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INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA
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**THE LINKAGES OF CORPORATE
GOVERNANCE ATTRIBUTES AND DISCLOSURE
QUALITY: BEFORE AND AFTER THE
IMPLEMENTATION OF MALAYSIAN CODE ON
CORPORATE GOVERNANCE (MCCG)**

BY

YAZKHIRUNI YAHYA

**INTERNATIONAL ISLAMIC UNIVERSITY
MALAYSIA**

2006

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BY

YAZKHIRUNI BINTI YAHYA

**A dissertation submitted in partial fulfilment of the
requirement for the degree of Master of Science in
Accounting**

**Kulliyyah of Economics and Management Sciences
International Islamic University Malaysia**

JULY 2006

ABSTRACT

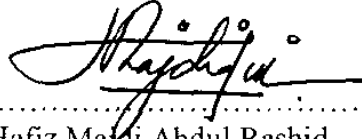
The Malaysian Code on Corporate Governance (MCCG) aims to set out principles and best practices on structures and processes that companies may use in their operations towards achieving the optimal governance framework. By using this as a framework, the study assumes that the company will significantly benefit from its adoption. Among the positive effects expected is the improvement in the level of corporate governance disclosure in the annual reports. As a measure of the level of disclosure, this study develops the "disclosure score" which was based on the Malaysian Code on Corporate Governance (MCCG) and Bujaki and McConomy (2002). The independent variables tested in this study were Duality (CEO Duality), percentage of Independent Board of Director (Outdir), Ownership Structures (Owner) and percentage of Independent Audit Committee (Auditcomm). This study used descriptive statistics, Mann Whitney U-Test, Correlation (Spearman's Rho and Pearson Correlation) and Linear Regression to test the hypotheses. Results show that, disclosure score is better for the year 2002 after the implementation of MCCG. In addition, larger companies disclosed more corporate governance information. While, the variables for the independent audit committee and independent board of directors are found significantly influence the level of corporate governance disclosure by companies in Malaysia.

ملخص البحث

يهدف القانون المالي المتعلق بشؤون إدارة المؤسسات التجارية (إم سي سي جي) على وضع مجموعة أسس/مبادئ وقواعد لأفضل الممارسات للأنظمة/تراكيب الإدارة والعمليات في المؤسسات التجارية؛ والتي يمكن للشركات استعمالها في عملياتهم للحصول على إطار إدارة مثالي. وبناء على هذا المفهوم كإطار، تُفترض هذه الدراسة بأن الشركة سوف تُستفيد بشكل ملحوظ من تبني مضمون هذا الإطار. ومن بين التأثيرات الإيجابية المتوقعة لدى تبني هذا الإطار، هو تحسين مستوى الشفافية في التقارير السنوية من قبل إدارة الشركة. وكمقياس لمستوى الشفافية، تُطور هذه الدراسة "معدل الشفافية" معتمدة في ذلك على القانون المالي المتعلق بإدارة المؤسسات التجارية (إم سي سي جي) ويوجاكي ومكونومي (2002). ومن بين المتغيرات المستقلة التي تم إختباره في هذه الدراسة، هي حالة ثنائية دور المدير التنفيذي (سيودواليتي) (CEO duality)، ونسبة المدراء المستقلين في لائحة/مجلس المدراء (Outdir)، وتركيب الملكية في الشركة (مالك) ونسبة مدققى الحسابات المستقلين من جملة لجنة مدقق الحسابات (أوديتكوم) (Auditcomm). واستعملت هذه الدراسة الإحصاء الوصفي، وإختبار مان ويتني يو (Mann Whitney U-Test)، والإرتباط (رولسبيرمان، وإرتباط بيرسون)، والإحدار الخطي لإختبار الفرضيات المطروحة. وقد أظهرت نتائج البحث بأن "معدل الشفافية" "disclosure score" كانت بشكل أفضل للسنة 2002 بعد تطبيق القانون المالي المتعلق بإدارة المؤسسات التجارية (إم سي سي جي). وبالإضافة، فإن النتائج تشير بأن أداءات الشركات الكبرى بما يتعلق بالشفافية تجاه معلومات إدارة المؤسسة كانت بدرجة أكبر قياسياً. بينما نجد تأثير المتغيرات الممثلة لمجلس مدققى الحسابات المستقلين، والمستقلين من أفراد مجلس الإدارة، يظهر بشكل ملحوظ على مستوى شفافية إدارة الشركات في ماليزيا .

APPROVAL PAGE

I certified that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.



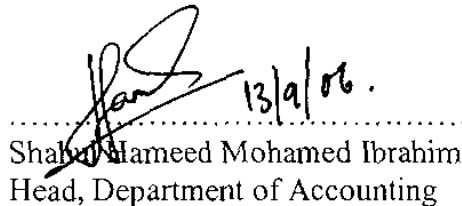
.....
Hafiz Majdi Abdul Rashid
Supervisor

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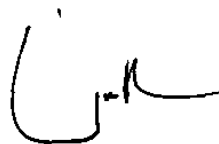
.....
Fatima Abdul Hamid
Examiner

The dissertation was submitted to the Department of Accounting and is accepted as a partial fulfilment of the requirements for the degree of Master of Science in Accounting.



.....
Shabir Mameed Mohamed Ibrahim
Head, Department of Accounting

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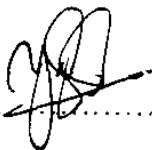


.....
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DECLARATION PAGE

I hereby declare that this thesis is the results of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Name: YAZKHIRUNI BT YAHYA

Signature: 

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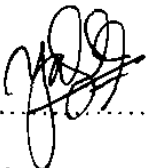
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I dedicate this dissertation to my ayahanda and bonda

Hj. Yahya Ismail & Hjh. Zaiton Hanas

Yours the words that shaped my voice,

The spirit within mine.

Yours the will that shaped my choice,

My fortune, and my sign.

How lucky I was to have had you .

At the core of me!

Wise and good, you always knew

Just what I could be.

And so I came to be someone

Whom I could be proud of.

For this I give my swollen sum

Of gratitude and love.

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LIST OF ABBREVIATIONS

ANOVA	Analysis of Variance
ASB	Accounting Standard Board
ASX	Australian Stock Exchange
BCCI	Bank of Credit and Commerce Industry
CBI	Confederation of British Industry
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COSO	Committee of Sponsoring Organization
CPA	Chartered Public Accountant
FPLC	Federation of Public Listed Companies
FRC	Financial Reporting Council
FTSE	The index company – Owned by The Financial Time and London Stock Exchange
GRI	Global Reporting Initiatives
ICAEW	Institute of Chartered Accountants in England and Wales
JPK1	Working Group on Best Practices in Corporate Governance
KLSE	Kuala Lumpur Stock Exchange
MASB	Malaysian Accounting Standard Board
MCCG	Malaysian Code on Corporate Governance
MICG	Malaysian Institute of Corporate Governance
MNCs	Multinational Corporations
NEAC	National Economics Action Council
NYSE	New York Stock Exchange
OECD	Organization for Economics Co-Operation
OLS	Ordinary Least Squares
PLCs	Public Listed Companies
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
SARBOX	Sarbanes Oxley
SC	Securities Commission
SEC	Securities and Exchange Commission
SES	Stock Exchange of Singapore
TSE	Toronto Stock Exchange
U.K	United Kingdom
U.S	United States of America
VDI	Voluntary Disclosure Index
VIF	Variation Inflation Factors

CHAPTER 1

BACKGROUND OF STUDY

Corporate governance issues have evolved and grown significantly in the last decade. The problems of corporate governance actually have been highlighted by Adam Smith (1723 – 1790) in his book “Wealth of the Nation” which stated that “Being the managers of other people’s money (rather than their own)... it cannot be expected that they should watch over it with the same anxious vigilance”. Therefore, the corporate scandals such as Enron, Maxwell and BCCI are nothing new since the problems have already occurred and have been discussed before. Corporate governance encompasses the set of institutional and market mechanisms that induce self-interested managers (the controllers) to maximize the value of the residual cash flows of the firm on behalf of its shareholders.

Research is increasingly showing that good corporate governance can lead to improved share price performance. Studies also show that investors are more keen to invest in well-governed companies. Thus, corporate governance can be a powerful tool to enhance the development of a company.

Many efforts have been made in order to help and solve the problems such as the development of the committees to discuss on the governance matters such as Cadbury Committee, Hampel Committee and the Organization for Economic Co-Operation and Development (OECD). In 1999, the OECD committee published Global Corporate Governance Principles which identify the key elements of good corporate governance such as rights and obligations of the shareholders, role of stakeholders and corporate governance, transparency, disclosure of information, board of directors, executive’s management, compensation and performance.

For this study, it is assumed that the primary responsibility for the preparation and the fairness of all the corporate information such as financial information and management information resides with the corporation itself and by extension, its management. Recent empirical work on the association between disclosure and corporate governance include Collet and Hrasky (2005), Bliss and Balachandran (2005), Bujaki and McConomy (2002), Forker (1992) and Chen and Jaggi (2000). The study done by Collet and Hrasky (2005) is more on the voluntary information of corporate governance and the impact of company's performance. Meanwhile, Bliss and Balachandran (2005) examine the association between corporate governance attributes and the extent of disclosure quality. Bujaki and McConomy (2002) examine the comprehensiveness of voluntary corporate governance disclosure in the annual reports and management information recommended by Toronto Stock Exchange (TSE). Then, Forker (1992) and Chen and Jaggi (2000) concentrate on specific issues of corporate governance such as corporate governance and share option disclosure and the association between the independent non-executives directors and comprehensiveness of information in mandatory financial disclosure, respectively.

However, this thesis will only concentrate on the issues of corporate governance disclosure and the relationship between corporate governance attributes which drive management towards increased disclosure levels. According to Bliss and Balachandran (2005), the board of director's composition influences the volume of voluntary disclosure and the extent of disclosure quality made by companies in its annual report

To provide empirical evidence for the factors affecting the level of corporate governance disclosure in the annual report and the association between the levels of disclosure with corporate governance attributes, 64 firms from the main board listed

on Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange – KLSE) have been selected for this research. In addition, this research will also look on the effect of the implementation of the Malaysian Code on Corporate Governance before and after its implementation.

1.1 OBJECTIVES OF THE STUDY.

Since little effort has been devoted in the accounting research literature in examining the empirical relationship between corporate governance attributes¹ and the extent of disclosure, this study tries to examine the relationship between these two issues. The first objective is to compare corporate governance disclosure in Malaysian companies' annual report before and after introduction of Malaysian Code on Corporate Governance. It is believed that, the level of corporate governance disclosure improved when the Bursa Malaysia mandated the rule that every listed company should comply with the Malaysian Code on Corporate Governance.

The second objective of this study is to ascertain whether a number of variables such as (1) dominant personality (duality), (2) percentage of independent board of directors (board composition), (3) percentage of independent board of director in audit committee (audit committee composition), (4) ownership structures and (5) control variables (i.e. firm size, leverage, types of industry, profitability and year) affect the level of corporate governance disclosure before and after the introduction of Malaysian Code on Corporate Governance (MCCG).

The last objective is to provide additional input to the policy makers in terms of providing evidence since the exposure or literature regarding corporate governance

¹ Such as board composition, board compensation, audit committees, ownership structures etc.

and the extent of disclosure has not been widely discussed by researchers and academicians. This can help to relate the importance of corporate governance attributes in producing or reporting high quality of annual report. Meanwhile, this is an important issue because the issues of corporate governance is ongoing and is becoming more controversial nowadays. Thus, it is hoped that this study will provide more evidence that good corporate governance practice is important for a company to drive its management towards better extent of disclosure, in terms of the volume of information disclosure.

1.2 MOTIVATIONS OF THE STUDY.

The Asian financial crisis in 1997 highlighted the realization that greater corporate disclosure was necessary to protect investors. Meanwhile, the lack of effective corporate governance has been identified as one of the major causes of many corporate collapses and corporate scandals around the world. This leads impairing investors' confidence. The followings are among the motivations of the study. Firstly, the study attempts to understand the relationship or linkages between corporate governance attributes and the extent of corporate governance disclosure. This information may be useful as a motivation for companies to disclose more information on corporate governance in annual report. Therefore, it will help to increase the level of transparency and stewardship for the companies. As a result, it can help to increase the level of confidence and reliability of investors and other stakeholders.

Secondly, this study would provide insights to investors, readers, and users of annual report on voluntary disclosure level of corporate governance. Thirdly, this study examines the effects of corporate governance attributes on the level of corporate governance information disclosure in the annual report. This will enrich and help the

regulators such as Bursa Malaysia in regulating effective rules and regulations. This is important in order to protect investor's need and to prevent any misconduct and misuse of capital provided by the investors.

1.3 OUTLINES OF THE STUDY.

This study consists of 6 chapters and organized as follows; First chapter consists of the background of the study, objectives and motivations of the study. The next chapter, i.e. Chapter Two, provides a review of the recent developments on corporate governance issues internationally and locally (i.e. Malaysia's environment). This chapter also provides some theoretical discussions on the issues of corporate governance such as the agency and stewardship theories. Chapter Three focuses on prior studies specifically in the area of corporate governance and disclosure practices. The literature review chapter is divided into two parts. The first part is on literature review of corporate governance and disclosure based on international environment such as in Australia, Canada, Singapore, and Hong Kong and second part is on studies done in the Malaysian environment.

Then, Chapter Four discusses the research methodology of the study. It explains the development of hypotheses, sampling procedures, selection of sample, periods of study, data collection, empirical model development and the measurement of the variables. The theoretical assumptions and empirical findings from the previous research have been used as the basis for the development of hypotheses for the study. Meanwhile, this chapter also discusses thoroughly on independent and dependent variables tested in this study.

The relationship between corporate governance attributes and corporate governance disclosure was analyzed and the findings of the tests were presented in

Chapter Five. The statistical analyses used include descriptive statistics, Mann-Whitney U-Test, Correlation analyses and linear regression. Finally, Chapter Six provides a summary and concludes the study. It also provides some insights on the limitations of the study and opportunities for future research.

CHAPTER 2

INSTITUTIONAL BACKGROUND AND THEORITICAL FRAMEWORK

This chapter briefly explains the history of corporate governance which is divided into two parts (1) Recent developments of corporate governance debate at international level and (2) Recent corporate governance developments in Malaysia. In the following section, a discussion on the theoretical framework of corporate governance is presented.

2.1 RECENT DEVELOPMENT OF CORPORATE GOVERNANCE DEBATE.

2.1.1 Corporate Governance Debate at International Level.

Corporate governance debate has evolved and grown significantly in the last decade. The issues arose most likely due to many corporate collapses that have occurred particularly during the twentieth (20th) century especially in the European countries. As a result, numerous countries have issued corporate governance codes, and the recommendations of these codes, that demonstrate "good" corporate governance, undoubtedly contribute towards increased transparency and disclosure.

The corporate governance debates started in the United States when the Treadway Commission issued a report on fraudulent financial reporting in 1987, which emphasized the role and status of audit committee. The Treadway Report required the Securities and Exchange Commission (SEC) to incorporate in its listing requirements in 1988, whereby all SEC regulated companies should have an audit

committee and the members of the audit committee must comprise a majority of non-executive directors. Further work done by a subgroup of Treadway Commission, COSO², developed a framework for internal control, providing detailed criteria for management to assess internal control system and guidance for reporting publicly on internal control.

Meanwhile in United Kingdom (UK) the corporate governance debates began due to a series of corporate scandals and financial distress problem in the late 1980s and early 1990s. The examples of corporate scandals occurred in UK's companies are BCCI, Poly Peck and Maxwell Communications Group. Due to this, the public started questioning how effective the boards of these companies had been monitoring the actions of their executive management.

As a subsequent to that scenario, the Cadbury Committee was set up in May 1991 by the Financial Reporting Council (FRC)³, the Stock Exchange and the accountancy profession in response to their concern about 'the perceived low level of confidence both in financial reporting and the ability of auditors to provide the safeguards which the users of company reports sought and expected'. The Cadbury Report emphasized on the responsibilities of the company to report on (1) the financial aspects of corporate governance (particularly in relation to financial reporting and accountability), (2) to consider the responsibilities of executive and non-executive directors, (3) the case for audit committees, (4) the principal responsibilities of auditors, (5) the extent and the value of the audit, and (6) the links between shareholders, boards of directors and auditors.

² Committee of Sponsoring Organizations (COSO) of the Treadway Commission, comprising CPAs, management accountants, internal auditors, financial executives and accounting educators.

³ Financial Reporting Council: is a body, which sets UK accounting standards, through its subsidiary organization, the Accounting Standards Board.