

THE INFLUENCE OF CORPORATE GOVERNANCE AND FIRM'S CHARACTERISTICS ON THE EXTENT OF COMPLIANCE WITH MASB STANDARDS AMONG MALAYSIAN LISTED COMPANIES

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ABSTRACT

This paper contributes to our understanding of compliance with mandatory accounting standards. Specifically, we examine the efficacy of agency related mechanisms on the degree of disclosure compliance with the Malaysian Accounting Standards Board (MASB) accounting standards. Using data drawn from a sample of 170 Malaysian companies listed on the Kuala Lumpur Stock Exchange (KLSE) in 2004, we show that although overall disclosure compliance is high (85.2% of the items of information being disclosed), companies do not fully comply with MASB 10 (Accounting for leases), MASB 11 (Consolidated financial statements and investments in subsidiaries), MASB 12 (Investments in Associates), MASB 15 (Property, plant and equipment), MASB 20 (Provisions, contingent liabilities and contingent assets), MASB 24 (financial instruments), MASB 27 (Borrowing costs) and MASB 29 (Employee benefits). We employ an ordinary least square (OLS) regression model to establish whether selected company-specific and corporate governance characteristics (proxying for agency-related mechanisms) are related to the degree of disclosure compliance. Our results indicate that only leverage is positively associated with the degree of compliance. The other variables consisting of board independence, audit committee independence, the existence of qualified accountant in the audit committee, CEO duality, the extent of outside blockholders' ownership, firm size and profitability do not show any significant relationship with degree of compliance. These results have important implications for policy because they suggest that whilst agency-related mechanisms may motivate compliance with mandatory standards, full compliance may be unattainable without regulations.

Keywords: Compliance, MASB, accounting standards, Disclosure level, Malaysia, Kuala Lumpur Stock exchange.

1.0 INTRODUCTION

The foundation of good corporate governance is transparent disclosure. If corporate sector entities do not follow the policy of complete and objective disclosure while preparing their financial statements, the users of this information do not receive early warning signals about deteriorating financial conditions and are therefore unable to make timely adjustments. Suddenly an event may unveil previously undetected risk exposure of the corporate sector and trigger panic among the investor community.

The recent Asian financial crisis was partly contributed by deficiencies in corporate disclosure or lack of corporate transparency. Mitton (2002) shows that during the 1997-1998 crisis period, Asian firms that had indicators of higher disclosure quality enjoy higher returns. Mitton (2002) used a crude measure of disclosure quality whereby firm that had a listed American depository receipt (ADR) is associated with higher disclosure quality. This, he argues, is either due to mandated disclosure requirements of the listing

exchange or larger pool of investors spurring increased demand for disclosure and increased scrutiny of the firm's reports.

In order to highlight the role of disclosure deficiencies in the East Asian financial crisis, the United Nations Conference on Trade and Development (UNCTAD) commissioned a study in the second half of 1998, led by Rahman. The team reviewed the published financial statements, for the year 1997, of 73 large corporations and banks in five countries—Korea, Thailand, Indonesia, Malaysia and Philippines. The actual accounting and disclosure practices of the sample companies were used to obtain a picture of compliance with International Accounting Standards (IAS).

Specifically for Malaysia, Rahman (1998) found that compliance with the required accounting and reporting practices are mixed which suggest the absence of appropriate enforcement efforts. For example, most of the sample companies disclosed the amounts of inter-company receivables and payables, but there was negligible disclosure on lending and borrowing activities with the associates. Most of the sample companies did not disclose the amounts of foreign debt either in local currency or in the currency of repayment. All the sample companies mentioned the use of the closing rate for translation of foreign currency transactions. However, the recognition and disclosure of the amount of foreign currency translation gains and losses by almost all the sample companies was not in compliance with International Accounting Standards. None of the sample companies disclosed their accounting policy on foreign currency risk management.

In a follow up study commissioned by Confederation of Asian and Pacific Accountants (CAPA), Lambert and Lambert (2003) examined the extent to which the accounting weaknesses identified by Rahman (1998) have been addressed to improve their disclosure quality thus providing a means to mitigate future financial crises. In addition to the accounting issues examined in Rahman (1998), Lambert and Lambert (2003) also include four additional disclosures contained in IASs issued since the end of 1997 and in force as at December 2001 namely IAS 35 "Discontinuing Operations" and IAS 36 "Impairment of Assets" which improve the transparency of financial statements for companies potentially subject to financial distress, IAS 38 "Intangible Assets" which is likely to highlight deficiencies in capacity to support debt especially for a firm in financial distress and IAS 39 which extends the disclosure requirements for financial assets and liabilities carried at fair values, supplementing disclosures already contained in IAS 32 "Financial Instruments: Disclosure and Presentation".

The results generally indicate there are marked improvements in disclosure levels, observance and compliance with IASs and greater transparency. For Malaysia, there is a relatively low level of compliance with foreign currency disclosures and derivative financial instruments. This is largely due to the Malaysian standards are silent on recognition, measurement or disclosure requirements on these areas, unlike the IASs.

The objectives of this study are i) to determine the extent of compliance with MASB standards in the annual reports, and ii) to determine the influence of corporate governance variables, ownership variables and other firm specific characteristics on the extent of compliance with MASB standards.

The motivation for the study is twofold. First, it extends previous studies by examining the factors (company-specific characteristics) that influence the degree of corporate compliance with mandatory disclosure requirements in Malaysia after the enactment of the FRA, so as to speculate on factors that would be critical in corporate compliance with International Financial Reporting Standards (IFRSs) when adopted for use in Malaysia in 2006. There is therefore the need to identify characteristics of companies

that complied with the mandatory disclosure requirements and those that did not, so that any educational effort can be focused on the latter group of companies. Thus, the study is an attempt to aid policy makers in any effort to educate companies on how to provide adequate information for investment and credit decision-making after the adoption of the IFRSs. Prior to the introduction of MASB in 1997, only two comprehensive studies were undertaken (Tan 1998; Abdul Latiff and Skeratt 1996), during which time compliance with the accounting standards was not mandatory in Malaysia. Since the introduction of mandatory MASB standards, no comprehensive studies have been conducted to examine companies' compliance with the standards. The studies by Rahman (1998) and Lambert and Lambert (2003) provide insights on disclosure levels relating to specific IASs and they use a limited sample size. Rahman (1998) includes only 15 Malaysian firms whereas Lambert and Lambert (2003) increased the Malaysian sample to 20 firms. A limited number of studies examining compliance with specific MASB standards include Wan Hussin et al. 2003, Ku Nor Izah 2003 and Sharir et al. 2003. They document that the compliance level is generally high. We undertake this study to provide a more comprehensive survey on compliance with all accounting standards in Malaysia as at 31 December 2004 by examining all Bursa-Malaysia listed firms. Secondly, while prior studies have examined the effects of several company-specific characteristics such as company size, company age, liquidity, profitability, industry, and auditor-type on the degree of corporate compliance with mandatory disclosure, none has investigated the influence of corporate governance parameters (board characteristics and ownership structure) on mandatory disclosure. The present study is, therefore, an attempt to fill this gap in the literature.

The year 2004 is chosen because various institutional changes have taken place, predominantly the introduction of Malaysian Code on Corporate Governance and Revamped Listing Requirements in 2001 that might improve further the compliance level with MASBs.

The remainder of the paper is organised as follows. The next section, section two, describes the legislative and institutional structures that impact on corporate financial reporting practices in Malaysia and develops the testable hypotheses between disclosure compliance (the extent of mandatory disclosure) and nine factors (corporate governance and company-specific characteristics). Section describes the procedures used to draw the sample, gather data, measure corporate mandatory disclosure compliance levels, and fit the regression equation to the data. Section four presents and discusses the results of the statistical tests conducted. Finally, section five summarizes the study, highlights the limitations of the study, provides suggestions for further research and concludes the paper.

2.0 LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The quality of financial reporting of a company is influenced, to a large extent, by the financial reporting regulations of the country the company belongs to (see Haniffa and Cooke, 2002). Financial reporting regulation is necessary in order to achieve quality financial reporting. There are several reasons why financial reporting regulation is necessary. Based on the rationales from the economic literature Ma (1997) for example cited two reasons. First, accounting information is a public good in which any interested party can have access to the information. Being a public good, besides shareholders who pay for the information, there will be *free riders*¹ who also obtain the information from the financial reports. In determining the quantity of information to produce, managers do not take into account the value of the information to the *free riders*. Thus, information is under-produced, and there is a *market failure*² unless regulation of financial reporting is introduced (Watts and Zimmerman 1986).

Second, it is argued that management has more information about the value of a firm than do outside investors, or there is *information asymmetry*. According to Watts and Zimmerman (1986), companies whose share prices are undervalued have the incentive to signal that fact by disclosing more information. Overvalued firms, on the other hand, do not provide additional information and this signals the fact that the firms are overvalued. The shares of some of the overvalued firms then drop and as a result become undervalued. These companies will signal the fact by providing more disclosure, and the process continues until the worst performing companies do not signal. However, the signalling activities can lead to overproduction of information in financial reports. Part of the information relates to historical performance and not to future performance. Thus there is no social benefit obtained. When this happens, the authorities have to interfere and introduce financial reporting regulation to overcome market failure.

However, based on the free-market approach of the *agency theory*³, it is argued that there is no need for accounting regulations. Under the theory, accounting information is regarded as an economic good, and like any other economic good, its optimal production is determined by demand and supply factors in the market place. Since market forces can ensure an optimal disclosure it is argued that financial reporting regulation is not necessary (Ma 1997). Although this is a sound theory, for some reasons its practical application is believed to be limited. In the presence of regulations, this free-market approach, however, can be argued to lead to extra disclosure to meet market forces since regulations only cover the minimum disclosure requirements.

The social environment and stage of economic development are also believed to have an influence on the financial reporting system of a country (Abdul Rahman, 1998). As the sophistication of the economy becomes greater, more regulations are likely to be needed in a country.

2.1 Historical Development of Financial Reporting in Malaysia

The history of financial reporting in Malaysia is reasonably short. Although the securities industry has existed since the 1870s with the presence of British companies in the tin and rubber industries (KLSE, 1998), the first financial reporting regulation in Malaysia can be traced back only as far as 1940 when the *Companies Ordinance* (amendments) of 1940 was established (Tan, 2000). Further *Ordinances* followed in 1946 and 1956. The *Ordinances* played a major role in regulating financial reporting during the period until the *Malaysian Companies Act* (based on the *Victorian Act* 1961) was enacted in 1965. Prior to the establishment of the *Act*, there had been calls for greater regulation in financial reporting. Babiak (1966) for instance, drew attention to weaknesses and the absence of uniform accounting standards, areas in which improvements were needed.

The development of accounting standards only began in the late 1970s and most of the accounting standards were adoption of the International Accounting Standards (IAS) (Tan 2000). A major turning point in the history of financial reporting in Malaysia started in the mid 1990s. Since 1995, several major events that resulted in significant impact upon financial reporting regulations have taken place. They were followed by the enforcement of the Financial Reporting Act 1997 on 6 March 1997 that saw the establishment of the MASB and the Financial Reporting Foundation (FRF). The outbreak of the 1997/1998 Asian financial crisis brought about significant development of financial reporting in Malaysia. Since then, a number of regulations have been amended and introduced.

Table 1
Present key agencies of Malaysian financial reporting

Agency	Year	Role
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	established	
Companies Commission of Malaysia (CCM)	2002	Administers Companies Act
Malaysian Accounting Standards Board (MASB)	1997	Sets accounting standards
Financial Reporting Foundation (FRF)	1997	Oversees MASB's performance, and financial and funding arrangements
Securities Commission of Malaysia (SC)	1993	Regulates capital market
Bursa Malaysia Berhad (BMB)	1973	Monitors securities market
Malaysian Institute of Accountants (MIA)	1967	Regulates accounting profession
Bank Negara Malaysia (BNM)	1959	A central bank, and regulates the financial institutions and insurance companies
Malaysian Institute of Certified Public Accountants (MICPA) ⁴	1958	A professional accounting body

The structure of financial reporting regulation in Malaysia is composed of legislation and requirements set by various regulatory agencies, which consists of the government and the private agencies. Table 1 summarizes the regulatory agencies that make up the present Malaysian financial reporting framework. The agencies are involved in formulating authoritative accounting regulations and/or in enforcing these regulations. They include the Companies Commission of Malaysia (CCM), which monitors compliance with Companies Act 1965, and the Malaysian Accounting Standards Board (MASB), which issues accounting standards. Presently, the Companies Act, MASB standards, Listing Requirements of the Bursa Malaysia and the guidelines of the SC are the major sources of reference for corporate reporting in Malaysia.

2.4 Hypothesis Development

Prior studies suggest that corporate compliance with mandatory disclosure is influenced by certain company-specific characteristics (e.g. Cerf, 1961; Wallace et al. 1994; Owusu-Ansah, 1998; Singhvi and Desai, 1971; Belkaoui and Kahl, 1978; McNalley et al., 1982; Chow and Wong-Boren, 1987; Cooke 1989, 1991, 1992; Craswell and Taylor, 1992; Meek et al., 1995; Wallace and Naser, 1995; Inchausti, 1997; Dumontier and Raffournier, 1998). The characteristics considered include size, listing status, leverage, profitability, dispersion of stock ownership, industry, type of auditor, and country of origin. Overall, these studies indicate that size and listing status are significantly associated with the level of disclosure. Findings regarding the relationship between level of disclosure and other corporate variables have been mixed (see Street and Gray [2001] for a review).

In this study, the influences of some of these characteristics, namely, board independence, audit committee independence, the existence of qualified accountant in the audit committee, CEO duality, the extent of outside blockholders' ownership, firm size, and leverage on mandatory disclosure compliance levels of Malaysian listed companies are investigated. In this section, several relational conjectures, based on economic theories, prior results, and a priori reasoning, between each corporate-specific characteristic and compliance with mandatory disclosure are made.

Board Structure

The board of directors could effectively delineate the rights and the interests and responsibilities of the various stakeholders in the company (Ho and Wong, 2001). Two important board's characteristics are board independence and the separation of the board chairman and CEO (e.g. Shamsul Nahar and Norita, 2004; Ho and Wong, 2001, Kosnik, 1987 and 1990; Weisbach, 1988).

Theory on the importance of the board of directors in protecting the various stakeholders' interests is mainly derived from the agency theory (Jensen, 1993; Fama and Jensen, 1983; Jensen and Meckling, 1976). The theory predicts that the representations of outside independent directors on the board leads to greater the board incentives to fulfill their monitoring roles. Thus, this would translate to the board effectiveness. Evidence, however, is mixed (Weisbach, 1988; Beasley, 1996; Shamsul Nahar and Norita, 2004; Norman, Mohd Mohid and Takiah, 2004). Thus, outside representations do not necessarily translate into board effective monitoring.

In the Malaysian context, several studies have been carried out to examine effects of board independence on its monitoring effectiveness. The earliest work was by Annuar and Shamser (1994) who examine the wealth effects of the announcement of outside directors. Their evidence shows that the announcement does not have any significant impact on the share price of the relevant companies. In a subsequent study by Abdullah (1999), a positive influence of board independence on earnings quality is documented. Norman et al. (2004), examining the period after the crisis and after the implementation RLRs, find that board independence does not influence accrual management. Mohd Nasir and Abdullah (2004), investigating distressed companies after the crisis and the period before and at the early implementation of RLRs, do not show any significant influence of board independence on the extent of voluntary disclosure.

It is expected that board independence plays an important role in ensuring the management to comply with MASB approved standards in preparing the company's accounts. This is because failures to comply with the standards could lead to negative publicity which adversely affect their value in the labor market. Further, outside directors are seen by the public as "decision expert and decision ratifications" (Fama and Jensen 1983). Being at center of the corporate governance, board independence is expected to be associated with compliance with the MASB standards. Second, the period the present study is interested in is financial year 2004, which is about three years after the implementation of RLRs. One of the requirements of RLRs is directors' training to enable directors to enhance their capacity to discharge their duties. Therefore, it is expected that during the period of this study, independent directors have attended this course. Thus, we predict that this translates into compliance with the MASB standards. Hypothesis relating board independence and compliance is as follows:

H₁: Board independence leads to higher level of compliance with MASB standards.

As discussed earlier, board's monitoring incentives are affected by whether the roles of the board chairman and CEO are separated or combined. Combining these two roles leads to the present of dominant personality (Collier, 1993). Further non-executive chairman promotes a higher level of corporate openness (Miller, 1997). Thus, combining these roles could disrupt the flow of information to the public as argued by Ho and Wong (2001), this leads to the Chairman-CEO withholding unfavorable information to outsiders. Forker (1992) also finds that CEO duality negatively associated with the quality of share-option disclosure in the annual reports. The Cadbury Report (1992), the Malaysian Code on Corporate Governance (Finance Committee on Corporate Governance, 2001) and the Hampel Report (1998) are supporting the separation of the top roles to ensure the that appropriate check and balance system exists.

Several studies have thus far been carried out to determine the effect of the separation of the board' monitoring effectiveness and the evidence is mixed. Abdullah (1999) shows that combining the roles leads to lower earnings quality. However, in a subsequent study, Abdullah and Mohd-Nasir (2004) do not find evidence relating CEO duality to accrual management. Norman et al. (2004), on the other hand, show that CEO duality leads to higher earnings management. This evidence is consistent with the evidence offered by Mohd-Nasir and Abdullah (2004), who find that CEO duality is associated with lower amount of voluntary disclosure.

Theory of dominant personality leads to the negative association between CEO duality and compliance with MASB standards. However, empirical studies, both in Malaysia and in developed countries including Hong Kong and Singapore, show mixed evidence. Perhaps, the positive effects of separating the two roles are negated by the slow of decision making processes which are better handled and much quicker if the two roles are combined. Thus, the hypothesis is as follows:

H₂: CEO duality leads to low level of compliance with MASB standards.

Audit Committees

Audit committees are sub-committee of the board of directors whose responsibilities are to oversee the financial reporting processes of their firms. Collier (1993) argues that audit committees help to ensure the financial accounting and control system. Forker (1992) also postulates that audit committees could effectively improve the internal control and thus could serve as a device to improve a firm's disclosure quality. His evidence, nevertheless, fails to support the contention. The evidence by McMullen (1996), on the other hand, supports the contention of a positive and significant link between audit committee and reliable financial reporting. A study in Hong Kong by Ho and Wong (2001), nonetheless, show no association between audit committee and the amount of voluntary disclosure.

Empirical studies on the monitoring incentives of audit committees in Malaysia have generally produced mixed results as well. Abdullah and Al-Murisi (1997) found that audit committee independence is not associated with its effectiveness while having a qualified accountant is associated positively with its effectiveness. In a subsequent study, Abdullah and Ku Ismail (1999) fail to show the importance of audit committee independence nor having a qualified accountant. Abdullah (1999) also fails to show a significant influence of audit committee independence on the earnings quality. In a subsequent study, Abdullah and Mohd-Nasir (2004) do not find evidence of the influence of audit committee independence on the accrual management. The relation between audit committee independence and having a qualified accountant on audit committee on the compliance with MASB standards is predicted to be positive and significant. The reason is that compliance with MASB standards is mandatory and failure to comply could have significant adverse impact on the reputation of independent audit committee members and their professional accounting bodies. Thus, the related hypotheses are as follows:

H₃: Audit committee independence is positively associated with compliance with MASB standards.

H₄: Having a qualified accountant on audit committee leads to higher level of compliance with MASB standards.

The presence of outside blockholders is expected to have significant impact on the compliance with the MASB standards. This is because these outside blockholders could demand more information to be disclosed in the annual reports to ensure transparency and to reduce information asymmetry among the small shareholders. The evidence by Mohd-Nasir and Abdullah (2004) supports this contention where a positive and significant influence between outside blockholders and the amount of voluntary disclosure. Further, Abdullah (2004) finds that outside blockholders are negatively associated with financial distressed status. It is therefore predicted the extent of ownership by outside blockholders leads to compliance with MASB standards. This is because the wealth of these outside blockholders is tied with the value of the firms. Any deviations from MASB standards lead to auditor to issue a qualified report which could adversely affect the market valuation of the shares of the firms. Thus, the extent of outside blockholders' ownership provides a greater incentive for compliance with MASB standards. Therefore, the hypothesis is as follows:

H₅: The extent of ownership by outside blockholders leads to higher level of compliance with MASB standards.

Control Variables

A large number of studies on financial disclosure attempted to associate the extent of disclosure with specific attributes of a company. Several company attributes have been examined in previous disclosure studies to explain the variations in the extent of disclosure. These include variables that are associated, for example, with structure (size and capital structure), performance (profitability and growth), corporate governance, and culture of a company. The most frequently examined attributes have been corporate size and capital structure (Ahmed and Courtis 1999).

Firm Size

In numerous disclosure studies, size has persistently been found to have a positive association with the extent of annual report disclosure (Cerf 1961, Buzby 1975, McNally et al. 1982, Naser 1998). Cerf (1961) provided a comprehensive discussion as to why size is hypothesised to be positively associated with the extent of disclosure. He argued that larger firms are more conscious of the needs of investors. They are likely to be in the public eye and more subject to shareholders' and analysts' pressures. Moreover, accumulation and dissemination of information is costly and smaller firms might not find it worthwhile. Larger firms which are argued to have better internal reporting would have the information ready for management to be adequately informed. It is also argued that a high level of disclosure would place smaller firms in a competitively disadvantageous position.

Based on the foregoing discussion, this study hypothesises that the size of a firm is positively associated with the extent of disclosure. This study measures size by the total assets of a company, a measure used in a large number of studies (e.g. Singhvi 1968, Buzby 1975, McNally et al. 1982, Tan et al. 1990, Wallace et al. 1994, Hossain et al. 1995, and Schadewitz and Blevins 1998). The hypothesis to be tested is:

H₆: There is a positive association between the level of compliance and size of a company.

Capital Structure

From the perspective of agency theory, Jensen and Meckling (1976) argued that higher bonding costs would be incurred by firms that are highly leveraged. As financial disclosure is used for monitoring purposes, it is expected that firms that are highly leveraged would disclose more information in the quarterly reports. Thus, the relationship between leverage and the extent of disclosure is expected to be

positive. Nevertheless, previous evidence shows that the results were inconclusive. Some studies showed a significant relationship (e.g. Courtis, 1979 and Hossain et al., 1995 in annual report studies; and Schadewitz and Blevins, 1998 in interim report studies), while others found no relationship. (e.g. Chow and Wong-Boren, 1987; Ahmed and Nicholls, 1994; and Wallace et al., 1994 in annual report studies).

Based on the argument provided by agency theory, this thesis hypothesizes that highly leveraged firms disclose more information in the annual reports compared to the lowly leveraged firms. Various measures of leverage have been adopted in the literature, depending on the objective of the analysis (Rajan and Zingales 1995). Leverage could be measured in terms of book value or market value. This study measures leverage in terms of the ratio of debt to total assets, as employed by Courtis (1979) and Chow and Wong-Boren (1987). Because some companies were insolvent and had a negative amount of equity⁵, measuring leverage as debt to equity ratio might be misleading. From the foregoing discussion, the following hypothesis is to be tested:

H₇: There is a positive association between the level of compliance and leverage of a company.

3.0 RESEARCH METHOD

3.1 Data Collection

According to the business magazine, Investors Digest which was published by the KLSE in 2004, as at 31 December 2004, there were 906 companies listed on the main and second boards of Bursa Malaysia. The year 2004 was chosen because this study is an ongoing research project that looks into different regimes of disclosure requirements. The first period (from 1997 to 2004) was known as the "MASB standards-regime", the second period (from 2005 to 2011) was known as the "MASB FRS-regime", and the third period (from 2012 onwards) was known as the "MASB IFRS convergence-regime". This study focuses on the first period by investigating the last year (2004, seven years after the introduction of MASB standards in 1997) before the introduction of FRSs in 2005⁶. These companies were classified into thirteen major sectors. Out of this, the total number of listed companies in the main board was 557. The trust, close-end funds, banking, finance and insurance sector were excluded from the study as these companies have to follow specific disclosure requirements and therefore do not have the same comparable characteristics, such as sales, as non-financial companies (Wallace and Naser, 1995). Following the exclusion of the banking, financial and insurance companies (51), the remaining number of companies that were eligible for the analyses was 461. After the screening process, a further 59 companies (in various sectors) were also excluded from the investigation as some of these companies were classified as 'failing' companies under PN4. In addition, there were several merger activities between some companies, whilst, a number of companies were newly established and were awaiting a full stock exchange listing. Consequently, the number of the selected population was further reduced to 402. From this population of 402 companies, a systematic random sampling was conducted by taking the second consecutive (even) number of companies from the list, giving a total of 203 companies. In order to minimize cost and time, only those companies that provided their annual reports in hard-copy form were analysed. A letter was sent to each of these companies requesting a copy of their audited annual report for the year 2004. One hundred and seventy companies responded, giving a response rate of 84%. The data on each company-specific characteristic were obtained or computed from the annual reports of the companies in the sample.

3.2 Research instrument

This study employs all the relevant MASB standards as at 31 Dec. 2004, after excluding standards that are not applicable to all industries. The standards that are excluded in this study are interim reporting (MASB

26), insurance (MASB 17 and 18), research and development costs (MASB 4), the effect of changes in exchange rates (MASB 6), construction contracts (MASB 7), financial reporting of interests in joint ventures (MASB 16), financial instruments (MASB 24), accounting for government grants and disclosure of government assistance (MASB 31), property development activities (MASB 32), and presentation of financial statements of Islamic financial institutions (MASB i-1), resulting in 22 standards. A disclosure checklist was developed for each standard to examine companies' disclosure practices.

3.3 Measuring Compliance

3.3.1 Level of Compliance

To determine the extent of compliance, this study assumes that the level of compliance is associated with the level of disclosure in the annual reports. A dichotomous procedure as adopted by Cerf (1961) will be adopted. Similar procedure was subsequently used by other researchers (e.g. Naser et al. 2002; Haniffa and Cooke 2002; Ku Ismail and Abdullah, 1998; A. Rahman 1998). It is a simple approach by which an item scores '1' if it is disclosed, and '0' if it is not disclosed. The total disclosure (TD) score for a company is computed as follows:

$$TD = \sum_{i=1}^m d_i$$

where $d = 1$ if the item d_i is disclosed,
 $d = 0$ if the item d_i is not disclosed, and
 $m \leq n$ (discussed below)

In deciding whether an item was of relevance to a company, several procedures used in prior literature were applied. First, following Cooke (1989), each annual report was thoroughly read to ascertain whether an undisclosed information item was, in fact, irrelevant to a company. Second, as in Owusu-Ansah (1998, 2000), the comparative figures for each information item disclosed in one year's annual report; say 2002, was crosschecked against the preceding (2001), and succeeding (2003) annual reports. Third, by deductive reasoning, relevance of some information items to every company was easily established. For example, when a company has fixed assets, its depreciation policy is expected to be disclosed.

As in prior studies, the content validity of the disclosure checklist was conducted by comparing it with the guidelines issued by a Malaysian Big-4 audit firm. Thus, using this auditor's internal checklists or guidelines for statutory audit as a referent, each of the disclosure items devised for this study was revised. The disclosure checklist was applied to the financial reports of each company, and the relevant mandated information items disclosed therein numerically scored. In addition, a Pearson product-moment correlation analysis was employed, as in prior studies, to test the reliability of the checklist after the annual reports have been scored to assess the subjectivity inherent in the scoring process. The present investigator scored the annual reports in the first instance, and then, another two persons independent of the study were requested to score a randomly selected sample of 10 annual reports for the same year. The reliability test was conducted on the scores obtained by these independent persons and those of the investigator. The inter-scorer coefficients are significant at the conventional levels, suggesting a minimal subjectivity in scoring each annual report for the presence of the mandated information items.

Some of the earlier studies assigned weights to the disclosure items according to their importance to the users of financial reports (e.g. Buzby, 1974; Wallace, 1988; Chew and Lee, 1990). However, the disclosure items used in this study were not weighted because it was assumed that each item of disclosure was equally important. This assumption is expected to be valid since this study deals with only mandatory disclosure, where all items that are required by the standards are regarded as of equally high importance. In contrast, it would have been better to have the items weighted if they had been voluntary in nature. An index was subsequently developed to measure the relative level of disclosure by a company. The index is a ratio of the actual scores obtained by a company to the maximum score possible. Since companies are not penalized for not disclosing irrelevant items, the maximum score (M) a company could earn varies:

$$M = \frac{\sum_{i=1}^n d_i}{n} \quad (1)$$

where d_i = expected item of disclosure, and
 n = the number of items which the company
is expected to disclose.

The total disclosure index (TDI) for each company then becomes TD/M . The index would thus lie between 0 and 1. A score of 1 indicates that a company disclosed all the relevant items as required by the standards and a score of 0 means that a company did not disclose any of the relevant items.

3.4 Analysis

Descriptive analysis was conducted for each standard in order to determine the pattern of accounting and disclosure practices. Next, multiple regression analysis was employed to test the determinants of the disclosure comprehensiveness.

The estimated multiple regression model takes the following form:

$$TDI = \alpha + \beta_1 BDIND + \beta_2 CEODL + \beta_3 ACIND + \beta_4 ACCT + \beta_5 OUTBLK + \beta_6 SIZE + \beta_7 LEV + \varepsilon \quad (2)$$

TDI : Total Disclosure Index;

BDIND : %age of independent directors on the board;

CEODL : a dummy variable, "1" if the roles of the board chairman and CEO are combined, "0" otherwise;

ACIND : a dummy variable, "1" if all members are independent directors, "0" otherwise;

ACCT : a dummy variable, "1" if at least one audit member is a qualified accountant; "0" otherwise;

OUTBLK : cumulative %age of shares owned by outside blockholders with shareholdings 2% and above;

SIZE : natural log of book value of total assets;

LEV : total debts divided by total assets;

ε : disturbance term.

4.0 RESULTS AND DISCUSSION

4.1 Extent of Compliance

4.1.1. Disclosure Level of the sampled companies

Table 2 presents a distribution of the sampled companies according to the level of their compliance with the MASB disclosure requirements. Distribution was computed for every sector and for the total sampled companies. In line with the framework of analysis used by Ali et. al (2004) and Samaha and Stapleton (2008) a distinction is made between four levels of company compliance with MASB requirements. The categories are: high compliance, if the disclosure index is 80% or more, intermediate compliance between 60% and 79%, low compliance between 40% and 59%, and below 40% which reflects a substantial gap between company disclosure practices and the MASB requirements.

Given the results presented in Table 2, and the above compliance level framework, the first note is that all sampled companies in all industry sectors were found to have at least 60% compliance level. This result suggests that Malaysian companies listed on the Bursa Malaysia (Malaysian Stock Exchange) complied with the majority of MASB disclosure requirements, with the lowest disclosure index 66% for the companies in the trading and service sector.

Table 2 also shows that about 80% of the sampled companies have a disclosure level between 70% and 90%. This result indicates that most of the sampled companies meet the high compliance level of the compliance framework used by Ali et. al, and the majority of these companies achieved a compliance level more than 80%. It is also noticed that only 30 companies (18% of the sampled companies) have a high compliance level (more than 90%), with the majority of them are from the industrial products (8), properties (7), and trading and service (6) sectors. No company obtained an overall compliance rate of 100% but one company achieved the highest level of disclosure score of 99.4%. Finally, data revealed that only 1% of the sampled companies achieved a disclosure compliance level less than 70%. Overall, the average compliance rate was reasonably high at 85%. These results indicate that most Malaysian companies listed on the Bursa Malaysia comply with the disclosure requirements as required by the MASB standards. This reinforces the usefulness of evaluation of the factors influencing companies' compliance with MASB-required disclosures, especially those companies with below than average disclosure level.

4.2 Univariate Analysis

Table 3 (Panel A and B) reports descriptive statistics for all the variables in Equation 2. The results of a Shapiro-Wilk's test of normality, also presented in Table 3, indicate that with the exception of SIZE and Total Disclosure Index (TDI), all the continuous variables are not symmetrically distributed. So the data on each variable in Equation 2 were standardized. According to Snee (1973), standardizing variables also offers the following benefits: (i) it converts data to a common scale, (ii) it improves precision of regression estimates, and (iii) it reduces collinearity problems among independent variables.

4.3 Bivariate Analysis

Table 4 presents Pearson product-moment pairwise correlation coefficients between the standardized independent variables. The results in Table 4 provide no indication that an unacceptable level of multicollinearity is present in the data. Gujarati (1995, p. 335) suggests that harmful levels of multicollinearity are present when bivariate correlations reach 0.80. In this study, no correlation coefficient between the independent variables reached this level.

4.4 Multivariate Analysis

The parameters of Equation 2 are estimated using Ordinary Least Squares technique, the results of which are reported in Table 5. The hypothesis that audit committee independence is positively associated with compliance with MASB standards is not supported by the data. Even the related hypothesis that having a qualified accountant on audit committee leads to higher level of compliance with MASB standards also is not supported. However, the relationships are in the hypothesized direction.

Table 2: Distribution of sampled companies according to the level of their compliance with the MASB standards

Disclosure level range (%)	PROP	IP	CP	TECH	PLANT	TS	CONST	INFR	HOTEL	MINING	Total sample No. (%)
Over 90%	7	8	4	2	1	6	---	1	1	---	30(18%)
80% - 90%	20	27	16	2	8	23	11	2	1	1	111 (65%)
70% - 79%	1	8	4	1	2	9	2	---	---	---	27 (16%)
60% - 69%	---	1	---	---	---	1	---	---	---	---	2 (1%)
50% - 59%	---	---	---	---	---	---	---	---	---	---	---
Less than 50%	---	---	---	---	---	---	---	---	---	---	---
Total	28	44	24	5	11	39	13	3	2	1	170 (100%)
Max. disclosure level	0.981013	0.994286	0.977401	0.938547	0.965116	0.989474	0.896341	0.966667	0.992366	0.843284	0.994286
Min. disclosure level	0.769634	0.695279	0.721739	0.707865	0.752632	0.664865	0.763285	0.805755	0.825243	0.84328	0.664865
Overall disclosure level	0.865776	0.927501	0.888317	0.84988	0.925964	0.874411	0.775945	0.863108	0.908805	0.843284	0.851626

Table 3: Descriptive Statistics
Panel A: Continuous Variables

Variable	N	Minimum	Maximum	Mean	Std. Deviation	Median
TDI	170	.66	.99	.8511	.06085	0.8491
BDIND	170	.20	.80	.4126	.11126	0.38
OUTBLK	170	.03	.90	.5489	.19964	0.59
LEV	170	.00	.92	.1556	.14920	0.12
SIZE	170	15.36	24.35	20.0779	1.31107	20.04

Panel B: Dichotomous (Dummy) Variables

Variable	N	n=0	n=1	Mean	Std. Deviation	Median
CEODL	170	120	50	.29	.455	0
ACIND	170	158	12	.07	.258	0
ACCT	170	11	159	.93	.247	1

Panel C: Tests of Normality

Continuous Variable	Shapiro-Wilk		
	Statistic	df	Sig.
BDIND	.911	169	.000
OUTBLK	.950	169	.000
LEV	.860	169	.000
TDI	.988	169	.145
SIZE	.982	169	.030

Table 4: Pearson Product-moment Correlation Matrix of Standardised Variables (n = 170)

	BDIND	CEODL	ACIND	ACCT	OUTBLK	LEV	SIZE
BDIND	1						
CEODL	.011	1					
ACIND	.137	-.075	1				
ACCT	-.050	-.096	-.114	1			
OUTBLK	-.021	-.031	-.090	.045	1		
LEV	.076	.096	-.042	.105	-.006	1	
SIZE	-.075	.036	-.154(*)	.011	.135	.256(**)	1

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

The explanation for the lack of highly significant relationship between independence of a corporate audit committee and the extent of compliance may be as noted by Kalbers and Fogarty (1993, p. 27), establishing an audit committee is one thing: establishing an effective audit committee is quite another. Indeed, prior research has shown that key audit committee characteristics (such as independence from management, expertise of members in the areas of accounting and financial reporting, and frequency of meeting) rather than the mere existence of an audit committee critically impact the audit committee's ability to effectively execute its objectives and responsibilities (Abbott and Parker 2000, 2001; Beasley et al. 2000; Raghunandan et al. 2001; Carcello and Neal, 2003).

Firm size (SIZE) variable shows a negative relationship with TDI, and also is not significant⁷. The SIZE variable was expected to have a positive sign, given the economies of scale in the production and dissemination of information, which postulates a direct relationship between company size and the extent of compliance. The lack of statistical significance of the SIZE variable is due to high compliance of Malaysian companies with MASB disclosure requirements irrespective of whether they are small or big

companies in terms of total assets. Since the sample of this study consists solely of publicly held companies; hence, size effect will be more difficult to detect by any statistical test.

The hypothesis that the extent of ownership by outside blockholders (OUTBLK) leads to higher level of compliance with MASB standards is also not supported by the data. In fact, it shows a negative relationship. This evidence contradicts that of Norita and Shamsul Nahar (2004) who find a positive and significant influence between outside blockholders and the amount of voluntary disclosure.

Table 5: Estimates of Regression Analysis

Variable	Predicted signs	Coefficients	t-values	Sig.
(Constant)	?	.884	8.727	.000
BDIND	+	.051	.642	.522
CEODL	-	-.039	-.442	.659
ACIND	+	-.099	-1.199	.233
ACCT	+	.031	.376	.707
SIZE	+	-.057	-.567	.572
LEV	+	.219	2.603	.010
OUTBLK	+	-.078	-.628	.531

Summary of model:

R	R Square	Adjusted R Square	F	Sig.
.308(a)	.095	.017	1.218	.272(a)

The board independence (BDIND) variable has a positive relationship with TDI even though it is not significant. This shows that the requirements for directors to undergo training to enable them to enhance their capacity to discharge their duties has been effective, in the sense that it has been translated into a high compliance with the MASB standards. The hypothesis that CEO duality (CEODL) leads to low level of compliance with MASB standards is not supported but it conforms with the hypothesized direction (negatively related) to TDI. This finding is consistent with the evidence offered by Norita and Shamsul Nahar (2004), who find that CEO duality is associated with lower amount of voluntary disclosure; as well as by Norman et al. (2004) who find that CEO duality leads to higher earnings management.

The empirical data also does not support the hypothesis that the extent of compliance by companies is positively associated with audit committee independence (ACIND). In addition, the result shows a negative relationship. This finding supports prior studies by Shamsul Nahar and Norizah (1999), Shamsul Nahar (1999), and Shamsul Nahar and Norita (2004). The related hypothesis that having a qualified accountant (ACCT) on audit committee leads to higher level of compliance with MASB standards is also not supported, but it was in the hypothesized direction. This finding corroborates the conclusions in prior studies by Norman et al. (2004) and Shamsul Nahar and Norizah (1999).

The only variable that shows a significant positive relationship with TDI is leverage (LEV). This finding support the findings in prior studies by Courtis (1979) and Hossain and Adams (1995) in annual report studies; and Schadewitz and Blevins (1998) in interim report studies. The significant positive relationship indicates that highly leveraged firms show a higher level of compliance with MASB standards compared to lowly leveraged firms.

In summary, the empirical analysis suggests that leverage is the most a critical explanatory factor of the extent by which Malaysia-listed companies complied with MASB accounting standards. The other variables consisting of board independence, audit committee independence, the existence of qualified accountant in the audit committee, CEO duality, management ownership, the extent of outside blockholders' ownership, ownership structure, firm size, scope of business, industry type, profitability and type of external auditor do not show any significant relationship with degree of compliance.

5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

The purpose of this study was to empirically investigate the relationships between nine factors (corporate governance and company-specific characteristics) and the extent of compliance with MASB accounting standards by companies listed on the Malaysian Stock Exchange (Bursa Malaysia) for the financial year ending 2004. The empirical results indicate that leverage is the only factor that could explain the degree of corporate compliance with mandatory disclosure requirements in Malaysia. All the other twelve variables show insignificant relationship. The results of this study provide empirical evidence that Malaysian companies irrespective of their different characteristics tend to provide a high compliance with the disclosure requirements imposed by the relevant regulatory bodies.

Overall, the results provide strong evidence that highly leveraged companies tend to provide greater compliance with MASB accounting standards compared to lowly leveraged companies. Therefore, policy makers in Malaysia may focus more on lowly leveraged companies in any educational effort to prepare these companies in the country about their external reporting responsibilities once the International Financial Reporting Standards (IFRSs) are fully adopted in the country in 2012.

The results of this study are subject to several limitations. First, while extensive efforts were made to develop an accurate proxy for the extent of compliance with accounting standards, the assumption that each disclosure item may represent the degree of compliance, as evidenced by the dichotomous scoring of the items, is subject to some degree of subjectivity. The disclosure of the same items by companies but located in different sections of their annual reports makes the comparison much more difficult. In addition, the number of non-applicable items also varies between different companies in different industries, which in turn affect the scoring of disclosure items. Second, the results may not be generalizable to all companies listed on the Malaysian Stock Exchange (Bursa Malaysia), as the empirical analysis is limited to only those Malaysian companies listed on the first board. Third, given the exceedingly complex nature of corporate disclosure, there are inherent limits in the ability of empirical research to capture all the factors that influence disclosure decisions made by managements of companies. Finally, the regression analysis does not resolve issues of causality. The observed relationships between the company-specific characteristics and the extent of compliance do not necessarily prove causation. Kerlinger (1973, p. 393) cautioned, "...the study of cause and causation is an endless maze. One of the difficulties is that the word "cause" has surplus meaning and metaphysical overtones. Perhaps more important, it is not really needed." Consequently, the coefficients of the significant company-specific characteristics of Equation 2 should not be viewed as elasticities that predict how much the extent of compliance will change following a change in any of those characteristics. Rather, the estimated coefficients evaluate the strength of the partial correlation between the characteristics and the degree of compliance. Although the observed relationships reported in this study do not establish causality, Graziano and Raulin (1997) argue that they serve two functions. First, any consistent relationships found in the data can be used to predict future events, which is one of the stated motivations for this study. Second, it provides data that are either consistent or inconsistent with some currently held scientific theory.

Several new directions for future research are suggested by the research design of this study. First, the relatively low adjusted R-squared in some cases suggest that there are several missing variables not factored into the estimation. Thus, in addition to those characteristics investigated in this study, the relationships between multiple-listing status, internationalization of operations and affiliation with multinational corporations, other important financial ratios, and company age should be investigated in future studies. Second, this study could be replicated using cross-national data. For example, data from Malaysia could be compared with those from other ASEAN or Asian countries, as these countries have similar accounting infrastructure and have had changes in the financial reporting regulatory regimes. Finally, a longitudinal approach could be used to investigate the degree of compliance over a long period or for a certain period before and after the effective implementation year to examine the trend or behavior of disclosure as well as specific types of corporate disclosure in Malaysia, such as segmental reporting.

Notes:

- ¹ A free rider is a person who does not purchase the public good since he is assured of the supply once it is made available to the public.
- ² According to Watts and Zimmerman (1986), market failure exists when accounting information produced in the absence of regulation is nonoptimal in a Pareto sense, or because the market for financial information results in resource allocation which is inequitable, that is, "unfair" to some groups or individuals.
- ³ Agency theory assumes a relationship between the principal (owner) and agent (manager) in which the agent manages the wealth of the principal. In such a relationship, information from the agent is desired by the principal in order to monitor the agent's behaviour as well as to motivate the agent to act in the principal's interest.
- ⁴ Formerly known as the MACPA.
- ⁵ In Malaysia, a KLSE listed company whose equity is negative is classified as a Practice Note 4 (PN4) company.
- ⁶ The second phase of this study will investigate the level of information disclosed by Malaysian public listed companies in their annual reports for the year ended 2011 (seven years from the introduction of FRS standards in 2005).
- ⁷ When the original value of total assets was tested (before transformation), the coefficient was positive.

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