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**RELATED PARTY TRANSACTION DISCLOSURE:
COMPLIANCE, DETERMINANTS, VALUE-RELEVANCE
AND REAL EARNINGS MANAGEMENT**



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**RELATED PARTY TRANSACTION DISCLOSURE: COMPLIANCE,
DETERMINANTS, VALUE-RELEVANCE AND REAL EARNINGS
MANAGEMENT**



ZAHARADDEEN SALISU MAIGOSHI

**Thesis submitted to
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**TUNKU PUTERI INTAN SAFINAZ
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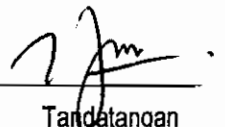
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ABSTRACT

Expropriation through Related Party Transaction (RPT) has been identified as one of the key factors that led to the collapse of several firms globally. Hence, its regulation becomes necessary. This study examines the extent and the determinants of compliance with the disclosure requirements on RPTs by Malaysian listed firms. It also investigates the value-relevance of Malaysian Financial Reporting Standard (MFRS) 124 adoption, real earnings management (REM) in RPTs and the moderating effect of compliance with MFRS 124 on the relationship between REM in RPTs and firm value. The study uses the data collected from the firms with significant RPTs from 2009 to 2015. Findings from the weighted disclosure index indicate a moderate level of compliance with MFRS 124. Furthermore, the regression results reveal that board independence, audit committee financial expertise, family ownership, managerial ownership and firm growth have significant positive relationships with the compliance of MFRS 124. Moreover, the study documents that RPTs disclosure is value-relevant. Findings of price model provide evidence that with the adoption of MFRS 124, capital market participants value the EPS of the RPT firms over its BVPS. The study documents that firms use RPTs to perpetrate REM. The results of the Roychowdhury models show that RPTs firms are characterized by low cash flow from operations, high production costs and low discretionary expenditures. It is also established that capital market discounts the stock price of firms that perpetrate REM in RPTs. Also, compliance with disclosure requirements on RPTs mitigates the negative relationship between REM in RPTs and firm value. The study reveals the need for the relevant authorities to increase the level of enforcement to achieve full compliance which will result to increase transparency of financial reporting and investor protection. The results of this study contribute to the agency, resource dependency and capital market theories.

Keywords: compliance, corporate governance mechanisms, firm financial characteristics, firm value, real earnings management, value-relevance.

ABSTRAK

Pengambilalihan melalui Transaksi Pihak Berkaitan (RPT) telah dikenalpasti sebagai salah satu faktor utama yang menyebabkan keruntuhan beberapa firma di seluruh dunia. Oleh itu, peraturannya menjadi keperluan. Kajian ini mengkaji sejauh mana dan penentu kepatuhan terhadap keperluan pendedahan kepada RPT oleh firma yang disenaraikan di Malaysia. Ia juga mengkaji nilai-relevan Piawaian Pelaporan Kewangan Malaysia (MFRS) 124, pengurusan pendapatan sebenar (REM) dalam RPT dan kesan penyesuaian pematuan dengan MFRS 124 mengenai hubungan antara REM dalam RPT dan nilai firma. Kajian ini menggunakan data yang dikumpulkan dari firma dengan RPT yang signifikan dari tahun 2009 hingga 2015. Penemuan dari indeks penzahiran berwajaran menunjukkan tahap pematuan yang sederhana dengan MFRS 124. Tambahan pula, hasil regresi menunjukkan kebebasan lembaga, kepakaran kewangan jawatankuasa audit, pemilikan keluarga, pemilikan pengurus dan pertumbuhan firma mempunyai hubungan positif yang signifikan dengan pematuan MFRS 124. Selain itu, kajian mendokumenkan pendedahan RPT adalah nilai yang relevan. Penemuan model harga menunjukkan bukti bahawa dengan penggunaan MFRS 124, peserta pasaran modal menilai EPS firma RPT ke atas BVPSnya (nilai buku sesaham). Dokumen kajian mendapati firma menggunakan RPT untuk melakukan REM. Hasil model Roychowdhury menunjukkan bahawa firma RPT dicirikan dengan aliran tunai yang rendah dari operasi, biaya pengeluaran yang tinggi dan perbelanjaan budi bicara yang rendah. Ia juga mendapati bahawa pasaran modal mendiskaun harga saham firma yang terlibat dalam REM melalui RPT. Selain itu, pematuan terhadap keperluan pendedahan mengenai RPT mengurangkan hubungan negatif antara REM dalam RPT dan nilai firma. Kajian itu mendedahkan keperluan pihak berkuasa yang berkaitan untuk meningkatkan tahap penguatkuasaan untuk mencapai pematuan penuh yang akan menyebabkan peningkatan ketelusan pelaporan kewangan dan perlindungan pelabur. Hasil kajian ini menyumbang kepada agensi, ketergantungan sumber dan teori pasaran modal.

Kata kunci: pematuan, mekanisme tadbir urus korporat, ciri-ciri kewangan firma, nilai firma, pengurusan pendapatan sebenar, nilai-relevan.

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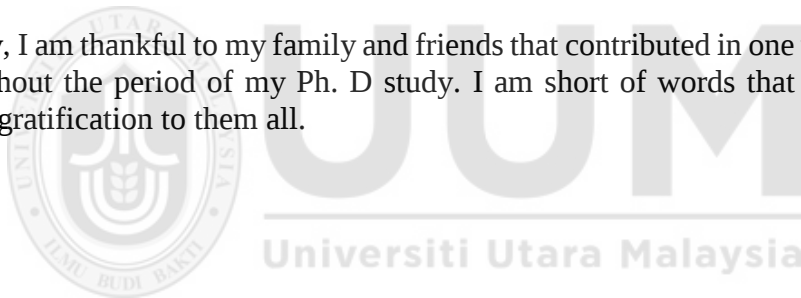


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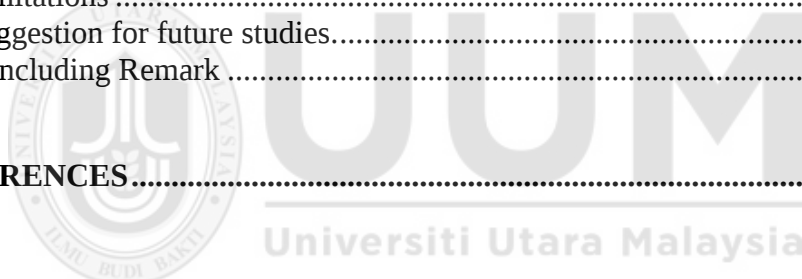
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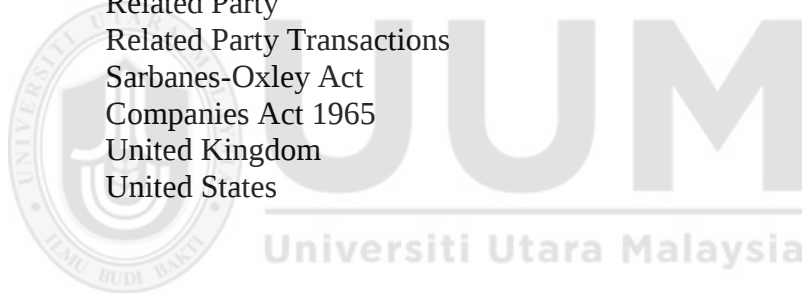
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LIST OF ABBREVIATIONS

ASA	Australian shareholder Association
BMLR	Bursa Malaysia Listing Requirements
BVPS	Book Value per Share
CEO	Chief Executive Officer
EPS	Accounting Earning per Share
FRS	Financial Reporting Standard
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standard
IASB	International Accounting Standard Board
IASC	International Accounting Standard Committee
IFRS	International Financial Reporting Standard
ISA	International Standard on Auditing
MASB	Malaysia Accounting Standard Board
MCCG	Malaysian Code of Corporate Governance
MFRS	Malaysian Financial Reporting Standard
MSWG	Minority Shareholder Watchdog Group
MVPS	Market Value per Share
OECD	Organization for Economic Co-operation and Development
RP	Related Party
RPT	Related Party Transactions
SOX	Sarbanes-Oxley Act
Act	Companies Act 1965
UK	United Kingdom
US	United States



CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter highlights the contemporary issues pertaining related party transactions (RPTs), corporate disclosure and RPTs disclosure regulations across the world in the background of the study. The chapter explains the problem statements, research questions and objectives of the study. Other headings in the chapter are scope of the study, significance of the study and organization of the thesis.

1.1 Background of the Study

Corporate monitoring, financial transparency and reporting quality have been among the major concerns of policymakers in many nations across the globe (Sierra García, Ruiz Barbadillo, & Orta Pérez, 2012). The collapse of giant corporations like WorldCom and Enron in the United State, Nortel in Canada, Equitable Life Assurance Society in the United Kingdom, Parmalat in Europe, China Aviation Oil in Singapore and alike have pushed political and business leaders to put much interest in regaining and sustaining public trust in capital market (Bauwhede & Willekens, 2008). Since the collapse of these giant corporations, many studies were conducted to find the tool and incentives behind the earnings management practices by the firm and provide possible solution accordingly Xiao (2015). Abusive related party transactions are identified as the key issues that led to the collapse of many multinational corporations such as Adelphia, Enron and Tyco (Munir, Saleh, Jaffar, & Yatim, 2013). Organization for Economic Co-operation and Development (OECD, 2009) claims that the biggest

corporate governance challenge facing Asian business landscape is the abusive RPTs which can take the form one- off material expropriations of wealth or the slow expropriation of wealth through continuous operational transactions. Abusive RPTs is defined as a situation where a party in control of a company enters into a transaction to the detriment of non-controlling shareholders (OECD, 2009).

In response to this, corporate governance change and detailed disclosures were proposed and adopted by many countries to prevent possible reoccurrence of such transactions in the future (Carnegie & O'Connell, 2013). Related party transaction is one of the major areas in accounting that require strict monitoring and tight accounting regulations through accounting standard (Morris, Pham, & Gray, 2011). This is because of the dual roles it plays for both value-generating and value-destroying purposes, and its attendant effect on the value generation processes.

The extent of literature has not arrived at a clear-cut motive behind the RPTs. This leads researchers to have opposing views on the actual position of RPTs in the firm's value generation chain. Proponents of the rationality of RPT believed that RPTs can be used to fast-track decision-making process and minimize transaction cost. It can also be used as a vehicle for the efficient resource allocation, effective coordination of divergent business activities, sustenance of marginally profitable business units and minimization of tax expenses; which in turn increase the value of the firm (Cheung, Rau, & Stouraitis, 2006; Downs, Ooi, Wong, & Ong, 2016; Jian & Wong, 2010; Loon & DeRamos, 2009; Pozzoli, Venuti, & Parthenope, 2014; Yeh, Shu, & Su, 2012).

In contrast, some studies argue that RPTs are used for self-serving transactions, tunneling, transfer of profit from listed to unlisted firms and it often serves as a vehicle

used by unlisted firms to get capital market financing through related listed firm (Cheung, Jing, Lu, Rau, & Stouraitis, 2009; Di Carlo, 2014; Mustafa, Abdul Latif, & Taliyang, 2011; Wong & Kim, 2015). These practices are prevalent in countries with weak legal or investors' protection (Ma, Ma, & Tian, 2013). RPTs provide an avenue for controlling shareholder to expropriate the wealth of the firm at the expense of the outside shareholders (Munir et al., 2013). Tunneling is defined as the act of diverting resources from listed firm by the corporate insiders (controlling shareholders and management) (Johnson, La Porta, Lopez-de-Silanes, & Shleifer, 2000 p 22).

The extent of literature provides many instances in which controlling shareholders expropriate corporate resources in various forms at the detriment of minority shareholders in RPTs (Djankov, La Porta, Lopez-de-Silanes, & Shleifer, 2008; Jameson, Prevost, & Puthenpurackal, 2014; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000). These necessitate the need for of RPTs regulation. The regulations will protect minority shareholders from the devious transactions that may lead to the expropriation of the firm and also let the firm enjoys the benefits attributable to the transactions.

Disclosure regulation through accounting standards can be used to contain the tunneling activities. This is because accounting standards are promulgated to monitor the affairs of corporate bodies, improve business reporting, maintain a principal-agent fiduciary relationship and compel financial reporting system to disclose the actual economic reality of the reporting entity (Kantudu, 2008). Reporting entities are required to comply with reporting standards completely (Houqe, van Zijl, Dunstan & Karim 2012). Noncompliance leads to diversity in reporting, which affect the comparability and relevance of the information contained in the financial reports.

Information on RPTs is crucial to the users of the financial statement. Thus, it forms part of the important information that must be disclosed in the financial statements to allow for the rational decisions.

It must be noted however, that sometimes controlling holder may engage in negative tunneling. This action is widely referred to as propping in many pieces of literature (Friedman, Friedman, & Johnson, 2003; Peng, Wei, & Yang, 2011; Ying & Wang, 2013). Propping is an act of importing personal resources to the listed firm by the controlling shareholders to save the firm from financial crises, meet certain legal requirements or achieve other personal gains. Yet, some studies establish that propping is followed with excessive tunneling (Williams, 2014; Ying & Wang, 2013).

RPT can be view as a strategy adopted by controlling holder to meet some legal requirements, market requirements or save the firm from major financial distress. In most cases, this is done with the intention of involving in expropriation when the situation permit (Friedman, Friedman, & Johnson, 2003). Concisely, any strategy adopted, whether tunneling, propping or a combination of both strategies brings distortion to accounting figures, affect the quality of the reported earnings and falsifies the reported financial position of the reporting entity.

Several studies investigate the effect of corporate governance mechanisms on RPTs (Almeida, Park, Subrahmanyam, & Wolfenzon, 2011; Cai, Hillier, Tian, & Wu, 2015; Chen, Wang, & Lin, 2014; Kang, Lee, Lee, & Park, 2014). Some of these studies relate prejudicial RPTs with corporate governance failure. Pizzo (2011) states that RPTs cannot be analyzed independently from corporate governance mechanisms. This is because in most cases RPTs have to be approved by the board of directors (Kohlbeck

& Mayhew, 2010). Malaysian code of corporate governance empowers the audit committee to scrutinize and approve all RPT. In doing so, the committee ensures that only the value-enhancing transactions are approved.

Norwani, Mohamad and Chek (2011) present many practical corporate scandals in Malaysia with a direct link with corporate governance failure. Abdul Wahab et al. (2011) and Black, Kim, Jang and Park (2015) document that RPTs are detrimental to firm performance. They also find that good corporate governance mitigates the negative effect of RPTs on the performance. Based on the above, both internal and external corporate governance mechanisms such as board composition, audit committee characteristics, chief executive officer (CEO) characteristics, ownership structure can be seen to have explaining power in determining the level of compliance with mandatory disclosure requirements on RPTs in financial reports.

The role of firm financial characteristics on voluntary disclosure has been thoroughly investigated in many studies (Chau & Gray, 2010; Gul & Leung, 2004; Heitzman, Wasley, & Zimmerman, 2010; Meek, Roberts, & Gray, 1995; Sodikin, 2013). Based on the findings of these studies, firm financial characteristics such as RPTs motives, firm performance can play an important role in explaining the level of compliance with RPTs disclosure requirements of a given accounting standards.

In many countries in the world, RPTs are required to be disclosed in financial reports in accordance with the disclosure requirements of the relevant accounting standard. Accounting numbers reported in financial statements are the ultimate product of accounting system which is dictated by an accounting standard. Accordingly, most of the capital market participants used accounting information in decision making

(Elshandidy, 2014). The relationship between accounting numbers and firm value is interesting not only for capital providers but also for the managers saddled with the responsibility for the efficient handling of the firm's resources. This can be seen as a result of increased awareness of the significance of connecting management to value creation (Gjerde, Knivsflå, & Sættem, 2011).

Since accounting numbers are the product of accounting system, change in accounting standard may affect the decision usefulness of accounting information to the capital market participant and other interested parties. Accounting information is said to be value-relevant if it is capable of explaining the variability in stock price. Switching from one set of accounting standard to another would only be worthwhile if it increases the value relevance of the accounting numbers. Therefore, it is possible that changes in the disclosure requirements concerning RPTs affect the value-relevance of accounting numbers (for the pre and post change periods). This is because capital market participants value RPTs disclosed in financial reports (Lin, Liu, & Keng, 2010; Xiao & Zhao, 2014). Hwang, Chiou and Wang (2013) believe that extensive disclosures requirements avert the possibility of indulgent into any dubious RPTs by the controlling shareholders.

Even though, there is no clear direction on the capital market reaction to the announcement of RPTs (Lin et al., 2010; Xiao & Zhao, 2014), information on RPTs must be disclosed in the financial reports to enable the stakeholders to assess the risk and return of RPTs (Ariff & Hashim, 2013). Peng et al. (2011) reveal that market reacts positively to the announcement of RPTs. This is more evident when the RPT involves the injection of resources to the reporting entity. In contrast, Gordon, Henry and Darius (2004) reveal that the industry adjusted return is low for the firms that

engage in RPTs, which in turn affect the firm value. Consistently, Ge, Drury, Fortin, Liu and Tsang (2010) document that the value coefficient of the firms that engaged in RPTs are lower compared to firms without RPTs. This could be seen as the possible effects of the studies that linked RPTs with the earnings management.

Earnings management is the intentional manipulations of accounting numbers within the scope of accounting principles or structuring transaction by management to meet pre-set earnings (Healy and Wahlen, 1999, 368). Management employs many techniques to manipulate the reported earnings. These techniques are categorized into accrual earnings management and real earnings management. Accrual earnings management is effected through the choice of accounting method, discretionary expenses as well as managerial estimates. Several studies investigate the relationship between RPTs and earnings management (Aharony, Wang, & Yuan, 2010; Beuselinck & Deloof, 2014; Cupertino, Martinez, & da Costa, 2015; Kuo, Ning, & Song, 2014). Munir et al., (2013) state that RPTs prompt management to engage in earnings management practices. Beuselinck and Deloof (2014) provide empirical evidence that RPTs are used for both earning management and tunneling purposes.

Studies such as Zang (2012) and Kuo, Ning and Song (2014) document that tight regulations have forced the management to shift attention from accrual earnings management to real earnings management¹. Real earnings management (REM) involves deliberate actions by the management to manipulate the real activities through techniques such as shares buyback, overproduction, lax credit policy, discounts and alike to achieve a pre-determined reported earnings. Real earnings

¹ This is because accruals earnings management can be detected by auditors, regulators and sophisticated investors.

management can be perpetrated conveniently in RPTs. This is because insiders determine and manipulate the terms and conditions of the transactions (Cheung, Qi, Rau, & Stouraitis, 2009; Hwang et al., 2013). Hwang et al. (2013) state that firms are prone to manage earnings in RPTs because of the low transparency and the complexities in such transactions. Gordon et al. (2004), Kohlbeck and Mayhew (2010) and Lei and Song (2011) provide evidence that earnings management in RPTs is detrimental to the firm value.

In response to the above issues, governments of many countries in the world have promulgated laws, code of corporate governance and sound accounting standards. The laws serve as tools for monitoring the activities of corporate management and directors against the minority shareholders' expropriation. In Malaysia, the Malaysian Accounting Standard Board (MASB) has issued a new Malaysian Financial Reporting Standard² on related party transactions (MFRS 124) in 2012. MFRS 124 is designed to guide the preparers on what information need to be disclosed regarding RPTs and how to disclose such information in the financial reports. The aim of the MFRS 124 is to provide users with relevant information on RPTs to enable informed decision and protect minority shareholders against the prejudicial use of RPTs by insiders.

In a similar development, Malaysian Code of Corporate Governance (MCCG) was revised in the same 2012. The revised code focuses on the role of directors as fiduciaries in their relationship with the firm and strengthens the independence of

² Throughout this thesis Malaysian Financial Reporting Standard (MFRS) and International Financial Reporting Standard (IFRS) are used interchangeably. This is based on the fact that the former is a direct replica of the later save for the name, numbering and effective dates. Similarly, Financial Reporting Standard (FRS) and MFRS are used interchangeably in the study. The former was the accounting standard in operation prior to the mandatory adoption of the later in 2012. So MFRS refers to the FRS in any firm-year prior to 2012.

independent directors. It also places more emphasis on the sustainability of the firm and empowers the audit committee to scrutinize all RPTs. This is to ensure that only value enhancing transactions are approved by the board. In addition to these, stringent capital market requirements were put in place to guarantee prompt disclosure of any material transaction with related parties to the whole market participants. Also, the Audit Oversight Board (AOB) was established and came into force on 1 April 2010 to promote and develop an effective audit oversight framework and to promote confidence in the quality and reliability of audited financial statements in Malaysia. These regulations have played important role in restraining the menace of accrual earnings management in Malaysian reporting environment (Ismail, Kamarudin, Zijl, & Dunstan, 2013; Saleh, Iskandar, & Rahmat, 2005).

Hence, this study evaluates the extent of compliance with disclosure requirements of MFRS 124 and documents the determinants of compliance with RPTs disclosure requirements. Also, the study reveals the value relevance of RPTs disclosure across the two accounting regimes (before and after the adoption of MFRS 124). Additionally, the study provides evidence of REM in RPTs and its negative effect on firm value. However, high level of compliance with the disclosure requirements on RPTs mitigates the negative effect of REM in RPTs on the firm value.

1.2 Problem Statement

Recent studies on corporate governance shift attention from the initial agency problem (principal-agent) to new dimension of agency problem between controlling shareholder and minority holders (principal-principal or type *II* agency problem) (see for example Fraile & Fradejas, 2014; Jameson et al., 2014; Song, Wang, & Cavusgil,

2015). Type *II* of agency problem arises as a result of concentrated ownership that is prevalent in emerging economies. In this economies most of the listed companies are significantly owned by an individual, group of family or the state (Claessens, Djankov, & Lang, 2000; Loon & DeRamos, 2009; Morris et al., 2011). In most of these types of business models, there is no separation between ownership and control. Therefore, RPTs can be infected with conflict of interest between controlling and minority shareholders. Controlling shareholders use RPTs to tunnel (Jiang, Lee, & Yue, 2010; Munir et al., 2013; Mustafa et al., 2011) or to prop resources to a firm (Cheng & Leung, 2014; Williams & Taylor, 2013; Ying & Wang, 2013) depending on the motive that intend to be achieved.

A listed subsidiary could deposit its excess cash with its unlisted parent for a long period instead of investing it in a fund that can generate interest income to both controlling and minority shareholders. In some instances, the parent company may take an interest-free loan from its subsidiary or associate entity. A typical example of this was the case when Hanqi group and its affiliated companies took a loan of 198.6 million RMB (31.1 million USD) from its listed associate company (Feng Hua Co. a Chinese listed company with stock code 600615). The total equity value of Hanqi's shares in Feng Hua Co. was 116.21 RMB (18.2 million USD). The amount and the nature of the loan were not properly disclosed in the financial report as it was reported under other receivables. Later the debtor (Hanqi group) went bankrupt and nowhere to find the money. This situation necessitates the lending firm (Feng Hua Co) to write up a large part of the loan at the detriment of its minority shareholders (Jiang et al., 2010).

For many decades, series of detrimental RPTs were reported within the Malaysian business circle. A typical example of these transactions is the case of United Engineers (Malaysia) Bhd (UEM). UEM acquires 32.6% interest of its financially distressed parent company (Renong) at an inflated cost of 2.34 billion Malaysian ringgits. This transaction was interpreted as a deliberate effort to bailout the parent company from its financial turmoil (Businessweek, 1998). Another example of detrimental RPT is the case of Genting Malaysia Bhd. The subsidiary (Genting Malaysia resort world) bought a property from its parent (Genting Bhd). The issues of concern were the appointment of the same valuer by the both parties and the position of the independent directors been members of the board of both companies. Analysts regarded the transaction as cash extraction by the parent company (Wahab et al., 2011).

The problem of abusive RPTs is not restricted to private firms alone; some government link companies have involved in some RPTs that are detrimental to minority shareholders in particular and Malaysians in general. Even in the recent cases of financial mismanagement in 1Malaysia Development Bhd (1MDB), anecdotal evidence of mismanagement presented by media and other stakeholders were allegedly conducted through (intergroup) RPTs (BBC, 2016; TNYT, 2017).

The above cases justify the position of Morris et al., (2011). The authors believe that RPT is among the seven major areas of accounting that require extensive disclosures to avert the possibility of poor accounting and its attendant effects in transparency and quality of reported numbers. Many states in the world have redefined the related parties to avoid ambiguity and established stringent laws that regulate RPTs and its disclosure. This is because RPTs disclosure has been found to be instrumental to the

users of financial reports in making wise economic decisions and understanding the effect of such transactions on the firm value (Kohlbeck & Mayhew, 2010).

It must be noted that total compliance with accounting standard is hard to achieve, as many entities may decide to ignore some disclosure requirements (Hogget, Edwards, Medlin, & Tilling, 2009). Hence, there is a need for the relevant authorities to enforce compliance with laid-down standards. The extent of compliance with the accounting standard is as important as the standard themselves (Hodgdon, Tondkar, Harless, & Adhikari, 2008). This is because corporate executives can manipulate and enrich themselves easily in the absence of higher quality and compliance with the disclosures requirements (Kalyta & Magnan, 2008).

Previous studies document that some firms claim to be complying with accounting standard but have not been fully complying (Glaum, Schmidt, Street, & Vogel, 2013; Hodgdon et al., 2008; Street & Gray, 2002). Therefore, it is essential to document the actual level of compliance with each accounting standard in operation. By doing so, regulators can easily identify the areas of weak compliance and take appropriate actions therefrom. This view is supported by Ariff and Hashim, (2013) who propose for the development of disclosure index to investigate the breadth and depth of RPT disclosure in financial reports. Hence, this present study has filled in this gap by providing the extent of compliance with the disclosure requirements of the accounting standard on RPTs.

Relevant authority to review the RPTs regulations and come up with the new stringent laws to avert the expropriation activities. In Malaysia for example, new sets of MFRS, MCGG, Bursa Malaysia listing requirements (BMLR) were in operations since 2012.

However, since the inception of this new regime, no any known study that assesses their effect extensively. Moreover, despite the numerous problems and other critical issues related to RPTs, generally, there exist limited studies to address the type *II* agency issues (Williams, 2014).

Given this, the need to conduct research to identify the factors that influence the level of compliance with mandatory disclosure of RPTs is paramount. Previous studies in this area were mostly on voluntary disclosure, while the aspect of determinants of mandatory disclosure was almost neglected by researchers (Glaum et al., 2013; Utama & Utama, 2014). The identification of the determinants of compliance with mandatory RPTs disclosure is essential to standard setters in the discharge of their routine duties of ensuring that financial reports contain all vital information that is pertinent to investors, capital market participants and other stakeholders' need concerning RPTs. Corporate governance mechanisms and firm financial characteristics are generally believed to influence the firm transparency and compliance with the laid-down regulations. In view of this, this study investigated the influence of corporate governance mechanisms and firm financial characteristics on the level of compliance with the disclosure requirements of the of accounting standard on RPTs.

Hellström (2006) emphasize the importance of tracking the change in the accounting principles of a nation for the real understanding of their effect in the development of value relevance. This is based on the fact that a positive profit reported by a firm may turn to be negative if the financial statements are restated using a different (more qualitative) set of accounting standard (Chen, Gul, & Su, 1999). Based on this premise, the adoption of IFRS as reporting standard across the world has attracted a number of study to determine whether the new standard is more value-relevant (Alali & Foote,

2012; Gjerde, Knivsflå, & Sættem, 2008; Kim, 2013; Lin, Riccardi, & Wang, 2012; Tsalavoutas & Dionysiou, 2014). However, the findings of these studies on the impact of the change in accounting standard on the value-relevance of accounting numbers remain inconclusive.

Some of these studies document an increase in value relevance of financial reports after IFRS adoption (Alali & Foote, 2012; Kim, 2013; Tsalavoutas & Dionysiou, 2014). Others such as Gjerde, Knivsflå and Sættem (2008) and Lin, Riccardi and Wang (2012) arrived at otherwise. The inconsistencies in the findings might be connected to the methodology adopted in the studies. The nature of these studies does not allow for the identification of the real source of increase or decrease of the value-relevance among the numerous accounting information reported in the financial reports under the new accounting regime. To address this issue, a new trend in the value-relevance studies begins to trace the changes in the value-relevance by focusing on single accounting standard.

Hamberg and Beisland (2014) conduct a study on the changes in the value-relevance of goodwill accounting following the mandatory adoption of IFRS 3. Similar to this, Badenhorst, Brümmer, & de Wet (2015) investigates the value-relevance of the disclosed summarized financial information of the listed associates (IAS 28). Despite, the value-relevance of the other individual standards (such as IAS 24 for RPTs) remain unknown. In light of this, this study investigates the value-relevance of the disclosed RPTs. Hence, this study has filled in this literature gaps by documenting the value-relevance of the disclosed RPTs. Furthermore, this study identifies the changes in the value-relevance of the disclosed RPTs with the changes in the accounting regimes.

Change in regulatory regime and increase disclosure requirements may push some firms to switch from accruals to REM (Cohen et al., 2008; Kuo et al., 2014). Another incentive for the switch may be the revelation that market fails to evaluate the effect of earnings management through real activities manipulations (Cupertino et al. 2015; Cheung et al., 2009; Hwang et al., 2013). These reasons, coupled with the ample opportunities available to controlling shareholders in determining the terms and conditions of RPTs provide incentives for them to embark on REM in RPTs. In view of this, the tendencies of using the RPTs to perpetrate REM is alarming.

Nonetheless, studies on the earnings management in RPTs have concentrated on the accrual method (see for example Aharony et al., 2010; Beuselinck & Deloof, 2014). However, most of the RPTs are real activities with the consequential effect on the cash flow and firm value. Hence accrual earnings management models are not suitable for studies of this nature. To address the issue, many studies developed and used some models to capture the REM in RPTs (Ding, Zhang, & Zhang, 2007; Liu & Lu, 2003; Lo, Wong, & Firth, 2010). Nevertheless, the measures fail to capture the REM in RPTs appropriately and produced conflicting results. For example, Jian and Wong (2010), Wong and Kim (2015) and Ying and Wang (2013) used abnormal related party sales to measure the effect of RPTs on the firm value generation process and arrived at inconclusive results.

Roychowdhury (2006) developed powerful models for capturing the REM through the estimation of the abnormal cash flow from operations, abnormal production cost and abnormal discretionary expenses. Subsequent studies on REM have used the prominent models with firms with small profits (Roychowdhury, 2006; Cupertino et al. 2015), target beating (Gunny, 2010), reverse merger (Zhu et al., 2015) season

equity offering (Cohen and Zarowin, 2010) as suspects firms. Roychowdhury (2006) models fit the researches of this nature as they capture manipulations in the cash flow from operations (CFO) and production costs which are the most important components of RPTs. Nonetheless, to the best knowledge of the researcher, there is limited study that used RPTs firms as suspect firms in the models to investigate the REM practices in RPTs. Hence, this study has filled in this literature gaps by using the RPT firms as suspect firms in the model.

In addition, several studies document negative relationship between earnings management and firm value. Cheng, (2012) provide evidence that the earnings of banks with lower discretionary loan loss provisions and higher discretionary gains from loan sales and securitizations are priced more negatively, suggesting that investors impose incremental penalties on the joint use of loan loss provisions and gains from loan sales and securitization to meet or beat earnings benchmarks. Similarly, de Jong, Mertens, van der Poel, and van Dijk, (2014) find that analysts perceive meeting earnings benchmarks, smoothing earnings to enhance investor perception of firm value and all earnings management actions to reach a benchmark are value destroying.

In addition, studies such as Gordon et al., (2004), Jian and Wong, (2004), Kohlbeck and Mayhew, (2010) and Lei and Song, (2011) provide ample evidence on the negative relationship between earnings management in RPTs and firm value. However, studies on how this menace can be mitigated are scarce. Recently, some studies proved that strong corporate government mechanisms moderates the negative effect of RPTs on firm value. Dahya, Dimitrov, and McConnell, (2008) document that board independence improves the value of the firms with dominance shareholders. Similarly,

Black, Kim, Jang, and Park, (2015) also show that better governance moderates the negative effect of related-party transactions on value and increases the sensitivity of firm profitability to industry profitability.

Despite, the means through which the corporate government mechanisms mitigates the REM in RPTs remain unknown. This study proposed compliance with accounting standard on RPTs to moderate the relationship between REM in RPTs and firm value. A moderator variable is used to alter the direction or strength of the relation between an independent and the dependent variables. (Baron & Kenny, 1986; Frazier, Tix, & Barron, 2004). This is because accounting standards are meant to be complied with in entirety, hence extent of compliance with these standards is important in defining the relationships. This study has filled in this gap by assessing the mitigating role of the compliance with the disclosure requirement on RPTs and firm value.

1.3 Research Questions

The following research questions are developed to serve as a compass during the operationalization process of the study. This study provides answers to the research questions, which automatically resulted in achieving the ultimate goal of the study.

- i. To what extent do companies listed in Bursa Malaysia comply with the disclosure requirements of the accounting standard on related party disclosure standard?
- ii. What are the determinants of compliance with the RPT disclosure in the financial reports of the companies listed in Bursa Malaysia?

- iii. Does MFRS 124 adoption increase the value relevance of financial reports of companies listed in Bursa Malaysia?³
- iv. Does real earnings management in RPTs has a relationship with the firm value?
- v. Does compliance with MFRS 124 moderates the relationship between real earnings management in RPTs and firm value?

1.4 Objectives of the Study

The aim of this study is to identify the factors that explain the firms' compliance behavior with the RPTs disclosure requirements which can be used to mitigate the multiple problems associated with RPTs. Hence, the following are proposed as objectives of the study:

- i. To examine the level of compliance with the disclosure requirements of the accounting standard on RPTs by companies listed on Bursa Malaysia.
- ii. To find out factors that determine the level of compliance with the RPTs disclosure requirement by the companies listed on Bursa Malaysia.
- iii. To measure the value-relevance of the disclosed RPT information in the financial reports of the companies listed on Bursa Malaysia for both pre and post mandatory adoption periods.
- iv. To assess the relationship between real earnings management in RPTs and firm value.

³ This thesis determines whether RPT disclosure is value-relevant first, then it assesses the effect of the change in accounting standard on the value-relevance of accounting numbers.

- v. To investigate the moderating role of compliance with the disclosure requirements of MFRS 124 on the relationship between real earnings management in RPTs and firm value.

1.5 Scope of the study

The study concentrates on assessing the extent of compliance with disclosure requirements of the of accounting standard on RPTs and examining the factors that determine the compliance with the standards by non-financial companies listed on Bursa Malaysia for the period of 2009 until 2015. The study also measures the value-relevance of the disclosed RPT information within the above stated period and evaluates whether the disclosed RPTs are associated with the REM.

The year 2012, been the year of the compulsory adoption of MFRS and MCGG is excluded from the study in the value-relevance analyses to enable the study to capture the real effect of changes in the regulations. The exclusion of financial services firms is justified by the fact that there are other regulations and laws (such as Insurance Act 1963, Financial Service Act 2013) and other supervisory agencies (such as Bank Negara Malaysia, Malaysia Deposit Insurance Corporation) that regulate and influence their disclosure behavior apart from MFRS and its custodians as used by (Chua, Cheong, & Gould, 2012; Dimitropoulos, Asteriou, Kousenidis, & Leventis, 2013).

1.6 Significance of the Study

Ball, Robin and Wu (2003) state that the implementation of high quality reporting standard may not necessarily translate to high quality financial reports. This is

because, firms do not comply with the mandatory disclosure requirements (Glaum et al., 2013; Hodgdon et al., 2008; Street & Gray, 2002), even with the existence of enforcement bodies (Yeoh, 2005). This study addresses the issue of mandatory compliance with the disclosure requirement of a single accounting standard (FRS and MFRS 124) in Malaysia. This is to overcome the problems attached to multiple accounting standards approach as highlighted earlier. The results reveal moderate compliance with the disclosure requirements of the accounting standard on RPTs. To the best of the researcher's knowledge, this is the first study that documents the extent of compliance with disclosure requirements of the accounting standard on RPTs. This contribution is useful to the standard setting bodies, regulatory agencies and academics with the interest to extend the literature in the area of firms disclosure behavior.

Second, previous studies on the determinants of firm transparency were on the whole set of accounting standard or governance code (Alsaeed, 2006; Robb, Single, & Zarzeski, 2001; Sharif & Ming Lai, 2015) and mostly during voluntary regime (Babío Arcay & Muiño Vázquez, 2005; Chen, DeFond, & Park, 2002; Wang, O, & Claiborne, 2008). The aspect of determinants of mandatory disclosure was almost neglected by researchers despite its irresistible need (Glaum et al., 2013; Utama & Utama, 2014). Recently, efforts have been put in place to identify the factors that influence compliance with certain disclosure requirements (see for example Lopes & Rodrigues, 2007; Wan-Hussin, 2009; Zango, Kamardin, & Ishak, 2016).

The present study has filled in the knowledge gap that existed in the field of factors that determine the mandatory compliance with accounting standard on RPTs. The study tests the influence of the board composition, audit committee characteristics, CEO characteristics, ownership structure, RPT motives and firm performance on the

firm's compliance with the RPTs disclosure requirements. The outcome of the regression of these factors as presented in chapter six of the thesis is useful to the investors. Institutional and individual investors will find the outcome of the study important because it will help them to identify the firms that disclose more information on RPTs. Equally, regulatory agencies can benefit from this findings by identifying the characteristics of firms with tendencies for low compliance with disclosure requirements of the accounting standard. Also among the beneficiaries of this contribution are academics with the interest to extend the literature in the area of determinants of compliance behavior.

Third, this study extends the existing literature on value-relevance by documenting the value-relevance of RPT disclosure. The study provides empirical evidence that disclosure of the RPTs is value-relevant. It is also evident that BVPS and EPS of firms with significant RPTs exhibit varying valuation pattern based on the quality of information attached to them. That is to say where there is sufficient information on EPS, the EPS of firms with significant RPTs is more value-relevant than the BVPS of such firms. Besides, the study extends the understanding on the importance of the reporting standard to the market participants.

The study provides empirical evidence that accounting numbers prepared under higher quality accounting standard are more value-relevant in the firm valuation. It is also documented that with the adoption of MFRS 124, both the level and changes in net income of RPT firms become value relevant. This study contributes to the debate that whether IFRS are more value-relevant than national generally accepted accounting principles (GAAPs). Previous studies established that value-relevance of accounting information increases when IFRS is of higher quality than former national GAAP and

decreases if otherwise (Clarkson, Hanna, Richardson, & Thompson, 2011; Devalle, Onali, & Magarini, 2010; Van der Meulen, Gaeremynck, & Willekens, 2007).

Hence, this contribution is interesting to MASB in particular and IASB in general that convergence to IFRS-based accounting standard has increased the value-relevance of the Malaysian reporting environment. Also, foreign investors that wish to invest in countries with high quality reporting system can benefit from the findings of this study. Equally, academics and future researchers can use these findings as reference material in their quest of learning and expand existing knowledge

Also, this study contributes to the existing literature on the earnings management. Most of the previous studies on earnings management in RPTs have concentrated on the accrual earnings management. This study extends the level of understanding the earnings management in RPT by considering the REM practices in the RPTs. The study provides empirical evidence that firms use the RPTs for REM purposes. More so, to the knowledge of the researcher the present study is the first of its kind that uses firms with significant RPTs as sample (suspect) for REM in the Roychowdhury (2006) models. Hence, this study extends the list of the firms suspected of REM practices.

In addition, the study contributes to the extant literature on earnings management and firm value. The relationship between REM in RPTs and firm value has been assessed in this study. Although, some studies document that capital market does not recognize earnings management perpetrated through the manipulation of real activities (Cupertino et al., 2015; Kothari, Mizik, & Roychowdhury, 2015). This study document that capital market captures and discounts the stock price of firms that engage in REM in RPTs. Lastly, this study documents that compliance with the

disclosure requirements on RPTs mitigates the negative relationship between REM in RPTs and firm value. Hence, extends the literature on the internal governance control mechanisms on firm value.

These contributions are timely because of the changes in regulations in Malaysian reporting environment might have made some firms to shift attention from the traditional accrual earnings management to the REM. Therefore, identifying the tricks that could be adopted to perpetrate the REM is paramount. This finding is important to the Security Commission Malaysia and Bursa Malaysia (the custodians of MCCG and Listing requirement respectively) in their quest to curb out the menace of earnings management among the Malaysian listed firms. Institutional and individual investors will find this finding handy as it will make them be vigilant with the RPTs and assesses if RPTs are associated with REM in making economic decisions. Auditors will also find this outcome useful as it will enable them to incorporate the risk of REM in audit planning and extend the scrutiny to REM in RPTs which REM in RPTs. Equally, academics and future researchers can use these findings as reference material in their quest of learning and expand existing knowledge on REM.

1.7 Organization of the Thesis

This thesis is organized into eight chapters. Chapter One introduces the thesis by discussing the practical and theoretical issues regarding RPTs and RPTs disclosure. It also contains the research questions, objectives of the study among others. Chapter Two presents the Malaysian reporting environment in particular and global environment in general. The chapter discusses the emergence and the roles of regulations such as MASB, MFRS, MCCG, IFRS, Company Act excetra. The issues

of the disclosure quality, measurement of disclosure and global compliance with the IFRS were highlighted in the chapter.

Chapter Three reviews the literature on the concept, types, perspectives and the disclosure of RPTs. The chapter also discusses the corporate governance mechanisms and firm financial characteristics that influence the compliance with the disclosure requirements of the of accounting standard on RPTs. Like in the previous chapter, Chapter Four reviews the literature on the concept of value-relevance, the value-relevance of accounting information and that of the disclosed RPTs. The chapter also covers the literature on both accrual and REM, the effect of accounting standard on earnings management, earnings management practices in RPTs and the mitigating role of the level of compliance with the disclosure requirements on RPTs on the relationship between REM in RPTs and firm value. The chapter concludes with the research underpinning theories.

Chapter Five presents the methodological approach adopted in the conduct of this research. Research hypotheses and frameworks are developed in this chapter for the determinants, value-relevance and REM in RPTs. The chapter proceeds to the research philosophy where the research paradigm and research design for this study are presented. Also, the chapter covers the measurement of the research variables. The chapter concludes with the sample selection procedure for the determinants, value-relevance and REM.

Chapter Six presents the results and discussion of the extent of compliance with the disclosure requirements of accounting standard on RPTs. The results and coefficients of the regressions conducted for the determinants of the compliance with the

disclosure requirements of the of accounting standard on RPTs are discussed in the chapter. Chapter Seven contains the coefficients and the results on the value-relevance of the disclosed RPTs for both the price and return models. The coefficients and the results from the regressions for the investigation of REM in RPTs, its effect on firm value and the moderating effect of compliance with MFRS 124 are presented and discussed in the chapter. Lastly, Chapter Eight concludes the thesis by providing the overview of the thesis, summary of findings, the contribution of the study, practical implications of findings, limitation of the study and suggestions for future studies.

1.8 Summary of the Chapter

This chapter introduces the study by warming up the issues in RPTs and highlighting the issues on RPTs disclosure in the background of the study. It also covers the theoretical gaps in the determinants, value-relevance and REM associated with the RPTs disclosure. The chapter dwells on the research questions and objectives of the study. Also, the chapter discusses the significance and contribution of the study and then concludes with the organization of the study.

CHAPTER TWO

INSTITUTIONAL AND REGULATORY BACKGROUND OF FINANCIAL REPORTING IN MALAYSIA

2.0 Introduction

This chapter presents a brief overview of the Malaysian political and economic environments. It also discusses the emergence of international accounting standard, a brief history of Malaysian Accounting Standard Board and the role it plays in designing, adoption and enforcement of the Malaysian financial reporting standard 124 in particular and all other MFRSs in general. The chapter reviews the Malaysian codes corporate governance, Bursa Malaysia listing requirements, Company Act 1965 and minority shareholder watchdog group with an emphasis on the provisions pertaining the RPTs. Also, the chapter considers the issue of disclosure measurement. The chapter concludes with the review of empirical studies on the compliance with IFRS across the world.

2.1 Overview of Malaysian Environment

Malaysia is a country located in Southeast Asia, consists of 149 local governments within its fourteen states. It is described as a multi-ethnic and multi-cultural country and also categorized among the most vibrant Southeast Asian economies (BBC, 2015). Malaysian ethnic and cultural diversity play significant roles in its national politics, which by extension affect the common and financial laws of the country (Haniffa & Cooke, 2002). According to the department of statistics Malaysia, the population of the country is estimated to be around 31.7 million as at 2016, of which majority

(51.8%) are classified as upper-middle-income earners (Chi, 2015; World Bank, 2013). The gross domestic product (GDP) of the country stood at USD313.2 billion and average growth rate of 7% (Bank Negara, 2015). As in any emerging economy, informal activities (shadow economy) was estimated to be around 25% of the reported GDP as at 2008 (Elgin & Oztunali, 2012), which is consistent with the recent estimate by world bank 25% to 40% of the GDP of developing economies.

Although, some economic experts have projected significant economic downturn (termed as a dark cloud) in the economy for 2015 fiscal year following the three consecutive years' robust economic growth (CNBC, 2015; MIER, 2015). The economic deterioration is not because of the crashing oil price alone but for other factors such as prolong budget deficit for almost 17 years, currency depreciation to its weakest position since the Asian financial crises, political pressure from the growing opposition parties and rising contingent liabilities (CNBC, 2015; Malaysian Insider, 2015; MIER, 2015). However, the prime minister Najib Razak believes that the economy is in a stronger position than it was during Asian financial crises 1997 (Reuters, 2015), and confident that the country will meet its target of becoming a high-income economy by 2020 (Malaysiakini, 2015).

Malaysian capital market is among the emerging capital market, with the dominance of concentrated and family ownership, which reflects the socio-political connections nature of the economy. These features of the market prone it to many relationship-based economic transactions (Wahab et al., 2011). Like many other capital markets in the world, multiple laws regulate the activities and operations of companies listed on Bursa Malaysia (formerly Kuala-Lumpur Stock Exchange) with many regulatory

agencies such Malaysian Accounting Standard Board (MASB), Securities Commission (SE) and MCCG supplementing the oversight role.

RPT is one of the primary concerns of many capital market operators in the world (Djankov et al., 2008) and highly regulated activities among the firm operations. Many countries promulgate several reporting standards, Act and market requirements (identical and some counter another) all target at improving transparency and efficiency in dealing with related parties (Nekhili & Cherif, 2011). Companies listed on Bursa Malaysia are required to comply with the provisions of MFRS, Bursa Malaysia listing requirement, MCCG, provisions of company Act 1965 and alike when conducting or reporting RPTs. These requirements are set to ensure transparency, protect ordinary market players, enhance investors' confidence and maintain smooth operation of the market. These various laws and institutions which are established to provide maximum disclosure of RPTs and protect the ordinary investor in Malaysia are discussed in the subsequent sections.

2.2 International Financial Reporting Standard (IFRS)

International Accounting Standard Committee (IASC), a predecessor to International Accounting Standard Board (IASB) was established in 1973 to improve the comparability of financial statement across the globe (Ball, 2006). IASC in its early years has reduced accounting diversity globally through the elimination of some accounting choices (alternatives). Since its inception, IASC has undergone a number of reconstructions, which lastly repositioned and rebranded the body as International Accounting Standard Board (IASB). The objectives of IASB are to promulgate high quality internationally acceptable reporting standard that can meet the needs of all

stakeholders in financial reports, promote compliance with the set standard and facilitates the process of adoption/convergence with the set standard globally.

On this note, several studies document that IFRS are capable of improving transparency, comparability and relevance of financial reports. IFRS are capable of displaying the actual economic reality of the reporting entity (Ball, 2006; Barth, Landsman, & Lang, 2008; Callao, Jarne, & Laínez, 2007; Dimitropoulos et al., 2013) and have been adopted by many countries across the globe. It is worthy to note that apart from the detail requirement of IAS 2 (presentation of the financial statement), IASB has issued separate accounting standards to deal with peculiar accounting concerns. These concerns include but not limited to goodwill, business combination, segment reporting, consolidation, financial instrument, foreign exchange and related party transaction. Correspondingly, Morris et al. (2011) states the above concerns as seven major accounting areas that required high transparency in reporting processes.

2.3 Malaysian Accounting Standard Board (MASB)

Prior to the establishment of MASB in 1997, the task of promulgation and issuance of accounting standards were under the control of professional bodies. The standards in the then period are enforceable under the codes of ethics of the professional bodies. With the establishment of Financial Reporting Act in 1997, an independent body (MASB) was established and saddle with the responsibility for the development and issuance of the financial reporting standard within the Malaysian territory. The Act confers a legislative backing to MASB to enforce compliance with the issued standards on all relevant entities. The first sets of financial reporting standards issued

by MASB are IASB-based taking into consideration local laws and business requirements.

The MASB initiates a strategic move in 2004 to align its reporting standards with those of IASB to catch-up with the global trend. The move was done through rebranding its standards to Financial Reporting Standard (FRS) and modifying their numbering to match with those of IASB to ease referral by investors and professionals. This trend continues until 2007 when FRSs were revised and become similar to IFRS in all ramifications save for some transitional provisions and effective dates. In 2008, MASB declared its intention to converge fully with IFRS effective from 1st January 2012, and Malaysian Financial Reporting Standard (MFRS) framework was issued effective from 1st January 2011 to facilitate a smooth transition by 2012.

After the convergence in 2012, MASB continues to serve as a body that keeps contributing, echo the voice of Malaysia and protect the peculiar needs of Malaysian entities while promulgating new standard in IASB. It also continues to participate in the regional accounting activities with the aim of achieving stronger voice of Asian-Oceanian in the IASB decisions. The MASB continues to manage the financial reporting of SMEs to allow for fair play and efficient competition among Malaysian SMEs with the aim of fostering their growth and ease access to both domestic and international finance.

2.4 Malaysian Financial Reporting Standard (MFRS) 124

MFRS 124 is an accounting standard that regulates what, and the manner in which reporting entities should disclose the related party (RP) relationship and RPTs in their

financial reports. MFRS 124 is synonymous to IAS 24 in all respect. It aims to ensure that annual reports contain the necessary information that can highlight the likelihood that financial position or operating performance of the reporting entity may have been tempered with by the presence of RP relationship or transactions with such parties. The standard provides extensive and explicit criteria for the identification of RP relationships and transactions, outstanding balances with RP, situations and the manner in which relationship and transactions need to be disclosed.

MFRS 124 defined RP from both natural and legal person viewpoints. Paragraph 9 (a) of the standard provides that any person including his surrogates is related to reporting entity if he has control, joint control, significant influence or occupies a key management position in the reporting entity or its parent company. Similarly, paragraph 9 (b) provides that an entity is said to be related to reporting entity if: (a) it belonged to the same business group with reporting entity. (b) is associate or in a joint venture with parent, subsidiary or sister companies of the reporting entity. (c) both are in joint venture with, or one is in the joint venture while the other is an associate of the same third party. (d) is a post-employment plan set-up for the employees of either entity. and (e) is controlled by the related person identified above.

Paragraph 13 of MFRS 124 requires the disclosure of the relationship between group members regardless whether there was transaction among them or not. The name of the parent and ultimate controlling party (if are not the same) should be disclosed. In a situation where neither the parent company nor the ultimate controlling party produces publicly consolidated financial report, the reporting entity should then disclose the name of the most senior parent that does so. According to paragraph 14 of the standard, where control exists in the relationship, the reporting entity should

disclose the nature of the control regardless of the existence of transaction with RP. The reporting entities are required by paragraph 17 to disclose all categories of key management emolument including their retirement benefits in their financial reports.

Where an entity has had RPTs during the reporting period, the nature of the RPT and any other information necessary for the proper understanding of potential impact of such transaction should be disclosed in the financial report. Information to be disclosed should, at least, cover the total value of the transaction, outstanding balances including commitments, terms and conditions of the transaction, provision of doubtful debt on outstanding balances and bad debt expensed during the reporting period. This information should be disclosed based on the category of RP to which the party belong.

As an extension of the disclosure requirements of the MFRS 101, Paragraph 20 of MFRS 124 requires the separate disclosure of the amount receivable from, and payable to each category of the RPs. The examples of common RPTs include sales or purchases of goods/assets of whatever type, receiving/rendering services, finance arrangement, research and development transfer, licenses arrangement, leases and many more transactions. A disclosure of arm's length equivalent amount of each RPT is required under paragraph 23, subject to the availability of open market system where such amount can be substantiated. Paragraph 24 provides for the disclosure of similar items in aggregate, save when separate disclosure is required for the understanding of the actual economic effect of the transaction.

Government-related entities are exempted from the requirements of paragraph 18 of the standard. However, they are required by paragraph 26 to disclose in their financial reports the name and nature of the government interest in the reporting entity. Other

items to be disclosed include amount and nature of each significant RPT, amount and nature of RPTs that are not individually but collectively significant. Paragraph 27 permits management to use its judgment in the determination of the economic level that can be collectively significant. However, the paragraph proposes some criteria that need be applied before arriving at such economic level.

2.5 Malaysian Code of Corporate Governance (MCCG)

Weak corporate governance and inadequate financial disclosure have frequently been identified as the genesis of Asian financial crises of 1997 (Mitton, 2002; Wahab et al., 2011). The crisis exposed a number of corporate governance weaknesses in many South-East Asian corporations, and Malaysian listed companies are not the exception. Most of the then Malaysian companies have been identified with lack of transparency, poor minority shareholders' protection and allegations of cronyism (Che-Haat, Rahman, & Mahenthiran, 2008; Wahab, How, & Verhoeven, 2007).

The finance committee on corporate governance (FCCG) identifies the importance of corporate transparency through improved financial disclosure and the increasing role of institutional investors' activism. FCCG believes that for Malaysia to catch-up with emerging global competition, corporate governance problems has to be resolved amicably (MCCG, 2000). Based on this, FCCG recommends for the establishment of the MCCG together with Minority shareholder watchdog group (to be discussed later). These recommendations are made to install corporate governance best practice in Malaysian firms and protect minority shareholders from insider-dealings (Wahab et al., 2007).

2.5.1 Malaysian Code of Corporate Governance 2000 (MCCG 2000)

The FCCG's recommendations of 1999 lead to the establishment of the first set of MCCG in 2000. The MCCG 2000 has been substantially clued from Cadbury and Greenburg codes, but more inclined to Hampel corporate governance disclosure approach. Hampel Committee recommends for a hybrid approach to disclosure of corporate governance codes. This approach takes some elements of both prescriptive and non-prescriptive approaches to corporate governance disclosure.

The prescriptive approach requires reporting entities to disclose their compliance with the stated desirable governance practice principles in their financial reports. On the other hand, non-prescriptive approach preferred narrative disclosure of the corporate governance practice adopted by reporting entity. This approach takes into cognisance the peculiarities of some companies and believes that directors should design the appropriate governance best practice that best suit their entity.

To overcome the shortcomings of both approaches, Hampel committee re-emphasizes the need for principles that firms have to comply with and disclose in their financial reports. However, the committee recommends the directors to make some narrative disclosure in the financial reports on how relevant principles are applied in their respective companies. This approach is aimed at securing sufficient information disclosure that will enable investors and other stakeholders to assess the performance and corporate governance practices of reporting entity, and take informed economic decisions accordingly. FCCG has recommended that MCCG 2000 be categorized into four parts.

The first part of the MCGG 2000 set out governance principles for all Malaysian registered firms. The recommendation permits listed firms to apply these principles flexibly and taking into account their varying nature. Narrative disclosures are required in the financial report on how each listed company applies principles that are relevant to their business circumstances. Part 1 Section (A) of the principle required firms to establish the board of directors that should effectively lead and control the affairs of the entity. Board composition (e.g. the proportion of outside directors including independent directors), access to confidential information, appointment and re-election procedures were all spelled out in the section.

Section (B) provides that directors' remuneration to be designed in a manner that will be able to attract and retain the best brain in the company's board. The remunerations of executive directors should be linked to the performance. Experience and quantum of responsibilities should serve as the basis for determining the remuneration of non-executive directors. Section (B II) required for the establishment of formal and transparent policy for the setting executives and directors remunerations. Details on emolument of each category of directors are required to be disclosed in the financial report.

Section (C) recommends for the discourse between firms and institutional shareholders where the need arise based on mutual understanding. Annual general meeting (AGM) should be used as an avenue for communication between the firm and private investors. The firm should use it as a means to encourage private investors' participation in its affairs. Section (D) of the principles recommends for the provision of multi-purpose and understandable financial report that permits the assessment of the present financial position and future prospects of the firm. The board should

course to establish a functional and sound internal control system to safeguard the assets of the company. Also, the board should establish and maintain a cordial and transparent relationship with firm's auditor.

The second part of MCCG 2000 set out best practices for Malaysian companies. Best practices are designed to help businesses in developing their governance. Compliance with this section is voluntary. However, companies are required to disclose the extent of compliance with best practices in their financial reports and justify or explain the cause of their departure from it if so exists. Section (AA) of Part 2 describes the duties and responsibilities of the company's board of directors. It also provides for the balance of power and authority within the board such that no any individual or small group that can dominate the decision of the board. The section requires the reporting entity to publicly explain the absence of CEO duality if so existed. The qualities of independent non-executive directors were enumerated in the section. Section (AA III) recommends that independent directors should constitute at least one-third of the total board membership and the compliance with this should be disclosed in the financial reports.

Where controlling or significant shareholder exists, the board should explain the mechanisms taken to ensure balance and fair representation of other shareholders in the board structure and firm's decisions. A committee of exclusively non-executive directors, with independent directors as the majority of the members is to be saddled with the duty of reviewing the board from every aspect, scrutinizing and proposing new directors to the board whenever such need arise. The board should meet on regular basis and properly documents the minutes of each meeting. They should also disclose in an annual report the number of meetings held in a year together with its attendance

by each director. The board, together with CEO should design or approve the schedule of responsibilities for the board and the CEO. They should design and approve the corporate objectives, which CEO and management team should meet. Members of the board should have access to any information that will enable them to discharge their duties effectively.

Section (BB) of Part 2 provides for the establishment of the audit committee with not less three directors as members, of whom the majority shall be independent. An independent non-executive director should head the committee, with the terms and references of the committee clearly written and given to the committee. The duties of the committee should include among others, the appointment of and review of management letters from the external auditor.

The committee should consider any RPTs with the firm or its group and should meet with the external auditor at least once in a year. The committee should disclose in an annual report the number of meetings held in a year together with its attendance by each director. Section (CC) requires the board to maintain efficient communication strategy that will allow both the board and management to communicate with all parties concern. The system should be able to receive feedback from company's shareholders, which should later be incorporated into business decisions of the company.

The third part of the MCCG 2000 is addressed to investors and auditors of the listed firms, not the companies themselves. This part is to enable them to participate and play a substantial role in achieving good corporate governance in their respective companies. Compliance with this section is purely voluntary and it advises

institutional shareholders to discharge their voting right and engage the company through direct communication on any matter affecting their interest. External auditors are advised to maintain their independence and reports directly to the shareholders as provided in the relevant professional guidelines. The last part of the MCCG 2000 provides explanatory notes to the three parts discussed above. The section spelled out some practices that are tagged best practices. They are developed for listed companies that need not disclose the situation that forces them to depart from the corporate governance best practice.

2.5.2 Malaysian Code of Corporate Governance 2007 (MCCG 2007)

The introduction MCCG in 2000 has improved corporate governance mechanisms in Malaysian corporations (Wahab et al., 2007). However, in 2007, MCCG have been reviewed by the securities commission and approved by high-level FCCG effective from 1st October 2007. The primary aim of the MCCG review is to improve the quality of the listed companies' board and maintain the existing investors' confidence in the Malaysian capital market (Badawi, 2007). The eligibility for appointment as director, the role of the nominating committee, qualification for appointment as a member of audit committee, composition of audit committees, frequency of meeting of the audit committee, internal audit unit and their reporting chain are the major areas affected by the amendment. The review did not affect the first part of the MCCG 2000, rather, are more on the second part of it that is the best practice.

The revised code provides clear direction on the areas that nominating committee should take into account while assessing the candidate's eligibility for directorship. This is done to improve the competency and efficiency of the board members in the

discharge of their corporate oversight and control. The reviewed code also requires the nominating committee to document the assessment and evaluation process undergone properly while recommending any candidate for directorship including independent non-executive directors. Minutes of the board meetings should cover, not only the decisions arrived at, but also the issues discussed before arriving at such decision.

On the audit committee, MCCG 2007 provides that membership of the audit committee should be exclusively for financially expert non-executive directors. The frequency of meeting with the external auditor without the present of executives has been increased to at least twice in a year. Moreover, the finance director, the head of the internal audit unit and representative of the external auditor should attend the meetings of the committee.

The committee can invite any other board member to attend its meetings where the situation warrants. The Chairman of the committee should engage with the management on all relevant issues affecting the company. The activities of the audit committee should form part of the corporate governance disclosure in the annual report of the company. The revised code mandates for the establishment of an internal audit unit in all public listed companies. The unit should be independent of the management and reports directly to the audit committee.

2.5.3 Malaysian Code of Corporate Governance 2012 (MCCG 2012)

Securities Commission Malaysia had issued a newly revised code of corporate governance in 2012. MCCG 2012 focuses on the roles of corporate directors, been responsible fiduciaries through strengthening the composition and structure of

corporate boards. Directors have the duty to direct their efforts and resources to achieve the best for the company and its shareholders without compromising the interest of other stakeholders.

They should be effective custodians and stewards of the company in setting strategic direction, effective risk management strategies, putting strong internal control in operations, compliance with relevant laws and ethical values and the rest. MCCG 2012 provides recommendations and commentary to each recommendation for a better understanding of its contents. In summary, MCCG 2012 places a sound basis for corporate boards and their committees to discharge their fiduciary duties efficiently. It also encourages balanced and timely disclosure, improves reporting quality, stresses the importance internal control as well as risk management in the corporations.

The first principle of the MCCG 2012 requires the board to set and ensure compliance with the code of conduct and ensure sustainability in corporate operations. It also requires the board charter to be public and periodically reviewed. Annual assessment of independent directors, restriction of their tenure and justification for the extension of tenure as non-executive as the case may be, becomes part of the new code. Principle 3 (recommendation 3.5) of MCCG 2012 provides that majority of board members should be independent directors if the chairperson happens to be a non-independent director, and the board should set a time expectation that each member must commit to the company. Corporate transparency through the efficient use of information technology where possible should be part of the corporate policies. The code promotes the use of poll while voting on any matter at general meetings.

2.6 Other Statutory Regulation

Apart from MFRS and MCCG, there are some other regulations that regulate the corporate activities and reporting in Malaysia. They include the followings:

2.6.1 Bursa Malaysia Listing Requirement

Bursa Malaysia listing requirement spelled out the requirements that existing or potential listed companies must comply with while operating in the market. Failure to comply with any part of the listing requirement can be penalized, depending on the magnitude of the breach. Bursa Malaysia has been authorized to enforce compliance with the MFRS, MCCG and other relevant financial laws by the listed companies through its listing requirements.

Section 2.03 (2) of the listing requirement provides that all listed companies should keep its investors and the general public fully informed of all facts or information that might have a material effect on their respective interests. Sub-section (5) requires directors to act in the interest of all shareholders, particularly in companies with a dominant shareholder in the event of transacting with the dominant shareholder. These requirements are aimed to achieve fairness among the market players, adequate, timely and balanced disclosure.

Section 10.08 requires for the announcement of any RPTs with the percentage ratio of 0.25% of the relevant item, and above as quick as possible after the terms of the transaction have been agreed on. The section also requires the listed company to send a circular to the shareholders and seek their approval at the general meeting for any RPTs with the percentage ratio of 5% of the relevant item or more. The circular should

contain a detail information on the terms and conditions of the transaction. Furthermore, the company must assign an independent adviser to vet whether the transaction is fair and reasonable, assess if it is detrimental to minority shareholders and advise them accordingly.

Section 10.08(4) requires the appointment of independent principal adviser (a competent corporate finance adviser) where the RPTs is up to 25% of the item concerned. The adviser is to advise the company on the appropriateness of the terms of the transaction, its effect on minority shareholders, compliance with operational laws, magnitude of disclosure required in the circular and its announcement. The circular should contain information on the parties involved, the relationship, nature and transaction type, the amount transacted, outstanding balance if any, announcement date and alike. The adviser should also confirm to Bursa Malaysia that the due process has been observed throughout the conduct of the transaction. Sub-section (6) refrains interested party from attending or voting at the meeting in which the affected transaction will be deliberated. The section also provides that the shareholders' approval should only be sort of at the general meeting through poll voting.

Section 15.25 sub-sections 1 and 2 require listed firms to provide narrative disclosure on their compliance with MCCG, detailing on how corporate governance principles have been applied in their ordinary or peculiar circumstances. Listed companies are required to take into consideration the recommendations provided in the MCCG while making corporate governance disclosure in the annual report. Recommendations in which the reporting company fails to comply with should also be disclosed together with the reason for non-compliance. The alternatives adopted (if any) are also required to be disclosed in the annual report of the listed company.

2.6.2 Companies Act 1965

Countries differ regarding outsider (minority shareholders and creditors) protection and this affects the nature, growth and development of their capital market (Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1996). Common law countries are regarded best in terms of investors' protection than civil law countries (Djankov et al., 2008; Porta et al., 1996). Like several other Commonwealth countries, Companies Act (the Act) in Malaysia is similar with that of the United Kingdom (the UK) in many respects. The Act (as amended) makes some provisions that protect investors from insider dealings and compel directors to disclose their interest in the company.

Section 131 (1) requires the director to as soon as possible inform the board the nature of his interest in transacting with the company. Section 131(A) restrains the director from deliberation in the issue in which he has an interest. The section does not require the interested director to be physically absent at such meeting, but it restrains him from taking part in the decision-making process. Though, some commentators are of the view that his presence can affect the outcome of the process (Chan, 2010).

Section 131(7A) requests the disclosure to include the interest of the immediate family of the director as well. Section 132 E requests for the approval of shareholders in the general meeting for any material transaction with directors, substantial shareholder, or any other person in charge of operations or management position in the company. Sections 134 prohibit the company from giving or guaranteeing a loan to its director or substantial shareholder except with prior approval of shareholders. The prohibition provided in these two sections covers the immediate family members of the interested party.

2.6.3 Minority Shareholder Watchdog Group (MSWG)

In 1999, the finance committee on corporate governance (FCCG) recommended for the establishment of the independent body that will monitor and combat corporate abuses by insiders against the interest of minority shareholders (Wahab et al., 2007). This recommendation leads to the establishment of MSWG in 2000. The body serves as an integral part of the capital market framework responsible for the protection of minorities against the selfish interest of the major stakeholders via shareholders activism.

MSWG influences the decision process of listed companies, monitors their compliance with the laid-down corporate governance principles and raises an alarm to the relevant authority on the breach or any action against the minority shareholders. Satkunasingam and Shanmugam (2006) state that even though MSWG yet to make any significant impact in minority shareholder protection, the group has a bright potential to engage more in shareholder activism in the future.

2.6.4 International Standard on Auditing 550 (ISA 550)

International standard on auditing 550 requires the corporate external auditors to perform appropriate audit procedures that will enable them to identify, assess and respond to the risk of material misstatement that may arise as a result of the reporting entity's failure to appropriately disclose the RP relationship, RPTs, outstanding balances or any other relevant information in accordance with relevant regulatory and statutory requirements that are in operations within the client accounting environment.

The fourth paragraph of the standard provides that regardless of the existence of other reporting regulations, the auditors are required to understand the client's RP relationships and RPTs. This is to enable the auditor to obtain sufficient evidence that will assist him to conclude whether the result of the operation and the financial position of the client are affected the RP relationship or RPTs. Paragraph 5 of the standard requires the auditor to exercise extra efforts to identify one or more fraud risk factors. This is because fraud can easily be committed in RPTs.

The auditors are also required to review the information given to them by those in charge of the affairs of the company on all categories of RP and the nature of the relationship. This is to enable the auditor to form an opinion on the scope of the work required to be conducted on the RPTs. The auditor is also required to assess the level of compliance with relevant disclosure requirements and form an opinion on whether such disclosure is adequate.

2.7 Disclosure Measurement Literature

There is no consensus about the process that must be followed to establish disclosure quality indices or model (Beretta & Bozzolan, 2008; Botosan, 2004; Urquiza, Abad Navarro, & Trombetta, 2009). The issue of narrative or non-quantitative information that has gained more prominence in recent times has compounded the long-standing disagreement as to whether the quantity of disclosed information represents the quality of disclosure. In most of the disclosure studies, measures of the disclosure are classified into two broad categories: namely subjective analysts' rating and semi-objective studies (Beattie et al., 2004; Beretta & Bozzolan, 2008; Urquiza et al., 2009).

2.7.1 Subjective Analysts' Rating

The history of the Association of Investment Management And Research (AIMR) the body in charge for the issuance of subjective analysts rating, can be traced to the US-based association, the Financial Analysts Federation (FAF) established in 1947. The management of FAF established another independent body, the Institute of Chartered Financial Analysts (ICFA) in 1959 for the credentialing program. Later, the two bodies merged to become AIMR. AIMR has been rebranded as Certified Financial Analysts (CFA Institute) with same mandates as that of the former body.

AIMR rank the quality of information disclosed by companies based on the information released in their corporate reporting. This type of ranking is referred to as subjective analysts' rating. AIMR collects all corporate information released to investors (ranging from annual, quarterly reports, direct communication with investors and analysts, press releases, and other corporate reports) from an average of twenty seven industries every year. On average, AIMR requests thirteen analysts to evaluate an average of seventeen companies from each industry. AIMR analysts use the list of predefined factors that are weighted according to their relative importance to determine the score obtained by each company.

Despite its widespread acceptance (Brown & Hillegeist, 2007; Lang & Lundholm, 1993, 1996), the approach has been criticized by Healy and Palepu (2001). The major drawback of the approach is that it considers US companies only, external users are not familiar with the scoring method and how the companies are selected for the inclusion in the ranking process. Similarly, Lang and Lundholm (1993) describe the approach as the one that is based on analysts view on disclosure, not on the actual

direct measures of disclosure. Moreover, the number of companies selected for the ranking are too small to represent the population (Urquiza et al., 2009).

2.7.2 Semi-Objective Studies

Semi-objective studies are disclosure studies that use self-constructed indices in the measurement of the extent and quality of disclosure. In these studies, self-constructed indices are developed to overcome the shortcomings of subjective ratings. Semi-objective studies are divided into two broad categories viz: textual analysis studies and disclosure index studies (Beattie et al., 2004; Urquiza et al., 2009).

2.7.2.1 Textual Analysis Studies

The use of thematic content analysis, which usually assesses the number of times that a word or sentence appear in the released information is common method under textual analysis. It is conducted without considering whether the quantitative value is assigned to those words or sentences or not. Several studies in accounting literature have adopted the approach in measuring narrative disclosure (Aljifri & Hussainey, 2007; Al-Najjar & Abed, 2014; ku Ismail, 2003; Williams, 1999). However, the approach has been challenged by some researchers. Urquiza et al. (2009) opine that the increasing number of words or sentences disclosed cannot be taken as an increase in transparency or increase in quality of information. Therefore, readability studies were proposed to address the limitations of thematic content studies.

Readability studies are designed in such a way that narrative disclosure are quantified through readability formula such as flesch index⁴. The score obtained from the index will then be compared with the established benchmark to assess the difficulties in reading the information disclosed in an annual report. The essence of studies of this nature is to detect the difficulty level of reading annual reports (Linsley & Lawrence, 2007).

The findings of all twenty six readability studies reviewed by Jones and Shoemaker (1994) document reading level as difficult or highly difficult. Like the previous method, this method has also been criticized that it pays attention to word or sentences while ignoring the real aspect of the text as a whole. Another problem associated with readability studies is that it does not consider the motivations or interest of the reader and there may exist variations in children or adult-based writings compared to technical accounting narrative writings (Beattie et al., 2004).

The last aspect of textual analysis studies is linguistic analysis. Sydserrff and Weetman (1999) in their seminal paper demonstrate how an applied linguistic method can be deployed to the field of accountancy to redress the shortcomings of readability studies. Sydserrff and Weetman designed a new index called “texture index” which was based on six criteria for scoring narrative disclosures. The six criteria are termed as indexicals and the total narrative score from each indexical will make up the overall score for the texture. The method is proved to be powerful in analyzing operation and financial reports. However, the authors caution against concluding that the higher the

⁴ An index constructed based on both words syllable and sentence length count.

textual index, the better the quality of the disclosure as there exist low correlation among the individual indexicals.

2.7.2.2 Disclosure Index Studies

Under disclosure index studies, researchers construct disclosure indices with the assumption that a certain amount of disclosure stands as a proxy for disclosure quality. Disclosure index studies are categorized into un-weighted and weighted disclosure indices. In most of the unweighted index studies, disclosures are scored using dummy variable in which one represents the disclosure of an item while zero for otherwise. Therefore, it measures only the quantity of disclosure (Beretta & Bozzolan, 2008; Yeoh, 2005).

Although un-weighted index studies have gained widespread acceptance in disclosure studies (see Tsalavoutas, 2011), the approach is criticized by many researchers. The approach may contain some items of disclosure that are not applicable to some companies. Additionally, the assumption that more disclosure represents more quality may not stand (Yeoh, 2005) and variation in the requirements of standards can make one standard to dominate other (Tsalavoutas, 2011).

Conversely, weighted index studies have gone beyond the quantity of disclosure and covered the aspect of disclosure quality. This approach takes an ordinal coding (typically three levels) in the measurement of disclosure quality. Based on Botosan (1997), quantitative disclosures are to be given more weight in the disclosure index because of their clarity, precision, usefulness and may even go further to improve credibility and reputation of management reporting.

In a somewhat extension to the work of Botosan (1997), non-financial information disclosed in annual reports are scored by Robb, Single, and Zarzeski (2001) using ordinal ranking. Three points were assigned to extensive disclosure, two points for some disclosures while one point was given to non-disclosure for each item of their disclosure index. Shenzhen stock exchange has developed information evaluation index in 2001, which measures both quantity and quality of disclosed information. Gao and Kling (2012) used this index and categorize information disclosure as excellent, good, sufficient and insufficient.

However, both weighted and un-weighted score give a nearly similar result if a lot of items are inserted in the index (Beattie et al., 2004; Sharma, 2014). In an effort to address the problems associated with the index based disclosure quality measurement, Beattie et al. (2004) developed a new disclosure quality framework. This framework incorporates many aspects of disclosure quality to deal with the problematic and complex nature of the disclosure quality issue. Nonetheless, their framework was criticized by Botosan (2004) as it failed to incorporate essential qualitative characteristics of quality information developed by IASB and FASB.

2.8 Compliance with International Financial Reporting Standard (IFRS)

Tower, Hancock and Taplin (1999) define compliance with IAS/IFRS as the degree to which reporting entity comply with vast issues stated in the IAS/IFRS issued by IASC/IASB. There are many factors that influence country's adoption of IFRS as reporting standards. Hassan, Rankin and Lu (2014) find that coercive, normative and mimetic institutional isomorphisms are among the major factors that motivate countries in adopting IFRS as reporting standards.

IFRS like many other accounting standards spelled out a guideline on the minimum relevant and high-quality information that a firm must disclose in the financial reports. This is because firms that fail to comply with the disclosure requirement withhold some vital information that can affect capital market operations. Intentional non-compliance with the standard can render the financial report to be biased and misleading (Glaum et al., 2013). However, some of the companies that voluntarily or are mandated to adopt IFRS as their reporting standard claim to comply with the standard but in actual sense are not (Street & Bryant, 2000).

Findings of the studies on the level of compliance with IFRS are inconclusive across the globe. Several studies document an increase in compliance with IAS/IFRS (Al-Akra, Eddie, & Ali, 2010; Al-Shammari, Brown, & Tarca, 2008; Street & Bryant, 2000; Taplin, Tower, & Hancock, 2002). Adenola (2011) documents decrease in the level of compliance with the accounting standard. Similarly, Dang-Duc (2011) assesses the level of compliance of SMEs with IFRS for SME and finds limited compliance with the standard by SMEs. Misirlıoğlu, Tucker and Yükseltürk (2013) state that although there is some improvement in general compliance, most of the items required to be disclosed by IFRS are not made available to the public.

Glaum and Street (2003) examine the level of compliance with IAS and US-GAAP by 100 German firms that used IAS and US-GAAP as reporting standard respectively for the financial year 2000. The authors find that the average compliance level is considerably high, and average compliance level is significantly lower for IAS firms compared to their US-GAAP counterpart. Hodgdon et al. (2008) use the sample of the financial statements of 89 firms for 1999 and 2000 financial years. They examine the level of compliance of the companies that claim to be complying with IFRS. The

authors find that firms disclose most, if not all, of the items required to be disclosed in a financial statement by IFRS.

Misirlioğlu et al. (2013) examine the level of compliance with IFRS by the Turkish firm in their first year of mandatory adoption (2005). They document modest improvement in disclosure compliance with respect to most of the standard been reviewed even though a high level of compliance was expected. Misirlioğlu et al. attribute the low level of compliance with the lack of proper preparation for adoption of the new standard by the Turkish companies. Dang-Duc (2011) document limited compliance with accounting standard by SMEs. The author provides evidence for the dominance of legal issue in accounting compliance on which SMEs stand little chance of benefiting from.

Dang-Duc (2011) finds that limited compliance with accounting standard by SMEs is associated with the low level of accounting and management knowledge on the cost-benefit relationship of the compliance with the standard. A study conducted by Glaum et al. (2013) examined the level of compliance with the disclosure requirements of IFRS 3 across seventeen European countries. The authors document substantial non-compliance with the standard and report uneven implementation of IFRS across the reviewed countries.

2.9 Summary of the Chapter

This chapter overviews the geographical, social and economic environments of the Malaysia. It also discusses the trend in the emergence of the financial reporting standards in Malaysia. It started with the IFRS issued by the IASB. The objectives of

IASB are stated as to promulgate high quality internationally acceptable reporting standard that can meet the needs of all stakeholders in financial reports, promote compliance with the set standard and facilitates the process of adoption/convergence with the set standard globally. It was established that the establishment of MASB has marked a significant landmark in the Malaysian reporting environment. The Financial Reporting Act of 1997 transferred role of issuance and enforcement of the compliance with Malaysian accounting standard to MASB. The board has issued a number of FRS before switching to MFRS in 2012.

Series of Malaysian codes of corporate governance together with other reporting regulations are presented in the chapter. The first code was issued in 2000 and revised in 2007 and 2012. Other supporting regulations includes Bursa Malaysia listing requirements, company Act of 1965 and minority shareholders watchdog group. Recently, international auditing standard becomes into operation. Disclosure measurement issues were also highlighted in the chapter. The chapter concludes with a discussion of the studies on the compliance with the IFRS globally.

CHAPTER THREE

DETERMINANTS OF RELATED PARTY TRANSACTIONS

DISCLOSURE

3.0 Introduction

This chapter reviews the concept of related party and RPTs from the academics and regulators points of view. The chapter discusses the types and perspectives of RPTs as postulated or discovered in related literature. RPTs disclosure and RPTs disclosure approaches are also presented in the chapter. Also, the chapter considers the issue of RPTs regulations across the globe and went further to discuss the issues of general disclosure, disclosure quality. The chapter ends with the review of the factors that determine the level of compliance with the the of accounting standard on RPTs.

3.1 The Concept of Related Party Transaction (RPT)

MFRS 124 defines RPT as any transfer of resources, services or obligations between reporting entity and a related party, regardless of whether the price is charged. Section 9 of the standard defines related party as any person (including his proxies) that controls, has a significant influence or occupies a key management position in the reporting entity or its parent company. Sub-section 2 provides that an entity is said to be related to reporting entity if:

1. It belonged to the same business group with reporting entity.
2. It is an associate or in a joint venture with parent, subsidiary or sister companies of the reporting entity.

3. Both entities are in joint venture with the same third party.
4. One of the entities is in the joint venture while the other is an associate of the same third party.
5. The entity is a post-employment plan set-up for the employees of either entity.
and
6. Controlled by the related person identified above.

Several studies discuss and elaborate RPTs definition based on the context given to it by IASB. In the words of Pozzoli et al. (2014) IASB definition extensively includes a transaction with major shareholders, board members and any other group with a power to influence the decisions of the company. Kang, Lee, Lee and Park (2014) define related party transactions as any transaction entered into with related entity such as board members, shareholders, managers and affiliated organizations. RPTs involves transactions between a company and another entity that are related such as managers, directors, controlling holders; or firms under their control and other affiliated companies (Nekhili & Cherif, 2011). Similarly, Di Carlo (2014) describe RPTs as a form of transaction that the entity engages with its holding company, subsidiary, associates, majority shareholders, directors, managers, or their immediate relative.

A proper understanding of related party is necessary for better understanding and identification of RPTs. In many countries, firms are believed to have an automatic relationship with their major shareholders, members of the board, managers, companies under their control, affiliated and associate entities and alike depending on the legal provisions that are in operation within the firm domain. Related Party relationship extends its frontiers to cover the persons or companies that have a direct connection with the persons or entities mentioned above. In Malaysia, section 9 of

MFRS 124 provides a concise definition of related party and an extensive list of individuals and entities that are seen by the law as related parties. Nowadays, some events have proved that firm can relate to herself. This usually takes place in a transaction as a share buyback, where the firm acquires her shares with the management or directors serving as her proxy.

RPTs are prevalent all over the world. Lin, Liu and Keng (2010) states that 96% of the Taiwanese listed companies reported RPT in 2006. Similarly, 90% of Chinese listed companies have engaged in different kinds of RPTs at varying degree (Jian & Wong, 2010), while more than 77% US firms have disclosed at least one form of RPT in 2004 financial year (Young, 2005). Excessive use of RPTs might warrant minority shareholders expropriation even if the transactions were not initiated for that purpose. This is because it is not all RPTs that are detrimental to outsiders (Yeh et al., 2012). Generally, if the motive of RPTs is not made public, the transaction leads to the tunneling of firm's resources by controlling holders, directors, managers or administrators (Nekhili & Cherif, 2011).

3.2 Types of Related Party Transactions

Several studies on RPTs have used divergent criteria to classify RPTs depending on the research objectives (Cheng & Leung, 2014; Ge et al., 2010; Kohlbeck & Mayhew, 2010). However, the most prominent classification is the one given by Cheung et al. in (2006). The authors classified RPTs into transactions that may result in expropriation, transactions that can lead to propping and transactions that are aimed at enhancing the strategic position of the firm. Recently, Williams, (2014) opines that all

forms of RPTs can be used for expropriation or propping purposes. Therefore, the primary concern should be on the terms of the transaction not on the transaction itself.

3.2.1 Tunneling Related Party Transactions

Tunneling RPTs are the dominant form of RPTs in the literature. The term tunneling has been defined as the prejudicial actions that are aimed at extracting undue resources from the firm. Several studies believe that most of RPTs are conducted with the intention of extracting private benefits. Based on this premise, many studies use RPTs to represent tunneling (Lou, Wang, & Yuan, 2014; Mustafa, et al., 2011).

Typical examples of expropriation RPTs include asset acquisition and disposal, trading relationships, equity sales and cash payment (Cheung et al., 2006; Lin et al., 2010), non-operational fund occupancy (Jiang et al., 2014), loan guarantee (Lin et al., 2010) and alike. Atanasov, Black and Ciccotello (2008) believe that insiders can use any form of RPT for expropriation purpose. They unbundle tunneling into four main categories namely cash flow tunneling, asset tunneling out, asset tunneling in and equity tunneling. These four transactions are further decomposed into fifteen sub-categories.

Recently, Williams (2014) decomposes expropriation in RPTs into operating, investing and financing transactions. Operating RPTs that can be used to tunnel resources include sales of goods or rendering services at the price below their fair value, purchases of goods or services at the price above the fair market value. Private offering of shares, convertible by company or sales of assets at the price below the fair value, acquisition of assets at the price above the open market price are some of the

common examples of tunneling investing activities. While financing tunneling in RPTs are usually executed through loans, donations, loan guarantee, leasing or borrowing at the terms that are unfavorable to the firm.

Controlling shareholders use several forms of RPTs such as favorable transfer pricing to their surrogates, advantageous lending terms, unjust assets transfer/exchange and many more to siphon corporate wealth (Djankov et al., 2008; Jameson et al., 2014; La Porta et al., 2000; Liu & Tian, 2012; Munir et al., 2013). In these environments, controlling shareholders are capable of shifting corporate resources to their personal advantage without shouldering the complete financial consequences (Lin, Ma, Malatesta, & Xuan, 2012). Jiang et al. (2014) find that tunneling is detrimental to the future prospect of firms and suggest that regulators should strengthen the minority shareholders' protection that is beneficial to the long-run survival of firms.

Peng et al. (2011) argue that when a firm is financially sound, controlling shareholder tend to use RPTs to tunnel the resources of that firm to benefit other firms within the group. Similarly, Cheung, Qi, et al. (2009) find that business group members engage in transactions at unfavorable prices compared to comparable arms' length transactions. Firms acquire assets through the RPTs at a higher price compared to prevailing market price. In contrast, when they dispose of assets to the group member, they dispose of at a lower price compared to the similar transaction based on the prevailing market price.

Lou et al. (2014) supported the position of Peng et al. (2011) with empirical evidence. They find that financially sound firms exchange their high-quality assets to group member firm with low-quality assets, which is a clear case of tunneling incentive. Du,

He and Yuen (2013) find that controlling shareholder in a firm with free cash flow undertakes many self-dealing transactions that lead to firm's value losses. When the firm becomes no longer attractive to the public, they delist the firm from the market (going private) through payment of small premium to minority shareholders.

To consolidate these findings, Su, Fung, Huang and Shen (2014) examine the relationship between payments of the cash dividend and RPTs. They find a negative relationship between payments of the cash dividend and RPTs. That is to say, firms with low cash dividend payments are associated with high RPTs, a clear sign of corporate wealth expropriation. Tunneling has also been identified as the factor that affects executive pay-performance sensitivity negatively (Wang & Xiao, 2011). In most cases, tunneling involves collusion between controlling shareholder and executives. It will make controlling shareholder to be less curious about the performance-based executive plan, which will in turn affect the future performance of the firm.

3.2.2 Propping Related Party Transactions

Friedman et al. (2003) define propping as an act of injecting personal resources to the listed firm. Propping RPTs involve the transfer of resources from a related party to the interested firm through related party activities. In this situation, a controlling shareholder uses his personal resources to bailout a listed firm (Jian & Wong, 2010). Propping RPTs covers cash receipts, loans, and donations from related parties.

Going by Williams, (2014) classification, sales of goods or rendering services at the price above their fair value, purchases of goods or services at the price below the fair

market price are good examples of propping through operating activities. Private offering of shares, securities, convertible by company or sales of assets at the price above the fair value, acquisition of assets at the price below their arm's length value are common examples of propping investing activities. Lastly, propping through financing RPTs can be performed using loans, donations, loan guarantee, leasing or borrowing at the terms that are favorable to the firm.

Jensen and Ruback (1983) theory of market for corporate control provides a theoretical rationale for the propping behavior. Controlling shareholders have to commit their personal resources in a bid to bail out their firms, protection against takeover bid or been delisted by regulators. Unlike in the case of corporate tunneling, minority shareholders benefit from propping by controlling shareholder (Bai, Liu, & Song, 2004). The possibility of propping by a controlling shareholder in a firm or group with pyramidal ownership structure provides minority shareholders with an intercorporate insurance in the event of financial distress (Dow & McGuire, 2009; Riyanto & Toolsema, 2008).

RPTs are used in many instances to prop up underperforming firms and save them from reporting loss (Yeh et al., 2012). The financial position of the firm has been found to be a major determinant for the period in which controlling shareholders decide to prop-up their listed firms or not. Peng et al. (2011) find that when listed firms are in financial distress, RPTs are used by controlling shareholders to prop-up their distress firms. Controlling shareholders use listed firms to guarantee the debt of other distress group members, leaving the securing firm at a risk of default (Johnson, La Porta, et al., 2000). Williams and Taylor (2013) investigate the factors that instigate Chinese listed firms to prop up their reported earnings via the use of abnormal RP

sales. They find that the firms' risk of been categorized as special treatment firm (and subsequently been delisted) and the proportion of non-tradable shares in the firms' capital structure are the primary factors that induce firms to involve into propping activities.

3.2.3 Strategic Rationale Related Party Transactions

According to Cheung et al. (2006) firms engage in these forms of transactions, not for the sake of minority expropriation. They are transactions meant to improve the firm's strategic position and increase its competitive advantage. Typical examples of this class of RPTs include a takeover of associate listed company, acquisition or sale of joint venture stake from/to remaining ventures and acquisition or divesting from foreign listed firm.

Table 3.1 summarises the different types of RPTs based on the classification given by Cheung et al. (2006).

Table 3.1
Classification of Related Party Transactions

Types of related party transactions	Description
<i>Transactions that are a priori likely to result in expropriation of the listed firm's minority shareholders</i>	
Asset acquisitions	Transactions that involve the acquisition of tangible or intangible assets by the listed company from a connected entity or from a private company majority-controlled by that entity.
Asset sales	Transactions that involve the sale of tangible or intangible assets by the listed company to a connected entity or to a private company majority-controlled by that entity.
Equity sales	Transactions that involve the sale of an equity stake in the listed company to a connected entity or a private company controlled by that entity.
Trading relationship	Transactions that involve the trade of goods and services between the listed company and a private company majority-controlled by a connected entity. They include purchases by the listed company or sales or both.
Cash payments	Transactions that involve direct cash payments by the listed company to a connected entity or to a company controlled by that entity or to a subsidiary (including loans and cash assistance), and or provision of cash guarantees by the listed company for debts owed by the connected entity or by the companies controlled by the connected entity.
<i>Transactions likely to benefit the listed firm's minority shareholders</i>	
Cash receipts	Transactions that involve direct cash assistance or loans provided by the connected person to the listed company.
Subsidiary relationship	Transactions between a listed company and one of its subsidiaries. They could involve acquisitions or sales of equity stakes or assets and trading relationships.
<i>Transactions that could have strategic rationales and perhaps are not expropriation</i>	
Takeover offers and joint ventures	Cases in which the listed company receives a takeover offer by another publicly listed company that holds a toehold, and cases in which the listed company forms a joint venture or strategic alliance with another company that already holds a stake in the listed company.
Joint venture stake acquisitions	Transactions that involve acquisitions by the listed company from a third party of a stake in a joint venture in which the company participates as a joint venture partner. The connected person is the third party in his or her capacity as a subsidiary shareholder.
Joint venture stake sales	Transactions that involve the sale by the listed company to a third party of a stake in a joint venture in which the company participates as a joint venture partner. The connected person is the third party in his or her capacity as a subsidiary shareholder.

Source: Adopted from (Cheung et al., 2006).

3.3 Related Party Transaction Perspectives

Based on existing literature, RPTs can be interpreted using three available perspectives viz: conflict of interest perspective, efficient transaction perspective and recent contingencies perspective.

3.3.1 Conflict of Interest Perspective

Under the conflict of interest perspective, RPTs are considered potentially harmful to minority holders and value destroying. This perspective is based on agency theory (Jensen & Meckling, 1976) which view RPTs as an instrument used by controlling shareholders, directors or managers to expropriate firm resources at the expense of minority shareholders (Di Carlo, 2014). In certain situation, RPTs can be used by corporate executives and controlling shareholders of listed firm to earn private benefit (Wong & Kim, 2015).

Private benefits of control are those benefits that are exclusively enjoyed by insiders ranging from exorbitant emolument package, empire-building power, perquisites, tunneling and many others⁵ (Doidge, Karolyi, Lins, Miller, & Stulz, 2009; Dyck & Zingales, 2004). RPTs can be used also to move profit from listed firm to the non-listed firm thereby depriving minority shareholders access to their fair portion of return (Wong & Kim, 2015). Cheung et al. (2006) opine that RPTs such as assets sales or acquisition, trading relationship, equity sales and cash payment to related parties can likely be used to tunnel the firm's resources at the detriment of minority shareholders.

⁵ See Burkart, Panunzi, and Shleifer (2003) for managerial benefits of keeping family firms.

Mustafa et al. (2011) support this position; they describe RPTs as prejudicial to minority shareholders.

Listed firms with free cash flow are found to be used by insiders to offer generous trade credit and other forms of loan to their related parties (Jian & Wong, 2004). In light of these results, investors are likely to be skeptical about the real reason behind the RPTs. They tend to be doubtful on the motives of the company that engaged in such dealings even if it is stated in the disclosure that the transactions are based on the arms' length principle (Di Carlo, 2014). Consequently, RPTs disclosures that are used as a technique for handling conflict of interest attributed to this kind of transactions may not offer a full solution to RPTs problems, leaving the conflict of interest perspective problems unsolved.

3.3.2 Efficient Transaction Perspective

Efficient transaction perspective relates RPTs to the internal market hypothesis that is coined from the transaction cost theory (Coase, 1937; Williamson, 1985). The principal assumption of these theories is that RPTs can serve as a tool for minimizing or even complete removal of both *ex-ante* and *ex-post* transaction costs. This perspective considers RPTs as economically viable especially in many emerging economies' institutional contexts, where there are no efficient factors of production and product markets (Pozzoli et al., 2014). Cheung et al. (2006), and Jian and Wong (2004) consider RPTs as routine business transactions aimed at enhancing the efficiency of the operation by minimizing transaction lag time and cost through the business link. One of the reasons behind the establishment of the business group is the

removal of transaction costs (Claessens, Fan, & Lang, 2002). There are several costs and benefits associated with internal market hypotheses.

Some of the benefits include better resource allocation and utilization, deeper reciprocal knowledge, efficient coordination of divergent activities (Yeh et al., 2012). RPTs have also been linked to quick decision making and response as well as eliminating delays or obstacles in contract negotiation with a third party (Loon & DeRamos, 2009). Several studies prove that RPTs saved some financially distressed firm from collapse. Some loss making (but marginally profitable) companies may be operating at an economic efficiency within the boundary of the group. These companies lack independent durability; they are bound to collapse if not supported by the group, yet, their contribution to the overall group is positive. RPTs can be used to retain these firms for the achievement of the overall goal of the group through system effect (Claessens et al., 2002; Jian & Wong, 2010; Williamson, 1985).

Djankov et al. (2008) observe that there is no legislation across the globe that forbid RPTs entirely because of its economic rationality. In fact, many countries in the world have promulgated relevant laws that permit appropriate regulatory bodies to regulate RPTs within their domain. These scenarios justify the superiority of the benefits of RPTs against its related costs. Only RPTs that portrayed the real risk of prejudicial use of firm's resources are banned by regulators (OECD, 2012).

3.3.3 Contingency Perspective

Recently, contingency perspective emerges based on the critical analyses of the theories and empirical studies of above two perspectives by Pizzo in 2011. Both conflicts of interest and efficient transaction theories have their pros and cons. Empirical studies on each of the theories have resulted in inconclusive results and established direct opposite view with each other; making it difficult to make any practical policy concerning RPTs. Contingency theory assumes organizational context and institutional environment to play a significant role in the interpretation and critical analysis of the economic implication of RPTs. Pizzo (2011) proposes that both conflicts of interest and efficient transaction theories can exist concurrently in any given business setting and that RPTs cannot be analyzed independently from governance variables.

To put the above position into practical view, in firms with disperse ownership where the type I agency problem is likely to exist, potentially abusive RPTs are those transactions between firms and their managers. In this case, contingency theory proposes that more monitoring mechanisms should be placed on all transactions that involve firms' managers. On the other hand, the problem in a firm with concentrated ownership is likely to exist in RPTs with controlling shareholders. Therefore, stringent monitoring mechanisms should be placed on all transactions that involve controlling shareholders and their connected parties. The risk of prejudicial RPTs is even higher in a group with pyramidal structure (Di Carlo, 2014). Therefore, it requires more scrutiny from both within and outside firm.

3.4 Related Party Transactions Disclosure

As mentioned earlier in the previous chapter, RPTs are required to be disclosed in financial reports by several financial regulations and enactments globally. These requirements are due to the importance attached to RPTs by the users of financial statements in making their economic decisions and its potential effect on the firm value (Ariff & Hashim, 2013). Capital market regulators in many countries have required listed companies to disclose RPTs in line with IFRS disclosure requirements (Williams, 2014).

In addition to IFRS disclosure requirements, RPTs have now turned out to be subject to vigorous scrutiny by many regulators (Gallery, Gallery, & Supranowicz, 2008). The aim is to avoid the possibility of siphoning firms' assets by insiders at the detriment of outsiders. In view of this, detail disclosure of RPTs can be said to be crucial for users of the financial report to understand, analyze the implications of those transactions on the firm and make appropriate economic decisions therefrom (Kohlbeck & Mayhew, 2010).

Ariff and Hashim (2003) recommend the consolidation of qualitative information (such as nature of the relationship and motive behind the transaction) in measuring the extent of RPTs disclosure. The authors realized that even non-monetary information such as the nature of the relationship can influence the decision of stakeholders and may affect the future operations or value of the firm. Qualitative information can also be used to detect the actual motive behind the transaction as different managerial incentives in RPTs may amount to various types of RPTs disclosure.

Regulators across the globe use RPTs disclosure as a mechanism for minority shareholders' protection, ensuring transparency as well as maintaining objectivity in transactions with related parties (Ge et al., 2010; Kang et al., 2014; Utama & Utama, 2014). The value of all RPTs, other non-financial information associated with such transactions and terms of the transaction are expected to be disclosed in financial reports and should be clear to all parties concern. RPTs should be based on market price principle as any RPT with conflict of interest can result in minority shareholders' expropriation (Gordon et al. 2004).

In an effort to protect minority shareholders against expropriation and intimate them with affairs of their company, countries like the UK, Malaysia and Australia requires both disclosure and approval of shareholders for any substantial transaction in which firm's director or any persons connected with him are parties to the transaction; and stand the chance of deriving some financial benefit from it. Other countries like the US and New Zealand requires only disclosure of those transactions to shareholders, not approval.

According to Lo and Wong (2011) and La Porta, Lopez-De-Silanes and Shleifer (2006) RPTs regulation mitigate the prejudicial transactions within insiders of the firm. It also constrains major parties from transferring company's asset to their personal domain secretly (Kohlbeck & Mayhew, 2010). RPTs disclosure regulation has also impacted on the level of earnings management. Hwang et al. (2013) find that RPT disclosure regulation has reduced the overall discretionary accruals of Taiwanese companies that engage in RPTs with their Chinese associates.

3.5 Related Party Transaction Regulation across the World

RPTs are regarded as healthy and beneficial transactions to firms all over the world. Nevertheless, they can be used as a tool to expropriate if not siphons the firms' resources. Given this two-sided effect of RPTs, many countries in the world resort to regulating the transactions and ensure that only beneficial RPTs are allowed. The adoption of IFRS (IAS 24) as financial reporting standard by many countries in the world leads to some level of uniformity in RPTs regulation across the globe. However, countries vary in terms of degree of compliance, and some countries have additional laws apart from accounting standard that regulates the RPTs within their territory.

Accounting standards serve as a backbone of PRTs disclosure regulation globally. In China, the Chinese ministry of finance is in charge of the issuance of Accounting Standard in the country. In 2007, a new set of Chinese Accounting Standards (CAS) was released to regulate presentation and disclosure of financial information. The new standards are substantially in line with IFRS requirements including those for RPTs disclosure (Williams, 2014). All firms listed on the Chinese capital markets are required to use IAS or HK SSAPs in their financial reporting to check the instances of minority abuse (Fung, Su, & Gul, 2013).

In Indonesia, the Statement of Financial Accounting Standard 7 regulates the conduct and disclosure of RPTs in the country. The RPTs disclosure requirements of Indonesian standard are identical to those of IFRS. Accounting standards play an important role in improving investors' protection in Hong Kong stock exchange. European nations and other countries that adopted IFRS as their financial reporting

standard utilize the requirements of IAS 24 in RPTs disclosure regulation in their respective countries.

Also, corporate governance codes supplement the requirements of accounting standard on RPTs disclosure regulations in many countries in the world. In countries like Nigeria, Indonesia, and Malaysia, the audit committee handles perusal of the effectiveness of all RPTs and ensures the appropriate disclosure in the annual reports. United States (the US)' corporate governance rules prohibit related party loans to directors after the introduction of the Sarbanes-Oxley Act (SOX) in 2002. This practice is similar in countries like Nigeria, Malaysia, France and China where both the loan and loan guarantee to the related parties are banned in the corporate governance codes. Conversely, Australian best practice does not prohibit the loan to directors and executives if is approved by the shareholders (Chan, 2010).

Capital market listing requirements have also been used in many countries as mechanisms to uplift corporate transparency and improve shareholders' protection. In Indonesia, the market-listing rule for the presentation and disclosure of financial statement VIII.G.7 stipulates additional disclosures concerning RPTs for any company listed on Indonesia stock exchange. Chinese security regulatory commission has set strict listing requirements on RPTs and their disclosure such as the prohibition of non-operational fund occupancy in Chinese capital markets (Jiang, Rao, & Yue, 2014). France and Malaysia require the appointment of independent adviser for RPTs that are up to 5% of the percentage ratios. In an effort to strengthen investors' protection, Hong Kong stock exchange imposes additional listing rules on Chinese-based firms (Fung et al., 2013).

On the issue of minority shareholders group, many countries have established a forum that can be used to echo the voice of minorities. In Australia for example, Australian shareholder Association (ASA) has been in existence since 1960 with the sole aim of advancing the interest of all shareholders within the country. The activities of ASA are similar to that of Malaysian MSWG though differs regarding the means of funding (Satkunasingam & Shanmugam, 2006). In the U.S. if the company take importance decision such as merger and acquisition or make a significant change in its article of association against the wish of minority shareholders, the minority group can compel that company to buyback the shares of any shareholder who oppose the decision.

3.6 Disclosure Quality

Quality is a relative, complex, multi-faced term which is associated with many measurement issues. The problem of quality measurement cut across many social science disciplines. Several studies have used some disclosure indices to compute proxy for disclosure quality (Beattie et al., 2004). Although, there is no universal agreement on the index that best describes or measures disclosure quality among those indices. Issues on disclosure measurement are yet to be resolved and still require the attention of researchers (Beretta & Bozzolan, 2008).

Hussainey and Mouselli (2010) define disclosure quality as the ability of the reporting entity to provide information in such a way that users can easily comprehend and interpret the intended message. It must be noted, however, that it is possible to arrive at different results if the index in one study is applied in other studies. Urquiza et al. (2009) empirically explore the use of various indices on a single set of data. The

findings reveal that different indices provide statistically significant different rankings of firms with regards to their disclosure level.

IASC Framework (1989) describes relevance, reliability, understandability and comparability as basic attributes that financial information must contain to quench the information needs of the users of financial reports. These qualities are termed as essential ingredients for any disclosure quality model (Botosan, 2004). According to IASB (2010) as cited by Palea (2012) the two main features of good accounting information are relevance and reliability. Relevancy of accounting information refers to the ability of accounting information to influence the decision of the users.

On the other hand, reliability stands for a faithful representation of the economic reality of the reporting entity. The framework provides that financial information must be presented in such a way that an average user can easily grasp non-complex part of it. Comparability of accounting information is described as presenting similar things in a similar manner to look more alike without making heterogeneous things look less different (Yip & Young, 2012). In most of the compliance studies, disclosure indices were designed on the assumptions that it best apprehend the transparency or quality of the disclosures. However, the increasing importance of narrative disclosure in corporate reporting has posed a new challenge to disclosure quality measurement. The quality of the information disclosed in the narrative disclosure cannot be viewed to be the same with that of the financial statement (Beretta & Bozzolan, 2008).

This inequality leads to the shift from the idea that disclosure quality cannot be separated from quantity, or the two terms are synonymous. Similarly, Beattie et al. (2004) are of the view that even if the quantity of information impact its quality, an

evaluation of disclosure quality cannot be based on that relationship. They portend that, quality of disclosure reflects in its ability to cover all business activities and balance among different headings and sub-headings.

3.7 Determinants of Compliance with the RPT Disclosure Requirements

Prior researchers justify the benefits of information disclosure over and above its related costs. However, Core (2001) states that perfectly credible disclosure is not ideal because it is too costly. Disclosure costs can be categorized into direct and indirect costs (Glaum et al., 2013). Direct costs include the cost of generating, processing, publishing and distributing information. Indirect costs, on the other hand, include proprietary cost (Beretta & Bozzolan, 2008; Glaum et al., 2013; Verrecchia, 1990), incentive costs (Core, 2001) and alike.

Nonetheless, sometimes firms may decide to extend the volume of information disclosure beyond the mandatory requirement. This decision can be traced to the benefits derivable from information disclosure by the firm such as reduced contracting cost, minimized litigation risk, low cost of capital (Core, 2001; Heitzman et al., 2010) and reduced agency costs (Samaha, Dahawy, Hussainey, & Stapleton, 2012). Based on the above, variation in the volume of firms' disclosure during the voluntary disclosure regime can be attributed to the analysis of information disclosure costs vis-à-vis the benefits derivable from it. Several studies identified many factors that influence firms behavior towards voluntary information disclosure (El-Gazzar, Finn, & Jacob, 1999; Street & Bryant, 2000; Street & Gray, 2002). In contrast, studies on the determinants of mandatory disclosure received little attention or were almost neglected by researchers (Glaum et al., 2013; Utama & Utama, 2014).

Similar to the voluntary regime, the following factors influence the level of compliance with the disclosure requirements of the accounting standard on RPTs. The factors are divided into corporate governance mechanisms and firm financial characteristics. Corporate governance mechanisms consisting board independence, board size, audit committee independence, audit committee financial expertise, CEO expertise, family CEO, CEO ownership, family ownership, managerial ownership and foreign ownership. Firm financial characteristics include tunneling, propping, profitability, firm growth and firm dividend policy.

3.7.1 Corporate Governance

Chen (2014) defined corporate governance as the mechanisms put in place to harmonize and direct the managers to act in the best interest of the shareholders. According to Shleifer and Vishny (1997) corporate governance is the process in which providers of finance to firms guarantee themselves maximum return on their investment. In summary, corporate governance can be described as the relationship between firm's capital suppliers and its management, with the board of directors serving as a link between the two parties.

Corporate governance mechanisms strengthen the fiduciary relationship that existed in the agency contract between the agent (management) and the principals (equity holders, debt holders, suppliers and groups with the stake in the business of the firm)(Goergen, Manjon, & Renneboog, 2008). Black et al. (2015) document that good corporate governance moderates the negative effect of RPTs on the firm value and increase the association between firm profitability with that of the industry. Corporate governance mechanisms can either be internal or external. Internal mechanisms

comprise the corporate board, board committees, CEO characteristics and other related mechanisms, while external mechanisms consist of external auditors, stock exchange listing requirements, the regulatory framework of the country, foreign shareholding and enlistment and alike.

3.7.1.1 Board Characteristics

Board characteristics refer to the attributes of the boardrooms that influence the process and manner in which the board discharges its responsibilities. These characteristics include board independence (Machuga & Teitel, 2009; Wagner, 2011), board size (Mak & Roush, 2000; Zona, 2014) among others.

3.7.1.1.1 Board Independence

Independent directors serve as one of the major internal governance mechanisms that reduce the potential opportunistic behaviors of managers in a well disperse organizational setting, or to minimize potential self-dealing by controlling shareholder in a firm with concentrated ownership structure (Adams, Hermalin, & Weisbach, 2008; Crespí-Cladera & Pascual-Fuster, 2014). Independent directors monitor, advise and resolve internal disagreement among the management on behalf of the common stockholders of the company (Fama & Jensen, 1983). MCGG (2012) requires independent directors to constitute the majority of the board membership if the chairman of the board happens to be a non-independent director.

The presence of adequate number of independent directors on a board has been seen as solution for preserving the interest of all categories of shareholders (Mallin, Melis, & Gaia, 2015) and certify that corporate decision are made in a manner that protects

the interest of all stakeholders (Lo, Wong, & Firth, 2010). Hence, the appointment of an independent director on the corporate boards reduces the owner-principal agency problem between controlling shareholder and minority shareholders. MCGG (2007) requires that independent directors should make at least one-third of the board members.

The presence of independent directors is expected to improve general business operations. This can be achieved through the expertise that a firm can derive from its outside directors in the areas of business strategy, marketing, finance, operations and more importantly high objectivity in monitoring executive management (Armstrong, Guay, & Weber, 2010). Brickley and Zimmerman (2010) opine that independent directors provide two separate roles to a firm. These roles are advising the executive management as well as monitoring the executive performance.

Independence of directors from the management helps in ensuring objective monitoring, through which advising role can be effectively discharged (Kim, Mauldin, & Patro, 2014). It must be noted however that, proper investigation on the genuine independence of outside directors is must, more especially in a market dominated by concentrated ownership. This assessment is necessary because the term outside directors and independent directors are interchangeably used in Anglo-Saxon context to mean independent directors.

Nevertheless, the situation is not the same in continental and emerging economies where concentrated ownership is dominant. Under this situation, outside directors may be nominated by controlling shareholder to supervise management on his behalf, whereas independent directors will be there to protect the interest of minority

shareholders or on the free float. So in the event of a conflict of interest between controlling shareholder and minority shareholders, the distinction between the two categories is crucial (Fraile & Fradejas, 2014).

Several studies document a positive relationship between a number of independent directors and firms disclosure practices (Chen & Jaggi, 2000; Ferreira, Ferreira, & Raposo, 2011; Patelli & Prencipe, 2007). Firms tend to increase their disclosure level to protect and intimate their minority shareholders with its internal affairs and increase the level of their protection (Gisbert & Navallas, 2013). Tang, Du and Hou (2013) document that independent directors play an important role in protecting the outsiders (minority shareholders and creditors).

On this note, a higher proportion of independent directors on the board guarantees maximum disclosure of information, thus, ensuring efficient operation of the firm in the best interest of all the parties concern. Armstrong, Core and Guay (2014) provide empirical evidence that the number of independent directors on the board influences the level of corporate transparency, against some insinuations that independent directors are willing to serve on the board of a firm with high corporate transparency.

Patelli and Prencipe (2007) examine the possibility of combining internal governance mechanism (independent directors) and external mechanism (voluntary information disclosure) in a firm with the dominant shareholder. The authors find a positive relationship between a number of independent directors and the volume of voluntary information disclosed in the financial reports of firms with the dominant shareholder. Similarly, Wahab et al. (2011) reveal that the level of independence of the board is crucial to mitigate the negative effect of RPTs.

Furthermore, Cheung et al. (2009) show that most of the firms that engage in RPTs have no independent directors. Dahya, Dimitrov and McConnell (2008) prove that presence of independent directors on a board minimizes the tendency of controlling shareholder to expropriate minority shareholders most especially in the countries with weak investors' protection. This is consistent with the finding of Lo et al. (2010) that firms with a high proportion of independent directors and a small proportion of parent directors on the board have less tendencies for maneuvering transfer price. Firms with a higher percentage of independent directors disclosed more voluntary information on the pricing policy regarding RPTs. Therefore, the presence of more independent directors in the firm board can control the managers' disclosure behavior with regards to RPTs' pricing policy (Lo & Wong, 2011).

3.7.1.1.2 Board Size

Board size represents the number of persons that sit on the firm board of directors. The board, been a supreme policy formulation body for a firm, decides on the strategies and process that should be adopted by the management (Akhtaruddin & Abdur Rauf, 2012). It plays a vital role in ensuring proper corporate governance and financial transparency in a firm (Samaha, Khelif, & Hussainey, 2015). The results of the studies on the optimal board size remain inconclusive. As a result, some stock markets stipulates a certain range of number that the board size must dwell within (Akhtaruddin & Abdur Rauf, 2012; Cheung et al., 2006).

Large boards are believed to be effective and beneficial to the firm because as the number of members increases, the firm will also benefit from their diverse and accumulated experiences (Hidalgo, García-Meca, & Martínez, 2011). According to

Coles, Daniel and Naveen (2008) large boards discharge their monitoring and advising roles more efficiently. On the contrary, Sengupta and Zhang (2015) state that effectiveness of board depends on the power of the board relative to that of CEO. Linck, Netter and Yang (2008) report that board size for large US corporations fall in the 90s and rise again after the SOX mandatory disclosure reforms, while the size of the small and medium-term firms remain stable for long period of time. Board size influences the firm corporate decisions and other characteristics including its cost of capital (Aman & Nguyen, 2013; Anderson, Mansi, & Reeb, 2004).

Firms with complex business model need to have a large board to perform better (Coles et al., 2008; Linck et al., 2008). Recent studies document a positive relationship between board size and performance (Black & Kim, 2012; Upadhyay, Bhargava, & Faircloth, 2013). However, this result is more pronounced in large firms (Lappalainen, 2012), because the size of the board in most cases increases as the firm grow bigger (Chen, 2014; Jameson, Prevost, & Puthenpurackal, 2014). Michelon and Parbonetti (2012) argue that disclosure policy spring from the decisions of the board. Therefore, the number of the members that constitute the board plays important role in its decision making process.

Several studies report the positive association between board size and corporate disclosure behavior (Grigoris, 2014; Ntim & Soobaroyen, 2013; Samaha et al., 2015; Wang & Hussainey, 2013). Nekhili and Cherif (2011) postulate that RPTs can be affected by the size of the board. However, many studies established that the impact of board begin to decrease if the board continues to increase after reaching its optimal size (Bozzolan & Beretta, 2015; Choi, Choi, Hogan, & Lee, 2013).

Some studies document a negative association between board size and firm stock value (Eisenberg, Sundgren, & Wells, 1998; Yermack, 1996). Consistently, Mak and Kusnadi (2005) analyses the stock value of the firms that uses different corporate governance codes and report that large board size reduces the firm value in both Malaysia and Singapore. Henry (2010) realize that large board is associated with an increase in discretionary expenditure, hence increasing the firm agency cost.

Similarly, Truong and Heaney (2013) argue that large board size is detrimental to a firm as it consumes more of the firm scarce resources and may lead to free-rider problems among the members. Many government reforms are found to encourage smaller boards (Chen, 2014). Nonetheless, Wahab et al. (2011) find that large boards are more effective in mitigating the negative effect of RPTs.

3.7.1.2 Audit Committee Characteristics

The listed firms are required to have an audit committee in many countries in the world. This position is based on the fact that existence of audit committee reinforces board's oversight of auditing and accounting practices in a firm (Lo et al., 2010). Audit committee members are saddled with the responsibilities for reviewing and monitoring compliance with all financial reporting disclosure requirements (Al-Akra et al., 2010). Brochet and Srinivasan (2014) argue that audit committee members are required to exhibit a high degree of oversight function on accounting and disclosure issues.

Anderson, Mansi and Reeb (2004), Benkel, Mather, and Ramsay (2006) and Black and Kim (2012) provide empirical evidence on how composition and quality of board and audit committee affect the quality of financial reports and stock price. Cai, Hillier,

Tian and Wu (2015) find that audit committee plays an important role in mitigating agency cost and serve as a substitute for external regulations in an economy with weak legal institutions. Audit committee performs its duty effectively when the members are independent, expert and well resourced (Li, Mangena, & Pike, 2012).

The roles and powers of an audit committee are provided in the code of corporate governance of the territory in which the firm domicile. Mintz (2006) reports that in an American model, for example, audit committee members are expected to recommend for the appointment, review compensation and independence of an external auditor and serve as intermediary between the board and external auditor. They should review the financial statements of the firm, auditors' reports, auditors' inquiries and recommendations as well as management responses to those inquiries and recommendations.

Assessment of the appropriateness of internal control, major auditing and accounting practices should also form part of their routine duties. There is no much difference between U.S., the UK, and many other common law countries models of audit committee's functions, considering the source of their legal system (Mintz, 2006). MCCG (2000) provide for the mandatory establishment of audit committee in Malaysia. The committee structure, independence and financial expertise have been reinforced by the latest version of the code (MCCG, 2012).

Al-Akra et al. (2010) identify mandatory establishment of audit committee to be the major determinant of compliance with mandatory requirements. Likewise, Ho and Wong (2001) document a positive association between audit committee and voluntary information disclosure. Similarly, Gao and Kling (2012) link the increased financial

transparency and disclosure oversight by audit committee to the increased responsibility accorded to them in many governance regulations and the tendency of been named among the dependent in case of financial lawsuits. Al-Najjar and Abed (2014), and Karamanou and Vafeas (2005) find a positive association between audit committee and forward-looking and earnings forecast information disclosure

It has been established that the main reason behind the positive relationship between good corporate governance and firm performance was as a result of the ability of former to curtail tunneling activities. Cheung et al. (2009) report that presence of audit committee mitigates tunneling practices in asset acquisition and disposal. However, Samaha et al. (2012) fail to establish any association between presence of audit committee and corporate governance disclosure practice in Egypt.

3.7.1.2.1 Audit Committee Independence:

The need for audit committee independence can be linked to the widespread literature on the importance of board independence (Carcello & Neal, 2003; Fama & Jensen, 1983). In order to strengthen the independence of audit committees, many countries in the world required that the committee should be chaired by independent directors and independent directors should compose the majority of the committee membership (Black & Kim, 2012; Crespí-Cladera & Pascual-Fuster, 2014).

Bédard and Gendron (2010) review the studies on audit committee for the period of 1994 until 2008. The authors reveal that most of the studies document a positive relationship between the audit committee independence and the effectiveness in their financial reporting oversight role. This position is consistent with the requirement of

many governance codes across the globe. The majority of the members of audit committee are required to be independent (Wan-Hussin, 2009). MCCG (2012) requires that executive director should not be appointed as a member of the audit committee and independent directors should constitute majority of its membership.

Abbott, Parker and Peters (2004) document an adverse relationship between independence of audit committee and restatement of the financial reports. This highlight the importance of the monitoring role plays by the independent of audit committee members in the financial reporting process. Aldamen, Duncan, Kelly, McNamara and Nagel (2012) document that audit committee independence improves the firm financial performance. Related to this, Be'dard, Chtourou and Courteau (2004), and Bronson, Carcello, Hollingsworth and Neal (2009) find that the possibility of audit committee members to reduce the likelihood of earnings management is significant only if the committee is constituted by purely independent directors.

Independent audit committee members who have much concern for their reputation and potential legal liability support the external auditor while conducting their assurance services (Lee, Mande, & Ortman, 2004). They discharge their monitoring role free from the dictate of management (Carcello & Neal, 2003; Li et al., 2012). Consistently, Nekhili and Cherif (2011) show that audit committee independence has a positive impact in curtailing prejudicial RPTs. Therefore, independence of audit committee members is essential in achieving good corporate and financial transparency.

3.7.1.2.2 Audit Committee Financial Expertise

Many corporate governance codes have mandated the inclusion of financial expert in the audit committee (Li et al., 2012; MCGG, 2007). Defining what constitutes financial expertise have been a subject of controversy in the extant literature. Bédard and Gendron (2010) reveal that most of the audit committee studies describe financial expert to include professional accountants and auditors, accounting academics, chief financial officers, investment advisors, and bankers. Carcello, Hollingsworth and Neal (2006) document a significant level of compliance with SOX on the disclosure of financial expert on audit committee in the annual report.

Capital market reacts favorably to the announcement of the appointment of a financial expert as a member of the audit committee (Defond, Hann, & Hu, 2005). Carcello and Neal (2003) document a positive association between audit committee expertise and its ability to prevent auditor from dismissal after the release of the qualified audit report. BMLR (2015), and MCGG (2012) require for the inclusion of financial expert in the board audit committees.

Be'dard et al. (2004) document that board with more expert are more effective in curtailing earnings management practices. Carcello and Neal (2003) posit that audit committee financial expertise helps in interpreting and explaining the implications of auditors reports to the board for proper actions. Firm internal control system can be affected by the richness of its audit committee. Firms with less financial experts in its audit committee have a large tendency of having a weak system of internal control (Zhang, Zhou, & Zhou, 2007). Similarly, Goh (2009) reveals that audit committee financial expert can easily identify internal control material weaknesses and force

management to rectify it within the shortest possible time. Cohen, Hoitash, Krishnamoorthy and Wright (2013) are of the view that audit committee with combine accounting and industry knowledge will perform better. This is because most of the accounting principles and estimations can be directly linked to particular industry. So having an industry expert on the committee will help immensely in exercising effective monitoring role.

Audit committee expertise has a significant negative association with the occurrence of restatement (Abbott et al., 2004). Moreover, Cohen et al. (2013) reveal that audit committee with a mixture of both financial and industry expert perform better than those committees with only financial expert. Related to this, Aldamen et al. (2012) find that presence of a financial expert in audit committee improves the firm financial performance. Firms with a high number of financial experts in their audit committees are found to be less engaged in transfer price manipulations (Davidson III, Xie, & Xu, 2004).

3.7.1.3 CEO Characteristics

Chief executive officers (CEOs) possess great power to influence the choice of the strategies and processes, and, therefore, the firm performance (Miller, Minichilli, & Corbetta, 2013). It is widely reported that some powerful CEOs use their power to influence the director nomination process to maintain a pliable board (Baldenius, Melumad, & Meng, 2014). Kalyta and Magnan (2008) report that powerful CEO engages into rent extracting activities in a low quality disclosure environment. Therefore, proper understanding of CEOs characteristics is necessary for explaining corporate disclosure behavior.

3.7.1.3.1 CEO Expertise

A CEO is expected to possess some generic skills and talent to deal with varying organizational activities and many external environments such as capital market, media, and stakeholders. CEO's ability to acquire these expertise has been identified as one of the factors that determine the success of decisions and programs. Custódio, Ferreira, and Matos (2013) find that CEOs with general managerial skills accumulated over years of experience receive higher pay package than others. This finding can be justified with the fact that CEOs with financial expertise are financially sophisticated and more likely to manage actively firm's financial policies (Custódio & Metzger, 2013a).

According to Haislip and Richardson (2015) CEOs with IT expertise make more accurate estimation and analysts that follow those firms make more accurate earnings forecast. They also find that firms with IT expert CEOs announce earning earlier than other firms. In the event of acquisitions, firms with experienced and expert CEO in the target's industry records higher abnormal return compared to non-experienced CEO firms (Custódio & Metzger, 2013b). Venture capitalist usually retains the founder CEOs in order to keep their managerial experience and their scientific skills (Dubocage & Galindo, 2013). CEOs talent has been found to influence the firm performance (Falato, Kadyrzhanova, & Lel, 2014).

Custódio and Metzger (2013b) demonstrate how CEO expertise affect the market value of the firm while taking business strategy decisions. Accordingly, Custódio and Metzger (2013a), and Huang (2014) find that firms that focus on the industry in which they possess managerial expertise achieved significant improvement in performance.

The improvement is higher for the firms with CEO with much experience in that industry. Haislip and Richardson (2015) find that IT expert CEOs make more accurate estimations that lead to more accurate earnings forecast. Despite the recorded importance of CEO expertise, previous studies have paid little attention to the effect of CEO financial expertise on firms disclosure practice.

3.7.1.3.2 Family CEO

Family members continue to maintain significant ownership, control and management of their firm, even after the retirement of the founding member (Bertrand & Schoar, 2006). Anderson and Reeb (2003) document that family firms outperformed non-family counterpart regardless of the family background of the CEO. However, Miller, Minichilli and Corbetta (2013) argue that family CEOs outperform only in small firms with concentrated ownership structure. Though family members may not be the best candidate, it is usual for the family firm to have a CEO from among the family members (Barnett, 1960). Hillier and McColgan (2009) report that family CEOs are less likely to be replaced even after the successive poor performance, and CEO turnover is lower for family firms (Chen, Cheng, & Dai, 2013).

McConaughy (2000) states that family CEOs have many incentives to work hard and maximize the firm value. Therefore, they required less compensation-based incentives. On the contrary, Miller, Le Breton-Miller, Minichilli, Corbetta and Pittino (2014) believe that family CEOs are more motivated by socio-emotional-incentives such as retaining the family control even if it is at the detriment of firm profitability. Family CEOs undertake decisions that will benefit the family firms such as long-term

R&D, thus, capable of increasing the financial performance of their firms (Minichilli, Corbetta, & MacMillan, 2010).

However, once it comes to professionalism and experience, non-family CEOs are found to be more experienced and educated than their family counterpart and family CEOs underperform more especially in past growing industry that requires special skills (Bennedsen, Nielsen, Perez-Gonzalez, & Wolfenzon, 2007). All of these findings provide empirical evidence on the how CEO family lineage affect the decision-making process.

3.7.1.3.3 CEO Ownership

CEO ownership is described as the proportion of all classes of shares held by the CEO of the firm out of the total outstanding shares of the firm (Schiehll & Bellavance, 2009). Griffith (1999) reports the positive U-shape relationship between the proportion of CEO ownership and the firm value. Consistently, Lu, Xu, & Liu (2009) document that an increase in the level of CEO ownership decreases the principal-agent conflict in export decisions. Similarly, Kim and Lu (2011), and Ting, Azizan and Kweh (2015) document the CEO ownership has a strong influence on the firm value.

Firms with higher CEO ownership are characterized by the presence of dual role. This enables the CEO excess power to dictate the process and the direction of the firm (Chen, Lin, & Yi, 2008). Schiehll and Bellavance (2009) posit that firms with higher CEO ownership will integrate some costly non-financial measures into the CEO bonus plan to sustain the long-term profitability of the firm. The stock-option plan is found to improve the CEOs boldness towards risk-taking (Sanders & Hambrick, 2007).

Consistently, Musteen, Datta and Herrmann (2008) reveals that CEOs with bonus plan tied to long-term performance are more inclined to full-control international market entry mode, which benefits the long-term firm performance. Kim and Lu (2011) state that CEO ownership serves as a substitute for external governance in mitigating the effect of conflict of interest. In contrast, Xie (2014) reveals that CEO ownership reduces the CEO risk-taking behavior. Consistent with this, Kim and Lu (2011) caution against the excessive CEO ownership because it will deter him from taking the risk.

3.7.1.4 Ownership Structure

Corporate ownership structure differs across the firms and across the world. The ownership structure affects many of the firm decisions (Bekiris, 2013; Samaha et al., 2012). Disperse ownership structure delegate the decisions and management of the firms to the managers. Conversely, concentrated ownership is required to implement the desired level of monitoring (Burkart & Panunzi, 2006). Some of the ownership structures including family, management or foreign ownership can influence the firm disclosure behavior.

3.7.1.4.1 Family Ownership

A firm in which the founders or offspring of the founding families remain the block holders and continue to appear on the board or hold some top management position are regarded as family firm (Ali, Chen, & Radhakrishnan, 2007; Cheng, 2014). Family ownership is described as the proportion of all classes of shares held by the family members in a firm (Ansari, Goergen, & Mira, 2014). Family ownership is frequent in developed and predominant in emerging markets (Siregar & Utama, 2008). It is

associated with less agency cost of debt (Anderson, Mansi, & Reeb, 2003). The family usually accumulate power over a firm through family ownership and family wedge (Ansari et al., 2014).

Corporate disclosures are used to reduce the information gap between management and owners (type *I* agency problem). This kind of problem is less dominant in family firms due to the nature of their ownership structure. The second type of agency problem (type *II* agency problem) is severe and more visible in family firms. This agency problem exists because of the concentrated ownership that characterized most of the family firms (Shleifer & Vishny, 1997; Wan-Hussin, 2009).

Family firms are found to be more efficient in terms of management and performance compared to non-family firms. Anderson and Reeb (2003) find that performance of family firms in terms of ROA and Tobin's Q are higher than that of non-family firms. This finding is substantiated by other studies in terms of organizational structure and concerning financial indicators (Andres, 2008; Maury, 2006; Villalonga & Amit, 2006). Similarly, Al-Dubai, Ku-Ismael and Amran (2015) provide evidence of non-linear relationship between family ownership and firm value. As the family ownership increases, the behavior of family members changes from expropriation to monitoring role.

In contrast, Klein, Shapiro and Young (2005) document an inverse relationship between corporate governance index and family firm performance. The negative relationship can be attributed to other specific characteristics of family firms that may restrain corporate governance mechanisms from working properly in a family-controlled firms. Similarly, firm performance decline after the demise of the founder

due to the dilution of ownership among the descendants, which may lead to the tunneling of resources out of the firm (Bertrand, Johnson, Samphantharak, & Schoar, 2008). Alipour (2013) reveals that family ownership militates the level of performance of the firm that can be related to lack of control mechanism is most of the family firms.

Munir et al., (2013) report a U-shape relationship between family ownership and quality of reported earnings. Family firms have unique characteristics that distinguished them from other firms. These characteristics affect their level of information disclosure and general disclosure practice. According to Chau and Gray (2002) firms with concentrated ownership are characterized by less voluntary information disclosure, but the problem is more visible in family-controlled firms.

Family-controlled firms are associated with less voluntary disclosure on forward-looking information, earning forecast and are characterized by high opaque information environment than disperse firms (Anderson, Duru, & Reeb, 2009; Chen et al., 2008). Chau and Gray (2010) report that the level of family firms' voluntary disclosure practice depends on the extent of the family ownership.

Nowland (2008) document an improvement in the general disclosure practice of family-controlled firms after the introduction of national governance codes across Asian countries. Consistent with this, Wan-Hussin (2009) find that family-controlled firms tend to make greater compliance with the segment reporting standard. Stressing on the need for and importance of RPTs disclosure regulation, Fernando, Schneible and Suh (2013) argue that putting rigorous financial reporting disclosure on family-controlled firm will restrain the founders or heirs from engaging into RPTs that will amount to wealth expropriation. Similarly, Di Carlo (2014) conducts case studies on

some selected Italian family-controlled business groups and recommends for increased disclosure from family-controlled firms based on the findings of the study.

3.7.1.4.2 Managerial Ownership

Managerial ownership is the proportion of all types of shares held by the managers, directors and supervisors in a firm (Huafang & Jianguo, 2007). It is used as a mechanism for minimizing the agency problem. Jensen and Meckling (1976) state that as management ownership increases, the value of the firm will also rise because of reduction in agency cost. Similarly, Mustapha and Ahmad (2011) documents that managerial ownership decreases the total monitoring costs in the countries characterized by the dominant shareholders. According to Niemi (2005) manager-owned firms are characterized by lower information asymmetry. This is because the owners pilot the day-to-day affairs of the firms, hence have the first-hand information about the state of affairs of the firm. Managerial ownership aligns the goal and financial incentives of the management with those of the outside shareholders (Arcay & Vázquez, 2005).

Nevertheless, managerial ownership creates owner opportunism—a situation where owner-managers resort to self-enrichment transactions at the detriment of the minority shareholders. These make managers be reluctant to release additional information to the market. In view of this, Warfield et al. (1995) state that managers have some obligations to their environment including the selection and application of accounting procedures. Managerial ownership encourages selective reporting. This is because, managers are conscious of setting disclosure precedent that may be costly to retain and fearful of releasing valuable business information to competitors (Li et al., 2012). On

the contrary, Huafang and Jianguo (2007) postulate a positive relationship managerial ownership and extent of voluntary information disclosure. Warfield et al. (1995) document that managerial ownership is associated with the high earnings explanatory power and reduced discretionary manipulations. Similarly, Al-Najjar and Abed (2014) state that managerial ownership provides incentives for managers to release more information in order to increase the stock market price, minimize overall monitoring costs and enhance the firm value

3.7.1.4.3 Foreign Ownership

Foreign ownership is described as the proportion of firm equity capital held by non-domestic investors. Firth, Fung and Rui (2007), and Desender, Aguilera, Lópezpuertas-Lamy and Crespi (2014) state that economic restructuring by many economies coupled with foreign ownership have prompted the need for high quality information by the market participant. Foreign ownership serves as one of the external corporate governance monitoring mechanisms (Jeon, Lee, & Moffett, 2011; Munisi, Hermes, & Randøy, 2014). The positive association between corporate governance and firm performance was identified to be the result of the debt monitoring and foreign ownership (Che-Haat et al., 2008).

Foreign investors survive in countries with weak legal investor protection through substantial equity ownership and change in the governance-orientation logic (Desender et al., 2014; Lskavyan & Spatareanu, 2011). This is facilitated by the transfer of managerial skills as well as strong monitoring roles plays by the foreign parent firm. Li, Nguyen, Pham and Wei (2011) document the effectiveness of the monitoring role and strong commitment of the large foreign shareholder. Chari, Chen

and Dominguez (2012) using difference-in-differences empirical approach document that foreign acquisition come with the better restructuring schemes that improve the firm performance.

Presence of foreign shareholders has been found to have an effect on the coefficients of earnings response and discretionary accruals (Firth et al., 2007). Moreover, Greenaway, Guariglia and Yu (2012) document that firms with mixed domestic and foreign ownership perform better than wholly domestic or foreign-owned firms. Cerrato and Piva (2012) provide evidence on the positive influence of foreign ownership on the small and medium enterprises internationalization process. Multinational subsidiaries with strong production and financial linkages with their foreign parent firms are found to be less affected by the global financial crisis compared to the local firm with similar characteristics (Alfaro & Chen, 2011). This has shown that firms with foreign ownership possess some managerial and governance qualities that are not available to their local counterpart.

Foreign institutional ownership has improved the firm transparency level through increased conference calls, which serve as a medium for communicating the firm private information to the market participants in emerging markets (Liang, Lin, & Chin, 2012). It is also believed that presence of foreign ownership increases the firm desirability for high quality audit (He, Rui, Zheng, & Zhu, 2014). Bova and Pereira (2012), and Misirlioğlu et al. (2013) show that foreign ownership is among the factors that are associated with increased information disclosure.

3.7.2 Firm Financial Characteristics

Firm characteristics represent the endogenous features that can be attributed to individual firms. Several studies define firm characteristics based on the researchers' objectives (Dechow et al., 2011; Kogan & Papanikolaou, 2012; Whiting & Woodcock, 2011). Firm characteristics constitute firm's important features that are believed to cross influence its activities or outcomes (Bessembinder & Zhang, 2013). In this study, these characteristics are divided into RPT motives and firm performance.

3.7.2.1 RPT Motives

According to Cheung et al (2006) managers can engage into RPTs with the intention for self-enrichment and minority shareholders' expropriations. In some instances, the RPTs are initiated to inject personal resources to a listed firm in order to achieve a pre-set target.

3.7.2.1.1 Tunneling

Johnson et al. (2000) was the first to describe the act of diverting resources from listed firm by its controlling shareholders as 'tunneling'. Several studies document that concentrated ownership is prevalent in countries other than U.S. and Japan (Claessens et al., 2000; Djankov et al., 2008; Faccio & Lang, 2002; Jaggi, Leung, & Gul, 2009; Wan-Hussin, 2009). Tunneling comes into play as a result of type *II* agency problem that exists between controlling shareholder and minority shareholders. Numerous studies provide empirical evidence that controlling shareholders use RPTs to expropriate minority shareholders especially in emerging market where enforcement and investors' protection is weak.

Empirical evidence has proved that capital market reacts to the announcement of RPTs, though the results are inconclusive. Lou et al. (2014) find that capital market reacts indifferently to the announcement of any form of RPTs. Contrary to this, Lei and Song (2011) report that the Tobin's Q and market to book value of firms that engage in prejudicial RPTs are significantly lower than those with no such form of transactions. This is consistent with the findings that investors cannot foresee tunneling, but they discount firms if it occurs (Cheung et al., 2006). Cheung et al. (2009) find that RPTs representing tunneling hardly been public compared to those representing propping.

Lei and Song (2011) find that Chinese listed companies use RPTs with disclosure exemption in tunneling, signaling the significance of disclosure requirement in curtailing prejudicial RPTs. Similarly, Black et al. (2015) document that public listed chaebols in Korea hardly disclose the pricing policies used in the complicated RPTs with privately held firms—a clear sign of minority shareholders' expropriation or RPTs that are not based on arm's length principles. Xiao and Zhao (2014) argue that even though Chinese Securities Regulatory Commission has required all listed companies to disclose all RPTs in their financial reports, in practice, most of these firms do not comply with those requirements.

3.7.2.1.2 Propping

The term propping was first used by Friedman et al. (2003) to describe the act of transferring personal wealth by entrepreneurs or controlling shareholders to the listed firm that have minority shareholders as well within their business group. Propping can be seen as a phenomenon by which controlling shareholder initiates advantageous

RPTs to improve the firm performance, induce potential investors or meets certain target required by regulatory bodies. Controlling shareholders have involved into propping activities after Asian financial crises of 1997 and beyond to save their firms from liquidation and maintain their normal operations (see for example Friedman et al., 2003; Peng et al., 2011; Ying & Wang, 2013).

Propping activities provide an avenue by which profitable firms transferred some funds to the financially distressed related firm (Gonenc & Hermes, 2008). Jian and Wong (2010) document that controlling shareholders use abnormal related sales to prop up the earnings of their Chinese listed firms. Controlling shareholders usually engage into propping to meet the capital market target for the right issue, initial public offer or to attain certain performance threshold to avoid been delisted. Ying and Wang (2013) document that propping by controlling shareholders improves operating performance of the firm only in the short period. This finding proved that the sole intention for propping the firms was maintenance of shell resources, not for value added reason.

Bai et al. (2004) portend that small piece of bad news by a listed firm attract overwhelming market reactions and may even lead to undue regulatory surveillance. These kinds of reactions motivate some controlling shareholders to engage in propping in order to overcome the possible damages that may result from the release of bad news to the market. Cheung et al. (2009) find that RPTs related to propping activities are accompanied with significant information disclosure compared to that of tunneling activities. Accordingly, Peng et al. (2011) find that capital market reacts favorably to the announcement of propping transactions.

3.7.2.2 Firm Performance

Several studies document that firm performance affects its level of information disclosure. Information on the firm business opportunities, competitive advantage, propriety information and dividend policy are some of the factors that shape the firms' disclosure behavior (Samaha et al., 2012; Wan-Hussin, 2009). In this study, factors such as profitability, firm growth and dividend payments are believed to affect the firm disclosure pattern.

3.7.2.2.1 Profitability

The term profitability refers to the ability of a firm to generated revenue in excess of its overall total costs. Maintenance of sustainable profit has been the ultimate goal of any business establishment (Mosebach & Simko, 2010). Profitability has been commonly used to measure the economic performance of a firm (Maziotis, Saal, Thanassoulis, & Molinos-Senante, 2014). Firm's profitability is widely used to assess the efficiency and effectiveness of the executive's decisions (Pugliese, Minichilli, & Zattoni, 2014). Profitability is multi-facet and multi-dimension in nature with numerous proxies depending on the researcher's objective. Some studies measured profitability from the overall business performance (return on asset, return on equity) viewpoint (Dietrich & Wanzenried, 2014; Flamini, Schumacher, & McDonald, 2009; Pugliese et al., 2014). Other studies went further to analyze the profitability right from the initial stage in the production process (Diewert, 2014; O'Donnell, 2010). Recently, Maziotis et al. (2014) introduce the use of index number technique to measure the profitability of a firm.

Profitability measures such as Return on Asset (ROA), Return on Equity (ROE) are commonly used to measure both financial and operating results of an entity (Brick & Chidambaran, 2010; Ganz, Gonce, & Nedell, 2014). Consolidating on these trends, Novy-Marx (2013) use gross profit scaled by total assets to measure firm's profitability. He argues that the new method is cleaner and almost provide the same power as book-to-market method in determining the stock expected returns. Novy-Marx documents that the new method is superior to the methods used by previous researchers such as net income, dividend, and cashflow.

However, Ball, Gerakos, Linnainmaa and Nikolaev (2015) provide empirical justification for the perceived superiority of Novy-Marx (2013). They argued that the differences in explaining power were as a result of the different deflators used in his analyses. Ball et al. document that predictive power of both gross profit and net profit are highest, intermediate and lowest if deflated with book value of asset, book value of equity and market value of equity respectively.

Profitability has been used and found to predict positively future stock performance and profitability premium (Lam, Wang, & Wei, 2014). Hou and Van Dijk (2014) find that firms that are more profitable have a higher market-to-book ratio and pay more dividends than what counterpart firms pay. All things been equal, productivity has been identified to have a positive relationship with profitability, even though in most cases the relationship is not linear (Islam, Xayavong, & Kingwell, 2014). Similarly, Ganz et al. (2014) find that profitability differs across industries. However, it is possible for high-profit firms in lower-profit industries to outperform lower-profit firms in higher-profitable industries.

Profitability has been identified as one of the major determinants of corporate disclosure (Al-Akra et al., 2010; Bokpin, 2013; Hussainey, Elsayed, & Razik, 2011; Wang & Hussainey, 2013). Profitable firms have many incentives to disclose their favorable performance to numerous stakeholders. This is consistent with the signaling theory, which suggests that information disclosure signals good business position to market participants.

Nonetheless, studies on the association between firms' profitability and corporate disclosure behavior produce inconsistent results. Samaha et al. (2012) and Sodikin (2013) arrive at the negative association between profitability and corporate disclosure practice. Another trend of studies finds no association between the profitability and firm disclosure behavior (Grigoris, 2014; Sharma, 2014).

Alsaeed (2006) examines three proxies of profitability (return on equity, profit margin, and liquidity) and finds that none of them explain the variability of firms disclosure behavior. This is consistent with the insignificant association arrived at by (Cheng & Courtenay, 2006). Tsalavoutas (2011) is of the opinion that the increase in the reported profit as a result of migration to IFRS is among the major incentives that motivate firms to adopt and disclose much information in their annual report.

3.7.2.2.2 Firm Growth

Growth has been defined as percentage changes in sales, total assets or operating profit (Belkaoui, 2004). Some studies defined firm growth in terms of increases in a number of employees in the firm (Nichter & Goldmark, 2009; Rahaman, 2011). Although, some researchers argued that employees growth cannot serve as an effective proxy for

firm growth because it may fail to capture the growth of capital extensive firms (Huynh & Petrunia, 2010). Huynh and Petrunia argue that the negative relationship between size, age and firm growth continue to hold.

Bei and Wijewardana (2012) argue that availability of internal fund should better serve as a proxy for growth. They assert that if a firm operates well and generates profit, there should be enough internal funds to finance their expansion, which will later translate to increase in sales, total assets and operating profit. Delmar and Wiklund (2008) state that there are multiple numbers of decisions and activities that affect firm's growth process. Firms with experienced, educated founders and access to finance are found to grow more quickly than their counterpart (Nichter & Goldmark, 2009).

Firms differ across countries in financing their growth. In some countries, firms consider the effect of the short-term or long-term source in financing their growth while, in other countries, the source of finance has no impact in financing business expansion (Demirgüç-Kunt & Maksimovic, 1998). Small firms are found to grow faster than average industry rate (Aghion, Akcigit, & Howitt, 2015; Park & Jang, 2010). Similarly, high growth firms are associated with high profitability and better cashflow (Anderson & Eshima, 2013).

Firms with growth potential have many incentives to disclose detail information to inform and justify some of their corporate decisions and minimize information asymmetric between managers and owners (Chau & Gray, 2010). Gul and Leung (2004) argue that firms with high potential growth signs have to disclose more information to justified that their stocks are not overvalued. Similarly, Hassan,

Romilly, Giorgioni and Power (2009), and Hussainey and Mouselli (2010) portend that firms with high sales and asset growth disclosed information to signal future increase in production capacity and dividend respectively.

In the same vein, Soon Yau, Sin Chun and Balaraman (2009) provide empirical support for the above assertions. The authors find that among the sample of small firms, high growing firms make more disclosure on the information regarding their intellectual capital. Also, Iatridis (2012) documents that high growth firms provide detail disclosure in accordance with the provisions of IFRS.

In contrast to the above, Liu and Sun (2010) and Lo and Wong (2011) document a negative association between growth and corporate disclosure practice. This is in line with the finding of Bamber and Cheon (1998) that the higher the growth potential, the low the managers intend to release information to public because of proprietary information cost. Similarly, Gisbert and Navallas (2013) find that high potential growth firms shelve away from unnecessary disclosure to deny competitors access to their strategic information.

3.7.2.2.3 Dividend

Dividend policies have been studied under both signaling and agency theories' perspectives. Each of these perspectives has its proponents with multiple empirical studies that support or against their view. Signaling theory perceived that dividend payment is used to convey private information to stakeholders on the firm operations and its future prospects (Manos, Murinde, & Green, 2012; Nissim & Ziv, 2001). On

the other hand, Grullon, Michaely, Benartzi and Thaler (2003), and Sharma and Pandey (2014) arrive at a contrary view.

Agency theory perceived that investors request for dividend payment to wipe out excess cash from the firm to minimize managers opportunistic behavior (Brockman & Unlu, 2011; La Porta et al., 2000). Conversely, Lin, Kuo and Wang (2014) use the same theory and prove the otherwise. Recent studies prove the emergence of new dividend ideology (catering theory). This theory state that capital market reaction to dividend payment depend on the investors demand and the decision of managers to meet the needs of the investors (Baker & Wurgler, 2004; Li & Lie, 2006)

La Porta et al. (2000) argue that managers tend to engage in high earning retention and pay fewer dividends until minority shareholders force them to pay. Therefore, dividend payment signals the presence of good corporate governance. On similar note, Ramalingegowda, Wang and Yu (2013) document that high quality financial reporting system reduces the negative effect of a dividend payment on investment. That is to say, shareholders press for the payment of a dividend in a firm with weak corporate governance or in countries with weak investor protection.

Consistently, Setiawan and Phua (2013) empirically reaffirm this position that weak corporate governance is compensated with higher dividend payment. Furthermore, foreign investors are found to be more interested in firms with higher dividend payout policy to minimize the agency conflict (Jeon et al., 2011). Aggarwal and Dow (2012) discover that strong affiliation with the business group has a negative effect on dividend payout.

Building on this, Wang (2014) reports that firms with large wedge pay large employees bonus than shareholder dividend. These findings support the prior studies that large dividend payment portrays that controlling shareholder is not willing to expropriate corporate resources (Gugler & Yurtoglu, 2003; Su et al., 2014). Similarly, Williams (2014) reports that low dividend payout encourage controlling shareholders to involve into tunneling behavior in RPTs. Van Overfelt, Deloof and Vanstraelen (2010) document that dividends were used as a substitute for financial reporting transparency during unregulated disclosure period. In contrast, Lin et al. (2014) validate the complimentary view that better disclosure leads to high payout ratio.

3.8 Summary of the Chapter

This chapter reviews the relevant studies on the concept and various definitions of RPTs. The types of RPTs which include the tunneling, propping and strategic rationale RPTs are discussed in this chapter. Similarly, the perspectives of RPTs ranging from conflict of interest, efficient transaction and contingency perspectives are highlighted. The chapter dwells also on RPTs disclosure studies globally. The issues of RPTs regulations across the world is highlighted in the chapter. Both developed and emerging economies have formulated a number of regulations to protect the investors from the prejudicial use of RPTs to siphon resources from the firms. Also, issues related to disclosure quality were highlighted in the chapter.

The determinants of compliance with the RPTs disclosure requirements are divided into corporate governance mechanisms and firm financial characteristics in the chapter. Under corporate governance characteristics, relevant conceptual and empirical studies on the board independence, board size, audit committee

independence, audit committee financial expertise, CEO expertise, CEO family lineage, CEO ownership, family ownership, managerial ownership and foreign ownership are reviewed and appropriate positions are synthesized. Similarly, studies related to tunneling, propping, profitability, growth and dividend policies are reviewed under the firm financial characteristics in the chapter.



CHAPTER FOUR

VALUE-RELEVANCE AND REAL EARNINGS MANAGEMENT

4.0 Introduction

This chapter discusses the concept of value-relevance in general and value-relevance of financial information disclosure. It reviews relevant literature on the value-relevance of disclosed RPTs. The chapter also presents the concept of earnings management, taking into consideration both accrual and real activity earnings management. The impact of accounting standard on earnings management and earnings management in RPTs are also highlighted. The chapter discusses the relationship between REM in RPTs and firm value and proceeds with the mitigating role of the compliance with MFRS 124 on the relationship between REM in RPTs and firm value. The chapter then concludes with the underpinning theories of the study.

4.1 The Concept of Value-Relevance

Value-relevance is defined as the ability of annual reports to contain information capable of influencing stock price (Al-Akra & Ali, 2012). Studies that examine the association between accounting numbers and capital market activities are termed as value-relevance studies. This is based on the notion that financial statements should disclose information that reflects the actual economic position of the reporting entity, manifested in the stock price. Therefore, value-relevance can be viewed as a way in which line items in the financial statements affect the process of stock valuation or return in the capital market, tested through statistical process.

Value-relevance has been taken as a surrogate of decision usefulness, which is the fundamental objective of standard setters (Barth, Beaver, & Landsman, 2001; Veith & Werner, 2014). This view conforms to the definition of relevant information given by Framework IASC (1989). It states that information is relevant only if it is capable of influencing the economic decisions of users while evaluating the past, present or future events, confirming or correcting their previous evaluations.

Over decades, the issue of whether value-relevance of accounting numbers has declined remains unresolved. Francis and Schipper (1999) report a decline in the value-relevance of earning information over time. Hellström (2006) contends this position; he finds an improvement in the value-relevance of accounting information in transitional economies, using the Czech Republic as a testing ground. Sami and Zhou (2004) document a cyclical fluctuation of value-relevance of accounting information in the A-share market of Shanghai stock exchange. A recent study by Lam, Sami and Zhou (2013) using Chinese capital market as a laboratory, reveals that accounting information plays a significant role in explaining the stock pricing process in emerging market. However, the increase in the value-relevance is more pronounced in firms with some specific characteristics such as ownership structure, size over others.

Previous studies identified two major sources of the changes in value-relevance of accounting numbers in any given country (Dimitropoulos et al., 2013; Gjerde et al., 2008; Samarasekera, Chang, & Tarca, 2012). The first source of the change in value-relevance emanates from the change in accounting standard. Barth et al. (2008), Gjerde et al. (2008), and Dimitropoulos et al. (2013) document inconclusive results on the change in value-relevance of accounting numbers after the mandatory adoption of IFRS. The mixed result as explained in other studies was because of the uneven quality

of previous national GAAPs. Value-relevance of accounting information increases when IFRS is of higher quality than former national GAAP and decreases if otherwise (Clarkson et al., 2011; Devalle et al., 2010; Van der Meulen et al., 2007).

The second source of the change in value-relevance of accounting numbers originates from the change in enforcement regime. Samarasekera et al. (2012) argue that the increase in the value-relevance of financial statement after the mandatory adoption of IFRS was because of the increased oversight of external auditors. Similarly, Christensen, Hail and Leuz (2013) find that the capital market effect after the mandatory adoption of IFRS in European nations was because of the change in reporting enforcement. The effects are witnessed in the countries that made a substantive change in their reporting enforcement concurrently with the adoption of new set of reporting standard. Similar changes have been observed by the countries that made significant changes in their reporting enforcement without switching to new reporting standard (Ahmed, Neel, & Wang, 2013; Garcia Osma & Pope, 2011).

4.1.1 Value-relevance of Financial Information Disclosure

Several studies have established the usefulness and value-relevance for individual accounting statements in particular and the whole set in general. Some of these studies cover the whole financial statements (Anderson, 1981; Maigoshi, 2014), individual statements such as balance sheet (Chen et al., 2002), cash flow statement (Hung, Chan, & Yhi, 1995; Jones & Ratnatunga, 1997), statement of profit and loss and other comprehensive income (Huang, Ye, & Du, 2014). Studies on individual component of some statement include operating cash flow (Ahmed, Nainar, & Zhang, 2006), other

accounting information (Hassan & Power, 2009), summarized financial information of listed associates (Badenhorst et al., 2015) among others.

On the value-relevance of individual line items, Alali and Foote (2012) find a positive and significant association between earning per share and book value per share with the stock price. They also document similar result between reported earnings per share and cumulative stock return. Darrough and Ye (2007) designed a special model to examine the value relevance of loss-making firms. The authors provide empirical evidence on the value-relevance of disclosure of information in the financial statement other than the book value of equity and earnings. They proved that research and development expenditure, sales growth ratio, nonrecurring charges or write-ups and business sustainability strategies disclosure are equally value-relevant, most especially for loss-making firms.

Similarly, Franzen and Radhakrishnan (2009) find that disclosure of research and development expenditure is useful and value-relevance not only for loss-making firms but also profitable firms. Jiang and Stark (2013) used the methodology of Darrough and Ye, and find that book values are less value-relevance for high research and development-intensive and zero-dividend firms.

The above studies demonstrate the importance of financial statement information by users in making their economic decisions. Shah, Stark and Akbar (2009) find a positive association between media advertising expenses and firm market value of non-manufacturing firms. This is consistent with the finding of Oliveira, Rodrigues and Craig (2010) that intangible assets are strongly and positively associated with the market value of the firm. Wang and Hussainey (2013) find that disclosure of forward-

looking statements improves the stock market's ability in anticipating future returns. Recently, Moumen, Ben Othman and Hussainey (2015) reveal that market participants use risk information disclosure to forecast subsequent years earnings change.

Ball (2006) and Daske, Hail, Leuz and Verdi (2008) find an increase in the value-relevance of accounting numbers after the mandatory adoption of IFRS as a reporting standard. The increased value-relevance results from useful information disclosed to investors during the post-adoption period compared to national GAAP period. Elshandidy (2014) find an increase in the value-relevance of accounting information of B-share market after the adoption of the converged IFRS, which requires more information disclosure to the users of the financial statements.

4.1.2 Value Relevance of Disclosed RPT

The famous case of Enron and many other North American corporate scandals in RPTs have made the market participants be skeptical about the quality of the reported earnings (Gordon et al. 2004). Cheung et al. (2006) find that firm that announces RPT earns significant negative and lower abnormal returns compared to the firm that announces similar transaction on arm's length basis. Similarly, Lin et al. (2010) used Tobin's Q and EPS as measures of firm value to examine the effect of RPTs on firm valuation. They provide empirical evidence that presence of RPTs has a significant negative relationship with the firm value.

Ge et al. (2010) find that investors value firms differently based on their engagement in RPTs. They document that earnings by the firms that engage in RPTs are less value-relevant compared to those reported by firms without RPTs. Kohlbeck and Mayhew

(2010) find that firms with RPTs have a significantly lower valuation and subsequent returns than their non-RPTs counterpart. They provide additional evidence that market participant partitioned firms based on the RPT type and the category of the parties involved. Moreover, Xiao and Zhao (2014) find a significant reduction in the stock value because of the announcement of the related party loan guarantee. This finding is consistent with Nekhili and Cherif (2011) that only transactions engage directly with shareholders, directors or managers are having an adverse effect on the firm value.

Buysschaert, Deloof and Jegers (2004) document that intergroup equity sales create value and are beneficial to minority shareholders. Confirming this finding, Wong and Kim (2015) find that related party sales within the business group increase the firm value. However, they further find that those values disappear for the firms with high parent directors, large government ownership or many incentives for tax avoidance.

4.2 The Concept of Earnings Management

Several studies have viewed earnings management from many perspectives. Earnings management can be seen as deliberate actions within the edges of GAAPs to meet the targeted reported earnings. Johari et al. (2008) describe earnings management as an unethical practice even if accounting principles are not violated. Earnings management erodes the quality of earnings reported in financial statements (Dechow, Ge, & Schrand, 2010) and hinder financial statements from meeting the qualitative characteristics of financial reports as prescribed by IASC Framework (1989).

Chen, Chen, Lobo and Wang (2011) identify several incentives that motivate managers to engage in earnings management such as seasoned equity offerings and initial public offerings. Shu and Chiang (2014) find that large firms manage earnings (proxy by discretionary accruals) during equity offering to portray a good performance, thereby increase their proceeds from the equity. Other incentives include a tax-minimizing incentive, expropriation, performance, debt covenants, bonuses capital market expectation and valuation, contracts ties with the accounting numbers, regulations among others (Beuselinck & Deloof, 2014; Dechow et al., 2010; Johari et al., 2008). Miko and Kamardin (2015) potent that managers still manage reported earnings to achieve their target despite the number of checks amid the reporting process.

Corporate governance has been identified as one of the mechanisms that mitigate management opportunistic behavior and increase earnings quality. Faleye, Hoitash and Hoitash (2011) and Jaggi et al. (2009) emphasize the importance of board independence in effective monitoring of earnings management and ensuring high quality financial reporting. Ye (2014) documents that compensating independent directors with cash impairs their independence and decreases their monitoring activity.

The role of accounting standard in curbing earnings management has been a point of discussion for decades (Demerjian, 2011; Goncharov & Zimmermann, 2006; Hope, 2003). Recently, the gale of mandatory adoption of IFRS has attracted the attention of professionals and academics. Several studies are conducted on the effect of mandatory accounting standard in limiting earnings management practice. The results of these studies revealed an inconclusive result (Ahmed et al., 2013; Dimitropoulos et al., 2013; Ismail, Kamarudin, Zijl, & Dunstan, 2013).

Researchers such as Leuz, Nanda and Wysocki (2003) and Daske et al. (2008) associate earnings management with the level of investors protection in the country. They document high earnings management in countries with low level of investor protection. In contrast, Ball, Robin and Wu (2003) document that there are so many discrepancies in earnings management practice between common law countries (presumed to have high investors protection) and code law countries. They attributed the differences in earnings management to preparers' incentives and other institutional factors. Zéghal, Chtourou and Sellami (2011) find that existence of block shareholders in a firm reduces the magnitude of earnings management. Chen et al. (2011) find that non-state-owned firms have less incentive to manage earnings over the state-owned firms.

4.2.1 Accrual versus Real Activities Earnings Management

There are two broad categories of earnings management mechanisms namely; accrual earnings management and REM. Accrual earnings management occurs when managers use accounting methods and estimates to manipulate the reported earnings (Healy & Wahlen, 1999). Real earnings management is defined as an intentional deviation from the normal operational process with a view to mislead stakeholders to believe that key performance goals have been achieved through normal operations. Real earnings management affect both reported earnings and cash flow (Burnett, Cripe, Martin, & McAllister, 2012). It focuses on the short-term profitability of the firm rather than the long-term value of the firm (Roychowdhury, 2006).

Accrual earnings management cannot be done through the operating activities with a direct effect on cash flow, but rather through the managers' discretion with regards to

judgment in estimations and accounting choice (Gunny, 2010). Prior studies have identified numerous incentives that motivate firms to engage in accrual earnings management. These incentives include meeting regulatory thresholds and or analysts' forecast, managerial compensation, meeting contractual agreement (Burgstahler, Hail, & Leuz, 2006; Dechow & Skinner, 2000; Kuo et al., 2014; Lo, 2008). However, Chang and Sun (2009) and Hazarika, Karpoff and Nahata, (2012) find that board independence and strong audit committee constrain the accrual-based earnings management practice.

Looking at the REM, some studies document that managers cut down research and development expenditure in their last year in office or when it threatens the ability to report the targeted earnings (Baber, Fairfield, & Haggard, 1991; Cheng, 2004). Cohen et al. (2008) and Cohen and Zarowin (2010) provide empirical evidence that managers manipulate the timing and extent of research and development expenditure to inflate the reported earnings. These practices affect the firms' competitive advantage (innovation, customer loyalty and alike) and are detrimental to the future value of the firm. The practice validates the findings of Graham, Harvey and Rajgopal (2005) that managers indicated their willingness to partake in REM even if it will affect the long-term value of the firm. It is generally believed in financial reporting that profits from the disposal of profitable assets form part of the current earnings. Bartov (1993) and Herrmann et al. (2003) document that managers dispose of some fixed assets and marketable securities to inflate the reported earnings for the purpose of meeting the pre-set benchmark. Similarly, Cheng (2012) document that managers complement the manipulation of loan loss provisions with the structured loan sales and securitizations to meet the earnings target.

Recent studies highlight the increased need for the understanding how firms use real activities manipulations to manage reported earnings (Burnett et al., 2012; Chi, Lisic, & Pevzner, 2011; Cohen & Zarowin, 2010). According to Gunny (2010), REM is conducted through the timing of financing or investment decisions and changing the magnitude or frequency of operating activities to manipulate the reported earnings or some part of it. Graham et al. (2005) find that financial executives prefer the use of REM than accrual earnings management method. This can be connected to the fact that regulators and knowledgeable investors can easily expose accrual management and accrual management takes place at the year-end or quarter, so the manager is not certain on the accounting treatment that can be allowed by auditors at that time (Gunny, 2010).

Additionally, accrual manipulations are more likely to draw the attention of auditors and regulators than production or price manipulations. This position has been empirically proved by Chi et al. (2011) that REM have not been detected by Big audit firms. Similarly, Cupertino et al. (2015) document that capital market has failed to detect the effect of earnings management accomplished through manipulation of certain types of real activities. Second, the risk associated with accrual manipulation. In the event of the shortfall between the desired thresholds and manipulated earnings, activity-based manipulation cannot be done at the year-end, while the reverse is possible (Roychowdhury, 2006).

Firms can manipulate reported earnings via decrease in discretionary expenses (Research and Development, Selling and Administrative Expenses) to decrease operating costs, timing fixed asset disposal to report high gain, increase production to lower unit cost, reduce price (including exceptional discount) to boost sales, stock

repurchase to alter earnings per share and a lot. Real earnings management can also be used for tunneling or propping purposes (Xiao Chen, Lee, & Li, 2008; Hribar, Jenkins, & Johnson, 2006; Jian & Wong, 2010). However, Cohen and Zarowin (2010) find that the negative consequences of REM on the firm performance are more severe than that of accrual earnings management.

Contrary to the finding of Chi et al. (2011), Zhu, Lu, Shan, & Zhang (2015) find that Big 4 audit firms constrained the attempted moves by firms to use REM during the conduct of reverse mergers within the Chinese firms. Moreover, Kuo et al., (2014) provide empirical evidence that firms can engage in both accrual earnings management and REM concurrently as against the findings of Zang (2012) that managers use accrual earnings management and REM as a substitute.

4.2.2 Impact of Accounting Standard on Earnings Management

Healy and Wahlen (1999) state that managers use personal judgment in financial reporting to choose accounting methods and estimate that may not portray the actual economic reality of the firm to mislead stakeholders or influence the outcome of some contractual agreements. Accounting standards with limited alternative accounting methods produce high quality earnings because it minimizes manager's opportunistic behavior. Similarly, accounting standards that require more information disclosure are seen as high quality standard (Leuz & Verrecchia, 2000).

Tendeloo and Vanstraelen (2005) demonstrate that IFRS has ruled out the possibility of creating hidden reserves, the action that makes earnings management more difficult. Similarly, Griffin, Hirschey and Kelly (2011) find that earnings announcements are

more informative in countries with stronger accounting standards (IFRS or US GAAP). Consistent with this, Landsman, Maydew and Thornock (2012) document an increase in abnormal return volatility and abnormal trading volume in sixteen countries that adopted IFRS compared to eleven countries that maintain their domestic standards. Houque et al. (2012), Ismail et al. (2013) and Guindy (2014) report an improvement in reported earnings quality across the globe after the mandatory adoption of IFRS as reporting standard.

Ball et al. (2003) state that high quality accounting standards are necessary for curtailing earnings management, even though it may not necessarily be sufficient one. In contrast, Van Tendeloo and Vanstraelen (2005) examine the level of earnings management practice by German firms that voluntarily adopt IFRS, which assume to be of high quality against the firms that use German GAAP. They find that IFRS firms do not present different earnings management practice compared to German GAAP firms. This finding stresses the fact that earnings management cannot be constrained by mere adoption of a high quality accounting standard. Furthermore, Burgstahler, Hail and Leuz (2006) discover that within the EU nation, private firms exhibit high earnings management behavior than public firms, even though they use the same accounting standard. This highlight the existence of other incentives that motivate firms to exhibit a high or low level of earnings management.

4.2.3 Earning Management and RPTs

Cheung et al. (2009) identify three motivations behind RPTs, which are tunneling, propping and earnings management. However, the incentives that make firms perpetrate earnings management in RPTs remains unexhausted. Johnson et al. (2000)

show that even in developed capital market insiders have been using RPTs to transfer profits and assets to other firms for the benefit of those own them. Similarly, Jian and Wong (2004) state that business groups report abnormal RP sales when they have incentives to meet some regulatory requirement. Liu and Lu (2007) are of the opinion that agency conflict between controlling and minority shareholders is a dominant factor that leads to earnings management in emerging markets.

Munir et al., (2013) posit that the effects of related-party transactions on earnings quality are determined by the level of family ownership. Johari et al. (2008) find that high management ownership induces managers into earnings management. That is to say, managers used their inside information and influence on the business operations to manipulate reported earnings and meet their desired objectives. Consistent with this, Kohlbeck and Mayhew (2010) state that management opportunistic behavior was the main factor that drives management to frauds, misappropriation of firm's assets and misleading financial statements in recent governance cases (Enron, Healthsouth, and others). The authors state that most of the frauds were perpetrated in RPTs. Fisman and Wang (2010) document a negative relationship between abusive RPTs and firm value. Similarly, Xiao and Zhao (2014) find that excess controls rights are associated with value-destroying related-party loan guarantees and the stock market react negatively to the release of such transactions.

Aharony et al. (2000) state that management of the state-owned enterprises that need capital market listing have incentives to engage into RPTs that will boost their earnings with their controlling shareholder since financial performance is one of the criteria for listing. Consistently, Chen and Yuan (2004) show that firms engage in earnings management to meet the capital market requirement on ROE for offering right issues.

Similarly, Aharony et al. (2010) provide empirical evidence that firms manipulate earnings in the pre-initial public offering period through RP sales of goods or services. Firms that perpetrate earnings management practice through related party sales employ both accrual and REM methods (Jian & Wong, 2010).

In contrast, Kuan, Tower, Rusmin and Van der Zahn (2010) examine the relationship between RPTs and earnings management practice and find that there is no association between the two variables. The authors state that mere existence of RPTs may not necessarily signal earnings management. This is consistent with the view held by Wong and Kim (2015) that RPTs can be arranged for tax minimization not necessarily for earnings management purpose. In whatever position, Hwang et al. (2013) find that earnings management within the business group can be mitigated through increased disclosure regulations.

4.2.4 Earning Management and Firm Value

Most of the studies in accounting literature believe that both accruals earnings management and REM approaches are detrimental to the firm value. However, the approaches differ in term of the time taken before the consequences manifest on the value of a firm (Graham et al., 2005). Although, a survey conducted by de Jong, Mertens, van der Poel and van Dijk (2014) reveals that all forms of earnings management (excluding share repurchases) to influence investor's perceptions of firm value are value-destroying. Family firms involve less in both accruals earnings management and REM to preserve the transgenerational sustainability of the firm (Achleitner, Günther, Kaserer, & Siciliano, 2014). However, Gunny (2010) provides that REM to meet earnings benchmarks are not detrimental to the future performance

of a firm. Similarly, Taylor and Xu (2010) reveal that firms that engage in REM are not associated with a decrease in subsequent operating performance.

Several studies assess the effect of accrual earnings management on firm value. Rangan (1998) documents that the market value of firms that engage in earnings management during the seasoned equity offerings declines in subsequent years after the offerings. He attributes the decline to earnings management at the period of the seasoned equity offerings. Consistently, Teoh, Welch, & Wong (1998) and Louis (2004) find that the market value of firms that engage in earnings management during the initial public offerings/firm acquisition declines in subsequent years after the offerings/acquisition. The authors provide evidence that initial public offerings issuers with higher earnings management indices have a three-year post-offering stock return of almost twenty percent less than initial public offerings issuers with lower earnings management indices. However, the negative relationship between earnings management and firm value is more pronounced in firms with weak corporate governance (Tang & Chang, 2015).

Like accrual earnings management, REM also has a negative effect on the firm value. (Farooqi, Harris, & Ngo, 2014; Graham et al., 2005). Recent studies on REM have shown that firms manipulate real activities to influence reported earnings as a substitute to accruals earnings management (Badertscher, 2011; Zang, 2012), or as its complement (Chi et al., 2011; Cohen, Dey, & Lys, 2008; Cohen & Zarowin, 2010). Moreover, Cohen et al. (2008) and Kuo et al. (2014) indicate that changes in mandatory and incentive-based regulations are associated with a decline in accruals earnings management and increase in REM in both developed and emerging markets respectively.

Cohen and Zarowin (2010) reveal that the performance of firms that engage in earnings management during the seasoned equity offerings declines in subsequent years after the offerings. The decline as a result of REM is severe compared to that of accrual earnings management. Consistently, Kothari, Mizik and Roychowdhury (2015) document that both earnings management strategies induce overvaluation at the period of seasoned equity offerings. These earnings management strategies are linked with the decline in the stock market performance in the post seasoned equity offerings period.

Zhu et al. (2015) provide evidence that accrual earnings management is more costly to a firm than REM in the short-term. This is because accrual earnings management predicts changes in post-acquisition operating performance in Chinese reverse merger firms. however, REM is more detrimental to the firm as it affects the actual cash flow of the firm (Roychowdhury, 2006), increase the volatility of the future cash flow (Ge, 2009) and its long-term value (Chi et al., 2011; Graham et al., 2005).

4.3 Underpinning Theories

4.3.1 Agency Theory

Agency theory has been a dominance theory in organizational control and governance studies for decades (see Fernando, Schneible, & Suh, 2013; Hossain, Perera, & Rahman, 1995; Leftwich, Watts, & Zimmerman, 1981; Watts, 1977). In most of the corporate setting, the capital providers who are the owner of the firms (principal) employ the service of the agent (managers) to run the affairs of the firm on their behalf. Under the rationality assumption Fernando et al. (2013) state that both parties act in the way that will maximize their interest. Watts (1977) states that vast of literature

believe that an agent can only maximize his satisfaction (compensation) through acting in the best interest of his principal. Based on this premise, the theory assumes a direct and positive relationship between agent's compensation and their performance. This situation is termed as a reconciliation of conflict (Watts, 1977).

However, in most cases, the principal has neither possesses the basic knowledge and experience to run the firm nor does he has information on the day-to-day operational information of the firm (Fernando et al., 2013). Hence poses the threat of having an agency cost—a situation where the agent derives financial benefits from the firm at the detriment of the principal as propounded by Jensen and Meckling (1976). This type of agency problem (principal-agent) is referred to as type *I* agency cost (Cai et al., 2015; Cheng, 2014; Lei, Lin, & Wei, 2013).

Jensen and Meckling (1976) recommend that this type of agency problem can be mitigated through a high portion of managerial ownership. This is because, the higher the managerial ownership, the more their personal interest is aligned with that of the shareholders. Similarly, Shleifer and Vishny (1986) demonstrate the importance of having large shareholders in public corporations to perform monitoring function and reduce the managerial opportunistic behavior.

Although insider ownership is widely proposed as the mechanism of dealing with principal-agent agency problem, this kind of ownership structure comes with its peculiar agency problem (Shleifer & Vishny, 1997). It presents an opportunity for insiders (large shareholders and management) to expropriate the wealth of the firm at the expense of outsiders (minority shareholders and creditors). This type of agency

(principal-principal) problem is widely known as type *II* agency problem (Bruslerie & Latrous, 2012; Fernando et al., 2013).

RPTs are generally believed to be the common tool used by controlling shareholders to expropriate the minority shareholders. Lin et al. (2012) state that controlling shareholders are linked with some value-destroying activities in both developed and developing nations. These activities include self-serving financial transactions, outright theft, and expropriation of corporate opportunities such the use of corporate information to secure a contract for another company (Johnson, La Porta, et al., 2000; Su et al., 2014).

Corporate transparency and information disclosure have been identified as the means of preserving the sanctity of financial reporting system as well as dealing with type *II* agency problem. Cottingham and Hussey (1995) emphasize the importance of the disclosure of RPTs in financial statements for the prevention of misleading financial information. Similarly, La Porta et al. (2006) find strong evidence that mandatory information disclosure benefits stock market operators in regulating the conflict between controlling and minority shareholders. Stressing on the importance of disclosure in curbing the negative effect of RPTs on minority shareholders, Djankov et al. (2008) designed a unique and comprehensive disclosure index to be used for measuring the level of minority shareholder protection against the self-dealing by insiders.

4.3.2 Institutional Theory

Managers should not only focus on improving internal efficiencies but should also scan and adopt external environmental factors so as to build and sustain institutional legitimacy (Meyer & Rowan, 1977; Oliver, 1997). DiMaggio and Powell (1983) suggest that organizations can compete favorably in the modern environment only if they adopt institutional isomorphism. Institutional isomorphisms are the forces that make organizations embrace similar environmental conditions (such as accounting standard). They argue that the process takes place through one or a combination of coercive, mimetic or normative pressures.

Coercive pressures arise from the formal and informal interactions with the external environment. This form of isomorphism arises due to pressures from the organizations in particular and general society in general that focal organization depends on. This pressure may take a form of force, persuasion and or invitation to join the club. A typical example of this type of pressure is the disclosure regulation by the relevant authorities on the minimum amount of information (such as RPTs) that must be disclosed in the annual report. This form of pressure is beyond the control of managers who may be seeking for the strategies that will help them to secure legitimacy (Scott, 1987).

It must be noted that not all the institutional isomorphism derive their pressure from coercive forces. Some forms of isomorphism arise because of powerful forces that motivate organizations to imitate from their peer organizations due to fear of uncertainty. Pressures of this kind are termed as mimetic pressures. A typical example of this kind of pressure is a situation where multinational and other large corporations

disclose information on corporate social responsibility to suit their class and protect their corporate image.

The last form of institutional isomorphism derives its force from normative pressure and professionalization. In most of the organizational settings, employees acquire similar training and job experience through direct engagement with their routine duties. Members of professional bodies interact with one another through the platform of their professional bodies. These interactions and other professional codes make professionals act uniformly in their respective organization, which in turn will make their organization to look similar with respect to activities of professionals. A common example of this form of pressure is the period where professional bodies regulate accounting practices and disclosures through the activities of their members. Oliver (1997) articulates that harnessing institutional forces with internal resources is indispensable in achieving sustainable competitive advantage.

In emerging economies, the nature of institutional setting has a great impact on the agency contract, which makes its enforcement problematic and costly (Khanna & Palepu, 2000; Peng & Delios, 2006). Institutional isomorphism (more especially coercive pressure) can serve as a better alternative in dealing with agency problem (Chizema & Kim, 2010). Organizations can imitate from their peer group or be compelled to release the information considered necessary for minority shareholders protection in particular, and legal enforcement and investor protection in general.

4.3.3 Resource Dependency Theory

Resource dependency theory assumes that the firm is embedded in its environment and depends on the resources from that environment to survive. The theory provides a theoretical basis for the role of corporate directors in the provision of resource and advice. Unlike the agency theory which assumes the main role of directors is monitoring, resource dependency theory provides that the main role of corporate directors is the provision of resource function (Pfeffer & Salancik, 1978). The theory provides that effectiveness of the board depends on the external resources that external directors are able to bring to the board for the benefit of the firm.

Under the resource dependency theory, the board of directors is useful as they provide the firm with important resources at lower costs and mediate the firm with the external environment (Chen, 2014; Davis & Adam Cobb, 2010; Hillman & Dalziel, 2003; Hillman, Withers, & Collins, 2009). Pfeffer and Salancik (1978) argue that directors provide four benefits to the firms: i) provision of advice and counsel, ii) channeling of information between firm and external environment, iii) preferential access to resources, and iv) legitimacy. However, Hillman and Dalziel (2003) states that firms benefit most from directors when director provide both monitoring and resource functions.

This study uses the resource dependency as underpinning theory for the relationship between board characteristics, audit committee characteristics and firm disclosure behavior (Biermann & Harsch, 2017; Hillman & Dalziel, 2003). The theory assumes that directors with vast industry and business knowledge and multiple directorships are saddled with the responsibility of counsel and advice as they possess the requisite

knowledge, expertise and experience to handle the duties. Therefore a well-diversified large boards handle the duties effectively (Castro, De La Concha, Gravel, & Periñan, 2009; Hillman & Dalziel, 2003; Pfeffer & Salancik, 1978).

4.3.4 Capital market theory

Capital market researches mostly constitute studies that tested the market reactions with the release of the choice of accounting methods, value-relevance of financial reporting and fundamental analyses (Kothari, 2001). Market-related studies are mostly based on the assumption of capital market efficiency. Hence, most of the regulations in the field of financial reporting are formulated on the premise that once a financial information is disclosed, the stock price will be adjusted to reflect that particular information (Beaver, 2002). The accuracy of the outcome of the value-relevance studies depends heavily on the relevance and reliability of accounting information disclosed to the market. These disclosures are critical to the effectiveness of the efficient capital market (Healy & Palepu, 2001).

Based on capital market transaction theory, firm has to release more information to the market to reduce the information asymmetry with the investors which in turn lowered the firm cost of capital (Barry & Brown, 1984, 1985; Merton, 1987). Similarly, managers with the potential capital market transaction have to provide market participants with more information to enable them to evaluate the strength and financial position of their firm (Healy, Hutton, & Palepu, 1999; Healy & Palepu, 1995).

The theoretical foundation of value-relevance studies is made up by the combination of contextual accounting arguments and valuation theory that permit the researchers to envisage how accounting figures associate with the stock price (Beaver, 2002). Value-relevance is one of the major dimension of capital market researches (Beaver, 2002; Healy & Palepu, 1995; Kothari, 2001). Value-relevance studies are categorized into the relative association, incremental association and marginal information content studies (Holthausen & Watts, 2001). This study used the incremental approach to test value-relevance of RPT disclosure. Under this approach accounting information is said to be value-relevant if its coefficient differs significantly from zero. The same approach is used to investigate the incremental value-relevance of RPTs disclosure as a result of a switch in accounting standard from FRS to MFRS.

4.4 Summary of the Chapter

This chapter discusses the concept of value-relevance of the disclosed accounting information in general and that of the disclosed RPTs in particular. Value-relevance is defined as the ability of the accounting information to influence the stock valuation. The major factors that lead to the change in the value-relevance of accounting information are the changes in the accounting standard and change in the enforcement regime. The chapter also reviews the definition and classification of earnings management. Although most of the previous studies focused on the accrual earnings management, REM is getting monumental attention nowadays. There exist strong indications that accounting regulations can be used to curtail the REM practices.

CHAPTER FIVE

RESEARCH METHODOLOGY

5.0 Introduction

This chapter contains the methodological approaches adopted to achieve the objectives of the study. The chapter discusses the conceptual frameworks for the factors that determine the level of compliance with the accounting standard on RPTs. Also, it contains the frameworks effect of MFRS 124 adoption on value-relevance of accounting numbers and that of the mitigating effect of compliance with accounting standard on RPTs on the relationship between REM in RPTs and firm value, and research hypotheses are generated therefrom. The chapter covers the philosophy adopted in the study which consists of research paradigm and research design. It also presents the process adopted in the operationalization of the study. The chapter concludes with the sample selection procedure adopted in the study.

5.1 Research Philosophy

This section discusses the research paradigm and research design adopted during the conduct of the study.

5.1.1 Research Paradigm

Research paradigm can be seen as the researcher's fundamental philosophical and theoretical assumptions about the nature of society and the social world, together with his personal beliefs, values, and knowledge that influence the selection of a methodological approach to a particular study (Burrell & Morgan, 1979; Hopper &

Powell, 1985). Early researchers have established the use of two extreme research paradigms (positivism and interpretivism). However, many more paradigms have evolved from the mixture of the assumptions of the two extreme paradigms to overcome the shortfall of the earlier paradigms (Collis & Hussey, 2009; Sekaran & Bougie, 2013).

Positivism is a philosophical paradigm that supports the application of the natural science method to study the social reality and beyond (Bryman & Bell, 2003). Positivists believed that the researcher is independent of being researched, the actual reality cannot be affected by the study of social reality and the aim of the research is the discovery of theory from the empirical facts (Creswell, 1994). Interpretivism, on the other hand, was built on the philosophy of idealism (Collis & Hussey, 2009). Unlike the former, interpretivism believed that social reality cannot be studied through the application of principles developed for natural science phenomenon (Blumberg, Cooper, & Schindler, 2011). They argued that social reality is highly subjective, has a meaning for human beings and highly affected by the intentional actions of the researcher (Bryman & Bell, 2003; Creswell, 1994). Collis and Hussey (2009) described interpretive research as any research that does not involve the use of the statistical technique of quantitative data analysis in arriving at the findings of the study.

This study subscribes to the idea of positivism paradigm for the following reasons. First, the objective of this study is to determine the level of compliance and the factors that influence the level of compliance with the disclosure requirements of accounting standard on RPTs, assess the relationship between stock price and RPTs disclosure, investigate the relationship between REM in RPTs and firm value and investigate if

the relationship between REM in RPTs and firm value is moderated by compliance with the disclosure requirements of accounting standard on RPTs.

In this regard, the study assumes that the influences, factors and the relationship have existed and are real. Second, theoretical conjunctures are developed and tested through empirical observation with the aid of statistical techniques of data analysis. Specifically, twenty research hypotheses are formulated and focus on theory testing and verification through the deductive approach. Based on this, the study subscribed to the ontological, epistemological, axiological, rhetorical and methodological assumptions of positivism paradigm.

5.1.2 Research Design

Research design is a blueprint for the collection, measurement and analysis of data, based on the research questions of the study (Sekaran & Bougie, 2013). Quantitative research approach is designed to collect secondary data from a sample, analyze them using statistical techniques to determine if any relationship exists between pairs of or multiple variables and generalize the result to a population (Collis & Hussey, 2009).

The study adopts this approach to determine the level of compliance and the factors that influence the level of compliance with the disclosure requirements of the accounting standard on RPTs, assess the relationship between stock price and RPTs disclosure, investigate if such disclosed figures are associated with earnings management and explore the moderating effect of level of compliance on the relationship between REM in RPTs and firm value based on the aforementioned theories. This approach is the most appropriate for the research of this nature as was

widely adopted in most of the financial reporting and corporate governance studies (Abdul Latif, 2010; Barth et al., 2008; Dechow, Hutton, Kim, & Sloan, 2012; Misirlioğlu et al., 2013). Secondary data are sourced from the annual reports and account of the firms, company announcement from the website of Bursa Malaysia and the Thompson DataStream.

Quantitative techniques for data analyses are employed to examine the relationship between research variables based on the data collected from the sampled firms and inferences are drawn from them. Descriptive statistics are run to condense, summarize and display the data in a logical manner that permits a logical insight into the possible outcome of the study. It comprises the mean, median, minimum, maximum, standard deviation skewness and kurtosis values for the research variables.

Pearson's correlation was used to determine the direction and magnitude of the association between the research variables. It was used to assess the multicollinearity among the research variables. The statistical significance level of ($p < 0.01$, 0.05 and 0.1) was adopted in the study. The study uses the independent t-test to test the mean difference of the extent of compliance. Multiple linear regressions are used to examine the relationship between dependent and independent variables in the research models.

Microsoft Excel and Stata 12 statistical packages were used in the study to compute the disclosure index and run the above-stated techniques namely, descriptive statistics, independent t-test, Pearson's correlations and multiple regressions. The use of the packages has helped the researcher to generate significance level easily, determine the coefficients of the models, residuals and R square, which serve as a yardstick to decide whether research hypotheses are supported or not supported.

5.2 Hypotheses Development and Research Frameworks

Several studies investigate the factors that determine the general level of information disclosure in the annual reports (Beretta & Bozzolan, 2008; Core, 2001; Samaha et al., 2012; Verrecchia, 1990) during voluntary (Heitzman et al., 2010; Samaha et al., 2012; Street & Bryant, 2000) and mandatory regimes (Al-Akra et al., 2010; Glaum et al., 2013). Most of these disclosure studies are based on the whole set of accounting standard while studies on the individual accounting standard remain scanty (Glaum et al., 2013; Utama & Utama, 2014). Based on the reviewed literature, corporate governance variables and firm financial characteristics are identified and hypothesized to affect the level of compliance with the accounting standard on RPTs.

5.2.1 Extent of Compliance with the Accounting Standard on RPTs

Based on the institutional theory, firms employ many mechanisms to create and maintain sound institutional legitimacy (Meyer & Rowan, 1977). These mechanisms include among others proper means of communication with outside environment. Regulators and other external parties use coercive isomorphism to compel a firm to disclose certain information for public consumption. Listed firms are required to comply with mandatory disclosure requirements in totality, and anything in short of that can be sanctioned by appropriate regulatory bodies (Houqe et al., 2012; La Porta et al., 2006). However, Tsalavoutas (2011), and Yeoh (2005) argue that existence of regulatory bodies cannot guarantee compliance.

Empirical studies document a low level of compliance in emerging market (Carlin, Finch, & Laili, 2009a; Dang-Duc, 2011; Hodgdon et al., 2008). Glaum et al. (2013) reveal substantial noncompliance with IFRS across seventeen (17) European nations

as postulated by (Street & Gray, 2002). Bova and Pereira (2012) document that, though both public and private firms are required to comply with IFRS requirement, the level of compliance is high for public firms. Hence, this study hypothesizes that:

5.2.2 Determinants of Compliance with Accounting Standard on RPTs

For the purpose of this study, corporate governance mechanisms, firm financial characteristics and control variables are identified and tested to assess their influence on the level of firm RPTs disclosure practice. Corporate governance mechanisms are divided into board characteristics, audit committee characteristics, CEO characteristics and ownership structure. Similarly, firm financial characteristics are divided into RPT motives and firm performance. Last, the study adopts firm size, auditor type and MCCG as control variables.

5.2.2.1 Corporate Governance

Agency theory by Fama and Jensen (1983) provide a theoretical support for using corporate governance variables in disclosure related studies. The role of corporate governance in promoting corporate information disclosure and mitigating the type II agency problem has long been established by literature (Chen, Chung, Lee, & Liao, 2007; Elhelaly, 2014; Gisbert & Navallas, 2013; La Porta et al., 2000; Lakhali, 2005; Singh & Davidson III, 2003). Apart from agency theory, resource dependency theory plays important role in explaining the firm decisions and disclosure behavior (Brown & Hillegeist, 2007; Hillman & Dalziel, 2003; Mudambi & Pedersen, 2007; Pugliese et al., 2014). Therefore, this study identified some corporate governance variables and assessed their effect on the compliance with the RPTs disclosure requirements.

Among the board characteristics, board independence and board size are selected for this study. This is based on their explaining power in defining the corporate disclosure behavior as documented by previous studies (Chau & Gray, 2010; Grigoris, 2014; Ntim & Soobaroyen, 2013; Samaha et al., 2015; Wang & Hussainey, 2013). Similarly, the choice of audit committee independence and audit committee financial expertise is based on the vital role they played in explaining the firm disclosure behavior during voluntary regime (Bédard & Gendron, 2010; Carcello et al., 2006).

5.2.2.1.1 Board Characteristics

Agency theory has been the dominant theory in board characteristic studies (Dalton, Daily, Ellstrand, & Johnson, 1998). Based on agency theory, several studies document that presence of independent directors on the board minimises both type I and II agency problems (Adams et al., 2008; Crespí-Cladera & Pascual-Fuster, 2014; Fama & Jensen, 1983), and their adequacy protect the interest of all stakeholders (Lo et al., 2010; Mallin et al., 2015). Resource dependency theory provides that outside directors promote firm disclosure practices through counseling and advising role (Davis & Adam Cobb, 2010; Pugliese et al., 2014). Germain, Galy and Lee (2014) state that the issue of independent directors has been gaining much attention in recent years and notice an upward trend of independent directors in many corporate boards. Several studies conducted on board independence establishes a positive association between the number of independent directors and the firm disclosure behavior (Chen & Jaggi, 2000; Ferreira et al., 2011; Patelli & Prencipe, 2007).

Chau and Gray (2010) examine the relationship between the extent of voluntary disclosure and board independence, including the influence of an independent director

serving as the chairman. The authors use the sample of firms listed on Hong Kong stock exchange and find that appointment of an independent director as chairman improves the firm's disclosure level in family firms. Similarly, Armstrong et al. (2014) investigate the causal effect of independent directors and firm transparency. Using NYSE and Nasdaq regulations that require independent directors to constitute more than fifty percent of the membership of listed firms. The authors find that it is the independent directors that influence the firm transparency and not the other way round.

Similarly, Wahab et al. (2011) investigate the effect on corporate governance on the relationship between RPTs and firm performance. The authors use the sample of Malaysian listed firms and found that independent directors mitigate the negative effects of RPTs on firm performance. However, the effect of independent directors on the level of compliance with accounting standard on RPTs remain unknown. Based on this, the study hypothesises that:

H1a₁: There is a significant positive relationship between the proportion of independent directors and compliance with the disclosure requirements of the accounting standard on RPTs.

Building on the same agency and resource dependency theories, the principal (owners) installs a large board to monitor the actions and advice their agents (Jaskiewicz & Klein, 2007). This has been proved by Germain et al. (2014) that board size has remained stable from 2000 to 2007 globally and grows based on the firm size and complexity. Regarding the effect of board size on corporate disclosure practice, Cheng and Courtenay (2006) document absence of any association between corporate voluntary disclosure with board size. However, Gordon et al. (2004) reveal that an

increase in the number of directors on the board has resulted to a higher occurrence of RPTs more especially in relation to executive directors. Notwithstanding this, Coles et al. (2008) use the sample of firms in the IRRC database and arrived at U-shape relationship between board size and firm value. This suggests that neither large board size nor small board size is optimal for a firm.

Based on the concept of expert power of resource dependency theory, large board contains many people with diverse knowledge, skills and experiences which imply strong monitoring and advising roles, thus promoting corporate transparency (Samaha et al., 2015). Nekhili and Cherif (2011) use the sample of the firms listed on Paris stock exchange for the period of 2002-2005 to investigate the relationship between board size and RPTs. The findings revealed that RPTs is influenced by the size of the board. In view of this, the next hypothesis is developed:

H1a₂: There is a significant positive relationship between the size of the board and compliance with the disclosure requirements of the accounting standard on RPTs.

5.2.2.1.2 Audit Committee Characteristics

Based on agency and resource dependency theories, audit committee plays important role in explaining firms' disclosure practice. Audit committee has a fiduciary duty of monitoring compliance with all related financial requirements (Al-Akra, Eddie, & Ali, 2010; Brochet & Srinivasan, 2014). Generally, the presence of audit committee is found to increase the firm disclosure behavior and mitigates agency costs (Al-Najjar & Abed, 2014; Cai, Hillier, Tian, & Wu, 2015; Cheung, Qi, et al., 2009; Gao & Kling,

2012; Ho & Shun Wong, 2001). The degree of independence in the audit committee affects the quality of the oversight of the firm financial reporting process (Black & Kim, 2012; Li, Mangena, & Pike, 2012). Abbott, Parker and Peters (2004) confirm that the presence of the independent audit committee with strong monitoring activities decreases the tendency of producing misleading financial reports.

Nekhili and Cherif (2011) use 3SLS simultaneous model on 85 Paris-listed firms to investigate the effect on audit committee independence on the RPTs. The results show that the degree of independence of audit committee influences the level of firm's RPTs, hence affecting the firm value. Similarly, Cai et al. (2015) investigate the role of the audit committee in mitigating the effect of agency costs of ownership structure. The authors used 3217 firm-year observations from 1126 sampled listed Chinese firms for the period of 2002 to 2004. The findings provide empirical evidence that audit committee independence is valued by shareholders and mitigates the agency costs associated with ownership structure. Based on this, the study hypothesizes that:

H1a₃: There is a significant positive relationship between audit committee independence and compliance with the disclosure requirements the of accounting standard on RPTs.

Furthermore, audit committee financial expertise allows the committee to identify shortly internal control weaknesses and ask management to take corrective measures accordingly (Goh, 2009; Zhang, Zhou, & Zhou, 2007). Based on agency and resource dependency theories, board members use their diverse knowledge and experience to monitor and advise management. This provides that audit committee members with financial expertise will assist the committee to work effectively (Dhaliwal, Naiker, &

Navissi, 2010). Lack of requisite expertise by audit committee members may trigger fraudulent reporting (Abbott et al., 2004), reduces investors ability in making wise economic decisions and consequently increases agency costs (Dhaliwal et al., 2010). Consolidating on these result, Cohen, Hoitash, Krishnamoorthy and Wright (2013) use the large sample of 18564 firm-year observations to measure the effect of audit committee expertise in monitoring financial reporting processes. The results prove that both industry and financial expertise play an important role in the prevention of financial misstatement.

Carcello, Hollingsworth and Neal (2006) document a significant level of compliance with Sarbanes-Oxley Act on the disclosure of financial expert on audit committee in the annual reports. This result signals the value attached to audit committee financial expertise by both the regulatory bodies and the reporting entities. Sarbanes–Oxley Act of 2002 (SOX) in U.S stressed the importance of audit committee financial expertise in enhancing the firm reporting quality (Badolato, Donelson, & Ege, 2014). It is also established that audit committee financial expertise improves firm performance (Aldamen, Duncan, Kelly, McNamara, & Nagel, 2012) and curtail earnings management practices and transfer price manipulations (Abbott et al., 2004; Davidson III, Xie, & Xu, 2004), hence mitigating the agency conflicts. Therefore, the next hypothesis is:

H1a4: There is a significant positive relationship between audit committee financial expertise and compliance with the disclosure requirements of the of accounting standard on RPTs.

5.2.2.1.3 CEO Characteristics

CEO characteristics have been studied based on both agency and resource dependency theories. The level of CEO expertise has been found to influence the success or otherwise of the numerous decisions and strategies he takes in a firm. Custódio and Metzger (2013a) investigate the relationship between CEO expertise and firm market value of 1500 Standard and Poor (S&P) firms. Using the sample of 25,562 CEO- firm-years observations, the results show that financially expert CEOs increase the market value of the firms. Financially expert CEOs take favorable business strategy decisions related to cash holding, share repurchase and so on. Accordingly, Custódio and Metzger (2013b) and Huang (2014) document that firms that focus on the industry in which they possess managerial expertise achieved significant improvement in performance. The improvement is higher for the firms with CEO with much experience in that industry.

Consistently, Haislip and Richardson (2015) find that IT expert CEOs make more accurate estimations that lead to more accurate earnings forecast. Correspondingly, Dubocage and Galindo (2013) conclude that venture capitalists retain the CEOs with core business expertise. However, previous studies did not pay attention to the effect of CEO expertise on firms disclosure practice. Based on the findings of Gul and Leung (2004) that independent directors expertise mitigate the negative CEO duality and voluntary information disclosure relationship, this study postulate that CEO expertise motivates CEO to comply with the regulatory disclosure requirements, hence hypothesize that:

H1a₅: There is a significant positive relationship between CEO expertise and compliance with the disclosure requirements of the of accounting standard on RPTs.

The level of family ownership and control determine the appointment and power of the CEO in a family-controlled firm (Ansari, Goergen, & Mira, 2014). Family owned firms have unique characteristics that distinguished them from other firms. These characteristics affect their level of information disclosure and general disclosure practice. According to Chau and Gray (2002) firms with concentrated ownership are characterized by less voluntary information disclosure, but the problem is severe in family-controlled firms. In most cases, family members become the CEOs of the family firms even if they are not the best candidate for the position.

Ali et al. (2007) reveal that family firms release less information about their corporate governance practices compared to non-family firms. Consistently, Miller et al. (2014) report that the comparison of the degree of professionalism of family and non-family CEOs reveals that the superiority of the latter is very plausible. Based on this, it becomes clear that family CEO may be at a lower end once it comes to the decision to corporate transparency. Given this, the next hypothesis is:

H1a₆: There is a significant negative relationship between CEO family lineage and compliance with the disclosure requirements of the of accounting standard on RPTs.

According to Jensen and Meckling (1976), CEO ownership minimizes the principal manager agency conflict. Based on this, Kim and Lu (2011), and Ting, Azizan and Kweh (2015) provide empirical evidence that CEO ownership improves the firm value by aligning the interest of the management with that of the firm. Regarding corporate governance, CEO ownership has been found to play an important role in improving the firm control mechanisms. Lilienfeld-Toal and Ruenzi (2014) reveal that CEO ownership mitigates the negative effect of weak governance on the firm. The authors argue that CEO owned firms are better organized and efficiently managed.

Kim and Lu (2011) document that in the absence of external governance mechanisms, CEO ownership can serve as a substitute. In most of the CEO owned firms, CEOs are found to play dual roles which enable them to control the firm decision-making process (Chen, Lin, & Yi, 2008) including the firm disclosure practice. Several studies identify firms with high level of insider ownership with low information disclosure to prevent information leakages of proprietary information and rent-seeking activities (Fan & Wong, 2002; Gul & Lai, 2002). This can be connected with the CEO duality that is frequent in most of the CEO owned firms which affect the firm disclosure practice negatively (Lakhal, 2005; Wang and Hussainey, 2013). Given this, the next hypothesis is:

H1a₇: There is a significant negative relationship between CEO ownership and compliance with the disclosure requirements of the of accounting standard on RPTs.

5.2.2.1.4 Ownership Structure

Based on agency theory, family owned businesses are associated with less agency problem. Since both ownership and control lay within the same circle, some of the stakeholders have the first-hand information on the operation and the financial position of their firm. Family-controlled firms are associated with less voluntary disclosure on forward-looking information, earning forecast and are characterized by high opaque information environment than disperse firms (Anderson, Duru, & Reeb, 2009; Chen et al., 2008). Ali et al. (2007) reveal that family firms release less information about their corporate governance practices compared to non-family firms. Chau and Gray (2010) report that the extent of firm's voluntary disclosure depends on the level of the family ownership in that firm.

However, some level of improvement has been reported in the family firm disclosure behavior across Asian countries about governance disclosure Nowland (2008) and accounting information disclosure Wan-Hussin (2009) after the Asia financial crises. Fernando, Schneible and Suh (2013) argue that RPT disclosure regulation can be used as a means of minority shareholder protection. Correspondingly, Di Carlo (2014) in his case studies on some selected Italian family-controlled firms recommends for more disclosure from such firm. In line with the above, the study hypothesizes that:

H1a₈: There is a significant negative relationship between family ownership and compliance with the disclosure requirements of the of accounting standard on RPTs.

Based on agency theory, managerial ownership aligns the goal and financial incentives of the management with those of the outside shareholders (Arcay & Vázquez, 2005). Jensen and Meckling (1976) state that as management ownership increases, the value of the firm will also rise because of reduction in agency cost. The theory of the firm provides that managerial ownership improves the financial reporting quality (Warfield et al., 1995). Similarly, Kweh (2015) provides empirical evidence that management ownership improves the firm value by aligning the interest of the management with that of the firm. Furthermore, Al-Najjar and Abed (2014) state that managerial ownership provides incentives for managers to release more information in order to increase the stock market price, minimize overall monitoring costs and enhance the firm value. Based on these, this study hypothesizes that:

H1a₉: There is a significant positive relationship between managerial ownership and compliance with the disclosure requirements of the of accounting standard on RPTs.

Based on agency theory, foreign ownership serves as external governance mechanism (Cho, Huang, & Padmanabhan, 2014). Foreign institutional ownership has improved the firm transparency level in emerging markets Liang, Lin and Chin (2012) and increases the desirability of high quality audit (He, Rui, Zheng, & Zhu, 2014). A positive association between corporate governance and firm performance was identified to be the result of the debt monitoring and foreign ownership (Chari, Chen, & Dominguez, 2012; Greenaway, Guariglia, & Yu, 2012; Haat, Rahman, & Mahenthiran, 2008). Hence, foreign ownership improves the firm general disclosure practice because of the increased information needs by the foreign investors (Misirlioğlu, Tucker, & Yükseltürk, 2013).

Moreover, foreign ownership has been found to have a direct association with increased disclosure (Bova & Pereira, 2012; Misirlioğlu et al., 2013). However, the place of living or physical distance affects the information disadvantage and effective monitoring of foreign directors (X. Du, Jian, & Lai, 2017). Thus foreign shareholders need some monitoring mechanisms to protect their investment rather than being seen as good inspectors of the management. Consistently, He et al. (2014) contend that foreign shareholders need high quality auditors to compensate for information barriers. This is based on the fact that big auditing firms persuade their clients to disclose more information in their financial reports (Premuroso & Bhattacharya, 2008). Therefore, the study hypothesizes that:

H1a₁₀: There is a significant positive relationship between foreign ownership and compliance with the disclosure requirements of the of accounting standard on RPTs.

5.2.2.2 Firm Financial Characteristics

Firm financial attributes have been identified as among the factors that affect its corporate decisions (Iatridis, 2012). Many studies have established the relationship between some firm attributes and its disclosure practices (Alsaeed, 2006; Gisbert & Navallas, 2013; Inchausti, 1997; Murphy, 1999). This study identified RPT motives and firm performance as some of the financial attributes and assess their effect on the compliance with the RPTs disclosure requirements.

5.2.2.2.1 RPT motives

Agency and resource dependency theories provide the conflicting view on the rationality behind the RPTs. Based on agency theory, RPTs are seen as a means by which the controlling shareholders, directors or managers used to expropriate firm resources at the expense of minority shareholders (Di Carlo, 2014; Wong & Kim, 2015). On the contrary, resource dependency theory views RPTs as a mean by which firms leverage their operations through collaborations with the related party to enhance their performance (Claessens et al., 2002; Jian & Wong, 2010; Williamson, 1985).

Jensen and Meckling (1976) identify another form of agency problem among shareholders in a firm with concentrated ownership. Based on type II agency cost, controlling shareholders expropriate the minority shareholders in most cases in RPTs. Empirical evidence proves that capital market reacts to the announcement of RPTs, though the results are inconclusive. Lou et al. (2014) find that capital market reacts indifferently to the announcement of any form of RPTs. Contrary to this, Lei and Song (2011) record that the Tobin's Q and market to book value of firms that engage in prejudicial RPTs are significantly lower than those with no such form of transactions. This is consistent with the findings that investors cannot foresee tunneling, but they discount firms if it occurs (Cheung et al., 2006). Cheung, Jing, et al. (2009) document that RPTs representing tunneling hardly been public compared to those representing propping.

Lei and Song (2011) find that Chinese listed firms use RPTs with disclosure exemption in tunneling, signaling the significance of disclosure requirement in curtailing prejudicial RPTs. Similarly, Black et al. (2015) document that public listed chaebols

in Korea hardly disclose the pricing policies used in the complicated RPTs with privately held firms—a clear sign of minority shareholders' expropriation or RPTs that are not based on arm's length principles. Similarly, Xiao and Zhao (2014) argue that even though Chinese Securities Regulatory Commission has required all listed firms to disclose all RPTs in their financial reports, in practice, most of these firms do not comply with those requirements. Given the above findings, the study hypothesizes that,

H1b₁: There is a significant negative relationship between tunneling and compliance with the disclosure requirements of the of accounting standard on RPTs.

The market for corporate control theory of Jensen and Ruback (1983) provide that controlling shareholders take desperate actions to protect their firms from hostile takeovers. Yeh et al. (2012) document that controlling shareholders prop-up their firms through abnormal related party sales to avoid reporting loss or on the verge of the issue of seasoned equity. Similarly, (Bai et al., 2004) portend that small piece of bad news by a listed firm attract overwhelming market reactions and may even lead to undue regulatory surveillance. These kinds of reactions motivate some controlling shareholders to engage in propping to overcome the possible damages that may result from the release of bad news to the market. Cheung et al. (2009) find that RPTs related to propping activities are accompanied with significant information disclosure compared to that of tunneling activities. Accordingly, Peng et al. (2011) find that capital market reacts favorably to the announcement of propping transactions. Given these, the study hypothesizes that,

H1b₂: There is a significant positive relationship between propping and compliance with the disclosure requirements of the of accounting standard on RPTs.

5.2.2.2.2 Firm Performance

Profitability has been identified as one of the major determinants of corporate disclosure (Al-Akra et al., 2010; Bokpin, 2013; Hussainey et al., 2011; Wang & Hussainey, 2013). Profitable firms have many incentives to disclose their favorable performance to numerous stakeholders to address the issue of information asymmetry based on signaling theory. This is consistent with the signaling theory, which suggests that information disclosure signals good business position to market participants. However, studies on the association between firms' profitability and corporate disclosure behavior produce inconsistent results. Samaha et al. (2012) and Sodikin (2013) have arrived at a negative association between profitability and corporate disclosure practice. Another stream of studies has reported the absence of association between the profitability and firm disclosure behavior (Grigoris, 2014; Sharma, 2014).

Alsaeed (2006) examines three proxies of profitability (Return on Equity, Profit margin, and liquidity) and finds that none of them explain the variability of firms disclosure behavior. This is consistent with the insignificant association arrived at by (Cheng & Courtenay, 2006). Tsalavoutas (2011) is of the opinion that the increase in the reported profit as a result of migration to IFRS is among the major incentives that motivate firms to adopt and disclose much information in their annual report. Based on this, the study hypothesizes that,

H1b₃: There is a significant positive relationship between firm profitability and level of compliance with the disclosure requirements of the of accounting standard on RPTs.

Firms with growth potential have many incentives to disclose detail information to inform and justify some of their corporate decisions and minimize information asymmetric between managers and owners (Chau & Gray, 2010). Gul and Leung (2004) argue that firms with high potential growth signs have to disclose more information to justified that their stocks are not overvalued. This is consistent with the position of signaling theory. Similarly, Hassan et al. (2009), and Hussainey and Mouselli (2010) portended that firms with high sales and asset growth disclosed information to signal a future increase in production capacity and dividend respectively. Soon Yau et al. (2009) provide empirical support for the above assertions. The authors have found that among the sample of small firms, high growth firms make more disclosure on the information regarding their intellectual capital. Iatridis (2012) document that high growth firms provide detail disclosure in accordance with the provisions of IFRS.

In contrast to the above, Liu and Sun (2010), and Lo and Wong (2011) document a negative correlation between growth and corporate disclosure practice. This is in line with the finding of Bamber and Cheon (1998). The authors find that the higher the growth potential, the low the managers intend to release information to the public because of proprietary information cost. Similarly, Gisbert and Navallas (2013) find that high potential growth firms shelve away from unnecessary disclosure to deny competitors access to their strategic information. Given this, the next hypothesis is:

H1b₄: There is a significant positive relationship between firm growth potential and level of compliance with the disclosure requirements of the of accounting standard on RPTs.

Investors request for the dividend payment to wipe out excess cash from the firm to minimize managers opportunistic behavior (Brockman & Unlu, 2011; La Porta et al. 2000). Harada and Nguyen (2011) reveal that ownership concentration is significantly associated with lower dividend payout ratio. They document that firms with concentrated ownership structure are less likely to increase dividend payment even after the increase in operating earnings or when debt capital decrease. Large dividend payment in a firm with concentrated ownership signal that controlling shareholder is not willing to expropriate corporate resources (Gugler & Yurtoglu, 2003; Su, Fung, Huang, & Shen, 2014; Williams, 2014).

High dividend payout represents financial transparency in weak reporting environment (Van Overfelt et al. 2010). A similar position has been arrived at by Williams (2014). He concludes that low dividend payout ignites the conflict among the shareholders and allow the dominant shareholders to expropriate the excess resources through RPTs. Lin, Kuo and Wang (2014) portrays that it is a better disclosure that leads to high payout ratio. Given this, the next hypothesis is,

H1b₅: There is a significant positive relationship between dividend payment and compliance with the disclosure requirements of the of accounting standard on RPTs.

Figure 5.1 represents the theoretical framework for the determinants of compliance with the of accounting standard on RPTs.

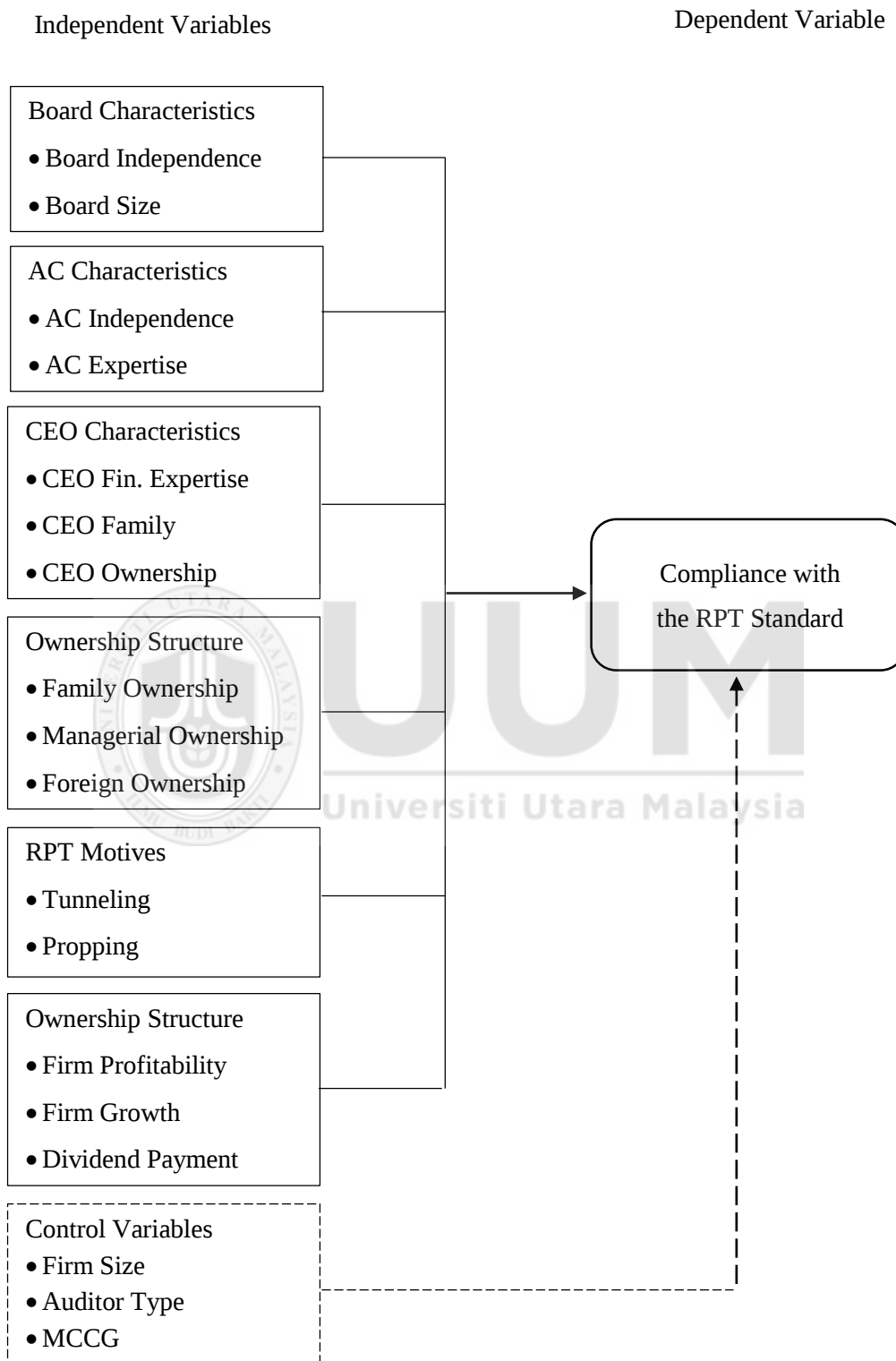


Figure 5.1
Theoretical Framework: Determinant of Compliance with the accounting standard on RPTs

5.2.3 Value-Relevance of MFRS 124 Adoption

Accounting information produced using IFRS are value-relevant (Alali & Foote, 2012; Tsalavoutas & Dionysiou, 2014). Several empirical studies support the superiority of the capital market responsiveness with the accounting information produced with IFRS under mandatory regime over voluntary or non-IFRS standards (Barth et al., 2008; Chua et al., 2012; Dimitropoulos et al., 2013; Kim, 2013). A recent study by Badenhorst et al. (2015) reinforces the previous literature on the value-relevance of IFRS through the use of the single standard. Similarly, Paglietti (2010) finds a significant improvement in the value-relevance of accounting information in the post-IFRS adoption era compared to pre-adoption period. However, Hung and Subramanyam (2007), and Gjerde et al. (2008) record no improvement in the value-relevance of accounting information for both voluntary and mandatory adoption periods respectively. In line with these previous studies, this study hypothesizes that:

H2a: RPTs disclosure in the financial reports of firms listed on Bursa Malaysia is value-relevant.

H2b: Mandatory adoption of MFRS 124 increases the value-relevance of the disclosed RPTs in the financial reports of firms listed on Bursa Malaysia.

The theoretical framework of value-relevance of MFRS 124 mandatory adoption using Ohlson (1995) price models is depicted as follows:

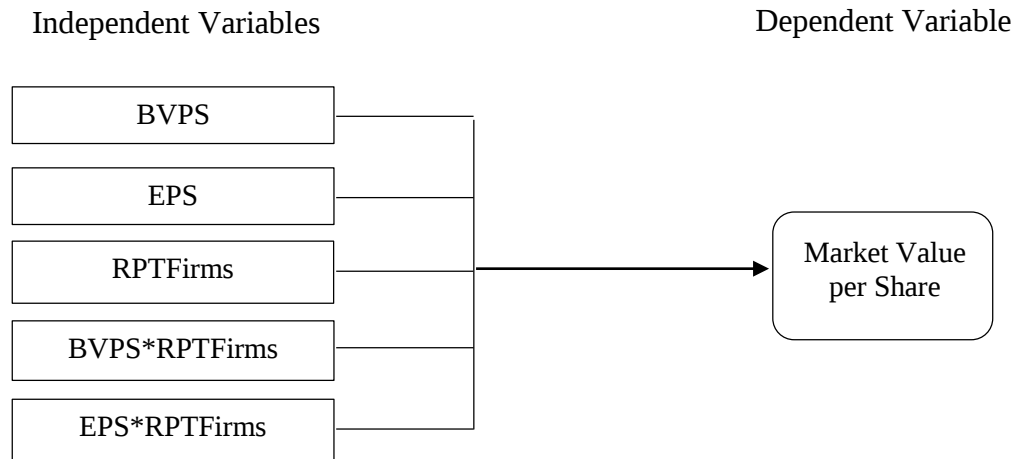


Figure 5.2
Theoretical Framework: Value-Relevance of MFRS 124 Adoption (Price Method)

Where:

MVPS = Market Value per Share of firm 3 months after the financial year-end;

BVPS = Book Value per Share of firm;

EPS = Accounting Earning per Share of firm;

RPTFirms = Dummy variable set equal to one for firms with RPTs disclosures, zero for otherwise;

BVPS*RPTFirms = BVPS multiply by RPTFirms;

EPS*RPTFirms = EPS multiply by RPTFirms.

Similarly, the theoretical framework of value-relevance of MFRS 124 mandatory adoption using Easton and Harris (1991) return model is depicted as follows:

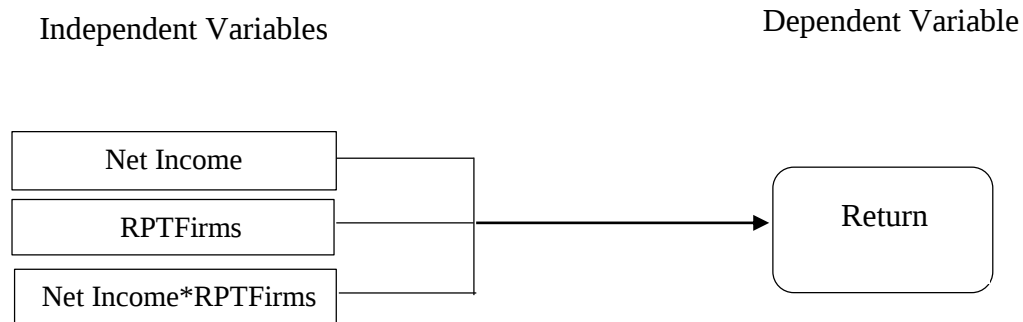


Figure 5.3
Theoretical Framework: Value-Relevance of MFRS 124 Adoption (Return Method)

Where:

$\text{Returns} = (\text{Price in month } t - \text{Price in month } t-1) / \text{Price in month } t-1$. Returns are accumulated during the 12-month period covering trading months, preceding March 31st of each year;

$\text{NetIncome} = \text{Net earnings in year } t / \text{Market value of equity in } t-1$;

$\text{RPTFirms} = \text{Dummy variable set equal to one for firms with RPTs disclosures, zero for otherwise;}$

$\text{NetIncome} * \text{RPTFirms} = \text{NetIncome multiply by RPTFirms.}$

5.2.4 Real Earnings Management

5.2.4.1 Real Earnings Management in RPTs

The quality of accounting standard determines its ability to curtail earnings management practices. Goncharov and Zimmermann (2006) reveal low earnings management for the firms that reported under US-GAAP compared to those that reported under German-GAAP. Accordingly, many countries in the world have adopted the IFRS on the premise of its higher reporting quality (Ball, 2006). Empirical result on the supremacy of IFRS over other accounting standards in curtailing earnings

management practice is inconclusive (Barth et al., 2008; Doukakis, 2014; Ismail et al., 2013). Nevertheless, the use of IFRS has recorded tremendous success in curbing earnings management practices across the world and more especially in emerging market (Capkun, Collins, & Jeanjean, 2013; Dimitropoulos et al., 2013; Guindy, 2014; Ismail et al., 2013).

Johari et al. (2008) document that high managerial ownership induces managers to engage in earnings management practice. Similarly, Lo and Wong (2011) find that management that engaged in RPTs to increase reported earnings or bonus remuneration are less likely to disclose the transfer pricing policy used in those transactions. Related to this, Beuselinck and Deloof (2014) provide empirical evidence that inter-group transactions play a substantial role in earnings management, while Hwang et al. (2013) disclose that disclosure regulation minimizes the earnings management in RPTs. Based on this, this study hypothesizes that:

H3a: Firms engage in real earnings management in related party transactions.

The theoretical framework of real activity manipulations using Roychowdhury (2006) REM detection model is depicted as follows:

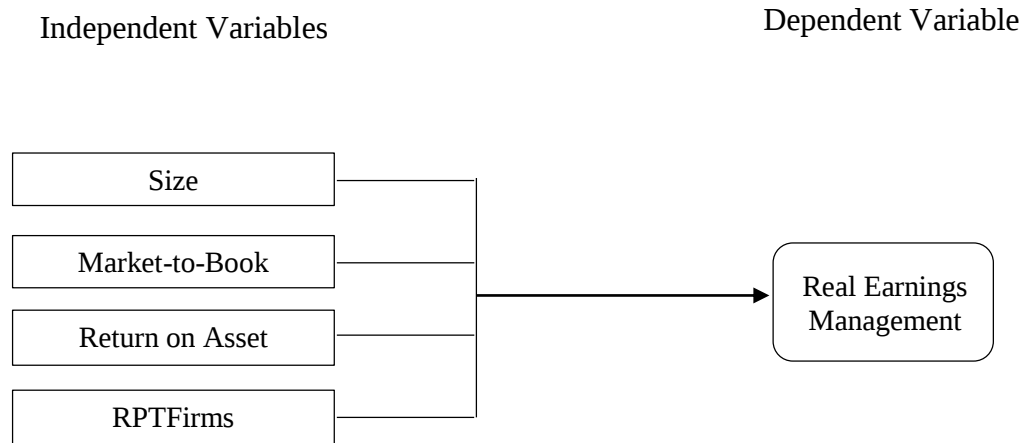


Figure 5.4
Theoretical Framework: Real Earnings Management in RPTs

Where:

Abnormal components = Abnormal production costs, abnormal CFO and abnormal discretionary expenses as dependent variables (are determined based on (Roychowdhury, 2006)).

Size = natural logarithm of the market value of equity at the beginning of the year.

MTV= Market-to-book ratio.

ROA = EBIT/Total Assets and,

RPTFirms are defined as firms with RPTs of up to 20% of its revenue or the firms that engage in more than one form of RPTs in any given year.

Because of the complexity and time-consuming nature associated with the compliance index, several compliance studies use market capitalization (see for example Glaum et al., 2013; Henry, 2010; Tsalavoutas and Dionysiou, 2014) to draw the sample size that represents the population of the study to relax the tediousness and time involved in constructing compliance index. Glaum et al. (2013) and Tsalavoutas et al. (2014) use the sample of large firms for disclosure index in their respective studies. In

Malaysia, Carlin et al. (2009) use the sample of 36 firms out of the 100 firms that constitute the FTSE Bursa Malaysia Index. However, restricting the sample size to bigger firms eliminates the small firms with frequent and heavy RPTs, hence, will not be ideal for the study of this nature. In view of this, this study, firms with RPTs of up to 20% of its revenue or firms that engage in more than one form of RPTs in any given year are identified and leveled as RPTFirms. This method captures the firms that split the transactions to avoid some reporting and other regulatory requirements.

5.2.4.2 Real Earnings Management in RPTs and Firm Value

Jong et al (2014) reveals that investors perceived all forms of earnings management (save share repurchases) as value-destroying. Teoh et al (1998) and Louis (2004) find that the market value of firms that engage in earnings management during the initial public offerings/firm acquisition declines in subsequent years after the offerings/acquisition. Similarly, Cohen and Zarowin (2010) reveal that the performance of firms that engage in earnings management during the seasoned equity offerings declines in subsequent years after the offerings. The decline as a result of REM is severe compared to that of accrual earnings management.

Kohlbeck and Mayhew (2010) state that management opportunistic behavior was the main factor that drives management to frauds, misappropriation of firm's assets and misleading financial statements in recent governance cases (Enron, Healthsouth, and others). In these cases, RPTs are used to siphon the firm resources which led to the loss of value and untimely liquidation of the giant corporations. This problem is severe in the firms characterized by weak corporate governance (Gordon et al., 2004; Tang & Chang, 2015) and concentrated ownership structure (Johnson, Boone, Breach, &

Friedman, 2000; Liu & Lu, 2007). Fisman and Wang (2010) and Xiao and Zhao (2014) view RPTs as value-destroying transactions (related-party loan and guarantee in particular) which trigger the stock market to react negatively to the release of such transactions. Based on this, this study hypothesizes that:

H3b: There is a significant negative relationship between real earnings management in related party transactions and firm value.

The theoretical framework of real activity manipulations in RPTs and firm value model is depicted as follows:



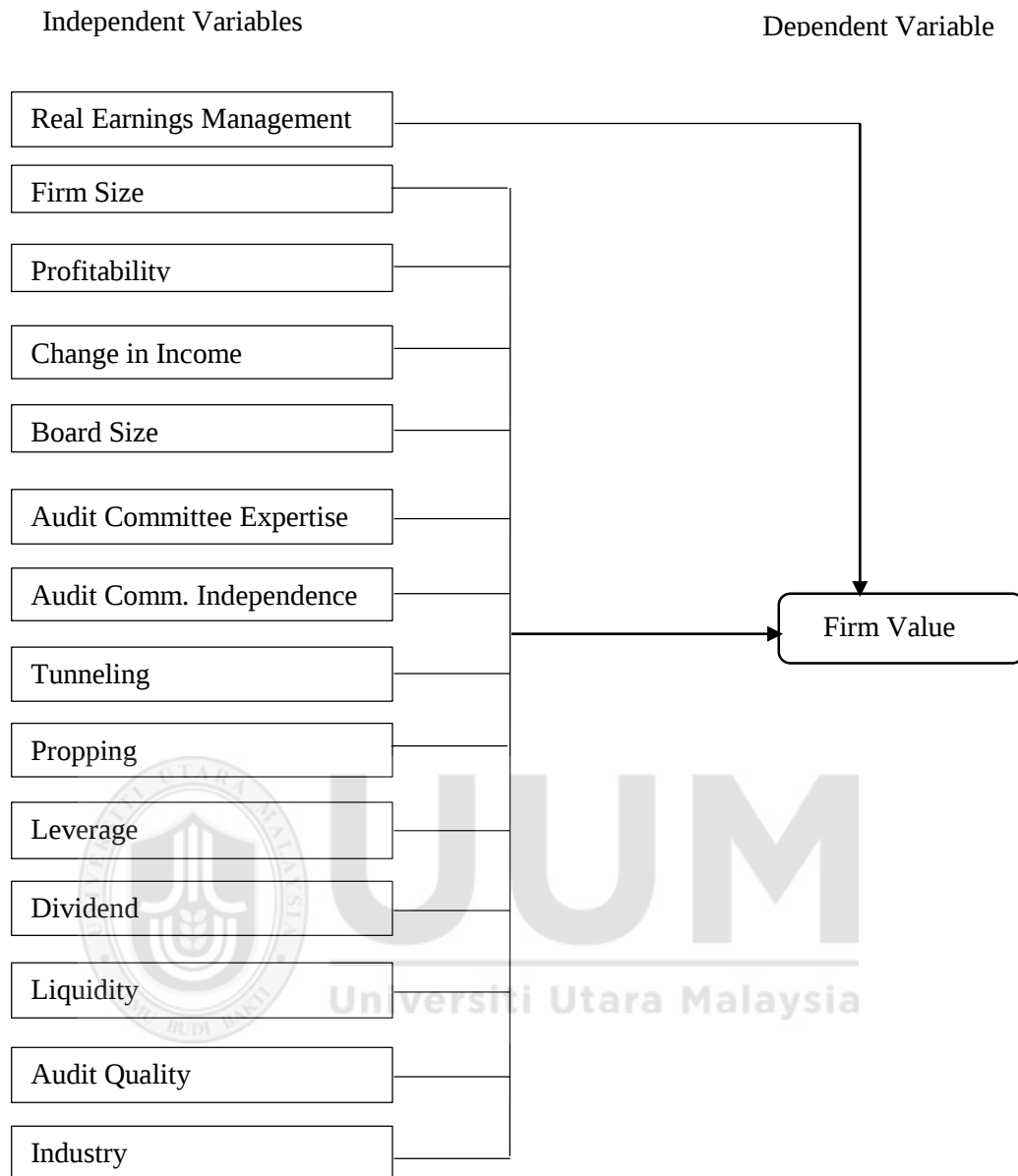


Figure 5.5
Theoretical Framework: Real Earnings Management in RPTs and Firm Value

5.2.5 Mitigating Effect of Compliance with MFRS 124 on Real Earnings Management in RPTs and Firm Value

Accounting standards are meant to describe the minimum amount of relevant and high-quality information that a firm must disclose while making financial reports. This is because firms that fail to comply with the disclosure requirement withhold some vital information that can affect capital market operations. Based on the dual (value-

generating and value-destroying) roles of RPTs, many countries across the globe resort to RPTs regulation. This is to ensure that only value-generating transactions are permitted. Generally, accounting standards are used as the main source of RPTs disclosure regulations across the globe. The adoption of MFRS 124 in Malaysia as financial reporting standard for the conduct and report of RPTs has led to uniformity in RPTs regulation between Malaysia and other countries across the world. Although, the disclosure requirements are the same, countries vary in terms of compliance level.

The quality of accounting standard is meaningless if not been complied with. Therefore, full compliance with the standard is essential for any standard to attain its basic objectives. Since accounting standards on RPTs are formulated and adopted on the premise that it will curtail the earnings management practice and improve transparency in RPTs reporting, compliance with the standards is expected to mitigate the negative effects of RPTs on the firm value.

Lei and Song (2011) document a negative cumulative abnormal return for some RPTs types, however, the cumulative abnormal return is lower for RPTs with disclosure exemption. This demonstrates that the negative relationship between REM in RPTs and firm value is more visible in firms characterized by the low information disclosure. Therefore, full compliance with disclosure requirements on RPTs (MFRS 124) indicates that the absence of tunneling in the transaction, hence, the firm has nothing to hide. On the contrary, when the extent of compliance with the disclosure requirements is low, investors will be skeptical about the real motive behind the transactions, hence, discount the stock price of the firm. Based on this, this study hypothesizes that:

H4: Compliance with disclosure requirements on RPTs significantly moderates the relationship between real earnings management in related party transactions and firm value.

The theoretical framework of mitigating effect of compliance with MFRS 124 on REM in RPTs and firm value is depicted as follows:



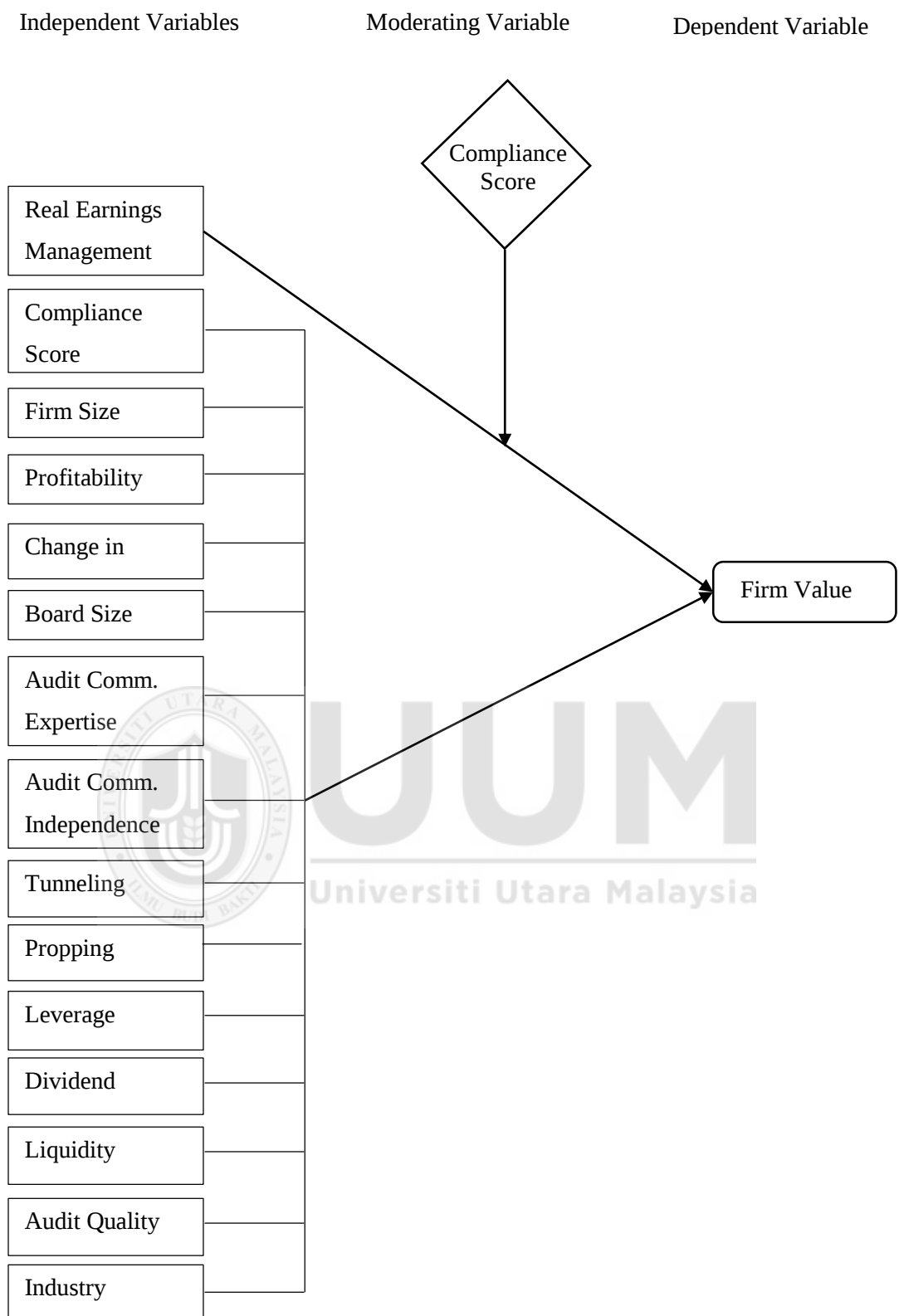


Figure 5.6
Theoretical Framework: Mitigating Effect of Compliance with MFRS 124 on Real Earnings Management in RPTs and Firm Value

5.3 Measurement of the Research Variables

Variables measurement refers to the process of the operationalization of the research variables (Zikmund, Babin, Carr, & Griffin, 2013). In this study, the research variables were operationalized through the processes used in prior studies.

5.3.1 Level of Compliance (Disclosure index)

The extent (level) of compliance with the disclosure requirements of the accounting standard on RPTs was measured using weighted disclosure index. The selection of weighted disclosure index is merited to overcome the drawbacks associated with un-weighted disclosure index (see for example Beretta & Bozzolan, 2008; Tsalavoutas, 2011; Yeoh, 2005). The disclosure index used by Cheung et al. (2010) was adopted and modified for this study. Under this approach, 0, 1, 2 and 3 points were given to the absent, partial, full and excellent level of compliance respectively. Absent compliance indicates none compliance while partial compliance represents incomplete compliance with the disclosure requirements of the accounting standard on RPTs. Full compliance signifies total compliance with the disclosure requirements of the standard. Lastly, excellent compliance represents a situation where the reporting entities go extra mile to disclose extra information in addition to what is mandatorily required from them to meet international standard. The classification of firms into absent, partial, full or excellent permits for the identification of the features of high and low compliance firms easily.

Specifically, a minimum of zero and maximum of three points are assigned to each of the 17 items required to be disclosed by the MFRS 124 as provided in appendix A. Firms with the full level of compliance can score more than thirty-four points while

firms with total non-compliance can score zero points. Hence, the disclosure score for each firm is the ratio of the points scored by a firm to the total points required to meet the mandatory disclosure requirement as expressed in the following formula:

$$CS_J = \frac{T \sum_{i=1}^m di}{M = \sum_{i=1}^n di}$$

Where:

CS_J = total compliance score for each company.

T = Total number of points scored.

J = Firm under consideration.

M = Total points required to meet the mandatory disclosure requirement.

To ensure the reliability of the disclosure index, independent person was asked to score up to 10% of the sampled firms through the use of the disclosure index used in the study. The results from his scorecard are similar to those obtain for this study. Independent t-test was used to test the mean differences of the compliance with the transaction-based disclosure and general disclosure. Similarly, the same test was used to test the mean difference of the compliance level between manufacturing and non-manufacturing firms.

5.3.2 Determinants of Compliance with Accounting Standard on RPTs

In this study, fifteen variables are tested as determinants of compliance with the disclosure requirement of the accounting standard on RPTs. The variables include corporate governance mechanisms, firm financial characteristics and control variables.

Corporate Governance

Under corporate governance variables, board independence is measured by the proportion of independent directors on the board of directors as was used in prior studies (Benkel et al., 2006; Chen & Jaggi, 2000; Patelli & Prencipe, 2007; Tang et al., 2013). Board size is measured by the number of directors on the firm board (Boone, Casares Field, Karpoff, & Raheja, 2007; Chang, Oh, Jung, & Lee, 2012; Cheng & Courtenay, 2006).

Audit committee independence is measured through dummy variable which was set to “1” if all members are independent non-executive directors and “0” if otherwise (Goh, 2009; Sharma, 2014; Sierra García et al., 2012). Audit committee expertise is measured by the proportion of members with a membership of accounting professional body, finance-related academic qualification or work experience in the finance-related field (Badolato, Donelson, & Ege, 2014; Goh, 2009).

CEO was considered financial expert and coded as “1” if he is a member of accounting professional body, possesses a finance-related academic qualification or work experience in the finance-related field, and “0” for otherwise (Custódio & Metzger, 2013a; Haislip & Richardson, 2015). Family CEO was measured through dummy variable that was set to “1” if he is a member of the controlling family and “0” if otherwise (Miller et al., 2013; Minichilli et al., 2010). CEO ownership was measured by the percentage of shares held by CEO out of the total outstanding shares (Kim & Lu, 2011; Xie, 2014).

Family ownership was measured by the percentage of family shareholding in the firm as it was used in the prior studies (Anderson et al., 2003; Cheng, 2014; Munir et al.,

2013; Sodikin, 2013). Managerial ownership was measured by the percentage of shares held by the executive directors out of the total outstanding shares (Huafang & Jianguo, 2007; Rashid, 2016). Percentage of equity shares held by foreigners (non-Malaysians) was used to measure the level of foreign ownership (Greenaway et al., 2012; Li et al., 2011).

Financial Characteristics

Under the financial characteristics, the variables of concern are tunneling, propping, profitability, growth and dividend. Because of the complexities in identifying tunneling and propping transactions, this study adopted the measurements used by Peng et al. (2011) and Ying and Wang (2013) in measuring the variables. Under this approach, controlling shareholders tunnel the firm with sound financial performance (firms with ROE of more than 10%) and prop up the firms in difficult financial (ROA of less than 6%) condition to maintain the shell resources and enjoy the private benefits of control when the circumstance permit. Hence, firms with the higher performance (ROE of more than 10%) are tunnel and coded “1”, and “0” if otherwise. Similarly, firms with the lower performance (ROE of less than 6%) are propped-up and coded “1”, and “0” if otherwise.

Return on asset was used to measure the firm profitability (Cheung et al., 2010; Onofrei, Tudose, Durdureanu, & Anton, 2015; Taplin et al., 2002; Wang & Hussainey, 2013). Market to book value was adapted to proxy the firm growth. This method is not new in disclosure studies as it was used in numerous studies (Chau & Gray, 2010; Chen et al., 2008; Iatridis, 2012; Lo & Wong, 2011). Dividend payout ratio measured

as cash dividend divided by sales was used as a proxy for a firm dividend policy (Hwang, Kim, Park, & Park, 2013; Lin et al., 2014).

Control Variables

Natural logarithm of the total asset was used as a proxy for firm size. This is consistent with the work of (Chen et al., 2008; Eiler, Miranda-Lopez, & Tama-Sweet, 2015; Lopes & Rodrigues, 2007; Tang et al., 2013). Auditor type was measured through dummy variable that was set equal to “1” for a firm with Big-4 auditing firm (Deloitte & Touche, Ernst & Young, KPMG and PricewaterhouseCoopers) and set to “0” for otherwise (Bokpin, 2013; Gao & Kling, 2012; Lopes & Rodrigues, 2007; Utama & Utama, 2014). MCGG was used to control for other regulatory changes (MCGG in 2012) in the accounting environment. It was measured through dummy variable that will be equal to “1” for the event after 2012 and “0” for otherwise.

Model Specification

Dscore = f (corporate governance mechanisms, firm financial characteristics, control variables)

$$\begin{aligned} Dscore = & \alpha_0 + \beta_1 Bind_{it} + \beta_2 Bsize_{it} + \beta_3 Aind_{it} + \beta_4 Aexp_{it} + \beta_5 Cexp_{it} + \beta_6 Cfam_{it} + \\ & \beta_7 Cown_{it} + \beta_8 Fmown_{it} + \beta_9 Mown_{it} + \beta_{10} Frown_{it} + \beta_{11} Tunn_{it} + \beta_{12} Prop_{it} + \beta_{13} ROA_{it} + \\ & \beta_{14} MTV_{it} + \beta_{15} Divi_{it} + \beta_{16} Size_{it} + \beta_{17} Aud_{it} + \beta_{18} MCGG_{it} + \epsilon_{it} \end{aligned} \quad (1)$$

Where:

Dscore = Disclosure index as defined in section 5.4.1

Bind = Board independence

Bsize = Board size

Aind = Audit committee independence

Aexp = Audit committee expertise

Cexp = CEO expertise

Cfam = CEO family

Cown = CEO ownership

Fmown = Family ownership

Frown = Foreign ownership

Tunn = Tunneling

Prop = Propping

ROA = Return on assets

MTV = Market to book value

Divi = Dividend

Size = Firm size.

Aud = Auditor type

MCCG = Malaysia code of corporate governance

α = Constant

β = Coefficients in the regression model

ε = Error term

i = Entity (Firm)

t = Time period

Table 5.1 presents the acronym, description, measures, expectation and expected data source of the research variables.

Table 5.1

Descriptive of Variable Measurement

Acronym	Description	Formula	Expectation	Data Source
Dscore	Disclosure Level	Points scored by a firm divided by the total obtainable points.	+	Annual Report
Corporate Governance				
Bind	Board Independence	Proportion of independent directors in the board	+	Annual Report
Bsize	Board Size	Number of directors on the firm board	+	Annual Report
Aind	Audit Committee Independence	Dummy variable “1” if all members are non-executive directors and “0” otherwise	+	Annual Report
Aexp	Audit Committee Expertise	Percentage of members with membership of accounting professional body, academic qualification or work experience in finance related field	+	Annual Report
Cexpt	CEO Expertize	Dummy variable “1” if CEO possesses a graduate level academic degree in any business related field or works in an executive capacity before his appointment as CEO, “0” if otherwise	+	Annual Report
Cfam	Family CEO	Dummy variable “1” if CEO is a member of controlling family and “0” otherwise	-	Annual Report
Cown	CEO Ownership	percentage of shares held by CEO	-	Annual Report
Fmown	Family Ownership	Percentage of family shareholding in the firm	-	Annual Report
Mown	Managerial Ownership	Percentage of executive shareholding in the firm	+	Annual Report
Fown	Foreign Ownership	Percentage of equity shares held by foreigners	+	Annual Report

Table 5.1 (Continue)

Acronym	Description	Formula	Expec Tation	Data Source
Financial Characteristics				
Tunn	Tunneling	Dummy variable “1” for firm with ROE of more than 10% and “0” otherwise	-	Data Stream
Prop	Propping	Dummy variable “1” for firm with ROE of less than 6% and “0” otherwise	+	Data Stream
ROA	Profitability	EBIT/Total Assets	+	Data Stream
MTV	Firm Growth	Market-to-book ratio	+	Data Stream
Divi	Dividend	Cash dividend divided by sales	+	Data Stream
Control Variables				
Size	Firm Size	Natural logarithm of total asset	+	Data Stream
Aud	Auditor Type	Dummy variable “1” for firm audited by Big 4 and “0” otherwise	+	Data Stream
MCCG	MCCG Dummy	Dummy variable “1” for event before MCCG 2012 and “0” otherwise	+	Annual Report and Data Stream

5.3.3 Value Relevance of MFRS 124 Adoption

In value-relevance studies, price model by Ohlson (1995) and return model developed and empirically proven by Easton and Harris (1991) are used to measure the relationship between stock price and accounting numbers. Kothari and Zimmerman (1995) document that Easton and Harris's model is preferred by most of the researchers than price model for its simplicity, but price model coefficients are proved to be less biased. In order to arrive at strong and justifiable results, this study tested the both models to assess the value-relevant of RPT disclosure before and after the mandatory adoption of MFRS 124. Price model is popular in value relevance literature and was used by Barth et al., (2008), Hamberg and Beisland, (2014) and Oliveira et al., (2010). The model defines the relationship between stock price, the book value of equity and net income. Mathematically can be depicted as follows:

$$MVPS = \alpha_0 + \beta_1 BVPS_{it} + \beta_2 EPS_{it} + \beta_3 V_{it} + \varepsilon_{it} \quad (2)$$

Where:

MVPS = Market Value per Share

BVPS = Book Value per Share

EPS = Accounting Earning per Share

V = other non-accounting information available

α = Constant

β = Coefficients in the regression model

ε = Error term

i = Entity (Firm)

t = Time period

The model 2 was adjusted to assess the value-relevance of RPT disclosure by replacing the V with the RPT firms as follows:

$$MVPS = \alpha_0 + \beta_1 BVPS_{it} + \beta_2 EPS_{it} + \beta_3 RPTFirms_{it} + \varepsilon_{it} \quad (3)$$

Where:

RPTFirms = Dummy variable set equal to one for firms with RPTs disclosures, zero for otherwise. Other variables as defined above. RPTFirms are defined in section 5.2.4.1.

The model 2 was further expanded to assess the changes in value-relevance of the BVPS and EPS of the RPT firms after the mandatory adoption of MFRS 124 as follows:

$$MVPS = \alpha_0 + \beta_1 BVPS_{it} + \beta_2 EPS_{it} + \beta_3 RPTFirms_{it} + \beta_4 BVPS_{it} * RPTFirms_{it} + \beta_5 EPS_{it} * RPTFirms_{it} + \varepsilon_{it} \quad (4)^6$$

Where:

$BVPS_{it} * RPTFirms_{it}$ = $BVPS_{it}$ multiply by $RPTFirm_{it}$

$EPS_{it} * RPTFirms_{it}$ = EPS_{it} multiply by $RPTFirm_{it}$.

Other variables are as defined above.

As mentioned earlier, the study used the return model to robust the outcome of the previous model. Return model that depends on the level of earnings was employed by many studies (Gul, Lynn, & Tsui, 2002; Ismail et al., 2013; Kothari & Zimmerman, 1995). It describes how changes in stock price relate to the level of income. Return model is depicted as follows:

$$R = \alpha_0 + \beta_1 NetIncome_{it} + \beta_2 RPTFirms_{it} + \beta_3 NetIncome * RPTfirms_{it} + \varepsilon_{it} \quad (5)$$

Where:

$R = (\text{Price in month } t - \text{Price in month } t-1) / \text{Price in month } t-1$. Returns are accumulated during the 12-month period covering trading months, preceding March 31st of each year.

$NetIncome_{it}$ = Net earnings of the firm in year t scaled by market value of equity in $t-1$.

$NetIncome_{it} * RPTFirms_{it}$ = Net earnings multiply by $RPTFirms_{it}$. Other variables as previously defined.

⁶ Model 4 was estimated for the pre-MFRS 124 adoption, post-MFRS 124 adoption and combined periods separately.

5.3.4 Real Earnings Management

5.3.4.1 Real Earnings Management in RPTs

This study adopts the models developed and used by Roychowdhury (2006) to estimate the abnormal production cost, cash flow from operations and discretionary expenses. Subsequent studies on REM studies (see for example Cohen & Zarowin, 2010; Cupertino et al., 2015; Doukakis, 2014; Zang, 2012) have proved that the models capture real-activity manipulations. The models were estimated for each industry to control for industry peculiarities on the dependent variables (Doukakis, 2014).

Model Specification

$$\text{CFO/Assets}_{t-1} = \alpha_0 + \beta_1(1/\text{Assets}_{t-1}) + \beta_2(\text{Sales}_t/\text{Assets}_{t-1}) + \beta_3(\Delta\text{Sales}_t/\text{Assets}_{t-1}) + \varepsilon_t \quad (6)$$

$$\text{PROD/Assets}_{t-1} = \alpha_0 + \beta_1(1/\text{Assets}_{t-1}) + \beta_2(\text{Sales}_t/\text{Assets}_{t-1}) + \beta_3(\Delta\text{Sales}_t/\text{Assets}_{t-1}) + \beta_4(\Delta\text{Sales}_{t-1}/\text{Assets}_{t-1}) + \varepsilon_t \quad (7)$$

$$\text{DISC/Assets}_{t-1} = \alpha_0 + \beta_1(1/\text{Assets}_{t-1}) + \beta_2(\text{Sales}_{t-1}/\text{Assets}_{t-1}) + \varepsilon_t \quad (8)$$

Where

CFO = cash flows from operations

PROD = production costs, defined as the sum of the cost of goods sold and the change in inventories from year t-1 to year t

DISC = discretionary expenses defined as selling, general and administrative expenses

Assets_{t-1} = Total assets in year t-1

ΔSales_t = change in sales from year t-1 to year t

ΔSales_{t-1} = change in previous sales from year t-2 to year t-1

Abnormal level of CFO, abnormal level of production costs and abnormal level discretionary expenses for each firm-year are computed as residuals from the predicted (normal) value from the corresponding industry regression. Each of the model measures a relevant aspect of REM. When the firm actual cash flow from operation is lower than the predicted value from the equation 6, then abnormal cash flow (Ab_CFO) from operation is negative as a result of lower margin to accelerate current year's sales by offering sales discount or relax credit terms. Similarly, if the actual production costs are higher than the value predicted by the equation 7, then the abnormal production cost (Ab_PRO) is positive indicating that the firm manipulates earnings by altering the level of production to lower its cost of goods sold. Lastly, when the actual discretionary expenditure is lower than the predicted value computed from equation 8, then the abnormal discretionary (Ab_DISC) expenditure is negative suggesting earnings manipulation by the altering expenditure (that do not generate immediate revenue) such as employee training, R&D, advertising and alike.

Consistent with the extant literature (see for example Cohen & Zarowin, 2010; Cupertino et al., 2015; Doukakis, 2014; Zang, 2012), the residual of Ab_CFO (equation 6) and Ab_DISC (equation 8) are transformed by multiplying them with minus one (-1) to have a uniform sign for all REM measures. Hence abnormally high values indicate REM across the three models.

Thus, the model for estimating the REM in RPTs is as follow:

$$REM = \alpha_0 + \beta_1 \text{Size}_{it} + \beta_2 \text{MTV}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{RPTFirms}_{it} + \varepsilon_{it} \quad (9)$$

Where:

REM = (Ab_CFO, Ab_PRO and Ab_DISC) as described above. The test is repeated

for each of the three proxies for REM

Size = natural logarithm of total assets

MTV = market-to-book value

ROA = earnings before extraordinary incomes (EBXI), scaled by total assets

RPTFirms = Dummy variable equals to one for the RPTFirms and zero for otherwise.

RPTFirms are defined in section 5.2.4.1

5.3.4.2 Real Earnings Management in RPTs and Firm Value

Following Downs et al. (2016), Kim et al. (2017) and Wang (2002), this study use Tobin's Q as a measure of firm value to investigate the relationship between REM in RPTs and firm value. Tobin's Q is defined as the market value of equity plus the book value of total liabilities scaled by total assets. Fama and French (1998) argued that regression of cross-sectional data has an upper hand over an event study in valuing the firms. This is because it is based on the long-term effect of the firm characteristics on the firm value. The variable of interest in the above equation is the proxy of REM (EM proxy).

$$\begin{aligned} \text{Tobins'Q} = & \alpha_0 + \beta_1 \text{REM}_{it} + \beta_2 \text{Size}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{ChangeNI}_{it} + \beta_5 \text{Bind}_{it} + \beta_6 \text{Aexp}_{it} \\ & + \beta_7 \text{Aind}_{it} + \beta_8 \text{Tunn}_{it} + \beta_9 \text{Prop}_{it} + \beta_{10} \text{Leverage}_{it} + \beta_{11} \text{Dividend}_{it} + \beta_{12} \text{Liquidity}_{it} \\ & + \beta_{13} \text{Audit}_{it} + \beta_{14} \text{Industry}_{it} + \varepsilon_{it} \end{aligned} \quad (10)$$

Where

Tobin's Q = market value of equity + book value of total liabilities, scaled by total assets;

REM = one of the three proxies for REM (Ab_CFO, Ab_PRO and Ab_DISC) as determined in section 5.4.4.1. The test is repeated for each of the three proxies for REM

ChangeNI = change in a firm's EBXI, scaled by total asset in year t-1

Leverage = total debt, scaled by total assets; Dividend = declared dividend, scaled by total assets

Liquidity = Current assets by current liabilities; Audit = audit fee, scaled by total asset

Industry = dummy variable 1 for firm manufacturing sectors and 0 otherwise.

Others as defined in section 5.4.2

5.3.5 Mitigating Effect of Compliance with MFRS 124 on Real Earnings Management in RPTs and Firm Value

Equation 11 is used to investigate the mitigating effect of compliance with the disclosure requirements on RPTs on the relationship between REM in RPTs and firm value. The model was arrived at after adding the level of compliance with MFRS 124 (Dscore) and the interacting variable with REM proxy (REM proxy*Dscore). The variable of interest in the above equation is the interaction of proxy of REM with the Dscore (EM proxy * Dscore).

$$\begin{aligned} \text{Tobin's } Q = & \alpha_0 + \beta_1 \text{REM}_{it} + \beta_2 \text{Dscore}_{it} + \beta_3 \text{REM}_{it} * \text{Dscore}_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{ROA}_{it} + \\ & \beta_6 \text{ChangeNI}_{it} + \beta_7 \text{Bind}_{it} + \beta_8 \text{Aexp}_{it} + \beta_9 \text{Aind}_{it} + \beta_{10} \text{Tunn}_{it} + \beta_{11} \text{Prop}_{it} + \\ & \beta_{12} \text{Leverage}_{it} + \beta_{13} \text{Dividend}_{it} + \beta_{14} \text{Liquidity}_{it} + \beta_{15} \text{Audit}_{it} + \beta_{16} \text{Industry}_{it} + \varepsilon_{it} \end{aligned} \quad (11)$$

Where

Tobin's Q = market value of equity + book value of total liabilities, scaled by total assets;

REM = one of the three proxies for REM (Ab_CFO, Ab_PRO and Ab_DISC) as determined in section 5.4.4.1. The test is repeated for each of the three proxies for REM

$Dscore_{it}$ = Points scored by a firm divided by the total obtainable points as defined in section 5.4.1

$\beta_3 REM_{it} * Dscore_{it}$ = REM multiply by $Dscore_{it}$

Other variables are as previously defined.

Table 5.2 summarizes the research variables, their measurement models, expectation and expected source of data.



Table 5.2
Description of Variables Measurement

Acronym	Formula	Data Source
Value-Relevance models		
Price model	$MVPS = \alpha_0 + \beta_1 BVPS_{it} + \beta_2 EPS_{it} + \beta_3 RPTFirms_{it} + \varepsilon_{it} \dots\dots\dots(3)$	Data Stream
MFRS Effect	$MVPS = \alpha_0 + \beta_1 BVPS_{it} + \beta_2 EPS_{it} + \beta_3 RPTFirms_{it} + \beta_4 BVPS_{it} * RPTfirms_{it} + \beta_5 EPS_{it} * RPTfirms_{it} + \varepsilon_{it} \dots\dots\dots(4)$	Data Stream
Return model	$R = \alpha_0 + \beta_1 NetIncome_{it} + \beta_2 RPTFirms_{it} + \beta_3 NetIncome * RPTfirms_{it} + \varepsilon_{it} \dots\dots\dots(5)$	Data Stream
Real Earnings Management Models		
CFO model	$\alpha_0 + \beta_1 (1/Assets_{t-1}) + \beta_2 (Sales_t/Assets_{t-1}) + \beta_3 (\Delta Sales_t/Assets_{t-1}) + \varepsilon_t \dots\dots\dots(6)$	Data Stream
Production Model	$\alpha_0 + \beta_1 (1/Assets_{t-1}) + \beta_2 (Sales_t/Assets_{t-1}) + \beta_3 (\Delta Sales_t/Assets_{t-1}) + \beta_4 (\Delta Sales_{t-1}/Assets_{t-1}) + \varepsilon_t \dots\dots\dots(7)$	Data Stream
Discretionary exp. model	$DISXP/Assets_{t-1} = \beta_0 + \beta_1 (1/Assets_{t-1}) + \beta_2 (Sales_{t-1}/Assets_{t-1}) + \varepsilon_t \dots\dots\dots(8)$	Data Stream
Estimation model	$Y = \alpha_0 + \beta_1 Size_{it} + \beta_2 MTV_{it} + \beta_3 ROA_{it} + \beta_4 RPTFirms_{it} + \varepsilon_{it} \dots\dots\dots(9)$	Data Stream & announcement
Firm value model	$Y = \alpha_0 + \beta_1 REM\ proxy_{it} + \beta_2 Size_{it} + \beta_3 ROA_{it} + \beta_4 ChangeNI_{it} + \beta_5 Bind_{it} + \beta_6 Aexp_{it} + \beta_7 Aind_{it} + \beta_8 Tunn_{it} + \beta_9 Prop_{it} + \beta_{10} Leverage_{it} + \beta_{11} Dividend_{it} + \beta_{12} Liquidity_{it} + \beta_{13} Audit_{it} + \beta_{14} Industry_{it} + \varepsilon_{it} \dots\dots\dots(10)$	Data Stream & announcement
Moderating effect model	$Y = \alpha_0 + \beta_1 REMproxy_{it} + \beta_2 Dscore_{it} + \beta_3 REMproxy_{it} * Dscore_{it} + \beta_4 Size_{it} + \beta_5 ROA_{it} + \beta_6 ChangeNI_{it} + \beta_7 Bind_{it} + \beta_8 Aexp_{it} + \beta_9 Aind_{it} + \beta_{10} Tunn_{it} + \beta_{11} Prop_{it} + \beta_{12} Leverage_{it} + \beta_{13} Dividend_{it} + \beta_{14} Liquidity_{it} + \beta_{15} Audit_{it} + \beta_{16} Industry_{it} + \varepsilon_{it} \dots\dots\dots(11)$	Data Stream & announcement

5.4 Sample Selection Procedure

The population of this study consists of all firms listed on both security markets of Bursa Malaysia. Bursa Malaysia comprises two security markets namely Main and ACE markets. The Main market is the security market where mostly big and some medium firms are registered upon meeting admission criteria. ACE market is designed to enable high growing small and medium size enterprises to meet their financing needs. Firms are registered on the ACE market after meeting the lax market admission criteria than that of the Main market.

Target population refers to the members of the general population that meet the crucial characteristics needed to form a data source (Zikmund et al., 2013). The target population of the study consists of firms that are listed on Bursa Malaysia for the period of at least three years before IFRS mandatory adoption year (2009, 2010 and 2011) and three years after the adoption (2013, 2014 and 2015). This is to enable the researcher to access consistent and relevant annual reports pertaining to the period under study. Firms that operate in the Banks and other financial service, close-end fund, REIT and SPAC sectors were eliminated from the population of the study. This is consistent with the works of Abdul Latif (2010), and Roychowdhury (2006) which state that those firms have other regulators that monitor their disclosure behavior.

Additional filtration criteria were applied on the target population to form different final samples based on the objectives thesis. To arrive at the sample size for the four objectives of the study (objective one, two, four and five), firms with trading RPTs of up to 20% of its revenue or the firms that engage in more than one form of RPTs in a given year were identified through circulars, market release and annual reports and used as the sample of the study⁷. Table 5.3 presents the detail procedures adopted, number of firms for each industry and for each year for the sample size as presented below.

⁷ The justification has been provided in the section 5.2.4.1 of this thesis.

Table 5.3

Sample selection procedure, industry and year distribution

Details	No.	Obs.	Industry	No.	Obs.	%	Year	Obs.	Percent
Total firm year observation	996	6972	Construction	10	27	4.1%	2009	92	14.1%
Banks and other financial service, closed-end, REIT and SPAC	141	(987)	Consumer products	32	143	21.9%	2010	94	14.4%
Non-highly regulated firm years	855	5985	Hostel	1	2	0.3%	2011	96	14.7%
Dead, delisted and non-equity firms	39	(273)	Industrial products	58	227	34.7%	2012	100	15.3%
Firm years with continuing operations	816	5712	IPC	2	4	0.6%	2013	96	14.7%
Firms without complete data	83	(581)	Plantation	19	69	10.6%	2014	97	14.8%
⁸Final firms/observations available for the study to test real earnings management in RPTs	733	5131	Properties	16	35	5.4%	2015	79	12.1%
Firms without intention or actual RPT	379	(2653)	Technology	11	41	6.3%			
Firms with actual RPT	354	2478	Trading and services	34	106	16.2%			
Firms/firm-years without actual RPT	0	(1389)							
Firms/firm-years with actual RPT	354	1089							
Firms/firm-year with less 20% or multiple RPT	171	(435)							
Final Firms/firm-years available for the study	183	654	Total	183	654	100%	Total	654	100%

⁸ Consistent with the Roychowdhury (2006) these firm-year observations are used as full sample to test real earnings management in RPTs. RPTFirms are expected to exhibit abnormally low cash flow from operations, abnormally high production costs and abnormally low discretionary expense. These characteristics evidenced the REM in RPT, hence can be used as experiment variable in any earnings management studies.

To arrive at the sample size for the value-relevance of the disclosed RPTs (objective three), firms with non 31st December year-end were excluded from the total firms with complete data (733 firms) available for the study. This practice is consistent with existing literature (Alali & Foote, 2012; Ku Ismail, 2003). This process ensures that the sample has a uniform accounting year-end and same firm-year observation in both pre and post-MFRS 124 adoptions which help in depicting a clear picture of the market reaction to the release of accounting numbers. Table 5.4 presents the sample selection process as follow.

Table 5.4
Sample selection procedure (Value-Relevance)

Details	No.	Obs.	Industries	Firms	Obs.	Years	Obs.
Firms listed on Bursa Malaysia		996	Construction	21	126	2009	369
Less: Financial service firms	141		Consumer	46	276	2010	369
Dead, delisted and non-equity firms	39		Hostel	4	24	2011	369
Firms not listed throughout the period of study	<u>83</u>	-263	Industrial products	122	732	2013	369
Firms with complete data		733	IPC	2	12	2014	369
Less: Firms with non-31 December year-end		<u>-364</u>	Plantation	23	138	2015	369
Firm included in the final sample		369	Properties	12	72		
Number of years		6	Technology	44	264		
			Trading and services	95	570		
Total		2214		369	2214	Total	2214

5.5 Chapter Summary

In this chapter, the research variables are redefined and research hypotheses are drafted therefrom. This study employed the ontological, epistemological, axiological, rhetorical and methodological assumptions of positivism paradigm in the operationalization process. Appropriate design has been drafted and followed to arrive at the valid findings and conclusion at the end of the study. Based on this, this study adopts the measures of the research variables from the existing literature. Weighted

disclosure index approach and multivariate regression model are used to assess the extent of and determinants of compliance with disclosure requirement on RPTs. The study applies the Ohlson' price model and Easton' return model to measure the value-relevance of the disclosed RPTs. Similarly, the study employs the Roychowdhury model to capture REM practices in RPTs. Also, the study used regression analyses to investigate the relationship between REM in RPTs and firm value. Lastly, hierarchical regression method was adopted to investigate the moderating role of compliance with disclosure requirement on RPTs on the relationship between REM in RPTs and firm value.



CHAPTER SIX
ANALYSIS AND INTERPRETATION I
THE EXTENT AND DETERMINANTS OF RELATED PARTY
TRANSACTIONS (RPT) DISCLOSURE

6.0 Introduction

This chapter presents the analyses and interpretations of the first two objectives of the study. The objectives are the extent of compliance and the determinants of compliance with the disclosure requirements of the accounting standards on RPTs. The chapter also explains the sampled firms, observations and related descriptive statistics for the firms. The multiple regression part of the chapter discusses the results of the multivariate regression diagnostic tests and the results of the estimation model. Lastly, the chapter concludes with the additional analyses.

6.1 Extent of Compliance with the Accounting Standard on RPTs

This section presents the data analyses and discussions on the first objective of the study. The section deals with the research findings on the extent of compliance with the accounting standard on RPTs.

6.1.1 Descriptive Statistics of RPT Firms

Table 6.1 presents the sectoral pattern of the firms that involved in the actual related party transactions (RPTs). From 2009 to 2015, a total of 183 firms from nine sectors of the Bursa Malaysia have involved in 654 various types of RPTs. Industrial products sector records the highest number of RPTs firms (58 firms) with the 227 incidents of

RPTs representing 34.7% of the total RPTs during the period under review. Consumer products sector is the second largest RPTs with the 143 cases from 32 firms representing 21.9% of the total related party transactions, then followed by trading and services sector with the 106 cases from 34 firms representing 16.2% of the total transaction.

Table 6.1
Industry classification of RPT firms

Industry	No.	Observations	Percentage
Construction	10	27	4.1%
Consumer products	32	143	21.9%
Hotel	1	2	0.3%
Industrial products	58	227	34.7%
IPC	2	4	0.6%
Plantation	19	69	10.6%
Properties	16	35	5.4%
Technology	11	41	6.3%
Trading and services	34	106	16.2%
Total	183	654	100%

The number of firms that engage in RPTs from trading and services sector is 34 which is greater than 32 firms from the consumer products. This indicates that consumer products sector has more repeated RPTs firms than trading and services sector. Other sectors include plantation sector which records 69 cases, then followed by 41 cases for technology, 35 cases for properties, 27 cases for construction, 4 cases for IPC and 2 cases for hotel representing 10.6%, 6.3%, 5.4%, 4.1%, 0.6% and 0.3% of the total RPTs for plantation, technology, properties, construction, IPC and hotel sectors respectively.

Table 6.2 displays the trend of the RPTs on yearly basis. It shows a nearly stable case of RPTs across the study period. However, further analysis portrays an increase in the number of RPT cases from 92 cases in 2009 to the 94 cases in 2010 and 96 cases in

2011 representing 14.1%, 14.4% and 14.7% of the total RPTs respectively. The number of cases increases further to its highest of 100 cases in 2012 representing 15.3% of the total RPTs.

Table 6.2
RPTs Cases based on Year

Year	Observations	Percentage
2009	92	14.1%
2010	94	14.4%
2011	96	14.7%
2012	100	15.3%
2013	96	14.7%
2014	97	14.8%
2015	79	12.1%
Total	654	100%

RPTs begin to slide down to 96 cases (14.7%), 97 cases (14.8%) and 79 (12.1%) cases in 2013, 2014 and 2015 respectively. This signifies that an increased regulation⁹ of the RPTs in 2012 has made the transactions less attractive to some firms leading to its decrease from 100 cases in 2012 to 79 cases which are the lowest figure recorded throughout the review period. Even though the number of firms that engage in RPTs remains considerably high, the magnitude and the frequency of RPTs are affected by the changes in the regulatory regime. Nevertheless, the number of Malaysian firms that engage in RPTs is not much compared to 90% of Chinese firms as reported by Jian and Wong (2010). This is because of the nature of the economic system used by the later gave rise to the higher level of government ownership which induced the level of related party activities in the economy.

⁹ Include mandatory adoption of IFRS as reporting standard, introduction of the revised set of Malaysian code of corporate governance and alike.

Table 6.3 presents the number of times that firms engage in the RPTs. The table shows that 55 firms representing 30.03% of the total firms have engaged into RPTs on one occasion only throughout the period of the study, while others have repeated the RPTs at varying frequencies. Out of the repeated firms, 36 firms representing 19.67% of the total firms have engaged in RPTs across all the years under review.

Table 6.3
Frequency of RPTs by firms from 2009 to 2015

No. of RPTs	No. of Firms	Percentage
1	55	30.05%
2	28	15.30%
3	13	7.10%
4	20	10.93%
5	14	7.65%
6	17	9.29%
7	36	19.67%
Total	183	100.00%

6.1.2 Compliance with the Accounting Standard on RPTs

One of the objectives of this study is to examine the level of compliance with the disclosure requirements on RPTs by listed firms in Malaysia. Table 6.4 presents the yearly and overall assessment of the level of compliance with the accounting standard on RPTs by the firms listed on the Bursa Malaysia. The descriptive statistics of the level of compliance with the accounting standard on RPTs for the period of the study reveals that the mean, minimum and maximum level of compliance were 0.705, 0.492 and 0.912 respectively. This implies that the average level of compliance was 70.5%.

This finding is closely similar to the mean of 68% and 75% found by Hodgdon et al. (2008) and Street and Bryant (2000) in their respective studies. However, the standard deviation of 9% for this study is lower than 18% and 19% reported by Hodgdon et al.

and Street and Bryant respectively. This indicates more stability in terms of compliance behavior of Malaysian firms. Similarly, Glaum et al. (2013) have found that the average level of compliance with the IFRS 3 Business Combination and IAS 36 Impairment of Asset for 17 European countries was 73% with the standard deviation of 18%. The mean of 70.5% in Malaysia is at par with the other countries that adopt IFRS as reporting standard such as United Arab Emirate (75%), Saudi Arabia (75%), Belgium (74%), France (73%), Kuwait (72%), Qatar (69%) and Italy (65%).

The average of the maximum level of compliance with the accounting standard on RPTs for the period was 94.1% which is short of the expected (100%) level of compliance. Accounting standards are expected to be complied with in totality and anything in short of that can be sanctioned by the appropriate bodies (Houqe et al., 2012; La Porta et al., 2006). Compliance with the disclosure requirements on the management compensation, employee's retirement benefit plan and arm's length transactions are generally lacking. For example, several firms state that the transactions were based on negotiated price. This piece of information may not allow the users to assess the motive and the faithfulness of the transactions that a firm engages with the other related parties. The information on the provision for and the actual bad debt was also lacking.

Table 6.4
Descriptive Statistics of the MFRS 124 compliance

IFRS 24	2009	2010	2011	2012	2013	2014	2015	All
Mean	0.708	0.702	0.715	0.706	0.699	0.698	0.707	0.705
Std. Dev.	0.091	0.089	0.097	0.089	0.089	0.086	0.086	0.089
Min	0.471	0.471	0.529	0.441	0.471	0.471	0.588	0.441
Max	0.941	0.912	0.941	0.912	0.882	0.882	0.912	0.941
Observations	92	94	96	100	96	97	79	654

The year-by-year analyses also reveal the steady level of compliance across the study period. The mean of the level of compliance with the disclosure requirements of the accounting standard on RPTs was 70.8%, 70.2%, 71.5%, 70.6%, 69.9%, 69.8% and 70.7% for 2009, 2010, 2011, 2012, 2013, 2014 and 2015 years respectively. This indicates that the mandatory adoption of IFRS as reporting standard in 2012 did not increase the level of compliance with the accounting standard on the RPTs. This may be connected to the fact that the previous accounting standards (FRSs) are substantially similar to IFRSs (Ismail et al., 2013). The second possible reason can be attributed to the effect of early adopters of IFRS as reporting standard. Since it was permitted to use the IFRS as reporting standard before 2012, some firms have voluntarily adopted the IFRS in their financial reporting before the mandatory year.

Further analyses on the level of compliance with the disclosure requirements of the accounting standard on RPTs as presented in table 6.5 reveal that the level of compliance was high for transaction-based requirements (DscoreT) compared to non-transaction-based requirements (DscoreG) when the total compliance was partitioned into transaction-based disclosure requirements and non-transaction-based disclosure requirements. The mean compliance of transaction-based disclosure requirements was 84.45% which is much higher than 58.1% for non-transaction-based disclosure requirements. This indicates that firms disclose more information on trading transactions with the related parties, while the other segments of the requirements are more or less neglected.

Consistently, as presented in table 6.5 there is a significant difference in the mean of the compliance level of the two groups of the disclosure requirements. The mean compliance for DscoreT was 0.844 which is higher than 0.581 the mean compliance

for the non-transaction-based disclosure. The implication of this finding is that managers conceal information on non-transaction-based disclosure requirements. Cross examination of the compliance index reveals that some of the non-transaction-based disclosure requirements in the accounting standard on RPTs are not been complied with appropriately. These requirements include disclosure of the total managerial compensation most especially related to the long-term and termination benefits which may be an item of interest to the relevant users of the financial statement and are mostly lacking in the financial statements.

Table 6.5
IFRS 24 compliance on disclosure type

Disclosure Type	N	Mean	Std. Dev.	Min	Max	t-stat	P-value
DscoreT	654	0.844	0.127	0.375	1.000	39.3542***	0.0000
DscoreG	654	0.581	0.119	0.222	0.944		

DscoreT refers to the transaction-based disclosure requirement
DscoreG refers to the non-transaction-based disclosure requirement

Table 6.6 presents the results of the comparison between the means of the level of compliance with the disclosure requirements of the accounting standard on RPTs by manufacturing and non-manufacturing firms. Manufacturing firms constitute the firms listed under construction, consumer products, industrial products, plantation and properties segments of the Bursa Malaysia. On the other hand, non-manufacturing firms are firms registered under the hotel, independent power companies, technology and trading and services segment of the market. The results proved a higher level of compliance by the manufacturing firms and a significant difference in the mean of the level of compliance with the requirements of the accounting standard on RPTs. This can be attributed to the fact that some manufacturing firms source their raw materials from the related parties and most of their revenue come also from the related parties.

This indicates that manufacturing firms have more tendencies in engaging in varieties of RPTs than non-manufacturing counterpart as confirm by the number of observations in manufacturing activities (501) against the (153) for the non-manufacturing observations.

Table 6.6
Firm-Industry analyses on IFRS 24 compliance

Industry	N	Mean	t-stat	P-value
Manufacturing	501	0.713338	4.3325***	0.0000
Non-manufacturing	153	0.6780085		

Conclusively, the level of compliance with the disclosure requirements on RPTs (71%) by the firms listed on Bursa Malaysia can be seen as moderate level of compliance. Although Glaum et al. (2013) termed the 73% level of compliance with the IFRS 3 Business Combination and IAS 36 Impairment of Asset for 17 European countries as low compliance, this cannot warrant the 71% of compliance in Malaysia to be seen as low. This is because of the differences in term of capital market development, ownership structure, corporate governance mechanisms, legal enforcement, economic, cultural and political factors among the others between the sampled countries. Moreover, this level of compliance is at par with other countries such as United Arab Emirate (75%), Saudi Arabia (75%), Belgium (74%), France (73%), Kuwait (72%), Qatar (69%) and Italy (65%).

6.2 Determinants of Compliance with the Accounting Standard on RPTs

This section presents the data analyses and discussions on the second objective of the study. The section deals with the analyses and interpretations of the research findings on the determinants of compliance with the accounting standard on RPTs.

6.2.1 Summary Statistics on Determinants of Compliance with the Accounting Standard on RPTs

This section presents and discusses the descriptive statistics of the research variables used for the first segment of the data analyses and interpretations. Descriptive statistics are used to condense and present data in a logical form to allow for a quick understanding of an event, behavior or circumstances.

Table 6.7 presents the descriptive statistics of the determinants of compliance with the disclosure requirement of the accounting standard on RPTs for the continuous variables. The results show that the mean of the board independence (Bind) is around 45% and the standard deviation of 11.5% for the variable is not much volatile. On average, the mean of Bind is above the one-third requirement of the MCCG (2007) as independent directors. The minimum value of 20% for the Bind indicates that there still exist some firms that yet to meet the requirement of at least one-third for independent directors.

The mean, minimum and maximum of the board size (Bsize) was 7.83, 3 and 17 respectively. This indicates that on average, 8 persons sit on the board of Malaysian firms with a minimum of 3 persons and maximum of 17 persons. This is similar to the size of Singaporean firms with the average of 8 persons on the board and maximum and minimum of 13 and 4 persons respectively (Cheng & Courtenay 2006). Comparatively, the average size of Malaysian boards is similar to the 7 persons obtainable in the UK (Guest, 2008), and differs with the 11 persons in Spain (Castro et al., 2009), and 13 persons in the USA (Hartarska & Nadolnyak 2011).

Table 6.7

Summary statistics on independent variables (Continuous Variables)

Variable	Mean	Median	Minimum	Maximum	Std. Dev.	Skewness	Kurtosis
Bind	0.4450	0.429	0.2	1	0.1154	0.9984	4.3092
Bsize	7.8349	8	3	17	1.9140	0.6269	4.0129
Aexp	0.8261	1	0.25	1	0.2416	-0.9880	2.5334
Cown	0.2013	0.1014	0	0.8288	0.2264	0.8118	2.4217
Fmown	0.2773	0.2823	0	0.8302	0.2622	0.2983	1.6960
Mown	0.2862	0.3004	0	0.8302	0.2421	0.2369	1.7684
Frown	0.1623	0.0228	0	0.8619	0.2319	1.2561	3.1958
RoA	0.0508	0.0617	-0.5688	0.4745	0.1664	-0.9902	6.9479
MTV	-0.0195	-0.0894	-2.3752	2.3814	0.8150	0.5373	3.9196
Divi	0.0635	0.015	0	0.4	0.1120	2.1498	6.3891
Size	13.2463	13.233	9.317	17.673	1.4698	0.0534	2.8386

Bind = Board independence; Bsize = Board size; Aexp = Audit committee expertise; Cown = CEO ownership; Fmown = Family ownership; Mown = Managerial ownership; Frown = Foreign ownership; ROA = Return on assets; MTV = Market to book value; Divi = Dividend; Size = Firm size.

The result also reveals the mean of audit committee expertise (Aexp) as 0.8261 and the minimum of 0.25, an indication that independent directors with financial expertise have dominated the audit committee of the Malaysian corporate boards. By examining the ownership structure, the results reinforced the findings of Abdullah (2006) and Wahab et al. (2011) on the concentrated ownership structure of Malaysian firms. CEO ownership (Cown) ranges from zero to 83% with the mean of 20%. This range is at par with the pattern of Cown obtainable in other countries with concentrated ownership structure. The mean of Cown in Greek is 23% as reported by Bekiris (2013). The mean of family ownership (Fmown) was 28%, indicating the presence of family firms in the country. Family ownership has the highest of 83% in some firms and absent of family ownership in others. A similar structure with the mean of 19% and highest ownership of 85% was recorded by the USA firms (Anderson et al., 2003).

The mean of managerial ownership (Mown) as presented in table 6.8 was 29% indicating a strong presence of managerial control. This is in line with the figure reported by other Malaysian studies such as 8.26% by Kamardin et al. (2015) and

17.68% by Mustafa et al. (2011). The Mown ranges from zero to 83%. A similar trend was recorded in Taiwan with the mean of 25% (Liang et al., 2012) and a mean of 35% and a maximum of 92% in Greek. The mean of foreign ownership (Frown) was 16% with the standard deviation of 0.23. The average foreign ownership in Malaysia has recorded a significant level of growth compared to just 6.31% reported by Said, et al in (2009). This can be seen as the result of the deregulation of the foreign investment committee during 2009 to 2012. With this development, Malaysian foreign ownership may in near future be at par with 25% in Australia (Henry, 2010) and 32% in sub-Saharan Africa (Munisi et al., 2014).

Profitability, as measured by return on asset (ROA), has a mean of 5%, while the mean of the firms' growth (MTV) was 2%. Dividend (Divi) was having a mean of 6% and standard deviation of 11%. The mean, median, minimum and maximum values of the firm size (Size) is 13.25, 13.23, 9.32 and 17. 67 respectively. The slight difference between the mean and median of the firm size indicates that the variable is normally distributed as reaffirmed by the skewness of 0. 0534 and kurtosis of 2.8386.

Table 6.8 presents the descriptive statistics of the determinants of compliance with the disclosure requirement of the accounting standard on RPTs for the dichotomous variables. The mean of the audit committee independence (Aind) was 0.5642 indicating that independent directors dominate the membership of audit committee in most of the Malaysian firms. This is consistent with the requirement of MCCG (2007) that independent directors should constitute the majority of audit committee members. The distribution of the Aind i.e. skewness (-0.2590) and kurtosis (1.0671) are within the normal range. The mean of CEO expertise (Cexp) was 51% indicating that more than 50% of the CEOs are financially literate. The skewness and kurtosis of Cexp

demonstrate the normal distribution of the Cexp among the firms. The mean of CEO family (Cfml) is 49% indicating almost 50% of the sample firms have a family member as CEO of the firm. This is consistent with the Cheng (2014) who reports that founding family retain more than 62% of the CEO position in a family owned firms to ensure that their interest is protected.

Table 6.8

Summary statistics on independent variables (Dichotomous Variables)

Variable	Mean	Median	Minimum	Maximum	Std. Dev.	Skewness	Kurtosis
Aind	0.5642	1	0	1	0.4962	-0.2590	1.0671
Cexp	0.5183	1	0	1	0.5000	-0.0734	1.0054
Cfml	0.4878	0	0	1	0.5002	0.0489	1.0024
Tunn	0.4205	0	0	1	0.4940	0.3221	1.1038
Prop	0.4159	0	0	1	0.4933	0.3413	1.1165
Aud	0.5596	1	0	1	0.4968	-0.2402	1.0577
MCCG	0.5688	1	0	1	0.4956	-0.2779	1.0772

Dscore = Points scored by a firm divided by the maximum obtainable points; Bind = Board independence; Bsize = Board size; Aind = Audit committee independence; Aexp = Audit committee expertise; Cexp = CEO expertise; Cfam = CEO family; Cown = CEO ownership; Fmown = Family ownership; Frown = Foreign ownership; Tunn = Tunneling; Prop = Propping; ROA = Return on assets; MTV = Market to book value; Divi = Dividend; Size = Firm size; Aud= Auditor type; MCCG = Malaysia code of corporate governance dummy.

On average, 42% of the firms have been expropriated as displayed by the mean of tunneling (Tunn). Though Tunn is highly volatile with the standard deviation of 49%, its distribution is within the normal range. Extant literature provides that in most cases profitable firms are subjected to expropriation while non-performing firms are propped up by the controlling holders (Peng et al., 2011; Ying & Wang, 2013). Based on this, the result reveals that 42% of the sampled firms are highly profitable and are subjected to expropriation. The mean of the propping (Prop) on the other hand reveals that 42% of sampled firms have been propped up by their controlling shareholders. This indicates that propped-up firms performed below the average profitability.

The average of 0.5596 in the audit quality (Audi) indicates that almost 56% of the sample firm-year were audited by Big-4 auditing firms. This provides an insight of higher audit quality among the sample firms. The skewness of -0.2402 and kurtosis of 1.0577 indicate that the variable was normally distributed. The mean of time variable (MCCG) 0.5688 signifies that almost 57% of the sampled firm-years are during the post-MCCG 2012 period. This implies that MCCG 2012 has not reduced the volume or magnitude of RPTs among the Malaysian listed firms. The skewness of -0.2779 and kurtosis of 1.0772 indicates that MCCG was normally distributed.

6.2.2 Univariate Analysis

Table 6.9 presents the correlation matrix for the research variables. Generally, the results reveal the less severe multicollinearity problem among the research variables. The highest correlation among the research variables was 0.8196 between audit committee independence (Aind) and audit committee expertise (Aexp). This indicates a strong correlation between the Aind and Aexp. Gujarati (2003) considers a correlation of more than 0.5 as high correlation. However, Hair, Black, Babin and Anderson (2014) and Tabachnik and Fidell (2007) state that a correlation of less than 90% could not be a problem to estimation. Hence, the correlation between Aind and Aexp, in this case, does not expose the regression model to severe multicollinearity problem. The dependent variable (Dscore) was having a significant and positive correlation at 1% level of significance with the board independence (Bind). Similarly, the association between Dscore and Aind was positive and significant at 10% level of significance. Based on this, it can be inferred that audit committee independence also affects the firm's level of compliance. Though the correlation is not as statistically significant as that of Bind.

Aexp was found to have a significant positive correlation at 1% with the Dscore. This can be interpreted that Aexp influences the firm's extent of disclosure practice. Nevertheless, causal analyses need to be employed to validate this initial insight. The correlation between Dscore with the CEO ownership was negative and significant at 10%. This also provides a preliminary clue of the effect of CEO ownership on the firm's level of compliance with the disclosure requirements of the accounting standard on RPTs. The association between Dscore and return on asset (ROA) was negative and significant at 10% level of significance. This indicates a possible negative effect of the profitability on the firm's disclosure behavior. Dscore was having a significant positive correlation with the dividend payment. From this, one can infer that dividend payment affects the firm's level of disclosure practice. A similar correlation was found by Dscore with the firm size and audit quality.



Table 6.9

Pearson Correlation Matrix of the Research Variables

	Dscore	Bind	Bsize	Aind	Aexp	Cexp	Cfml	Cown	Fmown	Frown
Dscore	1									
Bind	0.1309***	1								
Bsize	0.0103	-0.3333***	1							
Aind	0.0702*	0.3536***	0.0950**	1						
Aexp	0.1377***	0.2825***	0.0805**	0.8196***	1					
Cexp	0.0295	0.0095	0.1952***	-0.0017	-0.0308	1				
Cfml	-0.0636	-0.0936*	0.0267	-0.0431	-0.0575	-0.1613***	1			
Cown	-0.0672*	-0.0244	0.009	0.1294***	0.0754*	-0.2070***	0.4763***	1		
Fmown	0.057	-0.0133	0.0017	0.0481	0.0158	-0.0625	0.6727***	0.4804***	1	
Frown	-0.0225	0.005	0.0078	-0.0906**	-0.1528***	0.1805***	-0.3191***	-0.3523***	-0.2248***	1
Mown	0.0102	-0.1179***	0.0313	0.0782**	0.028	-0.1862***	0.5010***	0.7582***	0.6147***	-0.3006***
Tunn	0.0087	-0.0411	0.1432***	-0.0072	0.0186	0.0338	-0.0752*	-0.0809**	-0.0609	0.1371***
Prop	0.0025	0.043	-0.1477***	-0.0154	-0.0595	0.0125	0.0517	0.1198***	0.0884**	-0.0867**
RoA	-0.0741*	-0.1066***	0.1110***	-0.0205	-0.0359	0.092**	-0.0906**	-0.1569***	-0.1226***	0.1611***
MTV	0.047	-0.0002	0.0828**	-0.0443	0.0149	0.0927**	-0.1687***	-0.0307	-0.1961***	0.1770***
Divi	0.0702*	-0.0637	0.1161***	-0.1305***	-0.0900**	0.1210***	-0.2236***	-0.2357***	-0.2038***	0.4343***
Size	0.3616***	0.0064	0.2885***	0.1203***	0.1167***	0.078**	-0.0151	-0.0608	0.0213	0.0761*
Audi	0.0730*	-0.0098	0.1118***	0.0466	0.0175	0.1250***	-0.0587	-0.0980**	-0.0114	0.2709***
MCCG	-0.0323	0.0752*	-0.0364	0.0131	0.0358	0.0258	-0.0213	-0.0529	-0.0372	0.0011

Dscore = Points scored by a firm divided by the maximum obtainable points; Bind = Board independence; Bsize = Board size; Aind = Audit committee independence; Aexp = Audit committee expertise; Cexp = CEO expertise; Cfml = CEO family; Cown = CEO ownership; Fmown = Family ownership; Frown = Foreign ownership; Tunn = Tunneling; Prop = Propping; ROA = Return on assets; MTV = Market to book value; Divi = Dividend; Size = Firm size; Audi = Auditor type; MCCG = Malaysia code of corporate governance. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

Table 6.9 (Continued)

	Mown	Tunn	Prop	RoA	MTV	Divi	Size	Audi	MCCG
Mown	1								
Tunn	-0.0597	1							
Prop	0.1166***	-0.7188***	1						
RoA	-0.1298***	0.6178***	-0.6424***	1					
MTV	-0.1408***	0.3640***	-0.3337***	0.3664***	1				
Divi	-0.2669***	0.4094***	-0.3676***	0.4362***	0.4564***	1			
Size	-0.0678*	0.1254***	-0.1719***	0.1041***	0.0379	0.2581***	1		
Audi	-0.1181***	0.1317***	-0.1139***	0.1725***	0.1700***	0.2459***	0.2562***	1	
MCCG	-0.0322	-0.0777**	0.0707	-0.0229	0.061	-0.0512	0.0592	-0.082**	1

Dscore = Points scored by a firm divided by the maximum obtainable points; Bind = Board independence; Bsize = Board size; Aind = Audit committee independence; Aexp = Audit committee expertise; Cexp = CEO expertise; Cfam = CEO family; Cown = CEO ownership; Fmown = Family ownership; Frown = Foreign ownership; Tunn = Tunneling; Prop = Propping; ROA = Return on assets; MTV = Market to book value; Divi = Dividend; Size = Firm size; Aud= Auditor type; MCCG = Malaysia code of corporate governance. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

On the board characteristics, the association between Bind with the Bsize was negative and significant. This indicates that the larger the board, the less the proportion of independent directors on the board. However, Bind was having a significant positive correlation with the Aind and Aexp. This implies that the proportion of independent directors on the board influences the level of audit committee independence as well as audit committee expertise. This is because independent directors are appointed to the board based on their reputation and expertise. Since members of the audit committee are part of the board members, the independence and expertise of the board automatically manifest in the audit committee.

The association between Bsize was positive and significant with the Aind, Aexp and Cexp. This can signal that CEOs with the financial expertise prefers working with large board to tap the vast knowledge and expertise of the board members and apply it to the day-to-day management of the firm. Other variables with statistically significant correlation with the Bsize are tunneling, propping, ROA, MTV, Dividend, firm size and audit quality. Large boards are less likely to involve in the PRT that may lead to tunneling or propping. This is because of the number of persons with the divergence knowledge and interest that involved in the decision process which makes it less possible to reach consensus on the transactions that may harm the firm and impede their reputation. More so, large boards are characterized by the high profitability, high growth potentials, high dividend payment and with the high quality audit.

Aind was found to have a significant positive correlation with the Cown and Mown. This indicates more independent audit committee members in the firms with higher CEO or managerial ownerships. Aind and Aexp were having a significant negative

association with the dividend and significant positive association with the firm size respectively. The associations between Aexp with the CEO ownership (Cown), dividend and firm size was also statistically significant.

The association between Cexp with the CEO family (Cfml), Cown and management ownership (Mown) was negative and statistically significant. This type of correlation has been widely reported in the extent of literature (Barnett, 1960; Bennedsen et al., 2007; Hillier & McColgan, 2009). Family members or business founders used to be the CEO of the firms without due regards to their level of expertise. However, the association between Cexp and Frown was positive. The positive correlation between Cexp with the ROA, MTV, dividend, firm size and audit quality indicates that firms with a financial expert as CEOs are positively associated with the size, profitability, dividend payment, growth potential and higher audit quality.

The correlations between family CEO with the Cown, Fmown and Mown are positive and significant. This correlation reveals high tendency of having a family member as CEO in a firm with higher CEO ownership, family ownership and managerial ownerships. Meanwhile, the Cfml was found to have a significant negative correlation with the ROA, MTV and dividend. The correlation between the Cown and other research variables and that Fmown with the other research variables are similar to those reported in the Cfml. In addition, the significant positive correlation between Cown and Fmown with the Mown indicates that firms with the higher CEO and family ownerships are managed by the family members. The negative correlation of tunneling with the Cfml and Cown provides additional evidence for the underperformance of the family member as CEO and CEO owned firms.

Firms with the high form of foreign ownership performed better as indicated by the positive correlation between Frown with the tunneling and negative correlation with the propping. Foreign owned firms are large and profitable firms with the higher growth potentials. The positive correlation of Frown with dividend and audit quality can be justified that foreign investors usually repatriate their earnings to their local countries and engaged the service of big audit firms to guarantee the quality of the financial information.

The strong negative correlation between tunneling and propping indicates that the variables are nearly mutually exclusive. Furthermore, the positive correlation between tunneling and ROA, MTV, dividend and firm size indicates that large and profitable firms with the higher growth potentials and dividend payments are mostly tunneled. This may indicate that controlling shareholders engage in expropriation activities when the firms are performing well. It is widely believed that higher audit quality curtails the extent of tunneling. However, the positive correlation between tunneling and audit quality indicates that audit quality as proxied by big-4 auditing firm did not constrain the tunneling practices among the firms. Interestingly, the changes and improvements in the reporting regulations in 2012 have curtailed the extent of tunneling as demonstrated by the negative correlation between tunneling and MCCG. The correlation between propping and other research variables was in direct opposition to those reported under tunneling.

On the firm's characteristics, the univariate analysis reveals that profitable firms are large firms with the higher growth potentials, good history of dividend payments and are been audited by the big audit firms. These correlations are displayed by the significant positive correlation of ROA with the MTV, dividend, firm size and audit

quality. Similarly, the correlation between MTV with the dividend and audit quality are positive and significant. This indicates the dividend payments and high audit quality by the firms with the growth potentials. More so firms with the dividend payment are found to be large with the high quality audit. The negative correlation between audit quality and MCCG indicates a decrease in audit quality in the post-MCCG period.

6.2.3 Multiple Regression

This section presents the results of the diagnostic tests conducted to ensure that the research data satisfied all the basic regression assumptions. The section also contains the results of the model specification tests to ensure that the research models are correctly specified. The section presents the model selection criteria and concludes with the presentation and discussion of the results of the estimation models.

6.2.3.1 Multivariate Regression Diagnostic Test

The basic assumptions of the linear regression model include that the data should be free from outliers, normality, linearity, heteroskedasticity and multicollinearity. This study conducts the Doornik and Hansen (2008) normality test, Breusch and Pagan (1980) heteroskedasticity test, Hair, Black, Babin and Anderson (2014) variance inflation test of multicollinearity and Pregibon (1980) model specification test. The results of these tests are presented in the table 6.10. In addition, the study employs the Dixon (1980) outlier treatment method to minimize the effect of the outlier on the regression coefficient estimates.

Table 6.10
Results of the Diagnostic Tests

Test	p-value
Test for Normality (Doornik-Hansen)	0.1004
Heteroskedasticity (Breusch & Pagan)	0.1829
Test for Multicollinearity (VIF Test)	2.04
Model specification (Hat test)	0.798
Model specification (Hat-square)	0.452

6.2.3.2 Outliers

Outliers are observations with unique attributes that differ from the other observations (Hair et al., 2014). All continuous variables with unusual observations are winsorized at 1% top and bottom. Dixon (1980) states that winsorization of data gives more stable results than trimmed means. The added variable plots as displayed in figure 6.1 indicates that the data points of the research variables against the others are within the acceptable region.

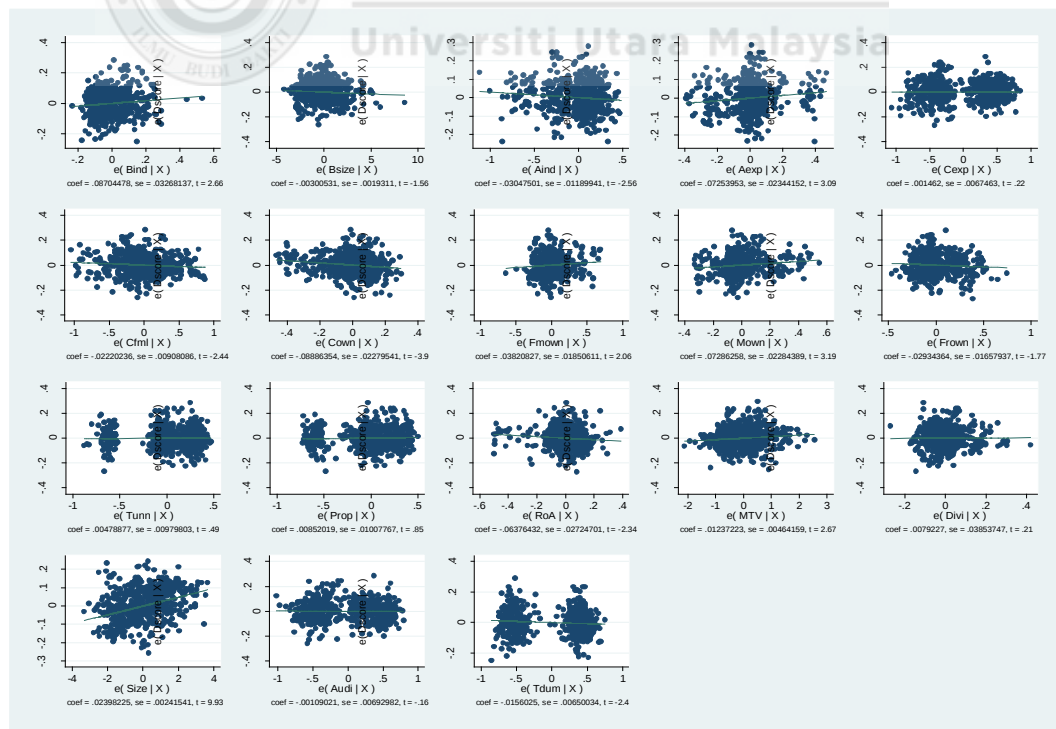


Figure 6.1
Added Variable Plots

6.2.3.3 Normality

Normality is one of the fundamental assumptions of linear regression. Failure to satisfy the normality assumption distorts the relationship and the level of significance between the research variables and renders the results from the statistical test invalid. Doornik-Hansen test for multivariate normality was used in this study to test the normal distribution of the residual of the model. This approach is superior to Shapiro-Wilk test for multivariate distributions (Doornik & Hansen, 2008). The p-value of 0.1004 as presented in Table 6. 10 indicates that the residual of the model is normally distributed. A graphical method of normality test was also employed in this study to support the results of the Doornik-Hansen test for multivariate normality. The histogram kdensity normal test was performed to check the pictorial distribution of the data. Based on Figure 6.2, the residual of the model is normally distributed.

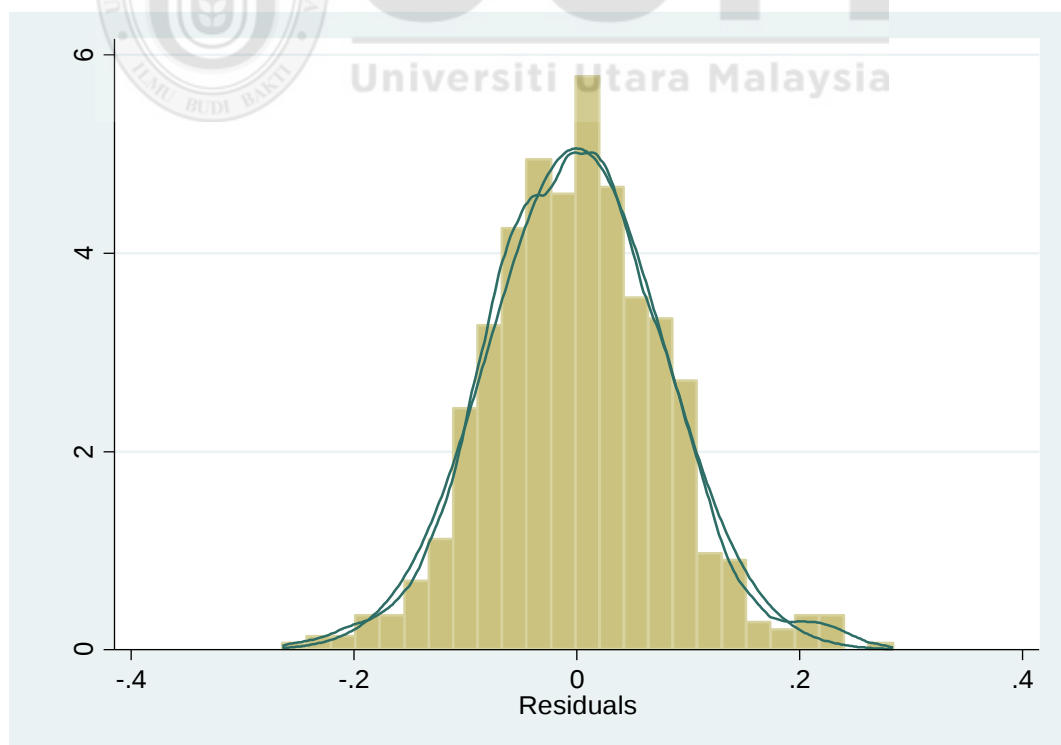


Figure 6.2
Residual Distribution

6.2.3.4 Heteroskedasticity

Breusch-Pagan/Cook-Weisberg test for heteroskedasticity was used in this study to test for the homoscedasticity of the regression model. The p-value of 0.1829 in the Breusch-Pagan/Cook-Weisberg test for heteroskedasticity as presented in table 6. 10 shows that the model is homoscedastic. A graphical residual versus fitted (RVF) plot was used to support the result of the Breusch-Pagan/Cook-Weisberg test for heteroskedasticity. Figure 6.3 graphs the residuals against the fitted values which shows that the dots seem to fluctuate around zero in unpattern direction, hence, indicating that the model used in this study is homoscedastic.

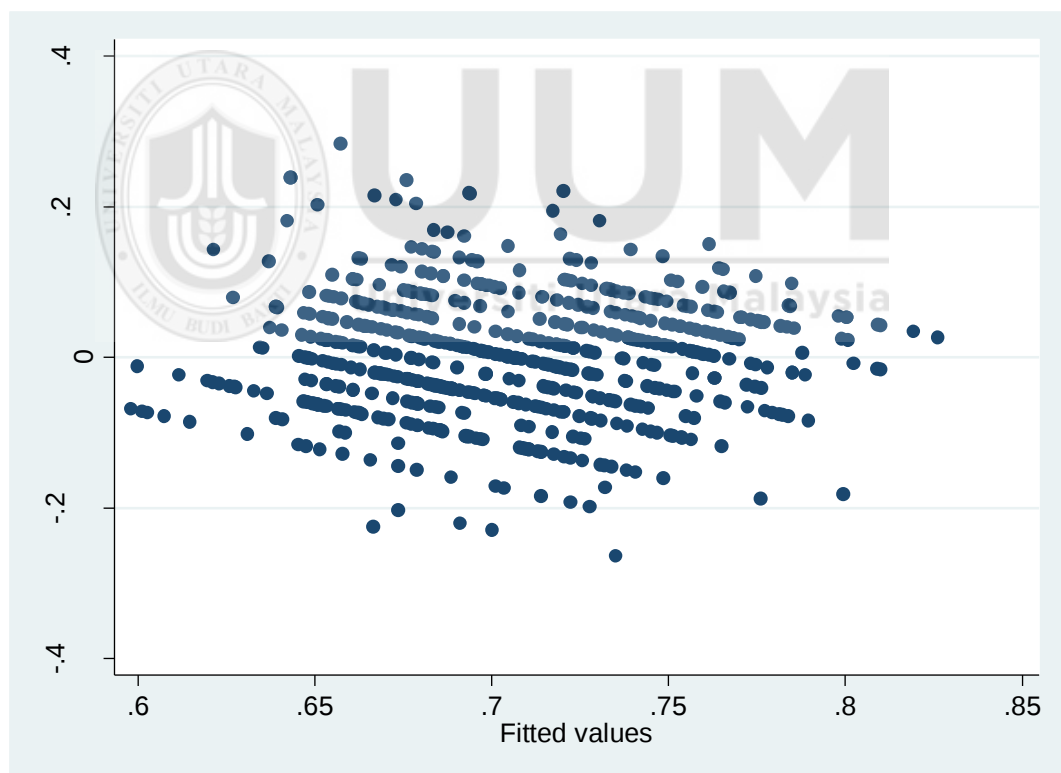


Figure 6.3
Residual versus Fitted Value Plots

6.2.3.5 Linearity

Linearity assumption provides that the relationship between dependent and independent variables should be linear. The linearity between dependent and independent variables demonstrates the degree to which changes in the independent variable affects the dependent variable. In this study, the linearity relationship is tested by comparing the standard deviation of the dependent variable with that of the residual of the regression. The rule of thumb is that linearity is achieved if the standard deviation of the dependent variable is greater than that of the residual of the model (Garson, 2012; Hair et al., 2014). Table 6.11 presents the standard deviation of the dependent variable and the residual of the regression. It reveals that the standard deviation of the dependent variable is greater than that of the residual. Hence, the linearity assumption is satisfied.

Table 6. 11
The Standard Deviation of the level of Compliance and Residuals

Variable	Standard Deviation
Dscore	.0894765
Residual	.0788754

6.2.3.6 Multicollinearity

Multicollinearity is a situation whereby the independent variables are highly correlated with one another. Though multicollinearity does not affect the consistency of ordinary least square regression coefficient estimates, it poses a challenge in arriving at imprecise and unreliable regression coefficient estimates (Defusco, Leavey, Pinto, & Runkle, 2011). The coefficient of the correlation matrix is widely used to detect the existence of multicollinearity (Garson, 2012). The highest correlation among the research variables was 0.8196 as presented in table 6.9 between audit committee

independence and audit committee expertise. This correlation does not pose a challenge to the regression coefficient estimates of this study¹⁰ as it does not exceed the threshold of 90% stated by Hair et al. (2014) and Tabachnik and Fidell (2007).

To support this, variance inflation factor (VIF) multicollinearity check was conducted for each independent variable. Multicollinearity can be said to exist where the tolerance value is less than 0.01 and the VIF is more than 10 (Hair et al., 2014; Pallant, 2007). Table 6.12 shows that there is no evidence of multicollinearity problem as both tolerance value and VIF are within the acceptable region.



¹⁰ Separate regressions are run for the variables with strong correlations (i.e. with either Aind or Aexp for the audit committee characteristics and another set of regressions with either Fmown or Mown for the ownership structure). The sign and significance of the results of these regressions as reported in the additional analyses section of this chapter are substantially similar with that of the main analyses.

Table 6.12

Collinearity Statistics: Tolerance Value and Variance Inflation Factor (VIF)

Variables	Collinearity Statistics	
	Tolerance Value	VIF
Aind	0.28098	3.56
Aexp	0.30541	3.27
Mown	0.32024	3.12
Cown	0.36776	2.72
Prop	0.3965	2.52
Fmown	0.41613	2.4
Tunn	0.41817	2.39
Cfml	0.4748	2.11
RoA	0.4768	2.1
Divi	0.52568	1.9
Frown	0.66289	1.51
MTV	0.68225	1.47
Bind	0.68919	1.45
Bsize	0.71717	1.39
Size	0.77739	1.29
Audi	0.82658	1.21
Cexp	0.86091	1.16
MCCG	0.94392	1.06

Note. The mean VIF = 2.04; whereas VIF = Variance Inflation Factor. Bind = Board independence; Bsize = Board size; Aind = Audit committee independence; Aexp = Audit committee expertise; Cexp = CEO expertise; Cfam = CEO family; Cown = CEO ownership; Fmown = Family ownership; Frown = Foreign ownership; Tunn = Tunneling; Prop = Propping; ROA = Return on assets; MTV = Market to book value; Divi = Dividend; Size = Firm size; Aud= Auditor type; MCCG = Malaysia code of corporate governance

6.2.3.7 Model specification Test

Gujarati (2004) states that model specification bias may be the result of or a combination of omission of important relevant variable(s), inclusion of unnecessary variable(s), measurement error, adoption of wrong functional form or wrong specification of the stochastic error terms. Pregibon (1980) model specification test was used to ensure that the model in this study is correctly specified. The results of the specification test as presented in table 6.10 reveals that the p-value of the Hat-square was 0.452. This indicates that the research model has been correctly specify.

6.2.4 Model Selection Criteria

Panel data regression analysis is used where the data are collected from the same unit over the period of time. To select the best model for the estimation, Baltagi (2005) states that the first step is to determine whether pooled Ordinary Least Square (Pooled-OLS) or random effect Generalized Least Square (RE-GLS) is appropriate. This is achieved through the estimation of heterogeneous (λ) of models using the Breusch and Pagan Lagrangian Multiplier test for random effect. When RE model was taken, the next step is to identify whether the Random or Fixed effect is more appropriate through Hausman specification test.

However, the above process is designed for the ideal panel data set. Where the panel data is extremely unbalanced, Baltagi (2005) suggests the use of Pooled-OLS estimators. The technique can be used for unbalanced data set without causing inconsistencies to the estimators. Consistently, Davis (2002) provides statistical evidence that OLS suffice for unbalanced data set arises from peculiar instances such as self-selectivity as was the case of this study. This is because both estimators of Pooled-OLS and Maximum likelihood estimator (MLE) produce similar results. The Pooled-OLS model was used in several studies of this nature such as Glaum and Street (2003), Glaum et al. (2013) and Haniffa and Cooke (2002). In view of this, the Pooled-OLS model was used and discussed to make meaningful inferences throughout the study.

6.2.5 Regression Results

Table 6.13 presents the coefficients of the regression for the determinant of compliance with the disclosure requirements of the accounting standard on RPTs.

Board independence and board size are the components of the board characteristics adopted in this study to measure their influence in the firm's compliance with the disclosure requirements of the accounting standard on RPTs. Board independence was measured as the proportion of independent directors on the corporate board. On the other hand, board size represents the actual number of persons that sit on the corporate board. The coefficient of board independence in this study was positive and significant at 1%. This indicates the positive relationship between board independence and firm's compliance with the disclosure requirements of the accounting standard on RPTs.

Previous studies have established that board independence enhances the firm disclosure practice (Chen & Jaggi, 2000; Ferreira, Ferreira, & Raposo, 2011; Patelli & Prencipe, 2007). This supports the agency theory that presence of independent directors on the board minimizes both type I and II agency problems (Adams et al., 2008; Crespí-Cladera & Pascual-Fuster, 2014; Fama & Jensen, 1983). The result for this study is consistent with the Lo and Wong (2011) that independent directors control the manager's behavior in RPTs. Hence H1a₁ which states that there is a significant positive relationship between the proportion of independent directors and compliance with the disclosure requirements of the accounting standard on RPTs is accepted.

Table 6.13

Regression Result on the Determinant of compliance with the disclosure requirements of the Accounting Standard on RPTs

Variables	Coef.	Std. Err.	t-value	P-value
Constant	0.338	0.039	8.57	0.000***
Bind	0.087	0.033	2.66	0.004***
Bsize	-0.003	0.002	-1.56	0.06*
Aind	-0.030	0.012	-2.56	0.005***
Aexp	0.073	0.023	3.09	0.001***
Cexp	0.001	0.007	0.22	0.415
Cfml	-0.022	0.009	-2.44	0.008***
Cown	-0.089	0.023	-3.90	0.000***
Fmown	0.038	0.019	2.06	0.020**
Mown	0.073	0.023	3.19	0.001***
Frown	-0.029	0.017	-1.77	0.039**
Tunn	0.005	0.010	0.49	0.313
Prop	0.009	0.010	0.85	0.199
RoA	-0.064	0.027	-2.34	0.02**
MTV	0.012	0.005	2.67	0.008***
Divi	0.008	0.039	0.21	0.419
Size	0.024	0.002	9.93	0.000***
Audi	-0.001	0.007	-0.16	0.875
MCCG	-0.016	0.007	-2.40	0.017**
R^2	0.2229			
Adj R^2	0.2009			
F-stat	10.12***			
N	654			

Equation (1) $Dscore = \beta_0 + \beta_1 Bind + \beta_2 Bsize + \beta_3 Aind + \beta_4 Aexp + \beta_5 Cexp + \beta_6 Cfam + \beta_7 Cown + \beta_8 Fmown + \beta_9 Mown + \beta_{10} Frown + \beta_{11} Tunn + \beta_{12} Prop + \beta_{13} ROA + \beta_{14} MTV + \beta_{15} Divi + \beta_{16} Size + \beta_{17} Aud + \beta_{18} MCCG + \epsilon$. Dscore = Points scored by a firm divided by the maximum obtainable points; Bind = Board independence; Bsize = Board size; Aind = Audit committee independence; Aexp = Audit committee expertise; Cexp = CEO expertise; Cfam = CEO family; Cown = CEO ownership; Fmown = Family ownership; Frown = Foreign ownership; Tunn = Tunneling; Prop = Propping; ROA = Return on assets; MTV = Market to book value; Divi = Dividend; Size = Firm size; Aud = Auditor type; MCCG = Malaysia code of corporate governance. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

It is widely believed that board size affects the firm's disclosure behavior. The benefit of shared responsibility permits board members to go deep into the financial reports and ensure that they comply with the requirements of the relevant laws. Based on this, it is hypothesized that board size improved the corporate transparency because of the diverse knowledge, skills and experience that are present on the large boards.

However, the results of this study as presented in table 6.13 do not support this hypothesis. The coefficient of the board size was negative and significant at 10%. The possible explanation for the negative relationship is the dominance of family members and cronies on the board. The finding is in line with Mak and Kusnadi (2005) that board size reduces the firm value of Malaysian and Singaporean firms. This by extension hampers the firm disclosure behavior. Hence H1a₂ which states that there is a significant positive relationship between the size of the board and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

Another aspect of internal governance mechanisms considered in this study is the audit committee characteristics. Audit committee independence and audit committee financial expertise were chosen for this study. To ensure the independence of audit committee, MCCG (2007) requires that none of the executive directors can be a member of the audit committee. This is because, previous studies established that the adequacy of independent directors protects the interest of all stakeholders (Lo et al., 2010; Mallin et al., 2015).

However, contrary to the expectation, the coefficient of audit committee independence was negative and significant at 1%. This proved that audit committee independence constrains the extent of compliance with the disclosure requirements of the accounting standard on RPTs. This finding is contrary to the previous studies that audit committee independence improves the financial reporting oversight (Black & Kim, 2012; Li, Mangena, & Pike, 2012). Hence H1a₃ which states that there is a significant positive relationship between audit committee independence and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

The possible explanations for this finding may be any of the following issues. First, the issue of the substance of the independence of the independent director. Some independent directors appears to be independent only in name but not fact. The number of years that independent director serves in a firm may impair his independence and his ability to form objective view on the firm operations. The second possible explanation to this can be related to the issue of the chairman busyness. The busyness of chairman is a position where one person heads the board and audit committee concurrently. In this setting, the tight schedule of the chairman may not allow him to fully participate in the activities of the committee, hence making his membership a minus to the committee.

The second variable under the audit committee characteristics is audit committee financial expertise. The committee's financial expertise allows it to identify internal control weaknesses and ask management to take corrective measures accordingly within the shortest possible time (Goh, 2009; Zhang, Zhou, & Zhou, 2007). The coefficient of audit committee financial expertise in this study was positive and significant at 1%. This indicates the positive relationship between audit committee' financial expertise with the firm's compliance with the disclosure requirements of the accounting standard on RPTs. The result is consistent with the previous studies that audit committee financial expertise mitigates manipulations in RPTs (Abbott et al., 2004; Davidson III, Xie, & Xu, 2004) and improves the firm's disclosure practices (Carcello et al., 2006). Hence H1a₄ which states that there is a significant positive relationship between audit committee financial expertise and compliance with the disclosure requirements of the accounting standard on RPTs is accepted.

The next category of corporate governance mechanisms in this study is the CEO characteristics. CEO characteristics influence firm's decisions and disclosure behavior. Several CEO's characteristics are used simultaneously in the model to analyze the influence of CEO in defining the firm disclosure behavior. These characteristics are CEO's financial expertise, CEO family lineage and CEO ownership. A CEO with financial expertise are more likely to pilot the financial affairs of the firm effectively (Custódio & Metzger, 2013a). Though the coefficient of the CEO expertise is positive as predicted, it is not a statistically significant determinant of the compliance with the disclosure requirements of the accounting standard on RPTs. H1a₅ which states that there is a significant positive relationship between CEO expertise and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

The possible reason behind this may be the concentrated ownership structure of the firms in Malaysia. The appointment of several financially expert CEO was influenced by the extent of their ownership and family decisions, not on the level of their competence. Therefore, once the disclosure works against their interest they may prefer to conceal the information to avoid the public outburst or market reaction against their internal dealing.

Several studies such as Ansari et al. (2014), Chen et al. (2013) and Chau and Gray (2002) prove the influence of the family members on the firm's disclosure practices. When the CEO is appointed from within the family, the family members enjoy the related monetary and non-monetary benefits¹¹ from the firm and might hesitate to replace him regardless of the consequences of his decisions. Therefore, family CEO

¹¹ These benefits are highlighted in section 3.3.1 of this thesis.

provide opaque information to hide the rent-seeking activities of the family members and covers his under-performance. Consistently, the coefficient of the CEO family lineage (Cfml) for this study was negative and significant at 1% level of significance. This result supports the hypothesized negative relationship between the CEO family lineage and the level of compliance with the disclosure requirements of the accounting standard on RPTs. H1a₆ which states that there is a significant negative relationship between CEO family lineage and compliance with the disclosure requirements of the accounting standard on RPTs is accepted.

On the CEO ownership, previous studies provide evidence that the level of CEO ownership assist in controlling the decision making processes of the CEO owned firms (Chen et al., 2008; Kim & Lu, 2011). As hypothesized, the coefficient of CEO ownership was negative and significant at 1%. The result reveals the negative relationship between CEO ownership and the level of compliance with the disclosure requirements of the accounting standard on RPTs. This finding is consistent with the extent of literature that CEO ownership is associated with the low information disclosure to prevent information leakages of proprietary information and rent-seeking activities (Fan & Wong, 2002; Gul & Lai, 2002). Hence, H1a₇ which states that there is a significant negative relationship between CEO ownership and compliance with the disclosure requirements of the accounting standard on RPTs is accepted.

Other forms of ownership structure considered in the study include family ownership, managerial ownership and foreign ownership. It is generally believed that family ownership is associated with the low level of information disclosure (Anderson, Duru, & Reeb, 2009; Chen et al., 2008). Conversely, the result of this study was positive and significant at 5%. Hence, H1a₈ which states that there is a significant negative

relationship between family ownership and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

The possible reasons behind this finding can be seen from two perspectives. First, the intention to preserve the family name might force the family members to disclose more information to compete favorably with the non-family firms. Consistently, Wang (2006) finds that founding family ownership is associated with the greater earnings informativeness. Similarly, Wan-Hussin (2009) reports improvement in the extent of information disclosure of family firm after the Asian financial crises. This improvement might be the result of the efforts of the family firms to alleviate the fears of market players on the internal dealings in the family firms.

The second reason for this result might be seen from the alignment effect viewpoint. With the average ownership of almost 28% and a maximum of more than 83%, the family members have less to benefit from if they destroy the image of the firm with the opaque information to the market. Anderson et al. (2009) reveal that family firms provide more opaque information when they pursue entrenchment policy¹². Based on this, the reverse may be the case when the family firm pursues the alignment policy. This is consistent with the Chau and Gray (2010) that the extent of family firm's voluntary disclosure depends on the level of the family ownership in that firm. Therefore, with this high level of family ownership in Malaysia, family firms might vote to exhibit a high level of compliance with the disclosure requirements of the accounting standard on RPTs.

¹² Most of the previous study on the disclosure behaviour of family firms have followed Anderson and Reeb (2003) to identify the family firms and focussed on the enrichment effect. This is because in some of these studies firms with the family ownership of just 2% were categorized as family firms and the findings were generalized see Xia Chen et al. (2013) and Chung (2014) for examples.

Based on agency theory, management ownership aligns the interest of the managers with that of the shareholders. Therefore, managerial ownership increases the firm's disclosure practices. Unlike Hidalgo et al. (2011) and Said et al. (2009) that failed to establish statistically significant relationship between managerial ownership and firm disclosure behavior, this study document a significant positive relationship between managerial ownership and compliance with the requirements of the accounting standard on RPTs. The result of managerial ownership for this study was positive and significant at 1%. H1a₉ which states that there is a significant positive relationship between managerial ownership and compliance with the disclosure requirements of the accounting standard on RPTs is accepted.

This finding is consistent with the Doidge et al. (2009) and Singh and Davidson III (2003) that as the managerial ownership increases, any decision taken by managers to benefit themselves at the detriment of minority shareholders has a cost that diminishes the firm value. Therefore, managers will be willing to comply with the disclosure requirements to improve the firm's image and increase the liquidity of the shares of the firm. Alternatively, the alignment effect in the ownership structure has manifested its self in the above findings. The mean of the managerial ownership among the sampled Malaysian firms was around 29%, while the highest level of managerial ownership was more than 83%. This level of ownership forces the managers to act in the best interest of the firm as they will be more affected by any slight stock shocks. This encourages the management to serve wholeheartedly in the best interest of all stakeholders.

The last form of ownership considered in the study was foreign ownership. Based on agency theory, foreign ownership serves as external governance mechanism (Cho, Huang, & Padmanabhan, 2014). Bova and Pereira (2012) and Misirlioğlu et al. (2013) identify foreign ownership with the increased information disclosure. In contrast with the above, the results of this study reveal a negative relationship between foreign ownership and the level of compliance with the disclosure requirements of the accounting standard on RPTs.

The coefficient of the foreign ownership was negative and significant at 5%. The negative relationship can be attributed to the level of foreign ownership among Malaysian firms. The median of the foreign ownership was 2%, unlike the 28% and 30% reported for the family and management ownership respectively. Given the lack of strong ownership may hamper the foreign investors' intention to control the firm and influence its level of information disclosure. This is consistent with the Desender et al. (2014) and Lskavyan and Spatareanu (2011) that foreign investors survive in countries with weak legal investor protection through substantial equity ownership. The strong commitment and increased monitoring role of foreign ownership documented in prior studies are associated with the large foreign investors. Therefore, small foreign ownership may not yield the benefits obtainable from large foreign ownership. H1a₁₀ which states that there is a significant positive relationship between foreign ownership and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

The next set of variables assessed in this study as determinants of compliance with the disclosure requirements of the accounting standard on RPTs are the firm financial characteristics. These variables are categorized into RPT motive and firm

performance. The variables considered under the RPT motive are tunneling and propping. Following prior studies such as Black et al. (2015), Cheung, Jing, et al. (2009) and Lei and Song (2011), this study hypothesized a negative relationship between tunneling (Tunn) and compliance with the disclosure requirements of the accounting standard on RPTs. Nonetheless, the results as presented in Table 6.13 was positive and insignificant. This indicates absent of statistically significant relationship between tunneling and compliance with the requirements of the accounting standard on RPTs. Hence H1b₁ which states that there is a significant negative relationship between tunneling and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

The possible reason for this finding might be the nature of the information released to the market which makes it difficult to identify firms with the tunneling RPTs. This position is supported by Xiao and Zhao (2014) who believed that even though Chinese Securities Regulatory Commission has required all listed companies to disclose all RPTs in their financial reports, in practice, most of these firms do not comply with those requirements. This practice makes the finding of this study to be at par with the Lou et al. (2014) that capital market react indifferently to the announcement of any form of RPTs.

Peng et al. (2011) find that capital market reacts favorably to the announcement of propping transactions. Similarly, Cheung et al. (2009) find that RPTs related to propping activities are accompanied with significant information disclosure. Based on these, the study hypothesized a positive relationship between propping (Prop) and the level of compliance with the disclosure requirements of the accounting standard on RPTs. Though the result from this study is positive as expected, the relationship was

found to be insignificant. This implies the absence of the strong relationship between propping and the level of compliance with the requirements of the accounting standard on RPTs. Hence H1b₂ which states that there is a significant positive relationship between propping and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

Several performance proxies are used concurrently in the regression model to assess their influence in defining the firm disclosure practice. The proxies are profitability (ROA), firm growth (MTV) and dividend payment (Divi). The coefficient of the profitability was negative and significant at 5%. This is consistent with the Samaha et al. (2012) and Sodikin (2013) that document a negative relationship between profitability and corporate disclosure practice. The possible explanation of this might be that firms involve in RPTs to manipulate their operational capacity and present exciting performance. It is expected that detailed disclosure may expose the internal arrangements. Thus, firms provide less information on the RPTs to avoid market reaction and regulatory sanctions. Another possible reason for this can be seen from the overall goal of rational investors. It is argued that once the profit is made, many investors may not be interested in the detail information on the process and source of that profit. Therefore, profitable firms have less pressure on the volume of information required to satisfy the information needs of the users of the financial statement. The practice saves the firms from the potential conflicts with the workers, regulatory bodies and other government agencies. Hence H1b₃ which states that there is a significant positive relationship between firm profitability and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

The coefficient of MTV was positive and significant at 1%. This finding is consistent with the Gul and Leung (2004) and Soon Yau et al. (2009) that document a positive relationship between firm growth with the voluntary corporate and intellectual capital disclosure respectively. Firms with the high growth potentials disclose more information to reduce the information asymmetric (Chau and Gray 2010; Huafang and Jianguo 2007). Therefore, high growing firm have to disclose more information to convince the market that the stock growth was based on fundamentals. H1b₄ which states that there is a significant positive relationship between firm growth potential and compliance with the disclosure requirements of the accounting standard on RPTs is accepted.

Based on agency theory, dividend payment is used to wipe out the excess cash from the management and minimize the agency conflict. Dividends were used as a substitute for financial reporting transparency during unregulated disclosure period (Van Overfelt et al., 2010). Therefore, it is hypothesized that dividend payment improves the firm level of disclosure during regulated disclosure period. The result as presented in Table 6.13 was positive as expected, but not statistically significant, thus not supporting the hypothesis. This might be the effect of the dominance ownership where ownership and control lay within the party. Therefore dividend policy may not increase the agency cost in those firms. Hence H1b₅ which states that there is a significant positive relationship between dividend payment and compliance with the disclosure requirements of the accounting standard on RPTs is rejected.

The comparison between the expected and actual results of the study are presented in the table 6.14. In summary, out of the fifteen variables tested in the study, seven variables support the research hypotheses while the remaining do not. More specific,

of the remaining eight, five variables are insignificant while the remaining three have the opposite sign with the research expectations.

Table 6.14

Comparison between expected and actual results

	Acronym	Expected result	Actual result	Decision
Corporate Governance				
Board Characteristics				
• Board independence	Bind	+	+	Accepted
• Board size	Bsize	+	-	Rejected
Audit Committee Characteristics				
• Audit committee independence	Aind	+	-	Rejected
• Audit committee financial expertise	Aexp	+	+	Accepted
CEO Characteristics				
• CEO expertise	Cexp	+	Insign.	Rejected.
• CEO Family lineage	Cfml	-	-	Accepted
• CEO ownership	Cown	-	-	Accepted
Ownership Structure				
• Family ownership	Mown	-	+	Rejected
• Management ownership	Fmown	+	+	Accepted
• Foreign ownership	Frown	+	-	Rejected
Firm Financial Characteristics				
RPT Motive				
• Tunneling	Tunn	-	Insig.	Rejected
• Propping	Prop	+	Insig.	Rejected
Firm Performance				
• Profitability	ROA	+	-	Rejected
• Firm growth	MTV	+	+	Accepted
• Dividend payments	Divi	+	Insig.	Rejected

Insig = Insignificant

6.3 Additional Analyses

6.3.1 Alternative Sampling Pattern (Sample Size)

To ensure the findings are free from unwanted bias, robustness checks were conducted to confirm that the results of the regression are insensitive to the sample partitioning or increase in the volume of RPTs. Inchausti (1997) and Street and Gray (2002)

document that industry type influences the firm level of information disclosure. Based on this, the sample was divided into manufacturing and non-manufacturing firms. Thus, manufacturing firms are subjected to further analysis to determine whether similar results can derive from the use of manufacturing firm alone. The total firm-year observations for the study are 654 observations. Out of this number, 501 firm-year observations belong to manufacturing industries while the remaining 153 firm-year observations belong to non-manufacturing industries as presented in table 6.6. Based on this, this section used the 501 firm-year observations for the additional analyses. In addition, the size of RPT was increased to 30% to test whether the volume of RPT influences the firm compliance with the disclosure requirements of the accounting standard on RPTs. This process generated the 417 firm-year observations for further regression analysis.

Table 6.15 presents and compares the results of the main and additional analyses. The results of the initial model (Model 1 for the full sample as explained above) were presented and compared with the results from the Model 2 (manufacturing firms), Model 3 (for firms with the trading RPTs of up to 30% of the total revenue).

In general, the results from the additional tests are substantially similar to the results of the main findings. The results are robust to all the research variables adopted. None of the corporate governance variables (with exception of Cexp) that changes the sign in the additional tests indicating that the same pattern of relationship has been arrived at throughout the additional tests. Though Cexp was not statistically significant in model 1 and model 2, it becomes negative and significant at 5% when the volume of RPTs was increased to 30%. This implies that as the volume of RPTs increases, the CEOs with financial expertise tend to reduce the volume of information disclosure or

the level of compliance with the requirements of the accounting standard on RPTs. This signal fishy transactions that need further investigation to identify the logic or motive behind such reduction in the level of information disclosure. Besides, managerial ownership (Mown) is statistically insignificant in Model 2 while foreign ownership (Frown) is statistically insignificant in the both additional tests, though the variables retain their respective signs across all the three tests.



Table 6.15
Results of the Alternative Sampling Pattern (Sample Size)

	Model 1 Coefficient (t-value)	Model 2 Coefficient (t-value)	Model 3 Coefficient (t-value)
Constant	0.338 (8.57)***	0.406 (8.95)***	0.269 (5.69)***
Bind	0.087 (2.66)***	0.099 (2.55)***	0.141 (3.76)***
Bsize	-0.003 (1.56)*	-0.004 (2.12)**	-0.000 (0.14)
Aind	-0.030 (2.56)***	-0.029 (2.25)**	-0.046 (3.39)***
Aexp	0.073 (3.09)***	0.077 (3.16)***	0.097 (3.53)***
Cexp	0.001 (0.22)	0.003 (0.42)	-0.017 (2.09)**
Cfml	-0.022 (2.44)***	-0.055 (5.35)***	-0.032 (2.71)***
Cown	-0.089 (3.90)***	-0.052 (2.00)**	-0.028 (1.01)
Fmown	0.038 (2.06)**	0.091 (4.07)***	0.054 (2.42)***
Mown	0.073 (3.19)***	0.015 (0.55)	0.034 (1.29)*
Frown	-0.029 (1.77)**	-0.004 (0.21)	-0.005 (0.23)
Tunn	0.005 (0.49)	0.001 (0.01)	0.002 (0.17)
Prop	0.009 (0.85)	0.003 (0.29)	0.013 (1.09)
ROA	-0.064 (2.34)**	-0.071 (2.12)**	-0.016 (1.55)*
MTV	0.012 (2.67)***	0.023 (4.29)***	0.010 (1.86)**
Divi	0.008 (0.21)	-0.058 (1.39)*	-0.019 (0.39)
Size	0.024 (9.93)***	0.022 (7.57)***	0.025 (8.38)***
Audi	-0.001 (0.16)	-0.012 (1.49)*	0.015 (1.79)**
MCCG	-0.016 (2.40)**	-0.027 (3.79)***	-0.019 (2.42)***
<i>Adj R²</i>	0.20	0.26	0.25
<i>F-stat</i>	10.12***	10.41***	8.84***
<i>R²</i>	0.22	0.28	0.29
<i>N</i>	654	501	417

Equation (1) $Dsocre = \beta_0 + \beta_1 Bind + \beta_2 Bsize + \beta_3 Aind + \beta_4 Aexp + \beta_5 Cexp + \beta_6 Cfam + \beta_7 Cown + \beta_8 Fmown + \beta_9 Mown + \beta_{10} Frown + \beta_{11} Tunn + \beta_{12} Prop + \beta_{13} ROA + \beta_{14} MTV + \beta_{15} Divi + \beta_{16} Size + \beta_{17} Audi + \beta_{18} MCCG + \epsilon$. Variables as previously defined. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

On the firm financial characteristics, all the variables under the RPT motive (Tunn and Prop) produced results similar to those reported in the main regression. Equally, the variables under firm performance (ROA, MTV and Divi) have materially maintained

the position in terms of sign and statistical significance. The few exceptions are that the sign of the Divi that turns to negative in both additional tests and significant in model 2.

The sign and the statistical level of significance of the firm size remain the same across the three models. Similar results have been arrived at with respect to MCCG except for the level of significance that increased from 5% to 1% in the additional tests. Conversely, for audit quality variable (Audi) the sign turns to positive and significant at 5% in model 3. This validates the insight in the descriptive and univariate analyses as presented in table 6.7 and table 6.9 respectively which highlighted the role of audit quality in explaining the firm compliance with the disclosure requirements of the accounting standard on RPTs. The practical implication of this finding is of much interest. This is because it reveals that Big auditing firms scrutinize and influences the level of RPTs disclosure in the firms with a high volume of RPTs. However, their influence is less visible (as revealed by model 1 and model 2) in the firm with the low RPT, which may be detrimental to the users of the financial statement of those firms.

6.3.2 Alternative Models without Strongly Correlated Variables

Some additional regressions are conducted to check whether the strong correlation among some of the research variables influences the coefficients and level of significance of the main regression estimation. As presented in table 6.9 the coefficients of the correlation between Aind and Aexp and that of the Fmown and Mown are 0.8196 and 0.6147 respectively. Hence, it will be interested to check if these strong correlations affect the consistency of the initial findings. Based on this, separate estimations are run by removing one of the variables identified with the strong

correlation with the other variable. Generally, the results from the new regressions are substantially similar with that of the main analysis. The sign of the coefficients of variables across all the four new regressions remain the same with those presented in the main analysis save for slight changes in the parameters. Nevertheless, little variations are noticed with regards to the level of significance in the new regressions.

Table 6.16 presents the results of the regressions after the removal of some selected variables. The second column of Table 6.16 contains the results of the main analysis to ease comparison. The results presented in the third column were arrived at after removing the Aexp from the list of the variables used in the main analysis. The major difference with the main analysis is that Aind is not statistically significant in the new regression as against the 1% level of significance recorded in the main regression. Similarly, Frown and ROA are statistically significant at 1% in the new regression while the level of significance was at 5% in the main regression.

The results of the regression after the exclusion of the Aind from the variables used in the main analysis are presented in the fourth column of table 6.16. The major variations with the main analysis are that Bsize is statistically significant at 5% against the 10% recorded in the main regression. Similarly, the statistical level of significance of the ROA has increased to 1% from the 5% recorded in the main analysis. However, the statistical level of significance of the Bind and Aexp has decreased to 5% from the 1% recorded in the main analysis.

Table 6.16

Results of the Alternative Models without Strongly Correlated Variables

	Main	Without Aexp	Without Aind	Without Mown	Without Fown
Constant	0.338 (8.57)***	0.386 (10.62)***	0.381 (10.68)***	0.353 (8.98)***	0.331 (8.41)***
Bind	0.087 (2.66)***	0.083 (2.52)***	0.064 (2.03)**	0.071 (2.18)**	0.093 (2.84)***
Bsize	-0.003 (1.56)*	-0.003 (1.60)*	-0.004 (1.94)**	-0.003 (1.48)*	-0.003 (1.65)**
Aind	-0.030 (2.56)***	-0.001 (0.17)		-0.029 (2.43)***	-0.031 (2.56)***
Aexp	0.073 (3.09)***		0.025 (1.74)**	0.071 (2.99)***	0.074 (3.14)***
Cexp	0.001 (0.22)	0.001 (0.09)	0.001 (0.18)	-0.000 (0.00)	0.003 (0.48)
Cfml	-0.022 (2.44)***	-0.023 (2.55)***	-0.021 (2.31)**	-0.024 (2.57)***	-0.012 (1.57)*
Cown	-0.089 (3.90)***	-0.093 (4.05)***	-0.095 (4.17)***	-0.043 (2.41)***	-0.092 (4.01)***
Fmown	0.038 (2.06)**	0.040 (2.13)**	0.038 (2.07)**	0.061 (3.54)***	
Mown	0.073 (3.19)***	0.071 (3.09)***	0.071 (3.09)***		0.091 (4.31)***
Frown	-0.029 (1.77)**	-0.038 (2.34)***	-0.035 (2.09)**	-0.028 (1.68)**	-0.028 (1.70)**
Tunn	0.005 (0.49)	0.005 (0.52)	0.005 (0.55)	0.007 (0.71)	0.006 (0.57)
Prop	0.009 (0.85)	0.006 (0.58)	0.007 (0.71)	0.010 (0.99)	0.009 (0.86)
ROA	-0.064 (2.34)**	-0.074 (2.73)***	-0.073 (2.71)***	-0.061 (2.21)**	-0.066 (2.43)***
MTV	0.012 (2.67)***	0.014 (2.91)***	0.013 (2.90)***	0.011 (2.44)***	0.012 (2.48)***
Divi	0.008 (0.21)	0.014 (0.37)	0.019 (0.51)	-0.002 (0.04)	0.009 (0.24)
Size	0.024 (9.93)***	0.024 (9.91)***	0.024 (9.80)***	0.024 (9.77)***	0.024 (10.04)***
Audi	-0.001 (0.16)	-0.001 (0.18)	-0.002 (0.26)	-0.003 (0.37)	-0.000 (0.01)
MCCG	-0.016 (2.40)**	-0.015 (2.25)**	-0.015 (2.29)**	-0.015 (2.27)**	-0.016 (2.45)***
R^2	0.22	0.21	0.21	0.21	0.22
Adj R^2	0.20	0.19	0.19	0.19	0.20
F -stat	10.12***	10.02***	10.24***	9.997***	10.41***
N	654	654	654	654	654

[Main equation (1)] $Dscore = \beta_0 + \beta_1 Bind + \beta_2 Bsize + \beta_3 Aind + \beta_4 Aexp + \beta_5 Cexp + \beta_6 Cfam + \beta_7 Cown + \beta_8 Fmown + \beta_9 Mown + \beta_{10} Frown + \beta_{11} Tunn + \beta_{12} Prop + \beta_{13} ROA + \beta_{14} MTV + \beta_{15} Divi + \beta_{16} Size + \beta_{17} Audi + \beta_{18} MCCG + \epsilon$; [Without Aexp] $Dscore = \beta_0 + \beta_1 Bind + \beta_2 Bsize + \beta_3 Aind + \beta_4 Cexp + \beta_5 Cfam + \beta_6 Cown + \beta_7 Fmown + \beta_8 Mown + \beta_9 Frown + \beta_{10} Tunn + \beta_{11} Prop + \beta_{12} ROA + \beta_{13} MTV + \beta_{14} Divi + \beta_{15} Size + \beta_{16} Audi + \beta_{17} MCCG + \epsilon$; [Without Aind] $Dscore = \beta_0 + \beta_1 Bind + \beta_2 Bsize + \beta_3 Aexp + \beta_4 Cexp + \beta_5 Cfam + \beta_6 Cown + \beta_7 Fmown + \beta_8 Mown + \beta_9 Frown + \beta_{10} Tunn + \beta_{11} Prop + \beta_{12} ROA + \beta_{13} MTV + \beta_{14} Divi + \beta_{15} Size + \beta_{16} Audi + \beta_{17} MCCG + \epsilon$; [Without Mown] $Dscore = \beta_0 + \beta_1 Bind + \beta_2 Bsize + \beta_3 Aind + \beta_4 Aexp + \beta_5 Cexp + \beta_6 Cfam + \beta_7 Cown + \beta_8 Fmown + \beta_9 Frown + \beta_{10} Tunn + \beta_{11} Prop + \beta_{12} ROA + \beta_{13} MTV + \beta_{14} Divi + \beta_{15} Size + \beta_{16} Audi + \beta_{17} MCCG + \epsilon$; [Without Fmown] Equation (1) $Dscore = \beta_0 + \beta_1 Bind + \beta_2 Bsize + \beta_3 Aind + \beta_4 Aexp + \beta_5 Cexp + \beta_6 Cfam + \beta_7 Cown + \beta_8 Fmown + \beta_9 Frown + \beta_{10} Tunn + \beta_{11} Prop + \beta_{12} ROA + \beta_{13} MTV + \beta_{14} Divi + \beta_{15} Size + \beta_{16} Audi + \beta_{17} MCCG + \epsilon$; Variables as previously defined. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

The fifth column in table 6.16 presents the results of the regressions after the exclusion of the Mown from the list of the variables used in the main analysis. The major difference with the main analysis is that the level of significance of Bind in the new regression has decreased to 5% from the 1% recorded in the main analysis. Nevertheless, the level of significance of the Fmown has increased to 1% in the new regression from the 5% recorded in the main analysis.

The last column in table 6.16 presents the results of the regressions after the exclusion of the Mown from the list of the variables used in the main analysis. The major difference with the main analysis is that Bsize is statistically significant at 5% against the 10% recorded in the main regression. Similarly, the statistical significance of ROA and MCCG have increased to 1% from the 5% recorded in the main regression. However, when the Fown was removed from the model, Cfml becomes significant only at 10% in the model. The implication of this finding is that absent of family ownership undermines the influence of the Cfml in explaining corporate disclosure behavior.

6.3.3 Alternative Measures of Independent Variables

Some variables from both corporate governance mechanisms and firm financial characteristics are selected for additional sensitivity analyses. In the main analysis, Aexp and Fmown are considered as continuous variables. Hence, in this sensitivity analyses, these variables are measured as dummy variables. Similarly, because of the problem associated with the measurement of tunneling and propping in the literature, the variables were measured in the main analyses using the ROE threshold of more than 10% to denote tunneling and less than 6% to denote propping. Extant literature

does not provide a clear measure of tunneling and propping because of the complexities in identifying tunneling and propping transactions. In this sensitivity check, the study employs the event study technique for the window period of -10, +10 days from the RPTs announcement date to determine the cumulative abnormal returns as a result of the announcement of RPTs using the 21 days window period. The selection of 21 days window is justified by Ismail and Manaf (2016) that used 21 days window in their study. Similarly, Ishak and Abdul Latif (2012) find significant market reaction to new information within the same window period. Transactions with negative cumulative abnormal return (CAR) are regarded as tunneling transactions because they are value-destroying transactions. Similarly, transactions with the firms with the small positive profits are considered as an attempt by the controlling party to inject resources to those firms to avoid reporting a small loss. Hence, these transactions are regarded as propping transactions.

Table 6.17 presents the results of the regression for the sensitivity checks. The signs of the coefficients and the parameters of the sensitivity model remain similar to those of the main analyses. The major exception is MTV which was positive and significant at 1% in the main analyses but turns to negative and significant at 1% in the sensitivity check. More on this, although the coefficient of the Aind remains negative, the variables become insignificant in the sensitivity check. The statistical significance of Cfml and ROA has decreased to 5% and 10% respectively from the 1% and 5% respectively recorded in the main regression.

Table 6.17

Results of the Alternative Measures of Independent Variables

Dscore	Main	Alternate measures
Contant	0.338 (8.57)***	0.378 (10.58)***
Bind	0.087 (2.66)***	0.106 (3.15)***
Bsize	-0.003 (1.56)*	-0.003 (1.31)*
Aind	-0.030 (2.56)***	-0.003 (0.36)
Aexp	0.073 (3.09)***	0.022 (2.87)***
Cexp	0.001 (0.22)	0.004 (0.64)
Cfml	-0.022 (2.44)***	-0.020 (2.12)**
Cown	-0.089 (3.90)***	-0.076 (3.27)***
Fmown	0.038 (2.06)**	0.017 (1.77)**
Mown	0.073 (3.19)***	0.074 (3.22)***
Frown	-0.029 (1.77)**	-0.034 (2.05)**
Tunn	0.005 (0.49)	0.005 (0.66)
Prop	0.009 (0.85)	0.006 (0.76)
ROA	-0.064 (2.34)**	-0.017 (1.57)*
MTV	0.012 (2.67)***	-0.008 (3.19)***
Divi	0.008 (0.21)	0.010 (0.95)
Size	0.024 (9.93)***	0.024 (9.37)***
Audi	-0.001 (0.16)	-0.001 (0.19)
MCCG	-0.016 (2.40)**	-0.013 (1.95)**
R^2	0.22	0.19
Adj R^2	0.20	0.17
F -stat	10.12***	8.30***
N	654	654

Equation (1) $Dscore = \beta_0 + \beta_1 Bind + \beta_2 Bsize + \beta_3 Aind + \beta_4 Aexp + \beta_5 Cexp + \beta_6 Cfml + \beta_7 Cown + \beta_8 Fmown + \beta_9 Mown + \beta_{10} Frown + \beta_{11} Tunn + \beta_{12} Prop + \beta_{13} ROA + \beta_{14} MTV + \beta_{15} Divi + \beta_{16} Size + \beta_{17} Audi + \beta_{18} MCCG + \epsilon$. Variables as previously defined. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

6.4 Summary of the Chapter

The chapter presents the findings and the interpretations of the extent of compliance and the determinants of compliance with the disclosure requirements of the accounting

standards on RPTs. The variables used are drawn from the corporate governance mechanisms and firm financial characteristics. Overall, the results indicate moderate compliance with the disclosure requirements of the accounting standards on RPTs. Firms listed on Bursa Malaysia comply with the most of the disclosure requirements on the transaction-based disclosures. However, the level of compliance with the non-transaction-based disclosure requirements is obviously low.

The study provides evidence that board independence and audit committee financial expertise improve the firm's compliance with the disclosure requirements of the accounting standard on RPTs. Similarly, family and managerial ownerships are associated with the high level of compliance with the disclosure requirements of the accounting standard on RPTs. This is the result of the alignment effect because of the concentrated ownership associated with the Malaysian firms. On the contrary, CEO ownership and family lineage affect the firm compliance with the disclosure requirements of the accounting standard on RPTs negatively. The practice signals shady deals in a firm with higher CEO ownership.

Firms with high market growth are associated with the high compliance with the disclosure requirements of the accounting standard on RPTs. This is to provide justifications that the stock price is not overvalued. Similarly, firms with high growth disclose more information to lower the future cost of capital as many studies believed that disclosure reduces the information asymmetry and lower the cost of capital. Contrarily, firm profitability influences the firm's compliance with the disclosure requirements of the accounting standard on RPTs negatively. This shows that firms involve in RPTs to manipulate their operational capacity and present exciting

performance. The study documents no evidence that dividend payment affects the firm's compliance with the accounting standard on RPTs.



CHAPTER SEVEN

ANALYSIS AND INTERPRETATION II

VALUE-RELEVANCE AND REAL EARNINGS MANAGEMENT

7.0 Introduction

This chapter presents the second part of the analyses and interpretations of the study. The first part covers the extent of and determinants of compliance with the disclosure requirements of the accounting standard on RPTs. This second part of the study covers the analyses and interpretations of the value-relevance of MFRS 124 disclosure, the relationship between REM in RPTs and firm value and the moderating effect of compliance with disclosure requirements on RPTs on the relationship between REM in RPTs and firm value.

7.1 Value-Relevance of MFRS 124 Compliance

This section presents the analyses and interpretation of findings of the tests conducted to determine whether RPTs disclosure is value-relevant and if mandatory adoption of MFRS 124 has increased the value-relevance of the disclosed RPTs.

7.1.1 Descriptive Statistics

Table 7.1 presents the summary statistics for the variables for the combined, pre and post-MFRS 124 adoption periods. The mean, median and standard deviation of the market value per share (MVPS) for the post-MFRS adoption period are 2.0330, 0.7100 and 5.8206. These values are higher than the corresponding mean, median and standard deviation for the combined (1.6810, 0.6000 and 4.8283 respectively) and pre-

MFRS adoption (1.3290, 0.4960 and 3.5382 respectively) periods. This indicates that the stock prices have witnessed some level of appreciation after the mandatory adoption of MFRS.

Interestingly, a similar pattern has been recorded in the mean, median and the standard deviation of the book value per share (BVPS) and earnings per share (EPS). The mean, median and standard deviation of the BVPS for the post-MFRS adoption period are 1.3885, 0.9060 and 1.6576 respectively. These values are higher than the corresponding values 1.1739, 0.8040 and 1.3700 for the pre-MFRS adoption period and 1.2812, 0.8535 and 1.5241 for the combined period. Likewise, the mean, median and standard deviation of the EPS for the post-MFRS adoption period are 0.1177, 0.0380 and 0.5363 respectively. These values are higher than the corresponding values 0.1039, 0.0460 and 0.2655 reported for the pre-MFRS adoption period and 0.1108, 0.0430 and 0.4231 for the combined period. These figures provide initial insight that stock market responses to the disclosure of accounting information. In other words, the pattern can be seen as an early evidence that BVPS and EPS are value-relevant.

Further investigation on the trend of the mean of MVPS, BVPS and EPS reveals that the stock market is healthier and more responsive to EPS in the post-MFRS adoption period. This is because a slight increase of 0.0138 (0.1177-0.1039) in the EPS in the post-MFRS adoption period resulted in the wider difference 0.704 (2.0330-1.3290) in the MVPS for the post-MFRS adoption period. The difference in the mean of MVPS and BVPS during the post-MFRS adoption period is 0.6445 (2.0330-1.3885) which is greater than 0.1551 (1.3290-1.1739) and 0.3998 (1.6810-1.2812) for the pre-MFRS adoption and combined periods respectively. The summary statistics of the RPTs variables of interaction (BVPS*RPTfirms and EPS*RPTfirms) are not materially

different from that of the basic variables. This indicates that a part of the general improvement in MFRS adoption, MFRS 124 on RPTs disclosure has incremental value-relevance in the post-adoption era.

Table 7.1
Descriptive Statistics of the Variables of Value-Relevance

	Combined			Pre-MFRS			Post-MFRS		
	Mean	Median	St. Dev	Mean	Median	St. Dev	Mean	Median	St. Dev
MVPS	1.6810	0.6000	4.8283	1.3290	0.4960	3.5382	2.0330	0.7100	5.8206
BVPS	1.2812	0.8535	1.5241	1.1739	0.8040	1.3700	1.3885	0.9060	1.6576
EPS	0.1108	0.0430	0.4231	0.1039	0.0460	0.2655	0.1177	0.0380	0.5363
BVPS*RPTfirms	0.4488	0.0000	1.3607	0.4065	0.0000	1.2169	0.4912	0.0000	1.4900
EPS*RPTfirms	0.0450	0.0000	0.2214	0.0431	0.0000	0.1911	0.0469	0.0000	0.2480
RPTfirms	0.2407	0.0000	0.4276	0.2430	0.0000	0.4291	0.2385	0.0000	0.4263
Return	0.2454	0.1457	0.6030	0.3165	0.1955	0.7168	0.1744	0.0907	0.4512
NetIncome	0.0454	0.0634	0.6121	0.0462	0.0803	0.5352	0.0446	0.0495	0.6805
ChngNetIncome	0.0350	0.0042	0.6776	0.0558	0.0102	0.6040	0.0143	0.0011	0.7437
NetIncome*RPTFirms	0.0573	0.0000	1.6017	0.0997	0.0000	2.2541	0.0150	0.0000	0.2212
ChngNetIncome*RPT Firms	0.0047	0.0000	0.2294	0.0093	0.0000	0.3019	0.0001	0.0000	0.1188

MVPS = Market Value per Share of firm 3 months after the financial year-end; BVPS = Book Value per Share of firm; EPS = Accounting Earning per Share of firm; RPTfirms = Dummy variable set equal to one for firms with RPTs disclosures, zero for otherwise; BVPS*RPTfirms = BVPS * RPTfirms; EPS*RPTfirms = EPS * RPTfirms; Returns = (Price of firm i in month t – Price of firm i in month t–1)/Price of firm i in month t–1. Returns are accumulated during the 12-month period covering trading months, preceding March 31st of each year; NetIncome = Net earnings for firm i in year t /Market value of equity in t–1; ChngNetIncome = (Net earnings for firm i in year t – Net earnings for firm i in year t –1) / Market value of equity in t–1; NetIncome*RPTFirms = NetIncome * RPTfirms and ChngNetIncome*RPTFirms = ChngNetIncome * RPTfirms.

The widening gap between the mean of BVPS and MVPS for the periods is an indicator for the decrease in the value-relevance of BVPS. This is because, the closer the BVPS to the MVPS the higher the contribution in influencing the stock price which signals less operating earnings to a firm. Darrough and Ye (2007) state that when the past or current earnings have no implication to the future earnings, then the MVPS equates the BVPS. Barth et al. (1998) have found that the financial health of the firm decreases when the explanatory power of its earnings (book-value) decreases

(increases). Therefore, the trend of the MVPS, BVPS and EPS denote an increase in the financial health of the firms in the MFRS post-adoption period.

The descriptive analyses of the return model variables highlight the decrease in the market return. The average return for the post-MFRS adoption period was 0.1744 which is less than (0.3165 and 0.2454) the mean of the return during the pre-MFRS and combined era. This might be the result of the increases in the scaling factor (price in $t-1$) in arriving at the return for the period. A similar pattern has been witnessed in the Net Income (NetIncome), changes in net income (ChngNetIncome), net income of RPT firms (NetIncom*RPTfirms) and changes in net income of RPT firms (ChngNetIncome*RPTFirms).

7.1.2 Univariate Analysis

Table 7.2 presents the correlation matrix for the value-relevance variables. In general, correlations between variables are considered moderate with the highest being 0.7126. Therefore, it can be said that there is less severe multicollinearity issue. Panel A presents the Pearson correlation matrix for the combined period. The correlation matrix reveals that the relationships between the dependent variable (MVPS) with the BVPS and EPS are positive. However, the relationship is stronger with the EPS (0.5693) than the BVPS (0.4020). The same positive association have been recorded for the BVPS*RPTfirms and EPS*RPTfirms. The correlation coefficient for EPS*RPTfirms was 0.5769 which was the highest between the MVPS and other variables. The coefficient of the association between BVPS*RPTfirms and MVPS was 0.3539. MVPS was positively (0.1664) correlated with the RPTfirms which was the

least between MVPS and other variables. All the relationships among the price model variables are significant at 1%.

On the return model where stock return serves as a dependent variable, its relationship with the NetIncome was positive and significant at 1%. This provides initial prove that the return on the stock of the firms listed in Bursa Malaysia is determined by the net profit of the firm. ChngNetIncome was also having a significant positive association with the stock return at 1% significance level. This implies that as the firm operating performance increases, such increase was reflected in the return of the stock of that firm, so also when the reverse is the case. On the relationship between stock return and the NetIncom*RPTfirms, the univariate result reveals absent of significant association between the variables. However, the relationship between stock return with the ChngNetIncome*RPTFirms was positive and significant at 1%. This indicates that ChngNetIncome*RPTFirms can influential in defining the variability of the stock return.

Table 7.2
Correlation Matrix of the Value-Relevance variables
Panel A (Pearson correlation for the combined period)

	MVPS	BVPS	EPS	BVPS* RPTfirms	EPS* RPTfirms	RPTfirms	Return	NetIncome	Chng NetIncome	NetIncome* RPTfirms	ChngNetIncome* RPTfirms
MVPS											
BVPS	0.4020***										
EPS	0.5693***	0.3302***									
BVPS*RPTfirms	0.3539***	0.7126***	0.2542***								
EPS*RPTfirms	0.5769***	0.4103***	0.4916***	0.5840***							
RPTfirms	0.1664***	0.2155***	0.1013***	0.5859***	0.3610***						
Return	-0.0789***	-0.1038***	-0.0041	-0.0359*	0.0067	0.0182					
NetIncome	0.0117	0.0657***	0.1959***	0.0272	0.0781***	-0.0157	0.1005***				
ChngNetIncome	-0.0156	-0.026	0.1218***	-0.0116	0.033	-0.0129	0.1356***	0.7141***			
NetIncome*RPTFirms	-0.0108	-0.0263	-0.0321	-0.0075	-0.0506**	0.0636***	-0.0015	-0.3373***	-0.1663***		
ChngNetIncome*RPTFirms	-0.0037	-0.0027	0.0619***	0.0095	0.1243***	0.0362*	0.1091***	0.1640***	0.3376***	-0.4866***	

MVPS = Market Value per Share of firm 3 months after the financial year-end; BVPS = Book Value per Share of firm; EPS = Accounting Earning per Share of firm; RPTfirms = Dummy variable set equal to one for firms with RPTs disclosures, zero for otherwise; BVPS*RPTfirms = BVPS * RPTfirms; EPS*RPTfirms = EPS * RPTfirms; Returns = (Price of firm i in month t – Price of firm i in month t–1)/Price of firm i in month t–1. Returns are accumulated during the 12-month period covering trading months, preceding March 31st of each year; NetIncome = Net earnings for firm i in year t /Market value of equity in t–1; ChngNetIncome = (Net earnings for firm i in year t – Net earnings for firm i in year t –1) / Market value of equity in t–1; NetIncome*RPTFirms = NetIncome * RPTfirms and ChngNetIncome*RPTFirms = ChngNetIncome * RPTfirms. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

Table 7.2 *Continued*

Panel B (Pre-MFRS correlation in the lower diagonal and Post-MFRS correlation in the upper diagonal)

	MVPS	BVPS	EPS	BVPS* RPTfirms	EPS* RPTfirms	RPTfirms	Return	NetIncome	Chng NetIncome	NetIncom* RPTfirms	ChngNetIncom E*RPTfirms
MVPS		0.3842***	0.5069***	0.3402***	0.5982***	0.1798***	-0.0920***	0.0066	-0.0072	-0.0159	0.0016
BVPS	0.4407***		0.2550***	0.7203***	0.3438***	0.2267***	-0.1153***	0.0452	-0.0146	0.0258	0.0196
EPS	0.7875***	0.5442***		0.1860***	0.4374***	0.0824***	-0.0167	0.1347***	0.0969***	-0.0338	0.1069***
BVPS*RPTfirms	0.3883***	0.7010***	0.4445***		0.4964***	0.5893***	-0.059**	0.016	-0.0028	0.0122	0.0221
EPS*RPTfirms	0.5455***	0.5165***	0.6683***	0.7237***		0.3381***	0.0021	0.047	0.0333	-0.0538*	0.2313***
RPTfirms	0.1601***	0.2064***	0.1566***	0.5898***	0.3980***		0.0183	-0.0004	-0.0105	0.1211***	0.001
Return	-0.0663**	-0.0910***	0.0156	-0.0153	0.0133	0.018		0.1215***	0.1151***	-0.0544*	0.1296***
NetIncome	0.0231	0.0979***	0.3686***	0.0449	0.1294***	-0.0352	0.0960***		0.8225***	-0.1279***	0.1432***
ChngNetIncome	-0.0264	-0.0379	0.1966***	-0.0225	0.0332	-0.0165	0.1601***	0.5454***		-0.1059***	0.1598***
NetIncome*RPTFirms	-0.0147	-0.0355	-0.065**	-0.0121	-0.0761	0.0781***	-0.0021	-0.5326***	-0.2538***		-0.6550***
ChngNetIncome*RPTFirms	-0.0057	-0.0115	0.0657**	0.0065	0.1011***	0.0543	0.1044***	0.2134***	0.4974***	-0.5011***	

MVPS = Market Value per Share of firm 3 months after the financial year-end; BVPS = Book Value per Share of firm; EPS = Accounting Earning per Share of firm; RPTfirms = Dummy variable set equal to one for firms with RPTs disclosures, zero for otherwise; BVPS*RPTfirms = BVPS * RPTfirms; EPS*RPTfirms = EPS * RPTfirms; Returns = (Price of firm i in month t – Price of firm i in month t–1)/Price of firm i in month t–1. Returns are accumulated during the 12-month period covering trading months, preceding March 31st of each year; NetIncome = Net earnings for firm i in year t /Market value of equity in t–1; ChngNetIncome = (Net earnings for firm i in year t – Net earnings for firm i in year t –1) / Market value of equity in t–1; NetIncome*RPTFirms = NetIncome * RPTfirms and ChngNetIncome*RPTFirms = ChngNetIncome * RPTfirms. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

On the association of the NetIncom*RPTfirms and ChngNetIncome*RPTFirms with the return of that firm, the univariate analysis reveals the absence of a significant correlation with respect to NetIncom*RPTfirms. That is to say, the NetIncom*RPTfirms has little association the stock return. ChngNetIncome*RPTFirms was found to have a significant positive correlation with the stock return. However, these relationships are subject to validation in the multivariate and additional analyses.

Panel B of Table 7.2 presents the coefficients of the Pearson correlation for the pre-MFRS adoption (lower diagonal) and post-MFRS adoption (upper diagonal) periods. When the sample size was partitioned into pre and post-MFRS adoption period, the highest correlation between MVPS and other variables in the pre-adoption era was 0.7875 between MVPS and EPS while the lowest correlation was 0.3883 between MVPS and BVPS*RPTfirms. This provides an initial signal that even during the pre-adoption regime, the BVPS*RPTfirms has the weakest explanatory power on the stock price.

During post-adoption, the lowest correlation between MVPS and other variables was 0.3402 between MVPS and BVPS*RPTfirms while the highest correlation was 0.5982 between MVPS and EPS*RPTfirms. The lowest correlation can be seen as a sign of diminishing role of BVPS*RPTfirms while highest denotes the incremental power of the EPS*RPTfirms in explaining the stock price variability in the post-adoption period. Hence, the incremental value-relevance of EPS*RPTfirms recorded in the combined period was due to the increased value-relevance of EPS*RPTfirms achieved in the post-MFRS adoption period.

The univariate analyses of the return model variables reveal that the relationships among the variables in the pre-MFRS adoption period were similar to those reported for the combined period. That is to say, there are significant positive relationships at 1% level of significance between stock return and three other variables viz and NetIncome, ChngNetIncome and ChngNetIncome*RPTFirms. As reported earlier the relationship between return and NetIncom_RPTfirms was negative though not statistically significant.

The correlation among the variables in the post-MFRS adoption period was similar to pre-MFRS adoption period. The major exception was that the coefficient of the NetIncom*RPTfirms is significant in the former. This highlights that, even if the negative correlations between the variables in the pre-adoption and combined periods are not clear because of the noise in the relationships, the situation is clear in the post-adoption period that the NetIncom*RPTfirms has a negative correlation with the stock return. From this one can deduce that under return model stock market places more emphasis on the change in net income. This may be connected to fact that stock return was based on the changes in the stock price. Therefore, changes in the NetIncom*RPTfirms may not influence the variation in the return more than what ChngNetIncome*RPTFirms does. Yet, the results from the multivariate analyses may support or dispute this initial insight.

7.1.3 Multivariate Regression

As mentioned earlier in chapter five, this study uses the Ohlson (1995) price model and Easton and Harris (1991) return model to measure the value-relevance of RPTs disclosure and assess the changes in the value-relevance of such disclosures after the mandatory adoption of MFRS 124.

7.1.3.1 Price Model Regression

Table 7.3 presents the coefficients of the regressions for the value-relevance of MFRS 124 disclosure using the price model. The first and second models cover the whole period under review. The first model (RPT model) was used to test the value-relevance of the RPTs disclosure while the second model was used to test the value-relevance of the BVPS*RPTfirms and EPS*RPTfirms. The subsequent models namely third model and fourth model are used for the pre-MFRS adoption and post-MFRS adoption periods respectively. The models are employed to test the value-relevance of the BVPS*RPTfirms and EPS*RPTfirms in the pre and post-MFRS adoption periods.

In the first model, the coefficients of the model basic variables (BVPS and EPS) are positive and significant at 1%. Similarly, the coefficient of RPTFirms, the variable of interest in the model was positive (0.7711) and significant at 1%. This indicates that RPTs disclosure is value-relevant during the period under review. This is consistent with the previous studies on the value-relevance of individual accounting information. Wang and Hussainey (2013), Bepari et al. (2013) and Badenhorst et al. (2015) in their respective studies find that disclosure of forward-looking statement, cash flow from operations and summarized financial information of listed associates are value-relevant.

Table 7.3

Price Model Regression Result

	Model 1 RPTs		Model 2 Combined period		Model 3 Pre-MFRS period		Model 4 Post-MFRS period	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	-0.039	-0.36	0.2032	1.98**	0.2243	2.14***	0.1695	0.83
BVPS	0.717	12.5***	0.6765	8.71***	-0.0487	-0.62	0.8545	7.01***
EPS	5.565	27.46***	3.8454	18.18***	10.3658	28.16***	2.9182	10.69***
RPTfirms	0.771	3.98***	0.1877	0.81	0.1128	0.56	0.2972	0.74
BVPS*RPTfirms			-0.4260	-3.86***	0.1594	1.34	-0.4731	-2.81***
EPS*RPTfirms			8.4570	17.99***	-0.1794	-0.29	10.5534	16.03***
R ²	0.3799		0.4615		0.6223		0.4615	
F-stat (P-value)	451.30(0.000)		473.24(0.000)		362.86(0.000)		188.72(0.000)	
Observation	2214		2214		1107		1107	

Variables as defined above. Model 1 (RPT, 2009-2015) $MVPS = \alpha + \beta_1 BVPS + \beta_2 EPS + \beta_3 RPTfirms_{it} + \varepsilon$; Model 2 (combined period, 2009-2015) $MVPS = \alpha + \beta_1 BVPS + \beta_2 EPS + \beta_3 BVPS * RPTfirms + \beta_4 EPS * RPTfirms + \varepsilon$; Model 3 (pre-IFRS, 2009-2011) $MVPS = \alpha + \beta_1 BVPS + \beta_2 EPS + \beta_3 BVPS * RPTfirms + \beta_4 EPS * RPTfirms + \varepsilon$; Model 4 (post-IFRS, 2013-2015) $MVPS = \alpha + \beta_1 BVPS + \beta_2 EPS + \beta_3 BVPS * RPTfirms + \beta_4 EPS * RPTfirms + \varepsilon$. ***, **significance at 1% and 5% respectively.

The second model provides further analysis on the value-relevance of the BVPS*RPTfirms and EPS*RPTfirms for the combined period. Like the previous model, the coefficients of the model basic variables are positive and significant at 1%. The coefficient of the BVPS*RPTfirms was negative (-0.4260) and significant at 1%. The magnitude of the coefficient implies that investors place less attention of the historical value of the assets of RPT firms. In other words, the result indicates that BVPS*RPTfirms are less value-relevant. Conversely, the coefficient of the EPS*RPTfirms was positive (8.4570) and significant at 1%. Comparing the coefficient of the BVPS*RPTfirms and EPS*RPTfirms (-0.4260 and 8.4570) it is evident that the EPS*RPTfirms are more influential and relevant than the BVPS*RPTfirms in explaining the variation in the stock price of those firms.

Furthermore, the study period was partitioned into pre and post-MFRS adoption periods. The results presented in third and fourth models in table 7.3 are for the pre and post-MFRS adoption periods respectively. During the pre-MFRS adoption period, the coefficient of basic BVPS was negative but not significant. However, the coefficient of the basic EPS was positive and significant. On the coefficients of the variables of interest in the model, neither the coefficient of BVPS*RPTfirms nor that of EPS*RPTfirms was significant during the period. This indicates that both BVPS and EPS of RPTFirms are not value-relevant in the pre-MFRS adoption period.

The analysis of the fourth model (post adoption) reveals that the coefficients of the model basic variables are positive and significant at 1%. The coefficient of the first variable of interest in the model BVPS*RPTfirms was negative (-0.4731) and significant at 1%. Interestingly, the coefficient of the second variable of interest EPS*RPTfirms was positive (10.5534) and significant at 1%. This implies that after

the mandatory adoption of MFRS 124, the EPS*RPTfirms become more informative and satisfied the information needs of the users of financial reports. Hence, the positive (negative) sign of the EPS*RPTfirms (BVPS*RPTfirms) indicates the incremental (decreased) value-relevance of the variables during the post-MFRS 124 adoption period. This is consistent with the Devalle et al. (2010) that with adoption of IFRS the influence of EPS increased in Germany, France and the UK (out of the Germany, France, Spain, Italy and the UK), while the influence of BVPS decreased in all the countries with exception of the UK. Ge et al. (2010) find that the value relevance of EPS of the firm with related party sales of goods and related party sales of assets has increased after the implementation of the improved RPTs disclosure regulations in China.

In summary, the results from the Ohlson price model reveal that RPTs disclosure is value-relevant throughout the period under review. Second, for the combined period, the EPS of the RPTFirms is value-relevant. Third, during the pre-MFRS 124 adoption period, both BVPS and EPS of RPTFirms are not value-relevant. Last, during the post-MFRS 124 adoption period, the EPS of RPTFirms is value-relevant.

7.1.3.2 Return Model Regression

Table 7.4 presents the coefficients of the regressions for the value-relevance of MFRS 124 disclosure using the return model. The first model (Model 1) was used to test the value-relevance of the net income of RPT firms. NetIncome*RPTFirms is the variable of interest in the Model 1. Subsequent models (Model 2 and Model 3) are for the pre and post-MFRS adoption periods.

In the Model 1, the coefficient of NetIncome was positive and significant at 1%. Similarly, the coefficient of the NetIncome*RPTFirms was (0.1115) positive and significant at 10%. This indicates that the net income of the RPT firms is value-relevant for the combined period. Moreover, when the sample period was partitioned into pre and post-MFRS adoption periods, the coefficients of the regression for the pre-adoption era was presented in the fourth column of table 7.4. In this model, the coefficient of the NetIncome was positive and significant at 5%. As expected, the coefficient of NetIncome*RPTFirms was positive but not significant. This signals that prior to mandatory adoption of MFRS 124 the net income of RPT firms was not value-relevant.

Table 7.4
Return Model Regression Result

	Model 1 Combined period		Model 2 Pre-MFRS period		Model 3 Post-MFRS period	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	0.2351	16.02***	0.3027	12.19***	0.1667	10.85***
NetIncome	0.0823	3.64***	0.1145	2.3**	0.0675	3.37***
RPTFirms	0.0243	0.81	0.0345	0.69	0.0011	0.04
NetIncome*RPTFirms	0.1115	1.93*	0.0431	0.51	0.4152	3.68***
R ²	0.0122		0.0099		0.027	
F-stat (P-value)	9.06(0.000)		3.68(0.005)		10.21(0.000)	
Observation	2214		1107		1107	

Variables as defined above. Model 1 (combined period 2009 - 2015) $\text{Return} = \alpha + \beta_1 \text{NetIncome} + \beta_2 \text{NetIncome} * \text{RPTFirms} + \varepsilon$; Model 2 (pre-IFRS, 2009-2011); $\text{Return} = \alpha + \beta_1 \text{NetIncome} + \beta_2 \text{NetIncome} * \text{RPTFirms} + \varepsilon$; Model 3 (post-IFRS, 2013-2015) $\text{Return} = \alpha + \beta_1 \text{NetIncome} + \beta_2 \text{NetIncome} * \text{RPTFirms} + \varepsilon$; ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

The coefficients of the regressions for the post-MFRS 124 adoption period were presented in the sixth column of table 7.4. In the sixth column, the coefficient of NetIncome was positive and significant at 1%. Equally, the coefficient of the NetIncome*RPTFirms was positive (0.4152) and significant at 1%. This indicates that the net income of the RPT firm for the post-adoption period is value-relevant. This

finding is consistent with the Kim (2013) and Ismail et al. (2013) that net income reported under IFRS is more value-relevant.

Collectively, the results from the Easton return model reveal that for the combined period, the net income of RPTFirms is value-relevant. Second, during the pre-MFRS 124 adoption period, the net income of RPTFirms is not value-relevant. Last, during the post-MFRS 124 adoption period, the net income of RPTFirms is value-relevant.

7.1.4 Additional Analyses

Some additional tests are conducted to ensure that the results presented in the main analyses are not sensitive to alternative sample size or measurement. To robust the results of the price model, all loss-making firms were removed from the initial sample of the study. This is based on Darrough and Ye (2007) and Jiang and Stark (2013) that loss-making firms have some distinctive features. Thus, their value-relevance cannot be measured with the simple BVPS and EPS models. The results of the tests conducted on profit firms as presented in table 7.5 were similar to the initial results from the full sample across all the four models. In the first model, the signs of the coefficients and level of significance of all the three variables remain positive at 1%, as reported in the initial results. Similarly, the signs of the coefficients and level of significance of all the five variables in the second model remain similar to those of the main analysis. The only exception is that while the coefficient of RPTFirms was positive and insignificant in the initial analyses, the variable becomes negative and significant at 1% in the additional analysis. The differences recorded in the third model are with respect to BVPS and EPS*RPTFirms which are significant in the additional analyses. There was no any identifiable difference noticed in the fourth models of the main and

additional analyses in terms of the sign of the coefficients and level of significance with exception of the coefficient of RPTFirms that was positive and insignificant in the initial analyses which becomes negative and significant at 1% in the additional analysis.



Table 7.5

Results of the Additional Analyses (Price Model)

	Model 1 RPTs		Model 2 Combined period		Model 3 Pre-MFRS period		Model 4 Post-MFRS period	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	-0.19597	-1.36	0.0977	0.7	-0.1267	-1.1	0.1722	0.74
BVPS	0.653535	9.56***	0.6706	8.09***	-0.2225	-2.81***	0.8517	6.77***
EPS	6.266984	26.08***	3.9759	18.58***	12.6128	33***	2.9542	11.29***
RPTfirms	0.790531	3.29***	-0.7300	-2.74***	-0.0131	-0.06	-1.1381	-2.61***
BVPS*RPTfirms			-1.0927	-9.18***	-0.1893	-1.57	-1.1539	-6.64***
EPS*RPTfirms			15.9596	28.24***	2.4851	3.67***	19.6894	25.38***
R ²	0.3932		0.5882		0.7398		0.6255	
F-stat (P-value)	368.50(0.000)		486.78(0.000)		487.27(0.000)		280.96(0.000)	
Observation	1710		1710		863		1107	

All variables and models are as defined above. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

The next tests are conducted to check the sensitivity of the results in the return model. In these tests, the study employed the change in net income (ChngNetIncome) as an alternative measure to the net income method presented in the main analyses. Easton and Harris (1991) state that the stock return can be influenced by the level of income or change in income. Therefore, the second approach was used in this section to validate the initial findings.

Table 7.6
Results of the Additional Analyses (Return Model)

	Model 1 Combined period		Model 2 Pre-MFRS period		Model 3 Post-MFRS period	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	0.2353	16.15***	0.2986	12.14***	0.1687	10.98***
ChngNetIncome	0.0997	5.01***	0.1718	4.22***	0.0589	3.23***
RPTfirms	0.0240	0.81	0.0311	0.63	0.0203	0.65
ChngNetIncome*RPTfirms	0.1857	3.16***	0.0744	0.91	0.4333	3.79***
R ²	0.0232		0.0268		0.0263	
F-stat (P-value)	17.50(0.000)		10.12(0.005)		9.94(0.000)	
Observation	2214		1107		1107	

All variables and models as defined above. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

The results of the regressions are substantially similar to those reported in the main analyses. The signs of the coefficients are the same across all the variables and across all the models. The slight difference recorded was in the level of significance of the ChngNetIncome*RPTFirms which was at 1% in the additional test of Model 1, instead of the 10% significant level reported in the net income approach. Similarly, the level of significance of the ChngNetIncome was 1% significant level in the additional test of Model 2, an increase from the 5% significant level reported in the net income approach.

7.2 Real Earnings Management.

This section presents the analyses and interpretations of findings of the tests conducted to find out whether disclosed RPTs are associated with REM. It also deals with the relationship between REM in RPTs and firm value and the mitigating effect of compliance with disclosure requirement on the relationship between REM in RPTs and firm value.

7.2.1 Descriptive Analyses

7.2.1.1 Estimation Models

Table 7.7 reports the coefficients of the estimation models that are used to determine the normal and abnormal levels of activities. The equations are estimated for each industry throughout the study period (2009 to 2015) using the whole sampled firm-years. The reported values are the mean of the coefficients and R^2 across the industries. Most of the coefficients in the models are statistically significant with the predicted values. To determine the t-value of each variable in the model, the means of the coefficients were divided by their respective means of standard errors. The high rate of the adjusted R^2 across the models indicates the explanatory power of the model variables in defining the variability of the dependent variables. The production costs model has the highest mean of adjusted R^2 of 87.38% among the models, followed by 55.31% for CFO model. The mean of adjusted R^2 of the discretionary expenditure model was 45.90% for the sake of comparison, the coefficients accrual were computed and the average R^2 of the accrual model was 39.36%. The pattern of the mean of adjusted R^2 reported in this study was similar to those reported by Roychowdhury, (2006).

Table 7.7
Estimation Models

	CFO/TA-1		Production/TA-1		DISC /TA-1	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Contant	0.0175	1.40	-0.0736	-4.94***	0.0163	2.47**
1/TA-1	1157	3.16***	-1408	-2.35**	5485	1.91**
Sales/TA-1	0.1161	7.15***	0.7707	31.87***	0.080	11.06***
Δ sales/TA-1	0.0379	0.96	0.0250	0.29		
Δ sales-1/TA-1			0.0141	0.15		
R ²	0.5531		0.8738		0.4590	
N	5131		5131		5131	

CFO is the cash flow from the operating activities. PROD = Production costs. It is determined as the sum of cost of goods sold and changes in inventory from year t-1 to year t; DISEXP = discretionary expenditure, defined as sum of advertising expenses, research & development and selling, general & administrative expenses; At-1 = total assets in year t-1; S = total sales revenue; Δ S = change in sales revenue from year t-1 to year t; Model 1 = $CFO_t/At-1 = \alpha_0 + \alpha_1(1/At-1) + \alpha_2(S_t/At-1) + \alpha_3(\Delta S_t/At-1) + \epsilon_t$; Model 2 = $PROD_t/At-1 = \alpha_0 + \alpha_1(1/At-1) + \alpha_2(S_t/At-1) + \alpha_3(\Delta S_t/At-1) + \alpha_4(\Delta SALES_{it-1}/At-1) + \epsilon_t$; Model 3 = $DISEXP_t/At-1 = \alpha_0 + \alpha_1(1/At-1) + \alpha_2(S_t/At-1) + \epsilon_t$. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

7.2.1.2 Summary Statistics of the Firm Characteristics

Table 7.8 presents the summary statistics of the variables included in the REM models. The values presented in panel A, B and C represent the statistics for the full sample, RPTFirms and non-RPTFirms years respectively. A critical view on the full sample, RPTFirms and non-RPTFirms provides an insight on the groups' behavior of the REM proxies and other characteristics. For the full sample, the summary statistics reveals a negative mean of abnormal CFO, positive mean of abnormal production costs and a negative mean of abnormal discretionary expenditure -5.50E-11, 9.91E-12 and -1.02E-11 respectively. Based on these, one may argue that the listed firms have engaged in manipulative activities that lowered the CFO, increased the production costs and decreased discretionary expenditure. However, further investigation reveals that these manipulative activities are associated with the RPTFirms. This was deduced from the apparent positive mean of abnormal CFO, the negative mean of abnormal production costs and the positive mean of abnormal discretionary expenditure by the non- RPTFirms. Conversely, the sign of the mean of abnormal CFO, mean of

abnormal production costs and mean of abnormal discretionary expenditure of the RPTFirms was exactly in opposite direction with those reported for the non-RPTFirms. These provide initial insight that RPTFirms are associated with the activities that would lead to real earnings manipulations.

It is evident that large firms are more involved in RPTs than the small firms' counterpart. This can be seen from the mean total assets of the RPTFirms RM1.82 million, which happen to be more than RM1.60 million and RM1.56 million the mean total assets of the full sample and non- RPTFirms respectively. The possible explanation to this is that, usually, large firms are holding companies with many subsidiaries, associates, joint operations and many other related parties to engage with. Therefore, the tendencies of those firms to be in RPTs are higher compared to the small counterpart. Similarly, the mean of the profitability (ROA) of RPTFirms 4.50% and is higher than the mean of profitability of 3.30% and 3.12% for the full sample and the non- RPTFirms firms respectively.

Table 7.8

Summary Statistics of the Earnings Management Variables

Panel A Descriptive statistics ¹³ (full sample N5116)				Panel B Descriptive statistics (suspect N639)			Panel C Descriptive statistics (non-suspect N4477)			Difference in Means: Suspect-non Suspect	
Variable	Mean	Median	Sta. Dev.	Mean	Median	Sta. Dev.	Mean	Median	Sta. Dev.	Diff. in Means	T-stat
Ab_CFO	-5.50E-11	-0.0021	0.1445	-0.0057	-0.0067	0.0752	0.0008	-0.0013	0.152	-0.0066	-1.09
Ab_PRO	9.91E-12	0.0096	0.196	0.0229	0.0327	0.1577	-0.0033	0.0057	0.2008	0.0262	3.20***
Ab_DISC	-1.02E-11	-0.0057	0.113	-0.014	-0.0132	0.0864	0.002	-0.0042	0.1162	-0.016	-3.38***
Total Assets	1600015	282764	6281690	1845442	549120	4086289	1564986	255543	6534757	280456	1.06
Size	12.66544	12.556	1.5939	13.2478	13.195	1.5158	12.5805	12.451	1.5873	0.6673	10.09***
MTB	1.334401	0.822	3.3181	1.5898	0.923	2.6196	1.2971	0.811	3.4067	0.2927	2.11**
ROA	3.295497	3.93	21.3994	4.5039	4.27	11.2359	3.1192	3.9	22.4968	1.3846	1.54
				Tobins' Q	1.1652	0.8710	2.6411				
				ChangeNI	0.0618	0.0038	2.3935				
				Leverage	18.8004	15.6700	18.0526				
				Divi	0.0635	0.0150	0.1120				
				Liquidity	2.9528	1.8400	4.6688				
				Audit	1562.38	194.94	28314				
				Ind_dumm	0.6663	1.0000	0.4716				
				Dscore	0.7054	0.7059	0.0893				
				DscoreT	0.8434	0.8130	0.1275				
				DscoreG	0.5821	0.5560	0.1194				
				Bind	0.4450	0.4290	0.1154				
				Aexp	0.8261	1.0000	0.2416				
				Aind	0.5642	1.0000	0.4962				
				Tunn	0.4205	0.0000	0.4940				
				Prop	0.4159	0.0000	0.4933				

¹³ Fifteen firm-year observations are missing from the control variables used in the study. Hence, the firm-year observations for the full sample and suspect has reduce from the initial 5031 and 654 to 5116 and 639 for the full sample and suspect firm years respectively.

7.2.2 Univariate Analysis

Table 7.9 presents the Pearson correlation matrix for the variables used in REM analyses. Overall, it portrays less severe problem of multicollinearity among the independent variables. Abnormal CFO (Ab_CFO) was found to have a positive relationship with the abnormal production cost (Ab_PRO) at 1% level of significance. The association between Ab_CFO and abnormal discretionary expenditure (Ab_DISC) was positive but not significant. Similarly, the correlation between Ab_PRO with Ab_DISC was positive and significance at 1%.

As expected, all market-related variables have a significant negative correlation with the proxies for REM. Ab_CFO was having negative relationships with Tobin's Q (-0.0223) and Market-to-book value (-0.1018) at 5% and 1% level of significance respectively. Similarly, negative correlations were also recorded between Ab_PRO and Tobin's Q (-0.0646) and Market-to-book value (-0.1174) at 1% level of significance. Ab_DISC relates negatively with Tobin's Q (-0.0112) while the association between Ab_DISC and Market-to-book value was negative -0.0321) and significant at 5%.

Table 7.9

Correlation matrix of the Real Earnings Management Variables

Variable	Ab_CFO	Ab_PRO	Ab_DISC	Tobins' Q	MTB	T A	Profitability	ChangeNI	Leverage	Divi	Liquidity
Ab_CFO	1.0000										
Ab_PRO	0.3730***	1.0000									
Ab_DISC	0.0102	0.8812***	1.00								
Tobins' Q	-0.0223*	-0.0646***	-0.0112	1.00							
MTB	-0.1018***	-0.1174***	-0.0321**	0.2340***	1						
T A	-0.0236**	0.026*	0.1042***	0.0044	0.0299**	1.0000					
ROA	-0.4613***	-0.1221***	0.0832***	-0.3603***	0.1513***	0.0243*	1				
ChangeNI	-0.0321**	-0.01	-0.0114	0.2946***	-0.0033	-0.01	-0.3162***	1			
Leverage	0.1199***	0.1086***	0.0333**	-0.0232*	-0.0345**	0.1412***	-0.0969***	-0.0166	1		
Divi	-0.0741***	-0.0638***	0.0004	0.0847***	0.2201***	-0.0015	0.4458***	0.0244*	-0.0799***	1	
Liquidity	-0.0291**	0.0186	-0.0432**	0.0101	0.0003	-0.0492***	-0.0089	0.0151	-0.2839***	0.0303**	1
Audit	-0.0042	0.0003	0.0154	0.0032	0.0041	0.1309***	-0.0011	0.0024	0.0227	-0.0027	-0.0031
Ind_dumm	-0.0002	-0.0002	-0.0002	-0.0752***	-0.0896***	-0.1247***	0.0523***	-0.0306**	0.0627***	-0.015	-0.0697***
Dscore	-0.0023	0.0554	0.1247***	-0.0347	-0.01	0.2187***	-0.0443	0.0139	0.1840***	-0.0622	-0.1342***
DscoreT	0.0743*	0.1227***	0.1188***	-0.2526***	-0.2267***	0.0753*	-0.1402***	0.0457	0.2594***	-0.1866***	-0.1774***
DscoreG	-0.0754*	-0.028	0.0803**	0.1751***	0.1826***	0.2395***	0.0678*	-0.0274	0.0164	0.0813**	-0.0176
Bind	0.0529	0.0971**	0.0575	0.0187	0.03	-0.0346	-0.0546	-0.0026	-0.0091	0.0289	-0.0489
ACFExp	0.0794**	0.0921**	0.0527	-0.027	-0.0053	0.0729*	-0.0885**	0.041	0.0623	-0.0401	0.0353
ACInd	0.0357	0.0781**	-0.0054	-0.0183	-0.0006	0.0414	-0.0864**	0.0013	0.1204***	-0.0295	0.0249
Tunneling	-0.3757***	-0.1975***	-0.0060	0.2735***	0.2227***	0.1031***	0.4407***	0.1923***	-0.1952***	0.1460***	0.0614
Propping	0.3771***	0.1509***	-0.0223	-0.2342***	-0.2058***	-0.1342***	-0.4778***	-0.1822***	0.1555***	-0.1045***	-0.0488

Table 7.9 (Continue)

	Audit	Ind_dumm	Dscore	DscoreT	DscoreG	Bind	Aexp	Aind	Tunn	Prop
Audit	1									
Ind_dumm	-0.0569***	1								
Dscore	0.0921**	0.2033***	1							
DscoreT	0.0315	0.0349	0.6994***	1						
DscoreG	0.1013**	0.2467***	0.7332***	0.0321	1					
Bind	-0.0366	-0.1904***	0.1415***	0.1230***	0.0893*	1				
Aexp	-0.0133	-0.0952**	0.1398***	0.0835**	0.1255***	0.2825***	1			
Aind	-0.0117	-0.1020***	0.0776*	0.042	0.0817**	0.3517***	0.8205***	1		
Tunn	0.0508	0.0034	0.0034	-0.1703***	0.1673***	-0.0333	0.0258	-0.0025	1	
Prop	-0.0987*	-0.0068	0.0023	0.1531***	-0.1456***	0.0412	-0.0616	-0.0194	-0.7270***	1

***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively. Variable as previously defined.

7.2.3 Multivariate Regression

As mentioned earlier in chapter five, this study uses the Roychowdhury (2006) REM models to measure the REM activities in RPTs by RPTFirms. This section presents the results of the multiple regressions on the relationship between REM in RPTs and firm value. The section also covers the multiple regression results of the mitigating effect of compliance the disclosure requirements on RPT on the relationship between REM in RPTs and firm value.

7.2.3.1 Real Earnings Management in RPTs

Table 7.10 presents the results of the regressions conducted to investigate the REM activities by RPTFirms. Proxies for REM are presented in separate columns of the table. The result of the first proxy for REM (Ab_CFO) was presented in the second column of the table. The coefficient of the firm size (Size), MTV and ROA are positive, negative and negative respectively. As expected, the coefficient of the variable of interest (RPTFirms) was positive (0.0103) and significant at 10%. This reveals that the CFO of the RPTFirms is lower (recall that Ab_CFO and Ab_DISC are transformed to positive through multiplying them by -1 as stated in section 5.4.4.1) than what it ought to be based on average total assets of the RPTFirms. The implication of this is that RPTFirms have engaged in some strange activities that alter the level of CFO from been at par to its normal level. The finding has proved Ab_CFO for RPTFirms is abnormally low which is an indication of REM (Roychowdhury, 2006).

Table 7.10
Regression Results for Real Earnings Management in RPTs

	Ab_CFO		Ab_PRO		Ab_DISC	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	-0.0046	-0.32	-0.1031	-4.68***	-0.0800	-6.25***
Size	0.0012	1.05	0.0088	5.08***	0.0063	6.2***
MTB	-0.0015	-2.69***	-0.0062	-7.51***	-0.0017	-3.53***
ROA	-0.0031	-35.99***	-0.0011	-8.53***	0.0004	5.12***
RPTFirms	0.0103	1.88*	0.0235	2.85***	0.0117	2.45***
R ²	0.2146		0.0322		0.0185	
F-stat (P-value)	349.17(0.000)		42.55(0.000)		24.07(0.000)	
¹⁴ Observation	5116		5116		5116	

Ab_CFO = Abnormal cash flow from operating activities; Ab_PRO = Abnormal production costs; Ab_DISC = Abnormal discretionary expenditure; Size = natural logarithm of total assets; MTV = market-to-book value; ROA = earnings before extraordinary incomes (EBXI), scaled by total assets. RPTFirms = Dummy variable equals to one for the RPTFirms and zero for otherwise. RPTFirms is defined as a firm with RPTs of up to 20% of its revenue or the firms that engage in more than one form of RPTs in a given year. Coefficients were estimated using $Y = \alpha_0 + \beta_1 \text{Size}_{it} + \beta_2 \text{MTV}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{RPTFirms}_{it} + \varepsilon_{it}$ replacing Y with one of the three proxies of REM. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

In the second regression, the Ab_PRO is used as dependent variable. All the variables in this model are significant at 1%. The coefficient of the firm size (Size), MTV and ROA are positive, negative and negative respectively. The coefficient of the variable of interest in this regression (RPTFirms) was positive (0.0235). This indicates that RPTFirms are characterized with over production to lower the unit production costs. This finding is similar to the Roychowdhury (2006) and Abad et al. (2016) that the RPTFirms use overproduction to manipulate reported earnings.

The result of the regression where Ab_DISC was used as the dependent variable was presented in the part of table 7.10. The coefficients of the Size, MTV and ROA are negative, positive and negative respectively; and significant at 1%. As expected, the coefficient of the variable of interest in the model (RPTFirms) was positive (0.0117)

¹⁴ Additional fifteen (15) firm-year observations are removed from the initial sample of 5131 because of the lack of data for the control variables used in the subsequent regressions.

and significant at 5%. This result reveals that the discretionary expenditure of the RPTFirms was lower in commensurate to the average total assets base. This implies that the discretionary expenditure of the RPTFirms is lower than match non-RPTFirms by 1.2% (represented by the negative coefficient of RPTFirms 0.0117 in the discretionary model). The extent of literature has defined lower abnormal discretionary expenditure as an element of REM. Hence, it is established that RPTFirms used discretionary expenditure to manipulate reported earnings.

In a nutshell, the results from all the three models revealed that the RPTFirms have the negative, positive and negative relationship with the abnormal CFO, abnormal production cost and abnormal discretionary expenditure respectively. As indicated by Roychowdhury (2006), Gunny (2010) and Cupertino et al. (2015) these relationships reveal that firms perpetrate REM in RPTs.

7.2.3.2 Real Earnings Management in RPTs and Firm Value

Table 7.11 presents the coefficients and the results of the regressions on the relationship between REM in RPTs and firm value. In the first regression, the coefficient of the variable of interest (Ab_CFO) is negative (-1.7432) and statistically significant at 1%. This implies that capital market discount stock price of the firm that manipulates its cash flow from operations through RPTs. As expected, the coefficient of the Ab_PRO was negative (-2.0022) and statistically significant at 1% in the second regression. The implication of these results is that capital market discount stock price of the firm that overproduced to lower the unit production cost. In the last regression, Ab_DISC was used as a proxy for REM. The results are consistent with those reported earlier. The coefficient of the Ab_DISC was negative (-4.1973) and statically

significant at 1%. This implies that capital market disciplines the firms that cut-down its discretionary expenditure to manipulate the reported earnings.

Table 7.11

Results of the Real Earnings Management in RPTs and Firm Value

	Ab_CFO		Ab_PRO		Ab_DISC	
Tobin's Q	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	0.9701431	2.18**	0.3500	0.8	0.5806	1.39
Ab_CFO	-1.7432	-2.82***				
Ab_PRO			-2.0022	-7.85***		
Ab_DISC					-4.1973	-9.83***
Size	-0.0001	-0.07	0.0388	1.34	0.0138	0.5
ROA	0.0152	3.31***	0.0124	2.92***	0.0166	4.07***
ChangeNI	-0.4582	-1.09	-0.4439	-1.1	-0.5594	-1.42
Bind	0.1970	0.54	0.4467	1.26	0.4715	1.37
Aexp	-0.0180	-0.06	-0.0186	-0.07	0.1260	0.48
Aind	-0.0052	-0.04	-0.0029	-0.02	-0.1079	-0.82
Tunn	0.2575	2.22**	0.2126	1.91*	0.2861	2.65***
Prop	-0.0189	-0.16	-0.0630	-0.55	-0.0966	-0.86
Leverage	0.0001	0.1	0.0003	0.12	0.0007	0.25
Divi	4.2334	10.26***	3.9335	9.88***	3.7541	9.64***
Liquidity	0.0239	1.85*	0.0322	2.6**	0.0417	3.43***
Audit	-0.0001	-0.39	0.0000	-0.53	0.0000	-0.16
Ind_dumm	-0.1645	-1.7*	-0.1130	-1.21	-0.1455	-1.61
R ²	0.3016		0.3563		0.3875	
F-stat (P-value)	19.25(0.000)		24.67(0.000)		28.20(0.000)	
¹⁵ Observation	639		639		639	

Coefficients are estimated using $Y = \alpha_0 + \beta_1 \text{REM proxy}_{it} + \beta_2 \text{Size}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{ChangeNI}_{it} + \beta_5 \text{Bind}_{it} + \beta_6 \text{Aexp}_{it} + \beta_7 \text{Aind}_{it} + \beta_8 \text{Tunn}_{it} + \beta_9 \text{Prop}_{it} + \beta_{10} \text{Leverage}_{it} + \beta_{11} \text{Dividend}_{it} + \beta_{12} \text{Liquidity}_{it} + \beta_{13} \text{Audit}_{it} + \beta_{14} \text{Industry}_{it} + \varepsilon_{it}$ (10). Y= Tobin's Q: Tobin's Q = market value of equity + book value of total liabilities, scaled by total assets. REM = one of the three proxies for REM (Ab_CFO, Ab_PRO and Ab_DISC) as determined in section 5.4.4.1. The test is repeated for each of the three proxies for REM. Other variables as previously defined. ***, **, * indicates that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

Collectively, the results of the regressions conducted to test the relationship between REM in RPTs and firm value indicate that stock market participants are aware that

¹⁵ Additional fifteen (15) firm-year observations are removed from the initial sample of 654 because of the lack of data for the control variables used in the subsequent regressions.

firms use RPTs for REM purposes. Similarly, the results indicate that capital markets discount the stock price of the firms that engage in REM in RPTs.

7.2.3.3 Mitigating Effect of Compliance with MFRS 124 on Real Earnings Management in RPTs and Firm Value

Table 7.12 presents the results of the regressions run to test the moderating effect of the compliance with the disclosure requirements on RPTs on the relationship between REM in RPTs and firm value. In the first part of the table, the total compliance (Dscore) was used as moderating variables. None of the variables of interest is statistically significant in this segment. The results of the first regression show that the coefficient of the variable of interest ($Ab_CFO \times Dscore$) is positive (2.4005). However, the variable is statistically insignificant. Similarly, in the second regression, the coefficient of the variable of interest ($Ab_PRO \times Dscore$) is negative (-1.1100) and statistically insignificant. The results of the last regression run in this segment produce are similar to the above-reported results. The coefficient of the variable of interest ($Ab_DISC \times Dscore$) is negative (-3.1500) and statistically insignificant. The results reveal a lack of statistical relationship between the dependent variable with the variable of interest across the three models.

Table 7.12

Results of the Moderating Effect

	ALL Disclosures						Transaction-based Disclosure					
	Ab_CFO		Ab_PRO		Ab_DISC		Ab_CFO		Ab_PRO		Ab_DISC	
Tobin's Q	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	0.9083	1.92*	0.2939	0.63	0.2690504	0.59	2.2357	4.68***	1.9056	4.21***	2.4053	5.47***
Ab_CFO	-3.4101	-0.92					-17.2428	-6.41***				
Ab_PRO			-1.2298	-0.59					-14.2782	-10.47***		
Ab_DISC					-2.0557	-0.62					-27.3387	-11.95***
Dscore	0.2227	0.45	0.1312	0.28	0.8355	1.77 *	-1.8565	-5.62***	-1.8807	-6.24***	-1.8869	-6.38***
Ab_CFO*Dscore	2.4005	0.46					17.9876	5.83***				
Ab_PRO*Dscore			-1.1100	-0.37					14.8464	9.15***		
Ab_DISC*Dscore					-3.1500	-0.67					28.0282	10.32***
Size	-0.0062	-0.2	0.0375	1.24	0.0026	0.09	0.0043	0.15	0.0224	0.83	-0.0190	-0.74
ROA	0.0151	3.25***	0.0126	2.94***	0.0170	4.16***	0.0095	2.11**	0.0064	1.59	0.0107	2.84***
ChangeNI	-0.4448	-1.04	-0.4581	-1.13	-0.6040734	-1.53	0.1225	0.3	0.0923	0.24	-0.1204	-0.33
Bind	0.1519	0.41	0.4290	1.19	0.3625201	1.04	0.4259	1.2	0.6103	1.84*	0.5259	1.65*
Aexp	-0.0383	-0.13	-0.0298	-0.11	0.0623391	0.23	0.1712	0.63	0.1810	0.72	0.2410	0.99
Aind	0.0086	0.06	-0.0016	-0.01	-0.0858376	-0.65	-0.0514	-0.38	-0.0171	-0.14	-0.1272	-1.04
Tunn	0.2576	2.22**	0.2128	1.91*	0.2784201	2.58**	0.2122	1.9*	0.1760	1.7*	0.3142	3.16***
Prop	-0.0220	-0.18	-0.0634	-0.55	-0.1078473	-0.96	-0.0119	-0.1	-0.0588	-0.55	-0.0310	-0.3
Leverage	0.0001	0.03	0.0004	0.13	0.0003988	0.15	0.0014	0.53	0.0003	0.13	0.0025	1.02
Divi	4.2278	10.2***	3.9469	9.87***	3.77E+00	9.69***	3.6512	9.00***	3.0758	8.09***	2.9230	7.98***
Liquidity	0.0238	1.83*	0.0323	2.61	4.23E-02	3.47***	0.0166	1.33	0.0301	2.61***	0.0466	4.16***
Audit	0.0000	-0.4	0.0000	-0.54	-4.66E-06	-0.19	0.0000	-0.3	0.0000	-0.08	0.0000	0.3
Ind_dumm	-0.1729	-1.75*	-0.1189	-1.25	-0.1796102	-1.94*	-0.1355	-1.45	-0.0631	-0.73	-0.1419	-1.7*
R ²	0.3022		0.3565		0.3906		0.354		0.4451		0.4849	
F-stat (P-value)	16.84(0.000)		21.54(0.000)		24.92(0.000)		21.31(0.000)		31.18(0.000)		36.60(0.000)	
Observation	639		639		639		639		639		639	

A Coefficients are estimated using $Y = \alpha_0 + \beta_1 \text{REMproxy}_{it} + \beta_2 \text{Dscore}_{it} + \beta_3 \text{REMproxy}_{it} * \text{Dscore}_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{ROA}_{it} + \beta_6 \text{ChangeNI}_{it} + \beta_7 \text{Bind}_{it} + \beta_8 \text{Aexp}_{it} + \beta_9 \text{Aind}_{it} + \beta_{10} \text{Tunn}_{it} + \beta_{11} \text{Prop}_{it} + \beta_{12} \text{Leverage}_{it} + \beta_{13} \text{Dividend}_{it} + \beta_{14} \text{Liquidity}_{it} + \beta_{15} \text{Audit}_{it} + \beta_{16} \text{Industry}_{it} + \varepsilon_{it}$ (11). Y= Tobin's Q: Tobin's Q = market value of equity + book value of total liabilities, scaled by total assets. REM = one of the three proxies for REM (Ab_CFO, Ab_PRO and Ab_DISC) as determined in section 5.4.4.1. Other variables as previously defined. ***, **, * indicates that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

Table 7.12 (Continued)

Tobin's Q	Non-transaction-based Disclosures					
	Ab_CFO		Ab_PRO		Ab_DISC	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	0.8734	2.02**	0.2258	0.57	0.3020	0.8
Ab_CFO	10.5600	3.96***				
Ab_PRO			11.9043	9.23***		
Ab_DISC					15.8727	8.5***
Dscore	1.6163	4.52***	1.8868	5.76***	2.4900	7.88***
Ab_CFO*Dscore	-21.1300	-4.7***				
Ab_PRO*Dscore			-24.1385	-10.89***		
Ab_DISC*Dscore					-34.8434	-11.05***
Size	-0.0505	-1.66***	-0.0107	-0.38	-0.0331	-1.26
ROA	0.0157	3.52***	0.0101	2.59**	0.0143	3.91***
ChangeNI	-0.5244	-1.29	-0.3408	-0.93	-0.2716	-0.77
Bind	0.1372	0.38	0.0482	0.15	-0.0243	-0.08
Aexp	-0.1369	-0.5	-0.1012	-0.41	0.0070	0.03
Aind	-0.0119	-0.09	0.0004	0	-0.1187	-1
Tunn	0.1967	1.74*	0.2064	2.04**	0.2316	2.38**
Prop	-0.0724	-0.62	-0.0674	-0.65	-0.0611	-0.61
Leverage	0.0021	0.77	0.0011	0.46	0.0004	0.16
Divi	4.0421	10.07***	3.4145	9.37***	3.0718	8.69***
Liquidity	0.0277	2.2**	0.0357	3.17***	0.0412	3.78***
Audit	0.0000	-0.5*	0.0000	-0.16	0.0000	0.33
Ind_dumm	-0.2693	-2.78***	-0.2229	-2.55**	-0.3461	-4.12***
R ²	0.3447		0.4707		0.5095	
F-stat (P-value)	20.45(0.000)		34.57(0.000)		40.38(0.000)	
Observation	639		639		639	

Coefficients are estimated using $Y = \alpha_0 + \beta_1 \text{REMproxy}_{it} + \beta_2 \text{Dscore}_{it} + \beta_3 \text{REMproxy}_{it} * \text{Dscore}_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{ROA}_{it} + \beta_6 \text{ChangeNI}_{it} + \beta_7 \text{Bind}_{it} + \beta_8 \text{Aexp}_{it} + \beta_9 \text{Aind}_{it} + \beta_{10} \text{Tunn}_{it} + \beta_{11} \text{Prop}_{it} + \beta_{12} \text{Leverage}_{it} + \beta_{13} \text{Dividend}_{it} + \beta_{14} \text{Liquidity}_{it} + \beta_{15} \text{Audit}_{it} + \beta_{16} \text{Industry}_{it} + \varepsilon_{it}$ (11). Y= Tobin's Q: Tobin's Q = market value of equity + book value of total liabilities, scaled by total assets. REM = one of the three proxies for REM (Ab_CFO, Ab_PRO and Ab_DISC) as determined in section 5.4.4.1. Other variables as previously defined. ***, **, * indicates that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

In summary, the results of the regressions portray the absent of the moderating effect of the compliance with disclosure requirements on RPT on the RPTs on the relationship between REM in RPTs and firm value. The possible reason for this results can be connected with the low level of compliance with the disclosure requirements on RPTs. Recall that in the section 6.1.2 of the thesis, it was established that the mean compliance with the disclosure requirements on RPTs was just 71%. This level of

compliance is considered moderate most especially in sensitive accounting issues like RPTs. This is because, in disclosure studies, points are given to each item of disclosure requirement regardless of its importance to the users of financial report. Therefore, firm may earn pretty points by complying with some disclosure items that are not pressing to the users while neglecting the most pressing one. Hence, for any accounting standard to achieve its objectives, extensive disclosure is a must.

The level of compliance was split into transaction-based compliance (DscoreT) and non-transaction-based compliance (DscoreG). As presented in section 6.1.2 the mean compliance of DscoreT was 84%. This level of compliance can be considered as high level of compliance. On the contrary, the mean compliance of the DcoreG was just 58%. This level of compliance can be considered as low level of compliance. Hence this study goes further to investigate the effect of high compliance and low compliance with the disclosure requirements on RPTs on the relationship between REM in RPTs and firm value.

Interestingly, the results of the regressions when the level of compliance was high (DscoreT) reveal that compliance with the disclosure requirements on RPTs mitigates the negative relationship between REM in RPTs and firm value. The results of the first regression under the transaction-based disclosure in the table 7.12 show a positive relationship. The coefficient of the variable of interest ($Ab_CFO \times DscoreT$) is positive (17.9876) and statistically significant at 1%. The results of the second regression in this category using the second proxy of REM reveal positive relationship. The coefficient of the variable of interest in the model ($Ab_PRO \times DscoreT$) is positive (4.8464) and significant at 1% statistical level of significance.

Consistently, the last proxy of REM produced a similar result. The coefficient of the variable of interest in the last model ($Ab_DISC * DscoreT$) in this category is positive 28.0282 and significant at 1% statistical level of significance. These results indicate that high level of compliance with the disclosure requirements on RPTs mitigates the negative relationship between REM in RPTs and firm value.

The study used the non-transaction-based compliance ($DscoreG$) to assess the moderating effect of low level of compliance with disclosure requirement on RPTs on the negative relationship between REM in RPTs and firm value. The results as presented in the last segment of Table 7.12 reveal that low level of compliance with disclosure requirement on RPTs exacerbates the negative relationship between REM in RPTs and firm value. The coefficient of the first variable of interest ($Ab_CFO * DscoreG$) is negative (-21.1300) and statistically significant at 1%.

Also, the results of the second regression in this category using the second proxy of REM reveal negative relationship. The coefficient of the second variable of interest in the model ($Ab_PRO * DscoreG$) is negative (-24.1385) and significant at 1% statistical level of significance. Consistently, the last proxy of REM produced a similar result. The coefficient of the variable of interest in the last model ($Ab_DISC * DscoreG$) in this category is negative -34.8434 and significant at 1% statistical level of significance. These results indicate that low level of compliance with the disclosure requirements on RPTs worsens the negative relationship between REM in RPTs and firm value.

In a nutshell, this study makes the following findings from the results from the moderating effect of compliance with the disclosure requirements on RPTs on the relationship between REM in RPTs and firm value. First, that high level of compliance

with the disclosure requirements on RPTs mitigates the negative relationship between REM in RPTs and firm value. Second, that low level of compliance with the disclosure requirements on RPTs has no effect on the negative relationship between REM in RPTs and firm value. Last, that low level of compliance with the disclosure requirements on RPTs worsens the negative relationship between REM in RPTs and firm value.

7.2.4 Additional Analyses

This section presents series of additional tests conducted through the use of alternative measures of the variables used in the main analyses. The results of the tests are presented and discussed in the following sub-sections.

7.2.4.1 Real Earnings Management in RPTs

In the robust analysis, three new proxies for REM are formed and used as additional tests to capture the existence REM in the RPTFirms. Consistent with the Cohen and Zarowin (2010), Ho et al. (2015) and Zang (2012) the proxies of REM (Ab_CFO, Ab_PRO and Ab_DISC) are combined to create three new variables that have been used in this section. The first measure was RM_1 and arrived at by summing the new Ab_DISC and Ab_PRO.

Table 7.13
Summary of the composition of New Variables

	Ab_DISC	Ab_CFO	Ab_PRO
RM_1	√		√
RM_2	√	√	
RM_3	√	√	√

The second measure RM_2 has been arrived at through summing the Ab_CFO and Ab_DISC. Finally, the last measure RM_3 was the product of the three proxies combined. As in the main analyses, the positive relationship between RPTFirms with the three new measures indicates the REM.

Table 7.14

Results of the Additional Analyses (Real Earnings Management in RPTs)

	RM_1		RM_2		RM_3	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	-0.1831	-6.15***	-0.0846	-4.25***	-0.1877	-5.11***
Size	0.0151	6.42***	0.0075	4.76***	0.0163	5.62***
MTB	-0.0079	-7.08***	-0.0032	-4.24***	-0.0093	-6.81***
ROA	-0.0007	-4.12***	-0.0027	-23.15***	-0.0038	-17.67***
RPTFirms	0.0352	3.16***	0.0220	2.95***	0.0455	3.31***
R ²	0.0229		0.1055		0.0754	
F-stat (P-value)	29.93(0.000)		150.72(0.000)		104.22(0.000)	
Observation	5116		5116		5116	

RM_1 = sum of Ab_DISC and Ab_PRO; RM_2 = sum of Ab_CFO and Ab_DISC; RM_3 = sum of Ab_CFO, Ab_DISC, and Ab_PRO; Size = natural logarithm of total assets; MTV = market-to-book value; ROA = earnings before extraordinary incomes (EBXI), scaled by total assets. Suspect = Dummy variable equals to one for the RPTFirms and zero for otherwise. RPTFirms is defined as a firm with RPTs of up to 20% of its revenue or the firms that engage in more than one form of RPTs in a given year. Coefficients were estimated using $Y = \alpha_0 + \beta_1 \text{Size}_{it} + \beta_2 \text{MTV}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{RPTFirms}_{it} + \varepsilon_{it}$ replacing Y with one of the three proxies of REM. ***, **, * indicate that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

Table 7.12 presents the result of the additional analyses for the REM measures. The regressions of the new measures produced results that are substantially similar to those reported for the main analyses. In the first measure (RM_1) the coefficients of the Size, MTV and ROA are positive, negative and negative respectively; and significant at 1%. The sign of the variable of interest was positive (0.0352) as expected, and the variable is statistically significant at 1%.

Moving to the second measure (RM_2), the coefficients of the Size, MTV and ROA are positive, negative and negative respectively; and significant at 1%. The sign of the

variable of interest was positive (0.0220) and significant at 1%. This emphasizes the relationship between Ab_DISC with the Ab_CFO as highlighted by (Roychowdhury, 2006). The coefficients of the Size, MTV and ROA are positive, negative and negative respectively; and significant at 1%. The coefficient of the variable of interest in the model was positive (0.0455) and significant at 1%. This measure produced the highest coefficients among the three measures reviewed. This was the result of the combine proxies for REM (Ab_CFO, Ab_DISC and Ab_PRO). The results indicate that RPTFirms exhibit a combined real activities manipulations to increase the reported earnings by 4.6% (represented by the positive coefficient of suspect 0.0455 in the RM_3 model).

Overall, the result presented is robust to all alternative proxies on whether firms listed on Bursa Malaysia manipulate the reported earnings by means of real activity manipulations through RPTs. It is evident that the levels of the CFO of the RPTFirms are not at par with the normal level of activities. Similarly, the RPTFirms are associated with the low level of discretionary expenditure. Lastly, it was evident that RPTFirms engage into over production to lower unit production cost, cut down discretionary expenditure and engage in activities that increase the current level of CFO. This consistent with Munir et al., (2013) that RPTs by Malaysian firms with significant family ownership appears to affect the quality of their reported earnings negatively.

7.2.4.2 Real Earnings Management in RPTs and Firm Value

To robust the initial findings on the market valuation of the firms that engage in earnings management, the study uses an alternative measure of the firm value.

Following Fama and French (1998) and Lei and Song (2011), this study proxy the firm value as the market value of the firm scaled by book value of the firm (MTB). Thus, Tobin's Q in equation 10 was substituted with the new proxy for the firm value (MTB). The results of the additional tests are similar to those reported in the main analysis. The coefficients of the variable of interest (Ab_CFO, Ab_PRO and Ab_DISC) are negative and statistically significant across the three models. The major noticeable difference is that the coefficient of the Ab_CFO is statistically significant at 5% in the additional analyses as against the 1% recorded in the main analyses.

Table 7.15
Results of the Additional Analyses (REM in RPTs and Firm Value)

	Ab_CFO		Ab_PRO		Ab_DISC	
MTB	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	0.3361	0.31	-0.9927	-0.94	-0.5548	-0.55
Ab_CFO	-3.1677	-2.13**				
Ab_PRO			-4.2787	-6.93***		
Ab_DISC					-9.5462	-9.26***
Size	0.0476	0.67	0.1341	1.92*	0.0826	1.23
ROA	0.0311	2.82***	0.0238	2.31**	0.0323	3.29***
ChangeNI	-1.1334	-1.12	-1.0989	-1.13	-1.3579	-1.43
Bind	0.5720	0.65	1.1176	1.31	1.2134	1.46
Aexp	0.1348	0.2	0.1623	0.25	0.5034	0.79
Aind	0.0144	0.04	0.0072	0.02	-0.2365	-0.74
Tunn	0.3049	1.09	0.1990	0.74	0.3556	1.36
Prop	-0.1468	-0.51	-0.2327	-0.84	-0.3118	-1.15
Leverage	-0.0051	-0.77	-0.0049	-0.75	-0.0040	-0.64
Divi	8.8722	8.95***	8.2039	8.52***	7.7429	8.23***
Liquidity	0.0138	0.44	0.0303	1.01	0.0526	1.79*
Audit	0.0000	-0.28	0.0000	-0.4	0.0000	-0.06
Ind_dumm	-0.1738	-0.75	-0.0604	-0.27	-0.1256	-0.57
R ²	0.2313		0.281		0.3192	
F-stat (P-value)	13.41(0.000)		17.42(0.000)		20.90(0.000)	
Observation	639		639		639	

Coefficients are estimated using $Y = \alpha_0 + \beta_1 \text{REM proxy}_{it} + \beta_2 \text{Size}_{it} + \beta_3 \text{ROA}_{it} + \beta_4 \text{ChangeNI}_{it} + \beta_5 \text{Bind}_{it} + \beta_6 \text{Aexp}_{it} + \beta_7 \text{Aind}_{it} + \beta_8 \text{Tunn}_{it} + \beta_9 \text{Prop}_{it} + \beta_{10} \text{Leverage}_{it} + \beta_{11} \text{Dividend}_{it} + \beta_{12} \text{Liquidity}_{it} + \beta_{13} \text{Audit}_{it} + \beta_{14} \text{Industry}_{it} + \varepsilon_{it}$ (10). Where Y = MTB: MTB = market value of the firm scaled by book value of the firm. REM = one of the three proxies for REM (Ab_CFO, Ab_PRO and Ab_DISC) as determined in section 5.4.4.1. The test is repeated for each of the three proxies for REM. Other variables as previously defined. ***, **, * indicates that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

7.2.4.3 Mitigating Effect of Compliance with MFRS 124 on Real Earnings Management in RPTs and Firm Value

Similar to the method used above, MTB was also used as an alternative measure of firm value to robust the initial findings. Table 7.16 presents the results of the additional tests using the alternative measure of firm value. The results of the regressions using the alternative measure are substantially similar to those reported in the main analyses. Both the signs and statistical significance of the variables of interest are similar across the three models (Ab_CFO, Ab_PRO and Ab_DISC) and across the three categories of compliance reviewed (Full compliance (Dscore), transaction-based compliance (DscoreT) and non-transaction-based compliance (DscoreG)).



Table 7.16

Results of the Additional Analyses (Results of the Moderating Effect)

	ALL Disclosures						Transaction-based Disclosure					
	Ab_CFO		Ab_PRO		Ab_DISC		Ab_CFO		Ab_PRO		Ab_DISC	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	0.1848	0.16	-1.2451	-1.11	-1.3429	-1.22	3.1453	2.72***	2.5863	2.35**	3.9270	3.73***
Ab_CFO	-3.3976	-0.38					-37.5936	-5.79***				
Ab_PRO			1.9020	0.3800					-33.0643	-9.96***		
Ab_DISC					-0.7505	-0.09					-68.8213	-12.58***
Dscore	0.4862	0.41	0.3963	0.35	1.9132	1.68*	-4.1204	-5.16***	-4.2993	-5.86***	-4.5291	-6.4***
Ab_CFO*Dscore	0.3972	0.03					39.9523	5.36***				
Ab_PRO*Dscore			-8.9210	-1.24					34.8113	8.82***		
Ab_DISC*Dscore					-12.7631	-1.13					71.7480	11.05***
Size	0.0389	0.52	0.1366	1.87*	0.0634	0.9	0.0619	0.89	0.0949	1.44	-0.0034	-0.05
ROA	0.0313	2.81***	0.0247	2.39**	0.0334	3.39***	0.0184	1.69*	0.0097	0.99	0.0175	1.93*
ChangeNI	-1.1573	-1.13	-1.1750	-1.2	-1.4520	-1.53	0.1560	0.16	0.1437	0.16	-0.2749	-0.32
Bind	0.5014	0.56	1.0697	1.23	0.9664	1.15	1.0799	1.25	1.4845	1.84*	1.3095	1.72*
Aexp	0.0909	0.13	0.1297	0.2	0.3643	0.57	0.5548	0.84	0.6206	1.01	0.7734	1.33
Aind	0.0335	0.1	-0.0058	-0.02	-0.1947	-0.61	-0.0880	-0.27	-0.0210	-0.07	-0.2737	-0.94
Tunn	0.3033	1.09	0.2031	0.75	0.3326	1.27	0.2043	0.76	0.1154	0.46	0.4337	1.82*
Prop	-0.1542	-0.53	-0.2274	-0.82	-0.3355	-1.24	-0.1313	-0.47	-0.2250	-0.86	-0.1503	-0.61
Leverage	-0.0053	-0.79	-0.0044	-0.68	-0.0047	-0.75	-0.0025	-0.39	-0.0050	-0.82	0.0003	0.04
Divi	8.8849	8.92***	8.2899	8.58***	7.7959	8.29***	7.5796	7.73***	6.2104	6.71***	5.6589	6.46***
Liquidity	0.0143	0.46	0.0309	1.03	0.0529	1.8*	-0.0025	-0.08	0.0257	0.91	0.0661	2.46**
Audit	0.0000	-0.29	0.0000	-0.41	0.0000	-0.08	0.0000	-0.19	0.0000	0.04	0.0000	0.44
Ind_dumm	-0.1933	-0.81	-0.0810	-0.35	-0.2065	-0.92	-0.1094	-0.49	0.0555	0.26	-0.1190	-0.6
R ²	0.2315		0.2828		0.2719		0.2806		0.3729		0.354	
F-stat (P-value)	11.71(0.000)		15.33(0.000)		14.52(0.000)		15.16(0.000)		23.12(0.000)		21.31(0.000)	
Observation	639		639		639		639		639		639	

Coefficients are estimated using $Y = \alpha_0 + \beta_1 \text{REMproxy}_{it} + \beta_2 \text{Dscore}_{it} + \beta_3 \text{REMproxy}_{it} * \text{Dscore}_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{ROA}_{it} + \beta_6 \text{ChangeNI}_{it} + \beta_7 \text{Bind}_{it} + \beta_8 \text{Aexp}_{it} + \beta_9 \text{Aind}_{it} + \beta_{10} \text{Tunn}_{it} + \beta_{11} \text{Prop}_{it} + \beta_{12} \text{Leverage}_{it} + \beta_{13} \text{Dividend}_{it} + \beta_{14} \text{Liquidity}_{it} + \beta_{15} \text{Audit}_{it} + \beta_{16} \text{Industry}_{it} + \epsilon_{it}$ (11). Where Y = MTB; MTB = market value of the firm scaled by book value of the firm. REM = one of the three proxies for REM (Ab_CFO, Ab_PRO and Ab_DISC) as determined in section 5.4.4.1. Other variables as previously defined. ***, **, * indicates that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

Table 7.16 (Continued)

	Non-transaction-based Disclosures					
	Ab_CFO		Ab_PRO		Ab_DISC	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	0.1113	0.11	-1.3169	-1.41	-1.2753	-1.44
Ab_CFO	28.9215	4.51***				
Ab_PRO			33.3626	10.94***		
Ab_DISC					46.0435	10.49***
Dscore	3.5952	4.19***	4.4757	5.78***	5.9010	7.94***
Ab_CFO*Dscore	-55.1664	-5.11***				
Ab_PRO*Dscore			-65.4254	-12.47***		
Ab_DISC*Dscore					-96.3950	-13***
Size	-0.0613	-0.84	0.0189	0.29	-0.0195	-0.32
ROA	0.0320	2.99***	0.0170	1.85*	0.0257	2.99***
ChangeNI	-1.3144	-1.34	-0.8274	-0.95	-0.5737	-0.69
Bind	0.4966	0.58	0.1264	0.16	-0.0366	-0.05
Aexp	-0.1249	-0.19	-0.0093	-0.02	0.2478	0.44
Aind	-0.0182	-0.06	0.0008	0	-0.2869	-1.03
Tunn	0.1630	0.6	0.1980	0.83	0.2326	1.02
Prop	-0.2817	-1.01	-0.2410	-0.98	-0.2061	-0.87
Leverage	-0.0007	-0.11	-0.0030	-0.53	-0.0054	-0.97
Divi	8.4246	8.74***	6.8420	7.94***	5.9485	7.16***
Liquidity	0.0238	0.79	0.0403	1.51	0.0514	2.01**
Audit	0.0000	-0.37	0.0000	0.06	0.0000	0.56
Ind_dumm	-0.4071	-1.75*	-0.3155	-1.53	-0.6176	-3.13***
R ²	0.28		0.435		0.4835	
F-stat (P-value)	15.12(0.000)		29.93(0.000)		36.39(0.000)	
Observation	639		639		639	

Coefficients are estimated using $Y = \alpha_0 + \beta_1 \text{REMproxy}_{it} + \beta_2 \text{Dscore}_{it} + \beta_3 \text{REMproxy}_{it} * \text{Dscore}_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{ROA}_{it} + \beta_6 \text{ChangeNI}_{it} + \beta_7 \text{Bind}_{it} + \beta_8 \text{Aexp}_{it} + \beta_9 \text{Aind}_{it} + \beta_{10} \text{Tunn}_{it} + \beta_{11} \text{Prop}_{it} + \beta_{12} \text{Leverage}_{it} + \beta_{13} \text{Dividend}_{it} + \beta_{14} \text{Liquidity}_{it} + \beta_{15} \text{Audit}_{it} + \beta_{16} \text{Industry}_{it} + \varepsilon_{it}$ (11). Where Y = MTB: MTB = market value of the firm scaled by book value of the firm. REM = one of the three proxies for REM (Ab_CFO, Ab_PRO and Ab_DISC) as determined in section 5.4.4.1. Other variables as previously defined. ***, **, * indicates that the parameter estimates are statistical significance at the 1%, 5% and 10% levels respectively.

7.3 Summary of the Chapter

The chapter presents the findings and the interpretations of the value-relevance of the disclosed RPTs and REM practice in RPTs, the relationship between REM in RPTs and firm value. The chapter concludes with the analyses and interpretations of the moderating effect of compliance with the disclosure requirements on RPTs on the relationship between REM in RPTs and firm value. It is documented that RPT

disclosure is value-relevant in both pre-MFRS and post-MFRS adoption periods. The basic EPS influences the stock price valuation across the study periods. Similarly, the basic BVPS influences the stock price valuation across the study periods with exception of pre-MFRS adoption period. The results of the analyses proved that BVPS of the RPTFirms is value-relevant before the mandatory adoption of MFRS 124 in 2012. On the contrary, EPS of the RPTFirms becomes value-relevant after the mandatory adoption of MFRS 124. This indicates that with the adoption of MFRS 124, capital market participants value the EPS of the RPTFirms over the BVPS of those firms. The results from the return models reveal that even though the basic net income and changes in the net income are value-relevant across the study period, the net income and changes in the net income of RPTFirms are value-relevant only in the post-MFRS 124 adoption period.

It is also established that firms use RPTs to perpetrate REM. This was evidenced by the abnormally low cash flow from operations, abnormally high production costs and abnormally low discretionary expenditure of the RPTFirms. The result shows that the cash flow from operations and discretionary expenditure of the RPTFirms are exceptionally low than what it ought to be under normal circumstances. Similarly, the study provides evidence that the production costs of the RPT firms are exceptionally low compared to the non-RPTFirms counterpart. This indicates that RPTFirms overproduced to lower the unit costs and boost the reported income.

It is evidenced that capital market discounts the stock price of the firms that engage in REM in RPTs. This can be seen from the sound negative relationships between REM proxies (abnormal cash flow from operations, abnormal production costs and abnormal discretionary expenditure) and firm value. It is also established that

compliance with disclosure requirements on RPTs moderates the relationship between REM in RPTs and firm value. This because high level of compliance with disclosure requirements on RPTs alleviates the negative relationship between REM in RPTs and firm value. On the contrary, low level of compliance with disclosure requirements on RPTs aggravates the negative relationship between REM in RPTs and firm value. Lastly, moderate/average compliance with disclosure requirements on RPTs has no effect on the relationship between REM in RPTs and firm value.



CHAPTER EIGHT

SUMMARY, CONCLUSION AND RECOMMENDATIONS

8.0 Introduction

Related party transactions are forms of legal transactions allowed all over the world for its associated benefits to the transacting parties in particular and the nation in general. It is used to facilitate the decision-making process, improve the efficiency in supply chain process, minimize transaction costs, efficient resource allocation, and serves as an alternate source of finance in certain situations. Nonetheless, these forms of transactions are used for self-serving purposes and lead to the collapse of many giant firms across the globe. Organization for Economic Co-operation and Development (OECD, 2009) claims that the biggest corporate governance challenge facing Asian business landscape is the abusive RPTs which can take the form one-off material expropriations of wealth or the slow expropriation of wealth through continuous operational transactions.

The rate at which RPTs are used to defraud firms or expropriate minority shareholders has pushed the regulators in financial reporting to increase the numbers of items required to be disclosed while transacting with the related entities. The need for the information is more pronounce in the firms with type II agency problem. In these firms, the controlling shareholders use their controlling power to take decisions that match their personal interest at the detriment of the minority shareholders in particular and firms in general. In view of this international accounting standard board has dedicated a complete standard to guide the preparers of financial reports on what should be disclosed in the annual reports to curb the menace and meet the information

needs of users regarding RPTs. However, studies on the extent of compliance and the effect of such disclosures are lacking.

This study has filled-up these gaps by providing empirical evidence on the extent of and determinants of compliance with the disclosure requirement of the accounting standard on RPTs in a country characterized by the dominance of the concentrated and family ownership. Also, this study has proved that RPTs disclosures are valued by the capital market participants. Moreover, the study provides evidence that many firms used RPTs to perpetrate REM. Similarly, it is documented that capital market disciplines the firms that engage in REM in RPTs, and that compliance with disclosure requirements on RPTs moderates the relationship between REM in RPTs and firm value.

8.1 Overview of the Thesis

This thesis contains the empirical findings on the five major issues on the RPTs disclosure. These issues are categorized into i) the extent of compliance with the disclosure requirements on RPTs. ii) determinants of compliance with the disclosure requirements on RPTs. iii) the value relevance of RPT disclosure. iv) the relationship between REM in RPTs and firm value and v) the moderating effect of compliance with the disclosure requirements on RPTs on the relationship between REM in RPTs and firm value. Chapter One of the thesis discusses the issues in RPTs and RPTs disclosure across the world in general and Malaysia in particular under the background of the study. The Chapter also highlights the theoretical problems regarding RPTs in the problem statement and explains the research questions, objectives of the study, significance of the study among others. Chapter Two presents the Malaysian and

global laws and regulations governing the conduct and disclosure of RPTs. Chapter Three reviews the literature on the concept of, the extent and determinants of RPT disclosure. Chapter four dwells on the literature on value relevance and REM in RPTs. Chapter Five describes the methodology adopted in this study and presents the hypotheses development and frameworks.

Chapter Six of this thesis presents the findings on the extent of compliance and determinants of compliance with the accounting standard on RPTs. Chapter Seven discusses the finding of the study regarding the value relevance of RPTs disclosure, REM in the RPTs, the relationship between the relationship between REM in RPTs and firm value and the moderating effect on compliance with the disclosure requirements on RPTs on such relationship. The last chapter presents the overview of the thesis, summary of the findings, the contribution of the study, limitations of the study and suggestions for future studies.

8.2 Summary of the findings

There are five main objectives of this study. First, to examine the level of compliance with the disclosure requirements of the accounting standard on RPTs by companies listed on Bursa Malaysia. Second, to find out factors that determine the level of compliance with the RPTs disclosure requirement by the companies listed on Bursa Malaysia. Third, to measure the value-relevance of the disclosed RPT information in the financial reports of the companies listed on Bursa Malaysia for both pre and post mandatory adoption periods. Fourth, to assess the relationship between REM in RPTs and firm value. Last, to investigate the moderating role of the level of compliance with

the disclosure requirements of MFRS 124 on the relationship between REM in RPTs and firm value.

8.2.1 Findings on the Extent of Compliance with RPTs Disclosure

The first finding relates to the extent of compliance with the disclosure requirements on RPT. The study finds a moderate level of compliance with the disclosure requirements on RPTs by firms listed on Bursa Malaysia. The average level of compliance for the period under review was 70.5%. This level of compliance is within the range reported by Carlin et al. (2009), Dang-Duc (2011), Glaum et al. (2013) and Hodgdon et al. (2008) in some European and emerging markets. However, accounting standards are expected to be complied with in totality. Thus, there is a need for high level of compliance most especially in sensitive accounting issues such as RPTs. Although there has been a positive improvement as the highest level of compliance was achieved in 2015 for the post-MFRS adoption period, there is a need for continued improvement. The result suggests the need for improvement more especially on the non-transaction-based disclosures where the rate of compliance is very low. This means that financial regulators should increase the level of enforcement to achieve the desired benefits attributed to the corporate transparency and financial reporting quality across the globe. On industry basis, the results highlight low level of compliance by non-manufacturing firms. In terms of firm characteristics, large firms and those with higher audit quality are associated with the high level of compliance compared to their counterparts. The study does not document any evidence that firm profitability and post-2012 regulations improve the level of compliance with the disclosure requirements on RPTs.

8.2.2 Findings on the Determinants of Compliance with RPTs Disclosure

The second finding relates to the determinants of compliance with the disclosure requirements. The determinants of compliance with the disclosure requirements are divided into corporate governance mechanisms and firm financial characteristics. The items considered under corporate governance mechanisms are board characteristics, audit committee characteristics, CEO characteristics and ownership structure. The financial characteristics contain the RPT motives and firm performance.

On the part of the influence of board characteristics, the study partially supports the influence of board characteristics on the firms' disclosure behavior with respect to RPTs. The variables measured under board characteristics are board independence and board size. The empirical evidence suggests that board independence is associated with the high level of RPTs disclosure. This signals that independent directors on corporate boards minimize agency problems and protect the interest of all stakeholders. They also ensure that relevant information is released to the users of the financial statement. On the part of board size, the result does not support the position that bigger boards are associated with the high level of RPTs disclosure. The results suggest that the smaller the board, the better in terms of compliance with the disclosure requirements on RPTs. This reflects the effect of a large number of business owners and family members on corporate board. These members in most cases lack the necessary skills to influence the firms' disclosure behavior or have some personal interests to protect rather than the overall firm transparency.

The second item of corporate governance mechanisms for this study is the audit committee characteristics. The result of the analyses partially supports the influence of audit committee characteristics on the firms' disclosure behavior with respect to

RPTs. The variables considered under audit committee characteristics are audit committee independence and audit committee expertise. Previous studies have documented that audit committee independence improves the firms' transparency and overall disclosure behavior. However, empirical result from this study documents a contrary position. The possible explanation for this contradictory finding is the independent director's industry or financial expertise. Most of the audit committee of the firms listed on Bursa Malaysia contains independent member(s) that lack the financial or industry expertise. Basically, the major roles of audit committee include to scrutinize the quality of the content of financial statements and ensure that relevant laws and regulations are adhered to. A member who falls short of the requisite expertise required to perform these roles cannot add value to the committee. Thus, lack of financial and industry expertise may explain why the audit committee independence fails to support its positive influence on compliance with the disclosure requirements on RPTs.

Previous studies have shown that audit committee financial expertise improves the quality of financial information and restraint the financial excesses by management (Davidson III et al., 2004; Zhang et al., 2007). The empirical result of the audit committee financial expertise supports the hypothesized positive relationship between audit committee financial expertise and compliance with the disclosure requirements on RPTs. This finding demonstrates that audit committee financial expertise is instrumental in the prevention and detection of fraudulent manipulation of accounting numbers. Hence, improves the financial reporting quality.

The third element of corporate governance mechanisms used in this study is the CEO characteristics. Three variables are tested as proxies for CEO characteristics. The

variables are CEO financial expertise, CEO family lineage and CEO ownership. On the CEO financial expertise, Custódio and Metzger, (2013a) provide evidence that CEOs with financial expertise are financially sophisticated and more likely to manage actively firm's financial policies. Conversely, the result of the regression does not provide statistical support that CEO financial expertise improves the level of compliance with the disclosure requirements on RPTs. The possible explanation for this finding can be related to the concentrated ownership structure of the firms in Malaysia. Therefore, many financially expert CEOs may prefer to serve their own interest or the interest of the family when the disclosure is capable of exposing their internal dealings.

This study provides evidence that the family lineage of CEO influences the level of compliance with the RPTs disclosure requirements negatively. Consistent with the literature, when the CEO is a family member (s)he does whatever possible to conceal vital information on RPTs to avoid market reaction or sanctions from the regulatory authorities. This finding supports the previous result on the CEO's financial expertise that CEOs in concentrated firms prefer to align with the interest of the family rather than professional etiquette. Related to this, this study documents that CEO ownership (generally be it in the family or non-family firm) decreases the extent of compliance with the disclosure requirements on RPTs. CEO firms are associated with the low transparency to prevent information leakages of proprietary information and rent-seeking activities (Fan & Wong, 2002; Gul & Lai, 2002).

The last element of corporate governance characteristics tested in this study is the ownership structure. In this category, the study considers family ownership, managerial ownership and foreign ownership. Contrary to the extent of literature, this

study provides empirical evidence that family ownership is positively associated with RPTs disclosure. Similarly, the study documents positive relationship between managerial ownership and the level of compliance with the RPTs disclosure requirements. The possible reason for these two findings is the presence of concentrated ownership in Malaysia. This might have made these firms to disclose more information, especially on RPT to minimize the type II agency problem and alleviate the fear of internal dealings. Another possible reason for this positive relationship can be seen from alignment effect. When the level of ownership is high, managers act in the best interest of the firm as any decrease in the firm value is more detrimental to the controlling owners than any other party. Al-Dubai et al. (2015) document that as the family ownership increases, the behavior of family members changes from expropriation to monitoring role.

One important thing to note is that the findings of the last two items of corporate governance are associated with the CEO position not the level of ownership. Hence, the CEO position (regardless of the pattern of ownership) affects the extent of compliance with the disclosure requirement on RPTs negatively. On the other hand, family ownership and managerial ownership improve the extent of compliance with the disclosure requirements on RPTs. This study has shown that foreign ownership is associated with the less compliance with the disclosure requirements on RPTs. The negative relationship can be associated with the level of foreign ownership as discussed in chapter six. Another possible reason for the negative relationship can be attributed to distance and cultural differences. Consistent with Du et al. (2017) that the place of living or physical distance affects the information disadvantage and effective monitoring of foreign directors.

On the part of firm financial characteristics, this study finds no evidence that RPTs motives affect the level of compliance with the disclosure requirements of the accounting standard on RPTs. The variables measured in RPT motives are tunneling and propping. None of the variables under RPTs motives is significant. The possible reason for this can be associated with the measurement issues. The extent of literature has not reached consensus or provide a clear-cut measure of tunneling. Most of the existing measures have been attacked by many studies for the lack of precision in capturing the tunneling motives (see for example Chen et al., 2014; Jiang, Rao, & Yue, 2015; Peng, Wei, & Yang, 2011). In most cases, the information disclosed in the financial statements or circulars does not allow for the understanding of the real motives behind the transactions. This makes it difficult for researchers to identify the tunneling transactions among the disclosed RPTs. A similar result has been documented with respect to propping. In short, these results stress the need for extended disclosure of information in order to distinguish the motive behind the RPTs

The last set of variables considered in this study is related to the firm performance. These variables consist of profitability, firm growth and dividend payment. This study documents that profitable firms are associated with less compliance with the disclosure requirements of the accounting standard on RPTs. This suggests that in most cases, firms manipulate RPTs to achieve impressive results. Hence, prefer to provide sketchy information on the RPTs to cover the underground dealings. Another possible reason for this can be seen from the overall goal of rational investors. Hence, once the profit is made, many investors may not be interested in the detail information on the process and source of that profit. Therefore, profitable firms have less pressure on the volume of information required to satisfy the information needs of the users of the financial statement.

The study also documents that high growth firms are associated with the high level of compliance with the disclosure requirements on RPTs. This is because firms with the high stock price growth have to provide detail information on their activities to justify the growth in the share price and lower the information asymmetric. Another possible reason is that high growth firms have ample business opportunities, therefore, they may wish to request for additional funds to finance their growth. Thus, they have to provide detail information on the current status to lower the future finance costs. This study does not support the dividend payment as a determinant of compliance with the disclosure requirements of accounting standards on RPTs. The possible reason for is the concentrated ownership nature of Malaysian firm. In these firms, the ownership and control lay with the same party. This makes the dividend policy irrelevant to the firm disclosure behavior. Because, any dividend policy adopted be it cash payment, share buyback or retained to finance future expansion will impose no additional agency problem to the firm.

8.2.3 Findings on Value Relevance of RPT Disclosure and MFRS 124 Adoption

The study documents that disclosure of RPTs is value-relevant throughout the period of study. The study provides empirical evidence that prior to the mandatory adoption of MFRS 124, neither the BVPS nor the EPS of the RPTFirms was value-relevant. However, with the adoption of the MFRS 124, the EPS of the RPTFirms becomes value-relevant. This indicates that mandatory adoption of MFRS 124 has increased the informativeness of the EPS of RPTFirms. Hence, investors have now shifted attention from the BVPS to the EPS of the RPT firms which makes it more value relevant.

Moreover, the study documents that both the level of the net income and changes in the net income of RPTFirms are not value-relevant before the mandatory adoption of MFRS 124. However, the adoption of MFRS 124 has made both the level of net income and changes in the net income of RPTFirms to be among the explanatory variables of the stock return. These findings support the stream of literature that documents the supremacy of IFRS over local GAAPs (Barth et al., 2008; Dimitropoulos et al., 2013; Maigoshi, 2014).

8.2.4 Findings on Relationship between Real Earnings Management in RPTs and Firm Value

Previous studies have established the existence of accrual earnings management in RPTs (see for example Aharony et al., 2010; Beuselinck & Deloof, 2014). On the other hand, this study provides evidence for the abnormal CFO in RPT firms which is an indication of REM. Similarly, the study identifies RPTFirms with abnormal production costs. This indicates that firms overproduce to lower the unit production cost which is one of the three techniques of REM identified by (Roychowdhury, 2006). The extent of literature has defined lower abnormal discretionary expenditure as an element of REM. This study provides evidence that firms use RPTs to manipulate the discretionary expenditure. Overall, it is established that RPTs firms use abnormal CFO, abnormal discretionary expenditure and abnormal production cost to manipulated reported earnings.

On the issue of the relationship between REM in RPTs and firm value, this study provides sufficient evidence that capital market discounts the stock price of firms that engage in REM in RPTs. firms engage in PRTs to manipulate the reported earnings. These transactions lead to abnormal low cash flow from operations, abnormal high

production costs and abnormal low discretionary expenditures. It is documented that capital market disciplines the firms with abnormally low cash flow from operations, abnormally high production costs and abnormally low discretionary expenditures. Hence, it can be said that the stock of the firms that engage in REM in RPTs are traded at discount. These findings are consistent with Gordon et al. (2004) Kohlbeck and Mayhew (2010), and Lei and Song (2011) that capital market discounts the stock price of firms that engage in REM in RPTs.

8.2.5 Findings on the Moderating Effect of Compliance with RPT Disclosures

This study finds that different level of compliance with the disclosure requirements on RPTs has a different effect on the relationship between REM in RPTs and firm value. It is documented that high level of compliance with the disclosure requirements on RPTs mitigates the negative relationship between REM in RPTs and firm value. On the contrary, the study provides evidence that low compliance with the disclosure requirements on RPTs worsens the negative relationship between REM in RPTs and firm value. It is worthy to note that low level of compliance with the disclosure requirements on RPTs has no effect on the negative relationship between REM in RPTs and firm value.

8.3 Contributions of the Study

This study has some theoretical contributions and methodological contributions as follows.

8.3.1 Theoretical Contributions

This study extends the understanding of existing theories. The study contributes to the agency theory by identifying the factors that can be used to mitigate agency costs. In an organizational setting that presents an opportunity for insiders to expropriate the wealth of the firm at the expense of outsiders, the findings of the study show that board independence, audit committee financial expertise and dominance ownership can be used to minimize the agency costs. It is also proved that CEO characteristics cannot be relied on to mitigate the agency problem in the countries with the concentrated ownership. Furthermore, the study extends the understanding of the techniques to expropriate the firm. Hence, the disclosure of RPTs in financial statements can be used for the detection of misleading financial information which ultimately minimizes the agency conflict.

Moreover, this study contributes to the resource dependency theory. Though the study does not document the influence of board size on the firms RPTs disclosure, it provides empirical evidence that audit committee financial expertise influences the extent of compliance with disclosure requirements of the RPTs. This stresses the need for firms to source directors with requisite experience and expertise for counseling and advising roles.

Also, this study contributes to the capital market research in accounting by testing the market valuation of the information released in the financial statement. Value-relevance is a process that uses the statistical tools to test how the line items or other items of information in the financial statements affect the stock valuation or return in the capital market. This study provides evidence on the value relevance of the RPTs disclosure, BVPS, and EPS of the RPTs firms under different accounting regimes. It

also documents how the level and change in the net income affect the stock return in the capital market.

Further, the study discovers that capital market is aware and discounts the stock price of the firms that manipulate reported earnings in RPTs. studies such as Cupertino et al. (2015) and Kothari et al. (2015) document that capital markets fail to identify the earnings management conducted through real activities manipulations. However, this study discovers that the situation is not the same with the real activity manipulations in RPT. This finding contributes to the existing literature by documenting that capital market is aware with REM perpetrated through some activities such as RPTs.

Moreover, to the best of the researcher's knowledge, this study is the first of its kind that documents the moderating effect of compliance with RPTs disclosure requirements on the relationship between REM in RPTs and firm value. Previous studies such Gordon et al. (2004) Kohlbeck and Mayhew (2010), and Lei and Song (2011) document the negative effect of abusive RPTs on the firm value. However, studies on how to mitigate such negative effect are grossly scarce. The present study has contributed to the existing literature on the moderating role of compliance with RPTs disclosure requirements on the relationship between REM in RPTs and firm value.

8.3.2 Methodological Contributions

This study contributes to the existing literature on the earnings management. Most of the previous studies on earnings management in RPTs have concentrated on the accrual earnings management. This study extends the level of understanding the earnings management in RPT by considering the REM practices in the RPTs. This

study provides empirical evidence that firms employ the RPTs to perpetrate REM. This contribution is timely because of the changes in regulations in Malaysian reporting environment might have made some firms to shift attention from the traditional accrual earnings management to the REM. Hence, identifying the tricks that could be adopted to perpetrate the REM is paramount.

Traditionally, most of the REM studies identify firms with specific characteristics or during certain event/activities and classify them as suspect firms. These characteristics or activities include small positive profit, meeting analysts forecast, on the eve of initial public offering /seasoned equity offering, meet previous year's earnings and alike. This study identifies (RPTFirm) and uniquely measures (Through Roychowdowry model) the RPTFirms for REM. Thus, the study extends the list of firms that could be the target firms for subsequent REM studies.

8.4 Implications of the Study

This study has some theoretical implications and practical implications as follows.

8.4.1 Theoretical Implications

This study has made a number of theoretical implications in the following ways. First, as mentioned earlier, to the best of the researcher's knowledge, there was no any previous study that documented the extent of compliance with the disclosure requirements of accounting standard on RPTs. Thus, this study is the first of its kind that fills in this literature gap by documenting the level of compliance with the disclosure requirements of accounting standard on RPTs. Moreover, this study reveals the areas of much deficiencies in terms of compliance with the standard. The study

provides evidence that firms recorded high level of compliance with the transaction-based disclosure requirements, while the level of compliance with the non-transaction-based disclosure requirements was very low.

Second, previous studies have concentrated on the determinants of firm transparency and general disclosure behavior (see for example Ali et al., 2007; Daske and Gebhardt, 2006; Urquiza et al., 2009). Recently, little efforts have been put in place to identify the factors that influence compliance with certain disclosure requirements (see for example Wan-Hussin, 2009; Zango et al., 2016). This study has contributed to this recent trend in disclosure studies by identifying the factors that determine the level of compliance with the disclosure requirements related to RPTs. Malaysian economic setting provides a unique environment for RPT disclosure studies and the results from these studies can apply to several economic settings for the following reasons. First, the dominance of concentrated ownership and business groups which induce firms to frequent and heavy RPTs. Second, the reporting environment has been subjected to a number of regulations and regulatory changes. These two factors have paved a way for this study to contribute to the existing body of knowledge by documenting these interesting findings:

(a) Audit committee financial expertise: audit committee members' financial expertise is more commanding than independence in terms of RPT disclosure. This is because of the technicalities involved in the RPTs which requires special expertise to identify the motive and any other hidden interest attached to it. An independent member with objective mind may not be able to scrutinize and discover some irregularities in RPTs without the requisite financial knowledge to do so. Hence, financial expertise is paramount on audit committee's effectiveness.

(b) CEO characteristics: CEO position is associated with less compliance with the RPTs disclosure requirements. None of the CEO's attributes been it financial expertise, family lineage or ownership influences the level of compliance positively. The results from the CEO family lineage and ownership are in line with the existing literature. Though, previous studies have established that CEO's financial expertise improves the transparency and financial decision. On the contrary, this study documents no evidence that CEO's financial expertise improves the RPTs disclosure.

(c) Ownership structure: Several studies document that family ownership and managerial ownership are associated with the less information disclosure. They find that family and managerial firms provide less information to conceal their internal dealings and extract private benefits of control. On the contrary, this study documents that these forms of ownerships are associated with high RPT disclosure. As mentioned earlier, the alignment effect might have been the reason for high RPT disclosure in the firms with the concentrated ownership structure.

(d) RPT motives: This study finds no evidence that RPT motives influence the level of compliance with the disclosure requirements of the accounting standard on RPTs. Studies like Cheung et al. (2006) and Peng et al. (2011) found that PRT motives influence the level of RPT disclosure. They find that tunneling RPTs are associated with less information disclosure. On the other hand, propping RPTs are associated with detail information disclosure. Nevertheless, this study finds no empirical evidence that neither of the motives influences the level of compliance with the disclosure requirements on RPTs. The issue of measurement might be the possible factor responsible for the above findings. It seems that firms do not release the necessary information that permits the classification between tunneling and propping

RPTs objectively. This makes it difficult for researchers to develop appropriate measures for the tunneling and propping RPTs.

(e) Firm performance: In the countries with the disperse ownership structure, profitable firms disclose more information to portray the performance of the management. On the contrary, this study documents a negative relationship between the extent of compliance with the disclosure requirements of the accounting standard on RPTs and the firm profitability in a concentrated ownership setting. This indicates less type I agency problem in this organizational setting. This is because firms with concentrated ownership structure are characterized with absent of owners-manager (type I) agency conflict because both ownership and control lay within the same party. This position has been supported by the absence of a significant relationship between the extent of compliance with the disclosure requirements of accounting standard on RPTs and dividend payments.

Third, this study extends the existing literature on earnings quality and value relevance by documenting the market valuation pattern of the RPT firms. The study provides empirical evidence that capital market values the disclosure of the RPTs. It is also evident that BVPS and EPS of RPTFirms exhibit varying valuation pattern based on the quality of information attached to them. That is to say where there is sufficient information on EPS, the market values the EPS of the RPTFirms over the BVPS of the RPTFirms. Besides, the study extends the understanding on the importance of the reporting standard to the market participants. It is documented that with the adoption of MFRS 124, both the level and changes in net income of RPTFirms become value relevant.

8.4.2 Practical Implication

The findings of this study highlight a number of practical issues with many practical implications. These issues need improvement to increase the current level of compliance with the accounting standard and accounting quality. First, the study highlights that with the adoption of MFRS, the financial health of the firms listed on Bursa Malaysia has been improved. This is based on the increased value relevance of BVPS and EPS after the mandatory adoption of MFRS across the market. Moreover, the mandatory adoption of MFRS standards has made the EPS of the RPT firms more relevant in the valuation process than what it does before the adoption. This implies an improvement in the earnings informativeness of the RPT firms.

Notwithstanding, the study identifies low compliance with some aspects of the disclosure requirements of the accounting standard on RPTs. Therefore, there is a need for the Malaysian Accounting Standard Board to increase the level of enforcement in these areas to achieve full compliance. Doing so will result to increased transparency of financial reporting and investor protection. These in turn, will enable the Malaysian economy to enjoy the benefits derivable from the high quality of the reporting environment. These benefits include increased market liquidity, low cost of capital, the inflow of foreign investment and many other economic benefits.

Second, the findings of the study exposed some weaknesses in the Malaysian code of corporate governance. It is apparent that the code places more emphasis on the independence of the audit committee than the level of members' financial expertise. However, the findings of the study highlight the importance of financial expertise more especially in the areas with financial technicalities that requires deep financial knowledge to identify any breaches or fraudulent activities in those areas. In view of

this, this study recommends that Suruhanjaya Sekuriti (Security Commission of Malaysia) should in the forthcoming code redefine the financial expert as (a) a person with a minimum of bachelor degree or professional qualification in accountancy or other finance related fields. (b) a person with at least 5 years' experience in the finance-related position or industry. The commission should also increase the required number of persons with the professional qualification in the audit committee to at least two persons. This is to allow the professionals to have a thorough review of the firms' financial activities and enjoy the benefit of shared responsibility. It is also recommended that the commission should train and retrain its staff so as to easily identify any breach in compliance with ease and take appropriate sanction against the perpetrators.

Third, this study reveals that the disclosures of the real motives behind the RPTs are not clear. Neither the circular to the shareholders nor the annual report contains clear information that enables the identification of the tunneling or propping transactions. Therefore, this study recommends Malaysian accounting standard board and Bursa Malaysia to initiate requirements that can force the management to disclose the actual or estimated/provision profit or loss (Net Present Value) derivable from transactions with the related parties. Where the transaction falls within the ordinary business of the firm, the reporting entity should be made to disclose any deviation from the normal price or terms of the transaction. This will help in curbing the instances of transfer of profits from one party to another and checkmates the occurrence of REM in RPTs.

Finally, this study has a significant impact on the investors, analysts and academics that need to broaden their level of understanding on the extent of and the factors that influence the level of compliance with the disclosure requirement of RPTs. The study

also investigates the value relevance of the RPT disclosure and accounting numbers and changes in the value relevance of accounting numbers as a result of the change of the accounting regime. The study covers also the issues pertaining REM activities through the RPTs and its market valuation. All these are some of the areas of interest in which investors, regulatory bodies and future researchers can benefit from this study.

8.5 Limitations

The findings of this thesis can be fairly interpreted with a better understanding of these research limitations. First, although necessary steps have been adopted, measuring the level of compliance with the disclosure is always attached with some degree of subjectivity. This can affect the replicability of the findings of the thesis by different researchers using the same index. Another item of concern is that MFRS 124 provides for compliance with other relevant standards (such as MFRS 2, MFRS 101, MFRS 119, MFRS 127, and MFRS 128). Hence some items such as employee compensation, investment in associates, operating segment might have been complied with based on those standards with different nomenclature and are not scored based on MFRS 124 which may affect non-transaction based compliance.

Second, this study uses only two variables from the board composition and audit committee characteristics and three variables from the CEO characteristics and ownership structure. It is possible that other corporate governance mechanisms such as gender diversity, ethnic diversity, board tenure, internal audit function, internal audit source that are not considered in this study contribute to the compliance with the disclosure requirements of the accounting standard on RPTs. Besides the corporate

governance mechanisms, other factors such as cross-listing, international footage and affiliations may have explanatory power on the level of compliance with the disclosure requirements of the accounting standard on RPTs are also omitted from this study.

Finally, this limitation is associated with the measurement of the tunneling and propping motives. This study uses the firm performance to predict the tunneling or propping intention which may not give a clear reflection of the actual intention of the transaction. The motives can be better measured through the interview or survey method.

8.6 Suggestion for future studies.

The findings of this study provide an avenue for future researchers to explore the following areas. First, this thesis suggests that future studies may consider the replication of this study in the countries with the disperse ownership structure. Concentrated ownership has played important role in shaping some of the findings of this study. So it will be interesting to document findings from different organizational setting. Another area of interest is the issue of direct and indirect ownerships. Future studies should explore the effect of direct and indirect ownerships on the level compliance with disclosure requirement on RPTs. future studies should also explore the effect of the magnitude of RPTs (that is extreme RPTs vs little RPTs) on REM in RPTs.

Second, this thesis presents the results of some selected corporate governance mechanisms and firm characteristics used in this study. The study can be extended by measuring the effect of the omitted governance mechanisms and characteristics. The

findings will provide additional information on the factors that influence the firm's disclosure behavior.

Third, qualitative research approach could be used to complement the findings of this thesis, especially related to the tunneling or propping motives and value relevance of accounting numbers. Discussion with the managers, investors and other stakeholders through interview or case study could provide more useful insight on their perception regarding the RPTs.

Finally, having established that firms engaged in REM practices in RPTs and the valuation effect of such practices with compliance with disclosure requirement as moderator. It is important to investigate the moderating effect of other firms monitoring mechanisms such as foreign directors, audit quality on the relationship between real earning management in RPTs and firm value.

8.7 Concluding Remark

Related party transactions disclosure can be used to minimize the agency conflict and improve the firm value. The disclosure of RPTs is mandatory on all listed firms, however, the extent of the compliance with the disclosure requirements depends on the firm's internal governance mechanisms and other financial characteristics. Hence, regulators are urged to increase the level of enforcement of the compliance with the laid-down disclosure requirements.

Listed firms have a lot to benefit by providing detail information on the transactions with the related parties. The disclosures alleviate fears of the market players on the internal dealings more especially in the firms characterized by the concentrated

ownership. It is equally important for investors to scrutinize the reported earnings and check whether such profits are the products of ‘arranged transactions’ to avoid the possible mistake of investing in bad eggs. This is because many firms use RPTs to perpetrates REM in such a way that it cannot be easily traced by the auditors and sophisticated investors. Finally, it is hoped that this study will be a bedrock for further studies on RPTs, compliance with the disclosure requirements of other accounting standards individually, value-relevance and REM issues in Malaysia and across the world.



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Appendix A

Related Party Transactions Disclosure (MFRS 124) Checklist

Paragraph	Sub-paragraph	MFRS 124 Related Party Disclosures	
13		Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been transactions between them. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.	√
14		To enable users of financial statements to form a view about the effects of related party relationships on an entity, it is appropriate to disclose the related party relationship when control exists, irrespective of whether there have been transactions between the related parties.	
	(a)	Percentage of ownership	√
17		An entity shall disclose key management personnel compensation in total and for each of the following categories:	
	(a)	Short-term employee benefits;	√
	(b)	Post-employment benefits;	√
	(c)	Other long-term benefits;	√
	(d)	Termination benefits; and	√
	(e)	Share-based payment.	√
18		If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17. At a minimum, disclosures shall include:	
	(a)	The amount of the transactions;	√
	(b)	The amount of outstanding balances;	√
	(c)	Their terms and conditions;	√
	(d)	Whether they are secured;	√
	(e)	Details of any guarantees given or received;	√
	(f)	Provisions for doubtful debts related to the amount of outstanding balances;	√
	(g)	The expense recognised during the period in respect of bad or doubtful debts due from related parties.	√

19		The disclosures required by paragraph 18 shall be made separately for each of the following categories:	√
	(a)	The parent;	
	(b)	Entities with joint control or significant influence over the entity;	
	(c)	Subsidiaries;	
	(d)	Associates;	
	(e)	Joint ventures in which the entity is a venturer;	
	(f)	Key management personnel of the entity or its parent; and	
	(g)	Other related parties.	
20		The classification of amounts payable to, and receivable from, related parties in the different categories as required in paragraph 19	√
23		Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.	√

