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Impact Of Board Characteristics On Earning Management: A Study On Private Sectors In Malaysia

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***Abstract:** Corporate governance is an idea or concept that is important for management and administrative in business decision-making process. This study is conducted on the effect of board characteristics such as board size, interlocking, internationalization and CEO duality on earning management in the companies of Malaysia. The primary data was used which is obtained through questionnaire with convenience sampling. Sample size of 150 is chosen with the target population of Shareholders. Further, descriptive and inferential methods of analysis are taken into consideration where bivariate and multivariate tests were applied. SPSS (statistical package of social science) is used for data analysis. Main findings demonstrated that board size is negatively associated with earning management while board interlocking, board internationalization and CEO have positive significant impact on earning management. In particularly board interlocking is more effecting variable. Agency and Dependency underpinning theories were used by researcher to support the findings.*

***Keywords:** Corporate Governance, Earning Management, Board interlocking, Dependency theory*

I. INTRODUCTION

Corporate governance is an idea or concept that is important for management and administrative in decision-making process in public and business establishments. This is legitimate requirement for many countries and mentioned as the basic tool of good corporate governance Aishah, (2008). Likewise, in past studies it has proved that board size Jaswadi, (2013), board independence Aishah, (2008), competency of the board (Saleh and Iskandar, 2005) and separation of roles between CEO and chairman are effective tools in monitoring the management (Rauf et al., 2008). Directors are motivated to handle earnings for maximizing firm's value Roberto, (2016), increasing corporate the compensations and job security of managers and to avoid the negative earnings as well as to avoid the reported loses (Saleh and Iskandar, 2005). Incentive to engage in earnings management could be moderated through active business governance tool (Rauf et al., 2008). Further, the business world inaugurated interrogative about the efficiency of corporate supremacy appliances within an association, after the crunch in Asian financial market in 1997. Probably these crises were started because of Enron in 2001 and WorldCom in 2002. Ultimately, various beliefs are raised that the prevailing corporate authority contrivances are not competent to deliver adequate governor above the effectiveness behaviour boosting of executives by the training of earnings management. However, many researchers have strained to develop a model of board characteristics explanation and its role in preventing and detecting earning management which leads to solve the economic issues (Parker et.al, 2000 and Archambeault, 2000). Hence, good governance by the board of directors is essential to improve the quality of financial reporting which in turn has impact on the inventors' confidence Levitt, (2002). As such good corporate governance reduces the negative effects of earning management as well as the likelihood of creative financial reporting arising from fraud and errors Dechow et al, (1996).

Although, there is very few studies conducting in Malaysia on this issue because of less data availability like the information published by Malaysia Securities and Exchange Commission (SEC) and the stock exchanges are not enough to understand the crises in earning management. While some studies have been conducted in developing countries with emerging economies, such as Indonesia and UK, these are limited by Hasnan Rahman and Mahenthrian, (2009). Eventually, this study is conducted on the effectiveness and efficiency of panel of directors in earnings management exercise within the monitoring and commerce settings in Malaysia. However, this study is important because it investigates the different board features and estimates the relationship of these characteristics with earning management practices in Malaysia. Indeed, the current study endeavours to evaluate the extent to which the panel of administrators are competent to accomplish the incomes in firms with board size, interlocking, internationalization and CEO duality. This study contributes to this literature (board of directors and accounting irregularities) by adding the importance of the board of directors' characteristics in mitigating earnings management in the companies of Malaysia.

LITERATURE REVIEW

(Pengurusan et al., 2005; Iraya et al., 2015) argued that board characteristics are considered more important factors to mitigate the risk in earning management and in reduction of agency problems in an organization. Further in previous research on board characteristics it is found that organizations with independent outside directors effective in mitigating real base earning management (Ortas, Igor and Zubeltzu, 2017). Moreover, many other researchers found that the characteristics of board have been significantly attached with earning management and in restraining accrual-type earnings management are not noteworthy in preventive actual earnings management but for the quantity of independent directors (Hanim et al., 2008; Amer and Abdelkarim, 2010; Obigbemi et al., 2016). Indeed, the board of directors is an important internal control mechanism intended to monitor the actions of top management as well monitoring the quality of the information confined in financial reports (Abu Siam, Laili and Bin Khairi, 2014). However, past studies such as (Kao and Chen, 2004; Anuar et al., 2012; Chi-chi and Friday, 2016) suggested that there is association among board size and earning management which means board size impact on company earnings. Further they argued that board in small size is more effective and efficient in coordination rather than larger board. Xie, et al. (2002), investigate earnings management and corporate governance in US firms, focusing on the role of the board and the audit committee. They find that larger boards and greater independent representation on the board are associated with a lower level of earnings management. However, the mere existence of an audit committee does not mitigate earnings management behaviour. Similarly, Peasnell, et al. (2000) investigates corporate governance and earnings management in UK firms. Their results show that the likelihood of managers making earnings-increasing abnormal accruals to avoid falling below important earnings thresholds is negatively related to the proportion of independent directors on the board. They too found no evidence that the existence of an audit committee influences the extent of earnings management. Analyzing both previous researches findings and gaps the main purpose of this research has been derived which is to is to determine the impact of board characteristics on earning management in the listed companies of Malaysia.

HYPOTHESIS DEVELOPMENT

This study developed four hypotheses based on agency theory and Dependency theory to defend the findings.

DATA AND VARIABLES

EARNING MANAGEMENT

Earnings management extends to cover managements other than accounting choices; thus, the effects of accounting choice to accomplish a goal are consistent with the idea of earnings management (Patrick, Paulinus and Nympha, 2015). Though, includes the preparation of financial reports in accordance to what associates with the power of the managers, such as improves the value of the company and that of the auditors. Moreover, in opportunistic earning management managers are concerned with their personal objectives rather than organizational objectives and shareholders benefits. Besides of this, the informative type of earnings management purpose is to enhance the value of the firm, via managers, by skimpy to stockholders their prospects about the firm's future cash flows (Murya, 2010). Furthermore, flexibility in the regulation of accounting makes it easy for managers to manage earnings (Bassiouny, 2016). Probably, it is divided into three types such as fraudulent accounting, accruals management and real earnings management (Gunny, 2005). Accounting choices which disrupt by GAAP are included in fraudulent accounting. However, opportunistic earnings management is related to the managers who pursue to mislead investors by following the management's interests (Halioui and Muhammad, 2015).

Therefore, in literature it is found that in opportunistic earnings management, Moreover, through increase income accounting policies companies can act as optimistically which can increase the trust of panel that leads toward earning management. Though, one of the study is conducted in Nigeria where it is found that there is lack of information existing on earnings management practices (Bulle, 2014), however diverse queries have been upraised on the causes of business failure in this country (Anaro, 2011).

BOARD OF DIRECTORS/ BOARD CHARACTERISTICS

The Board of Directors are main body of supremacy to which shareholders share the responsibility of supervision, recompensing and replacing managers as well as approving foremost tactical plans. However, board of directors play a crucial role in managing and monitoring the earnings and shareholders benefits (Ibrahim et al., 2014). Indeed, the board is an important part of any organization and considered main internal factor to reducing agency cost and conflicts between managers and shareholders (LaFond and Roychowdhury,

2006) and (De Andrade et al., 2009). Further in literature different studies are debating on the influence of different panel features on earning management but the most under observation variables which are found are Board size and CEO concentration of power in an organization (Nor, Shafee and Samsuddin, 2014).

BOARD SIZE

Board size means the strengths of individual in board committee. Normal size of board member is suggested five to seven for an organization and considered as crucial variable in earning management, it significantly effect on the monitoring ability. Indeed, the evidences of empirical research have recognized that the size of board is correlated to the level of unrestricted accretions. Therefore, in different readings, positive relation is found among earning management and size of board (Pengurusan et al., 2005) and (Kao and Chen, 2004) and (Saleh and Iskandar, 2005. Some researchers argued that smaller board provides good financial reporting monitoring and positively impact on earning management. Likewise, some other researchers argued that the size of should be consists four to six members it might be more operative. Further, moderate board members are capable to do operative communication and make appropriate tactical resolutions (Zouhayer, 2016). Furthermore, it is pointed out that more member in the board may be talented to pull from a wider choice of mutual practices (Chi-chi and Friday, 2016). Eventually, a larger board is more independent directors with financial experiences and they can manage efficiently the earning management also preventing the income of shareholders (Xie et al., 2003).

BOARD DUALITY

Board duality is also an important factor which play crucial role in earning management. (Gulzar and Wang, 2011) found that, in board duality, director holding two designations at a time one CEO and other is chairperson. However, non-duality is showed the different designations of different individual's means that diverse personalities hold the place of the chairman of the board and the CEO of the similar organisation (Aishah, 2008). Probably it is considered that the separate role is an important element of board system to manage earnings and shareholders property (Securities and Exchange Commission, 2003). However, theory of agency also opposed to this concept because it discourages the earning management and stakeholders whereas stewardship theory argued that it is important because it improves leadership (Alaryan and National, 2015). Further it is argued that the combination of CEO and chairman are the reasons of board weakness that cannot control and monitor the functions eventually agency cost becomes increased (Kim, Al-Shammari, Bongjin, & Lee, 2008). Researcher agreed that duality having adverse effects if the interest of CEO and shareholders are different (Roodposhti & Chashmi, 2010). However (Callaghan, 2005) agreed that separate role of directors and chairman are important because it can make easy to share responsibilities and address the issues related to earning management and shareholders.

BOARD INTERLOCK

Board interlocking is basically concept related to sharing the management and personals of board (Anuar et al., 2012). However, Rossoni and Machado-da-Silva (2013) conducted study on the companies listed on the Bursa Malaysia and found that the organization interlocking process is important to gain more experiences and knowledge. They also discussed that high qualified and experience members in board have potential to participate in different organizations meetings. Indeed, some researchers argued that worthy board participants tend to contribute in a larger number of establishments with certain positions and they have more able to get and share knowledge. Moreover, they have ability to reveal substantiation of their status as administrators, which hence means they are superior designation in an organization and have a larger aptitude to get confidential evidence and capitals (da Cunha and Piccoli, 2015). Chiu et al. (2013) discussed that to manage the earnings is moved from organization to organization by the exterior connections of board members such as relations of chief executive officers and audit committee associates.

BOARD INTERNALIZATION

Board internationalization is concerned with the number of foreigners in the board committee. However, there are different views found in literature about the impact of internationalization on earning management. Though, (Kumar, 2014; Iraya et al., 2015) pointed out that foreign directors are positively impact on earning management of companies because they are aware about international standards and laws as well as more experienced and knowledgeable. Furthermore, in some researches it is described that international directors in board can increases the effectiveness of the earning management and shareholders profits (Anuar et al., 2012; Sa, 2014). As external directors generally do not come from the similar pool of executives, it is likely that panels which contain at least one external administrator relate to a developing trend of directors to highlight directness and honesty in execution their responsibilities related to monitoring, relatively giving importance to courtesy and politeness among panel members (Ruigrok et al., 2007). Foreign directors are also helpful to prevent the high levels of cohesiveness of the board. Likewise, outside director circle are more likely display sovereign thinking and to feel less hesitant to increase provocative issues (Halioui and Muhammad, 2015). However, Srinidhi et al. (2011) disused that it is benefit for companies to inclusion of international members for increased monitoring effectively.

II. RESEARCH METHODOLOGY

RESEARCH FRAMEWORK

This research carried out to taken into consideration the various board characteristics elements that impact on earning management in Malaysia. The framework in this study is based on the relationship between board characteristics (board

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size, board internationalisation, CEO duality and board interlocking with earning management. An overview of the research framework is presented in the diagram below:

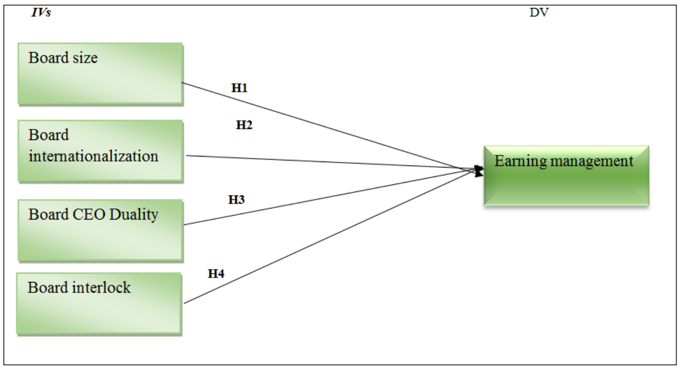

Figure 1: Research Framework

SAMPLING DESIGN

Stakeholders of companies located in Kula lumpur Malaysia was taken as population of this research. However, total sample of 150 respondents for data collection were chosen from bukit jalil and Sri Petaling areas of Kuala Lumpur. Additionally, researcher used the convenience sampling technique in order to collect the data by distributing the questionnaire randomly to the stakeholders of the companies. Conviennet sampling which is basically non probability in nature however may not be able to get effective responses of the variables in the population but found to be the best option for this study as it is time consuming to get the desired respondents.

DATA COLLECTION METHOD AND INSTRUMENTATION

Quantitative data was the basic focus of this study. As there were many studies done on earning management, it is more effectual to acquire better results by using new or primary data by means of questionnaire. Thus, questionnaire was selected as instrumentation to collect data from target sample. Researcher randomly distributed questionnaire to 150 stakeholders in selected areas. Moreover, pick and drop method was used to collect data through questionnaire. There were 2 sections in a questionnaire in which section A was designed to get information on the profiles of the respondents. Section B was made up of several questions related to variables and all these questions were designed to using five-point Likert scale.

III. FINDINGS AND ANALYSIS

DESCRIPTIVE ANALYSIS

DEMOGRAPHIC INFORMATION

Category		Frequency	Percentage (%)	Cumulative Percentage (%)
Gender	Male	83	55.3	55.3
	Female	67	44.7	100
Age	Below 30	36	24.0	24.0
	30-40	60	40.0	64.0
	41-50	46	30.7	94.7
	Above 50	8	5.3	100
Experience	Below 5 years	44	29.3	29.3
	6 – 10 years	67	44.7	74.0
	11- 20 years	33	22.0	96.0
	Above 20 years	6	4.0	100

Table 1: Frequency of Respondent Profile

Above table reveals that males were dominant at 55.3% and the rest of them were female 44.7%. In context of age 30-40 (Frequency; 60, percentage; 40%) years old stakeholders were in majority and age above 50 years (Frequency; 8, percentage; 5.3%) were least participant in this survey. In terms of experience, the results demonstrates that most of stakeholders respondents experience was 6 to 10 years (Frequency; 67, percentage; 44.7%) and more than 20 years (Frequency; 6, percentage; 4.0%) experienced participant were least in number.

DESCRIPTIVE DISCUSSION OF MEAN AND S.D

This part of analysis is carried out to check the agreement level of customers about each variable. Mean value less than 3 shows low influence, less than 4 shows moderate impact and the value 4 or greater than 4 shows high impact.

No.	Variables/Indicators	Mean	Description	S.D	Description
1	Board Characteristics (x)				
	Board Size	4.14	High	.622	Low variation
	Board Internationalisation	4.14	High	.606	Low variation
	Board CEO Duality	4.17	High	.574	Low variation
	Board Interlocking	4.18	High	.553	Low variation
2.	Earning Management (y)	4.16	High	.581	Low variation

Table 2: Descriptive Mean and S.D

Above table pointed out that the mean value range of all variables is between 4.14 to 4.18 with standard deviation from .553 to .622 which indicates that mostly respondents in this study responded within the scale of agree to strongly agree thus the most of the items measuring the success of board characteristics variables.

However to measure the uncertainty, standard deviation is used. High standard deviation show more variation in the data and indicates that values are so far from actual values. Thus in this research S.D values are very low which indicates that calculated values are near to actual values and the responses of respondents are not very similar with each other.

Consequently, the means of all variables in current research is above the scale midpoint which is indicating that the participants gave same opinions towards each variable in this study. Moreover, the S.D is less than one for all variables which indicates the low variations in respondent's opinions.

RELIABILITY ANALYSIS

For the adequacy and accuracy of data collection instrument reliability analysis is very crucial. Indeed for data analysis, to give the evidences of data cannot be neglected. Therefore, it is important to check the reliability before further analysis. Cronbach's Alpha value should be equal or greater than .70 for reliable data (Kumar, 2014; Hair et al. 2010).

Variables	Cronbach's Alpha Value
Earning Management	0.712
Board Size	0.716
Board Internationalisation	0.740
Board CEO Duality	0.723
Board Interlocking	0.749

Table 3: Reliability Analysis

It is demonstrated in table 3 that the Cronbach's alpha value for all variables such as Earning management (.712), Board Size (.716), Board Internationalisation (.740), Board CEO Duality (0.723) and Board Interlocking (.749) are greater than .70 which indicates that all variables are reliable for the study and instrumentation is best fit to the study and findings are accurate and reliable.

MULTIPLE REGRESSION ANALYSIS

Multivariate analysis is used to check the extent of relationship between two or more variables. Further it shows the impact of independent variables on dependent variable. This test is interpreted according to B value, if it significant at less than .05 level of significant we will accept the hypothesis otherwise hypothesis will reject. In particularly this is a statistical tool that allows examining how multiple independent variables are related to a dependent variable. However model summary and coefficient table is presented below.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.875[a]	.766	.759	.25541

a. Predictors: (Constant), Board Interlock, Board internationalization, Board CEO Duality, Board Size

Table 4: Model Summary

In table 4, it is found that the adjusted R^2 of the model is .759 with the R^2 = .766 which indicates that the linear regression explains 76.6% of the variance in the data. Basically R square value is the proportion of variance in the dependent variable which explained by independent variables. Therefore the value R square .766 shows that the independent variables (Board size, board internationalisation, board CEO duality and board interlocking) explain variability and predict the earning management. *R* square value of regression model is greater than 0.35 that can be interpreted as strong effect (J. Cohen, 1988).

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.443	.216		2.054	.042
	Board Size	-.090	.043	-.107	-2.088	.039
	Board internationalization	.181	.043	.210	4.173	.000
	Board CEO Duality	.079	.039	.088	2.054	.042
	Board Interlock	.718	.040	.802	17.758	.000

a. Dependent Variable: Earning Management Table 4.13– Coefficient Result of Multivariate Test

Table 5: Coefficientsa

Unstandardized coefficients indicate how much the earning management varies with board characteristics variables (Board size, Board internationalisation, Board CEO Duality and Board interlock) when all other independent variables are held constant. B is significant if $p < .05$. Therefore, above table 5 shows the results that B value of board size (B= -.90; Sig. =.039), board internationalisation (B= .181; Sig. =.000), board CEO duality (B= .079; Sig. =.040) and board interlock (B= .718; Sig. =.000), shows the impact of these variables on earning management in Malaysia. Board interlocking is more crucial factor which largely impact on earning management in Malaysian companies.

IV. DISCUSSION AND CONCLUSION

The main purpose of this research is to found whether there is any relationship or impact of board characteristic variables on earning management in Malaysian companies. However, results of the analysis revealed that all the variables to justifiable play its role in earning management success. The evidence exposed from the bivariate analysis specified that the impact of board size and CEO duality is not very high. Hence, it may be very beneficial to focus in-depth about numerous other components or items which may highly influenced on the success of earning management. Besides, the importance of board interlocking had been additional established based on the findings in which the beta value of 0.718 very highly recommends its usefulness in shaping the success earning management in companies. Moreover, board internationalisation also meaningfully played its practicality.

Therefore, the total findings based on the relationship of four dimensions (board size, board internationalisation, CEO duality and board interlocking) capable to produce an adequate model for making companies as successful earning management. Thus, the overall conclusion shows that board interlocking and board internationalisation are important characteristics to promote successful earning management in Malaysian companies.

The R square score of 0.766 indicates that the 76.6% variance in earning management is attributable to the following variables: board size, board internationalisation, CEO duality and board interlocking. However, there is quiet 24.4% of the variance in earning management that is not explained. This indicates that there are still other variables need to explore in further research that can affect the variance of earning management except the factors performed in this search.

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