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Management Motives and Firm Financial Misstatements in Malaysia

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ABSTRACT

This paper discusses issues concerning management motives, which influenced by the situational pressures that lead to the occurrence of financial misstatements. The situational pressures and management motives are measured using financial distress, family ownership, the existence of founder on the firm's board and earnings management (EM) of Malaysian public listed firms (referred to as PLCs) that influence the occurrence of financial misstatements. Results show that the existence of founder on the firm's board (FOUNDER) is positively significant while family ownership (FAMOWN) is negatively significant determinants of the occurrence of financial misstatement proxy by financial statement restatements. Two other variables namely financial distress (DISTRESS) and EM interact significantly and positively with financial misstatements. Additionally, FAMOWN positively interacts with EM to affect the occurrence of financial misstatements. Findings reveal that the extent of EM influences financially distressed firms and family-owned firms on the likelihood of financial misstatements by Malaysian PLCs.

Keywords: Management Motives, Financial Misstatements, Financial Statement Restatements, Malaysia

JEL Classification: G3 Corporate Finance and Governance

1. INTRODUCTION

The accounting framework states that the main objective of financial statements is to reflect fairly information concerning the financial position and performance of an entity, and to ensure its comparability for the purpose of economic decision making (European Commission, 2011, p. 1, 3). Nevertheless, based on the latest United States (U.S.) Government Accountability Office (GAO) report, the cumulative totals of financial misstatements cases were 6,436 for the fiscal years 2005 through 2011 (GAO, 2013). Further, the 6,436 restatement cases were reported by only 4,536 public firms, indicating that there are firms which restate their financial statement more than once. This shows that the issue of financial misstatements remains an imminent threat to the firms and regulators, even in the developed countries.

In Malaysia, although the scale is small, the corporate landscape is scattered by several bad accounting scandals such as Transmile

Group Berhad, Megan Media Holdings Berhad, and MEMS Technology Bhd, (Salin et al., 2011). This issue portrays serious corporate reporting failures, which cause global concerns about the credibility and reliability of firm financial reporting quality. According to Hasnan et al. (2013), Malaysia's weak regulation enforcement by relevant authorities is the leading reason for the widespread of fraudulent financial reporting. Perhaps, the inadequate punishments imposed by the authorities lead to the high occurrence of financial misstatements over time. Thus, the study takes the opportunity to investigate the seriousness of financial misstatement in Malaysia. By identifying the loophole that leads to higher misstatements, appropriate action can be made by the regulatory bodies to strengthen the enforcement aspect.

Because of the severity consequence of financial misstatement to the firm and its management, there be strong motives that influence manipulation activities. Thus, the purpose of this study is to identify the factors, specifically in the scope of management

motives, which are associated with the occurrence of financial misstatements. By using a sample from Malaysian public listed companies, this study attempts to highlight the different characteristics between restatement and non-restatement firms regarding the firm financial performance measured by financial distress, family ownership, the existence of founder on the firm's board and earnings management (EM) variables. It is hoped the findings from this study could point out the factors that need further attention, especially from the regulatory and governance aspects. By detecting the cause of the occurrences of financial misstatement, appropriate prevention and mitigation action can be implemented.

The organization of the paper is as follows. Section 2 describes the conceptual of financial misstatements, followed by a section on a literature review that contributes to the hypotheses development. Section 4 discusses the research methodology, data measurement and model developed for the study. The subsequent section discusses the results of the study, and the paper is concluded in the final section.

2. CONCEPTUAL OF FINANCIAL MISSTATEMENTS

2.1. Definition of Financial Misstatement

A formal definition of financial misstatement provided by International Federation of Accountants refers misstatement as:

“Difference between the amount, classification, presentation or disclosure of a reported financial statement item and the amount, classification, presentation or disclosure that is required for the item to be in accordance with the applicable financial reporting framework” (p. 370).

Financial misstatements are viewed as manipulation or falsification of financial statement disclosure which often are rather a fiction and do not fairly present the firm's financial condition to investors (Ettredge et al., 2010; Dechow et al., 2011).

2.2. Financial Misstatements Measured by Financial Statement Restatements

Richardson et al. (2003) emphasized that “it is reasonable to assume that earnings restatement firms can be characterized as firms who knowingly and intentionally engaged in earnings manipulation,” since restatements are only undertaken when misstatements are detected. Thus, the incidence of financial statement restatements acknowledges the fact that previously issued financial statements were misstated. Moreover, the terms “misstatement” and “restatement” are used interchangeably in the research of accounting issues as financial statement restatement is prepared when financial misstatements are detected (i.e., Palmrose et al., 2004; Abdullah et al., 2010).

Before the year 2006, the GAO classifies the financial statement restatements into nine categories (i.e., acquisition and merger, cost or expense, in-process research and development, other, reclassification, related party transactions, restructuring assets or

inventory, revenue recognition, and securities valuation related). However, the GAO has adopted the classification scheme developed by an academic scholar (i.e., Palmrose et al.), and latest GAO Report (2013) classifies financial statement restatements into six categories (i.e., revenue recognition, core expenses, non-core expenses, reclassifications and disclosures, underlying events and other). Prior studies document that the most common types of misstatements involve revenue, the cost of goods sold or operating expenses (Dechow et al., 2011). Financial statement restatements involving these items are classified as “core restatements” because it directly affects the main operation of the firm (Palmrose et al., 2004).

3. MANAGEMENT MOTIVES INFLUENCE FINANCIAL MISSTATEMENTS

Most of the financial misstatements are attributed to the firm top management; because they have significant influence in managing firm's financial and operational activities. Management willingness to allow aggressive financial reporting practices influences the likelihood of financial misstatements. Studies have proposed many factors that affect financial misstatements. This study focuses on the factors that are unique to the Malaysian market as highlighted by Hasnan et al. (2013) and goes deeper into understanding the influence of the existence of founder on the firm's board and family ownership that is prevalent in many developing countries.

3.1. Financial Distress

Financial distress refers to the situation where firm cash flow is insufficient to cover the current obligation (Wruck, 1990). Prior studies document that financial distress is often accompanied by comprehensive changes in management, governance, and organizational structure. Besides those negative impacts, Kinney and McDaniel (1989) suggest that poor financial condition of a firm is often an indicator of erroneous financial statements. Managers are motivated to engage in financial misstatements as a result of pressure to meet shareholders' and analysts' expectation, particularly, when firms are facing poor financial performance, which normally called as financial distress. Since poor firm performance can also affect their job security of the top management team, it can motivate the management to take unethical actions that help to improve the appearance of the firm's financial condition and the stock market valuation (Kinney and McDaniel, 1989). Smith et al. (2001) state that financially distressed firms, in order to maintain their reputation, are prone to switch their accounting policies to more opportunistic and aggressive methods to inflate the firm's profit. Chen et al. (2010) find that most financially distressed firms employ income-increasing manipulation techniques to avoid a delisting threat. In Malaysia, Hasnan et al. (2013), find a significant positive relationship between financial distress and fraudulent financial reporting. Therefore, current study hypothesized that:

H₁: There is a positive association between financial distress and financial misstatements.

3.2. Family Ownership

Claessens et al. (2000) posit that Asian firms have more concentrated ownership structure where family ownership is

common in both small and established firms. Although there are several characteristics that may align the interest of managers and shareholders in family firms, severe entrenchment effect may arise between controlling (majority) and non-controlling (minority) shareholders when family members hold significant ownership and control over the firm management and decision policies (Cheng et al., 2012). Arguably, these firms may be less efficient as concentrated ownership creates an incentive for the controlling shareholders to expropriate wealth from other shareholders (Fama and Jensen, 1983). This may lead to unmerited situations to minority owners as the controlling owners tend to maximize their wealth rather than the wealth of all owners. Family ownership arrangement is one of the factors that motivate the occurrence financial misstatements. In a family-controlled firm that is dominated by their descendants, the agency problem is less severe since the family members are greatly concerned about the reputation and provide greater support for the firm's well-being (Cascino et al., 2010).

On the other hand, the eccentric familial bond can create incentives for certain family members to behave opportunistically that affect the quality of earnings (Fama and Jensen, 1983). Beasley et al. (1999) provided evidence that family relationships exist among the directors and/or officers of fraud firms. Based on Malaysian family firms, Munir et al. (2013) reported that although some level of family ownership may contribute to high financial reporting quality, beyond some threshold, significant family ownership appear to negatively affect the quality of financial reporting. Hence, given this conflicting results on family ownership, we state the following non-direction hypothesis:

H₂: There is a significant association between family ownership and financial misstatements.

3.3. Existence of Founder on the Firm's Board

The existence of founder on the firm's board can also influence financial misstatements occurrences. Founders are the architects who built the business, which leaves a deep imprint on the culture of the business (Hasnan et al., 2013). Prior studies provide mixed findings with regards to the effect of the existence of founder on the firm's board and financial reporting quality. Based on the agency theory, a view states that; as the firm creators, founders have a vision for the success of the firm (Fama and Jensen, 1983). However, an opposing view suggests that founders may have a special interest in nurturing the firm (Davis et al., 1997). Beasley et al. (1999) find that firms which tolerate financial misstatements are more likely to be managed by their founders or are greatly influenced by the organizational culture created by the founder. Thus, findings prove that founders are trapped to commit illegal acts due to the pressure to maintain the firm's reputation for being successful (Ranft and O'Neill, 2001). Donohoe (2009) also found a positive and significant relationship between the presence of a founder-CEO and the incidence of financial reporting restatements. Such positive association supports the view that founders face extreme pressure to report expected results to ensure the survival of their firms. Such powerful stress may cause a founder to "turn-a-blind-eye" to misstate financial statements and ignore the negative consequences. Thus, it is hypothesized that:

H₃: There is a significant association between the existence of founder on the firm's board and financial misstatements.

3.4. EM

If the selection of aggressive financial reporting standards to fraudulent financial reporting is viewed as a continuum, then, arguably the variable that influences the occurrence of financial misstatements is the level of EM and the willingness of the top management team to ignore it despite the chosen standards push-the-envelope of the generally accepted accounting principle (GAAP). GAAP allows some level of judgment to be an exercise in the choice of the financial reporting standards, which is commonly referred to in the literature as "EM" or "income smoothing" (Beidleman, 1973). Healy and Wahlen (1999) state that EM occurs when:

"...managers use judgment in financial reporting and structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers." (p. 368).

Besides, firms that tolerate the exercise of EM in their financial reporting will likely increase the probability of financial misstatements. EM may start small without the intention to deceive investors or regulators, but then grow over time to exceed the limits of GAAP and result in full-blown "cooking the books" causing the financial statement to be fraudulently misstated that leads to fraudulent financial reporting (Hasnan et al., 2013). Thus, without the monitoring of professional judgment in exercising the flexibility given by GAAP, the occurrence of financial misstatements and fraudulent financial reporting is possible (Olsen and Zaman, 2013). Hence, it is hypothesized that:

H₄: There is a positive association between EM and financial misstatements.

Moreover, the motivation and situational pressures for EM as perceived by the top management team may influence the severity of financial misstatements (i.e., fraudulent financial reporting). Moreover, over time, a higher level of aggressiveness of EM practices within GAAP will become constrained and lead firms to consider non-GAAP financial reporting to window-dress their financial reporting that can eventually go out of hand. Therefore, it is hypothesized that:

H_{5a}: The level of EM moderates the relationship between financial distress and the occurrence of financial misstatements.

H_{5b}: The level of EM moderates the relationship between the level of family ownership and the occurrence of financial misstatements.

H_{5c}: The level of EM moderates the relationship between founders on the board and the occurrence of financial misstatements.

4. RESEARCH METHODOLOGY

The sample consists of PLCs on Main Board of Bursa Malaysia between 2005 and 2011 but excludes finance, investment, trust and fund firms since these industries are regulated differently

by the Bank and Financial Institution Act 1989. The 1997-1998 financial crisis was declared over in 1999. Thus, the next 5 years after the crisis are excluded from the sample. Additionally, since the data collection in this study includes 2 years prior (i.e., t-1 and t-2) to the restatement year (t), selection of sample is made by excluding the period of 3-year after the crisis. The sample selection is up to 2011 because the Economic Crime Survey by PwC revealed that fraud in Malaysia was critically high with 44% compared to the global average of 34% in 2011, and started to decline in the following year. Further, Malaysia was categorized as one of the territories with the lowest percentage of economic crime in 2014 with only 24% compared to global average of 37% (PwC International, 2014). Final sample in this study consists of 82 restatement firms and 83 non-restatement firms because one sample of restatement firm is deleted due to the extreme value of EM variable. A sample of the non-restatement control group is formed using a match-pair procedure based on financial year-end, firm size, and the industry group to which each pair of the restatement and non-restatement firm belong.

4.1. Measurement for Dependent Variable

Following prior research by Abdullah et al. (2010), the occurrence of financial misstatements proxy by financial statement restatements are measured using a dummy variable coded “1” for restatement firms and “0” for non-restatement firms. The categorization of financial statement restatement is based on GAO financial statement restatement category descriptions (GAO, 2013).

4.2. Measurement for Independent Variables

There are four independent variables, which consist of financial distress, family ownership, the existence of founder on the firm’s board, and EM. The financial distress variable is measured using Altman’s Z-score that is used to predict the possible bankruptcy of a firm (Abdullah et al., 2010). The study adopted the threshold used by Hasnan et al. (2013) that classify firm with Z-score smaller than 2.073 as financially distressed firms. Financially distressed firms were coded as “1” while firms with Z-score higher than the threshold value was coded as “0.” The linear equation of Altman’s Z-score model is as follows:

$$Z = 0.012X_1 + 0.014X_2 + 0.033X_3 + 0.006X_4 + 0.999X_5$$

Where:

X_1 : Working capital to total assets

X_2 : Retained earnings to total assets

X_3 : Earnings before interest and taxes to total assets

X_4 : Market value of equity to total liabilities

X_5 : Net sales to total assets, and

Z: Overall index, the lower a firm’s Z-score, the higher its probability of bankruptcy.

For family ownership, the study employed the measurement used by Munir et al. (2013) that measures family ownership as the percentage of the top ten largest shareholders where a higher percentage indicates higher family ownership. Before the aggregation the percentage of family ownership, the family relationship was first identified using keywords such as “family,” “relate” and “relation”

to trace for any family relationships stated in the corporate annual reports. Hence, only the 10 largest shareholders with the familial relationship are cumulated to measure family ownership.

The existence of founder on the firm’s board is measured dichotomously where “1” is coded for the existence of founder on the firm’s board, and otherwise, it is coded as “0”. This measure is similar to the measurement used by Donohoe (2009). To determine the existence of founder, each of the director’s profile in the corporate annual report is scanned using keywords such as “found,” “founder” and “incorporate” to identify the existence of founder on the firm’s board.

EM is measured using working capital accruals as employed in Dechow et al. (2011). The calculation of working capital accrual for each firm is as follows:

$$\text{WC accruals} = ([\text{Change in current assets} - \text{Change in cash and short-term investments}] - [\text{Change in current liabilities} - \text{Change in short-term debt}] - \text{Change in taxes payable}) / \text{Average total assets}$$

4.3. Model and Analysis

In this study, a logistic regression model is developed to analyze the relationship between various management motives (i.e., financial distress, family ownership, the existence of founder on the firm’s board and EM) used as determinants of financial statement restatements. The following regression model is employed to determine the extent of the influence of each of the variable included in the current study on the occurrence of financial misstatement proxy by financial statement restatement. In order to test the hypotheses, the logistic regressions analysis is conducted in the year immediately preceding the restatement year; it is presented as:

Model 1:

$$FR_i = \beta_0 + \beta_1 \text{DISTRESS}_{i(t-1)} + \beta_2 \text{FAMOWN}_{i(t-1)} + \beta_3 \text{FOUNDER}_{i(t-1)} + \beta_4 \text{EM}_{i(t-1)} + \varepsilon_{i(t-1)}$$

Besides examining the direct relationship between the independent variables (i.e., financial distress, family ownership, existence of founder on the firm’s board and EM) and the dependent variable (i.e., financial statement restatement), the study also examine the moderating effect of EM affecting the relationship between them and the probability of financial misstatement. The regression model adding the interaction terms (i.e., DISTRESS*EM, FAMOWN*EM and FOUNDER*EM) is as follows:

Model 2:

$$FR_i = \beta_0 + \beta_1 \text{DISTRESS}_{i(t-1)} + \beta_2 \text{FAMOWN}_{i(t-1)} + \beta_3 \text{FOUNDER}_{i(t-1)} + \beta_4 \text{EM}_{i(t-1)} + (\beta_1 \text{DISTRESS}_{i(t-1)} * \beta_4 \text{EM}_{i(t-1)}) + (\beta_2 \text{FAMOWN}_{i(t-1)} * \beta_4 \text{EM}_{i(t-1)}) + (\beta_3 \text{FOUNDER}_{i(t-1)} * \beta_4 \text{EM}_{i(t-1)}) + \varepsilon_{i(t-1)}$$

Where:

FR: The incidence of financial statement restatement as a proxy for the financial misstatement.

DISTRESS: The level of financial distress measured using the Altman's Z-score.

FAMOWN: The percentage of family ownership.

FOUNDER: The existence of founder on the firm's board.

EM: EM using the Dechow et al.'s (2011) working capital accrual model.

5. RESULTS AND DISCUSSIONS

Table 1 shows the correlation among all of the variables included in the study. There is a significant positive correlation between the existence of founder on the firm's board (FOUNDER) and financial statement restatements (RESTATEMENTS) at 5% level of significance. This correlation indicates that an increase in FOUNDER will also result in an increase in RESTATEMENTS variable. This result is consistent with Donohue (2009) who provide evidence that founder positively relate with the incidence of financial statement restatements. Besides, there is a significant positive correlation between family ownership (FAMOWN) and FOUNDER variable, which is significant at 5% level. The significant positive correlation between family ownership and the existence of founder on the firm's board indicate that an increase in the FAMOWN results an increase in FOUNDER variable too. In developing countries it is common that family-owned firms are operated by the founders or the second generation family members who are the children of the founders (Grand Thornton, 2002). This finding is also consistent with Hasnan et al. (2013) who found that family-owned firms were controlled by their founders who initially incorporate and manage the firms. Since the highest correlation coefficient, which is between family ownership variable and the existence of founder on the firm's board variable, is only 0.241, the multi-collinearity is not a significant issue (Pallant, 2007).

Table 2 shows the results of logistic regression analysis. In Model 1, the result indicates that two variables are important determinants

of financial statement restatements. FOUNDER variable is positively and significantly associated with restatements at 1% level of significance, and FAMOWN variable is negatively and significantly associated with the occurrence of financial statement restatements at 10% level of significance. Further, since financial distress and EM are not significantly associated with financial statement restatements, the study conclude that there is no support for hypotheses H1 and H4. The insignificant association between financial distress and financial misstatements indicate that financial distress is not the motivating factor for the occurrence of financial misstatements in Malaysian PLCs. This finding is inconsistent with Selahudin et al. (2014) who studies the EM in both Malaysia and Thailand. They found that financial distress measured by the Altman's Z-score has the highest standard deviation, and they conclude that financial distress has the largest dispersion among other variables which influences the likelihood of EM. The contradict finding is, however, consistent with Baucus and Near (1991), which highlight that firm poor financial performance only explain some variance of the corporate offenses and not a strong predictor of overall illegal activities. With regards to EM variable, although this study predicts a positive association between EM and the occurrence of financial misstatements, there are no significant findings to support such argument. Thus, the study concludes that while EM and financial distress may affect each other individually, these two variables do not influence financial statement restatements.

Hypothesis H₂ predicts a significant association between financial misstatements and FAMOWN variable. Table 2 shows that coefficient of FAMOWN is negatively and significantly associated with the occurrence of financial misstatements at the 10% level, which provides limited support for hypothesis H₂. The negative coefficients of FAMOWN variable with the occurrence of financial misstatements reveal that the existence of higher family ownership reduces the likelihood of financial statement restatements. The finding is in line with the prior study by Minichilli et al. (2010)

Table 1: Pearson correlation matrix of all variable

Variable	RESTATEMENTS	DISTRESS	FAMOWN	FOUNDER	EM
RESTATEMENTS	1	-0.068	-0.050	0.155*	-0.052
DISTRESS	-0.068	1	-0.059	-0.108	0.011
FAMOWN	-0.050	-0.059	1	0.241*	-0.015
FOUNDER	0.155*	-0.108	0.241*	1	0.017
EM	-0.052	0.011	-0.015	0.017	1

All P value are two-tailed. *Correlation is significant at the 0.05 level, FAMOWN: Family ownership

Table 2: Logistic regressions analysis results for Models 1 and 2

Variable	Model 1			Model 2		
	B	SE	Significant	B	SE	Significant
DISTRESS (1)	0.247	0.278	0.375	0.302	0.297	0.308
FOUNDER (1)	1.119	0.423	0.008***	0.885	0.445	0.047**
FAMOWN	-0.896	0.605	0.069*	-1.021	0.637	0.109*
EM	0.396	0.454	0.383	6.736	3.247	0.038**
DISTRESS*EM				6.191	3.236	0.028**
FOUNDER*EM				6.36	5.18	0.22
FAMOWN*EM				26.809	12.433	0.031**
Constant	0.944	0.243	0.00	1.139	0.279	0.00
R ²	0.07			0.12		
N	165			165		

*, **, ***Denote significance at 10%, 5%, and 1% levels respectively. SE: Standard error, FAMOWN: Family ownership

and Miller et al. (2013) which suggest that family owners are greatly concerned about their reputation that comes from their business wellbeing, which discourages them from aggressively manage firm earnings. Further, this finding is consistent with Hasnan et al. (2013) who examine fraudulent financial reporting in Malaysia, but it contradicts with Munir et al. (2013) which found that significant family ownership negatively affects the earnings quality of Malaysian PLCs.

The FOUNDER variable is found to be positively and significantly associated with the occurrence of financial misstatements at 1% level. This finding is consistent with Donohoe (2009) and Hasnan et al. (2013) which support the view that founder has a strong emotional commitment to the firm's survival, and it motivates them to engage in aggressive financial reporting practices that can lead to higher financial misstatements. Thus, the results support hypothesis H₃ that predicts the significant association between the existence of founder on the firm's board and the occurrence of financial misstatements.

Logistic regression analysis in Table 2 also shows the results of the interaction between all independent variables (i.e., financial distress, family ownership and founders on board) and EM too (Model 2). The findings reveal that EM interacts with DISTRESS variable to influence the occurrence of financial misstatements as hypothesized by H_{5a}. The main effect of the DISTRESS variable is insignificant, but the term interaction DISTRESS*EM is positive and significant at 5% level. This finding suggests that it is not financial distress parse, but the reaction to it via the level of EM that positively and significantly influences the probability of the occurrence of financial misstatements. The pressure to avoid bankruptcy and meet the shareholders' expectations seems to motivate managers of financially distressed firms to engage in aggressive financial reporting practices by Malaysian PLCs. According to Dechow et al. (2011), even in the U.S., the poorly performed firms manipulate earnings with the aim of covering up their slowdown and to maintain high stock price. This indicates that financially distressed firms create an incentive for managers to manage earnings and thus, increase the likelihood of financial misstatements.

The main effect of the FAMOWN variable is a negative association with the occurrence of financial misstatements. However, its interaction with EM turns positive and significant (FAMOWN*EM) at 5% level. This implies that when family owners begin to engage in aggressive financial reporting to uphold their reputation, it increases the likelihood of financial misstatements significantly. This result provides support for hypothesis H_{5b}. As suggested by Ishak and Napier, (2006) the families' strong bond with the top management team creates the incentives for them to behave opportunistically and engage in EM. A Recent study by Chi et al. (2015), who examined family-owned firms in Taiwan documents that family firms have higher abnormal accrual than non-family firms after controlling for the influence of board independence. Thus, they argue that family firms involve in more extreme EM due to the lack of independence of the board. This supports the view that family-owned firms are associated

with higher financial misstatement, which results from engaging, aggressive EM.

In addition, the findings in Table 2, Model 2 also reveal that EM variable is now positively and significantly associated with the occurrence of financial misstatement at 5% level, after controlling for the interaction effects of EM on other predictors. This result suggests that EM is a key factor that predicts the occurrence of financial misstatements.

However, although FOUNDER variable has a direct positive relationship with financial misstatements, the result of the interaction with EM (FOUNDER*EM) is not significant. Thus, we conclude that there is no support for H_{5c}. This result simply suggests that founder-led firms do not manage their earnings using working capital accruals. Perhaps, they might use other methods of misstating earnings, such as the use of related-party transactions (RPT) as evidence in Gordon and Henry (2005). Gordon and Henry (2005) who examined RPTs and EM document that misstating firms with founder-led managers tend to involve in higher RPTs as compared to non-founder-led firms.

6. CONCLUSIONS

Exploitation of financial statements is common in Malaysian PLCs as evidenced by high-profile fraud cases such as Transmile Group Berhad, Megan Media Holdings Berhad, MEMS Technology Berhad. Hence, in order to regain public trust on Malaysian PLCs, firms need to be more transparent to report their actual performance and establish sound corporate governance mechanisms to mitigate initiatives for financial misstatements. Firms need to convince public that appropriate action has been taken to ensure high-quality financial statements been prepared. Perhaps, Malaysia's regulatory enforcement should be strengthened as a means to deter future wrongdoing, particularly in relation to the financial reporting quality.

The current study attempts to identify the association between management motives measured using financial distress, family ownership, founders on board and EM with the likelihood of financial misstatements. Specifically, this study examines the moderating effect of EM on the relationship between the other three independent variables (i.e., financial distress, family ownership and the existence of founder on the firm's board) and the occurrence of financial misstatements. The empirical evidence shows that the existence of founder on the firm's board and family ownership has significant direct relationships with the occurrence of financial misstatements. The existence of founder on the firm's board is positively related while family ownership is negatively related to the occurrence of financial misstatements. The direct relationship of the other two variables namely financial distress and EM are not significant. Nevertheless, when interacting with EM, the financial distress showed a positive and significant association with the occurrence of financial misstatements, and family ownership variable turn to be positively associated with financial misstatements. Such findings reveal that the extent of EM exercised by the management may influence the likelihood of financial misstatements in certain financially distressed firms

and family-owned firms. Besides, the interactions also improve the R-squared value from 7% to 12%.

This study contributes to the body of knowledge in financial reporting and financial misstatement or financial statement restatement literature, as well as the growing literature on forensic accounting. The findings may help regulatory bodies such as Securities Commission of Malaysia, Bursa Malaysia and the accounting profession in formulating clear guidelines, specifically regarding the exercise of EM, to improve the law enforcement in detecting financial misstatements. Besides, result from this study may assist firms, particularly by family-owned firms and firm that is managed by their founders, in formulating the best strategies to improve their internal control systems in combating financial misstatements. However, there are several limitations in this study. First, there may be other factors that can influence the likelihood of financial misstatements which are not included in this study, such as RPTs (Gordon and Henry, 2005) and board independence (Chi et al., 2015). Second, proxy used to measure financial distress and EM variables mainly depend on a study from developing country, and, this could be the reason for the insignificant findings between these variables and the occurrence of financial misstatements. Thus, the current study encourages similar studies to be conducted to include other variables and also to verify appropriate measures that significant to developing countries.

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