EARNING QUALITY IN
MESDAQ COMPANY

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UNIVERSITI UTARA MALAYSIA
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EARNING QUALITY IN
MESDAQ COMPANY

A thesis submitted to the Graduate School in partial
Fulfillment of the requirement for the degree
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By
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ABSTRACT

Earning Management can be viewed from financial reporting perspective. From a financial reporting perspective, managers may use earning management to meet analysts’ earning forecast, thereby avoiding the strong negative share price reaction that quickly follow a failure to meet investor expectations. Also, they may record excessive write off or emphasize earning construct such as net income. Management may use it to create a stream of smooth and growing earning over time. Give securities market efficiency, this requires management to draw on its inside information. Thus, earning management can be a vehicle for the communication of management’s inside information to investors. Too much earning management, however, reduces the earning quality and the ability investor to interpret current net income as well, particularly if the earning management is buried in core earning or otherwise not fully disclosed. The reported net income is useful to investor in evaluating future firm performance but excessive earning management may reduce this usefulness. Thus this study is very important because from the research findings shows that the size of audit firm, internal audit establishment and former senior auditor as company director have no significantly effect on earning management which being proxy by total discretionary accruals. An understanding of the earning management is also important to accountants because it enables an improved understanding of the usefulness of the net income, especially for reporting to investor. It also may assist them to avoid some of the serious legal and reputation consequences that arise when firms become financially distress where such distress is often preceded by serious abuse of earnings management.
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ABBREVIATIONS

aud_signal  Audit delays
audit_partner  Senior and junior auditor
big4  Big four audit firm (KPMG, PwC, Deloitte and EY)
bodxsenaudit  Existence of former senior auditor as company director
caudpartner  Company audit partner
CLERP  Corporate Law Economic Reform Program
COGS  Cost of Good Sold
CPA  Chartered Public Accounting
EPS  Earning Per Share
EY  Earns & Young
GAAP  General Accepted Accounting Principles
IIAM  Institute of Internal Auditor of Malaysia
int_audit  Existence of independent internal audit function
IV  Independent Variables
lgasset  Total asset
lgaudfee  Audit fees
MESDAQ  Malaysia Exchange for Securities Dealing and Automated Quotation
MIA  Malaysia Institute of Accountants
MSC  Multimedia Super Corridor
NYSE  New York Stock Exchange
OLS  Ordinary Least Square
SAC  Statements of Accounting Concepts
SEC  Securities Commission
SFAC  Statement of Financial Accounting Concepts
SMI  Small Medium Industries
SOX  Sarbanes Oxley
SPSS  Statistical Package for Social Science
sqrtsubs  Number of all subsidiaries
CHAPTER ONE

INTRODUCTION

1.0 Introduction

Firm value is derived from the market's expectations of firm performance. Accounting provides the necessary information for the market to form these expectations. Books value of equity represents past performance and current earnings are indicative of future performance. Thus these measures are commonly used as the basis for firm valuation (Easton and Harris 1991; Wild 1992; Ohlson 1995; Penman 1998; Ou and Sepe 2002).

This study is conducted for the purposes that the reliability of accounting information may affect its relevance to the market in determining firm value and reducing the quality of reported earning as well. The earning figure is susceptible to manipulation that may also reduce its reliability and thus its usefulness in the valuation process. This is due to the accrual components of earnings which is in part subject to managerial discretion. This is because according to the GAAP (General Accepted Accounting Principles) allow a degree of freedom; this pliancy may be exploited by management (Levitt 19998). The prospect of exploitation increases when incentives exist for management to manipulate the accruals components of earnings targets (Beaver and Angel 1996; Dechow et al 1996; Wu 1997; Teoh et al 1998b; Erickson and Wang 1999; Holland and Ramsay 2003).

The rationale for the use of accrual accounting is that it allows management to adjust cash flows to better reflect the performance and position of the firms. In this context, accruals are used as a signal to the market. However when the managers use accruals to opportunistically manage earnings, the earning measure is not a reliable indicator of the firm's financial performance. Accordingly, such opportunistic behavior will reduce the usefulness of the information contained earnings. The difficulty for the market participants is to identify when accruals are used as a credible signal and when
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