

UNIVERSITI TEKNOLOGI MARA

**OWNERSHIP CONCENTRATION, BOARD
STRUCTURE AND EARNINGS MANAGEMENT:
MALAYSIAN EVIDENCE**

YVONNE JOSEPH ASON

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ABSTRACT

This study attempts to provide evidence as to the association between those companies having effective and ineffective internal governance mechanisms with the level of discretionary accruals. In order to achieve the objectives, the earnings management as represented by discretionary accruals have been regressed on the governance variables namely, ownership concentration and proportion of independent directors. The study is based on a sample of 961 observations of the companies that fulfilled the selection criteria from the year 2002 until the year 2005. This study employed the modified Jones model (Dechow et al., 1995) to obtain the discretionary accruals. Meanwhile, linear regression is used to examine the association between discretionary accrual and levels of effectiveness of the governance structure of the firm. The results from the regression show that there is a significant negative relationship between the dummy variable with the level of discretionary accruals. These results imply that the earnings management is higher in a company with ineffective internal governance mechanism. The present study also documents evidence that managers are highly influenced by the largest shareholder to engage in opportunistic earnings management. Therefore, the findings suggest that regulators and authorities concerned should enforce laws and regulations insisting the company maintain good internal governance mechanisms. Besides, academicians must continue to search for other corporate governance mechanisms that help to mitigate earnings management. This is important in preventing the opportunistic earnings management at its early stage before it becomes excessive and finally become a fraud. If the opportunistic earnings management can be reduced at its early stage, investors' wealth will be more well protected.

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TABLE OF CONTENTS

	Page
Candidate's Declaration	i
Abstract	ii
Acknowledgements	iii
Table of Contents	iv
List of Tables	vii
List of Figure	viii

CHAPTER ONE: INTRODUCTION

1.0	Introduction and Problem Definition	1
1.1	Objectives of the Study	7
1.2	Significance of the Study	8
1.3	Organization of the Study	9

CHAPTER TWO: LITERATURE REVIEW

2.0	Chapter Description	10
2.1	Earnings Management And Internal Governance Mechanisms	10
	2.1.1 Earnings Management	11
	2.1.2 Internal Governance Mechanisms	15
	2.1.2 [a] Ownership Concentration	16
	2.1.2 [b] Board Structure	18
2.2	Theoretical Framework	22
2.3	Summary Of The Chapter	23

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION AND PROBLEM DEFINITION

Accounting scandals are not a new phenomenon. Accounting crimes had highlighted in newspapers, business magazines as well as in the news on television since a long time ago. There are many accounting scandals widely publicized especially those that happened abroad. One of the most famous cases was the classic case of Enron. This company collapsed due to having a poor corporate governance. Its auditor, Arthur Andersen, had famously colluded with the board of directors to provide false financial statements for the purpose of hiding the company's losses.

The overseas cases may no longer attract our attention since Malaysia has these 'trendy' cases of accounting scandals happening in this country too. Recently, the Securities Commission of Malaysia had conducted an investigation with regards to the purported accounting irregularity at Transmile Group Bhd. Some short facts about the case: Transmile posted a pre-tax loss of US\$49.7 million instead of a profit of \$59.8 million in its 2006 financial year and a pre-tax loss of \$19.3 million in 2005 instead of a profit of \$34.6 million after being audited. It also reported a smaller pre-tax profit of \$2.3 million in its 2004 financial year than the \$25.1 million previously announced. It is believed that the existence of fictitious transactions had caused the company to undergo a special audit (Cargonews Asia, June 20, 2007).