



**UNIVERSITI PUTRA MALAYSIA**

***IMPACT OF CORPORATE GOVERNANCE AND EARNINGS MANAGEMENT  
ON VALUE RELEVANCE OF ACCOUNTING METRICS***

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**IMPACT OF CORPORATE GOVERNANCE AND EARNINGS MANAGEMENT ON  
VALUE RELEVANCE OF ACCOUNTING METRICS**



By  
**CHANG CHEE FEI**

**Thesis Submitted to the Graduate School of Management, Universiti Putra Malaysia, in  
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**IMPACT OF CORPORATE GOVERNANCE AND EARNINGS  
MANAGEMENT ON VALUE RELEVANCE OF ACCOUNTING METRICS**

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**July 2011**

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The growing incidence of corporate failures has significantly reduced shareholder wealth and pension funds, and caused financial crisis in many economic powerhouses and the emerging markets. Regulators point out that these failures are attributed to accounting scandals and mismanagement driven by managerial opportunism. Besides fraud and conspiracy, the causes of such failures are not exceptional; misinvestments, breaches in governance control and creative (or even imaginative) accounting which threatens the reliability and usefulness of accounting information in controlling and monitoring management efficacy and safeguarding shareholder interest. Following these corporate failures, relevant authorities have implemented a series of radical reforms to restore investors' confidence. For instance, the development of corporate governance codes and practices, amendments to the securities law and convergence of international accounting standards in Malaysia after the 1997-1998 economic crisis. This study examines the impact of corporate governance and income smoothing incident on the reliability of accounting metrics available from the published financial reports and how the equity market prices these attributes. In addition this study also examines the overall effectiveness of the governance and financial reporting reforms

implemented after crisis by the authorities to improve transparency, financial integrity and value relevance of accounting information.

This study deploys the regression-variation and dynamic portfolio-return models modified from well established theoretical and applied research frameworks in the prior literature. Inferences are drawn from the panel data empirical models as to assess the informativeness of accounting metrics under different specifications (e.g., economic conditioned-governance/ earnings management extended regressions and factor loading approaches). The sample size of this study covers 323 (317 for return models) firms listed on Bursa Malaysia with complete and continuous 15-year accounting and corporate governance data, and 168-month stock prices (for dynamic portfolio-return model) beginning from 1993 to 2007.

In overall, the inferences from the governance extended specifications and the dynamic portfolio-return model reveal that corporate governance attributes are value-relevant in general. The test results show that governance interacted-accounting metrics are informative, and the association between these metrics and firms' market prices and returns is statistically significant (price model: summed coefficient = 0.475,  $p = 0.008$ ; return model: earnings response coefficient = 1.427,  $p = 0.001$ ). In addition, the test statistics generated from the governance-controlled accounting based portfolio-return model reveal that after the economic crisis, governance control mechanism is empirically relevant to firms' market risk premium which subsequently determines their market value (coefficient = 0.344,  $p = 0.000$ ). Likewise, the information content of the accounting metrics produced by firms' with prevalence earnings management sign is significantly negative after the crisis (price model:

summed coefficient = -0.729,  $p = 0.002$ ; return model: summed coefficient = -0.790,  $p = 0.000$ ), implying that investors are becoming more cautious of accounting fraud in ‘managed earnings’ firms. Similar results are observed in the economic conditioned-earnings management extended dynamic accounting based portfolio-return regression specification.

In many instances, the results from the earnings management extended specifications cohere harmoniously with the inferences from the corporate governance extended value relevance models. These outcomes are perhaps attributable to increased investors’ awareness on the negative impact of managerial opportunistic behaviour, and improved investors’ confidence after the crisis due to the regulatory reform in corporate governance and financial reporting environment. Interestingly, the explanatory power of firm’s book value is gaining more significance after the crisis (economic conditioned-extended price model: coefficient = 0.172,  $p = 0.003$ ). Besides, inferences drawn from firms with low governance control show that accounting earnings relevancy has significantly decreased after the crisis period. This implies that earnings performance is perceived to be less reliable due to potential accounting manipulation, and thus book value is a more prudent alternative measure of firm’s performance.

The results of this study provide reasonable evidence on the effectiveness of the post-crisis reforms in corporate governance and reporting environment implemented by the regulators to improve the reliability and investors’ reliance on firms’ financial performance indicators, and thus might provide insights for regulation and standard setting in the future. Besides, this study reveals the meaningful valuation effect of

managerial opportunism and the importance of ex-ante efficient contracting and ex-post governance control to firms' reliability of accounting information content and market pricing decision. This study also substantiates empirical procedures to check the robustness of governance and earnings management attributes against accounting metrics reliability and modifications to the regression-variation and dynamic portfolio-return models for corporate governance and earnings management specifications.



Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Doktor Falsafah

**IMPAK AMALAN TADBIR URUS KORPORAT DAN PENGURUSAN  
PEROLEHAN KEPADA KERELEVANAN NILAI METRIK PERAKAUNAN**

Oleh

**CHANG CHEE FEI**

**Julai 2011**

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Insiden kegagalan korporat yang semakin meningkat telah melenyapkan harta kekayaan pelabur-pelabur ekuiti dan nilai dana-dana pencen, serta menyebabkan krisis kewangan di kalangan kuasa ekonomi dan negara-negara pasaran baru muncul. Pengawal selia sering mengaitkan kegagalan korporat ini dengan skandal perakaunan dan kejadian salah urus yang didorong oleh perilaku oportunistik pihak pengurusan. Selain penyelewengan dan konspirasi, sebab-sebab kegagalan korporat ini tidaklah mengejutkan; pelanggaran peraturan urus tadbir dalaman, amalan kaedah perakaunan kreatif (atau imaginatif) yang menjejaskan kebergunaan maklumat perakaunan dalam mengawal dan memantau keberkesanan pengurusan serta melindungi kepentingan pelabur-pelabur. Berikutan kegagalan korporat ini, pengubal undang-undang telah melaksanakan pelbagai langkah pembaharuan radikal untuk memulihkan keyakinan pelabur-pelabur. Misalnya, perlaksanaan kod tadbir urus korporat, pindaan kepada undang-undang sekuriti dan penggunaan piawai perakaunan antarabangsa di Malaysia selepas krisis ekonomi yang berlaku in antara tahun 1997 dan 1998. Kajian ini bertujuan untuk menyelidik impak amalan urus tadbir korporat dan kecenderungan firma-firma awam megurus perolehan terhadap kebolehpercayaan maklumat perakaunan dan kesan moderasi kedua-dua faktor ini ke atas nilai relevansi maklumat

ini, serta mengukur keberkesanan reformasi yang dilaksanakan oleh pihak berkuasa untuk meningkatkan ketelusan, integriti kewangan dan relevansi maklumat perakaunan selepas krisis tersebut.

Kajian ini menggunakan kaedah regresi-variasi dan juga model pulangan portfolio dinamik yang diubahsuai berlandaskan teori and rangka kerja penyelidikan yang berasal daripada karya lepas. Kesimpulan kajian ini adalah menurut hasil ujian empirik yang diperolehi daripada model-model data panel berasaskan spesifikasi yang berbeza (contohnya, model regresi pengawasan korporat/ pengurusan perolehan lanjutan and muatan faktor). Saiz sampel kajian ini meliputi 323 (317 untuk model pulangan) firma-firma tersenarai di Bursa Malaysia yang dikenal pasti mempunyai maklumat perakaunan dan tadbir urus korporat yang lengkap untuk tempoh 15 tahun, serta data pasaran ekuiti bulanan (untuk model portfolio pulangan dinamik) dari tahun 1993 hingga 2007.

Secara keseluruhannya, hasil-hasil kajian dari spesifikasi model tadbir urus lanjutan dan pulangan portfolio dinamik menunjukkan bahawa ciri-ciri tadbir urus korporat adalah relevan nilai. Keputusan dari model regresi lanjutan menunjukkan bahawa wujudnya kesan interaksi tadbir urus korporat yang signifikan ke atas hubungan diantara metrik-metrik perakaunan dan nilai pasaran serta pulangan firma (model harga: gabungan koefisien = 0,475,  $p = 0.008$ ; model pulangan: koefisien respons perolehan = 1,427,  $p = 0.001$ ). Hasil ujian dari model pulangan portfolio dinamik yang berasaskan maklumat perakaunan dan kawalan tadbir urus korporat menunjukkan bahawa selepas krisis ekonomi, mekanisme pengawasan urus tadbir adalah relevan terhadap premium risiko ekuiti sesebuah firma yang seterusnya



menentukan nilai pasaran firma tersebut (koefisien = 0,344,  $p = 0,000$ ). Di samping itu, selepas krisis ekonomi, maklumat perakaunan dipaparkan oleh firma-firma yang mempunyai petanda pengurusan perolehan ketara telah mencatatkan hubungan negatif yang signifikan dengan nilai pasaran firma-firma tersebut (model harga: gabungan koefisien = -0,729,  $p = 0,002$ ; model pulangan: gabungan koefisien = -0,790  $p = 0,000$ ). Ini menunjukkan bahawa pelabur-pelabur menjadi lebih berwaspada terhadap kejadian pengurusan perolehan. Hasil-hasil ujian seumpama juga diperolehi dari model pulangan portfolio dinamik yang berspesifikasikan portfolio perakaunan dengan kawalan pengurusan perolehan.

Kebanyakannya hasil ujian dari pelbagai model relevan nilai lanjutan berspesifikasikan pengurusan perolehan dan pengawasan urus tadbir korporat adalah konsisten. Ini mungkin disebabkan oleh peningkatan kesedaran pelabur-pelabur terhadap kesan negatif perilaku oportunistik pihak pengurusan firma, dan keyakinan pelabur-pelabur yang kian puleh akibat reformasi ke atas sistem pengawalseliaan urus tadbir korporat yang seterusnya meningkatkan kesahihan laporan kewangan selepas krisis ekonomi. Selain itu, perhatian harus diberi kepada peningkatan kuasa penjelasan nilai buku firma yang ketara selepas krisis (model harga rentas bahagian berlandaskan keadaan ekonomi: koefisien = 0,172,  $p = 0,003$ ). Seumpamanya, kerelevanan nilai perolehan perakaunan bagi firma-firma yang berkawalan urus tadbir lemah telah menyusut dengan ketara selepas tempoh krisis. Ini menunjukkan bahawa kesahihan aras perolehan berfungsi sebagai pengukur prestasi firma adalah rendah kerana kemungkinan berlakunya manipulasi perakaunan, oleh demikian, nilai buku firma adalah dianggap pengukur alternatif yang lebih tepat dan menyakinkan.

Kesimpulannya, hasil kajian ini menemui bukti yang munasabah mengenai keberkesanan pembaharuan dalam amalan urus tadbir dan tahap pengawasan korporat yang dilaksanakan oleh agensi-agensi pengawalselian selepas krisis ekonomi. Reformasi tersebut telah meningkatkan kepentingan metrik perakaunan sebagai petunjuk prestasi kewangan sesebuah firma dan penanda aras bagi pengubalan piawai-piawai perakaunan di masa hadapan. Di samping itu, hasil kajian ini menampilkan kepentingan kawalan kos agency secara ex-ante dan pemantauan urus tadbir korporat secara ex-post dalam membendung kesan negatif perilaku oportunistik ke atas kebolehpercayaan metrik perakaunan dan kesahihannya sebagai pengukur nilai pasaran firma. Tambahan pula, prosedur-prosedur empirik telah dibentuk untuk menguji kemantapan proksi-proksi amalan tadbir urus korporat dan petanda pengurusan perolehan yang terlibat dalam kajian ini, serta pengubahsuaian model-model regresi-variiasi dan pulangan portfolio dinamik di bawah spesifikasi yang berlainan.

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I certify that a Thesis Examination Committee has met on 18 July 2011 to conduct the final examination of Chang Chee Fei on his Doctor of Philosophy thesis entitled "Impact of Corporate Governance and Earnings Management on Value Relevance of Accounting Metrics" in accordance with Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the candidate be awarded the Doctor of Philosophy degree. Members of the Thesis Examination Committee were as follows:

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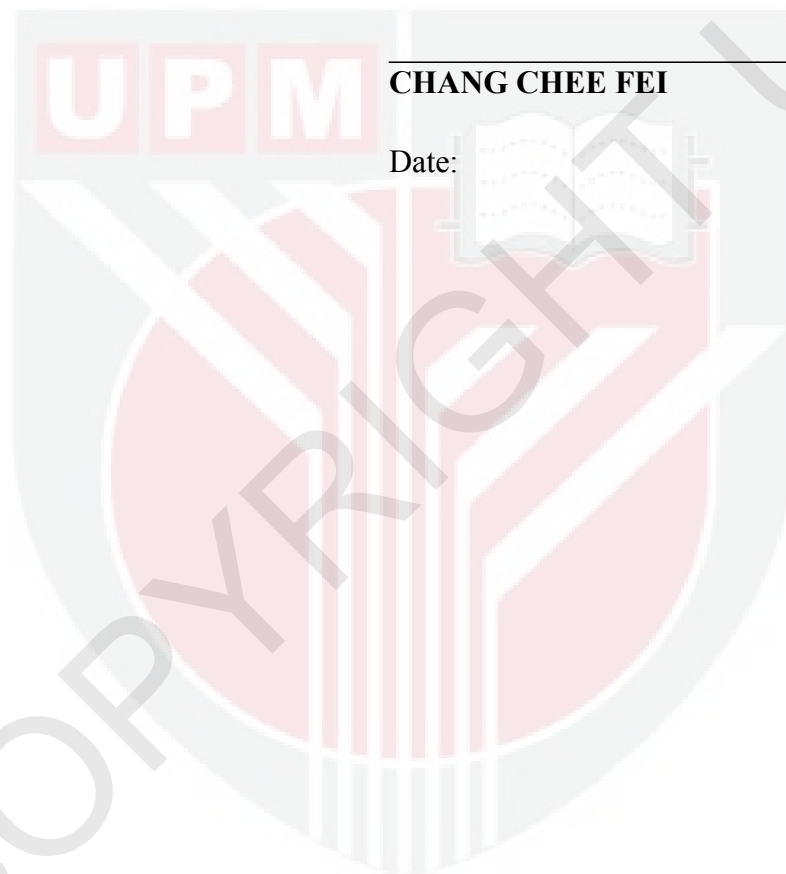
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## DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at Universiti Putra Malaysia or any other institutions.



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