Association between Board Characteristics and Accounting Conservatism: Empirical Evidence from Malaysia

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ATTESTATION OF AUTHORSHIP

I hereby declare that this submission is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person (except where explicitly defined in the acknowledgements), nor material which to a substantial extent has been submitted for the award of any other degree or diploma of a university or other institution of higher learning.

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ABSTRACT

This paper examines the association between board characteristics and accounting conservatism using a sample of 716 Malaysian listed firms for the year 2008. I use five board characteristics, namely the percentage of inside directors, CEO/Chairman separation, board size, board meetings and managerial ownership. Utilising three different measures of conservatism, I find that (i) percentage of inside directors is negatively related to conservatism and (ii) board size is negatively related to conservatism. Results hold after controlling for firm size, sales growth, profitability and leverage. These findings are consistent with previous studies by Beekes et al. (2004), Ahmed and Duellman (2007) and García Lara et al. (2007). Overall, my evidence shows that firms with strong boards use conservative reporting as a governance tool, even in a unique institutional setting like Malaysia.
1.0 INTRODUCTION

Accounting conservatism is defined as the asymmetrical recognition requirement for gains and losses where a higher degree of verification is required to recognise good news than bad news in earnings (Watts, 2003). Watts (2003) advances a number of explanations for conservative reporting, all of which suggest that conservatism benefits users and preparers of financial reporting, auditors and regulators. Firstly, conservatism arises as part of the efficient contracting mechanism. Under this explanation, conservative accounting acts as a mean of addressing moral hazards due to the condition of information asymmetry faced by stakeholders of a firm. For instance, the asymmetrical recognition requirement in conservative reporting constrains management’s opportunistic behaviour and offsets managerial biases (Watts, 2003). Secondly, shareholder litigation can explain the use of conservative reporting. Firms and their auditors are more likely to face litigation costs for overstatement rather than for understatement of assets (Pierre and Anderson, 1994). Conservatism understates a firm’s net assets, thus reducing the firm’s expected litigation costs. Thirdly, the links between taxation and reporting can generate conservative reporting. Accelerating the recognition of expenses and delaying the recognition of gains defer tax payments. Therefore, profitable firms will be able to reduce the present value of taxes and increase firm value (Watts, 2003). Lastly, standard setters and regulators also favour conservative reporting as this reduces the political costs imposed on them. These bodies are likely to face more criticism if firms overstate their net assets than if they understate them (Watts, 2003).

The board of directors represents a fundamental role in decision-making and is a crucial governance mechanism that directly monitors managers (Duellman, 2006).
Ponnu (2008, p. 217) explains that the main responsibilities of the board are “to endorse the organisation’s strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organisation to its shareholders, authorities and other stakeholders”. Conservative reporting serves as a potentially useful tool for directors in fulfilling their role of ratifying key decisions. It provides a mechanism which prevents managers’ overcompensation and any opportunistic payment made to themselves (Watts, 2003). This is important because recovery of excess compensation is difficult as managers’ tenure and liability are limited (Watts, 2003). Ball (2001) argues that the absence of conservative reporting creates an incentive for managers to continue operating negative NPV projects to avoid reporting losses on sale or abandonment. By speeding up loss recognition, conservatism helps the board to identify negative NPV investments. It provides the board with a signal to investigate the reasons for such losses thus leading to the termination of these projects or even dismissal of managers (Watts, 2003; Ahmed and Duellman, 2007). Ball (2001) argues that the timely recognition of bad news implicit in conservative accounting mitigates managers’ incentives to undertake negative NPV projects that might be in the interest of managers but not in the interest of shareholders (Ball and Shivakumar, 2005). Since conservatism is a useful tool in monitoring decision making, strong boards would demand conservative accounting. Conversely, weak boards dominated by insiders are likely to allow managers more opportunity to use aggressive accounting. Thus, under this view, the strength of board governance will be positively associated with accounting conservatism.

There are a number of prior studies that examine the relation between board characteristics and accounting conservatism. Beekes et al. (2004) document that the timeliness of bad news is positively related to the proportion of outside directors on the
board. Ahmed and Duellman (2007) extend the study by Beekes et al. (2004) and find similar results after controlling for industry, institutional ownership, profitability, R&D, litigation risk and strength of shareholder rights. García Lara et al. (2007) conduct a study in the Spanish context and document that firms with strong governance structure are more likely to use conditional conservatism than firms with weak governance structure. They confirm that the results from previous studies (Beekes et al., 2004; Ahmed and Duellman, 2007) hold even in a civil-law setting such as Spain. While previous studies find a strong association between board structures and conservatism, these findings may not be generalisable to Malaysia, due to its unique institutional settings. The Malaysian business environment is unlike those in the Anglo-Saxon world. Malaysia is characterised by a high concentration of shareholding in listed companies, similar to most East Asian countries (Rahman and Ali, 2006; Haniffa and Hudaib, 2006). Large shareholders of many Malaysian companies are usually family founders (Ball et al., 2003; Thillainathan, 1999). Secondly, government agencies have substantial ownership and political influence over many large government-linked corporations. These institutional features imply that there is a lack of market for corporate control and little threat for hostile takeovers to discipline managers of poor performing firms (OECD, 1999). Other problems associated with Malaysia in strengthening corporate governance are weak legal systems and regulatory framework, lack of quality accounting information and lack of investors’ protection (Hashim and Devi, 2007).

In Anglo-Saxon countries with diffuse ownership, conflicts of interest arise between managers and outside shareholders. However, the agency problem shifts to conflicts between the controlling owners and minority shareholders in highly concentrated ownership structures common in Malaysia (Claessens and Fan, 2002; Hashim and Devi, 2007). Due to close controls by owners and major shareholders, little
separation exists between these shareholders and managers, which consequently mean that the protection of minority shareholders might be at risk (Khan, 1999; Haniffa and Hudaib, 2006). Large shareholders are in position to oppress and expropriate minority shareholders, which are difficult to mitigate through the traditional functions assumed by the board of directors (Fan and Wong, 2003). The tightness of ownership allows self-interested managers to go unchallenged internally by the boards of directors (Hashim and Devi, 2008).

A number of prior studies in Malaysia examine the relation between board characteristics and financial reporting quality. For instance, Saleh et al. (2005) find that managerial ownership is negatively related to earnings management and CEO/Chairman duality is positively related to earnings management. Rahman and Ali (2006) reveal a positive association between size of the boards and earnings management. Haniffa and Hudaib (2006) find that multiple directorship is negatively related to market performance. Abidin et al. (2009) find that higher proportion of independent non-executive directors and larger board size have a positive impact on firm performance. However, Ponnu (2008) did not find any evidence linking board structures to corporate performance. Similarly, Hashim and Devi (2008) fail to find a significant relationship between the proportion of independent non-executive directors and earnings quality. While a survey by Ismail and Abdullah (1999) find that Malaysian financial analysts regard conservative accounting as a useful and important concept, there has been no study that examines the association between board characteristics and accounting conservatism.
This study is thus motivated by several factors discussed above: (1) the impact of various governance mechanisms on conservatism found in Anglo-Saxon countries may not necessarily be applicable to Malaysia due to its unique business landscape, (2) mixed results from prior studies in establishing a link between board structures and earnings quality and (3) no study to date which examines the association between the board of directors and conservative reporting.

I employ a sample of 716 non-financial companies listed on Bursa Malaysia’s Main Board for the year 2008. I use three proxies to measure conservatism: (a) an accrual-based measure, following Givoly and Hayn (2000), (b) a market-based measure, following Roychowdhury and Watts (2007) and (c) a C_Score measure, developed by Khan and Watts (2009). I study five board characteristics which are percentage of inside directors, CEO/Chairman separation, board size, board meetings and managerial ownership.

I find a negative association between the percentage of inside directors on the board and conservatism and a negative association between board size and conservatism. My findings hold for alternative measures of conservatism that I use in this study. The results also hold after controlling for firm size, sales growth, profitability and leverage. My findings are consistent with previous studies by Ahmed and Duellman (2007), García Lara et al. (2007) and Beekes et al. (2004).

This study contributes to the literature by establishing the link that stronger board of directors display greater reporting conservatism among Malaysian companies. A study in the Malaysian context is important as it is a developing country with an
emerging market and it has institutional features that are different from most Anglo-Saxon countries. Despite these differences, my findings are similar to results from previous studies done in the UK, US and Spain. Studies regarding conservative practices in Malaysia are still considerably scarce and the association between board structure and conservatism has not been addressed before. Therefore, this study hopes to be of significance to the present accounting literature in this country.

There are several limitations in this study. First, data is collected only from one year due to time constraints; therefore, results of this study may not be generalisable to other years. Second, Ahmed and Duellman (2007) average their accrual-based measure of conservatism over a 3-year period. I could not do that due to the limited sample; therefore, I could not mitigate the effect of large accruals that will likely reverse within the next few years. Third, the study may suffer from omitted variable problem. For example, firms that face higher litigation costs may choose to have more conservative reporting and more independent board of directors in order to mitigate such risks.

The remainder of the paper proceeds as follows. Section 2 discusses the background of corporate governance in Malaysia. Section 3 reviews the literature. Section 4 presents the development of hypotheses followed by research methodology in Section 5. Section 6 presents the results. Section 7 discusses the findings and Section 8 presents the conclusions.
2.0 BACKGROUND

2.1 Corporate Governance in Malaysia

Agency problem arises under the condition of asymmetric information, in which managers are driven by self-interest, thereby using their authority to benefit themselves instead of returning profits to outside investors (Jensen and Meckling, 1976). Corporate governance encompasses mechanisms that mitigate conflict of interest between managers and parties to the firm. It ensures assets of the firm are controlled and managed efficiently by the managers and it aims to protect outside investors against expropriation by the insiders (La Porta et al., 2000; García Lara et al., 2007). There are a number of governance mechanism in practice, such as board of directors, institutional shareholders, managerial ownership and the set of law that govern firms (Ahmed and Duellman, 2007).

Efforts to improve corporate governance mechanisms in Malaysian listed companies started as early as 1993 when audit committee were made mandatory under the KLSE listing requirements (Haniffa, 1999). The Malaysian Securities Commission further emphasised good governance practices by shifting its regulatory regime from merit-based to disclosure-based in 1995. However, the Asian economic crisis in 1997 exposed a lack of effective corporate governance mechanisms when a number of ‘blue chip’ corporations failed, such as Renong, UEM and KFC. This resulted in the erosion of investor confidence due to the lack of transparency in the financial system and weak corporate governance standards (Ponnu, 2008). Many believed that the existing corporate governance structures were insufficient to provide effective control over managerial behaviour. The government was forced to intervene and this prompted the
formation of a high level Finance Committee on Corporate Governance (FCCG). The committee comprised of senior representatives from the government, regulatory agencies, industry bodies and professional associations whose task was to review corporate governance practices and recommend legal reforms to strengthen their effectiveness (Ow-Yong and Cheah, 2000; Haniffa and Hudaib, 2006).

Some of the weak governance practices that were brought to the foreground include shareholder passivity, weak financial structure, lack of efficacy and responsibility awareness among directors, over-leveraging by companies as well as lack of transparency, disclosure and accountability (Othman, 1999; Khoo, 2003). Many believed that the existing corporate governance mechanisms were insufficient to provide effective control over managerial behaviour (Khoo, 2003; Ow-Yong and Cheah, 2000). In March 2000, The FCCG issued the Malaysian Code of Corporate Governance (MCCG), largely derived from the recommendation of the Cadbury Report (1992) and the Hampel Report (1998) in the UK (Haniffa and Hudaib, 2006). It is modelled extensively on the Hampel (1998) findings in particular, with several references made to the Hampel report. The recommendations of MCCG are prescriptive in nature and fall under four main headings which are ‘principles’, ‘best practices’, ‘exhortations to other participants’ and ‘mere best practices’ (FCCG, 2000).

The ‘principles’ address good governance practices with respect to board of directors, directors’ remuneration, shareholders, and accountability and audit. The objective of these principles is to allow companies to apply them with flexibility and with common sense to the varying circumstances of individual companies (Khoo, 2003; Haniffa and Hudaib, 2006). Companies are required by the KLSE listing requirements
to include in their annual reports a narrative of how they apply the relevant practices. This is to secure sufficient disclosure for investors and others to access companies’ performance and governance practices and respond in an informed way (FCCG, 2000). The ‘best practices’ to corporate governance identify a set of guidelines or practices related to board of directors, accountability and audit, and shareholders. Compliance to these guidelines are voluntary but companies are required to state in their annual reports the extent to which they have complied and explain any circumstances justifying departure from such best practices (FCCG, 2000). The ‘exhortation to other participants’ is mainly addressed to corporate investors and auditors to enhance their roles in corporate governance. This involves shareholder voting, dialogue between companies and investors, and evaluation of governance disclosures (FCCG, 2000; Khoo, 2003). The ‘mere best practices’ section provides explanatory notes and further explanations to earlier parts of the code.

The positive effects of the measure taken to improve corporate governance practices can be seen from the results of the KLSE-PricewaterhouseCoopers Corporate Governance Survey in 2002 which found sufficient evidence suggesting that the corporate governance reforms is headed on the right path (Khoo, 2003). The survey found that 93% of the investors in Malaysia felt that corporate governance in the corporate sector has improved since the introduction of the MCCG (Khoo, 2003). Although the MCCG has clearly enhanced corporate governance practices and restored investor confidence in Malaysia, the institutional features affecting investor protection have to be addressed.

The Malaysian Code of Corporate Governance has since been revised which supersedes the existing regulations issued in March 2000. As regards to the board
structure and composition, the code sets out a few recommendations and requirements that companies should follow. The code does not specify a desirable board size; instead, it proposes that every board should examine its size, and determine the impact of the number upon its effectiveness (Securities Commission, 2007). The code stresses that the board should include a balance of executive and non-executive directors (including independent non-executives). Following this view, it proposes that at least one third of the board should comprise of independent directors. The code recommends that there should be a clearly accepted division of responsibilities between the CEO and chairman on the board, such that no one individual has unfettered powers of decision. It further notes that in companies where the roles are combined, there should be a strong independent element on the board and this role duality should be publicly explained (Securities Commission, 2007). There is no set number of meetings that the code proposes, but is states that the board should meet regularly and annual reports should disclose directors’ attendance and the number of meetings held a year. The CEO and directors of a listed company are required to disclose their interest of a company to the Security Commission filing. A failure to do so will result in a criminal sanction of up to RM1 million, or imprisonment of up to 10 years, or both (Securities Industry Act, 1983).

2.2 Investor Protection in Malaysia

The traditional finance theorem that was proposed by Modigliani and Miller (1958) brought about the idea that securities are recognised by their cash flows. For instance, creditors are entitled to a fixed inflow of interest payments whereas shareholders are entitled to receive dividends. However, recent research suggests that the defining attribute of a certain security lies in the rights that it brings to its owners.
(Hart, 1995). For owners of a firm, shares typically give them the right to vote for
directors of the company, whereas creditors have the power to repossess collateral
should the company fail to meet its payments (La Porta et al., 1998). When investors
finance firms, they face an inherent risk of not receiving any return on their investment
if managers of the firm expropriate profits (La Porta et al., 2000). The rights attached to
securities, therefore, become critical as they give investors the power to extract from
managers the returns on their investment. La Porta et al. (1998, p. 1114) stress that
“shareholders receive dividends because they can vote out directors who do not pay
them, and creditors are paid because they have the power to repossess collateral”.
Investors would not get paid without these rights, making it harder for firms to raise
external finance (La Porta et al., 1998).

In many countries, expropriation of investors by managers or controlling
shareholders is extensive. Hence, investor protection is crucial to avoid any
inappropriate use of resources at the expense of these investors or parties to the firm.
The legal approach to corporate governance holds that the key mechanism to limit
expropriation is the protection of outside investors through laws and their enforcement
(La Porta et al., 2000). According to previous research, investor protection through
enforcement of legal rules is central to understanding the variation in corporate finance
structures across different countries (La Porta et al., 1998; La Porta et al., 2000). To a
large extent, shareholders and creditors are more willing to finance firms as their rights
are protected by the law. For instance, contract law deals with the binding legal
agreement between two parties, while company and securities laws explain the rights of
outside investors and corporate insiders. La Porta et al. (1998; 2000) stress that these
laws and the strength of their enforcement are vital essentials of corporate governance
and finance. Investors are willing to finance firms only when their rights are extensive
and the laws pertaining to them are well enforced by the regulators and courts. Conversely, in countries where the legal system is weak, corporate governance and external finance do not work well (La Porta et al., 2000).

In Malaysia, there is a high concentration of ownership in listed companies, similar to other companies in East Asian countries. A study by Ishak and Napier (2006) find that about 85% of their 355 sample companies have an ultimate controlling owner at the 20% cut-off point. By examining nine East Asian countries, including Malaysia, finds that more than two thirds of the firms are controlled by a single shareholder (Claessens et al., 1999a). This situation of concentrated shareholding is attributed to poor investor protection, such as weaknesses in shareholder rights and poor enforcement of these rights (La Porta et al., 1998; Thillainathan, 1999). Large shareholders need to own more shares to increase their voting rights to leverage up their legal protection in order to avoid being expropriated by managers. These shareholders can enforce their rights using simple legal interventions without relying on poorly informed and motivated courts (La Porta et al., 1998). Therefore, large investors with direct interest in a company do not need any special arrangements to establish effective corporate control over the company. On the other hand, investors without large shareholding can enhance their control through the use of dual-class shares with different voting rights (shares which are not based on one-share-one-vote-rule), pyramid structures1 or cross-holdings2 (Thillainathan, 1999). The study by Claessens et al. (1999b) finds that shareholders and corporate groups in Malaysia have resorted to such

1 Berle and Means (1932, p.183) defined pyramid structure as an ownership pattern which involves the owner “owning a majority of the stock of one corporation which in turn holds a majority of the stock of another – a process that can be repeated a number of times”.

2 Cross-holding is defined as the position when two companies each hold shares in the other.
devices to exercise control. Large shareholders are therefore in a position to oppress minority shareholders given their control rights.

An important institutional feature in Malaysia, which is similar to many other East Asian countries, is the large proportion of public listed companies owned and managed by families (Ball et al., 2003; Thillainathan, 1999). According to Claessens et al. (1999a), approximately 67.2% of listed companies in Malaysia were family-controlled in 1996. Control here is determined by studying all ultimate shareholders who hold over 20% of voting rights (Claessens et al., 1999a). An analysis by the World Bank in its Report on the Observance of Standards and Codes (ROSC) in Malaysia found that from their sample comprising fifty percent of the KLSE market capitalisation in 1998, 67.2% of the shares were in family hands. Some examples of large corporations where large shareholders are the founders or their family are Genting Berhad, YTL Corporation and the Hong Leong Group (Satkunasingam and Shanmugam, 2006). About 85% of the companies had owner-managers and post of CEO, chairman of the board or vice-chairman belonging to a member of the controlling family (World Bank Group, 1999). Similarly, results from a survey conducted by Pricewaterhouse Coopers in 2002 found a common occurrence whereby substantial shareholders are also directors of the company and are involved in making management decisions of the company (Satkunasingam and Shanmugam, 2006).

Another group of institutional shareholders in Malaysian listed companies are government agencies (Thillainathan, 1999). After the country gained independence in 1957, the Malaysian government established state agencies which bought over large businesses from British owners. In the 1980s, government policies led to the privatisation of state-run services such as the National Electricity Board and Telekom
Malaysia (Crouch, 1996). These corporations are called government-linked corporations (GLCs) and are listed in the stock exchange. The majority shareholders in these corporations comprise of government agencies. Therefore, it is assumed that the government of Malaysia easily dictate terms to these corporations (Satkunasingam and Shanmugam, 2006). Since institutional shareholders may nominate candidates to the board of directors, it can be argued that these candidates might be selected based on certain political influence over the government agencies.

Given the situations and institutional features discussed above, the agency problem between the controlling shareholders and the minority shareholders is potentially serious (Khoo, 2003). Thus, it can be seen that the protection of minority shareholder is very poor to non-existent in Malaysia. In large family-owned corporations, minority shareholders have very little say in practices, ethics and management decisions. It has been argued that these corporations are listed to raise capital, yet they deny small investors a say once the capital has been invested (Satkunasingam and Shanmugam, 2006; Thillainathan, 1999). Similarly, in government-linked corporations, management is heavily influenced by government policies. Therefore, the opinions of minority shareholders would not make much difference to management practices. In addition, minority shareholders are not likely to take action if the board of a GLC abuses its power as it is perceived as not only challenging the directors, but also the politicians who appoint them (Satkunasingam and Shanmugam, 2006).

The role of minority shareholders in upholding good corporate governance is therefore questionable in an environment like Malaysia. Shareholders have the right to raise opinions and query directors during annual general meeting. However, minority
shareholders are not likely to voice dissatisfaction over poor corporate governance practices, due to the fact that family members or the government are usually large shareholders of large corporations (Thillainathan, 1999). In addition, Satkunasingam and Shanmugam (2006) assert that shareholder activism is a foreign corporate governance mechanism among Malaysians, as the national culture does not encourage individuals to be assertive. Cultural traditions frown upon any challenge against those in power which may ‘rock the boat’ (Martinez, 2001). Thus, the most effective way minority shareholders could practice their right is by disposing off their shares. This action may not be effective unless the efforts are synchronised between all minority shareholders in order to affect the share price (Satkunasingam and Shanmugam, 2006). However, in most cases, shareholders are reactive instead of proactive and thus only sell off their shares when it is too late (Johnson and Mitton, 2001). The expropriation of minority shareholder rights can only be curtailed if there is a clear separation of ownership and management and if there are proper governance mechanisms, which are still not addressed in the current corporate governance reform.
3.0 LITERATURE REVIEW

There is a long line of research on the role and function of the board of directors. Prior studies investigate the relation between (a) financial statement fraud and board characteristics (Beasley, 1996; Dechow et al., 1996; Farber, 2004; Agrawal et al., 1999), (b) earnings management and board characteristics (Klein, 2002; Xie et al., 2003; Saleh et al., 2005), (c) firm performance and board characteristics (Haniffa and Hudaib, 2006; Abidin et al., 2009; Ponnu, 2008) and (d) accounting conservatism and board characteristics (Beekes et al., 2004; Ahmed and Duellman, 2007; García Lara et al., 2007).

3.1 Financial Statement Fraud and the Board of Directors’ Characteristics

Previous studies find an association between the likelihood of financial statement fraud and board of directors’ characteristics. Beasley (1996) investigates this link by using a logit regression analysis of 75 fraud and 75 no-fraud firms in the US between 1982 and 1991. He indicates that firms with records of fraud have significantly fewer numbers of outside directors and more management directors compared to no-fraud firms. In addition to that, the study finds that as outside director ownership and tenure increases and as the number of additional directorships held by outside directors in other firm increases, financial statement fraud decreases (Beasley, 1996). However, Beasley (1996) also finds that the presence of an audit committee in a firm does not significantly affect the chances of financial statement fraud. This could be explained by the lack of difference in the number of audit committee meetings between fraud and no-fraud firms.
Dechow et al. (1996) conduct another study where the sample comprise of firms subject to SEC Accounting and Auditing Enforcement Release (AAER). These are firms found to have violated the financial reporting requirements of the Securities Exchange Act 1934, leading to the publication of AAER which details enforcement actions taken by the SEC. The results of this study indicate that these firms are more likely to have boards of directors that are dominated by management, more likely to have a CEO who also acts as the chairman of the board, less likely to have an audit committee and more likely to have a CEO who is also the firm founder (Dechow et al., 1996). These findings are generally consistent with the study by Beasley (1996) which suggests that firms involved in frauds and earnings manipulation generally tend to have weak corporate governance structures.

Similar to Dechow et al. (1996), Farber (2004) examines firms identified in AAER and finds that these firms have poor governance structure in years prior to fraud detection by the SEC. For the three years following AAER, fraud firms improve their governance by increasing the percentage of outside directors and increasing audit committee activity. It is seen that governance changes were valued by investors, as indicated by superior stock price performance. However, analyst following and institutional shareholding did not increase, which suggest that the credibility of these firms were still questionable. It is believed that fraud scandals create incentives for firms to change managers in order to improve performance and recover lost reputation. Agrawal et al. (1999) investigate this notion but find little evidence of higher turnover among senior director and managers in firms charged or suspected with fraud. From their findings, they indicate that the revelation of fraud does not prompt a change in the firm’s leadership structure.
From previous literature, it can be seen that weak board governance has an influence in the likelihood of financial statement fraud in firms. It has been established that firms with records of fraudulent reporting tend have a board that is dominated by the management therefore less room for independent decision making. It was also found that fraudulent activities are more prevalent in companies where the CEO is also the chairman of the board. In a situation where role duality exists, there is a possible conflict of interest which may impair the independence of the monitoring group. Thus, it can be concluded that strong corporate governance structure plays an important role in reducing the chances of financial statement fraud.

3.2 Earnings Management and Board of Directors’ Characteristics

Klein (2002) conducts a study to examine the role of audit committee and board characteristics in earnings management practices by the firm. Using a sample of all firm-years on the S&P 500 from 1992 to 1993, their results indicate a negative relationship between board of director independences and abnormal accruals, which is the proxy for earnings management. This is consistent with the assertion that board independence improves governance, which reduces earnings manipulation. Furthermore, Klein (2002) finds that firms that change their board or audit committee from a majority to minority independent directors tend to have large increases in earnings management practices. However, no significant evidence is found between earnings management and an entirely independent audit committee.

Similar to Klein (2002), Xie et al. (2003) investigate the relationship between the structure and composition of board of directors and earnings management. They
were particularly interested in examining the role of outside directors and their influence on the audit and executive committee. The authors document links between the level of earnings management and the representation of outside directors in the board. More specifically, the monitoring of financially sophisticated outside directors in an active board could reduce the extent of earnings management behaviour in firms (Xie et al., 2003). Their findings suggest that the background of independent outside directors have an important implication on monitoring effectiveness and earnings management preventions.

Previous studies in this area have also been conducted in the Malaysian context. Saleh et al. (2005) assess several board characteristics using a sample of 561 publicly listed firms in Malaysia. Their results indicate that managerial ownership is negatively related to earnings management, suggesting that the interests of managers and shareholders will tend to converge as the proportion of managerial equity ownership increases (Saleh et al., 2005). The existence of CEO-Chairman duality is found to be positively related to earnings management. Another research conducted by Rahman and Ali (2006) reveal a positive relationship between earnings management and the size of the board of directors, which could be explained by the ineffectiveness of larger boards in coordinating tasks relative to smaller boards. The study, however, did not provide evidence of a significant relationship between board independence and earnings management. This could be attributed to the outside directors’ lack of knowledge with regard to the company’s affairs (Rahman and Ali, 2006).
3.3 Firm Performance and Board of Directors’ Characteristics

Numerous studies have aimed to establish a link between board of directors’ characteristics and firm performance. In Malaysia, Haniffa and Hudaib (2006) employ a sample of 347 publicly listed companies to find evidence of the relationship between several governance mechanisms and corporate performance. They find that the size of board is negatively related to market performance but positively related to accounting performance. This could be explained by the ‘free-rider’ problem and higher compensation costs incurred, hence the negative perception of Malaysian market on large boards. Contrary to this, the accounting measure of performance indicates that the company actually benefits from larger boards, probably due to the ability to secure critical resources and the wealth of expertise and experiences that larger boards offer (Haniffa and Hudaib, 2006). The findings also indicate a significant negative relationship between multiple directorship and market performance, implying that companies are better off when directors do not hold additional directorship. However, this study did not find significant evidence associating the proportion of non-executive directors on the board and CEO-Chairman duality with firm performance (Haniffa and Hudaib, 2006).

Abidin et al. (2009) conduct a study to examine the association between board structure and corporate performance using a randomly selected sample of 75 companies listed on Bursa Malaysia. The authors define performance as the value added (VA) efficiency of the firm’s physical and intellectual resources, calculated using the Value Added Intellectual Coefficient (VAIC) methodology. This differs from previous literature which commonly use financial terms or profitability ratios as a measure of firm performance. This study recognises the importance of intellectual property due to
the increasing prevalence of knowledge-intensive industries in this era. Baron (2003) argues that about 75% of market value relies on intangible assets, particularly human capital, yet the contribution of people to an organisation is rarely taken into account. Bontis et al. (2000) note that in 1999, approximately 37.5% of the workforce in Malaysia comprise of those in the service sector, which is a knowledge-intensive sector. Therefore, Abidin et al. (2009) argues that a comprehensive measure incorporating intellectual capital resources is crucial to represent a true picture of corporate performance. Based on this measurement, they find that higher proportion of independent non-executive directors and larger board size, both have a positive impact on firm performance. The effects of directors’ ownership and CEO duality on firm performance, however, were not established.

Based on the current literature, it can be established that board characteristics have a profound effect on organisational outcomes, including firm performance, the likelihood of fraudulent activities and earnings management behaviour of a firm. This is due to the important role that the board of directors play in the operation of the company. Board characteristics and their effects on various aspects of the firm is therefore an area of high interest among academicians. There has been a lack of such studies in Malaysia until the last decade, when the Asian economic crisis in 1997 accentuated recent focus on the board as it revealed weak monitoring mechanisms among many Malaysian companies. Recent corporate scandals in other countries such as Enron and WorldCom in the US also highlighted the inadequate monitoring role of the boards and the failure of corporate governance mechanisms. While more studies have focused on corporate governance in Malaysia, there is still a lack of research regarding the extent and demand of accounting conservatism in financial reporting.
3.4 Accounting Conservatism and Board of Directors’ Characteristics

It is noted that accounting conservatism plays a significant role in corporate governance (Watts, 2003). Accounting and financial system provides directors with verifiable information that is used to effectively monitor and advise managers (Ahmed and Duellman, 2007). However, top management supplies information to the board which might be biased in their favour (Ahmed and Duellman, 2007). Watts (2003) suggests that conservatism plays a role in offsetting this bias. Conservatism requires a higher standard of verification for gains recognition, therefore, it constraints managers’ ability to overstate earnings and net assets. Also, conservatism reduces managers’ ability to withhold information on expected losses. These mechanisms will prevent managers’ overcompensation and any opportunistic payments to themselves (Watts, 2003; Ahmed and Duellman, 2007).

Ball (2001) argues that conservatism facilitates the board in identifying negative NPV project through timely recognition of economic losses. It can be said that without timely identification, managers tend to delay or avoid reporting losses by prolonging negative NPV investments. Accounting conservatism aids in providing the board with a signal to investigate poor investment decisions by managers (Ahmed and Duellman, 2007). These arguments suggest that conservatism presents itself as a useful tool for directors to ratify and monitor key decisions. As such, it can be said that strong boards dominated by outside directors would be likely to demand more conservative accounting. Conversely, boards that are dominated by insiders are more likely to allow managers greater opportunities to use aggressive (or less conservative) accounting.
Based on this view, the strength of board governance will be positively related to accounting conservatism.

Beekes et al. (2004) examine the role of board composition in earnings timeliness and conservatism. Specifically, they investigate whether different compositions of the board of directors give rise to varying timeliness and conservatism in reported earnings. Their study comprise of a sample of listed non-financial firms in the UK from 1993 to 1995. They use the Basu (1997) model, predicting that the timeliness of bad news, reflected in earnings, is positively related to the proportion of outside directors on the board. Likewise, the timeliness of good news is predicted to be negatively related to the proportion of outside directors. The results obtained were consistent with their predictions, where it was seen that firms with a higher proportion of non-executive directors are more likely to recognise bad news in a timelier fashion (Beekes et al., 2004). As an additional sensitivity analysis, they include the influence of external blockholders in their measurement. Blockholders are defined as the existence of at least one external shareholder holding at least ten percent of the total outstanding equity. They act as external monitors, preventing aggressive accounting practices which influence accounting timeliness (Beekes et al., 2004). The results suggest that the presence of external blockholders did not affect the significant role of non-executive directors in ensuring accounting quality. Beekes et al. (2004) conclude that board composition is crucial in determining earnings quality with respect to incorporating bad news on a timely basis.

Ahmed and Duellman (2007) extend the study by Beekes et al. (2004) in three important ways. First, they use a sample of US firms, noting the differences in the UK
and US GAAP which generally result in more variation in conservatism across firms. They therefore argue that the results in Beekes et al. (2004) might not hold for US firms. Second, instead of using one measure of conservatism, Ahmed and Duellman (2007) employ three proxies for accounting conservatism, namely the market-value proxy, the Basu (1997) model, and a backward-cumulation approach suggested by Roychowdhury and Watts (2006). In addition, they include a more extensive set of control variables not included in Beekes et al. (2004) which tests industry, institutional ownership, profitability, R&D, litigation risk and the strength of shareholder rights (Ahmed and Duellman, 2007). Lastly, while Beekes et al. (2004) only focused on board independence, Ahmed and Duellman (2007) examine not only the board independence, but also a broader set of board characteristics to reflect the strengths of directors’ monitoring incentives. Their findings confirm the results by Beekes et al. (2004), documenting that the proportion of inside directors is negatively related to conservatism and the proportion of outside directors’ shareholding is positively related to conservatism. Their results hold after controlling for the set of variables mentioned previously. They conclude that accounting conservatism an important mechanism for assisting directors in reducing agency costs of the firms (Ahmed and Duellman, 2006).

García Lara et al. (2007) study this relationship in the Spanish context by incorporating 69 non-financial Spanish firms. Their study aims to confirm the results of Beekes et al. (2004) and Ahmed and Duellman (2007), with several variation from these previous studies. First, they use a more extensive measure of governance by aggregating the index incorporating eight board characteristics which are directors’ denominations, board size, proportion of non-executive directors, proportion of independent directors, the number of board meetings, CEO/Chairman duality, the existence of audit committee and the existence of a nomination/remuneration committee (García Lara et al., 2007).
García Lara et al. (2007) argue that the use of an aggregate index allows for the interactions between different governance mechanisms to be accounted for. This is justified by recent Spanish literature which showed that independent boards are efficient in maintaining earnings quality only when they are supported by other mechanisms such as an independent remuneration and nomination committee (García Osma and Gill de Albornoz, 2007). Second, this study controls for firm growth opportunities to mitigate the limitations of the asymmetric timeliness measure as discussed earlier. This is a necessary control as the differences in the asymmetric verifiability of good and bad news could be due to changes in growth opportunities (in effect, understating assets), instead of changes in conservatism (Roychowdhury and Watts, 2007). Third, García Lara et al. (2007) control for the endogenous nature of governance by incorporating size, growth opportunities, profitability, leverage, and changes in ownership into their model. Fourth, they argue that no prior studies have analysed the role of conservatism and governance in a civil-law setting, such as Spain (García Lara et al., 2007). Overall, their results are consistent with the findings by Beekes et al. (2004) and Ahmed and Duellman (2007) where firms with strong governance structure are more likely to use conditional conservatism compared to firms of weak governance structure. Furthermore, they find that weaker boards report good news timelier than those with stronger boards (García Lara et al., 2007).
4.0 DEVELOPMENT OF HYPOTHESES

While empirical evidence in the US or other Anglo-Saxon countries document the profound impact that boards have on organisational outcomes, this association may not hold in Malaysia. This is mainly attributed to the country’s unique business environment as well as the influence of culture that may affect the behaviour of Malaysian directors. A review of the Malaysian literature on the relationship between board characteristics and various aspects of financial statement quality yield mixed results.

4.1 Percentage of Inside Directors on the Board

It has been suggested that boards dominated by outside directors may help to alleviate the agency problem by monitoring and controlling the opportunistic behaviour of managers (Berle and Means, 1932; Jensen and Meckling, 1976). Thus, it can be postulated that the domination of insiders on the board may lead to transfer of wealth to managers at the expense of stakeholders (Beasley, 1996). In such boards, the managers tend to be the sole evaluators of their own performance (Baysinger and Hoskisson, 1990) and thus, they do not face the risk of being removed for poor performance (Weisbach, 1988). On the other hand, a board having high proportion of outside directors may be detrimental to companies as they may stifle strategic actions (Goodstein et al., 1994), lack the business knowledge to be truly effective (Patton and Baker, 1987), and engulf the company in excessive monitoring (Baysinger and Butler, 1985).
Previous research in the US have established the association between the percentage of insiders on the board and fraudulent reporting (Dechow et al., 1996; Beasley, 1996), earnings management (Peasnell et al., 2000; Klein, 2002; Xie et al., 2003) and analysts’ ratings of financial statement quality (Wright, 1997). These findings used the percentage of inside directors on the board as a proxy for board independence. Similarly, the proportion of outside directors or independent non-executive directors can also be used as a proxy for board independence. Baysinger and Butler (1985), Mehran (1995) and Klein (1998) fail to find significant relations between accounting performance and the proportion of outside directors. Haniffa and Hudaib (2006) find that the proportion of outside directors is not significantly related to performance in a sample of 347 Malaysian listed companies. Similarly, Rahman and Ali (2006) and Saleh et al. (2005) did not find evidence of an association between the percentage of independent non-executive directors and earnings management in Malaysian companies. Contrary to this, Abidin et al. (2009) document that a higher proportion of independent non-executive directors on the board had a positive impact on firm performance.

Ahmed and Duellman (2007) find positive association between outside directors and accounting conservatism. However, since previous studies in Malaysia indicate mixed results with respect to board composition and financial statement quality, I do not have a signed prediction for the relationship between the proportion of inside directors on the board and accounting conservatism.
4.2 Separation of CEO and Chairman of the Board

Jensen (1993) argues that the separation of position between the chairman of the board and chief executive officer results in greater independence of the board. According to the agency theory, separation of duty is necessary for efficient monitoring over the board process (Fama and Jensen, 1983; Jensen, 1993). In the absence of this separation, the strength of outside director monitoring incentives might be compromised as director nomination and election are likely to be influenced by the CEO/Chairman. In such cases, the CEO has more power over the board and firm without supervision by a chairman (Duellman, 2006). Therefore, he or she is more likely to pursue strategies which advance personal interest to the detriment of the firm as a whole (Jensen and Meckling, 1976).

Previous studies have found an association between the separation of CEO and chairman to higher credit ratings (Ashbaugh et al., 2006). Rhoades et al. (2001) find that firms in the US with a separation of both roles consistently have higher accounting returns compared to those with role duality. In contrast, Peel and O'Donnell (1995), and Balinga et al. (1996) find no significant difference in the performance of companies with or without role duality. Similarly, the UK studies by Vafeas and Theodorou (1998) and Weir and Laing (1999) find non-significant relationship between performance and role duality. In Malaysia, Haniffa and Hudaib (2006) document that companies with a separation of duty between CEO and chairman seem to perform better than those with role duality. In a sample of 561 Malaysian firms, Saleh et al. (2005) find that the existence of CEO/Chairman duality is positively related to earnings management. Contrary to this, Abidin et al. (2009) and Ponnu (2008) did not find any evidence associating CEO/Chairman separation to better performance among Malaysian
companies. Similarly, Rahman and Ali (2006) fail to document a significant relationship between role duality and earnings management. Due to the mixed results in both US and Malaysian studies, I do not have an assigned hypothesis to link CEO/Chairman separation to accounting conservatism.

4.3 Board Size

There are mixed views about the effects of board size. Jensen (1993) argues that larger boards are less effective than smaller boards due to difficulties in task coordination. ‘Free-rider’ problems are more common in larger boards as each board member might rely on others to monitor management (Duellman, 2006). The competing view is that large board information and expertise have an advantage over smaller boards. Larger boards may be more constructive as they have more external linkage and the ability to extract critical resources such as funding and expertise, which lead to higher performance (Pearce and Zahra, 1992; Pfeffer, 1987). Duellman (2006) state that larger board allow directors to specialise, which in turn enables effective monitoring. Lipton and Lorsch (1992) recommend a board size of between eight and nine directors.

Hermalin and Weisbash (2003) provide evidence of a negative relationship between board size and firm value. Using a large sample of US firms, Yermack (1996) finds a significant relationship between board size and market performance. Xie et al. (2003) and Peasnell et al. (2001) find that having a larger board is associated with less earnings management. The MCCG does not specify a desirable board size; instead, it suggests that firms should examine the impact of their board number on their effectiveness. Studies in Malaysia find that larger boards can be detrimental to the firm in several ways. The results by Haniffa and Hudaib (2006) suggest that large boards are
less effective in monitoring performance and could also be costly for companies in terms of compensation and increased incentives to shirk. Rahman and Ali (2006) document a significant positive relationship between board size and earnings management, implying that larger boards are more difficult to control, thus hampering the monitoring process of management activity. I hypothesise that:

**H₁:** There is a significant negative relationship between board size and accounting conservatism.

### 4.4 Board Meetings

There are competing views with respect to the number of board meetings as a corporate governance mechanism. One view is that board meetings are beneficial in terms of effective management monitoring, strategy discussion and implementation and ability for directors to consult together and share opinions (Vafeas, 1999). Conger et al. (1998) suggest that board meeting is an important resource which improves the effectiveness of the board. Lipton and Lorsch (1992) argue that a major problem directors face is the lack of time to carry out their duties. Previous articles criticise directors who spread their time too thin by holding multiple directorship, limiting their ability to attend meetings regularly and thus, confounding their role in monitoring the management well (Byrne, 1996). An implication of this argument is that directors in boards who meet more frequently are more likely to perform their duties in accordance with shareholders’ interests (Vafeas, 1999).

An opposing view to this is that board meetings might not be useful if the time during the meeting is not used for meaningful exchange of ideas among directors. This problem is said to be the by-product of the fact that the CEO often sets out the agenda
for board meetings (Jensen, 1993; Vafeas, 1999). Routine tasks absorb much of the meeting which limit opportunities for outside directors to exercise meaningful control over the management (Vafeas, 1999). In fact, Jensen (1993) argues that boards should be relatively inactive, and the fact that boards regularly meet might indicate presence of problems. Thus, higher board activity is a likely corporate response to poor performance.

Vafeas (1999) finds that boards meet more frequently following poor performance, consistent with Jensen’s (1993) prediction. The higher board activity, in turn, leads to improved firm performance which suggests that board meetings can be a remedy to limited board interaction time. Xie et al. (2002) find that the frequency of board meetings is negatively associated with earnings management practices in the US. They note that board activity influences members’ ability to serve as effective monitors. The MCCG recommends that boards should meet regularly. There is no set number of meetings that the code proposes, but it states that annual reports should disclose directors’ attendance and the number of meetings held a year. The next hypothesis is as follows:

$$H_2: \quad \text{There is a significant positive relationship between the number of board meetings and accounting conservatism.}$$

4.5 Managerial Ownership

Jensen and Meckling (1976) argue that conflicts of interest arise with the separation of stock ownership and control over firms. This is because managers are driven by the incentive to create their own wealth at the expense of shareholders. A potentially important factor that may reduce this conflict is when managers own stocks
in the company. The interest of managers and shareholders start to converge when managers own part of the firm as they develop shareholder-like interest. However, Morck et al. (1988) argues that managers with significant ownership might be less considerate toward the interest of other shareholders. This is because they have considerable voting rights and they also have the power to make decisions on the management of the company.

Previous research in the US finds that managerial ownership is related to lower likelihood of financial statement fraud (Beasley, 1996), lower earnings management practices (Warfield, Wild and Wild, 1995) and higher level of accounting conservatism (Duellman, 2006). In Malaysia, the CEO and directors of a listed company are required to disclose their interest in the company to the Securities Commission filling. A failure to do so will result in a criminal sanction of up to RM1 million, or imprisonment of up to 10 years, or both (Securities Industry Act, 1983). Haniffa and Hudaib (2006) find that managerial ownership is detrimental to accounting performance. However, it should be noted that managerial ownership is difficult to determine due to high cross-holdings of ownership via pyramiding (Haniffa and Hudaib, 2006). Contrary to this, Saleh et al. (2005) find that managerial ownership is negatively related to earnings management practices in Malaysian companies, suggesting that ownership in the firm provide incentives for effective monitoring. I hypothesise that:

\[ H_3: \text{ There is a significant positive relationship between managerial ownership and accounting conservatism. } \]
5.0 RESEARCH METHODOLOGY

5.1 Sample Selection

The sample selection comprises of all firms listed on the main board of Bursa Malaysia (formerly known as the Kuala Lumpur Stock Exchange) for the fiscal year 2008. Consistent with prior studies, financial and insurance firms are excluded from the sample, as the different accounting characteristics might present a problem when comparing to other firms in the sample (Duellman, 2006). Historical financial information are obtained from Datastream, while corporate governance data are manually collected from published annual reports publicly available from the Bursa Malaysia website.

Table 1 shows a summary of how the final sample was obtained. Of the 834 firms listed on the main board of Bursa Malaysia, 36 companies in the financial services and 11 insurance companies were eliminated. Two foreign companies, two newly listed companies and two companies that are suspended from trading were also eliminated from the final sample. In addition, 20 companies were excluded due to missing annual reports, 10 of which did not publish a report in 2008. The remaining 10 companies without published annual reports in 2007 were also excluded as a minimum of two-period observation is needed for certain analyses. Also, 24 firms without the required financial data from Datastream and 23 firms with missing corporate governance information were also removed, leaving a final sample of 716 firms.

Table 1 Panel B represents a breakdown of the sample by industry. The classification of firms into respective industry groups were provided on Datastream, although companies were roughly regrouped into broader industries based on Saleh et
al. (2005). The largest proportion of the sample is from the consumer products industry, which accounts for 28.4% of the sample. This is followed by industrial products (21.2%), construction and materials (15.4%), and companies in the trading and services industry (12.7%). Seventy one firms are from the property industry and 49 firms are from the technology industry, representing 9.9% and 6.8% of the sample respectively. The infrastructure and utilities industry makes up the least number of sample firms, which accounts for only 5.6% of the sample.
Table 1
Sample Selection

<table>
<thead>
<tr>
<th>Category</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of firms in year 2008</td>
<td>834</td>
</tr>
<tr>
<td>Less: Financial Services</td>
<td>(36)</td>
</tr>
<tr>
<td>Less: Insurance Firms</td>
<td>(11)</td>
</tr>
<tr>
<td>Less: Foreign Companies</td>
<td>(2)</td>
</tr>
<tr>
<td>Less: Newly listed companies</td>
<td>(2)</td>
</tr>
<tr>
<td>Less: Companies suspended from trading</td>
<td>(2)</td>
</tr>
<tr>
<td>Less: Companies without annual report in 2007 and 2008</td>
<td>(20)</td>
</tr>
<tr>
<td>Less: Missing data on Datastream</td>
<td>(24)</td>
</tr>
<tr>
<td>Less: Missing data on corporate governance</td>
<td>(23)</td>
</tr>
<tr>
<td><strong>Final Sample Size</strong></td>
<td><strong>716</strong></td>
</tr>
</tbody>
</table>

Table 2
Sample Breakdown Based on Industry

<table>
<thead>
<tr>
<th>Industry</th>
<th>No. of Firms</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction and Materials</td>
<td>110</td>
<td>15.40%</td>
</tr>
<tr>
<td>Consumer Products</td>
<td>203</td>
<td>28.40%</td>
</tr>
<tr>
<td>Industrial Products</td>
<td>152</td>
<td>21.20%</td>
</tr>
<tr>
<td>Infrastructure and Utilities</td>
<td>40</td>
<td>5.60%</td>
</tr>
<tr>
<td>Property</td>
<td>71</td>
<td>9.90%</td>
</tr>
<tr>
<td>Technology</td>
<td>49</td>
<td>6.80%</td>
</tr>
<tr>
<td>Trading and Services</td>
<td>91</td>
<td>12.70%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>716</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>
5.2 Measurement of the Variables

5.2.1 Measure of Accounting Conservatism

Basu (1997, p. 7) defined accounting conservatism as the “accountant’s tendency to require a higher degree of verification to recognise good news as gains than to recognise bad news as losses”. Since annual returns capture news arrival during the year, Basu (1997) introduces a measure of conservatism using a regression of annual earnings on returns, which is based on differential reaction of good and bad news in earnings. He used stock prices as a proxy for good and bad news, as changes in stock prices take into account all the information in a timely manner. Since bad news in earnings is reflected timelier than good news, he predicted a higher association between earnings and returns when returns are negative than when returns are positive. The Basu (1997) model, also known as the asymmetric timeliness of earnings, is as follows:

\[ \frac{E_t}{P_{t-1}} = \beta_0 + \beta_1 D_t + \beta_2 R_t + \beta_3 D_t R_t + \mu_t \]

where,

- \( E_t \) = annual earnings
- \( P_{t-1} \) = market capitalisation at the beginning of the year
- \( R_t \) = annual returns
- \( D_t \) = dummy variable that equals one in the case of bad news (negative \( R_t \)) and zero in the case of good news (positive \( R_t \))

In the regression above, \( \beta_2 \) measures the response of earnings to returns when returns are positive. Conversely, \( (\beta_2 + \beta_3) \) measures the response when returns are negative (Roychowdhury and Watts, 2007). Conservatism implies \( \beta_2 + \beta_3 > \beta_2 \), that is
when $\beta_3 > 0$. This coefficient is the primary measure of conservatism, called the asymmetric timeliness coefficient and is expected to be significantly positive, implying that more conservative firms have greater asymmetric verifiability between gains and losses (Duellman, 2006).

Since the introduction of the Basu (1997) model, numerous studies have used the asymmetric timeliness of earnings as a measure of conservatism. However, despite the widespread appeal of this model, the validity of asymmetric timeliness as an empirical measure has been questioned by recent studies. Ball and Shivakumar (2005) note that one of the limitations of the Basu (1997) model is that it cannot distinguish transitory gains or losses in earnings that arise as a result of earnings management practices (such as excess provision that may revert over time) and random errors in accruals. The existence of transitory components affects income changes, yet the model fails to identify whether these components are contemporaneously correlated with annual returns, which is a proxy for good and bad news (Ball and Shivakumar, 2005).

Another common measurement of accounting conservatism is the market-to-book (MTB) measure, which is the ratio of market value of equity to the book value of equity. This measurement is based on the notion that conservatism results in the understatement of book value relative to equity value (EV) (Roychowdhury and Watts, 2007; Beaver and Ryan, 2005). Roychowdhury and Watts (2007) note a deficiency inherent with the measurement of MTB, and also the asymmetric timeliness measure. The theory of conservatism in Watts (2003) suggests that the role of accounting is to record the value of separable net assets (NAV), not equity value (EV), with the difference between these two being rents (above-competitive returns representing growth opportunities or monopoly returns). Watts (2003) employs the asymmetric
verification standards in this theory which explain the understatement of separable net asset values, or conservatism. However, the asymmetric timeliness measure and MTB both assume that accounting reports EV, including the value of rents. The use of EV as a benchmark for conservatism results in error due to rents, but casual evidence suggests that accounting practice has not measured rents or changes in rents. Rents are only recognised when acquired, not when they are generated within the firm (Roychowdhury and Watts, 2007).

Roychowdhury and Watts (2007) further note that another important basis for the argument against the Basu (1997) measure is its observed negative correlation with the MTB measurement. Although several authors have attempted to discuss this negative association, they have not postulated any theories to explain how asymmetric timeliness relates to MTB (Roychowdhury and Watts, 2007). Beaver and Ryan (2005) propose a detailed model; however, they still generate their predictions from a mechanical model based on observed practice, rather than from the conservatism theory. Roychowdhury and Watts (2007) explain that the sign and magnitude of asymmetric timeliness might influence the measurement period of earnings and returns. When asymmetric timeliness is measured over a short horizon period, it may result in a negative association between this measure and MTB. Over longer measurement periods, as the intended effect of asymmetric timeliness becomes prominent, the correlation with MTB should be increasingly positive (Roychowdhury and Watts, 2007).

Givoly and Hayn (2000) suggest that another method to measure the degree of conservatism is to observe the sign and magnitude of accumulated accruals over time. The authors explain that accruals will tend to reverse. For instance, a firm experiencing a period where net income exceeds (falls below) cash flow from operations will be
expected to have negative (positive) accruals in the subsequent period. For a firm in a steady state, the accumulated net income before depreciation is expected to converge to cash flows from operations in the long run (Givoly and Hayn, 2000). It is predicted that a constant predominance of negative accruals over a long horizon period indicates conservatism, while the rate of accumulation of net negative accruals indicates the change in the degree of conservatism over time (Givoly and Hayn, 2000).

The above discussion indicates that all measures of conservatism are subject to measurement error and biases. Therefore, I use three measures of conservatism: (a) accrual-based measure of conservatism (CON-ACC), (b) market-based measure of conservatism (CON-MKT) and, (c) Khan and Watts (2009) measure of conservatism (CON-KW).

(a) **Accrual-based Measure of Conservatism, CON-ACC**

I use an accrual-based measure of conservatism, CON-ACC, following Givoly and Hayn (2000), as a primary measure of conservatism. This measurement equals to income before extraordinary items less cash flows from operations plus depreciation expense deflated by average total assets, multiplied by negative one. The intuition underlying this measure is that conservative reporting will result in persistently negative accruals (Duellman, 2006; Givoly and Hayn, 2000). Therefore, the more negative the average accruals, the more conservative the accounting. I multiply this measure so that positive values of CON-ACC will thus reflect greater conservatism. A previous study by Ahmed and Duellman (2007) which used this method averaged this measure over a three year period to mitigate the effect of temporary large accruals as accruals tend to reverse within a year (Richardson et al., 2005). However, since only a one-year
observation is involved in this study, I do not attempt to average the estimations. The top and bottom one-percentiles of this measurement will be winsorised.

(b) **Market-based Measure of Conservatism, CON-MKT**

The second measure of conservatism that I use is the market-based measure, CON-MKT. I define this variable as the market-to-book ratio. As conservatism results in understating book value of equity relative to market value of equity, companies with higher market-to-book ratio reflects higher degree of conservative reporting. Consistent with Ahmed and Duellman (2007), I winsorise this estimate at the top and bottom one-percentiles.

(c) **Khan and Watts (2009) C_Score Measure of Conservatism**

This proxy for conservatism employs a firm-year measurement based on the Basu (1997) measure of asymmetric timeliness. This method is useful as the standard Basu (1997) model is a cross-sectional measure, whereas this analysis requires a firm-specific measure due to the limited restrictions on data. The standard Basu (1997) regression is rewritten as:

\[ X_{i,t} = \beta_0 + \beta_1 D_{i,t} + \beta_2 R_{i,t} + \beta_3 D_t R_{i,t} + \mu_{i,t} \]  

(1)

where, \( X_{i,t} \) is the annual earnings deflated by the market capitalisation at the beginning of the year, \( R_t \) is stock returns and \( D_t \) is a dummy variable which takes the value of one for firms with negative stock returns and zero otherwise, and \( \mu_t \) is the regression residual. The coefficient \( \beta_3 \) captures the incremental timeliness for bad news relative to good news.
In order to estimate the timeliness which reflects both good news and conservatism at the firm-year level, Khan and Watts (2009) specify the timeliness of good news (referred to as G_Score) and the incremental timeliness of bad news (referred to as C_Score) as linear functions of firm-specific characteristics:

\[
G\_{\text{Score}} = \beta_2 = \mu_0 + \mu_1 \text{SIZE}_{i,t} + \mu_2 \text{M/B}_{i,t} + \mu_3 \text{LEV}_{i,t}
\]  (2)

\[
C\_{\text{Score}} = \beta_3 = \lambda_0 + \lambda_1 \text{SIZE}_{i,t} + \lambda_2 \text{M/B}_{i,t} + \lambda_3 \text{LEV}_{i,t}
\]  (3)

where \(\text{SIZE}\) is log of market value of equity, \(\text{M/B}\) is the market-to-book value of equity and \(\text{LEV}\) is long term debt deflated by beginning market value of equity. Equations (2) and (3) are not regression models. Instead, they are substituted into regression (1) above to obtain equation (4) below:

\[
X_{i,t} = \beta_0 + \beta_1 D_{i,t} + \beta_2 R_{i,t} (\mu_0 + \mu_1 \text{SIZE}_{i,t} + \mu_2 \text{M/B}_{i,t} + \mu_3 \text{LEV}_{i,t}) + D_{i,t} R_{i,t} (\lambda_0 + \lambda_1 \\
\lambda_2 \text{SIZE}_{i,t} + \lambda_3 \text{M/B}_{i,t} + \lambda_4 \text{LEV}_{i,t}) + \epsilon_{i,t}
\]  (4)

The above equation is the annual cross-section regression model where coefficients \(\lambda_0\) to \(\lambda_4\) are used to estimate C_Score. C_Score is the firm-year measure of conservatism, or incremental bad news timeliness and the sum of G_Score and C_Score represents the total bad news timeliness. Therefore, higher C_Score values mean higher conservatism. Consistent with Khan and Watts (2009), I delete firm-years with missing data for any of the variables. All continuous variables are winsorised at the top and bottom one-percentiles.
5.2.3 Board of Directors’ Characteristics

(1) **Percentage of Inside Directors on the Board** is the proportion of directors who are currently employed by the firm and are related to the current management of the firm.

(2) **Separation of CEO and the Chariman of the Board** is measured using a dummy variable, where a value of 1 will be assigned if the CEO is not the chairman of the board (as a proxy for good governance) and 0 is otherwise.

(3) **Board Size** is measured by calculating the natural log of the total number of directors in a board.

(4) **Board Meetings** is the number of board meetings held in a year

(5) **Managerial Ownership** is measured using the percentage of shares owned by managers (inside directors) divided by the total common shares outstanding. This measure includes only direct interest in the company.

5.2.4 Control Variables

I control for firm size since larger firms are more complex to run and tend to have stronger governance structure. Larger firms are likely to face large political costs which pressure them to use more conservative accounting (Watts and Zimmerman, 1978). I control for sales growth because Ahmed et al. (2002) argued that sales growth can affect CON-ACC and CON-MKT for three reasons; (1) sales growth affects
accruals, such as inventory and receivables, which will subsequently affect CON-ACC, (2) CON-ACC might be a poor measure for firms with declining sales and (3) firms with large sales growth will inflate the market expectations of future cash flows, which affect market value thereby affecting CON-MKT.

Cash flows from operations divided by average total assets act as a proxy for profitability. I control for profitability as Ahmed at el. (2002) argue that profitable firms tend to use more conservative accounting. Leverage is also included as a control variable since it has been documented that firms with high leverage are likely to have greater bondholder and shareholder conflicts which in turn may affect conservatism (Duellman, 2006). Duellman’s (2006) study also control for research and development and advertising expenditures. Ahmed (1994) argues that these items are likely to capture economic rents generated by assets-in-place, growth opportunities and GAAP mandated conservatism. However, I do not include this control variable as many companies in Malaysia do not have expenditures in this area.

An additional control variable is included for the CON-MKT measure, which is the lagged market-to-book ratio. Roychowdhury and Watts (2007) argue that the composition of equity value of a firm is affected by past asymmetric timeliness and its investment opportunity. Therefore, these components will affect future asymmetric timeliness. Lagged market-to-book ratio captures investment opportunity set and it is negatively associated with asymmetric timeliness of earnings. I do not use any of the control variables for the Khan and Watts (2009) model as their model takes into account firm characteristics that may affect conservatism.
5.3 Empirical Models

(a) Accrual-based Measure of Conservatism (CON-ACC)

\[
CON-ACC_{it} = \beta_0 + \beta_1 \text{Inside Director}\%_{it} + \beta_2 \text{CEO/Chairman Separation}_{it} + \\
\beta_3 \text{Board Size}_{it} + \beta_4 \text{Board Meeting}\#_{it} + \beta_5 \text{Managerial Ownership}_{it} + \\
\beta_6 \text{Firm Size}_{it} + \beta_7 \text{Sales Growth}_{it} + \beta_8 \text{CFO/TA}_{it} + \beta_9 \text{Leverage}_{it} 
\]

(b) Market-based Measure of Conservatism (CON-MKT)

\[
CON-MKT_{it} = \beta_0 + \beta_1 \text{Inside Director}\%_{it} + \beta_2 \text{CEO/Chairman Separation}_{it} + \\
\beta_3 \text{Board Size}_{it} + \beta_4 \text{Board Meeting}\#_{it} + \beta_5 \text{Managerial Ownership}_{it} + \\
\beta_6 \text{Firm Size}_{it} + \beta_7 \text{Sales Growth}_{it} + \beta_8 \text{CFO/TA}_{it} + \beta_9 \text{Leverage}_{it} + \\
\beta_{10} \text{CONMKT2007}_{it} 
\]

(c) Khan and Watts (2009) Measure of Conservatism (CON-KW)

\[
CON-KW_{it} = \beta_0 + \beta_1 \text{Inside Director}\%_{it} + \beta_2 \text{CEO/Chairman Separation}_{it} + \\
\beta_3 \text{Board Size}_{it} + \beta_4 \text{Board Meeting}\#_{it} + \beta_5 \text{Managerial Ownership}_{it} 
\]

where Inside Director\%_{it} = percentage of inside directors in the board
CEO/Chairman Separation_{it} = dummy variable equal to one if CEO is not the chairman of the board, and zero otherwise
Board Size_{it} = natural log of the number of directors
Board Meeting\#_{it} = number of board meetings held per year
Managerial Ownership_{it} = total number of shares held by inside directors divided by total common shares outstanding
Firm Size_{it} = natural log of average total assets
Sales Growth_{it} = percentage of annual growth in sales
CFO/TA_{it} = cash flows from operations divided by average total assets
Leverage_{it} = total long term liabilities divided by total assets
CONMKT2007_{it} = market-to-book ratio of previous year (2007)
6.0 RESULTS

6.1 Descriptive Statistics

Table 3 represents the descriptive statistics. The mean value of the accrual-based conservatism measure (CON-ACC) is 0.003. This figure is smaller than the mean value reported in the US study conducted by Ahmed and Duellman (2007), which suggests that the degree of conservative reporting in Malaysia is smaller than their US counterparts. However, it should be noted that the study by Ahmed and Duellman (2007) consist of S&P firms for years 1999 through 2001, as opposed to this study which used a one-year sample of listed firms in 2008. The market-to-book ratio (CON-MKT) measure of conservatism yields a mean of 0.695. This ratio is surprisingly low because in most cases, the ratio is usually greater than one. This is because many internally generated intangibles are hard to measure and not captured in the traditional accounting. Without knowing the impact of intangibles, investors may overvalue the company and wildly inflate the stock (Lev, 2001). A possible explanation of the opposing outcome in this study may be due to the recession in 2008 that causes share price to plummet. The third measure, which is C-Score measure (CON-KW), proposed by Khan and Watts (2009) yields a mean value of 0.223.

The average percentage of inside directors on the board is 36.5% which is slightly lower than the mean recorded by Saleh et al. (2005). This could be due to the fact that their study was conducted back in 2001. Approximately 85.2% of Malaysian companies have a separation of role between the CEO and the chairman of the board. This is a much higher percentage, compared to US companies where a study by Duellman (2006) finds that only 31% of companies have a CEO who is not the current board chairman. On average, companies in Malaysia have around seven total directors,
approximately three of which are independent non-executive directors (not reported). The average number of board meetings held a year is 5.3. From the sample, company directors hold roughly 9.8% of all stock, although it was found that 22% of companies do not have managers with any shareholdings.

The sample firms are then divided into two groups; firms with conservatism measure (CON-ACC) above the sample median and firms with conservatism measure below the sample median. The descriptive statistics for these groups are shown in Table 4. Surprisingly, companies in the Below Median group seem to have a slightly higher mean CON-MKT value compared to companies in the Above Median group. The t-test results showed a statistically significant difference between mean CON-KW values of these two groups. This might suggest that the CON-ACC and CON-KW measures are correlated and yield more similar results in measuring conservatism compared to the CON-MKT measure. The average percentage of inside directors and board size also showed a significant difference at a 10% level suggesting that more conservative companies operate with less inside directors and tend to have smaller board size. Results also show that more conservative firms tend to have higher operating cash flows compared to less conservative firms.
Table 3
Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>25%</th>
<th>Median</th>
<th>75%</th>
</tr>
</thead>
<tbody>
<tr>
<td>CON-ACC</td>
<td>0.0030</td>
<td>0.0849</td>
<td>-0.0426</td>
<td>0.0001</td>
<td>0.0417</td>
</tr>
<tr>
<td>CON-MKT</td>
<td>0.6952</td>
<td>0.6283</td>
<td>0.3240</td>
<td>0.5168</td>
<td>0.8344</td>
</tr>
<tr>
<td>CON-KW</td>
<td>0.2233</td>
<td>1.1168</td>
<td>-0.4294</td>
<td>0.2902</td>
<td>0.8882</td>
</tr>
<tr>
<td>Inside Director %</td>
<td>0.3655</td>
<td>0.1661</td>
<td>0.2222</td>
<td>0.3750</td>
<td>0.5000</td>
</tr>
<tr>
<td>CEO/Chairman Separation</td>
<td>0.8520</td>
<td>0.3554</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Board Size</td>
<td>0.8585</td>
<td>0.1059</td>
<td>0.7782</td>
<td>0.8451</td>
<td>0.9542</td>
</tr>
<tr>
<td>Board Meetings</td>
<td>5.3422</td>
<td>1.7362</td>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Managerial Ownership</td>
<td>0.0975</td>
<td>0.1428</td>
<td>0.0002</td>
<td>0.0226</td>
<td>0.1427</td>
</tr>
<tr>
<td>Firm Size</td>
<td>5.5667</td>
<td>0.5602</td>
<td>5.1526</td>
<td>5.4886</td>
<td>5.8731</td>
</tr>
<tr>
<td>Sales Growth</td>
<td>0.2096</td>
<td>1.3151</td>
<td>-0.0425</td>
<td>0.1120</td>
<td>0.2547</td>
</tr>
<tr>
<td>CFO/TA</td>
<td>0.0566</td>
<td>0.0935</td>
<td>0.0054</td>
<td>0.0508</td>
<td>0.1059</td>
</tr>
<tr>
<td>Leverage</td>
<td>0.1054</td>
<td>0.1339</td>
<td>0.0070</td>
<td>0.0584</td>
<td>0.1590</td>
</tr>
<tr>
<td>CON-MKT 2007</td>
<td>1.2990</td>
<td>1.8942</td>
<td>0.5530</td>
<td>0.8445</td>
<td>1.4455</td>
</tr>
</tbody>
</table>

CON-ACC<sub>it</sub> = Net income before extraordinary items plus depreciation expense less cash flow from operations, scaled by average total assets and multiplied by -1. CON-MKT<sub>it</sub> = Market-to-book ratio. Inside Director%<sub>it</sub> = Percentage of directors on the board who also hold management position in the company. CEO/Chairman Separation<sub>it</sub> = Dummy variable equal to one if the CEO is not the chairman of the board, and zero otherwise. Board Size<sub>it</sub> = Natural log of the number of directors. Board Meetings<sub>it</sub> = Number of board meetings held per year. Managerial Ownership<sub>it</sub> = Total common shares held by managers (inside directors) divided by total common shares outstanding. Firm Size<sub>it</sub> = Natural log of average total assets. Sales Growth<sub>it</sub> = Percentage of annual growth in total sales. CFO/TA<sub>it</sub> = Cash flows from operations divided by average total assets. Leverage<sub>it</sub> = Total long-term liabilities divided by average total assets. CON-MKT 2007 = Market-to-book ratio of year 2007.
Table 4
Descriptive statistics and test of differences between firms with above and below
CON-ACC median

<table>
<thead>
<tr>
<th></th>
<th>Above Median</th>
<th>Below Median</th>
<th>Mean Difference</th>
<th>t-stat</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Std. Dev.</td>
<td>Mean</td>
<td>Std. Dev.</td>
</tr>
<tr>
<td>CON-MKT</td>
<td>0.756</td>
<td>1.905</td>
<td>0.784</td>
<td>1.172</td>
</tr>
<tr>
<td>CON-KW</td>
<td>0.392</td>
<td>1.190</td>
<td>0.055</td>
<td>1.013</td>
</tr>
<tr>
<td>Inside Director %</td>
<td>0.355</td>
<td>0.164</td>
<td>0.376</td>
<td>0.168</td>
</tr>
<tr>
<td>CEO/Chairman Separation</td>
<td>0.863</td>
<td>0.344</td>
<td>0.841</td>
<td>0.366</td>
</tr>
<tr>
<td>Board Size</td>
<td>0.851</td>
<td>0.108</td>
<td>0.866</td>
<td>0.104</td>
</tr>
<tr>
<td>Board Meetings</td>
<td>5.439</td>
<td>1.830</td>
<td>5.246</td>
<td>1.633</td>
</tr>
<tr>
<td>Managerial Ownership</td>
<td>0.093</td>
<td>0.137</td>
<td>0.102</td>
<td>0.149</td>
</tr>
<tr>
<td>Firm Size</td>
<td>5.531</td>
<td>0.582</td>
<td>5.602</td>
<td>0.537</td>
</tr>
<tr>
<td>Sales Growth</td>
<td>0.194</td>
<td>1.770</td>
<td>0.225</td>
<td>0.575</td>
</tr>
<tr>
<td>CFO/TA</td>
<td>0.088</td>
<td>0.094</td>
<td>0.025</td>
<td>0.082</td>
</tr>
<tr>
<td>Leverage</td>
<td>0.104</td>
<td>0.138</td>
<td>0.107</td>
<td>0.130</td>
</tr>
</tbody>
</table>

*significant at 0.1 (2-tailed) **significant at 0.05 (2-tailed) ***significant at 0.01 (2-tailed)

**Above Median** \( i,t \) = Companies with conservatism measure above the sample CON-ACC median. **Below Median** \( i,t \) = Companies with conservatism measure below the sample CON-ACC median. CON-ACC \( i,t \) = Net income before extraordinary items plus depreciation expense less cash flow from operations, scaled by average total assets and multiplied by -1. CON-MKT \( i,t \) = Market-to-book ratio. **Inside Director %** \( i,t \) = Percentage of directors on the board who also hold management position in the company. **CEO/Chairman Separation** \( i,t \) = Dummy variable equal to one if the CEO is not the chairman of the board, and zero otherwise. **Board Size** \( i,t \) = Natural log of the number of directors. **Board Meetings** \( i,t \) = Number of board meetings held per year. **Managerial Ownership** \( i,t \) = Total common shares held by managers (inside directors) divided by total common shares outstanding. **Firm Size** \( i,t \) = Natural log of average total assets. **Sales Growth** \( i,t \) = Percentage of annual growth in total sales. **CFO/TA** \( i,t \) = Cash flows from operations divided by average total assets. **Leverage** \( i,t \) = Total long-term liabilities divided by average total assets. **CON-MKT 2007** = Market-to-book ratio of year 2007.
Table 5 shows the correlations between the three conservatism measures and the governance and control variables. Both the accrual-based measure of conservatism (CON-ACC) and the Khan and Watts (2009) measure (CON-KW) is negatively correlated to the market-based measure of conservatism (CON-MKT) at the five percent significance level. This negative correlation is likely due to the different aspect of conservatism that they measure. The CON-ACC measure and the CON-KW measure are positively correlated at the five percent level of significance. Out of the governance variables used, only board size is significantly correlated to CON-ACC. Several governance variables (Inside Director, Board Size and Managerial Ownership) are correlated to the market-based measure of conservatism, CON-MKT. All of the governance variables are correlated to the third measure, CON-KW at the five percent level of significance. For the control variables, Firm Size is negatively correlated to both the CON-ACC and CON-KW measure of conservatism, but is positively correlated to the CON-MKT measure. Cash flow from operations is found to be positively correlated to accounting conservatism, similar to previous studies (Duellman, 2006), although surprisingly results from the CON-KW measure showed negative correlation with this variable.
Table 5

Pearson Correlations

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 CON-ACC</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 CON-MKT</td>
<td>-0.08</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 CON-KW</td>
<td>0.21</td>
<td>-0.35</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Inside Director %</td>
<td>-0.06</td>
<td>-0.12</td>
<td>-0.20</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 CEO/Chairman Separation</td>
<td>0.01</td>
<td>0.02</td>
<td>-0.09</td>
<td>-0.12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Board Size</td>
<td>-0.11</td>
<td>-0.11</td>
<td>-0.34</td>
<td>0.09</td>
<td>0.17</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Board Meetings</td>
<td>0.06</td>
<td>0.00</td>
<td>-0.18</td>
<td>-0.21</td>
<td>0.03</td>
<td>0.06</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 Managerial Ownership</td>
<td>0.00</td>
<td>-0.10</td>
<td>0.22</td>
<td>0.34</td>
<td>-0.04</td>
<td>-0.07</td>
<td>-0.15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 Firm Size</td>
<td>-0.11</td>
<td>0.18</td>
<td>-0.78</td>
<td>-0.20</td>
<td>0.07</td>
<td>0.34</td>
<td>0.28</td>
<td>-0.25</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>10 Sales Growth</td>
<td>0.00</td>
<td>0.05</td>
<td>-0.05</td>
<td>-0.03</td>
<td>0.01</td>
<td>-0.02</td>
<td>-0.01</td>
<td>-0.04</td>
<td>0.03</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 CFO/TA</td>
<td>0.45</td>
<td>0.35</td>
<td>-0.20</td>
<td>-0.05</td>
<td>0.01</td>
<td>0.10</td>
<td>-0.04</td>
<td>-0.04</td>
<td>0.04</td>
<td>0.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 Leverage</td>
<td>-0.03</td>
<td>0.05</td>
<td>0.00</td>
<td>-0.03</td>
<td>-0.01</td>
<td>0.08</td>
<td>0.19</td>
<td>-0.02</td>
<td>0.34</td>
<td>0.00</td>
<td>-0.12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 CON-MKT 2007</td>
<td>-0.05</td>
<td>0.59</td>
<td>-0.24</td>
<td>-0.03</td>
<td>0.01</td>
<td>0.07</td>
<td>0.00</td>
<td>-0.10</td>
<td>0.20</td>
<td>0.06</td>
<td>0.32</td>
<td>0.14</td>
<td>1</td>
</tr>
</tbody>
</table>

Correlations in bold represent significance at the 5% level using a two-tailed test. Variable definitions are provided in Table 2
6.2 **Accrual-based Conservatism Measure and Board Characteristics**

Table 6 presents the results of the regression of accrual based conservatism measure (CON-ACC) on board characteristics. The categorical effects of different industry groups were taken into account by creating industry dummy variables during regression analysis. Column (i) presents the regression without control variables. Column (ii) presents the regression in column (i) augmented by the control variables. The figures in the parenthesis show the t statistics and the asterisks represent its corresponding significance level.

The coefficient of Inside Director% yields a negative figure but the t statistic shows that it is not significant with or without control variables. Similarly, the coefficient of CEO/Chairman Separation is positive but insignificant in both columns. However, the strength of this association is not strong enough to suggest that accounting conservatism is associated with these two variables. This is different from the previous study conducted in the US by Ahmed and Duellman (2007) where they find strong negative association between inside director percentage and accounting conservatism and weak positive association between CEO/Chairman Separation and conservatism. They also find that the coefficient on Board Size is generally not significant. However I find that the coefficient of Board Size is negative and significant at the 1% level in both columns. This suggests that firms with larger board size tend to be less conservative. The coefficient of Board Meetings shows a positive sign but only significant at the 1% level when the control variables are included. This is consistent with the expectation that higher number of board meetings represents stronger governance thus increasing conservatism. The coefficient of Managerial Ownership is not significant in both columns.
**Table 6**

Regression of Industry-Adjusted 1-year Accrual Based Conservatism Measure on Board Characteristics

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Predicted Sign</th>
<th>(i)</th>
<th>(ii)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td></td>
<td>0.074</td>
<td>0.157</td>
</tr>
<tr>
<td><strong>Board Characteristics</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inside Director %</td>
<td>-</td>
<td>-0.017</td>
<td>-0.013</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(-0.824)</td>
<td>(-0.720)</td>
</tr>
<tr>
<td>CEO/Chairman Separation</td>
<td>+</td>
<td>0.004</td>
<td>0.003</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.479)</td>
<td>(0.431)</td>
</tr>
<tr>
<td>Board Size</td>
<td>?</td>
<td>-0.094</td>
<td>-0.098</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(-3.060)**</td>
<td>(-3.394)**</td>
</tr>
<tr>
<td>Board Meetings</td>
<td>+</td>
<td>0.002</td>
<td>0.005</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(1.038)</td>
<td>(2.879)**</td>
</tr>
<tr>
<td>Managerial Ownership</td>
<td>+</td>
<td>0.012</td>
<td>0.005</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.501)</td>
<td>(0.237)</td>
</tr>
<tr>
<td><strong>Control Variables</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Firm Size</td>
<td>+</td>
<td>-0.024</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(-3.994)**</td>
<td></td>
</tr>
<tr>
<td>Sales Growth</td>
<td>-</td>
<td>0.000253</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(.012)</td>
<td></td>
</tr>
<tr>
<td>CFO/TA</td>
<td>+</td>
<td>0.441</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(14.350)**</td>
<td></td>
</tr>
<tr>
<td>Leverage</td>
<td>+</td>
<td>0.041</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(1.759)*</td>
<td></td>
</tr>
<tr>
<td>Sample Size</td>
<td></td>
<td>716</td>
<td>716</td>
</tr>
<tr>
<td>F Value</td>
<td></td>
<td>2.203***</td>
<td>16.623***</td>
</tr>
<tr>
<td>Adjusted R-Square</td>
<td></td>
<td>0.018</td>
<td>0.247</td>
</tr>
</tbody>
</table>

*significant at 0.1 (2-tailed) **significant at 0.05 (2-tailed) ***significant at 0.01 (2-tailed)
6.3 Market-based Conservatism Measure and Board Characteristics

Table 7 presents the results of the regression of market based conservatism measure (CON-MKT) on board characteristics. Similar to CON-ACC, the categorical effects of different industry groups were also taken into account using industry dummy variables. Column (i) presents the regression without control variables. Column (ii) presents the regression in column (i) augmented by the control variables. The figures in the parenthesis show the t statistics and the asterisks represent its corresponding significance level.

Consistent with the expectation that the percentage of inside director is negatively associated with accounting conservatism, I find a negative coefficient of Inside Director% at the 5% significant level. This shows that stronger governance is related to higher conservatism. I did not find any significant association between CEO/Chairman Separation, similar to the results from the CON-ACC measure. Board Size yields a significantly negative coefficient when measured with and without the control variables. The coefficient of Board Meetings is negative and weakly significant at the first column, but insignificant with the inclusion of the control variables. The coefficient of Managerial Ownership is negatively associated with CON-MKT at the 5% significance level, but insignificant when the regression is augmented by the control variables.
### Table 7

Regression of Industry-Adjusted 1-year Market Based Conservatism Measure on Board Characteristics and Control Variables

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Predicted Sign</th>
<th>(i)</th>
<th>(ii)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td></td>
<td>0.507</td>
<td>0.111</td>
</tr>
<tr>
<td><strong>Board Characteristics</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inside Director %</td>
<td>-</td>
<td>-0.351</td>
<td>-0.288</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(-2.343)**</td>
<td>(-2.379)**</td>
</tr>
<tr>
<td>CEO/Chairman Separation</td>
<td>+</td>
<td>0.008</td>
<td>0.013</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-0.125</td>
<td>-0.241</td>
</tr>
<tr>
<td>Board Size</td>
<td>?</td>
<td>-0.664</td>
<td>-0.293</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(-3.012)**</td>
<td>(-1.559)*</td>
</tr>
<tr>
<td>Board Meetings</td>
<td>+</td>
<td>-0.023</td>
<td>-0.014</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(-1.719)*</td>
<td>-1.23</td>
</tr>
<tr>
<td>Managerial Ownership</td>
<td>+</td>
<td>-0.341</td>
<td>-0.081</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(-2.003)**</td>
<td>-0.556</td>
</tr>
<tr>
<td><strong>Control Variables</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Firm Size</td>
<td>+</td>
<td>0.059</td>
<td>-1.483</td>
</tr>
<tr>
<td>Sales Growth</td>
<td>-</td>
<td>0.007</td>
<td>-0.498</td>
</tr>
<tr>
<td>CFO/TA</td>
<td>+</td>
<td>0.902</td>
<td>(4.234)***</td>
</tr>
<tr>
<td>Leverage</td>
<td>+</td>
<td>-0.272</td>
<td>(-1.773)*</td>
</tr>
<tr>
<td>CON-MKT 2007</td>
<td>+</td>
<td>0.173</td>
<td>(16.413)***</td>
</tr>
<tr>
<td>Sample Size</td>
<td></td>
<td>716</td>
<td>716</td>
</tr>
<tr>
<td>F Value</td>
<td></td>
<td>5.289***</td>
<td>30.675***</td>
</tr>
<tr>
<td>Adjusted R-Square</td>
<td></td>
<td>0.062</td>
<td>0.399</td>
</tr>
</tbody>
</table>

*significant at 0.1 (2-tailed)  **significant at 0.05 (2-tailed)  ***significant at 0.01 (2 tailed)
6.4 Khan and Watts (2009) Conservatism Measure and Board Characteristics

Table 8 shows mean coefficients from annual cross-sectional regressions of earnings on the variables listed. It shows that the relation between earnings and returns, as represented by the coefficients of Ret and D x Ret, is significantly positive as expected. D x Ret representing the asymmetric timeliness coefficient yields a significantly positive coefficient which suggests that firms are conservative on average. Consistent with the expectation that larger firms have higher good news timeliness, the coefficient of Ret x Size is significantly positive. The coefficient of D x Ret x Size is significantly negative as predicted which is consistent with the expectation that larger firms tend to have lower asymmetric timeliness (Khan and Watts, 2009). It has been noted that less conservative firms have higher good news timeliness and lower asymmetric earnings timeliness (LaFond and Watts, 2008).

Results also show that the coefficient of Ret x M/B is significantly negative. This is consistent with the notion that growth firms have lower good news timeliness, which means that they are more conservative (Khan and Watts, 2009). Similarly, the coefficient of D x Ret x M/B is significantly positive. The coefficient of Ret x Lev and D x Ret x Lev is not significant, suggesting that firms with higher leverage do not have higher asymmetric timeliness. Khan and Watts (2009), however, found that more levered firms have higher asymmetric earnings timeliness. The parameter estimates obtained are substituted into equation (3) to calculate the C_Score which represents the firm-year conservatism measure.
Table 8

Mean Coefficients from CON-KW Estimation Regression

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Predicted Sign</th>
<th>Coefficient</th>
<th>t-stat</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td></td>
<td>-0.044</td>
<td>-0.193</td>
</tr>
<tr>
<td>D</td>
<td></td>
<td>0.183</td>
<td>3.953***</td>
</tr>
<tr>
<td>Ret</td>
<td>+</td>
<td>-6.475</td>
<td>-3.396***</td>
</tr>
<tr>
<td>Ret x Size</td>
<td>+</td>
<td>1.433</td>
<td>3.483***</td>
</tr>
<tr>
<td>Ret x M/B</td>
<td>-</td>
<td>-0.44</td>
<td>-1.978**</td>
</tr>
<tr>
<td>Ret x Lev</td>
<td>-</td>
<td>-0.202</td>
<td>-1.023</td>
</tr>
<tr>
<td>D x Ret</td>
<td>+</td>
<td>8.263</td>
<td>4.323***</td>
</tr>
<tr>
<td>D x Ret x Size</td>
<td>-</td>
<td>-1.764</td>
<td>-4.276***</td>
</tr>
<tr>
<td>D x Ret x M/B</td>
<td>+</td>
<td>0.613</td>
<td>2.702***</td>
</tr>
<tr>
<td>D x Ret x Lev</td>
<td>+</td>
<td>0.234</td>
<td>1.182</td>
</tr>
<tr>
<td>Adjusted R-Square</td>
<td></td>
<td>0.261</td>
<td></td>
</tr>
</tbody>
</table>

*significant at 0.1 (2-tailed) **significant at 0.05 (2-tailed) ***significant at 0.01 (2-tailed)

Dependent Variable: Earnings scaled by beginning of the year market capitalisation

Table 8 shows mean coefficients from annual cross-sectional regressions of earnings on the variables listed, on the sample of 716 firm-years from year 2008. D is a dummy variable equal to 1 if returns (Ret) are negative, and 0 if returns are positive. ‘x’ is the multiplication operator. M/B is the market-to-book ratio. Lev is leverage, defined as long term debt deflated by market value of equity. The parameter estimates in this table are used to calculate the C-Score as described in the text.
Table 9 shows the regression of the C_Score measure of conservatism (CON-KW) on board characteristics. Similar to the previous two regressions, I include industry dummy variables to include the effects of various industry groups. Khan and Watts (2009) stated that using C_Score as an independent or dependent variable in a regression may require controlling for size, market-to-book or size, which are variables that are also inputs to the C_Score. They further assert that failing to include these controls may result in finding an association between conservatism and the variable of interest where there is actually no association. Khan and Watts (2009) suggest that an option is to use other conservatism measures in place of C_Score to verify the robustness of the association between conservatism and C_Score. This study includes three different measures of conservatism to ensure robustness of the results.

The coefficient of Inside Director% is significantly negative at the 1% level, which is consistent with the results using CON-MKT measure of conservatism. This is consistent with the findings by Ahmed and Duellman (2007) suggesting that the higher number of inside directors in a board (a proxy of weak governance) relates to lower demand of conservative reporting. The association between CEO/Chairman Separation and the CON-KW measure is insignificant, similar to both the CON-ACC and CON-MKT measures. The coefficient of Board Size is significantly negative at the 1% level, consistent with the CON-ACC measure. However, the coefficient of Board Meetings shows a significantly negative association with conservatism, which is inconsistent with the first measure (CON-ACC) and the expectation that more board meetings as a proxy for good governance result in higher demand of conservative reporting. The coefficient of Managerial Ownership is significantly positive at the 1% level, but this result is not consistent with the first two measures, CON-ACC and CON-MKT.
<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Predicted Sign</th>
<th>Coefficient</th>
<th>t-stat</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td></td>
<td>3.108</td>
<td></td>
</tr>
<tr>
<td>Board Characteristics</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inside Director %</td>
<td>-</td>
<td>-1.011</td>
<td>(4.079)***</td>
</tr>
<tr>
<td>CEO/Chairman Separation</td>
<td>+</td>
<td>-0.031</td>
<td>(-0.287)</td>
</tr>
<tr>
<td>Board Size</td>
<td>?</td>
<td>-3.467</td>
<td>(-9.500)***</td>
</tr>
<tr>
<td>Board Meetings</td>
<td>+</td>
<td>-0.058</td>
<td>(2.579)***</td>
</tr>
<tr>
<td>Managerial Ownership</td>
<td>+</td>
<td>0.914</td>
<td>(3.245)***</td>
</tr>
<tr>
<td>Sample Size</td>
<td></td>
<td>716</td>
<td></td>
</tr>
<tr>
<td>F Value</td>
<td></td>
<td>17.729***</td>
<td></td>
</tr>
<tr>
<td>Adjusted R-Square</td>
<td></td>
<td>0.205</td>
<td></td>
</tr>
</tbody>
</table>

*significant at 0.1 (2-tailed) **significant at 0.05 (2-tailed) ***significant at 0.01 (2-tailed)
7.0 DISCUSSION

Overall, there are mixed results resulting from using firm specific measure of CON-ACC and CON-MKT and firm-year specific measure of CON-KW. I find significant negative association between the percentage of inside directors and accounting conservatism in two of the measures used, which are the CON-MKT and CON-KW measures. The CON-ACC measure yields negative but insignificant relationship. Also, I find a negative relation between the size of the boards and accounting conservatism in all three measures. These evidences hold after controlling for firm size, sales growth, profitability and leverage. Therefore, it can be said that this findings are consistent with the notion that there is a relation between accounting conservatism and corporate governance.

The negative association between inside directors and conservatism that I find to be present in Malaysian companies is consistent with the US study by Ahmed and Duellman (2007). This evidence suggests that firms that are dominated by inside directors, which impair board independence, are likely to provide managers with greater opportunity to use aggressive or less conservative accounting. Outside directors in such boards would not have the power to employ conservative accounting as a tool for monitoring managers’ decision making. While some studies in Malaysia did not find significant relationship between inside directors and firm performance, I document that inside directors have an impact on the board. This is consistent with the prediction that the strength of board governance is positively associated with accounting conservatism. This is contrary to the belief that outside directors in Malaysian companies do not effectively perform their role due to the lack of awareness of their responsibilities.
Ahmed and Duellman (2007) did not find any evidence to link board size and conservatism. Contrary to this, I find a negative association between the size of the board and conservatism. This suggests that larger boards are less effective than smaller boards due to their complexity and difficulties in coordination. Large boards are also exposed to ‘free-rider’ problem as directors may have the incentive to shirk. Thus, larger boards are associated with weaker governance structure which results in less demand for conservative reporting. In Malaysia, studies have found negative association between board size and firm performance (Haniffa and Hudaib, 2006) and a positive relationship between board size and earnings management (Rahman and Ali, 2006). I find consistencies with these studies where it can be established that large board size is generally detrimental to a company. Although the MCCG is not informative on this issue, Malaysian companies should access the appropriate board size depending on each individual company’s circumstances.

I find no significant relationship between CEO/Chairman separation and accounting conservatism in Malaysian companies. Role duality is uncommon in Malaysian corporations, comprising only 15% of my sample firms. Despite this, some studies find evidence to link role duality to higher earnings management practices and lower performance (Saleh et al., 2005; Haniffa and Hudaib, 2006). This implies that the recommendation set out in the MCCG to have the roles separated is important and must be complied with, as it limits the excessive power of one individual managing the company (Haniffa and Hudaib, 2006). I find mixed result with regard to the association between board meetings and conservatism. This suggests that increasing board activity may not necessarily lead to an increase in the demand of conservative reporting. Similarly, I did not find a significant association between managerial ownership and conservatism. This could be due to the difficulty in determining managerial ownership.
in Malaysia due to high cross-holdings of ownership via pyramiding (Haniffa and Hudaib, 2006). It should be noted that previous studies in Malaysia document that higher managerial ownership is related to higher performance (Haniffa and Hudaib, 2006) and lower earnings management practices (Saleh et al., 2005).

My findings are also consistent with previous works conducted in other institutional settings aside from the US. Beekes et al. (2004) examine a sample of UK firms and find that firms with higher proportion of outside directors are timelier in reporting bad news, suggesting higher conservatism. García Lara et al. (2007) incorporate eight board characteristics as a measure of governance strength to determine its relationship with conservatism in Spanish companies. Their results indicate that the incorporation of bad news into earnings is significantly timelier in firms with stronger boards. Furthermore, they find that accounting earnings in firms with weaker boards capture good news faster than the earnings of firms with stronger boards (García Lara et al., 2007).
8.0 CONCLUSION

The purpose of this paper is to investigate the association between corporate governance and accounting conservatism. This research is based on the work by Ahmed and Duellman (2007) where the board of directors’ characteristics are chosen as a proxies for good governance. It has been established that conservatism is potentially useful in corporate governance in several ways. First, it prevents the likelihood of managers’ overcompensation and opportunistic payments made to themselves by constraining possible overstatement of assets and earnings. Second, conservatism facilitates directors to more readily identify negative NPV projects through timely recognition of economic losses and thus allowing them to take corrective actions to limit losses. Third, conservatism reduces managers’ incentives to undertake negative NPV projects. These arguments propose that there will be a positive relationship between conservatism and the strength of corporate governance.

I employ a sample of 716 non-financial companies listed on Bursa Malaysia’s Main Board for the year 2008. I use three proxies to measure conservatism, two of which are different from the ones used by Ahmed and Duellman (2007). More specifically, I use (a) the accrual-based measure of conservatism (CON-ACC), (b) the market-based measure of conservatism (CON-MKT), and (c) the C_Score measure of conservatism (CON-KW) which is a recent model developed by Khan and Watts (2009). I use five board characteristics as proxies for good governance, namely, the percentage of inside directors, CEO/Chairman separation, board size, board meetings and managerial ownership. While I obtain some mixed results from the different measures used, I find evidence of (i) a negative association between the percentage of inside directors on the board and conservatism, and (ii) a negative association between
board size and conservatism. The results hold after controlling for firm size, sales growth, profitability and leverage. Overall, my findings are consistent with the previous studies by Ahmed and Duellman (2007), Beekes et al. (2004) and Garcia Lara et al. (2007). Despite Malaysia’s unique business settings, it can be said that the board of directors play a significant role in the demand of accounting conservatism.

8.1 Limitations of the Study

There are several limitations of this study. Data is collected only from one year due to time constraints; therefore, results from this study may not be applicable to other years. Previous studies in this area have utilised sample ranging from three to five years. This is not possible for a study conducted in a limited time frame as corporate governance data has to be manually collected for each company every year. Aside from this, the study by Ahmed and Duellman (2007) average their accrual-based measure of conservatism over a 3-year period. I could not average this measure due to the limited sample; therefore, I could not mitigate the effect of large accruals that will likely reverse within the next few years. Another limitation of my study arises from the exclusion of other variables. For instance, firms that face higher litigation costs might choose to have more conservative reporting and more independent board of directors in order to mitigate such risks. Aside from this, this study may suffer errors in manual data collection and errors in the Datastream program.
8.2 Contributions of the Study

The results from this study help to establish a starting point for exploring the importance of board on conservatism in Malaysia, an area that has received little attention to date. Business analysts in Malaysia acknowledge the importance of conservatism in financial reporting, but the behaviour or influence of this practice has yet to be explored. This study finds that despite the unique business settings that this country possesses, there is a significant relationship between board characteristics and accounting conservatism. More specifically, I find that the percentage of inside directors increases the demand for conservative accounting. This is contrary to the belief that directors in Malaysia do not effectively perform their tasks. Results show that inside directors are likely to demand for conservative reporting in fulfilling their role of ratifying key decisions. I also find that larger board size tend to be detrimental to a company, consistent with previous studies in Malaysia. This could be an indication for possible revision of the code by specifying an ideal board size or imposing a maximum number of directors in a board.

8.3 Future Research

The contradicting results that I obtain suggest the need for further research regarding governance structures and conservatism in developing countries. Data from a longer period could be collected to improve accuracy and ensure that the results from this study still hold. Given the institutional environment, future research may examine the effect of block shareholding, family ownership and government linkages on accounting conservatism. Besides that, the moderating effects of these features on the relation between the board and conservatism can be explored. Apart from that, to
measure the quality of firm governance, an aggregate index that incorporates several board characteristics could be used to take into account the existence of interactions between the different characteristics. Alternative sensitivity tests can also be conducted to test the robustness of the association between corporate governance and conservatism. Future studies relating to conservatism practice is crucial in the Malaysian environment as research is still lacking considerably in this area.
REFERENCES


