CONTRIBUTION FROM UNIVERSITY RESEARCH TEAM

FACTORS THAT MOTIVATES MANAGEMENT TO COMMIT FRAUDULENT FINANCIAL REPORTING

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The collapse of a number of companies as a result of accounting manipulation by managers has raised serious questions about the effectiveness of the monitoring mechanism to protect investors' interests and control managerial opportunistic behaviour. This study examines financial performance, environmental characteristics and governance mechanisms on fraudulent financial reporting in Malaysia. Logit regression was performed on a sample of 36 fraud firms and 46 no-fraud firms for the period of 2001 to 2009. The predictive accuracy of the logistic regression model is 66.1 percent. This study found that the greater the direct shares of the company owned by the board of director, the lesser would be the likelihood of fraudulent financial reporting. High stock ownership of board of director will increase the firm value, thus eliminating some of the inherent agency conflicts between the management and shareholders which is related to managers making decisions to benefit themselves rather than the shareholders. Even though the internal control quality was found not to contribute significantly to fraudulent financial reporting, it was found that fraud companies, have lesser voluntary disclosure of internal control system compared to no-fraud companies.

This study also found that the shorter the tenure of the CEO, the greater the tendency of the company to be involved in fraudulent financial reporting. It could be that fraudulent financial reporting activities were detected earlier rather than later, which could have led to the earlier termination of CEOs who were found to be fraudulent.

According to Malaysian Code of Corporate Governance 2012, it is recommended that the maximum tenure for independent directors should be a term of 9 years. However, others in the Corporate Governance Sector suggest an absolute term limits for directors, including CEOs who are directors be introduced. It is suggested that shareholders should be the group responsible to determine the tenure of CEOs, which could be the maximum of 9 years or shorter depending on whether the shareholders are happy with their performance.