BOARD CHARACTERISTICS AND EARNINGS MANAGEMENT

An Empirical Evidence Form Malaysian Listed Companies

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ABSTRACT

This thesis investigates the relationship between board's characteristics and earning management on the companies listed on bursa Malaysia's main board, which examine roles of independence board, outside directors, CEO duality and management ownership in constraining the earnings management activities. In general, the study contributes to the literature by testing the issue of boards and investigates major board characteristics are related to earnings management by the firm, and it aims to provide empirical evidence according to regulatory and business environments in Malaysia. Hence, I have used data of eighty one firms from major sectors are available in bursa Malaysia, as below: industrial products, properties, plantation, hotels, consumer products, trade & services, technology, and construction sector. In addition, the time of period covered for this study in 2009 within Bursa Malaysia. This study finds a negative significant result of board independence, CEO duality, and outside directors to earnings management, results also indicates that ownership management has positive relationship to earning management. This indicates that the more manager own companies, that excessive shareholding more than 25% by managers may induce managers to manage earnings. While the matter of combined CEO and Chairman (CEO duality) is not effective to earnings management practice in Malaysia firms. board composition (outside directors) is not common in Malaysia firms as results indicate that have some companies haven't any outside director in their board directors, as suggested by the Cod of corporate governance in Malaysia is not satisfactory to monitor the management from earnings quality.

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LIST OF ABBREVIATIONS

FRF = Financial Reporting Foundation

MASB = Malaysian Accounting Standards Board

MCCG= Malaysian Code of Corporate Governance

MICPA = Malaysian Institute of Certified Public Accountants

IAS= International Accounting Standards

IBC = Independent Board's Composition

GAAP = Generally Accepted Accounting principles

EM= Earnings Management

BC= Board's Composition (Outside Directors)

CEO = Chief Executive Officer

CEO Duality = Chairman and Chief Executive Officer

MO= Management ownership

EPS= Earnings per Share

TA= Total accruals in year t

NI = Net Income in year t

CFO = cash flows from operating activities in year t

DAC = Discretionary accruals

IND = Directors independence

DUAL = CEO duality

OWN = Managerial ownership

ROA = Return on assets

LEV = Leverage

SIZE = Size

OCF = Operating cash flows

AUDIT4 = Audit quality

Chapter I

BACKGROUND OF THE STUDY

1.1 INTRODUCTION

In the period between 1997- 1998, where crisis of the emerging market has spawned an enormous body of researches on Corporate Governance issues in emerging markets, on the contrary with traditional literature such as Berle and Means (1932), and Jensen and Meckling (1976)[1], where Concerns regard corporate governance in East Asian countries emerged as a outcome of the East Asian financial crisis in 1997/1998. The crisis exposed the consequences of weak governance and poor governance standards were blamed indirectly in part for the crisis that weakened foreign investors' confidence in the East Asian capital market, including Malaysia (Leng, 2004, Abdul Rahman and Haniffa, 2005).

After the Asian financial crisis in 1997, business community started to asking and indicating about the effectiveness of Corporate Governance mechanisms within an organization. The crisis is followed by the two famous cases of Enron in 2001 and WorldCom in 2002, as a result, many studies are believes that the existing Corporate Governance Mechanisms are not able to provide sufficient control over the utility maximization behavior of managers through the practice of earnings management. In order to improve the monitoring function of corporate governance mechanisms in Malaysia, the code of corporate governance was drafted in 1999 and subsequently approved in 2000 by the Ministry of Finance. The Code outlines some necessary

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[1] Both argue that when ownership and control of corporations are not fully coincident, there are potential conflicts of interest between owners and controllers. Managers, by controlling the daily operating activities of a firm, may extract private benefits at the expense of the firm's ultimate owners - the shareholders

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