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EARNINGS MANAGEMENT, CORPORATE GOVERNANCE AND GOODWILL IMPAIRMENT AMONG MALAYSIAN LISTED COMPANIES

By

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Thesis Submitted to
Othman Yeop Abdullah Graduate School of Business
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In Partial Fulfillment of the Requirement for the Master of Sciences
(International Accounting)

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ABSTRACT

The study examines the impact of corporate governance and company characteristics on earnings management practices among Malaysian public listed companies. In particular, the board meetings, board size, chief executive officer (CEO) duality and independent board of directors represent corporate governance mechanism; while the size of the company, return on assets (ROA), market to book value, total current accruals, and operating cash flow represent company's characteristics. Data are obtained from Datastream and annual report of 126 companies for the financial year ended 2013. The findings indicate a low level of earnings management occurred among Malaysian listed companies. This study provides evidence that boards meetings are significantly and negatively related to discretionary current accruals. Therefore, this study recommends that public listed companies in Malaysia to have a minimum number of six times of board meetings in a year.

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ABSTRAK

Kajian ini menyelidik tentang kesan tadbir urus korporat dan ciri-ciri syarikat terhadap amalan pengurusan perolehan dalam kalangan syarikat-syarikat awam yang tersenarai di Malaysia. Secara khususnya, mesyuarat lembaga pengarah, saiz lembaga pengarah, ketua pegawai eksekutif berdwi-peranan dan lembaga pengarah bebas adalah mewakili mekanisma tadbir urus korporat; manakala saiz syarikat, pulangan atas aset, pasaran kepada nilai buku, jumlah akruan semasa dan aliran tunai operasi adalah mewakili ciri-ciri syarikat. Data kajian diperoleh dari *Datastream* dan laporan kewangan tahunan bagi 126 buah syarikat untuk tahun kewangan berakhir pada 2013. Hasil kajian menunjukkan pengurusan perolehan dalam kalangan syarikat-syarikat yang tersenarai di Malaysia adalah pada tahap yang rendah. Kajian ini menunjukkan bukti bahawa mesyuarat lembaga pengarah mempunyai hubungan negatif dan signifikan terhadap akruan semasa berpilihan. Oleh itu, kajian ini mencadangkan syarikat-syarikat awam yang tersenarai di Malaysia untuk melaksanakan mesyuarat lembaga pengarah minimum sebanyak enam kali dalam setahun.

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Universiti Utara Malaysia

TABLE OF CONTENT

PERMISSION TO USE ii

ABSTRACT iii

ABSTRAK iv

ACKNOWLEDGEMENT v

TABLE OF CONTENT vi

LIST OF TABLES ix

LIST OF FIGURES x

CHAPTER 1 1

INTRODUCTION 1

1.1 Background of Study 1

1.2 Statement of Problem 3

1.3 Research Objectives 4

1.4 Research Questions 5

1.5 Scope of Study 5

1.6 Significance of the Study 6

1.7 Organization of the Study 7

CHAPTER 2 9

LITERATURE REVIEW 9

2.1 Introduction 9

2.2. Agency Theory 9

Universiti Utara Malaysia

2.3 Earnings Management 12

2.4 Corporate Governance 15

2.5 Company Characteristics 21

2.6 Earnings Management and Corporate Governance 22

2.7 Earnings Management and Company Characteristics 24

2.8 Hypotheses Development 25

2.9 Conclusion 34

CHAPTER 3 35

METHODOLOGY 35

3.1 Introduction 35

3.2 Research Design 35

3.3 Regression Models 37

3.4 Research Framework 39

3.5 Data Analysis Techniques 40

3.6 Conclusion 41

CHAPTER 4 42

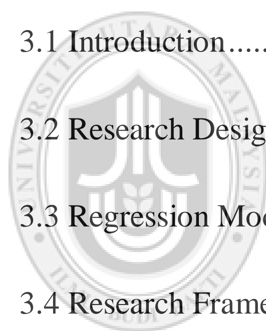
RESULTS AND DISCUSSION 42

4.1 Introduction 42

4.2 Descriptive Analysis 42

4.3 Correlation Analysis 45

4.4 Normality Test 47



Universiti Utara Malaysia

4.5 Collinearity Statistics..47

4.6 Regression Analysis 48

4.7 Conclusion 52

CHAPTER 5..53

CONCLUSION AND RECOMMENDATION 53

5.1 Introduction..53

5.2 Overview of the Study 53

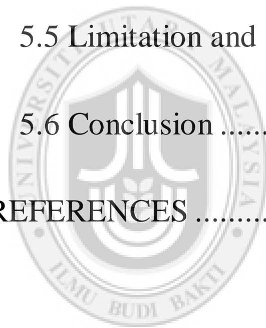
5.3 Summary of Findings 54

5.4 Implication on Theory, Practice and Policy...55

5.5 Limitation and Suggestion for Future Research 56

5.6 Conclusion 57

REFERENCES 58



Universiti Utara Malaysia

LIST OF TABLES

Table 4.1 45

Table 4.2 46

Table 4.4 48

Table 4.5 51

Universiti Utara Malaysia

LIST OF FIGURES

Figure 3.1 39

CHAPTER 1

INTRODUCTION

1.1 Background of Study

In the period between 1997 - 1998, the financial crisis has occurred, and it gives bad impact to the Asian countries. This crisis is due to weak and poor governance standards which cause confidence of foreign investors is reduce in the Asian nation including Malaysia (Leng, 2004; Rahman & Haniffa, 2005). After the crisis, the effectiveness of corporate governance mechanism within a corporation has been questioned in the business community. The crisis is followed by two international famous cases which are Enron in 2001 and WorldCom in 2002; this makes many types of researchers believes earnings management practices is difficult to root out by existing corporate governance mechanisms. In order to enhance the monitoring function of corporate governance mechanism in Malaysia, the code of corporate governance has been introducing by Ministry of Finance in the year 2000. The Code has outlined some necessary conditions for the structure and functioning process of the board of directors, audit committee, and external auditors to take care of the interest of shareholders.

Companies around the world are mandated to prepare a financial statement in the form of annual reports at the end of company's financial year. Financial statement user will refer to this statement in order to know company's outcome and activities while management often uses the financial statement in order to plan and control. Companies have to abide various statutory requirement and regulatory rules such as accounting standard, company law, and taxation law while preparing the financial

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statement. The financial accounting information reported shows the performance and governance efficiency (Healy & Palepu, 2001). This information is used by the users for various purposes such as investment decision and compensation policies, therefore, investor concern toward earnings management activity and quality of information released by companies. The relevance of accounting numbers has encouraged managers to distort and manage earnings at the expense of shareholders (Rahman & Ali, 2006).

Earnings management involves management mischief, wrongdoings and use of discretion in the structuring of the transaction, reporting numbers, to influence the financial information which could mislead shareholders and stakeholders opinion or contractual outcome that depends on accounting numbers (Healy & Wahlen, 1999). The earnings management can be achieved by using two different strategies which most common and used interchangeably which give consequences and effect for users of financial statement particularly to the investor (Ibrahim, Xu & Rogers, 2011). Cohen and Zarowin (2010) classified these strategies as real activities based concept and accrual-based concept. The real activities based is less costly to managers but unlikely to the draw attention of auditors investigation and regulatory scrutiny (Cohen, Dey & Lys, 2008). Whereas, the accrual-based concept has low manipulation cost and it is easy to practice (Chen & Tsai, 2010).

Corporate governance has become a long-standing issue, and it is a key policy agenda and needed for the development of a market-oriented economy (Claessens & Yurtoglu, 2012) and instils investor trust towards accountability and integrity of financial information (Claessens & Yurtoglu, 2012; Tsamenyi & Uddin, 2009). The corporate governance regulatory frameworks are structures, rules, and institution

Universiti Utara Malaysia

within and around corporation which deals with the allocation of resources and how a company rudder and affairs are to be governed, managed, and regulated with a view to achieving a long-term return to both shareholders and other stakeholders. Furthermore, quality of corporate governance and protection of investors is measured through frequency or magnitude of earnings management.

1.2 Statement of Problem

A financial statement of companies is necessary to show true and fair view to the users. The true and fair view in the financial statement will give a good impact for the users to analyse the companies in order to make a decision such as a forecast for investment and give a loan to the companies. Earnings quality nowadays becomes an issues when the earnings management always is a part of practice by companies in order to complete their financial statement. Many studies have been done regarding earnings management which it has received great attention by regulators due to the practice of earnings management has become more widespread, and the methods are more sophisticated (Levit, 1998). This practice threatens the credibility of financial statement reporting as well as the ability of companies to audit quality of their earnings.

Universiti Utara Malaysia

Average large public listed companies in Malaysia managed their reported earnings, whereby companies are more likely restate their prior earnings and use accounting discretion decrease (Jalil & Rahman, 2010; Rahman & Ali, 2006). There are three different strategies that companies always use to manage their earnings such as real earnings management, accrual-based earnings management, and classification shifting. The accounting scandals that occur in Malaysia in the year 2007-2008 such

as Transmile and Megan Media, GP Ocean, Ocean Capital Berhad and Nasioncom have raised a lot of question regarding trust of shareholders and stakeholder with capital market and regulators (Sahlan, 2011).

Corporate governance is one of the mechanisms that regulatory authorities have endeavoured in order to monitor and controls the managers and it is the cure to the wound against the unruly behaviour of the manager (Falaye, Hoitash & Hoitash, 2011). In addition, corporate governance would strengthen the long-term trust between management, shareholders and stakeholders because it would ensure that capital providers are compensated as overturn on capital invested and ensure that decisions made by management are free from its personal interest (Claessens & Yurtoglu, 2012; Shleifer & Vishny, 1997). The effectiveness of corporate governance is expected to prevent management from engaging in this behaviour. Furthermore, Malaysian Code on Corporate Governance was introduced to enhance monitoring function of the board of directors which it is developed due to Asian financial crisis (Saleh, Iskandar & Rahmat, 2005). Nor, Norman, Jaffar and Mohamet (2008) have recommended that code of corporate governance in Malaysia is not really adequate to monitor earnings management practices that have been done by management. Therefore, this study considers the effectiveness of corporate governance mechanism in mitigating earnings management practice.

1.3 Research Objectives

The objective of this study is to examine earnings management among top 126 companies listed on Bursa Malaysia for the year 2013. As such this research aims to fulfil the following specific objectives:

1) To investigate the level of earnings management among Malaysian listed companies.

2) To investigate the relationship between earnings management and corporate governance.

3) To investigate the relationship between earnings management and company characteristics.

1.4 Research Questions

There are three research questions designed for this study, which is following:

1) What is the level of earnings management among Malaysian listed companies?

2) What is the relationship between earnings management and corporate governance?

3) What is the relationship between earnings management and company characteristics?

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1.5 Scope of Study

This study focuses on seven (7) industries in Bursa Malaysia which are industrial, construction, technology, consumer product, plantation, trading, and property. Moreover, the period of the study is a focus on the year 2013, after the revision of Malaysian Code of Corporate Governance (MCCG) in the year 2012 in Malaysia.

The study is designed to contribute the understanding of the relationship between corporate governance and company characteristics with earnings management.

The study covers 126 public listed companies on the main board of Bursa Malaysia. The study uses secondary data which the financial data are extracted from Thomson Reuters Datastream Professional, and the corporate governance data are hand collected from the annual report that has been downloading through the website of Bursa Malaysia. This study is expected to cover four key governance variables (board meeting, board size, CEO duality and independent board of directors) and five company characteristics (size of the company, return on assets, market to book value, total current accruals, and operating cash flow).

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1.6 Significance of the Study

This study is the extension of the previous study (i.e. Haron and Atan (2008); Rauf, Johari, Buniamin, and Rahman (2012)) in order to obtain more evidence for the current period. However, there are only a few types of research addressed this issue as evidence from Malaysia. Since this issue is rarely done in Malaysia context thus, this study is expected to give a contribution to the knowledge. Moreover, this study is significant as it uses Malaysian’s companies as evidence for investigating the relationship between corporate governance and company characteristics with earnings management. The aims of the study are to gain knowledge into earnings management, corporate governance, and company characteristics. Therefore, the result of this study would contribute and support to agency theory, and it considers as one of the efforts to strengthen theories in this area.

In addition, this study would contribute to existing earnings management literature, corporate governance literature, and also company characteristics literature. The quality of financial reporting is essential for investment decision and the long-term performance of the company depends on management decision taken at present. Last but not least, the study will present the findings that will support regulators to improve the corporate governance tools in their role to prevent earnings management practices. In consequences, this study will lead to the trustworthiness of economic health for corporations in the market.

1.7 Organization of the Study

This study is structured into five chapters. This chapter evolved from a background of the study that gives an insight about essential of effective corporate governance and occurrence of earnings management. Also in this chapter have a problem statement that is the circumstances that warrant the study, research objectives, research questions, scope of study and significance of the study.

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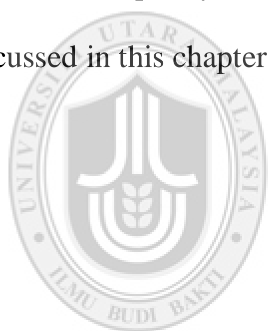
Chapter two deals with underpinning theory related to the study under review, which the main focus is related to agency theory. The chapter also provides some empirical literature related to earnings management, corporate governance, and company characteristics. In addition, the research hypothesis is established to determine the relationship between corporate governance and company characteristics on earnings management.

Chapter three provides the research methods and design used in the study. It explains the source of data used and justification for selecting the sample, data collection

method, the definition, and measurement of both the independent variables and the dependent variable, research framework and some related instrumental variables.

Chapter four reports the results of the empirical findings that examine the association between corporate governance (i.e. board meeting, board size, CEO duality and independent board of directors) and company characteristics (i.e. size of the company, return on assets, market to book value, total current accruals and operating cash flow) on earnings management. Here descriptive and correlative analyses are being made, followed by analysing each model.

Chapter five, summarises the overall findings, conclusion, implication on theory, practice and policy, and limitation and recommendation for future research are discussed in this chapter.



CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter consists of the relevant literature which related to earnings management. The first section of this study will discuss on an underpinning theory which is agency theory. The second section focuses on earnings management. The third and fourth section focuses on corporate governance and company characteristics. The remaining section is the form of hypotheses of the study and conclusion.

2.2. Agency Theory

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Agency theory has long been used as theory related to various fields, for example, management behaviour (Jensen & Meckling, 1976), finances and economics (Fama, 1980) and Sociology (Shapiro, 2005). Nevertheless, agency theory still received criticism and controversial series will prove its existence. Agency theory says about the relationship between shareholders or owner who act as principal and managers who act as agent (Eisenhardt, 1989). Jensen and Meckling (1976) stated the basis of agency theory was founded based on the insight that the separation of ownership (principal) and management (agent) companies lead to costs related conflict that resolved between principals and agents. Jensen and Meckling (1976) and Fama (1980) who proponents of agency theory have to identify that the theory was proposed to provide measures which can solve a conflict that arises between shareholders and managers.

In addition, Eisenhardt (1989) stated the agency theory is resolving two problems that occur between agent and principal relationship which known as agency problem and the problem of risk sharing. First, agency problem occur when agent and principal have a conflict of goals and desires, and difficulties for the principal to verify agent behaviour appropriately. Second, the problem of risk sharing occurred because different attitudes between principal and agent towards risk faced (Eisenhardt, 1989). Indeed, Eisenhardt (1989) said the ideal agency theory is principal and agent should act interdependent and cooperating with each other. The agent who have obligations to safeguard principal interest in business, whereas principal should reward agent based on their performance in business (Eisenhardt, 1989).

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Daily, Dalton, and Canella (2003) notified that agency theory reveals two main issues that significant to the relationship between shareholders and managers. Furthermore, Daily et al. (2003) stated agency theory then circumscription managers in the company can be self-centered. On the other hand, Padilla (2002) claimed based on the agency theory; shareholders expect that decision had been made by managers is for shareholders interest. However, it is indeterminate if the shareholders' interests are taken into consideration by the managers when making decisions. Apart from that, the problem between the shareholders and managers arises when managers hold little equity in that company which could create a conflict of interests between groups since managers could easily decide regardless of shareholders welfare (Bhimani, 2008). In addition, managers feasible decide based on his self-interests or opportunistic behaviors and this is different from the manager's interests and the shareholder's aspirations. The understanding of the risk can even different context

between managers and shareholders. Therefore, the introduction of agency theory is centred on detaching ownership and control (Bhimani, 2008).

In addition, the argument between shareholders and managers that motivated by self-interest consequently lead to earnings management (Fama, 1980). Agency problem that arises between shareholders and managers will agitate accounting earning disclosure and reporting (Healy & Palepu, 2001). Shapiro (2005) discovered that information asymmetry and opportunism behavior of the managers is two basic assumptions in agency theory. Hashim and Devi (2008) stated information asymmetry can be determined by the unfavourable dimension and moral hazard.

Consequently, Eisenhardt (1989) notified corporate governance mechanism could play an essential role to reduce conflict between shareholders and managers. Indeed, agency theory advocate organizational theory in the area of the information system, risk and uncertainty and incentives (Eisenhardt, 1989). Effective corporate governance will serve as a well-appointed measure to protect and align shareholders' and managers' interest for the organizational success and efficiency (Kamardin & Haron, 2011) and also significant to the economic growth of a country (Claessens & Yurtoglu, 2012). The effectiveness of the board of directors particularly independent directors through disciplinary measures and various monitoring could handle management behavior from getting thing engaged in opportunistic behavior such as incite investor goodwill (Healy & Palepu, 2001). Therefore, agency theory recommends board of directors and audit committee to play an important role in ascertaining that company engaged in the best practice of corporate governance (Healy & Palepu, 2001).

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2.3 Earnings Management

The earnings management definition have various meanings and several researchers (e.g. Schipper, 1989; Healy & Wahlen, 1999; Arya, Glover, and Sunder, 2003; McKee, 2005) come out with different meaning either in legal mean or illegal mean, therefore it results in lack of consensus on the definition (Noronha, Zeng, & Vinten, 2008). Schipper (1989) have defined earnings management unlawful mean which it is used to gain for individual interest. On the other hand, McKee (2005) defines earnings management in legal mean which financial statement user able to received private information from it. Healy and Wahlen (1999, p.368) explained: "Earnings management occurs when managers use judgment in financial reporting and structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers". The definition proposed by Healy and Wahlen is widely used by another researcher.

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Lin (2010) identified earnings management into managers' efficient behaviour or opportunistic behaviour. In addition, there a different purpose for managers to involve in opportunistic behaviour such as promotions, job security, and management incentive (Lin, 2010). Othman and Zeghal (2006) notified that earnings management motives are differed among countries, for example, Anglo-American countries used earnings management when issuing equity while Euro-Continental accounting model manipulates earnings for effective tax rate and contractual debt cost. The earnings management is significant to need of management desired which deflected from shareholders, thus it is a possibility for agency problem to occur because of misleading and deceitful information provided to investors. Managers

manage company's earnings because of their self-interest particularly if the benefit event depends on performance measure such as profitability. The quality of earnings will affect because of earning manipulation such as distortion of earnings which will impair corporate success (Demirkan & Platt, 2009).

Furthermore, Siregar and Utama (2008) classified earnings management into two categories, which are efficient and opportunistic of earnings management, while Scott (2003) categories earnings management as the good side and bad side of earnings management. Lo (2008) give an opinion on earnings management from the crime scene investigator perspective is a potentially fraudulent activity which they can examine earnings management if it occurs. Scott (2003) argues that earnings management with manage within its limit will deliver more informative to financial statement users. Mohanram (2003) has defined earnings management as the intentional misstatement of earnings lead to bottom line numbers with the different absence of any manipulation.

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In addition, earnings management is somewhat contentious and ambiguous for accounting practitioners because of they do not know where the boundary between opportunistic earnings management and efficient earnings management. Therefore, regulatory parties should clearly define the boundary to resolve the confusion arise from the earnings management practices (Scott, 2003). Majority prior researchers are centered on the magnitude of earnings management on various settings; however, there are only a few researchers (e.g. Siregar & Utama, 2008) concern the types of earnings management. The study done by Healy (1985) in examining the interaction between accounting choices and managers' bonus plan is proven that contractual agreement between company and manager is one of the motivations of earnings

management. Healy and Wahlen (1999) classify the motives of earnings management into contracting motivations, regulatory motivations, and capital market motivations.

2.3.1 Discretionary Current Accruals

Earnings management mostly define as a kind of alteration of accounting number. There are contradict meaning whether earnings management is legal or illegal, but if it practices with the purpose to manage users' awareness in companies, it is considered as unethical although no accounting standard are dishonoured (Rauf et al., 2012). Many studies have shown that those entrusted with the management engaged in earnings management and managed reported earnings regardless in developing and advanced economies with either accrual based or real based practices (Demers & Wang, 2010; Graham, Harvey & Rajgopal, 2005; Gunny, 2010; Matsuura, 2008; Roychowdhury, 2006; Visvanathan, 2008). The accrual earnings management is done after the financial year, while the real earnings management is perpetrated during the financial year either monthly or quarterly (Seybert, 2010).

Accounting literature uses discretionary accruals to measure market efficiency and earnings management since earnings are composed of accruals and operating cash flow (Demirkan & Platt, 2009). Stubben (2010) stated that aggregate accrual is the most common approaches to estimating earnings management. In addition, most of the accruals models are based on Jones Model (Jones, 1991) which the nondiscretionary accruals are usually estimated as a linear function of the change in property, plant, and equipment and revenues. Later, Dechow, Sloan, and Sweeney (1995) are created Modified Jones Model by using cash revenue because some credit

revenue may be discretionary. Discretionary accruals models judge discretionary accruals with considerable misspecification and inaccuracy (Stubben, 2010).

Demirkan and Platt (2009) explained there is bigger attention recently on discretionary current accruals (DCA) is a consequence of major accounting frauds (such as Enron) and in response to increasing evidence of corporate earnings management. It is doubtful that the earnings level is influenced by DCA. As financial of companies are under the closest scrutiny, the largest incidence of DCA occurred. Demirkan and Platt (2009) have assessed the usage of DCA with regard their corporate governance quality in the financial condition of companies.

Managers manage company's earnings because of their self-interest particularly if the benefit event depends on performance measure such as profitability. The quality of earnings will affect because of earning manipulation such as distortion of earnings which will impair corporate success (Demirkan & Platt, 2009). In addition, Xie, Davidson, and DaDalt (2003) have used current accruals in their study since it is easier for managers to manipulate by using it. Haron and Atan (2008) reported that DCA is not observable. Therefore, it is derived by subtracting nondiscretionary accrual from the total current accruals.

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2.4 Corporate Governance

Understanding on corporate governance has become a long-standing issue among researcher in the field of accounting, economics and finance literature. Claessens and Yurtoglu (2012) notified this issue has been discussed by academicians, practitioners and also regulators as main policy of agenda needed for development of a market-

oriented economy. Accounting scandals involving accounting fraud which exist in corporation throughout the world finally really emphasize the stake of corporate governance. In addition, the growth of corporate fraud domestically and abroad has concerned the amount of public awareness to corporate governance (Fengyi & Sheng-Fu, 2015). The Corporate governance acts as a safeguard from the effect of earnings management that done by managers and increase the quality of reported earnings (Marra, Mazzola, & Prencipe, 2011). Jensen and Meckling (1976) stated that accounting fraud happened because managers make decisions to allocate resources of company based own interest rather than company's general goals. The action that manager makes has destructive investors' trust and it destructs the company. This issue can be prevented with suitable corporate management's presence which includes not only a bundle of policies, process, and custom but also the rules and regulations governing the ways a company is administered, managed and controlled.

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Cadbury (1992) has defined corporate governance as a system that corporation is directed and controlled. Later, the OECD (2004) defined corporate governance as "a set of relationships between a company's management, its board, its shareholders and other stakeholders. It is designed in a way to formulate the objectives of the company, and the means of attaining those objectives." Furthermore, Garg (2007) stated that corporate governance carries the spirit of governance, accountability and responsibility and this is very importance in company with high widespread ownership. Brown, Beekes, and Verhoeven (2011) stated that corporate governance is about governance structure of companies. The field of corporate is about direction, monitoring, and control of a company in solving agency theory. Corporate governance mechanism can be categorized into internal (for example board of

director and shareholders) and external (for example market for corporate control) control mechanism (Mallin, Mullineux & Wihlborg, 2005).

The effectiveness of corporate governance embrace procedure and control which can improve management quality based on shareholder interest, therefore it can reduce manager possibility to act for self-interest which eventually the action had not achieved the objective to maximize shareholders wealth (Bar-Yosef & Prencipe, 2013). In addition, corporate governance would be expected to affect quality and amount of the information that will be disclosed by the company to outsiders. Consistently, effective corporate governance can improve and enhance company's transparency by mitigating management's capability to withdraw or garble disclosure (Bar-Yosef & Prencipe, 2013). Doupnik and Perera (2009) notified that corporate governance plays an important role in any corporations because it gives a clear picture of firms' objectives. Corporate governance ensures accountability of every individual in the company will enhance corporate relationship which eventually can reduce agency problems which involve shareholders and managers. A good corporate governance not only raises incentives that suitable for the board of directors and managers to focus in ascertaining based on the company and shareholders' interest, but it also became as an effective monitoring tool.

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Corporate governance has become major policy issue around the world, especially in Asia. This issue has become one of concern subject to all policy makers and academics. Johnson, Breach, and Friedman (2000) stated that the most countries with weak corporate governance agonized during the Asian financial crisis compared to some of the countries that have strong corporate governance. This is due to brittle corporate governance because the poor economic projections are causing result in

larger fall of assets prices (Shleifer & Vishny, 1997). Specifically, after the Asian crisis in 1997 - 1998 reformation series and frameworks have been initiated (Cabalu, 2005; Liew, 2009). The reforms address the effective guidance and monitoring of board accountability to company and shareholders.

Ghazali (2010) said after the economic crisis 1997, the Malaysian government has made Malaysia Corporate Governance Practices remained mandatory. The year after the economic crisis, the Minister of Finance has brought up a plan to restore back the trust of the market by announcing the need to establish Corporate Governance practices' framework for corporations which is founded by the committee comprise of financial expert. In addition, managers' opinion regarding the introduction of corporate governance reforms in Malaysia which are Malaysian Code of Corporate Governance (MCCG) 2002 after the economic crisis is to instil foreign investor confidence, fulfil various regulatory authorities requirement and pressure from international donors (Liew, 2009). Furthermore, the introduction of MCCG enables management to increase its responsibilities and roles in making strategic decisions, however, it is still problem looming issue related to ownership focus, interlocking and family ownership. Indeed, research on the effectiveness of corporate governance reform is still seldom (Liew, 2009).

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2.4.1 Malaysian Code of Corporate Governance (MCCG)

The prosperity of any nation really needs for a high standard of corporate governance, including effective communication between shareholders and managers. Companies are expected to make a decision which will enhance shareholders value. Therefore, Bursa Malaysia Berhad requires companies to disclose their

implementation of code and reason for non-compliance so that will increase market reputation, market confidence, and control. Corporate governance basically about make a decision, but the normative system and custom of the society also play an important role (Claessens & Yurtoglu, 2012).

The Asian Financial Crisis 1997 is significant element towards the establishment of the Malaysian Code of Corporate Governance (hereafter referred to 'MCCG' or 'Code') in 2000, and afterward have been revised in 2007 and 2012. In addition, Adibah, Nor, and Asyaari (2009) stated that Finance Committee of Corporate Governance introduce MCCG, which set out the best practices and principles on structure and process to attain optimal corporate governance framework. MCCG is initiatives of Securities Commissions Malaysia, which the Code is adapted from the UK's Hampel Report (Shamsul, Nor, & Mohamad, 2010). Shamsul et al. (2010) notified that will be attracted to examine whether the incidence of financial restatement in Malaysia is also resembled or different to those in the USA since corporate governance reforms in Malaysia are adopted and adapted from Anglo-American setting.

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The introduction first corporate governance code in Malaysia is in March 2000 and became effective in July 2001. The first Code addresses the need for board independence to ensure accountability and transparency of management, separation of CEOs responsibilities and various committees. For example, one-third of the board is expected to be independence, different individual play role of chairman and CEO, and the establishment of audit committee and audit remuneration.

Second Code has been introducing in October 2007 which categorically state that for assessing board member contribution and criteria used in appointing director and

committee, an evaluation process needs to be implemented. Strengthens the role and responsibilities of the board of directors and audit committee in effectively performing their duties are the key amendments to the Code. For example, nomination committee must consider the qualification, educational, expertise, professionalism and expertise, and the ability to discharge the portfolio given to specific individual and committee.

The third Code was introduced in 2012 and became effective on 31st December 2012. The MCCG explain the principle and specific recommendations on process and structures that company must adopt to make best practice of corporate governance and important part of the business and culture. This Code is based on eight principles. Some of the principles of the new Code are upholding the integrity of audit committee, dwell on multiple directorships and aligning the interest of shareholders with the company. The Code suggests that position of chairman and CEO should hold by a different individual which the chairman should be a non-executive director. However, if the chairman is not an independent director, the board should consist of the majority of independent directors. Concerning independence of directors, the Code dwells on capping its tenure to nine years and in maintaining effective monitoring, and the board has access to continuing education programmed. The Code had explained that notification must be handed to chairman before a director could accept new directorship from other companies. The revised of MCCG has set out the best principle and practices of good governance and describes the internal optimal process and corporate governance structures for companies (Germain, Galy, & Lee, 2014).

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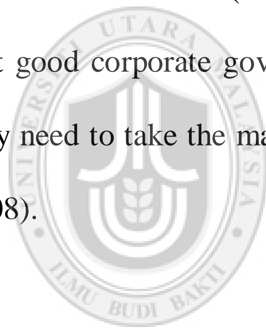
Adibah et al. (2009) notified that Bursa Malaysia Berhad has reformed its Listing Requirement to ensure that MCCG complies by public listed companies. Hence, this shows the Code is important as the main source of corporate governance reform in Malaysia. Shamsul et al. (2010) stated that MCCG is emphasizing the necessity for board independence to be sure accountability and transparency of management. Hence, the MCCG suggest that independent non-executive directors have to come at least one-third of the board memberships. The MCCG determines independence as do not have management influence and free from significant shareholders of the company. In addition, the MCCG also determine company's directors need to ensure that account of the company has been prepared in line with Malaysia Accounting Standard and Board (Shamsul et al., 2010). Furthermore, the Code also recognizes that good corporate governance rest strongly with the entire board of directors and they need to take the main role in creating best practice (Mohd, Rashidah, & Sakthi, 2008).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2.5 Company Characteristics

Company characteristics are progressed which companies perform to achieve their goal to sustain in the market. Managers have many alternatives by using company characteristics in order to maximize management wealth or shareholder wealth. The company characteristics that are examined in this study are the size of the company (SIZE), return on assets (ROA), market to book value (MTBV), total current accruals (TCA) and operating cash flow (OCF) as independent variables and earnings management as the dependent variable.

Haron and Atan (2008) defined the size of the company as the natural logarithm current year asset of company measure at the end of financial year. “Return on assets (ROA) is derivative from current year net income after tax scaled by assets at the end of the year” (Haron & Atan, 2008, p.53). Haron and Atan (2008, p.52) has defined that “market to book value (MTBV) is the ratio of current year company’s market to book value of assets at the end of the financial year.” Rauf et al. (2012, p.119) reported that “total current accruals (TCA) are defined as the changes in non-cash current assets less the changes in operating current liabilities”. “Operating cash flow is the current year operating cash flow” (Haron & Atan, 2008, p.53).

2.6 Earnings Management and Corporate Governance

The quality of earnings have been a topical issue from a corporate governance point of view, thus, the significant role played by corporate governance have received more interest in the last decades (Visyanathan, 2008). In addition, there are still inconclusive findings to identifying the appropriate mechanism of corporate governance (Hyo & Soon, 2008).

Agency theory has shown that corporate governance is serving as monitoring mechanism which it plays a significant role in enhances performance and reduces earnings management. In accordance with this theory, several accounting and finance literature have found array connection between corporate governance and earning management. After the occurrence of Asian financial crisis, the corporate manager had been given practices to comply with a regulatory requirement which is pressure from the confidence of international agency and foreign investors (Liew, 2009). But it is not yet be examined about the effectiveness of this reforms (Liew, 2009).

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Over the years, a different perspective of board governance issues have been discussed and understood (e.g independent directors, CEO duality etc.), but the significant agenda is the need to enhance board independence. The board of directors is an important variable of corporate governance of corporations (Alves, 2011). Other variables such as auditors, laws and regulation, and the market for control are expected to be responsible by shareholders. They play a role to advising and monitoring in preventing the management from doing opportunistic behaviour and potential to exploit of minority shareholders by block shareholders (Alves, 2011).

Kamardin and Haron (2011) categorised the monitoring role into performance evaluation and management oversight role by using factor analysis. At these centres, the independent director, this usually regarded to advocate a good governance system (George, 2013). The independent director makes sure that companies' managers act in accordance with the objectives of the company, facilitate the decision-making the process of the company and maximize shareholders wealth (Osma, 2008).

Universiti Utara Malaysia

The board of directors is a significant corporate governance mechanism used in providing advice related to business and monitoring CEOs' performance. In addition, the board of directors have fiduciary duties and serve as a tool for monitoring and controlling the activities of the managers in order to protect the interest of shareholders (Park & Shin, 2004). They basically depend on information that is being provided by executives, even, dependence in this leading to information asymmetry (George, 2013). On the other hand, although independent directors, factor damage is they may have no knowledge expertise in managing company.

Apart from the board of directors, the other committees (e.g. audit committees, nomination committees and executive remuneration committees) also play an

important role in aligning shareholders and stakeholders interest with them entrusted to manage the company. Earnings management is deceived and harmful due to false information in the assessment of a company. The board of directors and various committees can play a tremendous part in reducing earnings management. As have been discussed earlier that one of the causes for management gets engaged in earnings management is to increase income figure in order to avoid low figure or reporting lost to prior year earnings.

2.7 Earnings Management and Company Characteristics

Earnings management as defined by Healy and Wahlen (1999, p.368) explained: "Earnings management occurs when managers use judgment in financial reporting and structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers". Beneish (2001) reported that management is driven to manage earnings due to maximizing company's value. In addition, increasing job security and corporate managers' compensation also the motive of managers to manipulate earnings (Healy & Wahlen, 1999). Park and Shin (2004) notified that managers tend to avoid reporting earnings declines and losses by doing earnings management. Furthermore, Matsumoto (2002) documented that, in order to avoid negative surprises that may be faced by the company, manager take an alternative to fabricating and manage earnings.

There are several variables in company characteristics such as return on assets, the size of the company, market to book value, operating cash flow, current accruals and

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others. Company characteristics are progressed which companies perform to achieve their goal to sustain in the market. Managers have many alternatives by using company characteristics in order to maximize management wealth or shareholder wealth. Pincus and Rajgopal (2002) notified that the larger company tends to manage earnings more than a small company because of the pressure that management receive is more stressful. Furthermore, Lobo and Zhou (2006) reported that companies with poor operating cash flow are more probable to manage earnings than companies with strong cash flow in order to give the affirmative signal to shareholders. Haron and Atan (2008) documented that there is a significant relationship between return on assets and earnings management. In addition, Krishnan (2003) notified that the manager of great growth companies inclined to manage earnings upwardly in order to retain share price.

Universiti Utara Malaysia

2.8 Hypotheses Development

2.8.1 Board of Directors' Meetings

Various studies have proven that independent directors have a significant stake in influencing the decision-making process through the monitoring functions and board meeting. The board meetings serve as a way where management collectively consider on issues that are profitable and unprofitable to the company. In these meetings, the boards affirmatively make decisions which tend to objectives of the company.

In Malaysia, the average number of board meeting detained in a year is nine (Mohamad, Rashid & Shawtari, 2012). George (2013) stated those independent directors are predictable to have meetings six to eight times in a year. In addition,

George (2013) found that companies with high return on equity by financially and internationally, likelihood is because hold more meetings. Xie et al. (2003) reported that in a financial year, the average board meets is eight times and board meets when there is substance to be discussed; as a result, the companies' performance is improving. In Addition, if the number of the meeting is increasing, it will reduce the earnings management which shows that occurrence of meetings has influence in lessening earnings management (Xie et al., 2003). Vafeas (1999) clarified that boards often meet when companies have confronted with financial failure and issues related to earnings management are particular considerate during this meetings compared to a board that meets occasionally.

H1: Board meetings has a significant relationship with earnings management in Malaysian companies

2.8.2 Board of Directors' Size

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Board size in terms of the number of administrators on a corporate board and it plays a significant role in board efficacy. A number of members of the board should be realistic. In supporting this, there is no ideal stand whether the small or large board is significant to the competence of the board in producing reliable financial information. In fact, there has some confusion of finest number which will assure reliability of the financial reporting. There are several arguments among researchers that higher board size enhances information management and improve information sources.

Epps and Ismail (2009) notified that board size between six and eight or thirteen to fifteen is unconnected to income-decreasing discretionary accruals. Meanwhile,

board size between nine and twelve comprehensive to be positive and it is significant at 0.05. Therefore, the large board size is related to higher earnings management. The board size with less than six is negatively connected to income-decreasing accruals and it is significant at 0.05, which show that smaller board size is more efficient in mitigating earnings management.

Rahman and Ali (2006) has reported that Malaysian companies have an average of eight on the board. While Xie et al. (2003) notified that110 companies that listed on Standard & Poor's (S&P) 500 index have average board size is twelve person and the earnings management reduces at an increasing rate with the expertise of directors on the board. On the other hand, Lin (2010) stated that larger board has a positive relationship towards company value whereas smaller boards give better oversight purpose to managers.

Furthermore, Rahman and Ali (2006) notified that board size is not significant with earnings management, but based on regression analysis show there is a positive relationship between this two. Therefore, they propose that when the board is large, there is propensity that they may not be efficient like a smaller board. In addition, Abed, Al-Attar and Suwaidan (2012) had also found that board size is negatively related to earnings management. On the other hand, Banderlipe (2009) found that board size has a positive relationship with earnings management.

H2: Board size has a significant relationship with earnings management in Malaysian companies

2.8.3 CEO Duality

Aside from the directors' independence, there is a necessity for a balance of authority and power between the Chief Executive Officer (CEO) and Chairman thus there is no one individual has freed power over decisions. In addition, to the necessity of a well-proportioned board, the MCCG 2000 also recommends a separation of roles between the CEO and the chairman in order to evade the substantial attentiveness of power where the same person performs both roles. There is a hope to provide a necessary check and balance over the management's performance when the separation between CEO and chairman happens. Furthermore, the Cadbury Report endorses that all listed companies should have no duality role to assure a stability of authority and power leading to more independent boards (Ow-Yong and Guan, 2000). In addition, Davidson, Stewart and Kent (2005) reported that Standards Australia International 2003 guidelines believe that the monitoring role of the board will be jeopardized when the chairman of the board is also the CEO of the company.

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The leadership structure has to categories which are separated structure and united leadership structure (Coles, McWilliams, & Sen, 2001). A firm may adopt the separated structure which clearly divides the position of CEO from the chairman of the board while the combined structure is CEO also act as chairman of the board. MCCG has recommended that the role of CEO and chairman should be separated and distinct to safeguard the stability power of the two designations, to avoid conflict of interest and also to avoid a single person in the board dominant the others in the decision-making process. If there is a duality, MCCG recommends the strong independent component should be involved and such information must be revealed to the public for transparency purpose.

On the other hand, based on the stewardship theory and agency theory, there are two arguments regarding the issue of the separation power between CEO and chairman (Abdullah, 2004). Supporters of the agency theory believe that the separation of the two roles is essential for board efficiency supervision on management, by providing cross-checking evidence against the possibility of ambitious strategies by the CEO (Gul & Leung, 2004). Moreover, when same people occupied with two essential positions, they may be like to pursue strategies that develop their own personal interest in the company. The given power of the CEO and the chairman as a single person could severely harm the board's effectiveness chairman (Abdullah, 2004). Bliss, Muniandy and Majid (2007) reported that without a clear separation between the CEO and the chairman, the board is deemed as a not effective due to the absence of independence when the CEO is in the position of monitoring his own activities and decisions. Petra (2005) notified that it is unreasonable to have faith in the CEO or the chairman will evaluate himself objectively. In addition, agency theory puts full support for the separation of power; this will allow efficient monitoring by the board with two separate individuals holding the position of the CEO and the chairman.

Saleh, et al. (2005) examined Malaysian listed companies found that companies with CEO duality are positively related to earnings management which the sample companies collected nearly 45 per cent of companies have the CEO also acts as a chairman. In addition, the consequence of a lack of monitoring by the unified role of chairman and CEO is consistent with Rahman and Haniffa (2005) that find Malaysian companies with CEO duality did not perform well compared with their counterparts.

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MCCG has required companies listed on Bursa Malaysia to have a clear separation between the chairman and the CEO roles in order to mitigate earnings management. This shows that MCCG did not encourage the practice of CEO duality. The agency theory is considered in this study because it shows the monitoring function of the board over earnings management. Consistent with agency theory, Xie et al. (2003) have found a positive relationship between CEO duality and earnings management.

H3: CEO duality has a significant relationship with earnings management in Malaysian companies

2.8.4 Independent of Board of Directors

An independent director is a person who is a non-executive director and he or she is worthy of character, independent-minded, integrity and able to align shareholders and stakeholders interest (McCabe & Nowak, 2008). This type of director is lumbered with responsibilities to improve transparency of financial information (Marra, et al., 2011). Companies sometimes increase the number of independent directors in order to enhance the monitoring role. McCabe and Nowak (2008) notified that independent directors are responsible to shareholders, showing the spirit of independence and balance of power between management and board and able to focus their time to board task. Some scholar found that independent director plays a significant role in influencing the incident of earnings management of companies (Marra et al., 2011).

Liu (2012) found that board independence is associated with higher level of earnings management. This indicates that board independence in the Australian context is positively related to earnings management practice. On the other hand, Marra et al.

(2011) report that companies listed in Milan stock exchange have reduced the incidence of earnings management because the existence of the majority of independent directors on corporate boards. Other researchers have found that the board independence is uncorrelated with the level of earnings management (Agrawal & Chadha, 2005; Park & Shin, 2004).

Jaggi, Leung, and Gul (2009) findings show that when a number of independent directors are high, there is less income increasing accrual management to avoid earnings declines or losses. In addition, Beasley (1996) reported that financial statement fraud probably decrease when a company has a larger proportion of external directors on the board. Furthermore, there is a negative relationship between board independence and discretionary accruals (Xie et al., 2003).

H4: Independent board has a significant relationship with earnings management in Malaysian companies

Universiti Utara Malaysia

2.8.5 Size of Companies

Watt and Zimmerman (1978) notified that large companies sensitive to politics, therefore the managers are more likely to batten accounting discretion in order to reduce political cost. At the same time, when the firm is larger, the tendency to do earnings management is by the management is more stress (Pincus & Rajgopal, 2002). Lobo and Zhou (2006) reported that big companies may have more chances and greater incentives to overstate earnings and engage in earnings management due to the intricacy of their operations and the difficulty for the user to notice. Furthermore, a study has been made by Nor, Ahmad and Saleh (2010) for unlisted companies in Malaysia reported that size of companies have significant effects on

fraudulent financial reporting and the result shows that smaller companies are likely to commit more misstatement compared to larger companies.

On the other hand, Rauf, Johari, Buniamin and Rahman (2012) examined public listed companies in Malaysia and found that size of companies has a significant positive relationship with earnings management. This also consistent with Haron and Atan (2008) reported the significant positive relationship between the size of companies and earnings management.

H5: Size of companies has a significant relationship with earnings management in Malaysian companies

2.8.6 Return on Assets

"Return on assets (ROA) is derivative from current year net income after tax scaled by assets at the end of the year. It is expected that managers incline to manage earnings are determined by earnings growth leading to a positive sign" (Haron & Atan, 2008, p.53). Haron and Atan (2008) reported that it is negative associate between ROA and DCA in Malaysian-listed companies in the year 2006 while in the year 2005 there is a positive relationship.

H6: Return on assets has a significant relationship with earnings management in Malaysian companies

2.8.7 Market to Book Value

Haron and Atan (2008, p.52) has defined that "market to book value (MTBV) is the ratio of current year company's market to book value of assets at the end of the

financial year." Krishnan (2003) notified that the manager of great growth companies inclined to manage earnings upwardly in order to retain share price. However, it is also probable that manager of great growth companies do not manage earnings if their share price has even now been high (Haron & Atan, 2008). Therefore, the relationship between MTBV and DCA could have either negative or positive relationship. Haron and Atan (2008) documented that there is a negative association between MTBV and DCA among listed companies in Malaysia in the year 2008.

H7: Market to book value has a significant relationship with earnings management in Malaysian companies

2.8.8 Total Current Accruals

Rauf et al. (2012, p.119) reported that "total current accruals (TCA) are defined as the changes in non-cash current assets less the changes in operating current liabilities". TCA are computed because to estimate the discretionary current accruals which are not observable (Haron & Atan, 2008). In addition, TCA is disentangled into DCA and non-discretionary accruals (Rauf et al., 2012). Furthermore, TCA is expected to have a positive relationship with DCA, since DCA is derived from TCA minus non-discretionary current accruals (Haron & Atan, 2008).

H8: Total current accruals has a significant relationship with earnings management in Malaysian companies

2.8.9 Operating Cash Flow

Several researchers stated that there is a significant relationship between operating cash flow of companies and discretionary accruals (Dechow et al., 1995; DeFond &

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Jiambalvo, 1994). Becker, DeFond, Jiambalvo and Subramanyam (1998) argued companies with poor operating cash flow is more probable to take income increasing discretionary accruals to give a positive sign to shareholders while companies with strong operating cash flow performance are less to take income increased discretion accrual to enhancement earnings because the companies are performing well. Rauf et al. (2012) documented that there is a significant negative relationship between operating cash flow activities of the companies and earnings management. In addition, earnings management occur when companies with poor performance have a tendency to use accruals to growth earnings.

H9: Operating cash flow has a significant relationship with earnings management in Malaysian companies

Universiti Utara Malaysia

2.9 Conclusion

This chapter aimed to examine the relationship between corporate governance and company characteristics with earnings management by summing up the works of previous studies that related to earnings management, corporate governance and company characteristics. This studies takes into account the studies of agency theory, earnings management, discretionary current accruals as a proxy of earnings management, corporate governance (board of directors' meeting, board of director' size, CEO duality and independent of board of directors), MCCG and company characteristics (size of companies, return on assets, market to book value, total current accruals and operating cash flow). The following chapter describes details of research methodology and research framework.

CHAPTER 3

METHODOLOGY

3.1 Introduction

This chapter covers the methodology of the research work. It presents the research elements including population of study, sampling design, data collection procedures, measurement or instrumentation and data analysis techniques. This is building on existing relevant literature, hypotheses developed as described in the previous section. In order to test these hypotheses, a sample of listed companies in Malaysia has been composed.

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3.2 Research Design

The research is using quantitative data in order to collect the data. Secondary data is used to collect the data. The secondary data is got from the annual report of companies (i.e. board meeting, board size, CEO duality and independent board of directors) and Thomson Reuters Datastream Professional (i.e. size of the company, return on assets, market to book value, total current accruals and operating cash flow).

3.2.1 Type of Study

The research uses quantitative data that aligns with the research purpose, which investigates the relationship between corporate governance and company

characteristics with earnings management among Malaysian public listed companies. The study collects data on both corporate governance and company characteristics measures based on the model of the study.

3.2.2 Data Collection Source and Method

This study uses a secondary data which is a non-survey method. The data was obtained from Annual Report on the Bursa Malaysia-listed companies and Thomson Reuters Datastream Professional at Universiti Utara Malaysia. Items explained under the variable measurement below were collected accordingly.

3.2.3 Population Frame

The population frame of this study is the Bursa Malaysia public listed companies which focus on seven (7) industries which are industrial, construction, technology, consumer product, plantation, trading, and property. These seven (7) industries are chosen based on the Haron and Atan (2008) population frame. There are 323 companies in this research population which focus on these seven industries for the year 2013.

3.2.4 Sample and Sampling Technique

The sample consists of all top 126 non-financial companies listed on the Main Market of Bursa Malaysia for the year 2013 which compliance with the IFRS accounting standards. The companies were randomly selected using the random number generator available in Excel to ensure a representative sample from all seven

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sectors. The sample for the year 2013 is chosen due to the revised of Malaysian Code of Corporate Governance (MCCG) in 2012.

3.3 Regression Models

The variables used in this study are derived from a review of related literature from several studies (i.e. Jones, 1991; Dechow, et al. 1996; Healy, 1985; Haron & Atan, 2008; Rauf, et al., 2012). This study employ modified Jones model (1991) to establish the occurrence of earnings management. The equations are adopted and adapt from the research of Haron and Atan (2008) with the expansion of a few variables of corporate governance. As the DCA are not been seen, TCA are first calculated and the estimated non-discretionary accruals are then extracted (Haron & Atan, 2008).

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TCA is computed in equation 1. The computation of "TCA are calculated as changes in the non-cash current assets, excluding the changes in short-term investment; minus the changes in current liabilities excluding changes in the short-term debt, which is derived from the current maturity of long-term debt" (Haron & Atan, 2008).

Equation 1

TCA = (ΔCA - ΔCash -ΔSTI) - (ΔCL - ΔSTD)

TCA = Total current accruals in year

ΔCA = Current assets in year 2013 less current assets in year 2012

ΔCash = Cash in year 2013 less cash in year 2012

ΔSTI = Short-term investment in year 2013 less short-term investment in year 2012

ΔCL = Current liabilities in year 2013 less current liabilities in year 2012

ΔSTD = Short-term debt in year 2013 less short-term debt in year 2012

Equation 2 is about the computation of non-discretionary accruals. The computation of non-discretionary current accruals will lead the computation of dependent variable which is DCA (Haron & Atan, 2008).

Equation 2

$NDCA = \alpha(1/TA) + \alpha\ (\Delta REV - \Delta TR/TA)$

NDCA = Nondiscretionary current accruals

TA = Total assets in year

ΔREV = Revenue in year 2013 less revenue in year 2012

ΔTR = Trade receivable in year 2013 less trade receivables in year 2012

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DCA is computed by subtracting non-discretionary current accruals from the total current accruals which scaled by assets respectively in equation 3 (Haron & Atan, 2008).

Equation 3

$DCA = TCA/TA - NDCA$

DCA = Discretionary current accruals

The equation 4 is the regression model which will be used to test the hypothesis of this study.

Equation 4

$DCA = \beta 0 + \beta 1\ BODMeet + \beta 2\ BODSize + \beta 3\ DUALITY + \beta 4\ IndBOD + \beta 5\ LogSIZE + \beta 6\ ROA + \beta 7\ MTBV + \beta 8\ TCA + \beta 9\ OCF + \varepsilon$

BODMeet = Board of directors' meeting

BODSize = Board of directors' size

DUALITY = Duality between chairman and managing director / chief executive officer

IndBOD = Independent of board of directors

LogSIZE = Natural logarithm of company's current year assets

ROA = Return on assets

MTBV = Market to book value

TCA = Total current accruals

OCF = Operating cash flow

3.4 Research Framework

Independent Variables

Corporate Governance:

1. Board of directors' meeting (BODMeet)
2. Size of board of directors (BODSize)
3. CEO Duality (DUALITY)
4. Independent Board of Directors (IndBOD)

Company Characteristic:

1. Size of company (LogSIZE)
2. Return on assets (ROA)
3. Market to book value (MTBV)
4. Total current accruals (TCA)
5. Operating cash flow (OCF)

Dependent Variables

Discretionary Current Accruals (DCA)

Figure 3.1
Theoretical Framework of this Study

Universiti Utara Malaysia

The dependent variables for this research are discretionary current accruals (DCA) of earnings management. This variable is measured by adopting modified Jones model. DCA are calculated by subtracting non-discretionary accruals (NDCA) from the total current accruals (TCA) scaled by assets respectively.

The independent variables comprise corporate governance and company characteristics. Corporate governance comprises the board of directors' meeting (BODMeet), the size of the board of directors (BODSize), CEO Duality (DUALITY) and independent board of directors (IndBOD). Company characteristics comprise a size of the company (LogSIZE), return on assets (ROA), market to book value (MTBV), total current accruals (TCA) and operating cash flow (OCF).

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3.5 Data Analysis Techniques

The independent and dependent variables were first analysed with descriptive analysis and normality assessed, after that the Pearson correlation coefficient was applied to test their relationship, and finally, the study used Statistical Package for Social Science (SPSS) version 20.0 ordinary least regression analysis.

Furthermore, the study analyses descriptive analysis and interpretation of data by using minimum, maximum, mean and standard deviation. The study analysed skewness and kurtosis to confirm the normality of the data to ensure the reliability and validity of the data for arriving at substantial evidence upon which to base the study's conclusion.

The study employs Pearson correlation coefficient statistics to determine the relationship between corporate governance and company characteristics which are

independent variables with discretionary current accruals that represent earnings management which is the dependent variable.

The study used multiple regression analysis to measure the level which the independent variables explain or influence the dependent variable in the study. The multiple regression analysis of study examines the adjusted r-square, the significance level, standardized beta, and t-values. The analysis helps in knowing the extent to which the independent variables jointly explain the dependent variable in the study and indicate whether to reject or accept the hypotheses raised earlier.

3.6 Conclusion

This chapter contains the research design which consisting of the type of study, source and method of data collection, population frame and sample and sampling method. In addition, regression framework has been developing based on the regression model. Furthermore, the analytical procedures and techniques are discussed.

Universiti Utara Malaysia

CHAPTER 4

RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the results of this study that determines the earnings management after IFRS of Malaysian public listed companies for the year 2013, the year after revised of MCCG in 2012. The analysis, interpretation, and discussion include descriptive analysis, Pearson correlations and finally the regression analysis.

4.2 Descriptive Analysis

Table 4.1 below highlights the descriptive results of the sample companies in this study. Descriptive analysis summarizes the sample for 126 Malaysian companies for the year 2013. The table has four dispersions as follows: minimum, maximum, mean, and standard deviation.

The discretionary current accruals (DCA) is a proxy of earnings management, the mean value of DCA is 0.21 with a minimum value -6.87 while the maximum value is 37.02 and the standard deviation was 3.37. The results show that the average level of earnings management among Malaysian listed companies is low by only 0.21 occurred during the year 2013. These findings indicate that the low level of earnings management occurred among Malaysian listed companies is still under control.

The average of the board of directors' meeting (BODMeet) for this study is five (5) times during the year same with the previous study conducted by (Mohammad,

Wasiuzzaman & Salleh, 2016). The previous study has found that an average number of a board meeting during the year is six to eight times (George, 2013; Xie et al., 2003). Mohamad et al. (2012) also report that average number for board meetings detained in a year is nine. Therefore, its show that an average number of meeting for this study is small compared to the previous study. The minimum meetings during the year that have been held are two (2) times and the companies which have minimum value are WCT Holdings Berhad and Quality Concrete. While the maximum meetings held during the year are 21 times and the company that has this maximum value is Malaysia Airports.

The size of the board of directors (BODSize) for this study shows that the average number of people on the board is 7. Previous studies have reported that average people on the board for Malaysian companies are between seven to eight people (Rahman & Ali, 2006; Rauf et al., 2012; Mohammad, et al., 2016). Therefore, this study shows similarity with the previous study. The maximum person on the board is 16 directors while the minimum person is four (4) directors.

Universiti Utara Malaysia

The average value of duality between the chairman and managing director/chief executive director (DUALITY) is 22% (0.22) of the companies. Therefore, the recommendation for the splitting of the chairman of the board and CEO consist in the Malaysian Code on Corporate Governance had been well complied with by more than majority of Malaysian companies (Abdullah, 2004). This consistent with Jayalakshmy, Zipora, Ramaiyer and Murali (2015) documented most companies in Singapore complied with the separation of responsibilities between the chairman and CEO which only 35% of the companies had CEO duality.

Independent board of directors (IndBOD) had an average of three (3) people from the board. The study found that minimum independent director from the board is two (2) people while the maximum person of independent directors is seven (7). Marra et al. (2011) documented that majority of independent of directors on corporate board will reduce the probability of earnings management. Furthermore, Jayalakshmy et al. (2015) studied on Singapore-listed companies show that 97% of the sample had at least one third or more independent of the board of directors which imply a strong of corporate governance.

The company's size as measured by the natural log of total assets (LogSIZE) for Malaysian listed companies is 13.43 with a standard deviation of 1.87. The result shows a minimum size is 7.68 while the maximum size is 18.08. Return on assets (ROA) among the companies had an average of negative 0.04% (-0.04) with a standard deviation of 0.77, the minimum percentage in the sample is negative 0.92% while the maximum is 0.35%.

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The average of total current accruals among the companies (TCA) is RM 23,391.19 with a standard deviation of RM 275,379.64, the maximum TCA in the sample is RM 1,702,948.00 which is DRB-Hicom Berhad, while the minimum is negative (–) RM 1,260,212.00 which is IOI Corporation Berhad. The mean value of operating cash flow (OCF) among the companies is RM 205,070.49. The minimum value is negative (–) RM 541,972.00 which the company is WCT Holdings Berhad while the maximum value is RM 4,524,200.00 which is Genting Berhad.

Table 4.1
Descriptive analysis

	Year 2013				
Variables	**N**	**Minimum**	**Maximum**	**Mean**	**Standard Deviation**
DCA	126	-6.87	37.02	0.21	3.37
BODMeet	126	2.00	21.00	5.63	2.39
BODSize	126	4.00	16.00	7.72	2.22
DUALITY	126	0.00	1.00	0.22	0.42
IndBOD	126	2.00	7.00	3.46	0.99
LogSIZE	126	7.68	18.08	13.44	1.87
ROA	126	-0.92	0.35	-0.04	0.77
MTBV	126	-0.45	15.26	1.10	1.50
TCA	126	-1,260,212.00	1,702,948.00	23,391.19	275,379.64
OCF	126	-541,972.00	4,524,200.00	205,070.49	608,425.56

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4.3 Correlation Analysis

Table 4.2 reports the correlation matrix, the result of the year. Correlation indicates the existence and level of the relationship between the independent variables and dependent variable. It is used to check the existence of multicollinearity problem among variables which signal value of "1" is for a perfect relationship while "0" value signed is no relationship between the variable. The sign of 0.11 to 0.49 is indicating a weak relationship while 0.50 to 0.69 and 0.70 to 1.00 are indicating a strong and very strong relationship respectively.

Table 4.2
Pearson Correlation for the year 2013

	DCA	BOD Meet	BOD Size	DUALITY	Ind BOD	Log SIZE	ROA	MTBV	TCA	OCF
DCA	1									
BODMeet	-0.071	1								
BODSize	-0.087	0.222*	1							
DUALITY	0.182*	-0.038	-0.105	1						
IndBOD	-0.043	0.201*	0.490**	-0.037	1					
LogSIZE	-0.231**	0.189*	0.434**	-0.122	0.340**	1				
ROA	-0.902**	-0.043	0.143	-0.146	0.023	0.331**	1			
MTBV	-0.077	0.095	0.130	-0.044	0.013	0.118	0.150	1		
TCA	-0.015	-0.031	0.126	-0.037	0.214*	0.269**	0.047	-0.006	1	
OCF	-0.021	0.294**	0.273**	0.078	0.383**	0.568**	0.044	0.139	0.245**	1

*. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).

Table 4.2 presents that there are some correlations among the independent variables and dependent variables, which are CEO Duality, the size of companies and return on investment. The highest significant correlation is between DCA and ROA with significant negative correlation -0.902 ($p < 0.01$). The highest correlation among independent variables is between operating cash flow and size of the company at 0.568 and significant at 5%. This implies that multicollinearity problem does not exist since the correlation between the independent variables is less than 0.70.

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4.4 Normality Test

The SPSS normality result of skewness for a year after adoption IFRS and revised of CGCC in Malaysia. Normality result of kurtosis should not exceed ±10; while skewness should be less than ±3 (Kline, 1998). The statistics for the year show no any value in the kurtosis or skewness of up to ±10 or ±3; hence, the data is normal for regression analysis.

4.5 Collinearity Statistics

In this analysis, Durbin-Watson statistic should not be less than 1.5 or above 2.5. The analysis shows that Durbin-Watson is 2.0. Table 4.4 shows the variance inflaction factor (VIF) presents that all variables have a value below than 2.0 which is within the acceptable range of 10; therefore, the data has no problem of multicollinearity among all independent variables. Furthermore, this revealed that the regression model has significant explanatory power.

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Table 4.3
Collinearity Statistic

	After Adoption IFRS 2013	
	Tolerance	VIF
BODMeet	0.865	1.155
BODSize	0.655	1.527
DUALITY	0.937	1.067
IndBOD	0.673	1.486
LogSIZE	0.501	1.997
ROA	0.830	1.205
MTBV	0.941	1.063
TCA	0.886	1.129
OCF	0.559	1.788

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4.6 Regression Analysis

Table 4.5 exhibits the multiple regression results. The adjusted R2 for this model is 84.6%. BODMeet is a total of meetings among the board of directors. BODMeet is expected to have a negative relationship with DCA (Xie et al., 2003). The results show a significant negative association between BODMeet and DCA. It means the more meetings of the board during the year will mitigate earnings management of companies. This consistent with previous studies Xie et al. (2003) and Vafeas (1999) reported that if the number of the meeting increases, it will reduce the earnings management.

BODSize is the total amount of board of directors. BODSize is expected to have a positive or negative relationship with DCA (Abed et al., 2012; Rahman & Ali, 2006). The findings show a positive relationship between BODSize and DCA. It means a large amount of board will make the companies inefficient therefore it probably to increase earnings management of companies (Rahman & Ali, 2006).

Duality is the chairman and managing director / chief executive officer is the same person or not. Duality is expected to have a positive association with DCA (Abdullah, 2004; Xie et al., 2003). The findings show a positive relationship between DUALITY and DCA. Therefore, if the chairman position is the same person with managing director position, it is high probable the CEO will manage earnings.

IndBOD is an independent board of directors. IndBOD is expected to have a positive or negative relationship with DCA (Liu, 2012; Marra et al., 2011). The results show a negative relationship between IndBOD and DCA. It means the high number of independent board of director will mitigate earnings management of companies. This result is consistent with Marra et al. (2011), documented that incidence of earnings management is reduced because the existence of the majority of independent directors on the board.

SIZE is the natural logarithm of company's current year assets measured at the end of financial year. The relation between SIZE and DCA has expected a positive or negative relationship. The findings show a significant positive relationship between the size of the company and discretionary current accruals which mean an increase in the size of the company will increase earnings management of the companies. This is consistent with the previous study by Haron & Atan (2008), Ishak et al. (2011) and

Rauf et al. (2012) reported that the large size of the company more tendency to manage earnings than the small size of companies.

Return on assets (ROA) is predicts will have a positive relationship with earnings management (Haron & Atan, 2008). The results show a significant negative association between ROA and DCA. Therefore, the result shows that increase in earnings growth will lead to mitigating earnings management from occurs. This result is consistent with Haron and Atan (2008), reported the negative association between ROA and DCA.

MTBV is the ratio of current year company's market to book value of assets at the end of the financial year. MTBV is expected to have a positive or negative relationship with DCA (Haron & Atan, 2008). The results show a positive relationship between MTBV and DCA, therefore, it shows that when MTBV increase it will indirectly increase earnings management of companies. The result is consistent with Krishnan (2003), which the great growth companies inclined to manage earnings upwardly in order to retain share price.

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Haron and Atan (2008) documented that total current accrual (TCA) is expected to have a positive relationship with DCA because DCA is derived from TCA minus non-discretionary accruals (NDCA). The findings show the positive association between TCA and DCA, therefore, the increase in TCA will increase earnings management of companies. This result is consistent with Haron and Atan (2008) and Schoeler (2005), delivered that TCA is a very robust incentive to evade reporting earnings losses or decreases by controlling accounting accruals with discretion, thus it supported a positive association between TCA and DCA.

Operating cash flow (OCF) is the current year operating cash flow of companies. OCF is expected to have a negative relationship with DCA (Haron & Atan, 2008). The outcomes show a negative relationship between OCF and DCA, therefore, the companies with a great level of cash flows are less probable to manage the accrual. This result is consistent with Dechow (1994), Peasnell, Pope and Young (2005) and Rauf et al. (2012).

Table 4.4
Multiple Regression

Variables	B	Standard Error	Beta	t	Sig.	VIF
(Constant)	-1.722	1.230		-1.400	0.164	
BODMeet	-0.190	0.055	-0.135	-3.440	0.001	1.155
BODSize	0.092	0.068	0.060	1.341	0.183	1.527
DUALITY	0.473	0.304	0.059	1.556	0.122	1.067
IndBOD	-0.191	0.152	-0.056	-1.260	0.210	1.486
LogSIZE	0.188	0.093	0.105	2.034	0.044	1.997
ROA	-4.185	0.176	-0.951	-23.764	0.000	1.205
MTBV	0.141	0.084	0.063	1.670	0.098	1.063
TCA	7.758E-008	0.000	0.006	0.164	0.870	1.129
OCF	-5.147E-008	0.000	-0.009	-0.191	0.849	1.788

R2 = 84.6%, adjusted R2 = 83.4%

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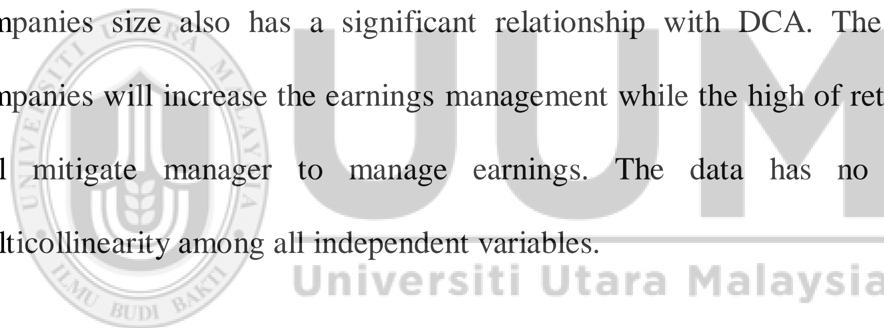
4.7 Conclusion

In this chapter, descriptive analysis, correlation analysis, normality test, collinearity statistics and regression analysis were presented and discussed. The results show that none of the Malaysian listed companies have less than four (4) members on their board of directors and with at least two (2) independent boards. The meetings occurred during the year is at least two (2) times. The duality of CEO is less than 30% show that MCCG has affected the separation position of chairman and CEO. The number of meetings of boards during the year has significantly negatively associated with DCA. Therefore, it shows that a high number of meetings occur during the year will mitigate manager to manage earnings. Return on assets and companies size also has a significant relationship with DCA. The big size of companies will increase the earnings management while the high of return on assets will mitigate manager to manage earnings. The data has no problem of multicollinearity among all independent variables.



CHAPTER 5

CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter emphasizes on the summary and conclusion of the empirical investigation based on the results discussed earlier in chapter four. The result of the corporate governance mechanisms is discussed with their relationship in constraining earnings management. Section 5.2 involve the overview of the study, followed by Section 5.3 that contains a summary of the findings, Section 5.4 presents implication on theory, practice, and policy, Section 5.5 presents the limitations of the study and proposes some suggestion for future research and Section 5.6 presents the conclusion of the study.

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5.2 Overview of the Study

Issues related to earnings management practices has become an interesting topic among accounting and finance researchers. Companies' characteristics are a tool that management use to show quality earnings or fabricate it by earnings management. Corporate governance mechanisms have been identified as controlling measures in reducing earnings management practices. Whereas series of corporate failures have subjected the importance role that corporate governance played in doubt, a situation whereby investors can no longer rely on the information provided by managers of companies because they are much interested in producing high earnings figures. Among these measures of corporate governance, the relationships of the board of directors meetings have been identified to be the most effective mechanism in

mitigating earnings management. On the other hand, the size of companies and return on assets has shown significant relationship towards earnings management.

Prior studies have examined series of the relationship between corporate governance mechanism and earnings management practices in developed and developing context. On this note, the present study investigates the relationship of discretionary current accruals on Malaysia companies rated by corporate governance agency and also company' characteristics. The financial year 2013 is considered since this year is the year after the introduction of MCCG 2012. The 126 sample of non-financial companies has been used to be analysed.

5.3 Summary of Findings

The study addressed three objectives; first is to investigate level earnings management among Malaysian Listed Companies. The result of the level of earnings management among Malaysian Listed Companies has shown the low level of earnings management during the year 2013 but cautious action may be made in order to mitigate the earnings management. The second objective is to investigate the relationship between corporate governance and earnings management, and the third objective is to investigate the relationship between company characteristics and earnings management. Among the second and third objectives, there are three most important independent variables that significant to discretionary current accruals of earnings management which are the board of directors' meeting, the size of the company and return on assets.

5.4 Implication on Theory, Practice, and Policy

This study is expected to contribute to earnings management study especially in Malaysian listed companies with corporate governance and company characteristics as its central themes. Furthermore, it is supported furthers the agency theory which corporate governance is a mechanism to solve agency problems. In addition, based on the result has found corporate governance and agency theory such as high of a number of the meeting held during the year may mitigate earnings management of the companies, and the CEO duality which shows conflict of interest of CEO who act as manager and chairman of the boards may tend to manage earnings.

Practically this study proves that the corporate governance has played important roles to mitigate earnings management based on discretionary current accruals. The significant negative relationship between the board of directors meetings and earnings management, help the shareholders to solve the problem of manager who manage earnings.

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However, even it has small involvement to knowledge in this area and has less consequence on the result; it is hoped that developing implication might be appropriate as a recommendation to the policy maker. Nevertheless, the results do indicate an associate link between the corporate governance and earnings management. In addition, the suggestion to standard setter to be more aware of this kind of earnings management, it is recommended to have a minimum number at least six (6) times of board meetings during the year for Malaysian Code on Corporate Governance in order to mitigate earnings management.

5.5 Limitation and Suggestion for Future Research

In the course of this study, several limitations have been identified. One of the limitations is not all variables of companies' characteristics and corporate governance has been tested in a relationship with earnings management. Another limitation is the selection of sampled companies could not be generalising for findings of all Malaysian listed companies because it is only 126 companies from the various sector. Thus, these limitations should be considered in interpreting the result. It is suggested to more variables of corporate governance and company characteristics and also expands the population of the study to larger sampling size; therefore, it would be new evidence to support the results.

In addition, ownership structure helps to denote where exactly agency problem arises between managers and among the shareholders (Claessens & Yurtoglu, 2012) and concentrated ownership structure of a company reduces information asymmetric that could arise from agency conflicts. Therefore future study should examine whether ownership structure could influence real earnings management. The assumption is that these companies are assumed to be strong in investors' protection, which might be inaccurate.

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Finally, external corporate governance mechanisms such as the role of the external auditor, analyst and gatekeepers could help in reducing earnings management because the equity analysts provide an understanding and a clear picture on the true status of the company. The fact that managers hide some information for their self-interest (Claessens & Fan, 2002), future study should consider the role of equity analyst in constraining earnings management activities.

5.6 Conclusion

This chapter contains the overview of the study, summary of findings, implication on theory, practice and policy, and limitation and suggestion for future research. The results have supported the objectives of this study. The earnings management is happening in Malaysian listed companies but in low. Not all variables of corporate governance and company' characteristics has a significant relationship with earnings management, but there are three significant relationships between the board of directors' meetings, the size of company and return on assets with earnings management.

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