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**RELIGIOUS ETHICAL VALUES AND EARNINGS QUALITY:  
SOME EVIDENCE FROM MALAYSIA**

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

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in

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## ABSTRACT

The main purpose of this thesis is to examine the association between religious ethical values and earnings quality. This study builds upon the principals and ethical framework of Islamic teachings (*Shariah*). It analyses how such ethical values affect the earnings quality of Malaysian listed firms. *Shariah* is the Islamic code for day-to-day conduct of individuals under Islam. It provides principles of good practices including accountability at both individual and organizational levels. It promotes justice and welfare in society by encouraging better ethical conduct. Based on these premises, it is hypothesised in this thesis that *Shariah* is associated with high quality reported earnings.

Two different attributes of earnings quality are used to test the above hypothesis. These are earnings management and accounting conservatism. A sample of 1,878 firm-year observations from 2000 to 2007 of Malaysian firms is used for examining the association between *Shariah* and earnings quality.

The study finds a significant negative association between *Shariah*, and real and accrual-based earnings management. In particular, this study finds that *Shariah* is associated with lower abnormal discretionary accruals, abnormal cash flow from operations, and abnormal discretionary expenses. Further, results of the study reveal that *Shariah* is associated with higher levels of accounting conservatism. Overall, the results suggest that *Shariah* is an important monitoring mechanism in limiting managerial opportunism and, consequently, enhances the quality of accounting earnings.

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## LIST OF ABBREVIATIONS

AAOIFI	Accounting, Auditing Organisations of Islamic Financial Institutions
ACC	Discretionary Accounting Accrual
AEM	Accrual-based Earnings Management
BAFIA	Banking and Financial Institutions Act 1989
BIMB	Bank Islam Malaysia Berhad
BNM	Bank Negara Malaysia
CEO	Chief executive officer
CMP	Capital market master plan
CMSA	Capital Markets and Services Act 2007
COGS	Cost of goods sold
CON-ACC	Accrual-based measure of accounting conservatism
CON-KW	C-Score measure of accounting conservatism
CSR	Corporate social reporting
EPF	Employees Provident Fund
FCCG	Finance Committee on Corporate Governance
GCC	Gulf Cooperation Council
GLC	Government-linked companies
GLIC	Government-linked investment companies
GRI	Global reporting initiative
ICM	Islamic capital market
IFSB	Islamic Financial Services Board
IPO	Initial public offering
ITA	Income tax act 1967
KLSE	Kuala Lumpur Stock Exchange
LOFSA	Labuan Offshore Financial Services Authority
MASB	Malaysian Accounting Standard Board
MICG	Malaysian Institute of Corporate Governance
MSWG	Minority Shareholder Watchdog Group
NAV	Net asset value

R&D	Research and development
RCFO	Abnormal cashflow from operation
RDE	Abnormal discretionary expenses
REM	Real Earnings Management
RLR	Revised Listing Requirement
ROA	Return on assets
RPC	Abnormal production cost
SAC	<i>Shariah</i> Advisory Council
SC	Securities Commission
SEO	Seasoned equity offerings
SOX	Sarbanes Oxley Act
SPI	Skim Perbankan Islam
VAS	Value added statement
VIF	Variance inflation factor