Audit Committee Characteristics and Unexpected Accruals: An Empirical Study of Malaysia

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Abstract

Even though there are many measures to put corporate governance in place and practice, an important tool for the success is the effective functioning of an audit committee (AC). As the eyes, ears and mouth of the board, the AC plays a pivotal role in helping to stop or reverse the rise in reported fraud incidents worldwide. Now-a-days, an AC is being looked upon as a distinct culture for CG and has received a wide-publicity across the globe. Regulation has bolstered the role of the AC in past years. Government authorities, regulators and international bodies all have indicated that they view an AC as a potentially powerful tool that can enhance the reliability and transparency of financial information.

High level of discretionary (or abnormal) accruals, which is a proxy of an earning management, is an issue that has received considerable attention around the world. Recently, the Malaysian Institute of Accountant's Financial Statements Review Committee indicates that there are common errors made in the audited financial statements in Malaysia, which suggests that earnings management in Malaysia is widespread. The main objective in this study is to investigate the association between audit quality and former auditor in audit committee on the level of discretionary accruals in the Malaysian public listed firms.

Two measurements models are used to estimate the level of discretionary accruals. The sample of this research study consists of 525 companies listed on the Bursa Malaysia for the financial year 2009. The results suggest former auditors in audit committee reduce discretionary accruals. However, other characteristics of audit committee are not significant related with earnings management. The present study does not examine the association board of director attributes and other external audit characteristics such as industry specialist on the level of discretionary accruals.

Key words: Discretionary Accruals, Audit Committee, Audit Quality.

1. Introduction

A corporation is a congregation of various stakeholders, namely, customers, employees, investors, vendor-partners, government and society. The relationship between shareholders and corporate managers is fraught with conflicting interests that arise due to the separation of ownership and control, divergent management and shareholder objectives, and information asymmetry between managers and shareholders. Due to these conflicting interests, managers have the incentives and ability to maximize their own utility at the expense of corporate shareholders. As a result, corporate governance structures evolve that help in mitigating these agency conflicts. Awareness of the OECD (2014) Principles of Corporate Governance is exceptionally high in the Asian region. All Asian economies are using the OECD Principles of Corporate Governance and outputs of the Asian Roundtable as a reference in the development of their regulations, corporate governance codes, listing rules, scorecards, as well as academic work. Simply stated, "Corporate governance is the system by which businesses are directed and controlled." In fact, corporate governance deals with conducting the affairs of a corporation in such a way that there is 'fairness' to all stakeholders and that its actions benefit the 'greatest' number of stakeholders. It is about "openness, integrity and accountability." Auditing is one of the most important elements of corporate governance and all the Codes of Governance across the world require the listed companies to form an Audit Committee. Thus, an audit committee is one of the mechanisms which help the Board of Directors to adopt better CG practices. Such ACs in the Board can help alleviate agency problems by reducing information asymmetry between insiders (managers) and outsiders. An effective AC is a leading aspect of a strong CG system. The board must set up an AC in order to monitor the accounting, reporting and auditing of financial statements. Auditing and reporting help in solving the agency problem and assists shareholders in monitoring and controlling the resources of a firm.

Recent accounting scandals and the resultant outcry for transparency and honesty in reporting have given rise to two disparate yet logical outcomes. First, forensic accounting skills have become very crucial in untangling the complicated accounting maneuvers' that have obfuscated financial statements. Second, public demand for change and subsequent regulatory action has transformed corporate governance scenario (Bhasin, 2016). Therefore, many senior-level company officers and directors are under the ethical and legal scrutiny. In fact, both these trends have the common goal of addressing the investors' concerns about the transparent financial reporting system. The failure of the corporate communication structure has also made the financial community realize that there is a great need for skilled professionals that can identify, expose, and prevent structural weaknesses in three key areas: poor CG, flawed internal controls, and fraudulent financial statements. Therefore, forensic accounting skills are becoming increasingly relied upon within a corporate reporting system that emphasizes its accountability and responsibility to stakeholders.

Discretionary (or abnormal) accrual, which is a proxy of earnings management (EM), is an important research area that has received considerable attention around the world. It has been argued that discretionary accruals masks the true financial results and position of businesses and obscures facts that stakeholders ought to know (Loomis, 1999). Hence, Lev (1989) recommends that research on motives and consequences of financial reporting manipulation should be a fundamental part of the earnings quality research agenda. This has led to a large and growing body of empirical research that investigates the existence of earnings management. Therefore, one of the most important topics related to managerial discretion is to identify the conditions in which mangers have incentives to manage earnings (Healy & Wahlen, 1999; Dechow & Skinner, 2000).

Leuz, Nanda and Wysocki (2003) show that Malaysian firms use aggressive accounting to indicate good financial performance. Based on data from 31 countries, Malaysia is ranked as one of the countries with higher incidence of earnings management compared to developed countries such as France, UK, Australia and US. Earnings management in Malaysia is also higher than a few developing countries such as Philippines and South Africa. Bhattacharya, Daouk and Welker (2003) compare earnings management across 34 countries and find that earnings aggressiveness in Malaysia is higher than the average. Out of the four South East Asia countries, earnings aggressiveness in Malaysia is worse than Thailand and Singapore but lower than Indonesia. Recently, the Malaysian Institute of Accountant's Financial Statements Review Committee (FSRC) highlights some common errors made in the audited financial statements in Malaysia which suggests that earnings management in Malaysia is widespread (Accountants Today, Dec. 2008).

Given the concern on the quality and reliability of audited financial statements, a major development that took place in Malaysia was the establishment of the Audit Oversight Board (AOB) in April 2010 to assist the Malaysian Securities Commission in fostering high quality independent auditing. The AOB consists of an executive chairman and six non-executive members, where not more than one-third are accountants. The AOB conducts regular and special inspections of audit firms and auditors determined on a risk-based approach, and at the end of the inspection process, audit firms are provided with inspection reports which indicate areas where firms failed to comply with auditing and ethical standards. We believe our findings help inform regulators, top management and audit practitioners on ways to improve audit committee and financial reporting quality.

Apart from investigating the association between audit committee characteristics and the level of discretionary accruals, the study is unique for developing countries as it also examines the role of former auditors in audit committee in constraining earnings management, and the differential effects of affiliated and unaffiliated former auditors. The "revolving door" hiring practice of appointing former audit partners as client management or directors deserves further examination as Naiker and Sharma (2009) and Menon and Williams (2004) obtain conflicting results on whether the appointment of former audit partners improve or impair the monitoring of internal controls and financial reporting in the US setting. Former auditors are suitable candidates to enhance the effectiveness of the audit committee because they have many years of direct experience with, and expertise on, auditing internal controls and financial statements, along with diverse corporate and industry experience (Naiker and Sharma, 2009). On the other hand, Iyer and Raghuandan (2002) used a survey to 83 former CPA firm respondents and find that CPA firms need to sensitize employees in the audit area to maintain professional scepticism when dealing with client personnel who are alumni of the firm. In addition, Lennox and Park (2007) find that companies with more independent audit committee members are less likely to appoint former auditor. In contrast, Lennox (2005) finds that alma mater affiliations companies are more likely to receive clean opinion especially when the alma mater held a senior position i.e. partner or senior manager.

To achieve the main objective of this study, which is to investigate the association between audit committee auditors on the level of discretionary accruals among Malaysian public listed firms, we examine 525 observations for year 2009. The period is selected due to several reasons. Firstly, the International Financial Reporting Standards (IFRS) was first implemented by Malaysian companies in 2006, and we want to avoid the contamination of data from the pre-IFRS period in estimating discretionary accruals. Secondly, Zuaini and Napier (2004) and Ghazali (2010) asserts

that that their studies fail to reveal significant results perhaps it was too early to analyze at the year of the regulatory changes might take a few years after it could be expected to show positive or intended results. Thirdly, due to the large amount of data that has to be hand-collected for the corporate governance variables, we limit the study period to one year to make the task viable.

We find that earnings management is significantly lower for firms that have former auditor in the audit committee. We also find evidence that suggests higher audit fees and longer audit firm tenure reduce discretionary accruals. On the other hand, we document that non-audit fees exacerbate earnings management.

2. Literature Review and Hypotheses

This section describes the methods and procedures of inquiry that are used in this study. The purposes of this study are to gauge the DAC in the public companies in Malaysia. The higher level of accruals may indicate a lower level of audit quality or audit committee effectiveness and less monitoring of institutional shareholders.

2. 1 Audit Committee and Earnings Management

The main responsibility of an audit committee is to control the financial reporting process as a key internal monitoring mechanism of a firm (Beasley & Salterio, 2001; DeZoort, Hermanson, Archambeault & Reed, 2002). Most research on audit committee effectiveness focuses on audit committee characteristics as defined by The Blue Ribbon Committee (BRC 1999). These characteristics include audit committee independence, audit committee expertise, audit committee size and audit committee activity. BRC (1999) argues that a more independent, active, knowledgeable and larger audit committee is better able to enhance the financial reporting quality. These attributes are likely to contribute to a better governance environment in a firm (Yatim, Kent & Clarkson, 2006), and are likely to decrease a firm's inherent and control risks associated with the firm's financial statements (Beasley, 1996; Dechow et al., 1996; Anderson, Mansi & Reeb, 2004). High quality audit committees are also more likely to support the internal audit function (Raghunandan, Read & Rama, 2001), appoint industry specialist auditor (Abbott & Parker, 2000), and are more likely to appoint high quality auditors when switching between auditors (Abbott & Parker, 2002). They are also less likely to have internal control problems (Krishnan, 2005). Audit committee members with business backgrounds are more likely to support the independent auditor (Knapp, 1987).

2.1.1 Audit Committee Independence

Klein (2002a) find the relationship between audit committee independence and earnings management significantly negative, and the lower the number of independent audit committee members, the more likely a firm is to use aggressive earnings management. This result is consistent with, Bédard, Chtourou and Courteau (2004), Van et al. (2004), Vafeas (2005), Yang and Krishnan(2005), Benkel, Mather and Ramsay(2006), Bradbury, Mak and Tan (2006), Saleh, Iskandar and Rahmat (2007), Jaggi and Leung (2007) and Lin and Hwang (2010). On the other hand, some studies do not find any a significant relationship between audit committee independence and earnings management (Xie, Davidson & DaDalt, 2003; Abdullah & Nasir, 2004; Lin et al., 2006; Abdul Rahman & Ali, 2006; Piot & Janin, 2007; Baxter & Cotter, 2009). The above discussion leads to the following hypotheses:

H1: There is a negative relationship between level of discretionary accruals and audit committee independence.

2.1.2 Audit Committee Size:

There are empirical studies that avail mixed evidence on the impact of audit committee size on earnings management. Yang and Krishnan (2005) find that audit committee size is negatively related to earnings management. Similarly, Lin and Hwang (2010) find the relationship between audit committee sizes and earnings management is significantly negative. This consequence is the same as Xie, Davidson and DaDalt (2003), Davidson, Stewart and Kent (2005), and Vafeas (2005). In contrast, Abdul Rahman and Ali (2006) and Saleh, Iskandar and Rahmat (2007) fail to find any significant relationship between audit committee size and DAC. In addition, Abbott et al., (2004) and Lin et al. (2006) show that the audit committee size does not influence restatement. This research examines that bigger audit committees are likely to decrease earnings management in the Malaysian listed firms. Hence, we provide the following hypotheses:

H2: There is a negative relationship between level of discretionary accruals and audit committee size.

2.1.3 Audit Committee Meeting Frequency:

In Malaysia, Mustapha and Ismail (2004) show that the higher the number of audit committee meetings, the lower is the likelihood that firms receives disclaimer audit report. Furthermore, fraud firms have less audit committee meetings compared to non-fraud firms (Beasley, Carcello, Hermanson & Lapides, 2000). The prior research on audit committee diligence and earnings management provides inconsistent evidence on the issue. For example, Xie et al. (2003), Vander, Zahn and Tower (2004), Davidson et al. (2005), Lin et al.(2006) and Lin and Hwang (2010) show a negative relationship between earnings management and the audit committee meetings frequency. In contrast, several studies find no association with earnings management (Yang & Krishnan, 2005; Choi, Jeon & Park, 2004; Baxter & Cotter, 2009). The above reasoning and previous evidence lead to the following hypotheses:
H3: There is a negative relationship between level of discretionary accruals and the frequency of audit committee meeting

2.1.4 Audit Committee Expertise:

Xie et al. (2003) show a significant negative association between audit committee financial expertise and earnings management. This result is similar to Choi, Jeon and Park (2004), Bedard et al. (2004), Abbott et al. (2004), Yang and Krishnan (2005), Vafeas (2005) and Baxter and Cotter (2009). However, others studies, such as by Vanderzahn and Tower (2004) and Lin et al. (2006) fail to find significant relationship between the magnitude of DAC and the audit committee's financial expertise. Similarly, others studies in Malaysia, report the association between the audit committee's expertise and earnings management are not significant for Malaysia sample (Abdul Rahman & Ali, 2006; Saleh, Iskandar & Rahmat, 2007). This research argues that audit committees with financial experts are likely to decrease earnings management in the Malaysian listed firms. Hence, we provide the following hypotheses:
H4: There is a negative relationship between level of discretionary accruals and former auditors in audit committee.

2.2.6 Discretionary Accruals

Davidson et al. (1987) defined earnings management as "the process of taking deliberate steps within the constraints of generally accepted accounting principles to bring about a desired level of reported earnings. Healy and Wahlen (1999) defined earnings management as occurring when managers use judgment in financial reporting, and in structuring transactions to alter financial reports to either mislead stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers.

There are various methods that have been developed by researchers to test earnings management as proxy by discretionary accruals, and the most widely used method to measure DTA in the literature are the Jones (1991) and the modified Jones (Dechow et al., 1995) models. Recently, some studies have argued that DA are more susceptible to earnings management (e.g., Ashbaugh et al., 2003; Jaggi & Leung, 2007; Jaggi et al., 2009). However, Kothari et al. (2005) argue that measuring DA without controlling for firm performance will produce misspecification in the earnings management model, therefore, they propose a model that includes an intercept and control for the firm performance using return on assets (ROA) to mitigate the problematic heteroskedasticity in residuals and mis-specified issues that exist in other aggregate accruals models. In this study, we use both discretionary current accruals (DCA) adjusted for lagged performance and discretionary total accruals (DTA) as proxies for earning management (Bamahros and Wan-Hussin, 2015). All the models are replicated and extended to accommodate the Malaysian setting.

3. Data and Methods

3.1 Sample selection

The board (including audit committee), auditor data are primarily hand-collected from annual reports, whereas financial data is collected from DataStream. This study utilizes the sample of all non-financial public listed companies on Bursa Malaysia during the period from 2007 to 2009. The period is selected because the FRS was first implemented in 2006 and thus the DA might be different in the period of pre- and post-FRS. The annual reports are available and downloadable from the Bursa Malaysia website (http://announcements.bursamalaysia.com). Banks and finance firms (insurance and unit trust) will be excluded from the sample due to their unique characteristics and highly regulated industry and their financial reporting requirements are different from other industries (Klein, 2002; Davidson et al., 2005; Peasnell et al., 2005; Abdul Rahman & Ali, 2006). The number of firms listed on the Bursa Malaysia at the end of 2009 is 985 firms (excluding firms listed on Malaysia Exchange of Securities Dealing and Automated Quotations Berhad (MESDAQ)). However, only 525 companies are usable in this paper.

3.2 Regression model

The following multiple regression model was utilized to determine the extent of the influence of each of the variables in the study on the DAC:

$$DCA = \alpha + \beta_1 ACSIZ + \beta_2 ACIND + \beta_3 ACMEET + \beta_4 ACAUDP + \beta_5 BIG4 + \beta_6 LNFEE + \beta_7 LNNAS + \beta_8 TENURE +$$

β_9LNASSET + β_{10}CFO + β_{11} SEGMENT$_P$ + β_{12} SEGMENT$_G$ + β_{13} FINANCE + β_{14} ROA+β_{15}LOSS+β_{16}SALGR+β_{17}MTB+β_{18}BANKRUPT+ε (1)

DTA = α + β_1ACSIZ + β_2ACIND + β_3ACMEET + β_4ACAUDP + β_5BIG4 + β_6LNFEE +β_7LNNAS + β_8TENURE + β_9LNASSET + β_{10}CFO + β_{11} SEGMENT$_P$ + β_{12} SEGMENT$_G$ + β_{13} FINANCE + β_{14} ROA+β_{15}LOSS+β_{16}SALGR+β_{17}MTB+β_{18}BANKRUPT+ε (2)

Where:

Dependent Variable:

- DCA = absolute discretionary current accruals obtained from both the performance adjusted model developed by Ashbough et al (2003),
- DTA= absolute discretionary total accruals obtained from the modified-Jones model.

Hypothesized Variables

- ACIND is measure by the percentage of the independent directors on the audit committee.
- ACSIZE is the number of directors serving on the audit committee.
- ACAUDP is the proportion of audit committee members who have auditing experience
- ACMEET is measured as the number of audit committee meetings held during the fiscal year.

Control Variables:

- BIG4 is a dummy variable indicating to 1 if the firm was audited by a Big4 auditor and 0 otherwise.
- LNFEE is (audit fee dependence) measured by total audit fees paid to the incumbent auditor less non-audit fees paid to the incumbent auditor.
- NAS is (non-audit fees) measured by total audit fees paid to the incumbent auditor less- dependence audit fees.
- TENURE1 is the number of continuous years the incumbent auditor has been with the client;
- TENURE1 - coded as 1 if the company does not change the audit firm in the year 2009 compared to the audit firm in year 2002, and 0 if otherwise,
- LNASSET - the natural log of total assets,
- CFO - cash flow from operation scaled by lagged total assets
- Firms Complexity - SEGMENTP, SEGMENTG, proxies for firm diversification;
    i. SEGMENTP - the number of product segments.
    ii. SEGMENTG - the number of geographical segments.
- FINANCE - dummy variable indicating to 1 if the firm has engaged in a merger or acquisition during the year and 0 otherwise.
- ROA - the return on assets,
- LOSS - a dummy variable indicating to 1, if ROA is negative, and 0 otherwise.
- SALGR - the annual growth of sales.
- MTB - the company's market-to-book ratio
- BANKRUPT - financial condition as defined by Zmijewski's (1984)1 financial condition index.

[1] financial condition index = 4.336 – 4.513*(net income to total assets) + 5.679*(total debt to total assets) + 0.004*(current assets to current liabilities).

4. Empirical Analysis

4.1 Descriptive Statistics

Table 1 shows the descriptive statistics for the sample. Provides the descriptive statistics for the variables used in this paper. The mean (median) of absolute value of DCA 0.071, (0.046), whereas the minimum value is much closer to 0 (0.0005). These results are consistent with local studies such as the study by Hashim (2011), who examined 462 firms listed in bursa Malaysia, and reported absolute value (0.049). On the contrary, the mean of absolute value of DCA in this study is less than 0.074 that reported by the Jalil and Abdul Rahman, (2010).

In terms of audit committee composition, the mean and median size of the audit committee is 3.25 (3), it is close to that reported by Saleh et al. (2007). About 87 percent are independent directors in audit committee it is higher than 68 percent reported by (Abdul Rahaman & Ali; Bradbury et al., 2006) which are basically following the previous recommendation of the old MCCG (2000), none of the audit committee has less than 50 percent independent members. The average size of the audit committee is three, with nearly two-thirds of the audit committees conduct more than four meetings per year, which is no different from studies conducted in Malaysia such as Adul Rahman and Ail (2006) and Yusof (2010). Interestingly, the proration of appoint former auditor (senior manager and audit partner) on the audit committee twenty six percent of the members have prior auditing experience (ex auditors).

The average percentage of companies audit by BIG4 auditors are 61percent, which is lower than that reported by (Salleh et al. and Yatim et al. 2006) 80% and 68.8%, respectively. The mean (median) of audit fees paid to external auditor in this sample 348000 (132000) and ranging from 7.00 to RM 20800, this mean is high than 282000 reported by Abdul Wahab et al. (2009). The mean (median) non-audit fees in this study 80797 (9520). The mean of audit firm tenure with clients (TENURE) more than 6 years, which also indicates that around 36% of sampled companies, had changed their audit firms over the period 2002-2009.

The control variables utilized in this study are LNASSETS, CFO, COMPLEXITY, FINANCE, ROA, LOSS, SALGR, MTB and BANKRUPT. Firm size as measured by natural logarithm of total assets (LNASSETS), the mean (median) of ASSTES is 1663692 (354607); this ranges from as small as 30 million to as large as 71363 billion, and this average is higher than 947812 reported by Bradbury, Mak and Tan, (2006) but lower than 1886000 reported by Abdul Wahab et al. (2009). Firm size right skewed and we log this variable LNASSETS to normalize it for multivariate analysis.

The mean and median CFO were 7.5%, and 7.2% of total assets respectively. The mean of CFO is larger than Abdul Rahman and Ali (2006) study that use Malaysian firms. The sample companies have on average three product segments and more than two geographical segments. During the sample period, 10.4 percent of the firms had financing. The average ROA is (0.039) this percent is different from previous local studies as Yusof (2010), Abdul Rahman and Ali (2006) who reported lower percent. The sample companies have, on average, three product segments and two geographical segments. Around twenty-four percent of the sample companies incur losses in 2009, it is close to that reported by Bradbury et al. (2006) find more than 20 percent of companies incur losses.

The average of sales growth in this study 1.372, The mean (median) of market - to- book (MTB) in this study 0.982 (0.650) that lower than US reported by Sun, Liu and Alan (2010) who examine 525 firms listed on the S&P 500 for the for years between 2003–2005 and report mean and median market-to-book 4.226 and 3.103 respectively. Finally, the average of mean (median) for BANKRUPT in this research is -3.197 (-3.340), the high values of BANKRUPT indicate higher financial distress. Thus, we expect the relationship between BANKRUPT and DAC should be negative related.

Table 1: Descriptive Statistics

Variable	Mean	Median	Minimum	Maximum	Std. Dev.
|DCA|	0.07	0.05	0	1.02	0.09
|DTA|	0.07	0.05	0	1.04	0.09
ACSIZ	3.25	3	2	6	0.51
ACINDP	0.87	1	0.5	1	0.15
ACMEET	4.98	5	1	15	1.36
ACAUDP	0.26	0.33	0	1	0.21
BIG4	0.61	1	0	1	0.49
FEES	348.18	132	7	20800	1061.37
NASFEES	80.8	9.52	0	6600	351.88
TENURE1	0.64	1	0	1	0.48
TENURE2	6.35	8	1	8	2.43
ASSTES	1663692	354607	29868	71363010	5488919.7
LNASSTS	12.95	12.78	10.3	18.08	1.42
CFO	117445.2	22289	-1524417	6450300	439410.29
CFO/ASST	0.08	0.07	-0.97	0.61	0.11
SEGMENTP	2.92	3	1	8	1.54
SEGMENTG	2.25	1	1	10	1.92
FINANCE	0.1	0	0	1	0.31
ROA	0.04	0.04	-0.59	1.62	0.11
LOSS	0.24	0	0	1	0.43
SALGR	1.37	-5.12	-93.99	1288.75	70.22
MTB	0.98	0.65	-5.76	27.82	1.68
LEV	0.22	0.2	0	0.85	0.18
BANKRUPT	-3.2	-3.34	-5.72	4.53	1.25
N=525					

4.2 Correlation Coefficients

The bivariate correlation procedure computes Pearson's coefficient, Speaman's and Kendall's tau-b and their significance levels. The results regarding the explanatory variables are approximately analogous under the test. In addition, they indicate a high significant positive correlation between two variables that are highly correlated (untabulated, LEV and BANKRUPT = 0.937), however, one of the variables included in the linear regression have variance inflation factors that exceed five. Nevertheless, from the Pearson correlation, the highest coefficient is 0.78 between LNASSET and LNFEES these correlations is expected and proposed that big companies give audit fees more than smaller companies, multicollinearity is not perceived as a serious threat, and the correlation with other variables have not more than 0.55. In this matter, Pedhazu (1997) indicates that colinearity under (0.8) is acceptable. With respect to the correlation among variables, the correlation matrix confirms that no multicollinearity exists between the variables as none of the variables correlates above 0.80.

Table 2 shows the correlation matrix among the explanatory variables based on Pearson correlations. The results showed that they are significantly associated among TENURE, ACAUDT, SIZ, CFO, $SEGMENT_G$, BANKRUPT and LOSS are significantly related to both modeling used to estimated current and total discretionary accruals ($p<0.01$). BIG4, FEE and PRSEG are also significantly related to both models used to estimated current and total discretionary accruals ($p<0.05$). Other variables are not associated with discretionary accruals.
BIG4 was positive associated with TENURE at the 1% level, showing firms with BIG4 auditors less expected to change their auditors in this study.

Table 2 illustrated that BIG4 have a significant positive correlation with the number of audit committee (ACSIZE). On the other hand, BIG4 have a significant negatively correlations with audit committee meeting (ACMEET) and percentage of audit committee independent (ACINDP). This result suggests that firms with larger audit committee size more likely to hire Big4 auditors than non-Big 4 auditors, and firms with higher meeting with higher percentage of independent directors less likely to hire Big 4 auditors, this results are consistent with Garcia et al. (2004). Firms with BIG4 auditors also have less likely to face financial distress or loss as shown by a negative association between BIG4 and BANKRUPT and LOSS. In addition, a significant positive also association between BIG4 with LNFEES, LNASSTS, ROA and CFO at the 1% level, suggesting that large firms or highly performance with good cash flow also likely pays more audit fees are likely to hire Big4 auditors than non-big4 auditors.

In terms of audit firm tenure this study find that firms with longer-tenured audit firm have significantly positive correlation with BIG4, NAS, ACSIZ, LNASSTS, ROA and CFO. These finding show that firms with big size and higher operating cash flows with good performance are likely to hire auditors for long time than those with poorer performance and operating cash flow.

TENURE was significantly negatively correlated with BANKRUPT, this indicated that firms with higher financial distress likely to change auditor than firms with lower financial distress, those perhaps higher firms with financial distress have more accounting and auditing issues than lower financial distress firms have and might because auditors' opinions or auditors might withdraw from them.

Interestingly, Audit fees and NAS positively and significantly correlated with BIG4, audit committee size and meeting. Firm size and firm complexity is also positively and significantly associated with audit fees, this result propose that large firms pay more audit and non-audit fees than do smaller firms.

Audit committee independence (ACINDP) is found to be negatively correlated with ACSIZ and BIG4, suggesting that a higher proportion of independent directors is related to small size of audit committee member and less likely to hire BIG4 auditors, and firms with high Geography segment more have higher proportion of independent directors in audit committee. ACAUDP a significantly negative association with $SEGMENT_P$, ACSIZE, LNASSET and BANKRUPT, suggesting that a higher proportion of former auditor in audit committee do relate to member with greater skills and expertise to constraint discretionary accruals and less get financial distress.

4.3 Multivariate Analyses

Table 3 presents main results of the regression that examine the effect of audit committee on discretionary accruals. The ordinary least squares regression results show the p-values reported in our regression results are based on White's standard error and robust to heteroscedasticity. The two DAC models that we use in this study have a good fit with adjusted R^2 ranging between 22 to 24 percent.

Even though the R^2 for this study considered comparable with the Malaysian study than by Saleh, Iskandar and Rahmat (2005) who study the relationship between board characteristics and earning management by used original Jones 1991 model. In addition, this study showed R^2 close to other study reported 0.21 that used discretionary current accruals than by Ashbaugh et al. (2003). In all the four models, out of the four hypothesized variables, only ACUDIT is highly significant, with a negative coefficient. This indicates that companies with former auditor in audit committee have lower discretionary accruals, their association is statistically positive significant. Thus, we find evidence to support of H4.

Our study suggests that one audit committee attributes have influences on discretionary accruals. Former auditor in audit committee seems to mitigate discretionary accruals. This finding supports the recommendations of the Malaysian Code Corporate Governance (2007) where the audit committees should include at least one member of an accounting association or have at least three years' working experience in order to be effective monitors of the financial reporting process. For their more, former auditor aspect of audit committee is strengthened, seems capable of improving the financial reporting process by reduce discretionary accruals.

However, the insignificant association between the size and numbers of independent directors on audit committee and audit committee meeting with discretionary accruals in both models. Based on the results in descriptive statistics, it shows that the average audit committee size is about 3 members. Out of 3 members, on average there are about 2.61 independent directors and 0.39 members are not independent. Therefore, even though they have negative relationships with discretionary accruals, they need some other characteristics or factors that might contribute to significant relationships.

Table 2: Pearson (Top) and Spearman (Bottom) correlations coefficients

		1	2	3	4	5	6	7	8	9	10	11	12	13	14
1	BIG4	1.00	0.25**	0.31**	0.37**	0.44**	0.17**	-0.12**	-0.09*	0.09	0.30**	0.15**	-0.07	0.00	0.03
2	LNAFEES	0.24**	1.00	0.41**	0.06	0.09*	0.18**	0.06	0.14**	-0.03	0.78**	0.03	0.27**	0.33**	0.29**
3	LNNASFEE	0.31**	0.31**	1.00	0.14**	0.16**	0.22**	-0.01	0.08	0.04	0.48**	0.06	0.17**	0.24**	0.13**
4	TENURE1	0.37**	0.05	0.14**	1.00	0.81**	0.03	-0.06	-0.06	-0.01	0.13**	0.09*	-0.02	-0.03	-0.03**
5	TENURE3	0.42**	0.09	0.16**	0.87**	1.00	0.08	-0.05	-0.06	0.01	0.16**	0.10*	-0.01	-0.03	0.03
6	ACSIZ	0.16**	0.16**	0.18**	0.03	0.07	1.00	-0.13**	0.13**	-0.07	0.28**	0.04	0.06	-0.02	0.07
7	ACINP	-0.11**	0.09*	0.00	-0.07	-0.06	-0.06	1.00	0.00	0.02	0.06	-0.02	0.03	0.13*	0.04
8	ACMEET	-0.09*	0.13**	0.07	-0.06	-0.06	0.13**	0.01	1.00	-0.02	0.05	-0.15**	0.12**	-0.01	0.02
9	ACAUDP	0.06	-0.04	0.01	-0.03	-0.03	-0.17**	0.02	-0.03	1.00	-0.08	0.07	-0.12**	0.01	0.02
10	LNASSET	0.30**	0.74**	0.41**	0.12**	0.15**	0.25	0.08	0.04	-0.11**	1.00	0.07	0.22**	0.25**	0.30**
11	CFO	0.13**	0.03	0.08	0.05	0.06	0.05	0.00	-0.18**	0.06	0.08	1.00	-0.11*	0.03	0.03
12	$SEGMENT_P$	-0.07	0.25**	0.16**	-0.02	0.00	0.08	0.04	0.13**	-0.12**	0.20**	-0.10*	1.00	0.16**	0.09*
13	$SEGMENT_G$	0.00	0.29**	0.19**	-0.04	-0.02	0.00	0.16**	0.00	0.03	0.23**	0.11*	0.12**	1.00	0.10*
14	FINANCE	0.03	0.23**	0.12**	-0.03	0.04	0.08	0.05	0.02	0.01	0.25**	0.10*	0.08	0.08	1.00
15	ROA09	0.23**	0.14**	0.07	0.12**	0.13**	0.15**	0.01	-0.11*	0.04	0.23**	0.50**	-0.06	0.04	0.18**
16	LOSS	-0.06	-0.07	0.00	-0.02	-0.03	-0.01	-0.02	0.06	0.01	-0.06	-0.14	-0.02	0.01	0.00
17	SALGR	0.06	0.14**	0.05	0.01	0.08	0.11*	0.05	0.04	0.05	0.09*	0.19	0.02	0.03	0.14
18	MTB	0.13**	0.18**	0.17**	0.00	-0.02	0.10*	0.01	-0.04	0.03	0.30**	0.28**	-0.08	0.09	0.25
19	BANKRUPT	-0.16**	0.22**	0.06	-0.09**	-0.10*	-0.10*	0.06	0.13**	-0.04	0.11*	-0.38**	0.15**	0.05	0.00

Tables 3: Regression Results of Audit Committee Characteristics and Discretionary Accruals

Variables	Expected Sign	Model 1 DAC			Model 2 DAC			Model 3 DTA			Model 4 DTA		
		Coeff.	t-statistics	Prob.	Coeff.	t-statistics	Prob.	Coeff.	t-statistics	Prob.	Coeff.	t-statistics	Prob.
ACSIZ	+	-0.001	-0.120	0.905	0.000	-0.010	0.993	0.003	0.510	0.612	0.004	0.650	0.518
ACINP	-	0.021	0.860	0.388	0.022	0.920	0.356	0.025	1.050	0.296	0.027	1.120	0.265
ACMEET	-	0.005	0.800	0.426	0.005	0.760	0.445	-0.003	-0.440	0.660	-0.003	-0.470	0.636
ACAUDP	-	-0.077	-4.360	0.000	-0.077	-4.360	0.000	-0.055	-3.180	0.002	-0.055	-3.180	0.002
BIG4	-	0.003	0.340	0.734	0.004	0.480	0.634	0.004	0.470	0.640	0.005	0.660	0.510
LNFEE	-	-0.012	-1.850	0.065	-0.012	-1.830	0.068	-0.007	-1.060	0.289	-0.007	-1.040	0.300
LNNAS	+	0.005	2.190	0.029	0.005	2.180	0.030	0.005	2.170	0.031	0.004	2.150	0.032
TENURE1	?	-0.018	-2.180	0.029				-0.022	-2.720	0.007			
TENURE2	?				-0.004	-2.200	0.028				-0.004	-2.810	0.005
LNASSET	-	-0.009	-1.930	0.055	-0.009	-1.940	0.053	-0.013	-2.800	0.005	-0.014	-2.790	0.005
CFO	-	-0.206	-1.340	0.181	-0.205	-1.330	0.183	-0.191	-1.140	0.255	-0.190	-1.130	0.259
SEGMENT*p*	?	0.005	2.180	0.030	0.006	2.200	0.029	0.004	1.510	0.131	0.004	1.530	0.126
SEGMENT*G*	?	0.008	3.060	0.002	0.008	3.040	0.003	0.009	3.060	0.002	0.009	3.030	0.003
FINANCE	+	0.030	2.100	0.036	0.031	2.170	0.030	0.028	1.850	0.065	0.030	1.930	0.054
ROA	-	0.052	0.700	0.485	0.053	0.700	0.484	0.015	0.180	0.854	0.016	0.200	0.844
LOSS	+	0.063	3.580	0.000	0.063	3.580	0.000	0.051	2.810	0.005	0.051	2.820	0.005
SALGR	+	0.000	-0.730	0.463	0.000	-0.610	0.539	0.000	0.040	0.970	0.000	0.090	0.925
MTB	+	0.007	1.800	0.073	0.007	1.780	0.076	0.009	2.170	0.030	0.009	2.150	0.032
BANKRUPT	+	0.001	0.130	0.894	0.001	0.160	0.872	0.004	0.830	0.405	0.005	0.870	0.384
Constant		0.228	4.370	0.000	0.237	4.470	0.000	0.251	4.830	0.000	0.261	4.940	0.000
R-Squared			0.241			0.240			0.223			0.222	
F Value			19.505			19.505			19.505			19.505	
Sig F			0.000			0.000			0.000			0.000	

Notes: the reported t-statistics are white-adjusted values to control for heteroscedasticity. N= 525,

5. Conclusion

The business failures of the past four decades have been closely associated with "Corporate Governance (CG)" failure, which very often involve a number of parties: senior-level managers, board of directors, auditors, and some institutional investors (Bhasin 2012, 2013). If the creative accounting starts with the loopholes in the accounting standards may be one of the biggest roles belong to the standard setters in decreasing the possible negative effects of CA. Moving away from the top-echelon of management team and Board of Directors' structure to audit, we believe that "an independent and powerful Audit Committee has to play very crucial role in discouraging the CA practices in the corporate world" (Bhasin, 2016a). As we know, the great financial scandals were based on accounting manipulation practices, but also on collaborations with the audit firms, which instead of acting as the 'guardians' of

the financial markets have come to overlook, to hide, and even to participate to some of the greatest frauds in the history. Thus, reform measures for the companies' CG systems were also imposed. It was equally revealed that one of the best ways to prevent the practice of CA is "to enforce both preventive, as well as, strong enough punitive measures on those that engage in CA practice."

This study examines whether the composition of audit committee members mitigate the discretionary accruals in Malaysian listed firms. The study covers 525 firms in 2009. Since most of the previous empirical studies focus on audit committee. The fundamental theories of this study are based on agency theory. The findings of this study indicate that the composition and the presence of former auditor's members on audit committee board are negatively associated with discretionary accruals. However, the association between audit committee size, independent and meeting with discretionary accruals are not significant. It might be due to the small size of audit committee board. The findings of the study will certainly make a significant contribution towards an understanding of the former auditor in audit committee effect on financial reporting quality.

Recent accounting scandals and the resultant outcry for transparency and honesty in reporting, therefore, have given rise to two disparate yet logical outcomes. First, forensic accounting skills have become very crucial in untangling the complicated accounting maneuvers' that have obfuscated financial statements. Second, public demand for change and subsequent regulatory action has transformed corporate governance (CG) scenario (Bhasin, 2016b). Therefore, many senior-level company officers and directors are under the ethical and legal scrutiny. In fact, both these trends have the common goal of addressing the investors' concerns about the transparent financial reporting system. The failure of the corporate communication structure has also made the financial community realize that there is a great need for skilled professionals that can identify, expose, and prevent structural weaknesses in three key areas: poor CG, flawed internal controls, and fraudulent financial statements. Therefore, forensic accounting skills are becoming increasingly relied upon within a corporate reporting system that emphasizes its accountability and responsibility to stakeholders. Moreover, by making a judicious mix of Audit Committee and Forensic Accounting, it would certainly help the stakeholders to protect their interests by controlling and reducing the tendencies to use earnings management practices in the corporate sector.

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