THE IMPACT OF CORPORATE GOVERNANCE AND AUDIT ASSURANCE ON ACCOUNTING CONSERVATISM IN MALAYSIA: THE MODERATING ROLE OF MANAGEMENT RISK DISCLOSURE

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by

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LIST OF ABBREVIATIONS

CGM	Corporate Governance Mechanisms
AA	Audit Assurance
MRD	Management Risk Disclosure
AC	Accounting Conservatism
TH	Lembaga Tabung Haji
IMDB	1Malaysia Development Berhad
MCCG	Malaysian Code on Corporate Governance
IAASB	International Auditing and Assurance Standards Board
KAMs	Key Audit Matters
MIA	Malaysian Institute of Accountants
GAAP	Generally Accepted Accounting Principles
FASB	Financial Accounting Standard Board
ISA	International Standard on Auditing
MCO	Movement Control Order
IASB	International Accounting Standard Board
MICPA	Malaysian Institute of Certified Public Accountants

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KESAN TADBIR URUS KORPORAT DAN JAMINAN AUDIT TERHADAP KONSERVATISME PERAKAUNAN DI MALAYSIA: PERANAN PENYEDERHANAAN PENZAHIRAN PENGURUSAN RISIKO

ABSTRAK

Kajian ini meneliti kesan tadbir urus korporat dan jaminan audit terhadap kualiti pelaporan kewangan dengan menggunakan konservatisme perakaunan sebagai petunjuk utama. Kajian ini mencadangkan bahawa tadbir urus korporat meningkatkan kualiti pelaporan dengan menggalakkan konservatisme, dan penzahiran risiko yang lebih baik dapat memperkukuhkan hubungan tersebut. Begitu juga, juruaudit luar dijangka memberikan jaminan yang lebih kukuh melalui pendedahan '*Key Audit Matters'(KAMs)*, yang dapat meningkatkan komunikasi mengenai penemuan audit yang signifikan. Model penyelidikan yang dibangunkan merangkumi enam pemboleh ubah bebas utama berkaitan dengan mekanisme tadbir urus korporat: kebebasan lembaga pengarah, kebebasan jawatankuasa audit, dwifungsi CEO, pelbagai keanggotaan lembaga pengarah, tumpuan pegangan saham, dan metrik lembaga pengarah. Jaminan audit diukur melalui KAM, manakala penzahiran risiko pengurusan bertindak sebagai pemboleh ubah penyederhana. Pemboleh ubah bersandar, iaitu konservatisme perakaunan, diukur menggunakan proksi kewangan ('C-Score') yang diperkenalkan oleh Khan and Watts (2009). Dengan menggunakan pendekatan kuantitatif melalui analisis regresi berganda, data daripada 736 firma tersenarai di Bursa Malaysia bagi tahun kewangan 2020 telah dianalisis untuk meneliti kesan pandemik COVID-19. Dapatan kajian menunjukkan hubungan positif di antara kebebasan lembaga pengarah, metrik lembaga pengarah, dan konservatisme

perakaunan. Ini membuktikan bahawa ciri-ciri tadbir urus tersebut telah menggalakkan konservatisme perakauan yang lebih tinggi sepanjang pandemik. Sebaliknya, kesan signifikan tidak ditemui bagi jaminan audit melalui KAM, ini menandakan cabaran yang dihadapi oleh juruaudit untuk menggalakkan pendekatan konservatif ketika krisis. Kajian ini juga mendapati bahawa penzahiran risiko pengurusan menyederhanakan hubungan antara kebebasan lembaga pengarah dan konservatisme perakaunan, menunjukkan bahawa komunikasi risiko yang jelas dan telus adalah penting dalam tempoh ketidaktentuan ekonomi. Dari segi teori, kajian ini menyumbang kepada Teori 'Stewardship' dengan menunjukkan keadaan di mana pengurus bertindak sebagai penjaga kepentingan pemegang saham melalui pelaporan konservatif, serta kepada Teori Agensi dengan membuktikan bagaimana mekanisme tadbir urus dan penzahiran pengurusan risiko dapat mengurangkan asimetri maklumat dan tingkah laku mementingkan diri. Dapatan ini juga mempunyai implikasi praktikal kepada pengawal selia, pengamal, dan pembuat dasar yang komited untuk meningkatkan ketelusan dan akauntabiliti pelaporan kewangan, khususnya semasa krisis, bagi mempromosikan kestabilan pasaran modal.

THE IMPACT OF CORPORATE GOVERNANCE AND AUDIT ASSURANCE ON ACCOUNTING CONSERVATISM IN MALAYSIA: THE MODERATING ROLE OF MANAGEMENT RISK DISCLOSURE

ABSTRACT

This study examines the impact of corporate governance and audit assurance on the quality of financial reporting, using accounting conservatism as a key indicator. It is proposed that corporate governance improves reporting quality by promoting conservatism, and that enhanced risk disclosures strengthen this link. Similarly, external auditors are expected to provide stronger assurance through the disclosure of Key Audit Matters (KAMs), which improves communication of significant audit findings. The research model developed includes six key independent variables related to corporate governance mechanisms: board independence, audit committee independence, CEO duality, multiple directorships, ownership concentration, and board metrics. Audit assurance is measured through KAMs, while management risk disclosure serves as a moderating variable. The dependent variable, accounting conservatism, is measured using the financial proxy (C-Score) introduced by Khan and Watts (2009). Using a quantitative approach with multiple regression analysis, data were analyzed from 736 firms listed on Bursa Malaysia for the financial year 2020 to capture the effects of the COVID-19 pandemic. The results show a positive relationship between board independence, board metrics, and accounting conservatism. This suggests that these governance attributes promoted greater conservatism during the pandemic. Conversely, a significant effect was not found for audit assurance via KAMs, indicating the challenges auditors faced in encouraging a conservative approach during the crisis. It was also established that management risk disclosure moderates the relationship between board independence and accounting conservatism, suggesting that clear and transparent risk communication is crucial during periods of economic uncertainty. Theoretically, this study contributes to Stewardship Theory by demonstrating the conditions under which managers act as stewards of shareholder interests through conservative reporting, and to Agency Theory by showing how governance mechanisms and disclosures mitigate information asymmetry and opportunistic behaviour. The findings also have practical implications for regulators, practitioners, and policymakers dedicated to improving the transparency and accountability of financial reporting, particularly during crises, to promote market stability.

CHAPTER 1

INTRODUCTION

1.1 Introduction

In the capital markets, high quality financial reporting is essential for providing reliable and credible information to stakeholders, enabling them to make informed decisions and evaluate corporate performance. Conversely, a lack of transparency and poor reporting quality can impair a firm's economic performance (Mohammed, Ahmed, & Ji, 2017). Misleading financial information can adversely affect the judgments of investors and other stakeholders. Despite the lessons that should have been learned from a series of high-profile financial scandals, including those involving Enron, WorldCom, Bernie Madoff, AIG, Lehman Brothers, and Transmile, the recurrence of such events continues to undermine market integrity and investor confidence.

1.2 Background of the Study

Contemporary corporate financial scandals in Malaysia, such as those involving 1MDB, Kenmark Industrial, Axis Inc, Linear Corp, and Lembaga Tabung Haji, highlight the questionable credibility of financial reporting in both developed and developing economies. These cases have severely eroded investor confidence in the transparency and reliability of financial reporting.

In 2018, the Malaysian government revealed that Lembaga Tabung Haji (TH), a pilgrims fund board, had been engaging in unlawful dividend distributions since

2014. Practically, these distributions were made despite the institution's assets being less than its liabilities. This was a clear violation of both financial and Islamic accounting principles as the fund was operating at a deficit, and therefore, the distributions were unlawful. A review by PwC confirmed a substantial asset shortfall of RM4.1 billion at the end of 2017, with liabilities of RM74.13 billion against assets of only RM70.3 billion. This deficit meant TH was using its capital or reserves to fund dividends, an unsustainable practice that masked its true financial state and raised serious questions about its accounting practices.

The 1MDB scandal illustrates how weak governance structures, compromised reporting quality, and constrained audit assurance can enable large-scale financial misstatement. Malaysia's Public Accounts Committee (PAC) and civil-society reports highlighted material failures in oversight and decision-making across 1MDB's advisory board, board of directors, and management, pointing to fundamental governance breakdowns (IDEAS, 2016; Transparency International Malaysia, 2016). In the audit domain, Ernst & Young refused to proceed without critical documentation and was removed in 2010. Similarly, KPMG declined to sign off the 2013 financials and was terminated, and in 2018 the firm advised 1MDB to disregard its previously audited accounts for the financial years 2010–2012. Deloitte, which later took over, resigned in 2016, noting that facts revealed in the U.S. Department of Justice (DOJ) complaint would have materially impacted the 2013–2014 audit reports (Malay Mail, 2016; The Edge Malaysia, 2016, 2018). These developments demonstrate that while statutory auditors did identify red flags, their capacity to enforce corrective action was limited, revealing weaknesses in audit assurance mechanisms.

International enforcement actions further confirmed the severity of reporting failures, with the U.S. DOJ estimating that over US$4.5 billion had been misappropriated, and more than US$1.4 billion subsequently repatriated to Malaysia (DOJ, 2021, 2025; Reuters, 2024). The scandal, which garnered international attention in 2015, also involved the alleged misappropriation of more than RM2.67 billion (approximately US$700 million) from the state-owned strategic development company. These funds, intended for national development projects, were instead allegedly diverted for personal enrichment, with international investigations tracing the money to the purchase of luxury properties, high-end art, and even the financing of a Hollywood film. This dimension of the scandal not only highlighted the scale of misappropriation but also reinforced how weak governance oversight, poor financial reporting quality, and limited audit enforcement capacity can facilitate large-scale financial misconduct.

These financial misconducts have had a significant impact on investor confidence, signaling that financial reporting in some Malaysian institutions may not accurately reflect their true financial position. This erosion of public trust underscores the urgent need for stronger financial governance and the application of principles such as accounting conservatism to prevent such misuse of funds and restore credibility (Karajian and Ullah, 2022; Wen, Li, Zhu, and Liu, 2021; Liang, Marinovic and Varas, 2017).

1.2.1 Accounting Conservatism: A Key to Reliable and Credible Financial Reporting

Conservatism is a Generally Accepted Accounting Principles (GAAP) principle and it is exceptionally beneficial because it seeks to standardise and regulate accounting terms, assumptions, and methods. The FASB views accounting conservatism as a competent approach to cope with uncertainty and to ensure that uncertainty and risks inherent in running a business are taken into account (Francis, Michas and Yu, 2013). Conservatism is one of the qualities required in a financial statement to ensure that it meets quality standards, which is the primary means of discharging accountability. Thus, management must monitor conservatism as one of the key aspects contributing to the high quality of financial reporting when preparing the financial statement. This concept is not primarily a theoretical concept but it is a practical way of ensuring the financial statements accurately reflect a cautious estimation and therefore prevent overstatement of assets or income.

Applying accounting conservatism helps reduce information asymmetry among stakeholders such as investors, auditors, and creditors. Reducing information asymmetry is essential for creating an environment of trust and transparency which is important for effective corporate governance. Conservative accounting and strong corporate governance can improve a company's investment performance and risk profile. Managers cannot inflate profits or net assets due to a high level of verifiability (Zhong and Li, 2017). Companies can ensure the reliability and verifiability of their financial statements by following conservative accounting standards, which help prevent over-optimistic financial reporting. Consequently, this improves the company's attractiveness to investors and its risk assessment, since stakeholders have a clearer picture of its financial position. Consistent with Solichah and Fachrurrozie (2019), it was found that companies use conservative accounting practices to prevent overly optimistic management and to generate third-party auditable financial statements.

Therefore, accounting conservatism is crucial for improving the reliability and credibility of financial reports, boosting investor confidence, and enhancing market efficiency by offering prudent financial estimations and minimizing the chances of unexpected negative surprises. This contributes to market efficiency by ensuring that security prices more accurately represent the economic reality of organizations.

1.2.2 Accountability with recommended corporate governance best practices

The financial crisis of 1997 was an important turning point for several Asian countries including Malaysia. The crisis emphasized the necessity of strong corporate governance to guarantee transparency, accountability, and integrity in the corporate sector. Malaysia, along with other countries, took steps to enhance its corporate governance structure in response to the financial crisis and its consequences. Malaysia's ongoing revisions to the MCCG demonstrate its dedication to upholding the highest standards of corporate governance. Malaysia strives to promote a corporate environment focused on transparency, accountability, and sustainability through ongoing code revisions that are essential for ensuring long-term economic growth and stability. These efforts not only aim to prevent another wave of financial crises but also to strengthen Malaysia's reputation as an investment hub.

In March 2000, the first Malaysia Code on Corporate Governance (MCCG) was introduced and considered as the first reform in Malaysia after taking into consideration the major financial crisis year 1997/98. A series of reforms in the MCCG 2007, 2012, 2017 and recently April, 2021 have been made to keep it relevant and consistent with internationally recognized best practices and standards. In 2017, the MCCG underwent a significant update that introduced a new approach to encourage the internalisation of corporate governance culture within organisations. This update highlighted the significance of key governance principles such as board leadership and effectiveness, risk management, and internal controls. The initiative focused on enhancing transparency as well as accountability by introducing the "CARE" concept (Comprehend, Apply, Report, and Evaluate) to urge organisations to go beyond basic compliance and make real governance improvements. Prior studies (Haniffa & Hudaib, 2006; Che Haat, Abdul Rahman, & Mahenthiran, 2008) emphasised that transparency and accountability are central to restoring investor trust, particularly in emerging markets such as Malaysia, where weak governance was associated with earnings manipulation and reduced reporting quality. Recent studies (Hashim, 2020; Liao, San, & Tsang, 2024) show that MCCG reforms have improved board effectiveness and transparency, although enforcement and consistent implementation remain challenges.

The major revision on MCCG 2017 introduced substantial enhancements to elevate corporate governance requirements. As this study focuses on the 2020 sample, the 2017 revision is particularly relevant, as it was the prevailing benchmark during this period. Key focal points were: 1) Board Independence: Fostering the composition at least half of the board are among independence directors to ensure unbiased oversight and decision-making. 2) Emphasising the significance of having a fully independent Audit Committee to provide efficient financial monitoring and auditor independence. 3) CEO Duality: Recommending against one person serving as both the CEO and board chair to maintain a clear separation between governance and management responsibilities. 4) Multiple Directorship: Directors are advised to restrict their involvement in director roles in listed companies to ensure they can dedicate themselves completely to their duties. 5) Ownership Concentration and Board metric: Dealing with issues arising from ownership concentration and complex group structure such as managing conflicts of interest. 6) Broadening board responsibilities to include risk management, internal controls, and sustainable value creation.

The changes were intended to bring Malaysia's corporate governance in line with global standards, emphasising transparency, accountability, and sustainability to safeguard shareholder interests and improve trust and integrity in the capital market. The continuing effort to revise Code on Corporate Governance aims to strengthen and ensure that the board of directors and audit committees effectively fulfil their roles and responsibilities. Empirical evidence confirms that accountability mechanisms such as board independence, audit committee oversight, and separation of CEO duality reduce earnings management and improve reporting conservatism (Al-Hiyari et al., 2024; Fera, Pizzo, Vinciguerra, & Ricciardi, 2022; Bepari, Nahar, Mollik, & Azim, 2023).

Sound corporate governance aims to ensure that the company is managed in a way that promotes long-term growth, success, and profitability through effective, entrepreneurial, and responsible management. Effective corporate governance is believed to enhance information transparency and to offer valuable perspectives for executives, shareholders, and policymakers (Al-Hiyari, Kolsi, Lutfi, Shakkour, & aljumah, 2024).

Table 1.1 Focal Points of MCCG 2017 Shaping Corporate Governance Practices in 2020

Key Focal Points	**Explanation**
1. Board independence	Promoting a board composition where at least half of the members are independent directors to ensure objective and unbiased decision-making.
2. Audit Committee	Highlighting the need for a fully independent audit committee to enhance financial oversight and maintain auditor independence.
3. CEO Duality	Discouraging the same individual from serving as both the CEO and the chairperson of the board to maintain a clear separation of governance and management roles.
4. Multiple Directorship	Encouraging directors to limit their board memberships in listed companies to ensure adequate focus and commitment to their responsibilities.
5. Ownership Concentration and Board Metric	Addressing issues stemming from concentrated ownership and complex corporate structures by strengthening mechanisms to manage potential conflicts of interest.
6. Board Responsibilities	Expanding the board's role to encompass risk management, internal controls, and fostering sustainable value creation for long-term success.

Corporate Governance as per OECD Principles, Malaysian Code on Corporate Governance and Sarbanes-Oxley Act refers to the degree to which a company's governance structures and processes are implemented within the organization to promote transparency, accountability, and fairness in its operations and management. Good corporate governance ensures that company decisions and activities are in line with the interests of its stakeholders, such as shareholders, employees, consumers, and the community. It includes guidelines that regulate the interaction between management and shareholders with the objective of minimising conflicts of interest and promoting the long-term value creation.

In the context of modern corporate governance, the separation of ownership and management is a normal practice that separates shareholders from managerial duties and grants management the power to make day-to-day decisions for companies' successful operation. This separation ensures the long-term sustainability of the business by entrusting its management to a team of experts with diverse skills capable of running the company efficiently (Francois, 2020). Therefore, management and the board have the responsibility to discharge the accountability in line with the perspective of Stewardship Theory. The board and managers are accountable to the shareholders for the company's operations and corporate governance with regard to companies' objectives and the maximization of shareholder wealth by providing stakeholders with a fair, balanced, and understandable assessment of the organization's financial performance and prospects which depends on high-quality financial reporting. Recent literature highlights that accountability is closely linked to accounting conservatism, as timely loss recognition and transparent risk disclosure protect investors in uncertain environments (Elamer, Ntim, & Abdou, 2020; Bi, Ye, & Xu, 2024; Ma, Coram, & Troshani, 2024). The primary means by which they discharge this accountability is through the reported financial statements. To ensure the quality of financial statements, several principles must be applied in their preparation, and one of the most critical is accounting conservatism.

1.2.3 Enhancing External Audit Assurance via Key Audit Matters Disclosure

Financial statements must be approved by the Board of Directors (BOD) and audited by an external auditor. An external auditor, as an independent professional, is engaged to provide assurance on the credibility, reliability, and transparency of financial statements. The role of the external auditor is to give reasonable assurance to the public that the company's financial reports are prepared in compliance with accounting standards and provide a "true and fair" view of the company's financial position and performance. As a result, auditors indeed play a critical role in ensuring the quality of financial statements.

The IAASB has issued ISA No. 700 (Revised) “Forming an Opinion and Reporting on Financial Statements” (IAASB 2015, 2016). The most crucial part of ISA No. 700 is the documentation inside an auditor’s report known as Key Audit Matters (KAM). ISA 700 (Revised) has been adopted by the MIA as well as other modified auditing standards for implementation in Malaysia. ISA 701 Communicating Key Audit Matters in the Independent Auditor’s Report was published in April 2015 and amended in July 2018. As such, starting from December, 2016 auditors of public interest entities will be required to communicate major audit issues (KAMs) which arose out of the audit of financial statements. This was done in view of the fact that the auditor’s report is valuable to capital market participants (MIA 2018). Recent worldwide developments in external auditing reports demand companies to provide more information to enhance transparency and create confidence in their financial reporting, aiding stakeholders in making informed investment choices (Rahaman, Hossain, & Bhuiyan, 2023; Rautiainen, Saastamoinen, & Pajunen, 2021).

The objective of communicating major audit issues is to increase the value of the auditor's report as a communication tool by enhancing the audit's transparency. Audit reports now require KAMs according to the IAASB or else Critical Audit Matters (CAMs according to the PCAOB) to enhance audit transparency (Ferreira & Morais, 2020; Ma, Coram, & Troshani, 2024). By disclosing significant audit matters, users of financial statements are provided with additional insights that improve their understanding of the issues the auditor considers most important in the audit of the current period's financial accounts. The communication of information regarding critical audit matters could also help those that are expected to make use of the audited financial statements in comprehending the entity and aspects where management decisions are important (ISA 701 Para. A1–A4). Key Audit Matters (KAMs) represent the most significant issues identified by the auditor during the audit of the current period's financial accounts. The areas of substantial management judgment or board metric in the financial statements are emphasized to show where auditors focused their efforts or faced complicated accounting problems. KAMs provide a way to evaluate how corporate governance and audit assurance impact accounting conservatism by concentrating on crucial and potentially disputed areas.

Furthermore, identifying and revealing Key Audit Matters (KAMs) demonstrate the comprehensive nature of the audit process. Effective audits are expected to reveal more relevant and significant KAMs, which serve as an indicator of the degree of assurance provided. KAMs can therefore be used as a proxy for audit assurance quality in studies investigating the relationship between corporate governance, audit assurance, and accounting outcomes such as conservatism. Strong corporate governance mechanisms that promote transparency are associated with higher audit quality and tend to result in more conservative accounting practices (Fera, Pizzo, Vinciguerra, & Ricciardi, 2022). KAMs are a valuable method for strengthening the quality of financial reporting by minimising aggressive financial reporting behaviour. KAMs reporting has the potential to significantly reduce managers' opportunistic behaviour by playing a monitoring role (Bepari, Nahar, Mollik, & Azim, 2023).

Also, auditors through KAMs will provide insight into management risk disclosure practices as auditors will highlight how they dealt with important aspects of management judgment in the financial statements, such as risk assessments. This can offer useful insights into how management's risk disclosure is affected by corporate governance practices and the level of audit assurance. Companies with strong governance mechanisms are likely to offer transparent risk disclosures, which will be visible in the auditors' KAMs.

Ultimately, KAMs serve as a medium through which auditors communicate assurance-related information to shareholders and other stakeholders. The disclosure of KAMs functions as both a proxy and a means of communication from external auditors to users of financial statements. KAMs highlight areas that auditors consider critical to the company’s ability to continue as a going concern. Assessing these issues is particularly important in developing countries where financial reporting and audit quality have historically been weak, and the overall information environment is limited (Bepari, Nahar, & Mollik, 2024).

1.2.4 Strengthening corporate governance with Management Risk Disclosure

Accounting conservatism is improved through good corporate governance practices that are strengthened by comprehensive risk disclosure. The board and investors can make more accurate decisions as a result of the increased transparency and accountability that management provides by disclosing comprehensive information on risks. This greater awareness of a company's risks promotes financial stability and encourages a more conservative approach to accounting practices (Düsterhöft, Schiemann, & Walther, 2023; C. M. Kang & Kim, 2022). The main reason why management risk disclosures enhance transparency is that they represent the way in which an organization informs stakeholders about potential risks and uncertainties it encounters. This transparency allows stakeholders to appraise the company's corporate governance practices and the quality of its audit assurance. When organisations openly disclose their risks, it demonstrates an environment of accountability which is considered a key element of sound corporate governance. Consequently, investors, analysts, and shareholders can use the valuable risk-related information disclosed by management to make better-informed decisions. This enables them to better assess risks and improve decision-making. The level of transparency and disclosure is associated with reduced earnings manipulation (Abed, Hussin, Haddad, Al-Ramahi, & Ali, 2022). The COVID-19 pandemic leads to a significant increase in uncertainty and risk, which in turn weakens the impact of information transparency (Bi, Ye, & Xu, 2024). However, evidence also shows that companies prioritizing transparency can effectively communicate relevant and reliable information, thereby reducing the potential impact of information asymmetry on decision-making.

On top of that, risk disclosure prepared and presented by management can be utilized by the Board of Directors (BOD) as input to strengthen monitoring among board members. When management prepares high-quality risk disclosures, it reflects how they deal with risk, since such disclosures explain their strategies and approaches to managing risk. If the risk information is well presented and of high quality, it strengthens the relationship between effective monitoring (from a corporate governance perspective) and accounting conservatism. Strong corporate governance procedures are typically reflected in effective risk disclosure practices (Kalia & Gill, 2023). The methods involve monitoring by the board of directors, particularly through its audit committee, and the establishment of internal controls aimed at recognizing and handling risks. High-quality risk disclosure can indicate strong corporate governance, which is known to influence accounting conservatism. Companies with strong governance structures are likely to implement conservative accounting practices to safeguard the interests of stakeholders. Accounting conservatism captures company uncertainty through the timely recognition of negative news. Its connection to company risks suggests that managers may align reporting and disclosure choices with the risks faced by the firm. Stakeholders view this as an extremely important matter (Elamer, Ntim and Abdou, 2020). Management risk disclosures are essential because they provide important information that readers of financial statements can use to evaluate the degree of uncertainty that pertains to a company's potential future cash flows.

1.3 Motivation of the Study

In an era of rapid economic changes and increasing financial complexities, corporate governance and audit assurance play a crucial role in influencing the quality of financial reporting. However, the complex interactions between these factors and accounting conservatism, which is crucial for investor protection by ensuring cautious financial reporting, have not been thoroughly investigated. Therefore, to examine the impact of good corporate governance and audit assurance on accounting conservatism, this study investigates these relationships, with management risk disclosure serving as a moderating variable between corporate governance and accounting conservatism. This study focuses on the year 2020, which was significantly affected by the Covid-19 outbreak. By examining this critical period, the study aims to clarify how management risk disclosure affects the impact of governance mechanisms on accounting conservatism. This focus on the pandemic's impact provides unique insights into how these interactions may shift during times of economic uncertainty, offering valuable lessons for improving financial transparency and credibility. This research has implications beyond academia for regulators, practitioners, and policymakers committed to promoting stable, transparent, and trustworthy financial markets, given the increasing demands for corporate accountability and the importance of informed risk management in today’s volatile markets.

1.4 Problem Statement

Accounting conservatism among public companies has been well-documented in academic literature and is regarded as one dimension of financial reporting quality. In accounting, conservatism is an important component because it requires accountants to exercise a high level of verification and implement solutions that present the least aggressive numbers when uncertainty exists. Consequently, it is an important approach for limiting risk or uncertainty and enhancing information reliability. It is an accounting concept that has been in practice for many years and that seeks to protect users of financial information from overstating revenues and to make sure that all possible risks are taken into account from the first moment they are identified. Conservatism will lower the net income when it is applied in conditions characterized by uncertainty (Basu, 1997). This means that investors will be given the most conservative figure for net income, which may assist them in making better investment decisions compared to relying on overstated income figures.

However, the corporate financial scandals in Malaysia as stated in the background of study section, indicate that many corporations have violated the conservatism principle by inflating their financial reporting and concealing misconduct. This has occurred in both developed and developing markets. One notable case outside Malaysia is the Hin Leong Trading scandal in Singapore, where the oil trading giant collapsed in 2020 after concealing over US$3 billion in losses and inflating its assets and trade receivables. Investigations revealed that Hin Leong's management had consistently overstated inventory values and fabricated sales, which directly undermined the principle of accounting conservatism and exposed the vulnerability of corporate governance and audit oversight in privately-owned firms (PwC, 2020; Karajian and Ullah, 2022). According to a PricewaterhouseCoopers (PwC) report in the year 2020, Hin Leong inflated its assets by "astonishing" amount of more than US$3 billion. This has affected the principle of accounting conservatism and as a result, investors' confidence in the capital market, in general, and in firms' financial reports particularly, has been negatively affected (Karajian and Ullah, 2022; Wen, Li, Zhu, and Liu, 2021; Liang, Marinovic and Varas, 2017).

The case of Hin Leong bears strong similarities with Malaysia's 1MDB scandal, where weak governance frameworks, poor reporting quality, and inadequate audit enforcement mechanisms allowed massive financial misstatements to go undetected for years. In both cases, the absence of effective risk disclosures and strong board oversight compromised investor trust and highlighted the limitations of regulatory frameworks in preventing accounting manipulation. Even though accounting conservatism encourages managers to exercise their professional judgement, accounting values are nonetheless susceptible to manipulation. The financial scandals of corporations demonstrate a failure to discharge accountability.

As a response, various governance rules and regulations such as the Sarbanes Oxley Act in the US and the Malaysian Code on Corporate Governance in Malaysia have been enacted, sought to strengthen board independence, audit committee oversight, and risk management responsibilities. At the same time, audit reforms such as ISA 701 – Communicating Key Audit Matters (KAMs) were introduced to enhance transparency in auditor reporting and to provide users with insights on significant risks and judgments. Yet, despite these reforms, corporate misconduct and questionable reporting practices persist, raising critical doubts about whether governance structures and audit assurance mechanisms are functioning as intended. Numerous questions remain, despite the fact that Malaysian corporate governance regulations have undergone significant changes since 2000 and the latest revision is in year 2021. It is crucial to determine if recent corporate governance reforms have resulted in improvements in the quality of earnings (Liao, San, & Tsang, 2024) and the level of accounting conservatism in Malaysia and to assess whether; consistent with the expectation of regulators, the various governance reform programs and management risk disclosure have been effective in enhancing earnings quality under accounting conservatism.

Besides, in light of ISA 701 – Communicating Key Audit Matters effective on or after 15th December 2016 pertaining to the roles and responsibilities of external auditors, this study will further investigate the auditing assurance through KAMs that promote better accounting conservatism. KAMs are audit disclosures that require auditors to highlight areas of significant risk or judgment in their reports, thereby improving transparency for stakeholders. However, an important unresolved question is whether such disclosures genuinely influence managerial reporting behaviour towards more conservative accounting practices, or if they are treated as symbolic disclosures with little substantive impact in the Malaysian context. This study thus addresses the empirical question of the extent to which corporate governance and audit assurance (via KAMs) affect accounting conservatism. It is important to look into risk disclosure in improving the role of effective corporate governance and audit assurance through KAMs towards the accounting conservatism. Accordingly, this study focuses on two forms of monitoring that affect financial reporting: corporate governance as internal monitoring, moderated by risk disclosure, and KAMs as external monitoring/assurance, specifically within the Malaysian context, which is shaped by unique rules, codes of conduct, and practices distinct from those in developed markets, and by successive MCCG reforms.

The COVID-19 pandemic significantly disrupted the global and Malaysian corporate landscape, placing immense pressure on financial reporting integrity. This study is anchored in the context of the pandemic year 2020, which serves as a natural stress test for corporate governance, audit assurance, and financial reporting practices.

During such a crisis, the credibility and conservatism of financial information become even more crucial for stakeholders, particularly investors, regulators, and auditors. Despite heightened risks and economic uncertainty, incidents of earnings management and reporting manipulation continued to surface, revealing gaps in governance structures and audit effectiveness. This environment makes the study of accounting conservatism highly relevant, especially in assessing how governance and audit mechanisms perform under crisis conditions. The financial strain experienced by firms in 2020 heightens the urgency to examine whether the Malaysian Code on Corporate Governance (MCCG 2017) and audit standards, including the implementation of Key Audit Matters (KAMs), were effective in promoting conservative and transparent reporting.

The complex association among corporate governance mechanisms, audit assurance services towards accounting conservatism in field of corporate finance and governance is not fully understood, particularly about how management's risk disclosures affect these connections. There is a lack of empirical evidence analyzing the relationship between corporate governance, audit assurance, risk disclosure, and their impact on accounting conservatism, despite theoretical support for this relationship. The gap is prominent in several regulatory settings and industries, where the level of accounting conservatism and its influencing factors can greatly affect stakeholders' decision-making and confidence in financial reporting. Existing studies have not thoroughly examined how the quality and scope of risk disclosures by management could impact or change the expected outcomes of corporate governance and audit assurance.

This study intends to investigate how corporate governance and audit assurance processes impact accounting conservatism, with a specific focus on how management's risk disclosures moderate these effects. Understanding this is crucial for regulators, investors, and practitioners aiming to improve transparency, accountability, and risk management in corporate reporting.

1.5 Research Objectives

The reforms of the Malaysian Code on Corporate Governance in 2001, 2007, 2012, 2017 and 2021 highlighted that all listed companies should "maintain a sound system of internal control to safeguard shareholders' investments and the company's assets." It is expected that the quality of financial reporting among listed companies will be improved by disclosing the Statement of Risk Management and Internal Control, as well as policy reforms implemented by the Malaysian government to enhance corporate governance practices (i.e. MCCG). Investor confidence towards the reliability of financial reporting will continue to be strengthened by these developments. Therefore, the main objective of this study is to investigate the connection between corporate governance mechanisms and accounting conservatism among Malaysian listed companies, with risk disclosure serving as a moderating variable in the relationship between corporate governance mechanisms and accounting conservatism, and with audit assurance through Key Audit Matters (KAMs) examined for its impact on accounting conservatism.

In particular, this study focuses on five research objectives as below:

RO_1: To examine the effect of corporate governance mechanisms on accounting conservatism.

RO_2: To examine the influence of audit assurance (Key Audit Matters) on accounting conservatism.

RO_3: To examine the combined effect of corporate governance mechanisms and audit assurance on accounting conservatism.

RO_4: To examine the moderating effect of management risk disclosure on the relationship between corporate governance mechanisms and accounting conservatism.

RO_5: To examine the comprehensive influence of corporate governance mechanisms, audit assurance, management risk disclosure, and control variables on accounting conservatism.

1.6 Research Questions

Based on the research objectives, the specific research questions are as follows:

RQ_1: Do corporate governance mechanisms increase accounting conservatism among Malaysian public listed companies?

RQ_2: Does audit assurance through Key Audit Matters increase accounting conservatism among Malaysian public listed companies?

RQ_3: Does the combination of corporate governance mechanisms and audit assurance significantly influence accounting conservatism among Malaysian public listed companies?

RQ_4: Does management risk disclosure strengthen the relationship between corporate governance mechanisms and accounting conservatism?

RQ_5: Does the inclusion of corporate governance mechanisms, audit assurance, management risk disclosure, and control variables significantly influence accounting conservatism among Malaysian public listed companies?

1.7 Scope of the Study

In this study, accounting conservatism will be used as a benchmark to evaluate the quality of financial reporting. Two main areas that contribute to quality financial reporting will be discussed, namely corporate governance mechanisms and audit assurance services. Corporate governance refers to several mechanisms that are a core concern in the promulgation and updating of the Malaysian Code on Corporate Governance. Furthermore, with regard to audit assurance, this study focuses on the Key Audit Matters (KAMs) highlighted by external auditors. Another scope of this study is to examine management risk disclosure as a potential factor that may enhance the relationship between corporate governance systems and accounting conservatism. The study focuses on companies listed on Bursa Malaysia for the year 2020.

1.8 Significance of the Study

The main weaknesses in Malaysian corporate governance practices were pointed out in the report that examined the Asian Financial Crisis of 1997/1998 and were identified as the causes of the financial crisis (OECD, 2003; World Bank, 2005).

Furthermore, the several reports emphasized the challenges that the pandemic Covid-19 posed to corporate governance in Malaysia (MSWG, 2021; OECD, 2020; SC, 2020;). These weaknesses included poor transparency, a weak board of directors and lack of responsibility from corporate heads that led to poor investors' confidence and worsened the economic challenges during the crisis. These conclusions pointed to the necessity for extensive changes to enhance the Malaysian corporate governance mechanisms to avoid such opportunities in the future. Good corporate governance and external monitoring and assurance by the external auditors can help to ensure that the accounting conservatism are in high level. Therefore, the revision of Malaysian Code of Corporate Governance and the improvement of external auditors' assurance role are expected to enhance good practices, thereby reducing the chances of similar financial scandals happening. However, studies need to be undertaken to objectively assess this proposition.

1.8.1 Theoretical Contribution

By examining the association between corporate governance, audit assurance, and management risk disclosure and their effects on accounting conservatism, this study will make a theoretical contribution by enhancing the current understanding of these concepts. This study is expected to strengthen Stewardship Theory by examining the situations in which managers behave as stewards rather than self-interested agents. It aims to provide valuable perspectives on the governance mechanisms and audit practices that promote stewardship behaviours, with a specific focus on conservative accounting practices. In addition, the study could serve as an empirical indicator for Stewardship Theory in real-world contexts, demonstrating the crucial role that risk disclosure plays in fostering a stewardship mindset among managers.

1.8.2 Practical Contribution

This study is expected to provide substantial practical contributions in financial reporting as this study use accounting conservatism as dependent variable. It also contributes to corporate governance, audit practices, risk management, investor relations, education, and policy development. It has wide-ranging implications, catering to the requirements of various stakeholders such as boards, executives, policy makers, auditors, accountants, corporate strategists, investor relations managers, market regulators, academic institutions, and regulatory agencies. Significant contributions involve providing guidance on the structuring of boards in term of independence directors and executive positions to improve accountability, advising on policy and governance code and guidelines to increase transparency, improving audit practices and standards, promoting conservative accounting practices, stressing the significance of thorough risk disclosure, building investor confidence through transparent practices, and supporting the development of educational syllabus. This study attempts to offer empirical evidence to assist in creating regulatory frameworks that adhere to international standards, emphasizing the significance of risk disclosure and governance in financial reporting. This work strives to connect theory and practice to enhance governance, audit assurance, and financial reporting for the benefit of all stakeholders in the financial reporting system.

1.9 Definitions of Key Terms

The following key terms are defined to provide clarity and precision for this study:

1. Corporate Governance = Corporate governance refers to the system of rules, procedures, and processes that can guide and manage the corporation.