BOARD DIVERSITY AS ANTECEDENT AND CORPORATE SOCIAL RESPONSIBILITY AS CONSEQUENCE OF EARNINGS MANAGEMENT: MALAYSIAN EVIDENCE

NOR ATIKAH BINTI SHAFAI

UNIVERSITI SAINS MALAYSIA

2019

BOARD DIVERSITY AS ANTECEDENT AND CORPORATE SOCIAL RESPONSIBILITY AS CONSEQUENCE OF EARNINGS MANAGEMENT: MALAYSIAN EVIDENCE

by

NOR ATIKAH BINTI SHAFAI

Thesis submitted in fulfilment of the requirements for the degree of Doctor of Philosophy

June 2019

ACKNOWLEDGEMENT

First and foremost, I give thanks to God, for His blessings, grace and mercy granted to me throughout all the days of my life.

Secondly, I must acknowledge my main supervisor, Professor Dr. Azlan Amran. I am very fortunate to have been his student. I have learned so much from his academic expertise as well as his example as a warm, caring person. My deep appreciation goes also to my secondary supervisor, Dr. Yuvaraj Ganesan. There are no words big enough to describe how thankful I am for all their encouragement, guidance, advice, criticism and support from the initial stage of my study to the final submission of this thesis. Both of you provided vital encouragement during challenging times and crucial feedback at important points in my analysis. It is an honour for me to have worked with both of you.

I am greatly indebted to Universiti Sains Malaysia and Universiti Utara Malaysia lecturers and examiners, especially Dr. Fathyah Hashim, Dr. Chu Ei Yet, Dr. ‘Atef Md Yusof and Professor Dr. Wan Nordin Wan Hussin for their valuable comments and suggestions. My profound gratitude goes to Malaysian Ministry of Higher Education and Universiti Utara Malaysia for funding my PhD study. Many thanks go out to all staff at the Graduate School of Business, Universiti Sains Malaysia and to all my friends who are pursuing their PhD studies.

Lastly, I would like to express my deepest gratitude to my family; my dear father who has always prayed for me to accomplish this goal, my beloved mother who has always been a rock to lean on in tough times, and my sisters and brother who have always coloured my world. Without the love and support from all of you, I would not have made it this far and successfully reached this destination.

TABLE OF CONTENTS

CHAPTER 3 - THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

CHAPTER 4 - RESEARCH METHODOLOGY

CHAPTER 5 - RESULTS

CHAPTER 6 - DISCUSSION AND CONCLUSIONS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

AGE	Age Diversity
BIG4	Audit Firm
BSIZE	Board Size
CEO	Chief Executive Officer
CFO	Cash Flow from Operations
COM	Competency Diversity
CSR	Corporate Social Responsibility
CR	Corporate Reputation
ETH	Ethnic Diversity
FSIZE	Company Size
GEN	Gender Diversity
IAFSOUR	Internal Audit Function Sourcing Arrangements
LEAD	Board Leadership
LEV	Leverage
MCCG	Malaysian Code on Corporate Governance
MUL	Multiple Directorships
NAT	Nationality Diversity
NDP	National Development Policy
NEP	New Economic Policy
NEDs	Non-executive Directors
OLS	Ordinary Least Square
PLCs	Public Listed Companies
ROA	Return on Asset
WLS	Weighted Least Square

LIST OF APPENDICES

KEPELBAGAIAN PENGARAH SEBAGAI ANTESEDEN DAN TANGGUNGJAWAB SOSIAL KORPORAT SEBAGAI KESAN KEPADA PENGURUSAN PENDAPATAN: BUKTI DARI MALAYSIA

ABSTRAK

Amalan pengurusan pendapatan telah meningkat sejak kebelakangan ini. Kesan dari amalan ini semestinya memudaratkan, oleh itu, telah mendapat perhatian yang luas dari ahli akademik dan pengamal. Isu pengurusan pendapatan telah menjadi satu kebimbangan yang serius, terutamanya yang berkaitan dengan keupayaan tadbir urus korporat sebagai mekanisma pemantauan dan akibat dari manifestasi pengurusan pendapatan. Teori Agensi dan Teori Modal Insan digunakan dalam kajian ini untuk mengkaji hubungan antara kepelbagaian lembaga (kepelbagaian-di-lembaga dan kepelbagaian-dalam-lembaga) dengan pengurusan pendapatan. Kajian ini juga mengkaji tanggungjawab sosial korporat (CSR) sebagai kesan dari pengurusan pendapatan berdasarkan Teori Pemegang taruh-Agensi dan Teori Pengisyaratan. Secara khususnya, kajian ini mengkaji sama ada pengurusan pendapatan memberi kesan terhadap kualiti pendedahan CSR. Di samping itu, kajian ini meneliti kesan penyederhana reputasi korporat terhadap pengurusan pendapatan dan CSR. Kajian ini telah menganalisis sejumlah 265 syarikat tersenarai awam di Pasaran Utama Bursa Malaysia bagi tahun 2016 dan melaporkan bahawa kepimpinan lembaga, pelbagai jawatan lembaga pengarah, kepelbagaian jantina dan kepelbagaian umur adalah negatif dan signifikan berhubung dengan pengurusan pendapatan. Hubungan diantara komitmen pengarah bukan eksekutif dan kepelbagaian kewarganegaraan, sebaliknya, dilaporkan positif dan signifikan dengan pengurusan pendapatan. Pembolehubah yang lain iaitu saiz lembaga, kepelbagaian etnik dan

kepelbagaian kompetensi tidak mempunyai pengaruh dalam mengurangkan pengurusan pendapatan. Beralih kepada kesan dari pengurusan pendapatan, hasil kajian melaporkan tiada perhubungan statistik dan signifikan diantara pengurusan pendapatan dan CSR. Malah, reputasi korporat juga tidak memberi kesan penyederhanaan diantara hubungan pengurusan pendapatan dan CSR. Berdasarkan hasil penyelidikan ini, pembuat dasar boleh menggunakan hasil kajian ini untuk mengiktiraf peranan penting yang dimainkan oleh beberapa sifat kepelbagaian lembaga dalam mengurangkan amalan tidak bermoral ini di Malaysia. Di samping itu, pihak berkuasa juga harus menggalakkan syarikat-syarikat untuk berusaha melaporkan pendedahan CSR yang lebih berkualiti, bukan kuantiti pendedahan semata-mata.

BOARD DIVERSITY AS ANTECEDENT AND CORPORATE SOCIAL RESPONSIBILITY AS CONSEQUENCE OF EARNINGS MANAGEMENT: MALAYSIAN EVIDENCE

ABSTRACT

Earnings management practices have escalated in recent years. The consequence of this practice is detrimental, and has received immense attention from academician and practitioners. The issue of earnings management has become a serious concern, especially in corporate governance ability as a monitoring mechanism and the consequence of earnings management manifestation. Using Agency Theory and Human Capital Theory, this research endeavours to investigate the relationship between board diversity (diversity-of-boards and diversity-in-boards) and earnings management. This research also determines to examine corporate social responsibility (CSR) as the consequence of earnings management based on Stakeholder-agency Theory and Signalling Theory. Particularly, this study investigates whether earnings management affects the quality of CSR disclosure. Additionally, this research examines the moderating effect of corporate reputation between earnings management and CSR. A total of 265 public listed companies on the Main Market of Bursa Malaysia for the year 2016 have been analysed. This study reveals that board leadership, multiple directorships, gender diversity and age diversity are significantly negative in relation to earnings management. Non-executive directors' commitment and nationality diversity, on the other hand, are found to be significant and positively associated with earnings management. The remaining variables which are board size, ethnic diversity and competency diversity were found to have no effect in mitigating earnings management. Concentrating on

the consequence of earnings management, the findings reported no significant statistical association between earnings management and CSR. Likewise, the corporate reputation appears to have no effect on the moderating the relationship between earnings management and CSR. Based on the results of this research, policy-makers might use the study’s findings to recognise the important roles played by several board diversity attributes in alleviating the opportunistic practices in Malaysia. In addition, the authority should also encourage companies to further address the quality of CSR disclosure, instead of solely focusing on quantity.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Over the past few decades, the subject of earnings quality and earnings management has received extensive attention due to the high-profile corporate scandals that were deliberately conducted by some companies in the business world. In the earlier years, 1997 and 1998 specifically, the Asian financial crisis uncovered the causes of the financial crisis which are weak governance and poor governance standards (European Central Bank, 2016).

Literature has presented several definitions of earnings management[1]. This current study employs the most widely used and comprehensive definitions which came from Healy and Wahlen (1999) and Schipper (1989) in the sense that these definitions refer to the management's intention to not report actual earnings and operating activities by using their own judgment in accounting choices legitimately or illegitimately, and with the aim to achieve some particular interests.

Earnings management is a global occurrence and Malaysia is no exception to this opportunistic practice. Bhattacharya, Daouk and Welker (2003) reported that out of 34 countries, Malaysia was ranked 9th place for its critical earnings opacity and used earnings management to smooth their income to plan their tax strategies (Kasipillai & Mahenthiran, 2013). In fact, there is a growing concern over the increase in misreporting cases in Malaysia. The Securities Commission in this country reported 17 cases of earnings manipulation from 1996 to 2012 (cited in Teh, Ong & Yin, 2017). In addition, a survey conducted by KPMG from January 2010 to

[1] The terms "earnings quality" are used interchangeably in prior studies because higher earnings management represent lower earnings quality and vice versa. Thus, research on earnings quality also can be referenced in the earnings management study (Dechow et al., 2010; Healy & Wahlen, 1999).

December 2012, found that 27 per cent of the respondents had experienced unethical behaviour or misconduct in the workplace during the survey period. To be specific, the most common unethical behaviour was management conflict of interest which carried 71 per cent (KPMG, 2013). In a more current survey, PwC revealed that the issue of business misconduct increased to the percentage of 45 per cent (PricewaterhouseCoopers, 2018). Interestingly, this audit firm stated that corporate control is the least mechanism that could detect opportunistic behaviours by which indicated that there was insufficient focus on controls in the companies. Particularly, the monitoring activity is the strongest mechanism in corporate control that played its role in detecting misconducts. With regards to this concern, costly and onerous regulatory requirements especially in the internal controls and the role of boards are required to reinforce monitoring mechanism and many Malaysian companies seem to underestimate these menaces and appear uncertain in rectifying them (PricewaterhouseCoopers, 2018).

Malaysian corporate scene has also been flawed by cases of weak corporate governance which are closely related to earnings management. In relation to revenue recognition for instance, this earnings management practices has raised concern among property developers in Malaysia. In the year 2011, Mutiara Goodyear Development Bhd, a subsidiary of ATIS Corp Bhd restated their revenue due to the confusion in recognising the revenue, either percentage of completion or at the point the constructed goods delivered to the customers. As said by ATIS Corp Bhd, this issue is mainly due to the absence of a definitive national view on when revenue should be stated in the accounts of property developers (The Star, 2011). Likewise, Xerox Corp and Bausch and Lomb are the example of revenue recognition in international business environment.

Some of the other high-profile scandals that have shaken the Malaysia market sentiments were Megan Media, Transmile Group Berhad, Perwaja Steel, Malaysia Airlines System, Renong and Tat Sang. Ever since, in addition to the vast research on earnings management, corporate governance has raised discourse among researchers and became one of the most controversial topics in both academic and business press (Larcker & Tayan, 2011). The publicity and attention around those cases have questioned the transparency and credibility of financial reporting and corporate governance.

Agency theorist stated that the separation of ownership and control leads to goal divergence between managers and shareholders (Jensen & Meckling, 1976) which ensued to earnings management. This agency problem increases the need for effective monitoring and control over management to protect the interests of investors and stakeholders (Fama & Jensen, 1983). Prior literature corroborates that the existence of poor corporate governance may facilitate manipulation, corruption and mismanagement in business. Larcker and Tayan (2011) stated that effective monitoring and advising system done by the directors could reduce and minimise the managers' opportunistic behaviour that caused by agency conflict. Hence, this resulted to lower earnings management practices.

In line with the definition of corporate governance, '…process and structure used to direct and manage the business…' (Malaysian Code on Corporate Governance, 2012), the most imperative internal controlling and monitoring device; the directors, have the power to control, monitor and provide the fittest decisions for the management to dissuade management from opportunistic behaviours (Baldenius, Melumad, & Meng, 2014; Dechow, Sloan, & Sweeney, 1995). Fama and Jenson (1983) denote board of directors as the apex of a company's monitoring and control system whereby they have the power over the managers' employment, rejection or approval of key decisions, and provide advice and expertise on managing the company. Directors are expected to assert on higher reporting quality since the reported financial and voluntary information is a crucial source of verifiable information that is useful in monitoring and evaluating the managers along with their decisions and strategies.

Due to the fear of recurrence of the economic meltdown like the previous Asian financial crisis, many countries in Asia have learnt the lesson the hard way and have rightfully strengthened their corporate governance mechanisms. Hence, Malaysia introduced Malaysian Code on Corporate Governance (MCCG) in 2000 and the code evolves and improves overtime to further strengthen corporate governance practices including board of directors' policies. The latest revision was made in the year 2017. MCCG and Bursa Malaysia Listing Requirements have been actively develop the best regulatory and structures that company should abide and practice which include the board members' structural attributes.

The effectiveness of board of directors is contingent on a myriad of factors. For instance, the board meeting frequency and attendance, remuneration and ownership could affect the board's effectiveness (Kamardin & Haron, 2011). Kang, Cheng and Gray (2007) added that board diversity could also influence the board effectiveness. Hafsi and Turgut (2013) consider board diversity in terms of structural attributes (i.e. board leadership, multiple directorships, board size and non-executive directors' commitment) and demographic attributes (i.e. gender, age, ethnic, competency and nationality). Due to the breadth of board diversity term, the researchers signify structural attributes as diversity-of-boards and demographic attributes as diversity-in-boards. This current study utilises such definition.

Carter, Simkins and Simpson (2003) is one of the earlier studies that investigated board diversity and they state that a diverse or heterogeneous group of directors possess different perspective, evaluate more alternatives and more careful in exploring the consequences of those alternatives which will result in effective problem-solving. Moreover, the researchers also indicate that heterogeneity members view issues in broader lenses, while homogeneity takes a narrow perspective. Therefore, a heterogeneous board of directors may augment the company performance.

National governments are concerned with diversity on democratic grounds. Therefore, Malaysia would be an interesting avenue as it has been known to encourage women participation and for its diverse ethnicity. With regards to gender equality, the efforts to increase women directors in the boardroom have commenced since 2011, whereby the former Prime Minister of Malaysia, Datuk Seri Najib Tun Razak set the goal to have 30 per cent women directors at the decision-making level by 2016. In the Budget 2012 speech, he stated that the government organised advanced management programmes for women with potential to become members of the board. Furthermore, the MCCG 2012 posits companies to disclose their effort in increasing the women directors in the annual reports commencing in 2012. Likewise, Malaysia also practices gender equality by integrating gender equality and women's empowerment into poverty reduction, democratic governance, crisis prevention and recovery, and environment and sustainable environment as pledged by the United Nation (UNDP) Sustainable Development.

With regards to ethnicity, Malaysian companies are operated in a markedly multi-racial environment. Statistically, the population is dominated by the

Bumiputera[2] or Malays and is followed with Chinese and others[3]. This unique setting requires more diversity in terms of ethnic composition of the board members than other countries that are predominantly populated by one ethnic, for instance, the United States, the United Kingdom and Hong Kong. The issue of ethnic composition can be seen as a more contentious issue since the issuance of National Economic Policy (NEP)[4] which stresses on the Malays and other indigenous rights on the country's economy, for instance, Malays dominate the country's politic and population while Chinese controls the business transaction. Rachagan, Marshall, Poon and Satkunasingam (2015) documented that albeit Malaysia is an ethnically diverse country, business has often been run and operated within ethnic and kinship groups (i.e. family owned Chinese companies). The researchers also noted that the appointment of Malays as the directors provide the advantage of having political benefits, particularly on their political connections. Moreover, the researchers suggested that Malaysian situation is made more complicated by the political environment in which there is strong policy support for Bumiputra economic participation and strong patronage networks. Hence, the mixture of multi-racial community in Malaysia delivers an exclusive research environment and setting that is not comparable with other countries.

Despite the abovementioned unique characteristics, Amran et al. (2014) reported that Malaysia is nowhere near to its goal since the female representation of directors in companies is only at 8.34 per cent. In addition, Malaysia is experiencing ethnic homogeneity issues in the boardroom (Abdullah, Ku Ismail, & Nachum, 2016)

---

[2] Bumiputera literally mean "the son of the soil". It also includes Orang Asli (the aborigines) and other indigenous ethnics, such as the indigenous natives from Sabah and Sarawak.
[3] To be precise, the percentage of population as at 2010 is 67.4% for Bumiputera, 26% for Chinese, 7% for others. Source taken from https://www.dosm.gov.my.
[4] The NEP issued by the Malaysia government with the effort to appease the 1969 racial tensions (between Chinese and Malays)

which is probably due to the strong homophily tendencies in East Asia which include Malaysia itself. Moreover, Cheong and Sinnakkannu (2014) deem corporate Malaysia is still be divided along racial lines despite Malaysians have been propagating the reduction of racial boundaries. Hence, this shows that Malaysia companies are still averse to challenge the status quo in appointing the board members.

The concern of appointing homogeneous line of directors indicates resistance to change the status quo and is still an on-going concern. Prior studies encourage higher diversity in boardroom as it brings up the company performance. For instance, gender diversity and ethnic diversity are able to lead to superior financial performance (Cheong & Sinnakkannu, 2014; Julizaerma & Sori, 2012; Lee-kuen, Sok-gee, & Zainudin, 2017; Marimuthu, 2008). Knowing the significant role of heterogeneous directors, now is the best time to promote heterogeneity in board to steer companies away from the tired status quo. Hence, companies are encouraged to enhance their boardroom with diverse board diversity attributes (Hafsi & Turgut, 2013).

Another strand of this study is to investigate the consequence of earnings management. Earnings management has been known to be the mechanism that negatively influenced financial performance (Ching, Teh, San, & Hoe, 2015; Gill, Biger, Mand, & Mathur, 2013), value relevance (Mostafa, 2017; Shan, 2015) and reputation (Martínez-Ferrero, Rodriguez-Ariza Manuel, & Bermejo-Sánchez, 2016; Zahra, Priem, & Rasheed, 2005). Based on these detrimental effects, companies tend to search for a technique and in accordance with stakeholder theory and legitimacy theory, prior studies reported that corporate social responsibility (CSR) could fix and ameliorate their affliction caused by earnings management. Zain and Janggu (2006) suggest that CSR facilitates companies to achieve balanced sustainability elements apart from serving as an effective mechanism to satisfy the stakeholders' expectation. From the same token, CSR helps to improve a company's financial performance, image and reputation as well as competitive advantage and valuation (Amran & Abdul Khalid, 2009; Kahreh, Babania, Tive, & Mehdi, 2014; Saleh, Zulkifli, & Muhamad, 2010). As a result, CSR can be used as a means of improving the affected companies.

Building upon these advantages of CSR, Malaysia encourages companies to be more socially responsible by issuing several incentives. In the year 2010, Bursa Malaysia launched a comprehensive framework for the public listed companies (PLCs) as guide for sustainability reporting. Since Bursa Malaysia has always been the advocate for sustainability, it has recently developed a Sustainability Reporting Guide for assisting the PLCs to improve their sustainability-related reporting that meet the needs of various stakeholders. Since then, numerous efforts by the regulators have been established to encourage more CSR engagement by Malaysian companies. However, CSR in Malaysia is still infancy and relatively in development despite being part of the government agenda. Likewise, in terms of reporting, Sadou et al. (2017) reported that the extent and quality of CSR disclosure fails to achieve a high level of quality.

Unfortunately, in recent time, CSR has been used in multiple formations albeit its benefits. Contradicting prior findings that showed positive effects of CSR, it was revealed that CSR can also be used opportunistically; for instance, as a green washing tool whereby the management provides a positive impression of their overall environmental performance with the intention of misleading the stakeholders from their actual operations that are opposite to the announced initiatives (Bowen &

Aragon-Correa, 2014). For instance, palm oil businesses in Malaysia received unequivocal allegations regarding their extension of palm oil plantation. Some of the allegations are affecting the survival of the animal and plant species, pollutions, practicing child labour and forced labour and other adverse effects. Hence, palm oil businesses are in high inclination to improve their environmental disclosure (Othman & Ameer, 2010).

Ultimately, there are still some other egregious CSR motivations where the focus of this study is to scrutinise CSR as the consequence of earnings management, by which the management is committed to practicing CSR by misusing it to reinforce the entrenchment strategy (Cespa & Cestone, 2007; Martinez-Ferrero, Rodriguez-Ariza, & Garcia-Sanchez, 2016; Prior, Surroca, & Tribó, 2008; Surroca & Tribo, 2008). This strategic approach is proven to be misused by irrational managers in developed countries and the notion behind this approach is that this opportunistic motivation is deliberately conducted by irrational managers to mislead stakeholders from detecting their opportunistic managerial discretion and gain the stakeholders' support (Cespa & Cestone, 2007; Choi, Lee, & Park, 2013; Prior et al., 2008). This issue of misusing CSR is less likely to be investigated in developing countries which motivate this study to delve into.

Following to the relationship between earnings management and CSR, this study would like to introduce a moderating variable that is believed to be able to moderate the respective relationship. Corporate reputation has been chosen as the moderator with the notion of strengthening the relationship between earnings management and CSR due to the pressure of sustaining and protecting the present reputation of the reputable companies.

Dechow, Ge and Schrand (2010) highlight that most of empirical studies examined earnings management subject on either its antecedents (similar to determinants and causes) or consequences (similar to outcomes) of earnings quality. The researchers regarded earnings quality and earnings management as the two sides of the same coin with the rationalization of earnings management erodes earnings quality. Additionally, they encourage future academician and researcher to execute a complete path research by which a study that examines both sides, particularly the antecedents and consequence of earnings quality. This type of research offers deeper and holistic insights that are unavailable on a partial research. Building on this proposal, this current research leverages and responds the researchers' suggestions. Therefore, board diversity serves as the antecedent of earnings management and CSR as the consequence of earnings management.

1.2 Problem Statement

Issues in corporate governance have been the interest of many researchers from various disciplines since many years (Al-Dhamari & Ku Ismail, 2014; Amran, Lee, & Devi, 2014; Carter et al., 2003; Haniffa & Cooke, 2002; Jo & Harjoto, 2011; Xie, Davidson, & Dadalt, 2003). This interest is due to various issues that persist which require continuous effort to find the best formula for better governance. One of the issues that require strong governance is earnings management. Further, earnings management has been accepted to be included as part of various untruthful actions. As discussed in previous sections, few cases of earnings management in Malaysia give the sense of urgency in conducting this research. Hosseini, Chalestori, Hi, & Ebrahimi (2016) concede by indicating that conducting this kind of research on earnings management could provide a higher quality of understanding for the capital market participants and insider's decision making process (i.e. shareholders, investors, regulators, social and environmental activists and consumers).

Earnings quality is expected to be improved across time due to the introduction of several initiatives affiliated to corporate governance. In respect to earnings management, the effectiveness of corporate governance especially on board of directors is still being questioned as reported earning is still reported to be low in quality (indicated higher earnings management) (Al-Rassas & Kamardin, 2015; Mohamad, Rashid, & Shawtari, 2012; Wan Mohammad, Wasiuzzaman, & Nik Salleh, 2016) due to the incapacity of the directors in constraining earnings management. Besides, investors continue to have reservations and are less confidents in regards to the boards' ability to enhance the quality of earnings although efforts have been made by the Malaysian regulators to reform corporate governance following the Asian financial crisis (Al-Dhamari & Ku Ismail, 2014). The researchers further explained that investors rely on information of the directors to assess the reported earnings but unfortunately the research found that the directors failed to do so. The findings indicate a need to revisit the revised corporate governance regulation in the near future to restore investors' confidence regarding reported earnings. Hence, this study attempts to renew the interest on corporate governance mechanism, specifically into leveraging the advantage of board diversity in addressing the governance issue of which represented by earnings management.

Stimulated with the approach of board diversity by Hafsi and Turgut (2013), this study implies board diversity in two dimensions. On one hand, structural board diversity attributes (namely board leadership, multiple directorships, board size and non-executive directors' commitment) as diversity-of-boards, while on the other hand, demographic board diversity attributes (namely gender, age, ethnic, competency and nationality) as diversity-in-boards. As the nature of both diversity-of-boards and diversity-in-boards are intertwined and tested in a study, a comprehensive and holistic discussion and insights on board's efficiency and effectiveness can be acquired.

The effectiveness of the board has raised discourse in several parties and thus, this study would like to prove as to whether this controlling mechanism could serve its duties. Agency theorists (Fama & Jensen, 1983; Jensen & Meckling, 1976) suggest that structural attributes or diversity-of-boards can be used to establish superior monitoring and control mechanism that minimise agency cost and may affect earnings management. It is also reported that diversity-in-boards (specifically demographic board diversity) can be an instrument to enhance its overall problem-solving capacity (Becker, 1964) and enhance the extent of moral or ethical development of a company (Labelle, Gargouri, & Francoeur, 2010). The effectiveness of board requires diversity of knowledge, competencies, work experience and functional background. As such, those values are often included in the board of directors selection process (Miller & Triana, 2009). Justified from the diversity advantages, this study aims to provide empirical evidence as to whether diversified or heterogeneous boards have a significant effect on earning management.

The research into earnings management has usually involved the identification of its determinants, controlling mechanism and the environmental conditions that influence its occurrence, which also known as the antecedent variables. Hence, this study selected board diversity as the antecedent of earnings management due to its ability in influencing the occurrence of earnings management. Known as the corporate governance mechanism that supposedly alleviates earnings management, it is practical to select board diversity and investigate whether it can effectively mitigate earnings management, be the cause of the occurrence or may be no response. Following to that, due to the occurrence of earnings management, it could also leads to CSR. Being the variable for the consequence of earnings management, this study would like to ratify in Malaysian context whether the increment of CSR was due to earnings management.

Traditionally, prior studies reported that CSR has been known to be beneficial for companies (improved performance and reputation). Therefore, companies are contending with each other to appear as socially responsible companies. However, academic research has also burgeoned with the issue of misuse of CSR against earnings management that serves as the managerial entrenchment. In relation to the underlying agency problem in earnings management, irrational managers may opt for overinvestment and increase the financial resources allocated to social and environmental concessions, namely, CSR as a hedging strategy against any disciplinary initiatives (Prior et al., 2008; Surroca & Tribo, 2008) and unfavourable media coverage.

Cespa and Cestone (2007) firstly denote that managers resort to more CSR engagements as this way may satisfy their stakeholders' demand and expectation which could appease the negative reactions to the perceived earnings management that resulted from the agency conflict of interest. CSR can be promoted as a means of building trust and cooperative relationships with stakeholders whom manage and control key resources that hold the longevity of a company (Prior et al., 2008), allow managers to reinforce their job security (Shleifer & Vishny, 1989) and protect from costly media boycotts and stakeholders activism since the stakeholders' demand have been satisfied with social and environmental concessions (Cespa & Cestone, 2007). Other than the issue of abusing CSR, practicing managerial entrenchment is also deemed to be harmful to the shareholders since the incumbent managers expropriated shareholders' power and control and transferred it to them. Hence, managerial entrenchment remains as another agency cost arising from the earlier agency conflict aroused between the managers and shareholders.

The association between earnings management and CSR has been studied mostly in the developed countries and the results are inconclusive. Previous studies reported that the positive relationship occurred when earnings management misused CSR as entrenchment mechanism and negative relationship occurred when companies practices or reports high CSR were less likely to involve in earnings management. Some of other underlying factors that also caused mixed results are the different business environment between developed countries and developing countries and also the different measurement for earnings management and CSR. Other than the Modified Jones model, prior studies used several other measurements for discretionary accruals, which is the proxy for earnings management. Dissimilar from previous studies, this study uses quality of CSR disclosure to capture the level of CSR in Malaysia which offers a more detailed measure. Nonetheless, this study expects other plausible variable that could explain the mixed results. Therefore, this study invests to examine a potential moderating variable; which is corporate reputation.

Companies can be either good reputation company or bad reputation company. According to Schwartz (2008), a good reputation company means it is profitable and fit for doing business, always strive to meet the aspirations of its many stakeholders, doing business with high integrity, honest, ethical, uncompromising about values and principal and always in tune with society. Likewise, Othman, Darus and Arshad (2011), a good reputation company is when it has done good community services or has obtained several recognition and certification on its products and services. In addition, socially reputed companies are referred to those companies that received award or certification in various category related to CSR (Kansal, Joshi, & Batra, 2014). On the other hand, bad reputation company can be classified as company that involved with controversial industry that produce products and services harmful to human being, society and environment (Cai, Hoje, & Carrie, 2012). Knowing the importance of corporate reputation, both poor and good reputable companies practice numerous CSR activities as it is deemed to be an important device to fix poor reputation (Guillamón-Saorín et al., 2017) and sustain good reputation (Kansal et al., 2014).

However, reputable companies, primarily, are much more obligated to be socially responsible as they receive more scrutiny from the stakeholders and even the public. It is also proven that those socially reputed companies are more prone to invest their CSR budget and report higher CSR disclosure to maintain and enhance their good reputation (Kansal et al., 2014). This is because those reputable companies are in the spotlight of multiple stakeholders, far more visible and most likely to be noticed when they did something controversial (earnings management as an example) or other misconduct. Besides, all news media and public are watching them and they tend to receive stricter treatment by the public. Fear that earnings management could destroy their reputation (Martinez-Ferrero et al., 2016), these companies shall increase their CSR to safeguard their reputation due to the harmful effect of earnings management. On this basis, corporate reputation can be a factor of moderation by strengthening the relationship between earnings management and CSR.

In summing up, studies in earnings management realm showcase equal distribution of importance in terms of its antecedent and consequences. This is because numerous studies have been diligently scrutinising both sides, either separately or simultaneously since many years ago. Hence, by incorporating both sides in one study can exhibits comprehensive coverage of knowledge.

1.3 Research Questions

This study investigates the antecedent and consequence of earnings management by addressing the following questions:

1. Do the attributes of diversity-of-boards (board leadership, multiple directorships, board size and non-executive directors commitment) affect earnings management?
2. Do the attributes of diversity-in-boards (gender, age, ethnicity, nationality and competency) influence earnings management?
3. Is earnings management associated with CSR?
4. Does corporate reputation moderate the relationship between earnings management and CSR?

1.4 Research Objectives

This study has four research objectives. The objectives are as follows:

1. To determine whether diversity-of-boards attributes (board leadership, multiple directorships, board size and non-executive directors commitment) affect earnings management.
2. To examine whether diversity-in-boards attributes (gender, age, ethnicity, nationality and competency) influence earnings management.

3. To investigate the association between earnings management and CSR.
4. To determine whether corporates reputation has a moderating effect on the relationship between earnings management and CSR.

1.5 Malaysian Institutional Setting

Malaysia is an appropriate and interesting setting to explore the antecedents and consequence of earnings management. In this section, an overview of Malaysian institutional setting is firstly introduced.

The Malaysian business environment, especially trading and commerce, originally followed the Great Britain economic system. This country was originally known as Malaya and gained its independence in the year 1957. Immediately after its independence, Malaysia boarded on a plan of rapid industrialisation and formulated its first Industrialisation Strategy in the 1970s. The diversification and industrialisation of the country's economy were the main focus of this strategy (Siddiquee, 2006).

Upon setting the government policy agenda in Malaysia, social considerations have played a significant role. The Malaysian population consists of two main groups known as Bumiputera and non Bumiputera. The indigenous people, the Malay, are called the Bumiputera whilst the others are known as the non Bumiputera. Malaysia is highly diversified in terms of ethnicity whereby it also comprises of three main ethnic groups which are the Malay, Chinese and Indian. These multiracial attributes provide multiple inherent economic backgrounds and cultures that impacted the business environment and operation.

Malaysia is known as a country with multicultural country with diverse ethnicity that practices different cultural values and religious beliefs. Historically, three main ethnic groups were involved in different levels of economy back then. Traditional agricultural sector ran by the Malays were considered irrelevant to foster in the British colonial economy which hindered the Malays to grow economically (Williams, 2007). Instead, the British opted to use cheap labours from China and India to uphold more profitable exports industries.

Aspired to alleviate the poor judgment of economy stability with regards to race capability, the Malaysian government enforced a policy named the New Economic Policy (NEP) from the year 1970 until 1990 and the National Development Policy (NDP) from 1991 to 2000. The NEP can be seen as a form of government involvement in answering the 1969 ethnic rampaging with the intention of eliminating the identification of race using economic functions (Johnson & Mitton, 2003). This effort has promoted a 30% increase in the Bumiputera ownership of the corporate sector by the year 1990. Since then, the Bumiputera have been given priority for various businesses including several subsidies, business deals and capital access (Johnson & Mitton, 2003). The effectiveness of these policies led to the increase in the corporate sector that is positively linked to business and politics in Malaysia (Economic Planning Unit, 2017). The Malaysian government then introduced the NDP but is unfortunately still deemed as a pro-Malay policy, or what Torii (1997) calls "ethnicity-oriented" despite the differences in priorities and strategy between these two policy instruments.

Tracing the history of the Malaysian economy, it is essential to indicate that having a multi-racial environment has affected the economy and this issue is still being discussed until today. The next section converses the significant attributes that designated Malaysia as the most appropriate avenue to use in this study.

1.5.1 Diversity in Malaysia Boardroom

The inclusion of women and ethnic minorities on corporate boards is an emerging issue in corporate governance. Other than Malaysia, several countries (such as Belgium, Brazil, Italy and others) have introduced or in the process of forming a requirement with regards to mandatory gender quota in the boardroom (Gyapong, Monem, & Hu, 2016). With regards to some encouragements carried by the Malaysia government in promoting diversity in the board of director members, the two minority demographic attributes are reviewed. Other than their substantial influence on Malaysia, these two demographic attributes are believed to be important for promoting diversity in the boardroom as they are included in the letter dated 22 July 2014 ("Letter") promulgated by Bursa Malaysia Berhad, clarified that PLCs is required to disclose its board of directors and workforce diversity policy in terms of gender, age and ethnicity in the annual reports that issued on or after 2 January 2015 as part of the enhanced disclosure requirements to Paragraph 15.08A of the Main Market Listing Requirements of Bursa Malaysia Securities Berhad. This serves to complement the various initiatives launched to inculcate diversity in the boardroom and workplace.

1.5.1(a) Gender Diversity

The poor representation of women in board indicates a major issue in Malaysia. The Woman, Family and Social Development Department (MWFSD) reported that in 2010, women constituted almost half of the population in Malaysia and made up 47.3 per cent of the workforce. Following to that, the government optimisms to increase the percentage to 55 per cent (The Star, 2011b). In promoting women's role and participation on board, the government has regulated a policy that the board must comprise at least 30 per cent of females in decision-making positions and listed companies had until 2016 to adhere such policy (The Star, 2011a). In a recent study, Amran et al. (2014) found that 8.34 per cent of the total seats of the board were occupied by female directors which is only a mere 1 per cent increase from the 2008 study, 7.7 per cent. This can indicate that Malaysian companies still have a long way to fulfil the 30 per cent board seats allocated for women. Hence, this study may provide some empirical evidence that shows a more diverse board in terms of gender diversity can improve the effectiveness of governance.

1.5.1(b) Ethnic Diversity

Ethnic diversity has been found to influence Malaysian economic and corporate governance (Abdullah & Ku Ismail, 2013; Ayoib & Nosakhare, 2015; Haniffa & Cooke, 2005). In Malaysia, the Department of Statistics reveals that the current population estimation from 2014 to 2016 comprises predominantly of Malays, Chinese and Indian. Referring to the business environment, the Malays dominate the country's politic and population, while the Chinese controls Malaysia's business transaction. In addition to the NEP and NDP, Bursa Malaysia has legislated that Bumiputera should hold 30 per cent equity ownership in any listed company. This continuous formulation is to strengthen the cultivation of Bumiputera participation (Marimuthu, 2010). However, as of 30th June 2015, Bumiputera-controlled PLCs accounted for only 17.4 per cent of market capitalisation on Bursa Malaysia. The formulation effectively increases the Bumiputera equity holding in the capital market (specifically rose 31 per cent from the year 2014) despite of the low percentage (The Star, 2015).

Rachagan et al. (2015) documented that the appointment of Malays as the directors provide political benefits that are consistent with policies targeted at increasing the level of importance of the Malays in business environment. Yet, the researchers suggested that this diversity is underutilised. A low ethnic diversification in board may not exhibit a culture of open-mindedness that hinders knowledge creation since directors with different ethnic backgrounds could contribute their knowledge and understanding especially to companies that are dispersed in different regions worldwide. Hence, this study is crucial to provide a stand for the policy-makers and regulators to enhance and improve ethnic diversity among board members.

Gender and ethnic diversity are the two elements that are substantial for Malaysia as the regulators have been putting much effort in promoting gender diversity as Malaysia is known as a multi-racial country. Build upon the above discussion, Malaysia can be a unique platform that substantial for this study's contribution in knowledge. Hence, this study conforms to Malaysia institutional setting by which encouraging and searching for better and superior corporate governance mechanism along with asserting companies to truthfully contribute to the society and environment.

1.6 Significance of the Study

This study contributes to the body of knowledge in earnings management by providing new awareness on board diversity attributes roles as the antecedents and CSR as the consequence of earning management in a developing country.

1.6.1 Theoretical Contributions

Most prior studies focus on specific attributes concerning board diversity, either the demographic or structural attributes of the directors despite of apparent widespread support for board diversity. In response, this study examines both dimensions, by separating the nature of the diversity, namely, diversity-of-boards (board leadership, multiple directorships, board size and non-executive directors commitment) and diversity-in-boards (gender, age, ethnicity, competency and nationality). Moreover, this study extends the findings of prior studies by not only incorporating the most common theory which is agency theory to scrutinise the association of board diversity and earnings management. Human capital theory is also incorporated to fortify the former theory.

Furthermore, this study may add another view to the literature by explaining the issue of managers using CSR as the entrenchment strategy using stakeholder-agency theory and signalling theory. This misuse of CSR realm is still limited especially in developing countries. Thus, this study fills the gap in the Malaysia literature.

Corporate reputation is also incorporated as the moderating variable in this study. This is done mainly due to its ability to affect the relationship between earnings management and CSR by which CSR will be practiced and engaged more aggressively by the irrational managers to safeguard their position and the companies' reputation. Hence, in accordance to legitimacy theory, corporate reputation is believed to could moderate the respective relationship.

Lastly, this study will serve as a study that takes into account both the antecedent and consequence of earnings management whereby it entails the corporate governance effects on earnings management and earnings management effects on CSR. This type of research is still limited as stated by Dechow et al. (2010).

1.6.2 Practical Contributions

The outcomes of this study on board diversity are valuable for the regulators and accounting standard-setting bodies in drawing superior policies for the board of directors as Malaysia has been working towards the attainment of an enriched corporate governance practice through effective board governance. The requirements for the board of directors' selection and corporate governance are still loose. Apart from the directors' monitoring role, this study offers empirical evidence and aims to promote a heterogeneous line of board members that possesses diverse attributes which appear to be significant in today's business environment. This study specifically intents to validate that diversity-of-boards and diversity-in-boards as it may improve the governance among Malaysian companies.

Moreover, the empirical findings of this study may shed light for the investors, analysts and researchers to better understand how the board of directors' diversity affects earnings management and how CSR is being exploited by irrational managers.

This study is also substantial for the investors to also pay much attention to socially responsible companies as they also have the possibility of not providing transparent reporting. Policymakers only seem to encourage companies to engage and report more CSR activities instead of motivating the desired behaviour and reporting quality disclosure which could provide more incentives for the managers to utilise CSR for opportunistic actions or as an entrenchment mechanism.

1.6.3 Methodological Contribution

This current study classifies board diversity in two terms which are diversity-of-boards and diversity in-boards. While the former will be measured using binary and ratio scale data as most prior studies employed, the latter will be measured using Blau's Index of diversity. The rationalisations for using Blau's Index of diversity are that it has been suggested as an optimal measure of diversity to capture variance within a group of people and a suitable measure of diversity for categorical variables. Therefore, this measurement meets the criteria of this study that contain categorical variables in the interest of examining the impact of board heterogeneity on earnings management which differ from prior studies, especially in Malaysia that have only looked into the ratio, percentage or proportion of a variable.

1.7 Scope of the Study

The study concentrates on the issue of earnings management occurring in Malaysia PLCs by examining its antecedent and consequence. Therefore, this study considers board diversity as the antecedent (specifically as the corporate governance mechanism) that could have a bearing on earnings management, while also considering the function of CSR to conceal earnings management practices. Malaysia is chosen as the country of the study because of its lower earnings quality caused by board of directors' incapacity that led to investors' reservations and the on-going improvements made by the regulators in enhancing corporate reporting environments. Moreover, the issue of CSR being the consequence of earnings management has been receiving immense attention by the developed countries. Since the two elements which are the earnings management and CSR are commonly carried out by companies in Malaysia, CSR being misused against earnings