Malaysia Financial Reporting Practices and Audit Quality Promote Financial Success: The Case of Malaysian Construction sector

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ABSTRACT

Prior research findings on the effect of financial reporting and audit quality on firm performance were mixed. The current study therefore, sought to examine the impact of audit quality and FRS practices of firms on their financial success. Samples firms listed on Malaysian stock market were selected from the construction sector for the period of 2010 to 2013. Data was collected from the published annual reports and their notes to the financial statements. To assess the level of compliance with the provisions of the Financial Reporting Standard (FRS) in Malaysia, content analysis was carried out. Firm's engagement with established audit firm is used as a proxy for audit quality, and return on assets is used as a measure of firm performance. Panel data analysis was employed in analysing the data and testing the stated hypotheses. The use of panel data reveals that practices of FRS by firms is significantly and positively related to their financial performance. The results also indicate that audit quality has a significant positive impact on business financial success. The study therefore recommends that the management of listed construction firms improve their practices of FRS and employ the service of established audit firms in support of financial success. Regular training may be organised to provide construction companies with practical guide for better compliance with the FRS in Malaysia.

Keywords: Financial Reporting, Audit quality, Financial Performance; Malaysia

1. INTRODUCTION

1.1 Financial Reporting and its Impact

Financial reporting plays a key role in communicating financial information about a business enterprise that is useful to a wide range of users in making informed decisions. In view of the fact that large listed companies are increasingly called to report on different dimensions of their performance (economic, social and environmental), financial reporting has becoming a key tool in developing corporate legitimacy and managing relationships with its stakeholders. As outlined in the IASB conceptual framework (CF), financial reporting should aim to provide "financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity."[1] Therefore, quality reporting practice that meets the objective of financial reporting is crucial for investors and the other stakeholders. Despite the important role financial reporting play in achieving

[1] Tom Clendon FCCA (2015), IASB's Conceptual Framework for Financial Reporting, available at http://www.accaglobal.com. Accessed on November 27, 2015.

economic goals and transferring resources to their best use in the economy, research focusing on measuring its differential impact on firms has been scant. Much of the extant studies have been examining the determinants that influence the quality of financial reporting, corporate governance and CSR. Thus, there is a need to fill the gap in the literature by assessing the impact of quality reporting (both financial and nonfinancial information reporting) at firm's level. With the evolution of corporate reporting, firms are required not only to present financial information but also non-financial information in providing both internal and external users with more comprehensive information. Other than corporate governance, corporations have also moved to disclose information on corporate social responsibility to inform stakeholders of their commitment and concerns on issues related to social, environmental and human resources (Altintas, Adiloglu & Altintas, 2007; Daub, 2007). The current study therefore refers to the agency theory and stakeholder theory for proxies of the financial and nonfinancial information reporting in the annual reports of companies for an analysis of their impacts at firm's level.

In this regards, corporate performance is considered as it has been the subject of shareholders and stakeholders interest. Financial performance of organizations may be calculated from the return on investment perspective, and measured by several indicators which include Return on Asset (ROA), Return on Equity (ROE), and Return on Investment (ROI). This study therefore, aims to determine whether corporate financial performance may be influenced by firm practices in Financial Reporting Standards (FRS), audit quality, corporate social responsibility, corporate governance as well as transparency and disclosure requirements in their annual reports. The impact that these five variables may have on firm success is examined in the context of companies listed under the construction sector of Bursa Malaysia over the period of 2010 to 2013.

1.2 Theoretical Perspectives of the Study

Agency theory laid the foundation for this study. Agency theory models the relationship between the accounting principal and agent; with shareholders (principal) delegate the running of companies to company management (agent). There is a separation of ownership and control. One of the resulting issues is the information asymmetry between managers and shareholders (owners). In this agency relationship, insiders (managers) have an information advantage, and management may exploit the information asymmetry and maximize their own interests at the expense of the shareholders. This separation of ownership and management functions, and the presence of asymmetric information result in the possibility of principal-agent conflicts (Jensen and Meckling, 1976). To help reduce information asymmetry, managers prepare annual reports. These annual reports contain information regarding the financial condition and its position, along with other nonfinancial information relating to a company. In this regards, corporate governance is viewed as a way of protecting minority shareholders from expropriation by managers or insider shareholders (Mitton, 2002), benefiting shareholders through increased information disclosure. With an emphasis on the transparency of decision making process, fairness and trustworthiness in managing a company, corporate governance can be described as the proper procedures on how the "government" of a company (the managers and board of directors), should be responsible to their "voters" (the shareholders, creditors and investors) (Zainal Abidin & Ahmad, 2007).

In addition, the Stakeholder theory explains the accountability of the board to more than the shareholders, and includes those who can affect or are affected by the achievement of the company's objectives (Freeman 1984). A firm's decisions can affect the well-being of its stakeholders. Similarly, if the achievement of a firm's objectives can be influenced by its stakeholders, then its decisions and in turn, its performance may be affected by the activities of the stakeholders. Therefore, corporate managers ought to take into consideration the effects of their decisions on all the stakeholders if their motive is to maximize total wealth of the organization. The stakeholder theory also holds that the firm has a responsibility to serve all the stakeholders who are affected by the activities of the firm, which would result in reporting to a broader stakeholder group beyond financial reporting. Therefore, it supports the practice of Corporate Social Responsibility (CSR) activities and suggests that CSR practices will help promote firms' market value and profitability. This raises the need to account for activities not reflected in the financial reports, and many companies are preparing a separate report to inform society of their accountability in CSR. Under this theory, it is unlikely that the managers can maximize the value of a firm to its owners when the interests of other stakeholders are completely ignored. Therefore, managers ought to consider the impact of their decisions on a broad spectrum of stakeholders, and evaluate their decisions based on the impact on the market value of their firms.

2. LITERATURE REVIEWS

2.1 FRS Practices and Financial Performance

The goal of financial reporting is to provide useful information to facilitate decision making process of economic agents. Despite the fact that companies may generate financial statements in accordance with the generally accepted accounting principles, these statements may vary in the levels of quality (Choi and Pae, 2011). In Malaysia, compliance with FRS are legislated under Financial Reporting Act 1997 [Section 26D]. The Financial Reporting Standards (FRS) were issued by the Malaysian Accounting Standards Board (MASB), which are applicable to entities other than private entities, as of 15 November 2009. MASB also issued several new/revised FRS which are mostly effective for annual periods beginning on or after 1 January 2010 in line with MASB's plan of full convergence of FRS with the International Financial Reporting Standards (IFRS). In a study to determine whether International Accounting Standards (IAS) was affiliated with financial reporting quality, Barth, Landsman, and Land (2008) shows that financial reporting quality of companies that apply IAS were higher than those that do not. On the other hand, a number of researchers have conducted studies with a hypothesis that higher financial reporting quality lead to a decrease of information asymmetries, which affects corporate performance. Previous research findings on the effect of financial reporting quality on firm performance were however, mixed. Ferrer and Ferrer (2011) for example, found that profitability measures such as ROE and ROA are statistically not associated with the extent of compliance with International Financial Reporting Standards (IFRS) disclosure requirements for publicly listed corporations.

On contrary, there are studies which show that financial information of better quality is associated with subsequent higher performance of corporations. Luqman (2014) for example, reported that there is significant relationship between practices of IFRS and business performance, while Chen, Hope, Li and Wang (2011) found that financial report quality positively affects private firm investment efficiency in emerging markets. In another research, Martínez-Ferrero (2014) examined the effect of a good Financial Reporting Quality (FRQ) of international non-financial listed companies on financial performance. The result is robust according to the different measurements of FRQ; financial performance is measured through market to book ratio, which is a market measure, and do not consider other accounting measures. Thus, the researcher suggested for future study to consider analysing whether results still stand if accounting measures such as ROA or ROE were to be used. Following review of prior studies, this paper sought to examine how financial performance of construction firms listed on Bursa Malaysia stock market may be influenced by financial reporting quality as measured by their practices of FRS.

2.2 Audit Quality and Financial Performance

Within the extant literature on the subject, size of audit firm has commonly be viewed as a surrogate for audit quality. Audit firms of larger size are more likely to allocate their resources to develop a reputation to add value to their audit service; thus, are better able to detect irregularities and reveal management's errors in financial reporting (DeFond and Jiambalvo, 1993). DeAngelo (1981) also concur that larger auditors have more reasons to issue accurate reports in light of their highly valuable reputations. This is supported by Fuerman (2006) who found evidence that big audit firms produced higher quality audit compared to non-Big-4 audit firms. Further, the impact of audit quality on financial performance of firms has been receiving attention from the researchers. Prior studies have shown that audit quality has an effect on financial performance of organization (Heil, 2012; Miettinen, 2007). Bouaziz (2012) examined the relationship between audit committee and financial performance; result indicates that audit committee has an important impact on the financial performance of firms as measured by return on assets and return on equity. With access to more facilities for training of auditors and performing various tests, other researchers suggests that bigger audit firms are likely to offer auditing services with higher qualities (Mojtahedizadeh and Aghaee, 2004). This is supported by Farouk and Hassan (2014) who found that auditor size and auditor independence have significant impacts on the financial performance of firms.

While previous researches have focused on the relationship between audit quality and financial performance in the west, this paper sought to empirically test the impact of audit quality on the financial performance of public listed firms in Malaysia. The current study investigates whether firm performance may be influenced by other proxy of audit quality, i.e. type of audit firm, in the context of Malaysia public listed companies. Companies' engagement with the Big 4 or non- Big 4 firms has been used as a proxy for audit quality.

2.3 Corporate Governance (CG) Practices and Financial Performance

Good corporate governance practice is important as corporate scandals involving companies such as Enron and the WorldCom had led to losses suffered by the corporation stakeholders, primarily the shareholders. Corporate governance (CG) may be considered as a good management process in which corporations, taking into account the interests of all stakeholders at maximum, operate according to the principles of transparency, fairness, accountability, and responsibility (Van Horne and Machowicz, 2005). Corporations that are well-managed with better corporate governance principles will have better performance (McKinsey and Company, 2002). It is likely that good corporate governance help increase the corporate performance through supervision or monitoring management performance and accountability based on the established framework of rules and regulations. Prior research by Arslan et al. (2014) has examined the relationship of audit committee and CEO duality with firm performance using ROA and ROE dimensions. In the context of emerging economies, Dar et al. (2011) established that corporate governance enhance property rights, decrease cost of capital, and promote development of capital markets. It is viewed as an important mechanism in investor protection. Having a board of directors as part of the governance mechanism for instance, enables firm performance to be monitored and the interests of shareholders to be protected. The creation of an independent board is particularly important in mitigating conflict arising from the agency problem; and to help promote firms' value and enhance shareholders' wealth.

Extant empirical research however, observes diverse outcomes in examining the nexus between corporate governance and firm performance. For instance, Klein (1998) observes a negative relationship between governance (measured by overall board independence) and firm performance. Using a paired sample methodology, Fosberg (1989) however, found no association between governance (measured by proportion of outside directors in the board) and firm performance proxied by ROE. Similarly, Bhagat and Black (2002) observe no causal link between governance (proxied by board independence) and ROA when a large-sample, long-horizon study on American large firms was analysed. On the other hand, a number of studies reported positive causality between corporate governance and firm performance (Bauer et al., 2008; Beiner et al., 2006; Core et al., 2006; Drobetz et al., 2004) but these studies had been focusing on developed economies. For the case of emerging markets, Cheung et al. (2007; 2010; and 2011) came up with a number of studies involving Asian context, characterized by ownership concentration, and found a significantly positive relationship between corporate governance and firm performance. In the context of Thai, nonetheless, conventional measures of corporate governance were reported to be not correlated with firm value (Connelly et al., 2012). In another research, Haat, Rahman & Mahenthiran (2008) however, observe that corporate governance factors have a strong predicting power on company performance in Malaysia. Samples were selected using matched-sampling method, and hierarchical regression was used for the analysis. The research limitation was that the data covers only one-year period.

From the review of the body of literature, it is obvious that the findings of empirical studies on the association of corporate governance and firm performance are mixed. This could partly be due to the different governance mechanisms, cultures and time frames investigated by prior studies. The question on corporate governance and firm performance nexus is therefore, a line of inquiry that remains inconclusive, especially in emerging markets. So the present study seeks to solicit an answer to the question: Does good governance benefit firms in the Malaysian business environment; or is it just the cost of doing business in the country?

2.4 Transparency and Disclosure (T&D) Practices and Financial Performance

The problem in transparency and disclosure lies with asymmetry of information between managers and stakeholders as described in the Agency Theory. Agency theory relates to separation of owner and managers, thus creating a principal and agent relationship among them (Sharma, 2013). Agency problem arise when there is a conflict of interest between a company's management and the company's stockholders. Ultimately this agency cost may have an impact on firm profitability. Thus, disclosure of corporate practices is important to help reduce asymmetry of information and enables shareholders to effectively monitor management decision and firm performance (Lang and Lundolm, 1993). Healy and Palepu (2001) also concur that companies can lower information asymmetry through financial report and information disclosures to help address agency conflicts between management and external investors. Extant literature supports that good corporate governance practices impact positively on firm’s performance. In a study conducted by Zaman, Arslan and Sidiqui (2014), an index was used as measurement of T&D, and the statistical result reveals that T&D is significantly and positively related to the financial performance indicators including ROA. It is likely that good T&D practices of firms serve as mechanisms of checks and balances to help mitigate the agency cost arising from separation of ownership and management. Although empirical studies have been carried out on CG in developed countries, study on T&D in emerging markets with different legal origin, political, regulatory and cultural tradition, and different types of agency conflict may serve as a test for the robustness of the results obtained in developed economies (Armağan, 2006). This paper therefore, sought to examine the impact of T&D practices on the financial performance of construction firms listed on Bursa Malaysia stock market.

2.5 Corporate Social Responsibility (CSR) and Financial Performance

Corporate Social Responsibility (CSR) has been defined as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis” (Green Paper Promoting a European Framework for Corporate Social Responsibility, 2001). Firm engagement in CSR activities are largely based on stakeholder theory (Freeman, 1984) that stakeholders have different interests in a corporation and thus have varying impacts upon it, positive or negative. A corporation is therefore, expected to be responsible to meet the interests of its stakeholders. In the context of Malaysia, there has been an increasing awareness of CSR in the country. The launch of a CSR Framework by Bursa Malaysia in September 2006 provides useful guidance for public listed companies to report CSR activities in their annual reports. The listing requirement on Bursa Malaysia, which has been amended to include disclosure of CSR information in annual report, entails potential influence on the financial performance of listed firms.

Firm engagement with CSR activities, however, needs to have a genuine economic foundation to continue to flourish in a competitive business world. Without evident benefits for firms, CSR may not be sustainable as CSR programs are costly given companies' limited financial resources (Wang et al., 2008). To provide this economic justification, researchers have been searching for an empirical link between CSR and corporate financial performance (CFP). On one hand, corporate social responsibility is viewed as adding costs to the organization which affects the level of profits (Aupperle, Carroll, & Halfield, 1985; Ullmann, 1985). On the other hand, the opponent view considers CSR as positively linked to financial performance, arguing that socially responsible firms lead to higher morale among employees, and increased loyalty among customers (McGuire, Sundgren, and Schmeeweis, 1988; Carden and Darragh, 2004). In other words, extant empirical studies has yet to provide a convincing causal link between two variables (Mwangi and Jerotich, 2013).

In a research to study the interaction between the social performance of firms and its profitability, Wibowo (2012) finds a positive interaction between corporate social responsibility disclosure and profitability of firms. Uadiale and Fagbemi (2012) also concur that CSR has a positive and significant relationship with the financial performance measures, and recommend corporate entities to invest in CSR activities in order to boost their image/reputation thereby increasing their returns. On contrary, Mittal, Sinha & Singh (2008) investigated the association between ethical commitment and financial performance over a four-year period, through statistical regression and correlation analysis but reported that there is little evidence that companies with a code of ethics would generate significantly more economic value added (EVA) and market added value (MVA) than those without codes. Similarly, Tuhin (2014) measures the impact of corporate social responsibility (CSR) expenditure on financial performance of banks. ROA and ROE are used as proxies for financial performance of the banks; data of CSR expenditure and the performance variable were analysed using regression analysis. Results show that there is no significant impact of CSR expenditure on banks' financial performance. With mixed results from prior research, this paper sought to determine whether CSR practices have an impact on financial performance of construction companies listed on Bursa Malaysia.

3. RESEARCH MODEL AND METHODOLOGY

The purpose of constructing this model is to examine whether financial performance is influenced by firm practices of FRS, audit quality, corporate governance, transparency and disclosure as well as CSR. While these five variables are chosen on the basis of prior evidence, it should be noted that they are inevitably limited to the extent that they may not be exhaustive (Larcker and Rusticus, 2010). There may be other variables that can potentially influence firm performance, which for reasons such as data unavailability and lack of appropriate theoretical links, not included in the model (Chenhall and Moers, 2007 as quoted in Sayyar, Basiruddin, Abdul Rasid, Elhabib, 2015).

The study makes use of data from secondary sources made available through published annual reports of firms. Sample companies listed on Bursa Malaysia stock market were selected from the construction sector for the period of 2010 to 2013. For FRS practices, data were gathered through published annual reports and accounts, and notes to the financial statements of the construction firms that represent the sample of this study. As there is no universally accepted way of measurement (Dechow et al., 2010), the analysis on the level of accounting compliance with FRS entails content analysis of annual reports (using Nvivo 10) which involves tracing of sentences for firms' compliance with the fourteen FRS commonly applied in the annual reports of listed companies. As defined by Weber (1990), content analysis is a set of procedures to make valid inferences from text. It is described as "a research technique for making replicable and valid inferences from texts (or other meaningful matter) to the contexts of their use" (Krippendorff, 2004, p.18). Queries to find the relevance disclosures requirements of the selected FRS were set up in the software to examine the contents of disclosure included in the annual report of individual firms. By observing the information included in the annual reports of individual firm, the level of its accounting compliance with FRS relevance disclosures requirements will be computed based on the fourteen FRS compliance scores.

Secondly, audit quality is measured using type of audit firm as proxy. If a firm's independent auditors are the international audit firms (Big-4), they are more likely to meet higher quality of accounting compliances in the financial reports. This view is supported by Tilis (2005) who concur that the quality of audits undertaken by large firms exceeds that of audits carried out by smaller firms. The findings propose that international audit firms are more strongly supportive of quality assurance in accounting compliance than with local audit firms. Therefore, this study follow Armstrong et al. (2010) to assign a score of 1 if the company is audited by internationally recognized Big-4 audit firms; otherwise, the company will receive a zero score for audit quality measurement.

Thirdly, Gill, Allen and Powell (2012) pointed out that cracks in Asian corporate governance have become more apparent since the last ACGA Corporate Governance Watch report. In the report, independence of the board had been identified as a key issue. It was noted that Asian corporations fare worst on independence of boards, and most companies fail the test of CG commitment in composition of audit committees. Further, Gill et al. (2012) revealed that the issues investors have had to face range from relatively minor corporate transgressions to growing concerns about the reliability of financial statements. Hence, corporate governance, can no longer be taken for granted. In light of the above reports, accounting related criteria are extracted and adopted from CG Watch of ACGA to assess Corporate Governance reporting in the annual reports of the listed firms. In particular, the following measurement criteria are adopted to assess good CG practice of firms: (1) Inclusion of mission statement which relates to good CG; (2) Disclosure of CG principles in the Annual Report; (3) Issuance timeline of Annual Report; (4) Disclosure of major market information in the Annual Report; (5) Availability and language of corporate website for regular updates; (6) Board characteristics. A score of 1 will be given where each of the six attributes of CG practice appeared in the annual report; any attribute that is missing from the annual report will be receiving a zero score. Then, the measurement score of an individual firm in the CG practice will be calculated as an arithmetic mean of the aggregated CG scores achieved by the firm for all six reporting attributes.

All investors, may they be large or small shareholders, ought to have their rights protected; and rules protecting investors come from different sources which include stock exchange regulations and accounting standards. The protection accorded by disclosure and accounting rules, for example, serves to provide investors with the information they need to exercise their rights. La Porta et al. (2002), using a sample of firms from 27 wealthy economies, find that firms in countries with better shareholder protection have higher Tobin's Q than do firms in countries with inferior protection. In another study, Mclean, Zhang, and Zhao (2012) also concur that in economies with stronger investor protections, investment in firms is less sensitive to financial constraints and that leads to greater growth in revenue and profitability. This study therefore seeks to investigate if firms' transparency and disclosure practices in annual report may promote corporate performance in the context of emerging market like Malaysia. As transparency and disclosure requirements appearing in the annual reports are investor protecting information and financial highlights, this study follows Hope et al. (2006) and La Porta et al. (2006) to measure Transparency and Disclosure of firms from their annual reports in the areas of: (1) Prospect/Outlook; (2) insiders' compensation; (3) ownership by large shareholders; (4) inside ownership; (5) contracts outside normal business; and (6) related parties transactions. As established by La Porta et al. (2006), the more transparent and complete the disclosures are in the annual reports, the more benefits it brings to the investors. Therefore, in this study, firm score for transparency and disclosure requirements are calculated as an arithmetic mean of the aggregate score of firms for the above six attributes (Hope et al., 2006; La Porta et al., 2006).

Lastly, ROA is used as a measure of financial performance of firms. In this regards, this study makes use of data from a secondary source made available through Worldscope. ROA measures firm profitability as a proportion of net income to firm total assets; it is calculated as [(Net Income before Preferred Dividends + ((Interest Expense on Debt-Interest Capitalized) * (1-Tax Rate))) / Last Year's Total Assets * 100]

Therefore, the firm performance equations are presented below:

$$ROA_{it} = \alpha_0 + \alpha_1 FRS_{it} + \alpha_2 AudQ_{it} + \alpha_3 CorGov_{it} + \alpha_4 TranDis_{it} + \alpha_5 CSR_{it} + \varepsilon_{it}$$

where:

ROA_{it} : Returns on Assets of firm *i* at time *t*.

FRS_{it} : Financial Reporting Standard of firm *i* at time *t*.

$AudQ_{it}$: Audit Quality of firm *i* at time *t*.

$CorGov_{it}$: Corporate Governance of firm *i* at time *t*.

$TranDis_{it}$: Transparency and Disclosure of firm *i* at time *t*.

CSR_{it} : Corporate Social Responsibility of firm *i* at time *t*.

ε_{it} : The random error term

4. DATA ANALYSIS AND RESULTS

Since the data are in the form of cross-sectional and time series, panel regression analysis is employed as the statistical method in this study. Panel data is a dataset in which the behaviour of entities such as companies is observed across time. In this study, Panel Data was developed for analysis using: 1) Pooled OLS Regression model; 2) Random effect model; 3) Fixed effect model. Sample companies from the construction sector in Malaysia were coded to analyse the association between ROA and the five explanatory variables, i.e. practices of FRS, audit quality, CG, T&D, and CSR for the period of 2010 – 2013. The statistical software, Stata (version 11) will be used to analyse all the data collected and generate results for interpretation.

4.1 OLS Regression Model

Table 1 shows the result of the pooled OLS Regression. The model is fit with F-value of 0.0004. Both FRS compliance (FRS) and audit quality (AudQ) are found to be significantly and positively related to ROA as a measure of firm performance. The t-value of FRS and AudQ are significant at 1 percent. This positive association suggests that companies with improved FRS practices and higher audit quality are more likely to have higher return on assets. Consistent with the findings of Luqman (2014), the use of panel data in this paper shows that practices of FRS support financial success of construction firms listed on Bursa Malaysia stock market. In line with prior literature that suggests higher quality in auditing is likely to reduce agency cost and increase company performance (Heil, 2012; Miettinen, 2007), audit quality is found to have an effect on financial performance of the Malaysian construction firms. The model nonetheless provides limited support for a direct and weak relationship between CSR and financial performance (ROA). Contrary to prior studies, the result does not support association between the other two variables (i.e. CG and T&D) with ROA (see table 1).

Table 1: Results of the Panel Data Analysis; dependent variable ROA

	Pooled OLS	Random Effect Results	Fixed Effect Results
FRS_{it}	4.11 (3.30)***	0.83 (0.72)	0.21 (0.16)
$TranDis_{it}$	-20.57 (-1.43)	-6.17 (-0.23)	-
$CorGov_{it}$	4.17 (1.23)	3.31 (1.10)	3.31 (1.02)
$AudQ_{it}$	3.28 (3.55)***	2.87 (1.73)	-
CSR_{it}	3.20* (1.73)	-0.23 (-0.09)	-2.22 (-0.59)
Constant	10.70 (0.91)	5.44 (0.25)	3.56 (0.96)
P-value	0.0004	0.4115	0.6995
R square	20.53%	Random effect model is appropriate	Fixed effect model is inappropriate

**** Significant at 1%significant level, ** 5%significant level and * 10% significant level*

4.2 Random Effect and Fixed Effect Model

The random effect assumption (made in a random effects model) is that the individual specific effects are uncorrelated with the independent variables. In other words, firm performance effect is uncorrelated with the independent variables. If the random effects assumption holds, the random effects model is more efficient than the fixed effects model. Otherwise, the random effects model is not consistent. From Table 1, Breusch-Pagan is noted that p-value is more than 10% is recorded for random effect model. Thus, the random effects assumption (H_1) does not hold, and null hypothesis that there is fixed effect (H_0) is not to be rejected. On the other hand, Fixed Effects assumes that the individual specific effect is correlated to the independent variable. From Table 1, Hausman Test is noted that p-value is greater than 10% is recorded for fixed effects model. Thus, the fixed effects assumption (H_1) does not hold, and the null hypothesis that there is random effect (H_0) is not to be rejected. It is therefore concluded that random effects are in existence and random effect model is considered as appropriate.

As reported in Table 1, Pool OLS model is the most appropriate at less than 1 percent significant level. Compliance with FRS relevance disclosure requirements (FRS) and audit quality assurance (AudQ) of the firms are positively significant at less than 1 per error term. These two independent variables are importantly associated with the firm performance. In line with Luqman (2014), the findings support the hypothesis that firms complying with FRS relevance disclosure requirements present better financial reporting quality, leading to a decrease of information asymmetries to support informed decision making which promote corporate performance. Besides, the finding that audit quality assurance (AudQ) supports positively in increasing return on assets of firms support the notion of Fuerman (2006) who assert that big audit firms produced higher quality audit compared to non-Big-4 audit firms. With access to more facilities for training of auditors and performing various tests, bigger audit firms are likely to offer auditing services with higher qualities (Mojtahedizadeh and Aghaee, 2004). The finding therefore support Farouk and Hassan (2014) who conclude that auditor size has a significant impact on the financial performance of firms.

5. CONCLUDING REMARKS

It is concluded that higher performance of the construction firms is attributable to the higher compliance of FRS relevance disclosures requirements and audit quality. Contrary to prior research, ROA as a profitability measure are found to be statically not associated with CG, T&D and CSR practices. The result of panel data analysis reveals that practices of FRS relevance disclosures requirements by firms is significantly and positively related to their financial performance. The results also indicate that audit quality has a significant positive impact on business financial success. In light of the findings, the study recommends that the management of listed construction firms improve their practices of relevance disclosures requirements and employ the service of established audit firms as a means of enhancing audit quality and ultimately in support of financial success. Regular training may be organised to provide construction companies with practical guide for better compliance with the accounting standards in Malaysia.

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