

UNIVERSITI TEKNOLOGI MARA

**THE RELATIONSHIP BETWEEN
FINANCIAL RATIOS, CORPORATE
GOVERNANCE AND FRAUDULENT
FINANCIAL REPORTING:
EVIDENCE FROM MALAYSIAN
PUBLIC LISTED COMPANIES**

HAZIYAH NAZIFAH BINTI BUSRO

Thesis submitted in fulfilment
of the requirements for the degree of
Master of Science
(Financial Criminology)

Accounting Research Institute

January 2024

ABSTRACT

Fraudulent financial reporting (FFR) has received greater attention worldwide due to the huge financial impact that wiped out billions of dollars. Since investors rely on financial reports in making investment decisions, an increase in fraudulent financial reporting issues corrodes the investors' confidence in the reliability of financial reporting in the financial market. Therefore, this study examines the relationship between financial ratios and FFR, corporate governance mechanisms and FFR, and whether corporate governance mechanisms moderate the relationship between financial ratios and FFR of Malaysian public listed companies (PLCs). The FFR companies are selected from Securities Commission Enforcement Release (SCER) listed by Malaysia's Securities Commission for furnishing false statements. The secondary data was acquired manually from the companies' financial reports and Eikon DataStream (database). This study used logistic regression analysis to test the research hypotheses, and the finding indicates that asset composition ratio and change in auditor have a positive relationship with FFR; however, the capital turnover ratio has a negative relationship with FFR. In terms of moderation, the finding indicates that board independence as a moderating variable weakens the effects of leverage on FFR while strengthening the effects of asset composition on FFR, and change in auditor that acts as a moderating variable weakens the relationship between capital turnover and FFR. Hence, FFR companies are found to have a higher asset composition ratio, more frequently change their auditors, and are less competitive in generating sales from their total assets than non-FFR companies. We provide policy implications based on these findings since they demonstrate some warning signs as FFR prediction tools for regulators such as Securities Commissions and Bursa Malaysia in tracking and monitoring PLCs; auditors and managers in undertaking preventive action at the initial stage; and investors in implementing proper decisions by screening the potential FFR companies so that the likelihood of FFR could be mitigated. Other than contributing practically by highlighting the factors of FFR as fraud predictors, this study also contributes academically by examining the combination of signalling and agency theories.

ACKNOWLEDGEMENT

First and foremost, praise the Almighty Allah for His bestowing, giving me the health and strength to complete this thesis. Without His blessings, I would never have finished my studies.

First, I am greatly indebted to my main supervisor, Assoc. Prof. Datin Dr. Norazida Mohamed, for her encouragement, guidance, and support. I appreciate her patient guidance, invaluable advice, and motivation throughout my studies. Sincere gratitude and thanks to my co-supervisor, Assoc. Prof. Dr. Nor Farizal Mohammed, for her support, assistance, and insightful suggestions; her assistance was so detailed and thoughtful, and I immensely appreciate it. Your patience, wisdom, and expertise are essential to my success; grateful appreciation to both of you.

Second, my appreciation goes to my family for their full support, love, tolerance, and courage throughout this journey. This thesis is dedicated to both of my parents, Busro Md Said and Amanah Iksan, who raised me with good life values. I would also like to thank all my friends for their inspiration, constant encouragement, and cooperation; I immensely appreciate it.

In addition, I would like to thank Universiti Teknologi Mara (UiTM) and the Faculty of Accounting Research Institute for providing me with this opportunity to conduct this study. This allows me to learn, gain knowledge and experience in conducting research. Finally, the success of my studies would not have been possible without the kind support and assistance of many individuals and organizations. Thank you very much indeed.

TABLE OF CONTENTS

	Page
CONFIRMATION BY PANEL OF EXAMINERS	ii
AUTHOR'S DECLARATION	iii
ABSTRACT	iv
ACKNOWLEDGEMENT	v
TABLE OF CONTENTS	vi
LIST OF TABLES	x
LIST OF FIGURES	xi
LIST OF ABBREVIATIONS	xii
CHAPTER 1 INTRODUCTION	1
1.1 Introduction	1
1.2 Background of the Study	1
1.3 Problem Statement	4
1.4 Research Objectives	7
1.5 Research Questions	7
1.6 Significance of Study	8
1.7 Scope of Study	9
1.8 Definition of Key Terms	10
1.9 Structure of the Thesis	12
1.10 Summary	13
CHAPTER 2 LITERATURE REVIEW	14
2.1 Introduction	14
2.2 Fraudulent Financial Reporting	14
2.3 Financial Ratios	16
2.4 Corporate Governance Mechanisms	17
2.5 Fraudulent Financial Reporting Issues in Malaysia	19
2.6 Underpinning Theories	21
2.6.1 Signalling Theory	21

CHAPTER 1

INTRODUCTION

1.1 Introduction

This first chapter sets the foundation for this research. It gives an overview of this study by exploring the nature of the study in the context of financial ratios, corporate governance mechanisms, and fraudulent financial reporting. This study aims to examine the relationship between these variables to analyse the factors contributing to the likelihood of fraudulent financial reporting, specifically in Malaysian public listed companies. Therefore, this chapter is organised as follows: Section 1.2 provides the background of the study, followed by Section 1.3, which discusses the problem statement; Section 1.4 outlines the research objectives; Section 1.5 provides the research questions; Section 1.6 explains the significance of the study; Section 1.7 covers the scope of the study; Section 1.8 outlines the definitions of key terms; Section 1.9 provides the structure of the thesis; and finally, Section 1.10 summarises this chapter.

1.2 Background of the Study

In the past few decades, scandals related to fraud in financial reporting seem to be a controversial topic globally following the collapse of many large companies such as Enron, Adelphia, WorldCom, SK Global, Vivendi, and Parmalat (Anning & Adusei, 2020; Doan & Ta, 2023; Rahmatika et al., 2019). These issues received greater attention worldwide due to massive losses that had wiped out billions of dollars (Rosli et al., 2020; Zin et al., 2023). Malaysia is not spared as cases involving Transmile Group Berhad, Megan Media, and many high-profile companies are also reported to be involved in fraudulent financial reporting (FFR), leading to great concern for financial statements' reliability (Zainudin & Hashim, 2016). Consequently, it corrodes the public's confidence in the reliability of financial reporting and the investors' confidence in the financial market, which is dampened by the exposure of these issues (Campos, 2018; Doan & Ta, 2023; Omar et al., 2017).

In addition, fraud has become a significant threat to businesses worldwide. It has become a substantial concern for organisations of all sizes, regions, and almost