

Reforming Corporate Governance in Malaysia to Address Fraudulent Financial Reporting Cases

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ABSTRACT

Fraudulent Financial Reporting has become an issue of great concern throughout the world. It is a global phenomenon which has attracted attention of the business and financial community, regulatory bodies and the public. It is harmful in many ways. As a result, various mechanisms have been introduced to mitigate the occurrence of fraudulent financial reporting case. In Malaysia, the Malaysian regulatory authorities have designed various controls and undertaken all kinds of actions and reforms to mitigate the occurrence of fraudulent financial reporting case, to enhance the integrity of the capital markets and to restore investors' confidence. The most important one is the reform of Malaysian Code of Corporate Governance (MCCG) which emphasizes on the role of audit committee and external auditor in an organization. Such a committee should possess certain characteristics in order for it to function effectively. From previous studies, it is apparent that not many researches have been conducted into examining the reform of corporate governance in Malaysia. Hence, the purpose of this study is to examine the reform that has been undertaken by the Malaysian regulatory authorities from 1998 until 2012.

Keywords: Reform, Corporate Governance, Fraudulent Financial Reporting, Malaysia

INTRODUCTION

Financial reporting is an important tool of communication (Nicolaescu & Mot, 2013) in the case of public listed company due to the separation of ownership and control (Jensen & Meckling, 1976). The purpose of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decision about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit (MASB, 2011). In other words, it serves as the main means of communication between companies and stakeholders by relieving fundamental asymmetry information between the directors who have access to management information and providers of fund who are external to the company. The most common and well-known form of financial reports made available to external parties of the company is the published corporate annual reports. An annual report is a comprehensive report on a company's activities throughout the preceding year. Companies used annual report to disseminate information about their past and future activities as well as outcome of those activities (Crowther, 2000). Typically annual reports will include financial statements, corporate information, operating and financial review, director's report, corporate governance information, chairpersons statement, auditor's report and notes to the financial statements. Such a document represents a measure of accountability on the part of the board of directors (Abdul Rahman, 1999). In total, the content of annual reports should be of a quality that is useful to users of the reports and meets the information needs of those users (Ismail et al., 2016).

In the context of Malaysian corporate law framework, Companies Act 1965 (now replaced by Companies Act 2016) (hereafter "The Act") expressly imposes the responsibility for the preparation and fair presentation of financial statements on directors (part of the management which also include Chief Executive Officer and Chief Financial Officer as per court interpretation). Section 166A(3), 166A(4) and 166A(5) of The Act state clearly that the directors of a company shall ensure that the accounts of the company (including consolidated accounts,

where applicable) laid before the annual general meeting are in accordance with the applicable approved accounting standards. Apart from that, the accounting information presented in the financial statements must possess the following desirable qualities namely relevance and reliability (Subramanyam & Wild, 2009). Relevance is the capacity of information to affect a decision. While for reliability, (Subramanyam & Wild, 2009) stated that for information to be reliable, it must be verifiable, representationally faithful and neutral. Verifiability means the information is confirmable. Representational faithfulness means the information reflects reality, and neutrality means it is truthful and unbiased. These qualities are crucial because they will give great impact to the investors' investment decision.

Investors, either individuals or institutions, commit their personal funds to companies in expectation of some returns in the future either in the form of dividend income, interest income or capital gain. In making investment decision, investors rely highly on the board's representation and the auditor's opinion that a company's financial statements in the audited annual report fairly reflect the financial position, results of operations and cash flow of the company. Investment generally involves huge amount of money which can be represented by market capitalization as shown below in Table 1.1.

Table 1.1: Market capitalization of top 10 public listed companies in Malaysia as of October 2025

No.	Code	Name	Stock	Market Capitalization
1.	1155	Malayan Banking Berhad	MAYBANK	\$28.63 Billion
2.	1295	Public Bank Berhad	PBBANK	\$19.68 Billion
3.	1023	CIMB Group Holdings Berhad	CIMB	\$19.20 Billion
4.	5347	Tenaga Nasional Berhad	TENAGA	\$18.35 Billion
5.	5225	IHH Healthcare Berhad	IHH	\$17.07 Billion
6.	8869	Press Metal Aluminium Berhad	PMETAL	\$11.90 Billion
7.	6947	Celcomdigi Berhad	CDB	\$10.22 Billion
8.	5819	Hong Leong Bank Berhad	HLBANK	\$10.03 Billion
9.	6033	Petronas Gas Berhad	PETGAS	\$8.89 Billion
10.	5285	Sime Darby Plantation Berhad	SDG	\$8.76 Billion

Sources: companiesmarketcap.com website

Table 1.1 shows market capitalization of top 10 public listed companies in Malaysia as of October 2025. Market capitalization is calculated by multiplying the number of company's shares outstanding with current market price of the share. The investment community uses this figure to determine a company's size as opposed to sales or total asset figures. From the market capitalization amounts above we can see that huge amount of money have been invested by shareholders. Hence, the management of any public listed companies must exercise reasonable care in the financial reporting process to ensure that the financial information provided to the existing and potential investors is free from deliberate material misstatements or omissions. Should this condition is not, then what is termed as fraudulent financial reporting (or financial statement fraud) would arise and the investors would lose their money.

LITERATURE REVIEW

Fraudulent financial reporting is defined (Association of Certified Fraud Examiners (ACFE), 2018) as "The intentional, deliberate, misstatement or omission of material facts, or accounting data to mislead and, when considered with all the information made available, would cause the reader to alter his or her judgment in making a decision, usually with regards to investments". In fact, there are many other definitions that can be found in the literatures. Fraudulent financial reporting is different from earnings management with respect to the acceptability of accounting treatment, while earnings management is still within generally accepted accounting principles (GAAP) but pushing its limits (Hasnan et al., 2014). GAAP is a collection of commonly followed accounting rules and standards for financial reporting. Nevertheless, since earnings management is not the central theme of this study, it shall not be further discussed.

Fraudulent financial reporting has become an issue of great concern to the business and financial community, regulatory bodies and the public around the globe (Rezaee, 2005) since late 80's. This is based on the number of literatures that are available in the online database. Using the Scopus database with the following search string "Fraudulent financial reporting" OR "Fraudulent Financial Statement*" OR "Financial Statement Fraud*" OR "Fraudulent Reporting" OR "Accounting Fraud*" OR "Accounting Manipulation" OR "Accounting Scandal*", 676 articles were found to be written related to fraudulent financial reporting from 1989 to 2021.

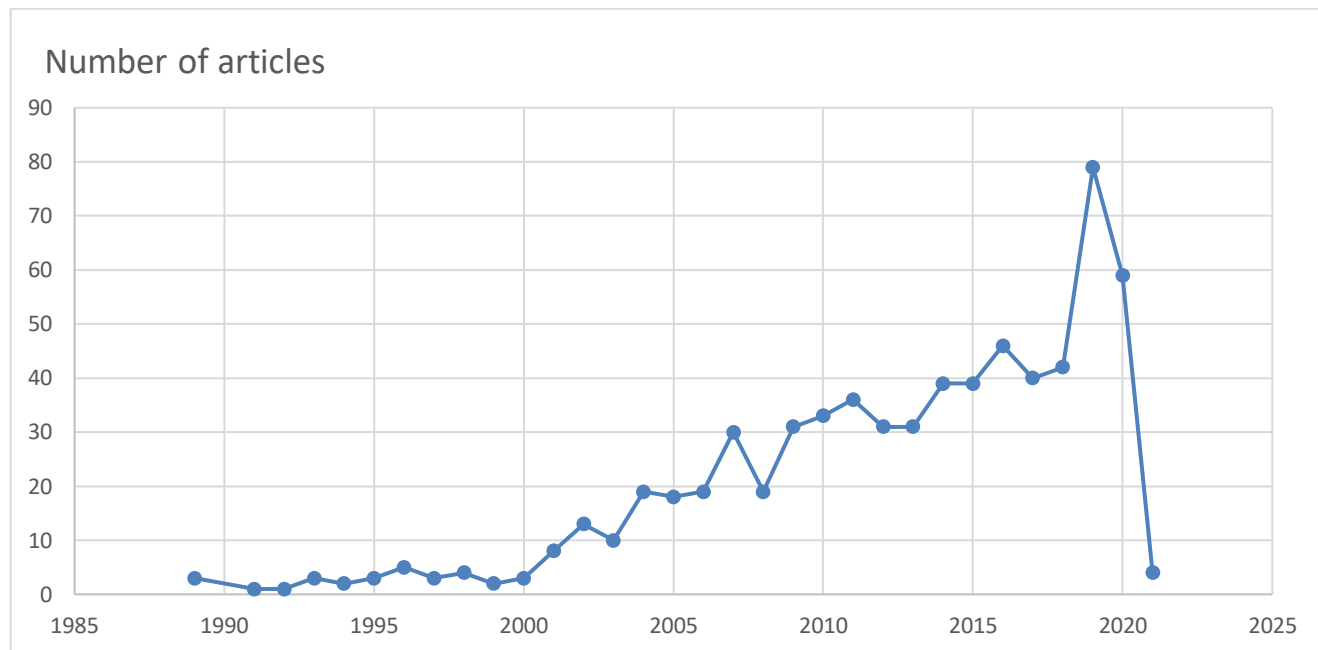


Figure 1.1: Number of articles related to fraudulent financial reporting (1989-2021)

Based on Figure 1.1 above, we can see the increasing trend in the research related to fraudulent financial reporting. This trend indicates that even after more than two decades the issue related to fraudulent financial reporting continue to be of interest by researchers of various countries. The main reason for the non-stop research in this area could be due to the severe economic consequences that the fraudulent financial reporting incidence could bring. A study by (Mark S. Beasley et al., 1999) found that, over 50 percent of the fraud companies in the USA from 1987-1997 filed for bankruptcy, became defunct, experienced a significant change in ownership following the fraud disclosure or in some cases the company executives were terminated or forced to resign. The collapse of Enron in 2001 obliterated more than \$60 billion market value, \$2.1 billion pension plans and 5,600 jobs (Gilpin, 2001). Enron scandal has also led to the demise of once renowned audit firm, Arthur Anderson. The ACFE (2002) reported that companies lost approximately six percent of their revenue to fraud and the cost to U.S. corporations from fraud approximates more than \$600 billion per year or \$4,500 per employee.

Furthermore, following the financial scandals, many of the fraudulent companies saw their equity values plummet dramatically and experienced a decline in the credit ratings of their debt issues, often to junk status (Agrawal & Chadha, 2005). Carcello & Hermanson (2008) stated that the misstated financial statements due to fraud often lead to large investor loss, subsequently followed by intense media and regulatory scrutiny. Employees lose their jobs, investors do not get optimal return on their investments and creditors are unable to get their payments, and as a result, the public lose their faith on the legislation (Omar et al., 2016). Another reason fraudulent financial reporting becomes a subject of considerable interest in current literature is due to the devastating consequences it can cause which include loss of investor confidence, reputation damage, potential fines and criminal actions Ernst & Young (2010). In addition, Vlad et al., 2011 claimed that fraudulent financial reporting undermines the reliability, quality, transparency, and integrity of financial reporting. Fraudulent financial reporting cases also eroded confidence towards the financial markets, financial information and also the accounting profession worldwide (Law, 2011). According to the 2020 Global study on occupational fraud and abuse which analyzed 2,504 cases between January 2018 and September 2019, fraudulent financial reporting is the least used scheme (10% of cases) yet the costliest category of occupational fraud. It results in median loss of USD 954,000 per case (ACFE, 2002). In other words, it is reported as the first rank of enormous losses as

compared to the other two occupational frauds namely asset misappropriation and corruption. In short, when fraudulent financial reporting occurs, the consequences to investors, the entity itself, employees, the fraud perpetrators, the financial markets and the accounting and auditing profession often are severe.

Another thing to highlight is that fraudulent financial reporting is a global phenomenon (Albrecht & Albrecht, 2002) with Enron in the USA being the most remembered corporate fraud case. It was one of the largest securities fraud scandals in history. Enron was forced to file for bankruptcy in December 2001. Other examples of the same fraud in the USA are Xerox, HealthSouth and Global Crossing which committed fraudulent financial reporting mainly by manipulating of revenues (Frieswick, 2003). WorldCom which is also in the USA, on the other hand, committed financial fraud by reducing reserve account and understated expenses (Frieswick, 2003). In Italy, a dairy and food corporation, Parmalat was caught involving in fraudulent financial reporting by overstating revenues. Adecco International which is an employment services company in Switzerland committed fraudulent financial reporting through manipulation of current assets and revenues. Ahold NV, a food retailer company in The Netherlands involved in fraudulent financial reporting via fictitious rebates which overstated earnings. Vivendi Universal, a mass media and telecommunications violated accounting principle (Badawi, 2005). The summary of corporate frauds cases around the globe is as in Table 1.2 and Table 1.3. Both tables also highlight various types of manipulation used by the perpetrators in committing the fraud with overstated revenue being the most popular type.

Table 1.2:List of corporate frauds in USA

No.	Name	Industry	Year	Type of manipulation
1.	Xerox	Photocopier company	2000	Overstated revenues
2.	Enron	Energy company	2001	Inflated earning and money laundering (used special purpose entities to hide losses)
3.	WorldCom	Telecommunication company	2002	Reduced reserve account and understated expenses
4.	Global Crossing	Telecommunication company	2002	Overstated revenues
5.	HealthSouth	Healthcare services	2003	Overstated revenues

Table 1.3: List of corporate frauds in Europe

No.	Name	Industry	Year	Type of manipulation
1.	Asea Brown Boveri (Sweden)	Digital Technologies	2002	Theft of cash &\$148 million by CEO
2.	Vivendi Universal (France)	Mass media and telecommunications company	2002	Violated accounting principles
3.	Adecco International (Switzerland)	Employment services	2003	Manipulation of current assets and revenues
4.	Ahold NV (Netherlands)	Food	2003	Overstating earnings by \$800 million over two years through invented cost savings called "promotional allowances"
5.	Parmalat (Italy)	Food and dairy conglomerate	2003	Overstated revenues
6.	Elan (Ireland)	Pharmaceutical company	2004	Use off-balance sheet
7.	Royal Dutch/Shell Group (Netherlands)	Oil company	2004	Overstated oil and gas reserves

Sources: Badawi (2005)

Being a global phenomenon, emerging countries such as Malaysia is of no exception to also experience their share of such fraud. In fact, such incidences have started to surface in Malaysia even before the collapse of

Enron. Based on the Securities Commission's enforcement record, the first case of submitting false information was committed by the director of Ganad Corporation Bhd in 1995. The information in the listing proposal about turnover, trade debtors and profit before tax was inflated for two financial year ends. The director admitted committing the offence and was fined RM600,000. Towards the end of 1990's, a few more similar cases arose in companies such as Westmont Industries Bhd, TCL Premier Holdings Bhd and Kiara Emas Asia Industries Bhd. Most fraudulent financial reporting cases occurred between 2000-2004 involving companies such as Chin Foh Bhd, UCP Resources Bhd, Sinmah Resources Bhd, Polymate Holdings Bhd and United U-Li Corporation Bhd. Later, between 2005 and 2007, among the companies that announced at least some form of financial irregularities during this time are Transmile Group Bhd, Megan Media Holdings Bhd, WelliMulti Corporation Bhd, Satang Holdings Bhd and LFE Corporation Berhad. In the Transmile fiasco, the share price was down to around RM8 from its peak of around RM14 in early May 2007 and Bursa Malaysia reprimanded Transmile and its Chief Executive Officer as well as all the three audit committee members (Wan Abdullah et al., 2012).

The latest fraudulent financial reporting case in Malaysia occurred in 2011 involving Silver Bird Group Bhd (now known as High-5 Conglomerate Bhd), a bread manufacturing company. This case really shocked local auditors because Silver Bird Group Bhd's shareholders filed a lawsuit not only against two of its former directors and an ex-general manager but also against its internal and external auditors (Crowe Horwath) at the Kuala Lumpur High Court claiming RM125.03 million as special damages, general damages, punitive and aggravated damages, interest and costs. Based on the latest record in the Securities Commission website, the case is still ongoing. The case was thought to have ended the 8-year legal saga when the Court of Appeal on 10 June 2020 had acquitted of all 134 charges of cheating charged on former Silver Bird Group Bhd managing director, Datuk Jackson Tan Han Kook and its former chief executive officer, Derec Ching Siew Cheong. Nevertheless, on 9 Dec 2020, Sessions Judge, Hasbullah Adam ruled that the appellate court's decision on June 10 2020 was not binding on his court as estoppel did not arise. As a result, both the former managing director and the former chief executive officer of Silver Bird continue to stand trial for providing false information to Bursa Malaysia.

DISCUSSION

The Malaysian regulatory authorities have designed various controls and undertaken all kinds of actions and reforms to mitigate the fraudulent financial reporting case, to enhance the integrity of the capital markets and to restore investors' confidence. The most important one is the installation corporate governance in corporate organization (Kamarudin & Wan Ismail, 2014). This action was stimulated and driven by actions of other countries such as in Table 1.4 below.

Table 1.4: Regulations to improve corporate governance environments

No.	Country	New legislation/regulation
1.	United Kingdom	Cadbury Report
2.	United States	Sarbanes Oxley
3.	Canada	The Dey Report
4.	France	Vienot report
5.	Spain	Olivencia Report
6.	South Africa	King's Report
7.	New Zealand	Principles and Guidelines on Corporate Governance
8.	Germany	Cromme Code

Sources: Bhagat & Bolton (2009)

In Malaysia, the effort to reform corporate governance commenced amid Asian financial crisis. The chronological events in relation to the reform in presented in Table 1.5 below.

Table 1.5: Corporate Governance Reforms in Malaysia

Year	Initiatives and Reforms
1998	The formation of the High-Level Finance Committee to conduct a detailed study on corporate governance and to make recommendations for improvements.
1998	Amendments were made to the Security Industry Central Depository Act (SICDA) with a view to enhancing transparency in share ownership amidst other improvements.
1998	The Malaysian Institute of Corporate Governance was established.
1998	The regulations for directors and CEOs to disclose interest in the publicly listed company were introduced.
1999	Quarterly reporting was introduced.
1999	A revamp of takeovers and merger code was done.
2000	The Malaysian Code on Corporate Governance was introduced.
2000	Amendments were made to the Securities Commission Act 1993 by making the Securities Commissions the sole regulator for fund raising activities and the corporate bond market.
2001	The audit committee must have a member who is financially trained.
2001	The Malaysian Capital Market master plan was launched to further streamline and regulate the capital market and to chart the course for the capital market for the next ten years.
2001	The financial sector master plan was launched to chart the future direction of the financial system over the next ten years. It outlined the strategies to achieve a diversified, effective, efficient and resilient financial system.
2001	The mandatory disclosure of corporate governance code compliance was introduced.
2001	The establishment of a minority shareholders watchdog group.
2001	The mandatory accreditation programme for director was introduced.
2002	The internal audit guidelines for PLCs were introduced.
2003	Guidance notes on share splits, guidance for companies to meet compliance and internal control requirements were introduced.
2004	Amendments to the security laws and takeover codes for better investor's protection were made.
2005	A review in respect of accounting minority interests in companies' financial statements and guidelines on compliance functions for fund managers to further strengthen investor's protection were introduced.
2006	Revised guidelines on securities borrowing and lending were made and the enhanced guidelines for placement of securities for greater shareholder's and investor protection were issued.
2007	The Malaysian Code on Corporate Governance was revised. Amendments in relation to corporate governance to Companies Act 1965 were made.
2012	Malaysia Code of Corporate Governance 2012 deliverable through Corporate Governance Blueprint 2012

Source: Jamil (2017)

With regards to Malaysian Code on Corporate Governance (MCCG), it was first introduced in March 2000, marked a significant milestone in corporate governance reform in Malaysia. It codified the principles and best practices of good governance and described optimal corporate governance structures and internal processes. The best practices being emphasized are the responsibilities of the board of directors, the establishment of audit committee and the relationship between the board and the shareholders. The Code was later revised in 2007 to strengthen the role and responsibilities of the board, audit committee and the internal audit function. The revision of The Code in 2007 was mainly following the judgement by the court related to the Transmile case. In the case, the auditor of the company at that time, Deloitte and Touche had discovered accounting irregularities and had brought up the material issues to the attention of the management, the Chief Executive Officer and the audit committee but these parties had failed to inform the board of directors about the findings (Wan Abdullah et al., 2012). In passing the sentence of one-year imprisonment and a fine of RM300,000 (in default six months imprisonment) to two former audit committee members, the Sessions Court Judge, Justice Dato' Jagjit Singh

Bant Singh stated that the public interest factor must be given paramount consideration. He said that the audit committee is a vital organ of the company and particularly important in the corporate governance of a company. The judge emphasized that the audit committee has specific duties, functions and responsibilities and that the investing public rely on them very much. The judge further highlighted that the independent non-executive directors of a company or audit committee members are not a decorative-pieces-of-a-company.

The most significant amendments in MCCG 2007 related to the composition of audit committee are that the audit committee should comprises of at least three members, a majority of whom are independent, all must be non-executive directors, all must be financially literate and at least one should be a member of an accounting association or body (Securities Commission Malaysia (SC), 2007). In addition, the MCCG 2007 requires a higher frequency of meetings between audit committee and external auditors without the presence of executive board members (Husnin et al., 2016) and places emphasis on the need for continuous training. The revision of MCCG 2007 was then followed by the amendments of securities and companies law including the amendment of The Companies Act 1965 (now Companies Act 2016). Then, the Audit Oversight Board (AOB) was established in 2010 to provide independent oversight over external auditors of companies. The Securities Industry Dispute Resolution Center was established to facilitate the resolution of small claims by investors. Statutory derivative action was introduced to encourage private enforcement action by shareholders.

In 2012, The Code was revised for the second time. The MCCG 2012 focuses on strengthening board structure and composition recognizing the role of directors as active and responsible fiduciaries (Securities Commission, 2016). Nevertheless, in relation to upholding the integrity of financial reporting, responsibility is placed explicitly on audit committee which is responsible in appointing the external auditor. The characteristics of these two control mechanisms (audit committee and audit firms) of financial reporting shall be the main focus of this study.

The role of the audit committee is to assist board of directors in monitoring management mainly in overseeing the financial matters of a company. The audit committee is expected to detect and stop any attempt by the management to engage in manipulation of earnings or misappropriation of assets. The fiduciary duties of the audit committee include monitoring the financial reporting process, monitoring the internal control system, oversee the external and internal audit functions, reporting findings to the board of directors and monitor and oversee the whistle-blower policy and hotline (AICPA, 2010). The main emphasis in MCCG 2012 is that the audit committee should ensure financial statements comply with applicable financial reporting standards and assess the suitability and independence of external auditors. The quality of earning is an indirect measure of the effectiveness of audit committee. Audit committee is considered effective if it can ensure that the interest of the shareholders in relation to financial reporting quality is protected and also ensure that the external audit process is working properly.

The role of the external auditor, on the other hand is to give independent professional opinion on the truth and fairness of the financial statements. On top of that, the external auditor also play important role in detecting fraudulent information. Despite the fact that the board of directors (management) is ultimately responsible for the fair presentation of the financial statements, a greater responsibility has been placed on auditors to assess the risk that fraud might be occurring within the organization. Auditors are engaged based on scope of activities laid out under the International Standards on Auditing and Fraud Detection. Auditors do not examine every transaction and event, so there is no guarantee that all material misstatements, whether caused by error or fraud, will be detected. Auditors could have the ability to detect fraud or financial irregularities at an earlier stage with the involvement of forensic techniques, but this would require increased cost and time.

CONCLUSION

Fraudulent financial reporting is a serious problem in any jurisdiction with WorldCom in the USA ranks first in the list of largest bankruptcy filings by AICPA in year 2005. Its lost assets value amounted to USD103.9 billion when filed in 2002. In general, if the occurrence of fraudulent financial reporting is not curbed, it will eventually dampen the economic growth of a country. Despites the introduction of various control mechanisms by regulatory authorities, the fraudulent financial reporting case continue to occur with a large number goes unreported (ACFE, 2020). Thus, it is essential to carry out this study to further understand the right

characteristics of the audit committee and the audit firm. The adoption of the right characteristics of audit committee and audit firm is expected to be able to mitigate the occurrence of fraudulent financial reporting case more effectively in the future.

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