

**CEO CHARACTERISTICS AND EARNINGS  
MANAGEMENT: EVIDENCE FROM MALAYSIA**

**BY**

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the degree of Master of Science (Accounting)**

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## **ABSTRACT**

This research examines the impacts of CEO characteristics on earnings management. Several corporate failures around the world have drawn the attention of relevant parties to CEO characteristics, and they have necessitated the need for strong corporate governance to improve financial reporting practices. CEOs are responsible for setting the organisation's activities and plans, managing organisation's overall operations, making important strategic decisions, and determining company resource's effective allocation on behalf of the shareholders. However, corporate managers usually decide on accounting policies and operational decisions that are not conformity with approved accounting standards to stabilise revenues and meet financial results. Thus, the main objective of this study is to examine the impacts of CEO characteristics on earnings management. The current study examines the impacts of four CEO characteristics, namely CEO age, CEO tenure, CEO gender, and CEO financial expertise, on earnings management. Data were collected from 122 companies from the top 200 Malaysian public listed companies' annual reports between 2015 and 2019 in order to build a reliable sample. Upper echelons theory was employed as the theory upon which this study is built; this theory also guides the development of research framework for the present study. Having adopted quantitative research design, the results show that CEO age and CEO financial expertise are positively related to earnings management. However, CEO tenure and gender are negatively related to earnings management. This study suggests an improvement in CEO characteristics among the Malaysian public listed companies. These findings can be helpful for Malaysian regulatory bodies, such as the Securities Commission and Bursa Malaysia, to improve the financial reporting practices. Furthermore, these findings have strong implications for the investors, policymakers, and accounting professionals on the extent to which CEO characteristics are associated with earnings management.

## خلاصة البحث

يختبر هذا البحث آثار السمات الشخصية للرئيس التنفيذي في إدارة الأرباح، فقد لفتت بعض حالات فشل الشركات حول العالم؛ انتباه الأطراف ذات الصلة إلى السمات الشخصية للرئيس التنفيذي، واستلزم ذلك الحاجة إلى حوكمة قوية في هذه الشركات لتحسين ممارسات إعداد التقارير المالية؛ إذ يُعدُّ الرؤساء التنفيذيون مسؤولين عن وضع نشاطات المنظمة وخططها، وإدارة العمليات الشاملة للمؤسسة، واتخاذ القرارات الإستراتيجية المهمة، والتخصيص الكفء لموارد الشركة نيابة عن المساهمين، ومع ذلك؛ يُبرم مديرو الشركات عادةً سياسات محاسبية وقرارات تشغيلية لا تتفق مع المعايير المحاسبية المعتمدة لتحقيق الاستقرار في الإيرادات والنتائج المالية المرضية، ومن ثم؛ كان الهدف الرئيس من هذا البحث اختبار آثار السمات الشخصية للرئيس التنفيذي على إدارة الأرباح، ويتناول تأثيرات أربع خصائص للرئيس التنفيذي في إدارة الأرباح؛ هي العمر، ومدة تقلد منصب الرئيس التنفيذي، والجنس، والخبرة المالية، وقد جُمعت البيانات من 122 شركة من التقارير السنوية لأكثر 200 شركة ماليزية عامة مدرجة بين عامي 2015-2019 من أجل بناء عينة موثوقة، واستخدم البحث نظرية المراتب العليا في بناء إطاره النظري وتطويره، وباعتماد أسلوب البحث الكمي؛ أظهرت النتائج أن العمر والخبرة المالية للرئيس التنفيذي يرتبطان إيجابياً بإدارة الأرباح، في حين أن مدة تقلد منصب الرئيس التنفيذي والجنس يرتبطان سلبياً بإدارة الأرباح، ويشير البحث أيضاً إلى تحسُّن في السمات الشخصية للرؤساء التنفيذيين في الشركات الماليزية العامة المدرجة، ويمكن أن تكون هذه النتائج مفيدة للهيئات التنظيمية الماليزية من مثل هيئة الأوراق المالية، وبورصة ماليزيا؛ لتحسين ممارسات إعداد التقارير المالية، علاوة عن أن لنتائج البحث آثاراً قوية في المستثمرين وواضعي السياسات ومحترفي المحاسبة؛ فيما يتعلق بمدى ارتباط السمات الشخصية للرئيس التنفيذي بإدارة الأرباح.

## APPROVAL PAGE

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## DECLARATION

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*I dedicate this thesis to my mother, Faduma Khalif Abdulahi, and my father, Abdulahi Nour Farah, for their prayers, understanding, support, and endurance throughout my life.*

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# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 INTRODUCTION**

This chapter presents an overview of the research and has been segmented into various sections to discuss relevant issues. The first section covers the background of the study, followed by the problem statement. The research objective, which is followed by the research questions and motivation and significance of the study are then discussed. Lastly, this chapter explains the structure of the study and ends with a chapter summary.

### **1.2 BACKGROUND OF THE STUDY**

Empirical investigation has shown that corporate governance affects shareholder's wealth and firm performance (Lazonick & O'Sullivan, 2000). The structure of a good governance can influence a firm's growth and sustainability. A CEO is highest ranking executive in a company has responsibility for the overall success the company. The separation of ownership and control may lead the CEO to select and apply accounting estimates and techniques to increase the wealth of the business. However, this separation creates opportunities for CEOs to focus on personal interests and use different types of accruals instead of focusing financial performance of the organization (Chou & Chan, 2018). Therefore, this may create a conflict between the owners of the firm and their managers. In recent years, this issue has become a critical issue in public listed firms (Mohd Ali, Mohd Salleh, & Hassan, 2008).

Furthermore, earnings management issue has attracted the attention of academicians and regulators from all over the world. Indeed, the financial crisis in South

East Asia in 1997/1998 and the subsequent financial scandals at Enron in 2001 and WorldCom in 2002 have raised public concerns about executives' opportunistic behaviours in financial reporting and corporate governance's effectiveness in protecting shareholders' interests.

Earnings management can be attributed to a situation in which executives use their decisions to manipulate financial reporting or arrange their companies' transactions in such that their financial performance is misrepresented or influenced (Cheng & Warfield, 2005). After the Enron scandal, WorldCom, and other corporate fiasco earnings, management is considered as one of the essential aspects of financial reporting. Many studies have been undertaken to examine how managers manipulate or influence organizational earnings (Biddle, Hilary, & Verdi, 2009; Habib & Jiang, 2015; Johl, Kaur Johl, Subramaniam, & Cooper, 2013; Klai & Omri, 2010). In most situations, earnings management arises through the flexibility to select the accounting methods; for instance, the recognition of revenues, expenses, depreciation, and the use of judgments in reporting and estimating of accruals to modify reports in financial statements (Healy & Wahlen, 1999).

Earnings signify the general financial condition of a company. As a result, many companies have attempted to reach higher income in order to demonstrate that they are doing well. Financial statement users are concerned about earnings, as they may need to make financial choices based on their economic performance. Management of the firms is attentive in deciding on accounting policies and making operational decisions for the company within the limits of approved accounting standards to stabilize revenues and meet the target financial outcomes (Heng Teh et al., 2017). However, it has been argued being CEOs provide an opportunity for them to pursue their personal

interests by using different accrual options to reach a level of reported earnings (Chou & Chan, 2018).

In Malaysia, most companies are run and controlled by families, and these controlling families may intend to manage earnings to achieve personal goals (Heng Teh, San Ong, & Yi Ying, 2017). Furthermore, it was reported that Securities Commission of Malaysia documented 17 cases of earnings manipulation between 1996 and 2012. According to a survey conducted by PwC, 48 % of the Malaysian businesses have become victims of white-collar crime, with only 25% able to improve their internal auditing systems and practices (Heng Teh et al., 2017).

Management is mainly responsible for presenting financial reports fairly and reliably in accordance with the globally accepted accounting standards i.e., international financial reporting (IFRS). Therefore, CEOs play essential roles in assuring high-quality financial information. Furthermore, a CEO's personal characteristics may have an impact on financial reporting processes (Ali & Zhang, 2015a, 2015a; Alqatamin, Aribi, & Arun, 2017; Bouaziz, Salhi, & Jarboui, 2020a; Hu, Hao, Liu, & Yao, 2015; Louis, 2004; Na & Hong, 2017; Zouari, Lakhali, & Nekhili, 2006). Corporate managers may employ accounting rules and make operational decisions that are not in compliance with authorised accounting standards to stabilise revenues and achieve financial outcomes (Heng Teh et al., 2017).

Meanwhile, shareholders appoint their CEOs to oversee the operations and activities of the companies. Therefore, shareholders of the companies expect the manager to raise the firm's profits and consequently increase their wealth. However, according to Finkelstein (1992), top directors with more experience and longer tenure in the organization may have higher power to control a firm's operational strategies because of several benefits They can build relations with the company's various

partners, develop their knowledge, and alleviate negotiating power. Bergh (2001) highlights that when CEOs have long duration and more experience with the company, they can influence the reported earnings for personal benefits. Therefore, this issue suggests an important question about whether CEOs or senior managers with highly reputed and long-term experience in organization carry out their administrative decisions to protect their reputation and manipulate reported earnings. To further understand this issue, this study focuses on how CEOs characteristics can affect earnings management among the listed companies on Bursa Malaysia.

### **1.3 PROBLEM STATEMENT**

Generally, CEOs play vital roles in shaping and controlling corporate performance. They are responsible for the organization's central tasks on behalf of the shareholders (D'Ewart, 2015). They are responsible for setting and developing long and short-term strategies for the company, and they exercise authority over corporate decisions on behalf of the shareholders (Chou & Chan 2018). They are also responsible for implementing company policies and directing strategies that are profitable to the company operations, and building long-term objectives that can help the company to develop (Wang, Tsui, & Xin, 2011).

Corporate scandals, such as Global Crossing, Enron, Arthur Andersen WorldCom, and several others have shown the managers' creative accounting consumption. These series of corporate fiascos have brought the accounting profession into public attention, particularly those occupying executive positions, such as CEOs. CEOs are considered the most influential persons in organization, and They take advantage of ineffective monitoring and increase their compensation (Shuto, 2007). This therefore provides the CEOs with the opportunity to focus on personal interests by

using different types of accrual options to reach a level of reported earnings (Chou & Chan, 2018).

In Malaysia, it has been reported that many accounting scandals and earnings misrepresentation have been committed by high profile companies such as LFE Corporation, Malaysian Airlines Systems and MEMS Technology Bhd and Transmile Group Bhd (Al-duais, Malek, Ali, & Hamid, 2019; Tay, Puah, Brahmana, & Malek, 2016). One issue could be the high agency costs those Malaysian businesses face (Haniffa & Hudaib, 2006), which could have lead to the earnings misrepresentation. Therefore, this weakens the quality of financial reporting and credibility of earnings numbers in shareholders and other interest groups in the organization (Abdul Jalil & Abdul Rahman, 2010).

The literature has significantly documented the determinants of managers' abilities in corporate earnings. The findings show that CEO may impact firm performance and the quality financial reporting (Bouaziz, Salhi, & Jarboui, 2020a; Hsieh, Chen, Tseng, & Lin, 2018; Khunkaew & Qingxiang, 2019; Zouari, Lakhali, & Nekhili, 2006).

CEOs with long tenure in organization are linked with the capability to manipulate firm's resources and process of financial reporting, as well as reported earnings of the company (Di Meo, 2014). This opportunistic behaviour poses a great challenge to internal decision-makers that may not be aware of the firm's accounting information, such as to assess investment policies correctly (Ali & Zhang, 2015). Institutional investors, such as Employees Provident Fund (EPF), have voiced their unhappiness over the CEO's compensation that totalled RM71.92 million in 2018 by one of the Malaysian listed companies, which reported a loss of RM2.5 billion in the same year. Therefore, this raises important questions about the highly valued and long

tenure CEOs in the organization and their ability to maintain their reputation with a report on the financial performance and stock market.

Gibbons and Murphy (1992) indicate that agency problems increase when the CEO is approaching retirement age. In the last year of his/her job, the CEO may take advantage of personal information to enhance their performance, purposely to achieve high compensation during the last year of employment. Thus, agency theory proposes that potential problems may occur when a CEO is getting close to the retirement age. These problems are related potential short-sighted behaviour, which concentrates on short-term performance rather than investing in the company's future value (Dechow & Sloan, 1991), or to set up a positive project value for the organization because of the believe that the reward will be enjoyed by the successors (Di Meo, 2014).

Prior studies in Malaysia have reported the association between earnings management and CEO characteristics by focusing on one type of CEO characteristics, such as CEO duality (Hashim & Devi, 2008), compensation (Chu & Song, 2012), and narcissism (Kontesa & Tong, 2020). However, very few studies, except for Hasan et al. (2015), have examined the influence of CEOs' tenure on the earnings management of Malaysian listed companies . Most of the previous studies have been considering only one type of CEOs' characteristic as their variable of interest. Therefore, this study investigates whether CEO characteristics, such as age, tenure, gender, and financial expertise, affect earnings management practices in Malaysia.

#### **1.4 RESEARCH OBJECTIVES**

The main purpose of this study is to investigate the impacts of CEO characteristics on earnings management among the listed companies on Bursa Malaysia. The specific objectives of this study are as follows:

1. To determine the effect of CEO age on earnings management.
2. To examine the impact of CEO tenure on earnings management.
3. To identify the effect of CEO gender on earnings management.
4. To explore the impact of CEO expertise on earnings management.

## **1.5 RESEARCH QUESTIONS**

The following are the research questions that this study intends to answer:

1. What is the effect of CEO age on earnings management?
2. What is the impact of CEO tenure on earnings management?
3. What is the effect of CEO gender on earnings management?
4. What is the impact of CEO expertise on earnings management?

## **1.6 MOTIVATION FOR THE STUDY**

Until now, there are limited studies on the relationships between earnings management and CEO characteristics, such as CEO age tenure, gender, and financial expertise, in Malaysia. This study is motivated by the need to conduct more studies on the earnings management practices among the Malaysian listed companies. Prior studies in Malaysia on earnings management and other variables, such as CEO narcissism (Kontesa et al., 2020), earnings management in public listed firms (Heng Teh et al., 2017), types of institutional investors (Bamahros & Wan-Hussin 2015), have showed a positive association. Therefore, the current study is motivated to conduct further research on the impact of CEO characteristics on earnings management in the context of Malaysia.

In addition, this study is motivated by the more comprehensive prior research on CEO characteristics conducted in developed countries, such as the United Kingdom and the United States. While there are studies on earnings management in Malaysia;

few studies have centred on the type of CEO characteristics, such as CEO duality (Hashim & Devi 2008), CEO compensation (Chu & Song (2012), CEO narcissism (Kontesa & Tong 2020), and CEO tenure (Hasan et al., 2015), and family ownership (Abdullah & Ismail, 2016) . As mentioned earlier they have been considering only one type of CEO characteristics as their variable of interest. These studies motivated the current study to investigate the effect of CEO characteristics on earnings management using data from Malaysian listed companies.

### **1.7 SIGNIFICANCE OF THE STUDY**

This research aims at studying the issue of CEO characteristics and earnings management. It investigates the association between CEO characteristics, such as age, tenure, gender, and expertise, on earnings management. It is hoped that this study will contribute to the existing literature on CEO characteristics and earnings management practice by providing evidence on CEO characteristics and earnings management practice using recent data in Malaysia, from the year 2015 to 2019.

Besides, this study may benefit Malaysian listed companies to improve their corporate governance and financial reporting practices. Thus, this study is envisaged to contribute to these companies by investigating whether different CEO characteristics (i.e., age, tenure, gender, and financial expertise) impact financial reporting practice as proxied by earnings management. Similarly, the implication of this study's findings for the regulators is that it will provide them with evidence on the effectiveness of corporate governance from the perspective earnings management practice better monitoring of management. For example, if the current study found that the age of the CEOs has positive impact earnings on management, it can be that the relevant authority the age

requirement of the CEO of listed companies in order to reduce the incidence of earnings manipulations.

Lastly, this research contributes to the body of literature by exploring the impact of CEO characteristics and earnings management practice in the Malaysian context. This study expands the literature on earnings management by providing new empirical research using recent data. It contributes to the existing literature on earnings management, particularly within the context of Malaysian listed firms.

## **1.8 STRUCTURE OF THE STUDY**

The current study encompasses six chapters.

**Chapter One:** This chapter focuses on the background of the study, where CEO characteristics and earning management are discussed. Other important issues discussed in this chapter are problem statement, motivation for the study, research objectives and research questions, the significance of the study, and organisation of the study.

**Chapter Two:** This chapter reviews pertinent literature for the study. It explains the concepts of corporate governance attributes, CEO characteristics, and earning management. It also discusses previous research pieces that are related to determinants of earnings management, measurements of earnings management, and corporate governance factors. Finally, the chapter ends by highlighting the literature gap.

**Chapter Three:** This chapter discusses upper echelons theory related to CEO characteristics and earnings management, followed by a theoretical framework and hypothesis development. The chapter concludes with the expectation of the

relationships between the independent variable, control variable, and earning management.

**Chapter Four:** This chapter discusses the research design, sample selection, data collection, variable measurement, and data analysis, such as normality test, collinearity and multicollinearity, descriptive statistics, correlation analysis, and regression and model development.

**Chapter Five:** This chapter presents the findings, compares the results with prior studies, and interprets them within the theoretical framework employed.

**Chapter Six:** This chapter discusses the overall findings and implications of the study. The limitations of the study are also discussed. Finally, the chapter concludes the review with recommendations for future research.

## **1.9 CHAPTER SUMMARY**

This study extends the literature on CEO characteristics and earnings management by using different types of CEO characteristics, such as CEO age, tenure, gender, and financial expertise among listed companies on the Bursa Malaysia. This study aims to investigate the relationship between CEO characteristics, such as CEO age, tenure, gender, and financial expertise, for five years period, from 2015 to 2019. While this discussion ends this chapter, a review of literature on CEO characteristics and earnings management, as well as several other relevant issues are discussed in the subsequent chapter.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 INTRODUCTION**

This chapter introduces literature review on CEO characteristics and earnings management based on prior studies. The objective of this chapter is to identify the gap that may exist in the literature. Segment 2.2 discusses an overview of corporate governance and the Malaysian Code of Corporate Governance. Section 2.3 discusses corporate governance and earnings management. Section 2.4 describes the influence of different CEO characteristics, such as tenure, gender, age, and financial expertise, on earnings management. Section 2.5 focuses on the research gap. While section 2.7 summarises this chapter.

#### **2.2 OVERVIEW OF CORPORATE GOVERNANCE**

The debate over corporate governance has grown and increased significantly over the years because of the failure of many high-profile companies worldwide. Corporate conflicts have occurred in many companies and as such, the need to improve corporate governance has garnered the attention of the discussion in economics, law, management, and other subjects (Aggarwal et al. 2014; Bokpin & Isshaq, 2009). It has also become an issue shared by academics, stakeholders, shareholders, the government, other related parties, regulatory bodies, and professionals around the world (Cheung & Chan, 2004).

Two key events have sparked a focus on the area, namely the 1997/1998 financial crisis in the Southeast Asian capital markets and the U.S. and European corporate governance scandals, such as Enron and Parmalat, that have abolished public

trust in the corporate sector. As a result of these events, most of the key players in the financial system began to understand the consequences of the global economy due to the weakness of corporate governance mechanisms (Claessens, 2006).

The Organisation of Economic Cooperation and Development (OECD) defines corporate governance as “the process by which companies are regulated and managed.” The organizational governance structure establishes the distribution of the rights and obligations of different company stakeholders, such as boards, managers, shareholders, and other stakeholders, and defines corporate rules and regulations. In doing so, it also provides a framework for the company's objectives and a means to achieve those goals and monitor performance (OECD, 1999).

Franks and Mayer (1997) state that corporate governance is the best way to fulfil the interests of owners and managers to achieve both parties' interests, which is the ultimate benefit for investors. It is also believed that proper company management helps create investment and good trust (Ponnu, 2008). Gregory and Simms (1999) assert that corporate governance is promoting the use of the company's resources and the broader economy, as well as helping companies and the economy attract cheaper investment. This is consistent with the view that well-managed companies can have more efficient operations, leading to higher returns (Jensen & Mackling, 1976). Corporate governance should be seen as an internal control mechanism (tools and structures) that minimises agency problems by adopting and self-monitoring behaviours (Shleifer & Vishny, 2007). Corporate governance goes through authorities' vetting to deal with agency problems to provide funding. Besides, robust corporate governance is provided with principles and procedures that can be used to control management practices to achieve business operations and to achieve good quality reporting (Gillan & Starks, 2011).