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The Relationship Between Board Skills and Conservatism: Malaysian Evidence

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This study seeks to examine the influence of board skill, multiple directorships (BSHIP), and tenure of independent directors on accounting conservatism, as measured by asymmetric timeliness and accrual-based conservatism (CONACCR). Fixed-effect regression models were constructed on a sample of 2016 firm-year observations for asymmetric timeliness model and 2033 firm-year observations for CONACCR model, which covered from 2001 to 2007. The findings show that the degree of financial expertise on the board is positively associated with the recognition of bad news which is relative to good news into earnings. BSHIP appears to have no effect on conservatism. Independent directors who have longer tenure in the board of the firms are slower in recognizing bad news which is relative to good news into earnings. The study provides empirical evidence on the effectiveness of the board of directors, which will be an interest to the practitioner or regulators in reviewing the corporate governance regulations.

Keywords: board skill, financial expertise, multiple directorships, tenure, conservatism

Introduction

The reliability of the financial reporting process depended on corporate governance and management control philosophy (Dechow, Sloan, & Sweeney, 1996). Agency theory pointed out the role of the board of directors to monitor both the majority of shareholders and management and to protect the minority of shareholders' interests (Fama & Jensen, 1983). The outside directors provided a balance and segregation of management and control duties to ensure that insiders did not take advantage of their position (Fama & Jensen, 1983). And the presence of independent directors on the board would enhance the flow of information to protect the firm resources and reduce uncertainty (Pfeffer & Salancik, 2003). From the leadership's aspect, the Malaysian firms' board was largely independent from the management as the majority of firms separated the roles of chief executive officer (CEO) and chairman (Abdullah, 2004, 2006a). Abdullah (2004) reported that about 20% of Malaysian companies combined the roles of chairman and CEO during a sample period of 1994-1996. Despite this level of compliance, the ability of the Malaysian board to ensure sound corporate governance was still in doubt, because the controlling of shareholders appointed the entire board of directors

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(Allen, 2000).

Many studies in developed countries focused on the composition of independent directors in relation to conservatism (e.g., Ahmed & Duellman, 2007; Beekes, Pope, & Young, 2004). Based on the mixed evidence in Malaysia on the effectiveness of the board independence, this study seeks to examine other than this quantitative aspect of board quality. Therefore, this study was interested in assessing board skills which were in association with accounting conservatism, because directors with a good understanding of business operations could effectively review the financial reports (Lanfranconi & Robertson, 2002), and hence contributed to a stronger governance.

This study uses two measures of conservatism: One is based on asymmetric timeliness and the other is on accrual-based conservatism (CONACCR). Three proxies used for board skill are financial expertise on the board, outside directorships, and tenure of the independent directors. The Malaysian Code on Corporate Governance (MCCG) and Bursa Malaysia place no emphasis on appointment of financial expertise to the board, and do not highlight the tenure of the independent directors. However, there is a limitation, of 10 and 15 directorships in other listed and non-listed companies respectively with regard to multiple directorships (BSHIP). The requirement of financial expertise is made only for audit committee membership, and because the audit committee is a sub-committee of the board, there should be financial expertise on the board. Independence is demonstrated by an absence of family ties, business transactions with the firm and advisers' roles.

Evidence from the US and UK is supportive of a positive accounting theory, as the firms with good governance structures tend to employ more conservative accounting. The outcome of this study will reduce the gap in corporate governance literature and provide evidence on whether the same tool is effective in emerging economies like Malaysia, particularly due to the concentrated ownership in the majority of Malaysian firms. The results of this study show that financial expertise on the board is associated with more asymmetric timeliness, and that independent directors with longer tenure are associated with less asymmetric timeliness. No significant finding is obtained for BSHIP, and none of these skills are significant in a model which uses CONACCR.

The remainder of the paper is organized as follows. Section two presents the literature review and hypotheses development. Section three explains the sample which has been used in the study, the research design, the regression models, and measurements of the variables. Section four presents the descriptive analysis, empirical results, and discussion. Section five concludes the paper.

Literature Review and Hypotheses Development

Conservatism

Conservatism is traditionally reflected as "anticipates no profit but anticipates all losses" (Bliss, 1924). It involved an accounting estimation that required a higher verification to recognize good news as gains than to recognize bad news as losses (Basu, 1997). Much evidence supported conservatism's advantages to firms particularly as an agency tool. Kwon (2005) showed that conservative accounting was useful in controlling the suboptimal managerial decisions which were relative to earnings that were reported neutrally or liberally, and conservatism lowered asymmetric information and enhanced value relevance of earnings. Lin (2006) showed that conservatism was effective in revealing managers' private information on projects which were undertaken by the firm. The study indicated that for a good project, managers were willing to employ conservatism, since they could enjoy compensation during the period when the project produced cash flow. However, managers who undertake bad projects decline to employ conservatism, because they will lose compensation in any of such period. LaFond and Watts (2008) asserted that accounting conservatism reduced asymmetric information as it provided hard information on verifiable gains and disclosed possible losses which managers might decline to reveal. With lower asymmetric information, managers are constrained from hiding unfavorable information. Hui, Matsunaga, and Morse (2009) investigated the effect of conservatism on forecasts of management earnings and showed that an increase in conservatism reduced the frequency and timeliness of the earnings forecasts. This result was consistent with the role of conservatism in reducing information asymmetry and future uncertainty. More conservatism disciplines and encourages managers to maximize the shareholders' wealth, as evidence from the findings of Francis and Martin (2010) indicated that financial reports of firms with more profitable investments which were measured by bidder's announcement returns and by changes in post-acquisition operating performance, were more conservative.

As a governance tool, conservatism was important in debt contracts and execution of compensation contracts (Watts, 2003). Creditors favored conservatism, because they were concerned with the lower bound measure of a firm's net assets before granting loans (Beneish & Press, 1993). Ahmed, Billings, Morton, and Stanford-Harris (2002) demonstrated the significant role of conservatism in debt contracts as the firms with conservative financial reports were ranked higher in debt rating and had a lower cost of debt. Further, Zhang (2008) showed that conservatism benefited the lender in terms of an early signal of possible debt violation, and that this advantage was shared with the borrower in terms of lower interest costs. Therefore, conservatism protected the shareholders and debt holders whose wealth may be jeopardized by the management.

Board Skills: Financial Expertise, BSHIP, and Tenure

Existing evidence on the association between board skill and conservatism is scarce. However, the influence can be seen from their impact on other attributes of financial reporting and their role in corporate governance. A number of empirical studies have shown that governance mechanisms with strong attributes are associated with quality financial reports and lower agency conflict. Since conservatism is an important governance tool that can limit agency conflict and improve the value relevance of the reported earnings, it is likely that board members with appropriate skills would demand more conservatism, in order to strengthen the firms' corporate governance.

Board financial expertise. To monitor the financial reporting process, the directors must have accounting knowledge, in order to control manipulation and to make information more transparent. Empirical studies show that financial expertise is an important determinant of quality financial statement. The findings of Agrawal and Chadha (2005) on the US firms highlighted the importance of accounting knowledge among the outside directors in reducing the probability of financial restatements only if they had financial expertise. Very few studies have explored a financial expertise on the board, as they focused mainly on the financial expertise of the audit committee. Overall, the empirical evidence showed that directors must have financial expertise, otherwise it may impair the directors' ability to monitor the management, thus, makes it unable to detect irregularities in the financial reports. It is expected that a higher proportion of financial expertise on the board is associated with more conservatism, because the financially literate directors understand and appreciate the merit of conservatism in reducing agency conflict. The following hypothesis is presented:

H1: The proportion of financial expertise on the board is positively related to conservative accounting.

BSHIP: Governance expertise. Governance expertise refers to the experience obtained from the directors' participation on the board of other firms, which deepens their knowledge in solving various problems.

Fama and Jensen (1983) suggested that outside directors developed reputational effects which reflected on them as an expert in decision control. The value of the outside directors primarily depended on their performance as internal managers in other companies, to signal their expertise to the market. Fich and Shivdasani (2006) used panel data, and reported that firms where the directors had three or more directorships experienced lower market to book ratios as compared with firms whose directors had fewer directorships. Their analysis further heightens the belief that BSHIP is associated with weak governance, because these "busy" directors are less likely to remove the CEO of poor performing firms.

BSHIP is also argued to improve information that has been shared on legal actions against other firms, thus avoids the associated pitfalls and litigation. Saleh, Iskandar, and Rahmat (2005) showed that BSHIP was effective in reducing earnings management only in firms with negatively unmanaged earnings. As directors in loss-making firms are more likely to be replaced than those of the profit-making firms, the result could have been driven by the motivation to secure their employment instead of reflecting their competency. Other empirical studies did not support BSHIP which was evidenced by low market performance (Haniffa & Hudaib, 2006), low accounting conservatism (Ahmed & Duellman, 2007), and high earnings management (Sarkar, Sarkar, & Sen, 2008). The evidence suggests that BSHIP is an attribute of weak governance that is associated with less conservatism. The following hypothesis is tested:

H2: The proportion of directors with BSHIP is inversely related to conservative accounting.

Board Tenure (BT): Firm-specific expertise. Firm-specific expertise refers to the cumulative knowledge about the firm through directors' longer service on the firm's board. Peasnell, Pope, and Young (2005) who examined UK firms reported that outside directors with longer tenure reduced earnings management, which implied that directors were more competent to curb earnings manipulation. A management-friendly hypothesis suggests that a longer tenure for independent directors in the Malaysian business environment is more likely to be considered. In Asian countries, the entire board of directors had been appointed by controlling shareholders (Allen, 2000), independent directors who served for a longer time could be bonded to the insiders, thus made them more sympathetic and had interests that were closely aligned with the insiders. Although, longer tenure enhanced their knowledge about the firm, they might not be in a position to apply it towards stronger governance. This study perceives that longer tenure in Malaysia is an attribute of weak governance, as their independence may be impaired by a long relationship with the insiders. Thus, their interest would be in line with those of the insiders to adopt less conservatism, and hence less control on their expropriation activities. The following hypothesis is presented:

H3: Directors' tenure is inversely related to conservative accounting.

Methodology

Sample Selection and Research Design

Non-financial companies that had been listed on Bursa Malaysia were included as a sample, which included financial years from 2001 to 2007. Finance-related companies were excluded, because they possessed unique characteristics and were operated in a different compliance and regulatory environment (Chu & Cheah, 2006; Yatim, Kent, & Clarkson, 2006). Practice Note (PN) 4-classified companies, which were distressed companies that had given time and opportunity to regularize their financial position to the required minimum of a listed company, were also excluded to avoid the influence of their financial condition on the results of this study. Following Strong and Walker (1993) and Abdullah (2006b), companies that changed their year-end finance during the sample period were excluded, and companies that had undergone significant mergers or reconstruction, and those companies with unavailable online annual reports were also excluded. Financial data were collected from Datastream, and data on corporate governance were manually extracted from annual reports. After deletion of outliers, the initial sample of 300 firms for seven years (2100 firm-year observations) was reduced to the 2016 firm-year observations for asymmetric timeliness and the 2033 firm-year observations for CONACCR. Table 1 presents the sector representation of the data distributions in the two models: Asymmetric timeliness and CONACCR.

Table 1
Sector Representation of the Sample

Sectors	Asymmetric timeliness		CONACCR	
	Firm-year observations	Percentage (%)	Firm-year observations	Percentage (%)
Industrial product	775	38.44	772	37.97
Trading and services	408	20.24	404	19.87
Consumer product	322	15.97	345	16.97
Plantation	163	8.09	165	8.12
Construction	168	8.33	166	8.17
Property	63	3.13	63	3.10
Infrastructure	27	1.34	28	1.38
Hotel	28	1.39	28	1.38
Technology	62	3.08	62	3.05
Total	2016		2033	

A panel data methodology is adopted, since it provides a solution to control the invariant factors that are not controlled either in cross sectional or time series studies. The fixed-effects model and random-effects model are the two alternative models in panel data methodology, which are used to control the heterogeneity effect in panel data. The fixed-effects model assumed that the independent variables were correlated with the error term, while the random-effects model did not (Wooldridge, 2003). To determine the existence of this correlation, a Hausman specification test was performed on the two regression models that had been used in this study, which suggested that both regression models should employ a firms' fixed-effects model.

Measures of Conservatism

This study seeks to associate conservatism with governance attributes so as to examine conditional conservatism, because it is more relevant to the contracting issue (Basu, 1997; Ryan, 2006).

The two fitted regression models represented two measures of earnings conservatism: Model 1—asymmetric timeliness that had been introduced by Basu (1997); and Model 2—CONACCR that had been proposed by Givoly and Hayn (2000). Despite its limitations, Basu's measure still remained as the primary measure of accounting conservatism (Ryan, 2006). CONACCR was used as an alternative measure, as reliance on a single measure to assess the conservatism of the reporting entity might lead to incorrect conclusions (Givoly, Hayn, & Natarajan, 2007). Similar measures were employed by Ahmed and Duellman (2007), Krishnan and Visvanathan (2008), and Lara, Osma, and Neophytou (2009).

Model 1: Asymmetric timeliness. Basu (1997) introduced asymmetric timeliness to measure accounting conservatism, where share returns were used as a proxy for news about firm performance. Timeliness in earnings is measured by using a reverse-regression between earnings and contemporaneous returns that capture the difference in the effects of negative returns and positive returns on earnings. A dummy variable (D) interacts with the return variable (R) to act for bad news ($R \times D$) while the main effect on return (R) is a proxy for good news. Basu's regression model is presented as follows:

$$E_{it} / P_{it-1} = \beta_0 + \beta_1 R_{it} + \beta_2 D_{it} + \beta_3 R_{it} \times D_{it} + \varepsilon_{it} \quad (1)$$

Where:

For each firm (*i*) and each year (*t*),

E_{it} / P_{it-1} = Net Income before extraordinary items are divided at the beginning of fiscal year's market value of equity;

R = Fiscal year share return;

D = Dummy variable is equal to one if returns are negative; zero if otherwise.

$R \times D$ = Interaction between R and D.

The sensitivity of earnings to good news is measured by the β_1, while sensitivity of earnings to bad news is measured by $\beta_1 + \beta_3$. Positive coefficients were predicted by intercept (β_0) and return (β_1). The positive sign for the intercept reflected the realized gain (good news) from previous periods that were recognized in the current year (Basu, 1997). The value of β_3 reflects the incremental sensitivity of earnings to bad news as compared with good news, and thus measures accounting conservatism. The coefficient of β_3 is commonly referred to as "asymmetric timeliness". Under greater conservatism, earnings will have higher sensitivity to bad news as compared with good news. Accordingly, β_3 is expected to be larger than zero.

To test the relationship between board skill and asymmetric timeliness, board financial expertise (BF), BSHIP, and BT were interacted with each variable in Basu's original model, as shown in Equation 2. The effect of each proxy of board skill on asymmetric timeliness is observed on β_7, β_{11}, and β_{15}. A positive coefficient for the interaction effect between the variable and $R \times D$ suggests that it corresponds with more conservatism. Similar interactions are made with the control variables, but are not shown for clarity purposes.

$$\begin{aligned} E_{it} / P_{it-1} = {} & \beta_0 + \beta_1 R_{it} + \beta_2 D_{it} + \beta_3 R_{it} \times D_{it} + \beta_4 BF_{it} + \beta_5 BF_{it} \times R_{it} + \beta_6 BF_{it} \times D_{it} + \beta_7 BF_{it} \times R_{it} \times D_{it} + \beta_8 BSHIP_{it} \\ & + \beta_9 BSHIP_{it} \times R_{it} + \beta_{10} BSHIP_{it} \times D_{it} + \beta_{11} BSHIP_{it} \times R_{it} \times D_{it} + \beta_{12} BT_{it} + \beta_{13} BT_{it} \times R_{it} + \beta_{14} BT_{it} \times D_{it} + \beta_{15} BT_{it} \times R_{it} \times D_{it} \\ & + Control\ Variables_{it} + \varepsilon_{it} \end{aligned} \quad (2)$$

The earnings (E_{it}) and returns (R_{it}) were measured on the three-year backward accumulation as suggested by Roychowdhury and Watts (2007).

Model 2: CONACCR model. Givoly and Hayn (2000) argued that a reverse pattern of accruals occurred when periods in which net income exceeded (falls below) operating cash flows (OCF), was expected to be followed by periods with negative (positive) accruals. A consistent predominance of negative accruals across firms over a period of time is an indication of conservatism.

The accrual-based measure of conservatism was computed as income before extraordinary items and discontinued operations (INC) plus depreciation expenses (DEPRN) minus OCF and was deflated by total assets (TA). The accrual value is averaged over a three-year period which is centered at year *t*, and is multiplied by -1, and referred to as CONACCR. Averaging over a number of years would mitigate the effects of any temporarily large accruals, since accruals were likely to be reversed within one to two years (Richardson, Sloan, Soliman, & Tuna, 2005). The CONACCR value above was derived after being multiplied by -1, so that a higher value of CONACCR indicated more conservatism.

$$\begin{aligned} CONACCR_{it} = {} & \beta_0 + \beta_1 BF_{it} + \beta_2 BSHIP_{it} + \beta_3 BT_{it} + \beta_4 BID_{it} + \beta_5 BCD_{it} + \beta_6 OSHIP_{it} + \beta_7 AUD_{it} + \beta_8 TA_{it} + \beta_9 PROF_{it} \\ & + \beta_{10} LEV_{it} + \beta_{11} SGROW_{it} + \varepsilon_{it} \end{aligned} \quad (3)$$

Where:

For each firm (*i*) and each year (*t*),

$CONACCR_{it}$ = CONACCR that had been proposed by Givoly and Hayn (2000);

BF_{it} = Proportion of board members with financial expertise;

$BSHIP_{it}$ = Proportion of directors with more than two outside directorships;

BT_{it} = Average years the independent directors served on the firm's board;

BID_{it} = Proportion of independent directors to total directors on board;

BCD_{it} = Dummy equals one if CEO-chairman roles are combined, zero if they are separated;

$OSHIP_{it}$ = Percentage of substantial shareholding in the firms;

AUD_{it} = Dummy equals one if it is audited by four large audit firms, zero if otherwise;

TA_{it} = Natural logarithm of total assets;

$PROF_{it}$ = Total assets divided by OCF;

LEV_{it} = Total assets divided by non-current liabilities;

$SGROW_{it}$ = Annual percentage of change in sales.

Measures of Board Skill

BF expertise, *BSHIP*, and *BT* are all proxies for board skill. *BF* is the proportion of board members with qualifications or experience in accounting or finance, including those who are members of accounting professional bodies. The definition includes directors who are current or former chief financial officers, accountants, and former auditors. *BSHIP* is the proportion of directors on the board with more than two outside directorships. A similar measure was employed by Ferris, Jagannathan, and Pritchard (2003), Saleh et al. (2005), and Fich and Shivdasani (2006). Most information in the annual reports reported the word "several" in place of the actual number of directorships. This study assumed "several" as more than two directorships. *BT* is the average years of service of all independent directors served on the firm's board.

Control Variables

Similar control variables were included in both regression models, except two different proxies that were used for sales growth (*SGROW*): Market to book ratio (*MTB*) is used as a control variable in the asymmetric timeliness model, while the annual percentage of sales is used as a control variable in the CONACCR model. *BID* and *BCD* represented board independence, and were included as control variables, because ratios of independent directors on the board and CEO duality had been shown to be associated with governance strength, and hence might influence conservatism. Best practice in the Malaysian Code on Corporate Governance dictates that listed Malaysian firms are comply with a minimum one-third ratios of outside directors on the board. Therefore, it is likely that conservatism is influenced by the proportion of the independent directors on the board. This is consistent with empirical evidence that independent directors have contributed to stronger governance as they are associated with more conservatism, and have lowered earnings management and improved firm value. The duality roles of CEO and chairman of the board have generated conflicting arguments and mixed evidence, as separating the two roles provides the board with an independent monitoring on the management including the CEO, but a combined role offers the prospect of better leadership due to a lesser transfer of information which leads to faster decision making. The conflicting views suggest that the leadership structure has an impact on firm governance, and therefore may influence conservatism. Other considered control variables are ownership concentration (*OSHIP*), auditor (*AUD*), firm size (*TA*), profitability

(*PROF*), leverage (*LEV*), and growth (either *MTB* or *SGROW*). *MTB* and *SGROW* are the two proxies for growth, where *MTB* is a control factor in asymmetric timeliness model, while *SGROW* is a control factor in CONACCR model.

OSHIP controls the differences in the extent of substantial ownership in the firms. Since the ownership structure of Malaysian firms is highly concentrated and the risks that these controlling shareholders take are harmful to the firm. They are likely to employ less conservatism, either because they are no longer relying on the financial statements to gather managers' information, or because they need to conceal their expropriation activities. *AUD* controls differences between large vs. small audit firms at the level of conservatism practices. *TA* controls differences in the political costs and information asymmetry between large and small firms. Watts and Zimmerman (1978) argued that large firms that were exposed to more political costs would adopt more conservatism. *PROF* controls for differences between profit-making vs. non-profit-making firms in adopting conservatism. Since conservatism would decrease the profit further, unprofitable firms would be less likely to employ more conservatism (Ahmed et al., 2002). *LEV* controls the demand of highly leveraged firms to employ more conservatism, in order to reduce the conflict between shareholders and debt holders. *SGROW* was included in the CONACCR regression model, because Ahmed et al. (2002) argued that growth in sales was likely to affect the CONACCR measure. *MTB* needed to be controlled in the asymmetric timeliness model, because changes in growth opportunities could create variations in the asymmetric timeliness that were unrelated to accounting conservatism (Roychowdhury & Watts, 2007).

Results

Descriptive Statistics

Examination of the descriptive statistics which reveals the mean value of 27% for *BF* indicates that, less than half of board members have academic qualification or experience in accounting or finance field. The average value for *BSHIP* suggests that nearly half of the board members hold more than two outside directorships. As *BSHIP* is associated with business or better knowledge, the statistic suggested that the involvement of the board members in other firms' directorships is reasonably balanced. The mean value for *BT* is 6.77, suggesting that independent directors have served on the firms' board for an average of seven years. The mean value for *BID* is 40%, which suggests that there is a minimal compliance with the best practice of corporate governance to appoint at least one-third ratio of independent directors to the board. The leadership structure of Malaysian firms follows the agency theory that split roles are better for monitoring, and only 5% of the sampled firms combine the CEO-chairman roles. The average value for CONACCR is -0.01, which turns out to be relatively lower than those that are reported for the US firms at 0.01, as reported by both Ahmed and Duellman (2007) and Krishnan and Visvanathan (2008).

The correlations between these variables show that CONACCR is not significantly associated with any of the board skill proxies, but is significantly related to all control variables except *BCD*. The relationship between the *OSHIP* and a proxy for board skill provides an interesting insight, since ownership of Malaysian firms is categorized as highly concentrated. It shows that firms with concentrated ownership have lower proportions of financial expertise but had high proportions of directors with *BSHIP*, and also had high proportions of independent directors who have served longer terms. *OSHIP* is associated with lower proportion of independent directors. The findings suggest that the firms with *OSHIP* have adopted weak governance mechanisms.

Multivariate Analysis

Fixed-effect regressions were performed on two regression models, i.e., asymmetric timeliness in Table 2 and CONACCR in Table 3. They provide mixed evidence. In the asymmetric timeliness model, a significantly positive coefficient on $BF \times R \times D$ supported H1. The findings showed that conservatism was not determined by the proportion of directors with *BSHIP*, thus H2 was not supported. A significantly negative coefficient for $BT \times R \times D$ supported H3. There were no significant findings obtained from the CONACCR model.

Table 2

Regression Results of Asymmetric Timeliness

$$E_{it} / P_{it-1} = \beta_0 + \beta_1 R_{it} + \beta_2 D_{it} + \beta_3 R_{it} \times D_{it} + \beta_4 BF_{it} + \beta_5 BF_{it} \times R_{it} + \beta_6 BF_{it} \times D_{it} + \beta_7 BF_{it} \times R_{it} \times D_{it} + \beta_8 BSHIP_{it}$$
$$+\beta_9 BSHIP_{it} \times R_{it} + \beta_{10} BSHIP_{it} \times D_{it} + \beta_{11} BSHIP_{it} \times R_{it} \times D_{it} + \beta_{12} BT_{it} + \beta_{13} BT_{it} \times R_{it} + \beta_{14} BT_{it} \times D_{it} + \beta_{15} BT_{it} \times R_{it} \times D_{it}$$
$$+ Control\ Variables_{it} + \varepsilon_{it}$$

	Predicted sign	Coefficient	*t*-value
Constant		-1.53	-0.85
R		0.12	0.38
D		-0.49	-1.95
$R \times D$		-1.22	-1.65
BF		0.02	0.19
$BF \times R$	−	-0.65	-4.98***
$BF \times D$		-0.19	-1.57
$BF \times RD$	+	0.66	2.56**
$BSHIP$		0.24	4.30
$BSHIP \times R$	+	0.01	0.08
$BSHIP \times D$		0.03	0.56
$BSHIP \times R \times D$	−	-0.09	-0.70
BT		0.00	0.05
$BT \times R$	−	0.00	0.31
$BT \times D$		0.00	-0.76
$BT \times R \times D$	+	-0.01	-2.64**
Control variables included			Yes
F-value			43.11***
R^2 within			0.2094
N			2,016

Notes. (1) Reported *t*-value was estimated based on Driscoll and Kraay's (1998) method, which was robust to cross-sectional dependence, heteroskedasticity, and autocorrelation; (2) $^{***}p < 0.01$; $^{**}p < 0.05$; $^{*}p < 0.10$; (3) R = Stock return, D = dummy equals one if R is negative and zero otherwise, $RD = R \times D$, BF = Board financial expertise, BT = Average tenure of independent directors; and (4) Control variables: *BID*, *CEO* duality, *OSHIP*, *AUD*, *TA*, *PROF*, *LEV*, and *MTB*.

A significant relationship between financial expertise and asymmetric timeliness signified the importance of accounting knowledge for directors to control manipulation and to produce transparent financial information. This study showed that directors equipped with financial knowledge were faster in recognizing bad news which was relative to good news into earnings. This result supported previous studies that highlighted the importance of financial experts' best practice in corporate governance, which required that all audit committee members should be financially literate with at least one being a member of a professional accounting body. The results of this study showed that *BSHIP* had no significant influence on conservatism, which suggested that conservatism practices in Malaysian financial reports were not determined by the reputational effects as suggested by Fama and Jensen (1983). This study found that directors with longer tenure were negatively associated with asymmetric timeliness, which suggested that they were slower in recognizing bad news which was relative to good news into earnings.

Table 3

Regression Results of CONACCR

$$CONACCR_{it} = \beta_0 + \beta_1 BF_{it} + \beta_2 BSHIP_{it} + \beta_3 BT_{it} + \beta_4 BID_{it} + \beta_5 BCD_{it} + \beta_6 OSHIP_{it} + \beta_7 AUD_{it} + \beta_8 TA_{it} + \beta_9 PROF_{it} + \beta_{10} LEV_{it} + \beta_{11} SGROW_{it} + \varepsilon_{it}$$

	Predicted sign	Coefficient	t-value
Constant		0.28	1.83
BF	+	0.02	0.92
BSHIP	−	-0.01	-0.99
BT	+	0.00	0.66
BID	+	0.03	1.12
BCD	−	0.00	-0.19
OSHIP	−	0.00	-2.82**
AUD	+	0.00	0.32
TA	−	-0.01	-1.78*
PROF	+	0.16	6.07***
LEV	+	0.04	1.45
SGROW	−	0.00	-2.89***
F-value			5.32***
R^2 within			0.0953
N			2033

Notes. (1) Reported t-value was estimated based on Rogers (1993) method, which was robust to heteroscedasticity and autocorrelation; and (2) $^{***}p < 0.01$; $^{**}p < 0.05$; $^{*}p < 0.10$; Control variables: *BID*, *BCD*, *OSHIP*, *AUD*, *TA*, *PROF*, *LEV*, and *SGROW*.

Although longer tenure might improve directors' knowledge about the firm (Buchanan, 1974), the results in this study supported the argument that their longer service in the firm might jeopardize their independence in monitoring the management. In Malaysia, the firms' board is dominated by the inside controlling shareholders, there is a risk that the directors' long-term service itself helps the controlling shareholders to pursue their own agenda and does not relate to the firm-specific knowledge that is necessary to the provision of quality financial reports. Therefore, lower conservatism may provide the opportunity for the entrenched managers to expropriate the firm wealth for their own interest.

Among the control variables, *BID* led to more asymmetric timeliness but had no significant effect on CONACCR. The finding suggested that outside directors did contribute to stronger governance via more conservatism, but the longer they stayed in the same firm, the more their effectiveness would be reduced. *BCD* had no association with either of the conservatism measures, which suggested that the form of leadership structure was not important in conservatism of Malaysian financial reports. *AUD*, *LEV*, and *MTB* were significantly associated with asymmetric timeliness, whilst *OSHIP*, *TA*, *PROF*, and *SGROW* were significantly associated with CONACCR.

Conclusions

Conservatism plays an important role in governance as it is able to constrain opportunistic behavior through a faster recognition of losses that are relative to gains into earnings, and board skills that have contributed to stronger governance are expected to be associated with more conservatism. The two measures of conservatism produced mixed results: The proxies for board skills were found significant in the asymmetric timeliness model but not in the CONACCR model. Specifically, the findings show that the proportion of financial expertise on the board is associated with more asymmetric timeliness, while average tenure of independent directors is associated with less asymmetric timeliness. None of the board skills appears as significant in the CONACCR model, and *BSHIP* do not influence conservatism.

Though this study found that contradicting results between the two measures of conservatism were relative to those of Ahmed and Duellman (2007), it was important to note that their study was carried out in the US where the ownership structure of the firms was dispersed, in contrast to the *OSHIP* of Malaysian firms. As such, the board of directors in dispersed firms plays an effective role in reducing the manager-shareholder conflict. On the contrary, the dominant role of controlling shareholders in Malaysia, particularly insiders, enables them to determine the reported earnings and may also influence the conduct of the board.

Consistent with the suggestion of the Securities Commission that longer tenure jeopardizes the independence of the directors, this study suggests that longer tenure may have weakened the ability of the independent directors to improve governance, thus leading them to adopting less conservatism, a policy which is likely to favor the controlling of shareholders. The potential for overriding power by controlling shareholders in a majority of Malaysian firms through a long-term relationship with the independent directors should not be neglected.

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