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Board diversity and discretionary accruals of the top 100 Malaysia corporate governance (MCG) index company

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This paper sought to examine the relationship between board diversity and discretionary accruals practices. Data was obtained from annual report for the year 2008 of the top 100 companies in Malaysia corporate governance (MCG) index. The discretionary accrual is measured using modified Jones model. The link was tested between five board diversity (that is, size, independence, competency, remuneration and gender) and discretionary accruals practices. The perspective of resource based view and agency theory was invoked to explain the board diversity that could influence the practice of discretionary accrual. The study revealed that discretionary accruals occurred even for the top 100 MCG companies. Women on board are found to have a positive significant relationship with discretionary accruals which indicate that higher number of women board may increase the discretionary accruals activity. In addition, it was also found that cash flow had a negative significant relationship with discretionary accruals which showed that companies with lower cash flow tend to use accruals to increase earnings.

Key words: Board diversity, gender, corporate governance, discretionary accrual, earnings management.

INTRODUCTION

Discretionary accruals or popular with term earnings management, occurs when “managers use judgment financial reporting and in 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” (Healy and Wahlen, 1999). Generally Accepted Accounting Principles (GAAP) allows alternative presentation of accounting information. In the absence of fraudulent reporting, management can alter reported earnings by choosing an accounting method in order to increase or decrease reported earnings (Teoh et al., 1998). This may lead to inaccurate presentation of information about the company. Therefore, discretionary accrual provides information asymmetry between insiders and outsiders of the firm which lead to agency problems.

Generally, firm managing earnings to “window-dress financial statements prior to public securities’ offerings, to increase corporate managers’ compensation and job security, to avoid violating lending contracts, and to reduce regulatory costs or to increase regulatory benefits” (Healy and Wahlen, 1999). The motive behind the discretionary accruals activities lies in the definition of discretionary accruals provided by Healy and Wahlen (1999); to mislead users or to influence contractual outcomes.

Matsumoto (2002) finds that firms manage earnings upward or guide analysts’ forecasts downward in order to avoid negative earnings surprises. This is similar to Park and Shin (2004) which found that earnings are managed upward to avoid reporting losses and earnings declines.

In China, Liu and Lu (2007) argue that the companies
may manage earnings with the objectives of benefitting the managers, for quick promotions, or pursuing political agenda. They also found that listed companies in China have strong incentives to manage earnings to avoid being de-listed. Following the Asian financial crisis in the mid 1997, it has created a negative effect on companies' performance which provides incentive to discretionary accruals (Chia et al., 2007).

In Malaysia, researches on discretionary accruals are still at an infant stage. Only a few studies have investigated the issue in Malaysian context; discretionary accruals and board characteristics (Mohd Saleh et al., 2005), audit committee characteristics (Mohd Saleh et al., 2007), board, audit committee and culture (Abdul Rahman and Mohamed, 2006) and board independence, competency and ownership (Johari et al., 2008). Hence, this study attempts to fill in the gap to achieve the following objectives; (1) to determine the relationship between board diversity and discretionary accruals among the top 100 MCG index companies. (2) To identify the influence of board gender diversity towards discretionary accruals.

The remainder of this paper is organized as follows: review of literature on board diversity and discretionary accruals; justification on theoretical framework which leads to the hypothesis development; research methodology; findings and discussion; conclusion.

LITERATURE REVIEW

The impact of corporate governance over discretionary accruals

There is a growing research that analyses the relation between corporate governance and its impact on earnings management. The study by Beasley (1996) and Dechow and Skinner (2000) demonstrate that certain attributes of corporate governance are generally associated with earnings manipulation. Board of directors play a vital role in controlling agency problem between shareholders and managers arise due to discretionary accruals (Ali et al., 2009). The number of director seats in the board is an important element in the effectiveness of the management of the company (Dalton et al., 1999). The smaller the board, the more efficient it is because close interactions and debates are possible (Firstenberg and Malkiel, 1994) and the more effective in monitoring managerial behavior as the smaller group forces members to be more engaged. While smaller boards lead to better company performance, larger boards may have communication and coordination problems, weakening the board’s control over the situation (Eisenberg et al., 1998). This is also consistent with Beasley (1996) who finds that companies with larger board sizes are more prone to fraud compared to those with smaller boards. However, Klein (2002) argues that large boards allow for directors to specialize in monitoring and have greater diversity among the committees of the board resulting in greater monitoring.

Independent board is one of the effective mechanisms in monitoring the accounting process (Klein, 2002). Therefore, board of director should consist of independent members, that is, non executive and/or external directors. The more the firms have external directors, the more effective they monitor managerial activities and incentive from the perspective of the shareholder than managerial directors as the incentives between these directors vary greatly. Beasley (1996) found that larger proportion of outside directors on boards reduces the likelihood of financial statement fraud while Johari et al. (2008), Peasnell et al. (2005 and 2006) and Xie et al. (2003) indicate high proportion of non-executive director are negatively related to lower discretionary accruals.

The Cadbury report 1992 emphasizes that the non executive directors’ competency is an important factor for the board to be effective. Among others, directors should have knowledge on managing company and corporate governance processes (Chtourou et al., 2001). Directors with accounting and finance background would have a better understanding of the implication of earnings manipulation, compared to managers who do not have that knowledge. Park and Shin (2004) found that only when outside directors have financial expertise are able to deter earnings manipulation. Firms with experienced external directors show significantly lower level of income increasing discretionary accruals compared to other firms (Chtourou et al., 2001). This is consistent with Xie et al. (2003) who found that the relationship between experienced board of director (directors with corporate and finance background), with discretionary accruals is low. Similarly, Agrawal and Chadha (2005) indicate that the probability of earnings manipulation is low for firms with board of directors who have knowledge in accounting and finance.

Malaysian corporate governance index (MCGI)

The Malaysian corporate governance index (MCGI) is the first of its kind in Malaysia which is introduced to measure the corporate governance levels in Malaysian public listed firms. The companies are screened and measured based on their conformance, performance and practice. Therefore, the index will ensure that companies not only comply with standards and regulation, but also present fair, transparent and good financial performance.

There are four stages to evaluate the top 100 PLCs in MCG Index. Stage 1, comprises 45% base score. Scoring based on the Malaysian Code on Corporate Governance, listing requirements of the best practices. In order to go to stage 2, PLCs must score 50% or more in the base score and 5-year average ROE of 4% or more. In stage 2, comprise of 25% bonus and penalty.
The company is assessed in terms of separation of Chairman/CEO, independent directors, director’s training, board diversity and whistle blowing policy. Some criteria that are more important will be given additional points while penalties imposed if reprimanded by authority or issues that irk minority shareholders. Stage 3 consists of 10% for performance and market cap whereby the performance criteria 5-year average return on equity (ROE) is given additional points when above minimum, depending on range. Final stage evaluates for 20% analysis input based on quality of Chairman Statement/CEO Review, Internal Control Statement, Corporate Governance Statement, Corporate Social Responsibility (CSR), communication matters, recurrent related party transactions and shareholding structure. In addition, the quality of disclosures in annual report and websites is monitored and taken into consideration.

The MCGI would be useful to the industry players particularly to the investors that require companies in which they invest to meet certain standard in terms of corporate governance.

THEORETICAL FRAMEWORK

Resource based view and agency theory

Resource based view and agency theory can be employed to explain issues of board diversity in the participation and leadership of board of directors. The composition of board of directors and its committee will have substantive implication to the firm (Zhang and Rajagopalan, 2004). Each director brings unique resources to organizations in terms of expertise, skill, information and potential linkage to external constituencies (Hillman et al., 2002). Resource based theory suggest that the acquisition and creation of valuable resources bring competitive advantage to companies as the board members and potential board members often present their experience, expertise and reputation that can benefit the firm (Dalton and Dalton, 2010). More diverse boards as regard to background of its members can reduce earnings management practices and at the same time reduce the possibilities of fraud in financial reporting (Beasley, 1996; Klein, 2002). The theory also implies that variety of occupational representation on a board increase the expertise present as well as the number of linkages to critical external constituencies (Hillman et al., 2002).

Similarly, agency theory suggests that a more diverse board may provides better monitoring of management, because board diversity increases board independence (Carter et al., 2007). Moreover, board members of diverse gender may better avoid practices of earnings management, thus, providing shareholders with more reliable figures financial reporting (Gallego et al., 2010).

The role of directors is imperative to counter managerial opportuinistic behavior, which include taking action for their own personal interest at the expense of shareholders interest (Donaldson and Davis, 1991). Therefore, board diversity can lead to an increase in effectiveness of monitoring, which can eventually lead to transparent and reliable reporting.

Hypothesis development

Board size is among the crucial corporate governance attributes that may have an impact on discretionary accruals. Smaller number of boards is more effective in monitoring the CEO’s action (Jensen, 1993). Similarly, Abdul Rahman and Mohamed (2006) found that discretionary accruals is positively related to the size of board showing that larger board is less effective in their oversight duties.

However, John and Senbet (1998) found that the board’s capacity for monitoring increases as more directors are added. Thus, our first hypothesis with respect to board size and discretionary accruals is:

**H**₁: There is a significant relationship between board size and discretionary accruals in top 100 MCG Index companies.

Another effective attributes in monitoring the accounting process is board independence (Klein, 2002). MCCG (2000) provides that, in order to be effective, bring independent judgment to the board and create accountability within the board team; at least one-third of the board should consist of independent non-executive directors. The board is believed to be more independent as the number of outside director increases proportionately (John and Senbet, 1998). Studies by Peasnell et al. (2005, 2006) and Xie et al. (2003) shows that external directors are negatively related to discretionary accruals. Their results support Beasley (1996), who found that board composition is important to reduce fraud. Meanwhile, Hashim and Devi (2008) in their study of 200 Malaysian public listed firms did not find evidence that independent non-executive directors mitigate the incidence of discretionary accruals. Hence, the second hypothesis with respect to board independence and discretionary accruals is:

**H**₂: There is a significant relationship between board independence and discretionary accruals in top 100 MCG Index companies.

Directors should have an adequate knowledge of particular board on which they are serving, the director they are interacting with, the company affairs and corporate governance processes (Chtourou et al., 2001). Chtourou et al. (2001) in their study of US firms found that firms with experienced external directors are negatively associated with discretionary accruals. In relation to this, Xie et al. (2003) and Agrawal and Chadha
(2005) argued that earnings manipulation is low for firms with directors who have knowledge in accounting and finance. However, a study by Johari et al. (2008) in Malaysian firms found no significant relationships between knowledge and experience of the Malaysian directors with discretionary accruals activities. Accordingly, the third hypothesis with respect to board competency and discretionary accruals is:

$H_3$: There is a significant relationship between board competency and discretionary accruals in top 100 MCG Index companies.

The Security Commission (SC) enhanced the Malaysian Code on Corporate Governance (MCCG) 2001 by requiring the companies to disclose directors' remuneration. Better remuneration serves as a motivating factor for directors to perform their duties well and may be able to constrain earnings management behavior. Study by Wenyao and Qin (2008), presents that remuneration committee could not influence in reducing earnings management practices. Shuto (2007) indicates the association between discretionary accruals and executive compensation. Furthermore, Dechow et al. (2010) found that CEO compensation is sensitive to the reported gains whereby, the gains appear to be treated as a regular earnings component. Thus, the following hypothesis is proposed;

$H_4$: There is a significant relationship between board remuneration and discretionary accruals in top 100 MCG Index companies.

The recent literature shows that the gender of the corporate executives and directors may affect corporate governance and the firms' financial performance (Adams and Ferreira, 2009). In particular, the executive gender diversity may impact managerial behavior (Peni and Vahamaa, 2010) which relate with either ethical or unethical behavior. With regard to the discretionary accruals practices, Healy and Wahlen (1999) viewed it as an unethical behavior because it provides misleading information to the stakeholders and it is unfair to competitors who do not engage in it. This unethical behavior entails a risk to those who engage in it (Roychowdhury, 2006). There is an evidence showing that female is more risk averse and more ethical than male (Wei and Xie, 2010). Peni and Vahamaa (2010) found that companies with female CFOs are associated with income-decreasing discretionary accruals. Niskanen et al. (2009) revealed that earnings quality is positively associated with gender diversity in corporate management. In addition, they found that female auditors allow more discretion in income reporting than male auditors. Following the claim of prior research the following hypothesis is proposed:

$H_5$: There is a significant relationship between gender of board and discretionary accruals.

RESEARCH METHODOLOGY

Data collection

Thompson's data stream was used to employ the data on discretionary accruals of top 100 MCG Index companies for financial year 2007 to 2008. Any missing data from the Datastream were collected manually from the respective annual reports, while board data were obtained by examining the disclosures in the annual reports. The 2008 financial year is selected as the MCG Index was announced in 2009. The top 100 MCG Index companies are examined because they are rated as the top 100 public limited companies (PLCs) in terms of corporate governance practices which include international best practices codes. Hence, these companies enable us to test the relationship of board diversity on discretionary accruals in the event of good corporate governance practices. The final sample represents 83 public limited companies. Firms from finance industries were excluded due to different statutory requirements and different accrual procedures.

Measurement of discretionary accruals

Consistent with Teoh et al. (1998), Xie et al. (2003) and Chitourou et al. (2001), this study uses modified Jones (1991) model as it was found to be superior than other extant methods at the time in detecting abnormal accruals that is, discretionary accruals (Dechow et al., 2000). In addition, a cross-sectional study is used instead of time series due to increased observation and it eliminates survivorship bias problem (Bartov et al., 2001). Current accrual is used since it is easier for managers to manipulate (Xie et al., 2003). Total current accruals (TAC), is defined as the changes in non cash current assets less the changes in operating current liabilities. TAC is decomposed into non-discretionary accruals (NDA) and discretionary accruals (DAC). Thus,

$TAC = NDA + DAC$

Non-discretionary accruals are considered as change in companies underlying performance (Rashidah and Afidah, 2002). In contrast, discretionary accruals are the managerial interventions into reporting process. In order to estimate NDA, the regression analysis is performed for current accruals on the change in sales. Specifically, the parameter of the following modified Jones model is described:

$$\frac{TAC_{ijt}}{TA_{ijt}} = \alpha_i \left( \frac{1}{TA_{ijt-1}} \right) + \beta_{ij} \left( \frac{\Delta Sales_{ijt}}{TA_{ijt-1}} \right) + \epsilon_{ijt}$$  \hspace{1cm} (1)

Where,

$TAC_{ijt}$ = Total accruals i.e changes in non cash currents assets minus changes in operating current liabilities for firm $i$, industry $j$ and year $t$,

$TA_{ijt-1}$ = Total assets for firm $i$ and year $t-1$,

$\Delta Sales_{ijt}$ = Changes in revenue for firm $i$ from year $t-1$ to year $t$,

$\alpha_i$, $\beta_{ij}$ = Specific parameters for industry $j$, and

$\epsilon_{ijt}$ = errors for firm $i$, industry $j$ and year $t$.

All variables are deflated by prior year's total assets to reduce the problem of heteroscedasticity. Consistent with prior studies (Rashidah and Afidah, 2002), NDA is defined as the fitted value of regressions using the parameter of estimates obtained in Equation 1 for each industry and year portfolio.
Table 1. Measurement of independent variables.

<table>
<thead>
<tr>
<th>No</th>
<th>Independent variable</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Board size</td>
<td>Number of board members (n)</td>
</tr>
<tr>
<td>2</td>
<td>Board independence</td>
<td>Number of independent non-executive directors divided by total number of directors on board (%)</td>
</tr>
<tr>
<td>3</td>
<td>Board Competency</td>
<td>Number of director who has professional qualification in accounting and finance</td>
</tr>
<tr>
<td>4</td>
<td>Board remuneration</td>
<td>Amount of board remuneration for a year</td>
</tr>
<tr>
<td>5</td>
<td>Board gender</td>
<td>Number of women on board</td>
</tr>
</tbody>
</table>

Table 2. Descriptive statistics for dependent and independent variables.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Min.</th>
<th>Max.</th>
<th>Mean</th>
<th>Standard deviation</th>
<th>Skewness</th>
<th>Kurtosis</th>
</tr>
</thead>
<tbody>
<tr>
<td>DAC</td>
<td>-0.6068</td>
<td>0.5569</td>
<td>-0.001704</td>
<td>0.1536977</td>
<td>0.143</td>
<td>5.461</td>
</tr>
<tr>
<td>ABDAC</td>
<td>0.0025</td>
<td>0.6068</td>
<td>0.099073</td>
<td>0.1170074</td>
<td>2.613</td>
<td>7.918</td>
</tr>
<tr>
<td>Bsize</td>
<td>5</td>
<td>13</td>
<td>8.00</td>
<td>2.000</td>
<td>0.417</td>
<td>-0.258</td>
</tr>
<tr>
<td>BIndep</td>
<td>30.00</td>
<td>83.30</td>
<td>47.3566</td>
<td>12.26963</td>
<td>0.655</td>
<td>-0.088</td>
</tr>
<tr>
<td>BComp</td>
<td>0.00</td>
<td>3.00</td>
<td>1.2530</td>
<td>0.60169</td>
<td>1.556</td>
<td>2.474</td>
</tr>
<tr>
<td>BRemun</td>
<td>5.51</td>
<td>10.80</td>
<td>8.0939</td>
<td>1.00186</td>
<td>-0.210</td>
<td>0.640</td>
</tr>
<tr>
<td>BWomen</td>
<td>0.00</td>
<td>4.00</td>
<td>0.7108</td>
<td>0.89074</td>
<td>1.352</td>
<td>1.789</td>
</tr>
<tr>
<td>Leverage</td>
<td>0.00</td>
<td>0.72</td>
<td>0.1452</td>
<td>0.89074</td>
<td>1.352</td>
<td>1.789</td>
</tr>
<tr>
<td>Cash Flow</td>
<td>-0.14</td>
<td>1.28</td>
<td>0.1233</td>
<td>0.18498</td>
<td>3.759</td>
<td>19.717</td>
</tr>
</tbody>
</table>

\[
NDA_{ij} = \alpha_{ij} \left( \frac{1}{TAC_{ij-1}} \right) + \beta_{ij} \left( \frac{\Delta Sales_{ij} - \Delta Rec_{ij}}{TAC_{ij-1}} \right) \quad (2)
\]

Where, 
DAC = Discretionary accruals
BSize = Board size
BIndep = Directors independence
BComp = Directors’ competency
BRemun = Directors remuneration
BGender = Women on board
Lev = Leverage
CF = Cash flow
ε = Error term

Since the discretionary accruals (DAC) can be obtained as \( TAC_{ij} - NDA_{ij} \), the discretionary accruals are estimated as follows:

\[
DAC_{ij} = \frac{TAC_{ij}}{A_{ij}} - \left[ \alpha_{ij} \left( \frac{1}{A_{ij-1}} \right) + \beta_{ij} \left( \frac{\Delta Sales_{ij} - \Delta Rec_{ij}}{TAC_{ij-1}} \right) \right] \quad (3)
\]

Measurement of board diversity

Table 1 presents the summary on measurement of each independent variable.

Data analysis

Linear multiple regression analysis is performed to test the relationship between the independent variables (including control variables) and the discretionary accruals. The assumptions underlying regression model are tested for multicollinearity based on the correlation matrix. Multicollinearity problem exist when the coefficient correlation between two variables is greater than 0.8 (Field, 2007). Normality test based on Kolmogorov-Smirnov (K-S) test is also conducted with significance level of less than 0.05 indicates that the distribution of the data is not normal (Field, 2007). All these analysis are performed using SPSS 18.0 for Windows software. The empirical models used to test the hypotheses are as follows:

\[
DAC = \beta_0 + \beta_1 BSize + \beta_2 BIndep + \beta_3 BComp + \beta_4 BRemun + \beta_5 BGender + \beta_6 Lev + \beta_7 CF + \epsilon
\]

FINDINGS AND DISCUSSION

Descriptive analysis

As shown in Table 2, the magnitude of the absolute accruals of the companies in the sample has a mean value of 0.099073 with the minimum value of 0.0025 and maximum value of 0.6068. Based on the one sample T-test, it shows that the p-value for absolute DAC is significantly different and thus, it provides evidence that even for the top 100 MCG companies, discretionary accruals is still occurring.

Based on Kolmogorov-Smirnov (K-S) test, all variables show significant value which indicates non normal data. Hence, Spearman correlation is used. Prior to perform regression analysis, data are transformed to normal scores (Young, 1998) in order to fulfill the requirements of linear regression to have normal distribution data (Field, 2007). The advantage of using normal scores is that the result from the test would have exact statistical properties as the significance level can be determined. Besides,
### Table 3. Spearman correlation.

<table>
<thead>
<tr>
<th>Variable</th>
<th>DAC</th>
<th>BSize</th>
<th>BIndep</th>
<th>BComp</th>
<th>BWomen</th>
<th>BRemun</th>
<th>Leverage</th>
<th>Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>DAC</td>
<td>1.000</td>
<td>0.228*</td>
<td>-0.210</td>
<td>-0.099</td>
<td>0.297**</td>
<td>0.152</td>
<td>0.207</td>
<td>-0.223</td>
</tr>
<tr>
<td>BSize</td>
<td>1.000</td>
<td>-0.340**</td>
<td>0.248*</td>
<td>0.219*</td>
<td>0.282**</td>
<td>0.129</td>
<td>0.215</td>
<td></td>
</tr>
<tr>
<td>BIndep</td>
<td>1.000</td>
<td>0.051</td>
<td>-0.195</td>
<td>-0.156</td>
<td>-0.045</td>
<td>0.075</td>
<td>0.218*</td>
<td></td>
</tr>
<tr>
<td>BComp</td>
<td>1.000</td>
<td>0.025</td>
<td>-0.006</td>
<td>0.075</td>
<td>0.218*</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BWomen</td>
<td>1.000</td>
<td>-0.086</td>
<td>0.069</td>
<td>0.024</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BRemun</td>
<td>1.000</td>
<td>0.286**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leverage</td>
<td>1.000</td>
<td>0.062</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash flow</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

** Significance at 0.01 level, * Significance at 0.05 level.

### Table 4. Multiple regression result.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>t-statistics</th>
<th>Sig. t</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.464</td>
<td>0.644</td>
<td></td>
</tr>
<tr>
<td>BSize</td>
<td>0.117</td>
<td>1.099</td>
<td>0.316</td>
</tr>
<tr>
<td>BIndep</td>
<td>-0.068</td>
<td>-0.628</td>
<td>0.532</td>
</tr>
<tr>
<td>BComp</td>
<td>-0.102</td>
<td>-0.951</td>
<td>0.345</td>
</tr>
<tr>
<td>BRemun</td>
<td>0.054</td>
<td>0.497</td>
<td>0.620</td>
</tr>
<tr>
<td>BWomen</td>
<td>0.321</td>
<td>3.070</td>
<td>0.003</td>
</tr>
<tr>
<td>Leverage</td>
<td>0.193</td>
<td>1.842</td>
<td>0.070</td>
</tr>
<tr>
<td>Cash flow</td>
<td>-0.263</td>
<td>-2.520</td>
<td>0.014</td>
</tr>
</tbody>
</table>

Both F and t-test, and also the regression coefficients from the transformation are more meaningful for interpretation.

### Correlation analysis

Table 3 presents the Spearman’s rho correlation which revealed that board size and women board have significant positive relationship with discretionary accruals (DAC). While negative correlation is found for the cash flow. The coefficient correlation for all variables shows no multicollinearity problems as none of the associations are having of greater than 0.8 (Field, 2007).

### Regression analysis

Table 4 depicts that women on board is positively and significantly to discretionary accruals. This indicates that higher number of women board may increase the discretionary accruals activities. Consistent with Peni and Vahamaa (2010) which found companies with female CFOs are associated with income-decreasing discretionary accruals. Niskanen et al. (2009) revealed that earnings quality is positively associated with gender diversity in corporate management. In contrast with Wei and Xie (2010) who found that female CFO firm-years have significantly lower discretionary accruals.

\[ R^2 = 0.270, F\text{-statistic} = 3.909, p = 0.001 \]

The finding also revealed that the cash flow has a negative association with discretionary accrual. This result is consistent with Peasnell et al. (2005). Becker et al. (1998) note that firm with strong operating cash flow performance is less likely to employ income increasing discretionary accruals to boost earnings because they are performing well. On the other hand, firms with poor operating cash flow are more likely to employ income increasing discretionary accruals to send a positive signal to investors.

However, no such relationship is observed for board independence, competency, remuneration and leverage. The result for board independence is consistent with the findings of Park and Shin (2004), Mohd Saleh et al. (2005) and Yang et al. (2009). Studies have found that having more outside independent directors on the board do not mitigate the incidence of discretionary accruals. A possible explanation is that some believe they perform little role in monitoring the board because lack of real independence, time and enough information (Abdul Rahman and Mohamed, 2006; Yang et al., 2009) and may be reflective of a corporate culture wherein corporate boards are controlled by management and the presence of outside directors has no discernible impact on management decisions (Petra, 2005). Meanwhile, Yang et al. (2009) claimed that, Malaysian outside directors may not fully independent in board and may be close friends of the non-independent directors or the people in board.

Financial leverage however is not significant with discretionary accruals. The result is inconsistent with Chang and Shun (2009), Park and Shin (2004) and Yang et al. (2009). The findings do not support the view that financial leverage factor affect managers’ discretionary accounting choices by practicing the earnings management when the firms are closer to default on debt convenient (Press and Weintrop, 1990 cited in Shen and
The study shows that firm's leverage does not have an impact on the effectiveness of corporate governance functions in monitoring accounting information.

Conclusion

This study examines the relationship between board diversity and discretionary accruals of top 100 MCG Index companies. The result shows that the MCG index companies do manage the earnings despite their best compliance on corporate governance. The findings also indicate that women on board have a positive relationship with discretionary accruals. It shows that larger women board may increase discretionary accruals activity. The results also show that firm with strong operating cash flow performance are less likely to employ income increasing discretionary accruals to boost earnings because they are performing well. The results however indicate that board independence, board competency, board remuneration and leverage do not influence the practice of discretionary accruals.

This study merely includes the board diversity and gender as variables tested. Future research could incorporate other board characteristics such as number of board meetings, competency, committee and corporate culture. Future study also could examine the impact of CEO and CFO gender on discretionary accruals as they involve directly in the management activities.

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