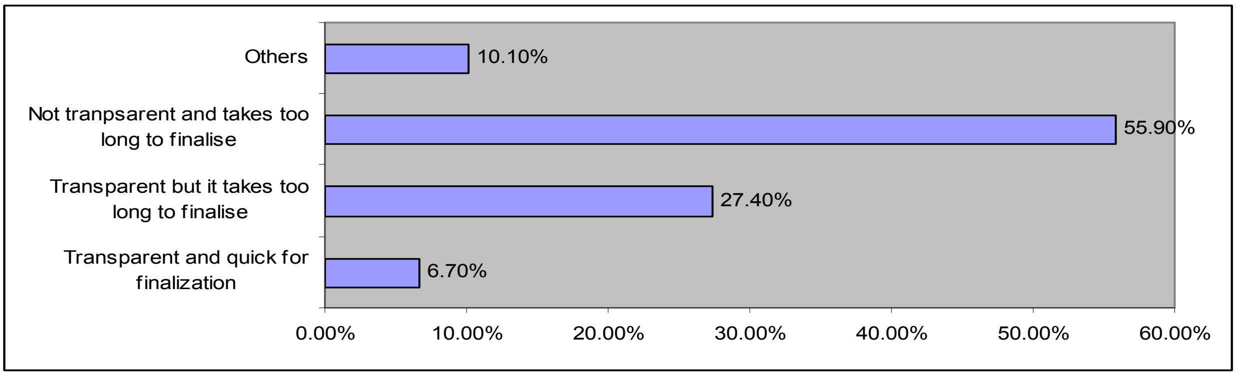


Figure 3 above shows that 66.5% of the tax practitioners surveyed had the opinion that the tax auditors had the intention or aim to find fault to impose penalties for incorrect returns or understatement of income during the tax audit. This finding is consistent with the complaints lodged by tax representatives in the tax dialogue with the IRBM on 14 December 2006. About 8.9% of respondents thought that tax auditors were incompetent, a small proportion thought that tax auditors were efficient and reasonable (8.4%) and 8.4% perceived tax auditors as efficient but aggressive. In comparison, in the EY Annual Tax Survey (2006), it was found that 45% of the Malaysian CEOs labeled tax auditors as aggressive. However, it is encouraging to find that about 5% of tax practitioners surveyed indicated that some tax auditors did make attempts to educate taxpayers on tax compliance during tax audits. One of the objectives of tax audit as stated in the 'Tax Audit Framework' is to educate taxpayers.

Opinion on the tax audit process

With regard to tax practitioners' opinions on tax audit process; Figure 4 shows that just 6.7% of the tax practitioners thought that the tax audit process was transparent and quickly finalized. About 27.4% of them thought that the tax audit was transparent but took a long time to finalize. Most of the respondents (55.9%) felt that the tax audit process was not transparent and took too long to finalize. About 10.1% indicated that there were incidences that tax auditors were unable to provide reasonable justification on the tax adjustment made after the tax audit. Overall, these findings lend support to the complaints raised by tax representatives in the meeting with the IRBM on 14 December 2006.

Figure 4: Tax Practitioners' Opinions About Tax Audit Process

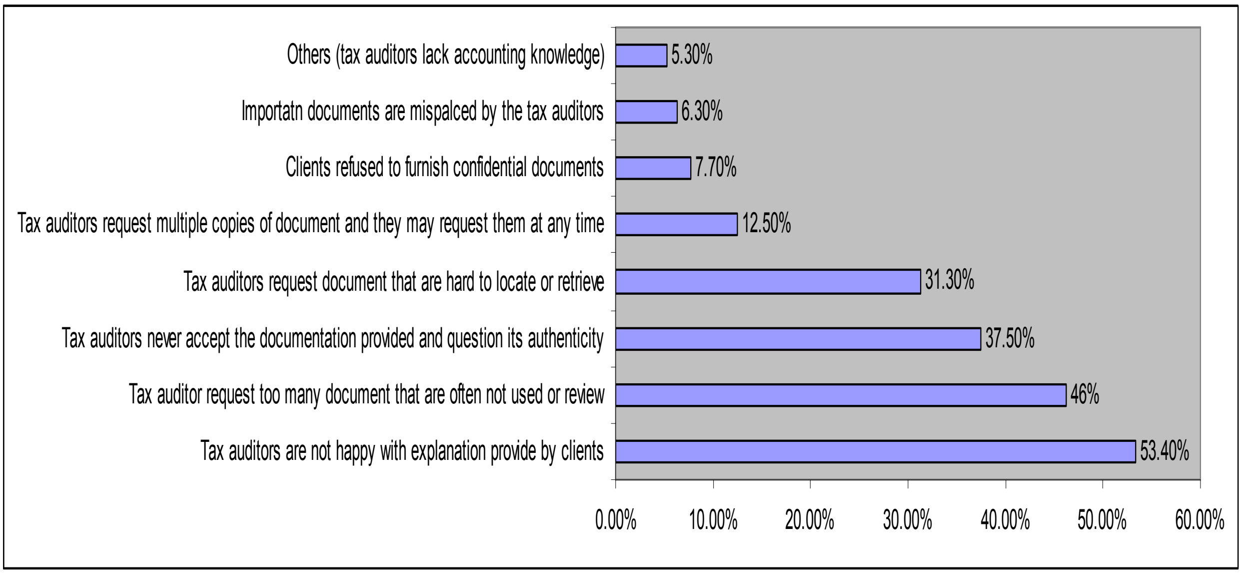


Problems with Tax Field Audit

In turn, the respondents were asked to indicate the main problems faced by tax practitioners when representing clients for tax audits. Figure 5 shows that a majority of the tax practitioners (53.4%) indicated that one of the main problems with tax audit was that tax auditors were not happy with the explanation provided by clients. About 46% indicated that their clients had to furnish tax auditors with various documents that were not used or not reviewed. Some 37.5% of the respondents indicated that tax auditors did not accept the documents provided and questioned its authenticity, and 31.3% indicated that their clients had difficulties to locate certain documents requested during tax audits as some documents requested were from old transactions. Meanwhile, 12.5% of respondents claimed that furnishing tax auditors with bundles of documents in multiple copies caused much hassle and was very time consuming. About

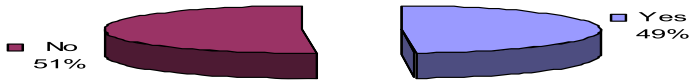
7.7% of the respondents indicated that there were moments when clients refused to cooperate in providing confidential documents to the tax auditors. A few of them (6.3%) had experiences whereby tax auditors lost or misplaced important documents. About 5% of the respondents indicated that one of the difficulties in tax audits was due to tax auditors lacking sound accounting knowledge.

Figure 5: Main Problems Faced By Tax Practitioners When Representing Clients For Tax Audits



When asked if "tax auditors checked beyond the scope of tax audits as stated in the letter of notification for audit", about 49% of the respondents indicated 'Yes" (see Figure 6) This finding seems to contradict the 'Tax Audit Framework' which states that the scope of the audit, such as the years of assessment involved and the documents required should be stated clearly in the letter of notification to the taxpayers.

Figure 6: Did The Inland Revenue Check Beyond The Scope And Purpose Of Field Audit As Informed In The Notification?



When asked "how long did tax auditors normally take to communicate the tax audits findings and reports to taxpayers". This survey found that 20% of the respondents indicated that tax auditors took more than 10 weeks to convey the tax audit findings to taxpayers (see Figure 7). Although the 'Tax Audit Framework' stated that the normal tax field audit procedure should take no longer than three months, however, in the tax dialogue held on 14 December 2006, tax representatives highlighted that in certain cases, tax audit took more than a year to be finalized. When asked if "there is always a penalty imposed after tax audits"? The survey found that more than 88% indicated 'Yes" (see Figure 8).

Figure 7: How Long Did The Tax Auditors Take To Communicate The Tax Audit Findings To Your Clients?

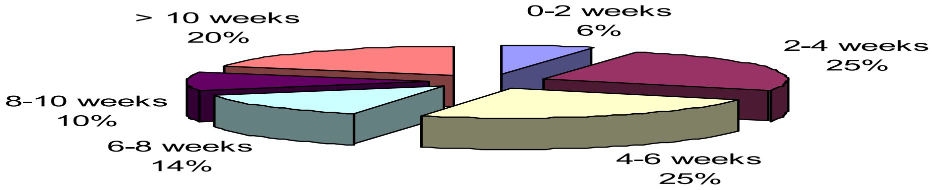
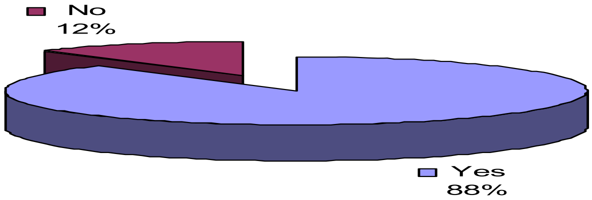


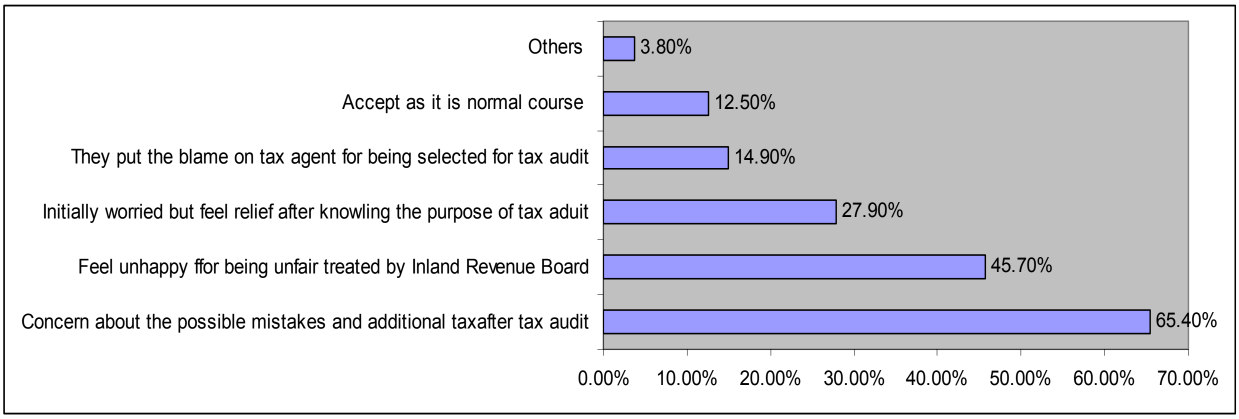
Figure 8: Upon Completion Of Each Field Audit, Is There Always A Penalty Imposed?



Tax Clients' Reaction Towards Tax Field Audits

Figure 9 reports that about 65.1% of tax practitioners surveyed indicated that their clients were unhappy and felt unfairly treated by the IRBM in tax audits. The finding suggests that either the taxpayers were unfairly treated or tax auditors did not conduct tax audits in a professional manner. Furthermore, 48.8% of the respondents claimed that the tax audit caused worry among their corporate clients. The survey also revealed that 23.3% of the tax practitioners were of the opinion that their clients placed the blame on them for being selected for tax audits. Only 20.9% of respondents indicated that their clients had no problems with tax audits as they accepted the procedure as a normal course under the SAS. A few respondents (2.1%) stated that tax audits consumed a lot of their clients' time.

Figure 9: Tax Clients' Reaction Toward Tax Audit



Other Findings On Tax Audit Related Issues

When asked if the tax authority should take legal action against the company auditors who fail to detect material underreporting of profit in the profit and loss account, the mean score was 1.67 on a 5-point scale (significant at *p*<.0001). This indicates that a majority of the respondents strongly disagreed that the IRBM should consider taking legal action against the company auditors who failed to detect material underreporting of profits (Table 5, row 2). This finding is in contrast with the study by Arenas del Buey Torres (2004), whereby he found that tax practitioners in Spain had the opinion that the financial auditor should be held responsible for a fiscal fraud.

Table 5: Other Findings On Tax Audit Related Issues

Statement	Mean	Standard Deviation	*t*	*p*-value
a. The IRBM should consider taking legal action against the company auditors who fail to detect material underreporting of profits in the profit and loss account	1.67***	1.074	-16.55	0.000
b. The IRBM should penalize the tax preparer/practitioner for tax evasion detected in tax field audit	1.73***	1.067	-15.83	0.000

* Notes: All mean values are measured based on a 5-point scale, anchored on 1= strongly disagree; 2= slightly disagree; 3=Neutral; 4=slightly agree; 5= strongly agree. All mean values were significant at ***$p<0.001$.

Meanwhile, tax practitioners who were surveyed also indicated that they strongly disagreed that the IRBM should penalise the tax preparer/practitioner for tax evasion detected in the tax field audit (Table 5, row 3); the mean score was 1.73 on a 5-point scale (significant at $p<.0001$). Notably, this finding did not support the suggestion of Ho and Lau (1999) that in order to ensure that tax preparers have properly advised taxpayers in a professional manner, the tax authorities should penalize both the tax preparer and the taxpayer for tax evasion detected by a tax audit.

Conclusion

This study has the merits of conducting a tax research in the real world by collecting feedback from the tax practitioners (i.e., the professional accountants in tax practice). The survey revealed several weaknesses in tax audits with a particular reference to the tax audit approach, audit processes, competency as well as mentality of tax auditors. The survey found that in some cases, tax audits were not conducted within the scope stipulated in the notification of tax audit and the 'Tax Audit Framework' issued by the IRBM in January 2007.

Overall, this study is timely and it provides important insights to the IRBM, which in turn is in line with what has been outlined in the 'Tax Audit Framework' whereby tax auditors are required to provide sufficient justification on tax adjustments. Tax auditors not only need to be technically sound in taxation, but they also need to be competent in accounting, forensic accounting, auditing, business, communication, interpersonal and negotiation skills. The findings also indicate that it is of paramount importance for tax auditors to change their mindsets; as taxpayers should not be perceived as offenders before proven guilty of tax evasion. Tax auditors ought to unsubscribe to the hidden motto “In God we trust, in taxpayers we suspect”. In the era of the self-assessment system, tax auditors ought to use tax audits as an avenue to educate, communicate and interact with the taxpayers and tax practitioners to build relationships, mutual respect and trust to encourage voluntary tax compliance.

The limitations of this study are firstly, it is a cross-sectional survey; hence the opinions of the tax practitioners might change over time. Secondly, this study only surveyed tax practitioners who attended the ‘Budget 2008 Tax Seminars’ organized by MIA in Peninsular Malaysia; hence, care must be exercised in generalizing the findings. A longitudinal study can be conducted in the future on a larger sample in order to gain a clearer picture.

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ABOUT THE AUTHORS

Assoc. Prof. Dr. Choong Kwai Fatt, C.A. (M), CPA (M), is an associate professor at the Faculty of Business and Accountancy, University of Malaya. He is a fellow member of ACCA and the Malaysian Association of Company Secretaries. His research interests are Malaysian and international tax, law and accounting. He has written and published 53 papers and 62 books, most of which are widely used in local universities and accounting firms. He hosts a tax website at www.kwaifatt.com and can be contacted at kwaifatt@yahoo.com

Assoc. Prof. Dr. Lai Ming Ling, C.A. (M), is an associate professor at the Faculty of Accountancy, Universiti Teknologi MARA. She is a fellow of ACCA and a member of the Malaysian Institute of Taxation. He research interests are in taxation, accounting education and behaviourial studies. She has published articles in many professional tax and accounting journals. She can be contacted at laimingling@salam.uitm.edu.my

SILVER AWARD

Integrated Strategic Governance (ISG) Dashboard : A Tool for Board Effectiveness

ASSOC. PROF. DR. SUZANA SULAIMAN

MS. SHARIFAH FADZLON ABD HAMID

ASSOC. PROF. DR. NAGARETHNAM THIRUMANICKAM

MS. ROSZILAH SHAMSUDIN

ASSOC. PROF. DR. NORAZAM MASTUKI

ASSOC. PROF. DR. RUHAYA ATAN

Abstract

Corporate failure in high-profile organisations has brought corporate governance to the forefront in most debates and agenda in important discussions. As a result, many countries have taken initiatives to review their corporate governance arrangements. Hence, new codes of best practice have been published. While corporate governance failure has been the focus, there are still many other companies running into difficulty as a consequence of their strategic choices and/or their failure to implement strategies effectively.

The Integrated Strategic Governance (ISG) Dashboard has been developed after an extensive literature review on Enterprise Governance, Strategic Scorecard, Malaysian Government Linked Companies (GLCs) high performances and interviews with related parties. It is the main objective of this Integrated Strategic Governance (ISG) Dashboard to assist the board, particularly the independent directors on ensuring compliance with the Malaysian Code on Corporate Governance [Revised 2007] (the Code) and at the same time exercising effective strategic oversight. The dashboard will provide the board with a holistic overview of the company's strategic position, options, implementation, risk and Corporate Governance compliance with the Code. This would enable the board to perform their task more efficiently and effectively.

Keywords:
Integrated Strategic Governance (ISG) Dashboard; Board of Directors; Strategic Oversight; Holistic Overview

Introduction

High-profile cases of corporate failure such as Enron, Worldcom and Parmalat has brought corporate governance to the forefront of debate and political agenda. Many countries have reviewed their corporate governance arrangements and in consequence, new codes of best practice have been published. For example, the US has gone further with the Sarbanes-Oxley Act. A survey conducted by the Economist Intelligence Unit (2002) also shows that two years after the collapse of Enron, the attention being given to the corporate governance issue is not diminishing. This study shows that over 300 senior managers from around the world reported that top management is spending more time on governance as compared to previous years and will remain devoted to the issue in the future. However, the respondents were unable to confirm whether they are better governed as 80% felt that governance changes have had no impact on revenues.

This shows that focusing on corporate governance conformance only will not achieve the required outcome as there have been cases of companies running into difficulty as a consequence of their strategic choices and /or their failure to implement strategies effectively. Therefore, to avoid corporate failure, both corporate governance (conformance) and business governance (performance) need to be given equal focus to attain a healthy balance between the two.

Improving Board effectiveness is imperative for any business that seeks to become a high performing company, regardless of size and location. Today, many Boards conform to compliance but this is often at the expense of or out of balance with 'performance' components. Thus for a Board to be truly effective, its role should be to focus on conformance as well as performance. Making this progression to focus on performance to create wealth by pursuing the right strategies is crucial for the Board. The Enterprise Governance Framework, issued by the International Federation of Accountants (IFAC) brings the corporate governance and strategic issues together.

Strong mechanisms in the form of audit committees are in place for the Board to ensure the oversight of good corporate governance processes. However, such well-established over-sight mechanisms are not available for the performance dimension. To overcome this drawback, The Chartered Institute of Management Accountants (CIMA) has developed the CIMA Strategic Scorecard. This assists in the oversight of the company's strategic processes. Hence, based on the Enterprise Governance Framework and the CIMA Strategic Scorecard, the Integrated Strategic Governance (ISG) Dashboard was developed. This project is to assist the Board to be truly effective, i.e. to avoid any corporate failures.

The Green Book – Enhancing Board Effectiveness

The Green Book launched on 29 July 2005 by the Putrajaya Committee on Government Linked Companies (GLCs) puts in place a framework to guide the effectiveness of GLC Boards. For GLC Boards to truly raise their effectiveness, they should ensure that the three main components of an effective Board are in place. These include structuring a high performing Board, ensuring effective day-to-day Board operations and interactions and fulfilling the Board's fundamental roles and responsibilities to best practice levels.

Structuring a high-performing Board

The Board structure and composition is the foundation of Board effectiveness. Firstly, the structure of the Board must match the company's requirements. Every company operates within a specific and unique context. Hence, the structure and composition of its Board must therefore reflect this context. The Green Book highlights seven of the common principles that apply to all Boards.

Secondly, the Board should establish committees to address specialized topics or specific issues more effectively. This limits the depth of involvement of all Directors on all issues. However, certain topics are discussed in depth by those individuals with appropriate and relevant knowledge and insight. Efficient and effective Board meetings encourage the Board to devote more time to the company's critical issues. The Green Book highlights the need that only those committees necessary are established, clear roles and authority of the committee and committees are composed of the 'right' Directors.

Thirdly, a disciplined process is required in the selection and nomination of directors. A clear selection criteria of the Board must exist, i.e. the nomination process is objective and should broaden the potential of suitable individuals from likely and unlikely sources.

Finally, Boards are expected to undertake an annual evaluation of the effectiveness of the Board as a whole, the committees of the Board and the contribution of each director. Therefore, a clear performance evaluation criteria must exist including a Nomination Committee that leads and recommends the performance evaluation criteria, a Chairman that leads the follow up process and ensuring that the individual Directors and Board have access to necessary skills or knowledge through attending training programs.

Ensuring Effective Board Operations and Interactions

The effectiveness of a Board largely depends on the quality of its procedures, processes and operations. The Green Book has several guidelines which include making every Board meeting productive, ensuring the quality and timeliness of all Board information and building trust via positive interaction, dynamics and open communication within the Board and management.

Productive Board meetings can be achieved through following a set schedule, i.e. the Chairman determines the agenda in consultation with the CEO and clear roles and boundaries for both the Chairman and CEO as stated in the Board charter or terms of reference (TOR).

The quality of the information received by the Board is critical to Board effectiveness. Information provided to the Board should not just be historical financial performance, but also include key leading indicators such as customer satisfaction, product and service quality, market share, market reaction and environmental impact. Hence, the Board papers should be set out logically and contain synthesized information and pertinent critical analyses. The Board is able to understand the issues clearly and provide management with constructive feedback on the matters that require further attention. The Board should also be given sufficient time to read and absorb issues prior to the Board meeting. It is suggested that meeting agendas are distributed at least 14 calendar days in advance and all Board papers and any pre reading materials are distributed at least 7 calendar days in advance.

Trust must also exist between the Board and management. Unless Directors trust one another and are able to function as a cohesive team, the Board will not be truly effective. Discussions during the Board meetings should be constructive, productive and effective. Instead of merely raising and debating issues, actual resolution or closure must be achieved. The Board should focus its discussions with management on the root causes of problems and the potential actions required to rectify them while the Management has a duty to ensure that the Board is furnished with sufficient information, analysis and options in order to make informed decisions. All Board decisions should be clearly understood by the management to enable them to execute the decisions.

Fulfilling the Board's Fundamental Roles and Responsibilities

Today, many Boards conform with compliance and oversight requirements or are out of balance with performance components such as results and impact. Boards should refocus their time and attention and spend about 80% of their time on the fundamental roles and responsibilities rather than on detailed operational matters. Boards should adopt a shareholders' perspective and balance all valid stakeholders' interests.

Boards are expected to develop the corporate strategy and set targets, oversee the performance of the company, devote more attention to the issue of human capital management, understand and manage the company's risk, ensure that the majority or significant shareholders' views are considered and balance valid stakeholders' interests.

The Board plays a key role in providing guidance and overall input in the overall strategic direction and aspirations early in the planning cycle. Management bears a similar responsibility in developing the strategy and only through this process will the end product be a strategy that both Board and management can truly co-own. It is after the strategy is decided, the business plan and budget are completed, the Board should test the CEO's and senior management's KPIs and targets. The Board should ensure that the KPIs and targets reflect the industry trends and internal capabilities.

A basic but critical function of the Board is to oversee the performance of the company and determine if the business is being properly managed. The most effective way to achieve this is through developing KPIs that link directly to the core values of the company's strategy. A balanced and holistic view is taken when establishing KPIs. The Board should also receive regular performance reports that indicate the current status of all corporate KPIs. Focus must be on any vital missed target (or 'red flags') and constructively challenge management to verify root causes and propose or endorse an action plan to get back on track.

The Board is expected to devote more attention to the issue of human capital management. It should select the CEO based on the context of the company and establish a clear succession model. Clear expectations of the CEO are laid out in the CEO mandate. This mandate should be aligned with the Board and company's overall priorities and should form the basis for the CEO's KPIs and targets.

The Board is also expected to approve the methodology for company wide rewards and sufficient differentiation in performance. In addition, the Board needs to understand the current performance, competencies and potential of those in pivotal positions and endorse their performance and development plans based on discussions with management.

It is essential for the Board to dedicate time to understand and gain sufficient exposure to the overall pool of potential leaders. This is to understand the current and future demand for potential leaders and whether a leadership gap exists within the organization.

It is critically important for the Board to understand and manage the company's risk in protecting the company's value. This includes setting the company's risk parameters, understand major risk exposures and consider the risk factors in all major decisions.

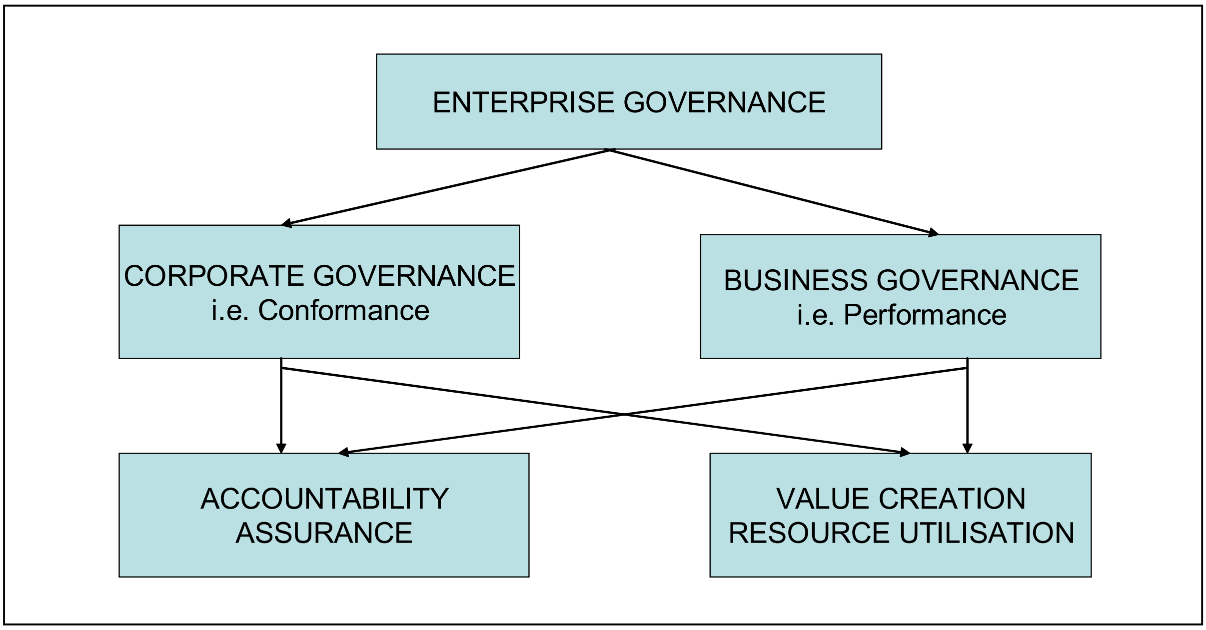
Enterprise Governance

It is clear that both corporate governance and strategic issues need to be considered and that company boards need to maintain a healthy balance between the two. Hence, the Professional Accountants in Business Committee (PAIB) of the IFAC was asked by the IFAC Board in October 2002 to explore the emerging concepts of both the corporate governance and strategic issues. The framework that brings these two together is called Enterprise Governance. The Information System Audit and Control Foundation (2001) defined Enterprise Governance as, The set of responsibilities and practices exercised by the board and executive management with the goal of providing strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that the organisation's resources are used responsibly.

Enterprise Governance Framework

The framework was tested and explored what went right or wrong in companies, on a series of 27 short international case studies. These were drawn from Australia, Canada, France, Hong Kong, Italy, Malaysia, the Netherlands, Thailand, the United Kingdom and the United States. A wide range of industries were covered including telecommunication, retailing, financial services, energy and manufacturing.

Figure 1: The Enterprise Governance Framework



Source: Enterprise Governance, Getting the Balance Right (International Federation of Accountants)

Figure 1 illustrates that Enterprise Governance constitutes the entire accountability framework of an organization. There are two dimensions of Enterprise Governance – conformance and performance. In general, the conformance dimension takes a historic view while the performance view is forward-looking. The lines show that although conformance feeds directly to accountability and performance to value creation, conformance can also feed to value creation while performance can feed to assurance.

The conformance dimension is normally understood by 'corporate governance' and it includes issues such as the roles of the chairman and CEO, the board of directors, board committees, risk management, executive remuneration and internal audit. Codes and/or standards on this continue to be developed and compliance is subject to assurance or audit. As such, the professional accountants role is to ensure accountability, the internal auditor is to assure controls are effective and the external auditors are to give an independent opinion on the truth and fairness of the financial statements of the enterprise. However, good corporate governance can help to prevent failure but it cannot guarantee success.

On the other hand, the performance dimension does not lend itself to a regime of standards and audit. It is desirable to develop a range of best practice tools and techniques that need to be applied intelligently within different types of organization. The tools and techniques are focused on helping the board to make strategic decisions, understand appropriate risks, determine key drivers of performance and identify the critical points needed in making decisions. Strategy is the responsibility of the board and its implementation needs to be assessed on a regular basis. There are a range of tools and techniques that can help boards to focus on strategic direction and its implications for all areas of the business. But these are not often dealt with as a coherent whole by the board. In other words, there could be what is termed as a 'strategic oversight gap'.

Strategic Oversight Gap

According to Johnson and Scholes (2002), strategy is defined as,

> The direction and scope of an organization over the long term which achieves advantages for the organization through its configuration of resources within a changing environment

and to fulfill stakeholder expectations.

There are times that strategy remains largely unchanged or changes incrementally. However, there are also turbulent periods that strategies change but in no clear direction. There is a danger that the incremental change of strategy does not match the pace of change in the environment. In several constraint situations, organizations become merely reactive to the environment and fail to question or challenge what is happening around them. Lack of proactiveness in creating new opportunities that best suit the environment may contribute to considerable deterioration of the business.

At times, transformational or 'abrupt' changes take place in the organisation's strategic planning. This has been identified as being the contributory factor in a number of strategic failures in companies such as Nortel, Cable and Wireless, Marconi, France Telecom and Vivendi. Transformation from a traditional energy company to a trading business in 1985 had also resulted Enron to be part of the statistics.

It is the board's responsibility to understand, test and endorse the company's strategy. The board is also responsible to monitor the management performance by referencing to the endorsed strategy. Any deviation should be challenged and explanation is therefore required. This is to ensure that the management is taking the necessary actions in progressing with the strategy.

Financial position is more transparent as compared to strategic position as there is no legislation, standards and codes on this. Hence, there is a greater chance for the board to be facing a lack of strategic oversight. A board that is not well informed and does not understand the organisation's strategic planning may not appreciate the risks that may be attached to it. Consequently, they will not ask the right questions to ensure the proper execution of the strategy.

Companies exposed to strategic oversight gap may also experience risk even with the appointment of independent non-executive directors who can bring considerable experience to the board's deliberations over strategy. Moreover, within severe time constraints, even with information supplied by the executive management, the board can easily fail to spot any weaknesses in the company's strategic position and progress.

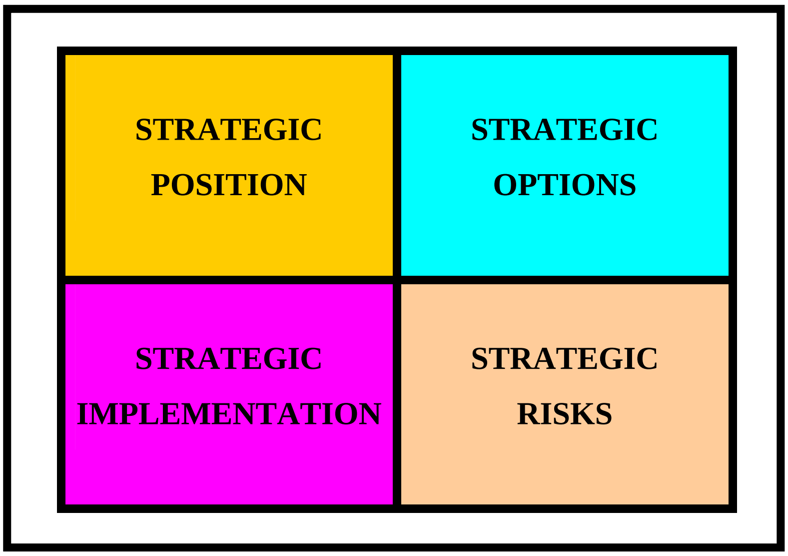
As a result, the CIMA Strategic Scorecard was introduced and it aims to fulfill the need to exercise effective oversight of the strategic process.

The CIMA Strategic Scorecard

The strategic scorecard is intended to be a pragmatic and flexible tool to help companies deal with the difficulty of maintaining effective oversight on strategy. The objectives of the scorecard are to:

- Assist the board, particularly the independent non-executive directors, in the oversight of a company's strategic process;
- Assist the board in dealing with strategic choice and transformational change;
- Give assurance to the board in relation to the company's strategic position and progress;
- Track actions in, and output from, the strategic process (not the detailed content); and
- Assist the board in identifying key points at which it needs to take decisions.

Figure 2: The CIMA Strategic Scorecard



Source: Enterprise Governance, Getting the Balance Right (International Federation of Accountants)

Figure 2 shows the four basic elements of the Strategic Scorecard. It helps the board to identify the decision points and the timing of strategic options, milestones in strategic implementation together with the identification and mitigation of strategic risks. The management team is expected to give an adequate description of the activity being undertaken and state when the last relevant information was put before the board and when the next is due. In addition, internal audit could give the board assurance focusing on process and coverage rather the precise detail of the output.

Strategic Position (Information for the board, no decision points)

In today's fast moving competitive environment, scanning should not be the one-off exercise especially associated with the strategic plan or strategic review cycle. It should be thin but reviewed constantly. The board should be continually informed on the company's strategic position. The areas that should be constantly reviewed are as follows:

- Micro environment(s) – eg: market, competition, customers
- Macro environment(s) – eg: economic, political, regulatory
- Threats from significant/abrupt changes – eg: strategic inflection points
- Business position(s) – eg: market share, differentiation on pricing, quality, service
- Capabilities – eg: core competencies, SWOT analysis
- Stakeholders – eg: investors, employees, suppliers

Strategic Options (How the board considers decision points on change)

The board also needs to be aware of the strategic options available to the company. This does not comprise a detailed strategic plan but rather a scoping of options. For each decision, there are probably only about three or four strategic options that will be under active consideration at any one time. It is useful for the board to know what analysis has been done, what are the resource constraints and the potential risks.

It is also useful for the board to know what other strategic options are available that are not under consideration at that point of time. A short rationale as to why they are not being pursued is also useful to the board especially to the independent directors.

The strategic options that the board needs to be aware of include the following:

- Change of scope – eg: geography, product, market sector
- Change of direction – eg: high/low growth, offering of price/quality

Strategic Implementation (measuring how well the strategy is being implemented)

The board needs to be updated regularly and especially when the project has moved through the evaluation to the implementation stage. Hence, a detailed evaluation of specific options should be developed, attainable milestones set and detailed timelines to be achieved. These should be reported regularly, whereby failure to meet the targets explained along with an outline of any implications and corrective action that has or needs to take place.

The board should also be aware of all breakpoints. At each breakpoint, the board might be required to make decisions. These decisions would also include whether to accelerate, abort, delay, or possibly switch strategy. The board needs to be clearly informed on the critical success factors and highlight tasks that must happen to make the strategy successful.

Strategic Risk (what can go wrong and what must go right)

In recent years, there has been a very heavy focus on risk management and various frameworks have been developed which include Enterprise Risk Management (ERM). Enterprise risk management is interrelated with corporate governance by providing information to the board of directors on the most significant risks and how they are being managed. It is also interrelated to performance management by providing risk-adjusted measures with internal control.

That is why Enterprise Governance is such an important framework as it encapsulates corporate governance, performance, internal control and enterprise risk management. It strives to achieve a balance between conformance and performance.

Strategic risk management is part of the enterprise governance scorecard and there are three key components attached to it:

- Risk appetite – where management is challenged on determining how much uncertainty to accept so as to strive for growth in the stakeholder value.
- Strategic risk and opportunities facing the organization – the likelihood of risk to occur and/or potential for exploitation and, ability to manage risk.
- Process issues – how risks are actually managed within the organization such as risk monitoring processes, etc.

Integrated Strategic Governance (ISG) Dashboard Framework

The Integrated Strategic Governance (ISG) Dashboard was developed based on the Enterprise Governance Framework, CIMA Strategic Scorecard and Strategic Oversight Gap concepts. Interviews with related parties were also conducted. The ISG Dashboard intends to provide guidance and assistance to the board on the company's strategic process oversight, strategic choice during transformational change, identifying key points in the decision making process and complying to the requirements of the Code. Within time constraints the dashboard hopes to provide thin but constant strategic review and corporate governance guidance to the board. It is also hoped that the board can easily spot the company's strategic position, progress and suggest necessary actions to manage related risks and compliance with the standards of the Code.

Figure 3: Integrated Strategic Governance (ISG) Dashboard

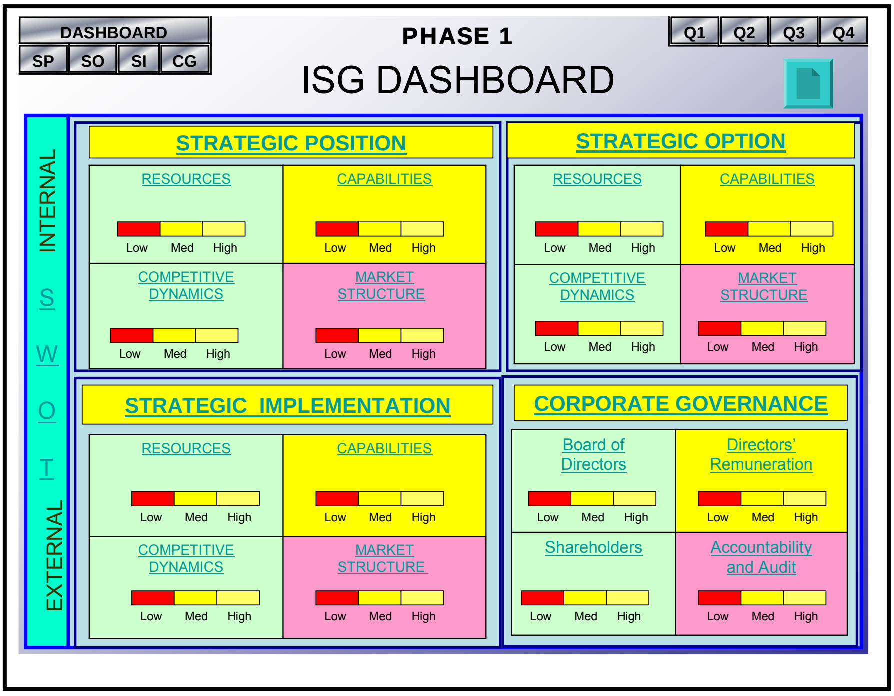


Figure 3 provides the SWOT analysis and four main quadrants that exist in the ISG Dashboard. The four quadrants are represented by Strategic Position, Strategic Option, Strategic Implementation and Corporate Governance. The quadrants analysis will provide the BOD with an overall overview by looking into the sub-quadrants: i.e. Resources; Capabilities; Competitive Dynamics; and Market Structure. The following paragraphs will explain generally on the SWOT analysis, each of the quadrants and sub-quadrants.

SWOT Analysis

Before analyzing the four quadrants, it is generally essential to identify the company's critical success factors through the SWOT's internal and external analysis. The internal and external analysis will provide a general view of the company's strengths and weaknesses, opportunity and threats, respectively.

The internal analysis will provide a checklist of the company's critical success factors on two main areas: resources and capabilities. The checklist will provide the board with general views on both the company's internal strengths and weaknesses.

For example, one of the strengths of the company is its business location but it is facing problems in its ability to acquire funds. Hence, the strength can be highlighted and used to neutralize the identified weakness.

Strategic Position

In today's fast moving competitive environment, companies need to continually review their strategic position. Strategic positioning is to be informed to the board in general but constantly on the company's position. It should provide general information on the companies' overall performance on the key drivers, critical factors, options with high risk and the status of compliance with the Code. Hence, the board is more focused on the strategic issues rather than on operational matters.

Strategic Options

The strategic options should provide the board with the high-risk initiatives. The dashboard will highlight the position of the high risk attached to the Resources, Capabilities, Competitive Dynamics and Market Structure initiatives. The strategic options provides the general information on the companies' overall performance on the critical high risk initiatives. This will enable the board to focus more on critical high risk rather than going through on all on-going initiatives. However, the dashboard also provides medium and low risk on-going initiatives.

Strategic Implementation

The board needs to be updated regularly on the selected on-going initiatives. At each board meeting, they should be provided with information such as the person / department / manager responsible, risk, benchmark, milestone and status to date. The risk of each initiative does change overtime. High-risk initiatives need to be highlighted. The benchmark should include the measurement of the initiatives. The benchmark will provide a guide to both the board and management, while the milestone should provide the starting and expected ending dates of the selected initiatives. Consequently, the status to date of the initiatives can be identified. Information on whether the initiatives are on time or otherwise can be provided. These offer the appropriate actions that need to be taken at that point of time which include whether to continue, switch strategy, delay or abort the initiatives.

Corporate Governance

The Code contributes to the conformance dimension of the enterprise governance. The dashboard is a mechanism for the board to ensure that the corporate governance processes are effective and provide an oversight of the entire accountability of an organization. Corporate Governance consists of four broad Corporate Governance attributes stipulated in the Code, namely the Board of Directors, Directors' Remuneration, Shareholders and Accountability and Audit. Each of the attributes could be "As To Form" (mandatory) or "As To Spirit" (voluntary) or best practice items. "As To Form" items are basic corporate governance that are specifically stipulated by Bursa Malaysia's Revamped Listing Requirements which are to be complied by all public listed companies (PLCs). PLCs are merely required to acknowledge in their corporate reports, the need to adopt these items. The Code does not require the "As To Spirit" items to be fully adopted but suggested by the Code as best practices.

All the above quadrants consist of sub-quadrants: Resources; Capabilities; Competitive Dynamics and Market Structure except the Corporate Governance quadrant. Each of the sub-quadrant is explained below:

Resources

Resources are input into a firm's production process, which include capital equipment, skills of individual employees, patents, finances and talented managers. This can be categorized into physical, human and organizational capital.

Capabilities

This model suggests that capabilities evolve and must be managed dynamically in pursuit of above-average returns. Individual resources alone may not yield a competitive dynamic. A capability is the capacity for a set of resources to perform a task or an activity in an integrative manner. Capabilities are formed through the combination and integration of sets of resources. This refers to the capacity for a set of resources to perform a task or an activity in an integrative manner and through continuous use, the capabilities become stronger and more difficult for competitors to understand and imitate. A capability 'should be neither so simple that it is highly imitable, nor so complex that it defies internal steering and control'.

According to the resource-based model, differences in the firms' performance across time are due primarily to their unique resources and capabilities rather than the industry's structural characteristics. Not all firms competing within a particular industry possess the same resources and capabilities.

Competitive Dynamic

The resource-based model view suggests that a firm's unique resources and capabilities provides the basis for a strategy. The strategy chosen should allow the firm to best exploit its core competencies relative to opportunities in the external environment. Not all of the firm's resources and capabilities have the potential to be the basis for competitive dynamic. The potential is realized when resources and capabilities are:

1. Valuable, rare, costly to imitate and non substitutable,
2. Able to allow a firm to take advantage of opportunities or neutralize threats in its external environment,
3. Rare when possessed by a few current and potential competitors,
4. Costly to imitate when other firms either cannot obtain them or are at a cost disadvantage in obtaining them compared with the firm that already possesses them.

Core competencies are resources and capabilities that serve as a source of competitive advantage for a firm over its rivals. If the above four criteria are met, resources and capabilities become core competencies. Core competencies need to be developed, nurtured and applied throughout a firm. This relates to managerial and product related competencies. Managerial competencies include the capability to effectively organize and govern complex and diverse operations and the capability to create and communicate a strategic vision. Managerial capabilities are important in a firm's ability to take advantage of its resources. Product related competency is the capability to develop innovative new products and to reengineer existing products to satisfy changing consumers' taste. Continuous development and systematic programs for updating old skills and introducing new ones are therefore required. Competitive dynamic is especially important in rapidly changing environments.

Market Structure

The Resource-Based Model of Above-Average Returns however could be further improved by adding the elements of strategic positions as suggested by the CIMA Strategic Scorecard. It is suggested that a company needs to continually review its market structure. In the fast moving competitive environment, scanning will not be the one-off exercise but a review cycle that is thin but constant. It means that the company needs to be sensitive on its market structure which relates to the general environmental influences eg: market share, customers, economic, political, regulatory, differentiation on pricing, quality and service.

Integrated Strategic Governance (ISG) Dashboard Methodology

This chapter discusses the processes involved in developing the Integrated Strategic Governance (ISG) Dashboard. The first section will explain the three phases involved in developing the initial ISG Dashboard. This initial framework was used on a case study of Large IT Berhad (LI) in further refining the ISG Dashboard. This is explained in the second section prior to a refined dashboard being developed.

Phases in the initial ISG Dashboard Development

The Integrated Strategic Governance (ISG) Dashboard was developed after several extensive discussions and meetings with the group members and related parties. There were three phases and each phase is briefly explained as follows:

Phase 1: Exploratory or Fact Finding

This fact finding mission included gathering related literature review and focus group interviews with two groups of institutions comprising of professionals and regulators. Two groups were formed to undertake this task. The first group was required to prepare a set of related interview questions. The questions formulated were grouped into three areas: corporate governance, corporate failures and strategic issues. The list of questions were pilot tested at the Malaysian Institute of Corporate Governance (MICG) and the questions were further refined accordingly.

For the purpose of the face-to-face interviews, the second group was assigned to identify and develop contact with relevant professional bodies and agencies. Eight parties were identified but only four agreed to be interviewed. They were representatives from the Minority Shareholder Watchdog Group (MSWG), Malaysian Institute of Corporate Governance (MICG), Institute of Integrity Malaysia (IIM) and Bursa Malaysia.

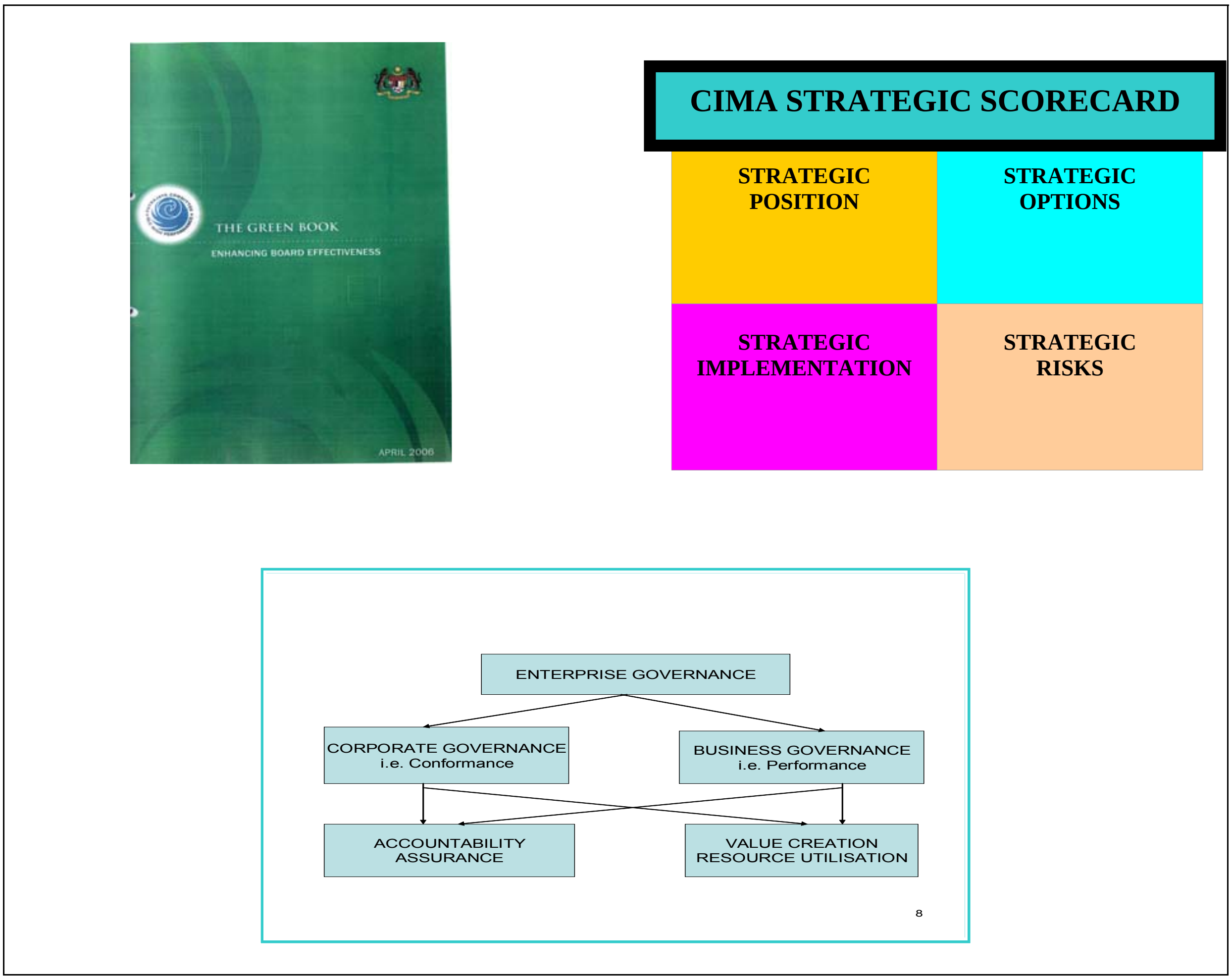
Figure 4: Interviewed Parties

The main purpose of these interviews was to gauge first hand opinions and feedback regarding the need to balance both the conformance and performance dimensions within an organization. This further supports the need for an Integrated Strategic Governance (ISG) Dashboard.

Phase 2: Development of the ISG Dashboard

Extensive readings and understanding of the Green Book – Enhancing Board Effectiveness, Enterprise Governance, CIMA Strategic Scorecard and feedback from the interviews conducted have enabled the ISG dashboard to be developed.

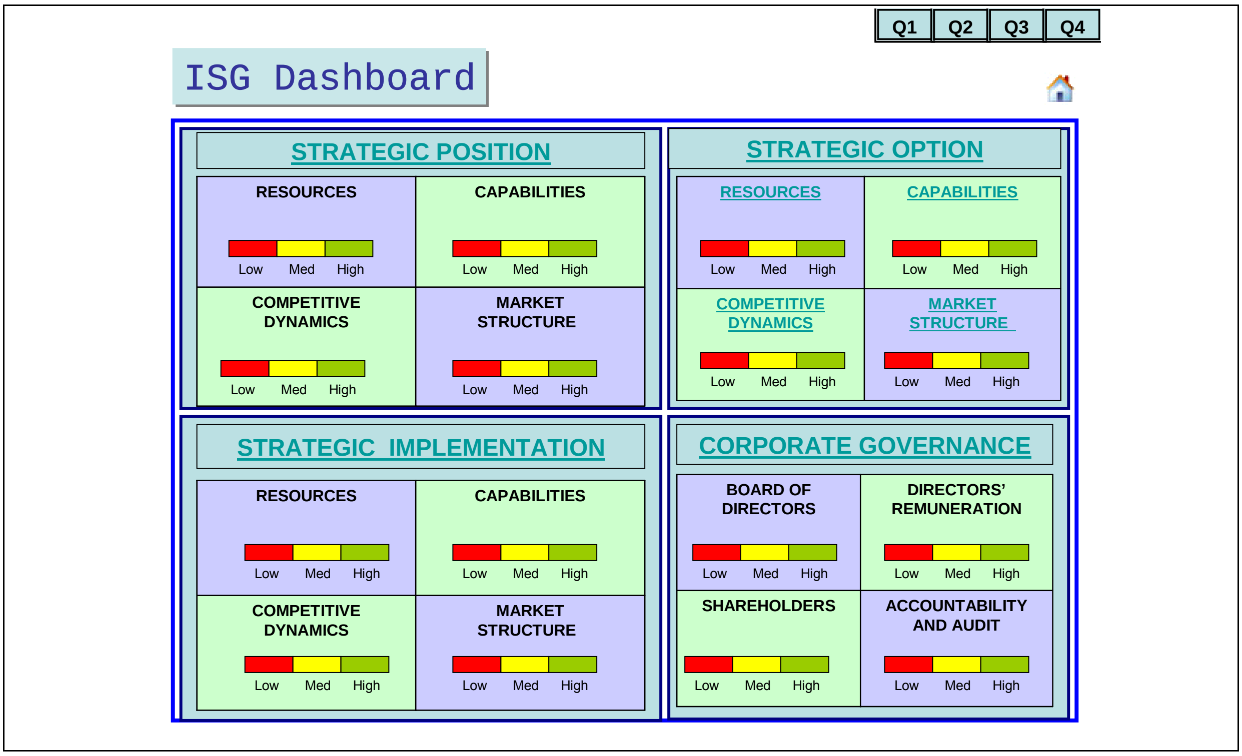
Figure 5: ISG Dashboard's Framework



Phase 3: Evaluate the initial ISG Dashboard

A case study company, Large IT Berhad (LI) has agreed to be piloted for this project. The ISG framework was used and explained to LI. A series of meetings were conducted between the project members and LI's representatives. With the feedback from the discussions, the initial ISG framework was further refined. Figure 6 shows the refined ISG Dashboard.

Figure 6: Refined Integrated Strategic Governance (ISG) Dashboard



The refined ISG still maintains the four main and sub-quadrants. However, the SWOT element was removed as it is embedded either in the main or sub-quadrants. In addition, the ISG Dashboard also provides the status of the four quarters (Q1, Q2, Q3 and Q4).

The ISG Dashboard was further explored and extended. The following paragraphs will explain the processes that have taken place in developing the final ISG Dashboard.

It started by identifying the definition of 4M's in LI's context. The 4M's referred to Manpower, Money, Machine and Materials. Table 1 provides the definition of each 4 M's items.

Table 1: 4 M's Definition

ITEMS	LI CONTEXT
Manpower	People
Money	Financial, Capital, Revenue, GP, Costing, Pricing
Machine	Solutions, Products
Materials	Process, Innovation, Internal Control

This was followed by identifying the definition of the four (4) sub-quadrants items in LI's context. The sub-quadrants are Resources, Capabilities, Competitive Dynamic and Market Structure. Table 2 shows the definition of the four sub-quadrants.

Table 2: Sub-quadrants Definition

ITEMS	LI CONTEXT
Resources (internal)	Headcount, size of unit, division, capital, knowledge/ skills, physical resources, physical assets
Capabilities (internal)	Management skills, ability, knowledge/ skills, expertise, specialist, service
Competitive Dynamic (external)	Geographical location, products differentiation, branding, quality, political influence, positioning, reputation, customer satisfaction
Market Structure (external)	Go to market, branding, positioning, market share, partnership/ principals, customer demography

A matrix is prepared for both groups of items. This further redefined the 4M's into each of the four sub-quadrant items. This will ease the following processes. Table 3 provides a detailed matrix definition of all the eight items.

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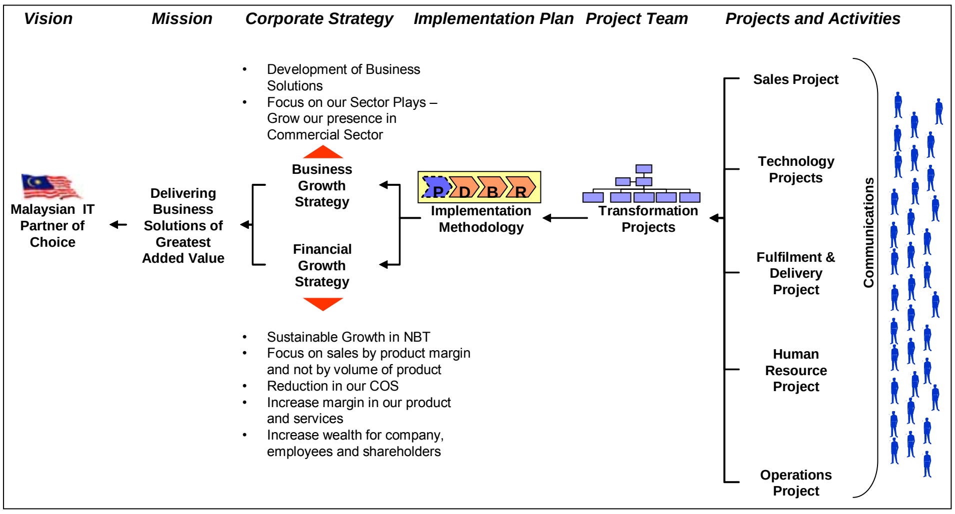
Table 3: 4M's vs Sub-quadrant Items

Items	Resources	Capability	Competitive Dynamic	Market Structure
Manpower	Headcount, Division, Distribution	Management skills, expertise, specialist, service, ability, reputation	Political influence, branding	Go to market model, partnership/ principals,
Money	Cost of people, Cost of training, capital	Share, profit, revenue, reputation, cashflow management	Pricing, costing, cashflow liquidity	Share price,
Machine	Physical property, asset	Service, reliability, ability, promotion, adopting new technologies	Quality, branding	Product differentiation, location
Materials	Knowledge, programming, application, idea	Comprehensive, reliability,	Quality, product differentiation, branding	Positioning, market share, customer satisfaction

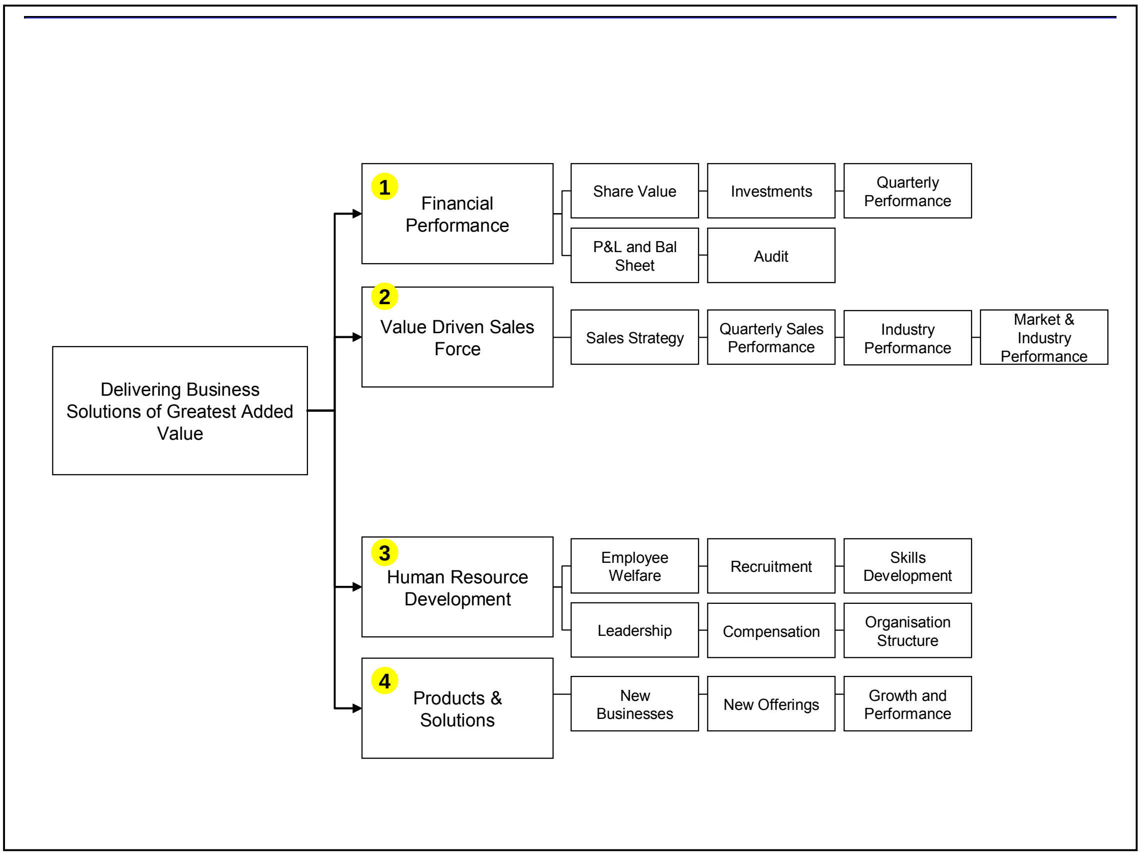
The next process is to identify LI's BOD key areas. The key areas can be identified by understanding LI's vision and mission. It is through the vision and mission that the corporate strategy and implementation plan were established. Figure 7 shows these relationships.

Figure 7: LI's Strategic Direction



In achieving LI's mission, which is delivering business solutions of greatest added value, the key areas were identified. Figure 8 shows the key areas in achieving the mission.

Figure 8: Key Areas in Achieving the Mission



There were four (4) key areas identified by LI in achieving its mission of delivering business solutions of greatest added value. Financial Performance, Value Driven Sales Force, Human Resources Development and Products and Solutions are the main areas that the board will be interested in.

Identifying the initiatives for each of the four areas was the next process. Several brainstorming sessions were required in classifying the on-going and planned initiatives for each key area. A brief definition for each initiative was also required. This was followed by identifying each initiative into the four sub-quadrant items: Resources (R); Capabilities (C); Competitive Dynamic (CD) and; Market Structure (MS). Figure 9 shows the Financial Performance's initiatives along with their definitions and classification.

Figure 9: Main Key Area's Initiatives, Definition and Classification

Driver	Initiatives	Definitions
Financial Performance	Financial Process Improvement • Annual budget • SAP realignment	To have a financial process in place. Review budget accordingly and realign the existing SAP system (C)
	New Pricing Guidelines	To have a competitive pricing guideline (CD)
	Investment Review Process (Investment Committee)	Establish investment committee in order to have a investment review process in place (C)
	Financial Analyst Briefing	M
	Budget Development and Implementation	C
	Quarterly Performance	Review and assess quarterly financial performance (C)
	Annual Performance	Review and assess annual financial performance (C)
	Margin Assessment	To measure current margin vs targeted margin (C)
	GP / Revenue Assessment	To measure sales performance as of to date (C)
	Financial Growth Plan	Develop 5 years financial growth plan (C)
	New Business Review	M
	Share Value Analysis	M

A different color for each initiative was used. This is to differentiate between the on-going and planned initiatives. A similar process was required for other key areas: Value Driven Sales Force, Human Resources Development and Products and Solutions.

Conclusion

The ISG Dashboard was developed after an extensive literature review on Enterprise Governance, CIMA Strategic Scorecard, Green Book prepared by the Putrajaya Committee and interviews with related parties. It is the main objective of the ISG Dashboard to assist the board, particularly the independent directors on ensuring compliance to the Code and at the same time exercising effective strategic oversight. The dashboard will provide the board with a holistic overview of the company's strategic position, options, implementation, risk and compliance with the Code that will enable the board to perform their tasks more efficiently and effectively.

In general, the conformance dimension takes a historic view while the performance view is forward-looking. It is clear that good corporate governance is only part of the story and strategy is equally important. Hence the ISG dashboard is intended to provide the Board with a holistic overview of the company's overall strategic aspects and thus enabling them to perform their tasks more efficiently and effectively.

The ISG dashboard won the Gold Award in the category of innovation at the Invention, Innovation and Design (IID) 2007 competition held at UiTM in January 2007. The dashboard was selected to represent UiTM for the Invention and Innovation Competition, Malaysian Technology Expo (MTE) 2007 organised by the Ministry of Information and Technology, Malaysia which was held from the 29 to 31 March 2007 and won the Silver medal. The ISG Dashboard was selected to represent Malaysia in the Belgian and International Trade Fair for Technological Innovation held at Brussels, Belgium, from 22 to 25 November 2007 and it won the Silver medal.

The ISG Dashboard has also obtained its copyright and is in the process of getting patented. A patent search was conducted and it appears that it is a novel and inventive idea. The future plan is to get the ISG Dashboard licensed.

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About The Authors

Assoc. Prof. Dr. Suzana Sulaiman is the Deputy Dean of the Faculty of Accountancy at Universiti Teknologi MARA (UiTM). She is a member of the Malaysian Institute of Accountants (MIA), CIMA (UK) Council Member of CIMA Malaysia Division and head of the Asian Management Accounting Research Centre (AMARC).

Ms. Sharifah Fadzlon Abdul Hamid is a senior lecturer at Universiti Teknologi MARA (UiTM) and currently she is the Head of Discipline in Management Accounting and Finance.

Assoc. Prof. Dr. Nagarethnam Thirumanickam is an Associate Professor at Universiti Teknologi MARA (UiTM) and specialises in Management Accounting**.**

Ms. Roszilah Shamsuddin is a lecturer at Universiti Teknologi MARA (UiTM) and was the Program Leader of Accountancy (Fast Track).

Assoc. Prof. Dr. Norazam Mastuki is an Associate Professor at Universiti Teknologi MARA (UiTM). He was the Deputy Dean from 1995 until 1999 and 2007 and specialises in Computerized Accounting, Financial Reporting and Finance.

Assoc. Prof. Dr. Ruhaya Atan is an Associate Professor at Universiti Teknologi MARA (UiTM). Currently she is the Director at the Examination Affairs Office in UiTM, a member of Malaysian Institute of Accountants (MIA), Research Institute Investment Analysts Malaysia (RIIAM) and Academic Panel of the Malaysian Institute of Integrity.

Assoc. Prof. Dr Suzana (corresponding author) can be contacted at s-suzana@mailcity.com

BRONZE AWARD

Benefiting from the International Standards on Quality Control (ISQC) 1 : A Tool for Assessing Audit Firms

Assoc. Prof. Dr. Zuraidah Mohd Sanusi

Abstract

This paper provides an overview on the International Standards on Quality Control 1 (ISQC 1) self-assessment checklist for audit firms in Malaysia. The checklist was developed by a Universiti Teknologi MARA research team in collaboration with the Malaysian Institute of Accountants (MIA) and Malaysian Accountancy Research and Education Foundation (MAREF). The checklist items are based on the ISQC1 requirements, ISQC 1 manual and MIA By-Laws. It is validated by a selected group of practitioners from various audit firms. It is hoped that this checklist would assist audit firms to assess themselves and hence, could improve the audit service quality. Although the implementation of ISQC 1 in audit firms imposes additional responsibilities, they should realize the importance in finding the right balance between governance, oversight and business growth.

Keywords:

audit quality, quality control system, ISQC 1, self-assessment, audit practices

Introduction

> *"We have policies and procedures, backed by rules and by-laws, that require member firms conducting transnational audits to: maintain appropriate quality control standards in accordance with the International Standards on Quality Control(ISQC 1) issued by the International Auditing and Assurance Standards Board (IAASB) in addition to relevant national quality control standards; participate in the network's audit quality control review programme; have policies and methodologies for the conduct of audits that are based, to the extent practicable, on International Standards on Auditing; and have policies and methodologies in place that, as a minimum, conform to the International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants and national codes of ethics" - Russell Bedford, an approved transnational audit firm & a member of the IFAC Forum of Firms, 2008.*

Recent developments concerning audit quality control has required audit firms to comply with the International Standards on Quality Control (ISQC 1) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). The Malaysian Institute of Accountants (MIA) has, in July 2006, adopted ISQC 1 as part of the approved standards of auditing in Malaysia. In essence, ISQC 1 focuses on the quality of audit performed by the audit firms and they are expected to comply with the standards. As such, audit firms are faced with additional responsibilities in respect of implementing new quality control safeguards and procedures. A recent study conducted by MIA and Universiti Teknologi MARA (UiTM) (2007) indicates that the implementation of ISQC 1 is rather limited in small and medium Malaysian audit firms. These firms tend to operate based on non-standard operating procedures, which essentially does not reflect total compliance with ISQC 1.

In order to gauge the quality of audit firms, it is important to have a guideline for them to rely on. Based on the ISQC 1 framework, a self-assessment questionnaire has been developed by a team of researchers from UiTM in collaboration with MIA and the Malaysian Accountancy Research and Education Foundation (MAREF). This project is hoped to contribute to the improvement in the quality control of small and medium audit practices in Malaysia. It is also to provide a more objective appraisal of audit quality in small and medium audit firms. The checklist would enable audit firms to self-assess their service and to recognize any deficiency that could have compromised audit quality.

The Search for Audit Quality

The strong interest in understanding audit quality is partly due to the concern on issues such as corporate collapse, expectation gaps and corporate governance. Although many people have supported the fact that high audit quality is related to firm size, the extent of audit quality for each firm requires a more objective measurement of audit quality. Audit quality is determined from a number of components such as good audit team, long-term firm experience, fully complying with generally accepted auditing standards and sufficient customer service. This also covers all stages of the audit process including engagement planning, interim fieldwork, year-end fieldwork and final administration. The extent of good quality audit services should not be limited to the audit engagement. Audit quality involves quality assurance in all aspects of a business such as managing human resources and relationships with clients.

Understanding the International Standards on Quality Control 1

In 2004, IAASB under the supervision of the IFAC, has approved the ISQC 1 that concerns the quality control for firms that perform audits and reviews of historical financial information and other assurance and related services engagements. In line with the requirement by IFAC, MIA has imposed that all registered accountants and auditors (practitioners) in Malaysia to comply with the ISQC 1 by 30 June 2006. The standards introduced several new concepts and requirements in respect of quality control within auditing firms. As a result, practitioners faced additional responsibilities in respect of implementing new quality control safeguards and procedures.

The ISQC 1 is different from the International Standard on Auditing (ISA) *220 "Quality Control for Audits of Historical Financial Information*" which sets out the quality control standards to be applied to individual audit engagements. On the other hand, the ISQC 1 deals with firms and its personnel to comply with professional standards and regulatory and legal requirements. As shown in Figure 1, the ISQC 1 sets out seven quality control elements that must be rigorously and comprehensively addressed.

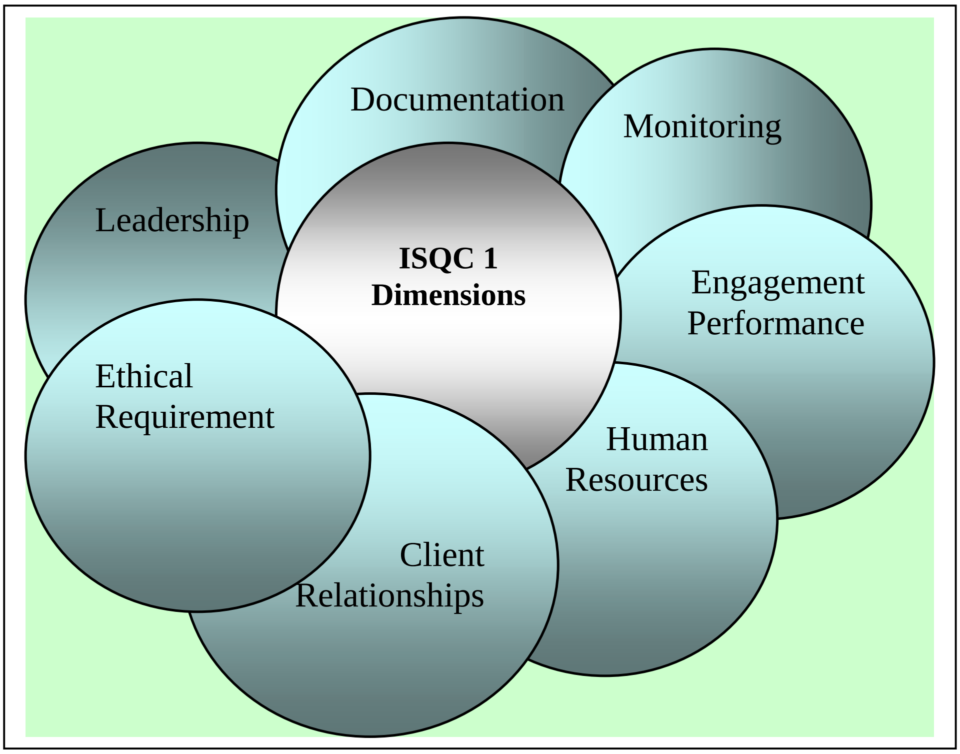

Figure 1: Dimensions of ISQC1 Audit Quality Control Dimensions

It covers (1) leadership responsibilities for quality within the firm; (2) Ethical requirements; (3) Acceptance and continuance of client relationships and specific engagements; (4) Human resources; (5) Engagement performance; (6) Monitoring; and (7) Documentation. These standards require audit firms to document the evidence of the operation of each of the seven elements of its quality control system and retain that documentation for an appropriate period. Detailed explanation on each dimension is shown in Table 1.

Table 1: Definition of ISQC 1 Elements

No.	Element	Definition
1.	Leadership responsibilities for quality within the firm	The firm shall establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures shall require the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent), to assume ultimate responsibility for the firm's system of quality control.
2.	Ethical requirements	The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.
3.	Acceptance and continuation of client relationships and specific engagements	The firm shall establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will only undertake or continue relationships and engagements where it: (a) has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity; (b) is competent to perform the engagement and has the capabilities, time and resources to do so; and (c) can comply with relevant ethical requirements.
4.	Human resources	The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.
5.	Engagement performance	The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.
6.	Monitoring	The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.
7.	Documentation	The firm shall establish policies and procedures for the documentation to provide evidence of the operation of each element of the system of quality control.

(Source: MASA 2007)

The Development of the Self-Assessment ISQC 1 Checklist

The development of the checklist involved three different stages. First, the researchers formed common themes of the ISQC 1 dimensions based on several sources. This study refers to the ISQC1 requirements (Malaysian Approved Standards on Auditing (MASA) 2007), ISQC 1 manuals issued by MIA, MIA Practice Review Questionnaires, MIA By-Laws, Australia Questionnaires on Quality Control for Firms and Pakistan's ISQC 1 Review Self-assessment Questionnaire. A series of brainstorming sessions were conducted to identify the critical factors for each element of the ISQC 1. Second, a review with two representatives from the MIA was conducted. The representatives were the manager of technical development and the manager of practice review. Both the representatives thoroughly checked the format, design and questions of the checklist. The checklist was further revised according to their comments. Finally, this study also conducted focus group interviews with ten audit practitioners to evaluate each item of the checklist. In this session, the practitioners provided their inputs and discussed in detail, the relevancy and usefulness of each question. The conclusion of this session was marked by a group consensus. Participants were also required to provide their feedback on the overall format of the checklist.

Components of the Self-Assessment ISQC 1 Checklist

The structure of the checklist consists of two parts (refer to Table 2). The first part presents questions on the policy and procedures and the second part presents questions regarding the practices. Questions on the policies and procedures shall be answered by either a yes or no, whilst questions on practices shall be answered by using four different indicators. The indicators enabled the audit firm to assess the degree to which practices and/or processes are in place that indicate adherence to the indicators. The audit firm may choose whether the practices and/or processes are highly functional in the firm, operational, emerging or not evident. The firm should use the indicators as an opportunity to generate self-challenging questions and to respond with accurate answers geared towards self-improvement.

Table 2: ISQC1 Self-Assessment Checklist - Format

<table>
<tr><th>Part</th><th>Explanation</th></tr>
<tr><td>Policy and Procedures</td><td>This part presents the questions on the policy and procedures on each elements of ISQC 1. The questions shall be answered by using a “YES” or “NO” option.</td></tr>
<tr><td>Practices</td><td>This part comprises questions on the practices of each element of ISQC 1. Each indicator shall be answered using the four-scale options.
<table>
<tr><th>Indicator</th><th>Explanation</th></tr>
<tr><td>Not evident</td><td>No evidence/ documentation exists</td></tr>
<tr><td>Emerging</td><td>Evidence indicates early or preliminary stages of implementation of practice</td></tr>
<tr><td>Operational</td><td>Evidence indicates practices and procedures are actively implemented</td></tr>
<tr><td>Highly functional</td><td>Evidence indicates practices and procedures are effectively and consistently implemented</td></tr>
</table></td></tr>
</table>

The self-assessment checklist is then formatted into the 7 different dimensions where each dimension contains both the policy, procedures and practices parts as shown in Table 2. The finalized question items for each dimension of the self-assessment checklist are shown in Table 3.

Table 3: Question items for each element of the quality control checklist

LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM
• Allocates sufficient resources
• Assigns appropriate person
• Aims in achieving quality in all engagements
• Emphasizes on firm’s quality control system
• Exerts quality auditing culture
ETHICAL REQUIREMENTS
• Complies with the fundamental principles of professional ethics
• Identifies and promptly notify the threats to independence
• Requires the rotation of the engagement partner and the engagement quality control reviewer
• Takes action on non-compliance with relevant ethical requirements
• Requires partners and staff members to at least make annual independence declaration
ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS
• Address the element of acceptance and continuance of client relationship and specific engagements
• Ensures that the personnel assigned the following matters in acceptance and continuance of client relationship and specific engagements

• Employs an assessment criteria on client's integrity
• Discusses with the appropriate level of client management and those charged with governance regarding the reasons for withdrawal and the appropriate action to be taken
HUMAN RESOURCES
• Establishes policies and procedures dealing with personnel issues
• Communicates the above policies and procedures to the partners and staff members
• Plans future staffing needs
• Provides continuous training for partners and staff members
• Communicates the identity and role of the engagement partner to client
• Ensures the engagement partner(s) has the capabilities, competencies, authorities and time to perform their engagements
• Defines and communicates clearly to the engagement partner of his or her responsibility
• Assigns appropriate staff with the necessary capabilities, competency and time to perform engagements
• Conducts partners and staff members' appraisals on a regular basis
• Offers appropriate remuneration package
ENGAGEMENT PERFORMANCE
• Designs the quality of engagement performance, for example, through audit manual, standardized documentation, specific guidance materials and software tools
• Undertakes appropriate consultation with experts within or outside the firm to resolve difficult and contentious matters
• Resolves differences of opinion by consulting other practitioners, professional or regulatory bodies
• Completes the assembly of final engagement files on a timely basis after the engagement reports have been finalized
• Maintains the confidentiality, safe custody, integrity, accessibility and easy retrieval of engagement documentation
• Conducts quality control review in a timely manner
MONITORING
• Establishes policies and procedures designed to provide reasonable assurance that the system of quality control is relevant and adequate
• Establishes policies and procedures on complaints and allegations relating to the system of quality control
• Ensures inspections of the engagement are conducted regularly
• Evaluates the effect of deficiencies noted as a result of the monitoring process
DOCUMENTATION OF SYSTEM OF QUALITY CONTROL
• Establishes policies and procedures requiring appropriate documentation to provide evidence on the operation of the six elements of the quality control system

Rating the Score

An extension on this checklist is the development of a score assessment. The score assessment would be weighted according to the importance of each dimension as well as the type of questions (either policies and procedures or practices). Audit firms may receive scores for each dimension as shown in Figure 2. The cobweb concept represents the degree of compliance with the ISQC 1. In the best scenario, total compliance with the ISQC 1 will depict a complete cobweb. The score represents the level of compliance for each of the 7 elements of the ISQC 1.

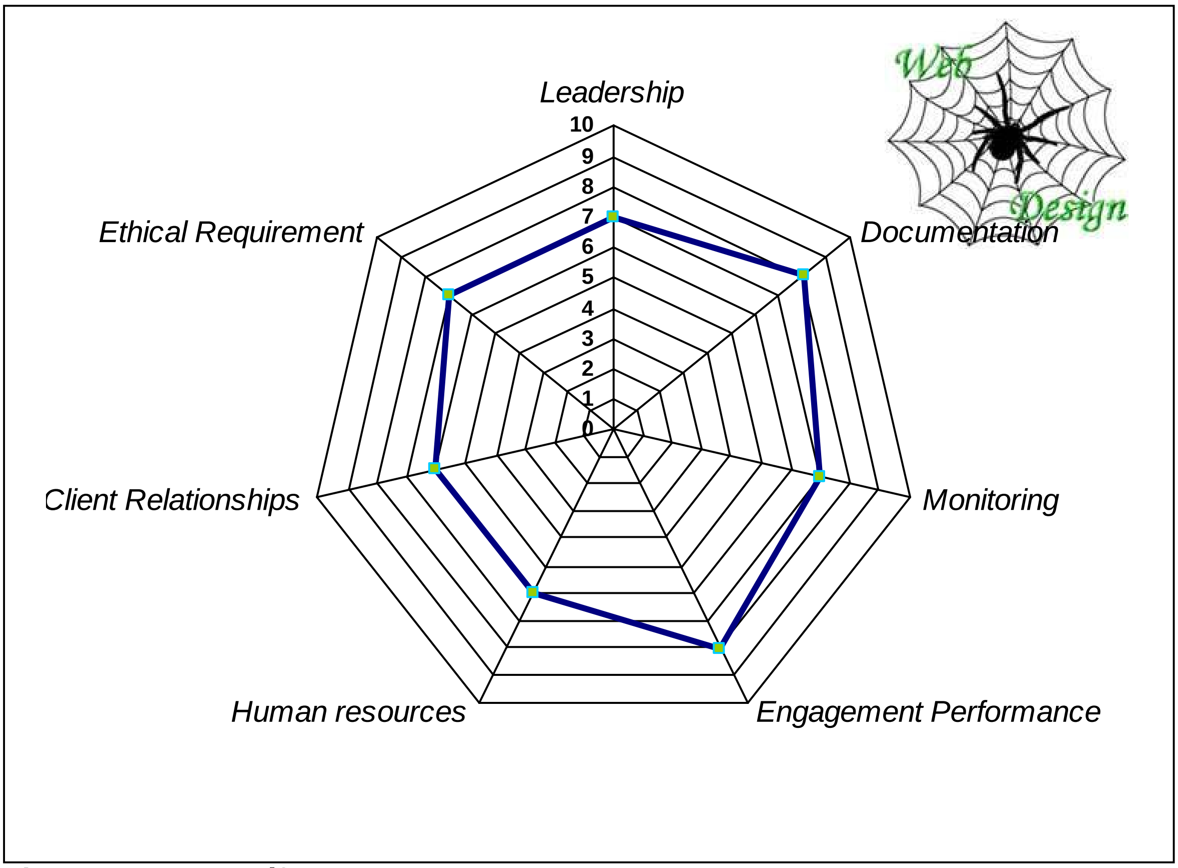

Figure 2: ISQC1 Self-assessment Score

Once the determination of the scores of each dimension have been calculated, audit firms will receive the overall score. As shown in Table 4, this score is ranked into five different scales. The overall assessment score indicates the firm's overall assessment in complying with the ISQC 1 and the score is represented by the number of stars with 5 stars indicating the highest level of compliance to the ISQC 1.

Table 4: Overall Score Assessment

Level of achievement	Score	Rating
Good to best practice in many areas	91-100%	*****
Good to best practice in at least one area	81-90%	****
Meets minimum standards	71-80%	***
Needs significant improvement in at least one area	61-70%	**
Needs significant improvement in many areas	0-60%	*

This self-assessment checklist is not meant for a pass-fail test or a competition. It is designed as a diagnostic tool in order to enhance understanding of each firm in comparison to the aspirational practices described in the ISQC 1. The score assessment could enable firms to pinpoint areas for improvement. Although the implementation of the ISQC 1 for small and medium audit firms might be a burden to them especially in terms of lacking the number of staff to take charge of the quality control system and understanding the standards itself, the standards are an effective method towards the improvement of quality control systems. The audit quality control assessment provides a practical proposition to enhance professionalism and credibility of the audit profession as well as to improve the effectiveness of small and medium audit firms.

Audit firms should have the initiative to provide the right tone that can influence audit quality. According to a recent paper issued by the Transnational Auditors Committee, the Executive Committee of the Forum of Firms of IFAC, entitled Tone at the Top and Audit Quality (2007)[i], audit firms should realize the importance of the tone at the top in finding the right balance between governance, oversight and business growth. As a result, a well-recognized audit quality of the organization would make customers' choices easier and lowers their expectation of risk.

[1] *Tone at the Top and Audit Quality* can be downloaded free-of-charge from the IFAC online bookstore at http://www.ifac.org/store. The paper describes five areas in which management can address tone at the top issues: strategy, communication, job descriptions, performance appraisals, and monitoring.

About The Author

Assoc. Prof. Dr. Zuraidah Mohd Sanusi (zuraidahms@salam.uitm.edu.my) is a lecturer in the Faculty of Accountancy, University Teknologi MARA, Shah Alam, Malaysia. Her main research interest is in auditing, corporate reporting, corporate governance, management accounting and consumers. She has presented papers in national and international conferences in these areas.

CONSOLATION PRIZE

Re-actualizing the Leadership of Professional Accountants in Business: The New Sciences and Human Governance Way

Assoc. Prof. Dr Arfah Salleh

Prof. Dato' Dr Aziuddin Ahmad

Introduction

Professional accountants in business play a profound role in the success of their organizations. Their performance is critical to the reputation and credibility of the business firm, its management and the accountancy profession (IFAC, 2005). Hence, it is not unexpected when the standing of the accountancy profession has earned misgivings as a result of the repercussions of the world corporate crisis. More recent financial meltdowns have only managed to dissipate any gain from previous confidence-building initiatives to counter the consequences of earlier accounting fiascos in the likes of Enron and WorldCom. Accountants, whether as leaders in organizations or acting in their professional capacity as individual accountants in organizations therefore cannot just stand aside and pretend that they are mere observers. They must take accountability for their behaviour as leaders and leaders of organizations. The question that follows is how these accountants can and should actualise their leadership role in being responsible leaders towards creating a credible profession.

This article examines the issue of leadership for accountants in business. In order to prepare for the future, we go backward in origin into the past to learn about the business philosophy that has shaped today's business; the meaning of leadership and the vocation of accountancy. The differentiating factor in this work is that we revisit the advances in science to understand the current worldview of reality and to establish whether the fundamentals of accounting based on the classical mechanistic Newtonian-Cartesian science is appropriate in today's business landscape. Justification for a shift in the mindset of accountants as leaders to adopt the axioms of quantum physics founded upon the interconnectedness model of the universe is provided. Based on the assessment of the current governance structure, the way forward for accountants to actualise meaningful leadership is proposed.

The Philosophy of Business

The 17th and 18th Century saw the creation of the intellectual foundation upon which modern business and capitalism was built. Of primacy was the notion of free-will within business practice and economic theory which later formed the basis of entrepreneurship and consumer behaviour. Entrepreneurs and consumers alike were looked at as free agents who were free to choose risky business in the hope for reward and to choose what to purchase, respectively. The underlying assumption of rationality prevailed where people were assumed to behave in a rational manner.

Given that modern business practices and theories were developed during the era of classical scientific discoveries where many of the physical sciences' basic tenets were replicated as the underlying axioms for human and social sciences, the philosophy of business was equally largely classically science-based. Where matter was seen as made up of atoms, businesses were viewed as a collection of mechanistic autonomous, independent clockwork parts with humans as machines detached of spiritual attachment, emotion and values. The business community and society appeared as an aggregation of the sum of individual separate entities rather than an organic collective of individuals who interconnected. Silo fragmented thinking and linearity approach among managers and leaders in solving problems became dominant. Since epistemology was restricted to observed knowledge and devoid of revealed knowledge, the method on knowing was limited to the devices of the sense perception with intellection less relied upon, while the contemplation of heart, hardly listened to.

This atomistic mindset has led to the advocating of the reductionist approach to solving social, management and business phenomena. Briefly, reductionism posits that a phenomenon can be reduced to individual parts so that the behaviour of the whole can be learned by reconstituting the parts. The idea with reductionism was based on Newton's view of the material reality of the universe where its operation could be understood by taking matter apart and studying its bits and pieces (Salleh and Ahmad, 2008).

Other primary canons of the classical Newtonian-Cartesian traditions like locality, determinism, causality, value-free and objectivity, too, became the pillars of management theories and the philosophy of business. In essence, the principle of locality states that distant objects cannot have direct influence on one another, that is, an object is influenced directly only by its immediate surroundings. Subscribing to the notion of determinism, where every future event is necessitated by present and past events, classical scientists believed that knowledge of the parts of the universe and their interaction could allow science to predict and control nature. Causality denotes a necessary relationship between one event (cause) and another event (effect) that is the direct consequence (result) of the first. Science was assumed value-free to fit into the objectivity rationale in order to remove observer biasness and prejudices.

From the perspective of the purpose of business, shareholders' interest as captured in the doctrine of privity of contract formed the focus of business practices for centuries. Maximization of profit through various strategies such as meeting customers' satisfaction became a sought after goal. But more recently, the actualization of social contract by business entities was insisted by society so that corporate social responsibility and business ethics became the new buzz words. With the demand by society for ethical conduct, the business landscape over the last two decades has seen the imposition of more stringent rules governing the behaviour of business entities including accountants in business organizations through corporate governance.

But do accountants really need to be governed by such rule-based and parameter driven structures when accountants in their true meaning are holders of public trust? We do not think so. The fundamental point we wish to stress is that accountants are in essence ethical professionals by virtue of being professional accountants. Regardless of their practicing accountancy in the capacity of accountant leaders or business and organizational leaders, accountants have pledged to undertake ethical behavior unconditionally prior to going into practice. Two issues thus warrant investigation here: i) why do accountants subscribe to an external "control" mechanism of legislation? and ii) what would be a more influential approach to motivate and sustain accountants to self-actualize ethical and meaningful leadership? To find answers to the questions, we next examine the subject of the leadership of professional accountants in business.

Leadership and Professional Accountants in Business

With the backings of archaeological findings, historians now accept that accountancy's infancy dates back to the time of human agriculture and civilization during the Sumerian and Egyptian Old Kingdom. Methods to record accurate measurements for agriculture produce was formalized by 2000 BC. Christian and Muslim empires further provided evidence of accounting practices. Later proof of more intensive application of accounting methodology was seen during Medieval Italy when merchants began to record business transactions. Despite the uncertainty of the source of the double-entry practice, historians agree that the technique originated in the Genoa-Venice-Florence triangle in the years from 1200 to 1350 (Mills, 1994). However, it was not until 1494 when Pacioli's manuscript was published that the foundation of today's accountancy took formal shape. "So overwhelming is Pacioli's book that he is celebrated as the "father" of modern accounting, and the conventional wisdom is such that accounting as a profession is typically dated from 1494" (Mills, 1994: 81).

Based on the above discussion, it can be deduced that accountancy is very much business interrelated. From its inception, accountancy has been a profound feature of business. Business decision-making processes are largely dependent upon the financial information prepared by accountants. As such, the integrity of accountants in performing their role cannot be compromised. Where accountants are leaders of businesses and other organizations, their role is extended to be the key decision-making player. Acting in the capacity of leaders, these accountants too have to actualise their roles with the highest level of integrity. We thus see that in any case, accountants *are* the custodians of public trust. Financial reports must be reliable and accountants need to be wary that their conduct impacts the world at large. Accountants must not only internalise their stewardship function but more importantly actualise it. Hence, it is imperative that the etymology of stewardship is understood.

Stewardship, from the original word 'steward' is derived from the Latin *senescallus* meaning 'the lord's officer whose duties included presiding at the sittings of the manor court'. In old

English, ‘steward’ is derived from *stigweard* that is, *stig* for ‘house or part of a house’ and *weard* for 'keeper'. “A steward is thus an official who controls the domestic affairs of a household, supervising the service of his master’s table, directing the domestics, and regulating household expenditure” (The Compact Oxford English Dictionary, 1989: 1901). While modern day stewardship connotes taking care of the property, meals and safety of others, stewardship in a theological perspective refers to the responsibility in maintaining and using wisely the gifts that God has bestowed. Regardless of whether a steward’s role is to either human beings or to God, stewardship signifies accountability, trust and leadership all together. The interconnectedness or oneness of the accountants and the global business world means that accountants bear great responsibility in ensuring the well being of the business community. And by virtue that businesses also affect the man in the street, accountants thus have responsibility to society at large. Therefore, accountants not only need to translate their stewardship role into a conduct that demonstrates values, ethics and moral obligations but in the first place, must themselves *be* ethical, of good values and high moral. This is because the source of an action in an individual is the “being” or ontology of that individual. For accountants, it is about the identity of the individual accountant as a leader. Accountants, as leaders, cannot assume a position separate from the organization nor from the community and the planet and its people. As asserted by Wheatley (1999), “No one can hope to lead an organization by standing outside or ignoring the web of relationships through which all work is accomplished.”

Following on from the preceding argument, accountants as leaders and leaders of businesses and organizations should have within them, leadership traits. Given that today, businesses have taken over the role of the government in effecting the well being of society, it gives more reason for accountants to accept their leadership role as that which transcends the self. But what are the traits of a leader and to whom should a leader be responsible? To answer this question, we revisit Plato’s work on leadership. Plato examined the issue of leadership in the context of sailing a ship. He stated that neither physical strength nor popularity with the sailors would keep a ship afloat. The true captain who is in control of the ship must consider the seasons of the year, the time of the day, the sky, the stars and the winds, and all the other subjects appropriate to his profession (Plato, 360 BC). Hence, a leader from Plato's viewpoint is the one who knows. Leadership need not be hereditary since one is not born knowledgeable. Knowledge according to Plato's teaching is knowledge of an idea rather than just technical knowledge. In light of today's misdeeds by accountants, the extension of the domain of knowledge transcending the technical is most apt. Accountants must not only be knowledgeable individuals from the technical sense, but more importantly must be knowledgeable of the idea of being a leader. It is the knowledge of the idea of leadership and its role that can distinguish the leader accountants from those who are not. And fundamental to the idea of leadership is integrity.

The word 'integrity' derived from the Latin *integritas* means 'integer' or whole or complete as in one. Again, we see the philosophy of interconnectedness or oneness being elemental in the concept of integrity. The interconnectedness, wholeness or oneness concept is also of primacy in non-linear systems thinking where it is the relationship between the parts that is emphasized instead of the objects per se. But as underscored in earlier sections, this "oneness" phenomenon contradicts the physical laws of the Western-based Newtonian-Cartesian science which has assumed a fragmented universe of separate parts and from which the business including accountancy model has been shaped. Classical science axioms too, form the base from which many management and entrepreneurship frameworks have been developed. And more importantly, leadership thoughts have also been sculpted along the same principles where the leaders' role was confined to the self. Therefore, we strongly believe that in order to form an understanding of what true leadership is about, we cannot, but highlight what the true model of reality is, based on science. Through appreciating the advances in science, the non-applicability of the dogmas of classical science to today's business context can be learned and respected by accountants and other humans and social scientists alike.

The New Sciences - Worldview of Reality and Implications

The 20th century marked a revolution in scientific thought with the discovery of quantum physics, that is, a branch of physics that concerns itself with the study of the subatomic realm. What started as anomalies that could not be explained by classical physics such as the non-happening of ultra-violet catastrophe in black body radiation phenomenon as predicted by the classical Raleigh-Jeans laws became instrumental in opening the door to a new horizon of scientific advancement. Einstein's contention of the constancy of the speed of light was another compelling axiom totally inconceivable, under classical physics laws where it was space and time that were deemed absolute. Given that in science, experimentation is the final arbiter, new quantum theories that were experimentally verified charted the way forward. With quantum physics too, the worldview of objective reality and other assumptions of classical science were proven inadequate. The birth of quantum physics not only allowed the understanding of many world phenomena, physical and meta-physical, cosmic and sub-atomic, but also led to the post-modern scientific revolution beyond the imagination of earlier minds.

According to Gough and Shacklett (1994), the most distinctive feature that distinguishes quantum physics from earlier classical physics is the principle of non-locality. Contrary to the locality axiom, with non-locality, distant objects can have direct influence on one another. This means that an instantaneous influence or communication can be brought about without any exchange of signals through space-time. The underlying foundation in quantum physics is unbroken wholeness or non-separability that transcends space-time unlike classical science that views parts of a whole as separate individual entities.

The new science of quantum physics also challenged the then-popular belief that light is a wave phenomenon by suggesting that light exists in discrete packets or quantum. In order to support the latter, light should behave as particles. The double slit experiment confirms the duality of the property of light both as wave and particle. Goswami (1995) explained that whenever we measure a quantum object, it appears at some single place as a particle. The probability distribution simply identifies that place where it is likely to be found when we do measure it. However, when we do not measure it, the quantum object spreads and exists in more than one place at the same time, in a way that a wave or cloud does. This implies that the mere act of observing a quantum particle will "disturb" it. The observer cannot be separated from the observed. Based on this property, Heisenberg concluded that "what we see is not nature but nature exposed to our method of questioning". The uncertainty factor with respect to the fundamental particles of matter led to the acceptance of science, which is subjective, contextual, value-laden and non-deterministic rather than objective, non-contextual or value-free and deterministic. The causality principle is also strongly challenged. While classical science prides itself with the ability to predict based on past and present events, the notion is abandoned with quantum physics. With non-locality and context-dependent behavior of atoms, any future event cannot be predicted with certainty or is controllable.

From the explanation of the progress from the classical to quantum science, we see a paradigm shift in the worldview of science and reality. We acknowledge that since the times of Descartes, Galileo and Newton, the dominant worldview of Western science has been that the universe is like a huge physical (material) machine working on a clockwork mechanism with the human in it also viewed as a machine. The locality and causal-effect principles further discounted the need to accept the presence of non-matter elements including consciousness. But the successful demonstration of the 'quantum entanglement' property of subatomic structures proves a major limitation with the locality principle. The unearthing of quantum entanglement shows that the universe is an inseparable whole or web consisting of interconnected parts that are related intrinsically by unknown factors; and that the whole is greater than the sum of the component objects. This basically describes the oneness of the universe. It is the oneness property too that becomes the basis for the chaos and complexity theory. What then are the implications of the paradigm shift in science on the leadership role of accountants?

Our Diagnosis

On the basis of the progress in science, it is now an established fact that the mechanical worldview of nature upon which the current model of business is built has been debunked. It has been subsumed by the new sciences of quantum physics, chaos and complexity theory (Ahmad and Salleh, 2008). Quantum physics is not an alternative but the science of the day. Yet accountants, like many other social scientists are still very classically science-based in both mindset and manifestation. We continue to observe to this very day how fixated accountants are with the objectivity postulate and quantitative measures. Accountants continue to manifest belief of the potency of the command-control leadership and the rationality of human behavior. Conventional management and economic theories founded upon classical science thinking of the West were accepted unquestioningly. To Capra, the tendency to model scientific concepts in the current era after those of Newtonian physics has become a severe handicap in the social sciences. The Cartesian framework is often inappropriate and has become increasingly unrealistic especially in economics (Capra, 1988).

Although calls are continually made for accountants to transform in order to be relevant to the global business environment, the leadership issue in accountancy has yet to query the underlying worldview of reality upon which the philosophy of accounting is shaped. The tendency has been to accept in totality a prescribed set of assumptions as a given. All these, to us, is the root cause of the problem of why accountants succumb to the existing belief of humans being "controllable" and that the only way of governance is through more extensive legislations. It appears somewhat that accountants fail to accept the logical notion that if a model is founded upon the wrong mould with assumptions that defy nature, eventually the theory will wilt over time. The very purpose of modeling is to create a representation of reality. Hence, if the model does not uphold the properties of the real world, the applicability of the model should be questioned.

But, where is the end state that accountants wish to reach? Will accountants continue to be oblivious to the transformation of the mindset that has occurred within the scientific domain or would accountants instead wish to behave like quantum physicists? Despite the deep-rooted materialism, objectivity and atomistic dogmas being synonymous with the thinking of science for three centuries, physical scientists were willing to abandon them in favor of a more realistic and complete representation of the universe. Even the medical profession is witnessing many transformational acts among its practitioners to reflect the reality of the world as found by quantum physics. In this regard, would accountants want to reduce themselves to be mere spectators only? Wouldn't accountants want to take the lead among social scientists to reframe the underlying building blocks of a new worldview that depicts reality as it is, and not as what it was thought to be since the 17th century? After all, accountants, by their very profession *are* leaders in business. And business leaders should be *knowledgeable* enough to know when a product's useful life has expired. It appears incorrigible for accountants to continue to uphold to the causal-effect, command-control blueprint when even the behavior of inanimate object has been shown not to follow a distinct pattern following quantum physics. The tight grip on the maxim of objectivity as the cornerstone of accounting theory and practice needs re-assessing. The response to these issues will be instrumental not only in influencing the type of leader and leadership role that accountants will play from now on but also in finding a meaningful approach that could motivate and sustain accountants to self-actualize ethical behavior.

The Need for a Paradigm Shift in the Mindset of Accountants

Central to our argument for a paradigm shift for accountants is the substantiveness of the implications of the oneness of the universe and its non-matter aspect. Evidence from new sciences shows that ordinary physical and observable matter makes up less than 5% of the universe. Dark matter which is non-observable and mysterious dark energy makes up the rest (Salleh and Ahmad, 2008). The inference from this discovery is phenomenal. While social scientists, accountants alike, continuously attempt to make meaning of human behavior through limiting their conceptual models to observable, empirically tested and measurable constructs or variables only in order to remove subjective biasness, the reality is that the subjectivity of the universe is about 95%! How reliable is a model that could account for only some percentage within 5% of a phenomenon since not all that counts can be measured!

Accountancy is about leadership and ethical professionals with values. Human values, consciousness and humanity to ancient philosophers were the heart to societal well-being hence, held sacred. Yet, the human was degraded to a machine under the Newtonian-Cartesian regime. This mechanistic model dismissed any non-material aspect of a human. Consciousness too was removed from science. If accountants wish to bring back values, it is imperative that humans takes centre-stage in the accountancy domain. Ironically, the business model of the world brings to primacy the corporation by giving it a legal personality. Many unintended consequences ensued, including attempts to govern the corporations externally with legislations for lacking *human* values through corporate governance. When this governance structure fails, accountants, rather than refocusing on the human needs within the corporations, continued to devise more stringent 'control' stratagems on to the non-natural but legal person. Upholding to the classical science fundamentals without human and humanness traits, accountants would not be able to bring back human values into their ambit. They must shift their fundamental belief and value system to the new sciences'. According to Stapp (2007), what we value depends on what we believe, and what we believe is strongly influenced by science. Quantum physics rescinds the materialistic/mechanistic conception of human beings. Since quantum physics can bring back and explain the concept of consciousness (Stapp, 1995), quantum physics thus is the door to reinstate values and credibility to the accounting profession.

We thus posit that the first step needed is for the accountancy profession to actualize a paradigm shift in their mindset. Like the engineering profession with the maxim of "go back to first principles", accountants too should go back to the origin and question the applicability of the underlying philosophy crafted upon an incomplete picture of the universe. Accepting quantum physics is the first prerequisite. Next, the 'human' needs a redefinition moving from the physical, machine concept to one where the psychological non-material soul is the core and embodied in the physical. It is the former that makes a human, human.

Our Proposed Model for Leadership and Governance

The oneness of the universe is manifested in the presence of paradoxes and dyadic state of affairs. These paradoxes rather than needing an "either-or" decision, presents a continuum state of situations. Balancing of the paradoxes usually results in a series of dilemmas and requires taking the right action that is applicable to the whole (universe) not just a part of the whole. In accounting leadership context, this will involve being responsible to all three strands at once: the self, as individual accountant; the corporation, as leaders of organizations; and the planet and its people.

Leaders must create a sense of identity and integrity with those whom they lead. Leaders should value their position and must remain connected to those below them genuinely without aspiring for the trappings of aggrandizement, honor and prestige. "Leadership is authentic self-expression or influence that really creates value… It's about full awareness of self and full awareness of others" (Cashman, 2001: 20). "The hallmark of a community of truth is in its claim that reality is a web of communal relationships, and we can know reality only by being in community with it" (Palmer, 1998: 97). In order for leaders to actualize oneness in leadership, they must first internalize the complete interconnectedness and interdependence between them and those being led just like all things in the universe. "Everything we have to say … starts with understanding the nature of wholes, and how parts and wholes are interrelated" (Senge et al., 2005: 5). It is the unseen connections that are the essence of creativity (Knowles, 2001). Leaders need to create an "edge of chaos" in order to drive innovation. Leaders cannot straightjacket their mind to be bound by the decisions on precedent. Prefabricated responses lack insight and run the risk of being inappropriate for the situation at hand. Leaders need to have the capacity to change, learn and adapt – to create complex adaptive systems through self-organization; to weave relationships; to transform akin to the morphing of the caterpillar to chrysalis and finally to the butterfly. To us, leaders should not subscribe to a particular path but instead leave a trail where no path has been created. Hence, a holistic but humanistic approach to managing risks and solving problems is needed.

Towards achieving this end, accountants need to move away from only quantitative-based constructs dependent to include too, the qualitative. Numbers alone do not ensure honesty for quality cannot be expressed meaningfully as quantity, without loss of essential datum. Founded upon Western traditions which give privilege status to left-brain activities (Ornstein, 1997), classical science tend to have a predilection for standard operating procedures (SOPs) and is exoteric. In contrast, quantum physics brings consciousness and conscience through the right brain into the fore. This parallels the ancient Eastern right brain-based traditions, which are steeped in spirituality and are esoteric. While the left brain is linear, sequential, abstract and analytical, the right is the reservoir of imagination, originality, intuition, insights and inspirations (OECD, 2007). According to Sahtouris (2002), the Western culture uses and transforms nature to achieve human ends, which is control, whereas others live with nature harmoniously, recognizing human's utter dependence on it. "A white man isolates a piece of nature and takes it into the laboratory to study it because he wants to control it. The red man goes into nature … to integrate with it" (ibid: 3-4). A more holistic approach for accountants is therefore, to balance the use of both sides of the brains unlike currently which is heavily left-brain skewed. Accountants must balance the need for the analytical with the synthesis, the imitative with imaginative, the material with the spiritual, and the objective with the subjective. They need to temper their intelligence with the generosity of the spirit and liberalness of imagination for leadership is about influencing NOT control. But first, accountants as leaders and professionals must have the bravery, self-belief and faith to loosen their grip on their old mindset. "Trace the word professional back to its origins and … it refers to someone who makes a "profession of faith" in a disheartening world" (Palmer, 1998: 212).

In managing the paradoxes of the interconnected universe, accountants, as leaders and leaders of organizations, need to be governed by some form of governance framework. Since leadership is about humanness, we propose an adherence to a governance structure that is human-centric and shaped upon trust in order to effectuate values-based human behavior. Therefore, we call upon accountants to embrace human governance as the core governance structure complemented with corporate governance. While corporate governance is manifested as an external, outside-in rules and regulations to legislate the corporations, human governance is an inside-out, principle- and values-based conviction to guide the human (Ahmad and Salleh, 2008).

We believe that the journey needs to start with the need to know the self through upholding an inner-out thinking perspective. Accountants need to acknowledge that the credibility of the profession can only be brought about by steward leaders who actualize leadership typified with high values, ethics and moral conduct, all internally-induced from the heart. But for change to occur there must be a change in meaning. And in order for accountant leaders to carry and live the meaning of stewardship as they are meant to, accountants need to shift back to a higher order mode of thinking, moving beyond “transactional” and “transformational” to the “transcendental” leadership. Leaders need to move from the lower Mercator projection to the globe, from map to terrain; and from an artist’s canvas to his or her inner vision. In other words, from the world of symbols to the world of meaning. And it is human governance, essentially, innate governance that emphasizes the spirit of the law that can reinstate human well-being.

Conclusion

To surmise, we say that the premise upon which the accountancy theory and practice is shaped no longer is appropriate to address the challenges of the 21st century business landscape. It is the belief system founded upon centuries-old mechanistic debunked model of reality based on classical science that led accountants to perceive the supremacy of an external “control” mechanism as a means to ensure ethical behavior. A more influential approach to motivate and sustain self-actualization of meaningful leadership is one that is inside-out, human-centric, principle-based and innate to human nature. But this cannot be realized unless accountants accept the unbroken wholeness epitome of the new sciences of quantum physics, and the chaos and complexity theory. A problem, according to Einstein, cannot be solved at the same level of consciousness that created it. Therefore, a transformation of the mindset is profoundly necessary. Today's business running on yesterday's model risks its presence tomorrow.

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About The Authors

Assoc. Prof. Dr. Arfah Salleh, C.A.(M), FCPA is an associate professor of accounting at the Faculty of Economics & Management, Universiti Putra Malaysia. Her teaching and research interests are in the areas of systems development, computer-based and problem-based learning, the philosophy of research in social sciences, epistemology and the application of new sciences in management.

Dr. Arfah serves as Adviser to the Ministry of Education for their programme to enhance the quality of the principles of accounting SPM curriculum. She was recently appointed as adviser by Tampere University of Science & Technology, Finland to advise on their project on integrating ICT in accounting. Dr Arfah is the Founding President of the Malaysian Accounting Association (MyAA). Arfah is a holder of a world patent on Methodology of Accounting Teaching. She can be contacted at arfah@putra.upm.edu.my

Prof. Dato' Dr Aziuddin Ahmad is a professor of risk management at the Graduate School of Management Universiti Putra Malaysia. His research interests are in the areas of human governance, the role of sentient heart in decision making, epistemology, ontology, eschatology and the application of new sciences in management.

Currently he is the Independent Non-Executive Director of ValueCap, and Non-Independent Director of i-VCap Management, both are Government-Linked Companies. He recently co-authored with Associate Professor Dr Arfah Salleh a book, Human Governance: A Paradigm Shift in Governing Corporations published by MPH, and a monograph, "Soulful Stewardship: Steering Corporations through Human Governance" published by the Malaysian Institute of Accountants. He can be reached at aziuddin@putra.upm.edu.my

CONSOLATION PRIZE

The Revolutionalized Landscape of Professional Accountants

Assoc. Prof. Pn Sri Datin Dr. Mary Lee Siew Cheng

Dr. Kalsom bt Salleh

INTRODUCTION

The rapid changes in technology and the need to keep business competitive in a borderless economy are some of the future challenges that will be posed to professional accountants in Malaysia and worldwide. Professional accountants would need to move in tandem with these changes to secure the credibility of the profession.

In the past, accountants were pejoratively called “bean counters” with a major role to record financial transactions and produce historical financial statements. However, accountants of today are more known as Knowledge Accountants (K-Accountants) who must be a visionary, flexible, technologically sophisticated, highly experienced and knowledgeable in all aspects of business (Asohan, 2002). Instead of concentrating on compiling and presenting numbers, K-Accountants will have to mine data, turn information into knowledge and share their forecasts with senior management. Major growth areas for K-Accountants are in cash flow forecasting and analysis, computer systems and technology procurement, strategic planning, management policies, strategic management accounting and strategic cost management. K-Accountants would also be dedicated to life long learning opportunities to broaden knowledge so that they can be placed in the mainstream business activities to deal with real time events around the globe (Asohan, 2002).

In the K-Economy era, an accountant cannot focus on accounting and auditing services alone as they also have to act as business advisors or business partners. Accountants must equip themselves with knowledge from other fields and be able to interweave this knowledge into their functions as professional accountants (Aljeffri, 2000). To have a competitive edge over other professionals in a globalised environment, the future accountant or K-Accountant or virtual accountant should be a specialized, adaptive and innovative worker (Khoo, 2000).

The Internet revolution is dramatically changing the role of the accountancy profession in more ways than one. The backward-looking perspective of traditional accounting practices and traditional role of an accountant as more of number crunching i.e. an information recorder and processor is obsolete. Accountants are being asked to perform services that stretch the limits of their ability, training and imagination when predictions or decision-making are made. Future accountants might need to take on the expanded roles of designer, manager and evaluator in the conceptual and technology based function of the accounting system. According to Robert (2007), the next generation of accountants also need to adopt knowledge management (KM), forecasting and optimisation techniques in their forward-looking finance as the latest financial reporting rules to make forward - looking statements mandatory.

Multi–Roles Of Professional Accountants

K-Accountants

The knowledge based economy (K-Economy) era will ultimately make voice, video and data services available anywhere and anytime as a basic business commodity (Khoo, 2000). Therefore, tomorrow's businesses will need people to manage electronic service delivery, integrated and collaborative databases, people networks, virtual corporations and tele-workers. It is inevitable that the 'traditional' accountants not only have to work in this new economic environment but now have to change their role from that of an information recorder or 'tick and bash' auditor to that of a 'plugged in' corporate advisor or computer auditor. Hence, the future of accounting may be in the accountant's ability to shift and to change with the times of the technology revolution while remaining a man of integrity (Kandiah, 2003).

The service of accountants as managers of value is also sought to maximise investments made in information and communications technology (ICT) by the organization. An accountant is ideally expected to give expert advice on selecting the right combination of hardware and software to suit both current business requirements and future expansion plans. An accountant must also ensure the smooth implementation and operation of ICT and future knowledge management systems (KMS), especially in identifying specific areas where ICT and KMS could substantially improve business efficiency, time and cost savings.

Planning, decision making, control and information systems require knowledge not only on financial information but the total information resources available to the organization. Consequently, accountants working in the private or public sectors are involved in the processes of knowledge management (KM), whether explicitly or implicitly (Edwards *et al.*, 2005). According to Edwards *et al.* (2005), KM is about ensuring that what is learned by individuals within organizations is shared and utilized and that processes exist to enhance the embedded intellectual capital of employees and to prevent knowledge assets of the organization from being lost.

In this new economic era, knowledge is critical to the success of an organization. It therefore, needs to be managed well via Knowledge Management (KM). To leverage and reuse the knowledge of the organization in its people, processes, products and structure, the concept of knowledge management has emerged which deals with the creating, sharing, retention and application of knowledge among the individuals to foster better decision making in the workplace.

The relatively recent emergence of knowledge management offers accountants a clear broader scope of information-based role in management. In his earlier study of the changing role of accountants, Parker (2001) argued that accountants have a role in KM. The role is stated as follows:

> "to identify necessary, versus available, knowledge for each organization to determine the gap between these and to develop or acquire the requisite knowledge, utilizing this and evaluating its utilization….. Accountants can be pivoted knowledge managers promoting a culture of continuous organizational learning, analysing and identifying knowledge gaps, managing knowledge capture, sharing and retention, incorporating KM into strategic planning and implementation, and leveraging organizational learning…Organizations stand to benefit from the accountants' attention to KM in the linking of operational and financial performance, more effective knowledge discovery, transfer and use, greater routinization and retention of specialist knowledge, more effective

employee training, lower knowledge loss rate.” (p.437 -8)

Another study on the key role of management accountants in KM was reported by Edwards *et al.* (2005) in their research work entitled “knowledge management and its impact on the management accountant”. The report highlighted several critical points in relation to KM and accountants. Accountants in general (management accountants in particular) are implicated in the management of their organization’s knowledge resources because the effective utilization of that knowledge is reflected in ultimate business performance. There is a potential role for accountants to become more involved in the broader issue of KM as the driver of business success. The accountant has become increasingly marginalized in the knowledge economy. By focusing on reporting the stock of intellectual capital rather than focusing on the flow of knowledge and how better KM can improve organizational performance is perhaps a reflection of that marginalization. This research has identified the potential role for management accountants i.e. to refocus (rather than to expand) their view of strategic management accounting from gathering more information about customers, suppliers and competitors to managing knowledge resources that are already held within organizations, but, which is not routinely or effectively utilized. The accountant has to be ‘inward-looking’ - making better use of the information and knowledge that is already available within the organization and not focused on ‘outward-looking’. Consequently, all professional accountants need to take a more strategic focus, expand their view to a range of non-financial measures and understand the links between the improved knowledge management process, organizational performance and intellectual capital (Edwards *et al.*, 2005).

Financial knowledge is the most visible organizational knowledge as it is being reported broadly and routinely. Therefore, accountants in general are implicated in the management of their organization’s knowledge resources because the effective utilisation of that knowledge is reflected in ultimate business performance (Edwards *et al.*, 2005). Thus, accountants should be more concerned with the ‘flow’ of knowledge that takes place as part of organizational processes and how better KM can improve organizational performance. In measuring intellectual capital (IC), accountants should go beyond the value of stocks of IC to measure the economic value they produce. The emphasis should shift from the stocks of IC to the processes by which it is managed i.e. the flow of knowledge (Van Buren, 1999). More often, people see KM processes purely in terms of information technology, but effective KM actually needs people, organizational processes and culture that are outside of the computer systems. Therefore, accountants should be the participants in the process for managing the flow of knowledge before they are involved in the valuing and reporting the embedded organizational knowledge or intellectual capital (Edwards *et al.*, 2005).

It is clear that the role of accounting and accountants are changing. For financial knowledge to add value and contribute proactively to organizational success, accountants need to take a more strategic focus to expand their views to a range of non-financial measures and demonstrate the links between improved KM processes, organizational performance and intellectual capital. The majority of KM metrics (internal management measures, workforce measures, quality measures, time measures, productivity measures, esteem measures and key performance indicators) suggested non-financial (indirect) measures of the effectiveness of KM processes (Edwards *et al.*, 2005) for the value creation capability of the embedded intellectual capital of the organization which are being measured by IC indexes for human, customer and structural capital.

Accountants do have a potential role to become more involved in the broader issues of KM and IC as well as in a reformulated strategic management accounting i.e. to be inward-looking focused by making better use of the information and knowledge that is already available within the organization (Edwards *et al.*, 2005). Edwards *et al*. (2005) also argued that the early study of strategic management accounting which required accountants to be outward-looking at information from suppliers and competitors to evaluate the organization's competitive position is found to be less eminent in the K-Economy era. The best area of the accountants' involvement in KM is in the area of strategic management accounting, in particular, how strategic management accounting may play a role in operationalising intellectual capital reporting into KM processes (Edwards *et al.*, 2005; Parker, 2001; Tayles *et al.*, 2002).

Accordingly, the reinvented accountants, particularly management accountants need a broader knowledge base including areas such as operations, product and process technology, systems, marketing and strategic management in order to address the risk of the marginalised role of accountants in this new economic era (Cooper, 1996). The brave new world requires management accountants to reinvent themselves for their reskilling and contribution to strategic management, knowledge management, risk management, environmental management and change management (Parker, 2002). The focus must be switched from historical stewardship to strategic management accounting and value creation accounting. Armed with strategic, analytical, technological, leadership and communication skills, the reinvented accountant i.e. K-Accountant can emerge in a possibly rebranded appearance to take on the value adding, knowledge based decisions and leadership roles being sought by present day organizations (Parker, 2002).

Enterprise Governance

The professional accountant as a chief executive officer in an organization provides the leadership pillar and plays a leading role in enterprise governance encompassing performance, conformance and corporate responsibility. Enterprise Governance is defined by the Information Systems Audit and Control Foundation as "the set of responsibilities and practices exercised by the board and executive management with the goal of providing strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that the organization's resources are used responsibly". Though much has been said and done on the need to conform to good corporate governance practices with codes, audit assurance and audit committee oversight boards but these seem to be inadequate to ensure the success of the organization to meet the shareholders' and stakeholders' expectations. Enterprise governance looks further, by addressing performance management with emphasis on strategy, resource utilization and value creation. This includes the business governance processes of assisting the board to make strategic decisions, strategic risk management, understanding the key performance drivers and ability to manage change.

Good corporate governance practices are a critical global issue. The financial crisis in 1997 triggered the corporate governance debate attributing the crisis to the lack of effective corporate governance mechanisms both from the regulatory authorities and from within organizations. Good corporate governance practices provide a check and balance mechanism within the organization to ensure that it is run in the best interests of the shareholders/stakeholders. The findings of a survey conducted by McKinsey in 2002 concluded that investors are willing to pay a share premium for companies that practice good corporate governance. Good corporate governance practices involve strong leadership, good management, effective monitoring and proper accountability. Professional accountants as directors provide the leadership role with entrepreneurial flair, integrity in personal and business dealings, competent to identify strengths and weaknesses of the company, ability to recognize opportunities and threats in the business environment, possesses analytical ability and professional skills. A professional accountant has the ability to assist the audit committee in its monitoring role. As the Chief Executive Officer, professional accountants assume the role of corporate responsibility and setting a good corporate practice culture and tone at the top of the organization.

The success of the enterprise governance also relates to the role of risk management, an area of paramount importance to an organization as taking too little risk or too much risk would affect its success or failure. Globalization warrants a risk model that focuses on external risks and threats, new competition, changing technology and mergers & acquisitions activity. In this respect, they can help companies to establish and maintain Enterprise Risk Management processes which include the five elements; of establishing a business framework to assess the risk appetite, identification of significant risks, measuring risks as to its likelihood of occurring and its impact on the business, ways to deal with risks and offering proactive advice on embedding risk management processes into business activities and lastly, to provide objective assurance that the risk management process is working, adequate, not being abused and is changing with the needs of the organization. As part of the risk management measure, professional accountants can ensure good internal controls (such as policies and procedures) are in place in the organizations to manage risks.

There has been a radical change in the relationship between business and society, moving from paternalistic philanthropy to corporate social responsibility (UNIDO Media Corner 2002), implying responsibilities to the society extending beyond making a profit (Wheelan & Hunger 2004). Porter and Kramer (2006) identified corporate social responsibility (CSR) as responsive CSR, to be a good corporate citizen and strategic CSR, requiring the company to adopt strategies going beyond best practices. As such, this requires firms to balance their strategic actions against the duty of being good corporate citizens.

Educators

It is interesting to note that no accountant should be out of a job in the future as accounting graduates are in high demand and are sought after by local and international firms (Nagu, 2008). The employment opportunities are endless for accounting graduates and therefore, professional accounting programs offered at public or private higher education institutions must be designed with an aptitude for numbers, logic and reasoning and other skills (leadership and soft skills) that are marketable and transferable in all types of business industries (Nagu, 2008). With the nature of the present information age, future accounting graduates must get accustomed to the change in roles of accountants as forward thinkers and business advisors or financial controllers with expertise in business problem solving. MIA president, En. Nik Mohd Hasyudeen Yusoff pointed out that the role of accountants has expanded and studying accountancy is no longer a means to end up working as a financial accountant or auditor. The extensive training which exposes accountants to various aspects of planning and strategy can make them assume leadership roles in the top management position of organizations

(Malaysian Institute of Accountants, 2008).

How can professional accountants play the role as educators with professional capabilities to meet the market expectations? The changing role of professional accountants has been highlighted by the President of the International Federation of Accountants (IFAC), Mr. Graham Ward in his speech in June, 2005 entitled "The Future of The Accountancy Profession". He reminds accountants to stay relevant, up to date and market oriented in order to ensure their bright future. Hence, they need to perform their role in three fields. First, in business by creating wealth and contributing to strong governance and fair financial reporting; second, in the public sector, they should play a role in the sound, efficient and ethical operation of government organizations and in protecting the rights of their citizens and in public practices as auditors, in facilitating fair, well informed capital markets; and lastly as professional advisors in creating wealth.

Hence, there is a need to produce 'hybrid accountants' that blends different skills and knowledge of business management and information management. Malaysian accountants cannot runaway from adopting them and have to think of innovative ways of doing business. Otherwise they will become less competitive as their employer or client's company would be facing the same global competition. En. Nik Mohd Hasyudeen Yusoff also felt that there needs to be more cohesion between the academia and accountants. They need to work together on projects based on real market needs and in the process of developing new knowledge. With understanding of these elements, the academics can also transfer this knowledge to students to equip them with relevant skills way in advance of joining the workforce and industry (Ravendran, 2007).

In tandem with the above, new required accountants' skill sets for professional accountants are required. IFAC (2003) has issued the International Education Standard 3 (IES 3): Professional Skills and General Education on the professional skills for professional accountants. The aim of this standard is to ensure the appropriate mix of skills to be acquired by professional accountants. The five (5) professional skills (IES 3) required that befit professional accountants are 1) intellectual skills 2) technical and functional skills 3) personal skills 4) interpersonal and communication skills and 5) organizational and business management skills. This standard enables accountants to function throughout their career as competent professionals in an increasingly complex and demanding environment. The skills are part of the set of capabilities required by professional accountants to demonstrate competence. The capabilities of professional accountants, which include knowledge, skills, professional values, ethics and attitudes are an indication of potential competence that can be transferred across different environments.

Public Sector Accountants

The former Accountant General of Malaysia, Datuk Othman bin Abdullah has also made a few important points at the National Conference of Public Sector Accountants in 2004 on the new expected roles of accountants in the public sector in delivering the quality of accounting and financial services to enhance greater accountability and transparency of government organizations. Accountants in the public sector are expected to transform from transactions processor to provider of financial information, being a party in decision making, be adaptable to all bases of accounting and to have greater involvement in the finance, budget, investment, audit, taxation and consultancy fields. Accountants in the public sector need to ensure that bureaucracy in service delivery should be reduced to the minimum in order to enhance work performance without sacrificing the check and balance. They must demonstrate their keen efforts in continuously improving the accounting systems and reengineering the business and accounting processes using the latest ICT tools (Abdullah, 2004).

Through the International Public Sector Accounting Standards issued by IFAC, public sector accountants are encouraged to report the government's financial position and performance and the cash flow in a transparent and high quality manner. Such high quality information and well-informed reporting is vital to the efficient operations of government and can assure the public that the government's resources are managed effectively (Ward, 2005).

The accounting function continues to be a critical component of the internal control and external reporting functions of the government. Public sector accounting seeks to prevent fraud and waste, ensure that the operations of an entity are reported accurately, ensure compliance with applicable laws and stated policies. The traditional roles of public sector accountants as historic reporters, custodians of financial accounts and guardians of assets may be incompatible with the various public management initiatives such as electronic government, key performance indicators, etc. that have recently been adopted by many government organizations. In response to the automation of the accounting function, fiscal pressure and downsizing, privatization of core functional areas, and increasing importance of non-financial measurement systems in program evaluation, accountants in the government sector must adapt to this evolving environment and break away from their traditional role as number crunchers. Thus, public sector accountants must function as public managers when they make decisions by exploring different options available in planning and executing various actions within agreed upon procedural norms. This can be achieved by making use of their knowledge, experience and professionalism and provide decision support through knowledge sharing and dissemination (McCue, 2001).

Conclusion

As the country moves towards becoming a borderless world in the era of globalization, people can engage the services of accountants anywhere for accounting services. In this respect, adequate steps should be taken by MIA to ensure that Malaysian accountants are competitive and can meet the international standards for global players. Therefore, MIA has to shoulder the responsibility of providing education and training towards professionalism and integrity of its registered members (Liew *et al.*, 2004).

In conclusion, accountants need to understand that they can play many important roles towards the revolutionalization of the professional accountant landscape for the success of the business organization in the K-Economy era. The focus of the professional accountant has to be 'inward-looking' in making better use of the information and knowledge that is already available within the organization for 'forward-looking' accounting approaches in the financial reporting and decision making purposes. There are 'forward looking' numbers and accounting concepts in the financial statements such as fair value accounting and reporting. Consequently, all professional accountants need to expand their view to a range of non-financial measures and understand the links between financial and non-financial measures for the improved organizational performance and financial results. In the past, accountants were mere bean counters that recorded financial transactions and produced historical financial figures but K-Accountants in the new economy era will need the knowledge and ability to analyze financial information and convert those results into predictive tools for effective financial reporting and decision-making systems.

Hence, accountants who received their training and qualification before the advent of the internet revolution will need to have their knowledge continuously updated throughout their working life to meet the needs of the future K-Accountants. Accountants like all other professionals are 'time and technology challenged' with increasing demands on their limited time and ability. The only way to do this is to attend the structured and accredited CPE/CPD courses for a sustainable competency assessment programs as organized by MIA and to attend other professional trainings for further specialist qualifications. It would also seem appropriate for the training needs of professional accountants to cover not just technology-based approaches but also people-based and process-based approaches. Despite maintaining credibility of the accountancy profession through many initiatives such as education, development, promoting professional standards and values, MIA also works towards its surveillance and enforcement responsibilities that can enable MIA to uphold public interest and confidence in the profession. Sustainable competence assessment programs and effective surveillance and enforcement mechanisms are essential in creating a sound financial reporting climate as well as enhancing the competitiveness of Malaysian accountants. It is equally important for Malaysia's professional accountants to take the necessary measures to adapt to the rapidly transforming landscape of professional accountants in order to play their important role in the dynamic changing business environments (Malaysian Institute of Accountants, 2008). Accountants need to become part of the solution in contributing towards real creativity and innovative action in financial reporting and new accounting systems and techniques to address the sustainability revolution (Mooney, 2008). In addition, the auditors of tomorrow will have to be always ready to live up to the expectations of the public, maintain high professionalism and uphold the good reputation of the auditing profession (Lee and Md Ali, 2008).

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About The Authors

Assoc. Prof. Puan Sri Datin Dr Mary Lee Siew Cheng, C.A.(M), is a senior lecturer in the Faculty of Accountancy, University Teknologi MARA, Shah Alam, Malaysia. She is attached to the Professional Program Department and is the lecturer for the Auditing and Professional Accountant paper (for the CIMA examination). She is a Fellow member of the Malaysian Institute of Taxation, CIMA, Association of International Accountants (UK) and The Institute of Internal Auditors, Malaysia.

Dr. Kalsom Salleh, C.A.(M), is a senior lecturer in the Faculty of Accountancy, University Teknologi MARA, Shah Alam, Malaysia. Her teaching and research areas of interest include knowledge management, intellectual capital, electronic government, public sector accounting and management, corporate governance, auditing and financial accounting and reporting. Dr Kalsom (corresponding author) can be reached at kalsom816@salam.uitm.edu.my

CONSOLATION PRIZE

The Motivations Of Professional Accountants In Business

Dr Foo Yin Fah

Abstract

According to the International Federation of Accountants (IFAC), professional accountants in business are expected to make rational and objective judgments and decisions that are based upon values of honesty, integrity, transparency and a high standard of ethical behaviour. But the actual values held by accountants, represented by the motivational goals that serve as guiding principles in their lives, are affected by their interaction with the environment in which they live and work. Drawing from the universal human values, a set of accounting values can be extrapolated that would represent the motivational goals of professional accountants. From a survey of professional accountants in Malaysia, it was found that many accountants are motivated by the need to transcend their own narrow self-interest to safeguard the broader concerns of others. The Malaysian accountants have a conformist tendency and an aversion to risky situations. At the same time, the accountants have a propensity to demonstrate independent thoughts and actions through exercising their professional judgments. An understanding of the actual values that motivate accountants would assist in their education, training and professional development so that they may play their role more effectively in an increasingly uncertain and volatile business environment.

Introduction

IFAC in their information paper on the Roles and Domain of the Professional Accountants in Business, described these roles to include the following:

> … implementing and maintaining operational and fiduciary controls, providing analytical support for strategic planning and decision making, ensuring that effective risk management processes are in place, and assisting management in setting the tone for ethical practices. (IFAC 2005a p.1)

According to IFAC (2005a), the professional accountant in business (PAIB) performs a critical role in balancing the need for good corporate governance and the pursuit of business performance and value creation. In carrying out these responsibilities, the PAIB is expected to apply a multitude of technical tools and techniques that are available in the field of accounting and financial management. In applying these tools and techniques in an increasingly uncertain and volatile business environment, the PAIB is expected to exercise rational, disciplined and objective analysis, judgment and decisions. The PAIB is also expected to uphold the principles of honesty, integrity, transparency and a high standard of ethical behaviour.

The accounting and financial management tools and techniques represent the technical aspect of the role of the PAIB. These skills and knowledge can be imparted through the process of education and training of accountants. The ability to make appropriate judgments and decisions based on the values of accuracy, honesty, integrity, objectivity, transparency and reliability are, however, related to the behavioural aspects of the accountant. The PAIB is expected to behave in accordance with the requirements of the profession based on a set of principles of good practice. These principles encompass the need to protect the interest of the public and not only the exclusive needs of the client or employer.

Studies have shown, however, that these behavioural aspects of accountants are influenced not only by their education and training but also by the environment in which accountants live and work. The accountants operate in an environment that comprises of institutions and groups such as corporations, regulatory bodies, investors, bankers, social and environmental interest groups and the general public. In interacting with this environment, the accountants develop appropriate behaviours and responses. The manner in which accountants behave and respond to their environment is influenced by their values, attitudes and beliefs. These values, attitudes and beliefs would in turn have been indoctrinated and reinforced through the accountants' specialised education, professional training and working experience. Therefore, the PAIB and the accounting profession as a whole may possess a unique set of values that are shared by all its members. The aim of this paper is to identify these accounting values and examine whether they are consistent with the expectations of IFAC. An understanding of these accounting values can also assist in the efforts of improving the education, training and professional development of accountants worldwide.

Universal Human Values

Values have been described by Schwartz and Bilsky (1987) as the criterion that people use to select and justify their actions and to evaluate themselves and others as well as events. These values represent the psychological processes that are developed in meeting the universal requirements of human existence. These universal requirements comprise the individuals' biological needs, their desire for coordinated social interaction and the social institutional demands for group welfare and survival. According to Schwartz and Bilsky, these psychological processes are manifested by a set of motivational goals that serve as guiding principles in the lives of individual persons.

Values may be acquired early in life and remain unknown to those who hold them. They cannot be discussed, or be directly observed by outsiders. Values are ordered by relative importance and can only be inferred from the way people act under various circumstances. Therefore, a professional accountant would possess a set of values that has been acquired through interaction with the environment including education, family and friends. These values, which transcend specific situations, can influence the way the accountant acts in different situations including the judgments and decisions they make.

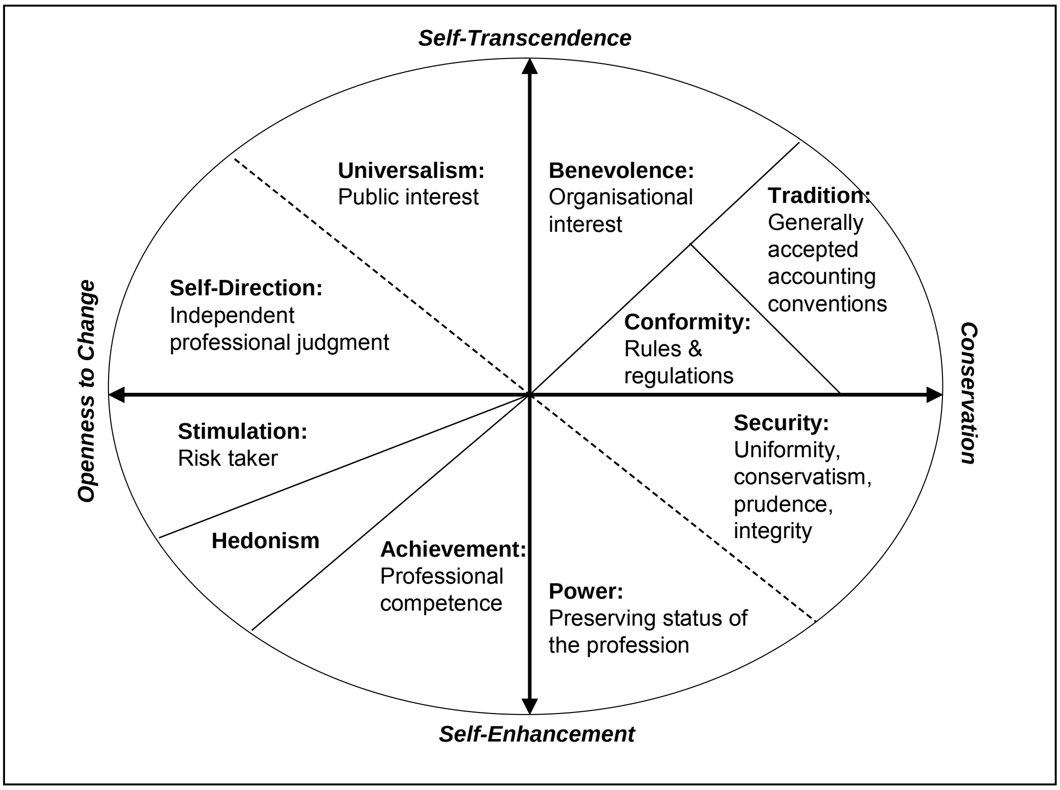
Schwartz (1992) later went on to discover a set of universal human values based on a sample of mainly school teachers from 20 countries representing different cultures, languages and religions. They were chosen as appropriate samples in Schwartz's study as they best represent their respective cultural groups. Schwartz argued that when people pursue the goals that represent their values, the universal aspects of the human social condition would lead to cross-culturally consistent psychological, practical and social consequences. As a result, consistent relationships among different values emerge across various cultural groups, reflecting the psychological dynamics of conflict and compatibility between these values. These relationships were used by Schwartz to develop a universal structure of human values represented by a set of ten value types that reflect different motivational goals.

The generality of Schwartz's (1992) structure of universal human values is supported by the consistency of the results from his 1992 study. Schwartz found evidence to show that people do implicitly distinguish the ten types of motivational values as guiding principles in their lives and these motivational values are quite close to universal values. These ten motivational value types comprise self-direction, stimulation, hedonism, achievement, power, security, conformity, tradition, benevolence and universalism.

Motivational Values in Accounting

Drawing from Schwartz's (1992) theory of the universal structure of human values, it is possible to hypothesise the application of the motivational goals of individuals in the domain of accounting. Figure 1 below shows a set of motivational values in accounting or accounting values that is extrapolated from Schwartz's ten universal human motivational values.

Figure 1: STRUCTURE OF MOTIVATIONAL VALUES IN ACCOUNTING



Adapted from Schwartz (1992)

According to Schwartz (1992), the array of values in the universal structure represents a circular continuum of motivations. Schwartz found that the order of regions around the circular structure of values supports his theory of the dynamic relationship between the ten motivational goals or value types. He argued that actions taken in the pursuit of each value type have psychological, practical, and social consequences that may be compatible or may conflict with the pursuit of other value types. Adjacent value types, as shown in the circular structure of motivational values in Figure 1, are postulated to be most compatible. Increasing distance around the circular order indicates decreasing compatibility and greater conflict. Value types that are in the opposing locations are postulated to be in greatest conflict.

The two motivational values on the left of the continuum are self-direction and stimulation. According to Schwartz (1992), self-direction represents an individual's desire for independent thought and action. Self-direction values in accounting can therefore refer to the desire of accountants to exercise their professional judgment in carrying out their duties without being restricted by rules and regulations. The motivational goal of stimulation represents the individual's pursuit of an exciting and challenging life. Stimulation values may manifest in the accountant's propensity to take on more risk, for example, in the recognition, measurement and disclosure of financial information.

Schwartz (1992) argued that the pursuit of stimulation values is compatible with self-direction values as these values motivate people to follow their own intellectual and emotional interests in unpredictable and uncertain directions. In the context of accounting, the desire to make independent and creative decisions through exercising professional judgment in the pursuit of self-direction goals is attuned to the willingness to operate within a challenging, unpredictable and uncertain environment that is consistent with the goal of stimulation. The combined motivational goals of self-direction and stimulation represent the desire to master one's own destiny and to embrace change.

However, the motivational values of self-direction and stimulation are in direct conflict with tradition, conformity and security values located on the opposite end of the circular continuum. According to Schwartz (1992), the motivational goal of security is derived from the basic needs of protecting the individual or the group. Security values incorporate the desire for social order, and family and national security. In the context of accounting, the motivational goal of security would include the need for certainty, stability and integrity in the practice of accounting and the conduct of the profession. The preference for security values would result in accountants adopting conservative and prudent attitudes, practising due care and diligence as well as placing importance on reliability and dependability. A desire for security would also mean an aversion to volatility, resulting in a preference for uniformity and consistency.

Schwartz (1992) found that the motivational goal of security is compatible with conformity and tradition values. The motivational goal for conformity is described by Schwartz to manifest in an individual's tendency to avoid actions that would violate social expectations and norms. Therefore, the pursuit of conformity values, in the context of accounting practice, refers to the propensity to comply with rules and regulations set by organisations and regulatory bodies. Tradition is a motivational goal that is closely related to conformity. It refers to the need to respect customs and traditions of the group that an individual belongs to. The values of tradition refer to the inclination of accountants to follow generally accepted accounting conventions and practices such as the traditional transaction-based historical cost accounting and the principle of conservatism. Tradition and conformity values share the same motivational goal of the subordination of the individual in favour of socially imposed expectations. Both values reflect the common need for self-restraint in making decisions and not to 'rock the boat' or challenge the system. Schwartz found support for the commonality of tradition and conformity values as they were usually located on the same wedge of the circular structure of values as shown in Figure 1.

According to Schwartz (1992), the distinguishing feature between tradition and conformity lie in the object to which one subordinates the self. While conformity values refer to the subordination to persons or groups that one interacts with, tradition values are concerned with subordination to more abstract ideas or concepts. But all three values of security, conformity and tradition motivate people to preserve the status quo and establish a degree of certainty, stability and integrity in the groups and institutions that they belong to. These conservation goals are in conflict with self-direction and stimulation values that motivate accountants to be open to change through exercising their own independent professional judgment in a dynamic and uncertain environment.

At the bottom of the universal structure of human values lie the motivational goals of achievement and power. Schwartz (1992) postulated that these values represent an individual's need for self-enhancement in order to advance personal interests. The defining goal for achievement includes striving for personal success through demonstrating competence according to social standards. The motivational goal of achievement is reflected in the accountants' effort to maintain a high level of professional competence in the work that they do. This is demonstrated in the standards issued by IFAC on the education and practical work experience (IFAC, 2003) of professional accountants as well as their continuing professional development (IFAC, 2004) to meet the increasing demands placed on the profession by the society.

Power has a similar focus on social esteem as achievement values but refers more to the abstract outcomes of actions in the form of the attainment of social status and prestige. According to Schwartz (1992), the desire for power stems from the importance of status differentiation in the functioning of social institutions. In accounting, professional associations like the Malaysian Institute of Accountants and the Malaysian Institute of Certified Public Accountants have constantly branded the accounting profession based on its status and prestige. The motivational goal of power may also manifest in the accountants' desire for professional self-regulation rather than be subjected to public regulation and statutory control.

On the opposite end of the circular continuum are the motivational values of benevolence and universalism representing the motivation to transcend one's own selfish needs to promote the interest of others.

According to Schwartz (1992), these self-transcendent values are in direct conflict with the self-enhancement values of achievement and power. The motivational goal of benevolence refers to the need to preserve and enhance the welfare of people with whom one is in frequent personal contact. In accounting, benevolence can be interpreted to refer to the need to safeguard or enhance the interest of the organisation or institution in which the accountant belongs. Universalism, however, has a broader focus than benevolence. The motivational goal for universalism refers to the understanding, appreciation, tolerance, and protection for the welfare of all people. In the context of accounting practice, the motivational goal of universalism is most closely related to the accounting profession's responsibility to act in the interest of the public (IFAC, 2005b).

The tenth motivational goal of hedonism does not appear to have any obvious manifestation in accounting practice. According to Schwartz (1992), hedonism refers to the pursuit of pleasure and enjoyment in life and is located in proximity to the values of stimulation and achievement. Depending on the location of hedonism relative to achievement and stimulation values, it serves to accentuate behaviours related to these motivational goals. Therefore, if hedonism is more strongly correlated with stimulation, the accountants have a tendency to obtain greater pleasure and excitement from the challenge of undertaking risky decisions and consequently are more inclined to take on more risk. However, if hedonism is more strongly correlated with achievement, the accountants obtain greater satisfaction from the recognition by society of their professional and technical competence. The accountants would therefore be more inclined to demonstrate their knowledge and competence in the work that they do.

Schwartz's (1992) theory of the universal structure of human values provides an interesting and compelling framework to examine the accounting values of the PAIB. The structure of the motivational values would enable the observation of the psychological and social consequences of pursuing the accounting values held by professional accountants. The accountants' evaluation of their motivational goals along the ten value types would provide a picture of whether they are more inclined to transcend their own self-interest to serve the needs of the public and the organisations that employ them. It would also reveal whether the accountants have a propensity for conservation values of conforming to rules, regulations and conventions and maintaining an environment of stability, certainty and integrity, or they are more inclined towards independent thoughts and actions and to embrace change and uncertainty.

Research Method

In order to observe the attitudes, beliefs and opinions of the PAIB in Malaysia about their motivational goals in accounting, a research survey was conducted. A nine-page survey questionnaire was mailed to 2,760 members of a professional accounting association in Malaysia in 2006. The survey instrument, adapted from Schwartz *et al*. (2001), contained 40 short verbal portraits of a hypothetical person's goals, aspirations or wishes. These 40 verbal portraits make up a set of multi-item scales that measure the ten individual-level universal motivational value types. Each verbal portrait requires respondents to rate "How much like you is this person?" using a six-point rating scale, ranging from 1 for 'not like me at all' to 6 for 'very much like me'.

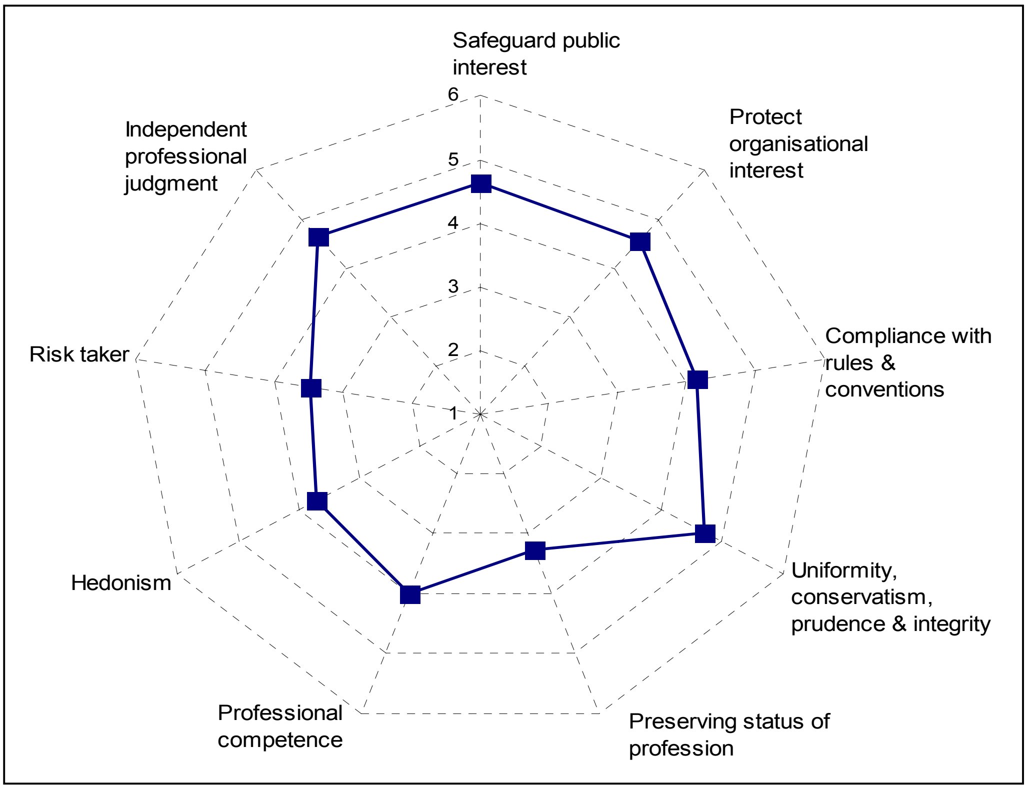
A total of 244 replies were received representing a response rate of 8.8%. Poor response rates appear to be more acute among accountants in Asian countries as found by Chanchani and Willett (2004). They conducted a survey of accountants in New Zealand and India and obtained a response rate of 44 and 18 percent from the New Zealand and Indian accountants, respectively. Despite the low response rate in this study, it is argued that the results of this study are still generalisable as the profile of the respondents is representative of the membership of the professional association surveyed. This is based on the findings that the age, ethnic and gender compositions of the respondents were consistent with the membership profile of the professional association.

Of the total respondents to the survey questionnaire, only 19% held the positions of senior, manager or partner in professional accounting firms. The rest of the respondents were employed in various finance and non-finance related positions in commerce and industry. Therefore, the result of this study is representative of the attitudes, beliefs and opinions of the PAIB in Malaysia.

The Accountants' Motivational Value Structure

The consistency and reliability of the 40 multi-item scales in measuring the ten individual-level universal motivational value types were tested and confirmed. The exception was that the scales used to measure conformity and tradition had to be combined into a single goal of compliance with rules and conventions in order to produce a better internal consistency. Consequently, the structure of the accounting values was found to comprise nine motivational goals as shown in the form of a radar chart in Figure 2 below. The shape of the radar chart provides a representation of the motivational goals of the PAIB in Malaysia.

Figure 2: MOTIVATIONAL VALUES OF ACCOUNTANTS



The IFAC would be happy to note that the PAIB in Malaysia have a propensity to transcend their own personal and professional needs in order to safeguard the interest of the public and the organisations that they belong to. This is evidenced from the relatively higher ratings given for the self-transcendent values of safeguarding public interest and protecting organisational interest as compared to the self-enhancement values of professional competence and preserving the status of the profession. Both these values of safeguarding public interest and protection of organisational interest have a strong positive correlation consistent with Schwartz's (1992) theory. It is, however, interesting to note that there were more variations in the ratings given by respondents for the motivational goal of safeguarding public interest than protecting organisational interest. Given that the majority of the respondents were employed in business, this is consistent with the argument that the PAIB have a vested interest in the organisation that employed them and would be more inclined to protect its interest relative to the general public.

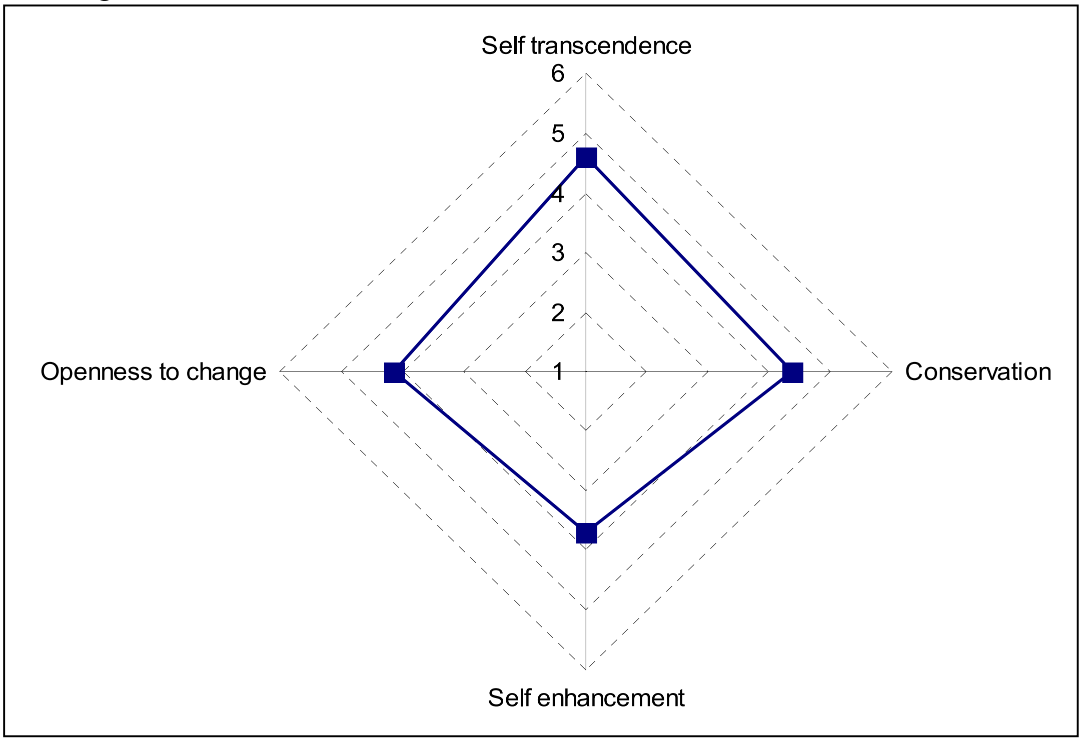
The radar chart in Figure 2 shows that the professional accountants are relatively less concerned about the status and prestige of the profession and do not place much importance on the need to demonstrate their professional competence. The two self-enhancement values have a strong positive correlation but the respondents rated preserving the status of the profession relatively lower. This is perhaps an indication of the fact that 80% of the respondents were made up of PAIB who may not be as concerned about the profession as the accountants in public practice.

The values of conservatism, prudence, integrity and uniformity are strong motivational goals for the accountants as shown by their relatively higher ratings. This is an indication that the respondents are generally motivated by the need to follow prescribed rules and regulations as well as established ways of doing things to meet their professional and social obligations. This stems from what Schwartz (1992) describes as a need to meet the expectations of society and not to create unnecessary disruptions in social interaction. This is perhaps a reflection of the accountants' education and training to exercise due care and diligence in their work, to place importance on honesty and dependability and to avoid volatility and instability. Consistent with this conservative outlook, the accountants were found to also have a propensity to avoid risky situations as shown by the relatively low rating for the stimulation values of risk taking. There is, however, some diversity in the respondents' opinion on this dimension.

The accountants, however, considered themselves as people who desire independent thought and action. They rated themselves highly on the self-directional goal of exercising independent professional judgment. The preference for this motivational goal will create psychological conflicts with conservation goals. Although accountants are prepared to accept new challenges and ways of doing things, they will always take a conservative and prudent approach that would create the least uncertainty and instability.

The accountants were found to be less inclined to indulge in hedonistic pursuits. The low rating for hedonism is strongly correlated with their low rating for the stimulation goal of risk taking. This explains the rather conservative and staid perspective of the profession.

Figure 3: HIGHER ORDER ACCOUNTING MOTIVATIONAL VALUES



In summary, the psychological conflicts and compatibilities, arising from the pursuit of the nine accounting motivational value types, is reflected in the two dimensional bipolar structure illustrated in the form of a separate radar chart in Figure 3.

The structure of this higher order motivational values indicate that accountants in Malaysia generally believe that collective interest is more important that the interest of the individual. The accountants feel it is more important to consider the interests of the public and the organisation rather than the status and prestige of the profession and to demonstrate their professional competence. However, it is interesting to note that the accountants place a lot of importance on exercising independent professional judgment, a goal that serves primarily individual interest. The pursuit of this goal appears to be tempered by the need to maintain an environment of certainty, stability and integrity. As a consequence, the accountants are generally inclined to follow rules and traditions and to adopt a cautious approach to their work. This is perhaps influenced by the desire to ensure that the interests of the public and organisation are not compromised by aggressive accounting and business transactions.

Conclusion

The structure of the accounting motivational values described in the preceding paragraphs has enabled the values, attitudes and beliefs held by the PAIB to be observed. Understanding the structure of the motivational values of accountants will help in examining how accountants make their judgments and decisions. The understanding of the motivational values of accountants would also assist in the efforts to improve the education, training and professional development of accountants worldwide. The knowledge of the accounting motivational values structure of particular groups of accountants would enable organisations such as the IFAC and other accounting institutions to formulate appropriate educational and professional development strategies. The implementation of ethics education, for example, may be facilitated by the understanding of the values, attitudes and beliefs of particular groups of accountants.

Understanding the nature of the motivational values that may have created barriers to the acceptance of new concepts and approaches to accounting may assist in the formulation of appropriate education and training approaches.

Future research may be conducted to examine whether the structure of the accounting values are consistent across different societies. If the values, attitudes and beliefs of accountants are affected by their environment, it is expected that accountants in different societies will have different preferences for the motivational goals. The different value priorities will therefore have an effect on the accountants' judgments and decisions. The results from such studies may have important implications to policymakers and regulatory bodies. The global community's effort to bring about international convergence of accounting and auditing practices should not be only about the introduction of a single set of standards and regulations. In order to bring about true convergence, there is a need to understand how different value priorities in accounting would affect the accountants' judgments and decisions. The accounting motivational values would, therefore, represent an important contribution to the efforts of bringing about true convergence in accounting and auditing practices.

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About The Author

Dr. Foo Yin Fah, C.A.(M), is the Head of the Australian University Programme at Sunway University College, Malaysia. He is also a lecturer in Advanced Financial Accounting at the undergraduate level and is an MBA facilitator of Accounting for Management with the Victoria University, Australia programme conducted in collaboration with Sunway University College. He is a member of MICPA and a Fellow of CPA Australia. He can be contacted at foo-yf@sunway.edu.my

CONSOLATION PRIZE

Internal Auditor In Strategic Decision Making: The Unheard Voice?

Ms. Nor Hafizah bt Zainal Abidin

Abstract

The internal audit function (IAF) is crucial in strategic decision making (SDM) more than many realize. IAF in SDM translates by gauging the nature and extent of the internal audit function's involvement in different phases of strategic decision making. The involvement of IAF in SDM contributes by enhancing and expanding the existing IAF's role in the assessment of risk management and control processes that enable IAF to create more value to the organization. The value creation process delivers through the utilization of a strategic and risk-based-audit approach supported with independent and competence criteria. In order to achieve far greater IAF involvement, *recognition, trust and support* from *management and the audit committee* is crucial. At present, greater emphasis is given to compliance and financial reporting direction rather than strategic management activities. This study aims to examine *how and why* IAF should be involved in SDM by means of reviewing existing literature and relevant standards in materializing the conceptual framework.

Introduction

Roles and responsibilities of professional accountants in business (PAIB) evolve rapidly in sequence with transformation in technology, regulations, competitive business environment and globalisation. According to IFAC (2005), professional accountants today are perceived as multi-contributors such as financial information providers, business leaders, corporate financiers as well as business advisers. In order to enhance the credibility of professional accountants, they need to comply with stringent requirements of professional standards on competencies, accountability and ethical values. Skills, knowledge and expertise must continuously be developed in a structured and monitored manner. In the same vein, values of honesty, integrity, objectivity, transparency and reliability must always be inculcated in practices. Ultimately, the professional accountant as an integral member of the management team should strive to create and sustain value for stakeholders.

The underlining *expertise and competencies* is crucial for the accounting profession; so to belong to certain professional bodies would ensure a high level of compliance with the code of conduct and the ability to fulfil required fiduciary duties. Amongst the *roles and responsibilities of professional accountants*, include implementing and maintaining operational and fiduciary controls, providing analytical support for strategic planning and decision making, ensuring that effective risk management processes are in place and assisting management in setting the tone for ethical practices (IFAC 2005).

Continuous occurrence of financial scandals seems to swing professional accountants in strengthening their existence in the business environment. Somehow, financial failures and scandals has propelled the internal auditing profession into the limelight. Internal auditors, being part of the professional accountants (IFAC 2005), undertake significant measures in transforming their existence and improving their value added contributions in a business entity (IIA 2008; PwC 2007).

The profession self-governs by its own Professional Practices Framework (PPF or the Standards) and Code of Ethics issued by The Institute of Internal Auditors, Inc. (the IIA). The latest definition introduced in 1999 by the IIA indicates a shift in the internal audit paradigm from assurance activities into advisory and consultancy based activities as part of its value-added services (Nagy & Cenker 2002) with a much broader spectrum of activities (Krogstad et al 1999). The focal attention is to enhance the profession towards a standard-driven approach with a heightened identity and credibility (Bou-Raad 2000, Krogstad et al 1999).

Motivation

Notably, many companies spent substantial amount of resources on the internal audit function every year. To strengthen the governance system, internal auditing bridges the gap between the management and the board especially in *assessing the ethical climate, effectiveness and efficiency of operations* and also serves as an organization's safety net in *ensuring compliance* with rules, regulations and overall business practices. Internal auditors strive for transparency, reliability and effectiveness throughout the organization. However, little attention is paid on the extent of IAF's contribution in the area of strategic management activities. *The issue is that the ultimate customers (i.e. senior management, audit committee or board of directors) of the IAF are more focused on reporting compliance rather than strategic management activities.* IAF in strategic decision making is more crucial than many realize. SDM is part of the process in defining the company's direction in achieving its target objectives. In fact, the present internal audit process in understanding a specific firm and industry as well as knowledge on business processes does complement the early stage of the SDM process. Moreover, the internal auditor model on integrity, good judgment, accountability, quality, diligence and professionalism is the platform to earn the trust of others particularly the management and the board cum audit committee (IIA 2007).

The objectives of this study are to explore *how and why* should the IAF be involved in SDM. '*How*' refers to the nature and extent of IAF's involvement in SDM whereas '*why*' refers to factors that may influence IAF's involvement in SDM. The contribution of the internal auditor in SDM has gained attention since early 1990s (see Neish and Jackson 1992, Gupta and Ray 1992, KPMG 2007). The interest of this study is relevant and timely which is propelled by two key reasons. Firstly, the newly mandated listing requirements in January 2008 on the establishment of the internal audit function in public entities indicates the importance and recognition of IAF in a company that aims to strengthen the existing governance system (SC 2008, MCCG 2007). Secondly, the existing quality of independence, competencies and roles of IAF in risk management, governance and control processes very much intersect with the SDM activities. Internal audit as one of the cornerstones in the corporate governance system should play its active role as an internal monitoring mechanism (Gramling et al 2004) as well as fulfilling the role of an independent information provider. In fact, the internal auditor could fulfill the gap of the board directors' needs in enhancing board performance in its strategic role (Chambers 2008) in considering risks associated with strategic development (PwC 2007). As such, *this study adopts the perspectives that the internal auditor serves as an <u>alternative channel in providing timely, accurate and objective information</u> as well as performing their role as an <u>internal</u>*

monitoring mechanism in the SDM process.

This paper is divided into five sections. The first section prescribes the existence of IAF in the Malaysian context and its relative importance to regulatory requirements. The second section discusses the nature and extent of IAF's involvement in the SDM process. The third section elaborates on the internal audit quality and followed by the internal auditor's role in governance, risk management and control processes. The final section comprises discussions on the *nature, extent and obstacles* and conclusion of IAF's involvement in the SDM process.

Internal Audit Function of Malaysia

The Institute of Internal Auditors Malaysia (IIA Malaysia) is a professional organization dedicated to the advancement and development of the internal audit profession in Malaysia. The IIA Malaysia was established in 1977 as a chapter of IIA Inc of United States. The code of conduct and practices of the internal audit profession in Malaysia is fully governed by the Professional Practices Framework (the Standards), issued by the IIA Inc. that are internationally recognized and accepted. The Standards emphasize the importance of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour (IIA 2008). In addition, IIA Malaysia has introduced Guidelines on Internal Audit Function in 2002 that aim to clarify the roles and responsibilities of the IAF.

A glance at the Malaysian environment shows an enduring transformation of the IAF in association to major developments of regulatory frameworks for the past ten years. In the 70s and 80s, internal auditors were mainly from financial institutions, large public listed companies and multinational companies. The Asian financial crisis in late 1990s saw the tightening of regulations, transparency and accountability in corporate governance. As a result, more reporting disclosure was required in the annual report with specific emphasis on the statement of internal control and corporate governance. By and large, it indicates the recognition of IAF as one of the governance cornerstones with emphasis on internal control in the Malaysian Code of Corporate Governance (the Code) and the Revamped Listing Requirements issued in 2000.

The number of accounting irregularities and financial fiascos in Malaysia keeps on increasing. As a result, the revised Code issued in October 2007 whose main objectives are to strengthen the quality of the board of directors, improve audit committees' effectiveness, recognition of internal audit's potential and enhancement in existing structures of the governance system in a company. The significant revision made to the Code in respect of the Audit Committee and establishment of the IAF became effective from October 1, 2007 (MCCG 2007). Subsequently, Para 15.28 in Part F of Chapter 15 in the Listing Requirements issued by Bursa Malaysia in January 2008 mandated the existence of the IAF or activity in public listed entities in line with changes made in the Code.

The revised Code re-emphasizes the independent criteria and professional status of IAF via reporting to the high-level constituent i.e. audit committee (MCCG 2007). Moreover, the audit committee is required to strengthen their responsibilities on the IAF via such avenues; a) in reviewing the internal audit scope of work, function, resources and authority to carry its duties; b) to review internal audit programs, procedures and results of the audit process; c) be involved in performance appraisal and assessment activity of internal audit staff; and d) approve any appointment and termination of senior audit staff. Supplementary to that, new disclosure requirements in the Statement on Internal Audit Function imposed by Securities Commission ought to be adhered by Malaysian public listed companies with effect from January 31, 2009 (SC 2008).

Remarkably, IAF in Malaysia has gained significant attention from regulatory authorities in strengthening the governance system of a company. It is timely for the IAF to be proactively utilizing their full potential in delivering newly extended roles, providing value added services and simultaneously helping the organization to accomplish its objectives. One of the avenues is by involvement in the SDM process (KPMG 2007, PwC 2007; Hespenheide et al 2007, 2008).

Internal Audit And Strategic Decision Making

Strategic Decision Making

Generally, a strategic decision is the output of the strategic decision making process. Numerous SDM models evolved in strategic management literature. Mintzberg et al (1976) introduced three steps of SDM; problem formulation and objective setting, identification and generation of alternative solutions, and analysis and choice of feasible alternative. Later, Hofer & Schendel (1978) introduced seven steps, which comprised strategy identification, environmental analysis, resource analysis, gap analysis, generating alternatives, and finally evaluation and choice. Frederickson (1984) viewed SDM as situation diagnosis, alternatives generation, alternatives evaluation, selection and integration. Whereas according to Wallace and Zinkin (2005), the SDM process comprised two main phases i.e. *formulation phase* (activities of problem identification, alternative generation, evaluating and choice selection) and *implementation phase* (implementation, monitoring and follow up activities).

Decision making is a process by which a person, group or organization identifies choices or judgments to be made, gathers and evaluates information about alternatives and selects from among the alternatives (Carroll and Johnson 1990, p19). It can be difficult when it involves uncertainty and complexity, presented with too many alternatives, and the existence of interpersonal issues (Harvard Business 2006, pg 3). Therefore, the outcome of the decision making process can be influenced by the *planners or strategists* (can be an individual or team), *characteristics of decision or strategy content* (risk propensity or type of strategy), *decision process characteristics* (approach or nature and extent of involvement) and these characteristics also are not mutually exclusive.

According to O'Shaughnessy and McNamee (1997), SDM is management's responsibility and commonly accomplished at the top level of management together with the board of directors. Effective strategic decision sets the direction of an entity by strategically coordinating all resources (i.e. people, time and financial) within an organization over the long range goals (Frederickson 1984).

Strategic decision making is highly complex and uncertain which needs to match with the high volumes of information. A variety of information derived from diverse backgrounds of parties involved could lead into conflict (Parayitam & Dooley 2007). To solve the conflict and clarify the issues, the board of directors or top management can always seek the opinions or advice from other available networks such as management, internal and external auditors and social networks (Arendt et al 2005). Seeking advice processes enhance the opportunities of seeking advice and reliable information to assist in a better understanding of the issues in hand.

Involvement of the internal auditors in the SDM process has received substantial attention and recommendations from practitioners in the field (KPMG 2007, PwC 2007) yet little empirical evidence is available to support their contribution in the SDM process.

Internal Audit Involvement In Strategic Decision Making

Internal audit role
- risk management
- control

Internal audit quality
- independence
- competence
- scope of work

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Internal audit involvement in SDM
- Formulation phase
- Implementation phase

Strategic or risk based audit approach aims for *value creation* by expanding the internal auditor's consultative role (KPMG 2007). The internal auditor's proactive role ensures that the organization's objectives are achieved by integrating internal control and risk management hence improving the integrity of information and reliability for decision making purposes (Bou-Raad 2000). In fact, the internal auditor adopts a holistic approach in strategic management activities, by looking at the whole organization as an integral part of the external environment (Neish and Jackson 1992).

In the case of Enron, though many governance aspects failed, the ultimate firm's viability vested on the inherent risk of business strategy is that which the board and others failed to understand (Gillan & Martin 2007).

Failure to understand the issues may be overcome by getting the support from IAF. Internal audit complement strategic information of external competitors by supplying current managerial and operational information (Lees 1992). Furthermore, the interaction with all staff across the company would overcome the issue of poor communication that is frequently faced during the strategy execution phase. Nowadays, the integration of strategic approach in the internal audit paradigm has enhanced their effectiveness in ensuring the attainment of corporate objectives and aligning their support services to senior management and audit committee (Rittenberg & Anderson 2002). Internal auditing is crucial in the strategic management activities more than many may realize. The i*nternal auditor's involvement in the formulation phase and implementation phase* is used to gauge the *nature and extent of the internal auditor's involvement* in the SDM process.

The formulation stage begins with an assessment of internal capabilities and the external environment. This process develops discovery, evaluation and selection of multiple alternatives that provides optimal direction to the company with the most efficient and cost-effective utilization of resources. The *implementation stage* continues with the allocation of resources relevant to the company's structure that provides for effective execution of strategies, goals and objectives. Then, effective evaluation and monitoring processes is accomplished by ongoing and periodic assessments of the quality of an organization's performance over a period of time.

Previous studies provide a glimpse of the *nature and extent of involvement* of the internal auditor in SDM. Most of the studies highlight the role of the internal auditor in assessing the control and risk processes of the strategic initiatives commonly found in the formulation, implementation and evaluation phases. Glenn (1973) found that large number of internal auditors in both industry and government sectors are engaged in development and installation of new systems and procedures. Essentially, the internal auditor makes a preliminary review of proposed systems and procedures so that recommendations are taken into account at the planning stage or even at early implementation and later evaluation stage (Mellalieu 1992). In addition, the internal auditor needs to understand the mission and vision setting process by understanding business risks through control and risk management assessment (Bell et al 1987).

Internal auditors can perform their duties effectively in strategic planning due to their involvement in utilizing strategic planning documents in operational audits and a thorough understanding of the business environment, overall strategy, external environment, primary risks provides them with relevant knowledge and expertise in financial and operational activities (O'Shaughnessy and McNamee 1997). In addition, they need to assess and evaluate strategic risks at the macro and micro level in order to ensure that risks, strategy and objectives are in tandem. In fact, the independent status upheld by an internal auditor and direct access to the audit committee cum board of directors may have added value in highlighting crucial issues on ethics and non-compliance.

Assessment of risk management or enterprise risk management is the main foundation for the internal auditor to be involved in assessing strategic initiatives. The internal auditor is perceived as 'risk intelligent' and applies that by means of 'capitalizing on strategic risks' as value creation (Hespenheide et al 2007, 2008; KPMG 2007; PwC 2007). Due to that, expansion of the audit scope into strategic audit (Wheelen and Hunger 1987) and transformation of a more forward-looking audit approach aims to align the firm's performance with stakeholder's expectations (Rossiter 2007). Besides, the internal auditor's key role in the strategic aspect is able to enhance its governance and internal monitoring functions. This would simultaneously reduce probability of ongoing concern and improve financial reporting quality (Cohen et al 2004).

The internal auditor may be greatly involved at the strategy formulation stage by conducting a proactive audit (Pomeranz 1998). The main idea is to ensure the viability of a particular strategic decision prior to any actual resource allocation being made. According to O'Shaughnessy and McNamee (1997), at this preliminary phase, normally an internal auditor needs to perform risk assessment associated with the strategic initiatives to ensure the alignment of strategic initiatives with the company's strategic goals and objectives. In addition, the internal auditor may need to assess the accuracy of financial and non-financial information used and reasonableness of the assumptions applied in justifying the reasonableness of the strategic initiatives.

Application of proactive auditing and comprehensive ERM in the strategy implementation stage are implemented through ongoing monitoring by the internal auditor. The internal auditor evaluates the information distribution process and reporting system by management for instance mechanisms in distributing observations and exception reports and its associated action plans. This actually forms part of the assurance activities performed by the internal auditors in providing comfort to the audit committee that they have carried out their oversight responsibilities (Kinney 2000). Besides, the internal auditor is able to minimize the issues associated with strategic decisions such as lack of clear communication among operational personnel, lack in monitoring and feedback would definitely delay immediate action plans (Neish and Jackson 1992).

Practically, internal auditors are in the best position to initiate continuous cost control and revenue enhancement, constantly strengthen the integrity of management information systems and solidify the reputation of the internal auditor, too. Thus, the ultimate objective of the internal auditors' involvement in the SDM is to perform their role as an *internal monitoring mechanism* by aligning actual performance achieved and strategic objectives, contribute comfort and *objective opinion*, as well as act as a *whistle blowing function* in case of non-compliance activities or actions by management (O'Shaughnessy and McNamee 1997).

Internal Audit Quality

Previous literature highlights the potential of an internal auditor in creating value in the SDM process but little empirical evidence is available to support this. According to Gramling et al (2004), the internal auditor's work is commonly referred by external auditors in performing their financial statement audit. In order to rely on the internal auditor's work, external auditors need to form an opinion on the *credibility and reliability* of the IAF, which normally would be judged by the internal audit quality. Internal audit quality reflects the quality of work performed by internal auditors and it consists of *independence, competence and scope of work*. In fact, the elements of internal audit quality are consistent with the Attributes Standards in PPF with emphasis on independence and objectivity (1100), proficiency and due care (1200).

Independence

Internal auditors perform their task as an independent reviewer and critical appraiser of internal control system effectiveness (Gupta and Ray 1992) and newly expanded roles provide alternative avenues in enhancing value towards organizations (KPMG 2007). The expanded roles include internal auditors performing a strategic role within the advisory capacity such as providing views in leveraging significant investment in compliance with company's policies as well as delivering real value to shareholders and management (Campbell et al 2006).

The degree of objectivity very much depends on the reporting line to the highest level i.e. audit committee and the internal auditor should refrain from assessing specific operations for which they were previously responsible (1130). The internal auditor, an independent party, should be able to spot any deficient disclosures, undocumented assumptions or communication ambiguities (O'Shaughnessy and McNamee 1997) as well as give an objective opinion on the feasibility of particular strategic initiatives.

As such, the independent status upheld by the internal auditor and direct access to audit committee cum board of directors may have added value in highlighting crucial issues such as ethical issues and non compliance to company policies. Apart from that, the internal auditor would be able to offer objective opinions on strategic initiatives from different and more holistic perspectives.

Competence

The Standards state that relevant knowledge, skills and other competencies are crucial in ensuring that the performance of work is proficient and of due care (1220). Continuous development, structured and non-structured training would ensure that the internal auditor is kept abreast with recent developments in industry and markets. The previous elements would form as relevant expertise and skills in addition to prior tacit knowledge that would be beneficial for the internal auditor in creating value (Bou-Raad 2000). Thus, cumulative firm specific knowledge and expertise acquired in the course of an audit would be beneficial in assessing the early stages of the viability of future strategic initiatives.

In spite of that, great exposure in statistical techniques, extensive knowledge on computerized environment and information technology knowledge would be a great advantage for any internal auditor (O'Shaughnessy and McNamee 1997). Those competencies would definitely be able to provide beneficial inputs in assessing statistical techniques or forecasting assumptions applied in the preliminary stage of strategic initiatives.

Scope of work

The transformation in audit approaches has seen adoption of strategic-based-audit approach by linking business process to strategic objectives, understanding and assessment of business risks in a more holistic view and forward looking (Wheelen and Hunger 1987; Rossiter 2007; Mellalieu 1992; Neish and Jackson 1992; PwC 2007; KPMG 2007; Hespenheide et al 2007). In planning the annual audit (Practice Advisory 2200-1, Practice Advisory 2110-1; Practice Advisory 2010-2), the internal auditor is supposed to have a thorough understanding of the business environment, overall strategy, external environment, primary risks of concern to the organization and crucial issues related to stakeholders (O'Shaughnessy and McNamee 1997; Roth 2002). Specifically in assessing and evaluating the risk management process, the internal auditor needs to consider strategic risks at the macro and micro level and to ensure that risks, strategy and objectives are aligned (Practice Advisory 2010-2; KPMG 2000).

In the course of performing audit procedures, the internal auditor should identify sufficient, reliable, relevant and useful information (PA 2310-1). Therefore, the internal auditor often makes use of internal (non public) documents (O'Shaughnessy and McNamee 1997) such as minutes of board and management meetings, report from strategic planning meetings and progress reports, budgetary information and reports from functional level departments on strategic issues. Meanwhile, in conducting respective audit procedures, the internal auditor also interacts extensively across the organization. The internal auditor can bridge the gap between senior or top management with other employees in an organization.

In summing up, SDM involves a lot of consideration on risk assessment, timely and accurate information in reducing uncertainty and complexity of strategic initiatives as well as clear communication of the company's direction to all employees. These concerns can be facilitated by incorporating IAF in SDM. In addition, the evolution of the internal auditor's role has seen a new avenue for IAF to be involved in SDM.

Roles Of the Internal Audit Function

The internal audit profession today has gain significant recognition and wider roles and responsibilities. The development of the internal auditing definition reflects the evolution of the internal auditor's roles. The sphere of influence has gone beyond the internal control system which includes risk management and governance processes (Staciokas & Rupsys, 2005). Figure 1 chronicles the revision in definition of internal auditing from the *Statement of Responsibilities of Internal Auditing* by the Institute of Internal Auditors (IIA) from the 1940s to the present.

1947

Internal auditing deals primarily with accounting and financial matters but it may also properly deal with matters of an operating nature.

1957

Internal auditing is an independent appraisal activity within an organization for the review of accounting, financial, and other operations.

1971

Internal auditing is an independent appraisal activity within an organization for the review of operations as a service to management.

1990

Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization.

1999

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

Figure 1: Definition from Statement of Responsibilities of Internal Auditing
Sources: Gupta and Ray (1992) and IIA (2008).

Traditionally, the IAF is known for its independent appraisal, compliance and re-performance and its main scope of activities focuses on accounting, financial and operations with management as the main auditor. The latest definition is evolutionary and evolving with new opportunities in meeting organizational needs. It broadens the internal audit self-image apart from existing risk-based audit approach and consultative activities (Krogstad et al 1999). Hence, IIA Inc. initiatives in promoting and enhancing the internal audit function successfully promoted a paradigm shift in its latest revised standards (IIA 2008) that is effective after January 1, 2009. Greater emphasis on the governance process proves the importance of IAF in strengthening the governance system of a company. Its unique position is able to provide senior management and audit committee cum board of directors with valuable assistance by providing objective assurance and advisory services on governance, risk management and control processes.

Accountability and the main responsibility of setting up the risk management framework lies with management. The Board of directors merely provides the highest level of authority to oversee the company's risk management practices, whereas, the internal auditor often takes responsibility for performing an internal review of the company's compliance with its risk management framework. This review includes the validation of the company's risk measurements, a review of the process flows and data integrity as well as an overall review of company's compliance with its policies and procedures (Wallace and Zinkin 2005). In spite of that, the primary purpose of risk management is to aid decision making (Selim and McNamee 1999).

Present strategic-risk-based audit approach requires the internal auditor to have a full comprehensive understanding of business operations, its strategic objectives and business competitive environment (KPMG 2000). Risks universally stem from many areas and these include business environment, governance, operations, financial, information and transactions (Wallace and Zinkin 2005). To simplify, those areas are classified in accordance to external environment risks, business processes risk and information risks (Kinney 2000). Notably, information risks cover threats from *poor quality information for decision making* within businesses due to being *misinformed* about the real world conditions, from biased measurement used or even from incomplete information. All risk areas assess the entire company which is also known as enterprise-wide risk management (ERM). ERM requires understanding of an entity's objectives, strategy, plans along with considerations of current external and internal conditions. In the process of that, any conditions that could adversely affect the achievement of the company's objectives will be identified along with planning for its responses. Hence, this particular scope of activities indeed intersects with the process of making strategic decisions.

Barriers and Recommendations

Involvement of the internal auditor in SDM seems crucial and relevant to an organization yet some barriers need to be minimized. First, involvement in strategic planning normally classified under consulting or advisory services and the nature of the engagement are not stipulated explicitly in the Internal Audit Charter. In view of that, the internal auditor opts not to pursue and add in more responsibilities to the existing workload. In fact, some internal auditors may find constraints in resources such as human capital and financial resources as well as time allocated for this kind of additional task.

Second, management might not prefer comprehensive and detailed exposure of confidential and relevant information and documents in respect of strategic initiatives. This would lead to unnecessary disclosure of information for instance in the case of mergers and acquisitions that may reduce the value of negotiations.

Third, in view of the increasing number of accounting irregularities and financial fiasco, the focus of the IAF is very much orientated by financial reporting issues. Hence, little emphasis is given on strategic issues, forward looking and non-financial elements link to threats or opportunities in external environments.

In order to enhance better involvement of the internal auditor in SDM, the IIA Malaysia should promote the positive attributes of an internal auditor by improving their *status, value and integrity*. Besides, shift in mindset of senior management and audit committee would facilitate in exploring the potentials of the IAF and provide an avenue for IAF's involvement in SDM. Finally, IAF activities should not be solely aligned to financial reporting alone as strategic issues do require immediate attention in responding quickly to rapid market developments and competitive business environment.

Discussion and Conclusion

Internal auditors in many large companies contains experts of many skills. Throughout the audit process, the internal auditor has acquired relevant knowledge, expertise and experience on operational and financial aspects of the organization. The internal auditor also regularly assesses the internal and external environment of the company in gathering a holistic view of enterprise risk management prior to embarking on a strategic-risk-based audit approach. In fact, the business environment is constantly changing rapidly. There are few opportunities and risks from changes in legislation, technology and competition that could be tackled and responded to immediately. As organizations attempt to deal with this uncertainty, internal auditors could play their role by assisting via providing timely and accurate information to the decision makers in making well-informed strategic decisions. The internal auditor could probably be auditing the strategic decision making process as well.

Annual performance of the quality assurance review would be able to improve internal audit quality in compliance to professional standards. Most importantly, the internal auditor should not be involved in setting objectives and policies. The scope of activities would merely concern performance evaluation and monitoring strategy formulation and implementation phase. The internal auditor must also conform to the Standards requirement in delivering assurance and consulting services. Independence in mind and in fact must be observed critically and not compromised. The internal auditor's involvement in the SDM process is more of an extension of the existing risk-based audit approach as part of the internal auditor's advisory capacity.

In conclusion, the internal auditor is one of the four cornerstones of corporate governance. A company should fully engage the internal auditor's contribution that could add value for the betterment and sustainability of company performance. In fact, the internal auditor should be able to undertake the leadership role and work closely with other governance constituencies. A strong and collegiality relationship underscores the dual alignment with the audit committee and management. Thus, support and recognition of values and potentials of the involvement of the IAF in SDM would open up the opportunities for the internal auditor in contributing more value added services.

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About The Author

Nor Hafizah bt Zainal Abidin is a PhD candidate in Universiti Sains Malaysia. Her current research interest is on the role of an internal auditor in strategic decision making or strategic planning and its contribution towards shareholder value. She can be contacted at nhafizahzainal@hotmail.com

CONSOLATION PRIZE

An Empirical Investigation on Determinants of Executive Directors' Remuneration in Bursa Malaysia

Mr Ooi Chye Khoon

Dr. Lai Ming Ming

ABSTRACT

The issue of executive director's remuneration has been the subject of debate in recent years. The Malaysian Code on Corporate Governance 2001 had recommended that executive's remuneration should be linked to the individual and company performance in order to attract and retain them. This study investigates the determinants of executive director's remuneration of all public companies listed on the main board of Bursa Malaysia from 2004 to 2006. A total of 1,734 samples were selected for three years with 569 samples selected in 2004, 581 samples in 2005 and 584 samples in 2006. The independent variables used to examine the executive directors' remuneration are company performance, company size, duality, qualification, directors with multiple directorships, age, and tenure. Multiple regression models were used to examine the relationships of these independent variables with executive directors' remuneration for all companies, Kuala Lumpur Composite Index (KLCI) companies, and non-KLCI companies. In addition, descriptive statistics and correlation are used, too.

Tenure or the number of years that an executive director has held the director's position appeared to be the most significant determinant for executive directors' remuneration. The average tenure for executive directors ranged from 8 to 9 years. Duality emerged as second significant determinant except for KLCI component companies. The results showed that about 40% of executive directors also held executive chairman post in the public listed companies. Company performance and size were found as determinants except for KLCI component companies. The results also suggest that age and qualification are the weakest determinants for human capital variables. Lastly, director with multiple directorships is not found as determinant.

Overall, net profit was significantly correlated with company size. Executive directors' remuneration relates to the strengths of net profits and company size and this is particularly evident for KLCI companies that reported relatively much higher directors' remuneration when compared to non-KLCI component companies. Nevertheless, regression results for KLCI companies have failed to show any significant

relationship between executives' remuneration with net profit and company size. Interestingly, the results showed the non-KLCI companies that are relatively smaller have rewarded their executive directors based on net profit and company size achieved each year.

Introduction

The remuneration of the directors should reflect the responsibility and commitment of the respective directors concerned. If the directors are paid too little, they may be de-motivated to carry out their duties effectively and efficiently. Nonetheless, there is high probability that the directors may lose their independence if the remuneration is excessive. Their performance will be perceived as not in line with the quantum of pay received.

The remuneration package of executive directors once again became a subject of interest when corporate governance issues were heated up recently with the irregularities found in some of the companies listed in Bursa Malaysia. These companies, namely Transmile Group Bhd and Megan Media Holdings Bhd had reported their profits extremely high while they were actually incurring losses (CNBC, 2007). These few cases have raised the questions on the standards of corporate governance in Malaysia. The other controversial economic trend was the soaring increases in pay for executive directors. Not only executives get paid well but they were also getting thriving pay even when their companies were losing money. The required disclosure of executive remuneration and corporate governance mechanisms information caused investors to question the link between executive compensation and company performance. Hence, this paper is motivated to examine the determinants on executive directors' remuneration of all public listed companies on Bursa Malaysia's Main Board from year 2004 to 2006. The findings contribute additional empirical evidence to the current literature on corporate governance pertaining to executive directors compensation.

Literature Review

Extensive research has been conducted on the topic of executive remuneration, particularly for firms in UK and the US since early 2000. In Malaysia, the topic of executive directors' remuneration package and corporate governance is seldom discussed until it was made mandatory by the listing requirement of Bursa Malaysia in 2001. Review of past research on determinants of executive directors' remunerations such as age, qualifications, tenure, duality, multiple directorship, company size and company performance are as below.

Age

Age is expected to have a positive effect on the remuneration as older executive directors gained valuable experience over time. McKnight, Tomkins, Weir and Hobson (2000) argued that the market demand for older executive director was also attributed to the organisation's size and its job complexity. As an organisation grows larger and more complex, the level of knowledge and understanding regarding the position becomes more demanding. As such, pay should increase for any additional human capital requirement demanded by the position.

Qualifications

Professional qualifications such as LLB, ICAEW, MIA, ACCA and educational qualifications such as degrees and higher degrees are likely to enhance a person's general human capital in the labour market and thus lead to higher remuneration in subsequent years. However, researchers have found mixed findings on the relationship of qualifications and pay. Laing and Weir (1999a) found the relationship is very insignificant but Storey, Watson and Wynarczyk (1995) found qualification was a significant determinant of executive's pay.

Tenure and Service Within A firm

A number of studies have found tenure to be positively and significantly related to pay (Hogan and McPheters, 1980; Mangel and Singh, 1993; Riachi-Belkaoui and Picur, 1993; Laing and Weir, 1999a).

Hill and Phan (1991) found that the link between pay and performance weaken as tenure increased suggesting that chief executive power increased as tenure increases. Finkelstein and Hambrick (1996) and Kostuik (1990) found that tenure and pay exhibited an inverted U-shape relationship. However, tenure was not found to be significant by Storey et al. (1995).
Executive director's tenure, which is likely to be correlated with executive's age, may also play a role in determining their remuneration. If tenure implies entrenchment, lower remuneration results from tenured

executives' ability to impose their will on the firms' directors and shareholders. If performance measurement improved with executive tenure, the need for incentive remuneration was reduced. These factors suggest executive tenure would be inversely related to incentive remuneration.

In this study, tenure is defined as the number of years that the highest rank executive director has served the company in the present position. It is expected that the longer the tenure, the greater the experience and the better the executive will perform and the remuneration is of course higher.

Independence of Executive Directors through Duality

Research findings noticed that some board of directors may be relatively less independent than others, and that executive remuneration is linked to influence of the executive directors over the board. Sridharan (1996) argued that executive's influence over the board significantly affected his remuneration. The executive director who had higher influence over the board of directors was able to demand higher remuneration than those with less influence.

The study of Carr (1997) found that executives' influence was one of the determinants of their remuneration for large firms but not small firms. This was because the corporate cultures and environments in small firms were quite different than in large companies. In smaller companies, the members of the board and the key officers were relatives of the executives. This suggested that these firms were entrepreneurial in nature and that the separation of ownership and control was not a dominating nature.

Ueng (2000) used two variables to proxy for executive director's influence that was the presence of inside directors and whether or not the executive also serves as chairman of the board. The study included 468 of Fortune 500 Companies and 424 small companies in 1995. The result of the study was consistent with the finding of Carr (1997). The reason explained by Ueng (2000) was that executives of small firms might be the owners of the firm or part of a family operation where co-owners or family members dilute executives' influence. In this situation, executive director's influence might be unimportant in determining remuneration.

In Malaysia, at least one third of the members of the board of directors were required to be independent and non-executive. These independent non-executive directors were encouraged to be the members of the remuneration committee. The decisions on the pay of directors would be passed through this committee and submitted to board of directors for approval (Finance Committee on Corporate Governance, 2000).

In Malaysia, Vicknes (2003) found that most of the owners-managed companies tend to have heftier payout to the directors. Owners-managed companies refer to the executive director and chairmen are the major shareholders of the companies. This finding is consistent with Sridharan (1996) and Carr (1997) on the influence of the executives over the board.

Directors with Multiple Directorships

Executive directors and their subordinates are often directors of other boards and executives often have much discretion in choosing new board members. If two executive directors or their subordinates serve on each other's boards, they are called "reciprocally interlocked" as defined by Hallock (1995). These executives may have both the incentive and opportunity to raise each other's remuneration packages.

Company Size

Previous empirical studies generally found a strong relationship between firm size and executive pay. Sridharan (1996) and Ueng (2000) found a positive relationship between executive remuneration and the book value of a firm's assets. However, Gupta and Bowers (1993) and Ricklefs (1996) suggested small companies compensated their executives relatively more than large companies compensate their executives. Higher pay in small firms, as explained by Ueng (2000) was mainly due to the highly competitive environment with growth and survival as the two major objectives. The positive relationship between firm size and executive remuneration has several explications rooted mainly in the economic theory and human capital theory.

The research done by Laing and Weir (1999b) on 125 of the largest public listed companies in UK found that company size is a key determinant of pay. The link between top executive pay and company size was justifiable given that larger organizations carried greater responsibilities that would be translated to a higher pay.

Company Performance

Gomez-Mejia and Wiseman (1997) argued that in higher uncertainty firms, remuneration based on performance might be seen as largely beyond the executive's direct control. To avoid the missing link of performance and remuneration, Gomez-Mejia and Wiseman (1997) have proposed to use size instead of performance as a pay determinant. The rationale is that greater size offers the executives more power and prestige, more control over firm size than performance, less employment risk since firm size provides a buffer against business cycle effects.

The research study of Ueng (2000) found that executive pay of large firms was mostly a function of firm performance other than executive's influence over the board and firm size as discussed above.

In Malaysia, KPMG Malaysia Business Advisory Sdn Bhd, jointly with Malaysian Business and Bursa Malaysia had conducted the survey on Directors' Remuneration in 2006 for companies listed on the Bursa Main Board, Second Board and MESDAQ (KPMG 2006). Among the determinants of directors' remuneration examined by the survey were directors' age, qualification, professional qualification, directorships in other companies and components of remuneration.

The results showed that approximately 67% of the directors were in the age of 46 to 65 years old while the mean age of the executive Chairman and director was 56 and 49 years old. This result indicated that experience accumulated throughout the years was the important measurement of remuneration.

The study also showed about 89% of directors have at least a degree qualification and above. However, the directors who are Degree holders is the highest, i.e. 68.96% followed by Master & above which is only 20.05%. In terms of education qualification, the results showed 50.36% of directors have qualifications in accounting and 12.41% in technical engineering. The recruitment of these knowledgeable directors was important for listed companies that the regulations are more stringent than private limited companies. The study also found that the chairman's average tenure length was 9 years while the executive director was 8 years. The executive directors recorded longer directorship tenure as compared to non-executive directors. These findings were expected especially for those family-owned companies where founders of the companies normally stayed till the end. For current directorship, the results showed that a director of public listed companies held a median of 2 executive directorships and 5 non-executive directorships in other companies. As for past directorship, a director of public listed companies had held a median of 2 executive directorships and 2 non-executive directorships in the past.

DATA AND METHOD

This study investigates the determinants of executive directors' remuneration using all public companies listed on the main board in Bursa Malaysia from 2004 to 2006. A total of 1,734 samples were selected for three years with 569 samples selected in 2004, 581 samples in 2005 and 584 samples in 2006. It covers all the main board companies listed on the Bursa Malaysia. However, real estate investment trust companies are excluded due to different regulations and disclosure requirements. The annual reports of the companies that did not have sufficient information of the variables were excluded, too. The information on the variables was extracted from the annual reports which can be downloaded from the Bursa Malaysia website. The sections of the annual reports relevant to this research are directors' profile, corporate governance statement and financial statements.

On the other hand, companies that have been delisted or privatized in 2006 were excluded from this study. This is because the data for 2006 is unavailable despite having data for 2004 and 2005. Therefore, these companies are excluded for comparison purposes. Firms would have less than 3 years of data if they were created or went public during the period.

The data selected has two advantages. First, it includes new firms and is not overly represented by the large firms. This should enhance the generalisability of the results reported here and validate work that has tended to re-use the same data of the firms.

Secondly, the data has been audited and complied with the disclosure requirements under Malaysian Code on Corporate Governance.

The independent variables are company performance, company size, duality, qualification, directors with multiple directorships, age and tenure.

The KLCI components samples selected for 2004, 2005 and 2006 are 89, 90 and 91. The sample was less than 100 mainly due to the exclusion of companies which did not have executive directors in the board of directors and with incomplete information.

Independent and Dependant Variables

The variables used in the study are as follows:

Variables	Acronym	Operationalisation
Dependent variable:		
Executives' Remuneration	Dir_Rem	Annual salary, bonus, allowances, fees and benefit-in-kind
Independent variables:		
Company Performance	NP	Net profit attributable to shareholders of the company
Company Size	Co_Size	Net assets attributable to shareholders of the company
Duality	Duality	This is the binary variable that has a value of 1 if the executive director has the joint-title of Executive Chairman. If the posts are separate, it is 0
Qualification	Quali	Binary variable of 1 if executive director has obtained at least a degree; otherwise 0
Directors with Multiple Directorships	Oth_Dir	Binary variable of 1 if executive director holds any directorship in public listed companies; otherwise 0
Age	Age	Age of the executive director
Tenure	Tenure	Number of years holding the post of executive director in the same company

The dependent variable – executive directors' remuneration is defined as the fees, salary, bonus, allowances, employee provident fund, benefit-in-kind and other benefits. However, this study did not take the value of ESOS or stock options owing to the fundamental measurement problems (Gomez-Mejia, Toshi and Hinkin, 1987). First, executive stock options are not traded and thus there is no market in which the value of these options could be observed. Secondly, other features of a substantial portion of executive stock options are such that there is little resemblance between executive stock options and options on stocks or securities in general, making it difficult to value them using the Black-Scholes option valuation model (Carr, 1997). Thirdly, the executives entitled for stock options must be in charge during the entire sample time period.

In this study, we used net assets attributable to the shareholders of the company or shareholders' equity to measure the company size. The reason is that despite market capitalization has been widely used to gauge the market size of the companies, the market price of the company share is much dependant on the market sentiment and regional stock market. In addition, not all companies' share price will go up when they report good profits.

Multiple Regression Model

Multiple regression produces multiple correlation which is the correlation of multiple independent variables with a single dependent variable. The regression approach has been recommended in remuneration research and has been used frequently in previous studies (Murphy, 1997 and Hill and Phan, 1991).

The regression estimated is as follows:

$$Dir\_Rem = a + b_1NP + b_2Co\_Size + b_3Duality + b_4Quali + b_5Oth\_Dir + b_6Age + b_7Tenure$$

where:

Dir_Rem	- Executive Directors' Remuneration
NP	- Net Profit
Co_Size	- Company Size
Duality	- Joint-title of executive Chairman and executive director
Quali	- Qualification
Oth_Dir	- Directors with multiple directorships
Age	- Age of the executive director
Tenure	- Number of years holding the post of executive director in the same cmpany

Since multivariate regression is used to test the hypotheses, assumptions of multicollinearity, normality, homoscedasticity and linearity are also tested. The Pearson correlation matrix is used to test the multicollinearity assumption, while an analysis of residuals, i.e. plots of the residuals against predicted values, are conducted to test for homoscedasticity, linearity and normality assumptions. Multivariate regressions for each model are conducted for each year (2004 – 2006) as well as for the pooled data for all three years.

ANALYSES AND DISCUSSIONS

Table 1 presents the descriptive statistics for the dependent and independent variables. The results show approximately 43%-45% held the joint-title of executive chairman and executive director. In terms of qualification, 84% of the executive directors were at least degree holders or hold professional qualifications. The average age of the executive directors was in the range of 53-54 years old. The mean tenure of executive directors was ranging from 8.47 to 9.57 years. The results of age, qualification, and tenure variables appear to be consistent with the survey results of KPMG (2006).

Table 2 presents the Pearson correlation matrix for the pooled samples 2004-2006 and individual year for 2004, 2005 and 2006. As indicated, no major multicollinearity problem was detected. Some correlations are found to be significant between variables but the size of the correlations does not cause concerns of multicollinearity except for net profit and company size that has exceeded 0.8[1]. The correlations between company size and net profit for pooled samples, 2004, 2005 and 2006 are 0.848, 0.848, 0.776 and 0.929, respectively.

Company performance as measured by net profit appeared to be positive and significantly correlated with company size, qualification, and directors with multiple directorships. On the other hand, the executive directors' remuneration indicated positive and significant correlation with independent variables of net profit, company size, duality, directors with multiple directorships, age, and tenure. Consistent with the findings of prior studies, tenure and age are positive and significantly correlated.

Collinearity statistics in coefficients as shown in Table 3 for independent variables are all greater than 0.1 and Variation Inflation Factors (VIF) are all lesser than 10[2]. Thus, the results indicate no multicollinearity problem.

[1] Multicollinearity may be a problem when the correlation exceeded 0.80 (Gujarati, 1995).

[2] No multicollinearity problem if tolerance for independent variables are greater than 0.1 and VIF are all lesser than 10 (Hair et al., 1998)

Table 1: Descriptive Statistics for Dependant and Independent Variables

	All *Minimum* *Maximum* *Mean* *Standard Deviation* *N=1734*	*2004* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=569*	*2005* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=581*	*2006* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=584*
Dependent Variables:				
Directors' Remuneration (RM'000)	0.00	0.00	0.00	0.00
	101,690.00	69,496.00	78,788.00	101,690.00
	1,852.24	1,694.82	1,819.58	2,038.10
	4,283.34	3,603.26	4,029.77	5,066.82
Independent Variables:				
Net Profit (RM'000)	-1,255,202.00	-1,116,573.00	-1,255,202.00	-663,402.00
	4,763,546.00	2,613,500.00	4,763,546.00	2,949,815.00
	61,405.09	55,740.07	57,589.18	70,720.92
	266,985.06	235,843.34	285,474.62	276,562.22
Company Size (RM'000)	-1,041,955.00	-740,534.00	-876,754.00	-1,041,955.00
	19,911,100.00	19,453,300.00	18,987,400.00	19,911,100.00
	688,404.85	653,667.04	686,372.64	724,272.18
	1,774,898.23	1,633,337.63	1,753,966.91	1,924,095.20
Duality (%)	44.00%	45.00%	44.00%	43.00%
Qualification (%)	84.00%	84.00%	84.00%	84.00%
Directors with multiple directorships (%)	39.00%	39.00%	39.00%	39.00%
Age (years)	30.00	30.00	31.00	32.00
	85.00	83.00	84.00	85.00
	53.82	53.16	53.82	54.45
	8.36	8.28	8.31	8.45
Tenure (years)	1.00	1.00	1.00	1.00
	56.00	54.00	55.00	56.00
	9.03	8.47	9.03	9.57
	8.12	8.03	8.12	8.19

Table 2: Correlation Matrix between Independent Variables and Executive Directors' Remunerations of Public Listed Companies in Bursa Malaysia

		Directors' Remuneration All 2004 2005 2006	*Net Profit All 2004 2005 2006*	*Company Size All 2004 2005 2006*	*Duality All 2004 2005 2006*	*Qualification All 2004 2005 2006*	*Directors with multiple directorships All 2004 2005 2006*	*Age All 2004 2005 2006*	*Tenure All 2004 2005 2006*
Directors' Remuneration	*All*	1.000							
	2004	1.000							
	2005	1.000							
	2006	1.000							
Net Profit	*All*	0.298**	1.000						
	2004	0.285**	1.000						
	2005	0.273**	1.000						
	2006	0.329**	1.000						
Company Size	*All*	0.299**	0.848**	1.000					
	2004	0.284**	0.848**	1.000					
	2005	0.293**	0.776**	1.000					
	2006	0.313**	0.919**	1.000					
Duality	*All*	0.123**	-0.041	-0.056*	1.000				
	2004	0.123**	-0.044	-0.058	1.000				
	2005	0.128**	-0.036	-0.060	1.000				
	2006	0.123**	-0.043	-0.051	1.000				
Qualification	*All*	0.000	0.086**	0.120**	-0.118**	1.000			
	2004	0.003	0.093*	0.126**	-0.129**	1.000			
	2005	-0.003	0.074	0.122**	-0.109**	1.000			
	2006	0.001	0.095*	0.113**	-0.117**	1.000			
Directors with Multiple directorships	*All*	0.089**	0.064**	0.130**	0.130**	0.160**	1.000		
	2004	0.090*	0.094*	0.157**	0.137**	0.159**	1.000		
	2005	0.089*	0.041	0.117**	0.117**	0.153**	1.000		
	2006	0.091*	0.064	0.119**	0.135**	0.168**	1.000		
Age	*All*	0.062**	0.010	0.000	0.318**	-0.211**	0.065**	1.000	
	2004	0.064	0.011	0.007	0.318**	-0.214**	0.074	1.000	
	2005	0.063	0.007	0.005	0.318**	-0.220**	0.057	1.000	
	2006	0.056	0.008	-0.014	0.322**	-0.203**	0.064	1.000	
Tenure	*All*	0.188**	0.028	0.018	0.223**	-0.127**	0.135**	0.439**	1.000
	2004	0.190**	0.052	0.036	0.216**	-0.110**	0.146**	0.413**	1.000
	2005	0.195**	0.012	0.005	0.221**	-0.131**	0.135**	0.431**	1.000
	2006	0.182**	0.021	0.014	0.235**	-0.141**	0.126**	0.465**	1.000

Notes:
** Correlation is significant at the 0.01 level (2 tailed), * Correlation is significant at the 0.06 level (2 tailed)

Table 3: Collinearity Statistics of Independent Variables from 2004 to 2006

Independent Variables	***All Tolerance VIF***	***2004 Tolerance VIF***	***2005 Tolerance VIF***	***2006 Tolerance VIF***
Net Profit	0.278	0.278	0.395	0.152
	3.597	3.597	2.534	6.585
Company Size	0.273	0.272	0.386	0.150
	3.664	3.675	2.591	6.665
Duality	0.872	0.868	0.875	0.868
	1.147	1.152	1.143	1.152
Qualification	0.908	0.906	0.907	0.909
	1.101	1.104	1.102	1.101
Directors with multiple directorships	0.916	0.907	0.925	0.910
	1.092	1.103	1.081	1.099
Age	0.737	0.753	0.740	0.720
	1.356	1.328	1.352	1.390
Tenure	0.787	0.806	0.793	0.764
	1.271	1.240	1.261	1.309

The Results of Regression Model for All Public Listed Companies Listed on Main Board in Bursa Malaysia

Table 4 presents the results of regression models in identifying the determinants of executive directors' remuneration of all public listed companies on Bursa Malaysia's Main Board from 2004 to 2006. The residuals statistics indicates no problem of homoscedasticity and linearity. The residuals can be assumed to be independent.

The overall regression results are significant. F values are in the range of between 12.112 in 2004 to 40.804 for pooled samples.

As shown in Table 4, the regression equation for pooled samples is as follows:

Executive Directors' Remuneration = 1,769.404 + 2.432 (Net Profit) + 0.415 (Company Size) + 974.376 (Duality) – 157.528 (Qualification) + 213.916 (Directors with multiple directorships) – 29.069 (Age) + 92.485 (Tenure)

This means that for every unit increase in net profit, executive directors' remuneration will increase by RM2.432 provided other variables, company size, duality, qualification, directors with multiple directorships, age and tenure remain unchanged. The same effects apply for company size, duality, directors with multiple directorships and tenure that will increase the executives' remuneration while other independent variables remain constant. However, qualification and age will decrease the executive's remuneration.

Net profit, company size, duality, age, tenure were found as significant determinants for the executive directors' remuneration. Through duality by assuming both executive chairman and executive director positions, he or she would maximize his or her investment interests in the company. Qualification and directors with multiple directorships are not significant determinants for executive directors' remuneration.

Table 4: Regression Results of Determinants of Executive Directors' Remunerations From 2004 to 2006 for All Companies in Bursa Malaysia

	Coefficient	Standard Error	t	Sig	
R^2	0.14				
F value	40.80				
p value	0.00				
2004-2006					
Constant	1,769.40	740.95	2.39	0.02	*
Net Profit	2.43	0.00	3.58	0.00	**
Company Size	0.42	0.00	4.03	0.00	**
Duality	974.38	206.14	4.73	0.00	**
Qualification	(157.53)	272.29	(0.58)	0.56	
Multiple directorships	213.92	204.72	1.05	0.30	
Age	(29.07)	13.30	(2.19)	0.03	*
Tenure	92.49	13.26	6.98	0.00	**
2004					
Constant	1,460.91	1,093.75	1.34	0.18	
Net Profit	2.17	0.00	1.90	0.06	
Company Size	0.36	0.00	2.17	0.03	*
Duality	827.51	305.86	2.71	0.01	**
Qualification	(99.16)	402.62	(0.25)	0.81	
Multiple directorships	118.05	305.01	0.39	0.70	
Age	(20.58)	19.74	(1.04)	0.30	
Tenure	75.38	19.66	3.83	0.00	**
2005					
Constant	1,822.52	1,219.15	1.50	0.14	
Net Profit	1.56	0.00	1.79	0.07	
Company Size	0.49	0.00	3.42	0.00	**
Duality	954.42	335.85	2.84	0.01	**
Qualification	(186.32)	445.96	(0.42)	0.68	
Multiple directorships	217.48	332.70	0.65	0.51	
Age	(29.94)	21.80	(1.37)	0.17	
Tenure	93.10	21.57	4.32	0.00	**
2006					
Constant	2,277.70	1,511.47	1.51	0.13	
Net Profit	4.97	0.00	2.76	0.01	**
Company Size	0.17	0.00	0.64	0.52	
Duality	1,152.10	420.44	2.74	0.01	**
Qualification	(194.75)	553.84	(0.35)	0.73	
Multiple directorships	366.24	417.26	0.88	0.38	
Age	(40.79)	27.10	(1.50)	0.13	
Tenure	107.81	27.14	3.97	0.00	**

Notes: ** denotes $p < 0.01$, * denotes $p < 0.05$

The Results of Regression Model for Kuala Lumpur Composite Index Components Companies in Bursa Malaysia

Table 5 presents the descriptive statistics for the dependent and independent variables. The samples selected for 2004, 2005 and 2006 are 270, 89, 90 and 91, respectively. On the descriptive statistics for pooled samples 2004-2006, the mean for the executive directors' remuneration is RM3,936,980. In 2004, the mean for executive directors' remuneration is RM3,469,910 but further increased to RM3,783,380 in 2005 and RM4,545,690 in 2006. The upward trend is consistent with the increase in net profit and company size. Pearson correlation matrix and Variation Inflation Factors (VIF) results for both full sample periods as well as individual year revealed no multicollinearity problem.

The regression results indicated that duality, age and tenure were significant determinants of executive directors' remuneration. However, net profit, company size, qualification and directors with multiple directorships are not determinants of executive director's remuneration for pooled samples (see Table 6).

Table 5: Descriptive Statistics for Dependent and Independent Variables for companies under Kuala Lumpur Composite Index

	All *Minimum* *Maximum* *Mean* *Standard Deviation* *N=270*	*2004* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=89*	*2005* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=90*	*2006* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=91*
Dependent Variables:				
Directors' Remuneration (RM'000)	0.00	100.00	0.00	30.00
	101,690.00	69,496.00	78,788.00	101,690.00
	3,936.98	3,469.91	3,783.38	4,545.69
	9,288.64	7,778.26	8,721.99	11,085.10
Independent Variables:				
Net Profit (RM'000)	-1,255,202.00	-19,644.00	-1,255,202.00	-203,981.00
	4,763,546.00	2,613,500.00	4,763,546.00	2,949,815.00
	321,925.32	292,900.19	309,070.60	363,025.99
	571,508.76	480,691.45	635,349.66	590,269.24
Company Size (RM'000)	36,470.00	114,377.00	36,470.00	192,772.00
	19,911,100.00	19,453,300.00	18,987,400.00	19,911,100.00
	2,674,800.00	2,478,703.00	2,661,761.00	2,879,482.00
	3,724,222.11	3,425,816.76	3,672,880.34	4,069,305.63
Duality (%)	40.00%	42.00%	40.00%	38.00%
Qualification (%)	98.00%	99.00%	99.00%	97.00%
Directors with multiple directorships (%)	59.00%	61.00%	58.00%	59.00%
Age (years)	30.00	30.00	31.00	32.00
	84.00	82.00	83.00	84.00
	52.87	52.35	53.08	53.19
	7.97	8.09	7.90	7.99
Tenure (years)	1.00	1.00	1.00	1.00
	43.00	41.00	42.00	43.00
	8.69	8.11	8.63	9.30
	8.01	7.96	7.98	8.14

Table 6: Regression Results of Determinants of Executive Directors' Remunerations from 2004 to 2006 for KLCI Companies

	Coefficient	Standard Error	t	Sig	
R^2	0.21				
F value	9.86				
p value	0.00				
2004-2006					
Constant	5,846.91	5,397.85	1.08	0.28	
Net Profit	1.24	0.00	0.73	0.47	
Company Size	0.35	0.00	1.32	0.19	
Duality	3,294.32	1,113.29	2.96	0.00	**
Qualification	701.22	3,792.32	0.19	0.85	
Multiple directorships	747.98	1,068.70	0.70	0.49	
Age	(180.68)	76.64	(2.36)	0.02	*
Tenure	445.49	77.18	5.77	0.00	**
2004					
Constant	4,145.35	9,584.59	0.43	0.67	
Net Profit	0.13	0.00	0.04	0.97	
Company Size	0.38	0.00	0.74	0.46	
Duality	3,064.12	1,681.25	1.82	0.07	
Qualification	1,922.60	7,439.63	0.26	0.80	
Multiple directorships	187.57	1,637.40	0.12	0.91	
Age	(150.91)	113.10	(1.33)	0.19	
Tenure	365.37	117.45	3.11	0.00	**
2005					
Constant	2,346.07	10,754.62	0.22	0.83	
Net Profit	0.82	0.00	0.40	0.69	
Company Size	0.39	0.00	1.11	0.27	
Duality	2,906.17	1,844.36	1.58	0.12	
Qualification	2,809.53	8,208.62	0.34	0.73	
Multiple directorships	876.11	1,774.06	0.49	0.62	
Age	(151.98)	125.59	(1.21)	0.23	
Tenure	436.53	127.25	3.43	0.00	**
2006					
Constant	10,498.40	10,053.62	1.04	0.30	
Net Profit	4.12	0.01	0.83	0.41	
Company Size	0.05	0.00	0.07	0.94	
Duality	3,939.87	2,373.94	1.66	0.10	
Qualification	(883.73)	6,012.72	(0.15)	0.88	
Multiple directorships	1,487.71	2,246.55	0.66	0.51	
Age	(267.91)	170.24	(1.57)	0.12	
Tenure	549.33	166.29	3.30	0.00	**

Notes: ** denotes $p < 0.01$, * denotes $p < 0.05$

Table 7 reports the correlation coefficients between dependant and independent variables for both KLCI and non-KLCI companies from 2004 to 2006. More significant correlations were found in non-KLCI companies.

Table 7: The Correlation Coefficient of Dependant and Independent Variables from 2004 to 2006

Table 7: The Correlation Coefficient of Dependant and Independent Variables from 2004 to 2006

Panel A: KLCI Companies	*Directors' Remuneration*	*Net Profit*	*Company Size*	*Duality*	*Qualification*	*Directors with multiple directorships*	*Age*	*Tenure*
Directors' Remuneration	1.000							
Net Profit	0.195**	1.000						
Company Size	0.193**	0.849**	1.000					
Duality	0.216**	-0.062	-0.103	1.000				
Qualification	-0.009	0.029	0.021	-0.056	1.000			
Directors with multiple directorships	0.122*	-0.040	0.010	0.077	-0.002	1.000		
Age	0.104	0.038	0.010	0.304**	-0.050	0.055	1.000	
Tenure	0.366**	0.049	0.021	0.276**	-0.057	0.206**	0.520**	1.000
Panel B: Non-KLCI Companies								
Directors' Remuneration	1.000							
Net Profit	0.434**	1.000						
Company Size	0.448**	0.557**	1.000					
Duality	0.132**	-0.023	-0.025	1.000				
Qualification	-0.072**	0.040	0.130**	-0.122**	1.000			
Directors with multiple directorships	0.023	0.008	0.150**	0.149**	0.148**	1.000		
Age	0.088**	0.059*	0.073**	0.319**	-0.222**	0.079**	1.000	
Tenure	0.161**	0.063*	0.074**	0.213**	-0.315**	0.129**	0.425**	1.000

*Notes: ** Correlation is significant at the 0.01 level (2 tailed), * correlation is significant at 0.05 level (2 tailed)*

Regression Results of Determinants of Executive Directors' Remuneration for Companies not included in the Kuala Lumpur Composite Index

Table 8 presents the descriptive statistics for the dependent and independent variables. It should be pointed out that the company size and net profit of non-KLCI companies were relatively smaller than KLCI companies.

The overall regression results are shown in Table 9. F values are in the range of between 23.193 in 2004 to 86.275 for all 2004-2006. All four models are significant at the 0.05 level as the p-value is less than 0.000. This means at least one of the 7 independent variables can be used to model executive directors' remuneration. Net profit, company size, duality, qualification, age and tenure are significant determinants of executive directors' remuneration. In other words, the results indicate that only directors with multiple directorships variable are not a determinant.

Table 8: Descriptive Statistics for Dependent and Independent Variables for Non-KLCI Companies

	All *Minimum* *Maximum* *Mean* *Standard Deviation* *N=1464*	*2004* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=480*	*2005* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=491*	*2006* *Minimum* *Maximum* *Mean* *Standard Deviation* *N=493*
Dependent Variables:				
Directors' Remuneration (RM'000)	0.00 50,369.00 1,467.76 2,217.86	0.00 35,944.00 1,365.69 1,893.87	0.00 40,973.00 1,459.62 2,136.87	0.00 50,369.00 1,575.24 2,562.30
Independent Variables:				
Net Profit (RM'000)	-1,116,573.00 968,200.00 13,358.33 97,696.91	-1,116,573.00 753,400.00 11,766.63 105,443.99	-772,387.00 968,200.00 11,492.79 96,951.54	-663,402.00 945,900.00 16,766.03 90,433.58
Company Size (RM'000)	-1,041,955.00 6,249,600.00 322,061.53 564,734.00	-740,534.00 4,753,000.00 315,275.02 523,192.31	-876,754.00 6,240,279.00 324,285.13 585,765.48	-1,041,955.00 6,249,600.00 326,454.50 583,141.07
Duality (%)	44.00%	45.00%	44.00%	44.00%
Qualification (%)	81.00%	81.00%	81.00%	82.00%
Directors with multiple directorships (%)	35.00%	35.00%	35.00%	35.00%
Age (years)	31.00 85.00 54.00 8.42	31.00 83.00 53.31 8.31	32.00 84.00 53.96 8.39	33.00 85.00 54.70 8.51
Tenure (years)	1.00 56.00 9.09 8.14	1.00 54.00 8.54 8.05	1.00 55.00 9.10 8.15	1.00 56.00 9.62 8.20

Table 9: Regression Results of Determinants of Executive Directors' Remunerations from 2004 to 2006 for Non-KLCI Companies

	Coefficient	Standard Error	t	Sig	
R^2	0.29				
F value	86.28				
p value	0.00				
2004-2006					
Constant	1,807.77	374.20	4.83	0.00	**
Net Profit	5.86	0.00	9.67	0.00	**
Company Size	1.27	0.00	11.88	0.00	**
Duality	605.19	105.48	5.74	0.00	**
Qualification	(567.15)	131.90	(4.30)	0.00	**
Multiple directorships	(197.87)	107.17	(1.85)	0.07	
Age	(15.46)	6.76	(2.29)	0.02	*
Tenure	29.54	6.71	4.40	0.00	**
2004					
Constant	1,383.90	573.64	2.41	0.02	
Net Profit	3.67	0.00	4.70	0.00	**
Company Size	1.29	0.00	7.96	0.00	**
Duality	455.30	162.23	2.81	0.05	*
Qualification	(474.19)	201.53	(2.35)	0.02	*
Multiple directorships	(200.97)	165.18	(1.22)	0.22	
Age	(8.57)	10.43	(0.82)	0.41	
Tenure	27.84	10.31	2.70	0.01	**
2005					
Constant	1,887.19	633.64	2.98	0.00	
Net Profit	6.43	0.00	5.90	0.00	**
Company Size	0.97	0.00	5.26	0.00	**
Duality	653.78	177.32	3.69	0.00	**
Qualification	(522.76)	222.09	(2.35)	0.02	*
Multiple directorships	(154.29)	179.32	(0.86)	0.39	
Age	(16.66)	11.43	(1.46)	0.15	
Tenure	30.15	11.25	2.68	0.01	**
2006					
Constant	2,257.55	722.21	3.13	0.00	**
Net Profit	9.31	0.00	6.67	0.00	**
Company Size	1.28	0.00	5.85	0.00	**
Duality	730.36	203.67	3.59	0.00	**
Qualification	(697.40)	255.80	(2.73)	0.01	**
Multiple directorships	(205.64)	207.09	(0.99)	0.32	
Age	(22.21)	12.95	(1.71)	0.09	
Tenure	28.72	12.99	2.21	0.03	*

Notes: ** denotes p <0.01, * denotes p < 0.05

Table 10: Comparisons of Results of Determinants of Executive Directors' Remunerations Under Various Samples in Bursa Malaysia from 2004 to 2006

	DETERMINANTS						
Panel A: All Companies	NP	CO_SIZE	DUALITY	QUALI	OTH_DIR	AGE	TENURE
All	√	√	√	X	X	√	√
p-value	0.000	0.000	0.000	0.563	0.296	0.029	0.000
2004	X	√	√	X	X	X	√
p-value	0.057	0.031	0.007	0.806	0.699	0.298	0.000
2005	X	√	√	X	X	X	√
p-value	0.074	0.001	0.005	0.676	0.514	0.170	0.000
2006	√	X	√	X	X	X	√
p-value	0.006	0.520	0.006	0.725	0.380	0.133	0.000
	DETERMINANTS						
Panel B: KLCI Components	NP	CO_SIZE	DUALITY	QUALI	OTH_DIR	AGE	TENURE
All	X	X	√	X	X	√	√
p-value	0.468	0.187	0.003	0.853	0.485	0.019	0.000
2004	X	X	X	X	X	X	√
p-value	0.971	0.462	0.072	0.797	0.909	0.186	0.003
2005	X	X	X	X	X	X	√
p-value	0.688	0.272	0.119	0.733	0.623	0.230	0.001
2006	X	X	X	X	X	X	√
p-value	0.408	0.943	0.101	0.884	0.510	0.119	0.001
	DETERMINANTS						
Panel C: Non-KLCI Components	NP	CO_SIZE	DUALITY	QUALI	OTH_DIR	AGE	TENURE
All	√	√	√	√	X	√	√
p-value	0.000	0.000	0.000	0.000	0.065	0.022	0.000
2004	√	√	√	√	X	X	√
p-value	0.000	0.000	0.050	0.019	0.224	0.412	0.007
2005	√	√	√	√	X	X	√
p-value	0.000	0.000	0.000	0.019	0.390	0.146	0.008
2006	√	√	√	√	X	X	√
p-value	0.000	0.000	0.000	0.007	0.321	0.087	0.027

Notes: NP denotes Net profits, CO_size denotes company size, Duality denotes joint title of executive chairman and executive director, Quali denotes qualification, Oth_dir denotes directors with multiple directorships, Age denotes age of the executive director, and tenure denotes number of years holding the post of executive director in the same company. X denotes not determinat, √ denotes significant determinant

Comparison of Determinants of Executive Directors' Remuneration among All Companies, KLCI and Non-KLCI Companies

Table 10 reports the summary of determinants of executive directors' remuneration for all public listed companies, KLCI and non-KLCI companies in Bursa Malaysia. Tenure is the strongest determinant as the p-value is significant for all the regression models. This implies that the longer the tenure, the power for the executive directors to demand higher remuneration is higher. At the same time, it is quite usual and normal that executive directors would expect an annual increment for their remuneration in terms of salary or fees or both to compensate for their experience and services contributed to the company. The results are consistent with the human capital theory, which states that the long service executives are entitled for higher remuneration based on their experience and skills.

The second strongest determinant is duality as evident by all companies except for KLCI companies. The possible reasons might be that the corporate governance of KLCI companies are relatively stronger and independent than the non-KLCI companies in which the executive directors' influence in determining remuneration is insignificant and sufficient check and balance even dual roles are assumed. This is in line with the Malaysian Code on Corporate Governance that had encouraged the companies to split the joint-title of chairman and executive director. KLCI companies had shown the decreased of dual roles from 40% to 38% from year 2004 to 2006. Unlike KLCI companies, non-KLCI companies particularly, the family-owned and smaller companies have significant influence over the board through the joint-title. Duality enables them to influence their own remunerations.

Company size and net profit are another two significant determinants after tenure and duality. However, the significance is less apparent. The results implied that the performance-based rewards were not practiced by every public listed company. Ironically, the regression results for KLCI companies have failed to show any direct relationship between executives' remuneration with net profit and company size. In contrast, the results show the non-KLCI companies are those smaller companies that have rewarded their executive directors according to the net profit and company size achieved each year. Thus, agency and labour market theories are more applicable to smaller public listed companies.

Age is the weakest determinant in which it only appears significant for

2004-2006 samples. As for executive directors with multiple directorships, it is not a determinant at all. One possible explanation is that not many companies have cross directorships like Genting Bhd and Resorts Bhd, IOI Corporation Bhd and IOI Properties Bhd, to name a few.

The results of the study also imply that other than the determinants mentioned, there might be other qualitative factors to influence the executive directors' remuneration. Overall, the R square for all the models is approximately 20%. The independent variables only manage to explain 20% of the remuneration. Some qualitative factors, such as technological change, organisational strategies and streamlining of business process may need to be taken into consideration. These qualitative factors may bear fruits only in the long term and are not immediately reflected in the short-term profits.

Conclusion

Overall, tenure appeared to be the most significant determinant. Accumulative of skills and contributions to the company influence greatly the remuneration of executive directors. The remuneration increases when directors have been incumbent in their positions for an extended length of time. Age and qualification fail to show that knowledge and experience are the key factors to decide the pay of executives. Most probably the companies require special competence of the company or industry as evident by tenure. This is because they have adapted and understood how business model, environment, and practices of a company operate. Besides, dual roles and age also serve as important determinants. Future research would be of interest to examine the linkage of directors' remuneration with directors' liabilities and responsibilities assumed to gauge indepth as well as different perspectives of director compensation.

This article was first published in Corporate Ownership & Control Journal, Volume 6, Issue 3, Spring 2009 (Special Issue). Reprinted with permission of the editor of the journal and Virtus InterPress.

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About The Author

Dr. Lai Ming Ming is a senior lecturer in the Faculty of Management, Multimedia, Malaysia. Her teaching interests include investments, portfolio management, corporate finance and personal finance in both undergraduate and graduate levels. Her research endeavours have resulted in several publications in local and international journals. She is listed in a variety of directories including Who's Who in America 2008, and Who's Who in the World 2008. Dr Lai (corresponding author) can be reached at mmlai@mmu.edu.my

Ooi Chye Khoon, CA (M), CPA (M) is the Assistant General Manager, Finance of a company listed on the main board of Bursa Malaysia. He worked as an auditor in one of the Big 4 accounting firms before joining the company.

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