# THE MODERATING EFFECT OF AUDIT QUALITY ON AUDIT COMMITTEE AND FINANCIAL REPORTING QUALITY IN MALAYSIA

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**ABSTRACT**

This study aims to investigate the relationship between the audit committee and audit quality on financial reporting quality. Specifically, studies on the impact of audit quality and on audit committee financial reporting quality in Malaysia have critical implications for Malaysia and this suggests to examine the significant effect of Audit Committee on Financial Reporting Quality (Earning Management). The study used financial statements of 93 of listed trading companies from 2013 to 2015 on Bursa Malaysia. Data from the financial statements were analysed with multiple regression analytical technique. Thus, this study investigates impacts of audit quality and audit committee financial reporting quality in Malaysia. The results show that the audit committee had a significantly and no significantly relationship with financial reporting quality. Based on finding audit committee independence, audit committee financial expertise, audit committee size is not supported and no significance, just audit committee meeting have a supported and significant results. As the size of audit committee increased, financial reporting quality was improved. However, this study reveals that a decreased quality of financial reporting may be a result from arisen discretionary accruals. Finally, when Audit Quality is treated as a moderator variable, there is no significant moderating impact on the relationship between Audit Committee and Financial Reporting (EM-Discretionary Accruals). This indicates that financial reporting was prepared according to generally accepted accounting standards. Therefore, understanding moderate effect of Audit Quality on Audit Committee and Financial Reporting Quality proxy Earnings Management (Discretionary Accruals) as an intervening variable could be a valuable future research field to venture.

*Keywords: audit committee, audit quality, quality of financial reporting, discretionary accruals, earnings management, Bursa Malaysia Listed Companies.*

## ABSTRAK

Kajian ini bertujuan untuk mengkaji hubungan antara jawatankuasa audit dan kualiti audit ke atas kualiti pelaporan kewangan. Secara khusus, kajian mengenai kesan kualiti audit dan jawatankuasa audit kualiti pelaporan kewangan di Malaysia mempunyai implikasi penting bagi Malaysia dan ini menunjukkan untuk memeriksa kesan ketara Jawatankuasa Audit Kualiti Pelaporan Kewangan (Pendapatan Management). Kajian ini menggunakan penyata kewangan 2013-2015 daripada 93 syarikat pemasaran tersenarai di Bursa Malaysia. Data daripada penyata kewangan ini telah dianalisis dengan teknik analisis regresi. Oleh itu, kajian ini menyiasat kesan kualiti audit dan jawatankuasa audit ke atas pelaporan kewangan di Malaysia. Keputusan menunjukkan bahawa jawatankuasa audit mempunyai hubungan yang pelbagai dengan kualiti pelaporan kewangan. Berdasarkan kepada mencari kebebasan jawatankuasa audit, kepakaran kewangan jawatankuasa audit, saiz jawatankuasa audit tidak disokong dan tidak penting, hanya mesyuarat jawatankuasa audit mendapat keputusan yang disokong dan penting. Kerana saiz jawatankuasa audit meningkat, kualiti laporan kewangan telah bertambah baik. Walau bagaimanapun, kajian ini mendedahkan bahawa kualiti yang menurun laporan kewangan boleh terjadi hasil daripada timbulnya akruan. Akhir sekali, apabila Kualiti Audit dianggap sebagai pembolehubah moderator, tidak ada kesan sederhana ke atas hubungan antara Jawatankuasa Audit dan Laporan Kewangan (EM-Budi Bicara Akruan). Ini menunjukkan bahawa laporan kewangan telah disediakan mengikut piawaian perakaunan yang diterima umum. Oleh itu, memahami kesan sederhana Kualiti Audit Jawatankuasa Audit dan Kualiti proksi Pengurusan Perolehan Laporan Kewangan (Budi Bicara Akruan) sebagai angkubah campur tangan boleh menjadi bidang kajian untuk diceburi pada masa hadapan.



*Kata kunci: jawatankuasa audit, kualiti audit, kualiti laporan kewangan, akruan, Syarikat pengurusan perolehan, Bursa Malaysia Tersenarai*

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# LIST OF ABBREVIATIONS

| Abbreviations | Description of Abbreviation |
|---|---|
| EM | Earning Management |
| FRQ | Financial Reporting Quality |
| CG | Corporate Governance |
| AC | Audit Committee |
| ACIND | Audit Committee Independence |
| ACFEX | Audit Committee Financial Expertise |
| ACMEET | Audit Committee Meetings |
| ACSIZE | Audit Committee Size |
| BRDSIZE | Board Size |
| FRMLEV | Firm Leverage |
| VIF | Variance Inflation Factor |
| TAC | Total Accruals |
| NDTAC | Value of Non-Discretionary Accruals |
| DTAC | Discretionary Accrual |
| PPE | Property, Plan, and Equipment |

# CHAPTER ONE: INTRODUCTION

## 1.1 Introduction

Earnings management constitutes a very important aspect of financial reporting, which reflects its integrity and quality. It further minimises asymmetry in information as well as agency conflicts among management, owners, and the majority and minority shareholders. The issue of earnings management has become an important concern of corporate governance as audit committees' (AC) effectiveness is largely assessed by their role in ensuring the quality of financial reporting. Although there is a rich body of literature on audit committee and earnings management issues in Malaysia, discussions on the relationship between audit quality and earnings quality have not been extensively explored but another country already discuss regarding this issues (Inaam Zgarni, Khmoussi Hlioui & Fatma Zehri, 2016; Zalewska, 2014; Ahmad Hussein Al- Rassas & Kamardin, 2015; Fariza Salim, Mohammad Norfien, Mohamad Sohail Tahir, 2016). According to Salleh and Haat (2014), the main aim of the audit committee is to achieve the legal responsibilities of the board of directors regarding the credibility and objectivity of the financial reports.

## 1.2 Background of Study

The financial report should be on time, transparent and present financial information objectively and impartially. It is a primary tool offering insight into the workings of a company and is crucial for investment decisions. It should serve as a guide to those interested in investing by detailing how a company performs and manages its resources. Behaviour management is thus essentially earnings management. Alzoubi (2012) claims that non-capital providers may also benefit from financial reporting. Definition of audit committee contains a detailed approach to deal with literature concerning its effectiveness. The Malaysian Code of Corporate Governance (MCCG) (2001) and the 2007 revised code emphasised that the AC should ensure high-level internal monitoring and risk management systems. Also, the MCCG (2012) and MCCG (2016) highlighted that the AC should ensure that the relevant standards of reporting are observed when producing financial reports. This stresses the importance of determining how the audit committee because oversees the quality of financial reporting as well as the auditor's independence.

Financial accounting standards allow the choice of accounting policies when preparing financial statements. The chosen policy may provide flexibility to the management in manipulating the company's financial statement figures, including the company's profit. Schipper (1989) defines that earnings management is the alteration of a firm's reported economic performance by insiders to either mislead some stakeholders or to influence contractual outcomes. It occurs when managers are given the discretion to select their approach to accounting for which they then alter financial reports to mislead stakeholders for some personal gain are given discretion (Healey and Wahlen, 1999).



To manage a business effectively and smoothly, forming several committees may be helpful with a view to assist the execution of the board's various responsibilities. This is aligned with the requirement of Malaysia Code on Corporate Governance 2012 (MCCG 2012) which states that all public listed companies should clarify the role of the board in providing leadership skills as well as to enhance board effectiveness (refer to MCCG 2012, principle 1). Therefore, the board may delegate certain responsibilities to the committees to operate within the defined terms of references. Aside from the audit committee which has been mandated since 1993, MCCG 2012 also recommends the formation of remuneration and nomination committee where their roles are to assist the boards (refer to MCCG 2012, principle 2).

## 1.3 Problem Statement

The 1997 economic crisis uncovered numerous weaknesses in Malaysia's corporate governance practices. This included a fragile financial structure, over-leveraging, and lack of transparency, disclosure, and accountability (Rahman & Ali, 2006; Al-Rassas, & Kamardin, 2016; Zgarni, Hlioui & Zehri, 2016; Zalewska, 2014; Al- Rassas & Kamardin, 2015; Salim, Norfien, & Tahir, 2016). According to Salleh and Haat (2014). One of the techniques to counter financial scandals is to improve the reporting of earnings management through the improvement in corporate governance quality. In this regard, corporate governance (CG) has been identified as playing a crucial part in ensuring the uptake of ethical practices within an organisation across all its operations. It also helps imbibe the staff with moral accountability. From here, this research uses corporate governance as a measure to examine earnings management. The objective of the current study is to provide additional evidence on the effectiveness of institutional investors in mitigating opportunistic earnings management in Malaysia.

Limited published studies have examined how audit committee's with poor audit quality produce weak financial reporting. Most existing research on the subject has focused on the general audit committee before Malaysian Code on Corporate Governance 2012 was introduced and the latest MCCG (2016) released by Security Commission on 27 April 2017.

Based on Zgarni Inaam, Halioui Khamoussi, (2016) many researchers, in several contexts, have investigated the influence of audit committee effectiveness and audit quality variables on reducing the extent of earnings management, and empirical evidence is rather inconsistent. Fan and Wong (2002) found that the accounting earnings are lower for East Asian firms including Malaysia. This further highlights the need for examining the impact of governance monitoring on the quality of financial reporting in this environment. Shen and Chih (2007) believe that a company having good corporate governance practices tends to conduct fewer earnings management. This study attempts to answer the questions related to identifying the quality of reported earnings by Malaysian firms.

### 1.4 Research Questions

Based on the research problem, three research questions are formulated. Thus, the research questions are as follow:

1. What is the level of audit quality in the Malaysian companies?
2. Is there any relationship between AC and FRQ?
3. Does audit quality has a moderate effect on the relationship (if any) of AC and FRQ?

## 1.5 Research Objectives

This research investigates the audit quality in Malaysian listed companies. More specifically this study shall examine how audit quality moderates the relationship between audit committee (AC) and quality of financial reporting (FRQ). The study has the following specific objectives:

1. To identify the level of audit quality in the Malaysian companies
2. To examine relationship between audit committee and FRQ
3. To examine the moderating of audit quality.

## 1.6 Significance of the Study

Basically, the finding of the study are significant to theoretical and practical aspects of earning management for the theoretical aspect, earnings management (EM) study is anticipated to be extremely important to the users of financial reporting. The current study offers theories regarding the influence of various factors of corporate governance mechanisms that improve Quality of financial reporting (FRQ) among Malaysian listed firms. This study also examines the moderating effect of the audit quality (audit fees) on the relationship between the audit committee and FRQ (EM). Furthermore, the study also examines the audit quality score as a moderator on AC and FRQ.

In the Malaysian context, only a handful of studies have examined the effect of corporate governance on EM, such as (Hashim & Devi, 2008, Rahman & Ali, 2006; Ali, Salleh, & Hassan, 2010; Sohail Ahmed, 2014). This study extends the literature by examining the extended, modified Jones model of Yoon, Miller and Jiraporn (2006), as the second measurement of discretionary accruals (DA). This has not been examined before with a Malaysian sample. It also examines the extended modified Jones model of Kasznik (1999) as the first measurement to estimate discretionary accruals as a dependent variable. Yoon et al. (2006) and Islam, Ali and Ahmad (2011) suggest that the extended modified Jones model is more robust than the modified Jones model for Asian countries.

Another theoretical contribution that this study hopes to make is examining the moderating effect of the AC (independence, financial expertise, meeting and size) on the relationship between the audit committee and FRQ. Furthermore, the study also examines the audit quality score as a moderator on the relationship between the audit committee and FRQ. As per results available on Google Scholar, these moderators have not been examined by any research since the year 2011. Hence, the results of this study shall attempt to fill the gaps in the corporate governance literature and back it up with evidence from an emerging economy, namely, Malaysia. Thus, the results of this study are significant in entrenching the views on the importance of the agency theory, in analysing the practices of corporate governance and earnings management in the Malaysian business environment.

This study is expected to help regulators better understand the earnings management (EM) of Malaysian companies. It contributes to the field of accounting research on earnings management (EM) in a different environment. It may aid in the reconsideration and review of accounting standards across the various sectors and to help evolve quality financial reporting by Malaysian listed companies. This can lead to a reduced reliance on earnings management (EM) and thus increase the credibility of financial reports.

## 1.7 Scope of the Study

The aim of this study is to examine the phenomenon of earnings management (EM) in light of the quality of financial reporting by Malaysian companies listed on the main market of Bursa Malaysia. The most important advantage of using the sample of all listed companies on the main market is to increase the generalizability of the results findings. Companies dealing primarily with financial products are excluded; this is because these companies have unique characteristics, different compliance requirements, separate regulatory environment, and fall under the Banking and Financial Institutions Act of 1989 (Yatim, Kent, & Clarkson, 2006). For the said analysis, this study uses the data available on the Bursa Malaysia website for the selected sample period of three years (2013-2015). This sample period has been selected keeping in view that the current study employs Bursa Malaysia's Corporate Governance Guide (2009), which has been effective since 2009, to identify the variables involved in corporate governance. Moreover, the current study is constrained to cover only these three years to make the task viable. It also encompasses probing some significant aspects of the effectiveness of audit committee. These may include its independence, financial expertise, meeting, size and the nature of its earnings management.

## 1.8 Organisation of Study

The study is divided into five chapters. After the first introductory chapter, the next chapter reviews the previous research related to audit quality and the relationship between the audit committee and quality of financial reporting. Meanwhile, chapter three underlines the hypotheses developed and theoretical framework used for the research. It further describes the research design, including the variables employed, the data obtained, and the sample selection used in the research. Chapter four discusses the results of the tests and is followed by the conclusion of the study in chapter five. The chapter concludes by detailing its limitations before suggesting recommendations for future research.

## 1.9 Conclusion

This chapter has canvassed the research background by highlighting the importance of achieving high standards of audit quality in the task of the audit committee as well as on the quality of financial reporting in Malaysia. Besides laying out the research objectives, this chapter has also discussed the theoretical as well as the practical significance of the research. The scope and organisation of this study have also been discussed.

# CHAPTER TWO: LITERATURE REVIEW

## 2.1 Introduction

This chapter reviews and discusses some of the prior studies conducted concerning the role of the audit committee in ensuring the quality of financial reporting and also those concerning the quality of audit in companies. In the end, the study would attempt to present a pertinent definition of corporate governance with specific reference to the audit committee. It shall also attempt to determine the strategies that may be used to improve the same. At the end of this chapter, a general review of the subject area, as well as a summary of reviewed literature, shall be presented.



## 2.2 Corporate Governance

Corporate governance is an important concern for shareholders as well as for the creditors. One issue of particular significance has been whether governance affects managerial behaviour and organisational performance. When seen in the light of corporate governance, the agency theory dictates that the shareholders, debt holders, and the management are parties that have their interests in the company. Attempted unification of these interests often creates a set of problems known as agency problems.

The role of other stakeholders like creditors, employees, government, tax collectors, and law enforcement agencies is also to be given due weight. Being the primary oversight actor in corporate governance, ensuring proper disclosure of needful information and transparency form integral duties of the board of directors. Furthermore, in agency theory, corporate governance refers to the manner in which capital suppliers are ensured appropriate returns not only of dividend but also of their invested capital as suggested by Shleifer & Vishny (1997). These definitions portray corporate governance as something that essentially concerns the process of decision-making within corporations for the benefit of shareholders and other stakeholders.

Lacker, Richardson and Tuna (2007) define corporate governance as the set of mechanisms that influence the decision made by managers with the interest of shareholders. Shleifer and Vishny (1997) give a straightforward definition: Corporate Governance (CG) deals with the ways in which suppliers for finance to corporations assure themselves of getting a return on their investment. Chisari and Ferro (2009) define Corporate Governance (CG) as The available system of institutions or mechanism that induce incentives in listed business firms, so as to distribute benefits between stakeholders, restricting discretion on such distribution. One recent definition by Brickley and Zimmerman (2010) views the term broadly, as the systems of laws, regulations, institutions, market, contracts and corporate policies and procedures that direct and influence the actions of the top-level decision makers in the corporation (shareholders, boards, and executives).



## 2.3 Audit Committee

The excessive fraudulent financial reporting practices on a global scale led to the collapse of various big corporations such as Enron and WorldCom in the United States, and Xerox in the United Kingdom. According to Marx (2009), this also gave rise to various corporate governance codes issued since 1992. To improve investors' confidence in the integrity of financial statements, audit committees are statutorily established as corporate governance devices to monitor and ensure the quality of financial reporting (Carcello and Neal, 2000).

As a liaison between the board and the external auditors, the audit committee serves as a bridge to reduce information asymmetry between the two. It also facilitates the monitoring processes and enhances the independence of the auditor from management. In this regard, Marx (2009) defines audit committee as a subcommittee of the board of directors that consists of independent non-executive members with financial and other expertise. The committee is charged with the role of assisting the entire board of directors in meeting their financial reporting, control, and audit related responsibilities through frequent meetings. Based on MCCG (2012) Part C audit committee's effectiveness is evaluated on its fulfilment of the current Bursa Malaysia requirements. *(*Please refer Appendix *1).*

## 2.4 Quality of Financial Reporting (FRQ)

Investors and stakeholders consider firm's performance through its financial reports. The quality of the report depends on its reliability that translates into investment decision as claimed by Zalewska (2014). The annual financial report is a process of communicating the activities of the company during a particular period with the stakeholders to help them make further decisions. The financial information provided as such should allow capital providers such as potential investors and creditors to make a decision. Therefore, the objective of the financial report has always been to offer quality financial information relating to, and useful for, economic decisions (IASB, 2007).

Global standards have a solitary probability of being ideal if the relevant institutions that control and impose commitment to standards function evenly well in the different countries of the world (Healy & Palepu, 2001). Factors hampering the quality of financial reporting such as financial statement fraud, restatements, and earnings management can be avoided by using high accounting standards and robust disclosure practices. This can, in turn, give investors the confidence to make a decision. In summary, FRQ can be defined as the reliability, relevance, comparability, and understandability of the quality that can be achieved through constraining FRQ factors on earnings management.

Healy and Palepu (2000) highlighted that companies afford disclosure by structured financial reports, inclusive of the analysis and discussions of management, statements, and footnotes on financial performance as well as further regulatory filings. Furthermore, some of the firms take part voluntarily in communication activities; for instance, reports by corporate bodies, internet sites, press releases, forecasts by management, conference calls, and presentations by analysts. Disclosures of various companies are also available through information intermediaries like the financial press, industry experts, and financial analysts.

Cascino and Gassen (2010) emphasised that FRQ as being in compliance with accounting standards accepted in general, the disclosure scale, and reported numbers although this is not merely a task for the IFRS.

## 2.5 Earnings Management (EM)

Since the issue of earnings management has been discussed from differing academic points of view, there is no single accepted definition of the term. According to Schipper (1989), earnings management denotes purposeful intervention in the external financial reporting process with the intent of obtaining same private gains. Healy and Wahlen (1999) note that earnings management might happen if managers, using opinion in structuring transactions and financial reporting, with a view to either misreport companies' actual economic performance to some stakeholders or to leverage outcomes of contracts based on accounting number reported by the company. Dechow, Sloan and Sweeney (1996) criticise these definitions based on the fact that they do not differentiate between EM and fraud. Fraud refers to the intentional, deliberate, misstatement or omission of material facts, or accounting data, which is misleading and when considered with all other information made available, would cause the reader to change or alter his or her judgment or decision. Moreover, EM is not only associated with earnings that are reported; it also influences other aspects of accounting.



## 2.6 Restatement of Financial Statement

The issue of financial restatements has received much attention since the 1980s. Some studies, for example, compare the characteristics of restating and non-restating companies during a certain period (DeFond & Jiambalvo, 1991). The issue of restatement highlights the failures of financial reporting companies since it acknowledges that financial statements – as originally released to the stock market and filed to SEC might not comply with the GAAP regulations (Sirinivasan, 2005).

## 2.7 Financial Reporting Fraud

Owing to the corporate failures of high-profile companies in recent years, corporate fraud has come to be of interest to regulatory and public spheres. There has also been a significant increase in the penalty for fraud in financial reporting, reflecting society's stance on such behaviour. Notable examples of this are Enron and WorldCom. Fraud is real and occurs in so many forms that most of the time, modern-day fraud activities go undetected until it is too late (Enyi, 2009). Nwaze (2008) sites that fraud is classified into a variety of categories such as:

a) Theft: the unauthorised taking of another's possessions
b) Forgery: falsification of documents
c) Manipulation of accounting records or entries

Unsurprisingly, then, the majority of previous researchers have discovered connections between fraud and poor practices of corporate governance. Earnings management, financial restatement, and financial reporting fraud are some of the factors that influence the quality of financial reporting. The focus of this study, however, is on EM, since it is the main factor to the quality of financial reporting.



## 2.8 Accounting Methods of Managing Earnings

For Stolowy and Breton (2004), accounts manipulation refers to the use of management discretion to make accounting choices or to design transactions so as to affect the possibilities of wealth transfer between the company and society (political cost), funds providers (cost of capital), or managers (compensation plans). It is used to conceal debt and compensation agreements, in addition to insider trading (Beneish, 2001). Income smoothing is another approach to manipulating the financial image of the company (Watts & Zimmerman, 1979; Jones, 1991).

**2.9 FRQ and CG**

CG should be able to motivate board members and managers with less monitoring, whereby they would pursue interests congruent with the interests of the firms and shareholders. It should serve as a mechanism to ensure against earnings management (Healy & Wahlen, 1999). Agency theory advocated that proper monitoring mechanisms with good governance at its heart will help control the opportunistic behaviour of agents (Jensen & Meckling, 1976). The global financial crisis and collapse of several large corporate entities have led to renewed focus on effective monitoring systems and the importance of ethical business. To this end, there has been a global concern for effective internal and external control mechanisms that play each party of the other to ensure accountability and encourage professional conduct.

Prior research on earnings management in Asia found that it was minimised during the Asian financial crisis; it is associated with feeble mechanisms of corporate governance (Davids-Friday, Eng & Liu, 2006). According to Cohen et al. (2004), since it is difficult to recognise indications of FRQ, factors such as earnings management, a restatement of financial performance, and fraud are the focal point of studies to delineate FRQ. The presence of these factors compromises the accomplishment of high-quality information and could reverse the failures of the financial reporting process. The Financial Statement Review Committee (FSRC) of the Malaysian Institute of Accountants found that Malaysian firms lack quality in financial reporting terms (FSRC, 2006). The committee called into question the role of the corporate director and the auditors in enhancing FRQ, as well as in providing distinctly complete and reliable information for ease of decision-making.

## 2.10 Audit Quality

Retrieved from www.cfodirect.pwc.com audit quality means complying with accounting and auditing standards, applying a deep and broad understanding of our clients' businesses and financial environments in which they operate, using our expertise to raise and resolve issues early; and exercising professional skepticism in all aspects of work. Asare, Davidson and Gramling (2008) describe the critical position of internal auditors and their incentives to manage to misreport in financial statements. The role of internal auditors is to ensure quality audits by ensuring against variance in reporting. Their role is also to help prevent fraud by ensuring the correct mechanisms are in place and are enforced. The audit committee is tasked with ensuring accurate financial reporting (Buchalter & Yokomoto, 2003) and general auditor independence, audit tenure, and audit fee have a positive influence on audit quality (Listya Yuniastuti Rahmina & Sukrisno Agoes, 2014). Hence, for the external auditor to offer favourable monitoring pertaining to decreasing the EM occurrence inturn improve FRQ, one crucial factor that effect the functionality of the external auditor is proposed, which is audit fee.

## 2.11 Audit Fee

The Generally Accepted Accounting Principles (GAAP) defined the audit as the cost of express an opinion regarding a company's conformity to financial statements (Solatni, 2007). Simunic (1984) defines audit fees as a cost associated with the audit service demanded by the client. Audit fee affects audit quality. It is also an issue in determining the amount of the audit fees charged towards the company. Bedard et al. (2004) found that auditors raise potential and billing rates for customers at risk of EM. There was a positive relationship between billing rate and the possibility of manipulated earnings, as well as raised risk of corporate governance. This suggests that auditors evaluate conditions including an aggressive EM and insufficient corporate governance and that there is an association between this estimation and the audit fee. Bedard et al. (2004) provide a particular example where an auditor might employ further precise assessment to reveal specific entries that might be manipulated towards managed earnings. They can also raise the testing level in certain parts that are extremely liable to earnings manipulation, such as light transactions at the end of a financial period.

Audit fees should be measured through the audit effort expended regarding risk involved in the audit engagement. The higher the audit engagement involved, the higher the audit fees that are charged. As stated by Arens, Elder, Beasly and Hogan (2014), as discretionary accruals increase, there is increased inherent risk in assessment, leading to requirements such as more audit work, extended reviews, and intensive staff supervision to attain audit assurance at the desired level. Abbott, Parker, and Peters (2016) investigated the link between audit fee and EM, hypothesising that, because of asymmetric litigation impacts, audit fees reduce with a customer's risk of income reducing, thereby increasing EM. They found that downward EM risk (negative EM) is related to lower audit fees, while as positive EM is related to higher audit fees.



### 2.12 Conclusion

This chapter explains some theoretical perspectives of financial reporting. It discusses earnings management as an important accounting principle related to FRQ. Corporate governance (monitoring) and earnings management are also discussed. Further, the chapter noted that research about the moderating of audit quality has not been extensive in the case of Malaysia. The next chapter discusses the research framework which leads to the development of hypotheses and the methods used in this study.

# CHAPTER THREE: RESEARCH METHOD

## 3.1 Introduction

This chapter develops the hypotheses that this research shall eventually test. The first section discusses related theories and theoretical framework of this research. The research methods adopted in the study are also described.

## 3.2 Related Theories

There are several theories that are related to the factors in improving FRQ among Malaysian listed companies. They include Agency Theory, Signalling Theory and Stakeholder Theory. Off all these theories Agency Theory is viewed to be more appropriate for this study.



### 3.2.1 Agency Theory

Agency theory explains the relationship between principles and agents. It seeks to separate the ownership and management of a company. Earnings management is an indicator of the agency problem. It can be mitigated by having proper CG mechanisms in place. Conflict arises either between the principal and agent, of amongst shareholders. Pei (2004) explained, It has often been said that the owner of a horse is responsible. If the horse lives, he must feed it. If the horse dies, he must bury it. No such responsibility is attached to a share of stock. The owner is practically powerless through his efforts to affect the underlying property. The spiritual values that formerly went with ownership have been separated from it; the responsibility and the sharing substance have been an integral part of ownership in the past are being transferred to a separate group in whose hands lies control. The employment of an audit committee may be regarded central to the framework for decision making and internal monitoring (Fama, 1980; Fama & Jensen, 1983). Agency theory is closely related to management practices and relationship among mechanisms of corporate governance and EM depended on agency theory to investigate the mechanisms in impacting a management of company's engagement in EM (Xie et. Al., 2003, Goodwin et al., 2010). In addition, previous literatures associating CG and EM mostly used agency theory in their studies on boards and governance mechanisms functions that found involvement of management in EM (Kao & Chen, 2004; Davidson, Goodwin-Stewart, & Kent 2005; Goodwin, Ahmed & Heaney, 2009).

### 3.3 Conceptual Research Framework

This research examining the moderating of audit quality in Malaysia. The conceptual framework is developed as shown in Figure 3.1.

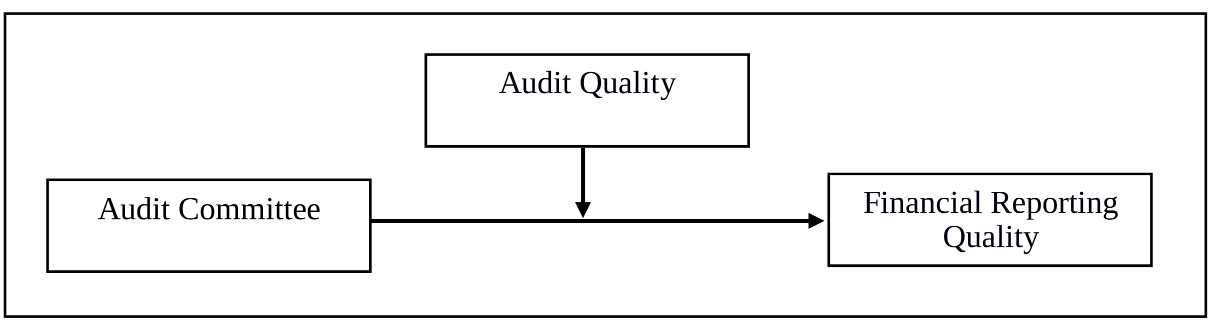


Figure 3.1: Conceptual Framework of the Research

### 3.4 Development of Theoretical Framework

Specifically, Figure 3.2 summarizes the theoretical research framework and the hypothesis of this study. Direct effect variant (Path diagram I) denotes the direct impact of Audit Committee and Financial Reporting Quality. Moderating effect variant (Path Diagram II) signifies the indirect effect of Audit Committee on Financial Reporting Quality through the moderator variable – Audit Quality. Figure 3.2 represents the Theoretical research framework and Hypothesis development of Audit Quality on Financial Reporting Quality and Audit Committee in Malaysia. Hypotheses 1a, 1b, 1c, 1d, 1e, 1f in the Direct effect variant (Path diagram I) embody the hypothesized relationships between Audit Committee, Audit Quality and Financial Reporting Quality. In the Moderation variant (Path Diagram II), Hypothesis 1g are exemplified by the Direct effect variant and Moderation variant (two path diagrams I and II), considered as a whole, that is, the total effect. This study is in agreement with the conditions set by Baron and Kenny (1986) for moderating path analysis. For instance, to establish moderation, some certain conditions as noted in the prior study of Baron and Kenny (1986) must be met in order to claim that mediation is occurring.

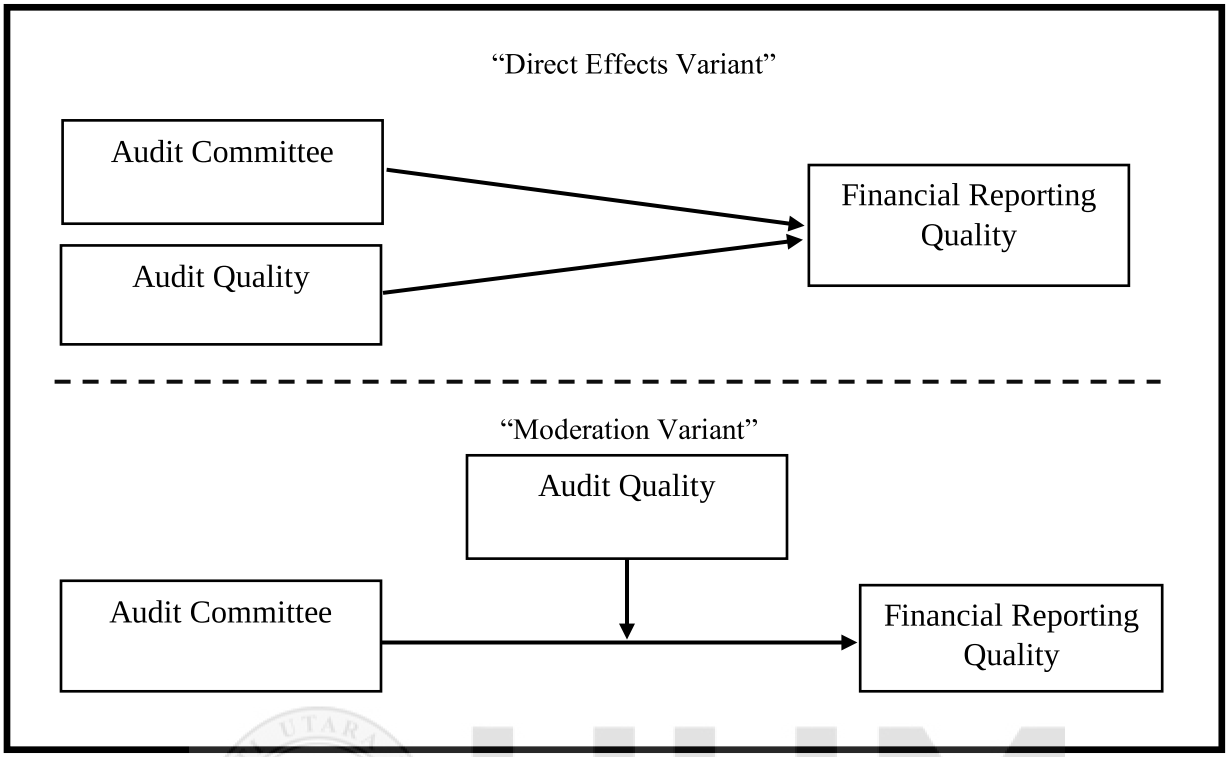


Figure 3.2: Theoretical Research Framework of the Study

The structure of corporate governance involves the processes and functions developed to supervise the actions of the company's management. The role of corporate governance in financial reporting is to assure shareholders that mandatory reporting requirements are complied with. Corporate governance also needs to keep the company's financial statements credible (Dechow et al., 1995).

The board of directors act as corporate governance agents to enhance FRQ through reduced agency costs. The audit committee is responsible for monitoring the management's financial discretion, this includes providing shareholders with the means to protect the credibility of the firm's financial statements. The variables examined in this study are presented in the diagram of the moderating effect of audit quality on the audit committee and quality of financial reporting in Malaysian listed firms.

### 3.5 The Quality of Financial Reporting (FRQ)

The quality of financial reporting has two main aspects: audit quality, and the quality of reported earnings. The present study focuses on earnings quality as a component of FRQ. In addition to third-party assessments or through a survey of stakeholder perception. This model uses the discretionary part of total accruals (discretionary as well as non-discretionary) as a proxy for earnings management. This research expands discretionary accruals as an EM measure, as in prior studies that proposed and improved this measure (please refer Appendix 2). The following table, Table 3.1 presents the models for detecting EM:

Table 3.1 Models to Detect Earnings Management (EM)

| Year | Model | Formula |
|---|---|---|
| **1985** | Healy | $NDAC_{ijt} = \sum j\ TAC_{ijt} / T$ |
| | | NDAC = non-discretionary accruals for company *i* in industry *j* in year *t* |
| | | TAC = total accruals for company *i* in industry *j* in year *t* |
| **1986** | DeAngelo | $NDAC_{ijt} = TAC_{ijt-1}$ |
| **1991** | Jones' Model | $NDA_t = \alpha_1 (1/A_{t-1}) + \alpha_2 (\Delta REV_t) + \alpha_3(PPE_t)$ |
| | | NDA = Estimated non-discretionary accruals |
| | | $\Delta REV_{t\,=}$ is the change in revenues from year *t- l* to year *t*, |
| | | $PPE_{t\,=}$ is gross property, plant and equipment in year *t*, |
| | | $A_{t-1}$ = Total asset at T-1 |
| | | $\alpha_1\ \alpha_2\ \alpha_3$ = firm specific parameters. |
| **1991** | Modified Jones' Model | $NDA_t = \alpha_1 (1/A_{t-1}) + \alpha_2 (\Delta REV_t - \Delta REC) + \alpha_3(PPE_t)$ |

### 3.6 Measuring the Research Variables

This section consist of four main variables, (1) dependent variable and (2) Independent variable and (3) Control variable and (4) Moderating Variable. These four variables are used to develop the research framework for this study as shown in Figure 3.3.

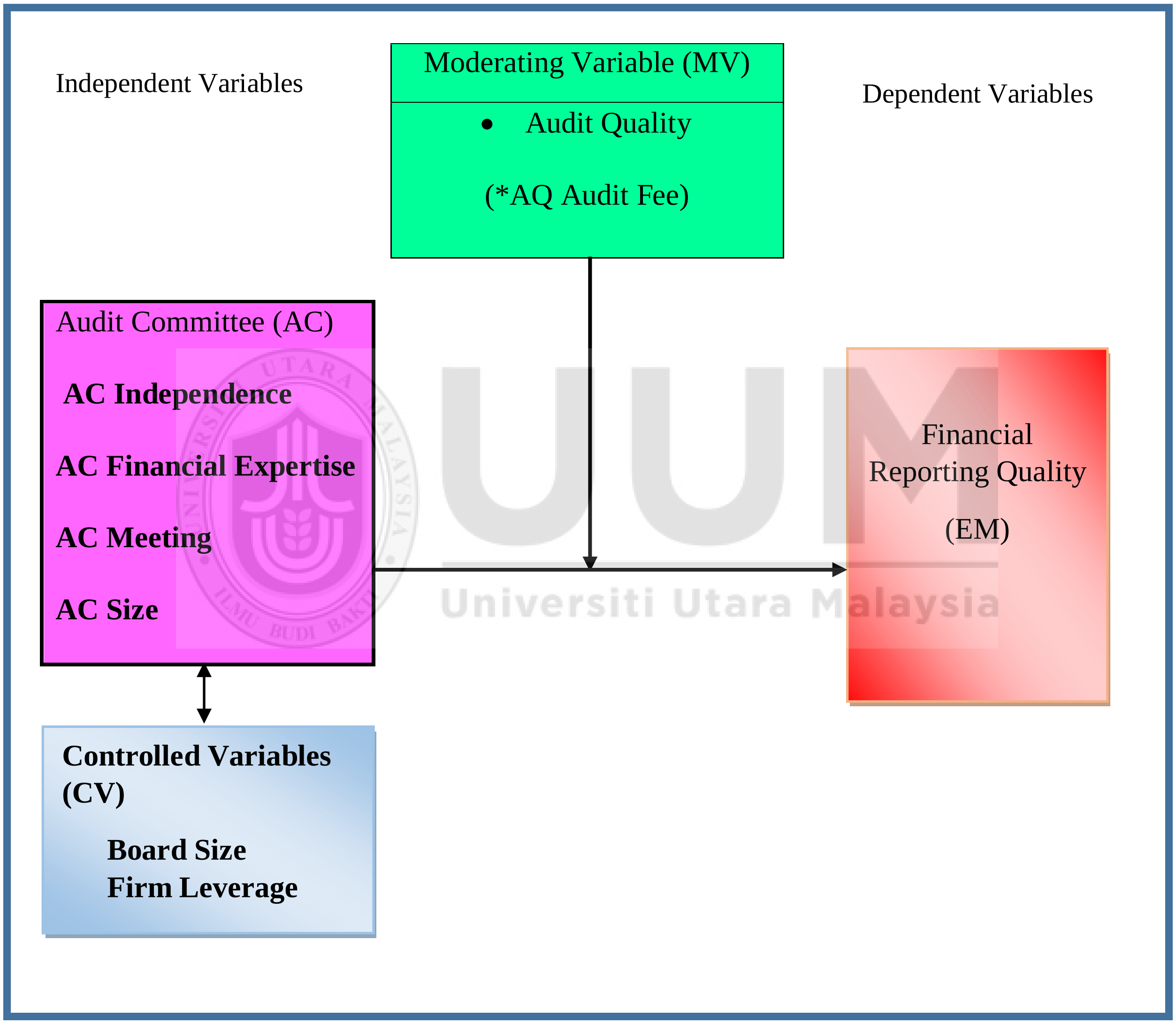


**Figure 3.3: Framework Development**

### 3.6.1 Dependent Variable

The method of accruals has been widely applied in EM studies since it captures the influence of methods like accounting estimation and manipulation of timing recognition. Most EM literature uses discretionary accruals to proxy EM. The current research employs discretionary accruals as a proxy of EM. Discretionary accruals refer to the variance between expected accruals and actual accruals. Earnings management is achieved through a variety of practices, usually through *discretionary accrual* or a change in accounting methods.

Accrual quality is used as a proxy for the dependent variable, quality of financial reporting. The method of accruals has been widely applied in EM studies since it captures the influence of accruals management and the influence of certain EM methods such as estimation and timing recognition. Most recent literature uses discretionary accruals to proxy EM. Different models are used to distinguish between discretionary accruals and overall accruals (Dechow et al., 1995). Accordingly, the current research employs discretionary accruals to proxy EM. Discretionary accruals refer to the variance between expected accruals and actual accruals.



### 3.6.2 Independent Variable

This research uses four independent variable there is AC Independence, AC Financial Expertise, AC Meeting and AC Size. In addition, the measure of AC Independence is the proportion of independence non-executive directors in the Audit Committee to total committee members (Total number of independence board in AC members) and AC Financial Expertise the measure is Total number of AC members who has financial and accounting background. Followed by AC Meeting based on the yearly number of Audit Committee Meetings and AC Size focused on AC Member.

### 3.6.3 Control Variables

#### 3.6.3.1 Board Size (BRDSIZE)

Kao & Shin (2004) and Menon & Williams (1994) report that large boards have a higher probability of independent directors with valued experience, who are more capable of delegating supplementary liabilities. They are also more likely to inhibit or reduce the opportunistic managerial behaviour. Rahman & Ali (2006) found positively related with EM to board size.

#### 3.6.3.2 Firm Leverage (FRMLEV)

The present research considers that the incentive for EM is to conceal debt to which end agents use the measure of leverage. Leverage represents debt reliance. Leverage has a positive association with earnings management practices, since making and understating the projection of liabilities or an overstating projection of assets might be utilised to concede violations of a debt covenant. A company is prone to default on debt covenants based on accounting whereby the accounting number might be misstated by the management to avoid consequences of default (Efendi et al., 2007). Dechow et al. (1996) and Persons (2006) relate leverage with earnings management, financial restatement, and fraud. Existing studies document that highly leveraged company managers have strong incentives to employ income-increasing accruals to slacken contractual debt-constraints (Ali, Salleh & Hassan, 2008; Alves, 2012). However, highly indebted companies may be less capable of engaging in earnings management activities, since they are under the scrutiny of lenders. Certain previous studies found a negative affiliation between leverage and earnings management (Yang et al., 2008; Park & Shin, 2004). Al Fayoumi et al. (2010) found that firm leverage does not significantly affect accounting information quality.

## 3.7 Hypothesis Development and Discussion of Variables

### 3.7.1 The Relationship between Audit Committee and Quality of Financial Reporting (Earnings Management)

#### 3.7.1.1 Audit Committee Independence (ACIND)

Vicknair, Hickman and Carnes (1993) argue that audit committees must pursue a course of action independent from the management to function efficiently. Choi, Jeon and Park (2004) found that a significant factor in improving its role in inhibiting financial statement fraud. Some studies found that committee independence correlated negatively with audit committee independence and earnings management (Soliman and Ragab, 2014; Habbash, 2010). Alves (2013) found a positive association between earnings management and audit committee independence. Others found that the independence of audit committee was not significantly related to earnings management (Habbash et al., 2013, Hamdan et al., 2013, and Rahman & Ali, 2006). Hence, it is hypothesised that:



*$H1_a$: ACIND is negatively with earnings management among Malaysian listed companies.*

#### 3.7.1.2 Audit Committee Financial Expertise (ACFEX)

Although independent directors with financial backgrounds might be monitors with good intentions, it is desirable for monitors to have sophistication in financial matters to detect financial. However, there is no response to the employment of a financial expert with a non-accounting background. Therefore, the following hypothesis is formulated:

*$H1_b$: The financial expertise of the audit committee is negatively associated with earnings management among Malaysian listed companies.*

#### 3.7.1.3 Audit Committee Meetings (ACMEET)

Audit committees are intended to ensure constant communication among the board, internal auditors, and external auditors so that there are frequent committee meetings with the auditors. Chang and Sun (2009), Lin et al. (2006), and Xie et al. (2003) argue that the frequency of audit committee meetings is related to decrease in discretionary current accrual levels. They anticipate that active controls supplement effective audit committees. Alkadi, Khalifa, and Hanefah (2012) investigated the effect of audit committee characteristics (size, independent non-executive director, accounting expertise, and the number of Muslim directors in audit committee) on EM activity. Kalbers (1993) and DeZoort (2002) found that the frequency of committee meetings affected the effectiveness of the audit committee. An increase in frequency is an indication that the committee is more efficient and committed to producing quality performance (Menon, 1994; Abbort, 2000; DeZoort, 2002; Lee & Mande, 2005; Stewart, 2007). This extends to the quality of earnings (Xie, 2003; Vafeas, 2005). The hypothesis is below:

*$H1_c$: ACMEET is positively associated with earning management among Malaysian listed companies.*

#### 3.7.1.4 Audit Committee Size (ACSIZE)

Chen and Zhou (2007) found that companies with large audit committees attract additional interest regarding the reputation of auditors. These companies opt for one of the Big Four auditors. Bedard et al. (2004) argued that audit committees with more members are better positioned to discover and resolve issues in financial reporting by possessing more skills due to its diverse members and a by producing a broader umbrella to monitor operations. Audit committees comprising one or two members are subject to greater pressure from management. This has led some studies to conclude that small audit committees are more prone to earnings management. Rahman & Ali (2006), Habbash (2010), Habbash et al. (2013), and Alkadi et al. (2012) found no significant relationship between the size of the audit committee. For Lin et al. (2006), found the negative members in an auditing committee might be pertinent to FRQ. This led to formulating the hypothesis:

*$H1_d$: ACSIZE is negatively associated with earning management among Malaysian listed companies.*

### 3.7.2 Audit Committee, Audit Quality, and Quality of Financial Reporting

Other studies found that larger size did not considerably reduce EM. However, any statically significant relationship has a negative directional sign. Several studies suggest that audit quality is influenced by corporate governance to mitigate EM (Gonzalez & Garcia-Meca, 2014). Therefore, more and better disclosure information is an effective factor for economic decisions (Soheilyfar et al., 2014).

### 3.7.3 Audit Quality as a Moderating Variable

Several studies empirically document type of auditor as a factor in explaining financial instrument disclosure. Jensen & Mackling (1976) argue that an audit firm acts as a good corporate governance mechanism to reduce agency costs and to provide oversight by mitigating the opportunistic behaviour of managers. The literature argues that larger and more well-known international auditing firms act as sources of inspiration for companies to disclose more financial instrument risk information to maintain the audit firm's reputation and to avoid unnecessary reputation cost (Chalmers & Godfrey, 2004). The agency theory literature suggests that both the auditing firm as well as their clients benefit from such disclosure. The choice of an external auditor especially serves to increase the company value. This choice is an indication to investors of the high quality of the annual reports. Audit firms may capitalise on this greater disclosure to prove to outsiders that their audit is of higher quality (DeAngelo, 1981).

Although both the banking as well as the insurance industries fall under the financial sub-sector, this study argues that financial instrument disclosure may vary with the type of industry. The present study uses audit fee to proxy audit quality. Johl, Johl, Subramaniam and Cooper (2013) analysed a single dataset of 64 companies (128 observations) listed on Bursa Malaysia for 2009-2010, which was obtained through the administration of a survey questionnaire to chief audit executives (or equivalent position). The first assessment showed that IAF quality was positively associated with EM, signifying reduced FRQ. Asare, Davidson and Gramling (2008) presented the internal auditors' critical position and incentive to manage to misreport of financial statements. They also found that there could be a rise in the budgeted hours worked if management tendency were to misreport increase. Internal auditors were critical to variances in the quality of audit committee and would be invested in their valuation of fraud risk and audit scheme.

*Audit quality significantly negatively moderates the relationship between AC independence and FRQ.*

*Audit quality significantly negatively moderates the relationship between AC financial expertise and FRQ.*

*Audit quality significantly negatively moderates the relationship between AC meetings and FRQ.*

*Audit quality significantly negatively moderates the relationship between AC size and FRQ.*

### 3.8 Data Source and Sampling

The study used secondary data and the population comprises trading companies listed on Bursa Malaysia from 2013 to 2015. The final sample comprises 279 public listed companies from 2013-2015. Bursa Malaysia consists of the Main Market.

Data was manually collected from the Bursa Malaysia issued guides of the shareholding companies in Malaysia and the companies' yearly reports. Bursa Malaysia has a strong mandate to ensure a culture of corporate governance. The Asian Corporate Governance Association in collaboration with CLSA Asia-Pacific (ACGA CG Watch) acknowledged Malaysia as having recorded consistent GC improvements with an increase of 52% in 2013 to 55% in 2014, and from 38% in 2013 to 43% in 2014. (Please refer Appendix 4)

### 3.9 Data Collection Procedures

Following are the steps employed in data collection in this research. First Collecting the list of all trading companies that were consistently and continuously quoted on the Bursa Malaysia published from 2013 to 2015. Second is identifying companies that published complete their financial statements during the observation period of 2013-2015. Financial statements for 2012 were used to calculate the excess or difference with the previous year when calculating the earnings management variable and third identifying companies which had incomplete data on variables of interest required in this study.

Summarises the process of sample selection based on selection procedures:

Table 3.2 Sample Selection Based on Selection Procedures

| No | Items | Companies | Percent (%) |
|---|---|---|---|
| 1. | Total number of companies consistently listed on Bursa Malaysia from 2013-2015 | 158 | 100.00 |
| 2. | Companies with incomplete Financial Statement published during 2013-2015 | 5 | 3.16 |
| 3. | Companies that do not report on variables used in this study (AC Independence, AC Financial Expertise, AC Meeting, AC Size, Control Variables (CV), Board Size, Firm Leverage) | 60 | 37.97 |
| | Total Sample (Retain /Used data for further analysis) | 93 | 58.86 |
| | Total Observations (3 years x 93 companies) | 279 | |

** Companies consistently listed on Bursa Malaysia from 2013-2015*

After compiling data for all necessary variables (dependent, independent, and moderating variables), 93 companies were found to have complete data for all the variables required. For three years, a total of 279 observations is analysed. This resulted in a response rate of 58.86% which is regarded as adequate for surveys (Sekaran, 2013; Bougie, 2010).

### 3.10 Data Analysis and Model Specification

Multiple regression is used in this study to explore hot the dependent, moderating, and independent variables are related.

There are three models of OLS regression used to test the proposed hypotheses.

#### 3.10.1 Techniques of Data Analysis

The current study adopted SPSS Statistical Analysis version 22.0 for multiple regression analysis to test the hypotheses are Normality Test, Multicollinearity Test, Heteroscedasticity Test, Autocorrelation Test, The Coefficient of Determination (R2) and Testing T- Statistic.

#### 3.10.2 Normality Test

The linear relationship between independent and dependent variables should take place in order to avoid over-estimation of other independent variables and to detect the significant impact of independent variables on the dependent variable (Vaus, 2002; Oborne & Waters, 2002).

#### 3.10.3 Multicollinearity Test

The first is by bivariate pearson correlations analysis (if the correlation between independent variables is below 0.8 then collinearity does not exist). The second is by using Variable Inflation Factor (VIF) index and tolerance measures to test for collinearity between the independents variables (when the variable has 0.2 tolerance or less; while collinearity is serious if VIF is 5 or more.

### 3.10.4. Heteroscedasticity Test

Homoscedasticity indicated by residuals are horizontally located (i.e. scattered) around the zero line. If the plots residual is inconsistently scattered around the line, it is a sign of heteroscedasticity. According to Vaus (2002) transformation techniques of the data is an appropriate method to eliminate heteroscedasticity, since heteroscedasticity occurs due to skewness on variables.

### 3.10.5 Autocorrelation Test

Autocorrelation takes place when the error terms (i.e. residuals) of a regression forecasting model are correlated. Residuals of regression should be independent and not correlated (Black, 2004). The Durbin-Watson test is one of the methods to detect the occurrence of autocorrelation between residuals.



### 3.10.6 The Coefficient of Determination ($R^2$)

A correlation coefficient is considered significant if it is close to $\pm$ 1.00 rather than value of 0. In the current study, two correlation analyses were conducted.

### 3.10.7 Testing T statistics

Univariate analysis is used to look at one variable only. Several tools fall under univariate analysis (e.g. mean, median, mode, standard deviation, variance, range) and tests (One-Sample T-test, Independent-Samples T-test, Paired-Sample T-tests, and One-Way analysis of variance (ANOVA)).

### 3.10.8 Goodness of Fit Test

The goodness of fit is a measure designed to determine how well the date suits or ‘fits’ a set of observations. They summarise the degree of difference between observed and expected values. It does this by comparing two data distributions, the theoretical and the observed. It differs from the binomial test by being able to record more than one possibility.

### 3.10.9 Analysis Model

**Hypothesis:**

Discretionary Accrual Models for the analysis (hypotheses 1a, 1b, 1c, 1d, 1e, 1f, 1g)

***H1a:*** $DTAC_{i,t} = \alpha_0 + \alpha_1 ACIND + \varepsilon$

***H1b:*** $DTAC_{i,t} = \alpha_0 + \alpha_2 ACFEX + \varepsilon$

***H1c:*** $DTAC_{i,t} = \alpha_0 + \alpha_3 ACMEET + \varepsilon$

***H1d:*** $DTAC_{i,t} = \alpha_0 + \alpha_4 ACSIZE + \varepsilon$

***H1e:*** $DTAC_{i,t} = \alpha_0 + \alpha_1 ACSIZE + \alpha_2 ACFEX + \alpha_3 ACMEET + \alpha_4 ACSIZE + \varepsilon$

***H1f:*** $DTAC_{i,t} = \alpha_0 + \alpha_1 ACSIZE + \alpha_2 ACFEX + \alpha_3 ACMEET + \alpha_4 ACSIZE + \alpha_5 BRDSIZE + \alpha_6 FRMLEV + \varepsilon$

***H1g:*** $DTAC_{i,t} = \alpha_0 + \alpha_1 ACSIZE + \alpha_2 ACFEX + \alpha_3 ACMEET + \alpha_4 ACSIZE + \alpha_5 BRDSIZE + \alpha_6 FRMSIZE + \alpha_7 LOGFEE + a_8 (ACIND * LOGFEE) + a_9 (ACFEX * LOGFEE) + a_{10} (ACMEET * LOGFEE) + a_{11} (ACSIZE * LOGFEE) + \varepsilon$

*where:*

$DTAC_{i,t}$ = *discretionary accruals* are calculated using the model of Jones (1995) Modified at the firm in year *t*

$\boldsymbol{ACIND_{1,t}}$ = AC Member at the firm *i* in year *t*

$\boldsymbol{ACFEX_{1,t}}$ = Total number of audit committee members with financial and Accounting Background

$\boldsymbol{ACMEET_{1,t}}$ = the yearly number of audit committee meetings at the firm *i* in year *t*

$\boldsymbol{ACSIZE_{1,t}}$ = the total number of members on the audit committee at the company *i* in Year *t*

$\boldsymbol{BRDSIZE_{1,t}}$ = the number of directors on the board at the firm in year t

$\boldsymbol{FRMLEV_{1,t}}$ = Total long-term debt by total assets at the firm *i* in year t

**ε** = Error

Quality to Earnings Management Models for the analysis

$$DTAC_{i,t} = \alpha_0 + \alpha_1 LogFees$$

*where:*

***LogFees: the Logarithmic transformation of ringgit-value paid to the auditor for audit services.***



### 3.11 Chapter Summary

This chapter detailed the conceptual and theoretical framework of the study. It employs audit quality, audit committee and quality of financial reporting as constructs to determine their interrelation. To this end, three hypotheses were formulated to study the relationships between the audit committee and quality of financial reporting, and between audit quality and quality of financial reporting.

Table 3.3: Summary Variables, Measures, Data Sources and Prior Literature

| No. | Variables | Type | Expected Sign | Measures | Data Sources | Prior Literature |
|---|---|---|---|---|---|---|
| **1.** | Earning Management (EM) | Dependent | d.v | DTAC Discretionary Accruals | Annual Report of sample firm downloadable from the website of Bursa Malaysia. | Choi et al (2009) |
| **2.** | Audit Committee Independence (ACIND) | Independent | Negative (-) | The proportion of independence non-executive directors in the Audit Committee to total committee members. (Total number of independence board in AC members) | Annual Report of sample firm, in the section: Biography and background of board members. | Beasly (1996), Bradbury et al (2006), DeFond and Jiambalvo (1991), Habbash (2010) Andres et al (2012) |
| **3.** | Audit Committee Financial Expertise (ACFEX) | Independent | Negative (-) | (Total number of AC members who has financial and accounting background) | Annual Report of sample firm, in the section: Biography and background of board members. | Chtourou et al (2001) Felo et al (2003) Abbott et al (2004), Bedard et al (2004) Choi et al |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | | (2004) Habbash (2010) |
| **4.** | Audit Committee Meeting (ACMEET) | Independent | Positive (+) | The yearly number of Audit Committee Meetings. | Annual Report of sample firm downloadable from the website of Bursa Malaysia. Audit Committee Report. | Raghunandan & Rama (2007), Habbash (2010) |
| **5.** | Audit Committee Size (ACSIZE) | Independent | Negative (-) | AC Member | Annual Report of sample firm downloadable from the website of Bursa Malaysia. Audit Committee Report. | Lin et al (2006) Adam & Mehran (2008) Habbash (2010) |
| **6.** | Board Size (BRDSIZE) | Control | Positive (+) | Board of directors. | Annual Report of sample firm, in the section: Biography and background of board members. | Rahman & Ali (2006) Hashim (2009) Habbash (2010) |

| | | | | | | |
|---|---|---|---|---|---|---|
| **7.** | Firm Leverage (FRMLEV) | Control | Positive (+) | Total long term debt divided by total assets. | Annual Report of sample firm downloadable from the website of Bursa Malaysia. (Balance Sheet) | Jelinek (2007) Jiang et al (2008) Hodgdonet al (2009) Dimitropoles & Asteriou (2010) Habbash (2010) |
| **8.** | Audit Quality (AQ) (Audit Fees) | Moderator | Positive (+) | Logarithmic transformation of Ringgit value paid to Auditor for audit service. | Annual Report of sample firm downloadable from the website of Bursa Malaysia. (Corporate Information) Income statement, Notes to the Financial statement. | Abbott, Parker, and Peters 2016 Bedard et. Al (2004) Bedard et. Al (2004) |

## CHAPTER FOUR: RESULTS AND DISCUSSION

### 4.1 Introduction

This chapter discusses characteristics of the data and the sample with the descriptive statistical result. Results from the Person Correlations test are presented in Section 4.4. Testing of classical assumptions including Hausmann Test and hypothesis testing follows in Sections 4.5 and 4.6.

### 4.2 Descriptive Analysis

Data were collected from the yearly financial reports that the listed companies in Bursa Malaysia published from 2013 to 2015. The research population comprises of trading companies listed on Bursa Malaysia from 2013 to 2015. The final sample comprises of 279 public listed companies from 2013-2015.



We also collected data from the audited financial statements of the purposively sampled firms. This study observes three fiscal years (2013- 2015). The financial statements of 2012 are used to calculate the delta or difference ($t_1$- $t_{t-1}$) with the previous year for calculating the earnings management variable.

### 4.2.1 Descriptive Statistics

Descriptive statistics for the dependent, independent, moderating, and control variables are presented in Table 4.1. Based on descriptive statistics, minimum amount -1.011 is DTAC, maximum amount is LOGFEE (2386000.000) and the mean for ACFEX 2.21505 with a minimum of 1 and maximum of 4 with the overall standard deviation is 0.867264.

**Table 4.1: Descriptive Statistics**

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| DTAC | 279 | -1.011 | .697 | -.22906 | .253655 |
| ACIND | 279 | 2.000 | 5.000 | 2.87455 | .769493 |
| ACFEX | 279 | 1.000 | 4.000 | 2.21505 | .867264 |
| ACMEET | 279 | 4.000 | 9.000 | 5.36201 | 1.252964 |
| ACSIZE | 279 | 3.000 | 6.000 | 3.42294 | .575561 |
| BRDSIZE | 279 | 4.000 | 16.000 | 8.40502 | 2.360674 |
| FRMLEV | 279 | .020 | 63.020 | 23.53953 | 15.968343 |
| LOGFEE | 279 | 12000.000 | 2386000.000 | 163234.73118 | 310982.369481 |
| Valid N (list-wise) | 279 | | | | |

EM : Discretionary accruals value

ACIND : Total number of independent board members on the AC

ACFEX : Total number of AC members with financial and accounting background

ACMEET : The yearly number of audit committee meetings

ACSIZE : Total number of members on the AC

BRDSIZE : The number of directors on the board

FRMLEV : Total long-term debt divided by total assets

LOGFEE : Natural logarithm of audit fee

### 4.2.2 Test of Normality

Table 4.2 presents the result for the normality test. The test of normality is conducted to determine if the data are normal enough for further statistical analysis. The distribution of score is examined through the value of skewness (asymmetry of the distribution) and kurtosis (peakedness of the distribution). According to Klein (1998), the data are normally distributed if the value of skewness is less than ±3 and the kurtosis does not exceed ±10.

**Table 4.2: Normality Test**

| | N | Skewness | | Kurtosis | |
|---|---|---|---|---|---|
| | Statistic | Statistic | Std. Error | Statistic | Std. Error |
| Unstandardized Residual | 279 | -.518 | .146 | 1.199 | .291 |
| Valid N (list-wise) | 279 | | | | |



Based on the table, normality output of skewness and kurtosis for the audit fees model. All the values of skewness are less than ±3, and the kurtosis does not exceed ±10, which indicates that the data fit the normality test hence, are suitable for further analysis.

### 4.2.3 Testing of Multicollinearity

Table 4.3 presents the Pearson product-moment correlation coefficient between all the independent variables involved. This result in crucial in determining the existence of multicollinearity problem in the case where the correlation coefficient is found to be more than 0.8. As the result shows that the correlation coefficient is less than 0.8, it can be assumed that the serious multicollinearity problem between independent variables based on correlation coefficient is nil (Hair et al., 2006)

**Table 4.3: Correlations**

| | DTAC | ACIND | ACFEX | ACMEET | ACSIZE | BRDSIZE | FRMLEV | LOGFEE |
|---|---|---|---|---|---|---|---|---|
| DTAC | 1 | -.132* | .016 | -.224** | -.117 | -.233** | -.216** | -.108 |
| ACIND | | 1 | .240** | .279** | .697** | .531** | .023 | .124* |
| ACFEX | | | 1 | .044 | .336** | .203** | -.019 | .109 |
| ACMEET | | | | 1 | .196** | .344** | .169** | .291** |
| ACSIZE | | | | | 1 | .504** | .065 | .283** |
| BRDSIZE | | | | | | 1 | .269** | .318** |
| FRMLEV | | | | | | | 1 | .191** |
| LOGFEE | | | | | | | | 1 |

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

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

Table 4.4 presents the VIF and tolerance level values for each variable of the model. In order to ensure the non-existence of multicollinearity, the VIF value must smaller than 10 and tolerance value greater than 0.10. As presented in the table, The VIF values of independent variables are laid between laid between 1.135 (ACFEX) to 2.289 (ACIND). As all the independent variables have a VIF of less than 10, there is no threat of multicollinearity among the independent variables. The values of tolerance as presented in the table for each of the independent variables are between 0.437 (ACIND) TO 0.888 (FRMLEV). Each variable has a tolerance value of greater than 0.10, suggesting that among the independent variables multicollinearity does not exist.

**Table 4.4 Collinearity Statistic**

| | | Collinearity Statistics | |
|---|---|---|---|
| Model | | Tolerance | VIF |
| 1 | (Constant) | | |
| | ACIND | .437 | 2.289 |
| | ACFEX | .881 | 1.135 |
| | ACMEET | .814 | 1.229 |
| | ACSIZE | .438 | 2.284 |
| | BRDSIZE | .577 | 1.734 |
| | FRMLEV | .888 | 1.126 |
| | LOGFEE | .798 | 1.253 |

### 4.2.4 Testing for Heteroscedasticity

The test aims at detecting whether in a regression model the pattern of residual variance varies from one observation to another. If the variance of the residuals of the model remains constant across observations, the model is said to be homoscedastic, whereas if the residual varies from one observation to another the model is said to be heteroscedastic (Ghozali, 2013). A good regression model is expected to be homoscedastic, or, in other words, to not be heteroscedastic. The result from the Glejser test is used to determine the heteroscedasticity or homoscedasticity for each hypothesis in this study. The Glejser test proposes the regression of the absolute value of the residuals with the independent variables in the regression equation (Gujarati, 2005):



$$Ut = \alpha + \beta\ Xt + vt$$

The results of SPSS output display show whether t for the above model is significant. In other words, it shows whether the independent variables statistically affect the dependent variable (AbsUt in this case). If independent variables have statistically significant effect on the dependent variable (AbsUt), it indicates that the regression model has a threat of heteroscedasticity and is unfit for further testing.

Table 4.5 presents the result of Glejser Test on the relationship between the audit committee and quality of financial reporting. None of the independent variables has a statistically significant effect on the dependent variable (AbsUt_1). The significance value for all variables is > 0.05 at p-value 0.05: ACIND (0.137), ACFEX (0.576), ACMEET (0.238), and ACSIZE (0.134). Therefore, we may conclude that the regression model does not contain any heteroscedasticity, and is fit for further analysis.

**Table 4.5 Glejser Test**

| Model | | T | Sig. |
|---|---|---|---|
| 1 | (Constant) | 1.491 | .137 |
| | ACIND | -.559 | .576 |
| | ACFEX | -1.183 | .238 |
| | ACMEET | .521 | .603 |
| | ACSIZE | 1.504 | .134 |

a. Dependent Variable: Discretionary Accruals (RES2) / AbsUt_1

Table 4.6 shows the result of Glejser Test. The result shows that none of the independent variables significantly affects the dependent variable (AbsUt_4). Each variable's significance value is > 0.05 with p-value at 0.05, with ACIND (0.493), ACFEX (0.942), ACMEET (0.179), ACSIZE (0.131), BRDSIZE (0.756), FRMLEV (0.705), and LOGFEE (0.206). Thus, the regression model does not contain any heteroscedasticity and is fit for use.

**Table 4.6: Glejser Test**

| Model | | t | Sig. |
|---|---|---|---|
| 1 | (Constant) | .837 | .404 |
| | ACIND | -.686 | .493 |
| | ACFEX | -.073 | .942 |
| | ACMEET | 1.348 | .179 |
| | ACSIZE | 1.515 | .131 |
| | BRDSIZE | -.311 | .756 |
| | FRMLEV | .379 | .705 |
| | LOGFEE | -1.268 | .206 |

*Dependent Variable: Discretionary Accrual (DTAC)(RES4)/AbUt_4



### 4.2.5 Testing of Autocorrelation

Autocorrelation arises because successive observations over time are related to each other (Ghozali, 2013). This problem arises because the residual (error disturbances) are not free from one observation to another. It is often found in the time series data. To confirm the presence of autocorrelation in a regression model, the Durbin-Watson (DW) test is used. In this study, Durbin-Watson (DW) statistics are extracted for each of the model regression. Following are the steps in the Durbin-Watson test:

1. The first step is to formulate the null and alternate hypotheses. The Durbin-Watson test is only used for autocorrelation at the first level (first order autocorrelation). The requirement of intercept (constant) in the regression model and there was no lag variable among independent variables. The hypotheses will be stated as follows:

   Ho: There is no autocorrelation

   Ha: There is autocorrelation

2. The second step is to calculate the value of the Durbin-Watson statistic.
3. The final step is to find the value of d 0L and d Lu on the table DW with a 5%, with k (many independent variables).
4. The fourth step is to take a decision whether or not there was autocorrelation (Ghozali, 2013).



In this study, the DW value using a significance value of 0.05, where n=93 (or in the table n =100). The total number of independent variables is seven (4) or k=4, then on the table of Durbin-Watson (DW) from Table 4.7 is shown as follows:

**Table 4.7 Durbin-Watson (DW) Table Statistics**

| | k = 4 | |
|---|---|---|
| n | D1 | du |
| 30 | 1.14 | 1.74 |
| . | . | . |
| 90 (n=93) | 1.57 | 1.75 |
| 100 | 1.59 | 1.76 |

**Table 4.8: Decision Table of Autocorrelation**

| Nol Hypothesis | Decision | If |
|---|---|---|
| There is no positive autocorrelation | Rejected | 0 < d < dl |
| There is no positive autocorrelation | No Decision | dl ≤ d ≤ du |
| There is no negative autocorrelation | Rejected | 4- dl < d < 4 |
| There is no negative autocorrelation | No Decision | 4-du ≤ d ≤ 4-dl |
| There is no positive and negative autocorrelation | No Rejected | du < d < 4-du |

Table 4.9 presents the Durbin-Watson test results of the model of the relationship between the audit committee and quality of financial reporting. It can be seen that the Durbin-Watson statistic is 1.848. The value of DW (1.809) is greater than the upper limit (du) of 1.75 refer Table 4.7 and less than 2.25[1] (4 - du, 4 – 1.75). It suggests that Ho is not rejected.



**Table 4.9: Durbin-Watson Test**

**Model Summary**

| R | R-Square | Adjusted R-Square | Std. Error of the Estimate | Durbin-Watson |
|---|---|---|---|---|
| .320[a] | .102 | .082 | .242971 | 1.809 |

a. Predictors: (Constant), FRMLEV, ACFEX, ACMEET, ACIND, BRDSIZE, ACSIZE

b. Dependent Variable: DTAC

[1] Ho: 4-1.75 = 2.25

According to the result of Durbin-Watson test in Table 4.10 the DW statistic is 1.806, which is greater than the upper limit (du) of 1.75 (DW table) and less than 2.25 (4 - du, @ 4 – 1.75). This signifies that Ho is not rejected and that there is no autocorrelation between the independent variables.

Ho: Moderate Accepted indicating that no autocorrelation between independent variables.

**Table 4.10: Durbin-Watson Test**

**Model Summary**

| R | R-Square | Adjusted R-Square | Std. Error of the Estimate | Durbin-Watson |
|---|---|---|---|---|
| .328[a] | .108 | .075 | .244023 | 1.806 |

a. Predictors: (Constant), acsize_logfee, ACFEX, FRMLEV, ACIND, ACMEET, BRDSIZE, ACSIZE, acmeet_logfee, acfex_logfee, acind_logfee

b. Dependent Variable: DTAC

### 4.3 RESULT AND FINDINGS

This study adopts multiple regression models to examine the relationships between the dependent, independent, and moderating variables. For the four regression models of fixed effect, method is run on SPSS to answer the hypotheses.

#### 4.3.1 Testing of Goodness of Fit

This section discusses the model testing of Goodness of Fit with coefficient of determination, F statistic, t-test statistic, and p-value.

##### 4.3.1.1 Testing of Determination Coefficient ($R^2$)

Table 4.11 presents the results for testing of determination coefficient ($R^2$). The adjusted R-Square of 0.082 (8.2%) indicates the level of variation in discretionary accrual accounted for by independent variables of corporate governance mechanisms. The adjusted R-square signifies that 8.2% of changes in the value of discretionary accruals is as a result of the combined effects of corporate governance mechanisms (audit committee independence, audit committee size, audit committee financial expertise, audit committee meetings), while variables outside the model caused the remaining 91.8%.

**Table 4. 11 Coefficient ($R^2$)**

**Model Summary**

| | R | R-Square | Adjusted R-Square | Std. Error of the Estimate |
|---|---|---|---|---|
| | .320[a] | .102 | .082 | .242971 |

a. Predictors: (Constant), FRMLEV, ACFEX, ACMEET, ACIND, BRDSIZE, ACSIZE

#### 4.3.1.2 Testing of F Significance

Table 4.12 presents the results for testing of F Significance. Based on the table, it can be seen that the calculated value of F is 5.165. Meanwhile, the F table value at df 1= 6 and df 2 = 272 is 2.405 at a probability level of 0.05. The result of F calculated (5.165) > F table (2.405) is high.

**Table 4.12 F Significance**

**ANOVA[a]**

| | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|
| Regression | 1.829 | 6 | .305 | 5.165 | .000[b] |
| Residual | 16.057 | 272 | .059 | | |
| Total | 17.887 | 278 | | | |

a. Dependent Variable: DTAC

b. Predictors: (Constant), FRMLEV, ACFEX, ACMEET, ACIND, BRDSIZE, ACSIZE

#### 4.3.1.3 Testing of t Statistic and (p-value)

The result of regression on the relationship between corporate governance and discretionary accruals using panel data fixed effect method with SPSS is shown in Table 4.13 to answer Hypothesis (H1a, H1b, H1c, H1d, H1e, and H1f).

Equation:

***H1a:*** $DTAC_{i,t} = \alpha_0 + \alpha_1 ACIND + \varepsilon$

***H1b:*** $DTAC_{i,t} = \alpha_0 + \alpha_2 ACFEX + \varepsilon$

***H1c:*** $DTAC_{i,t} = \alpha_0 + \alpha_3 ACMEET + \varepsilon$

***H1d:*** $DTAC_{i,t} = \alpha_0 + \alpha_4 ACSIZE + \varepsilon$

***H1e:*** $DTAC_{i,t} = \alpha_0 + \alpha_1 ACSIZE + \alpha_2 ACFEX + \alpha_3 ACMEET + \alpha_4 ACSIZE + \varepsilon$

***H1f:*** $DTAC_{i,t} = \alpha_0 + \alpha_1 ACSIZE + \alpha_2 ACFEX + \alpha_3 ACMEET + \alpha_4 ACSIZE + \alpha_5 BRDSIZE + \alpha_6 FRMLEV + \varepsilon$



**Table 4.13 Testing of t Statistic**

**Coefficients**

| | Unstandardised Coefficients | | Standardised Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | .113 | .102 | | 1.112 | .267 |
| ACIND | -.006 | .028 | -.020 | -.230 | .819 |
| ACFEX | .017 | .018 | .057 | .935 | .351 |
| ACMEET | -.029 | .013 | -.146 | -2.345 | .020** |
| ACSIZE | -.007 | .037 | -.016 | -.189 | .850 |
| BRDSIZE | -.014 | .008 | -.135 | -1.805 | .072 |
| FRMLEV | -.002 | .001 | -.153 | -2.518 | .012** |

Adjusted R-Square 8.2

a. Dependent Variable: DTAC
* Significant at 0.10 (one-tailed)
** Significant at 0.05 (one-tailed)
*** Significant 0.01 (one-tailed)

***DTAC*** $_{i,t}$ = *discretionary accruals* Modified at the firm in year t

***ACIND*** $_{1,t}$ = the ratio of independent AC members at the firm i in year t.

***ACFEX*** $_{1,t}$ = Total number of AC members with financial and accounting Background

***ACMEET*** $_{1,t}$ = the yearly number of AC meetings at the firm i in year t

***ACSIZE*** $_{1,t}$ = the total number of members on the AC at company i in year t

***BRDSIZE*** $_{1,t}$ = the number of directors on the board at the firm in year t

***FRMLEV*** $_{1,t}$ = Total long-term debt divided by total assets at the firm in year t

**ε** = Error

The results of the unstandardized coefficient positive value is 0.113 and Discretionary Accruals (EM) being worth 11.3% if audit committee independence, audit committee size, audit committee financial expertise, and the number of audit committee meetings is equal to zero.



Table 4.13 shows that the beta coefficient of ACIND (-0.020) is negative in its direction, which indicates that audit committee independent has an adverse effect on discretionary accruals. The beta value of ACFEX (-0.057) is also negative, indicating that the audit committee's financial expertise has a positive effect on discretionary accruals. The beta value for ACMEET (-0.146) is also negative, suggesting that the number of audit committee meetings has an adverse effect on discretionary accruals. In line with *a priori* expectation, the beta value of ACSIZE is negative (-0.016), which confirms that audit committee size has a negative effect on discretionary accruals.

### 4.3.2 Results of Hypothesis Testing

#### 4.3.2.1 Audit Committee Independence & Discretionary Accruals

Table 4.13 shows the result for t-value is -0.230 and value of significance is 0.819 > 0.05.

This finding is corroborated by previous studies (Baxter & Cotter,2009; Bedard et al., 2004; Benkel et al., 2006; Bradbury et al., 2006; Habbash, 2010; Klein, 2002; Saliman & Raga., 2014) can be useful to constrain EM practices. Nevertheless, these results are not in line with other prior studies (e.g., Rahman & Ali, 2006) which found indications that EM may be negatively related. This finding might be affected through various EM types.

*H1a: Not Supported*

#### 4.3.2.2 Audit Committee Financial Expertise & Discretionary Accruals

Table 4.13 shows t value is 0.935 and value of significance is 0.351 > 0.05. This finding is in line with previous studies (such as Baxter & Cotter, 2009; Carcello et al., 2000; Habbash, 2010; Lo et al., 2010; Nelson & Devi, 2013) which document that the financial expertise of the audit committee is effective in curbing EM activity. However, it also contradicts the findings of Habbash et al. (2013) and Rahman & Ali (2006) where no negative ACFEX and EM was found.

*H1b: Not Supported*

#### 4.3.2.3 Audit Committee Meeting

Table 4.13 shows t-value = -2.345 and value of significance is 0.020<0.05. That means is positive. This finding might support the proposition that audit committee meeting numbers extensively reduce EM.

*H1c:  Supported*

#### 4.3.2.4 ACSIZE & Discretionary Accruals

According to the fourth hypothesis H1d in Table 4.13 the result shows t-value = -0.189 and value of significance is 0.850 > 0.05. This finding is similar to Sharma & Kuang's (2014) study. Other studies found that the audit committee's larger size does not considerably reduce EM. However, since any relationship with statistical significance is absent, the coefficient has taken negative directional sign. The result is similar to a vast majority of studies (e.g., Habbash, 2010; Alkadi et al., 2012; Habbash et al., 2013) that did not discover a major impact on the size of the audit committee on EM. This Finding found the proposition that the audit committees' larger size does not reduce EM considerably.

*H1d: Not Supported*

### 4.3.3 The Moderating of Audit Quality

This research investigates the impact of audit quality as moderating variable is the interaction variable between X1 (Audit Committee) and X2 (Audit Quality). The interaction is then considered Predictors of Y (Financial Reporting Quality (EM)) (Baron & Kenny, 1986). The audit quality is proposed as moderating variable. Two factors could explain this argument. Many studies report that the relationship AC and FRQ emerging market is significant. Several studies suggest that audit quality's effectiveness on corporate governance to influence EM is negative (Gonzalez & Garcia-Meca, 2014). Increased audit quality shows an increase in the quality and transparency of financial information issued by companies. This study uses interaction as a moderating variable and uses Moderated Regression Analysis (MRA). MRA is a special application of multiple linear regression where the regression equation contains elements of interaction (multiplication of two or more independent variables).

#### 4.3.3.1 Testing of Goodness of Fit

Table 4.14 shows an adjusted R-square of 0.075 or 7.5%. This result indicates the moderating audit quality mechanisms with discretionary accrual. It means that 7.5% of the changes that occur in discretionary accrual are because of the corporate governance mechanism (audit committee independence, audit committee financial expertise, audit committee size, audit committee meetings) and audit quality (audit fees).

Testing of Coefficient of Determination ($R^2$)

**Table 4.14 Coefficient ($R^2$)**

**Model Summary**

| | R | R-Square | Adjusted R-Square | Std. Error of the Estimate |
|---|---|---|---|---|
| | .328[a] | .108 | .075 | .244023 |

a. Predictors: (Constant), acsize_logfee, ACFEX, FRMLEV, ACIND, ACMEET, BRDSIZE, ACSIZE, acmeet_logfee, acfex_logfee, acind_logfee

#### 4.3.3.2 Testing of F Significance

Table 4.15 shows the value of F Significance is 3.238 and F table on the level df 1=10 and df 2=268 is 1.825. The result for F table 3.238 ≥ 1.825 means hypothesis is accepted. F count (3.238) > F table (2.132), the regression equation on The Moderating (EM: Discretionary Accruals)

**Table 4.15 F Significance**

**ANOVA[a]**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 1.928 | 10 | .193 | 3.238 | .001[b] |
| | Residual | 15.959 | 268 | .060 | | |
| | Total | 17.887 | 278 | | | |

a. Dependent Variable: DTAC

b. Predictors: (Constant), acsize_logfee, ACFEX, FRMLEV, ACIND, ACMEET, BRDSIZE, ACSIZE, acmeet_logfee, acfex_logfee, acind_logfee

#### 4.3.3.3 Testing of t statistics and P-Value

The regression to the moderating of audit quality. Using the panel data fixed effect method with SPSS, Table 4.16 presents the result of testing hypothesis H1g. In a model of regression, this study adds corporate governance and audit quality as an interaction term. This allows for testing whether disclosure quality decreases earnings management practices.

Equation:

$$\textbf{H1g:}\quad DTAC_{i,t} = \alpha_0 + \alpha_1 ACSIZE + \alpha_2 ACFEX + \alpha_3 ACMEET + \alpha_4 ACSIZE + \alpha_5 BRDSIZE + \alpha_6 FRMSIZE + \alpha_7 LOGFEE + a_8 (ACIND * LOGFEE) + a_9 (ACFEX * LOGFEE) + a_{10} (ACMEET * LOGFEE) + a_{11} (ACSIZE * LOGFEE) + \varepsilon$$

**Table 4.16 Testing of t statistics and P-Value**

**Coefficients**

| | | Unstandardised Coefficients | | Standardised Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | | .102 | .111 | .916 | .361 |
| | ACIND | -.012 | .033 | -.038 | -.378 | .706 |
| | ACFEX | .008 | .021 | .026 | .363 | .717 |
| | ACMEET | -.023 | .015 | -.112 | -1.493 | .137 |
| | ACSIZE | -.006 | .042 | -.013 | -.140 | .888 |
| | BRDSIZE | -.013 | .008 | -.124 | -1.611 | .108 |
| | FRMLEV | -.003 | .001 | -.158 | -2.532 | .012** |
| | acind_logfee | 3.285E-8 | .000 | .138 | .323 | .747 |
| | acfex_logfee | 6.283E-8 | .000 | .208 | .707 | .480 |
| | acmeet_logfee | -2.076E-8 | .000 | -.177 | -.689 | .492 |
| | acsize_logfee | -3.231E-8 | .000 | -.167 | -.245 | .806 |
| | Adjusted R-Square | | | 7.5 | | |

* Significant at 0.10 (one-tailed)
** Significant at 0.05 (one-tailed)
*** Significant 0.01 (one-tailed)
a. Dependent Variable: DTAC

This can be interpreted that the accrual will be worth 10.2%. The beta results of the unstandardized coefficient is 0.102 (positive value), if audit committee independence, audit committee financial expertise, audit committee size, audit committee meeting, board size, and firm leverage valuable are equal to zero. The hypothesis shows t-value is -0.378 is less than t = 1.972 and value of significance is 0.706 > 0.05. The finding is consistent with previous studies done by Klein (2002); Davidson et al. (2005); Saleh et al. (2007); and Salleh & Haat (2014).

*H1a: Not Supported*

Since the t-value of 0.363 is less than the t-value in the table (1.972), and there is a significance value of 0.717 (> 0.05), Hypothesis H1b of the study is negative. It may be concluded that the audit committee's financial expertise has no effect on earnings management. Hypothesis H1b predicts a negative relationship between the financial expertise of the audit committee and EM. The result shows a negative and significant connection between the financial expertise of the audit committee and lower discretionary accruals. Thus, H1b is also supported. This finding is in line with previous studies which found that the financial expertise of audit committee is effective in curbing EM activity (e.g., Baxtor & Cotter, 2009; Habbash, 2010; Lo et al., 2010; and Nelson & Devi, 2013). This finding might be affected through various EM types or the small samples size.

*H1b: Not Supported*

Hypothesis H1c of the study is negative, in the case of audit committee size, the t-value is -1.493, which is less than t = 1.972 at a significance value of 0.137 (> 0.05). H1c states that a negative correlation exists between audit committee size and EM. This finding is similar to Sharma & Kuang (2014). Other studies found that audit committee size did not considerably reduce EM. However, even if any relationship with statistical significance is absent, the coefficient has taken a negative directional sign. The finding is similar to the vast of majority of studies which could not discover a major ACSIZE (e.g., Baxtor & Cotter, 2009; Bedard et al., 2004; Habbash, 2010; Alkadi et al., 2012; and Habbash et al., 2013). This finding found the proposition that the audit committees' larger size does not reduce EM considerably.

*H1c: Not Supported*

Hypothesis H1d for ACMEET shows t-value is -0.140 is lower than t = 1.972 and value of significance is 0.888 > 0.05. While there is no relationship which is statistically significant, the directional sign is detected as negative. This is similar to findings by Rahman & Ali (2006), Baxtor & Cotter (2009), and Habbash (2010). This finding might support the proposition that audit committee numbers does do not extensively reduce EM.

*H1d: Not Supported*

### 4.3.4 Controlled Variables (CV): Board Size, Firm Leverage

Table 4.17 presents the results of the regression model for control variables of all the control variables. The significance value of board size is 0.108 (> 0.05). This indicates that the effect of board size on is not significant. Firm leverage is significant at 0.012 (< 0.05) and indicates that the control variable has a significant.

**Table 4.17 Model Summary**

**Model Summary**

| Model | R | R-Square | Adjusted R-Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .320[a] | .102 | .082 | .242971 |

a. Predictors: (Constant), FRMLEV, ACFEX, ACMEET, ACIND, BRDSIZE, ACSIZE



Table 4.17 shows that the value of $R^2$ (R-Square) of 0.102 or (10.2%) shows that the percentage contribution of the impact of relationship between audit committee and quality of Financial Reporting (EM: Discretionary Accruals) is 10.2%. While the remaining 89.8% (100-10.2= 89.8) and the audit committee of 8.2% of the variation in the dependent variable of the relationship between the audit quality and quality of financial reporting (EM: Discretionary Accruals).

Based on Table 4.18, the $R^2$ value of 0.108 (or 10.8%) shows that the percentage contribution of the moderating of audit quality on AC and FRQ is 10.8%. The remaining is 89.2% and the audit committee of 7.5% of the variation in the dependent variable of relationship between the audit quality and FRQ.

**Table 4.18 Model Summary**

| Model | R | R-Square | Adjusted R-Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .328[a] | .108 | .075 | .244023 |

a. Predictors: (Constant), acsize_logfee, ACFEX, FRMLEV, ACIND, ACMEET, BRDSIZE, ACSIZE, acmeet_logfee, acfex_logfee, acind_logfee



## 4.4 Conclusion

The result before moderate from Model Summary of the Impact of Relationship between the audit committee and quality of financial reporting (EM: Discretionary Accruals) for R-Square is 10.2% and the impact on the moderating impact of audit quality on the relationship audit committee and quality of financial reporting (EM: Discretionary Accruals) is 10.8%. The result showed no support for the hypothesis, but the value for R-Square recorded a moderate increase 0.06%.

# CHAPTER FIVE: DISCUSSION AND CONCLUSIONS

## 5.1 Introduction

This chapter concludes the research. It begins by presenting a concise summary of the research results. This is followed by discussing the findings and implications. After this, the research draws to a close by detailing the research limitations before offering recommendations for future research.

## 5.2 Overview and Summary of Findings

The hypotheses and main findings of the statistical analysis are presented in Table 5.1 Audit quality has a moderating AC and FRQ (EM-discretionary accruals) in Malaysia. Having tested the hypothesised relationships in the context of a developing country like Malaysia, this research has helped create a more inclusive global picture of the relationship between the audit committee and FRQ. Thus, this study provides a valid starting point in examining the moderating effect of audit quality on the relationship between the audit committee and quality of financial reporting. The focus on moderating effects showed that one out of four hypotheses tested in the study are statistically significant with respect to audit quality.



The First objective of study has designed to identify the level of audit quality in the Malaysian companies, found positive and significant. Previously studies argue that there is positive and significant. An increase in frequency is an indication that the committee is more efficient and committed to producing quality performance (Menon, 1994; Abbort, 2000; DeZoort, 2002; Lee & Mande, 2005; Stewart, 2007).

The second objective of study has designed to examine relationship between audit committee and FRQ. Audit committee meeting and firm leverage found positive and significant. Previous research deemed the frequency meetings of audit committee like a signal of the diligent extent practiced through the members of audit committee (Klien 2000; Habbash 2010; Habbash et al.2013). Firm leverage, former studies documented that highly leveraged company managers have strong incentives to employ income-increasing accruals to slacken the contractual debt-constraints (Ali, Salleh,& Hassan, 2008; Alves, 2012).

The third objective of study examine the moderating of audit quality, postulates insignificant. These finding are consistent with previous finding of studies. The literature argues that larger and more well-known international auditing firms act as sources of inspiration for companies to disclose more financial instrument risk information to maintain the audit firm's reputation and to avoid unnecessary reputation cost (Chalmers & Godfrey, 2004).



The sample chosen in this research relied on predetermined criteria. Investigating a sample of trading companies in Bursa Malaysia did introduce an inveterate bias and probably induced an inexact relationship arising from the sample design.

**Table 5.1 Summary of Research Hypotheses and Findings**

| Objectives | No. | Hypothesis | Findings |
|---|---|---|---|
| To examine the level of audit quality in the Malaysian companies? | H1a | ***DTAC i,t = α 0 + α1 ACIND + ε*** | H1a: Not Supported |
| | H1b | ***DTAC i,t = α 0 + α2 ACFEX + ε*** | H1b: Not Supported |
| | H1c | ***DTAC i,t = α 0 + α3 ACMEET + ε*** | H1c: Supported and Significant ** Significant at 0.05 (one-tailed) |
| | H1d | ***DTAC i,t = α 0 + α4 ACSIZE + ε*** | H1d: Not Supported |
| | H1e: | ***DTAC i, = t α 0 + α1 ACSIZE + α2 ACFEX + α3 ACMEET + α4 ACSIZE + ε*** | H1e: ACMEET ** Significant at 0.05 (one-tailed) |
| To examine relationship between audit committee and FRQ | H1f | ***DTAC i,t = α 0 + α1 ACSIZE + α2 ACFEX + α3 ACMEET + α4 ACSIZE + α5 BRDSIZE + α6 FRMLEV + ε*** | H1f: ACMEET and FRMLEV ** Significant at 0.05 (one-tailed) |
| To examine the moderating of Audit Quality on AC and FRQ (Earning Management). | H1g | ***DTAC i,t = α 0 + α1 ACSIZE + α2 ACFEX + α3 ACMEET + α4 ACSIZE + α5 BRDSIZE + α6 FRMSIZE + α7 LOGFEE + a8 (ACIND * LOGFEE) + a9 (ACFEX * LOGFEE) + a10 (ACMEET * LOGFEE) + a11 (ACSIZE * LOGFEE)*** + ε | H1g: Not Supported |

## 5.3 Limitations of the Study

This study uses cross-sectional data from the financial years 2013, 2014, and 2015. Even though this study employs theoretical perspectives in a systematic way under vigilant supervision, there are several possible limitations. The main limitation identified in this study concerns the data. This study gathered only the data from trading companies listed on Bursa Malaysia that have all the 3-year period under investigation. This also means, the data covers only the non-financial companies.

## 5.4 Theoretical and Practical Implications of the Study

In the context of financial reporting in Malaysia, only a few studies have examined the effect of corporate governance on EM; examples of this are Hashim & Devi (2008), Rahman & Ali (2006), Ali, Salleh, & Hassan (2010), and Sohail Ahmed (2014). To the researcher's knowledge, no study with Malaysian samples has directly tested the moderating audit quality on the AC and FRQ. Also, this study extends existing literature by examining the extended and modified Jones' model of Yoon, Miller, and Jiraporn (2006). The second measurement of discretionary accruals (DA) has not been examined before with a Malaysian sample. It also uses the extended, modified Jones' model of Kasznik (1999) as the first measurement to estimate DA as a dependent variable. Yoon et al. (2006) and Islam, Ali and Ahmad (2011) suggest that the extended, modified Jones' model is more robust than the modified Jones model for Asian countries. The current study pertains to theories with regards to the influence of audit committee on FRQ.

This study is expected to help regulators better understand earnings management (EM) in Malaysian companies. It contributes to the field of accounting research in a different environment. This study may help them reconsider and review the accounting standards across different sectors and to develop more effective techniques for quality financial reporting for Malaysian listed companies to enhance the credibility of financial reports.

## 5.5 Directions for Future Research

Since this study only uses secondary data as its main source, it focuses only on trading companies; future research should seek to explore all types of listed businesses in Malaysia, including banking. Primary data may also be gathered to obtain more authentic information from auditors and other respondents. Further, research can be conducted by using earnings management as a mediating variable between corporate governance and FRQ. Future research can also be performed on the audit quality in a different setting through replication of the current study for validity and reliability purposes.

## 5.6 Conclusion

When these findings are made available to regulators, it will help them identify and formulate effective mechanisms of corporate governance as well as to evaluate the requirements of disclosure. The primary purpose of this study has been to investigate the moderating effect of audit quality (audit fee) on the relationship between the audit committee and quality of financial reporting among listed firms in Malaysia. The study was conducted on a sample of 279 listed trading companies in Malaysia for the period from 2013 to 2015. Having tested the hypothesised relationships like Malaysia, this research has helped create a more inclusive global picture of the relationship between the AC and FRQ. The focus on moderating effects showed that one out of four hypotheses tested in the study are statistically significant with respect to audit quality. (Please refer Appendix 3)

Based on analysed data from audit committee independence, audit committee financial expertise, audit committee meeting and audit committee size, the result shows the relationship between audit committee financial expertise and earning management is influenced by the level of the audit fee.

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**Appendix 1: MCCG (2012) Part C Audit Committee's Effectiveness**

***15.09 Composition of the audit committee***

*1. A listed issuer must appoint an audit committee from among its directors who fulfil the following requirements:*

*a. The audit committee must be composed of not fewer than three members;*

*b. All the audit committee members must be non-executive directors, with a majority of them being independent directors; and*

*c. At least one member of the audit committee -*

*i. Must be a member of the Malaysian Institute of Accountants; or*

*ii. If he is not a member of the Malaysian Institute of Accountants, he must have at least three years' working experience and -*

*aa. He must have passed the examinations specified in Part I of the First Schedule of the Accountants Act 1967; or*

*bb. He must be a member of one of the associations of accountants specified in Part II of the First Schedule of the Accountants Act 1967; or*

*iii. Fulfils such other requirements as prescribed or approved by the Exchange.*

*2. A listed issuer must ensure that no alternate director is appointed as a member of the audit committee.*

*[Cross reference: Practice Note 13]*

***15.10 Chairman of the audit committee***

*The members of an audit committee must elect a chairperson among themselves who is an independent director.*

**Appendix 2: Models to Detect Earning Management**

**Healy's Model**

Healy (1985) was the first to examine earnings management premises by using what is called Healy discretional accrual. Healy found that accrual policy can shift the accounting policies of the coming period to the current period under certain conditions.

Healy's formula of accrual policies is as follows:

**Tact = NDACt + DACt**

**where**

**Tact = Total operating accruals in year t,**

**NDACt = Non-discretionary accruals in year t, and**

**DACt = discretionary accruals in year t**

The second component was not observed with careful accrual, so Healy assumes that nondiscretionary accrual is zero.

**DeAngelo's Model**

In this model, DeAngelo (1986) assumes that non-discretionary accruals follow a random walk pattern. It uses accrual changes aggregate of the year t-1 to year t as an optional component. Thus,

***EDACit = TACt-1 / TAit-1***

***where***

***EDACit = Estimated discretionary accruals for firm i in year t,***

***TACt-1 = Total accrual companies in year t,***

***TAit-1 = Total assets of the company i at the beginning of the year t.***

Similar to the Healy's model, a source of measurement error in the model is the omitted variables that affect the accruals in the current year. However, this model is expected to reduce the measurement error of the Healy model if non-discretionary accruals follow a random walk.

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**Jones' Model**

Jones (1991) uses regression models to estimate the type of discretionary accruals. He applies the non-discretionary accruals model estimation by using the regression formula:

**Tacit/Ait-1 = AI1 (1 / Ait-1) + BI1 (DREVit / -Ait 1) + Bi2 (PPEit / Ait-1) + eit**

**where**

**Tacit = Total Accruals for firm i in year t,**

**Ait-1 = Total assets of the company i at the beginning of the year t,**

**Changes in the company's revenue DREVit = i from year t-1 to year t, and**

**PPEit = Gross property, plant, and equipment for firm i in year t.**

All variables are reduced by first i total assets to adjust heteroscedasticity. Regression is thus discretionary accruals:

**EDACit = Tacit/Ait-1-[AI1 (1/Ait-1) +BI1 (DREVit/Ait-1) +Bi2 (PPEit/Ait-1)]**

Where the coefficients used were those expected from the past least squares regression. Sources of measurement error in the model are derived from omitted variable is not captured by the sale and the level of Property, Plant and Equipment (PPE) such as changes in the credit standing of the client.

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**Modified Jones' Model**

Dechow et al. (1995) recommended an amended version of the model that supports a reduction or changes in receivables from revenue to account for the manipulation of non-cash income during the period. In a previous study testing, the modified Jones model exhibited the highest power and specifications. It is one with at least a measurement error when manipulation occurs through receivables (non-cash income).

**EDACit = Tacit/Ait-1-[AI1 (1/Ait-1) +BI1 ((DREVit-Darit)/Ait-1) +Bi2 (PPEit/ Ait-1)]**

**where**

**EDACit = Estimated discretionary accruals for firm i in year t,**

**Tacit = Total Accruals for firm i in year t,**

**Ait-1 = Total assets of the company i at the beginning of the year t,**

**DREVit = Changes in company earnings i from year t-1 to year t,**

**Darit = Changes in receivables i from year t-1 to year t, and**

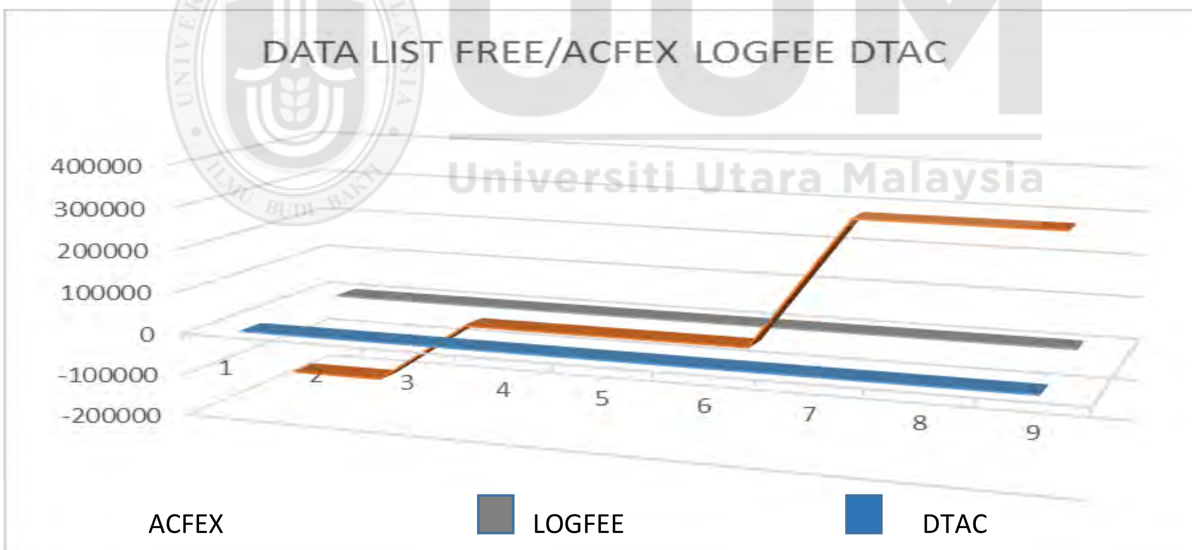
**PPEit = Gross property, plant, and equipment for firm i in year t.**

**Appendix 3: Data List Free/ACFEX LOGFEE DTAC**

The relationship between ACFEX and earnings management is influenced by the level of the audit fee.

Earning = α0 + ACFEX + LOGFEE + (ACFEX * LOGFEE) + *ε*

| Value | | | Percentage | | |
|---|---|---|---|---|---|
| -0.8673 | -151235 | -0.2046 | -86.73 | -1.5E+07 | -20.46 |
| 0 | -151235 | -0.2119 | 0 | -1.5E+07 | -21.19 |
| 0.8673 | 0.8673 | -0.2192 | 86.73 | 86.73 | -21.92 |
| -0.8673 | 0 | -0.2455 | -86.73 | 0 | -24.55 |
| 0 | 0 | -0.2334 | 0 | 0 | -23.34 |
| 0.8673 | 0 | -0.2213 | 86.73 | 0 | -22.13 |
| -0.8673 | 310982.4 | -0.3298 | -86.73 | 31098237 | -32.98 |
| 0 | 310982.4 | -0.2776 | 0 | 31098237 | -27.76 |
| 0.8673 | 310982.4 | -0.2255 | 86.73 | 31098237 | -22.55 |






Based on analysed data from audit committee independence, audit committee financial expertise, audit committee meeting and audit committee size, the result shows the relationship between audit committee financial expertise and earning management is influenced by the level of the audit fee.

**Appendix 4: List of Companies in the Table (2013-2015)**

| NO | COMPANY |
|---|---|
| 1. | AIRASIA BERHAD |
| 2. | AIRASIA X BERHAD |
| 3. | ALAM MARITIM RESOURCES BERHAD |
| 4. | ASTRO MALAYSIA HOLDINGS BERHAD |
| 5. | ATLAN HOLDINGS BHD. |
| 6. | AXIATA GROUP BERHAD |
| 7. | BERJAYA CORPORATION BERHAD |
| 8. | BERJAYA LAND BERHAD |
| 9. | BERJAYA MEDIA BERHAD |
| 10. | BERJAYA SPORTS TOTO BERHAD |
| 11. | BINTAI KINDEN CORPORATION BERHAD |
| 12. | BINTULU PORT HOLDINGS BERHAD |
| 13. | BOUSTEAD HOLDINGS BERHAD |
| 14. | BRAHIM'S HOLDINGS BERHAD |
| 15. | BUMI ARMADA BERHAD |
| 16. | CHEETAH HOLDINGS BERHAD |
| 17. | COMPUGATES HOLDINGS BERHAD |
| 18. | CYPARK RESOURCES BERHAD |
| 19. | DAYANG ENTERPRISE HOLDINGS BERHAD |
| 20. | DELEUM BERHAD |
| 21. | DKSH HOLDINGS (MALAYSIA) BERHAD |
| 22. | EDARAN BERHAD |
| 23. | EDEN INC. BERHAD |
| 24. | EITA RESOURCES BERHAD |
| 25. | ENGTEX GROUP BERHAD |
| 26. | FIAMMA HOLDINGS BERHAD |

| | |
|---|---|
| 27. | FITTERS DIVERSIFIED BERHAD |
| 28. | FREIGHT MANAGEMENT HOLDINGS BERHAD |
| 29. | FRONTKEN CORPORATION BERHAD |
| 30. | GD EXPRESS CARRIER BERHAD |
| 31. | GENTING BERHAD |
| 32. | GEORGE KENT (MALAYSIA) BERHAD |
| 33. | HAI-O ENTERPRISE BERHAD |
| 34. | HARRISONS HOLDINGS (MALAYSIA) BERHAD |
| 35. | IHH HEALTHCARE BERHAD |
| 36. | IPMUDA BERHAD |
| 37. | KEJURUTERAAN SAMUDRA TIMUR BERHAD |
| 38. | KPJ HEALTHCARE BERHAD |
| 39. | KUB MALAYSIA BERHAD |
| 40. | KUMPULAN FIMA BERHAD |
| 41. | KUMPULAN PERANGSANG SELANGOR BERHAD |
| 42. | MAGNUM BERHAD |
| 43. | MALAYSIA AIRPORTS HOLDINGS BERHAD |
| 44. | MALAYSIAN BULK CARRIERS BERHAD |
| 45. | MAXIS BERHAD |
| 46. | MBM RESOURCES BHD |
| 47. | MEDIA PRIMA BERHAD |
| 48. | MEGA FIRST CORPORATION BERHAD |
| 49. | MISC BERHAD |
| 50. | MMC CORPORATION BERHAD |
| 51. | M-MODE BERHAD |
| 52. | MULPHA INTERNATIONAL BERHAD |
| 53. | NAIM INDAH CORPORATION BERHAD |
| 54. | NATIONWIDE EXPRESS COURIER SERVICES BERHAD |
| 55. | OCK GROUP BERHAD |

| | |
|---|---|
| 56. | PANSAR BERHAD |
| 57. | PANTECH GROUP HOLDINGS BERHAD |
| 58. | PARKSON HOLDINGS BERHAD |
| 59. | PBA HOLDINGS BHD |
| 60. | PDZ HOLDINGS BHD |
| 61. | PERAK CORPORATION BERHAD |
| 62. | PERDANA PETROLEUM BERHAD |
| 63. | PERISAI PETROLEUM TEKNOLOGI BHD |
| 64. | PETRA ENERGY BERHAD |
| 65. | PETRONAS DAGANGAN BHD |
| 66. | PHARMANIAGA BERHAD |
| 67. | POS MALAYSIA BERHAD |
| 68. | PRESTARIANG BERHAD |
| 69. | PROGRESSIVE IMPACT CORPORATION BERHAD |
| 70. | RELIANCE PACIFIC BERHAD |
| 71. | SALCON BERHAD |
| 72. | SAPURAKENCANA PETROLEUM BERHAD |
| 73. | SCOMI ENERGY SERVICES BHD |
| 74. | SCOMI GROUP BERHAD |
| 75. | SEE HUP CONSOLIDATED BERHAD |
| 76. | SEG INTERNATIONAL BHD |
| 77. | SHIN YANG SHIPPING CORPORATION BERHAD |
| 78. | SIME DARBY BERHAD |
| 79. | SUIWAH CORPORATION BERHAD |
| 80. | SUMATEC RESOURCES BERHAD |
| 81. | SURIA CAPITAL HOLDINGS BERHAD |
| 82. | TALIWORKS CORPORATION BERHAD |
| 83. | TELEKOM MALAYSIA BERHAD |
| 84. | TENAGA NASIONAL BHD |

| | |
|---|---|
| 85. | TH HEAVY ENGINEERING BERHAD |
| 86. | TIONG NAM LOGISTICS HOLDINGS BERHAD |
| 87. | TMC LIFE SCIENCES BERHAD |
| 88. | UMS HOLDINGS BERHAD |
| 89. | UMW OIL & GAS CORPORATION BERHAD |
| 90. | UNIMECH GROUP BERHAD |
| 91. | UTUSAN MELAYU (MALAYSIA) BERHAD |
| 92. | VOIR HOLDINGS BERHAD |
| 93. | WESTPORTS HOLDINGS BERHAD |

**APPENDIX 5: SUMMARY OF STUDY RELATING TO THE MODERATING EFFECT OF AUDIT QUALITY ON AUDIT COMMITTEE AND FINANCIAL REPORTING QUALITY IN MALAYSIA.**

| Article | Introduction/ Background | Issue | Theory/Variable | | Method | Main Finding |
|---|---|---|---|---|---|---|
| | | | Independent | Dependent | | |
| **The Effect of Board Independence on the Earnings Quality: Evidence from Portuguese Listed Companies**<br><br>**Alves (2014)** | Agency theory suggests that independent outside board members may have an important monitoring function of the financial reporting process. As a result, boards with more independent directors have a tendency for increased monitoring and are therefore expected to insist on better earnings quality. | Examines whether board independence improves earnings quality by reducing earnings management in Portugal, a country with significantly different institutional and legal characteristics from the anglo-saxon Countries. | Board Independence | Earning Quality: Ordinary least square (OLS) and two stage least squares (2SLS) techniques; discretionary accruals using the modified Jones model | Earnings management for a sample of Portuguese listed firms:<br>Board independence and earnings quality on a sample of 33 Euronext Lisbon non-financial firms over a period of 8 years (2003 to 2010), | The findings of this study make the following contributions. First, the results indicate that, on average, independent members improve earnings quality by providing effective monitoring of earnings management in Portuguese listed firms. This result is interesting given the scrutiny of corporate governance mechanisms and the state of the financial reporting system. |
| **Audit Committee and Earnings Management: Pre and Post MCCG**<br><br>**Salleh, N., & Haat, M. (2014).** | The purpose of this study is to examine the effectiveness of audit committee in constraining earnings management after the revised MCCG among listed firms on Bursa Malaysia. | How audit committee impacted earnings management before and after the revision of MCCG in 2007. | The audit committee characteristics include size, independence, expertise, frequency of meetings and activity disclosure | The discretionary accrual was estimated using the Modified Jones Model (1995) which was used to proxy for earnings management. | The sample for this study was drawn from 280 companies listed on Bursa Malaysia in 2005, 2006, 2008 and 2009 | The empirical results on audit committees play an important and effective role in reducing earnings management after the revision of MCCG. After controlling for firm size, board size and leverage, the study found that audit committee size and audit committee that had meetings with external auditor without the presence of executive directors at least twice a year showed a significant association with earnings management. Overall, these findings called for further examination into the roles of audit committee in mitigating earnings management. |

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|---|---|---|---|---|---|---|
| **Board of Director Characteristics and Earnings Management in Malaysia**<br><br>**Sohail Ahmed. (2014).** | This paper seeks to study the relation between board of director characteristics as a corporate governance mechanism and earnings management in the Malaysian scenario. | No doubt the advent of joint-stock companies in the industrial world is one of the biggest economic Developments and probably the most important factor of industrial development. | Board of directors' characteristics includes number of meetings, existence of outside directors, financial expertise and separation of the roles of chair and CEO | Earnings management is measured by discretionary accruals and for estimating Discretionary accruals, Modified Jones Model is used. | Cross-sectional and pooled data of 71 companies listed In bursa Malaysia from 2001 to 2005<br><br>Multiple linear Regressions | The results demonstrate that financial expertise are positively related to earnings management in the Malaysian scenario. |
| **Audit Committee Composition and Auditor Reporting: A Malaysian Case.**<br><br>**Ali. R, Shuhidan. S. H, Adnan. N. L (2015)** | This study is conducted to examine the relationship between the composition of financially distressed firm's audit committees and the likelihood of receiving going-concern report in Malaysian context by examining published information for the year 2002 | In the wake of corporate failures following economic crisis, the role of audit committees as corporate governance mechanism has become more important to regulators, the accounting profession and the business community | Audit Committee Composition | Auditor Reporting Behaviour | The sample of the study involves public companies listed on Bursa Malaysia which are classified as PN4 companies for the year 2002.<br>The primary sample of this study contains 97 PN4 status companies listed on Bursa. | Consistent with [13] it is found that the lower the percentage of Affiliated directors on audit committee, the higher the tendency of receiving a going concern report. However, based on 95 percent confidence level, the relationship exist is not significant. The result of the study however inconsistent with [51] which found positive relationship between percentage of affiliated directors on audit committee and the tendency of receiving going concern report. It is This finding can imply that in the Malaysian environment, the attitude of affiliated directors is very positive and the Degree of professionalism among external auditors is very high that they could not easily influenced by the pressure given by affiliated directors in the audit committee also found in the study that majority of the company fulfilled the requirement to have at least three members in an audit committee or more. Future research to utilize latest data and using [28] financial condition index to recognize the distressed companies. |

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|---|---|---|---|---|---|---|
| **Challenges of corporate governance: Twenty years after Cadbury, ten years after Sarbanes-Oxley**<br><br>**Zalewska, A. (2014).** | This paper sets the background to the Special Issue of the Journal of Empirical Finance on Challenges of Corporate Governance. It identifies the alternative approaches that can be taken to solve agency problems stemming from asymmetries of information: (i) ex-post monitoring through audit and information provision, (ii) ex-ante monitoring through boards, and (iii) incentivisation through the alignment of managerial incentives with shareholders. | It discusses how the UK and the US have responded to corporate failures and relates the Development of regulation in these countries to the three alternative approaches. | Corporate Governance | Audit Committee | Annual Report | This is achieved through an imposition of 'strict' independence of non-executive directors, creation of various committees consisting entirely of non-executive directors or their majority, having a senior non-executive member of a board to whom all enquiries can be directed, and also That non-executive directors are at least as numerous as executive ones.<br><br>The monitoring is also conducted at higher than annual Frequency, as boards, unlike annual reports, meet several times a year. In these conditions Auditing is another supporting mechanism, rather than the main mechanism of monitoring. |
| Activating the Role of Audit Committees and Boards of Directors in Restricting Earnings Management Practices: A Perspective of Auditors in Jordan<br><br>Al Momani, A. M., & Obeidat, I. M. (2013). | Since the advent of the current century, the term of corporate governance acquired the attention of different interested groups of people such as academics, accountants, auditors, investors, and creditors. This attention was mainly attributed to the scandals of several corporations all around the world, especially in US, where large corporations such as WorldCom and Enron collapsed | The study objects for investigating the possibility of activating both audit committee and board of Directors for restricting the practices of earnings management phenomenon. | Audit Committees and Boards of Directors | Earnings Management | Questionnaire had been developed and self-administered for a selected sample consists of 123 auditors working in Jordan based on the simple random sampling method. | Earnings management phenomenon can be more restricted through activating both of audit committee and board of directors, based on the corporate governance rules. Earnings management practices can be reduced more if co-ordination and co-operation exists between audit committee and board of directors. |

| | | | | | | |
|---|---|---|---|---|---|---|
| Audit committee and earnings management: Pre and post MCCG..<br><br>Salleh, N., & Haat, M. (2014). | The purpose of this study is to examine the effectiveness of audit committee in constraining earnings management after the revised MCCG among listed firms on Bursa Malaysia. Specifically, the study explores how audit committee impacted earnings management before and after the revision of MCCG in 2007. | How audit committee impacted earnings management before and after the revision of MCCG in 2007. | The audit committee characteristics include size, independence, expertise, frequency of meetings and activity disclosure | The discretionary accrual was estimated using the Modified Jones Model (1995) which was used to proxy for earnings management. | The sample for this study was drawn from 280 companies listed on Bursa Malaysia in 2005, 2006, 2008 and 2009<br><br>The discretionary accrual was estimated using the Modified Jones Model (1995) which was used to proxy for earnings management. | The empirical results on audit committees play an important and effective role in reducing earnings management after the revision of MCCG. After controlling for firm size, board size and leverage, the study found that audit committee size and audit committee that had meetings with external auditor without the presence of executive directors at least twice a year showed a significant association with earnings management. Overall, these findings called for further examination into the roles of audit committee in mitigating earnings management. |
| Audit Committee Effectiveness, Audit Quality and Earning Management: An Empirical Study of the Listed Companies in 5(2), 155-166.<br><br>Soliman, M. M., & Ragab, A. A. (2014). | The role of audit committees and audit quality in ensuring the quality of corporate financial reporting has come under considerable scrutiny due to recent high-profile earnings management cases in the world | The purpose of this paper is to examine the association between the audit committee effectiveness, audit quality and earnings management practices of more active 50 Egyptian companies listed on the Egyptian Stock Exchange of the non-financial sector during the period 2007-2010. | Audit committees independence | Earning Management | The Egyptian companies from amongst the top 50 most active-traded companies listed in the Egyptian Stock Exchange over the period 2007-2010.<br><br>Financial companies; e.g. Banks, insurance companies, and leasing companies; were excluded from the sample due to the different requirements of disclosure and corporate governance. | After controlling for size, leverage and cash flow from operation activities, the results of univariate and multivariate analyses indicated that audit committees independence; experience of audit committee members; audit committee meetings; and audit quality have significant negative association with discretionary accruals as a proxy for earnings management. On the other hand, no significant relationship is found between audit committees size and the level of discretionary accruals. This paper is important because it offers useful information that is of great value to policy makers, academics and other stakeholders. |
| The Effectiveness of Monitoring Mechanisms for Constraining Earnings Management: A Literature Survey for a Conceptual Framework | This paper proposes a conceptual framework to investigate the role of regulatory mechanisms concentrating on corporate governance and external audit for mitigating earnings | The main issue involves manipulation of accounting data which lose investor confidence and | Corporate governance<br>And external audit attributes | Earnings management | A Literature Survey for a Conceptual Framework | Earnings management area has gained considerable attention in the accounting literature after large global corporate and financial collapse. Particularly, these scandals reduce investor confidence and trust in the financial reports. Therefore, |

| | | | | | | |
|---|---|---|---|---|---|---|
| Faiza Saleem, Mohd Norfian Alifiah, Muhammad Sohail Tahir (2016) | management. Evidence from previous studies supports the proposed model. Hence, the extant study argues that firms with effective monitoring mechanisms in the form of corporate governance and external audit are less likely to allow earnings management because opportunistic earning's cause uncertainty about the economic value of a firm | trust in the financial reports. | | | | corporate governance and external audit as controlling mechanisms play an important role for improving the quality of financial reporting process. Previous studies suggested that boards of directors with smaller size, having more independent directors and high frequency of meetings are effective in their monitoring role. Specifically, this paper intends to investigate the role of monitoring mechanisms by proposing a conceptual framework in line with previous research. More significantly, this study proposed prominent factors to overcome the earnings management issues. |
| Directors' Independence, Internal Audit Function, Ownership Concentration and Earnings Quality in Malaysia<br><br>Ahmed Hussein Al-Rassas, Hasnah Kamardin (2015) | Concentration of ownership in Malaysian public listed companies contributes to agency conflict between majority and minority shareholders. An effective monitoring mechanism is critical to mitigate this conflict | The study aims to examine the influence of board and audit committee independence, internal audit function and ownership concentration on earnings quality proxies by discretionary accruals. | Directors' Independence, Internal Audit Function, Ownership Concentration | Earnings Quality | The sample of the study 508 companies listed on the Bursa Malaysia Main Market from 2009 to 2012.<br><br>Two measures of discretionary accruals are used: Modified Jones model (Dechow et al., 1995); and extended Modified Jones Model (Yoon et al., 2006). Using OLS regression, | However, board of directors' independence and ownership concentration are associated with lower earnings quality. The finding indicates the importance of audit committee independence in producing quality financial reporting. Consistent findings are found for most variables in both models. The findings of the study have implication on the use of measurement of discretionary accruals in earnings quality studies and corporate governance practices in Malaysia. |