

**IFRS CONVERGENCE AND EARNINGS MANAGEMENT:  
MALAYSIAN EVIDENCE**

**By**

**KHOO CHUN PENG**

**Dissertation Submitted to the  
Othman Yeop Abdullah Graduate School of Business,  
Universiti Utara Malaysia,  
in Fulfillment of the Requirement for the Degree of  
Master of Science of International Accounting**

## **PERMISSION TO USE**

In presenting this dissertation in partial fulfillment of the requirements for a postgraduate degree from Universiti Utara Malaysia, I agree that the University Library make a freely available for inspection. I further agree that permission for copying of this dissertation in any manner, in whole or in part, for scholarly purpose may be granted by my supervisor or, in their absence by the Dean of Othman Yeop Abdullah Graduate School of Business. It is understood that any copying or publication or use of this dissertation or parts thereof for financial gain shall not be given to me and to Universiti Utara Malaysia for any scholarly use which may be made of any material from my dissertation.

Request for permission to copy or make other use of materials in this dissertation/project paper, in whole or in part should be addressed to:

Dean of Othman Yeop Abdullah Graduate School of Business

Universiti Utara Malaysia

06010 UUM Sintok

Kedah Darul Aman

## **ABSTRAK**

Kajian ini menyiasat tentang sama ada Piawai Laporan Kewangan Antarabangsa (PLKA) akan mengurangkan tahap pengurusan pendapatan dan menyampaikan maklumat penyata kewangan yang berkualiti kepada penggunaanya. Selain itu, kajian ini juga mengkaji tentang faktor-faktor yang menyumbang kepada pengurusan pendapatan sebelum dan selepas penggunaan PLKA. Sampel kajian ini terdiri daripada 231 buah syarikat-syarikat yang senarai di Bursa Malaysia. Tempoh masa kajian ini meliputi tahun 2005 (iaitu, sebelum penggunaan PLKA) dan tahun 2006 (iaitu, selepas penggunaan PLKA). Model akruan Kothari digunakan dalam kajian ini untuk mengukur tahap pengurusan pendapatan.

Dengan membandingkan tahap pengurusan pendapatan dalam dua tempoh yang berbeza (iaitu, sebelum dan selepas penggunaan PLKA), kajian ini mendapati bahawa penggunaan PLKA dapat mengurangkan tahap pengurusan pendapatan di kalangan syarikat yang senarai di Bursa Malaysia. Kajian ini juga menunjukkan bahawa faktor-faktor yang menyumbang kepada pengurusan pendapatan kekal sama selepas penggunaan PLKA. Hasil kajian melaporkan bahawa nisbah ahli pengarah yang tidak berlatarbelakang politik dalam lembaga pengarah mempunyai hubungan positif penting dengan pengurusan pendapatan sebelum dan selepas penggunaan PKLA. Di samping itu, kajian ini juga mendapati bahawa nisbah ahli pengarah bebas dalam lembaga pengarah, saiz lembaga pengarah, kualiti audit, pergantungan pasaran saham asing dan etnik tidak mempunyai hubungan dengan pengurusan pendapatan.

Antara pembolehubah kawalan, kajian menunjukkan bahawa saiz syarikat mempunyai hubungan negatif penting dengan pengurusan pendapatan sebelum penggunaan PKLA. Selain itu, kajian itu juga melaporkan bahawa keuntungan mempunyai hubungan positif penting dengan pengurusan pendapatan sebelum dan selepas penggunaan PKLA.

Kajian ini mempunyai implikasi untuk badan-badan kawal selia, tugas mereka untuk melihat ke dalam kesan IFRS penumpuan kepada sejauh mana pengurusan perolehan, terutamanya di negara Asia - Malaysia. Kajian ini mempunyai implikasi terhadap badan-badan kawal selia untuk memantau kesan penggunaan PKLA terhadap pengurusan pendapatan, terutamanya di negara Asia - Malaysia.

## **ABSTRACT**

The study sheds light on whether IFRS convergence would reduce the extent of earnings management, which in turns delivers higher quality of financial statement information to its users. Besides, the study also investigates the explanatory factors of earnings management before and after IFRS convergence. The sample of the study consists of 231 Malaysian listed companies. The time frame of the study is year 2005 (i.e., pre-IFRS convergence) and year 2006 (i.e., post-IFRS convergence). Kothari's discretionary accruals model is used in the study to measure the extent of earnings management.

By examining the extent of earnings management in two different periods (i.e., pre-IFRS convergence & post-IFRS convergence), the study finds that IFRS convergence reduces the extent of earnings management among Malaysian listed companies. In addition, the findings reveal that the explanatory factors of earnings management remain unchanged after IFRS convergence. The findings report that the proportion of non-political connected directors on boards is significant positively associated with earnings management before and after IFRS convergence. In addition, the study also finds that the proportion of independent external directors on board, board size, audit quality, foreign stock market listing and ethnicity do not have any association with earnings management before and after IFRS convergence.

Among the control variables, the study reveals that company size is significant negatively associated with earnings management before IFRS convergence. Besides, the study also

reports that profitability is significant positively associated with earnings management before and after IFRS convergence.

This study has implications for regulatory bodies, tasking them to look into the effects of IFRS convergence on the extent of earnings management, particularly in an Asian country – Malaysia.

## **ACKNOWLEDGMENTS**

First of all, I would like to express my deepest appreciation to my dissertation supervisor, Dr. Nurwati Ashikkin Binti Ahmad Zaluki, whose contribution in stimulating suggestions and encouragement. This dissertation would never have been completed without her guidance and constant supervision. Besides, I would like to thank her for spending valuable time to review my works. I am highly indebted to her.

Besides, I would like to express my gratitude and thanks to my family members who always giving their consideration, supports and unending love. A special appreciation goes to my fiancée, Liu JiaLi for her love, supports and patience during the past five years. I heartily thank to her encouragement all of the time.

My appreciations also go to my friends especially Redwan who always like my brother never hesitate to shares his knowledge and ideas with me. Last but not least, I am thankful to those who had helped me.

## TABLE OF CONTENT

PERMISSION TO USE.....	ii
ABSTRAK.....	iii
ABSTRACT.....	v
ACKNOWLEDGMENTS .....	vii
LIST OF TABLES.....	xi
LIST OF ABBREVIATIONS.....	xii
LIST OF FIGURE .....	xiii
CHAPTER ONE.....	1
INTRODUCTION .....	1
1.0    Introduction.....	1
1.1    Background of the study .....	1
1.2    Problem Statement.....	6
1.3    Research Objectives.....	8
1.4    Research Questions.....	9
1.5    Scope of the study.....	10
1.6    Significance of the study.....	10
1.7    Organization of the study.....	11
CHAPTER TWO.....	12
LITERATURE REVIEW .....	12
2.0    Introduction.....	12
2.1    Theoretical framework.....	12
2.2    Conceptual framework of earnings management .....	14
2.3    International Accounting Standards Board and IFRS.....	19
2.4    Malaysian Accounting Standards Board and accounting developments in Malaysia.....	22



2.5	Empirical results on IFRS and earnings management .....	24
2.6	Explanatory factors of earnings management.....	28
2.6.1	Independence of board members .....	30
2.6.2	Board size.....	32
2.6.3	Audit quality .....	33
2.6.4	Foreign stock market listing.....	34
2.6.5	Ethnicity .....	35
2.6.6	Political influence .....	37
2.7	Summary .....	39
CHAPTER THREE .....		40
METHODS .....		40
3.0	Introduction.....	40
3.1	Research frameworks.....	40
3.2	Hypotheses development .....	41
3.2.1	Impacts of IFRS on earnings management .....	41
3.2.2	Explanatory factors of earnings management.....	42
3.3	Research design .....	45
3.3.1.	Sample.....	46
3.3.2.	Operational definition and measurement of variables .....	49
3.3.3.	Research model for multivariate analysis .....	54
3.4	Summary .....	59
CHAPTER FOUR.....		60
RESULTS AND DISCUSSIONS.....		60
4.0	Introduction.....	60
4.1	Results of univariate analysis.....	60

4.2	The magnitude of IFRS convergence on earnings managements .....	71
4.3	Results of multivariate analysis .....	71
4.4	Results of additional analysis.....	78
4.5	Summary .....	82
CHAPTER FIVE .....		85
CONCLUSIONS AND RECOMMENDATIONS .....		85
5.0	Introduction.....	85
5.1	Findings of the study.....	85
5.2	Limitations of the study and recommendations .....	89
5.3	Summary .....	91
REFERENCES .....		92
APPENDIX.....		97

## LIST OF TABLES

	<b>PAGE</b>
Table 3.1 Derivation of sample size	46
Table 3.2 Industrial sector of sample companies	48
Table 3.3 Operational definition and measures	51
Table 4.1 Descriptive statistics	62
Table 4.2 Results of univariate analysis	67
Table 4.3 Pearson moment-product correlation analysis	74
Table 4.4 Ordinary Least Square regression analysis	77
Table 4.5 Descriptive statistics for joint data	79
Table 4.6 Pearson moment-product correlation analysis for joint data	81
Table 4.7 Ordinary Least Square regression analysis for joint data	82

## **LIST OF ABBREVIATIONS**

CCM	Companies Commission of Malaysia
FRS	Financial Reporting Standards
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offerings
MACPA	Malaysian Association of Certified Public Accountants
MASB	Malaysia Accounting Standards Board
MBO	Management Buyouts
MICPA	Malaysian Institute of Certified Public Accountants
MIA	Malaysian Institute of Accountants
NEP	New Economy Policy
SC	Securities Commission

## LIST OF FIGURE

	<b>PAGE</b>
Figure 3.1 Research framework for univariate analysis	40
Figure 3.2 Research framework for multivariate analysis	40

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.0 Introduction**

This introductory chapter is organized as follows: Section 1.1 discusses background of the study. Section 1.2 highlights problem statement of the study. Section 1.3 describes the research objectives. Section 1.4 relates to research questions. Section 1.5 explains the scope of the study. Section 1.6 highlights the significance of the study, and Section 1.7 expounds the organization of the study.

#### **1.1 Background of the study**

Effective from 1 January 2006, IFRS-based accounting standards that are known as Financial Reporting Standards (FRS) is employed by public accountability companies in Malaysia. The new accounting standards, FRS<sup>1</sup>, issued by Malaysian Accounting Standards Board (MASB) would be identical with International Financial Reporting Standards (IFRS) released by International Accounting Standards Board (IASB). The convergence of new accounting standards that are in line with IFRS is seen as a milestone in Malaysian accounting history, especially after the country experienced several domestic financial scandals, such as Transmile Group Berhad (TGB). In mid of 2007, TGB accounting scandal was shocked the domestic financial markets as its revenue for year 2005 and year 2006 was overstated by over RM500 million (The Edge Malaysia, 2009). The external auditor of TGB refused to declare true and fair view opinion on its financial statements and it resulted the company failed to file their audited account before

---

<sup>1</sup> The terms FRS, IFRS-based accounting standards and IFRS are used interchangeably in the study.

The contents of  
the thesis is for  
internal user  
only

## REFERENCES

- Abdul Rahman, R., & Mohamed Ali, F. H. (2006). Board, audit committee, culture and earnings management: Malaysian evidence. *Managerial Auditing Journal*, 21 (7), 783-804.
- Abdul Wahab, E. A., Mat Zain, M., & James, K. (2011). Political connections, corporate governance and audit fees in Malaysia. *Managerial Auditing Journal*, 26 (5), 393-418.
- Abdullah, Z., Shaari, H., Abdul Aziz, S., Abu Bakar, F., Sawandi, N., Sharif, Z., et al. (2009). *Financial Reporting Standards Requirements and Applications in Financial Accounting and Reporting*. Kuala Lumpur: Prentice Hall.
- Arya, A., Glover, J. C., & Sunder, S. (2003). Are unmanaged earnings always better for shareholders. *Accounting Horizons*, 17 Supplement, 111-116.
- Ashbaugh, H. (2001). Non-US firms' accounting standard choices. *Journal of Accounting and Public Policy*, 20, 129-153.
- Ashbaugh, H., & Pincus, M. (2001). Domestic accounting standards, international accounting standards, and the predictability of earnings. *Journal of Accounting Research*, 39 (3), 417-434.
- Ball, R. (2006). International Financial Reporting Standards: Pros and cons for investors. *Accounting and Business Research, International Accounting Policy Forum*, 5-27.
- Ball, R., & Shivakumar, L. (2008). Earnings quality at initial public offerings. *Journal of Accounting and Economics*, 45, 324-349.
- Ball, R., Robin, A., & Wu, J. S. (2003). Incentives versus standards: Properties of accounting income in four East Asian countries. *Journal of Accounting and Economics*, 36, 235-270.
- Barth, M. E., Landsman, W. R., & Lang, M. H. (2008). International Accounting Standards and accounting quality. *Journal of Accounting Research*, 46 (3), 467-497.
- Bazley, J. D., Bazley, J. D., & Jones, J. (2009). *Intermediate Accounting 11th Edition*. Cengage Learning.
- Beasley, M. S. (1996). An empirical analysis of the relation between the board of director composition and financial statement fraud. *Accounting Review*, 71 (4), 443-465.
- Ben Othman, H., & Zéghal, D. (2006). A study of earnings-management motives in the Anglo-American and Euro-Continental accounting models: The Canadian and French cases. *International Journal of Accounting*, 41, 406-435.
- Bradshaw, M. T., & Miller, G. S. (2007). Will harmonizing accounting standards really harmonize accounting? Evidence from non-U.S. firms adopting GAAP. *Working paper, Harvard Business School*.



- Burgstahler, D. C., Hail, L., & Leuz, C. (2006). The importance of reporting incentives: Earnings management in European private and public firms. *Accounting Review*, 81 (5), 983-1016.
- Canham, C. (2008, August 15). *Malaysia standard setter to complete IFRS adoption by 2012*. Retrieved April 2013, 16, from Accountant: <http://www.theaccountant-online.com/news/malaysian-standard-setter-to-complete-ifrs-adoption-by-2012>
- Chen, K. Y., Lin, K. L., & Zhou, J. (2005). Audit quality and earnings management for Taiwan IPO firms. *Managerial Auditing Journal*, 20 (1), 86-104.
- Christensen, H. B., Lee, E., & Walker, M. (2008). Incentives or standards: What determines accounting quality changes around IFRS adoption? *Financial Accounting and Reporting Section FARS*.
- Chuah, B. H. (1995). The unique breed of Malaysian managers. *Management Times*. New Straits Times Malaysia.
- Claessens, S., & Fan, J. (2002). Corporate governance in Asia: A survey. *International Review of Finance*, 3 (2), 77-103.
- Claessens, S., Djankov, S., & Lang, L. (2000). The separation of ownership and control in East Asian Corporations. *Journal of Financial Economics*, 58, 81-112.
- Cohen, J. (1988). *Statistical power analysis for the behavioral sciences*. Hillsdale, NJ: Erlbaum.
- Dalton, D. R., Daily, J. L., & Ellstrand, A. E. (1999). Number of directors and financial performance: A meta-analysis. *Academy of Management Journal*, 42, 674-686.
- Daske, H., & Gebhardt, G. (2006). International Financial Reporting Standards and experts' perceptions of disclosure quality. *ABACUS*, 42 (3-4), 461-498.
- Dechow, P. M., Sloan, R. G., & Sweeney, A. P. (1995). Detecting earnings management. *Accounting Review*, 70 (2), 193-225.
- DeFond, M. L., & Jambalvo, J. (1994). Debt covenant violation and manipulation accruals. *Journal of Accounting and Economics*, 26, 301-325.
- Duhamel, K. (2009). Personalized perspectives of Chinese ethnicity in modern Malaysian university students. *Unpublished dissertation*.
- Eisenhardt, M. K. (1989). Agency theory: An assessment and review. *Academy of Management Review*, 14 (1), 57-74.
- El-Gazzar, S. M., Finn, P. M., & Jacob, R. (1999). An empirical investigation of multinational firms' compliance with international accounting standards. *The International Journal of Accounting*, 34 (2), 239-248.
- Francis, J. (2001). Discussion of empirical research on accounting choice. *Journal of Accounting and Economics*, 31, 309-319.

- Gibbins, M., Richardson, A., & Waterhouse, J. (1990). The management of corporate financial disclosure: Opportunism, ritualism, policies and processes. *Journal of Accounting Research*, 28 (1), 121-143.
- Goncharov, I., & Zimmermann, J. (2006). Do accounting standards influence the level of earnings management? Evidence from Germany. *SSRN Working Paper Series*.
- Goodstein, J., Gautam, K., & Boeker, W. (1994). The effect of board size and diversity on strategic change. *Strategic Management Journal*, 15, 241-250.
- Gravetter, F. J., & Wallnau, L. B. (2000). *Statistics for the behavioral sciences (5th Edition)*. Upper Saddle River, NJ: Prentice Hall.
- Gul, F. A. (2006). Auditors' response to political connections and cronyism in Malaysia. *Journal of Accounting Research*, 118 (1), 107-155.
- Han, C. Y., & Wang, S.-w. (1998). Political costs and earnings management of oil companies during the 190 Persian Gulf crisis. *Accounting Review*, 73 (1), 103-117.
- Haniffa, R. M., & Cooke, T. E. (2002). Culture, corporate governance and disclosure in Malaysian corporations. *ABACUS*, 38 (3), 317-349.
- Healy, P. M., & Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. *Accounting Horizons*, 13 (4), 365-383.
- Healy, P. (1985). The impact of bonus schemes on the selection of accounting principles. *Journal of Accounting and Economics*, 7, 85-107.
- IASB. (2013). *About the IFRS Foundation and the IASB*. Retrieved January 30, 2013, from IASB Official Website: <http://www.ifrs.org/The-organisation/Pages/IFRS-Foundation-and-the-IASB.aspx>
- IASB. (2013). *The move towards global standards*. Retrieved January 30, 2013, from IASB Official Website: <http://www.ifrs.org/use-around-the-world/Pages/use-around-the-world.aspx>
- Iatridis, G. (2010). International Financial Reporting Standards and the quality of financial statement information. *International Review of Financial Analysis*, 19, 193-204.
- Johl, S., Jubb, C. A., & Houghton, K. A. (2007). Earnings management and the audit opinion: Evidence from Malaysia. *Managerial Auditing Journal*, 22 (7), pp.688-715.
- Johnson, S., & Mitton, T. (2003). Cronyism and capital controls: Evidence from Malaysia. *Journal of Financial Economics*, 67 (2), 351-382.
- Jones, J. J. (1991). Earnings management during import relief investigations. *Journal of Accounting Research*, 29 (2), 193-228.
- Kothari, S. P., Leone, A. J., & Wasley, C. E. (2005). Performance matched discretionary accrual measures. *Journal of Accounting and Economics*, 39 (1), 163-197.

- Koumanakos, E., Siriopoulos, C., & Georgopoulos, A. (2005). Firm acquisitions and earnings management: Evidence from Greece. *Managerial Auditing Journal*, 20 (7), 663-678.
- Leuz, C. (2003). IAS versus U.S. GAAP: Information asymmetry-based evidence from Germany's new market. *Journal of Accounting Research*, 41 (3), 445-472.
- Leuz, C., & Verrecchia, R. E. (2000). The economic consequences of increased disclosure. *Journal of Accounting Research*, 38 (Supplement: Studies on Accounting Information and the Economics of the Firm), 91-124.
- Leuz, C., Nanda, D., & Wysocki, P. D. (2003). Earnings management and investor protection: An international comparison. *Journal of Financial Economics*, 69, 505-527.
- Lo, K. (2008). Earnings management and earnings quality. *Journal of Accounting and Economics*, 45, 350-357.
- Malaysian Accounting Standards Board. (2013). *MASB Profile*. Retrieved January 31, 2013, from MASB Official Website.
- MASB. (2013). *Transition to IFRS*. Retrieved January 30, 2013, from MASB Official Website:  
[http://www.masb.org.my/index.php?option=com\\_content&view=article&id=1376&Itemid=63](http://www.masb.org.my/index.php?option=com_content&view=article&id=1376&Itemid=63)
- McKee, T. E. (2005). *Earnings management: An executive perspective*. Ohio: Thomson.
- Mohammed, N. F., Ahmed, K., & Xu, D. J. (2011). *Accounting conservatism, corporate governance and political influence: Evidence from Malaysia*. Retrieved April 23, 2013, from Accounting Finance Association of Australia and New Zealand:  
[http://www.afaanz.org/openconf/2011/modules/request.php?module=oc\\_proceedings&action=view.php&a=Accept+as+Paper&id=56](http://www.afaanz.org/openconf/2011/modules/request.php?module=oc_proceedings&action=view.php&a=Accept+as+Paper&id=56)
- Mohd Saleh, N., Mohd Iskandar, T., & Rahmat, M. M. (2007). Audit committee characteristics and earnings management: Evidence from Malaysia. *Asian Review of Accounting*, 15 (2), 147-163.
- Nikolai, L. A., Bazley, J. D., & Jones, J. (2009). *Intermediate Accounting*. Cengage Learning.
- Noronha, C., Zeng, Y., & Vinten, G. (2008). Earnings management in China: An exploratory study. *Managerial Auditing Journal*, 23 (4), 367-385.
- Saudagaran, S. M., & Diga, J. (2000). The institutional environment of financial reporting regulation in ASEAN. *International Journal of Accounting*, 35, 1-26.
- Schipper, K. (1989). Commentary on earnings management. *Accounting Horizons*, 3, 91-102.

- Scott, W. R. (2003). *Financial Accounting Theory, 3rd Ed.* Toronto: Pearson Education Canada, Inc.
- Siregar, S. V., & Utama, S. (2008). Type of earnings management and the effect of ownership structure, firm size, and corporate-governance practices: Evidence from Indonesia. *International Journal of Accounting*, 43, 1-27.
- Tan, L. L., Lazar, J., & Othman, R. (2007). *Adoption of Financial Reporting Standards (FRSs): Impact on Malaysian Companies*. Malaysian Accountancy Research and Education Foundation.
- The Edge Malaysia. (2009, August 17). *Cover Story: Learning from corporate scandals*. Retrieved June 6, 2013, from The Edge Malaysia: <http://www.theedgemaalaysia.com/first/148907-cover-story-learning-from-corporate-scandals.html>
- Van Tendeloo, B., & Vanstraelen, A. (2005). Earnings Management under German GAAP versus IFRS. *European Accounting Review*, 14 (1), 155-180.
- Wan Ismail, W. A., Kamarudin, K. A., van Zijil, T., & Dunstan, K. (2013). Earnings quality and the adoption of IFRS-based accounting standards: Evidence from an emerging market. *Asian Review of Accounting*, 21 (1).
- Wright, C. J., Anderson, W. T., & Guan, L. (2004). Corporate control and earnings management: Evidence from MBOs. *Managerial Finance*, 30 (11), 45-62.
- Xie, B., Davidson, W. I., & Dadalt, P. J. (2003). Earnings management and corporate governance: The role of the board and the audit committee. *Journal of Corporate Finance*, 9, 296-316.
- Yew, M. C., Lapsley, I., & Lee, H.-W. (2007). Choice of auditors and earnings management during the Asian financial crisis. *Managerial Auditing Journal*, 22 (2), 177-196.
- Zéghal, D., Chtourou, S., & Sellami, Y. M. (2011). An analysis of the effect of mandatory adoption of IAS/IFRS on earnings management. *Journal of International Accounting, Auditing and Taxation*, 20, 61-72.
- Zhang, X. (2009). From banks to markets: Malaysian and Taiwanese finance in transition. *Review of International Political Economy*, 16 (3), 382-408.