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## External Agency Monitoring Mechanisms and Earnings Management for Improved Financial Reporting

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**Abstract:** This study focuses on discretionary-accrual type earnings management by examining the importance of multiple roles of external agency monitoring mechanisms, i.e. auditors, shareholders and bankers. Using a sample of 443 listed Malaysian companies of two years annual reports, the study investigates the extant of three types of mechanisms; audit quality, dividend and leverage to control firms from applying earnings management. Results indicate that dividend is significantly related to earnings management for the year 2008. However, a positive relation between leverage, controlling mechanisms from lending institutions, and earnings management is not found. Results also shows that having a higher audit quality, through audit fees as a proxy, appears to be helpful in limiting this type of earnings management. These results should be of interest to the stakeholders who rely on the external governance mechanisms such as auditors to oversee the integrity of corporate financial reporting.

**Keywords:** Audit quality, leverage, dividend, earnings management, discretionary accruals

### INTRODUCTION

The collapsed of some large companies such as WorldCom, AIG and some others resulting partially from accounting manipulation or earnings management has raised serious questions about the effectiveness of different monitoring devices (Benston and Hartgraves, 2002; Lin et al., 2006; Putman et al., 2009).

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