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**Title** : REAL ACTIVITIES MANAGEMENT, FINANCIAL DISTRESS AND CORPORATE GOVERNANCE: MALAYSIAN EVIDENCE

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Positive accounting theory predicts that firms approaching deteriorating financial performance may make income-increasing accounting choices. The firms manipulate earnings upward in an attempt to ride out what is probably deemed by the management as a temporary bad period. The primary objective of this thesis is to examine real activities based earnings management among distressed Malaysian firms over the years, covering both prior and after being officially designated as “PN17 firms”. Additionally, the study aims to investigate whether real activities management techniques among distressed Malaysian firms change across time and industries in which the firms operate. The study also aims to examine the moderating effects of corporate governance on real activities management. The study detects real activities manipulation by investigating patterns in cash flow from operations (CFO), discretionary expenses, and production costs. This study uses the Roychowdhury (2006) models to derive the normal level of CFO, discretionary expenses and production costs. Deviations from the normal levels are termed abnormal CFO, abnormal discretionary expenses and abnormal production costs. In addition, a review of the corporate governance literature revealed several attributes that may affect the degree of real activities management, simply because their role in enhancing monitoring mechanism. The corporate governance attributes are organized into two categories: 1) Ownership Structures; and 2) Board of directors’ Composition. Imposing all the data availability requirement yields 4,130 firm-years over the period of 2001 to 2011, including matched samples of 295 distressed firms and 295 non distressed firms. The results

complement the existing literature on earnings management in several ways. Firstly, the results document evidences that are consistent with real activities manipulation during the years preceding and succeeding PN17. The results reveal distressed Malaysian firms engage in sales manipulation and reduction of discretionary expenditures to improve their reported margins over the years prior to being officially designated as “PN17 firms”. In addition, the results also indicate that the firms apply these techniques in a more aggressive manner in the years following the categorisation under PN17 list. Secondly, the results provide a new insight on the way managers from different industry engage in real activities manipulation. This study indicates that earnings management tools change according to the industry in which distressed firms operate and the number of years preceding the categorisation of PN17. Finally, the findings suggest that the degree of real earnings management among distressed firms are associated with corporate governance attributes, namely ownership structure and board of directors’ composition. The primary contribution to knowledge of this research is its extension of the literature on the phenomenon of real activities management among the financially distressed firms. The findings of this study is applicable by stock market participants towards the evaluation of companies’ board composition and the role of the ownership structures in constraining managerial opportunistic behaviours. Furthermore, the findings will also assist Bursa Malaysia in detecting the areas that are likely to be manipulated by managers.