

DOI: 10.5281/zenodo.12426514

THE IMPACT OF BOARD GOVERNANCE AND SHARIAH COMMITTEE QUALITY ON COSMETIC ACCOUNTING, ROLE OF AUDIT FEES AS MODERATOR IN MALAYSIAN ISLAMIC BANKS

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Received: 02/11/2025

Accepted: 24/03/2026

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ABSTRACT

This paper investigates the impact of board governance and Shariah committee quality on cosmetic accounting practices in Malaysian Islamic banks. This study also investigated the moderation effect of audit fees between governance attributes and cosmetic accounting. The sample used secondary data from 2011 to 2023 that involved 288 observations. The panel data analysis is used to test the hypothesis using Stata 15 Version. The result demonstrated that board size, Shariah committee size and audit committee independence affect on cosmetic accounting. Board independence and Shariah committee independence has no significant effect on cosmetic accounting. The results show that, audit fees have no moderation effect between governance attributes and cosmetic accounting. The findings of the study demonstrated that the application of good governance impacts the quality of financial reports and the incidence of unethical creative accounting. The quality of financial reporting was impacted by creative accounting, which was also influenced by the application of good governance. This demonstrated how crucial it is to put in place sound corporate governance to prevent creative accounting, which can result in unethical behaviour, and to give its consumers trustworthy, high-quality financial reporting. This study helped test the decision-usefulness hypothesis empirically, which posits that there are requirements that must be met when presenting accounting information reports in order for users to find them helpful in making decisions. The research specifically targets Malaysian Islamic banks, providing insights into how governance and Shariah committee quality affect financial practices within an Islamic banking context. Islamic finance operates under specific religious principles that make it different from conventional banking. Additionally, this study explores how audit fees might influence the relationship between governance (board and Shariah committees) and cosmetic accounting.

KEYWORDS: Board Governance, Shariah Governance, Creative Accounting, Cosmetic Accounting, Fraud, Malaysia Islamic Banks

1. INTRODUCTION

Corporate governance plays a crucial role in maintaining the integrity and stability of financial institutions. Effective governance mechanisms help mitigate risks, enhance transparency, and ensure management accountability. This is particularly significant in the banking sector, where systemic risks are high due to the critical role banks play in the economy. In recent years, there has been growing scholarly and practical interest in the governance of Islamic banks, particularly in Malaysia, which is a leading hub for Islamic finance. Islamic banks operate under Shariah principles, which impose additional governance requirements and ethical considerations.

Cosmetic accounting, also referred to as earnings management or creative accounting, involves manipulating financial statements to present a more favorable picture of a company's performance and financial position. Such practices undermine the reliability of financial reporting and can mislead stakeholders, including investors, regulators, and the public (Komalasari & Bertuah, 2024). While cosmetic accounting is a concern across all sectors, it is especially critical in banking due to the sector's systemic importance and the potential implications for economic stability.

The quality of financial reporting is essential for ensuring that financial statements accurately reflect a bank's performance and condition. High-quality reporting provides stakeholders with reliable information for decision-making. However, despite stringent regulatory frameworks, instances of cosmetic accounting have been observed in Islamic banks, raising questions about the effectiveness of existing governance mechanisms. The board of directors, as a central component of corporate governance, is expected to oversee financial reporting and ensure its integrity. Yet, the impact of specific board attributes—such as size, independence, expertise, and diligence—on cosmetic accounting practices in Malaysian Islamic banks remains underexplored.

Moreover, the literature offers no clear consensus on the relationship between governance attributes and cosmetic accounting, particularly when considering the moderating role of audit fees. Audit fees may reflect the intensity and quality of external audits, with higher fees potentially deterring earnings manipulation. Addressing these gaps, this study investigates the impact of board governance and Shariah attributes on cosmetic accounting practices in Malaysian Islamic banks between 2011 and 2023, while also examining the moderating role

of audit fees.

The study aims to contribute to both theory and practice. Empirically, it provides insights into the governance mechanisms that influence financial reporting quality in Islamic banks. Practically, it offers guidance for regulators, bank management, and auditors to strengthen governance frameworks and enhance the credibility of financial reports. Focusing on Malaysian Islamic banks is particularly relevant, as they constitute a significant segment of the country's financial system and play a key role in the development of the Islamic finance industry.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1 Board Size and Cosmetic Accounting

Board size is a fundamental aspect of corporate governance, influencing the board's ability to monitor management and supervise financial reporting. Agency theory posits that larger boards can allocate more directors with diverse expertise to monitor managerial actions, reducing agency costs and opportunities for earnings manipulation (Jensen & Meckling, 1976; Dalton *et al.*, 1998). However, larger boards may suffer from coordination difficulties, diluted accountability, and slower decision-making, which might weaken oversight effectiveness (Yermack, 1996; Paul *et al.*, 2020). Empirical evidence on board size and earnings management is mixed. Some studies report that larger boards reduce earnings management due to enhanced expertise and monitoring capacity (Alam *et al.*, 2020; Ya'qbeh *et al.*, 2020), whereas others find no significant impact or even potential weakening of governance quality (Sani & Owoade, 2021).

Given this mixed evidence and theoretical ambiguity:

H1: Board size has a significant effect on cosmetic accounting practices in Malaysian Islamic banks.

2.2 Board Independence and Cosmetic Accounting

Board independence enhances oversight quality by reducing information asymmetry and limiting managerial discretion. Independent directors are less likely to be influenced by executive management and more likely to act in the interests of shareholders, thereby constraining earnings management (Fama & Jensen, 1983; Bhuiyan *et al.*, 2013). Several studies find a negative relationship between board independence and earnings management, suggesting that independent boards discourage creative accounting practices (Hassan *et al.*, 2020; Kolsi & Grassa, 2017). However, some research reports an insignificant relationship, indicating that board

independence alone may not be sufficient to curb earnings manipulation without complementary governance mechanisms (Paul et al., 2020; Sani & Owoade, 2021).

Accordingly:

H2: Board independence has a significant effect on cosmetic accounting practices in Malaysian Islamic banks.

2.3 Shariah Committee Size and Cosmetic Accounting

In Islamic banks, Shariah committees are responsible for ensuring that banking products and financial reporting adhere to Shariah principles (Safiullah & Shamsuddin, 2018). A larger Shariah committee may bring broader expertise and enhanced scrutiny of financial practices, which can deter unethical reporting and earnings manipulation. Resource dependence theory supports this view, suggesting that larger committees provide access to more resources and knowledge, improving oversight quality (Dalton et al., 1998). While limited research directly examines Shariah committee size and earnings management, existing studies argue that stronger Shariah governance contributes to ethical behaviour and compliance (Dusuki & Abdullah, 2007; Daryaei et al., 2024).

Therefore:

H3: Shariah committee size has a significant effect on cosmetic accounting practices in Malaysian Islamic banks.

2.4 Shariah Committee Independence and Cosmetic Accounting

Shariah committee independence ensures unbiased monitoring of Shariah compliance and financial reporting. Independent members are less likely to have conflicts of interest, enabling them to critically evaluate financial decisions and ethical compliance (Kaaroud et al., 2020). Research suggests that independent supervisory bodies reduce agency conflicts and form a governance check that discourages managerial opportunism (Shofiyah & Wilujeng Suryani, 2020; Mersni & Othman, 2016). However, empirical evidence specifically linking Shariah board independence to earnings management remains scarce, highlighting a gap this study addresses.

Thus:

H4: Shariah committee independence has a significant effect on cosmetic accounting practices in Malaysian Islamic banks.

2.5 Audit Committee Independence and Cosmetic Accounting

Audit committees play a vital role in monitoring financial reporting quality and internal controls, serving as a key internal governance mechanism (DeZoort et al., 2002). Independent audit committees are more capable of scrutinizing financial statements, reducing the likelihood of earnings manipulation (Sani & Owoade, 2021; Komalasari & Bertuah, 2024). Empirical studies find a negative relationship between audit committee independence and earnings management (Iqbal et al., 2015; Omoye & Eriki, 2014), although some research finds insignificant associations, indicating that independence must be coupled with expertise and active oversight to be effective (Debbarma & Roy, 2023; Hassan et al., 2020).

Therefore:

H5: Audit committee independence has a significant effect on cosmetic accounting practices in Malaysian Islamic banks.

2.6 Moderating Effect of Audit Fees

Audit fees reflect the perceived risk and effort associated with auditing a firm's financial statements. Higher audit fees may indicate more intensive audit services, which can increase audit scrutiny and reduce information asymmetry, effectively constraining earnings management (Hegazy et al., 2022; Jizi & Nehme, 2018). Some studies suggest that higher audit fees are associated with higher audit quality and better financial reporting outcomes (Chun & Rhee, 2015; Rahman & Wu, 2021). Conversely, lower audit fees may signal limited audit effort, potentially allowing greater creative accounting practices. Prior research examining audit fees as a moderating factor shows that audit fees can influence the impact of governance attributes on financial reporting quality, though empirical evidence in Islamic banking is limited (Ahmad & Ahmed, 2016; Ishaku et al., 2021).

Accordingly:

H6: Audit fees moderate the relationship between board governance attributes and cosmetic accounting practices in Malaysian Islamic banks.

3. THEORETICAL FRAMEWORK

3.1 Agency Theory

Agency theory explains the contractual relationship between principals (shareholders) and agents (managers), in which managers are entrusted with decision-making authority on behalf of shareholders (Jensen & Meckling, 1976). However, because managers control internal information and daily operations, information asymmetry arises. This asymmetry creates opportunities for managerial opportunism, including earnings management and cosmetic accounting.

Cosmetic accounting emerges when managers exploit discretionary accounting choices to present a more favorable financial position than actual performance justifies. Warfield et al. (1995) show that firms with higher information asymmetry exhibit greater earnings manipulation. Similarly, Panda and Leepsa (2017) argue that managerial discretion increases when monitoring mechanisms are weak, leading to distorted financial reporting.

In Islamic banks, agency conflicts may be even more complex due to dual accountability: managers are accountable not only to shareholders but also to Shariah principles and broader stakeholders. This increases the importance of governance mechanisms that reduce information asymmetry and ensure transparency.

In this study, agency theory provides the foundation for explaining how governance and audit mechanisms reduce cosmetic accounting through enhanced monitoring:

- **Board Size:** A larger board increases monitoring capacity and diversity of expertise, potentially limiting managerial discretion.
- **Board Independence:** Independent directors are less aligned with management and more likely to challenge opportunistic reporting.
- **Shariah Committee Size and Independence:** These mechanisms introduce additional layers of oversight, ensuring ethical compliance and discouraging manipulative reporting.
- **Audit Committee Independence:** Strengthens internal financial monitoring and reduces financial reporting irregularities.
- **Audit Fees:** Reflect audit effort and scrutiny intensity, reducing information asymmetry between managers and stakeholders.

Thus, agency theory predicts that stronger governance structures and more intensive auditing reduce cosmetic accounting by constraining opportunistic managerial behavior.

3.2 Positive Accounting Theory

Positive Accounting Theory (PAT), developed by Watts and Zimmerman (1986), seeks to explain and predict managerial choices of accounting policies based on economic incentives rather than normative prescriptions. The theory assumes that managers are rational, self-interested agents who select accounting methods that maximize their personal utility or the firm's contractual advantages. Because financial reporting standards provide flexibility in recognition, measurement, and disclosure, managers are able to choose among alternative accounting treatments depending on their strategic objectives.

Within this framework, earnings management and cosmetic accounting are viewed as rational responses to contractual and market pressures. Managers may inflate or smooth earnings to increase performance-based compensation, avoid breaching debt covenants, reduce political visibility, or maintain investor confidence. The discretion embedded in financial reporting standards, particularly in accrual estimation and revenue recognition, creates opportunities for such strategic behavior. Asghar et al. (2020) argue that managerial opportunism becomes more pronounced when monitoring mechanisms are weak and when performance evaluation is closely tied to reported accounting numbers.

In the context of Islamic banking, these incentives may extend beyond traditional compensation or debt-related motivations. Managers may seek to present stable and resilient financial performance to maintain depositor confidence, protect the bank's reputation, and signal compliance with Shariah principles. Because Islamic banks operate under dual accountability—financial performance and religious legitimacy—the pressure to demonstrate stability may increase the likelihood of cosmetic accounting if governance oversight is insufficient.

However, Positive Accounting Theory also implies that managerial discretion is not unlimited. The presence of strong governance mechanisms and external auditing increases the expected cost of opportunistic reporting. When boards are independent, audit committees are effective, and Shariah committees actively supervise compliance, managers face greater constraints in selecting opportunistic accounting policies. Similarly, higher audit fees often reflect more extensive audit effort and greater scrutiny, which reduces the feasibility of manipulating financial numbers.

Thus, within this study, Positive Accounting Theory explains the underlying incentives that motivate cosmetic accounting, while governance structures and audit mechanisms serve as constraining forces that reduce managerial opportunism. By limiting discretionary accounting choices, these mechanisms enhance the credibility of financial reports, which ultimately contributes to stronger financial resilience in Malaysian Islamic banks.

4. RESEARCH METHODOLOGY

This study aims to investigate the impact of board governance and Shariah attributes on cosmetic accounting practices within Malaysian Islamic banks. Additionally, this study examines the moderating

role of audit fees in this relationship. The total population is 56 financial institutions, including licensed Islamic. Table 4.1 shows the population

frame summarizing the quantity of Islamic Financial Institutions and their categories under Bank Negara Malaysia (BNM).

Table 4.1: The population frame

No	Categories	Quantity
1.	Licensed Islamic Banks	16
2.	Licensed Investment Banks	11
3.	Takaful Operators	15
4	Retakaful Operators	8
5	Development Financial Institution (DAFIA 2002 Prescribe Institution)	6
	Total	56

The table indicates that 16 companies are categorized under licensed Islamic banks, 11 licensed investments banks, 15 takaful operators eight reinsurers and retakaful, and six development financial institutions. The sample for this study is comprised of all licensed Islamic banks in Malaysia, excluding MBSB Bank Bhd. MBSB Bank Bhd is not considered in this study because the acquisition and leadership change from Asian Finance Bank Berhad may affect the results of the audit report significantly. The Islamic banks is selected because the banks offer unique features and services that distinguish them from conventional banks. These special

characteristics are rooted in Islamic principles and Shariah law, which emphasize ethical and interest-free financial transactions.

The data taken is from the year 2011 until the year 2023. The data is collected from the company's annual report and information on the company's website. The data was chosen in 2011 because 2011 Malaysia implemented the Shariah Governance Framework (SGF) issued by Bank Negara Malaysia (BNM). The data taken is from the year 2011 until the year 2023. Table 4.1 presents the list of licensed Islamic banks in Malaysia.

Table 4.2: Sample of the Study

No	Categories
1.	Affin Islamic Bank Berhad
2.	Alliance Islamic Bank Berhad
3.	AmBank Islamic Berhad
4.	Bank Islam Malaysia Berhad
5.	Bank Muamalat Malaysia Berhad
6.	CIMB Islamic Bank Berhad
7.	Hong Leong Islamic Bank Berhad
8.	Maybank Islamic Berhad
9.	MBSB Bank Berhad
10.	Public Islamic Bank Berhad
11.	RHB Islamic Bank Berhad
12.	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad
13.	HSBC Amanah Malaysia Berhad
14.	Kuwait Finance House (Malaysia) Berhad
15.	OCBC Al-Amin Bank Berhad
16.	Standard Chartered Saadiq Berhad

The data is collected from the company's annual report and information on the company's website. This study is also only focused on financial institutions because it has been proven by previous studies that financial institutions are companies that are quick to issue annual statements and company audit reports. So, the results of this study can be used as a benchmark to be emulated by companies in other categories to also comply with the accuracy of financial reporting.

In addition, this study only considers licensed Islamic banks because it wants to test whether the Shariah Committee contributes to the speed of financial reporting. However, because of different

reporting styles, rules and regulations, this study does not consider other financial institutions such as takaful, insurance, development financial institutions and investment banks.

This study relies on secondary sources and cross-sectional time-series data (panel data) to accomplish the research goal and acquire all the information and data for the research variables. Panel data are used to estimate the regression equation and consist of some variables and various periods.

This study relied on secondary data. The data for this study is obtained from the company's annual report from 2011 to 2022. The data of this study was also obtained from the Islamic bank's website. In

total, the data for these 12 years should contain 180 data. The websites of Islamic banks were where most of the yearly reports

were obtained. Some annual reports could not be accessed and downloaded because they were not on the Islamic banks' websites. The data was collected manually through the company secretary and customer service. Therefore, the company secretary collected and gave the data after request. In this instance, this study called the corporate secretary and customer service to request a copy of the annual report

4.1 Variable and Measurement

Table 1 details the definitions and measurements of the variable. The dependent variable was cosmetic accounting of Malaysian Islamic Banks and the independence variable for this study consisted of board size, board independence, shariah committee size, shariah committee independence and audit committee independence. Auditor fees are the

moderator variable for this study. The research used discretionary accrual (DA) as a proxy of cosmetic accounting. This measurement was originally applied by Dechow et al. (2012) and was used by recent study by Debbarma and Roy (2023), Sani and Owoade (2021) and Abata and Migiro (2016).

Discretionary accruals refer to the accounting adjustments that management can make based on their judgment, rather than on strict rules (Debbarma & Roy, 2023). To match revenues and costs to the correct accounting period, these accruals are often used. Discretionary accruals in practice might include revenue recognition estimates, warranty liabilities, or bad debt cost estimates. Although they may contribute to a more realistic depiction of a business's financial health, they also add a degree of subjectivity that may result in "earnings management" or earnings manipulation. For this reason, accruals are often examined by analysts and investors to evaluate the caliber of a company's profits.

Table 4.3: The Variables and its measurement.

Name of Variables	Type	Symbol	Measurement	References
Cosmetic Accounting	Outcome	CA	Discretionary accruals are estimated by the modified model developed by Dechow et al. (1995).	Debbarma and Roy (2023), Sani and Owoade (2021) and Abata and Migiro (2016).
Board size	Predictor	BS	The number of board members.	Agyei-Mensah (2018), Chalu, (2021), Habib et al. (2018), Hasan et al. (2020); Lajmi and Yab (2021), Nouraldeen et al. (2021) and Warrad (2018)
Board independence	Predictor	BI	The proportion of independent director.	
Shariah Committee Size	Predictor	SCS	The number of Shariah committee members.	Rasli et al.(2020) and Uyob et al. (2022).
Shariah Committee Independence	Predictor	SCI	The proportion of independent Shariah Committee.	Kamaruddin and Hanefah (2022), Lajmi and Yab (2021), Kaaroud et al. (2020), and Salehi et al. (2018)
Audit Committee Independent	Predictor	ACI	The proportion of independent audit committee	Debbarma and Roy (2023)
Auditor Fees	Predictor	AF	Dummy variable: 0 = audit fees below the median value. 1 = audit fees above the median value.	Abernathy et al. (2019), Alharasis et al. 2021), Arianpoor et al. (2023), Baatwah et al. (2021), Lai (2019), and Salehi et al. (2018)
Firm Size	Control	FS	Total assets.	Alsheikh and Alsheikh (2023), Durand (2019), Fera et al. (2023) and Gontara, Khlif (2021), Habib et al. (2019), Lajmi and Yab (2021), Nouraldeen et al., (2021) and Warrad (2018).
Firm Age	Control	FA	The age of the Malaysian Islamic banks.	Eldaia et al. (2022) and Eldaia and Hanefah (2022).
Leverage	Control	LEV	Total debts to total assets.	Alsheikh and Alsheikh (2023), Durand (2019), Gontara and Khlif (2021), Nouraldeen et al. (2021) and Salehi et al. (2018)

4.2 Research Model

There are two methods to calculate total accruals in the first step: cash flow-based and balance sheet-based (Debbarma & Roy, 2023). It was discovered in earlier research that total accruals were assessed using both methods. Nonetheless, the majority of researchers favoured the cash flow-based method over the balance sheet based approach for predicting total accruals. Thus, the following is how the cash

flow-based strategy was used in this study:

$$TA = NI_t - CFO_t$$

Where,

TA_t = Total accrual in year t.

NI_t = Net income in year t.

CFO_t = Cash flow from operating activities in year t.

Total accruals (TA), however, are not substitutes for creative accounting. There are two more categories into which accruals occur. Normal accruals

are indicative of a company's typical earning activities; atypical accruals, on the other hand, show the management's freedom of choice. Thus, total accrual is as follows mathematically:

$$TA_t = NDA_t - DA_t$$

Where,

TA_t = Total accrual in year t.

NDA_t = Non discretionary accrual in year t.

DA_t = Discretionary accrual in year t.

Next, the modified Jones model (Dechow et al., 1995) was used to estimate DA. The following model (Equation i) has been used to perform the regression in order to estimate the parameters.

Equation (i)

$$TA_t / A_{t-1} = \alpha_1 (1 / A_{t-1}) + \alpha_2 (\Delta REV_t - \Delta REC_t) / A_{t-1} + \alpha_3 (PPE_t / A_{t-1}) + \epsilon_t$$

Where,

TA_t = The difference between net income and cash flow from operational operations in year t is used to compute total accruals in year t.

A_{t-1} = The firm's total assets in the year t - 1.

ΔREV_t = The company's revenue for the year t less the company's revenue for the previous year

ΔREC_t = The company's revenue for the year less the company's net receivables in the previous year

PPE_t = Property, plant and equipment in the year t.

α_1, α_2 and α_3 = Represent the specific parameters of firms

ϵ_t = The residual is the firm's discretionary component of accruals

Therefore, the OLS technique was used to estimate the coefficients, or alphas (i.e., α_1, α_2 , and α_3). By entering the values of the estimated parameters α_1, α_2 , and α_3 in equation (i), the total accruals values estimated – which reflect non-discretionary accruals (NDA_{it}) – are produced. Ultimately, the discretionary accrual is determined by plugging the amount into equation (ii).

Equation (ii)

$$DA_{it} = TA_{it} / A_{t-1} - NDA_{it} / A_{t-1}$$

Where,

DA_{it} = Discretionary accrual

TA_{it} = Total accrual

A_{t-1} = The total assets of the firm in the year t - 1.

NDA_{it} = Non discretionary accrual

However, the value of discretionary accruals, as

represented by creative accounting in this research, is equal to the difference between total accruals and non-discretionary accruals. Creative accounting is more prevalent the more discretionary accrual value there is, and vice versa.

4.3 Econometric Model Estimation

This study used two regression models to test the hypotheses for the impact of board governance and Shariah committee quality on the cosmetic accounting of Malaysian Islamic banks. Equation (iii) analyses the association between the independent and dependent variables. Equation (iv) was used to analyse the moderation effect of the auditor fees on the relationship between board governance and Shariah committee quality on creative accounting.

Equation iii : The relationship between independent variables and dependent variable.

$$CA = \beta_0 + \beta_1 (BS) + \beta_2 (BI) + \beta_3 (SCS) + \beta_4 (SCI) + \beta_5 (ACI) + \beta_6 (AF) + \beta_7 (FS) + \beta_8 (FA) + \beta_9 (LEV) + \epsilon$$

Where,

CA = Cosmetic Accounting

BS = Board Size

BI = Board Independent

SCS = Shariah Committee Size

SCI = Shariah Committee Independent

ACI = Audit Committee Independent

AF = Audit Fees

FS = Firm Size

FA = Firm Age

LEV = leverage

This equation examines the impact of board size, board independence, Shariah committee size, Shariah committee independence and audit committee independence on the cosmetic accounting of Malaysian Islamic banks. This equation tests hypothesis 1 to hypothesis 5

Equation iv : The moderation effect of auditor fees between board governance and Shariah committee quality and cosmetic accounting.

$$CA = \beta_0 + \beta_1 (BGSC * AFEES) + \alpha$$

Where,

CA = Cosmetic Accounting

$BGSCQ$ = Board governance and Shariah committee quality

$AFEES$ = Auditor fees

Equation iv determines whether auditor fees moderate the relationship between board governance and Shariah committee quality and cosmetic accounting. This equation test hypothesis 6.

4.4 Statistical Techniques in the Data Analysis

In statistics analysis, data is collected, structured, and analysed using predefined principles to identify patterns and trends (Mishra et al., 2019). This

extensive research has applications in social sciences, engineering, business, genetics, and population studies, among other fields. Statistical analysis may assist businesses and organisations in making sense of data and informing their decision-making. Besides, data analysis reduces the cost of the business. Businesses may use their data to identify areas for improvement, trends, and patterns and then plan their strategy accordingly (Ali & Bhaskar, 2016). It will eventually allow you to avoid spending money and resources on incorrect techniques. Different statistical techniques may be used to study different data, types, sectors and applications.

This study used the Statistical and Data (STATA) version 17 to examine the effect of independent variables on the dependent variable. STATA is a software package for statistical analyses of data. Like other statistical software, STATA can run descriptive statistical analysis, the association between variables, inferential statistics, modelling, and graphs (Mehmetoglu & Jakobsen, 2016). It is versatile because it provides the graphical user interface or the

STATA command language. It has a convenient help feature within the software.

5. RESULTS AND DISCUSSION

5.1 Descriptive Statistics

The descriptive analysis is the first step in the quantitative analysis process. It aids in revealing the information contained inside the data. In addition to detecting outliers and typos, descriptive analyses may verify data normalcy, symmetry, and other properties (Sekaran, 2019). By creating summaries of data samples, descriptive statistics may be used to describe the characteristics of a data set. It is frequently displayed as a summary of the data's contents. Descriptive statistics are mainly used to offer details about a data set. A descriptive analysis in this study was carried out mainly to describe and clarify the key elements of the data set. Using suitable data descriptive processes to extract relevant information from the data is necessary.

Table 5.1 presents the descriptive results for the dependent, independent and control variables.

Table 5.1. Descriptive statistics of the variables

Variables	Obs	Mean	SD	Min	Max
Cosmetic Accounting	180	0.152	0.184	-0.327	0.879
Board Size	180	6.56	1.69	4	11
Board Independence	180	71.72	89.75	22	100
Shariah Committee Size	180	5.22	0.83	3	9
Shariah Committee Independence	180	5.44	1.123	3	9
Audit Committee Independence	180	4.231	1.028	4	6
Audit fee	180	333812	231950	50000	1587000
Firm size	180	3870000	4650000	5710136	255000000
Firm age	180	13.05	6.97	5	40
Leverage	180	91.88	8012	3.28	110.84

Table 5.1 presents the descriptive statistics for this study across 180 observations. The observations involve data for 15 Malaysian Islamic banks starting from 2011 until 2022, which is 12 years. The key statistics, mean, standard deviation (SD), minimum (min) and maximum (max) allow us to understand the central tendency, variability and range of the variables.

The average value of creative accounting (CA) is 0.152, which is positive. This suggests that, on average, creative accounting practices are somewhat present, but not excessively so, in the companies studied. The standard deviation of 0.184 indicates that there is moderate variation in the extent of creative accounting practices across the sample. A negative minimum value of -0.327 indicates that some companies exhibit negative creative accounting or perhaps conservative accounting practices, suggesting variations in how companies report their financials. The maximum value of 0.879 indicates that some companies engage significantly in creative

accounting practices, as their accounting choices are closer to the upper end of the scale.

On average, companies have 6.56 members on their boards, suggesting that the boards are moderately sized. The standard deviation of 1.69 reflects moderate variation in board size. Some companies have slightly larger boards, while others have smaller ones. The smallest board size observed is 4, indicating that some companies have relatively small boards with minimal governance structure. The largest board size is 11, showing that some companies opt for a larger board to potentially enhance governance, diverse expertise, or representation.

The mean for board independence was 71.72 indicating that, on average, a significant portion (around 72%) of board members are independent, suggesting that board independence is common in this sample. The standard deviation of 89.75 is very high, implying large variability in the proportion of independent board members. Some companies may have nearly 100% independent directors, while

others have significantly fewer. The minimum value of 22 indicates that some companies have very few independent directors on their boards, possibly relying more on insiders or related-party directors. The maximum value of 100 reflects companies that have a fully independent board with all directors being independent.

For Shariah committee size, the mean of 5.22 suggests that, on average, companies have around 5 members on their Shariah committees, indicating moderate-sized committees for Shariah governance. The standard deviation of 0.83 shows relatively low variability in committee size, indicating that most companies have Shariah committees of similar sizes. The smallest committee size is 3, suggesting that some companies maintain smaller, possibly more focused Shariah committees. The largest committee size observed is 9, indicating that some companies prefer a larger, potentially more diverse Shariah committee.

The mean for the Shariah committee independent of 5.44 implies that, on average, the Shariah committees are moderately independent, with the value likely representing some form of a score or rating. The standard deviation of 1.12 suggests moderate variability in the independence of Shariah committees across the sample. The minimum value of 3 indicates that some Shariah committees have very little independence, possibly comprising members with closer ties to the company. The maximum value of 9 represents Shariah committees that are highly independent, possibly with members who have no ties to the company's management or stakeholders.

The mean of 4.231 for audit committee independent suggests that the average audit committee has a moderate level of independence, although the scale is likely from 1 to 10 or some other scale of independence. The standard deviation of 1.028 indicates a moderate range of variability in audit committee independence, but the values are relatively clustered around the mean. The minimum value of 4 suggests that even the least independent audit committees maintain some level of independence. The maximum value of 6 indicates that the audit committees are generally not completely independent but lean toward having some degree of autonomy from the management.

The mean value of audit fees (AF) represents the average audit fee paid by the Malaysian Islamic banks. On average, companies in this dataset paid RM 333,812 for their audit services. The standard deviation (SD) measures how spread out the audit fees are around the mean. A high SD (like RM 231,950) indicates that there is substantial variation in

audit fees across the 180 companies. This means that while the average audit fee is around RM 333,812, individual fees may vary significantly. Some Malaysian Islamic banks may pay far more or less than this average. The minimum value indicates that the smallest audit fee paid by a Malaysian Islamic bank in the sample is RM 50,000. This suggests that at least one Malaysian Islamic bank in the sample paid only RM 50,000 for their audit services, which is significantly lower than the mean of RM 333,812. The maximum value indicates that the largest audit fee paid by a company in the sample is RM 1,587,000. This is quite high compared to the mean and minimum values, indicating that some Malaysian Islamic bank in the sample paid significantly more for audit services.

Creative Accounting (CA) shows a positive average, but the significant variability in the data, with both negative and positive extremes, suggests that some companies adopt aggressive accounting techniques, while others may be more conservative. Board Size (BS) ranges from 4 to 11, with a mean around 6.56. This suggests a relatively moderate board size, indicating that the firms in this sample generally do not have extremely large or small boards. Board Independence (BI) exhibits substantial variability, with some boards being fully independent (100%) and others having only 22% independent directors. This variability might indicate differences in corporate governance practices. Shariah Committee Size (SCS) and Shariah Committee Independence (SCI) both show moderate central tendencies (means of 5.22 and 5.44, respectively), but with reasonable variability. This suggests that most companies maintain moderately sized and fairly independent Shariah committees, though there are differences in practice. Audit Committee Independence (ACI) shows relatively low variation in terms of independence, with values ranging from 4 to 6. This suggests that audit committees tend to have some level of independence but may not be fully autonomous in all companies.

Overall, the data highlights a diversity of practices across the companies, particularly in terms of board independence, audit committee practices, and Shariah governance. The variability in these variables underscores the importance of corporate governance structures in shaping organizational practices and potentially influencing factors like financial transparency and accounting methods. Further analysis (e.g., regression or correlation) would be necessary to explore relationships and causality among these governance elements and outcomes like creative accounting.

5.2 Correlation Analysis

A correlation test measures the strength and direction of the relationship between two variables. Correlation analysis is used to investigate the connection between dependent and independent variables. This study used Pearson Correlation Coefficient. A correlation coefficient's value can be between -1 and 1, with -1 denoting an idealised negative association, 0 denoting no association, and one denoting an idealised positive association. According to Gujarati (2022), the correlation aims to determine any connection between the independent variables and whether that correlation is less than 80%. If the correlation is more than 80%, the multicollinearity problem should be considered as it may jeopardise the regression study.

Table 5.2 presents the correlation matrix analysis between cosmetic accounting as the dependent and independent variables. The result indicates that the

correlation problem between the variables does not exist. The co-efficient value is between -1 and 0, revealing that the associations between the variables are relatively small and were below the threshold of 0.80 (Gujarati, 2022). It should also be mentioned that the correlation coefficient's value falls between 1.0 and -1.0. A variable's matrix (diagonal) coefficient of 1.0 implies a perfect strong positive linear relationship, while a value of -1.0 denotes a perfect strong negative correlation. However, a moderate association and a weak relationship are indicated by correlation coefficient values between 1.0 and -1.0. In other words, the correlation coefficient's value of more than 0 represents a positive relationship, below 0 represents a negative relationship, and equal to 0 represents no relationship. According to the correlation matrix, the relationship is fragile if it is between 1% and 10%, weak between 11% and 29%, moderate between 30% and -60 %, and intense relationship above 61%.

Table 5.2: The Pearson Correlation Coefficient Matrix

	CA	BS	BI	CSC	SCI	ACI	AF	FS	FA	LEV
CA	1.0000									
BS	-0.3206	1.0000								
BI	-0.4009	0.0563	1.0000							
SCS	-0.2080	0.1191	0.0396	1.0000						
SCI	-0.2136	0.0264	0.0174	0.1196	1.0000					
ACI	-0.1335	0.0232	0.1289	0.2701	0.5488	1.0000				
AF	0.1831	0.0459	-0.0139	0.0047	0.5891	0.0557	1.0000			
FS	-0.2218	-0.1030	0.1240	0.3249	0.0191	0.0944	0.2212	1.0000		
FA	0.2370	0.2111	-0.1456	-0.0025	0.3719	0.2789	0.3960	0.2869	1.0000	
LEV	-0.0520	-0.1160	-0.0146	0.0768	-0.0035	-0.0974	-0.041	0.0959	-0.229	1.0000

Table 5.2 shows the negative and moderate relationship between cosmetic accounting and board size, with a correlation value of -0.3206. The co-efficient value for cosmetic accounting and board independence is -0.4009, indicating that the association is negative and moderate. The relationship between cosmetic accounting and Shariah committee size, Shariah committee independence and audit committee independence is weak. The co-efficient values are -0.2080, -0.2136 and -0.1335, respectively.

5.3 The Multi-Collinearity Analysis

High levels of correlation between independent variables in a regression model are known as

multicollinearity, and they may cause problems such as unstable coefficient estimates and make the model difficult to understand (Hair et al., 2022; Gujarati, 2022). The idea that independent variables shouldn't be correlated is a fundamental tenet of traditional regression models. Multicollinearity has the potential to skew model findings by making major predictors seem unimportant. Tolerance tests and the Variance Inflation Factor (VIF) are two detection techniques. Possible multicollinearity problems are indicated by a tolerance value less than 0.2 or a VIF more than five. In general, multicollinearity is absent when the VIF is less than 2, and it is present when the VIF is less than 10 (Hair et al., 2022; Gujarati, 2022). The result of the VIF value is shown in Table 5.3.

Table 5.3: VIF value for the Multicollinearity Test Matrix

Variables	VIF	1/VIF (Tolerance)
Board Size	1.28	0.782
Board Independence	1.39	0.719
Shariah Committee Size	1.11	0.900
Shariah Committee Independence	1.50	0.667
Audit Committee Independence	1.52	0.658
Audit fee	1.49	0.671
Firm size	1.52	0.658

Firm age	1.22	0.822
Leverage	1.49	0.671

Based on the results presented in Table 5.3, it can be concluded that the multi-collinearity problem does not exist. Based on the opinions of Hair (2022), Gujati (2022), and Thomas and Aryal (2021), it clearly shows that the multi-collinearity problem does not exist.

5.4 Hausman Specification Test

The Hausman Specification Test is used to evaluate the consistency of a model's estimators and spot any possible specification bias. It is particularly utilized to compare the Fixed Effects Model (FE) with the Random Effects Model (RE) in the context of panel data analysis, thereby evaluating the suitability

of the random effects model. FE assumes that the explanatory variables are connected with individual-specific effects (for instance, across various entities like enterprises, nations, etc.). Individual-specific effects are assumed to be uncorrelated with the explanatory factors in the RE.

Table 5.4 present the results of Hausman specification test. The results showed that panel random-effect regression analysis was a suitable choice for the research, with a Chi-square statistic of 7.892 and a p-value of 0.341, indicating that the p value is larger than 0.05. Therefore, while estimating the parsimonious variables model, the random-effect model will be a plausible assumption.

Table 5.4: Hausman Specification Test

Test of Summary	Chi ² statistics	p-value
Cross-section random	7.892	0.341
Decision: Random-effect model		

5.5 Regression Analysis

Regression analysis is a statistical method used to examine the relationships between a dependent variable (outcome) and one or more independent variables (predictors). Linear regression, the most common type, determines the best-fitting line or model for the data based on statistical criteria, allowing researchers to compute the dependent variable's expected value given specific independent variable values. Regression analysis is used in two main contexts: forecasting and prediction, particularly in machine learning, and exploring potential causal relationships between variables. However, regression only reveals correlations within the dataset and does not necessarily imply causality.

A test of the regression model's coefficient of determination is required to assess each independent variable's impact on the dependent variables. The p-value assigned to each independent variable

examines the significant relationship between the independent and dependent variables. The multiple regression analysis was used to determine the relationship between the board, Shariah, and audit committee attributes to the cosmetic accounting.

5.6 Regression Analysis for Independent Variables

Based on the Hausman specification test presented in Table 5.4, the random-effect regression analysis is most suitable for this study. Equation iii is used to analyse the relationship between board size, board independence, Shariah committee size, Shariah committee independence and audit committee independence on the cosmetic accounting of Malaysian Islamic banks. This equation tests Hypothesis 1 to Hypothesis 5 in this study. The multiple regression analysis was used based on the following guidelines and rules in Table 5.5.

Table 5.5: Rules for the Regression Analysis

Hypothesis	Significant value less than 0.05 ($\alpha \leq 0.05$)	Significant value more than 0.05 ($\alpha > 0.05$)
Null hypothesis	Not accepted	Accepted
Alternative hypothesis	Accepted	Not accepted

According to Table 5.5, if the level of significant value is less than or equal to 5%, the null hypothesis is rejected. In this instance, the alternative hypothesis is used. On the other hand, the null hypothesis is accepted if the level of significance value is less than 5%.

Table 5.6 shows the regression analysis results for each independent variable that affected the cosmetic accounting.

Table 5.5: The Regression Analysis for Equation 1

Variables	Acronym	Coefficient	T-value	p-value
Board Size (H ₁)	BS	-3.87	-2.98	0.001***
Board Independence (H ₂)	BI	-1.98	-1.04	0.301
Shariah Committee Size (H ₃)	SCS	-6.22	-2.12	0.017***
Shariah Committee Independence (H ₄)	SCI	-21.11	-3.50	0.301
Audit Committee Independence (H ₅)	ACI	-0.152	-2.30	0.021***
<u>Control variables:</u>				
Firm size	FS	-13.71	-4.18	0.000***
Firm age	FA	0.15	0.55	0.609
Leverage	LEV	1.40	3.91	0.609***
Constant R ²	0.52	279.50	5.77	0.000
Adjusted R ²			0.40	
F-statistic			7.02	
F-value			0.0000	

Notes: Significant level at 0.01***, 0.05** and 0.1*

Based on Table 5.5, the regression analysis using Equation 1, the regression shows that the F-value is 0.0000, less than significant value of 0.05. The result indicates that the null hypothesis is not accepted and the alternative hypothesis is accepted. It shows that the board governance and Shariah committee quality are significantly associated within the cosmetic accounting. The results show that the F-statistic value is 7.07, while the F-value (Prob > F) is 0.0000. The large F value, indicated by a small p-value, implies a good fit (George & Mallery, 2019). So, the analysis is valid and significant.

The R-square value in the analysis shows the variation-dependent variable that the independence variable can explain. The R² value is 52%. It means that 52% of the variation in the cosmetic accounting can be explained by board size, board independence, Shariah committee size, Shariah committee independence and audit committee independence. The model has a robust explanatory capacity to explain the variation in the cosmetic accounting by the independent variables, as evidenced by the F-statistics (7.02), which is significant (0.0000), and the adjusted R² of 40%, which is comparable with earlier research conducted in Malaysia by Kaaroud (2020), Indonesia by Zulfikar et al. (2020), Nigeria by Odjaremu and Jeroh (2019), and Africa by Chalu (2021).

The regression results demonstrated that the level of contribution of variables, the coefficient exhibited positive for BS (3.87), FA (1.40) and LEV (0.15), while BI (-1.98), SCS (-6.22), SCI (-21.11) and ACI (-0.152) indicating the negative coefficient. Table 5.5 shows that board size, Shariah committee size and audit committee independence are significantly related to cosmetic accounting. The result demonstrated that board size, Shariah committee size and audit committee independence have a negative significant effect on cosmetic accounting. It is indicating that the

larger the board size, Shariah committee size and more independence audit committee the fewer manipulating and irregularities in preparing the financial reporting. The result is consistent with Alia et al (2020 and Obigbemi et al (2016). However, the result is inconsistent with Debbarma and Roy (2023) that found the positive relationship between board size and audit committee independence with cosmetic accounting.

However, board independence and Shariah committee independence were found to have no significant relationship with cosmetic accounting. Concerning the control variables, firm size and leverage significantly affect the cosmetic accounting for Malaysian Islamic banks, while the firm age was found to have insignificant implications. The age of the Malaysian Islamic bank has failed to influence the manipulation of the financial reporting. The result also indicates that the large Malaysian Islamic banks reduced cosmetic accounting. The same result reported by Debbarma and Roy (2023), Rusmin et al. (2013) and Safari et al (2013).

5.7 The Moderation Regression Analysis.

This study used moderation analysis to determine the boundaries of a relationship between independence and dependence variables. According to Hair et al. (2017) and Becker et al. (2018), moderation refers to a scenario where the value of a third variable, known as a moderator variable, determines the interaction between two constructions, which is not constant. Furthermore, moderator factors directly impact how the independent and dependent variables relate. Audit fees are the moderator variable for this study. Equation IV is used to analyse the moderation regression. The result for this analysis is shown in Table 5.6.

Table 5.6: The Moderation Regression Analysis

	Acronym	Coefficient	T-value	p-value
Board governance, Shariah Committee Quality	BGSCQ	-5.01	-0.10	0.001***
Control Variables:				
Firm size	FS	0.12	0.91	0.462
Firm age	FA	1.58	4.59	0.000***
Leverage	LEV	14.15	5.25	0.000***
R ²	0.541			
Adjusted R ²	0.37			
F-statistic	7.15			
F-value	0.0000			

Notes: Significant level at 0.01***, 0.05** and 0.1*

Based on Table 5.6, the regression analysis using Equation iv, the regression result shows that the F-value is 0.00, less than the significant value of 0.05. The result indicates that the null hypothesis is not accepted and the null hypothesis is accepted. The F-statistic value is 7.15, while the F-value (Prob>F) is 0.0000. According to George and Mallery (2019), the larger F-value, indicated by a small p-value, implies a good fit. Thus, the analysis is valid and significant. Hypothesis 6 predicts that audit fees moderate the relationship between board and Shariah committee

quality with cosmetic accounting. The coefficient value of -5.01 indicates the negative relationship. The p-value for this moderation analysis is 0.001, which is significant. Thus, H6, which predicts that audit fees do not moderate the relationship between the board governance and the Shariah committee and the cosmetic accounting, is supported.

Table 5.7 presents the summary of the hypothesis result.

Table 5.7: Summaries of Hypothesis Results

Hypothesis	Decision
H1 There is no significant effect between the board size and cosmetic accounting	Not supported
H2 There is no significant effect between the board independence and cosmetic accounting	Supported
H3 There is no significant effect between the Shariah Committee Size and cosmetic accounting	Not supported
H4 There is no significant effect between the Shariah Committee Independence and cosmetic accounting	Supported
H5 There is no significant effect between Audit Committee Independence and cosmetic accounting	Not supported
H6 There is no moderation effect of audit fees between board attributes and cosmetic accounting	Supported

6. CONCLUSION

The main objective of this study is to identify the factors associated explicitly with the board, the Shariah audit committee, on the cosmetic accounting of Malaysian Islamic banks. Particularly, this study has examined the relationship between board size, independence, Shariah committee size, independence and audit committee independence with cosmetic accounting. Cosmetic accounting or creative accounting was defined as the manipulation of financial statements to present a more favourable view of a company's financial position and performance. The study used the theory of agency to direct its hypotheses. The study examined the annual reports of 16 Malaysian Islamic banks from 2011 through 2020.

This study provides evidence that board size, Shariah committee size and audit committee independence influenced the cosmetic of Malaysian Islamic banks. It also indicates that audit fees moderate the relationship between the board and Shariah committee quality with cosmetic accounting.

However, board and Shariah committee independence were not significantly related to the cosmetic accounting. The study revealed that the effective board, Shariah and audit committee motivate the Malaysian Islamic banks to produce ethical financial reporting and avoid fraudulent financial reports. Firm size and leverage also found to have a significant relationship with cosmetic accounting. However, the age of the firm has an insignificant relationship with cosmetic accounting. The findings support agency theory that companies should have good corporate governance and a more robust accounting regulatory environment to stay on the cutting edge of cosmetic accounting. It suggests that agency conflict may be resolved by excellent corporate governance, which would result in the lowest possible cost of agency issues. Furthermore, although tight limits are unlikely to greatly enhance corporate governance practices, greater flexibility in regulations is necessary to keep up with complex business models and the changing flexibility of the business environment.

It is essential that policymakers assess the governance legislation and adjust the governance framework as needed. Therefore, businesses in developing nations should use good governance concepts in accordance with innovative reporting procedures that are morally acceptable within the parameters to guarantee the quality of financial reporting. Therefore, the research recommends that in order to lessen the anomalies in business organisations' financial reporting practices. Businesses should implement efficient corporate governance procedures and choose capable board members who follow the Corporate Governance Framework. Furthermore, the Malaysian Islamic banks should have a more independent audit committee to curtail the practice of fraudulent financial reporting. Then, it states that the committees should determine if businesses are adhering to the legal and moral requirements of the financial reporting process. The regulatory bodies should promote irregulates in corporate enterprises beyond

the flexibility of the accounting framework and the code of corporate governance in Malaysian Islamic banks should face disciplinary action from the regulatory organisations.

The limitation of the study is the small sample size that comprise of Malaysian Islamic banks. There may also be certain restrictions on the approach used to decipher the influence pattern. Nonetheless, this study provides a framework and a roadmap in the area of corporate governance, allowing the researcher to provide a case and a setting for more research that includes other factors and samples that are relevant to financial reporting methods. To guarantee the authenticity and dependability of accounting information, additional study in this area may be tried to provide more insightful information on the impacts of a variety of factors, such as audit quality, the internal procedures of the audit committee, and the presence of women on board. Finally, other data methods, such as interviews, may help gain a better understanding of the subject.

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