

**AUDIT COMMITTEES AND ACCURACY OF
MANAGEMENT EARNINGS FORECASTS OF
MALAYSIAN IPOs**

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**AUDIT COMMITTEES AND ACCURACY OF MANAGEMENT EARNINGS
FORECASTS OF MALAYSIAN IPOs**

By

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ABSTRACT

This study aims to make a meaningful contribution to the IPO literature by examining the impact of audit committee characteristics on the accuracy of earnings forecasts in 190 Malaysian IPO prospectuses during the period of 2002-2012. This study also adds to the body of knowledge by investigating the accuracy of IPO earnings forecasts during the former mandatory earnings forecasts (January 2002 to January 2008) and the current voluntary earnings forecasts (February 2008 to February 2012). Furthermore, it explores the provided explanations in the first published annual reports after IPO, which explain the reasons behind the errors of earnings forecasts. Two proxies were used for accuracy; absolute forecast error and squared forecast error. The models were developed using the frameworks of the agency theory, the signaling theory, and the resource-dependence theory to examine the association of eight characteristics of the audit committee (size, independence, financial expertise, gender diversity, ethnicity, stock ownership, educational background, and experience) with the accuracy of IPO earnings forecasts. The findings indicate that the earnings forecasts of Malaysian IPO are pessimistic and the percentage of accuracy is unsatisfactory. Further, the results show that Malaysian IPO earnings forecasts have been more pessimistic and less accurate under the voluntary regulation regime than the mandatory regime. The findings of multiple regressions of the audit committee and absolute forecast error show significant relationships with positive impacts among size, experience and accuracy of earnings forecasts. In terms of the findings of multiple regressions of the audit committee and the squared forecast error, the results show significant relationships with positive impacts between size and earnings forecasts accuracy. Finally, the results indicate that the number of provided explanations was greater when the management were more optimistic and the forecasts errors were large. The results of this study can be of interest to investors, policymakers, investment analysts and other market participants.

Keywords: audit committee, earnings forecasts accuracy, earnings forecasts regulation, explanations of earnings forecasts errors, Malaysian IPO.

ABSTRAK

Tujuan kajian ini dilakukan adalah memberi sumbangan kepada literatur IPO dengan mengkaji kesan ciri-ciri jawatankuasa audit ke atas ketepatan ramalan pendapatan 190 prospektus IPO di Malaysia bagi tempoh 2002-2012. Kajian ini juga menyumbang kepada pengetahuan dengan mengkaji ketepatan ramalan pendapatan IPO semasa tempoh ramalan pendapatan mandatori (Januari 2002 hingga Januari 2008) dan ramalan pendapatan secara sukarela (Februari 2008 hingga Februari 2012). Tambahan pula, ia meneliti penjelasan yang diberikan dalam laporan tahunan pertama yang diterbitkan selepas IPO yang menjelaskan sebab-sebab di sebalik kesilapan ramalan pendapatan. Dua orang proksi telah digunakan untuk ketepatan; kesilapan ramalan mutlak dan kesilapan ramalan berkuasa dua. Model-model telah dibangunkan dengan menggunakan rangka kerja teori agensi, teori isyarat dan teori sumber pergantungan untuk mengkaji hubungan lapan ciri jawatankuasa audit (saiz, kebebasan, kepakaran kewangan, kepelbagaian jantungina, etnik, pemilikan saham, latar belakang pendidikan dan pengalaman) dengan ketepatan ramalan pendapatan IPO. Dapatan kajian menunjukkan bahawa ramalan pendapatan IPO Malaysia adalah pesimis dan peratus ketepatannya adalah tidak memuaskan. Selanjutnya, hasil kajian menunjukkan bahawa ramalan pendapatan IPO Malaysia adalah lebih pesimis dan kurang tepat di bawah rejim peraturan secara sukarela berbanding rejim secara mandatori. Hasil regresi berganda ke atas jawatankuasa audit dan kesilapan ramalan mutlak menunjukkan hubungan yang signifikan dengan kesan positif antara saiz, pengalaman, dan ketepatan ramalan pendapatan. Manakala dari segi hasil regresi berganda ke atas jawatankuasa audit dan kesilapan ramalan berkuasa dua, keputusan menunjukkan hubungan yang signifikan dengan kesan positif antara saiz dan ketepatan ramalan pendapatan. Akhir sekali, keputusan menunjukkan bahawa bilangan penjelasan yang diberikan adalah lebih banyak apabila pihak pengurusan lebih optimis dan ramalan kesilapan adalah besar. Keputusan kajian ini boleh menarik minat pelabur, penggubal dasar, penganalisis pelaburan dan ahli-ahli pasaran lain.

Kata kunci: jawatankuasa audit, ketepatan ramalan pendapatan, peraturan ramalan pendapatan, penjelasan mengenai kesilapan ramalan pendapatan, IPO Malaysia.

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LIST OF ABBREVIATIONS

Abb.	Full List
ACE	Access, Certainty, Efficiency
BMLR	Bursa Malaysia Listing Requirement
BRC	Blue Ribbon Committee
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CMSA	Capital Markets and Services Act
CPA	Certified Public Accountant
FCCG	Finance Committee on Corporate Governance
IPO	Initial Public Offering
KLSEB	Kuala Lumpur Stock Exchange Berhad
MBA	Master of Business Administration
MCCG	Malaysian Code on Corporate Governance
MESDAQ	Malaysian Exchange of Securities Dealing and Automated Quotation
MIA	Malaysian Institute of Accountants
MICG	Malaysian Institute of Corporate Governance
NDP	National Development Policy
NEP	New Economic Policy
OLS	Ordinary Least Squares
PAT	Profit After Tax
RESET	Ramsey Regression Equation Specification Error Test
RM	Ringgit Malaysia
SC	Securities Commission
SEC	Securities Exchange Commission
SES	Stock Exchange of Singapore
SIA	Securities Industry Act
SOX	Sarbanes–Oxley Act
SPAC	Special Purpose Acquisition Companies
UK	United Kingdom
US	United States

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The magnitude of information that can be explained in the IPO prospectus is enormous. However, one aspect of this information has attracted particular research interest. This is the management earnings forecasts figure and its quality as indicated by its accuracy (Hutton & Stocken, 2010). Issuing IPO earnings forecasts is considered as management promise to shareholders that the IPO company will give a specific future income by the end of IPO year (Hutagaol, Warganegara, & Wibisono, 2012). The accuracy of IPO earnings forecasts has received attention from researchers in several countries due to its importance for the investors' decisions (e.g., Henry, Ahmed, & Riddell, 2002; Hussin, Sulong, & Osman, 2004); IPO company valuation (e.g., Jelic, Saadouni, & Briston, 1998; Chen & Firth, 1999; Keasey & McGuinness, 2008; Jelic, 2011); and security prices (e.g., Gounopoulos, 2011). The present study investigates the issue related to the level of accuracy of management earnings forecasts included in the prospectuses of Malaysian IPOs.

The participants of capital markets depend on a stable stream of information in order to evaluate the risk and judge future prospects to perfectly assess the equity of a company (Foerster, Sapp, & Shi, 2013). However, there is a dire lack of financial information publicly available for an IPO company compared to a listed company. Thus, IPO companies face great information asymmetry between the current shareholders and expected investors (Guo, Lev, & Zhou, 2004; Chong & Ho, 2007;

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