POLITICAL INFLUENCE, CORPORATE GOVERNANCE AND FINANCIAL REPORTING QUALITY: EVIDENCE FROM COMPANIES IN MALAYSIA

A thesis presented in partial fulfilment of the requirements for the degree of

Doctor of Philosophy
in
Accountancy

at Massey University, Wellington,
New Zealand

Mohd Fairuz Bin Md Salleh

2009

ABSTRACT

This study investigates the relationship between political influence, corporate governance and financial reporting quality using Malaysian data spanning 1999–2003. The study builds upon agency theory, analysing the conflicting incentives of politicians, shareholders and managers, and how they affect governance and financial reporting. Four hypotheses are put forward: (1) Political influence is associated with lower financial reporting quality; (2) Political influence is associated with weaker corporate governance; (3) After controlling for political influence, weak corporate governance is associated with low financial reporting quality; and (4) Corporate governance mediates the relationship between political influence and financial reporting quality. In addition, knowledge obtained from interviews of top managers from several companies is used to look further at the influence of politics in managerial decision-making, particularly in relation to governance structure, accounting and reporting.

Malaysia offers an interesting and important case study of relationship-based capitalism. Malaysian companies are regarded as politically sensitive, they are highly concentrated, and government participation in equity ownership is significant.

One advance is that this study uses three observable proxies for political influence: government ownership, the presence of politician/s on the board, and the existence of a golden share giving special rights to the government. It appears that political influence is not a single construct. The findings support previous studies only if political influence is defined as the presence of politician/s on the board. Government ownership improves both governance and reporting quality, contrary to the findings of most previous studies. Having a golden share is not associated with governance or financial reporting quality. These findings suggest that institutional details matter when considering the effect of political influence on corporate governance and financial reporting. Findings from interviews provide a rich source of support for some of the quantitative findings, and new details on the complexity of the relationship between governments, boards and managers.

Overall, the study provides insights and additional guidance for regulators and policy makers, for improving the design of corporate governance features and financial reporting frameworks as well as for deciding on the level of involvement of government and politicians in business. The contrasts with findings of earlier studies in Western economies suggest opportunities for future research to understand the sources of the differences.

ACKNOWLEDGEMENTS

I am greatly indebted to my supervisors Professor Paul V Dunmore and Dr Nives Botica Redmayne for their support and encouragement throughout my PhD journey. They have provided invaluable critical evaluation and guidance throughout all stages of the study and this thesis. My grateful thanks to you both.

I gratefully acknowledge the contribution of Associated Professor Agus Yusof from the Political Science Department Universiti Kebangsaan Malaysia, who helped to verify the presence of politicians on board of directors; Edmond Lim as a second scorer of corporate governance and disclosure quality; Encik Farid Omar and Dato' Haji Mat Ali, who made it easier for me to access most of the top management personnel through their personal connections and networks. Thank you to all the participants of the interviews. This study could not have been completed without your interest and participation.

I would like to thank the Universiti Kebangsaan Malaysia and the Ministry of Higher Education of Malaysia for the granting of a scholarship which enabled me to undertake study leave and pursue my doctoral studies.

Special thanks to members of the School of Accountancy, Massey University for their friendship and moral support, and to Hana Craig for patiently reading and editing the manuscript.

Finally and most importantly, my deepest appreciation goes to my parents, Hajjah Zaharah Man and Haji Md Salleh Bin Abd Wahab. This thesis is dedicated to both of you for sacrifices made to teach me what life is all about. This thesis is also dedicated to my grandmother, Ishah and my late grandfather, Abdul Rahman. Both of you have been a source of great encouragement and inspiration throughout my life. Thank you so much for having always believed in me and the unconditional love that I have received.

Fairuz Salleh
Wellington, 2009

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

ADR	American Depository Receipt
AIMR	Association for Investment Management and Research
CAPM	Capital Asset Pricing Model
CC	Commercial Code
CCM	Companies Commission of Malaysia
CFRA	Center for Financial Research and Analysis
CIFAR	Center for International Financial Analysis and Research
CLSA	Credit Lyonnais Securities Asia
CPA	Certified Public Accountant
EOI	Export Oriented Industrialisation
FAF	The Financial Analysts Federation
FASB	Financial Accounting Standards Board
FRA	Financial Reporting Act
FRQ	Financial Reporting Quality
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standard Committee
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
ISI	Import Substitution Industrialisation
ISS	International Shareholder Services
ITC	International Trade Commission
KLSE	Kuala Lumpur Stock Exchange
MASB	Malaysian Accounting Standards Board
MCA	Malaysian Chinese Association
MCCG	Malaysian Code of Corporate Governance
MIA	Malaysian Institute of Accountants
MICG	Malaysian Institute of Corporate Governance

MICPA	Malaysian Institute of Certified Public Accountants
MIM	Malaysian Institute of Management
MYR	Malaysian Ringgit
NACRA	National Annual Corporate Reporting Award
NDP	National Development Policy
NEP	New Economic Policy
NZD	New Zealand Dollar
NZSE	New Zealand Stock Exchange
OECD	Organization of Economic Cooperation and Development
ROB	Registrar of Business
SC	Security Commission
SCA 1993	Security Commission Act 1993
SEC	Security and Exchange Commission
SEDC	State Economic Corporation Development
SEL	Securities and Exchange Law
SFAC	Statement of Financial Reporting Concepts
SICDA	Securities Industry Central Depository Act
SOE	State-owned Enterprises
SOCPA	Saudi Organization of Certified Public Accountants
SPSS	Statistical Package for the Social Sciences

CHAPTER ONE
INTRODUCTION

1.0 INTRODUCTION, MOTIVATION FOR AND SIGNIFICANCE OF THE RESEARCH

The importance of publicly available financial reports has long been recognised, as they enable stakeholders to make more informed economic decisions by utilising information about the financial conditions and performance of an organisation (Watts & Zimmerman, 1986).

Financial reporting has also been viewed as a vital part of the infrastructure involved in gaining access to global capital such as foreign direct investments, especially in emerging market economies[1] (Chowdhury & Mavrotas, 2006). Companies in such economies face greater obstacles obtaining access to global capital and higher quality financial reporting has been claimed to help reduce such barriers (Frost, Gordon, & Pownall, 2008). Therefore, high quality financial reporting is useful not only for stakeholders when making economic decisions but also to developing countries who are attempting to attract global capital inflows.

While the importance of high quality financial reporting has been recognised, it is worrying when recent corporate misdeeds suggest that financial reporting quality needs further scrutiny (Canada, Kuhn, & Sutton, 2008; Penman, 2003). Some studies have connected low-quality financial reporting with the influence of political factors (Bushman, Chen, Engel, & Smith, 2004; Leuz & Oberholzer-Gee, 2006). In addition to political influence, corporate governance has also been known to have an effect on financial reporting quality. Wright (1996) and Han (2005) found that corporate governance mechanisms influence financial reporting quality. Byard, Li and Weintrop (2006) and Claessens and Fan (2002) suggested that low financial

[1] Emerging economies are ''low-income, rapid-growth countries using economic liberalization as their primary engine of growth'' (Hoskisson, Eden, Lau, & Wright, 2000, p. 249). In common usage, the term refers to formerly socialist countries in Central/Eastern Europe and East Asia (most notably China), the newly independent states of the former Soviet Union, as well as the more advanced developing countries in South Asia (most notably India), Southeast Asia, Middle East, Latin America (most notably Brazil), and Africa (Peng, 2003; World Bank, 2002).

reporting quality is associated with weak corporate governance and this in turn has been associated with political influence (ADB, 1998; Aggarwal, 1999; Fan, Wong, & Zhang, 2007). While prior studies recognised political influence and corporate governance as contributing factors to low financial reporting quality, to date there has been no research that examines the three variables – political influence, corporate governance and financial reporting quality – in a single study. Therefore, a study that examines financial reporting quality and the factors that may influence the quality, such as political influence and corporate governance, is necessary and important, especially in emerging economies like that of Malaysia.

Currently, although non-western companies in emerging and developing economies are becoming increasingly important in the world market, little is known about their financial reporting quality. These economies are typified by very different cultures and regulations compared to western institutions. Market activities in these countries are often relationship-based[2] as opposed to rule-governed as in developed economies (Peng, 2003). Emerging economies rely less on formal rules and more on informal constraints (North, 1990). Businesses work to build informal networks or relationships with stake-holders (for example the government and politicians) that help secure trust, commitment and loyalty in the absence of an effective regulatory framework (Foo, 2007), and thus protect the interests of the business.

In addition, there is often concentrated ownership in firms in such economies, particularly manifesting itself via government-ownership, but also seen in other forms. This unique feature may have resulted in corporate success in the past (for example, in East Asian economies), but effective corporate governance mechanisms still need to be implemented to ensure the protection of interests of both majority and minority shareholders (Rachagan, 2007; Reed, 2002). A recent McKinsey & Company study (2002) advocated more transparency when it came to portraying the distinct and complex ownership structures that exist in emerging markets, such as those of government-owned businesses. Without such transparency, these unique structures could continue to act as a barrier to corporate governance reform.

---

2 Alavi (1996) justifies the close relation between politics and firms on policy grounds while Rajan and Zingales (2003) argue that relationship-based business is a result of a relative financial under-development rather than some cultural propensity for corruption.

Claessens, Djankov and Lang (2000) and La Porta and Lopez-de-Salanes (1999) reported that Malaysian companies are highly concentrated and government participation in equity ownership is significant as government policy attempts to rationalise the distribution of economic resources among different races (Menon, 2009). In fact, some Malaysian companies were initially set up to achieve social rather than purely economic objectives, and as a result such companies may be regarded as more politically sensitive (Mohd Ghazali, 2007). Malaysian firms tend to be smaller and younger than those in the west, while also being strongly influenced by government incentives, support and subsidies (Jusoh, 2008). For these reasons, the Malaysian market requires specialised corporate governance schemes and offers the chance for unique research.

Apart from the above, Malaysia has also been through significant financial sector and corporate governance reform. Since the 1970s, there has been the launch of various financial restructuring programs that aim to achieve a better financial and corporate governance system (Ang & McKibbin, 2007). Unfortunately, there is little empirical evidence providing policy makers with the necessary information as to whether these reforms have had a positive or negative impact on financial systems, or on economic growth.

This study provides insights and additional guidance for regulators and policy makers of Malaysia in particular and of other developing countries or emerging capital markets in general, in order to improve the design of corporate governance features and financial reporting frameworks.

Another reason why Malaysia has been chosen is because it is one of the emerging capital markets in Asia that complies with the IFRS (International Financial Reporting Standards, which are claimed to be of high quality) but which has been reported to exhibit low financial reporting quality (Ball, Robin, & Wu, 2003).[3] The researchers claim accounting standards are not the sole contributing factor but suggest that political determinants may be among the contributing factors to this low

[3] Ball's et al. (2003) study involved four Asian Countries – Malaysia, Singapore, Hong Kong and Thailand. At the time of Ball et al.'s (2003) study, the IFRS was known as the International Accounting Standards (IAS).

quality. Among companies, government-owned companies have been claimed to be highly exposed to political influence (Boardman & Vining, 1989; Megginson, Nash, & Randenborgh, 1994; Shleifer & Vishny, 1998) and have weak corporate governance (ADB, 1998). Moreover, Malaysia has a relatively good database of historical economic information by the standards of developing countries, and the availability of a set of sufficiently long time series data allows for a meaningful time series investigation. This provides an added incentive for the research.

Generally, Malaysia offers an interesting and important case study of relationship-based capitalism that is being forced to evolve as Malaysia attempts to liberalise its capital market for further economic development and growth. Given this special environment, Malaysia provides a setting in which the study can robustly examine the relationship between political influence, corporate governance and financial reporting quality.

Overall, this study expands on the existing body of knowledge on financial reporting quality in two ways. First, it examines political influence and financial reporting quality from two perspectives: earnings quality and disclosure quality. Therefore, it follows the recommendation of Ball et al. (2003) to take into account political factors as a determinant of financial reporting quality. At the same time, the study extends upon Ball et al.'s (2003) study by examining financial reporting quality in terms of disclosure quality as well as earnings quality. In addition, the study examines political influence from three perspectives – government ownership, a special share (a golden share) held by government and politician/s on board of directors. This is an extension of prior studies on political influence (Belkaoui, 2004; Faccio, 2006; Faccio, Masulis, & McConnell, 2006), which defined political connectedness as existing if there is one or more politicians on a company's board of directors. Second, to further understand the contributing factors of financial reporting quality, the study examines the mediating effect of corporate governance on the political influence – financial reporting quality relationship and employs a qualitative approach, via interviews, to support and supplement the findings of the quantitative data analysis. No research (to date) has examined corporate governance as a mediating variable nor employed a qualitative approach to confirm and explain findings from a quantitative analysis in this way.

1.1 RESEARCH PURPOSE, OBJECTIVES AND QUESTIONS

The study uses listed and non-listed companies in Malaysia in order to get a clear picture of financial reporting quality and corporate governance strength in each of the firms, and to quantitatively and qualitatively investigate the effects of political influence on corporate governance and financial reporting quality. To achieve this, the study has the following specific objectives:

1. To analyse Malaysian companies in terms of their disclosure and earnings quality and corporate governance strength.
2. To examine the direct effect of political influence on financial reporting quality.
3. To examine the direct effect of political influence on corporate governance strength.
4. To examine the effect of corporate governance strength on financial reporting quality, after controlling for political influence.
5. To examine the mediating effect of corporate governance on the relationship between political influence and financial reporting quality.
6. To discover the perceptions of top management personnel regarding political influence in Malaysian companies.

Having outlined the objectives, the research questions addressed in this study include:

1. What is the extent of financial reporting quality (in terms of disclosure and earnings quality), and corporate governance strength of Malaysian companies?
2. What is the relationship between political influence and financial reporting quality?
3. What is the relationship between political influence and corporate governance strength?
4. What is the relationship between corporate governance strength and financial reporting quality, after controlling for political influence?

5. Does corporate governance strength mediate the relationship between political influence and financial reporting quality?

Because of the complexity of the relationships, qualitative data was collected to help explain and understand the results of the quantitative analysis answering the above five questions. To achieve this, interviews were conducted to discover the perceptions of top management personnel of political influence in Malaysian companies, especially government-owned companies.

1.2 MAJOR FINDINGS

In general, the results of this study are consistent with the findings of prior studies that recognise political influences (Bushman, Chen et al., 2004; Bushman, Piotroski, & Smith, 2004; Leuz & Oberholzer-Gee, 2006), and corporate governance (Wright, 1996; Han, 2005) as contributing factors to low financial reporting quality. Since there is no standard measure of reporting quality (Daske & Gebhardt, 2006), the conclusion derived from the current study is limited to financial reporting quality as measured by disclosure quality (indicated by extent of disclosure) and earnings quality (measured by accruals quality).

Specifically, the findings of the study reveal that political influence, only in terms of the presence of politician/s on the board, is significantly and negatively associated with both financial reporting quality (disclosure and earnings) and corporate governance strength. Political influence measured by government ownership, on the other hand, has a positive relationship with both financial reporting quality (disclosure and earnings) and corporate governance strength. The latter contradicts the findings of past studies (Aggarwal, 1999; Naser & Nuseibeh, 2003; Zhuang, 1999b) which found that the higher the percentage of government ownership in a company the lower the disclosure quality, in that the protection and support the companies received from government allowed them to get easy access to financial resources, especially from government-owned banks, and thus reduced their need to rely on securities markets which often demand higher transparency of information or higher disclosure quality. The disparity is possibly due to the fact that, in Malaysia, government-controlled companies play a key role in national economic growth[4] and especially in attracting foreign direct investment and thus it is critical for these companies to ensure high quality financial reporting. As a result, government-controlled companies in Malaysia are willing to share the companies' financial information (Chu & Cheah, 2006). These possible causes of a disparity in the results can also be applied to the positive effect of government ownership on corporate governance strength, because in attracting global capital Malaysian companies need not only to have higher financial reporting quality, but also to have quality corporate governance.

This study also provides evidence that after controlling for political influence; corporate governance strength is an important predictor of financial reporting quality, especially in terms of disclosure quality. In addition, the findings suggest that corporate governance strength mediates the relationship between political influence and financial reporting quality, in that political influence will affect corporate governance strength and together affect financial reporting quality. This implies that more attention needs to be given to efforts to strengthen the corporate governance structure of companies, especially in relation to political influence in companies, at least in Malaysia. Although initiatives by the Malaysian government, such as the introduction of the Malaysian Corporate Governance Code in 2000[5] and the full implementation of the disclosure-based regime in 2001, have apparently helped improve the corporate governance strength and disclosure quality of Malaysian firms, more such measures are needed. Furthermore, the findings obtained from the qualitative investigation into the perceptions of top management and ex-top management of the sample companies on political influence and the effect of political influence on managerial decisions such as decisions on corporate governance structure, accounting and reporting, indicate that political influence does occur in Malaysian companies and it affects managerial decisions. The findings also provide some explanation of the relationship between political influence, corporate

4 Mohd Ghazali (2007) mentioned that, government companies controlled more than 30 percent in terms of market capitalisation in Malaysia as at December 2000.

5 The Malaysian Code on Corporate Governance was revised in 2007.

governance strength and financial reporting quality. Overall, the findings obtained from the qualitative investigation support and supplement the quantitative findings.

1.3 THESIS ORGANISATION

The remainder of the thesis is organised as follows. The following chapter (Chapter Two) describes the institutional settings and since Malaysia is used as a case study here, the chapter begins by explaining the Malaysian business environment. Specifically, this chapter talks about the history of the Malaysian political economy after Malaysia achieved its independence in 1957, its introduction of a public policy dimension to address the socio-economic imbalance between ethnic groups in the country and the subsequent effects of this on the business environment. This chapter also discusses the nature of companies in Malaysia where the government and certain families are the biggest shareholders and play an active role in management. Initiatives undertaken to improve corporate governance, especially after the economic crises in 1997 are reviewed and the Malaysian reporting environment is also discussed.

Chapter Three provides a review of prior studies on agency theory, which forms the theoretical framework of the study. This chapter also discusses why government, particularly the Malaysian government, wants control over companies. The concept of political influence defined in prior studies is also clarified in this chapter and the concept of financial reporting quality is also presented. Studies of financial reporting quality from 1968 to 2008 are grouped into two main categories: those that use disclosure quality and those that use earnings quality as a proxy of financial reporting quality. This chapter also discusses the concepts of corporate governance and what makes strong and weak governance. Finally, this chapter presents a review of prior studies on the association of political influence with financial reporting quality and with corporate governance strength, and the relationship between corporate governance strength and financial reporting quality.

Chapter Four develops the research hypotheses. For this purpose, agency theory and evidence from prior studies provide a basis on which to examine the relationship between financial reporting, corporate governance and financial reporting quality. Four hypotheses are developed, predicting the relationships between political influence, corporate governance and financial reporting quality.

Chapter Five describes the research methods employed in the study. The chapter includes a discussion on the structure of the inquiry process including the way the samples are selected, and how data is collected and analysed.

Chapters Six and Seven report and discuss findings for the study. Quantitative findings and discussion are reported in Chapter Six and qualitative findings and discussion in Chapter Seven. Generally, the findings show that politics do influence corporate governance strength and financial reporting quality. However the findings suggest that the nature of the relationship between political influence and corporate governance strength and financial reporting quality is dependant on how political influence is defined.

Chapter Eight concludes the study by summarising the findings and discussing the contributions of the study to the literature, the limitations of the study and suggestions for future research.

CHAPTER TWO
INSTITUTIONAL BACKGROUND

2.0 INTRODUCTION

This chapter discusses the institutional background surrounding business in Malaysia, the involvement of politics in business, and the corporate governance and reporting environments.

Section 2.1 outlines political and business environments in Malaysia, focusing on the influence of politics on business. Section 2.2 provides a discussion of the corporate governance structure of Malaysian firms as well as the initiatives undertaken to improve corporate governance and Section 2.3 describes the Malaysian reporting environment, focusing on statutory requirements and other measures undertaken to ensure high quality reporting and the problems associated with them. Finally, Section 2.4 provides a summary of the chapter.

2.1 POLITICS AND BUSINESS IN MALAYSIA

When analysing the business situation in Malaysia, it is logical to begin by considering Malaysia's post-1957 social, economic and political history that led to the development of the intimate relationships between government and business seen today. In 1957, when Malaya, later to become Malaysia, achieved independence from Britain, it inherited a form of government based on the Westminster model which, with some local adaptation, remains very much in place today (Goh, 2008). Equally significant is the inheritance of an economy based on the traditional British colonial mercantile interest centred on rubber and tin exports. At that time, the nation boasted the most efficient plantation economy in the world; so efficient, in fact, that Malayan foreign exchange earnings helped Britain enormously to repay much of its war debt to the United States. Economic prosperity, by Asian standards, was not new to Malaysia (Aziz, 1999).

The Industrialisation Strategy, as Malaysia's government policy was known, has since focused on the diversification and industrialisation of the country's economy (Alavi, 1996; Siddiquee, 2006). This strategy was implemented via Import Substitution Industrialisation (ISI) in the 1960s and 1970s but Export Oriented Industrialisation (EOI) became the dominant method in the 1980s and 1990s. Both forms of industrialisation continue to be pronounced in Malaysian government policy. This is evidenced by the fact that companies found to be compatible with the government industrialisation policy are more likely to be chosen to receive ISI/EOI motivated patronage from the government (Fraser, Zhang, & Derashid, 2006).

Social considerations have also played an important role in government policy. Following the riots of 1969, the Malaysian government set out to address the socio-economic imbalance between the two dominant ethnic groups in the country – the Malays and Chinese (Butcher, 2001; Jomo & Hui, 2003). The riots proved to be damaging for nation-building (Chakravarty & Roslan, 2005), and economic factors were blamed. The government was widely criticised for its inept handling of the growth and division of economic gains that had widened the economic gap between ethnic groups. The uneven distribution of wealth in Malaysia was mostly a legacy of British colonial policy (Ritchie, 2005; Crouch, 2001). According to Haque (2003), ethnic groups had been divided into specific employment areas to facilitate their administration. Malays were encouraged and moulded to fit the "padi" field; Indians, the rubber estates; and Chinese, the business arena.

> Because Malay society was feudal, with all the inequities that such a system brings, the British believed the Malay were particularly ill suited for modern economic activity. Traditional agriculture, where the majority of Malay peasants worked, was considered irrelevant to the promotion of colonial rule and left largely unaffected. The British chose to foster a modern urban economy consisting of trade and commerce and considered the immigrant population[6] to be better suited to those activities (Williams, 2007, p.252).

[6] British colonial intervention in the Malay states in the 1860s expanded the number of Chinese and Indian immigrants for economic purposes (Stockwell, 1982).

To restructure the socio-economic imbalance, the policy instruments used by the Malaysian government were the New Economic Policy (NEP) from 1970 to 1990 and the National Development Policy (NDP) from 1991 to 2000. While there were differences in priorities and a strategy between the two, the NDP was still what Torii (1997, p.210) called "ethnicity-oriented policy". As a result of this policy, government involvement in the corporate sector increased, effectively intertwining business and politics in Malaysia (Tam & Tan, 2007). The policy to support companies with certain group ownership resulted in another group of companies being "picked" by the government to receive NEP/NDP motivated patronage.

Moreover, the introduction of the NEP/NDP resulted in the politicisation of civil service management and functions. The elite Bumiputera[7] of the bureaucracy increasingly took on senior business management roles and functions in state owned enterprises (SOEs) (Chatterjee & Nankervis, 2007). As a result, "both Chinese and foreign companies began to actively solicit business ties with the politically influential, but co-operative Malays" (Bowie, 1991, cited in Jomo & Gomez, 2000, p.290).

However, while the government used the large numbers of SOEs as proof of increased diversification and growth, the poor coordination and accountability of the sector started to become apparent. This has been evidenced by regular cases of "rent seeking" (Jomo & Gomez, 2000, p.75) and improper governance, consequently leading to a call for reform implementation (Aziz, 1999). As Aziz (1999, p.19) stated,

> To make matters worse, each of the state governments competed to set up its own state economic development corporation with literally hundreds of subsidiaries that were accountable to no one but themselves. Although some attempts were made to monitor and coordinate their activities, they were feeble at best, and unethical business practices continued unhindered.

[7] Bumiputera means in Malay "sons of soil". The Malays are the main Bumiputera in Peninsular Malaysia. In Sabah, the main Bumiputera are Kadazan, Bajau and Murut, while in Sarawak, they are Iban, Malay, Bidayuh and Melanau. Both Sabah and Sarawak are part of Malaysia.

When the fourth Malaysian prime minister, Tun Dr Mahathir Mohamed came to power in 1981, the government interventionist policies focused more on increased industrialisation and advancement of the manufacturing sector. The prime minister believed that the development and modernisation of Malaysia was closely associated with the development and modernisation of the civil service. The slogan "leadership by example" underpinned the administrative approach of his vision (Ahmad, 2004, p.68). This period saw the strengthening of a tripartite relationship between the civil service, the political sphere and business, and proved the theory that administrative reform and political leadership priorities can be said to be "inter-supportive and complementary" (Ahmad, 2004, p.68).

As a result of the affirmative policy, the Malaysian public sector grew from only ten SOEs in 1957 to over 1100 by 1990 (Salazar, 2004). Increasing regional competition and the need to improve local productivity resulted in a steady privatisation of the SOEs and development of a privatised and market-based business culture. However, the early privatisation process received some criticism for concentrating wealth in the hands of a small group and exacerbating many of the inefficiencies that the policy aimed to resolve (Salazar, 2004). This was due to excessive government involvement such as in ensuring corporate and social responsibility. With the government involved in business, political considerations often won out over commercial ones. To worsen the situation, politicians often seemed to end up in jobs as advisers or board members while the companies to which they were attached were poorly managed (Daily Times, 2005).

The close link between business and politics in Malaysia is well documented (see for example, Faccio, Lang, & Young, 2001; Fraser et al., 2006; Gomez, 2002). In Malaysia, politically connected companies are not necessarily owned by the state but are identified as "favoured" companies by the ruling government (Gul, 2006, p.937), and the Malaysian government plays the role of political patron. It exerts a significant influence over the corporate sector through listing restrictions, direct equity ownership of listed companies, control of the banking sector, and through government-sponsored "institutional investors"[8] (Gomez & Jomo, 2000, p.36). In

[8] All "institutional investors" in Malaysia are supported by various levels of government. In particular, the two largest institutional investors, Amanah Saham National and Amanah Saham

addition, Malaysia's resource wealth generated has been captured by the business cronies of those in power, who in turn have contributed to growth by re-investing in the protected domestic economy, mainly in import-substitute industries, commerce, services, property, privatised utilities and infrastructure (Jomo, Felker, & Rasiah, 1999). As for privatised state-run enterprises, the government has awarded privatisation contracts under concessionary terms and offered special privileges such as soft credit, state-backed guarantees for loans, and in some cases secure monopoly status. This has led to the establishment of conglomerates that include totally unrelated businesses (Salazar, 2004). Bowie (1991) reports that in many cases, despite giving up ownership stakes of 50 percent or more, the state has continued to have control over privatised companies, often by the sale of equity to quasi-state entities such as Petronas or the Central Bank. In other instances, the government maintained control through the relatively widespread use of special rights or golden shares (Adams & William, 1992).

The formation of government corporations has also created a competitive threat to some Malaysian Chinese business groups. The threats have led to a complete overhaul of their operations, an increased involvement of the dominant Chinese political party (the Malaysian Chinese Association or MCA) and an establishment of the Multi Purpose Holding Berhad, the MCA-owned business entity, with the express purpose of getting involved in various sectors (Bhaskaran & Sukumaran, 2007).

Besides the direct involvement of government and politicians in business, informal ties between companies and politicians may represent another type of political patronage in a "relationship-based" capitalist system such as that of Malaysia (Fraser et al., 2006, p.1293). It could logically be suggested that the informal ties may result in political connections that include personal dimensions, along with economic and social dimensions, and that the three overlapping components reinforce one another.

In summary, the evolution and development of "close" relationships between government and business have become the hallmark of the Malaysian economy. It is

---

Bumiputera, are under the control of the Department of Finance in Malaysia (Gomez & Jomo, 2000, p.36).

widely acknowledged that the government has played a significant role in the Malaysian economy (Amsden, 1989; Deyo, 1987; Ragayah, 2008; White, 1988; White, 2004). The government created a holding company whose main purpose is to identify, invest in and manage projects in heavy industries such as basic metals, automobiles, petrochemicals, machinery and equipment (Jomo & Wah, 1999). Investment incentives were also introduced in an attempt to increase foreign direct investment and to stimulate private enterprise. Moreover, in Malaysia, as in many East Asian countries, the government sometimes plays a quasi-directive role to encourage firms to pursue a strategy that is seen to be of national interest (Mamman, 2004).

From the outset, it is important to recognise that the Malaysian political economy is distinguishable by a number of ethnic, political and economic relationships that make it very different from the general Anglo-American experience. As in the rest of East Asia, economic policy-making in Malaysia has had a critically important and overtly political dimension (Norhashim & Aziz, 2005). Malaysia's politics are also based on patron-client relations between the government and business. Although their strong solidarity contributes to economic development, it may result in a negative aspect of capitalism emerging, the so-called "crony capitalism" (Lee, 2004, p.23).

The review and analysis of the socio-economic and political environment in Malaysia suggest that colonial heritage, the economic policies of the British colonial government, and the economic position of different ethnic groups before and after independence and the national policies in the post independence era, have all influenced the growth and development of political and business relationships in Malaysia. The next section discusses the corporate governance position of Malaysian companies.

2.2 CORPORATE GOVERNANCE IN MALAYSIA

According to Gourevitch and Shinn (2005), the story of corporate governance in Malaysia began almost one hundred years ago, when a company called Kuala Kangsar Plantations became the first publicly listed company in Malaysia. In the early days, most publicly listed companies tended to be trading, plantation or tin companies which had their origin in the United Kingdom, or were subsidiaries of United Kingdom companies. After Malaysia got its independence in 1957, the number of listed companies in Malaysia also blossomed, and many ventured into different sectors, for example construction, property, infrastructure, technology, trading and services, consumer products, industrial products and plantations. By the end of 1997, the number of listed companies in Malaysia was 708 (Rahman, 1998), 795 in 2000 (Rahman, 2002), and 874 by the end of 2003 (KLSE, 2003).

When reviewing these important years, 1998 cannot be ignored. It was the time when relatively small companies were permitted to be listed for the first time, enabling them to raise capital from the public.[9] Very quickly, an owner-entrepreneur who had been the ego-led manager of his own private firm now found himself the director of a publicly listed company that needed to follow a huge range of regulatory requirements, the significance of which he neither understood nor appreciated (Gourevitch & Shinn, 2005). Many of these companies had been established using the financial and human capital of one particular family (McConaughy, 2000). As a result, even after these companies had been publicly listed, shareholders maintained intimate relationships with their businesses.[10] Redding (1996) shown that the entrepreneurs' wealth and esteem were often linked with the companies' performance. With their large initial contribution, the entrepreneurs found it important to concentrate shareholding in order to maintain a dominant voice in the companies' policy and decision-making. In addition, these entrepreneurs wished to maintain control of their firms so that they could pass the business down to future offspring (Anderson & Reeb, 2003; Schulze, Lubatkin, Dino, & Buchholtz, 2001).

9 KLSE rules: (1) the company is incorporated in Malaysia, (2) the paid-up ordinary share capital is not less than MYR 40 million (NZD19 million), (3) at least 25 percent, but not more than 50 percent, of the paid-up capital is in the hands of a minimum of 500 public shareholders holding not less than 1000 shares each, (4) the company has five consecutive years of after-tax profit of at least MYR 1million (NZD 0.5 million) and an aggregate after-tax profit of not less than MYR 12 million (NZD 6million) over the same five years, and (5) the company complies with the corporate disclosure requirements and other rules and by-laws of the KLSE.

10 The majority of businesses in Malaysia are owned and operated by Chinese. Chinese business generally have some common characteristics including centralised decision-making with heavy reliance on one dominant chief executive, family ownership and control, and most, if not all, top management positions being filled by family members (Horii, 1991).

The rapid growth of Malaysia's economy has not diluted the concentrated structure in Malaysian companies (Tam & Tan, 2007). Lim (1981) found the ownership of shareholding and wealth among the hundred largest companies in the 1960s to be highly condensed. An update by Zhuang, Edwards and Capulong (2001), showed that the largest shareholder still possessed an average 30.3 percent of outstanding shares among all listed companies in Malaysia in 1998, with the top five shareholders owning 58.8 percent. About 40.4 percent of the 238 sample companies in Malaysia are closely held by a single large shareholder (Claessens et al., 2000). The nominee company is the largest shareholder group among the top five shareholders in Malaysia. Capulong, Edwards, Webb and Zhuang (2000) postulated that the majority of shareholdings by the nominees were owned by families. In 2002, the nominee firms held 46.5 percent of the total shares of an average non-financial public limited company while the rest were shared by non-financial firms (22.5 percent), the government (20.5 percent), finance companies (5.9 percent), individuals (3.4 percent), and foreign investors (1.2 percent) (Bank Negara Malaysia, 2003).

Concentrated ownership in most industrialised nations often sees the general separation of management and control, but this is not the case in Malaysia, where most companies are dominated by large shareholders who exercise control rights, resulting in significant risk to minority shareholders (Claessens et al., 2000). There is also scepticism about the ability of boards, especially the non-executive directors, to monitor management, as they are often perceived as a "rubber stamp" only and are selected for reasons other than monitoring (Haniffa & Cooke, 2002). Moreover, governmental activism in the corporate sector may diminish incentives for institutional investors to actively monitor returns on their investments, leading to greater information asymmetry and free rider problems (Suto, 2003). Foreign companies are unlikely to be active in this area because their ability to compete is limited due to the nature of highly personal and close-knit business networking and information sharing in Malaysia, as in many Asian countries (Redding, 1996; Wong, 1996). These characteristics of weak corporate governance could be among factors that lead to economic downturn, for example the economic downturn that happened in Southeast Asian countries, including Malaysia, in 1997.

There has been much debate since the onset of that crisis about the factors and the structural weaknesses in the afflicted economies that helped to trigger the downturn (see for example, Joh, 2003; Mitton, 2002; Ow-Yong & Guan, 2000; Rahman, 1998; Rajan & Zingales, 2003). Although it may not have been the prime factor, there is some truth to the claim that poor governance was partly to blame (Harvey & Roper, 1999; Johnson, Brone, Breach & Friedman, 2000; Lemmon & Lins, 2003; Kim, 1998; Salim, 2007). Malaysia is no exception: unlike the crisis of the 1980s where inadequate public sector governance could be held accountable, the primary contributing factor to 1997's economic problems in Malaysia was poor corporate governance in the private sector (Piei & Tan, 1999). Political influence was found to be an additional contributing factor to the financial crisis. As Johnson and Mitton (2003) point out, political interference by the government, such as through crony alliances, a relatively easy access to credit or other facilities enjoyed by the particular companies resulted in unproductive and unviable investment and ventures.

In the wake of the financial crisis, the Malaysian government began a renewed program to enhance minority shareholder protection, promoted as 'top-down reforms'. The top-down reform project began with the establishment of the High Level Finance Committee on corporate governance by the Ministry of Finance in March 1998, which unleashed a series of regulatory changes through the Securities Commission (SC), the Kuala Lumpur Stock Exchange (KLSE), and the Registrar of Companies. These changes led to the creation of a Malaysian Code on Corporate Governance, the Malaysian Institute of Corporate Governance, and the Minority Shareholder Watchdog Committee – each of which attracted strong participation by the representatives of the Employees Provident Fund. The motives for these changes were to reassure investors, both domestic and international, so as to hold and attract capital. Domestic groups had the usual response: block holders did not like being challenged, yet domestic investors wanted protections enforced (Gourevitch & Shinn, 2005). Table 2.1 below shows the corporate governance initiatives and reforms made by Malaysian authorities since 1965 and after the 1997 financial crisis.

Table 2.1 Corporate Governance Initiatives and Reforms

Year	Initiatives and Reforms
1965	The true and fair certification by directors of financial statements was introduced.
1993	The audit committee requirement was introduced.
1997	An independent accounting standard setting board was introduced.
1998	The formation of the High Level Finance Committee to conduct a detailed study on corporate governance and to make recommendations for improvements.
1998	Amendments were made to the Security Industry Central depository Act (SICDA) with a view to enhancing transparency in share ownership amidst other improvements.
1998	The Malaysian Institute of Corporate Governance was established.
1998	The regulations for directors and CEOs to disclose interest in the publicly listed companies (PLC) were introduced.
1999	Quarterly reporting was introduced.
1999	A revamp of takeovers and mergers code was done.
2000	The Malaysian Code on Corporate Governance was introduced.
2000	Amendments were made to the Securities Commission Act 1993 by making the Securities Commission the sole regulator for fund raising activities and the corporate bond market.
2001	The Audit Committee must have a member who is financially trained.
2001	The Malaysian Capital Market master plan was launched to further streamline and regulate the capital market and to chart the course for the capital market for the next ten years.
2001	The Financial Sector master plan was launched to chart the future direction of the financial system over the next ten years. It outlined the strategies to achieve a diversified, effective, efficient and resilient financial system.
2001	The mandatory disclosure of corporate governance code compliance was introduced.
2001	The establishment of a minority shareholders watchdog group.
2001	The mandatory accreditation programme for directors was introduced.
2002	The internal audit guidelines for PLCs were introduced.
2003	Guidance notes on share splits, guidance for companies to meet compliance and internal control requirements were introduced.
2004	Amendments to the security laws and takeover codes for better investors' protection were made.
2005	A review in respect of accounting for minority interests in companies' financial statements and guidelines on compliance functions for fund managers to further strengthen investors' protection were introduced.
2006	Revised guidelines on securities borrowing and lending were made and the enhanced guidelines for placement of securities for greater shareholders' and investors' protection were issued. A set of guidelines to strengthen corporate bond market was also introduced.
2007	A Public Companies Accounting Oversight Board (PCAOB) was formed. Amendments to audit committee guidelines were made. The Malaysian Code on Corporate Governance was revised. Amendments in relation to corporate governance to Companies Act 1965 were made.

Source: Mahmood, (2003); Securities Commission of Malaysia (www.sc.com.my/index.asp; accessed on 02.01.09); Malaysian Institute of Corporate Governance (www.micg.net/home.htm; accessed on 02.01.09)

Among the initiatives taken after the economic downturn, the introduction of the Malaysian Code on Corporate Governance in 2000 is seen as the most important. It was largely derived from the recommendations of the Cadbury Report (1992) and the Hampel Report (1998) in the United Kingdom (FCCG, 2000). The revised listing requirements (LRs) of Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange – KLSE) in 2001 provide a greater obligation for publicly listed companies to enhance Malaysia's corporate governance regime. Specifically, these amended LRs outline the requirements for financial reporting disclosure on corporate governance matters and continuing listing obligations.

The Malaysian Code on Corporate Governance also recommends that the board of directors appoints remuneration and nomination committees other than the audit committee, which has been mandatory since 1993. The establishment of other committees such as a risk management committee and corporate governance committees are also recommended but are less frequently set up by listed companies.

The code strongly recommends the separation of responsibilities between the board chair and the chief executive officer even though the LRs of Bursa Malaysia (2001) do not require the segregation of these positions. The code also states that the board of directors should maintain a sound system of internal control. This led to the issue of a Guide on Statement of Internal Control in May 2000. This guide explained the key areas that directors must pay attention to before they present a Statement of Internal Control in their company's annual reports. A listed company is required to address in their annual reports the principle and best practices of the Malaysian Code on Corporate Governance relating to internal controls such as identifying principal risks and ensuring implementation of appropriate systems to manage risks.

In addition, directors appointed to the board of directors of a publicly listed company are required under the LRs to attend a directors' training program known as the mandatory accreditation programme. The programme covers topics such as the Companies Act 1965, the LRs, risk management and internal control and relevant securities laws. As for the composition of boards of directors, recent studies suggest that 90 percent of listed companies have at least two non-executive directors, and the Malaysian Code on Corporate Governance has set a minimum of 30 percent independent non-executive directors on boards (PricewaterhouseCoopers, 2002). The obligations of directors have begun to be monitored by the Government Minority Shareholders Watchdog Committee, created on the recommendation of the High Level Finance Committee on Corporate Governance.

Self-regulatory initiatives also continue to be developed by various industry and professional bodies aiming at promoting knowledge and awareness of corporate governance best practice in Malaysia (Yatim, Kent, & Clarkson, 2006). Moreover, Malaysia generally accepted these accounting principles, with a few minor deviations, that were adapted to match the International Financial Reporting Standards (IFRS). With the influence of the strong professional traditions of the Commonwealth, the accounting profession was well-organised through the Malaysian Institute of Accountants and the Malaysian Association of Certified Public Accountants. The Malaysian Accounting Standards Board also became relatively independent of the Ministry of Finance, with greater freedom in setting standards. In terms of auditing, the Company Act 1967 allowed third party auditing, a requirement backed-up by new rules issued by the KLSE.

Malaysia's legal system also plays an important role in corporate governance. The system imposes strong standards of fiduciary duty to minority shareholders, and the court has begun to entertain derivative suits for breaches of this duty, although class-action suits are not possible. The Watchdog Committee, the SC, and the KLSE have enforced a one share, one vote rule and have ensured that minority shareholders have at least a nominal voice in key corporate decisions. Malaysia's Codes of Takeovers and Mergers were revised in 1999 to resemble the City Code in most respects. With regards to providing protection to minority shareholders, Malaysian information institutions are said to have become more robust (Gourevitch & Shinn, 2005). Efforts to protect investors and shareholders were continued in 2004 where amendments were made to the securities laws and takeover code. The accounting for minority interests in companies' financial statements was then reviewed in 2005. The efforts to ensure higher shareholders' and investors' protection were then continued in 2006.

To date, the obvious effort to strengthen and enhance the corporate governance framework can be seen with a revision of the Malaysian Code on Corporate

Governance and amendments to Companies Act 1965 in 2007. The Malaysian Code on Corporate Governance was revised to represent the continued collaborative efforts between government and the industry (the Malaysian Code on Corporate Governance, revised 2007). This code was specifically revised to strengthen boards of directors and audit committees and accordingly to ensure both effectively perform their roles and responsibilities. In this revision, the eligibility criteria for appointment of directors, the role of nominating committees, the eligibility criteria for appointment as an audit committee member, the committee composition, the frequency of meetings and the need for continuous training were spelt out. While the Malaysian Code on Corporate Governance has been revised to strengthen corporate governance in Malaysian companies, various statutory requirements have been issued and various efforts have been implemented by statutory bodies to ensure higher reporting quality within the Malaysian reporting environment. These are discussed in the following section.

2.3 MALAYSIAN REPORTING ENVIRONMENT

All listed companies in Malaysia are obligated to publish annual reports in accordance with the Ninth Schedule of the Companies Act 1965 and must follow the accounting standards of the Malaysian Accounting Standard Board (MASB). The MASB is authorised by the Financial Reporting Act 1997 (FRA) to set reporting and accounting standards. The FRA's purpose was to streamline financial reporting of Malaysian companies in accordance with International Financial Reporting Standards (IFRS) and to allow for effective enforcement of financial reporting. The Supreme Court and the Companies Commission of Malaysia (formerly known as the Registrar of Companies) monitor such enforcement in order to promote financial reporting quality. Further, to ensure high quality financial reporting, Bursa Malaysia has set LRs which require the preparation of complete accounting records and financial statements that follow accounting standards.

Professional accounting bodies are also concerned with maintaining high standards in financial reporting. Three such bodies include the Malaysian Institute of Accountants (MIA), the Malaysian Institute of Public Accountants (MICPA) and the

Malaysian Institute of Management (MIM). In 1990, these three bodies, along with Bursa Malaysia, introduced the National Annual Corporate Reporting Award (NACRA) which gives esteem and recognition to organisations deemed to have achieved excellence in annual corporate reporting. The award was designed to encourage the highest standards in the presentation and reporting of financial and other information needed by shareholders, investors and other interest groups. Nine criteria are used to assess annual reports under certain headings which include timely publication of annual reports, compliance with accounting standards and unqualified reports from auditors. Annual reports are classified as having a good quality of reporting when they meet these NACRA criteria.

Following the move from the merit-based regime, the disclosure-based regime (DBR) was introduced to further ensure high quality financial reporting. It was introduced by the Securities Commission in 1996 and fully implemented in 2001. Table 2.2 shows the three-phased shift to DBR over that time.

Table 2.2: Three-Phased Shift to DBR

Phase	Time Frame	Focus
I	1996–1999	Flexible/hybrid merit-based regime which emphasises disclosure, due diligence and corporate governance.
II	Jan 2000	Partial DBR which further emphasises disclosure, due diligence and corporate governance, and the promotion of accountability and self-regulation.
III	2001 onwards	Full DBR which emphasizes high standards of disclosure, due diligence and corporate governance as well as the promotion of self-regulation and responsible conduct.

Source: Capital Market Master Plan (KLSE, 2001).

As seen in the table, the DBR has three founding principles: disclosure, due diligence, and corporate governance. Disclosure means divulgence of all material information in order to aid investors' investment decision-making. With regards to due diligence, it is important for companies to undertake a due diligence process in disclosing information, to make sure that all information is fully and accurately disclosed in a timely manner. Finally, corporate governance is used to direct and manage a company's business and affairs in order to promote business prosperity and corporate accountability (PricewaterhouseCoopers, 2002).

In terms of Malaysian listed companies, disclosure can be divided into two areas: primary market disclosure and continuous disclosure. Primary market disclosure is related to the initial public offering (IPO). The ultimate aim of primary market disclosure is to provide potential investors with tools that enable the self-evaluation of the risks of investing in the IPO, based on the risk profile of any offering company. The Malaysian Companies Act 1965 and the SC Act 1993 outline these disclosure obligations in full.

Continuous disclosure and reporting obligations, on the other hand, are dictated by the Bursa Malaysia's LRs. In accordance with the DBR, Malaysian publicly listed companies are required (1) to publish financial statements on a quarterly basis within two months of each financial quarter (these include an income statement, a balance sheet, a cash flow statement and explanatory notes); (2) to furnish annual audited accounts, auditors' and directors' reports within four months from the end of the financial year; (3) to state the extent to which they have complied with the Malaysian Code on Corporate Governance and; (4) to make immediate public disclosure of all material information (of a financial and non-financial nature) concerning its affairs (Nathan, Lin, & Fong, 2000). Parts two and ten of the Bursa Malaysia's LRs set out the obligation to immediately reveal any information which is necessary to avoid a false market. Such disclosures include changes in dividend policy, substantial shareholders, directors, company secretary or auditors; acquisition of shares beyond a certain threshold; valuation of assets and any proposed issue of new securities.

In spite of all the improvements in financial reporting, disclosure still remains a problem in Malaysia (Nathan et al., 2000). Rahman (1998) argues that these initiatives to increase quality reporting have not achieved their objectives because of the lack of appropriate enforcement efforts. Asian Development Bank (ADB, 1998), mentioned that in most of the countries affected by the financial crisis of 1997, including Malaysia, the regulatory framework for transparency appears to have been adequate on paper only. Their SC regulations, listing rules of stock exchanges and company laws have ample provisions requiring disclosure of information to protect investors. The real problem is compliance and enforcement and how to strengthen regulations to facilitate these processes.

On this issue, the Malaysian Finance Committee Report on Corporate Governance states that regulators must be allowed to enforce laws without interference or fear or favour; the enforcement of law must be consistent, to ensure a level playing field for all participants; and the regulator cannot countenance a market that is perceived to be unfair and must be allowed to enforce laws and regulations to protect the integrity of the system (FCCG, 2000). But as the experiences of many countries have shown, regulators cannot exercise their functions independently when the regulated are either owned by the state or the business has close connections with state or political powers.

Ball et al. (2003) described a case study of four East Asian countries, including Malaysia, that have a similarly low endogenous demand for high-quality financial reporting and disclosure, and that have implanted accounting rules developed in overseas common-law economies without making widespread complementary changes in infrastructure. According to the author, this experiment achieved no appreciable effect on the quality of financial reporting in these countries. One conclusion is that mandating the IAS/IFRS, without altering the incentives facing financial statement preparers, is at best a superficial exercise.

In summary, Malaysian authorities have put a lot of effort and energy into improving the reporting environment in the country as mentioned by the chairman of the Malaysian Institute of Corporate Governance (MICG), Megat Najmuddin (in Hardy, 2005, p.16).

> We have one of the highest set of accounting standards in the world, totally transparent, and we have some of the toughest disclosure rules in the world but we have to do more to ensure that companies and directors conform to the values as envisaged by our national program initiated by Pak Lah [Prime Minister, Abdullah Badawi], for corporate responsibility.

2.4 CHAPTER SUMMARY

In this chapter, the institutional setting of this study, that is the relationship between business and politics, corporate governance and the Malaysian reporting environment, has been discussed. The inheritance of the colonial state by nationalist elites in the era of post-war decolonisation raises some important implications for the sociology of postcolonial societies, as shown by the case of Malaysia. It is well documented that one of the British legacies in Malaysia is the distinct ethnic divisions in the country, where ethnic groups had been divided into specific employment areas to facilitate British administration. These divisions have not only affected the formation of the state and its policy agenda but have drawn the state into the role of mediating and managing inter-ethnic tensions arising from competition amongst major ethnic groups for economic resources and political power. What is known as "affirmative action" in other countries (referring to corrective measures taken to reduce discrimination and ensure proportional representation of the underprivileged ethnic groups) has taken the form of "preferential policies" or "special rights" in Malaysia. In implementing the policies (for example the ISI/EOI, NEP, NDP) business and politics have not been separated. As an emerging economy, seeking investments or funds from outside the country is necessary to the Malaysian economy. For this purpose, the western idea of corporate transparency is seen as important for application by Malaysian companies. Further, following the global economic crisis, better corporate governance standards have been emphasised all over the world, including Malaysia. If Malaysia wishes to be part of the global market, it must further enhance corporate governance and bring its standards to the highest level possible. However, the existence of political influence in the Malaysian firms is seen as an issue.

The Malaysian economic environment has been criticised heavily due to its lack of monitoring and control by authorities when implementing policies which are supposed to address the lack of income equality between ethnic groups in Malaysia (Gomez & Jomo, 1999). The problems were exacerbated during the economic recession in 1997, with many researchers documenting the existence of cronyism in many companies. This phenomenon and the lack of strong corporate governance and financial reporting quality in such companies have been given as the cause of the economic downturn. In the wake of 1997, the Malaysian government has taken steps to strengthen corporate governance and reporting quality by implementing and enforcing new rules and regulations. Evidence from previous research suggests that further changes are still needed. Research that addresses the business and political environment of Malaysia and looks deeply into the relationship between political influence, corporate governance strength and financial reporting quality can help clarify areas for such changes.

To this end, the next chapter provides a review of literature that forms a basis and framework to examine the link between political influence, corporate governance strength and financial reporting quality.

CHAPTER THREE
LITERATURE REVIEW

3.0 INTRODUCTION

This review of literature is carried out to provide an understanding of agency theory that forms the framework to relate political influence, corporate governance and financial reporting quality. In addition, the review of literature provides an understanding of the concepts of the three variables. Prior studies on political influence, corporate governance and financial reporting quality are also reviewed and the review is also discussed in this chapter. Following the introductory section, Section 3.1 discusses agency theory. Section 3.2 discusses the merits and demerits of government influence and the importance of government influence in the Malaysian context. The concept of financial reporting quality is introduced in Section 3.3 and it is elaborated on in the four subsections that follow. The concept of corporate governance is discussed in Section 3.4 and followed by a discussion on the review of prior studies on political influence, corporate governance and financial reporting quality in Section 3.5. This chapter concludes with a summary, provided in Section 3.6.

3.1 AGENCY THEORY

This study examines the link between political influence, corporate governance and financial reporting quality. Although there is a literature which relates political costs to earnings quality (for example, Cahan, Chavis & Elmendorf, 1997; Cahan, 1992; 1996; Wong, 1988), there is no specific theory that directly links political influence to corporate governance or financial reporting quality. This study uses agency theory to relate the three variables.

Agency theory explains the origin of conflict and ways to minimise the conflicts that can occur between parties in a contract (Jensen & Meckling, 1976). In a company, the parties involved are owners (the principals) and managers (the agents). As stated by Jensen and Meckling (1976, p.308), a company is a "set of formal and informal contracts under which one or more principals engage another person as their agent to perform some service on their behalf, the performance of which requires the delegation of some decision making authority to the agent." In this regard, agency theory recognises the existence of a contract or relationship between managers and owners. In addition to individual shareholders, the owners may include financial institutions and government shareholders (Hill & Jones, 1992). Based on the theory, conflicts between managers and owners occur when they have dissimilar and contrary interests such that the acts of the managers do not meet the interests of the owners. Jensen and Meckling (1976) point out that agents (managers in a company) are assumed to make decisions that maximise their own interests and that do not satisfy the interests of principals (the owners of the company). This conflict involves cost to the principals and this cost is known as agency or conflict cost (Watts & Zimmerman, 1990).

For companies where the government holds an ownership (government-owned companies), more severe agency problems may occur (Shleifer & Vishny, 1994). In such companies, the principal-agent relationship is broken down into two other agency relationships as the government acts simultaneously as principal and agent. In relation to the managers of a government-owned company, the government is a principal, thus it must assign goals (Rodriguez, Espejo, & Cabrera, 2007). The government is also the agent in its relationship with the public, the ultimate owners of the resources invested in by the government-owned company (Ernst, 2004). Based on Downs's (1957) model of government, in the decision-making process, government considers not only the interests of the public as voters, but also the plans or agendas of the opposition parties that compete for votes. Therefore, government wants to control or monitor managers and managerial decisions so that the decisions are in line with its political interests. In the current study, the government is deemed to have controls on or monitor managers and managerial actions through share ownership in the companies, holding golden shares, and/or by locating politicians or appointed officials as its representatives on the board of directors.

The government may use its political power to interfere with companies' operational decisions (Chen, 2004). For example, the government, either directly or through its representatives on the board, can put pressures on managers to stabilise employment or provide other benefits to supporters (for political interests) and induce them to drift beyond profit-maximising goals (Brumby, Hyndman & Shepherd, 1997; Kornai, 2001; Roe, 2003). Government influence can also be seen in the areas of investment planning, pricing of goods, work force levels, and board and management appointments (Wong, 2004). According to Wong (2004), government actions can influence taxes and, as a result, determine cost and capital structures. Governments also decide on the need to regulate (or own) natural monopolies or other monopolies, intervene in the case of externalities (such as regulating pollution), and help provide public goods (such as providing national defence and education, or in areas where there is a public good aspect to providing information). The arguments for government influence become more complicated when they extend to distributional concerns. For example, the government can enact a "welfare state" by using state intervention in the market economy to modify the actions of the market (Briggs, 1961, p.222).

Bortolotti and Faccio (2006) examine control or intervention of government in newly privatised companies and find that this is common in Organisation of Economic Cooperation and Development (OECD) countries. Bortolotti and Faccio (2006, p.2) refer to this situation as "reluctant privatisation", in which the governments do not surrender complete control after privatisation and either remain the largest shareholders of the company, or use special powers (specifically, golden shares). Golden shares are seen as a means to keep the companies politically tied and thereby for the government to retain control.

In addition to political influence in government-controlled companies, political influence can occur in any companies other than government-controlled companies. The managers of these companies see the importance of linking companies to the government, which is consistent with the resource dependency theory pioneered by Pfeffer and Salancik (1978). Resource dependency theory explains the importance of the link between companies and external contingencies that create uncertainty and interdependence (Hillman, 2005). According to Hillman (2005), for a business a critical source of uncertainty and interdependence is government, and a way to form a link with government is through the appointment of politicians on the board of directors. This link is said to be able to reduce external uncertainties sourced from the government policies, regulations and enforcements (Hillman, Zardkoohi & Bierman, 1999). Such links could protect companies from external fluctuations, lower transaction costs and improve firms' survival (Pfeffer, 1972; Singh, House & Tucker, 1986 in Hillman, 2005; Thompson, 1967). Companies that have the link would also enjoy significant benefits in terms of high leverage, low taxation and high market value (Faccio, Masulis & McConnel, 2006; Fisman, 2001).

However, the involvement of politicians in a company can create double agency problems involving self-interested behaviour by both managers and politicians (Wong, 2004). As Buchanan and Tullock (1968) argue, individuals involved in the political process are self-interested actors who want to maximise their own self interests which can be to the detriment of the interest of the majority shareholders as the owners. For example, politicians may supply information on public policy or regulations or offer a linkage between managers and government agencies (such as preferential access to credit) in return for financial incentives such as campaign financial contributions and social welfare expenditures that could gain constituency supports or votes during election (Hillman & Hitt, 1999).

There can also be negotiations or bargaining processes between politicians and managers in order to maximise their own self-interest. Shleifer and Vishny (1994) provide a model of bargaining between politicians and managers. The model suggests that when a company is controlled by managers, politicians involved in the company (such as those who are board members) use subsidies as bribes to influence companies' managers to pursue their political objectives. On the other hand, when politicians have control rights in a company, managers use bribes to convince politicians not to urge companies to follow their political objectives that go beyond the managers' interests. In either way, the involvement of politicians in a company can affect managerial decisions and as a result may affect the outcomes of the company's economic decisions. The current study looks at corporate governance strength and financial reporting quality as the outcomes.

Overall, the interference from government and politicians in companies may give the impression that managerial autonomy in the companies has not been fulfilled. This, according to Chen (2004), creates a lack of incentives for managers to monitor the companies' success and as a result the management may pursue its own interests at the expense of companies' interests (Andrews & Dowling, 1998). The conflict of interest between the principal and agent doubles in these companies. Managers are the agents of both the government and other stakeholders as the principals. Politicians as the government's representatives are the agents of the government. The interests of the managers may differ from those of the government and other stakeholders. Also there may be conflict of interests between the government, the politicians and the managers. The companies suffer not only from agency costs, but also political costs – specifically, the costs associated with control of companies by government or politicians who have political goals that differ from economic efficiency (Shleifer & Vishny, 1994). The companies may also suffer additional political costs if they are perceived to be operating in a manner that can be exploited by the government (Ikin, 2005) and by politicians. The "exploitation" by the government is assumed in the current study to take place via government control or influence through share ownership, by holding golden shares and by locating politicians on the board.

In addition to political interference causing severe agency problems, the accounting systems of the companies may also be affected. This is because accounting systems are closely linked to the agency problem (Tagesson, 2007). Government or politicians may prefer an accounting system which allows them to report selective subsets of information and for annual reports to be presented in their best interests (Zimmerman, 1977). Managers may provide quality financial reporting in order to increase confidence among current and potential investors and to reduce agency conflicts (Chow & Wong-Boren, 1987). Agency problems can also generate a tendency for management to produce substandard financial information (Chung, Firth & Kim, 2005; Richardson, 2006; Warfield, Wild & Wild, 1995) in order to cover actions that have not been in the best interests of the shareholders or debt holders (Jensen & Meckling, 1976).

With regards to corporate governance and within the framework of agency theory, corporate governance provisions appear as a result of the agency conflict between the different parties of a company. Because of the differences between the interests and incentives of managers, shareholders and other resource providers, corporate governance mechanisms are put in place to reduce agency conflicts (Beasley, 1996; Fama & Jensen, 1983a, 1983b) in that it can be used as a mechanism to monitor management's behaviour (Botica-Redmayne, 2004).

In summary, agency theory provides a framework for linking political influence, corporate governance strength and the outcomes of management behaviour (including financial reporting quality). The current study focuses on the effect of political influence in Malaysian companies and looks at how decision-making outcomes in terms of corporate governance strength and financial reporting quality are associated with the influence of politics. In this study, political influence is assumed to occur through government ownership, golden shares and politicians on the board of directors. The next section discusses the merits and demerits of government influence.

3.2 MERITS AND DEMERITS OF GOVERNMENT INFLUENCE

The merits and demerits of government influence have been comprehensively analysed and commented on by researchers in the areas of business and political economics (for example, Esfahani & Ardakani, 2002; Brewer, 1993; Brumby, Hynman, & Shepherd, 1997; Gunasekarage, Hess, & Hu, 2007; Henderson & Phillips, 2007; Kornai, 2001; Mamman, 2004; Sappington & Stiglitz, 1987; Wong, 2004; Zhuang, 1999b). Sappington and Stiglitz (1987) argue that under the assumption of a benevolent government, market failure may be addressed by government control. According to the researchers, information, contracting and bargaining costs limit the government's ability to regulate by ex-ante design and when government cannot exactly determine its objectives due to lack of experience, it may want to retain direct control to avoid costly contract renegotiation procedures with private parties.

The inability of a sovereign government to commit to market-friendly tax and regulatory policies, which discourages private investment, may also result in direct government involvement in production as a substitute (Esfahani & Ardakani, 2002).

The researchers further suggest that the direct control of government over companies can be the solution for regulators to control significant decisions by private owners. In Asia, government influence in companies was one of the factors that contributed to the 1997 financial crisis (Mamman, 2004), including in Malaysia. Government influence, such as the subsidising of particular industries, sectors, and firms by direct lending, implicit and explicit guarantees and various forms of protection, may lead to misallocation of resources or distortion of incentives and result in moral hazard problems (Zhuang, 1999b). These moral hazards, such as excessive risk-taking, inefficient allocation of capital and the weakening of the domestic financial system were the keys to the wider economic crisis that ensued.

Given the moral hazard and agency problems that are caused by political or government influence in a company and which are expected to consequently affect the management and management economic decisions, a question arises as to why government wants control or influence over companies? Within the Malaysian context, this issue is discussed in the following section.

3.2.1 The Importance to the Malaysian Government of Control over or Influence on Companies

Chapter Two has provided a background to politics and business in Malaysia. In order to address the question of why the Malaysian government wants control over companies, this background information can be referred to. The reason why the Malaysian government wants control over companies is because of the balanced socio-economic policy. Within the policy, the government carried out the New Economic Policy (NEP) for the period of 1971 to 1990, the National Development Policy (NDP) for the period of 1991 to 2002, and the National Vision Policy (NVP) for the period 2001 to 2010, in order to restructure the socio-economic imbalance among ethnic groups, particularly the *Bumiputera* (including the majority ethnic – Malays and other *Bumiputera* such as Kadazan, Bajau, Bidayuh and Melanau), Chinese and Indians. The imbalanced socio-economic status among the ethnic groups has been the result of the economic and political interests of the British colonialism (Abdullah, 1997; Chin, 2000). At the time of colonialism, the British open-door immigration policy which brought a great number of immigrant labourers from

China and India drastically and substantially reduced the percentage of the Malay population within mainstream economic growth and social development (Furnivall, 1956). This is because, according to Furnivall (1956), the British divide and rule policy resulted in the different ethnic groups living in different geographical areas, engaging in different economic activities with different rate of economic progress. The Chinese and Indians were involved with the major economic sectors while the Malays and other indigenous populations were left in rural areas and lived in a very traditional and economically unproductive way. This policy, since then, has benefited certain groups, especially the Chinese and Indians, and has neglected the others, especially the Malays and other indigenous people. The Malays have been "left out" in terms of economic and social development compared to the other major ethnic groups.

In order to correct the economic imbalances and to reduce the identification of race with economic functions, the NEP was implemented with the main targets being to ensure the Malays and other indigenous people come to manage and own at least 30 percent of the total commercial and industrial activities; to ensure the employment pattern at all levels and in all sectors reflects the racial composition of the population; and to establish new industrial activities in selected new growth areas. To achieve these targets the government has played a significant dominant role, in that the government has participated more directly in the establishment and operation of productive enterprises by having ownership in them (Abdullah, 1997) and therefore having controls over their management and operations. In addition, and especially to accelerate the creation of the Malay and other indigenous "commercial and industrial community", the government has upgraded and created specialised agencies such the National Trading Corporation, the State Economic Development Corporations and the National Equity Corporation. These agencies are owned and controlled by the government.

Furthermore, the government, through privatisation policy, also has controls over its privatised companies' operations in order to ensure that the Malay and other indigenous people continued to participate in business by involving them in the workforce even after privatisation (Rasiah & Shari, 2001). The NDP was then introduced based on the objectives of NEP, aimed at attaining balanced development and emphasised the strategy of growth with equity (Malaysia, 1991). The key feature of the NDP has been the reliance on the private sector to proactively act as the economic engine growth with the supportive and complementary role played by the public sector. At present, the NVP continues the efforts of the NEP and NDP to attain a united, progressive and prosperous Malaysian society (Ragayah, 2008). All these policies have seen significant government intervention into and control over Malaysian companies especially the government-owned.

The Malaysian government has also intervened and controlled significantly through its industrial policy. Within the policy, a holding company is created with the main purpose to involve in the operations of heavy industries (Jomo & Wah, 1999). In addition to boosting national economic growth, the introduction of the government-sponsored heavy industries is to promote the indigenous people's businesses by filling professional positions in the government-sponsored companies with individuals with the indigenous status (Rasiah & Shari, 2001). In addition, government wanting control over companies is to ensure national and public interests (Abdullah, 1997). The government exercises control over companies which are of national or public interest such as those within the energy and infrastructure sectors. These companies are required to pursue a particular government strategy to ensure that national and public interest are being protected and to ensure continuous political support from the constituents.

As an emerging economy, Malaysia is dependent on foreign direct investments (FDI) in stimulating corporate sectors (Doraisami, 2007; Mamman, 2004) Therefore, in order to attract more FDI, the government has to ensure that Malaysian companies are well-governed and perform well. For this purpose, in addition to providing investment infrastructures and incentives to the corporate sector, the government gains its control rights on the companies' managerial and economic decisions through substantial share ownership and holding golden shares in the particular companies. With these rights, the management and operation of the companies can be monitored. This is necessary because private Malaysian companies, which are mainly family-owned (Mallin, 2007), tend to be badly governed with expropriation of minority shareholders and self-dealing by controlling shareholders, among others. According to Mallin (2007), the governance of these companies, which have evolved from the traditional family-owned enterprises, is relatively poor as their directors may not be responsive to minority shareholders' rights and for that reason, the governance and transparency of these companies need to be improved to restore investors' confidence.

In summary, the literature on why the Malaysian government wants control over firms provides further understanding into the context of the study. The expected relationships between the three main variables (political influence, corporate governance strength and financial reporting quality) are discussed in the following chapter – Chapter Four: Hypotheses Development. The following sections provide a review of literature on financial reporting quality, corporate governance and the relationship between political influence, corporate governance and financial reporting quality.

3.3 FINANCIAL REPORTING QUALITY

Financial accounting information and disclosure are very important tools for investors (Healy & Palepu, 2001; Lambert, Leuz, & Verrecchia, 2007) as financial accounting information and disclosure supply a key quantitative representation of individual corporations (Bushman & Smith, 2003). A high level of disclosure quality can reduce the cost of capital of a company (Ashbaugh, Collins, & LaFond 2006; Krishnamurti, Sevic, & Sevic, 2005b). Moreover, as a result of the increased globalisation of financial and product markets, interest of both market participants and regulators in financial reporting quality is developing worldwide (Kothari, 2001).

While much attention is given to the quality of financial reporting and indeed the phrase "financial reporting quality" is widely used, the concept of financial reporting quality is elusive and has been interpreted in a variety of ways (Ball et al., 2003). There has been no agreement on the definition of or the framework for financial reporting quality among researchers and accounting professionals (Jonas & Blanchet, 2000). As stated by McDaniel, Martin, and Maines, (2002, p.144) "the SEC, auditing profession and national exchanges (in the US) have not specified an explicit definition of or a framework for financial reporting quality". As a result, there are various interpretations of or proxies for financial reporting quality.

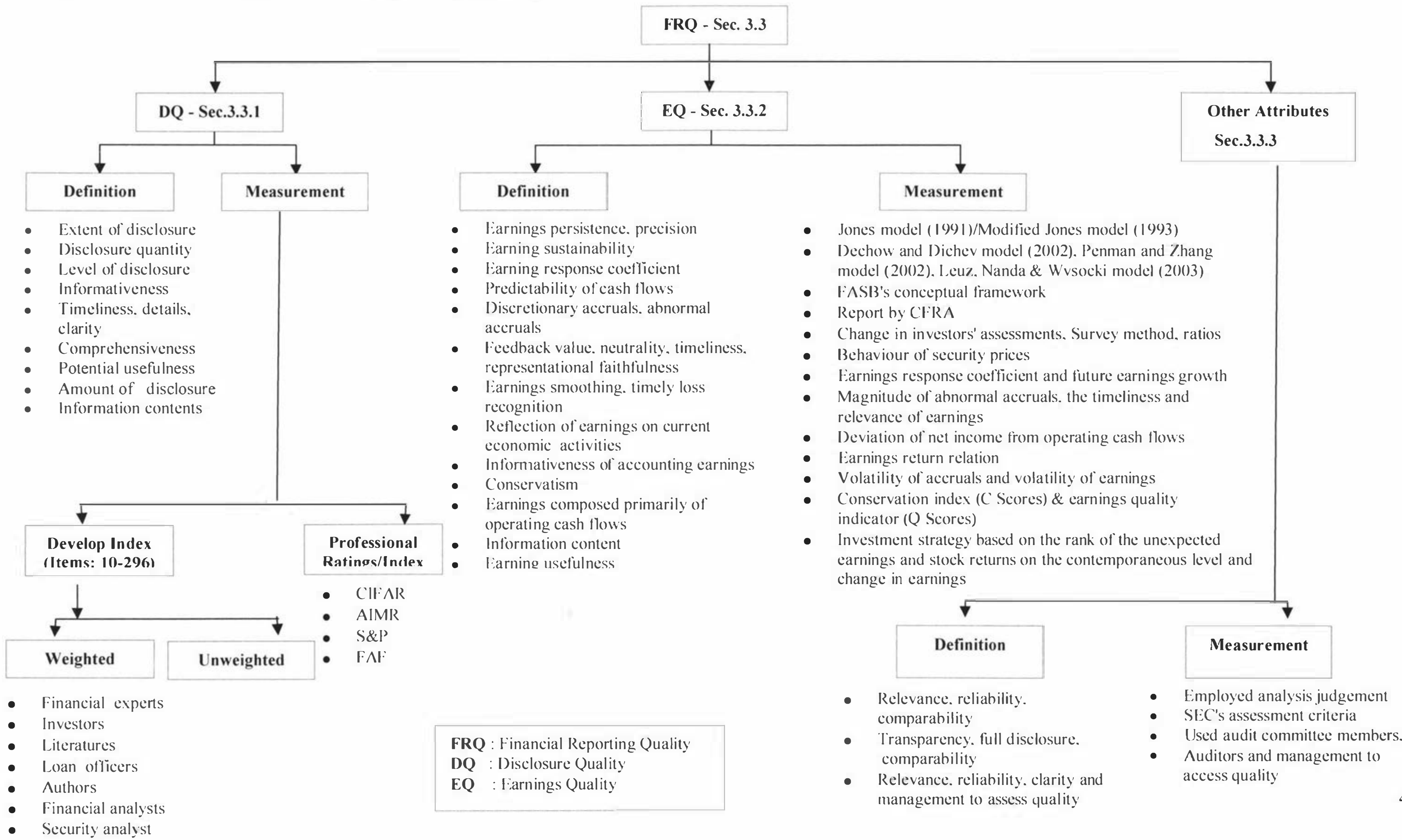
Most prior studies use either disclosure quality (for example, Wright, 1996) or earnings quality (Bushman, Piotroski et al., 2004) as a proxy for financial reporting quality (refer Appendix A for a summary of the studies). Very few studies use multiple proxies for financial reporting quality (see for example Barton & Waymire, 2004; Han, 2005; Rajgopal & Venkatachalam, 2008). This has motivated the current study to provide an understanding of the concept of financial reporting quality through multiple proxies.

The current study assumes incorporation of both disclosure quality and earnings quality as being important because it has been shown that companies with high quality disclosure substitute enhanced disclosure for low quality of earnings, that is, earnings are managed and delayed earnings recognition of value-relevant events is overcome by providing high quality disclosure (Shaw, 2003). In other words, even if a company's disclosure quality is high, this does not necessarily mean its earnings quality is also high. Therefore, taking only disclosure quality as a proxy for financial reporting quality misleads users of financial reports.

Only taking earnings quality as a proxy for financial reporting quality is seen as inadequate as earnings information in investment decision-making is often insufficient (Schadewitz & Kanto, 2002). It is claimed to be insufficient because it is based primarily on historical figures (Collins, Maydew, & Weiss, 1977), and therefore limits a prediction of a company's future prospects. On the other hand, according to Schadewitz and Kanto (2002), disclosure allows management to communicate detailed information about not only historical information but also the future prospects of a company's business activities.

Generally, a review of prior studies in the area of financial reporting quality can group them into two main categories; those that use disclosure quality and those that use earnings quality as a proxy for financial reporting quality. Other than these major categories, there are studies that refer to financial reporting quality in relation to certain characteristics or attributes. The following sub-sections discuss these two major proxies of financial reporting quality and also look at other attributes of financial reporting quality. The review of disclosure and earnings quality studies reported in the following sections focuses on understanding the concepts and measurements instead of the findings of those studies. However, Appendix A provides the details of the studies, including their findings. Figure 3.1 shows the proxies for financial reporting quality established from the literature review and the discussions of the proxies in the following sections.

Figure 3.1: Proxies for Financial Reporting Quality



3.3.1 Disclosure Quality and Its Measurement

Various interpretations of disclosure quality have been put forward by prior studies. It has been referred to as adequacy of disclosure (Buzby, 1974); comprehensiveness of information disclosure – the fact that no important aspect has been left undisclosed (Imhoff, 1992; Wallace and Naser, 1995); the extent of disclosure (Bushee, 2004; Cooke, 1989, 1992), as well as the degree of compliance with standards requirements (Naser and Nuseibeh, 2003). Unlike the studies that carried out annual report content analysis, Mitton (2002) considers companies to have indicators of high quality disclosure if the companies have a listed American Depository Receipt (ADR) and if their auditor is one of the Big Four[11] international companies.

In determining disclosure quality, prior studies have used either their own self-developed disclosure index (for example Buzby, 1974; Cooke, 1989, 1992; Naser & Nuseibeh, 2003; Robbins & Austin, 1986; Singhvi & Desai, 1971; Wallace & Naser, 1995); indices of professional bodies (such as Chartered Financial Analysts Institute – CFA[12]; Financial Analysts Federation – FAF; the Center for Financial Analysis and Research – CIFAR; or Standard and Poors – S&P) or the professional bodies' disclosure ratings. The disclosure index procedure involves an evaluation of the information items disclosed in a report (such as an annual report), based on a pre-defined list of the possible index items. The disclosure index used is either weighted or un-weighted. A weighted index takes into account the importance of information items whereas an un-weighted index assumes all items are of equal importance.

The studies that developed weighted disclosure indices include those of Singhvi and Desai (1971), Buzby (1974), Firth (1979), Hooks, Coy and Davey (2002) and Naser and Nuseibeh (2003). Singhvi and Desai (1971) developed an index of thirty-four items to assess the adequacy of disclosure of listed and non-listed companies' annual reports. Buzby (1974) developed a weighted index of thirty-nine items to measure the extent of disclosure of financial and non-financial items in annual reports of small and medium size companies. The index was based on the importance of each

11 At the time of Mitton's (2002) study, it was the Big Six.

12 Formerly known as the Association of Investment Management and Research (AIMR).

of the items for disclosure in annual reports as perceived by financial analysts. Similar to Buzby's (1974) study that measured the extent of disclosure, Firth (1979) also developed a disclosure index made up of forty-eight voluntary items. The index developed in this study was a weighted index where the voluntary items were weighted based on their importance to financial analysts working for stockbrokers and investment institutions. By also developing and applying a weighted index, Hooks, Coy and Davey (2002) measured the extent and quality of disclosure based on seventy-six information items, where the weighting of disclosure importance was based on literature and a panel of expert opinions.

In contrast to the above weighted indices to measure disclosure quality, there are studies that have used an un-weighted index. These include Cooke (1989), who used a dichotomous procedure in developing and applying a disclosure index in order to measure the disclosure quality of annual reports of Swedish companies. The procedure identified whether an item was present in the companies' annual reports or not. A score of 1 was allocated to each item disclosed and 0 for non-disclosure. The ratio of actual scores awarded to the total expected (maximum possible) scores indicated the quality of disclosure. In Cooke's (1989) study, the un-weighted index was made up of 229 items. Also using the un-weighted index procedure, Wallace and Naser (1995) constructed a disclosure index of thirty items to assess the comprehensiveness of disclosure.

While the above studies developed and applied either a weighted or un-weighted index in order to assess disclosure quality, there are studies that have used both weighted and un-weighted indices (for example, Barrett, 1976; Robbins & Austin, 1986; Naser & Nuseibeh, 2003; Chow & Wong-Boren, 1987). Barrett (1976) constructed a disclosure index using seventeen categories of information. The quality of disclosure was indicated by the extent of financial disclosure that was determined from the application of the index and the degree of comprehensiveness of the companies' financial statements as determined by quality criteria identified by the researcher. In Robbins and Austin (1986), the index was made up of twenty-seven items and used to measure the extent and importance of disclosure of sample companies' annual reports. Naser and Nuseibeh (2003), in assessing the quality of information disclosed by a sample of non-financial Saudi companies listed on the

Saudi Stock Exchange, constructed a disclosure index which was weighted by the mean and median responses of several user groups of annual reports in Saudi Arabia. In the study, the un-weighted procedure was also applied. Naser and Nuseibeh considered the extent, the importance of disclosure and the degree of compliance to the statutory requirements as a measure for disclosure quality.

Similarly, by using an index and compared scores when weighting was added and not added, Chow and Wong-Boren (1987) examined the extent of voluntary financial disclosure. The index consisted of eighty-nine items that were weighted for various degrees of importance by loan officers. Their comparison between weighted and un-weighted scores revealed almost identical results and the finding has been used in a lot of subsequent research to defend the use of un-weighted indices (for example, Marston and Shrives, 1991; Wallace and Naser, 1995; Naser and Nuseibeh, 2003). These studies found that the use of weighted and un-weighted indices gave no material difference in results.

From the late 1990s, researchers in the disclosure quality used disclosure ratings issued by professional bodies as a measure of disclosure quality. For example, Lang and Lundholm (1996), Sengupta (1998) and Shaw (2003) used companies' disclosure ratings as outlined in the report of the FAF.

In addition to the FAF ratings or scores, disclosure quality ratings issued by the CFA/AIMR were also used (for example, Bens & Monahan, 2004; Brown & Hillegeist, 2007; Bushee & Noe, 2000; Healy, Hutton, & Palepu, 1999; Lee, Petroni, Shen, & Hirst, 2006). The AIMR ratings were based on the financial analysts' perceptions of the importance and quality of disclosure items selected. The disclosure quality scores issued by CIFAR have also been used in prior studies, for examples Bushman and Smith (2003); DeFond, Hung and Trezevant (2007) and Hope (2003). The CIFAR index largely covers the same items as S&P's Transparency and Disclosure index and focuses on the quantity or extent of disclosure (Bushee, 2004).

While the above reviewed studies used the ratings/scores issued by the professional bodies as the construct of disclosure quality, there are studies that applied the index used by professional bodies – such as the S&P's index – to the annual reports of their sample companies (for example, Dargenidou, McLeay, & Raonic, 2006; Patel, Balic, & Bwakira, 2002). This index was used by Patel et al. (2002) to assess the level of disclosure of ninety-eight possible information items which were divided into three sub-categories: ownership structure and investor relations; financial transparency and information disclosure; and board and management structure and process.

In summary, the review of disclosure quality studies finds that there is no common understanding of the concept of disclosure quality. In terms of its measurement, prior studies have recognised the use of disclosure indices to measure disclosure quality. The index can be either weighted or un-weighted. In addition, there is no agreement on the number of items used in the index developed. Appendix A provides a summary of prior studies related to disclosure quality and disclosure indices (including the above reviewed studies). The results of each study are also reported in the summary.

The disclosure quality assessed in the current study is that of annual reports. Annual reports are not the only source of corporate reporting; however, focusing on this source only will not reduce the quality of information, as it is generally believed that the annual report is one of the most important sources of corporate reporting (Botosan, 1997). The definition of disclosure quality that is employed in the current study is in line with Cooke (1989, 1992), who considers the extent of disclosure as a construct of quality. Extensiveness ensures a sufficient amount of disclosure is provided to the users of financial reports to make economic decisions. It is an adequate measure of the quality of disclosure (Botosan & Plumlee, 2002). As this current study is concerned with the extent of disclosure as a proxy for the quality of disclosure, the use of a disclosure index is seen as appropriate. Chapter Five provides details of the development of the disclosure index.

3.3.2 Earnings Quality and Its Measurement

Earnings quality has also been defined and measured differently in previous studies. Earnings quality has been referred to as earnings informativeness (Beaver, 1968; Fan

& Wong, 2002; Vafeas, 2000), and the usefulness of earnings operationalised by the behaviour of security prices (Ball & Brown, 1968).

Schipper and Vincent (2003) came out with an extensive review of earnings quality constructs and measures which were classified into four sources – the time-series properties of earnings; the relationships between income, cash and accruals; selected qualitative characteristics in the FASB's Conceptual Framework; and implementation decisions (Schipper & Vincent, 2003, p.99). Earnings constructs have been mostly derived from the first two sources. The time-series-based and accrual-based constructs have been then modified and/or combined in subsequent studies for the purpose of measuring earnings quality. For the time-series classification, three constructs have been identified (Schipper et al., 2003, p.99) – "persistence" where earnings are viewed as "more permanent and less transitory"; "predictive ability" which is referred to as "the ability of past earnings to predict future earnings" (Lipe, 1990 in Schipper et al., 2003, p. 99); and "variability" which is identified from whether the earnings are naturally smoothed earnings or result from income smoothing activities.

Studies that used earnings quality constructs derived from the time-series classification, as reviewed by Schipper et al. (2003) include Kormendi and Lipe (1987), Collins and Kothari (1989), and Leuz Nanda and Wysocki (2003). In more recent studies, DeFond et al. (2007) also measured earnings quality using the time-series classification – a variation of the earnings management metric used by Leuz et al. (2003).

The second earnings construct classified by Schipper et al. (2003, p.99) was mostly related to accruals which include "changes in total accruals", "direct estimation of discretionary accruals" and the "relations of accruals-to-cash". According to the researchers, changes in total accruals indicate manipulations by managers, in that the greater the changes, the lower the quality of earnings. The direct estimation of discretionary accruals was initially introduced by Jones (1991) using accounting fundamentals – revenues adjusted for receivables or plant, property, and equipment. In this approach, total accruals are regressed on the accounting fundamentals and the residuals from the regression are the discretionary accruals which indicate earnings management that reflects lower earnings quality. Jones's (1991) model was also used in the studies of Bedard, Chtourou and Courteau (2004), Cahan (1996) and Myers, Myers and Omer (2003).

According to Schipper et al. (2003), Jones's (1991) model was improved by Dechow and Dichev (2002) by capturing aspects of the relations of accruals-to-cash. This approach involves a regression of changes in working capital accruals on prior, current, and next period cash flows. The estimated residuals from the regression describe an estimation error in unintended and manipulative accruals and indicate an opposite measure of earnings quality. The extent to which working capital accruals map onto operating cash flow realisations reflects accruals quality (Francis, LaFond, Olsson, & Schipper, 2005). Dechow and Dichev's (2002) model has been employed in a number of research studies, for example Francis, Huang, Rajgopal and Zang (2008a); Francis, Nanda and Olsson (2008b), Francis, LaFond et al. (2005) and Chen, Shevlin and Tong (2007). Francis, LaFond et al. (2005) and Francis et al. (2008a; 2008b) integrate Jones's (1991) model and Dechow and Dichev's (2002) models in measuring earnings quality. Dechow and Dichev's (2002) model is able to identify a direct link between cash flows and current accruals.

While the above studies employed time-series properties-based and/or accrual based earnings quality constructs, Basu (1997) operationalised earnings quality as timely recognition of economic losses. This operationalisation of earnings quality was then used in other studies (see for example, Ball et al., 2003; Ball & Shivakumar, 2005). Ball et al.'s (2003) highlighted the fact that financial reporting quality was ultimately determined by the underlying economic and political factors influencing managers' and auditors' incentives, and not by accounting standards per se. However, Ball et al. (2003) did not empirically examine the relationship between political factors and financial reporting quality. This provides an opportunity for the current study to investigate the relationship.

If Ball et al. (2003) and Ball and Shivakumar (2005) focused on timely recognition of economic losses, Ashbaugh et al. (2006) used timeliness and value relevance (transparency) of accounting earnings as one of the proxies of earnings quality. According to Ashbaugh et al. (2006), more transparent and current earnings reflect a company's current economic activity information and contribute to higher earnings quality. In Ashbaugh et al. (2006), the construct of timeliness and value relevance of earnings was combined with two other constructs – discretionary accruals and the independence of the audit committee. The magnitude of the three constructs was used as the proxy of earnings quality.

Similar to Ashbaugh et al. (2006) in combining more than one construct in determining earnings quality, Francis et al. (2008a; 2008b) took into account accruals-based and time-series-based earnings quality as classified by Schipper et al. (2003). In Francis et al.'s (2008a) study, the proxy of a company's earnings quality was the common factor identified by factor analysis performed on the constructs of accruals quality, absolute value of discretionary accruals and earnings variability.

Appendix A provides a summary of prior studies related to earnings quality including the determination of earnings quality, the purpose and the results of each study. Since there is no standard definition and measurement of earnings quality, the current study employs the modified model of Dechow and Dichev (2002) as the main model, and the original model of Dechow and Dichev (2002), as an alternative model, in the determination of earnings quality, similar to those used in Francis, LaFond et al. (2005) and Francis et al. (2008a; 2008b). Other previous studies that have used the Dechow and Dichev (2002) model include Francis, LaFond, Olsson and Schipper (2004); Aboody, Hughes and Liu (2005) and Ashbaugh et al. (2006). The original model of Dechow and Dichev (2002) shows a direct link between cash flows and current accrual and assumes that estimation errors in current accruals decrease the quality of accruals and earnings (Schipper & Vincent, 2003). However, according to McNichols (2002), the model does not distinguish between intentional and unintentional estimation errors[13] in accruals. The original model is modified and improved upon by taking into consideration accruals association with cash flows from operation in the current, prior and future periods as well as the change in revenues and property, plant and equipment (PPE) (Francis, et al., 2008a; 2008b; McNichols, 2002). The modified model takes into consideration the unintentional

---

13 Intentional errors arise from incentives to manage earnings as proxied by Jones's (1991) model and unintentional errors are related to management lapses and environmental uncertainties (Francis, LaFond et al., 2005).

errors and the two additional variables; the change in revenues and PPE provide a more complete characterisation of the relation between accruals and cash flows. The modified model is more appropriate to the current study, as this study involves uncertainties such as political risks that may affect accruals and cash flows. The details of the modified model are presented in Chapter Five.

3.3.3 Financial Reporting Quality in Relation to Certain Characteristics or Attributes

In addition to disclosure or earnings quality, financial reporting quality has also been related to certain characteristics. Jonas and Blanchet (2000), in their commentary, suggest that the quality of a company's financial reporting ultimately depends on the quality of each part of the financial reporting process, which highlights the financial information's qualitative characteristics (for example relevance, reliability and clarity).

From a similar perspective, Daniel, Beasley, Menelaides and Palmrose (2002), refer to financial reporting quality as having selected characteristics of reporting quality as espoused in the Statement of Financial Accounting Concepts (SFAC) No. 2. These include feedback and predictive value for the relevance characteristic, and verifiability, comprehensiveness, representational faithfulness, and neutrality for the reliability characteristic.

While the above studies refer to certain qualitative characteristics, Pownall and Schipper (1999) use multiple proxies in determining financial reporting quality. The study refers to financial reporting as being of high quality if it possesses three attributes: transparency, full disclosure and comparability. Transparency is referred to as the revealing of information about events, transactions, judgments and estimates which allows users to see the results and implications of the decisions, judgments and estimates of preparers. Full disclosure is related to the provision of all information necessary for decision-making, while comparability means that similar transactions and events are accounted for in the same manner, both cross-sectionally among companies as well as over time.

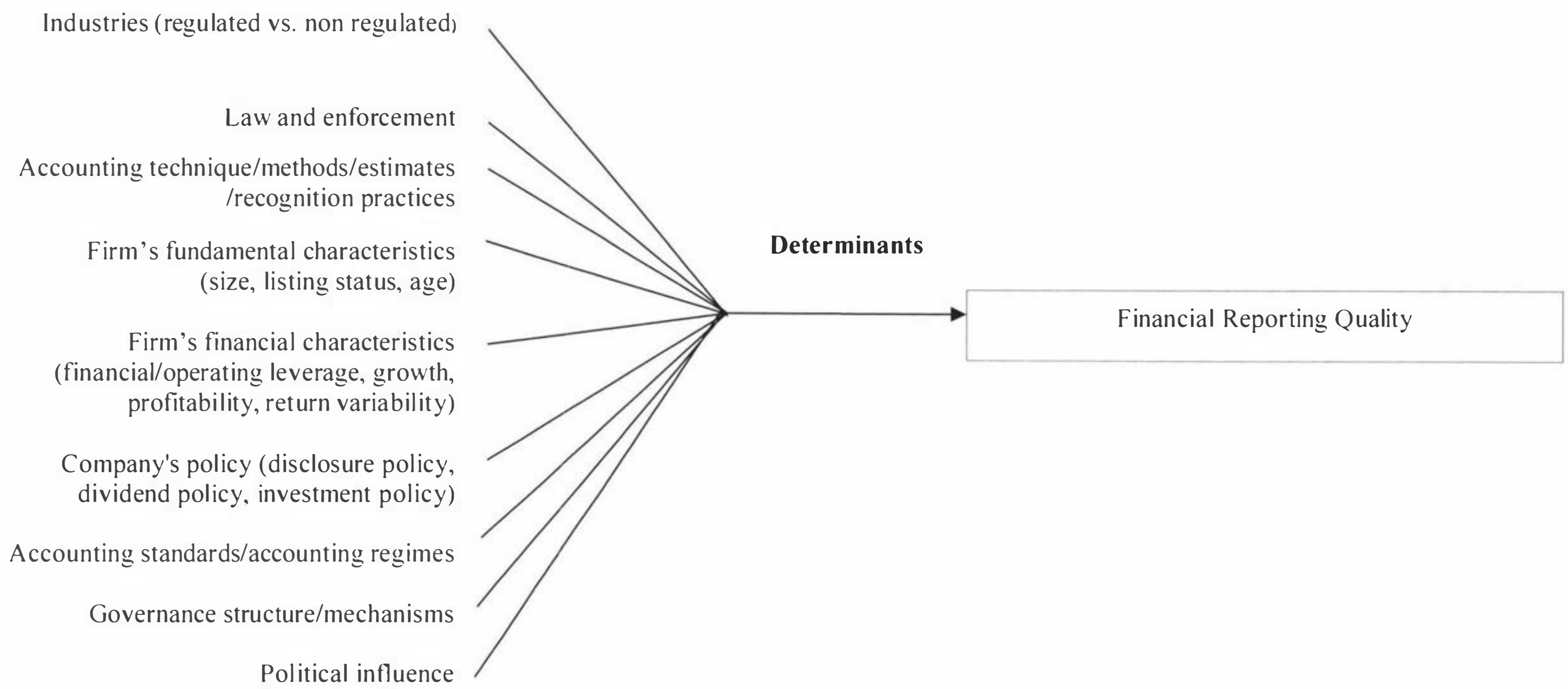
By also including transparency, Barton and Waymire (2004) combine the attribute of transparency of the income statement and balance sheet with two other attributes – the existence and quality of the external audit and the extent to which conservatism influences the firm's financial reporting – when determining the quality of financial reporting. Similarly, Rajgopal and Venkatachalam (2008) use multiple proxies in determining financial reporting quality - earnings quality and analysts' forecast dispersion. Multiple proxies of financial reporting quality are also found in Han's (2005) study in which the researcher uses earnings quality and disclosure quality as measures of financial reporting quality. Similar to Han (2005), the current study uses both disclosure quality and earnings quality as proxies for financial reporting quality. Han (2005) employs the S&P's transparency and disclosure rating (which include the overall company rating and rating of financial information) as a measure for disclosure quality and the absolute value of discretionary accruals and standard deviation of residuals as proxies for earnings quality. However, the current study develops and applies an index in measuring disclosure quality and employs the modified Dechow and Dichev's (2002) model in determining earnings quality.

3.3.4 Prior Studies on Determinants of Financial Reporting Quality

Prior studies have examined the determinants of financial reporting quality (either in terms of disclosure or earnings quality). These determinants include a company's fundamental characteristics such as size, listing status, age, governance structure; their financial characteristics, namely financial leverage, operating leverage, growth, return variability and profitability; their policies, such as dividend and investment policies and degree of internationalisation; and external factors such as statutory regulations and enforcement, accounting regimes, the type of industry (regulated or non-regulated) that the company is involved in and any political influence on the company's dealings. For example, prior studies have identified company characteristics that determine the quality of disclosure (for example, Buzby, 1974; Cooke, 1989; Singhvi & Desai, 1971). Ownership structure has been identified in prior studies as another determinant of financial reporting quality, in terms of earnings (for example, Fan & Wong, 2002). In addition, corporate governance structure has also been found in prior studies to determine financial reporting quality (for example, Bedard et al., 2004; Vafeas, 2000). Prior studies have also identified that political factors help determine the quality of financial reporting (for example, Bushman & Piotroski, 2006; Bushman, Piotoski et al., 2004; Leuz & Oberholzer-Gee, 2006).

Figure 3.2 illustrates examples of determinants of financial reporting quality examined by prior studies. Most of the determinants shown in Figure 3.2 are included in the current study either as test or control variables. The study looks at both disclosure and earnings quality as proxies of financial reporting quality and uses multiple proxies of political influence – government ownership, politicians on board of directors and golden shares. The current study extends the literature on the determinants of financial reporting quality by examining the relationship between different proxies of political influence and corporate governance strength and/or financial reporting quality.

Figure 3.2 Examples of Determinants of Financial Reporting Quality (FRQ) Examined by Prior Studies.



The following subsections provide a review of literature related to corporate governance in order to gain insights into the concept of corporate governance and what makes strong or weak corporate governance. This is relevant because the current study includes corporate governance strength as a test variable.

3.4 CORPORATE GOVERNANCE

There is no common definition of corporate governance used in the literature. Donaldson (1990) defined corporate governance as the structure whereby managers at the organisational apex are controlled through the board of directors, its associated structures, executive incentives and other schemes of monitoring and bonding. From a broader perspective corporate governance is defined as a system by which companies are directed and controlled (Cadbury, 1992). It consists of two components: corporate, which refers to corporations and governance, which refers to the act, fact or manner of governing (Lanno, 1999).

Stressing stakeholders' rights, Demb and Neubauer (1992) stated that corporate governance is the process by which corporations are made responsive to the rights of stakeholders. Monks (1994) defined corporate governance as the relationships between the various participants who determine the direction and performance of corporations. It helps address the issues facing the board of directors, such as interaction with top management and the relationships with the owners and others interested in the affairs of the company, including creditors, debts financiers, analysts, auditors and corporate regulators (Tricker, 1994).

Corporate governance is used as a mechanism to protect stakeholders' interests, by which stakeholders of a corporation exercise control over corporate insiders and management (John & Wenbet, 1998) and especially minority shareholders. Corporate governance is the means by which minority shareholders are protected from expropriation by managers or controlling shareholders (Mitton, 2002).

Scott (1999) referred to corporate governance in its most comprehensive sense as every force that supports a decision-making process of a company. This encompasses not only the control rights of stakeholders, but also the contractual covenants and solvency powers of debt holders, the commitments entered into with employees, customers and suppliers, the regulations issued by government agencies, and the statutes enacted by parliamentary bodies. Additionally, corporate governance is said to influence how business corporations allocate resources and returns (O'Sullivan, 2000).

In Malaysia, the Finance Committee on Corporate Governance (FCCG, 2000) defined corporate governance as the process and structure used to direct and manage the business and affairs of a company towards enhancing business prosperity and corporate accountability. The ultimate objective is to realise long term shareholder value, while at the same time taking into account the interests of other stakeholders. The current study takes a broad definition of corporate governance – the system and processes within and by which a corporation is owned, managed and controlled.

The importance of corporate governance has been widely recognised in prior studies. It is noted as being an important factor in firm value (La Porta & Lopez-de-Salanes, 1999; La Porta, Lopez-de-Salanes, Shleifer, & Vishny, 2000) and an important control mechanism (Dechow, Sloan, & Sweeney, 1995). In relation to government-owned companies, many of which have commonly been regarded as natural monopolies, comparison with similar companies to assess relative performance become difficult and this makes it easier for managers to pursue their own interests (Ernst, 2004). Therefore, with these limited market mechanisms to control for managers' performance of government-owned companies, corporate governance becomes a very important control mechanism.

As a control mechanism, four basic categories of individual corporate governance mechanisms outlined by Jensen (1993) include (1) legal and regulatory mechanisms, (2) internal control mechanisms, (3) external control mechanisms and (4) product market competition. The current study focuses on internal control mechanisms of corporate governance as unlike the others; these mechanisms are within the control of a company. "The internal governance structure of a firm consists of the functions and processes established to oversee and influence the actions of the firm's management" (Davidson, Goodwin, & Kent, 2004, p.244). Thus, internal corporate governance mechanisms must be strong enough to ensure better outcomes such as good performance, higher firm value and higher financial reporting quality.

3.4.1 What Makes Strong or Weak Corporate Governance?

A system of strong corporate governance allows a board of directors to drive their companies forward without restraint while exercising this freedom within a framework of accountability (Cadbury, 1992). It is aimed at treating the shareholders equally and preserving their rights (Darman, 2004). In other words, strong corporate governance means little expropriation of corporate resources by managers or controlling shareholders. Strong corporate governance goes beyond rules and regulations (Wieland, 2005) and is about ethics and values, which drive companies in the conduct of their business where directors, management, employees, accountants and auditors have to each play a role. Similarly, Mitchell (2003) associated strong corporate governance with good manners: treating others the way one likes to be treated and taking responsibility for ones conduct and the consequences of ones behaviour.

Similarly, Mitchell (2003, p.14) considered weak corporate governance as "corporate rudeness", having a damaging impact on stakeholders, management, directors and other related parties. She claimed that the victims of weak corporate governance include shareholders, directors and management. Shareholders, who (through their elected directors) choose the executives leading the company whose shares they own, stand to lose on their equity investments. Directors, who are financially and personally responsible for the business conduct of the executives, lose when poor judgements and the consequences of them surface. Finally, management itself ultimately pays for its rude behaviour through stock options that become worthless, lost employment for themselves, criminal prosecution or civil law suits, and private civil actions for damages.

Indicators of weak corporate governance (as stated by Moody's Investors Service in Duffy, 2004) include: (1) an insider-dominated board of directors; (2) the presence of a "celebrity" CEO; (3) questionable board composition, including members with inadequate business experience or those who appear to be members due to political or other influence; (4) risky pay schemes for top executives that could encourage short-term actions harmful to companies' creditors; (5) the absence of an independent committee to nominate directors; (6) accounting restatements or indications the company is unusually aggressive in its accounting assumptions, indicating a lack of proper controls or effective director oversight; (7) evidence that the company's audit committee is not firmly in charge of the relationship with the external auditor; (8) high director absenteeism or lack of attendance at key meetings, particularly those of the audit committee; (9) lack of reasonable director turnover, which may indicate the absence of fresh perspective on the board; (10) an excessive number of takeover defences indicating an entrenched management and desire to protect the status quo; (11) no respect for shareholders' view by rejecting shareholder proxy requests; and (12) an incoherent ethics policy or one without a clear implementation plan.

To summarise, strong corporate governance motivates managerial behaviour towards improving the business and directly controls the behaviour of managers to ensure that the rights of stakeholders are protected. Based on the indicators outlined by Moody's Investors Service cited in Duffy (2004) above, it can be summarised that strong or weak corporate governance is dependant on the internal mechanisms of corporate governance. The current study develops a corporate governance index to measure overall corporate governance strength and relates it to political influence, firm disclosure and earnings quality, instead of using a particular corporate governance mechanism or a combination of several mechanisms as in the above studies.

Prior studies that relate political influence and corporate governance, disclosure quality or earnings quality, and corporate governance and disclosure quality or earnings quality are relevant to the current study. The next section provides a review of those studies.

3.5 PRIOR STUDIES ON POLITICAL INFLUENCE, CORPORATE GOVERNANCE AND FINANCIAL REPORTING QUALITY

Prior studies have shown that politics can have an influence on corporate governance especially in terms of board composition and/or the management appointment (for example Agrawal & Knoeber, 2001; Chen, 2004; Fan et al., 2007). Agrawal and Knoeber (2001) found companies that have business relations with government tend to include outside directors with backgrounds in politics or have government representatives on their board. If a company's board of directors consists of members who have political influence, the company's CEO will also be someone with political connections (Fan et al., 2007). Chen (2004) found that politics do influence the composition of management teams and board of directors.

In the Malaysian context, Abdul Wahab, How and Verhoeven (2007) investigated the impact of the Malaysian Code on Corporate Governance. The results of the study showed that the corporate governance reform in Malaysia has been successful, with a significant improvement in governance practices. They also found that political connection has a significantly negative effect on corporate governance, which is mitigated by institutional ownership. However, Abdul Wahab et al.'s (2007) study classified politically connected companies as those that had been associated with certain politicians (as identified by other researchers) and companies that are under Khazanah Berhad (the government's investment company). The current study extends the operational definition of political influence of Abdul Wahab et al's. (2007) study by including government ownership, not only by Khazanah Berhad but also other companies either listed or non-listed with government ownership, the presence of politicians on the board of directors and the existence of a golden share as the proxies for political influence.

Prior studies have found that political influence can arise through connection with individuals who have power in the government (Belkaoui, 2004; Faccio, 2006; Fisman, 2001; Johnson & Mitton, 2003; Leuz & Oberholzer-Gee, 2006), through state ownership of enterprises (Bushman, Piotroski et al., 2004; Nee, Opper & Wong, 2007); the presence of politician/politicians on the board of directors (Faccio, 2006) and through golden (special) shares held by government (Hanousek, Kocenda, &

Svejnar, 2007; Jones, Megginson, Nash, & Netter, 1999). Political ties or connections between a company and politicians are difficult to identify because (in reference to Malaysia), the ties or connections are mostly informal and are not disclosed in company annual reports. Although Gomez and Jomo (1997) released a list of companies with political ties or connections in Malaysia, the list is outdated because the politicians referred to are no longer in positions of political power in the government.

In relation to financial reporting quality, Leuz and Oberholzer-Gee (2006) and Bushman, Piotroski et al. (2004) empirically found that political influence is negatively related to disclosure. Leuz and Oberholzer-Gee (2006) examined the relationship between political connections and corporate transparency, finding that political connection is negatively related to proxies for disclosure. Bushman et al. (2004a) also found that financial transparency is negatively related to political factors. In Bushman, Piotroski et al.'s (2004) study financial transparency was referred to as the amount and timeliness of financial disclosure and one of the political factors included in the study was direct political involvement in terms of the extent of state or government ownership.

In terms of earnings quality, political influence is found as contributing to earnings opacity (Belkaoui, 2004), which indicates low quality of earnings. In addition, prior studies have documented several outcomes of the association between corporate governance mechanisms and both disclosure and earnings quality. Wright (1996) found significant correlations between the composition of a company's board of directors, financial reporting quality measured by the AIMR's rating and the existence of an SEC Accounting and Auditing Enforcement release against the company or its auditors. Prior studies have tended to focus on specific corporate governance mechanisms and the extent of specific information disclosure that indicates the disclosure quality. Leftwich, Watts and Zimmerman (1981) compared the proportion of independent directors to interim reporting disclosure and found a significant positive relationship. Chen and Jaggi (2000) used the same corporate governance mechanism but related it to the extent of voluntary and mandatory disclosure. They found a significant positive relationship, in that the higher the proportion of independent directors, the higher the extent of disclosure.

While the above studies focused on the proportion of independent directors, Millstein (1992) focused on the existence of dominant personalities on the board and related it to the extent of share option disclosure and found a significant negative association between the variables.

In addition, it is argued that a company may have higher disclosure quality if its auditor is one of the big firm auditors (Mitton, 2002), as these audit firms have been associated in previous research with higher quality auditing (DeAngelo, 1981; Reed, Trombley, & Dhaliwal, 2000). The type of auditor used has also been classified as a corporate governance mechanism. The structure of the audit committee as a corporate governance mechanism has also been related to disclosure quality. For example, Carcello and Neal (2003) found that audit committee independence is positively related to the extent of disclosure of financial statement notes and Management Discussion and Analysis (MD&A) in annual reports.

There are also studies that have used more than one corporate governance mechanism and related them to disclosure quality. Forker (1992) looked at the relationship between the proportion of independent directors, the existence of dominant personalities and the existence of an audit committee with the extent of share option disclosure. Except for the existence of dominant personalities, the other two attributes show a significant and positive relationship with share option disclosure. Ho and Wong (2001b) related four corporate governance mechanisms to the extent of voluntary disclosure. The mechanisms are the proportion of independent directors to the total number of directors on the board, the existence of an audit committee, the existence of dominant personalities and the percentage of family members on the board. They found a significant and positive relationship for the existence of an audit committee as well as a significant and negative relationship for the existence of dominant personalities. However, the relationship between the other two attributes and the extent of voluntary disclosure is not significant.

In the Malaysian context, Haniffa and Cooke (2002) related two corporate governance mechanisms (a chairman who is a non-executive director and domination of family members on boards) and culture (race and education) to the extent of voluntary disclosure. They found a significant association between the corporate governance mechanisms and the extent of disclosure. A significant association was also found between one cultural factor (proportion of Malay directors on the board) and the extent of disclosure.

Gul and Leung (2004) examined the link between CEO duality and the proportion of expert outside directors on the board (as corporate governance mechanisms) and the level of voluntary disclosure. Their results showed that CEO duality is associated with lower levels of voluntary disclosure. However, they also found the association is moderated by the expertise of non-executive directors, in that the negative association between CEO duality and the level of disclosure is weaker for firms with a higher proportion of expert outside directors on the board.

While the above review focused on studies that examine the relationship between corporate governance and disclosure quality, a review of studies that relate corporate governance and earnings quality is also carried out.

Chtourou, Bedard and Courteau (2004) investigated whether a company's corporate governance has an effect on earnings quality proxied by the extent of earnings management. Specifically, this study examined the relationship between audit committees and the board of directors' characteristics and the extent of corporate earnings management. The study concluded that effective boards and audit committees constrain earnings management activities and thus increase its earnings quality.

Looking at a broader aspect of audit committee, Saleh, Iskandar and Rahmat (2007) used Malaysian data to investigate the relationship between audit committee characteristics and earnings management (another indicator of earnings quality). The characteristics used in Saleh et al.'s (2007) study included the independence of members, frequency of meeting and knowledge of the members. Their study found that each of these variables reduces earnings management practices, which indicates higher earnings quality.

Dechow, Sloan and Sweeney (1996) investigated the impact of board of directors on financial statement fraud. The greater the fraud, the greater the negative impact on earnings quality. They found that companies manipulating their earnings through alleged violations of generally accepted accounting principles were more likely to have board of directors dominated by management. Similarly, Sharma (2004) found that as the percentage of independent director increases, the likelihood of fraud decreases. Both studies suggest that less independent board members are likely to be associated with poor quality of earnings as the result of accounting fraud.

Other studies have analysed the association between characteristics of board members and earnings quality (indicated by earnings management). These studies include Peasnell, Pope and Young (2005), which revealed that the likelihood of managers making income-increasing abnormal accruals is negatively related to the proportion of outside board members.

In the Malaysian context, Abdul Rahman and Mohamed Ali (2006) investigated board characteristics – board independence, board member tenure, CEO duality and board size – and related them to earnings management. They found that earnings quality as indicated by earnings management is positively related to board size but found no significant evidence between board independence, audit committee independence, and earnings management.

How the system of independent directors influenced the earnings conservatism, another proxy of earnings quality was analysed in a recent study by Chen, Zeng and Tan (2008). They looked at four dimensions: percentage of independent directors within the board of directors, professional capacities, stimulations and work conditions. Their results showed that the more powerful the independent directors, the better the accounting conservatism (thus the better the earnings quality).

The above reviewed studies in relation to corporate governance have shown the relationship between an individual corporate governance mechanism or a combination of several corporate governance mechanisms and the quality of specific disclosure (mostly in terms of voluntary disclosure) in annual reports. Only a few studies (for example, Cheung, Jiang, Limpaphayom, & Lu, 2008; Shen & Chih,

2007) have used an aggregate level of corporate governance strength measured by using a corporate governance index. Cheung et al. (2008) developed and applied a corporate governance index to measure the overall quality of corporate governance and disclosure practices of the ten largest Chinese listed firms. Shen and Chih (2007) used a corporate governance index to determine good (strong) or poor (weak) corporate governance. They examined the relationship between the strength of corporate governance and the extent of earnings management and concluded that companies with good corporate governance (indicated by a higher score on the corporate governance index) constrain earnings management and thus increase the earnings quality. Supporting this conclusion, Lara, Osma and Penalva (2007) also found that companies with stronger corporate governance exhibit a higher degree of earnings quality (indicated by a higher degree of accounting conservatism).[14] The current study follows these studies by using a corporate governance index in determining the strength of corporate governance.

The current study controlled various company characteristics (size, age, leverage, listing status and industry) in examining the relationship between the key variables. Size has been documented in past studies to have a significant positive association with corporate governance quality (Nam & Nam, 2005). Size has also been found to be positively associated with the existence of an audit committee, with board independence and with the use of internal audit (Goodwin & Kent, 2006b). Larger companies face a greater information demand from financial analysts (Lang & Lundholm, 1993) and a positive association between size and disclosure has been found in past studies such as those carried out by Hossain, Tan and Adams (1994), Firth (1979) and Cahan, Rahman and Perera (2005). Higher earnings quality has also been found in larger firms (Sanchez & Garcia, 2007). The reason for including age as a control variable is that older companies might have more valuable political influence or connections (Leuz & Oberholzer-Gee, 2006). In relation to leverage as a control variable, companies with high leverage will have increased reporting quality as the higher the leverage level, the higher the demand for quality reporting (Craswell & Taylor, 1992). Leverage has been found to be positively associated with financial reporting quality (Ab Manan & Mohd Iskandar, 2003) and with corporate

---

14 Beekes, Pope and Young (2004) relate earnings conservatism to accounting quality.

governance (Harford, Li, & Zhao, 2008). Listing status has been associated with disclosure level (Ahmed & Courtis, 1999). Specifically focused on cross listing status, Charitou, Louca and Panayides (2007) found that cross listing was positively associated with corporate governance. Furthermore, type of industry has been shown to have effect on disclosure level (Cooke, 1989).

The review of prior studies indicates that there has been no study (to date) that relates political influence, corporate governance and financial reporting quality in a single study. This provides an opportunity to carry out the current study by addressing the following questions:

1. What is the extent of financial reporting quality (in terms of disclosure and earnings quality), and corporate governance strength of Malaysian companies?
2. What is the relationship between political influence and financial reporting quality?
3. What is the relationship between political influence and corporate governance strength?
4. What is the relationship between corporate governance strength and financial reporting quality, after controlling for political influence?
5. Does corporate governance strength mediate the relationship between political influence and financial reporting quality?

Overall, the reviewed studies have provided a theoretical framework within which to relate political influence, corporate governance strength and disclosure quality or earnings quality. The expectations of the relationships are stated in research hypotheses that are developed and discussed in the next chapter.

3.6 CHAPTER SUMMARY

This chapter has reviewed prior studies that have provided an understanding of the concepts of political influence, disclosure quality, earnings quality, and strong and weak corporate governance. The occurrence of political influence in a company has been recognised in prior studies through (1) political ties or connections between the company and politicians or individuals with political power in the government; (2) the presence of politician/politicians on the board of directors; (3) government share ownership of the company and (4) golden (special) shares held by government. The current study employs the last three as proxies for political influence.

As prior studies refer to financial reporting quality mainly as disclosure and earnings quality, the current research takes up these two as the proxies for financial reporting quality.

In relation to corporate governance, since internal corporate governance mechanisms play an important role in ensuring compliance with mandated reporting requirements and maintaining the credibility of a firm's financial statements (Dechow et al., 1995), the overall strength of internal mechanisms of corporate governance is the concern of the current study and its relation to political influence and financial reporting quality is analysed.

The next chapter provides a discussion on the expectation of the relationships that involve the three test variables – political influence, corporate governance strength and financial reporting quality and how the hypotheses of the relationships between the variables are developed.

CHAPTER FOUR
HYPOTHESES DEVELOPMENT

4.0 INTRODUCTION

The previous chapter provided a theoretical framework within which to develop research hypotheses. This chapter describes the development of the research hypotheses predicting the relationships between political influence, corporate governance and financial reporting quality.

Following the introduction section, this chapter has three main sections: Section 4.1 describes the framework of the study based on the theoretical framework discussed in the previous chapter. Section 4.2 covers the development of hypotheses and is divided into four sub-sections related to four research hypotheses. Section 4.3 provides a summary of the chapter.

4.1 THE STUDY FRAMEWORK

This study argues that political influence can occur through government ownership, government holding of a golden share and the presence of politician/s on board of directors. In this regard, the study examines political influence in Malaysian companies. These companies include those where the government has share and/or golden share ownership and politician/s on the board, non government-owned companies but with politicians appointed on the board, and other private companies.

It is argued in the study that the government has influence on and/ or control over a company through the ownership of shares or a golden share in it and through politicians appointed by the government as its representatives on the company board. Political influence can also occur in a non government-owned company with the presence of politicians on the board of directors.

Within the framework of agency theory discussed in the previous chapter, it is argued in the current study that in the government-owned companies, agency conflict can occur between (1) the government (the principal and also the agent of the people) and the managers (the agents); (2) the government (the principal) and the politician as the government's representative on the board (the agent)[15]; (3) politician (the principal) and the managers (the agents); and (4) the managers (the agents) and other shareholders (the principals). Government can have a direct influence on or control over its owned companies by imposing its policies, rules and regulations in order to achieve national and political agendas. The actions of the manager that have been influenced by the government may conflict with the manager's economic interest.

In addition, the government can monitor or have control over managers' actions and decisions by appointing politicians as its representatives on the board. A politician is a true agent for the government when he/she is acting in the government's interest. On the other hand, a politician as the government's representative can also use his/her political power to influence the managers in his/her personal interests. These personal interests may contradict the government's policies and/or the managers' economic objectives. The study argues that the influence of politicians on the board can also occur in a company which is not owned or controlled by the government but which has appointed a politician to its board to create linkage with the government. The linkage, as discussed in the previous chapter, can secure benefits from the government. In some situations, politicians may use bribes in terms of subsidies to influence managers to act in their personal interests (Shleifer and Vishny, 1994). The interests may contradict with those of the managers to maximise other shareholders' interests.

Therefore, it is expected that there is a link between political influence and the outcomes of the managers' actions and decisions. In this study, political influence is proxied by government ownership, the existence of a golden share, and the presence of politician/s on the board, and the outcomes in terms of both corporate governance

---

[15] Politician control is viewed as a form of agency problem because politicians enjoy the control rights but are not the residual claimants, and thus can be viewed as agents of the citizens too (Bai & Wang, 1998).

strength and financial reporting quality (both disclosure quality and earnings quality) are examined.

The findings of prior studies, as discussed in the previous chapter, indicate that political influence negatively affects financial reporting quality and corporate governance. However, almost every study reviewed limits political influence to a particular measure, most of them using political connection and government or state ownership. The current study considers three measures of political influence simultaneously – government ownership, political connection through the presence of politician/s on the board, and the existence of a special (golden) share held by the government. In relation to financial reporting quality, the current study tests both the main proxies for financial reporting quality – disclosure quality and earnings quality.

In respect of corporate governance, most of the prior studies examine certain corporate governance mechanisms, and indicate that certain corporate governance mechanisms (such as an effective board and / or audit committee) have done an effective job of monitoring which then resulted in enhanced financial reporting. Only a few research studies incorporate various corporate governance mechanisms to represent the strength of corporate governance as a whole. The current study extends prior studies by incorporating various mechanisms in an index, in order to determine corporate governance strength and then relates this to financial reporting quality. Further, the current study extends prior studies by examining the mediating effect of corporate governance on the relationship between political influence and financial reporting quality. The results of most of the prior studies are based on listed companies in developed countries, especially in the United States, which might not represent unique characteristics of companies in developing countries and emerging markets. Whether political influence provides the same effect on corporate governance and financial reporting quality in the setting of developing countries and emerging markets has not been thoroughly examined.

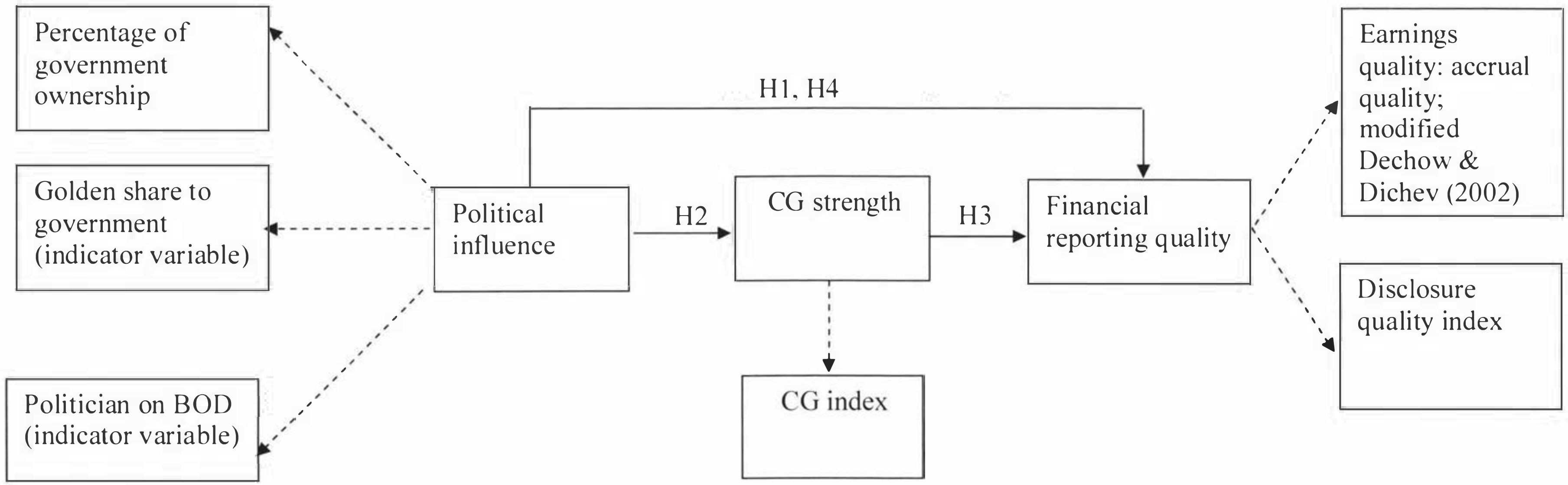
Figure 4.1 summarises the framework of the study. The relationship between political influence, corporate governance strength and financial reporting quality is examined to achieve the following four relevant research objectives:

1. To examine the direct effect of political influence on financial reporting quality.
2. To examine the direct effect of political influence on corporate governance strength.
3. To examine the effect of corporate governance strength on financial reporting quality after controlling for political influence.
4. To examine the mediating effect of corporate governance on the relationship between political influence and financial reporting quality.

As shown in Figure 4.1, political influence is proxied by three attributes –the percentage of government ownership, the existence of a golden share held by the government (indicator variable) and the presence of politician/s on the board (indicator variable). Corporate governance strength is measured by a total score from company annual report as per corporate governance index. Two attributes are used for financial reporting quality – earnings quality (accrual quality derived from the regression of the modified Dechow & Dichev (2002) model) and disclosure quality (measured by a total disclosure score from company financial report as per a disclosure index).

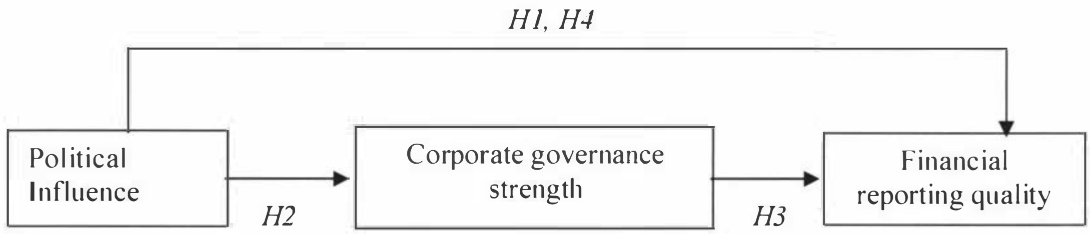
The expected links between the three variables (political influence, corporate governance strength and financial reporting quality) as modelled in Figure 4.2 become the framework used to develop the hypotheses of this study.

Figure 4.1 The Study Framework



Key:
BOD : Board of directors
CG : Corporate governance

Figure 4.2 Expected Links between Political Influence, Corporate Governance Strength and Financial Reporting Quality



Hypothesis one tests a direct relationship between political influence and financial reporting quality. Hypothesis two tests a direct relationship between political influence and corporate governance strength. After controlling for political influence, hypothesis three tests the relationship between corporate governance strength and financial reporting quality. Finally, hypothesis four tests the mediating effect of corporate governance strength on the relationship between political influence and financial reporting quality. The development of the hypotheses is discussed in the following section.

4.2 HYPOTHESES DEVELOPMENT

4.2.1 Political Influence and Financial Reporting Quality

Within the framework of agency theory, severe agency problems may occur when there is government influence in a company and/or politicians as board members. In addition to the usual agency problems, political pressures can induce managers to move away from profit-maximising goals (Roe, 2003). The accounting systems of a firm can also be seriously affected when there exist such political influences.

Government or politicians can influence managers to report selective information and to present the annual reports in their best interests (Zimmerman, 1977). Agency problems may also lead to the issuance of substandard financial information (Chung et al., 2005; Richardson, 2006) or may result in the amount of accounting information that is disclosed being reduced (Rodriguez et al., 2007). In this regard, Belkaoui (2004, p.6) points out that "principal-agent conflict suggests that the firm's insiders are more inclined to mask firm performance to minimize outsiders' and/or legal intervention and/or to present a financial picture that can be deemed as financially attractive by outsiders" – the activities which Belkaoui (2004) refers to as earnings opacity, which indicates a low quality of earnings. In another study, agency problems may negatively affect the credibility of earnings due to manipulation by controlling owners (Fan & Wong, 2002). The low credibility of earnings can imply a low earnings quality and the controlling owners in the current study include the government through a concentrated ownership.

The concentrated ownership structure and dominance of control-oriented shareholders have a negative impact on transparency and disclosure (Zhuang, 1999a). If ownership is concentrated in government, the demand for disclosure is less. This is consistent with Kothari (2001), who states that the demand for high-quality financial information is reduced because the stakeholders and management resolve much of the information asymmetry when corporations have concentrated ownership (Kothari, 2001). Lack of demand for disclosure, coupled with weak enforcement, suggests that the quality of financial disclosure will be poor. In addition, according to Kothari (2001), financial statement numbers in such corporations are likely to be influenced by the payout preferences of the agents for labour, capital and government, which can be met in part by earnings management. This suggests that corporations with concentrated government ownership have a tendency to produce low-quality financial reporting.

Empirical studies have found that political influence is negatively related to financial reporting quality (Aggarwal, 1999; Belkaoui 2004; Bushman & Piotroski 2006; Bushman, Piotroski et al. 2004; Kothari 2001; Leuz & Oberholzer-Gee 2006). Bushman, Piotroski et al. (2004) found low financial disclosure in companies with political influence. Kothari (2001) suggested an increase in earnings smoothing and earnings management in companies which are exposed to political influence and Belkaoui (2004) related political influence to earnings opacity, which indicates low earnings quality.

Therefore, it is expected that political influence would negatively affect financial reporting quality and the relationship is hypothesised as follows (stated in the alternative form against a null of no effect):

H1: Political influence is associated with lower financial reporting quality

4.2.2 Political Influence and Corporate Governance Strength

Within the framework of agency theory, corporate governance provisions appear as a result of the agency conflict between the different parties of a company. Because of the differences between the interests and incentives of managers, shareholders and other resource providers, corporate governance mechanisms are put in place to reduce agency problems. Agency theory suggests that agency problems can be reduced by separating management and the control aspects of decision-making (Beasley, 1996; Fama & Jensen, 1983a, 1983b). In this regard, the board of directors, in terms of its size and composition, is recognised as being the most important internal protection against issues arising from agency conflict (Fama & Jensen, 1983a, 1983b; Singh & Davidson, 2003).

Specifically, corporate governance is designed to monitor management's behaviour (Botica-Redmayne, 2004) as well as to monitor and determine a company's overall information disclosure policy (Lopes & Rodrigues, 2007). The role of governance mechanisms in determining disclosure policy may be either complementary or substitutive (Ho & Wong, 2001a). It is complementary when the adoption of governance mechanisms strengthens the internal control of a company and prevents managers from withholding information for their own benefit. This leads to an improvement in disclosure comprehensiveness and in the quality of financial information. It is substitutive when governance mechanisms reduce information asymmetry and opportunistic behaviours in a company, resulting in a decrease in the need for more monitoring and disclosure.

If corporate governance structure is weak, management's behaviour cannot be properly monitored and may result in unfavourable outcomes. Previous studies have provided evidence that poor governance is associated with the consequences of management's misbehaviour, such as earnings manipulation (for example, Dechow et al., 1996), financial statement fraud (for example, Beasley, 1996) and low quality of financial reporting (Wright, 1996). This implies that the strength of corporate governance may affect the outcomes of management behaviour such as the quality of financial information and reporting. The stronger the corporate governance mechanism, the more effective its monitoring function in reducing unfavourable outcomes is.

Higher government ownership tends to be closely related to more political control (Xu, Zhu, & Lin, 2005). Having government or political control over a company indicates political influence on a company's major economic decisions and in appointing a board of directors and management. As discussed in the literature review, prior studies have confirmed this relationship (Agrawal & Knoeber, 2001; Fan et al., 2007). Fan et al. (2007) found that politically connected companies are likely to appoint more bureaucrats to the management team and board of directors and fewer directors with professional backgrounds or prior business experience. This may influence the strength of the company's governance. Political power or control is exercised over a firm not only through the appointment of the board of directors and management, but also through controlling its board in selecting auditors (Wang, Wong, & Xia, 2008). In addition, government influence or interference has been found to weaken the governance of a company (ADB, 1998; Nee et al., 2007).

If a government has control over a company, the government may influence the company's governance systems to achieve political objectives rather than optimal economic performance. Overall, with political influence, the strength of corporate governance may be reduced. Within this framework, the following relationship is hypothesised (stated in the alternative form against a null of no effect):

H2: Political influence is associated with weaker corporate governance

4.2.3 Corporate Governance and Financial Reporting Quality

One purpose of corporate governance is to mitigate agency costs by improving the quality of financial reporting. Prior studies have documented links between internal governance mechanisms and financial reporting quality, measured in terms either of the quality of disclosure or of the quality of earnings.

Associations have been found between disclosure quality and board characteristics: the proportion of independent board members (Chen & Jaggi, 2000; Leftwich et al., 1981), the existence of an audit committee (Ho & Wong, 2001a), the existence of dominant personalities on the board (Forker, 1992), and the expertise and independence of the audit committee (Bedard et al., 2004). Other studies also show links between disclosure quality and governance mechanisms (Claessens & Fan, 2002; Haniffa & Cooke, 2002; Wright, 1996).

Earnings management has been found to be associated with board competency, board size, audit committee independence, frequency of audit committee meetings and the existence of financial experts on the audit committee (Chtourou et al., 2004). Independent boards of directors and audit committees have been found to control earnings aggressiveness (Beasley, 1996; Klein, 2002; Peasnell et al., 2005). Effective boards are also positively related to earnings accuracy (Ajinkya, Bhojraj, & Sengupta, 2005; Karamanou & Vafeas, 2005), earnings informativeness (Vafeas, 2000) and earnings credibility (Fan & Wong, 2002; Francis, LaFond et al., 2005).

Shen and Chih (2007) used an index to measure the strength of corporate governance and concluded that companies with good corporate governance constrain earnings management and thus increase earnings quality. Lara et al. (2007) found that companies with stronger corporate governance report more conservative earnings.

In general, prior studies have found that the characteristics of weak corporate governance structure such as the existent of dominant personalities, a lower proportion of independent directors, the non-existence of audit committees, and the non-independence of audit committees are associated with low financial reporting quality. The evidence suggests that weak corporate governance reduces financial reporting quality even when the effects of political influence are absent. Accordingly, the current study hypothesises the same relationship when political influence is present but controlled for (stated in the alternative form against a null of no effect):

> **H3:** After controlling for political influence, weak corporate governance is associated with low financial reporting quality.

4.2.4 Mediating Role of Corporate Governance on Political Influence – Financial Reporting Quality Relationship

The presence of a dominant shareholder, such as the government, in a company has been argued to have a negative influence on the quality of corporate communication, by using the company's financial reporting system to benefit the dominant shareholder (Melis, 2004). When the owner of a company is part of management, they may have a personal interest in the information disclosed and incentives to manage the disclosures (Ball, 2001). This creates a moral hazard and information asymmetry between the owner and outside investors; and when the owner's holding in a company increases and governance mechanisms of the company are weak then monitoring will be more difficult to perform (Morck, Shleifer, & Vishny, 1988).

Prior studies do not relate the two variables – political influence and corporate governance – with financial reporting quality. However, it has been shown in past studies that political influence leads to weak corporate governance (for example, Bushman, Piotroski et al., 2004; Leuz & Oberholzer-Gee, 2006) and weak corporate governance contributes to low financial reporting quality (Wright, 1996; Shen & Chih, 2007; Lara et al., 2007).

Within the agency theory framework, the existence of political influence causes severe agency conflicts and problems and the problems would negatively affect the outcomes of the managers' decisions. Corporate governance, which supposedly acts as a control mechanism, could not perform as expected because the political influence could lead to the weak governance structure that best accommodates the interests of the government or politicians. Specifically, political influence, either in terms of direct influence from government or influence from politicians as board members, has been found to weaken the governance of a company (Nee et al., 2007; Wang et al., 2008). It is therefore expected that when there is political influence on corporate governance, the corporate governance strength will be weaker and the quality of financial reporting as a whole will be reduced. Therefore, it is expected that political influence will negatively affect corporate governance strength and will together affect financial reporting quality. Therefore corporate governance strength mediates the political influence-financial reporting quality relationship. This expectation helps develop the following hypothesis (stated in the alternative form against a null of no effect):

> **H4:** Corporate governance mediates the relationship between political influence and financial reporting quality.

4.3 CHAPTER SUMMARY

This chapter has discussed the framework of the study based on agency theory, and the concepts and measurement of political influence, corporate governance strength and financial reporting quality provided in the previous chapter. Agency theory provides a framework linking political influence, corporate governance and financial reporting quality to develop the hypotheses.

It is first hypothesised that political influence is associated with lower financial reporting quality, and it is then hypothesised that political influence is associated with weaker corporate governance. Further, it is hypothesised that after controlling for political influence, weak corporate governance is associated with low financial reporting quality. Finally, it is hypothesised that corporate governance mediates the relationship between political influence and financial reporting quality.

The next chapter describes the analysis employed in testing the hypotheses, including the dependent, independent and control variables.

CHAPTER FIVE
RESEARCH DESIGN

5.0 INTRODUCTION

This chapter outlines the research methods employed in the current study. Following the introduction section, Section 5.1 presents a discussion on the mixed-method design used in this study. Section 5.2 discusses the sample and data collection. The measurement and measures of variables involved are discussed in Section 5.3. Section 5.4 discusses the data analysis which covers both quantitative and qualitative analyses. Finally, Section 5.5 provides a summary of the chapter.

5.1 MIXED-METHOD DESIGN

In an effort to shed light on the relationship between political influence, corporate governance and financial reporting quality, a mixed-method design was deemed appropriate for meeting the aim and objectives of the current study. A mixed-method design is defined as "the collection or analysis of both quantitative and qualitative data in a single study in which the data are collected concurrently or sequentially, are given a priority, and involve the integration of the data at one or more stages in the process of research" (Creswell, Plano Clark, Gutmann & Hanson, 2003, p.212). Within this design, quantitative and qualitative methods are combined and the results from one method can be used to elaborate on results from the other method (complementarily) and to help develop or inform the other method (development) (Hanson, Plano Clark, Petska, & Creswell, 2005). According to the researchers, the combination of the two methods can also recast results from one method to those from the other method (initiation) and extend the inquiry range by using different methods for different inquiry components (expansion). In the current study, the rationale for using the mixed-method design is "complementarily", in that the results from qualitative method were used to elaborate on the results from quantitative method.

In a mixed-method design, data is collected either concurrently or sequentially. According to Creswell (2003), in a sequential procedure, both quantitative and qualitative data are collected in phases (sequentially). In this procedure, either the quantitative or qualitative data may come first, depending on the purpose of the research. It is called "sequential explanatory design" when the quantitative data collection and analysis are carried out first, to be followed by that of the qualitative data. In this regard, the qualitative results are used to help explain and interpret the findings of the quantitative method. If the qualitative data comes first, followed by the quantitative data, it is called "sequential exploratory design". For this design, the primary focus is to explore phenomena of research through a qualitative approach. Another version of the sequential procedure is "sequential transformative design". In this design, either method may be employed first and be given equal or different priority. In contrast with the other two strategies using a sequential procedure, sequential transformative design needs a theoretical perspective to guide the particular study.[16]

Whereas the above sequential-based procedures collect types of data sequentially, concurrent procedures gather quantitative and qualitative data at the same time – concurrently – during the data collection phase. This procedure can be divided into three types – the "concurrent triangulation strategy", the "concurrent nested strategy" and the "concurrent transformative strategy" (Creswell, 2003, p.216). In the concurrent triangulation strategy, both quantitative and qualitative methods are employed simultaneously in order to confirm, cross-verify or support findings within a single study (Greene, Caracelli, & Graham, 1989; Morgan, 1998). The priority may be equal between the two methods or may be given to either quantitative or qualitative method. When this strategy is utilised, the results of the two methods are integrated during the interpretation phase. With the concurrent nested strategy, one particular method (either quantitative or qualitative) is embedded within the predominant method. The data collected from both methods are mixed when the data is analysed. Finally, the concurrent transformative strategy applies a specific theoretical perspective to guide the particular study. In order to facilitate the

[16] See Creswell (2003, pp.215–216) for a detailed discussion on the three sequential strategies.

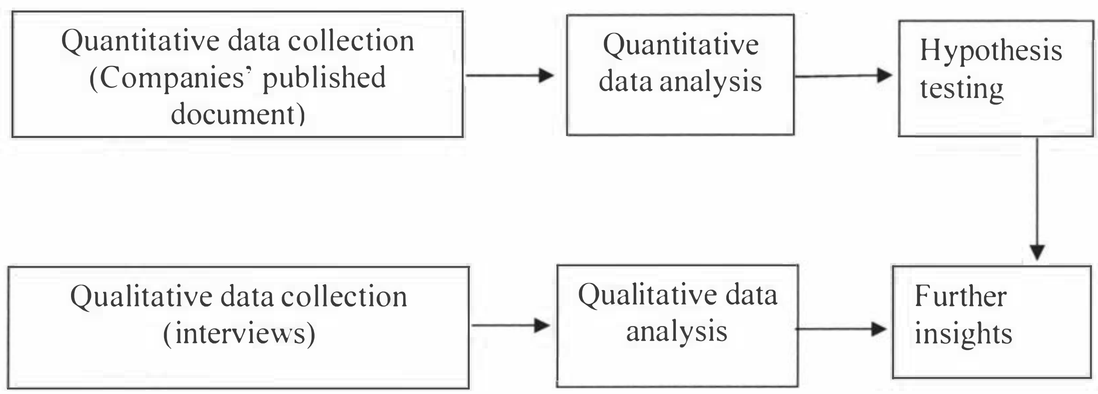
particular theoretical approach, either triangulation or a nested strategy may be used.[17]

The current study employed the sequential explanatory design of inquiry, where quantitative data were collected and analysed to test formal hypotheses and then qualitative interviews were conducted to provide further insights into the findings. Specifically, companies' financial data and other published corporate data gathered from companies' annual reports and databases (quantitative data) were collected and analysed, and the political factors that are associated with corporate governance and financial reporting quality were identified. In addition, insights gained from the interviews of a sample of companies' top management (qualitative data) were used to further examine the impact of political influence on the economic decision-making process in a company. In this regard, priority or relative emphasis given to the two types of data would be unequal, in that the quantitative data as major component of the study was emphasised more than the qualitative data. By employing this design, the two forms of data were analysed separately and an integration of the quantitative and qualitative results occurred in the discussion (Hanson et al., 2005). This sequential explanatory design is appropriate to the current study as it allows explanation and interpretation to relationships and study findings to be made (Creswell, 2003), especially when unexpected results arise from a quantitative method (Hanson et al., 2005). The results from the interviews may serve confirmation (Denzin, 1970) and completeness (Jick, 1983) purposes. In the current study, the interviews serve a completeness function: the results from the quantitative method were elaborated on and enhanced by the results from the analysis of interview data. The strategy of inquiry employed in the current study is shown in Figure 5.1.

---

[17] See Creswell (2003, pp.217–219) for a detailed discussion on the three versions of the concurrent procedure.

Figure 5.1 The Current Study's Strategy of Inquiry



The data collection and analysis of both quantitative and qualitative methods are discussed in the sections that follow.

5.2 SAMPLE SELECTION AND DATA COLLECTION

As the current study involved both quantitative and qualitative methods, both types of data were gathered. In so doing, the selection of samples and data sources were determined for each method of data collection.

5.2.1 Quantitative Data Collection

The population for this study comprises non-financial Malaysian companies active during the period 1999 – 2003 (See Appendix B for the list of companies used in the study). This period was chosen as it was an economically stable period after the financial crisis of 1997. Malaysia had introduced a disclosure-based regime to encourage transparency and accountability, and this regime was fully implemented in 2001. The five-year period covers both the time before and after this implementation. This enables an indirect look at the contribution of such a regime towards improvement of financial reporting quality and corporate governance in Malaysia.

Financial institutions were excluded because they were subject to a regulatory framework that did not apply to other companies.[18]

The sampling frame for listed companies was the Bursa Malaysia (formerly known as the Kuala Lumpur Stock Exchange – KLSE)[19] list, and for non-listed companies was the list of companies registered with the Companies Commission of Malaysia (CCM). A sample of listed companies was selected by stratified random sampling, with firms being randomly selected from each of the nine major industry sectors classified by the Bursa Malaysia. The stratified random sampling was used to ensure that different industries in the population were adequately represented in the sample (Frankfort-Nachmias & Nachmias, 1996). Of the total 757 companies listed on the Bursa Malaysia (as in 1999), the appropriate sample size should be of about 251 companies or the ratio of 1:3 (Neuman, 1997). In the current study, a sample size of 256 listed companies was drawn. The sampling from the different industries was done by applying a uniform sampling ratio (sample size/population size), in that the sample size drawn from each industry was proportionate to the population size (Frankfort-Nachmias & Nachmias, 1996, p.188). Having decided the number of companies needed for each industry, companies were randomly selected from each industry. Companies having insufficient data, being under special administrators, or having changed their accounting year-end were excluded.

A sample of non-listed companies was selected from companies registered with the CCM. Forty-three non-listed companies which were clearly classified under one of the Bursa Malaysia classifications of industry sectors and which had data available for the five-year period were purposively selected for analysis.[20] The combined

---

18 The industry is greatly regulated under the Banking and Financial Act, 1989. Among others, the act allow financial institutions (FIs) to make portfolio investments in non-financial business up to a maximum of 20 percent of a FI's shareholders' funds and up to 10 percent of the issued share capital of a company in which the investment is made. The FIs are not allowed to assume any management role or take up a board position.

19 The Kuala Lumpur stock Exchance (KLSE) became a de-mutualised exchange and was renamed Bursa Malaysia in April 2004.

20 This was done for cost reasons: a fee is charged for each company record retrieved, with no assurance that the selected company will have useable data. However, it was assumed that the selected non-listed companies would represent the active companies during the period of study and cover the nine industry classifications.

sample comprised 299 companies (256 listed and 43 non-listed) with 1495 company-years of observations. The sample of listed companies represented approximately 34 percent of the total companies listed on the exchange in 1999.

The number of selected companies (listed and non-listed) from the nine major industry sectors are as follow: construction (26), property (39), consumer products (31), industrial products (73), plantation (32), technology (7), infrastructure (7), hotels (7) and trading and services (77).

The main source of data for the listed companies was Thomson DataStream. Also used were companies' annual reports[21], KLSE annual handbooks and the KLSE-RIAM Information System. Data collected from one source were verified by reference to other sources whenever possible. For non-listed companies, the data were hand-collected from copies of companies' annual reports acquired from the CCM.

5.2.2 Qualitative Data Collection

For the qualitative data collection through interviews, the selected interviewees were Chief Executive Officers (CEO), Managing Directors (MD), General Managers (GM) and Chairmen (or ex-CEO and ex-MD) of companies that were deemed to have political influence (conceptualised in the study as companies with government ownership, politician/s on the board or a golden share held by the government). These individuals were chosen because they were considered to be the top management people and had been directly involved in the company's decision-making processes. They were the company's substantive leader whose roles included the gathering and dissemination of information, decision-making and resource allocation (Thomas & Simerly, 1994), and cultivating organisation culture to achieve business excellence (Hardjono & Marrewijk, 2001). Ex-CEOs and ex-MDs were also included because their past experiences in governance and decision-making process was still relevant. In addition, the ex-CEOs and ex-MDs were believed to have more freedom to express their views regarding political influence in the companies they

21 Companies' annual reports were accessed via http://www.klse.com.my/website/bm/ or from the Bursa Malaysia Library.

had previously headed. The interview subjects were from listed and non-listed companies from different industries. A convenience sampling method was used in the selection of the potential interviewees. They were chosen from those who were easy to access and agreed to participate. Personal contacts were used in order to get their cooperation, which would otherwise have been difficult given the sensitive, political nature of the study subject. Thirty top management or ex-top management personnel were approached but six declined an interview. In total, the interviews involved twenty-four people from twenty-four companies.

Face-to-face semi-structured interviews were employed in the current study in order to allow the interviewees to explain their thoughts and to highlight any areas of particular interest they had, as well as to enable certain responses to be explored in greater depth, for example, to bring out and resolve any apparent contradictions (Horton, Macve, & Struyven, 1996).

A semi-structured interview was preferred as it gave the researcher more control over the timing, content and sequencing of questions. In addition, having the researcher as interviewer allowed the improvisation of suitable follow-up questions and the interviewees a degree of freedom to explain their views. Structured and unstructured interview approaches were not considered in the study. This is because in structured interviews, interviewees are not free to provide additional information and to express their thoughts. Unstructured interviews are unsuitable and impracticable because they can be time consuming and would not suit the time constraints of interviewees with busy working lives. Although an unstructured interview may provide more interesting and expanded information, unfocused information would not be helpful at the data analysis stage. As Cavana, Delahaye and Sekaran (2001) point out, unstructured interviews can provide more interesting information but are very time consuming and can lose the focus on the research objectives.

In the current study, open-ended and probing questions were used in the interviews, in addition to questions related to the interviewees' demographic characteristics (namely age, education, position in the company, number of years in the position, number of years in the company and other positions held in the last five years) (see Appendix C for the interview schedule used in the study). This information is important because background and experience may influence the evaluation of the activities they were involved in (Wiersema & Bantel, 1992). Additionally, age and education factors may influence the decision-making process as Mellahi and Guermat (2004) found that younger executives are more receptive to new ideas compared to older executives and O'Neill, Saunders and McCarthy (1989) found that a person's values, knowledge and skill-base are shaped by their educational background.

For the open-ended questions, an interview guide was prepared and was followed during the interview sessions. At the initial stage of the interview process, the interviewees were asked to describe their background and experience and their personal or company's policy on voluntary disclosures. They were then asked about the importance of earnings predictions in addition to their methods for achieving such predictions. Towards the end of each interview, the issue of political influence was raised and topics such as the respondent's understanding of political influence concepts and their views on political influence in their company were included. These issues were saved until last because they were potentially sensitive. This is consistent with the suggestion of Sudman and Bradburn (1983) that riskier questions be asked later in the interview.

Throughout the interviews, leading questions and pre-set agendas were avoided as much as possible. Instead, the respondents were asked to freely discuss the importance of political influence in economic decision-making in their respective companies. Within this, decisions related to voluntary disclosure and reported earnings were spontaneously explored. These were then followed by clarifying questions on, for example, the relative importance of different groups in decisions involving voluntary disclosure and reported earnings. Allen and Blythe (2004) stated that clarifying questions play a key role in clarifying discussion and provide specific information that the interviewer needs in order to enhance their own understanding.

The interviews were recorded on tape (with the permission of the participants – the participants were first informed that their answers would be recorded and they were assured of confidentiality) and were summarised in note-form. The notes were used to recall comments that were unclear on the tape. The interviews varied in length from forty-five to sixty minutes.

5.2.2.1 Ethical Issues

As the interviews involved investigation into the attitudes and beliefs of human subjects, ethical issues were considered in relation to privacy and other rights of the subjects (Neuman, 2000). Prior to the interview data collection, approval from the Massey University Human Ethics Committee: Southern B (reference: HEC: Southern B Application – 06/33) was obtained. The approval was granted based on the considerations of any potential risks to the human subjects, the existence of procedures to obtain informed consent and to ensure privacy and confidentiality. During the interviews, informed consent was obtained by giving a brief description of the purpose and procedure of the study along with an information sheet that detailed the approach of the study. They were also informed that their participation was completely voluntary and were assured of the confidentiality of their responses as the results of the study would be used only in aggregated form. This was done to ensure that there would not be any risk to the interviewees in their work place or to their personal environment.

5.3 MEASUREMENT AND MEASURES OF VARIABLES

As the nature of the current study is mainly hypothesis testing, careful measurement of the variables related to these hypotheses is important (Cavana et al., 2001). The key variables used were disclosure quality and earnings quality (as dependent variables and proxies for financial reporting quality), percentage of government ownership, the existence of a golden share and the presence of politician/s on the board of directors (as independent variables and proxies for political influence), and corporate governance strength (as the dependent variable in one hypothesis and mediating variable in another hypothesis). The measures of these and control variables are discussed in the sections that follow.

5.3.1 Disclosure Quality

As discussed in Chapter Three, most previous research used two proxies for companies' disclosure quality – self-constructed scores (such as Botosan, 1997; Cooke, 1989; Naser & Nuseibeh, 2003), and externally generated scores such as the Association of Investment Management Research (AIMR) scores and Standard and Poors's (S&P) scores (for example, Lang & Lundholm, 1996; Patel, Balic, & Bwakira, 2002; Wright, 1996). Ab Manan and Mohd Iskandar (2003) assessed disclosure quality using the classification of companies made by the NACRA[22] committee, so their study was restricted to companies which entered the NACRA competition and were chosen for its selection process.

Since a broader set of companies was needed in the current study, a disclosure index using items selected from a combination of the NACRA criteria and S&P's financial information disclosure items was constructed.

Whereas prior studies (for example, Wei, Hui, Cheng, & Wei, 2007; Chen, Chen, & Cheng, 2008) used S&P analysts' ratings as proxies of disclosure quality, the current study uses the S&P list only to identify items to include in the disclosure index. Scoring the items directly from financial reports allows objective measurement, avoiding the subjectivity inherent in analysts' judgments (Khanna et al., 2004). Moreover, Healy and Palepu (2001) noted that self-constructed measures increase confidence as the index captures what it is intended to evaluate. In the same vein, Bushee (2004, p. 524) noted that "the biggest payoff to future researchers will likely come to those who construct their own disclosure indexes"[23]. Out of the ninety-eight disclosure items that constitute the S&P's index, only financial information items were involved as the current study focused on financial reporting quality, and not on overall corporate reporting quality. The S&P disclosure index was chosen instead of other indices, such as those of the Center for Financial Analysis and Research (CIFAR) or the Association of Investment Management Research (AIMR), because

[22] The National Annual Corporate Report Awards (NACRA) is organised by the Bursa Malaysia Berhad, the Malaysian Institute of Accountants, the Malaysian Institute of Management and the Malaysian Institute of Certified Public Accountants to promote the highest standards in corporate reporting (Pushpanathan, 2007). The awards are based on criteria including timely publication of annual reports, compliance with accounting standards and having an unqualified audit report.

[23] See Bushee (2004) for a discussion of positive and negative aspects of the different types of disclosure indexes.

when comparing the S&P disclosure items with the other two disclosure indices, it was found that the S&P was more comprehensive and transparent. As Patel et al. (2002) argued, the S&P has introduced a methodology to assess the level of transparency and disclosure along the dimensions of timely and adequate disclosure of financial information, among others. Although the S&P list constitutes a global benchmark (Patel et al., 2002), it is based on best practice in United States companies and may also be biased towards large companies (Francis et al., 2008a). Thus, it was deemed better for the current study to add the NACRA criteria, which take into account the Malaysian business environment. The use of NACRA criteria is considered appropriate as the criteria were determined by Malaysian professional bodies and are widely recognised in Malaysia. However, basing assessment on only local requirements, such as this, may bias the disclosure. Therefore, in the current study, the NACRA criteria were combined with the thirty-five items of financial information disclosure from the S&P index to form a list of items used to assess disclosure quality. By combining the NACRA criteria and S&P's financial information disclosure items, the assessment of the financial reporting quality of the Malaysian companies' financial reports has taken into account both the local recognition of good quality financial reporting in an international context, as well as the common practice of financial reporting.

The index includes both mandatory and voluntary items, as some of the items in the NACRA portion of the index are mandatory items (e.g. provision of balance sheet, income statement, cash flow statement, statement of changes in equity, consolidated statements, significant accounting policies and auditor's report). Although the sampled companies are expected to disclose all mandatory items, the assumption is not necessarily true. This is due to inadequate regulatory framework and weak enforcement mechanism, especially in a developing country, like Malaysia (Ku Ismail & Abdullah, 1998; Ahmed & McNicholls, 1994). An initial examination on the disclosure of two of the mandatory items from the NACRA portion ("a signed audit report" and "a signed statement by the directors stating their views on the financial statements") revealed that 64% (in 1999) and 47% (in 2003) of the total 256 listed companies in the sample did not present "a signed audit report", and 64% (in 1999) and 48% (in 2003) did not present "a signed statement by the directors stating their views on the financial statements". This indicates that even a listed company which is expected to disclose all mandatory items fails to do so because of the country's weak enforcement mechanism. Therefore, the inclusion of mandatory items in the index in determining disclosure quality is relevant for the current study.

An unweighted index was employed in the current study because prior studies employing both weighted and unweighted indices have reported identical results (Chow & Wong-Boren, 1987; Naser & Nuseibeh, 2003; Wallace & Naser, 1995). This type of index employs a dichotomous procedure in that a score of 1 was given to each disclosed item and 0 otherwise. The study's disclosure index score is simply a count of items disclosed divided by the number of items applicable to each particular company. This avoids penalising companies for non-disclosure of irrelevant items (Ferguson, Lam, & Lee, 2002; Wallace & Naser, 1995). The disclosure index developed and used in the current study is shown in Table 5.1. Some of the index items appear to be very similar (e.g. item 12 from the NACRA portion and items 16 and 17 from the S&P portion). However, the items were retained and included in both NACRA and S&P portions because it was thought that the NACRA criteria was very general while the S&P criteria could provide detailed description or discussion. This means that if an item appears in both portions, NACRA and S&P, it is more widely seen as essential and the item is scored more than once indicating greater weight is given to that particular item.

Table 5.1: Disclosure Index

No	NACRA Financial Reporting Quality Criteria.
1	Does the company provide a summary of results covering at least three years' performance?
2	Does the company provide a summary of share prices for at least three years?
3	Does the company provide a summary of earnings per share for at least three years?
4	Does the company provide a summary of dividends per share for at least three years?
5	Does the company provide a summary of shareholder statistics for at least three years?
	Review of operations:
6	Is there a discussion of the organisation's principal activities and results for the year?
7	Does the company provide an indication of earnings trends and prospects?
	Financial statements should comprise:
8	A balance sheet.
9	An income statement.
10	A statement of changes in equity or a statement of recognised gains and losses.
11	A cash flow statement.
12	Significant accounting policies.
13	Disclosure of comparative figures covering at least the last financial year.
14	Cross-references between the statements and notes.
15	A signed statement by the directors stating their views on the financial statements.
16	A signed audit report.
	Additional disclosures beyond the statutory requirements
17	Analysis of major expenses (e.g. raw materials, labour cost, R&D expenditure).
18	Details of short-term debt financing arrangements and facilities.
19	Details of long term debt financing arrangements and facilities.
20	Disclosure of the estimated fair value or replacement market value of major assets.
	Total
	S&P's
No	**Business focus**
1	Is there a discussion of corporate strategy?
2	Does the company report details the kind of business it is in?
3	Does the company give an overview of trends in its industry?
4	Does the company report details of the products or services produced/provided?
5	Does the company provide a segment analysis, broken down by business line?
6	Does the company disclose its market share for any or all of its business?
7	Does the company report basic earnings forecast of any kind? In detail? (Two items)
8	Does the company disclose output in physical terms?

Table 5.1: Continue...

No	**Business focus**
9	Does the company give an output forecast of any kind?
10	Does the company give characteristics of assets employed?
11	Does the company provide efficiency indicators (ROA, ROE, etc.)?
12	Does the company provide any industry-specific ratios?
13	Does the company disclose its plans for investment in the coming years?
14	Does the company disclose details of its investment plans in the coming years?
	Accounting policy review
15	Does the company provide financial information on a quarterly basis?
16	Does the company discuss its accounting policy?
17	Does the company disclose the accounting standards it uses for its accounts?
18	Does the company provide accounts according to the local accounting standards?
19	Does the company provide each of the balance sheet, income statement, and cash-flow statement by internationally recognised methods? (Three items)
	Accounting policy details
20	Does the company disclose methods of asset valuation?
21	Does the company disclose information on method of fixed assets depreciation?
22	Does the company produce consolidated financial statements?
	Related party structure and transactions
23	Does the company provide a list of affiliates in which it holds a minority stake?
24	Does the company disclose the ownership structure of affiliates?
25	Is there a list/register of related party transactions?
26	Is there a list/register of group transactions?
	Information on auditors
27	Does the company disclose the name of its auditing firm?
28	Does the company reproduce the auditors' report?
29	Does the company disclose how much it pays in audit fees to the auditor?
30	Does the company disclose any non-audit fees paid to auditor?
	TOTAL
	TOTAL NACRA + S&P

In order to ensure validity, the researcher and an independent individual, familiar with annual report disclosure and holding a relevant accounting background, were involved in the scoring process. The scores given for every item by both parties were compared. Where there were differences, the Accounting Standards and Statutory Requirements were referred to and discussions followed until a consensus was achieved.

5.3.2 Earnings Quality

In determining earnings quality as a joint proxy of financial reporting quality with disclosure quality, the current study applied the modified version of Dechow and Dichev's (2002) accruals quality model proposed by McNichols (2002). This modified model is a combination of the Dechow and Dichev's original model (2002) and Jones's (1991) model (McNichols, 2002). The modified model captures the change in sales revenue and property, plant and equipment (PPE), the important elements that form expectations about current accruals, over and above the effects of operating cash flows (Francis et al, 2005). The use of these accrual quality models allows for improved measure of earnings quality as it is able to overcome the weaknesses of the absolute discretionary accrual model (McNichols, 2002) and other attributes of earnings quality such as earnings persistence, value relevance, predictability of earnings and timeliness and conservatism (Francis, LaFond et al., 2005). Additionally, the modified Dechow and Dichev model could significantly increase the explanatory power of the original model of Dechow and Dichev (McNichols, 2002).

The modified Dechow and Dichev (2002) model is as follow:

$$\frac{TCA_{j,t}}{Assets_{j,t}} = \beta_{0j} + \beta_{1,j}\frac{CFO_{j,t-1}}{Assets_{j,t}} + \beta_{2j}\frac{CFO_{j,t}}{Assets_{j,t}} + \beta_{3j}\frac{CFO_{j,t+1}}{Assets_{j,t}} + \beta_{4j}\frac{\Delta REV_{j,t}}{Assets_{j,t}} + \beta_{5j}\frac{PPE_{j,t}}{Assets_{j,t}} + \varepsilon_{j,t}$$

Where;

$TCA_{j,t}$	Firm j's total current accruals in year t $= \Delta CA_{j,t} - \Delta CL_{j,t} - \Delta Cash_{j,t} + \Delta STDebt_{j,t}$
$\Delta CA_{j,t}$	Firm j's change in current assets between year t-1 and t.
$\Delta CL_{j,t}$	Firm j's change in current liabilities between year t-1 and t.
$\Delta Cash_{j,t}$	Firm j's change in cash between year t-1 and t.
$\Delta STDebt_{j,t}$	Firm j's change in debt in current liabilities between year t-1 and t.
$Assets_{j,t}$	Firm j's average total assets in year t and t -1.
$CFO_{j,t}$	Firm j's net operating cash flows in year t.
$\Delta REV_{j,t}$	Firm j's change in revenues in year t-1 and t.
$PPE_{j,t}$	Firm j's gross value of plant, property and equipment (PPE).

Following Francis et al., (2008b), the accruals quality metric was determined based on firm-specific and time-series estimations of the modified Dechow and Dichev (2002) model. In the current study (where 5 years data from t =1999 – 2003 was used), for each company (j) and time (t), the relation between current accruals and past, current and future cash flows using the most recent seven years data (because of the inclusion of a lead and a lag cash flow term in the model) was estimated. The estimation provided five values of residuals for each firm. The accruals quality is therefore the standard deviation of the resulting five firm-specific residuals.[24] This is an inverse measure of quality in that the larger the standard deviation of the residuals (i.e. the larger the extent to which accruals do not map into cash flows, change in revenues and PPE), the lower the accruals quality which indicates lower earnings quality (Francis et al., 2005; 2008a; 2008b). The final measure of earnings quality used in the current study is discussed in Chapter Six.

5.3.3 Political Influence

Three proxies for political influence were used. The first followed the measurement of political economy used by Bushman, Piotroski et al. (2004). Since Bushman, Piotoski et al. (2004) used cross-country data, not all the measurements of political economy that they used are relevant to this study. The one used in the current study

[24] The firm-specific approach uses the firm as its own benchmark (as opposed to an industry approach used in Francis et al., 2005). According to Francis et al., (2008b, pg. 66), the firm-specific approach requires a time series of observations about each firm, while an industry approach requires only a sufficient size cross-section of firms in a given industry at a point in time, and the firm-specific approach may reduce noise in the measure of accruals quality.

was the percentage of government ownership.[25] To suit the Malaysian environment, the second measure of political influence was the control rights specified to government through a golden share.[26] A golden share permits the government to exert control over the affairs of a company, which indicates political influence in such a company (Adams & William, 1992). In the current study, the existence of golden share was a dummy variable that took a value of 1 if a government had control rights through a golden share and a value of 0 otherwise. The third measure of political influence was the presence of politician/s on the board of directors. This was also a dummy measure that took a value of 1 if one or more politicians were members of the board and a value of 0 otherwise.

A politician was defined as any politician who held a position at state or federal level, or who had previously been in a political party committee at state or federal level. In order to identify whether the board members were politician/s, the following procedures were carried out:

1. Review of information about the background of each member, available in each company's annual report.
2. Review of a list of cabinet members at federal or state level.
3. Review of a list of committee members of each political party, available on party websites.
4. Confirmation of the list of politicians identified in the above three procedures by a political expert from the Political Science Department of the National University of Malaysia.

---

25 In compliance with the Companies Act 1965, all listed companies disclose their substantial shareholders including their thirty largest shareholders in their annual reports. Section 69D (1) stipulates the mandatory disclosure of substantial shareholders who hold more than 5 percent of equity in any company, irrespective of their direct or indirect control interest. This includes their investment through nominees' institutions and other means. The government shareholding percentage is based on the thirty largest shareholders. The government shareholdings are proxied by Khazanah Nasianal, Employess Provident Funds (EPF), Tabung Haji (TH), Lembaga Tabung Angkatan Tentera (LTAT), Permodalan Nasional Berhad (PNB), State Economic Corporation Development (SEDC), Ministry of Finance Incorporated, Felda, Felcra and other government agencies.

26 Can be accessed under "Syarikat-syarikat Menteri Kewangan Yang Diperbadankan" via: http://www.treasury.gov.my/index.php

5.3.4 Corporate Governance Strength

Scores were calculated to represent the strength of corporate governance of each company. These were determined by applying a corporate governance index developed for the purposes of this study. The index was developed by taking into account (where appropriate) the index used by Brown and Caylor (2006). These researchers based their index on the International Shareholders Services (ISS) Corporate Governance Best Practice Users Guide and Glossary 2003. In addition, the Corporate Governance Codes of OECD countries (the United Kingdom, Australia and New Zealand) and Malaysian statutory requirements (the Companies Act 1965 and Listing Requirements of Bursa Malaysia 2001) were taken into account. With this combination, it was believed that the assessment of corporate governance strength would not be biased to the Malaysian environment but would also take into consideration best practice internationally. Table 5.2 shows the corporate governance index developed and used in the study.

In scoring each sample company's corporate governance strength, the disclosure of each item of the corporate governance index was given a score of 1 and a score of 0 was given to non-disclosed items. Each company's strength of corporate governance was represented by the total score of the company divided by the maximum possible score applicable to the particular company as a result of the application of the index. The same procedure applied in the scoring of disclosure quality, which involved an independent scorer, was also applied in the scoring of corporate governance strength.

Table 5.2: Corporate Governance Index

NO	CORPORATE GOVERNANCE ATTRIBUTES
	Board Characteristics/Structure:
1	Board size – at least six but not more than fifteen.
2	Proportion of independent non-executive directors at least one third or two directors if the board size is less than six.
3	Non-executive directors on the board for not more than nine years.
4	Board comprises mix of skills and experience and other qualities, including core competencies which non-executive directors should bring to the board.
5	Separation of roles of CEO and Chairman.
6	Directors' appointment – annually elected.
8	Directorship: directors serve on boards of not more than twenty-five other companies, ten listed and fifteen unlisted.
9	Directorship: CEO serves on the boards of no more than two listed companies.
10	No former CEOs serve on board.
11	CEO is not listed as having a "related party transaction" in proxy statement.
12	The existence of remuneration committee in a listed company.
13	Remuneration committee – composed wholly or mainly of non-executive directors.
14	Remuneration committee is chaired by an independent director.
15	Remuneration policies disclosed.
16	Directors' education – all directors have attended mandatory training.
17	The existence of a nominating committee in a listed company.
18	Nominating committee – composed exclusively of non-executive directors; majority must be independent.
19	Nominating committee chaired by independent directors.
20	Nominating committee annually reviews board's required mix of skills and experience and other qualities, including core competencies which non-executive directors should bring to the board.
21	Number of board of directors meetings per year – at least four.
22	Minimum number of meeting directors to attend – at least 75 percent.
	Audit Committee
23	The existence of an audit committee in a company.
24	Audit committee size – at least three directors.
25	Proportion of independent members of the total members – majority.
26	The chairman must be an independent member who is not chairperson of the board.

Table 5.2: Continue...

	Audit Committee
27	Proportion of expert members from the total members – at least one must be financially trained or a qualified accountant.
28	Number of meetings per year – four.
29	The main roles and responsibilities are set out in written terms of reference and reported in a separate section of the directors' report.
	Internal Audit Function
30	Presence of an internal audit function.
	External Auditor
31	Employment of a high quality auditor – Big Four.
32	Consulting fees paid to auditors are less than audit fees paid to auditors.
33	Company has formal policy on auditor rotation.
	Director Compensation
34	Directors receive all or a portion of their fees in stock.
35	Company does not provide any loan to executives for exercising options.
36	The remuneration for each of five highest-paid (non-directors) is disclosed.
37	The values of benefits other than remuneration received during the accounting period are disclosed in the annual report for each of the directors or former directors.
	Ownership
38	All directors with more than one year of service own stock.
39	Officers' and directors' stock ownership is at least 1 percent but not more than 30 percent of total shares outstanding.
40	Directors are subject to stock ownership guidelines.
	Progressive Practices
41	Board has outside advisor.
42	Minimum amount of time the audit committee has to meet with the external auditors without executive board members present – at least once a year.
	Code of Business Conduct
43	Existence, adoption and disclosure of a code of business conduct and ethics.
	TOTAL CORPORATE GOVERNANCE SCORE

5.3.5 Control Variables

The current study controlled for variables that have been recognised in previous literature to have an effect on disclosure quality, earnings quality, corporate governance or political influence. The control variables are as follows:

1. Size, measured by the natural log of the total assets of the company.
2. Leverage, measure by the natural log of total liabilities divided by total assets.
3. Listing status, a dichotomous variable that was 1 if the company was listed.
4. Firm age, measured by the natural log of the number of years since incorporation.
5. Eight dummy variables for the nine industry groupings described in section 3.1. Property was taken as the reference group.
6. Four dummy variables for the years 2000–2003, to capture calendar-time effects. The year 1999 was taken as the reference year.

As discussed in Chapter Three, size, leverage, age, listing status and industry are all expected to be associated with disclosure or earnings and/or corporate governance quality (see Section 3.5). Year dummies were included as control variables to control for changes in the regulatory environment over time.

5.4 DATA ANALYSIS

As stated in Section 5.2, the current study involved both quantitative and qualitative data, and thus the analysis of data was also carried out both quantitatively and qualitatively.

5.4.1 Quantitative Data Analysis

For quantitative data analysis, descriptive, univariate and regression analyses were carried out. A descriptive analysis has been used to represent the characteristics of a phenomenon and univariate analysis has been used to establish similarities and differences between the characteristics of the phenomenon or describing patterns or connections between such characteristics (Blaikie, 2003). In the current study, descriptive analysis was used to ascertain and describe the characteristics of the variables of interest (such as disclosure quality and political influence attributes) by calculating measures of central tendency such as mean and median, and the dispersion around the mean. The univariate analysis was performed to establish differences in means of tested variables between different categories of the sample companies and to establish the strength of correlation between the variables.

A multiple regression analysis was employed to test the hypotheses. The following five multiple regressions were estimated to investigate the relative contribution of each political influence attribute in affecting the financial reporting quality of a company, after controlling for factors that are likely to affect the association. The regression equations are as follows:

$$DQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} \quad (1)$$

$$EQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} \quad (2)$$

$$CG_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} \quad (3)$$

$$DQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + \alpha_4 CG_{it} + f(control\ variables) + \varepsilon_{it} \quad (4)$$

$$EQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + \alpha_4 CG_{it} + f(control\ variables) + \varepsilon_{it} \quad (5)$$

Where:

DQ	Disclosure quality.
EQ	Earnings quality.
OWN	Percentage of government ownership.
GOLD	Control rights through a golden share (dummy variable: 1 if government has a golden share in a particular company or 0 otherwise).
POL	The presence of politician/politicians on the board of directors (dummy variable: 1 if there a politician/s on the board or 0 otherwise).
CG	The strength of corporate governance.
Control variables	Size, leverage, firm age, listing status, industries and years.

The first two regression equations used disclosure quality and earnings quality as the dependent variable and the set of three political influence attributes (government ownership, politician/s on the board and a golden share) as independent variables. The third regression equation used corporate governance strength as the dependent variable and was used to examine the effect of political influence on corporate governance strength. The fourth and fifth regression equations were similar to the first two, but added corporate governance strength as an independent variable.

Equations (3) and (4) and equations (3) and (5) form sets of structural equations of which the pairs of equations (1) and (3) and equations (2) and (3) are the reduced forms. The coefficients in equations (1) and (2) will differ from those in equations (4) and (5), which may be described as bias due to the omitted variable (corporate governance). However, the mediating effect of corporate governance can be measured by its effect in changing these coefficients.

The use of the five regression equations is consistent with Baron and Kenny's (1986) steps in establishing the mediating effect of a variable (e.g. corporate governance). The steps are as follows.

1. To show that political influence affects financial reporting quality - Equations (1) and (2).
2. To show that political influence is correlated with corporate governance strength (the mediator) – Equation (3).
3. To show that corporate governance strength affects financial reporting quality even after controlling for political influence – Equations (4) and (5). The mediating effect of corporate governance is determined from this step by comparing the changes in coefficients of political influence variables (i.e. by comparing equation (1) with (4) and equation (2) with (5)).

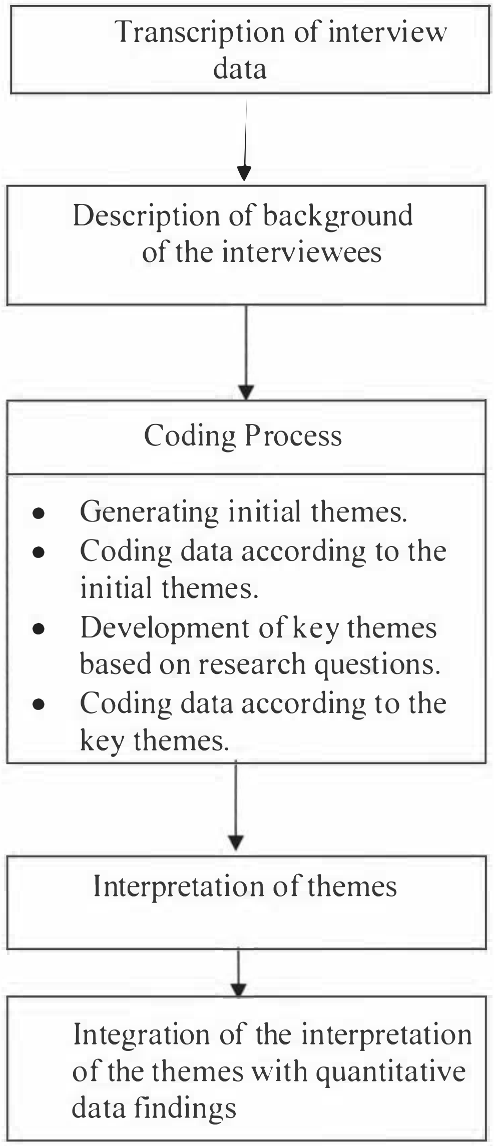
All regressions controlled for firm size, listing status, firm age, leverage and differences in the regulatory environment across industries and over time.

5.4.2 Qualitative Data Analysis

The main purpose of a qualitative data analysis is to make sense of the interview records. Qualitative data analysis needs to be tailored to specific types of research strategies (Creswell, 2003). Four types of strategy may be identified. In grounded-theory research, the analysis of qualitative data involves systematic steps (based on the studies of Strauss & Corbin, 1990, 1998) – open coding (information category generation), axial coding (setting of information position within a theoretical model) and selective coding (explication of a story from the information categories). Alternatively, for case studies and ethnographic research, the analysis involves a detailed description of the setting or individuals, followed by analysis of the data for themes or issues. In phenomenological research, the analysis of significant statements, the generation of meaning units and the development of a core description are involved. Finally, in narrative research, the qualitative data analysis involves a reinstatement of the participants' stories (Creswell, 2003).

This study took an ethnographic approach. The interview data analysis involved a description of interviewees and the companies to which the interviewees were attached, followed by an analysis of the interviewees' views for relevant themes. The steps involved in the interview data analysis are summarised in Figure 5.2.

Figure 5.2: The Steps of the Interview Data Analysis



In the transcription process, the interview records were transcribed word-for-word[27]. Each interview transcript was taken back to the particular interviewee for comments, correction and confirmation.

The description process involved a detailed rendering of information about the background of the interviewees such as their age, education background, current

[27] There were a few interviewees who provided bilingual (English and Malay languages) responses. Therefore, the interview records in the Malay language (the amount was insignificant) were transcribed and translated into English.

position, number of years in the position and the company, and their past experiences.

In the coding process, initial themes or categories were first generated based conceptual framework from the earlier part of the thesis, the interview schedule, and on initial reading of interview transcripts. Data from interview transcripts were then classified and coded according to the initial themes or categories. This was done to allow the researcher to become familiar with the data to gather a general idea of the interviewees' perceptions of political influence in their companies. The initial themes or categories were related to the key issue investigated – the political influence in a firm. The categories included "the formation of the firm by the government" (coded FORM), "business opportunities given by the government" (coded BO), "direct connection with government, for example direct access to the state Chief Minister" (coded DC), "the government's final say on economic decisions" (coded ED), "meeting of the government's social obligations" (coded SO), "presence of politicians on the board" (coded PBOD), and "general" (coded PIMO). Any statements that the researcher considered as indicating the existence of political influence in the company's management and operations were classified into one of the initial themes or categories and coded accordingly.

Since the number of interviewees was small (twenty four) and the interview was not the major instrument in the study, the data from each transcript were manually coded. The functions within Microsoft Word and Excel were utilised to manage datasets and assist in data analysis.

The initial themes or categories were reconsidered and the key themes related to the main research questions were developed. For example, the original code PIMO was split into "political influence on earnings quality" (coded PIEQ), "political influence on disclosure quality" (coded PIDQ) and "political influence on corporate governance" (coded PICG). The data was revisited and was re-coded accordingly.

In the interpretation stage, data under each key theme was re-read carefully to extract meaningful summaries of issues, which are reported in Chapter Seven.

In the integration process, results from the interpretation of themes were compared with quantitative findings to identify new insights and extensions. These are also discussed in Chapter Seven.

5.5 CHAPTER SUMMARY

In this chapter, the application of the mixed-method design has been discussed. The quantitative method, which is considered the dominant part of the study, involved quantitative data collection through the use of secondary data and quantitative data analysis, both descriptive and regression analyses. The qualitative method is considered supplementary to the quantitative method and involved qualitative data collection through a series of interviews and analysis through descriptive analysis and thematic interview data transcription analysis.

This chapter has also discussed how financial reporting quality, political influence proxies, corporate governance strength and control variables were measured. For financial reporting quality, two proxies were used – disclosure quality and earnings quality. The measurement of disclosure quality involved disclosure index development and application of the index to score the quality of financial disclosure. For earnings quality, the measures were derived from the modified Dechow and Dichev (2002) model. Political influence proxies used in the current study consisted of the percentage of government ownership, the existence of a golden share and the presence of politician/s on the board of directors. Corporate governance strength was determined by developing and applying a corporate governance index.

Overall, the research design discussed in this chapter was used to structure the current study. The following chapters report and discuss the findings of the study.

CHAPTER SIX
QUANTITATIVE FINDINGS AND DISCUSSION

6.0 INTRODUCTION

The previous chapter reported on the methods used to gather and analyse the quantitative data related to financial reporting quality (both disclosure and earnings quality), political influence and corporate governance strength, as well as sample firm characteristics. This chapter reports the findings obtained from quantitative data analyses. Before reporting the findings, Section 6.1 provides a list of the definition and measurement of variables used in the analyses. Section 6.2 provides a descriptive analysis of the characteristics and the distribution of disclosure quality, earnings quality and corporate governance strength of the sample companies. The findings from univariate and bivariate analyses are presented in Section 6.3. The findings obtained from multivariate analyses are provided in Section 6.4 and the robustness of results is discussed in Section 6.5. In order to further describe the relationship between the tested variables, supplementary analyses were performed and the results of these are reported in Section 6.6. Section 6.7 presents a discussion and conclusion of the findings. Section 6.8 provides a summary of the chapter.

6.1 DEFINITION AND MEASUREMENT OF VARIABLES

Table 6.1 provides the definition and measurement of both continuous and dichotomous variables used in the data analyses. Since tests of normality on some of the variables suggest non-symmetrical distribution, the variables (for example earnings quality, the percentage of government ownership, total assets, leverage and firm age) were transformed for the statistical analyses used in the study. In order to make the data distribution closer to a normal distribution, the square root of the percentage of government ownership (OWN), the natural log of total assets (SIZE), the natural log of leverage (LEV) and the natural log of firm age (AGE) were used as the final measures.

In respect of earnings quality, the measurement is basically consistent with prior studies (e.g. Francis et al., 2005; 2008a; 2008b), that is an inverse measure of accruals quality, in that the larger the standard deviation of the residuals of the regression using the modified Dechow and Dichev (2002) model, the lower the earnings quality. However, in the current study, the standard deviation of the residuals was transformed using natural log. This was done because the skewness of the untransformed values indicated non-normality in the data distribution. The transformation is necessary to make the data closer to normal distribution, so that the effect of distribution in the variable can be reduced. The use of dependent variable (e.g. earnings quality) that does not display outliers or that has an acceptable number of outliers is necessary because if the dependent variable has extreme outliers then in general the residuals of the regression estimated will also have extreme outliers. This will then make significant tests unreliable. However, in the current study, the normality test for the residuals of the regression where earnings quality is the dependent variable (refer to Figures 6.4 and 6.5 , Section 6.5) shows that the distribution of the regression residuals is very close to normal distribution.

As the final measure and for an easier interpretation of the study results, the natural log value of the standard deviation was multiplied by negative 1, so that, higher value would reflect better quality of earnings.

Table 6.1: Definition and Measurement of Variables

Variable	Definition	Measurement
DQ	Disclosure quality (the extent of disclosure)	Total disclosure score from company financial report as per disclosure index. (a count of the index items disclosed divided by the number of items applicable to each particular company)
EQ	Earnings quality (accruals quality)	Standard deviation of residuals of a regression of current accruals on prior period, current period and future cash flows from operation, change in revenue and plant, property and equipment (i.e. modified Dechow and Dichev [2002] model). For the final measure, the standard deviation is transformed using natural log and then multiplied by -1.
OWN	Government ownership	Square root of the percentage of government ownership of company*.
GOLD	Existence of a golden share (control rights through a golden share)	1 if there is a golden share in the company's equity; 0 otherwise.
POL	Presence of politician/s on the board of directors	1 if there is politician/s on the board; 0 otherwise.
CG	Corporate governance strength	Total score from company annual report as per corporate governance index. (a count of the index items disclosed divided by the number of items applicable to each particular company)
SIZE	Size	Natural log of total assets.
LEV	Leverage	Natural log of the ratio of total liabilities to total assets.
LIST	Listing status	1 if a company is listed; 0 otherwise.
AGE	Firm age	Natural log of number of years since the date of incorporation.
INDUSTRY	Industry dummies	1 for companies belonging to the industry of consumer product (CONS), industrial product (IPROD), trading (TDG), plantation (PLANT), construction (CONST), hotel (HOTEL), technology (TECH), and infrastructure (INFRA); 0 otherwise. Property is taken as the reference industry group.
YEAR	Year dummies	1 if the years 2000, 2001, 2002 or 2003 are involved; 0 otherwise. The year 1999 is taken as the reference year.

Note:

* The square-root transformation was used because there were companies in the sample with zero percentage of government ownership. The log transformation cannot take zero or negative numbers.

6.2 DESCRIPTIVE ANALYSIS

6.2.1 Sample Characteristics

With regards to political influence, the descriptive statistics reported in Table 6.2 suggest political influence is strong. A majority (87 percent) of the sample (company-year observations of 299 companies, 1999 to 2003) have some government ownership. Although only 3 percent of the sample companies have a golden share, a substantial number of the companies (39 percent) have at least one politician on their board of directors. Listed companies make up 86 percent of the sample and non-listed companies make up the remaining 14 percent. The sample companies represent nine major industry sectors, with the property sector acting as a reference group. All variables showed in Table 6.2 (in parentheses) are the dichotomous variables used in the subsequent analyses.

Table 6.2: Descriptive Statistics of Sample (Company-years N=1495[1])

Sample/variable	Frequency	Percentage
Companies with government ownership	1300	87
Companies with politician/s on Board (*POL*)[2]	580	39
Companies with a golden share (*GOLD*)[2]	40	3
Companies by listing status (*LIST*)[2]:		
Listed	1280	86
Non-listed	215	14
Samples by industry:		
Property (*taken as reference*)	190	13
Consumer products (*CONS*)[2]	155	10
Industrial products (*IPROD*)[2]	370	25
Trading (*TDG*)[2]	385	26
Construction (*CONST*)[2]	130	9
Plantation (*PLANT*)[2]	160	11
Hotel (*HOTEL*)[2]	35	2
Infrastructure (*INFRA*)[2]	35	2
Technology (*TECH*)[2]	35	2

Note:
[1] 299 companies for five years (1999–2003).
[2] Identified as dichotomous variables (see Table 6.1 for the definition and measurement of the variables).

Table 6.3 reports on the statistics of government ownership and sample company characteristics which were identified as continuous variables. As shown in the table, the mean square root percentage of government ownership is 4.06. Total assets range from Malaysian ringgit (MYR) 48,000 ($e^{3.87}$) to MYR 60 billion ($e^{17.91}$), with a geometric mean of MYR 355 million ($e^{12.78}$). The geometric mean of the leverage ratio is 0.36 ($e^{-1.02}$) with a range of 0.006 ($e^{-5.12}$) to 9.8 ($e^{2.28}$). The geometric mean firm age is 20.7 years ($e^{3.03}$) since incorporation, but ages range up to 102 years ($e^{4.63}$).

Table 6.3: Descriptive Statistics of Government Ownership and Company Characteristics (Identified as Continuous Variables)

Variable	Mean	Median	Min	Max	Std Dev
Square root percentage of government ownership *(OWN)*[1]	4.06	3.40	0	10	3.26
Natural log of total assets *(SIZE)*[1]	12.78	12.95	3.87	17.91	1.93
Natural log of leverage *(LEV)*[1]	-1.02	-.90	-5.12	2.28	.93
Natural log of age (*AGE*)[1]	3.03	3.20	-.54	4.63	.74

Note:
[1] Identified as continuous variables (see Table 6.1 for the definition and measurement of the variables).

6.2.2 Financial Reporting Quality and Corporate Governance Strength

Table 6.4 reports a descriptive analysis of the disclosure quality, earnings quality and corporate governance strength of the sample companies (see Table 6.1 for the measurement of the variables).

Table 6.4: Descriptive Statistics of Disclosure Quality, Earnings Quality and Corporate Governance Strength

Variable	Mean	Median	Min	Max	Std Dev
Disclosure quality (DQ)[1]	.63	.64	.38	.87	.11
Earnings quality (EQ)[1]	2.36	2.50	-1.55	4.91	1.07
Corporate governance strength (CG)[1]	.58	.58	.29	.86	.12

Note:
[1] Identified as continuous variables (see Table 6.1 for the definition and measurement of the variables).

Disclosure scores ranged from 0.38 to 0.87 with a mean of 0.63. This indicates that, on average, companies in Malaysia only disclose 63 percent of the total items expected by the disclosure index, with a large variation among the sample companies.

In terms of earnings quality, it should be noted that the values reported in Table 6.4 are the natural log transformed values multiplied by negative 1. Comparing the untransformed earnings quality mean and median values (and without multiplying the values with negative 1) of 0.205 and 0.082 respectively with the mean and median estimates of accruals quality reported by Francis et al. (2005) of 0.044 (mean) and 0.031 (median); and Francis et al., (2008b) of 0.016 (mean) and 0.012 (median), the untransformed mean and median values of the current study are larger. The larger values should be expected as the current study included both listed and non-listed companies, where the untransformed mean and median were influenced by large variations in terms of cash flows, sales revenues and property, plant and equipment (the components of the modified Dechow and Dichev (2002) model). Francis et al. (2008b) used large and healthy listed US companies where there seem not much variation in each component of the modified Dechow and Dichev (2002) model and involved multi-year period estimation. These, taken as a whole would greatly reduce the mean of their earnings quality.

Corporate governance scores range from 0.29 to 0.86 with a mean of 0.58. On average, companies in Malaysia only practise 58 percent of the items expected by the corporate governance index.

The data shown in Tables 6.3 and 6.4 are not seriously non-normal: means and medians are roughly equal, and only a few extreme values are more than three standard deviations from the mean. The statistical test for the presence of outliers was carried out (refer to Section 6.5) and the amount of outliers found was deemed acceptable.

6.3 UNIVARIATE AND BIVARIATE ANALYSES

The univariate analysis carried out in the study involved an analysis of means and the bivariate analysis involved a correlation analysis. The results of the analyses are reported in the following subsections.

6.3.1 Analysis of Mean Values between Listed and Non-listed Companies

Table 6.5 reports mean values of disclosure quality, earnings quality, corporate governance strength, government ownership and other continuous variables for various subsets of the data. Panel A compares the mean values of listed and non-listed companies, and panel B compares the mean values of companies with and without political influence (at this stage, if a company has at least one political influence measure – government ownership, a golden share or at least one politician on its board of directors, it is classified as a politically influenced company).

There are substantial differences between mean values of all variables for listed and non-listed companies. The difference for each variable is statistically different at $p<0.01$. However, when a comparison is made according to politically and non-politically influenced companies, almost all variables are not statistically different between the two groups. The sample companies with some level of political influence have a different mean value of disclosure quality to the companies without any political influence (statistically significant at $p<0.01$). The data from Table 6.5 suggests that listing status has a much greater effect than political influence status (when political influence is identified as a composite measure).

Table 6.5: Analysis of Mean Differences in Financial Reporting Quality, Corporate Governance Strength and Company Characteristics between Listed and Non-listed Sample Companies; and between Politically Influenced and Non-politically Influenced Sample Companies

	N[1]	Mean						
		DQ	EQ	CG	OWN	SIZE	LEV	AGE
Panel A:								
Listed	1280	.657	2.51	.602	3.27	13.27	-1.09	3.11
Non-listed	215	.450	1.50	.418	8.80	9.88	-.569	2.53
Difference								
(t-stats)		57.25**	12.11**	40.75**	-40.58**	23.35**	-7.22**	11.24**
Panel B:								
Politically influenced	1349	.626	2.36	.576	4.50	12.77	-1.00	3.03
Non-politically influenced[2]	146	.644	2.37	.568	0.00	12.90	-1.14	3.00
Difference								
(t-stats)		-2.60**	-.142	.869	52.76**	-1.01	1.67	.474

Note:
* Significant at $p<0.05$ ** Significant at $p<0.01$ (2-tailed)
[1] N = firm-year observations = 1495.
[2] Politically influenced companies are companies with at least one political influence attribute (government ownership or politician/s on board of directors or a golden share).
(See Table 6.1 for the definition and measurement of variables).

6.3.2 Analysis of Mean Values between Politically Influenced and Other Companies

While Table 6.5 shows a combination of the three attributes of political influence (government ownership, politician/s on board of directors and a golden share), in identifying politically and non-politically influenced companies, Table 6.6 shows each measure of political influence separately. The table compares companies with and without government ownership, a golden share and politician/s on the board. Mean values of these companies were compared using *t* tests for significant differences. The findings suggest that the disclosure quality, earnings quality and corporate governance strength are all worse for companies with politician/s on the board. The findings imply that politicians have not acted as true agents. They have their own private interest in that they may use their political power to influence managers to act in their best interest such as to manipulate financial information and reporting. This is consistent with Buchanan and Tullock (1968) as discussed earlier in Chapter Three, where politicians are considered self-interested actors.

For the other two measures of political influence the conclusion is mixed. The disclosure quality is significantly better for companies with a golden share, but does not differ between companies with and without government ownership. Corporate governance strength is significantly better for companies with government ownership, but does not differ between companies with and without a golden share held by the government. Table 6.6 also shows the differences for the other variables.

Table 6.6: Univariate Analysis of Mean Differences in Financial Reporting Quality, Corporate Governance Strength and Company Characteristics between Politically Influenced and Other Companies

	N[1]	Mean						
		DQ	**EQ**	**CG**	**OWN**	**SIZE**	**LEV**	**AGE**
Government ownership?								
Yes	1300	0.627	2.39	0.578	4.67	12.79	-1.016	3.03
No	195	0.628	2.18	0.558	0.00	12.75	-1.018	3.04
Difference								
(t-stats)		***-0.13***	***2.52****	***2.38****	***54.94*****	***0.29***	***0.03***	***-0.23***
Golden share?								
Yes	40	0.671	3.07	0.597	6.59	15.44	-0.72	2.51
No	1455	0.626	2.34	0.575	3.99	12.71	-1.02	3.04
Difference								
(t-stats)		***2.65*****	***4.29*****	***1.13***	***5.01*****	***9.04*****	***4.51*****	***-3.32*****
Politician/s on board?								
Yes	580	0.558	1.98	0.523	4.92	12.11	-0.79	2.92
No	915	0.671	2.60	0.609	3.52	13.21	-1.16	3.11
Difference								
(t-stats)		***-22.45*****	***-10.5*****	***-13.76*****	***7.80*****	***-10.18*****	***7.72*****	***-4.98*****

Note:
* Significant at $p<0.05$ ** Significant at $p<0.01$ (2-tailed).
[1] N = firm-year observations (total = 1495).
(See Table 6.1 for the definition and measurement of variables).

As shown in Table 6.6, companies with politician/s on the board are smaller, have more leverage and are younger than companies without. Similarly, companies with a golden share are larger and younger and have more leverage than those without a golden share. Differences in size, leverage and age between companies with and without government ownership are not significant. The percentage of government ownership is larger for companies with a golden share and for companies with politician/s on the board than for companies without these characteristics.

6.3.3 Correlation Analysis

A correlation analysis was performed for the test variables (except the dummy variables of year and industry). Table 6.7 provides Pearson correlations and Spearman correlations among all variables except the dummy variables of year and industry.

Table 6.7: Correlation Matrix

(Pearson – lower triangle; Spearman – upper triangle)

	DQ	EQ	CG	OWN	GOLD	POL	SIZE	LEV	LIST	AGE
DQ	-		0.79 **	-0.18 **	0.06*	-0.50 **	0.53 **	-0.21 **	0.60 **	0.27 **
EQ		-	0.24**	-0.03	0.09**	-0.26**	0.39**	-0.29**	0.32**	0.16**
CG	0.79 **	0.25 **	-	-0.18**	0.03	-0.34**	0.31**	-0.15**	0.53**	0.19**
OWN	-0.29**	-0.09**	-0.22**	-	0.13**	0.18**	-0.14**	0.06*	-0.54**	-0.18**
GOLD	0.07**	0.11**	0.03	0.13**	-	0.08**	0.22**	0.06*	0.07**	-0.08**
POL	-0.53**	-0.28**	-0.34**	0.21**	0.08**	-	-0.22**	0.18**	-0.34**	-0.12**
SIZE	0.61**	0.47**	0.39**	-0.26**	0.23**	-0.28**	-	0.02	0.52**	0.20**
LEV	-0.22 **	-0.30**	-0.14**	0.10**	0.05*	0.20**	-0.09**	-	-0.21**	-0.16**
LIST	0.69 **	0.33**	0.53**	-0.60**	0.07**	-0.34**	0.62**	-0.20**	-	0.30**
AGE	0.28 **	0.10**	0.20**	-0.20**	-0.12**	-0.13**	0.18**	-0.15**	0.28**	-

** Significant at $p<0.01$ (2-tailed), * significant at $p<0.05$ (2-tailed)

Although most correlations are statistically significant, a few of them are large enough to be interesting. The Pearson correlations larger in magnitude than 0.5 involve disclosure quality (positively correlated with corporate governance strength, size and listing status, and negatively correlated with having politician/s on the board) and being a listed company (positively correlated with size, disclosure quality and corporate governance strength, and negatively correlated with the proportion of government ownership). All of these also correspond to large values of Spearman's correlations.

In addition, although the correlations are less than 0.50 in magnitude, the positive correlations between earnings quality (EQ) and size (SIZE), listing status (LIST) and corporate governance strength (CG) are considered strong. There also appears to be strong negative correlations between earnings quality, the presence of politician/s on the board and leverage.

For corporate governance strength, the positive correlation suggests that corporate governance strength is better if a company is larger, listed and older. On the other hand, the corporate governance of a company is weaker if the company has concentrated government ownership and a compensated control through politician/s on its board and/or has higher leverage.

The correlations in Table 6.7 also suggest that no serious multi-collinearity exists among the independent variables, since none exceeds 0.7 (Pallant, 2007, p.155). This is further discussed in Section 6.5.2.

Based on the correlation analysis, the finding of the negative relationships between both disclosure quality and earnings quality and both the presence of politician/s on the board and government ownership supports hypothesis 1 in that political influence in terms of the presence of politician/s on the board and government ownership is associated with low financial reporting quality (in terms of disclosure and earnings quality). However, the correlation between government ownership and disclosure and earnings quality is not as strong as the correlation that involves politician/s on the board. Since other independent variables show some degree of correlation, multivariate analyses are more appropriate in interpreting the relationship between dependent and independent variables than interpreting the bivariate correlations. While correlation analysis shows some connections between the dependent variables and explanatory variables, the analysis cannot identify which types of connections are the most important. Multivariate analysis was employed to investigate the relative contribution of each political influence attribute in affecting the financial reporting quality of a company, after controlling for factors that are likely to affect the association.

6.4 MULTIVARIATE ANALYSIS

As discussed in Chapter Five (Section 5.4.1), five regression equations were estimated to test the hypotheses of the study. Having a panel of data, in which 299 companies were observed over 5 years (1999-2003), it was acknowledged that there was a possibility of correlations. By using a Fixed Effects Model (FEM) with dummies for years but not for companies, the possible correlations were taken into account. Other possible choices were to ignore the problem and use pooled Ordinary Least Square (OLS), to use FEM with company dummies in addition to year dummies, and to use a Random Effects Model (REM). The Likelihood Ratio test (Chi-Square 2682.10, $p < 0.001$) showed that OLS was unsatisfactory, using FEM with company dummies would use up too many degrees of freedom and prevent the effect of any variable that is the same in every year to be measured and the Hausman test (Chi-Square 116.75, $p<0.001$) showed that the FEM was superior to the REM.[28]

The five regression equations estimated are as follows.

[28] The statistics are related to structural equation (4). The similar tests (Likelihood Ratio and Hausman) were also carried out for all equations (1-5) and the statistics provided the same indication – the FEM was the most appropriate model.

$$DQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} \quad (1)$$

$$EQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} \quad (2)$$

$$CG_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} \quad (3)$$

$$DQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + \alpha_4 CG_{it} + f(control\ variables) + \varepsilon_{it} \quad (4)$$

$$EQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + \alpha_4 CG_{it} + f(control\ variables) + \varepsilon_{it} \quad (5)$$

(See Table 6.1 for the definition and measurement of variables)

All regressions controlled for company size, listing status, age, leverage and differences in the regulatory environment across industries and over time (i.e. year dummies – 2000, 2001, 2002 and 2003, were included in the equations). The regressions examined how political influence (OWN, GOLD and POL) directly and indirectly affects financial reporting quality (DQ and EQ). While the direct effect refers to the direct relationship between the political influence and financial reporting quality, the indirect relationship concerns the effect via corporate governance strength (CG). The results from the five regression equations above are reported in the following sub-sections.

6.4.1 Direct Relationship between Political Influence and Financial Reporting Quality

a) Disclosure Quality

Table 6.8 presents the results of estimating the direct effects of political influence on disclosure quality.

The results show that disclosure quality is better among companies with higher government ownership, worse among companies with politician/s on the board, and not significantly related to whether the companies have a golden share. The finding on the negative relationship between the presence of politician/s on the board and disclosure quality supports hypothesis 1 in that political influence is associated with low financial reporting quality (in terms of disclosure quality). Leuz and Oberholzer-Gee (2006) also find a negative association between political influence and disclosure quality but the study defines political influence as political connection (for example, companies that have political connection with the President are regarded as politically influenced companies). However, when political influence is defined as government ownership, the finding on the positive relationship between government ownership and disclosure quality does not support hypothesis 1 and contradicts the findings of prior studies (for example, Aggarwal, 1999; Zhuang, 1999b; Naser & Nuseibeh, 2003) which found that the higher the percentage of government ownership in a company the lower the disclosure quality. These varying results suggest that the types of political influence need to be clearly specified.

Table 6.8: Results of the Relationship between Disclosure Quality and Political Influence and Control Variables

$$DQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} \text{............}(1)$$

Variables	Coefficient	Standardised Coefficient	t-stat	Sig. p (2-tailed)
OWN	.005	.141	8.79	.000
GOLD	-.010	-.016	-1.19	.236
POL	-.064	-.295	-21.52	.000
SIZE	.011	.211	12.62	.000
LEV	-.004	-.033	-2.44	.015
LIST	.164	.549	26.71	.000
AGE	.003	.024	1.74	.082
CONS	.001	.004	.27	.787
IPROD	-.024	-.097	-5.18	.000
TDG	.001	-.003	-.17	.864
PLANT	.002	.007	.42	.674
CONST	-.004	-.011	-.74	.463
TECH	-.019	-.027	-1.99	.046
HOTEL	.006	.009	.70	.486
INFRA	-.024	-.034	-2.51	.012
Y00	.003	.012	.75	.453
Y01	.063	.240	15.37	.000
Y02	.082	.312	19.92	.000
Y03	.085	.323	20.56	.000
Intercept	.304		23.73	.000
Observations	1495			
R^2	.776			
Adj. R^2	.774			

Table 6.8 also shows the effect of the control variables on disclosure quality. Disclosure quality is higher among larger, listed and older companies (note that the coefficient of firm age is only significant at the 10 percent level). These findings are consistent with the findings of previous studies (for example, Chow & Wong-Boren, 1987; Cooke, 1989, 1993; Singhvi & Desai, 1971; Wallace, Naser, & Mora, 1994). The positive relationship between size and disclosure quality is consistent with the expectation that larger companies are likely to be under closer scrutiny from outsiders than small companies (Lang & Lundholm, 1993) which then leads to extensive disclosure of financial accounting information by such companies. Another possible explanation for this is that larger companies disclose more as they benefit most by reducing information asymmetry that could reduce a company's cost of capital (Diamond & Verrecchia, 1991) and enhance market liquidity as a result (Heflin, Shaw, & Wild, 2005). However, disclosure quality is lower among highly leveraged companies, supporting earlier findings (Eng & Mak, 2003), as companies with high leverage may have an incentive to hide information in order to avoid a potential loss from disclosing more information. In addition, highly leveraged companies that also have close relations with banks may prefer to settle information problems between them, and thus the extensive disclosure of information seems unnecessary.

Further, disclosure quality is higher across the years 2001, 2002 and 2003 (the year 1999 was used as a reference year). The disclosure-based regime (which emphasises high standards of disclosure and disclosure of all material information) was first fully implemented in 2001, which may explain the better disclosure beginning in that year. Disclosure quality is lower among companies in the industrial products, technology and infrastructure sectors if compared to the property sector which has been used as an industry dummy variable in this study. A possible reason is because export oriented industrialisation (EOI) policy still continues in present government policy (Fraser et al., 2006, p. 1293). Companies that are deemed to be compatible with such policy are likely to be selected to receive EOI incentives[29]. Moreover, Multimedia

[29] Industrial products sector contributed 12 percent in 1970, 19 percent in 1975, 22 percent in 1980, 33 percent in 1985 (Jomo, 1990) and 53.29 percent in 2008 (Department of Statistic Malaysia, http://www.statistic.gov.my; accessed on 06.03.09) of total exports and provide greater employment of the labor market (Ragayah, 2008).

Super Corridor Malaysia, which was launched in 1996 has given great incentive for companies involved in the technology sector[30].With respect to the infrastructure sector, it is apparent that the sector has been selected by the government to boost the Malaysian economy since the recession in 1997 (Perkins & Woo, 2000). With the government supports and incentives, companies in these sectors are less dependent on equity market which requires high quality financial disclosure. Therefore, industry may be seen as a different proxy for political influence, appropriate only in Malaysia, which is associated with reduced disclosure quality.

b) Earnings Quality

Table 6.9 presents the results of estimating the direct effects of three political influence attributes on earnings quality. Similar to the effects on disclosure quality, government ownership is positively and significantly associated with earnings quality, which implies that earnings quality is better among companies with higher government ownership. Earnings quality is worse if a company has politician/s on its board of directors and it is not significantly related to whether companies have a golden share held by the government.

[30] Refer to Seventh Malaysia Plan (1996) for a further discussion.

Table 6.9: Regression Results of the Relationship between Earnings Quality and Political Influence and Control Variables

$$EQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} ....(2)$$

Variables	Coefficient	Standardised Coefficient	t-stat	Sig. p (2-tailed)
OWN	.034	.103	3.71	.000
GOLD	.184	.028	1.20	.229
POL	-.256	-.117	-4.94	.000
SIZE	.222	.402	13.94	.000
LEV	-.295	-.257	-11.14	.000
LIST	.213	.070	1.97	.049
AGE	-.007	-.005	-.21	.834
CONS	.231	.066	2.40	.017
IPROD	-.068	-.027	-.85	.397
TDG	.004	.002	.05	.959
PLANT	.027	.008	.28	.783
CONST	.031	.008	.31	.759
TECH	-.389	-.055	-2.38	.017
HOTEL	.875	.124	5.39	.000
INFRA	.435	.062	2.63	.009
Y00	-.017	-.006	-.24	.810
Y01	-.034	-.013	-.47	.641
Y02	-.047	-.018	-.66	.511
Y03	-.035	-.013	-.488	.626
Intercept	-.988		-4.56	.000
Observations	1495			
R^2	.336			
Adj. R^2	.328			

The negative relationship between the presence of politician/s on the board and earnings quality supports hypothesis 1, that political influence in terms of the presence of politician/s on the board is associated with low financial reporting quality in terms of earnings quality. This finding is consistent with the finding of a study by Belkaoui (2004), who relates political connection and earnings opacity, which indicates low quality of earnings. However, the hypothesis has not been supported if political influence is defined as government ownership. Similar to disclosure quality, the types of political influence in relation to earnings quality also need to be clarified.

Table 6.9 also reports the association of control variables with earnings quality. The quality of earnings is higher for larger and listed companies and lower among highly leveraged companies and companies in the technology sector. These results are consistent with those for disclosure quality. The positive relationship between earnings quality and size is consistent with earlier studies (for example, Cahan, Liu & Sun, 2008; Chaney et al., 2007; Lee & Choi, 2002; Dechow & Dichev, 2002; Sanchez & Garcia, 2007). The positive relationship between earnings quality (and even disclosure quality) and listing status is obvious because listed companies are regulated companies which are bonded with statutory regulations that would ensure higher quality of financial reporting. This finding supports the finding of Vander Bauwhede, Willekens and Gaeremynck (2003). However, inconsistent with the findings for disclosure quality, earnings quality is not affected by firm age or by different calendar years. The effect of years on earnings quality probably does not occur because there were no significant changes in accounting standards or regulations during the period 1999 to 2003.

The results reported in Tables 6.8 and 6.9 show that political influence variables are significantly associated with financial reporting quality, except for the existence of golden share (GOLD). The results establish that the association may be mediated. The following sub-section reports the association of political influence variables with the mediator (corporate governance strength).

6.4.2 Direct Relationship between Political Influence and Corporate Governance Strength

The findings of estimating the effects of political influence on corporate governance strength are presented in Table 6.10.

Table 6.10: Results of the Relationship between Corporate Governance Strength and Political Influence Attributes and Control Variables

$$CG_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} ....(3)$$

Variables	Coefficient	Standardised Coefficient	t-stat	Sig. p (2-tailed)
OWN	.005	.121	6.47	.000
GOLD	-.015	-.020	-1.29	.198
POL	-.042	-.167	-10.43	.000
SIZE	.003	.041	2.12	.035
LEV	-.001	-.011	-.717	.474
LIST	.185	.532	22.09	.000
AGE	-.006	-.037	-2.28	.023
CONS	.011	.028	1.45	.140
IPROD	-.009	-.030	-1.38	.168
TDG	-.007	-.024	-1.09	.277
PLANT	-.006	-.016	-.86	.392
CONST	.003	.006	.35	.727
TECH	.009	.011	.70	.482
HOTEL	.028	.035	2.22	.027
INFRA	-.047	-.058	-3.67	.000
Y00	.010	.033	1.81	.000
Y01	.123	.403	22.01	.000
Y02	.160	.525	28.62	.000
Y03	.173	.566	30.77	.000
Intercept	.305		18.42	.000
Observations	1495			
R^2	.694			
Adjusted R^2	.690			

As shown in the table, corporate governance strength is better for companies with higher government ownership, worse for companies with politician/s on the board, and unaffected by the existence of a golden share. These findings are similar to those found for disclosure quality and earnings quality. The negative association between the presence of politician/s on the board and corporate governance strength supports hypothesis 2 in that political influence is associated with weak corporate governance. However, the hypothesis is supported if political influence is defined as the presence of politician/s on the board but not in terms of government ownership.

The negative relationship found generally supports prior studies (for example, ADB, 1998; Agrawal & Knoeber, 2001; Fan et al., 2007; Nee et al., 2007) which suggests that companies with political influence (in terms of having political connection or government interference) are more likely to have weaker governance. In particular, the finding supports Wang et al. (2008) who say that politicians on the board can influence the decision on governance structure that helps the politicians to achieve their own agendas. When political influence is referred to government ownership, the finding contradicts the finding of Xu et al. (2005) who find that government ownership leads to government interference in the company's major economic decision-making, such as that related to governance structure. However, the current study's finding is consistent with the finding of Ang and Ding (2006) who report that government-owned firms in Singapore have better governance than non-government-owned firms.

In relation to control variables, corporate governance strength is better among larger and listed companies but is poorer among older companies. The positive relationship between corporate governance and size is consistent with prior studies (for example, Nam & Nam, 2005; Yermack, 1996). The positive relationship with listing status is consistent with Charitou et al., (2007). Corporate governance strength is not significantly related to the leverage ratio and is consistent with the findings of Ang and Ding (2006) and Charitou et al. (2007). Corporate governance strength is better across the years 2000, 2001, 2002 and 2003 (although the positive effect is relatively small in the year 2000). One possible explanation for this is that the Malaysian Code on Corporate Governance was introduced in March 2000. Infrastructure is worse than property (the reference sector) but other sectors do not significantly affect corporate governance strength.

Except for the existence of a golden share (GOLD), the results reported in Table 6.10 indicate that there is an association between political influence and corporate governance strength as a mediator. This association must be proven in order to establish the indirect effect of political influence on financial reporting quality through corporate governance. The following sub-section reports the effect of corporate governance on financial reporting quality after controlling for political influence and the indirect effect of political influence on financial reporting quality through corporate governance.

6.4.3 Relationship between Corporate Governance Strength and Financial Reporting Quality, and the Mediating Effect of Corporate Governance Strength

Tables 6.11 and 6.12 give results for regressions of disclosure quality and earnings quality respectively, adding corporate governance strength (a mediator) as an independent variable.

As shown in Table 6.11 – regression (4), corporate governance strength is positively associated with disclosure quality – the better the corporate governance strength, the better the disclosure quality. However, controlling for corporate governance strength does not qualitatively change previous results (regression 1) – government ownership is positively related to disclosure quality; the presence of politician/s on the board is negatively related to disclosure quality, and the existence of a golden share does not have a significant effect. The results that show the association with company characteristics (size, leverage, listing status and age) are substantially the same whether corporate governance is included in the regression or not.

However, the coefficients of OWN and POL are reduced in magnitude when CG is added as a mediator, suggesting that corporate governance strength does mediate the relationship between political influence and disclosure quality (comparing regressions (1) and (4), Table 6.11). The results show the reduction of the effect of political influence (OWN and POL) on disclosure quality, indicating the indirect effect of OWN and POL on DQ through CG.

Table 6.11: Results of the Relationship between Corporate Governance Strength and Disclosure Quality and the Mediating Effect of Corporate Governance Strength on the Relationship between Disclosure Quality and Political Influence

$$DQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} ....(1)$$

$$DQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + \alpha_4 CG_{it} + f(control variables) + \varepsilon_{it} ....(4)$$

	Regression (1)			Regression (4)		
Variable	Coefficient	Standardised Coefficient	t-stat	Coefficient	Standardised Coefficient	t-stat
OWN	.005***	.141	8.79	.003***	.092	6.4
GOLD	-.010	-.016	-1.19	-.005	-.008	-0.6
POL	-.064***	-.295	-21.52	-.049***	-.227	-18.2
CG				.351***	.408	20.8
SIZE	.011***	.211	12.62	.011***	.194	13.2
LEV	-.004**	-.033	-2.44	-.003**	-.028	-2.4
LIST	.164***	.549	26.71	.099***	.333	15.9
AGE	.003*	.024	1.74	.006***	.039	3.2
CONS	.001	.004	.27	-.002	-.007	-0.5
IPROD	-.024***	-.097	-5.18	-.021***	-.085	-5.1
TDG	.001	-.003	-.17	.002	.006	0.4
PLANT	.002	.007	.42	.005	.014	0.9
CONST	-.004	-.011	-.74	-.005	-.014	-1.0
TECH	-.019**	-.027	-1.99	-.022***	-.031	-2.6
HOTEL	.006	.009	.70	-.003	-.005	-0.4
INFRA	-.024**	-.034	-2.51	-.007	-.010	-0.8
Y00	.003	.012	.75	.001	-.002	-0.1
Y01	.063***	.240	15.37	.020***	.076	4.8
Y02	.082***	.312	19.92	.026***	.098	5.7
Y03	.085***	.323	20.56	.024***	.093	5.2
Intercept	.293***		23.73	.184***		15.3
Obs.	1495			1495		
R^2	0.78			0.83		
Adj. R^2	0.77			0.82		

*** indicates significance at 1%; ** indicates significance at 5%; * indicates significance at 10% (2-tailed)

In terms of earnings quality, after controlling for political influence, there is no significant relationship between corporate governance strength and earnings quality (refer regression (5), Table 6.12).

Table 6.12: Regression Results of the Relationship between Corporate Governance Strength and Earnings Quality and the Mediating Effect of Corporate Governance Strength on the Relationship between Earnings Quality and Political Influence

$$EQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + f(control\ variables) + \varepsilon_{it} \text{ ....(2)}$$

$$EQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + \alpha_4 CG_{it} + f(control\ variables) + \varepsilon_{it} \text{ ...(5)}$$

	Regression (2)			Regression (5)		
Variable	Coefficient	Standardised Coefficient	t-stat	Coefficient	Standardised Coefficient	t-stat
OWN	.034***	.103	3.71	.032***	.096	3.4
GOLD	.184	.028	1.20	.191	.029	1.2
POL	-.256***	-.117	-4.94	-.237***	-.108	-4.4
CG				.445	.051	1.3
SIZE	.222***	.402	13.94	.221***	.399	13.8
LEV	-.295***	-.257	-11.14	-.295***	-.256	-11.1
LIST	.213**	.070	1.97	.130	.043	1.1
AGE	-.007	-.005	-.21	-.005	-.003	-0.1
CONS	.231**	.066	2.40	.226**	.065	2.3
IPROD	-.068	-.027	-.85	-.064	-.026	-0.8
TDG	.004	.002	.05	.007	.003	0.1
PLANT	.027	.008	.28	.030	.009	0.3
CONST	.031	.008	.31	.030	.008	0.3
TECH	-.389**	-.055	-2.38	-.392**	-.056	-2.4
HOTEL	.875***	.124	5.39	.862***	.122	5.3
INFRA	.435**	.062	2.63	.456**	.065	2.7
Y00	-.017	-.006	-.24	-.022	-.008	-0.3
Y01	-.034	-.013	-.47	-.088	-.033	-1.1
Y02	-.047	-.018	-.66	-.119	-.044	-1.3
Y03	-.035	-.013	-.488	-.112	-.042	-1.2
Intercept	-.988***		-4.56	-1.126***		-4.7
Obs.	1495			1495		
R^2	.336			.337		
Adj. R^2	.328			.328		

*** indicates significance at 1%; ** indicates significance at 5%; * indicates significance at 10% (2-tailed)

Controlling for corporate governance strength does not change the previous results of the relationships between the key variables – government ownership is positively and significantly related to earnings quality but the presence of politician/s on the board is negatively and significantly related to earnings quality, while the relationship between earnings quality and the existence of a golden share is not significant (comparing regression (2) and (5), Table 6.12).

As shown in Table 6.12 (regression 5), the coefficients of OWN and POL are reduced when CG is added to the regression, but only very slightly. Therefore, corporate governance strength has at most a small mediating effect on the relation between political influence and earnings quality.

The positive relationship between corporate governance strength and disclosure quality supports hypothesis 3 in that after controlling for political influence, weak corporate governance is associated with low financial reporting quality, but only when financial reporting quality is defined as disclosure quality. The findings are consistent with prior studies (for example, Bédard et al., 2004; Chen & Jaggi, 2000; Haniffa & Cooke, 2005; Ho & Wong, 2001; Wright, 1996), which report that effective boards of directors are positively related to disclosure quality. Prior research has found that good corporate governance contributes to lower earnings management and more conservative earnings (Lara et al., 2007; Shen & Chih, 2007) and consistent with that research, the current study finds a positive sign for the relationship of corporate governance strength and earnings quality; but the relationship found is not significant.

The results in relation to the mediating effect of corporate governance strength on the relationship between political influence and disclosure quality and between political influence and earnings quality support hypothesis 4 in that corporate governance strength mediates the relationship between political influence and financial reporting quality. In other words, there is an indirect effect of political influence on financial reporting quality through corporate governance strength.

6.5 ROBUSTNESS OF RESULTS

In order to ensure that the results are robust, a series of procedures were performed. These procedures involved tests for statistical assumptions, multicollinearity and heterocedasticity, and sensitivity analyses.

6.5.1 Statistical Assumptions

The assumptions of normality, linearity, and independence of residuals were checked for by inspecting the histogram, scatter plot and normal probability plot (P-P) of the standardised residuals of each regression as shown in Figures 6.1– 6.15.

Figure 6.1 Histogram of Standardised Residuals of Regression 1

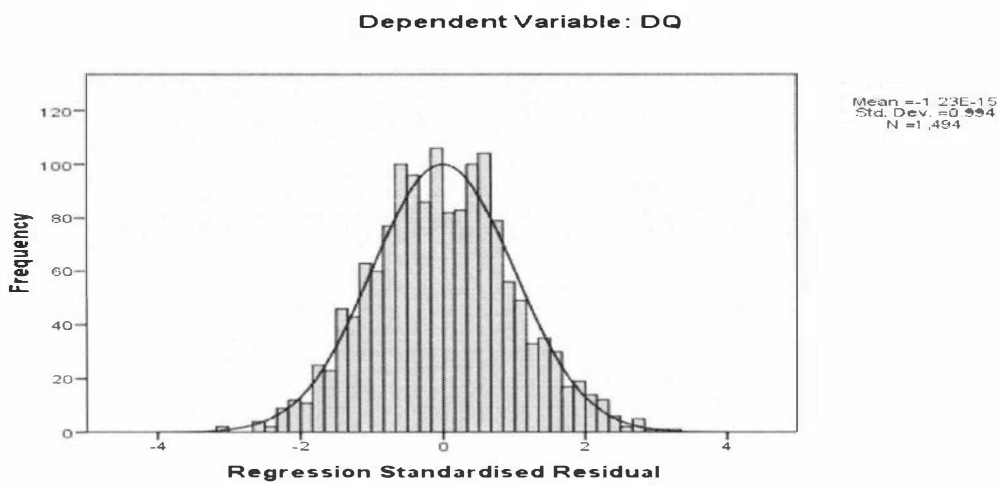


Figure 6.2 Normal Probability Plot (P-P) of Standardised Residuals of Regression 1

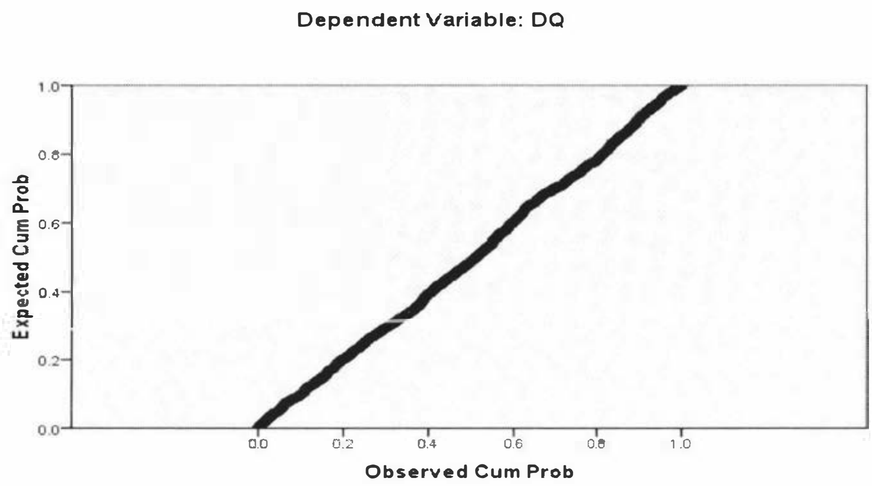


Figure 6.3 Scatter Plot of Standardised Residuals of Regression 1

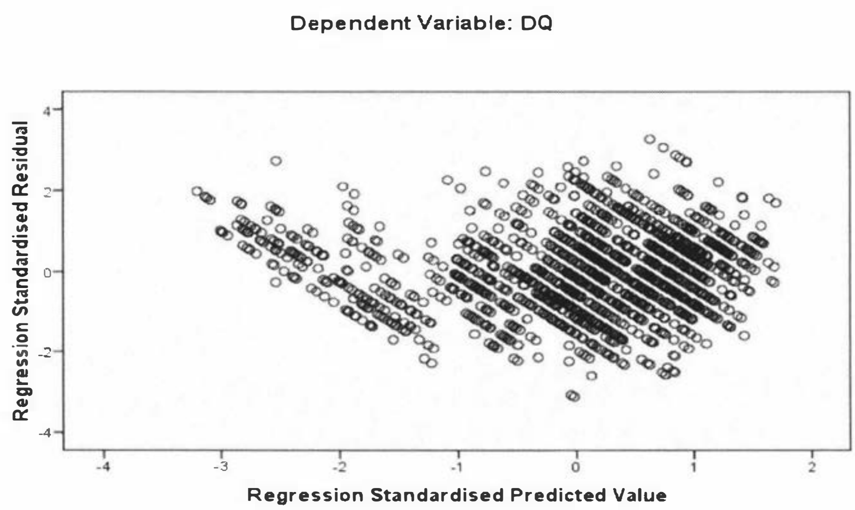


Figure 6.4 Histogram of Standardised Residuals of Regression 2

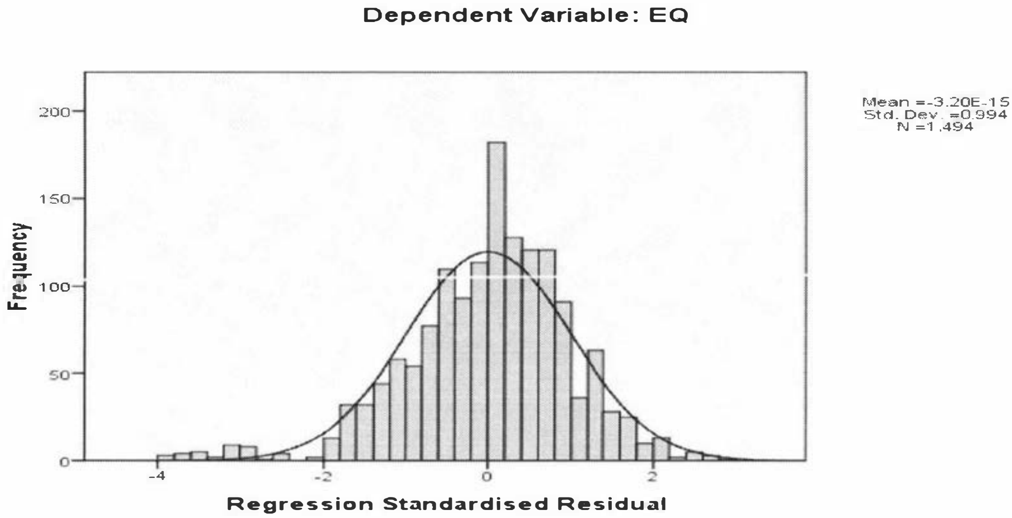


Figure 6.5 Normal Probability Plot (P-P) of Standardised Residuals of Regression 2

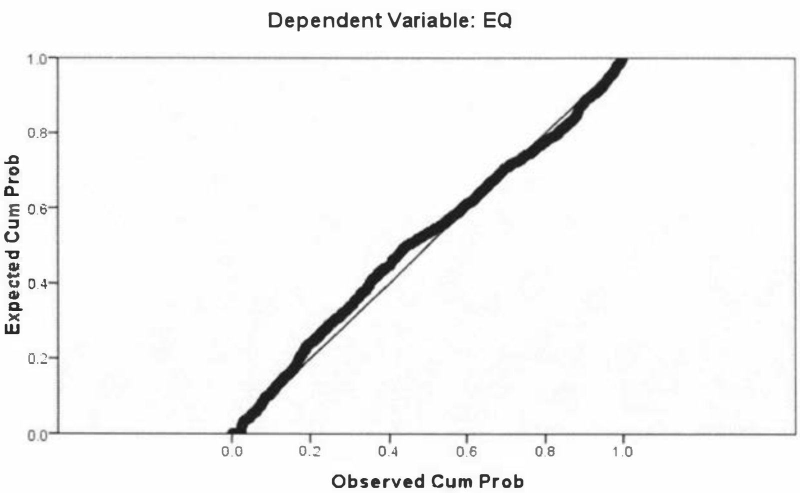


Figure 6.6 Scatter Plot of Standardised Residuals of Regression 2

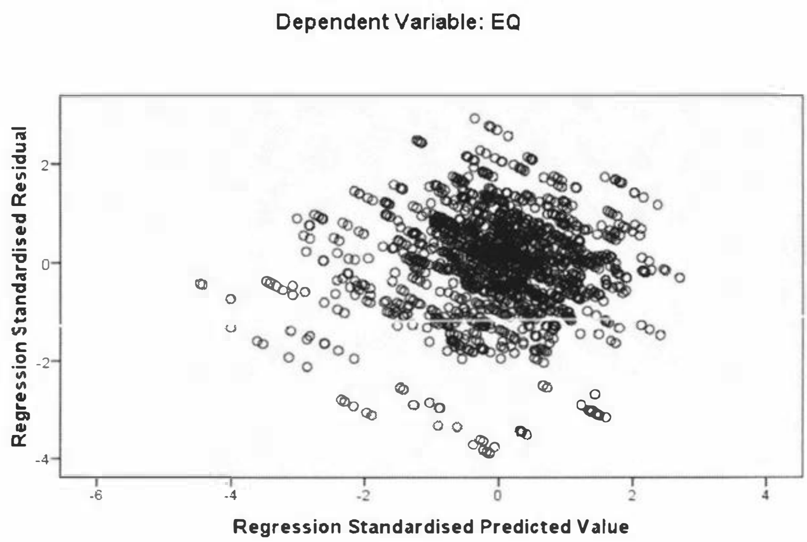


Figure 6.7 Histogram of Standardised Residuals of Regression 3

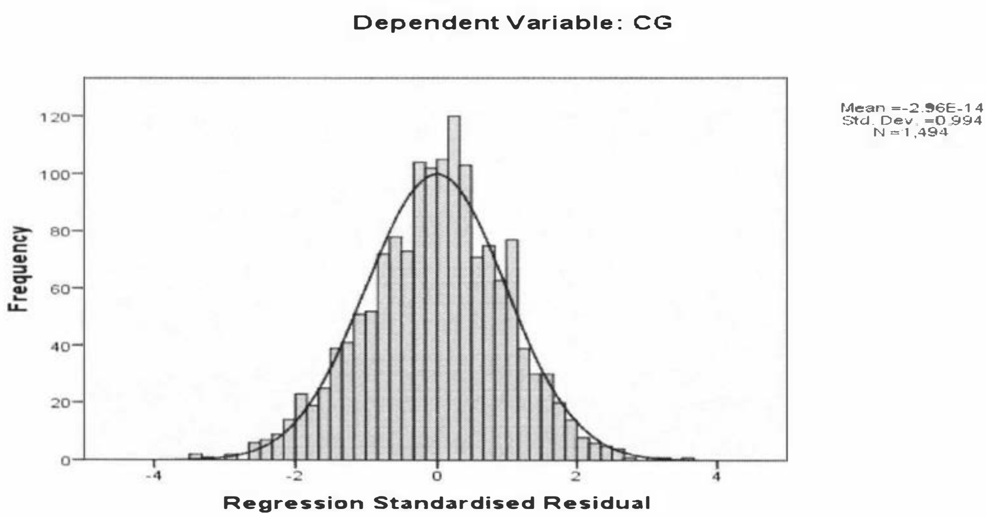


Figure 6.8 Normal Probability Plot (P-P) of Standardised Residuals of Regression 3

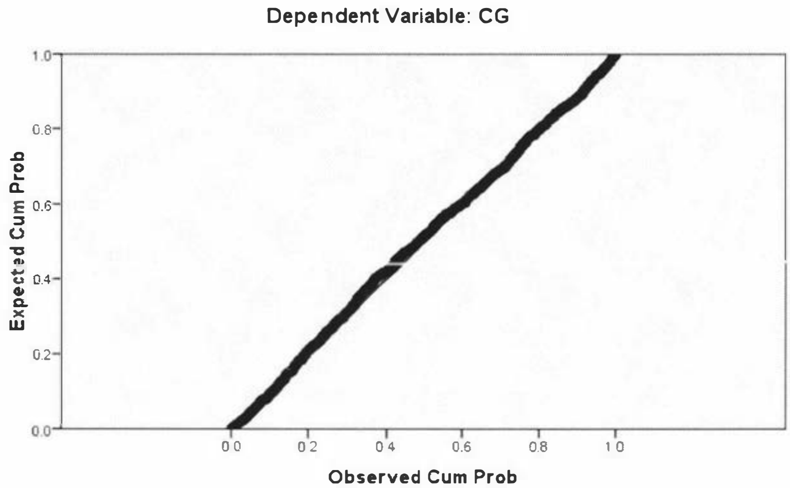


Figure 6.9 Scatter Plot of Standardised Residuals of Regression 3

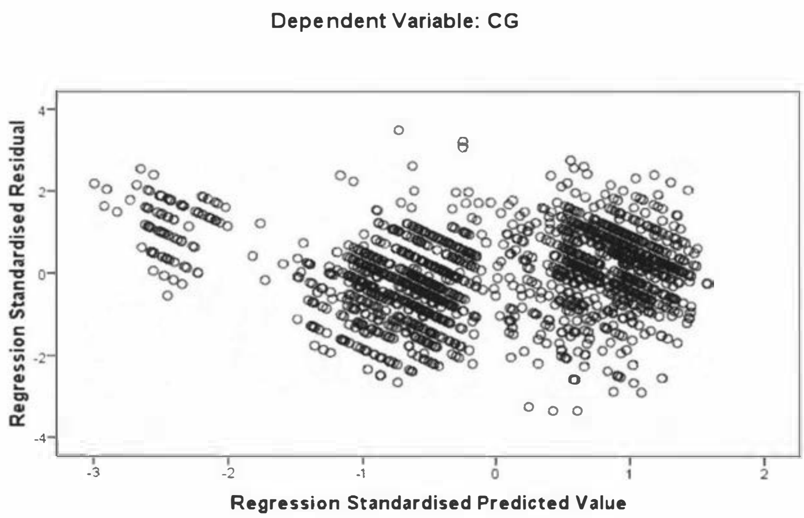


Figure 6.10 Histogram of Standardised Residuals of Regression 4

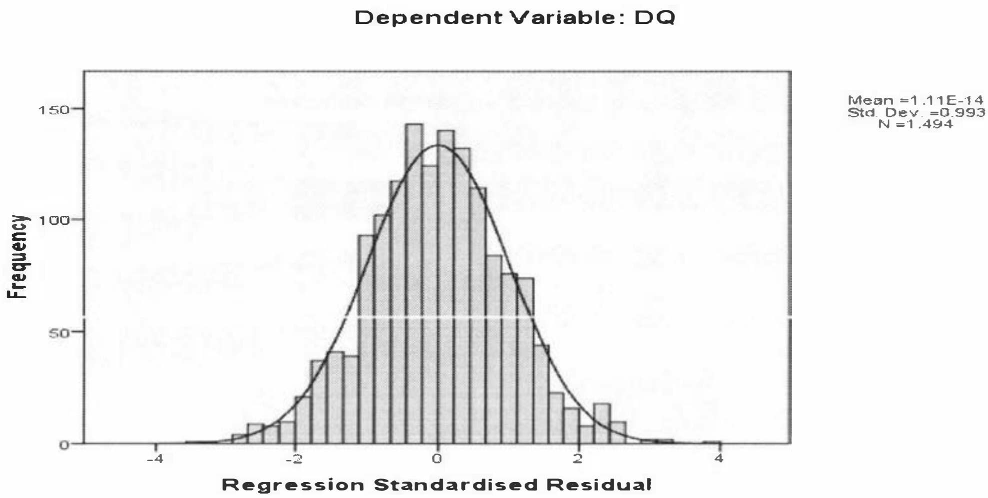


Figure 6.11 Normal Probability Plot (P-P) of Standardised Residuals of Regression 4

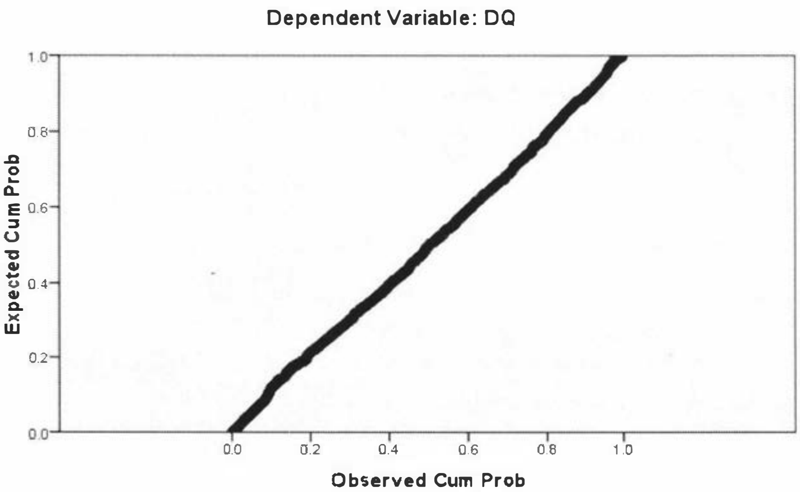


Figure 6.12 Scatter Plot of Standardised Residuals of Regression 4

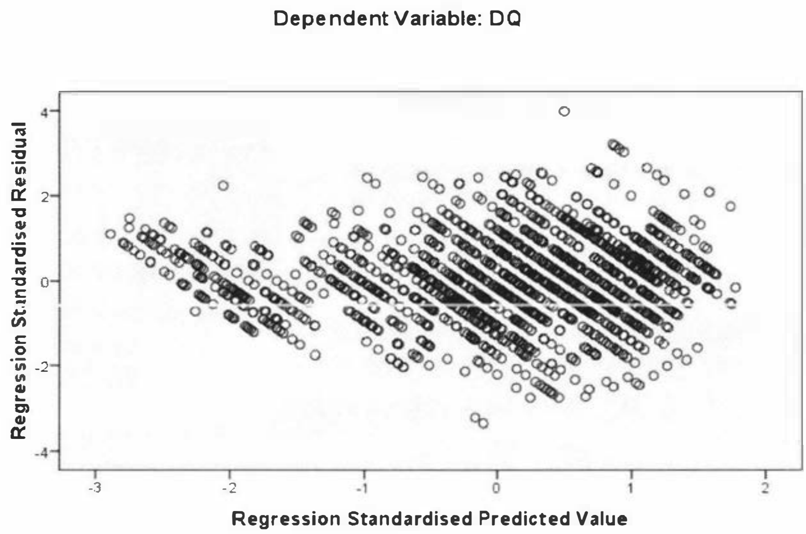


Figure 6.13 Histogram of Standardised Residuals of Regression 5

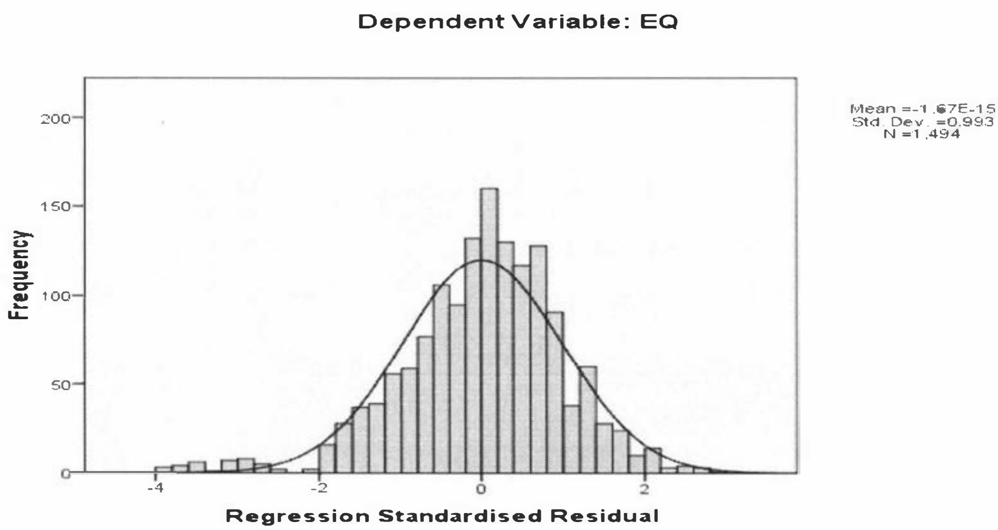


Figure 6.14 Normal Probability Plot (P-P) of Standardised Residuals of Regression 5

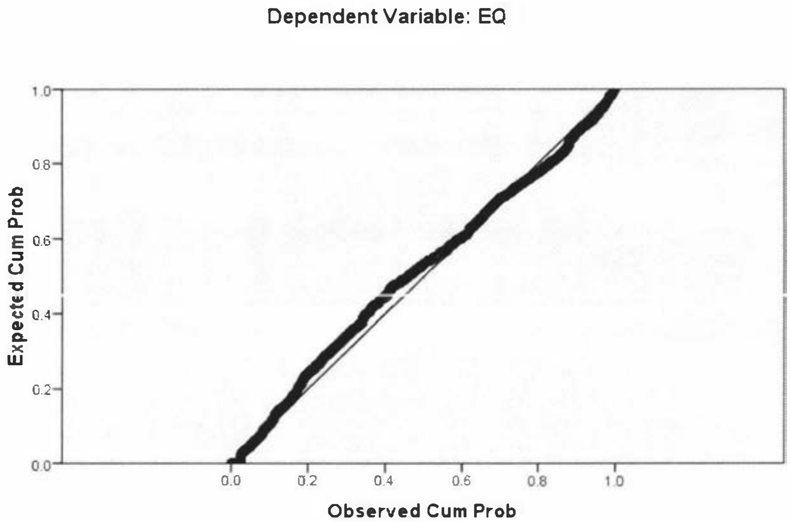
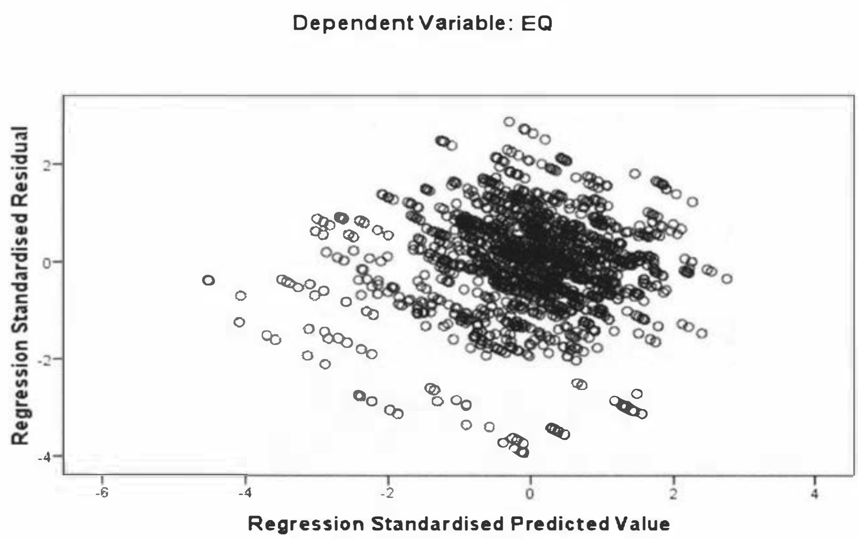


Figure 6.15 Scatter Plot of Standardised Residuals of Regression 5



The histogram of standardised residuals of each regression seems to be normally distributed (see Figures 6.1, 6.4, 6.7, 6.10, 6.13). The normal P-Ps for all the regressions (see Figures 6.2, 6.5, 6.8, 6.11 and 6.14) show that the points lie in a reasonably straight diagonal line, suggesting no major deviations from normality.

As shown by the scatter plots of the standardised residuals displayed above (Figures 6.3, 6.6, 6.9, 6.12 and 6.15), there is no dependence of residuals on predicted values (although slightly possible in Figure 6.9) and linearity assumption is reasonable. The scatter plots also indicate that the presence of outliers is not a serious problem as cases that have a standardised residual of more than 3.3 or less than -3.3 (Tabachnick & Fidell, 2007) are very rare and thus acceptable (Pallant, 2007).

The presence of outliers was also identified by inspecting Mahalanobis distances (Pallant, 2007). For nineteen independent variables (regressions 1 to 3) and by using an alpha level of 0.001, the critical chi-square value is 43.82 and for twenty independent variables (regressions 4 and 5), the critical chi-square value is 45.31. Table 6.13 shows that the maximum value of Mahalanobis distance for each regression model is above the critical chi-square values. However, less than 10 percent of the total cases in all regressions have the Mahalanobis distances above the critical value. According to Pallant (2007), the 10 percent of outliers are regarded as acceptable as it is not uncommon to find a few outliers in large samples such as the one used in this current study.

Table 6.13: Mahalanobis and Cook's Distances

	Minimum	Maximum	Mean	Std Dev
Mahalanobis distance:				
Regression 1 – 3	7.75	66.25	18.99	11.66
Regression 4 – 5	7.89	68.87	19.99	11.77
Cook's distance				
Regression 1	.000	.018	.001	.001
Regression 2	.000	.011	.001	.001
Regression 3	.000	.011	.001	.001
Regression 4	.000	.012	.001	.001
Regression 5	.000	.010	.001	.001

When "casewise diagnostics" were performed, cases that have standardised residual values outside the range of 3.0 and -3.0 in all regressions (except for regressions 2 and 5) were less than 1 percent of total cases. In regressions 2 and 5 only 1.5 percent of the total cases had standardised residual values outside the range. This slightly exceeds the acceptable percentage – less than 1 percent of total cases in a normally distributed sample (Pallant, 2007). Cook's distance value was checked for the cases with standardised residual values that fall outside the range. Cases with Cook's distance values larger than 1 were given attention. However, the maximum value of Cook's distance (see Table 6.13) of 0.011 and 0.010 for regressions 2 and 5 respectively suggests no major problem, in that the 1.5 percent of cases with standardised residual values above 3.0 or below -3.0 do not have any extreme influence on the results of the model as a whole (Tabachnick & Fidell, 2007).

6.5.2 Multicollinearity

Problems arise in regression when independent variables are highly correlated. Such multicollinearity often results in inflated standard errors of the fitted coefficients. For this reason, potential collinearity between variables was diagnosed by running a correlation matrix (see Table 6.7). The table shows that there are significant correlations between independent variables. However, the highest correlation coefficient between independent variables as shown in the table is 0.62 (Pearson correlation) and 0.54 (Spearman correlation). This is less than 0.7, suggesting no serious problem of multicollinearity (Pallant, 2007) and therefore all variables were retained.

In order to further check for multicollinearity, "collinearity diagnostics" were performed. By doing this, problems with multicollinearity that might not have been evident in the earlier correlation matrix could be identified (Pallant, 2007, p.156). The values of "tolerance" (an indicator of the level of the variability of the specified independent variable not being explained by the other independent variables in the regression model employed) were checked. Further, multicollinearity was diagnosed by evaluating the variance inflation factor (VIF) for each variable (Chau & Gray, 2002; Owusu-Ansah, 1998; Patton & Zelenka, 1997). The VIF (the inverse of the tolerance value) measures the degree to which each independent variable is explained by the other independent variables. Table 6.14 shows the values of "tolerance" and VIF of each independent variable in all regressions.

Table 6.14: Multicollinearity Tests

	Regression (1), (2) and (3)		Regression (4) and (5)	
Variable	**Tolerance**	**VIF**	**Tolerance**	**VIF**
OWN	.589	1.70	.573	1.75
GOLD	.840	1.19	.839	1.19
POL	.808	1.24	.752	1.33
CG	-	-	.306	3.27
SIZE	.542	1.84	.541	1.85
LEV	.848	1.18	.848	1.18
LIST	.358	2.79	.269	3.71
AGE	.797	1.25	.794	1.26
CONS	.595	1.68	.594	1.68
IPROD	.431	2.32	.430	2.32
TDG	.436	2.29	.435	2.30
PLANT	.565	1.77	.565	1.77
CONST	.639	1.57	.638	1.57
TECH	.845	1.18	.845	1.18
HOTEL	.852	1.17	.849	1.18
INFRA	.822	1.22	.815	1.23
Y00	.623	1.61	.622	1.61
Y01	.620	1.61	.467	2.14
Y02	.617	1.62	.397	2.52
Y03	.613	1.63	.374	2.68

The results, as reported in Table 6.14, indicate that the tolerance values of each variable in all regressions are more than 0.10 and VIF values are all far below 10, with the average of 1.73 and maximum value of 3.71. This suggests that the multiple-correlation with other variables is not considered to be a problem (Chatterjee & Price, 1991, pp.191–193; Pallant, 2007, p.156). Therefore, the multicollinearity is not a concern.

6.5.3 Heterocedasticity Test

Heterocedasticity is said to exist if the residuals of a regression model are unequal or have inconstant variance (Kennedy, 1998). In order to detect heterocedasticity, and following Firth (1984), the results of Spearman correlations between the absolute value residuals and the key independent variables (see Table 6.15) show that the largest correlation was 0.26 in regressions 2 and 5, 0.14 in regressions 1 and 3 and 0.12 in regression 4. Correlations less than 0.50 can be described as a weak correlation and suggest that heterocedasticity is not a serious threat to the validity and robustness of the results.

In addition, a normal distribution of the standardised residuals of each regression, as indicated by the standardised residuals histogram plots (shown earlier in Figures 6.1, 6.4, 6.7, 6.10 and 6.13), suggests that the error or disturbance can be regarded as having a constant variance leading to a reliable conclusion.

Table 6.15: Correlation Coefficient between Absolute Value of Regression Residuals and Key Independent Variables

Absolute Value of Regression Residual	CG	OWN	GOLD	POL	SIZE	LEV	LIST	AGE
Regression 1	-	.096*	.115**	.140**	.076	-.025	-.036	.033
Regression 2	-	-.037	-.037	.260**	-.070**	.047	-.050	.064*
Regression 3	-	.066**	-.003	.054*	-.047	.087**	-.140	-.011
Regression 4	.061*	-.033	.118**	.085**	.124**	-.014	.102**	-.013
Regression 5	-.124**	-.038	-.038	.262**	-.072**	.045	-.053*	.059*

Note: Correlations with other control variables – industries and years – are not reported.
** Correlation is significant at the p<0.01 (2-tailed) * Correlation is significant at the p<0.05 (2-tailed)

6.5.4 Sensitivity Analysis

6.5.4.1 Alternative Measure for Disclosure Quality

Following Lundholm and Myers (2002) and Cheng and Courtenay (2006), two alternative measures of disclosure quality were used in regressions 1 and 4. The first measure (DQRANK)[31] is the ranked percentiles of the disclosure score which measures the relative levels of disclosure of the firms within the sample. The second measure (DQRANK_IND) is the industry-adjusted percentile ranks which represent the ranking of each firm's disclosure level within its own industry. The value ranges from 0 to 1 (for the firms with the lowest to highest ranking). Table 6.16 compares the results of regressions 1 and 4 that involve each disclosure quality measure.

As shown in Table 6.16, all significant coefficients remain significant with the same sign, except that AGE becomes not significant for regression 1, when the DQRANK_IND measure was used. A golden share (GOLD) remains with the same sign except it becomes slightly significant (at $p<0.10$) when the DQRANK measure was used. For regression 4, all significant coefficients remain significant with the same sign[32] and the role of corporate governance as a mediator remains. This indicates that the results for the key independent variables (especially political influence and corporate governance) are robust against alternative measurements of disclosure quality.

---

31 The DQRANK measure was used in Botosan (1997) and Cheng and Courtenay (2006).

32 Naturally, because of the way the ranking is constructed, the coefficients of the industry dummies change, and when the DQRANK_IND measure was used, the sign of the industry dummies also changes.

Table 6.16: A Comparison of Results of Regressions between Measures of Disclosure Quality

Variable	Regression (1)						Regression (4)					
	DQ		DQRANK		DQRANK_IND		DQ		DQRANK		DQRANK_IND	
	Coeff.	**t-stat**	**Coeff.**	**t-stat**	**Coeff.**	**t-stat**	**Coeff.**	**t-stat**	**Coeff.**	**t-stat**	**Coeff.**	**t-stat**
OWN	.005***	3.71	.016***	9.88	.016***	9.31	.003***	6.4	.011***	7.63	.011***	7.04
GOLD	-.010	1.20	-.050*	-1.83	-.047	-1.64	-.005	-0.6	-.033	-1.38	-.030	-1.19
POL	-.064***	-4.94	-.178***	-19.30	-.179***	-18.48	-.049***	-18.2	-.133***	-15.72	-.133***	-14.87
CG							.351***	20.8	1.098***	20.80	1.108***	19.78
SIZE	.011***	13.94	.031***	11.05	.038***	10.91	.011***	13.2	.029***	11.40	.030***	11.16
LEV	-.004**	-11.14	-.009**	-1.96	-.014**	-2.74	-.003**	-2.4	-.008*	-1.85	-.012***	-2.71
LIST	.164***	1.97	.391***	20.27	.375***	18.56	.099***	15.9	.188***	9.60	.171***	8.22
AGE	.003*	-.21	.011*	1.73	.006	.91	.006***	3.2	.017***	3.20	.013**	2.19
CONS	.001	2.40	.017	.89	-.074***	-4.07	-.002	-0.5	.005	.33	-.086***	-5.34
IPROD	-.024***	-.85	-.067***	-4.71	-.055***	-3.68	-.021***	-5.1	-.058***	-4.60	-.046***	-3.42
TDG	.001	.05	.012	.82	-.032**	-2.17	.002	0.4	.019	1.52	-.025*	-1.88
PLANT	.002	.28	.004	.21	-.050***	-2.76	.005	0.9	.011	.70	-.043***	-2.66
CONST	-.004	.31	-.004	-.23	.042**	2.22	-.005	-1.0	-.007	-.46	.039**	2.31
TECH	-.019**	-2.38	-.054*	-1.86	.024	.77	-.022***	-2.6	-.064**	-2.50	.014	.50
HOTEL	.006	5.39	.025	.87	.078*	2.57	-.003	-0.4	-.005	-.21	.047*	1.75
INFRA	-.024**	2.63	-.060**	-2.03	.102***	3.29	-.007	-0.8	-.008	-.32	.154***	5.57
Y00	.003	-.24	.009	.67	.011	.79	.001	-0.1	-.002	-.21	.001	-.04
Y01	.063***	-.47	.196***	15.23	.208***	15.39	.020***	4.8	.061***	4.68	.072***	5.18
Y02	.082***	-.66	.257***	19.93	.273***	20.18	.026***	5.7	.081***	5.74	.096***	6.38
Y03	.085***	-.488	-.404***	20.62	.203***	20.89	.024***	5.2	.077***	5.29	.092***	5.97
Intercept	.293***	-4.56	-.404***	-10.45	-.392***	-9.65	.184***	15.3	-.744***	-19.71	-.734***	-18.34
R^2	.78		.71		.68		.83		.78		.75	
Adj. R^2	.77		.71		.68		.82		.77		.75	

*** indicates significance at 1%; ** indicates significance at 5%; * indicates significance at 10% (2-tailed)

6.5.4.2 Alternative Measure for Earnings Quality

As a sensitivity test, two other measures of earnings quality were tested, in addition to the standard deviation of residuals from the modified Dechow and Dichev (2002) model that was used in regressions (2) and (5). The first additional measure (EQDDum) is the standard deviation of residuals from the original (unmodified) Dechow and Dichev (2002) model[33] that is based on firm-specific time-series estimations.

While the main measure and the first alternative measure of earnings quality use the standard deviation of residuals from a regression of the modified and original Dechow and Dichev (2002) models respectively, the second, alternative measure of earnings quality uses the absolute value residual from the regression of the modified Dechow and Dichev (2002) model. The values are then multiplied by -1 so that higher values of the variable (AbsRes) indicate better earnings quality. Table 6.17 compares the results of regressions 2 and 5 using the absolute value of residuals measure and the results of the two other measures. As shown in Table 6.17, results are similar in almost all respects to the two alternative measures for regressions 2 and 5. All significant coefficients of test variables (OWN, POL) remain significant with the same sign. However, for regression 5, GOLD becomes significant when the AbsRes measure was used, and CG becomes significant when EQDDum was used, after controlling for political influence variables. This indicates that the results for the key independent variables (especially political influence and corporate governance) can be considered robust against alternative measurements of earnings quality.

[33] This alternative measure of earnings quality was used in Francis, LaFond et al., (2005).

Table 6.17: A Comparison of Results of Regressions between Measures of Earnings Quality

Variable	Regression (2)						Regression (5)					
	EQ		EQDDum		AbsRes		EQ		EQDDum		AbsRes	
	Coeff.	t-stat	Coeff.	t-stat	Coeff.	t-stat	Coeff.	t-stat	Coeff.	t-stat	Coeff.	t-stat
OWN	.034***	3.71	.042***	5.09	.023*	1.76	.032***	3.4	.042***	4.61	.025*	1.88
GOLD	.184	1.20	.165	1.08	-.100	-.45	.191	1.2	.178	1.16	-.106**	-.48
POL	-.256***	-4.94	-.186***	-3.59	-.144**	-1.94	-.237***	-4.4	-.151***	-2.82	-.162***	-2.11
CG							.445	1.3	.839***	2.51	-.432	-.897
SIZE	.222***	13.94	.213***	13.41	.157***	6.85	.221***	13.8	.211***	13.3	.158***	6.89
LEV	-.295***	-11.14	-.327***	-12.34	-.193***	-5.09	-.295***	-11.1	-.325***	-12.3	-.194*	-5.10
LIST	.213**	1.97	.264**	2.45	.247	1.60	.130	1.1	.109	.88	.326	1.83
AGE	-.007	-.21	.010	.30	.027	.54	-.005	-0.1	.016	.45	.024	.48
CONS	.231**	2.40	.281***	2.92	.086	.62	.226**	2.3	.272***	2.83	.090	.65
IPROD	-.068	-.85	-.012	-.14	.163	1.42	-.064	-0.8	-.004	-.05	.159	1.38
TDG	.004	.05	.047	.59	.088	.78	.007	0.1	.052	.67	.085	.76
PLANT	.027	.28	.092	.94	.045	.32	.030	0.3	.097	1.00	.042	.299
CONST	.031	.31	.195*	1.94	.105	.73	.030	0.3	.193*	1.92	.106	.74
TECH	-.389**	-2.38	-.318*	-1.96	-.369	-1.58	-.392**	-2.4	-.326**	-2.00	-.365	-1.56
HOTEL	.875***	5.39	.955***	5.89	.001	-.01	.862***	5.3	.932***	2.75	.012	.05
INFRA	.435**	2.63	.289*	1.75	-.127	-.54	.456**	2.7	.329**	1.99	-.148	-.62
Y00	-.017	-.24	-.023	-.32	.074	.72	-.022	-0.3	-.031	-.43	.078	.76
Y01	-.034	-.47	-.042	-.58	.267**	2.59	-.088	-1.1	-.145*	-1.75	.320***	2.70
Y02	-.047	-.66	-.056	-.78	.288***	2.78	-.119	-1.3	-.191***	-2.13	.357***	2.77
Y03	-.035	-.488	-.044	-.61	.183**	1.76	-.112	-1.2	-.189***	-2.04	.257**	1.94
Intercept	-.988***	-4.56	-1.070	-4.95	.086	.28	-1.126***	-4.7	-1.33***	-5.55	.220	.64
R^2	.34		.33		.12		.34		.34		.12	
Adj. R^2	.33		.32		.11		.33		.33		.11	

*** indicates significance at 1%;** indicates significance at 5%;* indicates significance at 10% (2-tailed).

6.5.4.3 Different Model Specifications for Political Influence

To the extent that the attributes of political influence are significantly correlated, it is possible that including all of them as independent variables may weaken the significance of each individual coefficient to the point that significance disappears. This should be detected by the variance inflation factor, but as an alternative test, each political variable in turn was used separately as a proxy for political influence (following Fraser et al., 2006). The results of regressions 1 to 5 with each different measure of political influence – government ownership (OWN), the presence of politician/s on the board (POL) and a golden share (GOLD) – are reported in Table 6.18.

As shown in Table 6.18, the use of the political influence variables alternatively in each of the regressions did not qualitatively change any of the results: political influence continues to have a positive relationship with disclosure and earnings quality when it is measured purely as government ownership, is negatively associated with disclosure and earnings quality when measured purely by the presence of politician/s on the board, and has no effect when measured purely by the existence of a golden share (except for regression 1 where it is slightly significant). The results of corporate governance also did not change. There is a positive relationship with government ownership and a negative relationship with politician/s on the board. After controlling for political influence (either purely as government ownership or the presence of politician/s on the board or the existence of a golden share), the significant positive relationship between corporate governance strength and disclosure quality remains. However, the insignificant relationship between corporate governance strength and earnings quality changes to a significant and positive relationship.

Table 6.18: Results of Regressions Using Each Political Influence Variable Alternatively

Variable	Regression (1) DQ			Regression (2) EQ			Regression (3) CG			Regression (4) DQ			Regression (5) EQ		
OWN	.004***			.035***			.004***			.002***			.031***		
	(.129)			(.105)						(.072)			(.095)		
GOLD		-.022**			.184			-.018			-.014			.203	
		(-.034)			(.028)						(-.021)			(.031)	
POL			-.063***			-.242***			-.042***			-.048***			-.215***
			(-.294)			(-.110)						(-.222)			(-.098)
CG										.434***	.445***	.369***	.819**	1.00***	.636*
SIZE	.013***	.015***	.013***	.234***	.240***	.237***	.004***	.005***	.004***	.012***	.013***	.011***	.231***	.235***	.235***
LEV	-.009***	-.009***	-.004**	-.314***	-.316***	-.296***	-.005**	-.005**	-.002	-.007***	-.007***	-.003**	-.310***	-.311***	-.295***
LIST	.182***	.155***	.135***	.298***	.075	-.007	.196***	.168***	.155***	.097***	.080***	.078***	.137	-.095	-.106
AGE	.004*	.002	.003	-.013	-.016	-.023	-.006**	-.007**	-.007**	.006***	.005**	.005***	-.009	-.008	-.019
CONS	.016**	.016**	.002	.286***	.294***	.237***	.021***	.021**	.012	.007	.007	-.002	.269**	.273**	.230**
IPROD	-.023***	-.023***	-.023***	-.067	-.064	-.069	-.008	-.008	-.008	-.019***	-.019***	-.020***	-.060	-.056	-.064
TDG	.001	.001	-.002	.023	.008	.009	-.006	-.006	-.008	.003	.004	.001	.028	.014	.015
PLANT	.002	.004	.005	.024	.043	.044	-.007	-.004	-.004	.005	.006	.006	.029	.047	.047
CONST	.004	.002	-.007	.068	.046	.017	.008	.006	.003	.001	.001	-.007	.061	.040	.017
TECH	-.036***	-.034***	-.015	-.469***	-.436***	-.373**	-.002	.001	.013	-.035***	-.034***	-.020**	-4.67***	-.436**	-.381**
HOTEL	.011	.003	-.001	.894***	.836***	.814***	.031**	.023*	.020	-.002	-.007	-.009	.869***	.813***	.801***
INFRA	-.035***	-.034***	-.027***	.379**	.359**	.392**	-.054***	-.059***	-.050***	-.011	-.014	-.009	.423**	.418**	.424**
Y00	.003	.004	.004	-.018	-.013	-.012	.010*	.011*	.011*	-.001	-.001	.001	-.026	-.023	-.019
Y01	.063***	.064***	.064***	-.034	-.028	-.026	.123***	.124***	.124***	.010**	.009*	.018***	-.135	-.152	-.104
Y02	.082***	.083***	.083***	-.049	-.040	-.038	.160***	.161***	.161***	.012**	.011**	.024***	-.179*	-.202**	-.140
Y03	.085***	.086***	.086***	-.035	-.028	-.025	.172***	.174***	.174***	.010*	.008*	.022***	-.177*	-202**	-.136
Intercept	.222***	.245***	.323***	-1.32***	-1.08***	-.815***	.264***	.288***	.341***	.107***	.117***	.198***	-6.91***	-1.36***	-1.03***
R^2	.70	.70	.77	.33	.32	.33	.67	.66	.69	.79	.79	.82	.33	.32	.33
Adj. R^2	.70	.69	.76	.32	.31	.32	.67	.66	.68	.78	.78	.82	.32	.31	.32

Note: Figures in parentheses are the standardised coefficients to examine a mediating effect. *** Significant at $p<0.01$; ** Significant at $p<0.05$; * Significant at $p<0.10$ (2-tailed).

In terms of the mediating effect of corporate governance strength on the relationships between political influence and disclosure quality and between political influence and earnings quality, the use of political influence variables alternatively does not change the results. Corporate governance strength still mediates the relationship between disclosure quality and earnings quality when political influence is measured either purely as government ownership or purely as the presence of politician/s on the board. This is indicated by a reduction in the magnitude of the standardised coefficients of political influence variables for regressions 4 and 5 compared to regressions 1 and 2 respectively (standardised coefficients for these variables are shown in parentheses in Table 6.18).

6.5.4.4 Serial Correlation

The results from the main analyses (reported in Tables 6.8 – 6.12) do not take serial correlation into account. The low value of Durbin-Watson statistic (DW) found for each of the regression equations (1) to (5)[34] is indicative of the presence of serial correlation in the residuals of the estimated equations that will lead to incorrect estimates of the standard errors.

In order to account for serial correlation, the original specifications were modified by including an autoregressive (AR) term in each of the five original regression equations. Table 6.19 reports the results including the DW statistic for all regression equations. The DW statistic for each of the autoregressive regressions shows the values that close to 2, indicating serial correlation has been treated[35].

[34] Equation 1, DW = 0.620; Equation 2, DW = 0.403; Equation 3, DW= 0.866; Equation 4, DW = 0.632; Equation 5, DW= 0.404.

[35] The DW statistic around 2 indicates no serial correlation (http://wps.aw.com/wps/media/objects/2228/2281679/EviewsGuide/chapter09.pdf; Gusti Ngurah Agung, 2008).

Table 6.19: Results of Autoregressive Regressions

Variable	Regression (1) DQ			Regression (2) EQ			Regression (3) CG			Regression (4) DQ			Regression (5) EQ		
	Coeff	**t-stat**	**p-value**	**Coeff**	**t-stat**	**p-value**	**Coeff**	**t-stat**	**p-value**	**Coeff**	**t-stat**	**p-value**	**Coeff**	**t-stat**	**p-value**
OWN	0.003	5.511	0.0000	0.034	4.104	0.0000	0.004	4.747	0.0000	0.002	3.887	0.0001	0.033	4.000	0.0001
GOLD	-0.008	-0.683	0.4944	0.230	1.371	0.1707	-0.008	-0.485	0.6276	-0.006	-0.619	0.5358	0.231	1.373	0.1698
POL	-0.061	-17.424	0.0000	-0.323	-6.320	0.0000	-0.033	-6.455	0.0000	-0.052	-16.629	0.0000	-0.318	-6.172	0.0000
CG										0.299	20.490	0.0000	0.175	0.751	0.4526
SIZE	0.010	9.863	0.0000	0.186	12.683	0.0000	0.004	2.455	0.0142	0.009	9.790	0.0000	0.185	12.599	0.0000
LEV	-0.005	-3.210	0.0014	-0.215	-10.352	0.0000	-0.002	-0.680	0.4966	-0.004	-3.259	0.0011	-0.215	-10.334	0.0000
LIST	0.163	23.094	0.0000	0.522	5.070	0.0000	0.182	17.282	0.0000	0.109	16.117	0.0000	0.491	4.410	0.0000
AGE	0.001	0.364	0.7156	-0.009	-0.256	0.7978	-0.009	-2.686	0.0073	0.004	1.954	0.0509	-0.007	-0.196	0.8450
CONS	-0.005	-0.7262	0.4679	0.079	0.851	0.3949	0.005	0.521	0.6028	-0.005	-0.982	0.3263	0.078	0.848	0.3965
IPROD	-0.028	-5.016	0.0000	-0.184	-2.258	0.0241	-0.007	-0.818	0.4135	-0.026	-5.313	0.0000	-0.183	-2.245	0.0249
TDG	-0.007	-1.246	0.2131	0.048	0.581	0.5613	-0.009	-1.140	0.2544	-0.004	-0.791	0.4288	0.050	0.604	0.5461
PLANT	-0.005	-0.774	0.4392	-0.100	-1.022	0.3070	-0.007	-0.735	0.4622	-0.003	-0.508	0.6113	-0.099	-1.009	0.3132
CONST	-0.006	-0.865	0.3873	0.084	0.837	0.4028	0.004	0.428	0.6685	-0.007	-1.205	0.2283	0.083	0.829	0.4074
TECH	-0.025	-2.207	0.0274	-0.330	-1.962	0.0499	-0.006	-0.364	0.7156	-0.022	-2.171	0.0301	-0.328	-1.946	0.0518
HOTEL	0.005	0.457	0.6479	1.046	6.574	0.0000	0.031	1.955	0.0508	-0.005	-0.482	0.6297	1.040	6.530	0.0000
INFRA	-0.037	-3.245	0.0012	0.093	0.553	0.5803	-0.046	-2.777	0.0056	-0.023	-2.334	0.0197	0.100	0.597	0.5508
Y00	0.003	1.571	0.1165	-0.018	-0.593	0.5533	0.010	2.739	0.0062	0.001	0.232	0.8167	-0.019	-0.650	0.5161
Y01	0.064	24.063	0.0000	-0.031	-0.857	0.3915	0.123	28.580	0.0000	0.027	9.099	0.0000	-0.053	-1.138	0.2553
Y02	0.083	31.042	0.0000	-0.044	-1.191	0.2338	0.160	37.012	0.0000	0.035	10.464	0.0000	-0.072	-1.371	0.1706
Y03	0.086	38.1376	0.0000	-0.036	-1.147	0.2514	0.173	46.945	0.0000	0.034	10.565	0.0000	-0.066	-1.296	0.1957
AR(1)	0.699	37.098	0.0000	0.812	53.056	0.0000	0.576	26.558	0.0000	0.699	37.274	0.0000	0.812	53.029	0.0000
Intercept	0.328	22.861	0.0000	-0.626	-2.880	0.0040	0.306	14.531	0.0000	0.237	17.608	0.0000	-0.680	-2.971	0.0030
R^2	0.884			0.767			0.692			0.910			0.767		
Adj. R^2	0.882			0.763			0.688			0.909			0.763		
Durbin-Watson (DW)	1.816			1.857			1.869			1.865			1.857		

After correcting for serial correlation, the results reported in Table 6.19 do not change the direct and indirect effect of political influence on financial reporting quality. Directly, government ownership is still positively associated with both disclosure quality and earnings quality and the presence of politicians on the board is still negatively associated with disclosure quality and earnings quality. The effect of the existence of golden share on financial reporting quality remains not significant.

The association between political influence and corporate governance strength also does not change from the original equation. After controlling for political influence, the effect of corporate governance on disclosure quality is still positively significant and on earnings quality remains not significant. The results also show that there is an indirect effect of political influence on financial reporting quality through corporate governance strength (mediating effect).

6.5.4.5 Moderating Effect of Corporate Governance Strength on the Relationship between Political Influence and Financial Reporting Quality

The results reported in Tables 6.11 and 6.12 show that corporate governance strength improves both disclosure quality and earnings quality and that different forms of political influence have different effects. With these results, it would be interesting to see whether corporate governance moderates the effect of different types of political influence on financial reporting quality. In order to see the moderating effect of corporate governance, interaction terms were introduced[36] (i.e. the interactive variables of OWN*CG, POL*CG and GOLD*CG). The results are reported in Table 6.20.

[36] The researcher is indebted to an examiner for the suggestion of the interaction terms.

Table 6.20: Moderating Effect of Corporate Governance on the Relationship between Political Influence and Financial Reporting Quality

$$DQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + \alpha_4 CG_{it} + \alpha_5 OWN * CG + \alpha_6 GOLD * CG + \alpha_7 POL * CG + f(\text{control variables}) + \varepsilon_{it} \quad \text{....(6)}$$

$$EQ_{it} = \alpha_0 + \alpha_1 OWN_{it} + \alpha_2 GOLD_{it} + \alpha_3 POL_{it} + \alpha_4 CG_{it} + \alpha_5 OWN * CG + \alpha_6 GOLD * CG + \alpha_7 POL * CG + f(\text{control variables}) + \varepsilon_{it} \quad \text{.....(7)}$$

Variable	Regression (6)			Regression (7)		
	Coefficient	t-stat	p-value	Coefficient	t-stat	p-value
OWN	-0.007	-3.145	0.0017	-0.047	-1.419	0.1562
GOLD	-0.041	-1.224	0.2210	-0.314	-0.584	0.5592
POL	-0.045	-4.090	0.0000	-0.593	-3.344	0.0008
CG	0.259	14.231	0.0000	-0.388	-1.339	0.1806
OWN*CG	0.014	4.188	0.0000	0.138	2.500	0.0125
GOLD*CG	0.060	1.090	0.2761	0.930	1.054	0.2919
POL*CG	-0.008	-0.424	0.6715	0.521	1.738	0.0824
SIZE	0.008	9.030	0.0000	0.178	11.982	0.0000
LEV	-0.004	-3.130	0.0018	-0.212	-10.211	0.0000
LIST	0.097	13.006	0.0000	0.338	2.765	0.0058
AGE	0.004	1.815	0.0698	-0.012	-0.355	0.7227
CONS	-0.003	-0.584	0.5591	0.106	1.136	0.2560
IPROD	-0.025	-5.093	0.0000	-0.169	-2.072	0.0385
TDG	-0.003	-0.541	0.5889	0.066	0.789	0.4300
PLANT	-0.001	-0.143	0.8865	-0.067	-0.686	0.4930
CONST	-0.006	-0.945	0.3448	0.099	0.989	0.3227
TECH	-0.021	-2.096	0.0363	-0.327	-1.945	0.0520
HOT	-0.005	-0.484	0.6283	1.025	6.451	0.0000
INFRA	-0.023	-2.250	0.0246	0.126	0.749	0.4542
Y00	0.001	0.255	0.7989	-0.018	-0.612	0.5410
Y01	0.026	9.019	0.0000	-0.057	-1.234	0.2175
Y02	0.034	10.407	0.0000	-0.079	-1.505	0.1325
Y03	0.033	10.436	0.0000	-0.076	-1.494	0.1354
AR(1)	0.703	37.600	0.0000	0.813	53.215	0.0000
Intercept	0.280	16.055	0.0000	-0.109	-0.377	0.7063
R^2	0.911				0.767	
Adjusted R^2	0.910				0.765	
Durbin-Watson	1.861				1.857	

The results reported in Table 6.20 show that corporate governance strength moderates the relationship between government ownership and either disclosure quality (significant at $p<0.01$, 2-tailed) or earnings quality (significant at $p<0.05$, 2-tailed). Independent of corporate governance, increased government ownership, makes disclosure quality worse and does not significantly affect earnings quality. However, in company with strong (weak) corporate governance, increased government ownership makes both disclosure quality and earnings quality better (worse). The net effect of government ownership on disclosure quality and earnings quality reported in the earlier tables appears to be driven by this interaction.

However, there appears to be no interaction between corporate governance and either the existence of golden share and the presence of politicians on the board, indicating no moderating effect of corporate governance on the relationship between the two political influence variables and either disclosure quality or earnings quality.

6.6 SUPPLEMENTARY ANALYSIS

6.6.1 Analysis According to Government Ownership Structure

In order to further analyse the effect of government ownership on financial reporting quality and corporate governance strength, the percentage of government ownership was divided into four types of government ownership structure: 0 percent; less than 20 percent; 20 percent to 50 percent; and more than 50 percent (following Chu & Cheah, 2006 and Thomsen & Pedersen, 1996). Less than 20 percent ownership is regarded as the minority structure (MIN), 20 percent to 50 percent ownership is regarded as the dominant minority (DOMTMIN) structure, and more than 50 percent ownership is classified as the majority structure (MAJ). These variables are dummy variables (1 if a firm is identified as having government ownership of either less than 20 percent or 20 percent to 50 percent or more than 50 percent; and 0 otherwise). Non-government ownership (0 percent) structure is used as a reference group. These variables replaced the original government ownership variable (OWN) in all regressions. The results are reported in Table 6.21.

Table 6.21: Results of Regressions Using Different Types of Government Ownership Structure

	Regression (1) DQ		Regression (2) EQ		Regression (3) CG		Regression (4) DQ		Regression (5) EQ	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
MIN	.006 (.027)	1.371	.240*** (.112)	3.220	.011*	1.912	.002 (.009)	.520	.234*** (.109)	3.139
DOMTMIN	.010** (.037)	2.100	.281*** (.098)	3.208	.030***	4.470	.000 (.001)	-.042	.265*** (.093)	3.006
MAJ	.043*** (.177)	8.391	.245*** (.098)	2.686	.044***	6.271	.028*** (.114)	6.058	.222** (.089)	2.398
GOLD	-.011 (-.017)	-1.296	.243 (.037)	1.581	-.017	-1.444	-.005 (-.008)	-.690	.252 (.038)	1.640
POL	-.064*** (-.296)	-21.714	-.247*** (-.113)	-4.766	-.041***	-10.318	-.049*** (-.221)	-18.444	-.225*** (-.103)	-4.195
CG	-	-					.350***	5.302	-.142	1.576
SIZE	.011***	12.635	.223***	13.880	.003**	2.178	.011***	13.173	.221***	13.775
LEV	-.004**	-2.496	-.292***	-10.978	-.001	-.649	-.003**	-2.487	-.291***	-10.956
LIST	.166***	27.557	.078	.731	.184***	22.425	.101***	16.546	-.020	-.163
AGE	.003	1.406	-.018	-.532	-.007**	-2.606	.005***	3.010	-.015	-.425
CONS	.003	.541	.220**	2.272	.011	1.500	.000	-.200	.214**	2.210
IPROD	-.023***	-5.034	-.094	-1.160	-.008	-1.257	-.020***	-5.042	-.090	-1.109
TDG	-.003	-.704	.000	.003	-.007	-1.085	.000	-.211	.004	.047
PLANT	.002	.283	.065	.659	-.006	-.846	.004	.781	.068	.694
CONST	-.005	-.824	.022	.219	.003	.446	-.006	-1.180	.020	.201
TECH	-.014	-1.483	-.413	-2.504	.007	.553	-.016**	-1.989	-.416**	-2.528
HOTEL	.006	.641	.825***	5.077	.028	2.210	-.004	-.472	.811***	4.980
INFRA	-.024**	-2.536	.413**	2.483	-.045***	-3.491	-.008	-.983	.436**	2.617
Y00	.003	.726	-.023	-.320	.010*	1.801	.000	-.152	-.028	-.393
Y01	.063***	15.354	-.052	-.712	.122***	21.860	.020***	4.852	-.117	-1.399
Y02	.082***	20.011	-.064	-.877	.160***	28.527	.026***	5.824	-.149	-1.644
Y03	.085***	20.634	-.051	-.694	.173***	30.691	.025***	5.302	-.142	-1.526
Intercept	.297***	24.365	-.909***	-4.213	.309***	18.531	.189***	15.893	-1.073***	-4.481
R^2	.78		.34		.70		.83		.34	
Adj. R^2	.78		.33		.69		.83		.33	

Note: Figures in parentheses are the standardised coefficients to examine a mediating effect. *** Significant at $p<0.01$; ** Significant at $p<0.05$; * Significant at $p<0.10$ (2-tailed).

Earlier, as shown in Tables 6.8 and 6.9, government ownership (regardless of how great the percentage of ownership is) has a significant and positive relationship with disclosure quality and earnings quality. When the percentage of government ownership is broken down into various ranges – less than 20 percent (MIN), 20 percent to 50 percent (DOMTMIN) and more than 50 percent (MAJ), the results (as reported in Table 6.19) indicate that minority government ownership (< 20 percent) does not have a significant effect on disclosure quality. A significant and positive relationship becomes apparent when government has dominant minority or majority ownership, that is, when the percentage of ownership is at least 20 percent. The results are similar for the relationship with corporate governance strength (except that minority government ownership (MIN) does have a slightly significant relationship). However, for earnings quality, each type of government ownership structure is significantly and positively related, regardless of how much the percentage is; whether it is minority, dominant minority or majority ownership, each type of government ownership is significantly and positively related to earnings quality.

With regards to the division of ownership structure, the findings are similar to Chu and Cheah (2006), who also find that the breakdown of ownership structure into dispersed, dominant minority and majority structure matters in explaining the relationship between test variables[37].

The results for other political influence measures – the existence of a golden share and the presence of politician/s on the board remain, when government ownership is broken into various ranges of ownership percentage. The presence of politician/s on the board has a significant and negative relationship with disclosure quality, earnings quality and corporate governance strength and the existence of a golden share continues to have an insignificant effect. In addition, the relationship between corporate governance strength and disclosure quality and earnings quality, after controlling for political influence, also does not change. Corporate governance strength continues to mediate the relationship between political influence and

[37] Among others, Chu and Cheah (2006) find that the dispersed structure shows the largest value in terms of firm size. However, firm size is not significantly different from other structures. Dispersed structure firms appear to be greater risk-takers compared to dominant minority structure firms. Majority-controlled firms show risk -seeking behaviour.

financial reporting quality, both in terms of disclosure and earnings. This is indicated by the reduction in magnitude of the standardised coefficients of political influence variables for regressions 4 and 5 compared to regressions 1 and 2 respectively (standardised coefficients for these variables are shown in parentheses in Table 6.21).

6.6.2 Analysis of the Relationship between Corporate Governance and Financial Reporting Quality

Earlier results (see Section 6.4.3, Tables 6.11 and 6.12) showed that after controlling for political influence variables, corporate governance strength was significantly and positively related to disclosure quality. However, the relationship between corporate governance strength and earnings quality, although positive, was found to be not significant. A supplementary analysis was performed to clarify the direct effect of corporate governance on disclosure quality and on earnings quality, without controlling for political influence. Two additional regressions were performed and the results are shown in Table 6.22.

The results in Table 6.22 show that without controlling for political influence, a significant and positive relationship was found between corporate governance strength and both disclosure quality and earnings quality. This indicates the direct effect of corporate governance strength on financial reporting quality in that the higher the corporate governance strength, the higher the disclosure quality and earnings quality.

Table 6.22: Relationship between Corporate Governance Strength and Financial Reporting Quality

$$DQ_{it} = \alpha_0 + \alpha_1 CG_{it} + f(control\ \ variables\ ) + \varepsilon_{it} \text{........}(6)$$

$$EQ_{it} = \alpha_0 + \alpha_1 CG_{it} + f(control\ \ variables\ ) + \varepsilon_{it} \text{.........}(7)$$

Variable	Regression (6)			Regression (7)		
	Coefficient	Standardised Coefficient	t-stat	Coefficient	Standardised Coefficient	t-stat
CG	.447***	.519	24.98	.987***	.113	3.06
SIZE	.012***	.228	14.42	.240***	.433	15.45
LEV	-.007***	-.058	-4.49	-.310***	-.269	-11.70
LIST	.080***	.267	13.73	-.095	-.031	-0.91
AGE	.006***	.040	2.99	-.016	-.011	-0.46
CONS	.007	.020	1.30	.270***	.077	2.79
IPROD	-.019***	-.079	-4.29	-.059	-.024	-0.72
TDG	.003	.013	0.73	.024	.010	0.31
PLANT	.006	.018	1.15	.047	.013	0.47
CONST	.001	-.003	-3.68	.044	.011	0.43
TECH	-.033***	-.048	-0.75	-.443***	-.063	-2.71
HOTEL	-.007	-.010	-1.38	.811***	.115	4.96
INFRA	-.013	-.018	-0.28	.405**	.057	2.42
Y00	-.001	-.004	1.85	-.023	-.009	-0.31
Y01	.008*	.032	2.18	-.149*	-.056	-1.80
Y02	.011**	.041	1.61	-.198**	-.074	-2.22
Y03	.008	.031	9.75	-.198**	-.074	-2.15
Intercept	.118***			-1.388		-6.33
Obs	1495			1495		
R^2	0.79			0.32		
Adj. R^2	0.79			0.31		

*** Significant at p<0.01; ** Significant at p<0.05; * Significant at p<0.10 (2-tailed).

6.7 DISCUSSION AND CONCLUSION

The study examines the relationship between political influence, corporate governance and financial reporting quality. The findings support the first hypothesis, that there is a negative relationship between political influence and financial reporting quality (both in terms of disclosure and earnings quality), but only if political influence is stated in terms of the presence of politician/s on the board. The hypothesis is not supported if political influence is defined in terms of government ownership. Contrary to prior studies (for example, Aggarwal, 1999, Kothari, 2001;

Naser & Nuseibeh, 2003; Zhuang, 1999b), higher government ownership is related to higher financial reporting quality.

In addition, the findings support the second hypothesis, that there is a negative relationship between political influence and corporate governance strength, but only if political influence is defined as the presence of politician/s on the board. However, if political influence is defined as resulting from government ownership, a positive relationship occurs between the variable and corporate governance strength – which does not support the hypothesis.

The findings also support the third hypothesis, that corporate governance is positively related to financial reporting quality (after controlling for political influence). However, this relationship is true only if financial reporting quality is represented by disclosure quality.[38] Finally, the findings also support the final hypothesis, that corporate governance strength mediates the relationship between political influence and financial reporting quality.

The findings in general support the agency theory discussed in Chapter Three, in that there can be conflicts between the principal (the shareholders) and the agent (the managers) and the conflicts or agency problems could be severe when there is political influence in a company. The severe agency problems could negatively affect the managers' economic decisions such as those related to accounting, reporting and governance. This negative effect is evidenced in the current study. However, the study finds evidence that only political influence in terms of the presence of politicians on the board would provide a negative effect on the managers' economic decisions.

In general, the findings are consistent with those of prior studies that recognise political influence (for example, Belkaoui, 2004; Bushman & Piotroski, 2006; Bushman, Piotroski et al., 2004; Kothari, 2001; Leuz & Oberholzer-Gee, 2006), and

[38] The results of an additional analysis (see Section 6.6.2) on the direct effect of corporate governance on disclosure quality and on earnings quality (i.e. without political influence variables in the regression) show that corporate governance is positively and significantly related to both disclosure and earnings quality.

weak corporate governance (for example, Han, 2005; Shen & Chih, 2007; Wright, 1996) as contributing factors to a lower financial reporting quality. However, the evidence that only political influence in terms of the presence of politician/s on the board negatively associated with financial reporting quality and corporate governance deserves attention.

The finding that government ownership contributes to a higher financial reporting quality is consistent with Eng and Mak (2003), who argue that government ownership leads to bigger agency problems and high-quality financial reporting is required to ease the problems. The study's finding, which shows a positive relationship between government ownership and corporate governance strength is consistent with Ang and Ding (2006). Moreover, the findings are consistent with literature which explores the monitoring effect of large institutional owners (such as government in the current study) to create higher financial reporting quality (Bushee & Noe, 2000; Healy et al., 1999) and better corporate governance (Han, 2005).

Appendix D summarises the findings of the regression analysis and shows a comparison between the findings of this study and of relevant reviewed prior studies. Overall, the findings obtained from quantitative analyses have achieved the objectives of the study which are related to (1) the extent of the financial reporting quality (in terms of disclosure and earnings quality) and corporate governance strength of Malaysian companies; (2) the direct effect of political influence on financial reporting quality; (3) the direct effect of political influence on corporate governance strength; (4) the effect of corporate governance strength on financial reporting quality, after controlling for political influence and (5) the mediating effect of corporate governance on the relationship between political influence and financial reporting quality.

6.8 CHAPTER SUMMARY

This chapter has provided findings of the quantitative data analysis which involved descriptive, univariate, bivariate and multivariate analyses. The findings reported in this chapter document the extent of financial reporting quality and corporate governance of Malaysian companies. The results provide quantitative empirical evidence of the relationship between political influence (proxied in this study by government ownership, the presence of politician/s on the board and the existence of a golden share), corporate governance and financial reporting quality (in terms of disclosure quality and earnings quality). The main findings of the study are that having politician/s on the board is negatively associated with financial reporting quality and corporate governance, and government ownership is positively associated with financial reporting quality. The latter finding contradicts the findings of most prior studies. The findings of the study, especially in relation to political influence on companies' accounting and reporting decisions, were further clarified by the findings from the interviews with key personnel of a sample of Malaysian companies. The findings from the interviews are reported in the next chapter.

CHAPTER SEVEN
INTERVIEW FINDINGS AND DISCUSSION

7.0 INTRODUCTION

In addition to the archival data which was examined quantitatively, face-to-face interviews were conducted. The purpose of the interviews was to complement and reinforce the results of the quantitative data analysis. Generally, the interviews looked into the issues of political influence on accounting and financial reporting, as well as on corporate governance in Malaysian listed and non-listed companies. Twenty-four top management personnel (including chairmen, general managers/ex-general managers, managing directors/ex-managing directors and chief executive officers/ex-executive officers [CEOs]/ex-CEOs) of listed and non-listed companies were involved in the interviews. Pertaining to the ethical issues discussed in Chapter Five, the interviewees clearly understood their identity would remain confidential. They were told their opinions were the main focus and that there were no right or wrong answers to the questions, so, any comments or insights would be helpful. Throughout the interview sessions, the interviewees seemed happy to discuss in detail any issues that particularly concerned them.

Not all of the variables tested in Chapter Six have equivalents in the interviews. For example, the small number of interviews rules out total understanding of the differences between industries or over time. In addition, the level of government ownership is a variable which is not of highest importance to individual managers and could not usefully be discussed. However, the interviews gave considerable insight into the actual relationships between governments, board members, and managers, and in particular, showed how the simple quantitative variable "politician/s on the board" captures what is really a rich source of relationships, conflicts, and synergies.

A new concept that emerges from the interviews is the distinction between ownership by the federal government and by one of the states. As an example, state-owned firms are likely to be non-listed and state owners are likely to be directly involved in a company's decision-making process. On the other hand, federally owned companies are more likely to be listed and to be operated in an arms' length relationship with the shareholding government. The different objectives and practices of different levels of government do not appear to have been previously studied. The single concept of government ownership in previous work (including Chapter Six) can usefully be unpacked further. There is clearly scope for further research on this point.

Section 7.1 reports on the background of the interviewees and the firms where the interviewees were working or had worked. The findings of the interviews are reported in Section 7.2 and the section is divided into five subsections according to the main themes that have emerged from the analysis. Section 7.3 presents discussion and conclusion to the findings and Section 7.4 summarises the chapter.

7.1 BACKGROUND INFORMATION ON THE INTERVIEWEES AND THE COMPANIES

A summary of interviewees' backgrounds including age, education, current and previous positions, and years of employment in the companies is shown in Table 7.1. From this table, it can be seen that the majority of the interviewees are aged 45 and over, from which it can be inferred that they are relatively experienced individuals. Nearly all have a degree at bachelor's level or higher, with only a few of them having only a qualification at diploma level. For this last group, based on information about their previous positions, their professional experience implies personal values, knowledge and skill-base have not been completely shaped by their educational background. About one-third of the interviewees have been in their position for five years or more and the majority of them have worked for the same company for more than five years. Both the ex-CEO and ex-managing director (ex-MD) (not specifically shown in the table) had been in their positions for at least three years and had previous experience as general managers. Positions held by the interviewees prior to joining their respective companies, along with the other background information just discussed, indicate that the interviewees have a significant amount of knowledge of and experience with the issues examined in this study.

The companies the interviewees were working for or had worked at are listed or non-listed firms. The majority of the companies have politician/s on their board of directors and less than half of the companies have a golden share held by the government. All companies have government ownership ranging from 20 percent to 100 percent. The following sections present the results of the interviews.

Table 7.1: Background Information on the Interviewees

Information	Category	Frequency (n=24)	%
Age	35 to 40	2	8.3
	41 to 45	6	25
	46 to 50	6	25
	More than 50	10	41.7
Education	Professional education (ACCA)	3	12.5
	Master's degree	5	20.8
	Bachelor's degree	11	45.9
	Diploma	5	20.8
Current position	Chairman	1	4.1
	CEO/ex-CEO	10	41.7
	General manager	3	12.5
	Managing director (MD)/Ex-MD	10	41.7
No. of years in current position	1 to 2	10	41.7
	3 to 4	6	25
	5 to 6	8	33.3
No. of years in the firm	1 to 4	9	37.5
	5 to 9	11	45.9
	10 to 15	2	8.3
	More than 15	2	8.3
Previous position (prior to joining the firm)	Vice chairman	1	4.1
	Director	2	8.3
	CEO/CFO	5	20.8
	General manager	7	29.3
	Manager	6	25
	Accountant/engineer	3	12.5

For companies where the state government is the major shareholder, a cross-reference with the Registrar of Business data showed that the chairman of these companies is the chief minister of the state government; their CEO, managing director or general manager is appointed by the state or the chief minister and they usually report directly to the chief minister.

However, for companies where the federal government is the major shareholder, the board members are not usually politicians. An examination of top management backgrounds[39] (such as CEOs', managing directors' and chairmen) showed that they are usually professionals with international or multinational experience. They are chosen through a headhunting process, even though this type of process has been criticised as fulfilling certain political agendas.[40] An examination of the Registrar of Business also revealed the positions of the top management of these types of companies cannot be related directly to the prime minister's or finance minister's positions. In other words, there are other criteria used to evaluate the CEOs, managing directors or general managers of the companies regardless of the prime minister or finance minister.

7.2 INTERVIEW FINDINGS

The findings from the interviews confirmed political influence does exist in government-owned companies, in companies with politician/s on the board and in companies with a golden share held by government.

It was found from the interviews that there are different levels of political influence. The interview findings showed that companies for whom the state government is the biggest shareholder, usually via a State Economic Development Corporation (SEDC)[41], those which are non-listed, and those which have politician/politicians on their board, have the most political influence. Generally, these firms survive because of government projects specially allocated to them. There are also political influences involved for listed companies and those that have the federal government

---

39 Information regarding the backgrounds was gathered through interviews and from company annual reports.

40 One of the government policies through NEP is to restructure the community via economic equality. To achieve that, trust institutions for example, PNB, TH, LTAT are being set up. Refer to Gomez and Jomo (1997).

41 SEDC is an investment arm of state government. All states in Malaysia have their own SEDC.

as the biggest shareholder (via the government's institutions)[42] but the level of influence is different. Mostly, political influence from the government occurs at policy level; the government does not intervene to the same extent at an operational level. Other types of firms are those where the federal government holds a special share of the company (a golden share). Usually this type of company is involved in monopoly industries or what is defined as strategic investments and its products or services involve the whole country. The government has a final say about all economic decisions such as client charges. The management of the company has freedom in its operations but this is diminished if a politician is on the board of directors.

The findings also showed that political influence affects both accounting and reporting decisions, particularly the decisions relating to earnings, what to disclose and how much to disclose in the annual reports, as well as decisions connected to corporate governance.

7.2.1 Why Earnings Targets Are Missed

The focus was to obtain the interviewees' views on political influence on earnings, earnings targets or predictions. Earnings targets or predictions were used to indicate earnings quality. Predictability of earnings was one of the measures used in prior studies (for example Lipe, 1990). It was thought the subject of earnings targets was not "too technical" and was familiar to all interviewees, compared to other earnings quality measures such as accrual quality which was also used in this study.

In this regard, the interviewees were asked whether they had experiences of missing an earnings target. Failure to meet an earnings target indicates that the company is facing problems (Graham, Harvey, & Rajgopal, 2005). This question was asked because the factors that contribute to such problems play a vital role in this study, especially when the company is exposed to political influence.

---

[42] PNB, TH, Khazanah Holdings, EPF, LTAT, MoF, Felda, Felcra, Petronas, BNM, SOCSO, KWAP, MARA, ASN, ASB.

The interview results revealed that companies for whom the state government is the biggest shareholder, those which are non-listed and those which have politician/s on the board are likely to have missed or nearly missed their earnings targets. It was also found that management had a tendency to reduce expenses in an effort to report positive earnings levels and changes, and to meet targets. This is likely a practice of earnings management which could lower earnings quality.

Four causes of difficulties in meeting earnings targets were identified: unbudgeted expenditures imposed for political reasons, planned public service obligations which cannot be met profitably, broken commitment by government owners, and imprudent investment undertaken at the firms' own initiative.

As one of the respondents of a state-owned firm said:

> There was a subsidiary which was not creating a profit. We decided to close it but the state government, through its representative in our company, said no because people need jobs. So we have to retain it (Ex-MD U).

Another senior executive stated:

> We have put in our budget to build and sell medium and high-cost houses and the state government agreed at the early stage but later requested we build more low-cost houses. Definitely this has affected our earnings target (CEO M).

Similarly, an ex-CEO of a state-owned company said:

> We are in the oil and gas and service industry. We are experts in our area but the politicians wanted us to venture into business where we do not have expertise. They asked us to venture into housing. The worst thing is they wanted us to build low-cost houses. That is not our line and the project was not profitable. We didn't meet our target (Ex CEO B).

The above examples illustrate the weaknesses in companies' economic decision-making and governance caused by political influence, as identified in the previous chapter in order to facilitate the achievement of non-business interest. For example, the government influence has caused companies to over ride economic obligations in favour of social obligations and political advantage, resulting in earnings targets being missed.

Companies which have the federal government as their biggest shareholder are also expected to meet public obligations as ordered by the government, but the difference is their obligations are planned well in advance. For example, they may be asked to build and manage universities or to set up infrastructure and electricity supplies in rural areas. In other words, these companies have anticipated the amount of money in their budgets.

Even though some of the interviewees from this type of companies admitted that some projects are awarded to them by the government, there are also projects that they initiate themselves through open tenders. Moreover, they also invest to expand their businesses abroad. As a result, the interviewees said their companies were stable, profitable and rarely miss earnings targets. In short, the survival of these companies does not completely depend on the government's allocation of projects, compared to their counterparts. As mentioned by one CEO, some people might argue that government projects give companies secure profits, but in reality there are a lot of uncertainties involved.

The government might pull back the offers based on the current economic and political situation. As a result, the expected earnings targets may not be met. In one instance the government withdrew its previous offer to allow a company to carry out the government's "mega projects".

As one CEO said:

> Our target was usually missed because we did not get what had been promised to us by the state government. For example, we had been promised a 500 million ringgit project early this year, but a few months later, the state government came back to us and said that they could not give the project to us (CEO S).

This shows that the failure or near failure to meet earnings targets was caused by an unfavourable decision made by the government.

7.2.2 How Do Managers Respond When Earnings Are Threatened?

Following the question related to missing earnings targets/predictions, the interviewees were asked about actions taken to put the companies back on target. The majority of the interviewees who had experienced missing an earnings target said they preferred to make economic sacrifices rather than to manipulate accounting figures or to take any actions related to accounting.

As one of the CEOs said:

> We sit down in our third quarter meeting, look into the figures then try to reduce expenses like advertising, travelling and R&D. These actions are within our control. Some officers are not happy when we cut costs on travelling but we have to explain it to them (CEO A).

These findings show that the management of the companies would elect to sacrifice long-term economic values to fulfil short-term targets, rather than manipulate accounting figures. In this respect, one CEO admitted: "Since IFRS was implemented in Malaysia, there is not much room for playing and massaging accounting figures. We do not practice that." (CEO H). Most of the interviewees were reluctant to employ within-GAAP accounting discretion, such as accrual management, to meet earnings targets, although conducting accrual management is cheaper than giving up economic targets.

The tests for earnings management in the previous chapter do not distinguish between manipulations of accruals and real actions to reduce expenses. The interviews allow us to make that distinction, showing that managers prefer real actions to accounting manipulation.

7.2.3 Earnings Forecasts and Achieving Targets

All the interviewees agreed that earnings should be predicted. The majority of those interviewees from listed companies suggested that external factors or market forces explained why earnings should be predicted. On the other hand, the majority of the interviewees from non-listed companies named internal factors as the reason for earnings prediction. Table 7.2 details the reasons given by the interviewees, categorised under each factor.

Table 7.2 Reasons Why Earnings Should Be Predicted

External Factors
- Positive influence on share price
- Growth prospects
- Indication of management credibility
- Positive analysts' evaluation
- Business expansion
- Business stability

Internal Factors
- Career concerns
- Stakeholders' motivation
- Justification for decision on employee bonuses

A clear distinction appeared in the responses from companies that were listed and federally owned versus those that were state-owned (whether listed or not). Managers of state-owned companies gave career reasons for ensuring earnings targets were met. According to one CEO, "If I don't meet the target, I'm out of a job. Everybody is eyeing this post. A CEO post in a state-owned company is very fragile. You have to deliver." (CEO X).

When the respondent was asked further whether he felt the CEO post is a political post or if he agreed his post is a political appointment, he replied:

> I don't deny it but I had to prove my track record before being appointed to this post. The state government chooses those who they think they can work with and those who can deliver. The bottom line here is you have to deliver. We have to be realistic. If you didn't deliver it is very difficult for the party who appointed you to defend you. They have to face their opposition in the Dewan Undangan Negeri [the State Assembly], they have other supporters too. Moreover they are answerable to "rakyat" [the people] (CEO X).

This view is shared by an ex-CEO:

> The CEO or managing director post of a government company is a political post. You rise and sink with those who choose you. Regardless of what, you have to show a good record of your achievements. But sometimes, even with your good achievements, it is not guaranteed that you will be automatically appointed again to be in your seat. Like my case, I feel that the company had performed very well under my management. I always met earnings targets but when the new chief minister was elected, he chose his own man and supporter to be the CEO (Ex CEO B).

In order to confirm that the CEO and managing director's posts were related to political appointment, the dates of appointment of CEOs and managing directors of state-owned companies and those of new chief ministers of two states in Malaysia as stated in the Malaysian Registrar of Business were checked. The results were quite unexpected: of thirty randomly selected state-owned companies, twenty-seven CEOs and managing directors were appointed soon after the date of appointment of a new chief minister. This means when the new chief minister was in power, the previous CEO was replaced with a newly appointed individual. This finding indicates the top management has an agency relationship with the government or politician (such as the chief minister of the ruling party). Consequently, executives in state-owned companies are under pressure to meet earnings targets to protect their reputation and image of competence, which can be associated with their personal interests.

However, if the interviewees are of listed companies, which have the federal government as the biggest shareholder, market forces were found to be the main driver to meet earnings targets. Most of the interviewees from these companies said by meeting earnings targets, companies remove themselves from the "uncertainty" zone with regards to their future. According to them, the "market" will translate this into the companies' share prices. If the companies are unable to meet their earnings targets, then the market will conclude that the companies are having problems. In other words, a company has to perform and that performance is evaluated through the company's share price. For these types of companies, their performance gives "licence" to their CEOs, managing directors and general managers to remain in their positions. The finding indicates that market forces and mechanisms are working in conjunction with government intervention[43].

---

[43] This is consistent with market for managerial labour as control mechanism where the performance of the management is assessed based on market reactions (Fama & Jensen, 1983a) and also consistent with evidence on capital market returns which have shown that significant valuation appreciation occurs when targets are attained (Bartov, Givoly, & Hayn, 2002; Kasznik & McNicholas, 2002), and disproportionately significant valuation reductions, or "penalties" occur when earnings targets are not met (Skinner & Sloan, 2002).

7.2.4 Political Influence on Disclosure Quality

In relation to financial reporting, the interviewees were asked if their companies supplement their financial reports with voluntary disclosure. As the measure of disclosure quality in this research is the extent of disclosure, voluntary disclosure contributes significantly to quality. They were also asked why such a disclosure was made and who they thought the most important users of their annual reports were.

The interviews provided the following finer and more detailed information beyond what could be found from the quantitative analysis: distinction between state and federal ownership, motives behind politician/s on the board (POLBOD) / disclosure quality (DQ) association, and absence of motive to disclose when companies are not listed.

All interviewees of all listed firms said their firms supplemented their financial reports with voluntary disclosure whereas mostly, the interviewees of non-listed firms stated that their firms did not. The major shareholder of non-listed companies was the federal government through the Kementerian Kewangan DiPerbadankan (Ministry of Finance Incorporation). According to the interviewees of non-listed companies, there are four main reasons for not supplementing their financial reports with voluntary disclosure. These are:

- It is not necessary
- It is not mandatory
- Company's information is exposed to competitors
- Companies are led by an official decision of the board of directors for non-disclosure.

On the other hand, the interviewees of the listed companies provided five main reasons for voluntary disclosure of additional information. The reasons are:

- Transparency
- Value added to a company

- Reduction of information asymmetry
- Reduction of litigation costs
- Improvement of capital raising capability.

One of the CEOs of a listed company who mentioned transparency as a reason for voluntary disclosure added that:

> Companies, regardless of whether they want to be or not, are always transparent to the public to some degree. Many are choosing to be more transparent in order to better serve their shareholders and members of the public. Companies that don't pay attention to the needs of shareholders run the risk of attack; those who do are much better able to develop sustainable business models (CEO P).

The responses from the interviewees generally appear to be have been driven by economic and political motivations. In particular, the interviewees whose firms had state government ownership as the biggest shareholder did not look at other stakeholders' needs as a reason for publicly revealing extra information. Another CEO stressed that:

> It is impossible for us to take into account the needs of all our stakeholders – there are too many of them. If we did this, we would not be able to fulfil our main obligations. We need to establish the relevant levels of disclosure and decide what should be included when meeting reporting requirements. Our main goal is to maximise shareholder value and all our activities should work towards that end (CEO L).

The above findings are consistent with the findings obtained from quantitative analysis (see Table 6.5, Chapter Six), that politically influenced companies disclose less. Management of state-owned companies, especially those with politician/s on their board of directors, felt somewhat protected from external threats (such as pressure groups), which could impair economic interest as a result of their connections with the government. Therefore, they did not make voluntary disclosures. This confirms the finding reported in the previous chapter (see Tables 6.6 and 6.8), that the existence of politician/s on the board is associated with less disclosure.

Only two CEOs stated "industry trends" as a reason for voluntary disclosure. Another CEO said "if competitors are publicly reporting on certain issues, we may look at what they are reporting and consider doing the same." (CEO J).

When probed further as to whether state-owned company disclosure of information is an ethical necessity, as these types of companies belong to the people and other stakeholders and the government is only a custodian, one GM replied:

> To me, opinions related to ethics are strongly subjective – what matters to you will not matter in the same way to me and most people have different sets of ethical standards. Add to that different cultures, different races and different environments, and nobody can make a judgment on what is appropriate or not for someone else. It is not within our jurisdiction to criticise other people's moral values (GM O).

To the question of who were the most important users of their annual reports, the interviewees of non-listed companies said the state government, the chief minister and shareholders. This is not surprising since most of the non-listed companies have politician/s on their board or the chief minister as the chairman of their board. As mentioned by one of the MDs of the non-listed companies:

> Actually the chief minister of the state government is the chairman of the SEDC [State Economics Development Corporation], our parent company. Regarding the disclosure of information that is beyond what is required by law, I think transparency is very important. We have nothing to hide except that we do not disclose our directors' salaries because we thought that is not mandatory and there is no reason for us to disclose such information and we don't do anything wrong (MD K).

Similarly another MD said:

> We don't disclose extra information. Why must we? We are not a listed company. Our biggest shareholder is the state government. They have their representative on our board. We only produce the information that we have to produce (MD Q).

These views also support the quantitative finding that politician/s on the board is associated with less disclosure.

Another interviewee had different reasons for not disclosing extra information. He believed his experience of providing extra information had exposed him and the company to even greater demands and increased scepticism. Apparent quests for legitimacy effectively backfired due to this disclosure being used in many instances as a stick with which to beat the company. He said:

> We have to consider carefully all the information that we plan to disclose. Any extra information can be twisted and used by groups that plan to oppose us. Even information disclosed with positive intent can be used against us. Since we are a state-owned company, we need to be much more sensitive to these issues (CEO S).

Reporting any extra information was also claimed as sometimes "obliged" managers to repeat the same thing in the future. As one interviewee said:

> When we make extra disclosures, people come to expect it and take it for granted. We cannot go back easily to the previous level of disclosure as people feel a right to the extra information. Backtracking in such a way can open the company up to strong criticism (CEO L).

The perception that the state government is the most important user of a company's annual reports and that disclosing additional information is unnecessary has also been supported by another interviewee, who said: "We are non-listed and just a subsidiary to our parent company. They are our boss. We pass what is required by law only. No one is interested in reading any extra information" (CEO K). This is consistent with the quantitative finding reported in Tables 6.5 and 6.8, Chapter Six, which indicates that listed companies disclose more but non-listed companies disclose less.

When the interviewees of the non-listed companies were asked about whether they made their annual reports available to the public, most of them revealed that they did not. Some of them denied the public rights to the report due to the fact that the state government was their shareholder and they only reported to the government. One of the interviewees said: "We are a subsidiary to SEDC. It is not our duty to decide on whether to pass the information on to the public or not. It is up to our parent company." (CEO R).

Evidence from the interviews also revealed that politics does influence disclosure decisions, especially in companies which have politicians on their board and a state government as their major shareholder. These types of companies have to gain consent from the government for what to include due to political implications. The politicians on the boards of directors, as the representatives of the government, influenced the board to decide what and how much to disclose. While most interviewees were supportive of voluntary disclosure, the interviewees of companies with politician/s on their board and a state government as their major shareholder often failed to act on this belief due to these political factors.

One executive of this type of firm said:

> About financial disclosure, maybe the audit committee would like it to be transparent but when it comes to the board decisions, they choose not to disclose because of the political implications of some of the information. This is something unique about a state-owned company. We, as executives, don't mind if we have to give extra info and to explain further but this depends on how the board perceives what the implication will be (MD D).

This finding strongly supports the negative association between the presence of politician/s on the board (POLBOD) and disclosure quality (DQ) obtained from the quantitative analysis. As reported in the previous chapter (see Tables 6.6 and 6.8, Chapter Six) – that the presence of politician/s on the board is associated with low disclosure quality.

Not only politicians who are members of the board influence disclosure decisions; other parties, such as the executive members of the state may also have some influence.

When he was asked about whether there are any parties that influence the decisions of financial reporting, one GM said:

> Quite a lot! The board members, executive members of the state, politicians and our customers. They all influence my decisions. We are a state-owned company and our chairman is the chief minister (GM N).

The state government and politicians' intervention in the reporting decision of the companies which have politicians on their board and a state government as their major shareholder clearly indicate the severe agency conflicts or problems between the principal (the state government) and the agent (managers), as discussed in theoretical framework of agency theory in Chapter Three. The government, through politicians as their representative on the board, controls managerial decision (such as the decision of what to disclose or not disclose in the annual reports), so that the decision is in line with its political agendas.

The findings from the interviews revealed extra information and provided useful insight into the relationship between political influence and disclosure quality, extending the findings of the quantitative analysis. Political influences on disclosure decisions are found to be not as severe if the companies are listed and the federal government (via its agencies) is the major shareholder. In fact, these companies are more likely to pay more attention to disclosure guidelines, other companies' reports and various reporting schemes' criteria (such as those of NACRA). Such means are useful for providing an overview of what to report and how. These companies often release extra information to the market, through newsletters or bulletins, meetings with investors or potential investors, meetings with analysts, conference calls, media previews and annual reports. The interviewees from these companies believed that voluntary disclosures help market participants and other stakeholders form conclusions about the company (especially with regards to current or future performance), and as a result, the company can benefit from improved terms of exchange. However, if the companies are listed and have politician/s on their boards, the interviewees of these companies said they also often reveal extra information to the market but that their board scrutinises and elects the type and amount of information to be formally revealed. Information which is believed to have implications for the politicians or the government is not allowed to be revealed. This indicates that although the companies are listed (which are regulated), political influence is worse if there are politicians on the board.

7.2.5 Political Influence on Corporate Governance

In addition to examining the effect of political influence on accounting and reporting, the interviews were carried out to investigate whether politics are involved in corporate governance.

Political influence does occur in corporate governance. The findings of the interviews showed that almost half of the interviewees of companies where the state government was the biggest shareholder and politicians were part of the board of directors admitted they have "a very close connection" with the government. They have to report their activities or their performance directly to the chief minister in regular meetings. Another interviewee said:

> My chairman is the chief minister. I will contact him at least once a week. I report things that the chairman should know. As a CEO of a SEDC subsidiary, I have a close relationship with him (CEO T).

An ex-CEO of a state-owned company said:

> I had been the CEO since the previous government of the state. I can say that politics are very much involved at all levels. Politics are involved in determining how the company is supposed to be. That influence comes from the representative of the state government on the board. The state executive members want to get involved in businesses where the state has control. They become the chairman of the company. Once they become the chairman, what I can see is that they want to "drive" the company, for example on how things should be done. As a result, the CEO is in a situation that is difficult to operate (Ex-CEO B).

The existence of political influence on boards of directors is confirmed by another ex-MD who said:

> When there is a dominant figure on the board then problems arise. Like in my company where one of the directors is a politician, decisions made were always referred to him. The board didn't understand (when it came to a good business proposal that had to be put aside). For example, they will ask you, why do you want to close the company? When I said, it is not doing well, they were not happy because we never closed a company before (Ex-MD U).

Almost all interviewees whose companies have politicians on their board agreed that the dominant figure does influence their decision-making as CEO.

The above findings clearly show that the presence of a politician or government representative on a company's board of directors contributes to the elements of weak governance which in turn makes the manager's economic decision-making difficult. This justifies the quantitative findings that the presence of politician/s on the board makes corporate governance worse (see Table 6.10, Chapter Six) and subsequently contributes to low disclosure quality (see Table 6.11, Chapter Six).

7.3 DISCUSSION AND CONCLUSION

The interviews in this chapter provide a rich source of support for some of the quantitative findings and new details on the complexity of the relationship between governments, boards and managers. First, they reveal a strong difference between state and federal governments as corporate owners. State owners appear to have much greater direct involvement in their companies, and a new state government frequently replaces the senior management of its businesses. Federally-owned companies are more likely to be listed and to be operated in an arms' length relationship with the shareholding government.

Earnings management, which is equivalent to the more precise concept of earnings quality in the previous chapter, is seen as necessary to provide an image of managerial competence for career reasons. Difficulty in meeting forecasts can come from politically imposed conditions, governments making promises of contracts which are then not honoured, and from the companies' own investment projects. Predominantly, managers try to achieve earnings targets by taking real actions to cut expenses, not by accounting manipulations or by exploiting the judgements required in preparing financial statements. The quantitative analysis was not able to distinguish the particular methods used to manage earnings, and so this additional information is provided by the interviews.

Disclosure was shown in the previous chapter to be particularly affected by the presence of politician/s on the board, and the interviews brought out some of the complexity of this relationship. Managers tended to consider the needs of the government owner only, and for non-listed companies there was little alternative pressure for better disclosure. The government ownership protected the company from external pressure for better disclosure, and any sense of obligation the managers had for better public disclosure was over-ridden by political factors. But if companies were listed, this provided a counter to political pressure and led to greater transparency.

Having politician/s on the board also affected corporate governance and particularly the decision-making process around this. The politician provided a channel through which the government could have direct input into corporate decisions, and their authority was not readily challenged by governance processes.

Overall, the findings have affirmed the purpose of the interviews – to reinforce and confirm findings from the quantitative data analysis. They have also provided extra, valuable information that complements and strengthens the findings obtained quantitatively.

7.4 CHAPTER SUMMARY

This chapter has reported findings from the interviews. The findings have achieved the final objective of the study: to discover the perceptions of top management personnel of political influence in the Malaysian companies. Generally, the perceptions gathered confirm the presence of political influence on managerial decisions and support some of the quantitative findings reported in the previous chapter.

The next chapter, which is the final chapter, provides a summary of the findings obtained from both quantitative and qualitative data analyses, and the conclusion of the study.

CHAPTER EIGHT
SUMMARY AND CONCLUSION

8.0 INTRODUCTION

The purposes of this study, as outlined in the first chapter of the thesis, are to get a clear picture of the financial reporting quality and corporate governance of Malaysian companies and to examine the relationships between political influence, corporate governance and financial reporting quality. In order to achieve this, six objectives were focused on:

1. To analyse Malaysian companies in terms of their disclosure and earnings quality and corporate governance strength.
2. To examine the direct effect of political influence on financial reporting quality.
3. To examine the direct effect of political influence on corporate governance strength.
4. To examine the effect of corporate governance strength on financial reporting quality, after controlling for political influence.
5. To examine the mediating effect of corporate governance on the relationship between political influence and financial reporting quality.
6. To discover the perceptions of top management personnel regarding political influence in Malaysian companies.

Section 8.1 reviews the research approach carried out in achieving the objectives and Section 8.2 presents a summary of the findings. Section 8.3 discusses the limitations of the study. Section 8.4 provides an overall conclusion including the contributions of the study. Finally, in Section 8.5, this thesis concludes with a number of suggestions for future research.

8.1 SUMMARY OF THE IMPLEMENTATION OF THE STUDY

The objectives of the research study were achieved by employing both quantitative and qualitative approaches. To achieve the first research objective, a disclosure index was developed and applied to companies' financial reports to determine the level of disclosure as the measure of disclosure quality. In addition, a corporate governance index was developed and applied to the annual reports of companies in order to measure corporate governance strength. The main measure of earnings quality in the study was accruals quality, measured by the natural logarithm of the standard deviation of residuals derived from the regression of the modified model of Dechow and Dichev (2002) and multiplied by negative 1. The disclosure quality, earnings quality and corporate governance strength were descriptively analysed. Listed and non-listed, and politically influenced and non-politically influenced companies were compared. Politically influenced companies were identified in this study as those that have government ownership, the presence of politician/s on the board and/or the existence of a golden share held by government. Comparisons were also made between government-owned and non-government-owned companies; between companies with and without the existence of a golden share; and between companies with politician/s on the board and those without.

To achieve the next four objectives, four hypotheses were tested. The hypotheses are:

- H1: Political influence is associated with lower financial reporting quality.
- H2: Political influence is associated with weaker corporate governance.
- H3: After controlling for political influence, weak corporate governance is associated with low financial reporting quality.
- H4: Corporate governance mediates the relationship between political influence and financial reporting quality.

The final objective was accomplished by conducting interviews with top management personnel including chairmen, CEOs, managing directors and general managers of companies that were deemed to have political influence – companies with government ownership, companies which have politicians on the board and companies which have a golden share held by government. These interviewees were able to provide extra understanding of political influence in such companies and the influence of politics in managerial decision-making with regards to accounting, reporting and corporate governance.

The results obtained from each of the approaches have been reported in Chapters Six and Seven. However, the next section summarises the major findings.

8.2 SUMMARY OF THE FINDINGS

The findings obtained from an analysis of the financial reporting quality (both in terms of disclosure and earnings quality) and corporate governance strength of Malaysian firms revealed that for sample companies disclosure quality ranged from 0.38 to 0.87 on a scale from 0 to 1. On average, the disclosure quality was 0.63, which implied that 63 percent of the total disclosure items were disclosed in the companies' financial reports. Regarding earnings quality, there was a large variation among the sample companies, ranging from 0.212 to 136, with the geometric mean of the standard deviation of residuals of 10.6. For the whole sample, corporate governance strength scores were on average 0.58, suggesting that 58 percent of the criteria for strong corporate governance were present.

When listed and non-listed companies were compared, significant differences in the mean values of disclosure quality, earnings quality and corporate governance strength were found. The mean disclosure quality, earnings quality and corporate governance strength of listed companies was found to be higher than those of non-listed companies.

When politically influenced and non-politically influenced companies were compared, only the difference in the mean of disclosure quality was slightly significant. The means of earnings quality and corporate governance strength between the two groups were not significantly different. A company was classified as being under political influence if it had one or more of government ownership, the presence of politician/s on the board and the existence of a golden share.

For further analysis, the three attributes of political influence were analysed separately. First, the means of disclosure quality, earnings quality and corporate governance of government-owned companies were compared with those of non-government owned companies. The difference in the means of disclosure quality between the two groups was statistically not significant. However, for earnings quality and corporate governance strength, the means of companies with government ownership were higher than those without government ownership. Secondly, disclosure and earnings quality of companies with a golden share were significantly higher than those without. However, the means of corporate governance strength was not significantly different. Finally, companies with politician/s on the board had lower disclosure quality, earnings quality and corporate governance strength than companies without politician/s on their board.

The findings obtained from regression analysis (with controls for other variables including size, leverage, listing status and age), suggest the following:

1. Political influence measured by percentage of government ownership has a significant and positive association with disclosure quality, earnings quality and corporate governance strength.
2. Political influence measured by the presence of politician/s on the board has a significant and negative association with disclosure quality, earnings quality and corporate governance strength.
3. Political influence measured by the existence of a golden share has no significant association with disclosure quality, earnings quality or corporate governance strength.
4. After controlling for political influence attributes, corporate governance is significantly and positively associated with disclosure quality but has no significant association with earnings quality.
5. Corporate governance strength does mediate the relationship between political influence and financial reporting quality.

The quantitative findings therefore supported the first two hypotheses, but only if political influence is defined as the presence of politician/s on the board. The third hypothesis was supported only if financial reporting quality is represented by disclosure quality. The findings supported the fourth hypothesis.

The findings from the interviews confirmed that political influence does exist in Malaysian companies and the influence does to some extent affect the companies' managers' decisions regarding accounting, reporting and governance structure. The level of political influence was higher in companies owned by state governments and with politician/s on the board compared with those owned by the federal government. Having a politician on the board has a pervasive influence on the companies. Politicians involve themselves at every level of companies' decisions, including operations, corporate governance, disclosure and earnings quality. This is consistent with findings that political variables affect all of these, so that the effect of political influence on disclosure or earnings quality is not due purely to its effect on corporate governance. The interviews further explained how the influence and why the positive relationship between government ownership and financial reporting quality exists.

8.3 LIMITATIONS OF THE STUDY

The study is subject to several limitations. Financial reporting quality in this study has been measured as disclosure quality (measured by the extent of disclosure) and earnings quality (measured by accruals quality); other interpretations or measurements have been disregarded. The scores for disclosure quality were based on whether items were disclosed or not disclosed and did not represent a qualitative indicator of the value of the information. Further, this study used only one form of disclosure and assumed that all disclosures were made through corporate annual reports. In practice, there may be information that flows through private meetings, which are highly effective in a relationship-based economy.

There are other measures of earnings quality, such as performance-matched abnormal accruals (for example, Niu, 2006; Ball and Brown, 1968) and asymmetric timeliness of earnings measures (for example, Ball and Shivakumar, 2005; Basu, 1997); use of such alternative measures may give different results. However, since this study was also dealing with non-listed companies, methods that use market prices could not be used.

Political influence in the study has been limited to government ownership, the presence of politician/s on the board and the existence of a golden (special) share held by government; other interpretations of political influence have not been taken into account. The study could not use the definition of "political connectedness" as used by Gul (2006) and as defined by Gomez and Jomo (1997) since the politicians on Gomez and Jomo's list are no longer active in politics. It is possible that other possible causes of influence (for example, managers who have close connections with politician/s or government in other ways) do occur but the links are not clear and hence the three attributes identified as political influence may not be a complete list.

Moreover, the measure of the strength of corporate governance used in the study has emphasised internal mechanisms. Only one external mechanism, "board members are elected annually", which indicates the absence of a staggered board (similar to that in Brown and Caylor, 2006; Cremers and Nair, 2005) has been included. Other external firm-level mechanisms which indicate protection against takeover, such as "the absence of a poison pill" and "no restrictions on shareholders on calling special meetings or acting by written consent", have not been included.

Furthermore, the analysis of the secondary data through the checklist may not be sufficient to fully determine the actual level of corporate governance. For example, information about independent directors used to assess the strength of corporate governance in this study was collected from company annual reports. The fact that independent, non-executive directors may have a close relationship with management that may create dependence was ignored. Corporate governance as reflected in public documents may not relate to real practices because the formal acceptance of regulations does not mean commitment, especially in Malaysia where although regulatory standards have been rated as high, enforcement is weak (Chuanrommanee & Swierczek, 2007).

Qualitative evidence collected through face-to-face interviews was open to biases such as false memory recall and social desirability bias. The interviewees may have been unwilling to admit to unacceptable behaviour. However, the interviewees appeared to be sincere and were not hesitant. Unwillingness to admit to undesirable behaviour did not appear to be a major problem in this study. The sample of the interviews might also be considered as opportunistic sample which could lead to bias in the interpretation of the findings. The interview findings cannot confirm whether or not there is political influence in companies other than government-owned companies.

Finally, the concept of earnings quality brought up during the interviews was earnings predictability. This is one measure of earnings quality, but is different from the measure of earnings quality used in the hypothesis testing (accruals quality).

8.4 CONCLUSION

Overall results of the study are consistent with prior studies in that political factors such as political influence are directly related to the credibility or quality of financial reporting. However, this study suggests that political influence and financial reporting quality need to be specified more precisely. In this study, political influence is specified as government ownership, having politician/s on the board and the existence of a golden share. Financial reporting quality needs to be specified as either disclosure quality, earnings quality or some other possible measure. The results showed that different proxies for political influence may produce different results, depending on the institutional setting, and the effect may be different for different measures of financial reporting quality.

Notably, the most important contribution of the study to the current body of literature of financial reporting quality and corporate governance is related to the effect of government ownership on financial reporting quality and corporate governance.

While most prior studies found negative relationships between government ownership and the quality of financial reporting and corporate governance, the current study showed contradictory findings. The study provides evidence that government ownership is positively related to financial reporting quality, both in terms of disclosure and earnings quality, and corporate governance strength. Companies with a higher percentage of government ownership are likely to have higher disclosure and earnings quality and stronger corporate governance. This positive relationship is probably related to the specific situation in Malaysia.

The key role of government-owned companies in national economic growth, such as the role of attracting foreign direct investment, may be why financial reporting quality and corporate governance of those companies is better than private companies. Government-controlled companies (as at December 2000) contribute 30.3 percent to total market capitalisation (Mohd Ghazali, 2007) and play a crucial part in securing foreign direct investment. If these companies do not focus on high-quality financial reporting, they will have trouble generating such investment. In addition, these companies play a large part in controlling the nation's strategic resources. Thus, they are not only responsible for maximising shareholder value, but also supporting all government functions in order to maintain stability in the country. The international outlook of managers of these companies and their role in securing strategic resources and meeting government obligations to the constituents were confirmed by the interview results.

The positive relationship between government ownership and disclosure quality and between government ownership and corporate governance is consistent with Singapore studies (for example, Eng & Mak [2003] who found that government ownership increased disclosure and Ang & Ding [2006] who found that corporate governance of government-owned companies is better than that of private companies). Government-linked companies in Singapore have played a strategic and important role in Singapore's economic development (Eng & Mak, 2003; Feng et al., 2004) as they have in Malaysia. This similarity may suggest that if a country's economic growth is dependent more on government-owned companies, the companies tend to be more transparent and extensive in their disclosure and strengthen their governance structure. Perhaps this requires government-related companies to have better governance and more transparent disclosure in Malaysia and Singapore than elsewhere. A further study may be required to validate this suggestion. The quantitative and qualitative findings of the current study have provided useful insights and could be taken as the basis for future studies. In addition, the positive relationship may suggest that the government investment agencies (such as Perbadanan Nasional Berhad and Tabung Haji in Malaysia) have played an effective monitoring role that leads to better financial reporting quality and corporate governance. The monitoring role played by the government in ensuring better earnings quality is in line with Gul's (2006) Malaysian study which found that financial subsidies and other assistance to politically connected companies, such as government-controlled companies (as a result of the imposition of capital controls), reduced the incentive for managers of these companies to misstate financial statements (including earnings).

In relation to the conceptualisation of political influence, there is very little information to date about the interplay of political influence, corporate governance and financial reporting quality in "relationship-based economies" such as Malaysia's, where political connections play an important role in corporate relationships. The significant expansion of such economies around the world has led to them having increased power and influence, and this is set to continue. Prior studies have looked at political connections in such economies, with a specific emphasis on Malaysia (Adhikari, Derashid, & Zhang, 2006; Gul 2006; Johnson & Mitton, 2003), using Gomez and Jomo's (1997) interpretation of "informal ties" as signifying "political connectedness". However, informal ties are difficult to verify and may be very time-specific, producing studies that soon become dated: for example, they may refer to individual politicians who are no longer active in politics[44]. This study has proposed and tested a set of conceptual relationships among political influence, corporate governance, and financial reporting quality; it has done so in a relationship-based economy; and it has offered objective and replicable proxies for political influence.

[44] Refer to Gul (2006), Johnson and Mitton (2003), Adhikari et al. (2006), Leuz and Oberholzer-Gee (2006). All these studies relate companies to certain politicians who are already out of power.

The study has also contributed to the existing literature by finding that there is a mediating effect of corporate governance on the political influence–financial reporting quality relationship. No prior research has examined political influence, corporate governance and financial reporting quality in a single study. The findings of this study have therefore extended the existing literature which includes the studies of Bushman, Chen et al. (2004) and Leuz and Oberholzer-Gee (2006), who relate political factors to financial reporting quality and those of Wright (1996) and Claessens and Fan (2002), who relate corporate governance to financial reporting quality.

Overall, the findings have provided insights and additional guidance for regulators and policy makers in Malaysia and possibly in other emerging economies for improving the design of corporate governance features and financial reporting frameworks, as well as for deciding on the level of involvement of government and politicians in business.

8.5 SUGGESTIONS FOR FUTURE RESEARCH

There are several future research avenues that may flow from this study.

The current study has found positive relationships between government ownership and financial reporting quality, and between government ownership and corporate governance. These findings contradict those of most prior studies but are consistent with the related findings of Singapore studies, in that government ownership is related to better quality of financial reporting quality and corporate governance. It is therefore desirable for future studies to address questions such as the following: For what countries is the positive relationship true? What are the characteristics of those countries? And how do they differ from countries where government involvement makes financial reporting quality and corporate governance worse? The quantitative and qualitative findings of the study have provided useful insights and can be taken as the basis for future studies.

The study has provided evidence that having politician/s on the board makes both governance and financial reporting quality worse. These practices are improved only when government ownership increases, displacing private ownership. One possible explanation of the findings is that political influence does weaken governance and financial reporting quality in Malaysia, but that private owners are even worse than the government. These issues clearly require future research. This study shows some of the conceptual distinctions that need to be made in future research.

In the quantitative analysis, the study only took into account the effect of government ownership and did not differentiate between the ownership by state and federal governments. However, the interviews have found differences between political influence on managerial economic decisions (including decisions on accounting, reporting and corporate governance) in state-owned and in federal-owned companies. Therefore, future research may treat state ownership and federal ownership as separate variables to provide better understanding on the effect of government ownership on financial reporting quality and corporate governance.

Finally, an important extension to this study would be an examination of cultural variables as predictors of financial reporting quality for, in countries such as Malaysia, mixed cultures and races can produce significant differences. The impact of culture in Malaysia has been evidenced in Haniffa and Cooke's (2005) study, in that culture has a significant influence on corporate social reporting. Future research on the impact of culture on financial reporting quality may extend the findings of Haniffa and Cooke's study and consequently may provide further understanding of the impact of culture on broader accounting and reporting issues.

APPENDIX A: A SUMMARY OF PRIOR STUDIES ON FINANCIAL REPORTING QUALITY

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Barth, Landsman and Lang	2008	EQ	Less earnings management indicates higher earnings quality. Focuses on the characteristics of accounting amounts to provide evidence on earnings management, particularly earnings smoothing and timely loss recognition.	To investigate whether applying IAS is associated with less earnings management, more timely loss recognition, higher value relevance of accounting amounts, and a lower cost of capital.	IAS firms have higher accounting quality and may have a lower cost of capital than non-IAS firms.
DeFond et al.	2007	EQ & DQ	EQ Measured using a variation of the earnings management metric computed in Leuz et al. (2003). Less earnings management indicates higher quality earnings index. DQ CIFAR's rating. A higher CIFAR rating indicates a higher disclosure quality.	To measure country-level earnings quality and disclosure quality for investor protection and the information content of annual earnings announcements.	Annual earnings announcements are more informative in countries with higher quality earnings or better enforced insider trading laws. Annual earnings announcements are less informative in countries with more frequent interim financial reporting.
Brown and Hillegeist	2007	DQ	AIMR's rating. Higher AIMR scores indicate higher disclosure quality.	To examine the relationship between the quality of a firm's disclosures and the average level of information symmetry among equity investors.	Overall quality of a firm's disclosures is negatively associated with the average level of information asymmetry.
Chen et al.	2007	EQ	EQ = accruals quality (from the application of the Dechow and Dichev [2002] model). Higher accruals quality indicates higher earnings quality because accruals quality reflects the mapping of accounting earnings into cash flows.	To examine whether accrual earnings quality is a priced information risk factor in a dividend change setting.	Market's perception of firms' information risk changes around dividend changes.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Velury and Jenkins	2006	EQ	Quality criteria of FASB SFAC No.2 – predictive value or feedback value, neutrality, timeliness and representational faithfulness. Earnings are of high quality if all the quality criteria are met.	To investigate the association between the quality of reported earnings and the level of institutional ownership in the corporate structure	A positive association between institutional ownership and several attributes of earnings quality. Concentrated ownership may have a negative effect on earnings quality.
Daske and Gebhardt	2006	DQ	Score or ranking from 'best annual report' contest. A higher score/ranking indicates better quality.	To assess the quality of the financial statements of Austrian, German and Swiss firms which have already adopted internationally recognized standards (IFRS or United States GAAP).	The perceived disclosure quality has increased significantly for companies applying internationally recognized accounting standards, particularly IFRS, both statistically and economically in all the three continental European countries involved in the study.
Yee	2006	EQ	Uses Penman and Zhang's (2002) model. Earnings quality refers to how quickly and precisely reported earnings reveal fundamental earnings. The more quickly and precisely reported earnings communicate shocks to the present value of expected dividends, the higher the quality of earnings.	To establish a model that links earnings quality to the equity risk premium in an infinite horizon consumption capital asset pricing model (CAPM) economy.	The model succeeds in demonstrating the link between earnings quality and equity risk premium - earnings quality magnifies fundamental risk. When fundamental risk is absent, poor earnings quality cannot affect the equity risk premium.
Lee et al.	2006	DQ	AIMR's rating/score. A higher rating/score indicates higher disclosure quality.	To examine the relationship between disclosure quality and the institutional holding, bid-ask spread and analyst following.	The disclosure of a firm is of high quality if the firm has institutional holdings, low bid-ask spread, and high analyst following.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Dargenidou et al.	2006	DQ	Standard and Poor's Financial Transparency and Disclosure Score. A higher score indicates higher disclosure quality.	To examine whether differences between accounting regimes lead to biased expected earnings that may have cost of capital effects.	Accounting diversity *per se* does not have costs as long as the underlying economies are converging.
Ashbaugh et al.	2006	EQ	Uses the magnitude of abnormal accruals, the timeliness and relevance of earnings, and the independence of the audit committee to proxy for the quality of firms' financial information. The more transparent the earnings i.e. the more current earnings reflect information about the firm's current economic activities, the higher the earnings quality. Higher abnormal accruals signal lower earnings quality and higher information risk for investors. The higher the percentage of the audit committee made up of outside independent directors, the better the quality of earnings.	To identify the relationship between key governance attributes - ownership structure, stakeholder rights, and board structure and the quality of firms' financial information (earnings quality).	Firms with higher earnings transparency and greater integrity of the audit process, have lower costs of equity capital.
Krishnamurti, Sevic and Sevic	2005	DQ	Scores reported by the Credit Lyonnais Securities Asia (CLSA) in 2001 – primary component: transparency. A higher disclosure score indicates better quality.	To examine whether there exists cross-sectional differences in effective spread, depth and adverse selection component of spread that are related to disclosure quality.	Firms with higher disclosure scores have significantly lower relative effective spreads and adverse selection component costs, other things being equal.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Heflin et al.	2005	DQ	FAF's score (a weighted average of three components: annual report disclosures, quarterly and other written disclosures, and other aspects). A higher score indicates higher disclosure quality.	To examine the relationship between disclosure quality, information asymmetry, and market liquidity.	Higher disclosure quality is associated with reduced risk of informed trading and increased market liquidity – a policy of higher quality of disclosures enhances a firm's market liquidity.
Francis, LaFond et al.	2005	EQ	EQ = Accrual Quality determined from Dechow and Dichev's (2002) model.	To investigate the relationship between accruals quality and the costs of debt and equity capital.	Lower-quality accruals are associated with higher costs of debt: smaller price multiples on earnings, and larger equity betas.
Dunn and Mayhew	2004	DQ	AIMR's score/rating. A higher score indicates higher disclosure quality.	To examine the association between the uses of an industry specialist audit firm and the quality of the firm's disclosures.	A positive association between industry-specialist audit firms and analysts' rankings of disclosure quality in unregulated industries, but no relation in regulated industries.
Bens and Monahan	2004	DQ	AIMR's score/rating. A higher score indicates higher disclosure quality.	To examine the valuation implications of differences in firms' disclosure practices.	A positive relation between disclosure quality and the excess value attributable to diversification.
Hodge	2003	EQ	EQ = the extent to which net income reported on the income statement differs from true earnings (based on a survey of the perceptions of investors).	To investigate whether investors' beliefs mirror the Securities and Exchange Commission's (SEC) concerns that earnings quality and auditor independence has declined over time.	Perceived earnings quality for all publicly traded firms has declined overtime.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Richardson	2003	EQ	EQ = the deviation of net income from operating cash flows. Firms with high accruals (or a large gap between net income and operating cash flow) experience a decline in earnings performance and therefore have low quality.	To examine whether investors short sell securities with high accruals.	No evidence that short sellers trade on the basis of information contained in accruals.
Myers et al.	2003	EQ	EQ = absolute abnormal accruals (Jones model).	To investigate the extent to which auditor tenure is associated with the dispersion in accruals and whether the recognition of income-increasing or income-decreasing accruals varies with auditor tenure.	Increased auditor tenure does not lead to reduced audit and earnings quality.
Hope	2003	DQ	CIFAR's score (seven areas – income statements, balance sheet, cash flow statement, general information, accounting policies, stockholders' information and supplementary information). A higher score indicates higher disclosure quality.	To investigate the effects of variations in annual report disclosure quantity and enforcement of accounting standards on the accuracy of financial analysts' earnings forecasts.	Firm-level annual report disclosure quantity is positively associated with forecast accuracy.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Shaw	2003	EQ	DQ: the FAF's total disclosure quality score. Higher score indicates higher quality. EQ: earnings smoothing activities (measured by discretionary accruals), the timeliness of earnings' recognition of value-relevant events (measured through the earnings-return association). The lesser the earnings smoothing activities, the more timely the recognition of earnings, and the higher the quality.	To investigate the interaction between corporate disclosure quality, earnings smoothing activities, and the timeliness of earnings' recognition of value-relevant events.	Firms with better disclosure substitute enhanced disclosure for delayed recognition of some value-relevant events in earnings.
Naser and Nuseibeh	2003	DQ W & UW No. of items: fifty-five WG: seven groups of annual report users.	DQ = the degree of compliance and the level of disclosure. The higher the degree of compliance and disclosure, the higher the disclosure quality.	To assess the quality of information disclosed by a sample of Saudi-listed companies. To compare disclosure quality before and after the creation of the Saudi Organisation of Certified Public Accountants (SOCPA).	A relatively high compliance with mandatory requirements in all industries except the electricity sector. Although the level of disclosure is relatively low, the companies disclose information more than the minimum required by law. SOCPA has little impact on corporate reporting.
Fan and Wong	2002	EQ	EQ = the informativeness of accounting earnings to investors (measured by the earnings-return relation).	To investigate the relationship between corporate ownership structure and the quality of accounting information in seven East Asian economies, excluding Japan.	Earnings informativeness, measured by the earnings–return relation, is significantly negatively related to the ultimate owner's control level, conditional on the owner having gained effective control.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
McDaniel et al.	2002	DQ	Uses SFAC No. 2's characteristics of relevance, reliability, and comparability to capture characteristics related to overall financial reporting quality. Financial expert perceptions on quality from a survey.	To investigate whether and how financial experts' judgments related to financial reporting quality differ from those of financial literates.	Financial experts' frameworks for evaluating overall financial reporting quality for a set of financial statements differ from those of financial literates. Specifically, experts' individual assessments of the relevance and comparability characteristics of quality espoused in SFAC No. 2 better aggregate to their overall assessments of reporting quality, while literates' evaluations of overall reporting quality were unrelated to their assessments of relevance and comparability.
Dechow and Dichev	2002	EQ	EQ = Accrual quality i.e. the extent to which working capital accruals map into operating cash flow realizations – measured the residuals from firm-specific regressions of changes in working capital on past, present, and future operating cash flows. A poor match signifies low accrual quality.	To establish a new measure of one aspect of the quality of working capital accruals and earnings.	Accrual quality is positively related to earnings persistence.
Beneish and Vargus	2002	EQ	Earnings quality is defined as the likelihood that a firm can sustain current earnings in the future (Mishkin [1983] framework).	To investigate whether insider trading is informative about earnings quality and the valuation implications of accruals.	Market participants and researchers can use managers' contemporaneous trading in ex ante assessment of the likelihood that the firms' accruals are of high or low quality, and in assessing the likelihood of earnings management.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Penman and Zhang	2002	EQ	Scores from a combination of two indices: 1) Conservatism Index (C-Score) – measures the effect of conservative accounting on the balance sheet. 2) Earnings Quality Indicator (Q-Score) – measures the effect of conservative accounting in the income statement. A higher score indicates higher quality.	To develop diagnostic measures of the joint effect of investment and conservative accounting.	Quality concerns arise if firms apply conservative accounting consistently without any change in accounting methods or estimates.
Hooks et al.	2002	DQ W No of items: seventy-six WG: weightings derived from literature review.	DQ = the extent and quality of information provided in the annual reports. Uses own developed index (EARS).	To evaluate the extent and quality of information provided in the annual reports of New Zealand electricity retail and distribution companies.	There is an information gap between stakeholders' expectations and the disclosure provided by the companies.
Patel et al.	2002	DQ UW, ninety-eight items	Using T&D S&P Index. Items are broadly divided into three sub-categories: i) ownership structure and investor relation, ii) financial transparency and information disclosure iii) board of management structure and process. A higher score indicates higher quality.	To introduce a new dataset on transparency and disclosure for emerging markets, examines differences in the levels of transparency and disclosure among countries, regions, and economic sectors and provides an exploratory analysis of the correlation of transparency and disclosure with ownership structures and valuations.	Asian emerging markets exhibit greater transparency and disclosure following recent currency, banking, and equity market crises. Float is positively correlated with transparency and disclosure. Valuation is also positively correlated with transparency and disclosure, consistent with the notion that the market places a premium on companies with lower asymmetric information problems.
Gelb and Strawser	2001	DQ	AIMR's rating. A higher rating indicates higher disclosure quality.	To examine the relationship between firms'_disclosures and measures of social responsibility	A positive relationship between disclosure level and corporate social responsibility.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Barth, Cram and Nelson	2001	EQ	Uses Dechow et al.'s (1998) model (a model of the accrual process).	To investigate the role of accruals in predicting future cash flows.	Disaggregating earnings into cash flow and six major accrual components - change in accounts receivable, change in inventory, change in accounts payable, depreciation, amortization, and other accruals - significantly enhances the predictive ability of earnings.
Leuz and Verrecchia	2000	DQ	DQ = the level of disclosure. Proxies for the information asymmetry component: the bid-ask spread, trading volume in firm shares, and share price volatility.	To study German firms that have switched from the German to an international reporting regime (IAS or United States GAAP), thereby committing themselves to increased levels of disclosure.	Firms that commit to increased levels of disclosure garner economically and statistically significant benefits.
Bushee and Noe	2000	DQ	AIMR's rating. A higher rating indicates higher disclosure quality.	To investigate whether a firm's disclosure practices affect the composition of its institutional investor ownership and its stock return volatility.	Firms with higher disclosure quality have greater institutional ownership, but the particular types of institutional investors attracted to greater disclosure have no net impact on return volatility.
Chen and Jaggi	2000	DQ UW No of items: thirty	DQ = the disclosure extensiveness of each item of mandatory disclosure. Follows the Wallace and Naser (1995) index.	To examine the relationship between comprehensive financial disclosures and the proportion of independent non-executive directors (INDs) on corporate boards, and whether family control has an impact on this association.	The ratio of INDs to the total number of directors on corporate boards is positively associated with the comprehensiveness of financial disclosures, and this association is weaker for family controlled firms compared to non-family controlled firms.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Vafeas	2000	EQ	EQ = earnings informativeness (proxied by the earnings–returns relationship which is examined through Spearman rank correlations between income before extraordinary items deflated by assets and median-adjusted stock returns across the range of outsider representation).	To examine whether the informativeness of earnings varies with the fraction of outside directors serving on the board and board size.	Earnings of firms with the smallest boards in the sample (with a minimum of five board members) are perceived as being more informative by market participants. By contrast, there is no evidence that board composition mitigates the earnings–returns relation.
Cotelli, Gardiol, Asner and Tuchschmid	1999	DQ	The Swiss Financial Analyst Federation (SAFAIM)'s rating. A higher rating indicates higher disclosure quality.	To investigate the influence of Swiss firms' disclosure policy and their financial analysts' coverage on stock price abnormal reactions to the publication of the annual reports.	The absolute abnormal returns are not significantly affected by the quality of the firm's annual reports disclosure.
Healy et al.	1999	DQ	AIMR's rating. A higher rating indicates higher disclosure quality.	To investigate whether firms benefit from expanded voluntary disclosure by examining changes in capital market factors associated with increases in analyst disclosure ratings.	The disclosure rating increases are accompanied by increases in sample firms' stock returns, institutional ownership, analyst following, and stock liquidity.
Sengupta	1998	DQ	FAF's score. A higher score indicates higher disclosure quality.	To investigate the link between a firm's overall disclosure quality and its cost of debt financing.	A significant negative association between a firm's overall disclosure quality and two alternative measures of a firm's incremental borrowing cost: (1) the yield to maturity and (2) the effective interest cost to the issuer.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Botosan	1997	DQ UW No. of items: sixty-three	Uses own developed disclosure index (DSCORE) to measure disclosure level. The higher the level of disclosure (score), the higher the disclosure quality.	To examine the association between disclosure level and the cost of equity capital by regressing firm-specific estimates of cost of equity capital on market beta, firm size and a self-constructed measure of disclosure level.	For firms that attract a low analyst following – greater disclosure is associated with a lower cost of equity capital. For firms with a high analyst following – no evidence of an association between disclosure level and cost of equity capital.
Sloan	1996	EQ	High-quality earnings – earnings composed primarily of operating cash flows. Low-quality earnings – earnings composed principally of accruals.	To investigate whether market participants use a relatively simple measure of the quality of reported earnings based on publicly available information.	Firms where accruals are large and positive: 1) earnings tend to decline over the next three years because of reversals of accounting accruals; 2) the largest accrual reversals are attributable to current accruals; and 3) the stock prices of these firms decline over the three-year period, and these stock price declines are related to a predictable decline in earnings.
Lang and Lundholm	1996	DQ	FAF's score/rating. A higher score indicates higher disclosure quality.	To examine the relationship between the disclosure practices of firms, the number of analysts following and properties of the analysts' earnings forecasts.	Firms with more informative disclosure policies have a larger analyst following, more accurate analyst earnings forecasts, less dispersion among individual analyst forecasts and less volatility in forecast revisions.
Wright	1996	DQ and the existence of an SEC Accounting and Auditing Enforcement Release against a firm or its auditor.	DQ = AIMR's rating. A higher rating indicates higher disclosure quality.	To investigate the relationship between corporate governance characteristics and the quality of financial reporting.	A negative correlation between the FRQ measures and the presence of insiders and 'grey' directors on the audit committee.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Wallace and Naser	1995	DQ UW No. of items: thirty	Uses own developed index to determine disclosure quality. A higher index score indicates better disclosure quality.	To examine the relationship between disclosure quality and firm's characteristics – asset size, scope of business and profits.	Disclosure quality varies positively with asset size and the scope of business operations but negatively with profits.
Hossain, Perera, and Rahman	1995	DQ UW No of items: ninety-five	DQ = the extent of disclosures. Uses own developed index. A higher index score indicates the more information disclosed, the higher the quality.	To examine the relationship between five firm-specific characteristics and the level of accounting information voluntarily disclosed by companies listed on New Zealand Stock Exchange (NZSE).	Firm's size, foreign listing status and leverage are significantly related to the extent of voluntary disclosure but assets-in-place and types of auditor are not significant explanatory variables.
Wallace, Naser and Mora	1994	DQ UW No of items: sixteen	DQ = the comprehensiveness of disclosure. Uses own developed index. A higher index score indicates higher disclosure quality.	To investigate whether the differences in the details offered on selected information items in the annual reports mirror the differences in the firms characteristics and whether the firm characteristics found to be relevant in the previous country disclosure are also implicated in Spain.	Sample firms with higher (lower) structure (with asset size or total sales serving as a proxy) tend to offer more (less) comprehensive disclosure in their annual reports and accounts; those with higher (lower) operational performance as determined by liquidity tend to offer less (more) comprehensive disclosure; while firms that are listed on the Madrid and Valencia stock exchanges tend to provide more comprehensive disclosure than those are not listed.
Cooke	1993	DQ UW No. of items: 195	DQ = the level of disclosure. Uses own developed index. A higher index score indicates higher disclosure quality.	To investigate the disclosure level of Japanese corporate annual reports - differences in the extent of disclosure by companies that are classified by quotation status and the analysis extends to both the Commercial Code (CC) and the Securities and Exchange Law (SEL).	The level of disclosure in the SEL accounts is greater than the domestically listed and unlisted companies in the CC accounts. Disclosure in the CC accounts by unlisted and domestically listed companies is very limited – restricted to mandatory items. Unlisted companies prefer to keep as much information as possible secret.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Alford, Jones, Leftwich and Zmijewski	1993	EQ	EQ = accounting informativeness (measured by information content and timeliness for accounting earnings).	To compare the information content and timeliness of accounting earnings in several countries using the United States as a benchmark.	Significant differences in the timeliness and information content of accounting earnings across the sampled countries.
Lev and Thiagarajan	1993	EQ	EQ = earnings persistence. Two indicators of persistence: the earnings response coefficient and future earnings growth.	To determine the value of corporate securities by examining key value-drivers, such as earnings, risk, growth, and competitive position.	Support the incremental value-relevance of most of the identified fundamentals. The returns—fundamentals relation is considerably strengthened when it is conditioned on macroeconomic variables.
Imhoff	1992	EQ	Defines earnings quality "to be overall subjective assessment of the relevance, reliability, and comparability of the accounting data". Employs analysts' judgements of accounting quality as the quality measures.	To examine security analysts' perceptions of firms' accounting quality to understand how differences in accounting quality are related to observable accounting characteristics.	Accounting (earnings) quality is systematically related to important characteristics of earnings and several other accounting characteristics of the sample firms. Earnings announcements from firms with relatively high accounting quality produce larger response coefficients per unit of unexpected earnings than their low quality counterparts.
Jones	1991	EQ	An estimate of the discretionary component of total accruals is used as the measure of earnings management rather than the discretionary component of a single accrual.	To test whether firms that would benefit from import relief (e.g., tariff increases and quota reductions) attempt to decrease earnings through earnings management during import relief investigations by the United States ITC.	Managers decrease earnings through earnings management during import relief investigations.
Biddle and Saudagaran	1989	DQ W No of items: 296 WG: weighting is based on literature.	DQ = the level of financial disclosure. Uses own developed index. A higher index score indicates higher disclosure quality.	To investigate the association between financial disclosure levels and observed choices among alternative stock exchange listings.	Firms appear less likely to list their shares on foreign stock exchanges with higher disclosure levels than those of their domiciles.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Cooke	1989	DQ UW No of items: 229	DQ = the level of disclosure. Uses own developed index. A higher index score indicates higher disclosure quality.	To examine the overall extent of corporate annual report disclosure in Sweden, and to assess the association between a number of corporate characteristics and the extent of disclosure.	A significant association between the extent of disclosure and listing status. Disclosure by unlisted companies is lower than listed companies. Disclosure by listed companies is lower than that for companies with multiple quotations. There is a significant association between the size of enterprises and the extent of disclosure.
Chow and Wong-Boren	1987	DQ W & UW No. of items: eighty-nine WG: Loan officers	DQ = the extent of voluntary financial disclosure. Uses own developed index to measure. A higher index score indicates higher disclosure quality.	To examine the association between the extent of voluntary financial disclosure and a firm's characteristics – size, financial leverage and proportion of assets in place.	The extent of voluntary disclosure increases with firm size. No significant effects due to financial leverage or assets in place.
Robbins and Austin	1986	DQ W & UW No. of items: twenty-seven WG: Bond Analysts.	DQ = the extent of disclosure. Uses own developed index A higher index score indicates higher disclosure quality.	To examine the association between the non-weighted (simple) and weighted (compound) indices and independent variables i.e. factors identified in previous studies as possible determinants of disclosure in governmental financial reports – coalitions of voters, administrative power and management incentives.	The independent variables which are significantly associated with the simple index of disclosure quality are also significantly associated with the compound index.
Firth	1984	DQ W & UW No. of items: forty-eight WG: Analysts	DQ = the amount of disclosure. Uses own developed index. A higher index score indicates higher disclosure quality.	To examine the association between the amount of disclosure and the level of stock market risk.	No significant association between the amount of disclosure and the level of stock market risk.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Firth	1980	DQ W No of items: forty-eight WG: Financial analysts	DQ = the extent of disclosure. Uses own developed index. A higher index score indicates higher disclosure quality	To examine whether firms significantly increase the extent and quality of voluntary financial disclosure in their annual reports when they raise new finance on the stock market	Smaller sized firms (market capitalizations of under £50 million) increase their voluntary disclosure levels significantly when raising new stock market finance, via new issues and rights issues. For larger firms, raising finance on the equity market has no impact on disclosure levels.
Garsombke	1979	DQ	Uses Singhvi's disclosure index (1969). A higher disclosure score indicates better quality.	To analyze the validity of arguments made for a theoretical relationship between disclosure and firm risk.	Disclosure and risk are not causally related and disclosure is an insignificant variable in explaining differences in firm risk.
Dhaliwal, Spicer and Vickrey	1979	DQ	DQ = quantitative and qualitative increase in disclosure based on the segmental disclosure requirements of the United States Securities and Exchange Commission.	To examine the impact of an increase in disclosure on the cost of equity capital.	The segmental disclosure requirement produced lower costs of equity capitals.
Altman	1977	EQ	Uses ratio of net income to total assets.	To develop a system for identifying serious financial problems in savings and loan associations.	The results of the study show that a 12-variable econometric system is both accurate and practical for at least three semi-annual periods preceding the serious problem data. The system involves (1) quadratic discriminant analysis, and (2) a composite S&L rating based on three two-group discriminant models.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Barrett	1976	DQ W & UW Seventeen categories of information. WG: literature and researcher's own judgement.	DQ = the extent and quality of financial disclosure. Uses own developed disclosure index. A higher index score indicates better quality.	To examine the overall extent of financial disclosure and the degree of comprehensiveness of firms' financial statements in seven different countries namely United States, United Kingdom, Japan, France, Germany, Sweden and Netherlands.	The overall level of corporate financial disclosure steadily improves throughout the period of study. A wide variance between the overall level of disclosure of American and British firms, and the firms from the other five countries. The American and British firms' financial statements are considerably more comprehensive in terms of including the results of related companies and of taking a broad view of income related items than those of the firms located in the other five countries. The French firms have less disclosure and less comprehensive financial statements than the firms in any of the other six national samples.
Buzby	1975	DQ W No. of items: thirty-nine WG: Financial analysts.	DQ = the extent of disclosure of selected items. Uses own developed index. A higher index score indicates better quality.	To investigate the relationship between a sub-component of adequate disclosure - the extent to which selected items of information are presented in corporate annual reports and the two firm's characteristics – size and listing status.	The extent of disclosure in annual reports is positively associated with the size of the company's assets and is not affected by listing status.
Buzby	1974	DQ W No. of items: thirty-nine WG: Financial analysts.	DQ = the extent of disclosure of selected items. Uses own developed index. A higher index score indicates better quality.	To measure the relative importance and/or the extent of disclosure of selected types of financial and non-financial information in annual reports.	Many of the items are inadequately disclosed in the sample and the correlation between the relative importance of the items and the extent of their disclosure was small.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Baker and Haslem	1973	DQ W No. of items: thirty-three WG: Investors	DQ= information informativeness.	To examine the information needs of individual investors in their analyses of common stock.	Factors related to expectations about the future are the most highly regarded by the investors. Individual investors are also interested in historical factors
Singhvi and Desai	1971	DQ W No. of items: thirty-four WG: Security analysts	Uses index developed by Cerf (1961) with another six items added. A higher index score indicates better quality.	To identify some of the characteristics of corporations in the United States which are associated with the quality of corporate disclosure.	The corporations which disclose inadequate information are likely to be: (a) small in size as measured by total assets, (b) small in size as measured by number of stockholders, (c) free from listing requirements, (d) audited by small CPA firms, (e) less profitable as measured by rate of return, and (f) less profitable as measured by earnings margin.
Pankoff and Virgil	1970	DQ UW No. of items: thirty-five	DQ = usefulness of information (the extent to which information facilitates decision making).	To measure the usefulness of accounting and other information to professional security analysts who participate as subjects in their laboratory stock market.	No empirical support for the belief that accounting information is generally and highly useful for decision-making.
Ball and Brown	1968	EQ	EQ = earnings usefulness.	To assess the usefulness of existing accounting income numbers by examining their information content and timeliness.	Of all the information about an individual firm that becomes available during a year, one-half or more is captured in that year's income number. The annual income report does not rate highly as a timely medium, since most of its content (about 85 to 90 percent) is captured by more prompt media which perhaps include interim reports.

Author(s)	Year	FRQ Interpretation	Determination of Quality	Purpose of Study	Result
Beaver	1968	EQ	EQ = earnings informativeness (information content). A firm's reported earnings is assumed to have information content if it leads to a change in investors' assessments of the probability distribution of future returns (or prices).	To examine the extent to which common stock investors perceive earnings to possess informational value.	Investors do look directly at reported earnings and do not use other variables to the exclusion of reported earnings. News announcements occurring prior to the earnings report do not entirely pre-empt the information content of reported earnings.

Key:
DQ: Disclosure quality
EQ: Earnings quality
UW: Unweighted
W: Weighted
WG: Weighted group

APPENDIX B: LIST OF COMPANIES USED IN THE STUDY

	COMPANY	STATUS
1.	A&M Realty Bhd	L
2.	Advance Synergy Capital Bhd	L
3.	Ajinomoto (Malaysia) Bhd	L
4.	Aliran Ihsan Bhd	L
5.	Aluminium Company of Malaysia Bhd	L
6.	Amalgamated Containers Bhd	L
7.	Amway (Malaysia) Holdings Bhd	L
8.	Ancom Bhd	L
9.	Ann Joo Resources Bhd	L
10.	Antah Holdings Bhd	L
11.	Aqfa Sdn Bhd	NL
12.	Asas Dunia Bhd	L
13.	Asia File Bhd	L
14.	Asia Pacific Land Bhd	L
15.	Astral Asia Bhd	L
16.	Ayer Hitam Tin Dredging Bhd	L
17.	Batu Kawan Bhd	L
18.	Bayou Bay Development Sdn Bhd	NL
19.	BCB Bhd	L
20.	BCIC Holdings Sdn Bhd	NL
21.	Behrang 2020 Sdn Bhd	NL
22.	Benta Wawasan Sdn Bhd	NL
23.	Berjaya Land Bhd	L
24.	Berjaya Sports Toto Bhd	L
25.	Bina Darulaman Bhd	L
26.	Bina Puri Holdings Bhd	L
27.	Binaraya PKINK Sdn Bhd	NL
28.	Bloomingdate Advertisment Sdn Bhd	NL
29.	Boustead Holdings Bhd	L
30.	Box-Pak (Malaysia) Bhd	L
31.	Brem Holdings Bhd	L
32.	British American Tobacco (Malaysia) Bhd	L
33.	Bukit Katil Resources Bhd	L
34.	Business & Budget Hotels (Penang) Sdn Bhd	NL
35.	C.I Holdings Bhd	L
36.	Camerlin Group Bhd	L
37.	Carlsberg Brewery (Malaysia) Bhd	L
38.	Cement Industries of Malaysia Bhd	L
39.	Central Industrial Bhd	L
40.	Chemical Company of Malaysia Bhd	L
41.	CHG Industries Bhd	L
42.	Chin Teck Bhd	L
43.	Choo Bee Metal Industries Bhd	L
44.	Cindee Development Sdn Bhd	NL
45.	Computer Forms (Malaysia) Bhd	L
46.	Cosway Corporation Bhd	L
47.	Country Heights Hdg. Bhd	L
48.	Cycle & Carriage Bintang Bhd	L
49.	Dai Hwa Holdings (M) Bhd	L
50.	Daibochi Plastic Bhd	L
51.	Damansara Realty Bhd	L

	COMPANY	STATUS
52.	Datuk Keramat Holdings Bhd	L
53.	Daya Perumahan Sdn Bhd	NL
54.	DFZ Capital Bhd	L
55.	Digi.Com Bhd	L
56.	Dijaya Bhd	L
57.	DKLS Industries Bhd	L
58.	DNP Holdings Bhd	L
59.	Dolomite Corporation Bhd	L
60.	DRB-HICOM Bhd	L
61.	Dutch Lady Milk Industries Bhd	L
62.	E&O Property Development Bhd	L
63.	Eastern Pacific Industries Bhd	L
64.	Ecofirst Consolidated Bhd	L
65.	Edaran Otomobil Nasional Bhd	L
66.	Ekovest Bhd	L
67.	Ekran Bhd	L
68.	Eksons Corporation Bhd	L
69.	Eng Teknologi Bhd	L
70.	Esso Malaysia Bhd	L
71.	F A Peninsular Bhd	L
72.	Faber Group Bhd	L
73.	FACB Industries Incorporation Bhd	L
74.	Far East Holdings Bhd	L
75.	Formosa Prosonic Bhd	L
76.	Fountain View Development Bhd	L
77.	Fraser & Neave Holdings Bhd	L
78.	General Corporation Bhd	L
79.	Genting Bhd	L
80.	George Kent (Malaysia) Bhd	L
81.	George Town Bhd	L
82.	Glenealy Plantations Bhd	L
83.	Goh Ban Huat Bhd	L
84.	Goh Holdings Bhd	L
85.	Golden Hope Plantation Bhd	L
86.	Golden Pharos Bhd	L
87.	Golden Plus Holdings Bhd	L
88.	Gopeng Bhd	L
89.	GPQ Sdn Bhd	NL
90.	Grand Central Ents. Bhd	L
91.	Guinness Anchor Bhd	L
92.	Gula Perak Bhd	L
93.	Guthrie Ropel Bhd	L
94.	Harwood Timber Sdn Bhd	NL
95.	Hexza Corporation Bhd	L
96.	Highlands & Lowlands Bhd	L
97.	Hirotako Holdings Bhd	L
98.	Ho Hup Construction Bhd	L
99.	Ho Wah Genting Bhd	L
100.	Hock Seng Lee Bhd	L
101.	Hubline Bhd	L
102.	I-Bhd	L
103.	IJM Corporation Bhd	L

	COMPANY	STATUS
104.	Inch Kenneth Kajang Bhd	L
105.	Industrial Concrete Bhd	L
106.	Innoprise Capital Sdn Bhd	NL
107.	Intan Utilities Bhd	L
108.	Integrated Logistics Bhd	L
109.	Integrated Rubber Company Bhd	L
110.	Integrax Bhd	L
111.	Inti Universal Holdings Bhd	L
112.	IOI Corporation Bhd	L
113.	IOI Oleochemical Industries Bhd	L
114.	Ipoh Cargo Terminal Sdn Bhd	NL
115.	Ireka Corporation Bhd	L
116.	Isedecor Bina Sdn Bhd	NL
117.	Island & Peninsular Bhd	L
118.	Java Incorporated Bhd	L
119.	Jeroco Plantation Sdn Bhd	NL
120.	Johan Ceramics Bhd	L
121.	Johan Holdings Bhd	L
122.	Johor Land Bhd	L
123.	JT International Bhd	L
124.	Keck Seng (Malaysia) Bhd	L
125.	Kedah Resort Sdn Bhd	NL
126.	Keladi Maju Bhd	L
127.	Kelkon Sdn Bhd	NL
128.	KESM Industries Bhd	L
129.	KFC Holdings Bhd	L
130.	KFS Support Services Sdn Bhd	NL
131.	Kia Lim Bhd	L
132.	Kian Joo Can Factory Bhd	L
133.	KIG Glass Industrial Bhd	L
134.	Kim Hin Industry Bhd	L
135.	Konsortium Logistik Bhd	L
136.	Kossan Rubber Industries Bhd	L
137.	KPJ Health Care Bhd	L
138.	Kramat Tin Dredging Bhd	L
139.	Kretam Holdings Bhd	L
140.	KTPC Construction Sdn Bhd	NL
141.	Kuala Lumpur Kepong Bhd	L
142.	KUB Malaysia Bhd	L
143.	Kulim (Malaysia) Bhd	L
144.	Kulim Golf & Country Resort Sdn Bhd	NL
145.	Kulim Techno-City Sdn Bhd	NL
146.	Kumpulan FIMA Bhd	L
147.	Kumpulan Guthrie Bhd	L
148.	Kurnia Setia Bhd	L
149.	Ladang Rakyat Terengganu Sdn Bhd	NL
150.	Ladang Serasa Sdn Bhd	NL
151.	Lafarge Malayan Cement Bhd	L
152.	Land & General Bhd	L
153.	Landmarks Bhd	L
154.	Latitude Tree Holdings Bhd	L
155.	Leader Universal Holdings Bhd	L
156.	Linear Corporation Bhd	L

	COMPANY	STATUS
157.	Lingkaran Trans Kota Bhd	L
158.	Lingui Developments Bhd	L
159.	Lion Industries Corporation Bhd	L
160.	Lityan Holdings Bhd	L
161.	LKPP Corporation Sdn Bhd	NL
162.	LKT Industrial Bhd	L
163.	Magnum 4D Bhd	L
164.	Magnum Corporation Bhd	L
165.	Mains Holdings Sdn Bhd	NL
166.	Malakoff Bhd	L
167.	Malayan Flour Mills Bhd	L
168.	Malayan United Industries Bhd	L
169.	Malaysia Aica Bhd	L
170.	Malaysia Airline Systems Bhd	L
171.	Malaysia Airports Holdings Bhd	L
172.	Malaysia Smelting Company Bhd	L
173.	Malaysian Mosaics Bhd	L
174.	Malaysian Pacific Incorporated Bhd	L
175.	Malaysian Resources Bhd	L
176.	Mamee-Double Decker Bhd	L
177.	Marco Holdings Malaysia Bhd	L
178.	Measat Global Bhd	L
179.	Mechmar Corporation Bhd	L
180.	Mega First Corporation Bhd	L
181.	Mentakap Rubber Company Bhd	L
182.	Meta Corp Bhd	L
183.	Metroplex Bhd	L
184.	Minho (M) Bhd	L
185.	MMC Corporation Bhd	L
186.	Muhibbah Engineering Bhd	L
187.	Mulpha International Bhd	L
188.	Multi Vest Resources Bhd	L
189.	Multi-Purpose Holding BHD	L
190.	Naluri Corporation Bhd	L
191.	Nanyang Press Holdings Bhd	L
192.	Nationwide Express Corporation Bhd	L
193.	Negara Properties Bhd	L
194.	Negeri Road Stones Sdn Bhd	NL
195.	Negeri Sembilan Cement Industries Sdn Bhd	NL
196.	Negri Sembilan Oil Plantation Bhd	L
197.	Norsechem (Sabah) Sdn Bhd	NL
198.	OCB Bhd	L
199.	Olympia Industries Bhd	L
200.	Opus International Bhd	L
201.	Padiberas Nasional Bhd	L
202.	Pan Malaysia Corporation Bhd	L
203.	Pantai Holdings Bhd	L
204.	Paracorp Bhd	L
205.	Parkmay Bhd	L
206.	Pasdec Corporation Sdn Bhd	NL
207.	Pasdec Holdings Bhd	L
208.	Pelangi Bhd	L

	COMPANY	STATUS
209.	Pelikan International Bhd	L
210.	Pengurusan KPRJ Ranhill Sdn Bhd	NL
211.	Pentanah Sdn Bhd	NL
212.	Perak Corporation Bhd	L
213.	Perusahaan Sadur Timah Bhd	L
214.	Petaling Garden Bhd	L
215.	Petronas Dagangan Bhd	L
216.	Petronas Gas Berhad	L
217.	Pilecon Engineering Bhd	L
218.	Pintaras Jaya Bhd	L
219.	PK Resources Bhd	L
220.	PKPS Agro Industries Sdn Bhd	NL
221.	PKPS Feed Mill Sdn Bhd	NL
222.	PLB Engineering Bhd	L
223.	PM Cultural & Tourism Sdn Bhd	NL
224.	PNE PCB Bhd	L
225.	PNSB Insurance Brokers Sdn Bhd	NL
226.	Prestar Resources Bhd	L
227.	Prime Utilities Bhd	L
228.	Proton Holdings Bhd	L
229.	PSC Industries Bhd	L
230.	Puncak Niaga Holdings Bhd	L
231.	Ramatex Bhd	L
232.	Reliance Pacific Bhd	L
233.	Riverview Rubber Bhd	L
234.	Road Builder (M) Holdings Bhd	L
235.	Rohas-Euco Industries Bhd	L
236.	Sabah Melale Industries Sdn Bhd	NL
237.	Safeguards Corporation Bhd	L
238.	Sarawak Enterprise Company Bhd	L
239.	Sarawak Oil Palms Bhd	L
240.	Saujana Consolidated Bhd	L
241.	Scientex Incorporated Bhd	L
242.	Seal Incorporation Bhd	L
243.	Selaman Sdn Bhd	NL
244.	Selangor Properties Bhd	L
245.	Shangri-La Hotels (M) Bhd	L
246.	Silverstone Corporation Bhd	L
247.	Sime Darby Bhd	L
248.	Sime UEP Properties Bhd	L
249.	Sindora Bhd	L
250.	South Malaysia Industries Bhd	L
251.	Southern Acids (M) Bhd	L
252.	Southern Steel Bhd	L
253.	Srii Bhd	L
254.	Star Publications (M) Bhd	L
255.	STIDC Belian Holdings Sdn Bhd	NL
256.	Subur Tiasa Bhd	L
257.	Sungei Bagan Rubber Bhd	L
258.	Sunway City Berhad Bhd	L
259.	Sunway City Sdn (Ipoh) Sdn Bhd	NL
260.	Sunway Holdings Incorporated Bhd	L

	COMPANY	STATUS
261.	Taliworks Corporation Bhd	L
262.	Tanjong Public Limited Bhd	L
263.	Tanjung Manis Sawmill Sdn Bhd	NL
264.	Tasek Corporation Bhd	L
265.	TDM Bhd	L
266.	Tebrau Teguh Bhd	L
267.	Tekala Corporation Bhd	L
268.	Teknologi Tenaga Perlis	NL
269.	Telekom Malaysia Bhd	L
270.	Tenaga Nasional Bhd	L
271.	TH Group Bhd	L
272.	The Store Corporation Bhd	L
273.	Thong Guan Industries Bhd	L
274.	Time Engineering Bhd	L
275.	Tiong Nam Logistics Bhd	L
276.	Tractor Malaysia Holdings Bhd	L
277.	Tradewinds Corporation Bhd	L
278.	Tru-Tech Holdings Bhd	L
279.	TSH Resources Bhd	L
280.	UAC Bhd	L
281.	UDA Holdings Bhd	L
282.	UEM Builders Bhd	L
283.	UMW Holdings Bhd	L
284.	Unisem (M) Bhd	L
285.	United Chemical Industries Bhd	L
286.	United Malacca Bhd	L
287.	United Plantation Bhd	L
288.	UPA Corporation Bhd	L
289.	Utusan Melayu Bhd	L
290.	Wembley Industries Holdings Bhd	L
291.	Wijaya Baru Global Bhd	L
292.	Worldwide Holdings Bhd	L
293.	Worldwide Ventures Sdn Bhd	NL
294.	WTK Holdings Bhd	L
295.	Ya Horng Electronics Bhd	L
296.	Yee Lee Corporation Bhd	L
297.	Yeo Hiap Seng (Malaysia) Bhd	L
298.	YTL Corporation Bhd	L
299.	YTL Power Bhd	L

Key: L – Listed companies; NL – Non-listed companies

APPENDIX C: INTERVIEW SCHEDULE

Introduction

Thank interviewee for his/her time

Mention nature and relevance of the research

Background information

Company's name

Company's status: listed/non-listed

Position

Number of years in the position

Number of years in the company

Other positions in the last five years

Date(s) interviewed

Opening questions

1. Reasons behind the existence of the company
2. Role(s) of companies/GLCs in Malaysian economic development

Financial reporting

1. How are financial reports prepared in your company?
   (Follow-up if necessary: is respondent involved; role of managers; final approval)
2. How do you decide whether to disclose information beyond what is required by law?
   (Follow-up: respondent's opinion about reasons; factors considered; influence of auditor, industry norms, regulations, professional consultants)
3. Who are the most important readers of your annual reports?
   (Follow-up: how much contact do you have with them?)

Earnings targets

1. Have you ever been close to missing an earnings target?
2. a) If so, what actions did you take?

   b) If not, what actions should companies take to meet earnings targets?
3. Is it important that company earnings should be predictable? Why does it matter?

Political influence

1. Who are the most important people in influencing your decisions as a CEO/Chairman?
2. How much influence do the people have on your financial reporting decisions?

   (Follow-up: clarify? relative important of different group? example?).

Closing remarks

Ask whether there is anything to add

Promise a copy of the transcript and summary of overall findings.

APPENDIX D: A SUMMARY OF MAJOR FINDINGS AND A COMPARISON WITH THE FINDINGS OF PRIOR STUDIES

Variables	Current Study	Reviewed Prior Studies	Conclusion
Regression (1) and (2)			**Hypothesis 1**
Dependent Variable: disclosure quality (DQ):			Support research **hypothesis 1:** Political influence is associated with low financial reporting quality but only if political influence refers to the existence of politician/s on the board.
Independent Variables: *Political Influence:* Government Ownership (GOV)	Significant and positive	Significant and positive: Eng & Mak (2003) Significant and negative: Aggarwal (1999); Kothari (2001); Zhuang (1999); Naser & Nuseibeh (2003)	
Golden share (GOLD)	Not- significant	-	
Politician/s on the board (POL)	Significant and negative	-	
Size (SIZE)	Significant and positive	Significant and positive: Buzby (1975); Cahan et al. (2005); Kent & Stewart (2008); Krishnan & Zhang (2005); Singhvi & Desai (1971); Lang & Lundholm (1993); Chow & Wong-Boren (1987); Cooke (1989); Eng & Mak (2003); Haniffa & Cooke (2005)	

Leverage (LEV)	Significant and negative	Significant and negative: Eng & Mak (2003) Significant and positive: Inchausti (1997) Not-significant: Chow & Wong-Boren (1987); Raffournier (1995); Wallace & Naser (1995), Ahmed & Nicholls (1994)	
Listing status (LIST)	Significant and positive	Significant and positive: Raffournier (1995); Cooke (1989); Singhvi & Desai (1971); Hossain, Perera & Rahman (1995); Chow & Wong-Boren (1987)	
Age (AGE)	Significant and positive	Significant and positive: Chow & Wong-Boren (1987); Cooke (1989); Singhvi & Desai (1971); Cheng and Courtenay (2006) Significant and negative: Ho & Wong (2001); Raffournier (1995)	
Dependent Variable: earnings quality (EQ)			
Independent Variables: *Political Influence:*			
Government Ownership (GOV)	Significant and positive	-	
Golden share (GOLD)	Not- significant	-	

Politician/s on the board (POL)	Significant and negative	-	
Size (SIZE)	Significant and positive	Significant and positive: Cahan et al. (2008); Chaney et al. (2007); Dechow & Dichev (2002); Lee & Choi (2002); Myers et al., (2003) Significant and negative: Shen & Chih (2007)	
Leverage (LEV)	Significant and negative	Significant and negative: Sweeney (1994) Significant and positive: Sun, Liu & Wang (2005); Dechow & Skinner (2000) Not-significant: Chung & Kallapur (2003)	
Listing status (LIST)	Significant and positive	Significant and positive: Vander Bauwhede et al. (2003)	
Age (AGE)	Not- significant	Significant and positive Doyle, Ge & McVay (2007) Myers et al. (2003) Significant and negative: Chen, Chen & Su (2001) Myers et al.(2003)- this study used various measures of EQ	

Regression (3)			**Hypothesis 2**
Dependent Variable: Corporate Governance Strength (CG)			Support research **hypothesis 2**:
Independent Variables:			Political influence is associated with weak corporate governance but only if political influence refers to the existence of politician/s on the board.
Political Influence:			
Government Ownership (GOV)	Significant and positive	Significant and positive: Ang & Ding (2006), Xu et al., (2005)	
Golden share (GOLD)	Not- significant	-	
Politician/s on the board (POL)	Significant and negative	-	
Size (SIZE)	Significant and positive	Significant and positive: Nam & Nam (2005), Yermack (1996) Not-significant: Ang & Ding (2006)	
Leverage (LEV)	Not- significant	Not-significant: Ang & Ding (2006); Charitou et al., (2007)	
Listing status (LIST)	Significant and positive	Significant and positive: Charitou et al., (2007)	
Age (AGE)	Significant and negative	-	
Regression (4) and (5)			**Hypothesis 3 and Hypothesis 4**
Dependent Variable: disclosure quality (DQ)			Support research **hypothesis 3**:
Independent Variables:			After controlling for political influence, corporate governance strength is associated with low financial reporting quality but
Corporate Governance (CG)	Significant and positive (after controlling for political influence)	Significant and positive: Kent & Stewart (2008); Beekes & Brown (2006); Bedard, Chtourou, & Courteau	

		(2004); Chen & Jaggi (2000); Ajinkya et al. (2005), Leung & Horwitz (2004); Leftwich et al. (1981); Haniffa & Cooke (2005); Ho & Wong (2001); Wright (1996) However these studies do not control for political influence and used an individual or a combination of several corporate governance mechanisms	only if financial reporting quality refers to disclosure quality. Support research **hypothesis 4** : Corporate governance strength mediates the relationship between political influence and financial reporting quality.
Government Ownership (GOV)	Significant and positive	Significant and positive: Eng & Mak (2003) Significant and negative: Aggarwal (1999); Kothari (2001); Zhuang (1999); Naser & Nuseibeh (2003)	
Golden share (GOLD)	Not- significant	-	
Politician/s on the board (POL)	Significant and negative	-	
Size (SIZE)	Significant and positive	Significant and positive: Buzby (1975); Kent & Stewart (2008); Krishnan & Zhang (2005); Singhvi & Desai (1971); Lang & Lundholm (1993); Cahan et al. (2008); Chow & Wong-Boren (1987); Cooke (1989); Eng & Mak (2003); Haniffa & Cooke (2005)	

Leverage (LEV)	Significant and negative	Significant and negative: Eng and Mak (2003) Significant and positive: Inchausti (1997) Not significant: Chow & Wong-Boren (1987); Raffournier (1995); Wallace & Naser (1995), Ahmad & Nicholls (1994)	
Listing status (LIST)	Significant and positive	Significant and positive: Raffournier (1995); Cooke (1989); Singhvi & Desai (1971); Hossain, Perera & Rahman (1995); Chow & Wong-Boren (1987)	
Age (AGE)	Significant and positive	Significant and positive: Chow & Wong-Boren (1987); Cooke (1989); Singhvi & Desai (1971); Cheng & Courtenay (2006) Significant and negative: Ho & Wong (2001); Raffournier (1995)	

Dependent variable: earnings quality (EQ)			
Independent Variables:			
Corporate Governance (CG)	Not- significant (after controlling for political influence)	Significant and positive: Chtourou, Bedard & Courteau (2004); Saleh et al., (2007); Dechow et al., (1996); Lara et al. (2007); Shen & Chih (2007); Chen et al., (2008); Klein (2002); Peasnell et al., (2005) However these studies do not control for political influence and used an individual or a combination of several corporate governance mechanisms except for Shen and Chih (2007) and Lara et al., (2007) who used a corporate governance index	
Government Ownership (GOV)	Significant and positive	-	
Golden share (GOLD)	Not- significant	-	
Politician/s on the board (POL)	Significant and negative	-	

Size (SIZE)	Significant and positive	Significant and positive: Cahan et al. (2008); Dechow & Dichev` (2002); Lee & Choi (2002); Myers et al. (2003) Significant and negative: Shen & Chih (2007)	
Leverage (LEV)	Significant and negative	Significant and negative: Sweeney (1994) Significant and positive: Sun et al. (2005); Dechow & Skinner (2000) Not-significant: Chung & Kallapur (2003)	
Listing status (LIST)	Not- significant	Significant and positive: Vander Bauwhede et al. (2003)	
Age (AGE)	Not- significant	Significant and positive Doyle et al., (2007) Myers et al. (2003) Significant and negative: Chen et al., (2001) Myers et al. (2003) - this study used various measures of EQ	

REFERENCES

Ab Manan, L. M., & Mohd Iskandar, T. (2003). Kualiti pelaporan maklumat syarikat-syarikat di Bursa Saham Kuala Lumpur. *Jurnal Pengurusan*, 22, 24–45.

Abdul Rahman, R., & Mohamed Ali, F. H. (2006). Board, audit committee, culture and earnings management: Malaysian evidence. *Managerial Auditing Journal*, 21(7), 783–804.

Abdul Wahab, E. A., How, J. C. Y., & Verhoeven, P. (2007). The impact of the Malaysian code on corporate governance: Compliance, institutional investors and stock performance. *Journal of Contemporary Accounting and Economics*, 3(2), 1-36.

Abdullah, F. (1997). Affirmative action policy in Malaysia: To restructure society, to eradicate poverty. *Ethnic Studies Report*, XV(2), 1–33.

Aboody, D., Hughes, J., & Liu, J. (2005). Earnings quality, insider trading and cost of capital. *Journal of Accounting Research*, 43(5), 651–673.

Adams, C., & William, C. (1992). Malaysia. In *Adjusting privatization: Case studies from developing countries* (pp. 111–177). London: James Curry.

ADB. (1998). *Governance in Asia: From crisis to opportunity*. Manila: Asian Development Bank. Retrieved May 15, 2006, from http://www.adb.org/Documents/Reports/Governance/default.asp?p=governance.

Adhikari, A., Derashid, C., & Zhang, H. (2006). Public policy, political connections, and effective tax rates: Longitudinal evidence from Malaysia. *Journal of Accounting and Public Policy*, 25, 574–595.

Aggarwal, R. (1999). Restoring growth in Asia after the late 1990s economic crisis: Need for domestic and international economic reforms. *Multinational Business Review*, 7(2), 3–14.

Agrawal, A., & Knoeber, C. R. (2001). Do some outside directors play a political role? *Journal of Law and Economics*, XLIV(April), 179–198.

Ahmad, A. S. (2004). Public administration reforms in Malaysia: A developing country perspective. Manila: Asian Development Bank. Retrieved June 06, 2006 from http://www.adb.org/Document/Conference/Governance/chap6.pdf.

Ahmed, K., & Courtis, J. (1999). Associations between corporate characteristics and disclosure levels in annual reports: A meta-analysis. *The British Accounting Review*, 31(1), 35–61.

Ahmed, K., & Nicholls, D. (1994). The effect of non-financial company characteristics on mandatory disclosure compliance in developing countries: The case of Bangladesh. *The International Journal of Accounting*, 29(1), 62–77.

Ajinkya, B. B., Bhojraj, S., & Sengupta, P. (2005). The association between outside directors, institutional investors and the properties of management earnings forecasts. *Journal of Accounting Research*, 43(3), 343–376.

Alavi, R. (1996). *Industrialisation in Malaysia: Import substitution and infant industry performance*. London: Routledge.

Alford, A., Jones, J., Leftwich, R., & Zmijewski, M. E. (1993). The relative informativeness of accounting disclosures in different countries. *Journal of Accounting Research*, 31(Supplement), 183–223.

Allen, D., & Blythe, T. (2004). *The facilitator's book of questions: Tools for looking together at student and teacher work*. Ohio: Teachers College Press.

Altman, E. I. (1977). Predicting performance in the savings and loan association industry. *Journal of Monetary Economics*, 3(4), 443–466.

Amsden, A. H. (1989). *Asia's next giant: South Korea and late industrialisation*. New York: Oxford University Press.

Anderson, R. C., & Reeb, D. M. (2003). Founding family ownership and firm performance: evidence from the S&P 500. *Journal of Finance*, 58, 1301–1328.

Andrews, W. A., & Dowling, M. J. (1998). Explaining performance changes in newly privatised firms. *Journal of Management Studies*, 35, 601–617.

Ang, J. B., & McKibbin, W. J. (2007). Financial liberalization, financial sector development and growth: Evidence from Malaysia. *Journal of Development Economics*, 84(1), 215–233.

Ang, J. S., & Ding, D. K. (2006). Government ownership and the performance of government-linked companies: The case of Singapore. *Journal of Multinational Financial Management*, 16(1), 64–88.

Ashbaugh, H., Collins, D., & LaFond, R. (2006). The effects of corporate governance on firms' credit ratings. *Journal of Accounting and Economics*, 42(1-2), 203–243.

Aziz, T. A. (1999). Malaysia incorporated: Ethics on trial. *Australian Journal of Public Administration*, 58(4), 19–25.

Bai, C. E., & Wang, Y. (1998). Bureaucratic control and the soft budget constraint. *Journal of Comparative Economics*, 26(1), 41–61.

Baker, H. K., & Haslem, J. A. (1973). Information needs of individual investors. *Journal of Accountancy*, 136(5), 64–69.

Ball, R. (2001). *Infrastructure requirements for an economically efficient system of public financial reporting and disclosure*. Brookings-Wharton Papers on Financial Services, 127 – 169.

Ball, R., & Brown, P. (1968). An empirical evaluation of accounting income numbers. *Journal of Accounting Research*, (Autumn), 159–178.

Ball, R., Robin, A., & Wu, J. S. (2003). Incentives versus standards: Properties of accounting income in four East Asian countries and implications of acceptance of IAS. *Journal of Accounting and Economics*, 36(1-3), 235–270.

Ball, R., & Shivakumar, L. (2005). Earnings quality in UK private firms: Comparative loss recognition timeliness. *Journal of Accounting and Economics*, 39, 83–128.

Bank Negara Malaysia. (2003). *Bank Negara Malaysia annual report 2002*. Kuala Lumpur: Bank Negara Malaysia.

Baron, R.M., & Kenny, D.A. (1986). The moderator-mediator variable distinction in social psychological research: Conceptual, strategic and statistical considerations. *Journal of Personality and Social Psychology*, 51, 1173-1182.

Barrett, M. E. (1976). Financial reporting practices: Disclosure and comprehensiveness in an international setting. *Journal of Accounting Research*, (Spring), 10–26.

Barth, M., Landsman, W., & Lang, M. (2008). International accounting standards and accounting quality. *Journal of Accounting Research*, 46(3), 467–498.

Barth, M. E., Cram, D. P., & Nelson, K. (2001). Accruals and prediction of future cash flows. *The Accounting Review*, 76, 27–58.

Barton, J., & Waymire, G. (2004). Investor protection under unregulated financial reporting. *Journal of Accounting and Economics*, 38(December), 65–116.

Bartov, E., Givoly, D., & Hayn, C. (2002). The rewards to meeting or beating earnings expectations. *Journal of Accounting and Economics*, 33(2), 173–204.

Basu, S. (1997). The conservatism principle and the asymmetric timeliness of earnings. *Journal of Accounting and Economics*, 24, 3–37.

Beasley, M. S. (1996). An empirical analysis of the relation between the board of director composition and financial statement fraud. *The Accounting Review*, 71, 443–465.

Beaver, W. H. (1968). The information content of annual earnings announcements. *Journal of Accounting Research*, (Supplement), 67–92.

Bedard, J., Chtourou, S. M., & Courteau, L. (2004). The effect of audit committee expertise, independence, and activity on aggressive earnings management. *Auditing: A Journal of Practice and Theory*, 23(2), 13–35.

Beekes, W., & Brown, P. (2006). Do better-governed Australian firms make more informative disclosure? *Journal of Business Finance & Accounting*, 33, 422–450.

Beekes, W., Pope, P. F., & Young, S. (2004). The link between earnings timeliness, earnings conservatism and board composition: Evidence from the UK. *Corporate Governance – An International Review*, 12(1), 47–59.

Belkaoui, A. R. (2004). Politically-connected firms: Are they connected to earnings opacity? *Research in Accounting Regulation*, 17. Retrieved May 15, 2006, from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=459300.

Beneish, M. D., & Vargus, M. E. (2002). Insider trading, earnings quality and accrual mispricing. *Accounting Review*, 77(4), 755–792.

Bens, D. A., & Monahan, S. J. (2004). Disclosure quality and the excess value of diversification. *Journal of Accounting Research*, 42(4), 691–730.

Bhaskaran, S., & Sukumaran, N. (2007). National culture, business culture and management practices: Consequential relationships? *Cross Cultural Management: An International Journal*, 14(1), 54–67.

Biddle, G. C., & Saudagaran, S. M. (1989). The effects of financial disclosure levels on firms' choices among alternative foreign stock exchange listings. *Journal of International Financial Management and Accounting*, 1(1), 55–87.

Blaikie, N. (2003). *Analyzing quantitative data* (1st ed.). London: Sage Publications.

Boardman, A. E., & Vining, A. R. (1989). Ownership and performance in competitive environments: A comparison of the performance of private, mixed and state -owned enterprises. *Journal of Law and Economics*, 32(1), 1–33.

Bortolotti, B., & Faccio, M. (2006). *Reluctant privatization*. CEI Working Paper Series, No. 2006-5. Tokyo: Institute of Economic Research, Hitotsubashi University.

Botica-Redmayne, N. (2004). *The production of audit services in the New Zealand public sector: An investigation into the effects of political risk and corporate governance on audit effort*. PhD thesis. Massey University, Palmerston North.

Botosan, C. A. (1997). Disclosure level and the cost of equity capital. *The Accounting Review*, 72(3), 323–349.

Botosan, C. A., & Plumlee, M. A. (2002). A re-examination of disclosure level and the expected cost of equity capital. *Journal of Accounting Research*, 40(1), 21–40.

Bowie, A. (1991). *Crossing the industrial divide: State, society, and politics of economics transformation in Malaysia*. New York: Columbia University Press.

Brewer, T. L. (1993). Government policies, market imperfections, and foreign direct investment. *Journal of International Business Studies*, 24, 101–120.

Briggs, A. (1961). The welfare state in historical perspective. *Archives of European Sociology*, 11, 221–258.

Brown, L. D., & Caylor, M. L. (2006). Corporate governance and firm valuation. *Journal of Accounting and Public Policy*, 25(4), 409–434.

Brown, S., & Hillegeist, A. (2007). How disclosure quality affects the level of information asymmetry. *Review of Accounting Studies*, 12(2-3), 443–477.

Brumby, J., Hynman, M., & Shepherd, S. (1997). State owned enterprise governance. *Public Management Service*, pp.1–10.

Buchanan, J., & Tullock, G. (1968). The "dead" hand of monopoly. *Antitrust Law and Economics Review*, 1(Summer), 85–96.

Burgess, R. G. (1982). *Field research: A source book and field manual*. London: Allen & Unwin.

Bushee, B. (2004). Discussion of disclosure practices of foreign companies interacting with U.S markets. *Journal of Accounting Research*, 42(2), 509–525.

Bushee, B., & Noe, C. (2000). Corporate disclosure practices, institutional investors, and stock return volatility. *Journal of Accounting Research*, 38(Supplement), 171–202.

Bushman, R. M., Piotroski, J. D., & Smith, A. J. (2004). What determines corporate transparency? *Journal of Accounting Research*, 42(2), 207–252.

Bushman, R. M., Chen, Q., Engel, E., & Smith, A. J. (2004). Financial accounting information, organizational complexity and corporate governance systems. *Journal of Accounting and Economics*, 37, 167–201.

Bushman, R. M., & Piotroski, J. D. (2006). Financial reporting incentives for conservative accounting: The influence of legal and political institutions. *Journal of Accounting and Economics*, 42, 107–148.

Bushman, R. M., & Smith, A. J. (2003). Transparency, financial accounting information, and corporate governance. *Economic Policy Review*, 1–23.

Butcher, J. (2001). 13 May: A review of some controversies in accounts of riots. In K. S. Jomo (Ed.), *Reinventing Malaysia*. Bangi, Selangor: Universiti Kebangsaan Malaysia.

Buzby, S. L. (1974). Selected items of information and their disclosure in annual reports. *Accounting Review*, 49(3), 423–425.

Buzby, S. L. (1975). Company size, listed versus unlisted stocks, and the extent of financial disclosure. *Journal of Accounting Research*, (Spring), 16–37.

Byard, D., Li, Y., & Weintrop, J. (2006). Corporate governance and the quality of financial analysts' information. *Journal of Accounting and Public Policy*, 25(5), 609–625.

Cadbury, A. (1992). *Report of the committee on the financial aspects of corporate governance*. London: Gee Publishing.

Cahan, S. F. (1992). The effect of antitrust investigations on discretionary accruals: A refined test of the political-cost hypothesis. *The Accounting Review*, 67(1), 77–95.

Cahan, S. F. (1996). Political vulnerability and earnings management: Evidence from the Carter and Reagan administrations. *Pacific Accounting Review*, 8(2), 69–97.

Cahan, S. F., Chavis, B. M., Elmendorf, R.G. (1997). Earnings management of chemical firms in response to political costs from environmental legislation. *Journal of Accounting, Auditing & Finance*, 12(1), 37–65.

Cahan, S. F., Liu, G., & Sun, J. (2008). Investor protection, income smoothing, and earnings informativeness. *Journal of International Accounting Research*, 7(1), 1–24.

Cahan, S. F., Rahman, A., & Perera, H. (2005). Global diversification and corporate disclosure. *Journal of International Accounting Research*, 4(1), 73–93.

Canada, J., Kuhn, J. R., & Sutton, S. G. (2008). Accidentally in the public interest: The perfect storm that yielded the Sarbanes-Oxley act. *Critical Perspectives on Accounting*, 19, 987–1003.

Capulong, V., Edwards, D., Webb, D., & Zhuang, J. (2000). *Corporate governance and finance in Asia: A study of Indonesia, Republic of Korea, Malaysia, Philippines and Thailand*. Asian Development Bank. Retrieved January 15, 2006,from http://www.adb.org/Documents/Books/Corporate_Governance/vol1/default.asp.

Carcello, J. V., & Neal, T. L. (2003). Audit committee independence and disclosure: Choice for financially distressed firms. *Corporate Governance*, 11(4), 289.

Cavana, R., Delahaye, B. L., & Sekaran, U. (2001). *Applied business research: Qualitative and quantitative methods*. Queensland: John Wiley & Sons Australia.

Chakravarty, S. P., & Roslan, A. H. (2005). Ethnic nationalism and income distribution in Malaysia. *The European Journal of Development Research*, 17(2), 270–288.

Chaney, P. K., Faccio, M., & Parsley, D. C. (2007). *The quality of accounting information in politically connected firms*. Retrieved May 14, 2008, from http://papers.ssm.com/sol3/papers.cfm?abstract_id=966379#Paperdownload.

Charitou, A., Louca, C., & Panayides, S. (2007). Cross-listing, bonding hypothesis and corporate governance. *Journal of Business Finance & Accounting*, 34(7&8), 1281–1306.

Chatterjee, S. M., & Nankervis, A. R. (2007). *Asian management in transition: Emerging themes* (1st ed.). New York: Palgrave, Macmillan.

Chatterjee, S. M., & Price, B. (1991). *Regression analysis by example*. New York: John Wiley & Sons.

Chau, G. K., & Gray, S. (2002). Ownership structure and corporate voluntary disclosure in Hong Kong and Singapore. *The International Journal of Accounting*, 37, 247–265.

Chen, C. J. P., Chen, S., & Su, X. (2001).Profitability regulation, earnings management, and modified audit opinions: Evidence from China. *Auditing – A Journal of Practice & Theory*, 20(2), 9–30.

Chen, C. J. P., & Jaggi, B. (2000). Association independent non-executive directors, family control, and financial disclosure in Hong Kong. *Journal of Accounting and Public Policy*, 19, 285–310.

Chen, J. J. (2004). Corporation of China's state-owned enterprises and corporate governance. *Corporate Ownership & Control*, 1(2), 82–93.

Chen, S., Chen, X., & Cheng, Q. (2008). Do family firms provide more or less voluntary disclosure? *Journal of Accounting Research*, 46(3), 499–536.

Chen, S., Shevlin, T., & Tong, Y. H. (2007). Does the pricing of the financial reporting quality change around dividend changes? *Journal of Accounting Research*, 45(1), 1–40.

Chen, W., Zeng, L., & Tan, L. C. (2008). Does the system of independent directors help improve the quality of accounting information: From the perspective of earnings conservatism. *Chinese Business Review*, 7(1), 49–55.

Cheng, C. M., & Courtenay, S. M. (2006). Board composition, regulatory and voluntary disclosure. *The International Journal of Accounting*, 41(3), 262–289.

Cheung, Y. L., Jiang, P., Limpaphayom, P., & Lu, T. (2008). Does corporate governance matter in China? *China Economic Review*, 19(3), 460–479.

Chin, C. B. N. (2000). The state of the 'state' in globalization: Social order and economic restructuring in Malaysia. *Third World Quarterly*, 21(6), 1035–1057.

Chow, C. W., & Wong-Boren, A. (1987). Voluntary financial disclosure by Mexican corporations. *The Accounting Review*, 62(3), 533–541.

Chowdhury, A., & Mavrotas, G. (2006). FDI and growth: What causes what? *The World Economy*, 29(1), 9–19.

Chtourou, S. M., Bedard, J., & Courteau, L. (2004). The effect of audit committee expertise, independence, and activity on aggressive earnings. *Auditing – A Journal of Practice & Theory*, 23(2), 13–35.

Chu, E. Y., & Cheah, G. K. (2006). Does ownership structure matter? Evidence from Malaysian equity market. *Corporate Ownership & Control*, 4(1), 77–90.

Chuanrommanee, W., & Swierczek, F. W. (2007). Corporate governance in ASEAN financial corporations: Reality or illusion? *Corporate Governance*, 15(2), 272–283.

Chung, H., & Kallapur, S. (2003). Client importance, non-audit fees, and abnormal accruals. *Accounting Review*, 78(4), 931–955.

Chung, R., Firth, M., & Kim, J. B. (2005). Earnings management, surplus free cash flow, and external monitoring. *Journal of Business Research*, 58(6), 766–776.

Claessens, S., Djankov, S., & Lang, L. (2000). The separation of ownership and control in East Asian corporations. *Journal of Financial Economics*, 58(1-2), 81–112.

Claessens, S., & Fan, J. P. H. (2002). Corporate governance in Asia: A survey. *International Review of Finance*, 3(2), 71–103.

Collins, D., & Kothari, S. P. (1989). An analysis of intertemporal and cross-sectional determinants of earnings response coefficients. *Journal of Accounting and Economics*, 11(2 & 3), 143–181.

Collins, D., Maydew, E. L., & Weiss, I. S. (1977). Changes in the value-relevance of earnings and book values over the past forty years. *Journal of Accounting and Economics*, 24, 39–67.

Cooke, T. E. (1989). Disclosure in the corporate annual reports of Swedish companies. *Accounting and Business Research*, 19(74), 113–124.

Cooke, T. E. (1992). The impact of size, stock market listings and industry type on disclosure in the annual reports of Japanese listed corporations. *Accounting and Business Research*, 22(87), 229–237.

Cooke, T. E. (1993). Disclosure in Japanese corporate annual reports. *Journal of Business Finance & Accounting*, 20(4), 521–535.

Cotelli, B. C., Gardiol, L., Asner, R. G., & Tuchschmid, N. S. (1999). Are investors sensitive to the quality and the disclosure of financial statements? *European Finance Review*, 3, 131–159.

Craswell, A., & Taylor, S. (1992). Discretionary disclosure of reserves by oil and gas companies: An economic analysis. *Journal of Business Finance and Accounting*, 19 (2), 295-308

Cremers, K. J. M., & Nair, V. B. (2005). Governance mechanisms and equity prices. *Journal of Finance*, 60, 2859–2894.

Creswell, J. W. (1999). Mixed method research: Introduction and application. In T. Cijek (Ed.), *Handbook of educational policy*. San Diego: Academic Press.

Creswell, J. W. (2003). *Research design: Qualitative, quantitative, and mixed method approaches*. London: Sage Publications.

Creswell, J. W., Plano Clark, V. L., Gutmann, M. L., & Hanson, W. E. (2003). Advanced mixed methods research designs. In A. Tashakkori & C. Teddlie (Eds.), *Handbook of mixed methods in social and behavioural research* (pp. 209–240). Thousand Oaks: Sage Publications.

Crouch, H. (2001). Managing ethnic tensions through affirmative action: The Malaysian experience. In N. J. Colletta, T. G. Lim & A. Kelles-Viitanen (Eds.), *Social cohesion and conflict prevention in Asia*. Washington: The World Bank.

Daily Times. (2005, Sunday, July 31). Malaysia deepens state-linked firms' reform. Retrieved June 15, 2007, from http://www.dailytimes.com.pk.

Daniel, D. M., Beasley, M. S., Menelaides, S., & Palmrose, Z. V. (2002). Auditors' new procedures for detecting fraud. *Journal of Accountancy*, (May), 63–66.

Dargenidou, C., McLeay, S., & Raonic, I. (2006). Expected earnings growth and the cost of capital: An analysis of accounting regime change in European financial market. *Abacus*, 42(3–4), 388–414.

Darman, G. M. (2004). *Corporate governance worldwide: A guide to best practices for managers*. Paris: ICC Books Worldwide.

Daske, H., & Gebhardt, G. (2006). International financial reporting standards and experts' perceptions of disclosure quality. *Abacus*, 42(3/4), 461–498.

Davidson, R., Goodwin, J., & Kent, P. (2004). Internal control structures and earnings management. *Accounting and Finance*, 45(2), 241–267.

DeAngelo, L. (1981). Auditor size and audit quality. *Journal of Accounting and Economics*, 3, 183–199.

Dechow, P. M., & Dichev, I. D. (2002). The quality of accruals and earnings: The role of accrual estimation errors. *Accounting Review*, 77(Supplement), 35–59.

Dechow, P. M., & Skinner, D. J. (2000). Earnings management: Reconciling the views of accounting academics, practitioners, and regulators. *Accounting Horizons*, 14(2), 235–250.

Dechow, P. M., Sloan, R. G., & Sweeney, A. P. (1995). Detecting earnings management. *The Accounting Review*, 70, 193–225.

Dechow, P. M., Sloan, R. G., & Sweeney, A. P. (1996). Causes and consequences of earnings manipulation: An analysis of firms subject to enforcement actions by the SEC. *Contemporary Accounting Research*, 13(1), 1–36.

DeFond, M., Hung, M., & Trezevant, R. (2007). Investor protection and the information content of annual earnings announcements: International evidence. *Journal of Accounting and Economics*, 43, 37–67.

Demb, A., & Neubauer, F. F. (1992). The corporate board: Confronting the paradoxes. *Long Range Planning*, 25(3), 9–20.

Denzin, N. K. (1970). *The research act in sociology: A theoretical introduction to sociological methods*. London: Butterworth.

Deyo, F. (1987). *The political economy of the new Asian industrialism*. Ithaca: Cornell University Press.

Dhaliwal, D. S., Spicer, B. H., & Vickrey, D. (1979). The quality of disclosure and the cost of capital. *Journal of Business Finance & Accounting*, 6(2), 245–266.

Diamond, D., & Verrecchia, R. (1991). Disclosure, liquidity and the cost of capital. *Journal of Finance*, 46(4), 1325–1355.

Donaldson, L. (1990). The ethereal hand: Organizational economics and management theory. *Academy of Management Review*, 15(3), 369–381.

Doraisami, A. G. (2007). Financial crisis in Malaysia: Did FDI flows contribute to vulnerability? *Journal of International Development*, 19, 949–962.

Downs, A. (1957). *An economic theory of democracy*. New York: HarperCollins.

Doyle, J., Ge, W., & McVay, S. (2007). Determinants of weaknesses in internal control over financial reporting. *Journal of Accounting and Economics*, 44(1-2), 193–223.

Duffy, M. N. (2004). Corporate governance and client investing. *Journal of Accountancy*, 197(1), 43–48.

Dunn, K. A., & Mayhew, B. W. (2004). Audit firm industry specialization and client disclosure quality. *Review of Accounting Studies*, 9(1/March), 35–58.

Eng, L. L., & Mak, Y. T. (2003). Corporate governance and voluntary disclosure. *Journal of Accounting and Public Policy*, 22(4), 325–345.

Ernst, U. F. W. (2004). Methods for resolving problems of responsibility and transparency in the activities of SOEs in market economies: Models and results. *Corporate Ownership & Control*, 1(3), 37–43.

Esfahani, H. S., & Ardakani, A. T. (2002). *What determines the extent of public ownership?* Retrieved June 16, 2008, from http://ssrn.com/sol3/papers.cfm?abstract_id=306899#PaperDownload.

Faccio, M. (2006). Politically connected firms. *American Economic Review*, 96(1), 369–386.

Faccio, M., Lang, L., & Young, L. (2001). Dividend and expropriation. *American Economic Review*, 91, 54–78.

Faccio, M., Masulis, R. W., & McConnell, J. J. (2006). Political connections and corporate bailouts. *The Journal of Finance*, LXI(6), 2597–2635.

Fama, E. F., & Jensen, M. (1983a). Agency problems and residual claims. *Journal of Law and Economics*, 26, 327–349.

Fama, E. F., & Jensen, M. (1983b). Separation of ownership and control. *Journal of Law and Economics*, 26, 301–326.

Fan, J. P. H., & Wong, T. J. (2002). Corporate ownership structure and the informativeness of accounting earnings in East Asia. *Journal of Accounting and Economics*, 33, 401–425.

Fan, J. P. H., Wong, T. J., & Zhang, T. (2007). Politically connected CEOs, corporate governance, and post-IPO performance of China's partially privatized firms. *Journal of Financial Economics*, 84(2), 330–357.

FCCG. (2000). *Malaysian code of corporate governance (2000)*. Malaysia: Ministry of Finance.

Feng, F., Sun, Q., & Tong, H. S. (2004). Do government-linked companies underperform? *Journal of Banking and Finance*, 28, 2461–2492.

Ferguson, M. J., Lam, K. C. K., & Lee, G. M. (2002). Voluntary disclosure by state-owned enterprises listed on the stock exchange of Hong Kong. *Journal of International Financial Management and Accounting*, 13(2), 125–152.

Firth, M. (1979). The impact of size, stock market listings and auditors on voluntary disclosure in corporate annual reports. *Accounting and Business Research*, (Autumn), 273–280.

Firth, M. (1980). Raising finance and firm's corporate reporting policies. *Abacus*, 16(2), 100–115.

Firth, M. (1984). The extent of voluntary disclosure in corporate annual reports and its association with security risk measures. *Applied Economics*, 16(2), 269–277.

Fisman, R. (2001). Estimating the value of political connections. *American Economic Review*, 91(4), 1089–1096.

Foo, L. M. (2007). Stakeholders' engagement in emerging economies: Considering the strategic benefits of stakeholder management in a cross-cultural and geopolitical context. *Corporate Governance*, 7(4), 379–387.

Forker, J. (1992). Corporate governance and disclosure quality. *Accounting and Business Research*, 22(86), 111–124.

Francis, J. R., Huang, A. H., Rajgopal, S., & Zang, A. Y. (2008a). CEO reputation and earnings quality. *Contemporary Accounting Research*, 25(1), 109–147.

Francis, J., Nanda, D., & Olsson, P. (2008b). Voluntary Disclosure, Earnings Quality and Cost of Capital. *Journal of Accounting Research*, 46(1), 53-99.

Francis, J. R., LaFond, R., Olsson, P., & Schipper, K. (2004). Cost of equity and earnings attributes. *Accounting Review*, 79(4), 967–1010.

Francis, J. R., LaFond, R., Olsson, P., & Schipper, K. (2005). The market pricing of accruals quality. *Journal of Accounting and Economics*, 39(2), 295–327.

Francis, J. R., Schipper, K., & Vincent, L. (2005). Earnings and dividend informativeness when cash flow rights are separated from voting rights. *Journal of Accounting and Economics*, 39(2), 329–360.

Frankfort-Nachmias, C., & Nachmias, D. (1996). *Research methods in the social sciences* (5th ed.). London: Arnold.

Fraser, D. R., Zhang, H., & Derashid, C. (2006). Capital structure and political patronage: The case of Malaysia. *Journal of Banking and Finance*, 30(4), 1291–1308.

Frost, C. A., Gordon, E. A., & Pownall, G. (2008). *Financial reporting quality, disclosure, and emerging market companies' access to capital in global equity markets*. Retrieved December 15, 2008, from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=802824#Paperdownload. SSRN Paper.

Furnivall, J. S. (1956). *Colonial policy and practice*. New York: University Press.

Garsombke, H. P. (1979). The relationship between corporate disclosure and firm risk. *Journal of Business Finance & Accounting*, 6(1), 53–70.

Gelb, D. S., & Strawser, J. A. (2001). Corporate social responsibility and financial disclosure: An alternative explanation for increased disclosure. *Journal of Business Ethics*, 33(1/September), 1–13.

Goh, D. P. S. (2008). From colonial pluralism to postcolonial multiculturalism: Race, state formation and the question of cultural diversity in Malaysia and Singapore. *Sociology Compass*, 2(1), 232–252.

Gomez, E. T. (2002). Political business in Malaysia. In E. T. Gomez *Political business in East Asia*. London: Routledge.

Gomez, E. T., & Jomo, K. S. (1997). *Malaysia's political economy: Politics, patronage and profits*. Cambridge: Cambridge University Press.

Goodwin, J., & Kent, P. (2006). The use of internal audit by Australian companies. *Managerial Auditing Journal*, 21(1), 81–101.

Gourevitch, P. A., & Shinn, J. J. (2005). *Political power and corporate control*. New Jersey: Princeton University Press.

Graham, J. R., Harvey, C. R., & Rajgopal, S. (2005). The economic implications of corporate financial reporting. *Journal of Accounting and Economics*, 40(1-3), 3–73.

Greene, J. C., Caracelli, V. J., & Graham, W. F. (1989). Toward a conceptual framework for mix-method evaluation designs. *Educational Evaluation and Policy Analysis*, 11(3), 255–274.

Gusti Ngurah Agung, I. (2008). *Time Series Data Analysis Using EViews*. Singapore: John Wiley & Sons.

Gul, F. A. (2006). Auditors' response to political connections and cronyism in Malaysia. *Journal of Accounting Research*, 44(5), 931–963.

Gul, F. A., & Leung, S. (2004). Board leadership, outside directors' expertise and voluntary corporate disclosure. *Journal of Accounting and Public Policy*, 23, 351-379.

Gunasekarage, A., Hess, K., & Hu, A. (2007). The influence of the degree of state ownership and the ownership concentration on the performance of listed Chinese companies. *Research in International Business and Finance*, 21, 379–395.

Han, S. (2005). *Ownership structure and quality of financial reporting*. Working paper. Urbana: Department of Accountancy, University of Illinois at Urbana-Champaign

Haniffa, R. M., & Cooke, T. E. (2002). Culture, corporate governance and disclosure in Malaysian corporations. *Abacus*, 38(3), 317–349.

Haniffa, R. M., & Cooke, T. E. (2005). The impact of culture and governance on corporate social reporting. *Journal of Accounting and Public Policy*, 24, 391–430.

Hanousek, J., Kocenda, E., & Svejnar, J. (2007). Origin and concentration: Corporate ownership, control and performance in firms after privatization. *Economics of Transition*, 15(1), 1–31.

Hanson, W. E., Plano Clark, V.L., Petska, K. S., Creswell, J. W., & Crewell, J. D. (2005). Mixed methods research designs in counselling psychology. *Journal of Counselling Psychology*, 52(2), 224–235.

Haque, M. S. (2003). The role of the state in managing ethnic tensions in Malaysia: A critical discourse. *American Behavioral Scientist*, 47, 240–266.

Hardjono, T. W., & Marrewijk, M. (2001). The social dimension of business excellence. *Corporate Environmental Strategy*, 8(3), 223–233.

Hardy, A. (2005, June, 09). *MISG to introduce corporate governance rating by year-end*. Retrieved June 7, 2007, from http://www.theedgemalaysia.com/.

Harford, J., Li, K., & Zhao, X. (2008). Corporate boards, leverage and debt maturity choices. *International Journal of Corporate Governance*, 1(1), 3–27.

Harvey, C. R., & Roper, A. (1999). The Asian bet. In A. Harwood, R. Litan & M. Pomerleano (Eds.), *The crisis in emerging financial markets* (pp. 29–115). Washington: Brookings Institution Press.

Healy, P., Hutton, A., & Palepu, K. (1999). Stock performance and intermediation changes surrounding sustained increases in disclosure. *Contemporary Accounting Research*, 16(3), 485–520.

Healy, P., & Palepu, K. (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of empirical disclosure literature. *Journal of Accounting and Economics*, 31, 405–440.

Heflin, F., Shaw, K. W., & Wild, J. J. (2005). Disclosure quality and market liquidity: Impact of depth quotes and order sizes. *Contemporary Accounting Research*, 22(4), 829–865.

Henderson, J. W., & Phillips, R. (2007). Unintended consequences: Social policy, state institutions and the 'stalling' of the Malaysian industrialization project. *Economy and Society*, 36(1), 78–102.

Hill, C. W. L., & Jones, T. M. (1992). Stake holder-Agency theory. *Journal of Management Studies*, 29(2), 131–154.

Hillman, A. J. (2005). Politicians on the board of directors: Do connections affect the bottom line? *Journal of Management*, 31(3), 464–481.

Hillman, A. J., & Hitt, M. A. (1999). Corporate political strategy formulation: A model of approach, participation, and strategy decisions. *The Academy of Management Review*, 24(4), 825–842.

Hillman, A. J., Zardkoohi, A., & Bierman, L. (1999). Corporate political strategies and firm performance: Indications of firm-specific benefits from personal service in the US government. *Strategic Management Journal*, 20(1), 67–81.

Ho, S. M., & Wong, K. S. (2001a). A study of the relationship between corporate governance structures and the extent of voluntary disclosure. *Journal of International Accounting, Auditing & Taxation*, 10(2), 139–156.

Ho, S. M., & Wong, K. S. (2001b). A study of corporate disclosure practice and effectiveness in Hong Kong. *Journal of International Financial Management and Accounting*, 12(1), 75–102.

Hodge, F. D. (2003). Investors' perceptions of earnings quality, auditor independence, and the usefulness of audited financial information. *Accounting Horizons*, 17(Supplement), 37–48.

Hooks, J., Coy, D., & Davey, H. (2002). The information gap in annual reports. *Accounting, Auditing & Accountability Journal*, 15(4), 501–522.

Hope, O.K. (2003). Disclosure practices, enforcement of accounting standards, and analysts' forecast accuracy: An international study. *Journal of Accounting Research*, 41(2), 235–272.

Horii, K. (1991). Disintegration of the colonial economic legacies and social restructuring in Malaysia. *The Developing Economies*, 29(4), 281–313.

Horton, J., Macve, R., & Struyven, G. (1996). *A qualitative research into changes in insurance accounting: The use of semi-structured interviews.* Paper presented at the ICAEW Beneath the Numbers Conference, Portsmouth.

Hoskisson, R., Eden, L., Lau, C., & Wright, A. M. (2000). Strategy in emerging economies. *Academy of Management Journal*, 43(3), 249–267.

Hossain, M., Perera, M. H. B., & Rahman, A. R. (1995). Voluntary disclosure in the annual reports of New Zealand companies. *Journal of International Financial Management and Accounting*, 6(1), 69–87.

Hossain, M., Tan, M. L., & Adams, M. B. (1994). Voluntary disclosure in an emerging capital market: Some empirical evidence from companies listed on the KLSE. *The International Journal of Accounting*, 29(4), 31–57.

Ikin, C. C. (2005). Do auditor-provided non-audit services (APNAS) fees impair auditor independence? In T. Campbell & K. A. Houghton (Eds.), *Ethics and Auditing* (pp. 289–326). Melbourne: ANU E Press.

Imhoff, E. A. J. (1992). The relation between perceived accounting quality and economic characteristics of the firm. *Journal of Accounting and Public Policy*, 11, 97–118.

Inchausti, B. G. (1997). The influence of company characteristics and accounting regulation on information disclosed by Spanish firms. *European Accounting Review*, 6(1), 45–68.

Jensen, M. (1993). The modern industrial revolution, exit and the failure of internal control systems. *Journal of Finance*, 48(3), 831–880.

Jensen, M., & Meckling, W. (1976). Theory of the firm: Managerial behaviour, agency costs and ownership structure. *Journal of Financial Economics*, 3, 305–360.

Jick, T. D. (1983). Mixing qualitative and quantitative methods: Triangulation in action. In J. Van Maanen (Ed.), *Qualitative Methods*. Beverly Hills: Sage Publications.

Joh, S. W. (2003). Corporate governance and firm profitability: Evidence from Korea before the economic crisis. *Journal of Financial Economics*, 68(2), 287–322.

John, K., & Wenbet, L. W. (1998). Corporate governance and board effectiveness. *Journal of Banking and Finance*, 22, 371–403.

Johnson, S., Boone, P., Breach, A., & Friedman, E. (2000). Corporate governance in the Asian financial crisis. *Journal of Financial Economics*, 58, 141–186.

Johnson, S., & Mitton, T. (2003). Cronyism, and capital controls: Evidence from Malaysia. *Journal of Financial Economics*, 67, 351–382.

Jomo, K. S. (1990). *Growth and structural changes in the Malaysian economy*. London: MacMillan Press.

Jomo, K. S., Felker, G., & Rasiah, R. (1999). *Industrial technology development in Malaysia: Industry and firm studies*. London: Routledge.

Jomo, K. S., & Gomez, E. T. (2000). *The Malaysian development dilemma in rents, rent-seeking and economic development: Theory and evidence in Asia*. Cambridge: Cambridge University Press.

Jomo, K. S., & Hui, W. C. (2003). The political economy of Malaysian federalism: Economic development, public policy and conflict containment. *Journal of International Development*, (15), 441–456.

Jomo, K. S., & Wah, T. (1999). *Industrial policy in East Asia: Lessons for Malaysia*. Kuala Lumpur: University Malaya Press.

Jonas, G. J., & Blanchet, J. (2000). Assessing quality of financial reporting. *Accounting Horizons*, 14(3), 353–363.

Jones, J. J. (1991). Earnings management during import relief investigations. *Journal of Accounting Research*, 29(2), 193–228.

Jones, S. L., Megginson, W. L., Nash, R. C., & Netter, J. M. (1999). Share issue privatizations as financial means to political and economic ends. *Journal of Financial Economics*, 53(2), 217–253.

Jusoh, R. (2008). Competitive strategy and performance measurement in the Malaysian context: An exploratory study. *Management Decision*, 46(1), 5–31.

Karamanou, I., & Vafeas, N. (2005). The association between corporate boards, audit committees, and management earnings forecasts: An empirical analysis. *Journal of Accounting Research*, 43, 453–486.

Kasznik, R., & McNicholas, M. (2002). Does meeting earnings expectation matter? Evidence from analyst forecast revisions and share prices. *Journal of Accounting Research*, 40(3), 727–759.

Kennedy, P. (1998). *A guide to econometrics*. (4th ed.). London: Blackwell Publications.

Kent, P., & Stewart, J. (2008). Corporate governance and disclosure on the transition to international financial reporting standards. *Accounting & Finance*, 48, 649–671.

Kim, E. H. (1998). Globalisation of capital markets and the Asian financial crisis. *Journal of Applied Corporate Finance*, 11, 30–39.

Klein, A. (2002). Audit committee, board of director characteristics and earnings management. *Journal of Accounting and Economics*, 33, 375–400.

KLSE. (2001). KLSE: *Annual handbook, 2001*. Kuala Lumpur: KLSE Publication.

KLSE. (2003). KLSE: *Annual handbook, 2003*. Kuala Lumpur: KLSE Publication.

Kormendi, R., & Lipe, R. (1987). Earnings innovation, earnings persistence and stock returns. *The Journal of Business*, 60(3), 323–345.

Kornai, J. (2001). Hardening the budget constraint: The experience of the post-socialist countries. *European Economic Review*, 45, 1573–1599.

Kothari, S. P. (2001). Capital market research in accounting. *Journal of Accounting and Economics*, 31, 105–231.

Krishnamurti, C., Sevic, A., & Sevic, Z. (2005a). Voluntary disclosure, transparency, and market quality: Evidence from emerging market ADRs. *Journal of Multinational Financial Management*, 15, 435–454.

Krishnamurti, C., Sevic, A., & Sevic, Z. (2005b). Legal environment, firm-level corporate governance and expropriation of minority shareholders in Asia. *Economic Change and Restructuring*, 38, 85–111.

Krishnan, G. V., & Zhang, Y. (2005). Auditor litigation risk and corporate disclosure of quarterly review report. *Auditing – A Journal of Practice & Theory*, 24(Supplement), 115–138.

Ku Ismail, K.N., & Abdullah, S.N. (1998). Mandatory disclosure in the annual reports of general insurers in Malaysia. *Analisis*, 5(1&2), 47-66.

La Porta, R., & Lopez-de-Salanes, F. (1999). Corporate ownership around the world. *Journal of Finance*, 54(2), 471–517.

La Porta, R., Lopez-de-Salanes, F., Shleifer, A., & Vishny, R. W. (2000). Investor protection and corporate governance. *Journal of Financial Economics*, 58, 3–27.

Lambert, R., Leuz, C., & Verrecchia, R. (2007). Accounting information, disclosure, and the cost of capital. *Journal of Accounting Research*, 45(2), 385–420.

Lang, L., & Lundholm, R. J. (1993). Cross sectional determinants of analyst ratings of corporate disclosures. *Journal of Accounting Research*, 31(2), 246–271.

Lang, L., & Lundholm, R. J. (1996). Corporate disclosure policy and analyst behaviour. *The Accounting Review*, 71(4), 467–492.

Lanno, K. (1999). A European perspective on corporate governance. *Journal of Common Market Studies*, 37(2), 269–295.

Lara, J. M. G., Osma, B. G., & Penalva, F. (2007). Accounting conservatism and corporate governance. *Review of Accounting Studies*, 42, 1–41.

Lee, B. B., & Choi, B. (2002). Company size, auditor type, and earnings management. *Journal of Forensic Accounting*, 3, 27–50.

Lee, S. (2004). The politics of the Asian financial crisis in Malaysia and South Korea. *Journal of the Asia Pacific Economy*, 9(1), 10–31.

Lee, Y. J., Petroni, K. R., Shen, M., & Hirst, D. E. (2006). Cherry picking, disclosure quality, and comprehensive income reporting choices: The case of property-liability insurers. *Contemporary Accounting Research*, 23(3), 655–700.

Leftwich, R., Watts, R., & Zimmerman, J. (1981). Voluntary corporate disclosure: The case of interim reporting. *Journal of Accounting Research*, 19(Supplement), 50–71.

Lemmon, M. L., & Lins, K. V. (2003). Ownership structure, corporate governance and firm value: Evidence from the East Asian financial crisis. *Journal of Finance*, 58, 1445–1468.

Leung, S., & Horwitz, B. (2004). Director ownership and voluntary segment disclosure: Hong Kong evidence. *Journal of International Financial Management and Accounting*, 15(3), 235–260.

Leuz, C., Nanda, D., & Wysocki, P. (2003). Earnings management and investor protection: An international comparison. *Journal of Financial Economics*, 69, 505–527.

Leuz, C., & Oberholzer-Gee, F. (2006). Political relationships, global financing, and corporate transparency: Evidence from Indonesia. *Journal of Financial Economics*, 81, 411–439.

Leuz, C., & Verrecchia, R. (2000). The economic consequences of increased disclosure. *Journal of Accounting Research*, 38(Supplement), 91–124.

Lev, B., & Thiagarajan, S. R. (1993). Fundamental information analysis. *Journal of Accounting Research*, 31(2), 190–215.

Lim, M. H. (1981). *Ownership and control of the one hundred largest corporations in Malaysia*. Kuala Lumpur: Oxford University Press.

Lipe, R. (1990). The relation between stock returns and accounting earnings given alternative information. *The Accounting Review*, 65, 49–71.

Lopes, P. T., & Rodrigues, L. L. (2007). Accounting for financial instruments: An analysis of the determinants of disclosure in the Portuguese stock exchange. *The International Journal of Accounting*, 42, 25–56.

Lundholm, R., & Myers, L. A. (2002). Bringing the future forward: The effect of disclosure on the returns-earnings relation. *Journal of Accounting Research*, 40(3), 809–839.

Mahmood, N. R. (2003). *Developments in Malaysian corporate governance: The regulatory perspective*. Working Paper Series, Securities Commission, Malaysia.

Malaysia. (1991). *The second outline perspective plan 1991–2000*. Kuala Lumpur: The National Printing Department.

Mallin, C. A. (2007). *Corporate governance.* New York: Oxford University Press.

Mamman, A. (2004). Managerial perspectives on government intervention in Malaysia: Implications for international business. *Competition & Change*, 8(2), 137–152.

Marston, C. L., & Shrives, P. J. (1991). The use of disclosure indices in accounting research: A review article. *The British Accounting Review*, 23(3), 195–210.

McConaughy, D. L. (2000). Family CEOs vs. non family CEOs in the family-controlled firm: An examination of the level and sensitivity of pay to performance. *Family Business Review*, 13, 121–131.

McDaniel, L., Martin, R. D., & Maines, L. A. (2002). Evaluating financial reporting quality: The effects of financial expertise vs. financial literacy. *The Accounting Review*, 77(Supplement), 139–167.

McKinsey & Company. (2002). *Global investor opinion survey: Key findings*. Retrieved April 23, 2006, from www.mckinsey.com/governance.

McNichols, M. (2002). Discussion of 'The quality of accruals and earnings: The role of accrual estimation errors'. *The Accounting Review*, 77(4 Supplement), 61–69.

Megginson, W. L., Nash, R. S., & Randenborgh, M.V. (1994). The financial and operating performance of new privatized firms: An international empirical analysis. *Journal of Finance*, 49(2), 405–454.

Melis, A. (2004). Financial reporting, corporate communication and governance. *Corporate Ownership and Control*, 1(2), 31-37.

Mellahi, K., & Guermat, C. (2004). Does age matter? An empirical examination of the effect of age on managerial values and practices in India. *Journal of World Business*, 39, 199–215.

Menon, J. (2009). Macroeconomic management amid ethnic diversity: Fifty years of Malaysian experience. *Journal of Asian Economics*, 20(1), 25-33.

Millstein, I. (1992). *The limit of corporate power: Existing constraints on the exercise of corporate discretion*. New York: Macmillan.

Mitchell, M. (2003). How rude! Just what is good corporate governance? It's simply good manners. *Directors and Board*, Winter(1), 14.

Mitton, T. (2002). A cross-firm analysis of the impact of corporate governance on the East Asian financial crisis. *Journal of Financial Economics*, 64, 215–241.

Mohd Ghazali, N. A. (2007). Ownership structure and corporate social responsibility disclosure: Some Malaysian evidence. *Corporate Governance*, 7(3), 251–266.

Monks, R. A. G. (1994). Relationship investing. *Corporate Governance*, 2(2), 58–76.

Morck, R., Shleifer, A., & Vishny, R. W. (1988). Management ownership and market valuation: An empirical analysis. *Journal of Financial Economics*, 20, 293–315.

Morgan, D. L. (1998). Practical strategies for combining qualitative and quantitative methods: Applications to health research. *Qualitative Health Research*, 8, 362– 376.

Myers, J. N., Myers, L. A., & Omer, T. C. (2003). Exploring the term of the auditor-client relationship and the quality of earnings: A case for mandatory auditor rotation? *Accounting Review*, 78(3), 779–799.

Nam, S. W., & Nam, I. C. (2005). *Corporate governance in Asia*. Manila: Asian Development Bank Institute.

Naser, K., & Nuseibeh, R. (2003). Quality of financial reporting: Evidence from the listed Saudi non financial companies. *The International Journal of Accounting*, 38, 41–69.

Nathan, R. S., Lin, C. S., & Fong, S. W. (2000). *Country paper for Malaysia*. Paper presented at the Second Asian Roundtable on Corporate Governance, Hong Kong, May 31 – June 2, 2000.

Nee, V., Opper, S., & Wong, S. (2007). Development state and corporate governance in China. *Management and Organization Review*, 3(1), 19–53.

Neuman, W. L. (1997). *Social research methods: Qualitative and quantitative approaches*. (3rd ed.). Needham Heights: Allyn and Bacon.

Niu, F. F. (2006). Corporate governance and the quality of accounting earnings: A Canadian perspective. *International Journal of Managerial Finance*, 2(4), 302–327.

Norhashim, M., & Aziz, K. A. (2005). Smart partnership or cronyism? A Malaysian perspective. *The International Journal of Sociology and Social Policy*, 25(8), 31–48.

North, D. (1990). *Institutions, institutional change and economic performance*. Cambridge: Cambridge University Press.

O'Neill, H. M., Saunders, C., & McCarthy, A. (1989). Board members' background characteristics and their level of corporate social responsiveness: A multivariate investigation. *Academy of Management*, pp.32–36.

O'Sullivan, M. (2000). *Contest for corporate control: Corporate governance and economic performance in the United States and Germany*. Oxford: Oxford University Press.

Owusu-Ansah, S. (1998). The impact of corporate attributes on the extent of mandatory disclosures and reporting by listed companies in Zimbabwe. *The International Journal of Accounting*, 33(5), 605–631.

Ow-Yong, K., & Guan, C. K. (2000). Corporate governance codes: A comparison between Malaysia and the UK. *Corporate Governance: An International Review*, 8(2), 125–132.

Pallant, J. (2007). *SPSS survival manual: A step by step guide to data analysis using SPSS for Windows (Version 15)*. NSW: Allen & Unwin.

Pankoff, L. D., & Virgil, R. L. (1970). Some preliminary findings from a laboratory experiment on the usefulness of financial accounting information to security analysts. *Journal of Accounting Research*, 8, 1–48.

Patel, S. A., Balic, A., & Bwakira, L. (2002). Measuring transparency and disclosure at firm-level in emerging markets. *Emerging Market Review*, 3(4), 325–337.

Patton, J. M., & Zelenka, I. (1997). An empirical analysis of the determinants of the extent of disclosure in annual reports of joint stock companies in the Czech Republic. *European Accounting Review*, 6(4), 605–625.

Peasnell, K. V., Pope, P. F., & Young, S. (2005). Board monitoring and earnings management: Do outside directors' influence abnormal accruals? *Journal of Business Finance & Accounting*, 32(7 & 8), 1311–1346.

Peng, M. W. (2003). Institutional transitions and strategic choices. *The Academy of Management Review*, 28(2), 275–296.

Penman, S. H. (2003). The quality of financial statement: Perspectives from the recent stock market bubble. *Accounting Horizons*, 17, 77–96.

Penman, S. H., & Zhang, X. J. (2002). Accounting conservatism, the quality of earnings, and stock returns. *Accounting Review*, 77(2), 237–264.

Perkins, D. H., & Woo, W. T. (2000). Malaysia: Adjusting to deep integration with the world economy. In W. T. Woo & J. D. Sachs (Eds.), *The Asian financial crisis: Lessons for a resilient Asia*. Cambridge: MIT Press.

Pfeffer, J. (1972). Size and composition of corporate board boards of directors: The organization and its environment. *Administrative Science Quarterly*, 17, 218–228.

Pfeffer, J., & Salancik, G. (1978). *The external control of organization: A resource-dependence perspective*. New York: Harper & Row.

Piei, M. H., & Tan, T. (1999). *Rising to the challenge in Asia: A study of financial markets. (Vol. 8)*. Manila: Asian Development Bank.

Pownall, G., & Schipper, K. (1999). Implications of accounting research for the SEC's consideration of international accounting standards for US securities offerings. *Accounting Horizons*, 13(3), 259–280.

PricewaterhouseCoopers. (2002). *KLSE-PwC commence corporate governance survey 2002*. Retrieved March 28, 2007, from http://www.pwcglobal.com.

Pushpanathan, K. (2007). National annual corporate report awards. Retrieved March 28, 2008, from http://www.micpa.com.my/document_NACRA_2007_Brochure.pdf.

Rachagan, S. (2007). Controlling shareholders and corporate governance in Malaysia: Would the self-enforcing model protect minority shareholders? *The Corporate Governance Law Review*, 3(1), 1–25.

Raffournier, B. (1995). The determinants of voluntary financial disclosure by Swiss listed companies. *The European Accounting Review*, 6(3), 493–496.

Ragayah, H. M. Z. (2008). Income inequality in Malaysia. *Asian Economic Policy Review*, 3, 114–132.

Rahman, M. (1998). The role of accounting disclosure in the East Asian financial crisis: Lessons learned? *Transnational Corporations*, 7(3), 1–53.

Rahman, U. M. A. (2002). *The effect of religion on earnings management and capital structure: Evidence from Muslim and non-Muslim managed firms in Malaysia*. PhD Thesis. Massey University, Palmerston North.

Rajan, R., & Zingales, L. (2003). *Saving capitalism from the capitalist*. New York: Crown Business.

Rajgopal, S., & Venkatachalam, M. (2008). *Financial reporting quality and idiosyncratic return volatility over the last four decades*. SSRN Working Paper Series. Retrieved January 13, 2009, from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=650081#PaperDownload.

Rasiah, R., & Shari, I. (2001). Market, government and Malaysia's new economic policy. *Cambridge Journal of Economics*, 25, 57–78.

Redding, S. G. (1996). Weak organizations and strong linkages: Managerial ideology and Chinese family networks. In G. G. Hamilton (ed.) *Asian business networks*. Berlin: Walter de Gruyter.

Reed, B. J., Trombley, M. A., & Dhaliwal, D. S. (2000). Demand for audit quality: The case of Laventhol and Horwath's auditees. *Journal of Accounting, Auditing and Finance*, 15(2), 183–198.

Reed, D. (2002). Corporate governance reforms in developing countries. *Journal of Business Ethics*, 37(3), 223–247.

Richardson, S. (2006). Over investment of free cash flow. *Review of Accounting Studies*, 11(2-3), 159–189.

Richardson, S. A. (2003). Earnings quality and short sellers. *Accounting Horizons*, 17(Supplement), 49–61.

Ritchie, B. K. (2005). Coalitional politics, economic reform, and technological upgrading in Malaysia. *World Development*, 33(5), 745–761.

Robbins, W. A., & Austin, K. R. (1986). Disclosure quality in government financial reports: An assessment of the appropriateness of a compound measure. *Journal of Accounting Research*, 24(2), 413–421.

Rodriguez, G. C., Espejo, C. A., & Cabrera, R. V. (2007). Incentives management during privatization: An agency perspective. *Journal of Management Studies*, 44(4), 536–560.

Roe, M. (2003). *Political determinants of corporate governance*. New York: Oxford University Press.

Salazar, C. (2004). *The legacies of Mahathir's privatization policy*. Retrieved July 05, 2007 from http://www.aseanfocus.com/asiananalysis/article.cfm?articleID=721.

Saleh, N. M., Iskandar, T. M., & Rahmat, M. M. (2007). Audit committee characteristics and earnings management: Evidence from Malaysia. *Asian Review of Accounting*, 15(2), 147–163.

Salim, M. R. (2007). The oppression remedy in Malaysia – A critique on the reform proposal. *The Corporate Governance Law Review*, 3(1), 56–69.

Sanchez, J. P., & Garcia, E. (2007). Ownership structure, discretionary accruals and informativeness of earnings. *Corporate Governance: An International Review*, 15(4), 677–691.

Sappington, D., & Stiglitz, J. E. (1987). Privatization, information, and incentives. *Journal of Policy Analysis and Management*, 6, 567–582.

Schadewitz, H. J., & Kanto, A. J. (2002). The impact of disclosure on the market response to reported earnings. *Scandinavian Journal of Management*, 18(4), 521–542.

Schipper, K., & Vincent, L. (2003). Earnings quality. *Accounting Horizons*, 17(Supplement.), 97–110.

Schulze, W. S., Lubatkin, M. H., Dino, R. N., & Buchholtz, A. K. (2001). Agency relationships in family firms: Theory and evidence. *Organization Science*, 12, 99–116.

Scott, K. E. (1999). *Corporate governance and East Asia*. Working Paper No 176, Stanford Law School. Retrieved March 13, 2006, from http://paper.ssrn.com/sol3/papers.cfm?abstract_id=173369.

Sengupta, P. (1998). Corporate disclosure quality and the cost of debt. *The Accounting Review*, 73(4), 459–474.

Seventh Malaysia Plan 1996–2000. (1996). Kuala Lumpur: Percetakan Nasional Malaysia Berhad.

Sharma, V. (2004). Board of director characteristics, institutional ownership, and fraud: Evidence from Australia. *Auditing –A Journal of Practice & Theory*, 23(2), 105–117.

Shaw, K. W. (2003). Corporate disclosure quality, earnings smoothing and earnings' timeliness. *Journal of Business Research*, 56, 1043–1050.

Shen, C. H., & Chih, L. H. (2007). Earnings management and corporate governance in Asia's emerging markets. *Corporate Governance*, 15(5), 999–1021.

Shleifer, A., & Vishny, R. W. (1994). Politicians and firms. *The Quarterly Journal of Economics*, 109(4), 995–1025.

Shleifer, A., & Vishny, R. W. (1998). *The grabbing hand: Government pathologies and their cures*. Cambridge: Harvard University Press.

Siddiquee, N. A. (2006). Public management reform in Malaysia, recent initiatives and experiences. *International Journal of Public Sector Management*, 19(4), 339–358.

Singh, M., & Davidson, W. N. (2003). Agency costs, ownership structure and corporate governance mechanisms. *Journal of Banking and Finance*, 27(5), 793–816.

Singhvi, S. S., & Desai, H. B. (1971). An empirical analysis of the quality of corporate financial disclosure. *The Accounting Review*, 46(1), 129–138.

Skinner, D. J., & Sloan, R. G. (2002). Earnings surprises, growth expectations, and stock returns: Don't let an earnings torpedo sink your portfolio. *Review of Accounting Studies*, 7(2-3), 289–312.

Sloan, R. G. (1996). Do stock prices fully reflect information in accruals and cash flows about future earnings? *The Accounting Review*, 71(3), 289–315.

Stockwell, A. J. (1982). The white man's burden and brown humanity: Colonialism and ethnicity in British Malaya. *Southeast Asian Journal of Social Science*, 10(1), 59–62.

Strauss, A. L., & Corbin, J. (1990). *Grounded theory methodology*. Thousand Oaks: Sage Publications.

Strauss, A. L., & Corbin, J. (1998). *Basics of qualitative research: Techniques and procedures for developing grounded theory. (2nd ed).* Thousand Oaks: Sage Publications.

Sudman, S., & Bradburn, N. (1983). *Asking questions: A practical guide to questionnaire design.* San Francisco: Jossey Bass.

Sun, Z., Liu, F. W., & Wang, H. (2005). Debt, corporate governance and earnings conservatism. *China Accounting and Finance Research*, 3, 112–141.

Suto, M. (2003). Capital structure and investment behaviour of Malaysian firms in the 1990s: A study of corporate governance before the crisis. *Corporate Governance*, 11(1), 25–39.

Sweeney, A. P. (1994). Debt-covenant violations and managers' accounting responses. *Journal of Accounting and Economics*, 17, 281–308.

Tabachnick, B. G., & Fidell, L. S. (2007). *Using multivariate statistics*. Boston: Pearson.

Tagesson, T. (2007). Does legislation or form of association influence the harmonization of accounting? A study of accounting in the Swedish water and sewage sector. *Utilities Policies*, 15(4), 248–260.

Tam, O. K., & Tan, M. G. S. (2007). Ownership, governance and firm performance in Malaysia. *Corporate Governance*, 15(2), 208–222.

Thomas, A. S., & Simerly, R. L. (1994). The CEO and corporate social performance: An interdisciplinary examination. *Journal of Business Ethics*, 13(12), 959–968.

Thompson, J. D. (1967). *Organizations in action*. New York: McGraw-Hill.

Thomsen, S., & Pedersen, T. (1996). Nationality and ownership structures: The 100 largest companies in six European nations. *Management International Review*, 36(2), 149–166.

Torii, T. (1997). The new economic policy and the United Malays National Organization. *The Developing Economies*, XXXV(3), 209-239.

Tricker, R. I. (1994). *International corporate governance*. Singapore: Simon & Schuster.

Vafeas, N. (2000). Board structure and the informativeness of earnings. *Journal of Accounting and Public Policy*, 19(2), 139–160.

Vander Bauwhede, H., Willekens, M., & Gaeremynck, A. (2003). Audit firm size, public ownership, and firms' discretionary accruals management. *The International Journal of Accounting*, 38, 1–22.

Velury, U., & Jenkins, D. S. (2006). Institutional ownership and the quality of earnings. *Journal of Business Research*, 59, 1043–1051.

Wallace, R. S. D., & Naser, K. (1995). Firm-specific determinants of the comprehensiveness of mandatory disclosure in the annual corporate reports of firms listed on the stock exchange of Hong Kong. *Journal of Accounting and Public Policy*, 14, 311–368.

Wallace, R. S. D., Naser, K., & Mora, A. (1994). The relationship between comprehensiveness of corporate annual reports and firms characteristics in Spain. *Accounting and Business Research*, 25(7), 41–53.

Wang, Q., Wong, T. J., & Xia, L. (2008). State ownership, institutional environment and auditor choice: Evidence from China. *Journal of Accounting and Economics*, 46(1), 112–134.

Warfield, T. D., Wild, J. J., & Wild, K. L. (1995). Managerial ownership, accounting choices, and informativeness of earnings. *Journal of Accounting and Economics*, 20, 61–91.

Watts, R., & Zimmerman, J. L. (1986). *Positive accounting theory*. Englewood Cliffs: Prentice-Hall.

Watts, R., & Zimmerman, J. L. (1990). Positive accounting theory: A ten year perspective. *Accounting Review*, 65(1), 131–156.

Wei, P. C., Hui, M., C, Cheng, F. L., & Wei, L. L. (2007). Corporate governance and equity liquidity: Analysis of S&P transparency and disclosure rankings. *Corporate Governance: An International Review*, 15(4), 644-660.

White, G. (1988). *Development states in East Asia*. London: Macmillan.

White, N. J. (2004). The beginning of crony capitalism: Business, politics and economic development in Malaysia, c.1955–70. *Modern Asian Studies*, 38(2), 389–417.

Wieland, J. (2005). Corporate governance, values management and standards: A European perspective. *Business & Society*, 44(1), 74–93.

Wiersema, M. F., & Bantel, K. A. (1992). Top management demography and corporate strategic change. *Academy of Management Journal*, 35(1), 91–121.

Williams, L. K. (2007). How culture evolves: an institution analysis. *International Journal of Social Economics*, 34(4), 249–267.

Wong, S. C. Y. (2004). Improving corporate governance in SOEs: An integrated approach. *Corporate Governance International*, 7(2), 5–15.

Wong, S. L. (1996). Chinese business networks: A comparative view. In G.G. Hamilton (ed.) *Asian Business Networks*. Berlin: Walter de Gruyter.

Wong, J. (1988). Political costs and an intraperiod accounting choice for export tax credits. *Journal of Accounting and Economics*, 10(1), 37– 51.

World Bank. (2002). *World development report: Building institutions for markets*. Washington, DC: World Bank.

Wright, D. (1996). *Evidence on the relation between corporate governance characteristics and the quality of financial reporting*. Working paper, University of Michigan, Ann Arbor.

Xu, L. C., Zhu, T., & Lin, Y. (2005). Politician control, agency problems and ownership reform: Evidence from China. *Economics of Transition*, 13(1), 1–24.

Yatim, P., Kent, P., & Clarkson, P. (2006). Governance structures, ethnicity, and audit fees of Malaysian listed firms. *Managerial Auditing Journal*, 21(7), 757–782.

Yee, K. K. (2006). Earnings quality and the equity risk premium: A benchmark model. *Contemporary Accounting Research*, 23(3), 833–877.

Yermack, D. (1996). Higher market valuation of companies with a small board of directors. *Journal of Financial Economics*, 40, 185–211.

Zhuang, J. (1999a). *Corporate governance in East Asia and some policy implications.* (EDRC Briefing Notes Number 14) Economics and Development Resource Center, Asian Development Bank.

Zhuang, J. (1999b). *Some conceptual issues of corporate governance.* (EDRC Briefing Notes, Number 13) Economics and Development Resource Center, Asian Development Bank.

Zhuang, J., Edwards, D., & Capulong, M. V. A. E. (2001). *Corporate governance and finance in East Asia: A study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand.* Manila: Asian Development Bank.

Zimmerman, J. L. (1977). The municipal accounting maze: An analysis of political incentives. *Journal of Accounting Research*, 15(Supplement), 107–144.