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Corporate Governance And Earnings Management Practices: Moderating Role Of Audit Committees

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Abstract

Purpose- This paper investigates whether effective corporate governance eradicates the accrual earnings management practices while using the audit committee as moderating variable.

Design/methodology/approach– The data set consists of 1644 shariah-compliant non-financial firm-year observations from Hijrah Shariah Index Malaysia over the period 2008 to 2019. This study uses a two-step system generalize method of moment (2SYS-GMM) estimation techniques in which moderate variables are added into the model afterwards and earning management is measured from the modified jones model.

Findings- Study findings verified that corporate governance mechanisms significantly constrain the practices of earnings management. The findings highlight that board size, board independence, board meetings, non-existence of a CEO duality plays a significant role to curb the practices of accrual earnings management. Moreover, the moderating effect of the audit committee size and the member's independence of the audit committee also has statistical negative and significantly assists in reducing the earning management activities in Shariah-compliant non-financial firms of Malaysia.

Research implications– Policymakers and regulators can use the study's findings to strengthen the board of directors' oversight responsibilities to increase corporate accountability and transparency and maintain shareholders' interests.

Originality/value – This study is distinctive on the grounds it explores the issue linking inward pressures from the owners and outer obligations from the investors regarding earning management phenomena. Previous studies, both locally and globally, had neither developed nor empirically tested the proposed model.

Keywords- Corporate governance, Earnings management, Non-discretionary accruals, Investor sentiments

Introduction

Earnings management (EM) is the way of achieving the goals to enhance the worth of the company's market value through the best practices of governance (Yuniarti & Hanim, 2017). In today's economy, earnings management is a common term used by managers in accounting activities and managers' involvement in earning management intentionally to get targets like to increase shareholders' wealth, or to get personal benefits (Asogwa et al., 2019). Companies practice earning management in either progressive or regressive directions of earnings (Kighir, Omar, & Mohamed, 2013). This cause is known as earning management to either ascend or descend and it can be managed with the purpose of the pros and cons of earning forecasting (Kighir et al., 2013). In the last few decades, gigantic accounting fraud exposed in stock markets, once more it has confirmed the presence of ethical failure and the importance of transparency and reliability of financial information provided to stock markets (Chen, Cumming, Hou, & Lee, 2016). Companies have the option to choose a legitimate and unapproved way to manage earnings to achieve a specific goal that can impact an entity's revenue. Consequently, investors, and stakeholders, start to raise queries about the manipulation of accounting reports, frauds, and the effectiveness of the governance mechanism of organizations, as well as a massive body of literature, obscured the issues related to EM that are considered the critical factor in financial reporting. Uwuigbe, Uwuigbe, and Okorie (2015) explain earning management employing a willful association of reporting or production decisions based on their financial impact. Oehmichen (2018) find how managers should carefully adjust reports to either deceive investors by changing contractual outcomes that depend on the disclosed accounting figures and the fundamental economic management of the organization.

Several prominent scandals such as Enron, Xerox, WorldCom, Flowtex, Royal Ahold, Marconi, Parmalat, and Tyco all around the world, led to the emergence of ‘corporate governance as an important issue (Goel, Kumar, Singh, & Manrai, 2017; Oehmichen, 2018). These disasters negatively influence investment opportunities and reveal the lack of effective governance mechanisms for poor financial disclosure (Lutfi et al., 2016). The corporate sector was sapped by corporate governance scandals and triggered the largest economic failure in history (Shahzad, 2016). Failure to curb these scams has sparked a lot of debate over the viability of existing corporate governance roles, principles, structures, and mechanisms (Aguilera & Crespi-Cladera, 2016).

Similarly the sub prime crisis also effect on the Malaysian economy in 2008, which highlight the weak corporate governance practices, miss reporting, disclosure and accountability, weak transparency (Burdekin & Langdana, 2015). Specifically, earning management has become the major agonizer of the collapse subprime crisis (Shahzad, 2016). Moreover, through the earnings management process companies hide their actual performance and mislead stakeholders. Managers maximize their interest by manipulating the financial report (Rehman, Aslam, & Iqbal, 2021). Earning management is a concern on the need to provide reliable quality accounting information in the financial report because whenever the interest of shareholders deviates, managers manipulate the earning for their reasoning, conferred based on shareholders' interest. Therefore, it becomes a matter of investigating the protection and interests of shareholders and stakeholders, examining the cause of governance failure, and investigating the transparency, credibility, and quality of financial reports through legislation or other revelation standards (Armstrong, Guay, & Weber, 2010).

These scams tended to manage earnings in general, although earnings management and corporate governance got a lot of consideration and have a significant impact on the global business economy (Lutfi et al., 2016). Undoubtedly, the concern related to CG and EM shortfalls are justified and remains an apprehension with the growth of an organization, with the relative contradiction of agency conflicts and inconsistent interests between management and investor rights (Omar, Rahman, Danbatta, & Sulaiman, 2014). Therefore, the present study fills the gap by examining corporate governance (internal mechanism) that they have an alliance with earning management behaviour. Second, in this study researcher evaluated the presence and role of auditor monitoring capability to exercise moderating impact on the earning management of corporations. Third, the finding of this study is based on Shariah-compliant non-financial firms listed Bursa Malaysia Hijrah Shariah Index. Lar, this study employed the 2SYS-GMM method to control the unobserved endogeneity and heterogeneity, which were missed by a large portion of the literature.

The rest of the paper follows the following structure. Second section outlines the relevant literature on corporate governance and audit committees on earning management. The third section describes the research methodology. Fourth section discusses the findings, and the last section concludes the overall study.

2. Literature and hypotheses development

2.1. Board Size

The size of the board is intended by its number of members and the ability to monitor the board. The size of the corporate board and its influence on earnings management practices are still a matter of debate (Al-Haddad & Whittington, 2019: Gulzar, 2011). According to conventional agency theory, managing managers for companies with large boards is likely to be less effective because of these boards' potential coordination and communication issues (Jensen, 1993). Consequently, permitting opportunistic managers to involved in self-dealing, such as raising earnings and expanding their remuneration plans (Jensen & Meckling, 1976). When the size of the board increases then it can be expected that due to the high degree of inspection and oversight of the board of directors, the extent of discretionary accruals will be minimized, and the quality of financial reporting will be improved (Muda, Maulana, Sakti Siregar, & Indra, 2018). In this case, board members provide more benefits to their companies through the sharing of alternative company experiences, which can reduce the magnitude of earning management, and able to make effective communication and well timely strategic decisions (Al-Haddad & Whittington, 2019)

The study by González and García-Meca (2014) examined that a smaller board size seems to associate with the failure of the organization. Aslam, Ur-Rehman, and Iqbal (2021) stated that size of the board should not exceed more than eight or nine directors; the exceeding number of board members decreases the effectiveness because of coordinating flaws. Some studies find that larger boards are less efficient in their oversight functions than smaller boards (Alareeni, 2018; Wali &

Masmoudi, 2020). In contrast, the study Huynh (2020) recognized that a large board size could lessen the practice of earnings management or decrease the proportion of discretionary accruals and reported a negative relationship between the board size and earning management. Similarly, the study of El Diri, Lambrinoudakis, and Alhadab, (2020), stated that larger board has vast expertise so they help to curb the earning management practices in the firms. In the light of above discussion, the present study proposed the following hypothesis.

H1: Large board size reduces the earning management practices in Malaysian firms.

2.2. Board Independence

Board independence presents the total number of independent directors on the board (Aslam & Haron, 2020). Board independence is important because it improves the effectiveness of the board as a control mechanism and strong the CG mechanism. The earlier study demonstrates how the interaction between independent non-executive directors and earnings management can lead to conflict (Saona, Muro, & Alvarado, 2020). Board independence can prevent managers from abusing their positions of authority, waning investor interest, and effectively restraining earnings management. The study by da Costa (2017) intimated that the presence of non-executive directors on the board is due to a potential shortage and weakening of the alliance between the board of directors detriment and the corporate governance system However, several studies found the mixed results (Saona, Muro, & Alvarado, 2020; Wasan & Mulchandani, 2020) and some studies independence of the board is less likely to involve activities of financial statements manipulation (Luthan & Satria, 2016; Uwuigbe et al., 2015).

On the other side, several prior studies find a negative association between board independence and earning management (Chen, Cheng, & Wang, 2015; Chi, Hung, Cheng, & Lieu, 2015; Fuzi, Halim, & Julizaerma, 2016). The perspective of earlier work, and various empirical data imply that a higher proportion of independent directors in governance boards increases the integrity of the financial report and provides assurance about the quality of earnings. Thus, the current study will examine the impact of the board of directors' independence on practices of earning management. Based on the above discussion the following hypothesis is proposed.

H2: Board independence reduces the earning management practices in Malaysian firms.

2.3. CEO Duality

If the same individuals occupy both the Chief Executive Officer (CEO) and the Chairman positions inside an organization, this is referred to as CEO duality (Aslam & Haron, 2021). The CEO is responsible and delegating duties for implementing the firm's policies, running it daily, and acting as a firm representative for the stakeholders (Chi et al., 2015). While as, the responsibility of the chairman is to ensure the work of the board and provide timely, clearly accurate information, and promotes accountability and transparency throughout the firm (Aslam, Ur-Rehman, & Iqbal, 2021). Ab Razak and Palahuddin (2014) have found that the role of an individual having duality is positively related to discretionary accrual. Moreover, Bouaziz et al. (2020) reviewed the positive impression of CEO duality and the negative impression of earnings management and earning management measured by discretionary accrual. CEO with double function is more incited to manage earnings. Because having more power on the board makes it easier to inflate earnings by manipulating financial reports (Ab Razak & Palahuddin, 2014).

Aslam, Ur-Rehman, and Iqbal (2021) documented that when the same person holds the positions of chairman and CEO of the board, there are ample opportunities for administrative discrimination and the board is less autonomous and likely to oversee the management's behaviour of earnings management. From the perspective of the agency's theory, when CEO simultaneously occupies two positions, the shareholders' interests will be sacrificed as there will be management opportunities and the loss of the agency. Independent chairman-CEO structured corporations can significantly prevent earnings management activities and can get better corporate performance (Chi et al., 2015) and earnings quality (Asogwa, Ofoegbu, Nnnam, & Chukwunwike, 2019). Contrarily, the notion of stewardship contends that CEO duality can be beneficial for excellent performance because of the unity of power it delivers. The management dual function will improve stable performance because management compensation is tied to stable performance and the CEO's strategic vision can leastwise frame the firm's fortune as a board intervention. In light of the above discussion, the following hypothesis is proposed.

H3: Non-CEO duality reduces the earning management practices in Malaysian firms.

2.4. Board Meetings

The number of board sessions conducted in a year is connected to board meetings. It is an indicator that reflects their attention toward the duties of the board (Aslam, Haron, & Ahmad, 2020). The frequent meetings among the board of directors connected them more involved in resolving the issues as management and enhancing the efficiency of the board (Nuryana & Surjandari, 2019) and minimising the risk of accounting fraud, and the control overseeing become easier to execute (da Costa, 2017). Furthermore, it has been determined by Asogwa, Ofoegbu, Nnnam, and Chukwunwike (2019) frequency of board meetings strengthens the firm's earnings quality in terms of earnings forecasts and persistence in earnings.

Board meetings and earnings management have a favourable and significant association (Muda, Maulana, Sakti Siregar, & Indra, 2018). Obigbemi, et al., (2016) pointed out a positive and significant relationship between a board meeting and earnings management. While the study of Muktadir-Al-Mukit and Keyamoni (2019) finds that board meetings have no significant impact on earning management. The different empirical results among the board meeting and earning management due to the differences in countries' corporate governance codes, regulations, structures as well as the standards that are implemented (Chakib & Rihab, 2017; Farooq & AbdelBari, 2015). Thus, most of the literature suggests that board meetings increase the accuracy and reliability of financial statements and alleviate the activities of earning management (Asogwa et al., 2019; Gulzar, 2011; Obigbemi et al., 2016). In this regard, the study proposed the following hypothesis.

H4: Board meetings reduce the earning management practices in Malaysian firms.

2.5. Managerial Ownership

Managerial ownership refers to the percentage of shares owned by the internal executive managers divided by the total number of shares (Khan & Aslam, 2018). The ownership mechanism of the company has a crucial and significant extent. The effective structure of ownership is used to diminish the potential of earning management practices. It is claimed that an efficient system of ownership restrains the behaviour of earning management (Alzoubi, 2019). Several prior studies found a significant positive relationship between managerial ownership and earning management (Luthan & Satria, 2016; Muktadir-Al-Mukit & Keyamoni, 2019). In contrast, some studies' findings reveal that the internal ownership structure minimizes the opportunistic behaviour of the managers and has a negative impact (González & García-Meca, 2014; Huynh, 2020). So, in order to resolve this, the current study tested the following hypothesis.

H 5: Managerial Ownership reduces the earning management practices in Malaysian firms.

2.6.1. Moderating Role of the Audit Committee

The audit committee plays a very important role in the monitoring of audits and finances and provides more insight into the company's financial statement. Concerns about the integrity of the corporate financial reporting process as a result of accounting irregularities have led to an increase the concern about the audit committee's performance (Aslam & Haron, 2020a). The larger size of the audit committee buildup the trust and confidence of stakeholders that rely on the quality of reports and implementation of financial standards (Luthan & Satria, 2016). Lin et al. (2006) large audit committee ensure more oversight and effectively controls the accounting reporting process and its quality. Whereas, the study of Nazir and Afza (2018a) due to the spread of responsibilities, large audit committees cannot enhance a company's financial performance. On the other side, the study of Kipkoech and Rono (2016) stated that audit committee size overcomes the practices of earning management. Likewise, Agency theory claims that an effective audit committee member on the board can minimize agency costs and control earnings management practices (Nazir & Afza, 2018a).

H6: large size of the audit committee has a moderating effect on the relationship between corporate governance and earnings management.

2.6.2. Audit committee independence

The independence of the audit committee has a significant effect on the monitoring of earnings management (Alzoubi, 2019). Many studies found different results among the independence of audit committees and their practices of earning management. Previous research has shown that firms with less independence from the audit committee are more likely to have financial statements fraud (Mouratidou, 2020). Although, the audit committee which comprises the majority of independent directors negatively and significantly related to earning management (Huynh, 2020). However, El Diri, Lambrinoudakis, & Alhadab (2020) argue that the presence of a fully independent audit committee has no relationship with earning management. According to agency theory, the creation of the audit committee serves to lessen information asymmetry and enhance managerial opportunism and financial reporting quality (Shen & Chih, 2007). This study also favours more independent members in audit committees can curb the earnings management practices in Malaysian firms. In this regard, the following hypothesis is proposed.

H7: Independence in audit committees has a moderating effect on the relationship between corporate governance and earnings management.

3. Research Methodology

3.1. Sample Selection

The sample for the current study comprises 180 non-financial firms from Malaysia that are listed as shariah-compliant companies in the Hijrah Shariah Index in Malaysia from 2008 to 2019. The study takes only those shariah-compliant non-financial companies that provide full information about corporate governance and earning management during selected periods. To ensure the accuracy and robustness of the analysis, we exclude the firms that do not obtain the data and have been excluded from Hijrah Shariah Index during the screening period. Therefore, the final sample consists of 137 Shariah-compliant non-financial firms. Moreover, all the values of the data were collected in US$ million, meanwhile similar previous studies have used this type of data for their research (Nazir & Afza, 2018).

3.2. Measurement of variables

This study examines the relationship between corporate governance and earning management. The earning management is measured from the modified jones model (1995), which is measured as

TA= DA+NDA

Moreover, In the second level, the model is standardized after a change in the statistical model.

$$TAit = \beta 0 + \beta 1DAit + \beta 2NDAit + \varepsilon it$$

Furthermore, in the third stage, the model is divided by Ait-1 to control heteroskedasticity.

$$TA_{it}/A_{it\text{-}1} = \beta 0(A_{it\text{-}1}) + \beta 1(DA_{it}/A_{it\text{-}1}) + \beta 2(NDA_{it}/A_{it\text{-}1}) + \varepsilon_{it}$$

As a final proxy, variables are selected for DA and NDA in step (4). These proxies comprise Revenue (REV), Receivable (REC), and Property Plant and Equipment (PPE).

$$TAit/Ait\text{-}1 = \beta 0(Ait\text{-}1) + \beta 1(\Delta REV\ Ait\text{-}1 - \Delta REC\ Ait\text{-}1) + \beta 2(PPE\ Ait\text{-}1t) + \varepsilon it$$

$$\mathrm{NDAit/TAit-1} = \beta 0\left(\frac{1}{\mathrm{TAit-1}}\right) + \beta 1\left(\frac{\Delta\mathrm{REVit} - \Delta\mathrm{RECit}}{\mathrm{TAit-1}}\right) + \beta 2\left(\frac{\mathrm{PPEit}}{\mathrm{TAit-1}}\right) + \varepsilon\mathrm{it}$$

TAit-1= Total assets for the firm I at the end of year t-1, ΔREVit refers to the change in net revenue for firm i in year t, ΔRECit refers to the change in net receivables for firm i in year t, PPEit refers to Gross property plant and equipment at the end of year t, $\beta 0$ $\beta 1$ $\beta 2$ = Firm-specific coefficient model parameters, Residual which represent the firm-specific discretionary portion of total accrual. The independent, moderator, and control variables measured in Table 1 are as follows.

Table. Measurement of Independent and Control Variables

No	Variables	Codes	Definition
1	**Corporate Governance Mechanisms (Independent)**		
I.	Board Size	BSIZE	Total number of members on the board of directors
II.	Board Independence	BIND	The ratio of outside directors to total numbers of non-executive directors in the board
III.	CEO Duality	CD	A value of (1) is assigned if the chairman and CEO are the same person and (0) otherwise
IV.	Bard Meeting	NBM	Number of Board meetings per annum
V.	Managerial Ownership	MGSP	the ratio of shares owned by the internal directors to total shares outstanding
2	**Firm Characteristics (Controls)**		

I.	Firm Size	FS	Natural log of corporate's total assets
II.	Firm Growth	Tobin's Q	The market value of equity per share divided by the book value of equity
III.	Cash Flow	CF	Cash flow from operating activities/Total assets
IV.	Leverage	LEV	Total debt/total asset
3	**Macro Economical, and Industry growth (Controls)**		
V.	Consumer price index	CPI	The ratio of operating income over equity
VI.	GDP growth	GDP	Natural log of total gross domestic product adjusted for inflation
4	**Audit Committee (Moderating Variable)**		
I.	Audit Committee Size	SIZAUD	The number of members of the audit committee
II.	Audit Committee Composition	AUDIND	Proportion of independent directors in audit committee

3.3. Econometric Specification Model

To evaluate the objective of this study, a two-step system generalized method of moment (2SYS-GMM) estimation was employed because OLS ignores the data panel structure, and the fixed effect model cannot predict the time-invariant variable (which does not change over time). Additionally, this estimate is appropriate since it reduces the impact of the CG mechanism's over-stabilization and manages the endogeneity and heteroscedasticity issues by including the regressor's lagged value. To analyse the objective the following regression model is developed.

$$\mathrm{EM_{it}} = \alpha_0 + \mathrm{EM_{it-1}} + \sum_{k}^{5} \mathrm{B_1 CG_{it}} + \sum_{M}^{6} \mathrm{B_2 X_{it}} + \varepsilon_{it} \ldots\ldots\ldots\ldots\ldots\ldots\ldots 1$$

$$\mathrm{EM_{it}} = \alpha_0 + \mathrm{EM_{it-1}} + \sum_{k}^{5} \mathrm{B_1 CG_{it}} + \sum_{L}^{2} \mathrm{B_2\, AUD_{it}} + \sum_{M}^{6} \mathrm{B_3 X_{it}} + \varepsilon_{it} \ldots\ldots 2$$

In above equation 1, where i denotes a firm, t denotes a year, EM refers to the earning management estimated by Dechow et al. (1995), and CG indicates corporate governance with six attributes (BSIZE, BIND, CD, NBM, MGSP), while the X indicates as a set of control variables (FS, FMG, LEV, TA, CPI, and GDP), and ε indicate as the error term. In equation 2, the moderate variable AUD refer to two proxies (SIZAUD and AUDIND).

4. Result and Discussion

4.1 Descriptive Data

Table 2 describes the summary statics of the variables. The mean statistical value of earning management is 3.481 with a standard deviation of 14.82 and minimum and maximum mean statistics of -9.11 and 159.5. mean statistic value of board size is 7.432 with a standard deviation of 1.85, and minimum and the maximum value is 4 and 15. The mean value of board independence is 3.25 with a standard deviation of 1.12, and the minimum and maximum values are 0 and 9. CEO duality has a mean value of 0.52 with a standard deviation of 0.50, and minimum and the maximum value is 0 and 1. The mean value of board meeting and managerial ownership is 5.38 (18.76) 7.432 with a standard deviation value of 19.88(0.92).

Table. Descript statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Earning management	1644	3.482	14.825	-9.11	159.41
Board size	1644	7.432	1.852	4.00	15.00
Board independence	1644	3.251	1.120	0.00	9.00
CEO duality	1644	0.527	0.500	0.00	1.00
Board meeting	1644	5.384	1.431	2.00	16.00
Managerial ownership	1644	18.767	19.890	0.00	74.77
Audit committee size	1644	2.684	0.926	1.00	8.00
Audit committee independence	1644	3.313	0.685	2.00	10.00
Bank size	1644	11.967	1.559	7.75	17.20
Cash flow	1644	9.852	19.866	0.00	268.30
Firm growth	1644	27672	65218	-142665	610946
Leverage	1644	0.407	0.577	-0.05	6.50
Inflation	1644	71.611	76.354	12.57	744.68
Gross domestic product	1644	27.737	0.162	27.46	27.98

As per control variables, bank size and cash flow mean value is 11.96 (9.85) with a standard deviation value of 1.55(19.86) respectively. Moreover, the firm growth and leverage mean value is 27672 (0.40) with a standard deviation value of 65217(0.57) respectively. The macroeconomic variable inflation and gross domestic product mean value is 71.61 (27.73) with a standard deviation value of 12(27.46) respectively.

4.3 Correlation and Multicollinearity

Table 3 shows the result of the correlation matrix that regulates the tendency of the relationship among descriptive variables. The value of all the coefficients is less than 0.80 as suggested by Gujarati (2009) so there is no problem with coherence in these results.

The variance inflation factor (VIF) is tested to show that multicollinearity in the data. Table 4 shows that the VIF value of all the variables is less than ten, overall there is no multicollinearity problem in this study (Wooldridge, 2005).

4.4. Result and discussions

This study used regression to examine the impact of corporate governance on earning management with moderating role of the audit committee. In the first model direct impact of corporate governance on earning management. In the second model, the impact of the moderating variables (size and independence of the audit committee) on the relationship between CG and EM variables. Table 4 shows that the signs of the coefficient of lag earning management have a positive and statistically significant relationship with the current year EM in both models. This indicates that last year's earning management becomes the bases for the current year's EM. Furthermore, the null hypothesis is rejected for all models in the Hansen test, implying that the instruments are valid. Furthermore, AR (2) shows that in all models, there is no autocorrelation problem.

The coefficient signs of board size have a negative and statistically significant relationship in both models, thus accepting hypothesis 1. These results indicate that large boards significantly curb earnings management practices in Malaysia. This relationship is based on the agency's theory, which affirms that an effective board size will reduce agency costs and control the endeavours of earning management in non-financial companies. Thus, results indicate that a larger board is more impressive in overseeing financial reporting and supports the arguments (Alareeni, 2018; Ch, Zeb, Hussain, & Khan, 2021). Board independence is positively and significantly associated with earnings management, thus rejecting H2. The finding is against agency theory, which indicates that the weakened independence of the board members leads to an ineffective monitoring process in restraining managerial opportunism (Alareeni, 2018).

The board meetings have a negative and significant relationship with EM in non-financial companies of Malaysia, thus supporting H3. These results indicate that more board meetings curb the earning management practices in Malaysian Shariah-compliant firms. The results are in line with the finding of Muktadir-Al-Mukit and Keyamoni (2019) who stated that more board meetings can reduce earning management practices. The result shows that board meeting is an effective measure to prevent the practices of earning management consistent with previous studies (Abbadi, Hijazi, & Al-Rahahleh, 2016; González & García-Meca, 2014).

Non-CEO duality has a negative and significant association with earning management, thus accepting the H4. The results found that the non-existence of CEO duality is a sign of a strong leadership structure and effective oversee of that firms that do not have a dual CEO's ability to perform better, and increase financial transparency, are more likely to prevent the practices of earnings management. The present results are in line with the agency's theory, the best practices of corporate governance codes all around the world indicate that the duties of the CEO and Chairman of the Board should be performed by two separate individuals. Management ownership has a negative and significant relationship with EM, thus accepting the H4. The results imply that companies owned by management are not involved in reported earnings manipulation. As Agency theory assumes that nexus between managerial ownership and EM and conjectures that managerial ownership assists to minimize EM behaviours. The findings of this study conflict with earlier research by Obigbemi et al., (2016), who emphasize that managers prefer manipulating real activities to managing reported earnings. Thus, the present results documented the role of managerial ownership in restricting accrual earnings management activities in the Malaysian context.

Table. 2SYS-GMM Estimation

Variables	**GMM 1**	**GMM 2**
Earning management lag value	.1712136***	.1702027***
Board size	-.6101481***	-.2808551***
Board independence	.799176***	1.043014***
Board meeting	-.3034069***	-0.0458122
CEO duality	-5.172308***	-5.500118***
Managerial ownership	-.007231*	-.0090218**
Leverage	1.186631***	1.480034***
Firm size	5.051511***	5.100155***
Cash flow	.0000131***	.000012***
Firm growth	.1042669***	.1040539***
Inflation	.0135466***	.0156697***
Gross domestic product	-.8185232***	-.494897**
Audit committee size		-.4683754***
Audit committee composition		-.7317068***
constant	-30.40241***	-40.57745***
Year dummy	Yes	Yes
No of observation	1644	1644
AR (1) test statistics (P-value)	0.1324	0.0122
AR (2) test statistics (P-value)	0.2456	0.5236
Hansen test (P-value)	0.7435	0.6582

In respective to moderating variables, audit committee size has a negative and significant relationship between corporate governance and earning management. The results are parallel with the findings of (Agyei-Mensah & Yeboah, 2019; Muktadir-Al-Mukit & Keyamoni, 2019). The results indicate that large audit committee size have vast numbers of experienced members who have the expertise to evaluate and monitor the financial statement for having the proper knowledge and experience to detect earnings management practices. Moreover, the audit committee independence exhibited the same effect on earning management. Thus hypotheses 6 & 7 both are accepted. The results are in line with the findings by (Abbadi, Hijazi, and Al-Rahahleh 2016; González and García-Meca 2014), who stated that audit committees' independence is more effective in constraining earnings management activities. These results present that audit committee size and independence play moderating roles between corporate governance and earning management. Thus, larger, and greater audit committee independence help to curb the earning management practices in Malaysian Shariah-compliant firms.

Concerning the control variables, Table 4 reveals a substantial positive association between firm size and earning management. This indicates that bigger firms are involved in using abnormal discretionary expenses in managing reported earnings. The study by Omid (2012) advocates that larger companies reduce EM operations, as larger companies are always considered by the public to be more careful in their financial reporting (Lemma et al., 2013; Rahman et al., 2016). Similarly, firm growth has also a positive and significant relationship with EM. The results imply that high-growth businesses in Malaysia are more inclined to use unusual discretionary spending to manage their profitability. This finding supported Chen, et al., (2015) claim that high-growth companies have better incentives to optimize earnings to reach earnings targets. The higher the growth rate, the higher the abnormal accrual, and the more positive the relationship between growth and earnings management exists (Ch et al., 2021).

Additionally, the results show that leverage has a positive and significant relationship with earning management. These stated that companies with a high debt ratio are anticipated to use discretionary accruals to boost reported profitability and prevent debt covenant defaults. The outcome is in line with earlier studies that demonstrate how leverage motivates earnings management actions to prevent debt covenant violations (Nantyah, 2019). Inflation also exhibits the same results with earning management. These results indicate that in the presence of high inflation companies are more involved in earning management practices. Lastly, the results present that GDP limits EM practices, supporting the finding (Al-Absy et al., 2020). This outcome is consistent with the theoretical prediction that high GDP levels increase management effectiveness toward practices of earning management by reducing discretionary accrual practices.

5. Conclusion

The purpose of this research is to examine the impact of corporate governance on the practice of earning management with moderating role of the audit committee. The study data contain 137 listed companies in the Bursa Malaysia index year from 2008 to 2019. This study used Modified Jones Model to calculate earning management, and a set of hypotheses asserted to investigate whether corporate governance attributes and audit factors significantly constrain EM behaviour in Malaysia. This study finds that corporate governance practices promote the value of an organization and a company with an effective governance system to reduce conflicts of interest between dispersed minority shareholders and authorized managers of firms as well as enhance management efficiency and reduce information conflicts. The findings indicate that the mechanism of corporate governance board size, number of board meetings and non-existence of CEO duality have significantly influenced curbing the practices of earning management practices. Moreover, the negative moderate effect of the size of the audit committee on the relationship between CG and EM suggests that members of the audit committee help to curb the EM practices. Auditing is a powerful monitoring tool for harnessing profit management practices, especially in companies with a high executive ownership ratio and strong CG mechanisms.

This study offers several contributions. First, the scope of the study is specifically on non-financial Shariah-compliant firms in Malaysia. It contributes to the literature on the importance of corporate governance along with earnings management. Second, this study contributes to the literature by evaluating non-discretionary accrual with a Modified Jones model. Third, the attributes of the audit committee of non-financial firms as the role of moderator among CG and EM provide evidence of more efficiency at a high level of significance. Fourth, this study employed the 2SYS-GMM method to control the unobserved endogeneity and heterogeneity, which were missed by a large portion of the literature. Lastly, the findings of this study can serve as a benchmark for studies in countries with an institutional and economic environment like Malaysia. The study findings will help investors to understand that enforcing both governance and monitoring mechanisms is a critical approach to reducing earnings management behaviour. Policymakers and regulators should ensure that there is no CEO duality and independent board members must be professional in order to reduce earning management practices. This study is limited because it only used Shariah-compliant non-financial firms' data from Malaysia and future studies can compare with other non-financial firms as well from across the country.

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