

UNIVERSITI TEKNOLOGI MARA

**EARNINGS QUALITY,
BOARD ATTRIBUTES AND
THE REQUIREMENT OF ISLAMIC
CORPORATE GOVERNANCE:
EVIDENCE FROM SHARIAH-
COMPLIANT COMPANIES IN
MALAYSIA**

RIZWANA BINTI MD YUSOF

Thesis submitted in fulfillment
of the requirements for the degree of
Doctor of Philosophy
(Accountancy)

Faculty of Accountancy

September 2019

ABSTRACT

This thesis examines the relation between Earnings Quality and Board characteristics of *Shariah-compliant* securities companies in Malaysia. The study integrates *Shariah* Principle as additional layer of regulation to examine the importance of having *Shariah* Supervisory Board in these companies. Three empirical studies were undertaken and the findings was triangulated to provide more comprehensive picture of the results. **First**, accruals quality models (Jones, 1991; Modified Jones, 1995) have been examined and reviewed in the new dataset; and Modified Jones model has been identified as the model that could accurately measure the quality of earnings reported. **Second**, the level of EQ has been examined from year 2003 to year 2012. The multivariate analysis revealed that independent director, financial and competency; and director with *Shariah* background influenced the level of EQ. The composition of the board members is revealed to have influence over the quality of *Shariah* decisions issued by the board. Moreover, the integrity of the board members, such as their ethical value, reputation and scholarly background, was found to be important in influencing its accountability and independence. **Third**, the response from external *Shariah* committee has been investigated. The result from Path Coefficient Evaluation provide evidence that most of the *Shariah* committees agree that *Shariah-compliant* securities companies (SCC) should have their own internal *Shariah* committee since it will improve the quality of earnings of SCC in Malaysia. Findings were then being triangulated to develop the Islamic Corporate Governance (i-CG) model for SCC and stakeholder's reference. The contributions of this study include: i) a new research setting, where the study used within-triangulation method provides new research evidence on the relationship of EQ, boards attributes, requirement of SSB and i-CG in *Shariah-compliant* securities companies; ii) the Modified Jones model could be used by the stakeholders to assess the earning situation of the Malaysian companies; iii) the findings regarding positive response from external *Shariah* committee and *Shariah* advisers on the importance and the need of internal *Shariah* committee sits in SCC to monitor and improve the business processes as well as in issuing *Shariah* compliance reports which leads to the development of Islamic Corporate Governance (i-CG) model. However, the internal *Shariah* reviews were found not to be effectively implemented by the Securities Commission (SC) thus raising concern regarding the quality of the *Shariah* status issued by the SC highlighting both the importance and need for an internal *Shariah* committee.

ACKNOWLEDGEMENT

Alhamdulillah, Thank you Allah, the Most Gracious and Most Merciful God for all His blessing, for giving me the opportunity to embark on my PhD and for completing this long and challenging journey successfully. Immeasurable appreciation and deepest gratitude for the help and support are extended to my beloved supervisors, Associate Professor Dr Zuraeda Ibrahim and Professor Dr Rashidah Abdul Rahman for the generous guidance, encouragement and patience over the last six years. Your advice, insightful criticisms and valued comments and support were essential to my success.

My appreciation goes to the Ministry of Higher Education, Malaysia specifically MyBrain15 for providing financial support for my study. Warm thanks also go to the Securities Commission and Bursa Malaysia who provided facilities and assistance in the data collection for this study.

My appreciation also goes Dr. Md Nurdin Ngadimon, Deputy Director of *Shariah*, and En Zainol Ali, Manager, of the Islamic Capital Market Department of the Securities Commission Malaysia, for helping me with all the information related to Islamic Capital Market. I am also indebted to Assoc Prof. Dr Roslani Embi (UiTM), Mr Mohd Hanafi Azman Wong (UiTM), Assoc. Prof. Dr Norzaidi bin Mohd Daud (UiTM), Dato' Dr Abdul Halim Ismail, (*Shariah* Advisory Council), Asmah Hakimah Abdul Halim (Islamic scholar), and all the academics, supporting staff and doctoral researchers of the Faculty of Accountancy UiTM and Faculty of Business, Management and Professional Studies in Management and Science University (MSU), especially my colleagues in Department of Accounting and Finance (DAF) who have provided me assistance and support in one way or another during the process of accomplishing my study.

My heartfelt gratitude goes to my family. Special dedication to my beloved father (Md Yusof Saidin), mother [REDACTED], mother-in-law [REDACTED] and family members for their assistance, endless support and prayers in making this journey a success.

I owe my loving thanks to my husband (Abdul Rahman bin Abdul Aziz), my children (Nur Damia Aina, Dzakwan Hadi, Durrah Azzahra and Dayyan Ar Razin) who had made sacrifices in such a special way that I urged myself to focus and to invest more time in my studies, so that I could finish my PhD quickly and spend more time with them. Their love remains my passion and my light.

Finally, I am sincerely grateful to all who have significantly contributed directly and indirectly towards the completion of this thesis; and may Allah bless all of you.

TABLE OF CONTENTS

	Page
AUTHOR'S DECLARATION	ii
ABSTRACT	iii
ACKNOWLEDGEMENT	iv
TABLE OF CONTENTS	v
LIST OF TABLES	xi
LIST OF FIGURES	xv
LIST OF SYMBOLS	xvi
LIST OF ABBREVIATIONS	xvii
CHAPTER ONE INTRODUCTION	21
1.1 Introduction	21
1.2 Background of the Present Study	22
1.3 Problem Statement	25
1.4 Research Objectives of the Study and Research Questions	29
1.5 Research Questions and Method of Investigation	31
1.6 Professional Contributions of the Study	34
1.7 Scope and limitations	36
1.8 Organization of the Study	37
1.9 Conclusion	41
CHAPTER TWO LITERATURE REVIEW	42
2.1 Introduction	42
2.2 Earnings Quality	42
2.2.1 Definition of earnings quality (EQ)	42
2.2.2 Incentives for earnings management	43
2.2.3 Method in assessing earnings management	46
2.3 Corporate Governance	47
2.3.1 International corporate governance	48

2.3.2	Corporate governance in Malaysia	49
2.3.3	Current issues in corporate governance	52
2.3.4	Corporate governance from Islamic perspective	53
2.4	Theories Related to Corporate Governance and Earnings Quality	62
2.4.1	Agency theory	62
2.4.2	Signalling theory	63
2.4.3	Resources dependency theory (RDT)	63
2.4.4	Institutional theory	64
2.5	Conclusion	65
 CHAPTER THREE ISLAMIC CAPITAL MARKET IN MALAYSIA		65
3.1	Introduction	65
3.2	The Malaysian Islamic Capital Market	66
3.3	Regulatory Bodies	68
3.3.1	Securities Commission	68
3.3.2	Malaysia International Islamic Financial Center	70
3.4	Islamic Capital Market Products	70
3.5	<i>Shariah</i> Compliant Securities Companies	71
3.5.1	<i>Shariah</i> screening methodology	75
3.6	Reason for Choosing the ICM for the Study	79
3.7	Conclusion	80
 CHAPTER FOUR		81
 COMPARATIVE ANALYSIS OF THE METHODS TO ASSESS EARNINGS QUALITY		81
4.1	Introduction	81
4.2	Accruals Quality Models	82
4.2.1	Model 1: Jones (1991) model	83
4.2.2	Model 2: Modified Jones (1995) model	84
4.3	Research Method and Implementation	85
4.3.1	Research design and data collection stage	85
4.3.2	Data analysis stage	90
4.3.3	Issues related to multivariate analysis and modelling methods	91