CEO Duality, Family-Control and Goodwill Impairment

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ABSTRACT

Deterioration in performance may increase the likelihood of the recognition of goodwill impairment in firms. It is believed that the magnitude of discretion given in the new accounting standards FRS 136- Impairment of Assets gives managers an additional incentive to manage the perception of users of financial statements using the impairment of goodwill item, particularly during the transition period. This problem can be exacerbated when there is a high concentration of family ownership and when family owners have control over the management and Board of Directors at the same time. This paper argues that the Chief Executive Officer (CEO) and Chairman role duality, particularly in family-controlled firms, could enhance the effect of entrenchment and expropriation activities. This study uses a sample of 948 firm-years observations of public firms listed on Bursa Malaysia from years 2006 to 2008 to examine whether the combined effect of CEO duality and family-controlled firms is related to goodwill impairment. This study finds evidence that the combined effect of CEO duality and family-controlled firms have significant effect on the recognition of goodwill impairment.

Keywords: CEO Duality, Corporate Governance, Corporate Reporting, Family-Controlled Firms, Financial Accounting, Goodwill Impairment

JEL Classification: M41

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1. Introduction

Goodwill impairment recognition is complex because it involves a significant number of highly subjective estimates by the management; thus, making it a useful tool to manage earnings (Astami & Tower, 2006). Prior research has found that firms with the tendency to take a ‘big bath’ have a higher likelihood to record goodwill impairment (Jordan & Clark, 2004; Sevin & Schroeder, 2005). The goodwill impairment standard has attracted much attention since the introduction of the goodwill impairment approach by the United States (US) through the Financial Accounting Standard Board (FASB) in 2001, as in SFAS 141 and 142, and at the international level by the International Accounting Standard Board (IASB) in 2004, as in IFRS 3 and FRS 136. From the perspective of agency theory, the complexities involved in determining whether impairment on goodwill provide a potential area of earnings management (Lapointe-Antunes, Cornier, & Magnan, 2008; Ramanna & Watts, 2012). Ramanna and Watts (2012) argue that based on agency theory, managers are more likely to manage financial reports using the goodwill impairment standard due to the difficulty in verifying the estimates. This event is more likely to happen in family-controlled firms when substantial control of the management exists. In family-controlled firms, a member of the family tends to be routinely appointed as the Chief Executive Office (CEO) or chairman of the firm (Ho & Wang, 2001). This gives more power to the CEO or chairman to appoint more members of his family on the Board of Directors because he has greater voting rights due to the substantial shares that he owns.

The separation of roles between the CEO and Chairman (non-duality) has been generally accepted as part of a good corporate governance structure at the international level including Malaysia (MCCG, 2007). The non-duality of the CEO is part of the recommendations in the Malaysian Code on Corporate Government (MCCG) in order to ensure a balance of power and authority, such that no individual can...

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1 Earnings management literature proves that family firms are more prone to tunnel away the wealth of the firms and manage earnings to conceal such activities (Munir, Mohd-Saleh, & Yatim, 2013).

2 There are several definitions for family-controlled firms. A family firm is defined “as those where the founder or a member of his or her family by either blood or marriage, is an officer, a director, or a blockholder either individually or as a group”. Another additional condition may include a control of “a minimum threshold of 20 per cent of the votes, being the largest shareholders or voteholders, having family officers or directors, or being in second or later generation” (Villalonga & Amit, 2006).
dominate the decision making of the Board. In Malaysia, the evidence regarding the effectiveness of the requirement on the non-duality of the CEO stated in the 2000 version of the MCCG is inconclusive (Abdullah & Mohd Nasir, 2004).

Amran and Che-Ahmad (2009) find evidence in Malaysia based on a sample from years 2000 to 2003 that family firms with non-CEO duality tend to outperform family firms with CEO duality. Consistent with Fama and Jensen (1983), they examine the impact of corporate governance on the performance of family and non-family firms and they find that family and non-family firms tend to have a different set of corporate governance. However, mixed results have been found in relation to the effect of CEO duality on the quality of financial reporting. Other studies fail to find any significant association between CEO duality and earnings management, such as Kao and Chen (2004), Xie, Davidson, and DaDalt, (2003), Davidson, Goodwin-Steward, and Kent (2005), and Hashim and Devi (2008). According to Hashim and Devi (2008), the independence of the Board of Directors and CEO duality have an insignificant relationship with earnings management.

According to Lam and Lee (2008), CEO duality has no significant effect on performance. However, further analysis indicates that CEO duality affects performance positively in non-family firms. Therefore, Lam and Lee (2008) suggest that the relationship of CEO duality and financial performance is negatively moderated by the existence of the family control factor. The findings of Lam and Lee (2008) are consistent with the argument by Shleifer and Vishny (1997) in that a family-controlled firms has a tendency to entrench the firm and expropriate the minority shareholders by investing in projects with low or negative returns and involving the firm in related party transactions. As a result, CEO duality in a family firm may provide opportunities for the controlling family members to “obtain private benefits that are not shared by minority shareholders” (Shleifer & Vishney, 1997, p. 759). Thus, the question is: does CEO duality become an important factor to expropriate wealth (and hence goodwill is impaired) in family firms?

Therefore, the aim of this paper is to investigate the conflicting perspectives concerning the effect of CEO duality on the recognition of goodwill impairment, and whether CEO duality in family-controlled firms further promotes goodwill impairment. Based on the argument above, we predict that the Board is more effective in monitoring firms when non-duality exists. Prior research has investigated the managerial influence on accounting for goodwill to avoid debt covenant violations.
(Beatty & Weber, 2006; Zang, 2008), to increase bonus (Beatty & Weber, 2006) and to take the opportunity of the transition year to impair goodwill values (Henning, Shaw, & Stock, 2004; Beatty & Weber, 2006; Lapointe-Antunes et al., 2008). To this end, we believe that this study could make a significant contribution to knowledge by looking at the interplay between family control and the CEO duality effects on goodwill impairment decisions. Such investigation in the literature is still lacking.

We select Malaysia as our case for study because, firstly, Malaysia is identified as a country where firms have high political connection and the shareholding is highly concentrated. Such scenario may reduce the level of quality in financial reporting (Ball, Robin, & Wu, 2003). The combination of high political connection and high concentrated shareholdings, particularly with respect to family ownership in Malaysia, is distinctive compared to developed countries such as the US, UK and Australia (Claessens, Djankov, & Lang, 2000). In an emerging market, such as in East Asia, Malaysia represents a highly concentrated ownership with significant government influence on listed firms that can affect managerial decisions in governing the firms (Shleifer & Vishny, 1997; Claessens et al., 2000). This scenario is further complicated by the CEO duality issue, which is found to be common in family-controlled firms (Ho & Wang, 2001). Secondly, despite stronger corporate governance in Malaysia compared to other Asian countries (Nam & Nam, 2004), the high level of ownership concentration and family control (Claessens et al., 2000) may provide a greater incentive for the management of firms to manage earnings. This argument is consistent with Mohd-Saleh, Mohd Iskandar, and Rahmat (2005) who suggest that CEO duality has a positive association with earnings management in Malaysia. What can be learnt from Malaysia’s case? Investigation of the issue could highlight whether the incentive and opportunity provided by family control with the CEO duality feature are strong enough to result in earnings management through impairment of goodwill in a unique Asian environment. In some Asian countries, such as Malaysia, it is common to see a highly concentrated shareholding with strong family influence although corporate governance is generally strong.3

As such, the effect of the combined effect of CEO duality and family

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3 Claessens and Yortoglu (2013) show that Malaysia is highly ranked in terms of minority shareholders protection, legal rights and disclosure requirements among emerging countries.
control on goodwill impairment in Malaysia is an interesting setting to be the focus of the study.

The results from this study provide evidence that CEO duality in family controlled firms do not have an additional significant effect on goodwill impairment recognition. Additionally, following prior work by Lam and Lee (2008), this study focuses on the effect of family-controlled firms and goodwill impairment using CEO duality as a moderating factor. Thus, different from Lam and Lee (2008), who find that CEO duality is negatively associated with performance in the presence of the family factor, this study finds that family-controlled firms are positively associated with goodwill impairment irrespective of the presence of CEO duality. Evidence from this study also suggests that performance is an important determinant of goodwill impairment. Return on assets and change in return on assets are both significant and negatively related to goodwill impairment. On the other hand, the year of adoption and firm size are also significantly and positively associated with goodwill impairment. The findings of the relationship of the control variables with goodwill impairment are consistent with prior research.

The discussion of this paper is organised as follows. Section 2 introduces the theoretical standpoint for this study. Section 3 discusses the relevant literature to develop the research hypotheses. Section 4 outlines and explains the sample selection, research methods and variable measurement. Section 5 analyses and discusses the research results. Finally, the limitations and suggestions for future research are considered in section 6.

2. Theoretical Framework

Accounting numbers are often used explicitly in the contracts between their firms and their stakeholders. Two of the most popular contracts are compensation contracts (between the managers and shareholders), and debt contracts (between the managers and debt-holders). Jensen and Meckling (1976) refer to the former as an agency relationship that specifies the rights of the agent (managers) and the principal (shareholders), whereas the latter (debt contracts) introduces restrictions to reduce the conflicts between the managers and debt-holders. The restrictions that are stated in a debt contract are referred to as debt covenants.

Compensation contracts in the form of bonus plans are designed to align the incentives of managers with the shareholders that, ultimately,
would maximise accounting profit. Similarly, covenant restrictions in
debt contracts are designed to reduce the potential conflict of interest
between parties in an organisation. Conflicts in the lender-borrower
relationship are always in the form of wealth transfer to shareholders
at the expense of debt-holders. An example of the conflict includes the
intention to pay excessive dividends by the owner-managers even when
the firm is in financial distress to the extent it requires liquidating some
assets, and, consequently, putting the debt-holders’ claim on assets in
jeopardy. Owner-managers can also forgo value-increasing investment
decisions when more benefits from the investment may flow to the
debt-holders than to the owner-managers. Such conflicts are expected
to be aggravated when the management of family controlled firms are
able to control the Board (in the case of CEO duality).

To reduce the potential conflicts in the lender-borrower relationship
that will in turn reduce the cost of financing, the owner-managers are
willing to write contracts that may restrict the firm from engaging in such
activities. Indeed these contracts are costly. Contracting costs include
the evaluation, negotiation, writing and renegotiation of the terms of the
contracts (Watts & Zimmerman, 1986). Monitoring costs are the costs
associated with being informed about the performance of the contracts
and evaluating it relative to the terms of the contracts (Holthausen &
Leftwich, 1983). For the users of financial statements, their inability to
directly access private information results in information costs that will
cause information asymmetry between contracting parties.

Accepting that there are information costs associated with the
contracts means choices in the accounting methods (including choices
in the timing and amount of assets impairments, among other things)
could facilitate the masking of certain problems in a firm, because it is
costly for financial statement users to undo the manipulation. Watts
and Zimmerman (1978) argue that because contracting and monitoring
costs exist in management compensation plans, government regulations
and lending agreements, accounting choices will have economic
consequences. Holthausen and Leftwich (1983) further argue that
without those costs, users can ‘unravel’ accounting numbers so that
the accounting method choice has no effect on the wealth of the users.

On the other hand, Jensen and Meckling (1976) suggest that the
signalling of private information can reduce agency costs, and, hence,
the costs of financing. Thus, the accounting methods that are used for
this purpose can maximise a firm’s value, and, consequently, increase
the aggregate effect of the contracting parties. If managers select
accounting methods prior to writing any contract (ex-ante) in order to reduce the agency costs of the firm, then these methods are often known as ‘efficient’ accounting methods (Deegan, 2000). Nevertheless, Ronen and Sadan (1981), and Young (1995) argue that managers are only motivated to communicate private information when it gives good news to the market. For example, when firms are involved in heavy investments in the current year, this activity will increase future income but affect current income downward. As such, these firms have the incentive to give a signal that future income will increase by inflating current earnings. However, as goodwill impairment reduces current level earnings, it has more bad than good news for the firm. Thus, on average (although at firm’s level it might happen), it is less likely that firms would use goodwill impairment charges for signalling purposes.

However, there is one important question before we proceed further: Is impairment or amortisation appropriate? The majority of economists advocate a continuous accounting record for goodwill “to reveal the change in the total present value of the enterprise” (Bryer, 1995, p. 294). Profit or reserve is reduced if there is a reduction in its value. Thus, a periodic economic valuation of goodwill seems necessary. Conversely, from Marx’s point of view, goodwill is regarded as surplus profit from expenditure within the firm (Bryer, 1995). The present value of surplus profit would only become ‘fictitious capital’ and due to its subjective nature, goodwill should not be placed anywhere on the balance sheet (Bryer, 1995). This practice (as compared to treating goodwill as a permanent item) is also consistent with the principle of conservatism, i.e. a practice that requires a higher degree of verification to recognise good news as gains than to recognise bad news as losses (Watts, 2003). Clearly, the debate is between accounting goodwill as a permanent record versus writing-off goodwill as it emerges. The debate continues even after the convergence of the accounting standard requiring a permanent record of goodwill with periodic impairment tests. The previously practiced amortisation of goodwill might have originated from the demand from vested interest parties in their contracting process during certain economic events (such as economic crises) when the standard was discussed. Overall, there is no “true” answer to this question. While taking the above into consideration, this study attempts to investigate the behaviour of managers in the face of the adopted new standard on goodwill.

Overall, it is believed that managers would follow similar behaviour consistent with agency theory. Managers could be motivated to manage
earnings by the intention to fulfil contractual outcomes, such as to meet a certain benchmark indicated in the bonus plan, to avoid debt contract violations or to reduce political vulnerability. In this study, rather than investigating the whole spectrum of accounting policy choices, the focus of study is on the impairment of assets. At the same time, the effects of efficient contracting and signalling are also controlled.

3. Literature Review and Hypothesis Development

3.1 Goodwill Impairment Standard

Previously, Malaysia was closely following the standard produced by the United Kingdom (UK) on the Statement of Standard Accounting Practice (SSAP)-22. In year 2001, it was superseded by the Malaysian Accounting Standard (MAS) 22- Business Combination; however, the guidance on goodwill standard was limited. It prescribed that goodwill should be treated in accordance with the generally accepted accounting principles on goodwill (MAS 22 para 77) (Carlin, Finch, & Laili, 2009). In November 2002, an exposure draft (ED 28) was issued by the Malaysian Accounting Standard Board (MASB), which recommended that purchased goodwill should be recognised and amortised on a straight-line basis over a period not exceeding twenty years. Such a move was consistent with the Australian amortisation of goodwill policy stated in AASB 1013, which was implemented in 1996. Consequently, Malaysian firms only relied on ED 28 until MASB announced the adoption of FRS 136- Impairment of Assets and FRS 3-Business Combination, which became effective in 2006. In the same year, the US Financial Accounting Standard Board (FASB) took a larger step on goodwill accounting through the issuance of SFAS 141- Business Combinations and SFAS 142-Goodwill and Other Intangible for Assets in which amortisation is no longer required and goodwill is to be subjected to annual impairment testing. Similarly, the IASB began a project to review IAS 22-Business Combination to improve the quality of accounting for business combination. In March 2004, the IASB concluded its project by issuing IFRS 3- Business Combinations and revised version of IAS 36-Impairment of Assets. These two projects by the IASB and US FASB reached a similar conclusion on major issues. The international standard was later adopted by many other countries around the world including Malaysia.

Despite the harmonisation of goodwill accounting standards achieved through the IASB standard, the shift from the amortisation
system to periodic impairment challenges the management and auditors in carrying out their new responsibilities (Wines, Dagwell, & Windsor, 2007). Management have a new responsibility to determine the fair value of goodwill and the auditors, regulatory bodies and investors need to evaluate managers’ determination (Hayn & Hughes, 2006; Wines et al., 2007). Thus, the difference in the standards adopted in Malaysia allows significant discretion for managers to manage earnings. In summary, significant discretion occurs in the (1) transition year, (2) estimation of recoverable amount, (3) timing of impairment recognition, and (4) allocation to proper cash generating unit. These issues are discussed in turn, as follows.

Firms are required to complete a transitional impairment test of all goodwill in their first year of adoption. We include this variable for a number of reasons. First, while some studies find that the opportunities to manage earnings are greater in the transition year because the effect of changes resulting from the new standard does not affect the operating income (Lapointe-Antunes et al., 2008; Hamberg, Paananen, & Novac, 2011; Henning et al., 2004), the effect might be different in Malaysia. In this country, the sudden move from the laissez-faire approach to a more complicated approach may have caused accountants and even the auditors to take a more conservative and sceptical approach, respectively. Thus, more impairment is expected in the transition year. Secondly, all accumulated prior amortisation charges are eliminated and initial impairment loss may be recognised either in their first adoption year or later (as part of continuing income). According to Benz and Heltzer (2005), the market reaction to goodwill impairment that is recorded in the adoption year is significantly less negative than impairment recorded as part of continuing income in the subsequent years. Thus, it can be expected that managers have a tendency to record larger impairment in the year of adoption and the effect is recorded as the cumulative effect of changes in accounting policies.

The requirements to estimate the recoverable amount is argued as being highly reliant upon the estimates by managers, which results in difficulty for verification by the auditors (Wines et al., 2007). In Malaysia,

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4 This is because for the condition when goodwill value is expected to be amortised, the amortisation requirement seems to have a negative impact on firms. James, How, and Verhoeven (2008) find mandatory goodwill amortisation significantly lowered the median of bid premium of Australian takeovers. Similarly, Onesti, and Romano (2012) note that their sample firms would have recorded significantly higher net profit if goodwill impairment is implemented instead of systematic amortisation.
most firms are using the present value of cash flow to calculate the value-in-use as a method to determine the recoverable amount due to illiquidity of the capital market compared to other developed countries, such as the UK, US, and Australia, which commonly use fair value less cost to sell (Carlin et al., 2009). Managers have a better opportunity to use estimates that would reflect a higher recoverable amount if they do not expect to impair goodwill. On the other hand, managers may use key estimates that result in a lower recoverable amount if they expect to recognise lower goodwill impairment. Managers may adjust their assumptions and use their discretion on the measurement of the recoverable amount that reflects their desired amount of goodwill to be impaired. In addition, the use of discount rate and growth rate to evaluate future expected cash flow are subject to high managerial discretion. These assumptions make it more difficult for auditors to obtain objective evidence to support such assumptions of managers (Wines et al., 2007).

Prior studies find that managers select the best timing for their recognition of goodwill impairment by selecting the years when the amount of expenses should be incurred. Hayn and Hughes (2005) suggest that goodwill impairment is the result of overpayment on acquisition, which can be determined using the post-performance indicators. They track the goodwill of acquiring firms from the acquisition year to the impairment year to examine the trigger points for goodwill impairment. About one third of the acquiring firms delay the goodwill impairment of acquired entity until at least six to ten years (Hayn & Hughes, 2005). The study of Hayn and Hughes (2005) supports the assertion that managers use their discretion by timing the goodwill impairment to meet certain reporting objectives. Some firms may also have a tendency to avoid recording any impairment. It is found that not writing off goodwill is positively associated with dividend payout (Onesti & Romano, 2012).

The verification of the estimation of recoverable amount is further complicated by the cash generating unit aggregation problem (Carlin et al., 2009). Management may rely on a professional valuation services firm to perform valuations on its cash generating ability and goodwill value, which make it difficult for the auditor to disapprove the valuation being made (Wines et al., 2007).

Overall, due to several complicated issues in the determination of whether impairment should be recognised as goodwill, there is a high possibility that opportunistic managers may inappropriately manage earnings through goodwill. This relates to the objective of the study
as to whether a specific family ownership and control as well as CEO duality could affect the recognition of goodwill impairment. The next section discusses the managers’ motive to manage earnings.

3.2 Factors for Managing Earnings through Goodwill Impairment

With the existence of incentives to manage earnings, such as to manage contractual outcomes, to reduce political cost or to influence the capital market, inappropriate recognition of goodwill impairment is more likely to occur. Large firms are argued to be more politically visible and hence more vulnerable to political costs. This motivates the managers to engage in earnings management to avoid these costs (Watts & Zimmerman, 1986). Godfrey and Koh (2009) find a significant positive association of firm size with the magnitude of goodwill impairment loss. This is consistent with the political cost argument that larger firms record greater impairment loss to lower their reported earnings.

The study of Hamberg et al. (2011) on the effect of the adoption of IFRS 3 found evidence that the amount of goodwill impairment under IFRS is considerably lower than goodwill amortisation under Swedish GAAP. They find that firms with a substantial amount of goodwill, experience a considerable increase in reported earnings during the adoption of IFRS 3. It is reported that the stock price of these firms went upward in the seven months prior to IFRS adoption and that these firms earned a higher abnormal return than firms without proportionally large goodwill balance. This was caused by investors’ misinterpretation that an increase in earnings (caused by the abolishment of amortisation) was an indication of higher future cash flows (Hamberg et al., 2011). In the study of Lapointe-Antunes et al. (2008), they find that managers have an incentive to reveal their private information regarding future cash flows through goodwill impairment disclosure. If the market perceives the firms as having higher future cash flow, they are more likely to invest in the firm, which, later, see an increase in the share price.

From the perspective of investors, Al-Khadash and Salah’s (2009) study on Jordanian firms investigates whether the users of financial statements, apart from the management, are capable of assessing goodwill impairment. Their study reveals that the external users would not be able to assess goodwill impairment effectively through financial information and disclosure. Hayn and Hughes (2005) examine whether investors can effectively predict goodwill impairment. They also find that the available disclosure does not provide adequate information
to enable investors to predict goodwill impairment. Thus, investors could easily be manipulated due to their inability to predict goodwill impairment based on the available information (Hayn & Hughes, 2005; Al-Khadash & Salah, 2009). They may misinterpret the increase in earnings due to the abolishment of amortisation as an indication of future cash flow (Hamberg et al., 2011).

Beatty and Weber (2006) find that firms are less likely to take goodwill write off when they are close to violating their debt covenants. This is supported by the study of Zang (2008) in Singapore who finds that highly leveraged firms are more likely to report lower goodwill impairment. Beatty and Weber (2006) also find that firms with an earnings based bonus plan that includes the effect of special items are less likely to record goodwill impairment loss because it is believed that the management’s bonus is not shielded from a reduction in income. These studies imply that the performance based incentive plans used by a firm can directly influence managers to manage earnings within the latitude given in the existing goodwill standard. However, this issue is beyond the scope of this study since the firm’s level of compensation package is not directly observable. Nevertheless, we acknowledge that this constitutes a limitation of this study.

3.3 The Monitoring Role of Corporate Governance

One of the most acceptable definitions for corporate governance is by Cadbury Committee, which was set up in May 1991 by the Financial Reporting Council of the London Stock Exchange. The committee defined ‘corporate governance’ as “…the system by which companies are directed and controlled”. The Cadbury report also suggested that the “board of directors should be free to drive their companies forward, but exercise that freedom within a framework of effective accountability” (Cadbury Report, 1992). Given that managers act as an agent for other stakeholders in the firm, it is essential to have an effective monitoring of the managers’ behaviour to oversee the risk of breaching the contract between the managers and the other stakeholders (Jensen & Meckling, 1976). For family-controlled firms, the agency cost arises when the major shareholders (who are involved in the management of the firm) are transferring the wealth from the minority shareholders to themselves either through tunnelling or expropriation of assets (Anderson & Reeb, 2003; Cheung, Jing, Lu, Rau, & Stouracitis, 2006; 2009).
Although good corporate governance structure has been argued to be an important mechanism in monitoring the firm’s management, there are some issues concerning whether certain characteristics of corporate governance may not be feasible in a highly concentrated ownership structure. A Canadian study by Klein, Shapiro, and Young (2005), propose that not all elements of measured governance in an index are important and that the effects of governance differ by ownership category. They find no evidence that Board independence (the most heavily weighted sub-index) has a positive effect on firm performance. Interestingly, the relationship between Board independence and performance is negative for family-owned firms (Klein et al., 2005). This could be supported by the alignment effect of agency theory, where the interests of owner-managers and shareholders are aligned; this could alleviate the need for external monitoring. Muld and Donalson (1998) find that the stewardship theory should be viewed in a family-controlled firm where the Board’s role is to provide service and advice rather than monitor and control. Jaggi, Leung, and Gul (2009) and Jaggi and Leung (2007) suggest that monitoring the effectiveness of the Corporate Board and Audit Committee is moderated in family-controlled firms. Thus, this study focuses specifically on the CEO duality issue because the combination of CEO and Chairman’s role can significantly affect the independence of the Board of Directors as a whole.

3.4 Hypotheses Development

The role of corporate governance in family-controlled firms lies behind two branches of agency theory, Type 1 and Type 2. In agency Type 1, the proportion of managerial ownership can reduce the agency cost between managers and shareholders by aligning the interest of managers with that of shareholders (Jensen & Meckling, 1976). When managerial ownership is low (high), managers’ are more likely to engage in opportunistic (value enhancement) activities (Warfield, Wild, & Wild, 1995). From this perspective, family ownership could have potential benefit to firm performance. An increase in the family interest could increase the sense of ‘familiness’ of the owner-managers. Thus, according to this perspective, an increase in the family ownership is expected to reduce the opportunistic goodwill impairment recognition. Recorded goodwill impairment is expected to be caused by the underlying economic decline in value, which is triggered by the past and current performance and is likely to influence the prediction of the future cash generating ability.
of the unit. Investigation of this effect should include the performance metric as an important factor determining the impairment decision so that the signalling intention is adequately captured.

On the other hand, agency Type 2 is more likely to occur in a closely held economy and in a highly concentrated ownership structure. The agency conflict within a family-controlled firm is mainly dominated by Type 2 agency problems, a conflict between the majority and the minority shareholders. The entrenchment effect could induce the controlling owners to deprive the rights of minority shareholders in a weak legal system and by conducting an ineffective corporate governance mechanism (Shleifer & Vishny, 1997; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000; Fan & Wong, 2002). In contrast, the alignment effect could align the controlling owner-manager with the interest of minority shareholders (Demsetz & Lehn, 1985; Jaggi et al., 2009). Due to the political cost, family managers may have a higher tendency to entrench their power, which can have a detrimental effect on the minority shareholders.

Family-controlled firms are identified as firms with the substantial family shareholders involved in the management of the business and sit on the Board of Directors. Accordingly, the controlling family has the power to seek private benefit through expropriation of minority shareholders, related party transactions (Anderson & Reeb, 2003) and managerial entrenchment (Shleifer & Vishny, 1997). Omar and Mohd-Saleh’s (2011) study includes family controlled firms as a determinant of goodwill impairment. They find a positively significant relationship between family-controlled firms and goodwill impairment beyond other traditional factors and indicators (such as the transition year, leverage, performance, change in performance and firm size). For the purpose of this study, it is important to first investigate the relationship between family and goodwill impairment. Therefore, this study hypothesises that:

$H1$: Family-controlled firms are more likely to impair goodwill compared to non-family-controlled firms beyond other related factors.

From the corporate governance perspective, the Board of Directors should serve as a monitoring mechanism on behalf of the shareholders to ensure the CEO aligns his or her actions in the interest of shareholders (Fama & Jensen, 1983; Vance 1983). If a CEO is also the Chairman of the Board, he or she has the ability to determine and control the agenda, contents and discussions of the Board meetings including controlling
the nomination process (Mallette & Fowler, 1992; Chen & Liu, 2010). As such, CEO domination in the Board process could reduce the effectiveness of the Board in monitoring managerial decisions and activities (Vance, 1983). The potential cost associated with CEO duality includes the tendency of the CEO to dominate the Board meeting and lack of ability to monitor the Board independently.

A study in Hong Kong argues that the practice of CEO duality may have a positive effect on family-controlled firms, and has the potential to make the firms outperform the non-family-controlled firms (Lam & Lee, 2008). This view is taken from the stewardship theory that managers are self-actualising persons. It is also believed that there is an alignment of interests between the managers with the owners. CEO duality is also expected to promote “a unified and strong leadership” (Lam & Lee, 2008). Some evidence suggests that CEO duality may provide better leadership to the firms since there is a reduction in the “incomplete transfer” of critical information between the CEO and the chairman (Brickley, Coles, & Jarrell, 1997, p. 194).

Additional support for the costs of CEO duality is provided by a recent study in Italy by Prencipe and Bar-Yosef (2011). The study finds evidence that the impact of Board independence on earnings management is weaker in family-controlled companies. They also find that earnings management is stronger if the CEO is a member of the controlling family. The findings of Prencipe and Bar-Yosef (2011) support the argument by Tam and Tan (2007, p.208) who propose an integrated model that explains how firm performance is affected by different types of ownership concentration, governance and firm performance in Malaysia. Tam and Tan (2007) suggest that “different types of majority owners exhibit distinct traits of behavior and preferences for corporate governance”. Based on a sample of the top 150 public listed firms in year 2000, they find that 30.6 per cent of the individual/family owned firms practice CEO duality. Thus, it appears that CEO duality is found to be common in Malaysia. It can become an important conditioning factor that determines the effectiveness of the Board in relation to the financial reporting quality if the situation remains.

This paper concentrates on the issue of CEO duality because the independence of directors on the Board is weak if there is CEO duality on the Board. According to Jaggi and Leung (2007), they find that a high concentration of family ownership leads to the appointment of family members on the Board. However, despite the shares held by the family members and positions held by them in the management, a
good corporate governance structure should be implemented in order to facilitate appropriate recognition of a complex goodwill impairment standard. Therefore, to enhance the effectiveness of the monitoring role of the Board of Directors, certain guidelines on corporate governance need to be strictly adhered to by family-controlled firms. A study in Malaysia by Mohd Saleh et al. (2005) suggests that the practice of CEO duality should be totally eliminated because it promotes earnings management practices. Interestingly, the study reveals Board independence is not able to constrain earnings management practices once CEO duality exists. Similarly, Abdullah and Mohd Nasir (2004) find the independence of directors and CEO non-duality are not able to constrain earnings management. This result could be attributed to the influence of family ownership and family directors on the Board and in the management team. The study of Ishak, Haron, Nik Salleh, and Abdul Rashid (2011) on 236 sample firms in Malaysia in year 2009 finds that the proportion of family members on the Board is positively associated with earnings management. The higher the proportion of family members on the Board, the lower the discretionary accruals. Thus, this study expects that the practice of CEO duality in a family-controlled firm may distort the independence of decision-making by the Board of Directors. A study by Lam and Lee (2008) indicates that CEO duality in family controlled firms strengthens the desire and provides more opportunities for expropriation activities, which is in line with Shleifer and Vishny (1997). Based on the above discussion, Lam and Lee (2008) also suggest that CEO duality (CEO domination) only affects performance negatively when there is a family control factor. As far as this study is concerned, there have been no studies that examine the combined effect of CEO duality and family-controlled firms on goodwill impairment.

We focus on this effect because Omar and Mohd-Saleh (2011) find that family control affects goodwill impairment beyond its traditional determinants and that the incentives to use goodwill impairment for perception management are greater due to the opportunity that the managers have in making discretionary judgement provided by the standard for impairment, as well as the power given by the duality status. Therefore, due to the common practice of CEO duality (Chen, Cheung, Stouraitis, & Wong, 2005) and supported by empirical evidence regarding expropriation activities (Anderson & Reeb, 2003) and related party transactions among family-controlled firms, it is hypothesised that:
H2: The combined effect of CEO duality and family control on goodwill impairment is more prominent than its separate effects.

4. Research Method
This study focuses on the combined effect of CEO duality and family-controlled firms on goodwill impairment using a sample from public firms listed on Bursa Malaysia. Logistic regression is conducted to generate empirical results for verifying the formulated hypotheses.

4.1 Period of Study
Since the requirement to adopt FRS 3 and FRS 136 became effective on 1 January 2006, the starting period used in the sample is year 2006. The period of study is from years 2006 to 2008 to allow a comparison of changes between the first adoption year and the years afterward. This method can increase the size of the sample because the use of maximum likelihood estimation requires a large sample size (Tabachnick & Fidell, 2007). We limit the data collection to until 2008 in order to control for the effect of the financial crisis that affected Malaysia after 2008.

4.2 Source of Data Collection
The sampling frame is based on all firms listed on Bursa Malaysia. The source of data collection was mainly the OSIRIS database for financial data, such as the goodwill amount, total assets, total liability, and earnings before tax and net profit to determine the key ratios, such as return on assets, debt to equity ratio, goodwill over total assets and firm size. Where the information was not available on the database, the data were manually collected from the firm’s financial report on the Bursa Malaysia website. The information regarding corporate governance variables and ownership structure were determined directly from the annual report in the Corporate Information, Directors’ Profile and Shareholdings Information section. The data on foreign shareholdings and market capitalisation were obtained directly from the Bursa Malaysia Information Service.

4.3 Sample Selection
This study adopts a similar approach to that of Omar and Mohd-Saleh (2011). Table 1 describes the sample selection process used in this study.
Table 1: Sample Selection Process

Panel A: First stage

<table>
<thead>
<tr>
<th>CRITERIA</th>
<th>Number of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total firms listed on BURSA MALAYSIA, which are indicated as active firms by OSIRIS as at 13/1/2010</td>
<td>954</td>
</tr>
<tr>
<td>Exclude Financial, REITS and CLOSED/END FUND industries</td>
<td>-46</td>
</tr>
<tr>
<td>Exclude firms without goodwill balance from year 2006-2008</td>
<td>-319</td>
</tr>
<tr>
<td>Exclude firms with insufficient annual report available</td>
<td>-109</td>
</tr>
<tr>
<td>Total firms with goodwill balance</td>
<td>480</td>
</tr>
<tr>
<td>Total firms that did not satisfy goodwill balance criteria(^5)</td>
<td>-105</td>
</tr>
<tr>
<td>Firms excluded for not adopting FRS 3</td>
<td>-5</td>
</tr>
<tr>
<td>FINAL SAMPLE OF FIRMS</td>
<td>370</td>
</tr>
</tbody>
</table>

Panel B: Second stage

<table>
<thead>
<tr>
<th>CRITERIA</th>
<th>Firm-year observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final Sample firms = 370 x 3 years</td>
<td>1110</td>
</tr>
<tr>
<td>Minus observation with negative goodwill balance and observation years where FRS 3 is not yet adopted</td>
<td>-115</td>
</tr>
<tr>
<td>Sample of firm-year observations available</td>
<td>955</td>
</tr>
<tr>
<td>Exclude firms with missing observation</td>
<td>-57</td>
</tr>
<tr>
<td>FINAL COMPLETE SAMPLE OF FIRM-YEARS</td>
<td>948</td>
</tr>
</tbody>
</table>

There are two stages in the sample selection process in which first a list of 954 active\(^6\) firms is obtained from OSIRIS database as at 13 January 2010. Next, firms from the financial related industry are excluded. This industry is highly regulated and the financial statement differs from the non-financial industry. The information concerning the ending balance of goodwill is obtained from the OSIRIS database, resulting in the exclusion of 319 firms without any goodwill balance from years 2003 to 2008. One hundred and nine firms whose annual reports are inadequate or not available are also excluded. Later, the identification of whether the firms satisfy the following goodwill balance selection criteria is undertaken as follows:

i. The firms must have positive goodwill balance at least in one of the three years prior to FRS 3 adoption – the reason being because prior

\(^5\) At this stage, because FRS 3 became effective on 1 January 2006, firms were expected to adopt FRS 3 in 2006. However, some firms adopted FRS 3 only in 2007 and 2008. Thus, a dummy variable ADOPT is included to control the effect of first year adoption.

\(^6\) “Active” firms are firms that are not delisted or remain inactive status (source: OSIRIS).
goodwill policy is important to indicate whether the firms changed from the prior standard in order to adopt FRS 3 requirement.

ii. The firms must EITHER have a positive goodwill balance in at least one year after the adoption of FRS 3 OR have a positive beginning goodwill in their year of adoption. This is to allow investigation of managers’ decisions whether or not to impair goodwill based on the requirement of FRS in the transition year or in the years afterwards (Omar & Mohd-Saleh, 2011).

As a result, 105 firms are excluded because these firms do not satisfy the stated goodwill balance selection criteria. Subsequently, five out of 375 firms are removed because they do not adopt FRS 3 in years 2006, 2007 or 2008. The final sample contains 370 firms with panel data observations.

The second stage involves obtaining a sub-sample for the purpose of analysis. Out of 370 final firms, 1,110 observations are derived. Observations with negative beginning goodwill are excluded from the sample following Beatty and Weber (2006) to include only positive beginning goodwill. This is because if the firms do not have goodwill balance, their financial statement is not affected by the goodwill impairment standard; thus, the decision to impair or not to impair goodwill is irrelevant. Only firm-year observations in the year of adoption and the year after the adoption are included in the sub-sample. Finally, only 948 firm-year observations remain for analysis after 57 firm-years with missing data are excluded.

4.3 Measurement of Variable

4.3.1 Recognition of Goodwill Impairment

The dependent variable, IMP represents a binary variable, which indicates the recognition or non-recognition of goodwill impairment loss. A value of 1 indicates the recognition of goodwill impairment loss, otherwise zero. The measurement has been used by prior researchers, such as Beatty and Weber (2005). We also test another dependent variable, IMTA, which actually measures the impairment amount scaled by total assets.

---

7 370 x three years (years 2006-2008)
4.3.2 CEO Duality

CEO duality is measured as one, (i.e. if the role of the CEO and Chairman are combined) (Klein, 2002). There are a few cases in which no formal CEO is indicated in the annual report and there is only one independent Chairman. In that case, this study assumed that the Executive Director is regarded as holding the responsibility of the CEO. Thus, a zero value is given.

4.3.3 Family-controlled Firm

We identify a firm as a family firm if the largest shareholder in the firm is a family, an individual or an unlisted firm. This is consistent with the definition used by Faccio and Lang (2002). To ensure that a family controls the firm, we only select those in which the largest shareholder holds at least 10 per cent shareholding or voting rights in the particular firm. This is consistent with previous studies (LaPorta et al., 1999; Claessens et al., 2000; Faccio & Lang, 2002) in which cut-off levels of 10 per cent and 20 per cent are commonly used. We collect the data on the percentage of family voting rights by referring to the section of Analysis of Shareholdings of the companies’ annual reports. Information from the subsections, such as directors’ shareholding and profile of Board of Directors, is also scrutinised to reveal the identity of the largest shareholders. In most instances, we find that the management of family firms consists of members of the controlling families. This is consistent with the prior findings that suggest that the managers in the majority of firms in East Asian countries are related to the family of the controlling shareholder (Claessens et al., 2000).

4.3.4 Foreign Shareholding

The level of foreign shareholding is measured as the percentage of shares held by foreign investors following Anderson, Jandik, and Makhija (2001). The percentage of shareholding would represent the extent of ownership and whether the foreign investors play a significant role in capital contribution to the firm. Leuz, Lins, and Warncoch (2010) find that foreign investors are less likely to invest in firms with a high level of managerial ownership and family control. The effect is more significant when these firms are located in countries with poor protection. As this study focuses on the influence of family-controlled firms, foreign shareholdings also play a significant monitoring role to constrain the
tendency by managers to expropriate the minority shareholders, thus the effect of foreign shareholdings is controlled.

4.3.5 The Year of Adoption
The effect of a transition year is measured using a dummy variable of one to indicate the first year of adoption, otherwise zero. To the extent of the authors’ knowledge, none of the prior studies on the goodwill impairment issue has used panel data. Instead, they use the sample of firms on the year of transition, such as Beatty and Weber (2006), Henning et al. (2004) and Lapointe-Antunes et al. (2008). Most prior studies have found that firms record larger goodwill impairment in the first year of adoption. Therefore, this effect is controlled using the dummy variable ADOPT.

4.3.6 Other Control Variables
Firm specific characteristics include profitability, leverage and firm size. Profitability is proxied by return on assets and change in return on assets. Return on assets is used to determine a firm’s overall performance (Jordan & Clark, 2007; Beatty & Weber, 2006; Lapointe-Antunes et al., 2008). Prior studies use return on assets as a proxy of profitability in studies concerning earnings management (Jordan, Clark, & Vann, 2007). Leverage is measured by debt-total asset ratio as has been used in prior studies regarding the propensity for violation of the debt covenant (Dechow, Sloan, & Sweeney, 1996) and delaying recognition of expense (Beatty & Weber, 2006). Lapointe-Antunes et al. (2008) also find that firms with higher than target leverage, record lower goodwill impairment loss to avoid deviation from the industry median. Firm size is measured by the natural logarithm of total assets. The use of natural log is to adjust the effect of heteroscedasticity (Klein, 2002). We also include prior period amortisations as control variables, i.e. $\text{AMORT}_{t-1}$, $\text{AMORT}_{t-2}$ and $\text{AMORT}_{t-3}$. Following prior research, it is predicted that the lower prior period amortisation (as proxied by 3 years lagged amortisation expense), the higher the impairment of goodwill in the current period (negative relationship). This prediction is consistent with the fact that the change in the practice from amortisation to impairment, as required by the standard, might have an impact on the impairment charge in the current year. The proxy only takes three years lagged values, as longer lagged values will result in a significant reduction in the sample period.
4.4 Empirical Model

Based on the conceptual framework illustrated in Figure 1, this research utilises the logistic regression model to test the stated hypotheses. The use of logistic regression is appropriate because the dependent variable is a dichotomous variable (IMP) that takes the value of one if the firm recognises goodwill impairment loss and zero if otherwise. The empirical model is described as follows:

Model 1:

\[
IMP_{it} = \beta_0 + \beta_1 FAM_{it} + \beta_2 CEO_{it} + \beta_3 CEOFAM_{it} + \beta_4 FOREIGN_{it} + \beta_5 LEV_{it} + \beta_6 ROA_{it} + \beta_7 ROACHG_{it} + \beta_8 ADOPT_{it} + \beta_9 FIRMSIZE_{it} + \beta_{10} AMORT_{t-1} + \beta_{11} AMORT_{t-2} + \beta_{12} AMORT_{t-3} + \beta_{13} CEOCHG_{it} + \beta_{14} CEOFAM_{it} + \beta_{15} CEOTEN_{it} + \beta_{16} INDPAC_{it} + \beta_{17} BIG N_{it} + \sum_{j=17-n} \beta_{17-j} INDUSTRY_{it} + e_{it}
\]

Where,

1) IMP : An indicator variable equal to one if impairment loss is recorded and zero if otherwise.
2) CEO : A dummy variable of one if the CEO is also the Chairman of the firm and not a family controlled firm, otherwise zero.
3) FAM : A dichotomous variable equal to one if the firm is a family-controlled firm and not having CEO duality, and zero if otherwise.
4) CEOFAM : A dichotomous variable if the CEO is also the Chairman of the firm and is a family controlled firm, otherwise zero.
5) FOREIGN : The percentage of foreign shareholdings.
6) LEV : Total liability to total asset ratio.
7) ROA : Return on assets.
8) ROACHG : Changes in return on assets.
9) ADOPT : A dummy variable of one if the firm is in the year of transition, otherwise zero.
10) FIRMSIZE : Natural logarithm of total assets.
11) AMORT_{t-1}, AMORT_{t-2}, AMORT_{t-3} : Prior period amortisation amounts deflated by total assets.
12) CEOCHG : Dichotomous variable of 1 if there is a change in CEO, zero if otherwise.
13) CEOTEN : Number of years of service by CEO.
14) INDPAC : Proportion of independent directors on the Audit Committee.
15) INDPBOD : Proportion of independent directors on the Board of Directors.
16) BIG N : Dichotomous variable equal to one if the firm audited by a Big N audit firm, zero if otherwise.
17) INDUSTRY : Industry dummies.
5. Results and Discussion

This section describes the descriptive statistics, correlation and results of regression for the purpose of this study.

5.1 Descriptive Statistics

The untabulated results show that despite the recommendation in MCCG since year 2000 that CEO duality should be avoided, 20 per cent of the firm-years observations in the sample practice duality of CEO and 21 per cent of firms impair goodwill. This observation is consistent with Munir, Mohd-Saleh, and Yatim (2013) who find that 22.9 per cent of their sample has CEO duality. In this case, each firm needs to explain the divergence of practice from what is recommended as best practice in their annual reports. The sample comprises 70 per cent of family-controlled firm-years, and 37 per cent of the observations that impair goodwill in the first year of adoption. The findings on family controlled firms is marginally higher than prior research in the western countries. According to Faccio and Lang (2002), 60 per cent of all listed firms in France, Italy, and Germany are family firms.

Table 2 shows the descriptive statistics of the variables used in this research. The mean of foreign shareholding, leverage and return on assets are 12.0 per cent, 50.2 per cent and 3.1 per cent, respectively (Panel A), which are comparable to Mohd Ali, Mohd-Saleh, and Hassan (2008). The average for CEO tenure is 8.099, consistent with Mohd-Saleh, Mohd Sanusi, Abdul Rahman, and Bukit (2012). The percentage of independent Board members and independent Audit Committee members are 43.189 per cent and 81.499 per cent, respectively. Bivariate comparison shows that return on assets, and size of firms with and without impairment, are significantly different. Thus, it is necessary to control for these effects in the multiple regression analysis. It also appears that the distribution of recorded impairment is different between family and non-family firms with the likelihood that it is higher in the family firms. The initial findings support our prediction. The distribution of impairment also appears to be more proportionate in the adoption year and those with CEO duality in family controlled firms (Panel B).

5.2 Correlation Analysis

Table 3 below indicates the Spearman-rank correlation matrix due to the existence of categorical variables in the regression. None of the
Table 2
Panel A: Descriptive Statistics

<table>
<thead>
<tr>
<th>IMPAIRMENT</th>
<th>FOREIGN</th>
<th>LEV</th>
<th>ROA</th>
<th>CHGROA</th>
<th>FIRM.SIZE</th>
<th>AMORT-1</th>
<th>AMORT-2</th>
<th>AMORT-3</th>
<th>CEOTEN</th>
<th>INDPAC</th>
<th>INDPAC</th>
</tr>
</thead>
<tbody>
<tr>
<td>YES (747)</td>
<td>Mean</td>
<td>0.122</td>
<td>0.499</td>
<td>0.034</td>
<td>-0.003</td>
<td>5.608</td>
<td>0.045</td>
<td>0.108</td>
<td>0.140</td>
<td>7.916</td>
<td>43.269</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>0.053</td>
<td>0.497</td>
<td>0.038</td>
<td>0.000</td>
<td>5.571</td>
<td>0.000</td>
<td>0.000</td>
<td>0.003</td>
<td>6.000</td>
<td>40.000</td>
</tr>
<tr>
<td></td>
<td>SD</td>
<td>0.163</td>
<td>0.284</td>
<td>0.107</td>
<td>0.162</td>
<td>0.594</td>
<td>0.188</td>
<td>0.287</td>
<td>0.339</td>
<td>7.462</td>
<td>12.032</td>
</tr>
<tr>
<td>NO (201)</td>
<td>Mean</td>
<td>0.112</td>
<td>0.512</td>
<td>0.019</td>
<td>-0.014</td>
<td>5.703</td>
<td>0.086</td>
<td>0.135</td>
<td>0.255</td>
<td>8.781</td>
<td>42.893</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>0.057</td>
<td>0.525</td>
<td>0.032</td>
<td>0.000</td>
<td>5.658</td>
<td>0.000</td>
<td>0.000</td>
<td>0.008</td>
<td>5.000</td>
<td>41.429</td>
</tr>
<tr>
<td></td>
<td>SD</td>
<td>0.147</td>
<td>0.216</td>
<td>0.090</td>
<td>0.110</td>
<td>0.662</td>
<td>0.284</td>
<td>0.249</td>
<td>0.803</td>
<td>9.516</td>
<td>11.296</td>
</tr>
<tr>
<td>TOTAL (948)</td>
<td>Mean</td>
<td>0.120</td>
<td>0.502</td>
<td>0.031</td>
<td>-0.006</td>
<td>5.628</td>
<td>0.054</td>
<td>0.114</td>
<td>0.164</td>
<td>8.099</td>
<td>43.189</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>0.053</td>
<td>0.503</td>
<td>0.036</td>
<td>0.001</td>
<td>5.589</td>
<td>0.000</td>
<td>0.000</td>
<td>0.003</td>
<td>6.000</td>
<td>40.000</td>
</tr>
<tr>
<td></td>
<td>SD</td>
<td>0.160</td>
<td>0.271</td>
<td>0.104</td>
<td>0.152</td>
<td>0.610</td>
<td>0.213</td>
<td>0.280</td>
<td>0.478</td>
<td>7.943</td>
<td>11.875</td>
</tr>
</tbody>
</table>

Table 2
Panel B: Distribution

<table>
<thead>
<tr>
<th>IMPAIRMENT</th>
<th>Chi-Sq</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>FAM</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>243</td>
</tr>
<tr>
<td>Yes</td>
<td>511</td>
</tr>
<tr>
<td>CEO</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>608</td>
</tr>
<tr>
<td>Yes</td>
<td>146</td>
</tr>
<tr>
<td>CEOFAM</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>491</td>
</tr>
<tr>
<td>Yes</td>
<td>263</td>
</tr>
<tr>
<td>ADOPT</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>491</td>
</tr>
<tr>
<td>Yes</td>
<td>263</td>
</tr>
<tr>
<td>BIG N</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>298</td>
</tr>
<tr>
<td>Yes</td>
<td>456</td>
</tr>
</tbody>
</table>

Note: IMP is an indicator variable equal to one if impairment loss is recorded and zero if otherwise; CEO - a dummy variable of one if the CEO is also the chairman of the firm in a non-family controlled firm, otherwise zero; FAM - a dichotomous variable equal to one if the firm is a family-controlled firm and not having CEO duality, and zero if otherwise; CEOFAM- A dichotomous variable if the CEO is also the chairman of the firm and is a family controlled firm, otherwise zero. FOREIGN-percentage of foreign shareholdings; LEV- prior year total liability to prior year total assets ratio; ROA - return on assets measured as earnings before tax over beginning total assets. ROACHG- changes in return on assets; AMORT-1, AMORT-2 and AMORT-3 – Amortisation of goodwill over total assets in year t-1, t-2 and t-3, respectively. ADOPT-dummy variable of one if the firm is in the year of transition; FIRM.SIZE-natural logarithm of total assets; CEOTEN-Number of years of service by CEO; INDPAC-proportion of independent directors on the audit committee; INDPBOD-proportion of independent directors on the board of directors; BIG N dichotomous variable equal to one if the firm is audited by a Big N audit firm, zero if otherwise. ***,**,* represent 1%, 5% and 10% significance levels, respectively.
Table 3: Correlation Matrix

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
<th>15</th>
<th>16</th>
<th>17</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 FAM</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 CEO</td>
<td>-1.187</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 CEOFAM</td>
<td>-0.476</td>
<td>-0.078</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 FOREIGN</td>
<td>-0.046</td>
<td>-0.03</td>
<td>-0.18</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 LEV</td>
<td>-0.046</td>
<td>0.145</td>
<td>0.021</td>
<td>0.001</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 ROA</td>
<td>0.043</td>
<td>-0.056</td>
<td>-0.015</td>
<td>0.214</td>
<td>-0.254</td>
<td>1</td>
<td></td>
<td></td>
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<tr>
<td>7 CHGROA</td>
<td>0.023</td>
<td>-0.179</td>
<td>0.022</td>
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<td>-0.485</td>
<td>-0.115</td>
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<tr>
<td>8 ADOPT</td>
<td>-0.020</td>
<td>0.046</td>
<td>0.035</td>
<td>0.012</td>
<td>-0.020</td>
<td>-0.015</td>
<td>0.033</td>
<td>1</td>
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<tr>
<td>9 FIRMSIZE</td>
<td>0.030</td>
<td>-0.074</td>
<td>-0.043</td>
<td>0.302</td>
<td>-0.106</td>
<td>-0.292</td>
<td>-0.102</td>
<td>0.001</td>
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<tr>
<td>10 AMORTt-1</td>
<td>-0.058</td>
<td>-0.039</td>
<td>0.088</td>
<td>-0.028</td>
<td>-0.001</td>
<td>-0.081</td>
<td>0.059</td>
<td>0.346</td>
<td>-0.055</td>
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<tr>
<td>11 AMORTt-2</td>
<td>-0.035</td>
<td>-0.063</td>
<td>0.046</td>
<td>-0.060</td>
<td>-0.015</td>
<td>-0.058</td>
<td>0.079</td>
<td>0.089</td>
<td>-0.097</td>
<td>0.424</td>
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<tr>
<td>12 AMORTt-3</td>
<td>-0.088</td>
<td>-0.054</td>
<td>0.024</td>
<td>-0.033</td>
<td>-0.026</td>
<td>-0.007</td>
<td>0.020</td>
<td>0.017</td>
<td>-0.012</td>
<td>0.219</td>
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<tr>
<td>13 CEOFAM</td>
<td>-0.21</td>
<td>-0.53</td>
<td>0.245</td>
<td>0.086</td>
<td>0.038</td>
<td>0.110</td>
<td>-0.003</td>
<td>0.027</td>
<td>0.104</td>
<td>-0.043</td>
<td>-0.066</td>
<td>-0.076</td>
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<tr>
<td>14 CEOCHG</td>
<td>-0.058</td>
<td>-0.028</td>
<td>0.108</td>
<td>-0.036</td>
<td>-0.005</td>
<td>-0.038</td>
<td>-0.003</td>
<td>-0.002</td>
<td>-0.047</td>
<td>0.004</td>
<td>0.006</td>
<td>-0.015</td>
<td>-0.032</td>
<td>1</td>
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<tr>
<td>15 INDPAC</td>
<td>0.162</td>
<td>-0.014</td>
<td>-0.112</td>
<td>0.013</td>
<td>-0.017</td>
<td>0.009</td>
<td>0.022</td>
<td>-0.029</td>
<td>0.039</td>
<td>-0.085</td>
<td>-0.035</td>
<td>0.025</td>
<td>0.011</td>
<td>0.041</td>
<td>0.373</td>
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<tr>
<td>16 BIG N</td>
<td>0.044</td>
<td>0.019</td>
<td>0.047</td>
<td>0.171</td>
<td>-0.020</td>
<td>0.128</td>
<td>-0.019</td>
<td>0.017</td>
<td>0.233</td>
<td>0.065</td>
<td>0.034</td>
<td>-0.017</td>
<td>-0.010</td>
<td>-0.070</td>
<td>-0.009</td>
<td>0.016</td>
<td>1</td>
</tr>
</tbody>
</table>

Note: IMP is an indicator variable equal to one if impairment loss is recorded, otherwise zero; CEO - a dummy variable of one if the CEO is also the chairman of the firm in a non-family controlled firm, otherwise zero; FAM - a dichotomous variable equal to one if the firm is a family-controlled firm and not having CEO duality, and zero if otherwise; CEOFAM - A dichotomous variable if the CEO is also the chairman of the firm and is a family controlled firm, otherwise zero; FOREIGN-percentage of foreign shareholdings, LEV- prior year total liability to prior year total assets ratio; ROA- return on assets measured as earnings before tax over beginning total assets, ROACHG- changes in return on assets; ADOPT-dummy variable of one if the firm is in the year of transition; FIRMSIZE-natural logarithm of total assets; AMORTt-1, AMORTt-1 and AMORTt-3 – Amortisation of goodwill over total assets; CEOCHG – dichotomous variable of 1 if there is a change in CEO, zero if otherwise. CEOTEN-Number of years of service by CEO; INDPAC- proportion of independent directors on the audit committee; INDPBOD-proportion of independent directors on the board of directors; BIG N dichotomous variable equal to one if the firm is audited by a Big N audit firm, zero if otherwise. ***, **, * represent 1%, 5% and 10% significance levels, respectively.
independent variables are highly correlated as there is no correlation that is higher than 0.80 (Tabachnick & Fidell, 2007). Therefore, it is believed that multicollinearity is not a concern. The table also shows that CEO duality is more in family controlled than non-family controlled firms (0.87, p<0.05). The practice of CEO duality is also negatively associated with firm size, implying more prominent CEO duality in small firms compared to large firms. Duality also promotes higher leverage, while influencing the change in performance (ROA) negatively. In general, CEO duality is associated with unfavourable firm characteristics.

5.3 Regression

Due to the nature of the sample selection process, where only firms with positive beginning goodwill are included, each firm-year observation is treated as an independent observation. The advantage of using a period of three years in this study is the ability to obtain a larger sample size, which is important for logistic regression (Verbeek, 2004). Prior research has found that the presence of all (100 per cent) independent members on the Audit Committee (Mohd-Saleh, Mohd Iskandar, & Rahmat, 2007) and more than 50 per cent board independence (Johari, Mohd-Saleh, & Jaffar, 2008) are effective factors to significantly reduce earnings management. As such, we include other important corporate governance variables, such as the ratio of independent Audit Committee members, the ratio of independent Board of Director members and audit quality (proxied by Big N audit firms) because there is a concern about the omitted variables problem in our original regression. The mean ratio of independent Audit Committee members is 81 per cent, while the mean ratio of independent directors is 43 per cent. Table 4 below provides the information on logistic regression based on the family-controlled firms as an independent variable and CEO duality and family-controlled as a combined variable. The industry effect is not shown in the table.

In Table 4, Model 1, based on Logistic regression, it appears that there is a positively significant association between family-controlled firm and goodwill impairment recognition. Thus, hypothesis 1 is accepted. The existence of CEO duality alone does not significantly associate with goodwill impairment recognition. However, the interaction effect between CEO duality and family-controlled firm shows a significantly positive association with goodwill impairment recognition. Table 4, Model 2 shows the results using Ordinary Least Square where the dependent variable is the magnitude of goodwill impairment recorded over company’s total asset. The result shows
Table 4: Regression Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Logistic</th>
<th>OLS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dependent variables</strong></td>
<td>IMP</td>
<td>IMPTA</td>
</tr>
<tr>
<td><strong>Independent variable</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(FAM) (+)</td>
<td>0.413**</td>
<td>0.057**</td>
</tr>
<tr>
<td>(CEO) (+)</td>
<td>-0.474</td>
<td>-0.034</td>
</tr>
<tr>
<td>(CEOFAM) (+)</td>
<td>0.704***</td>
<td>0.111***</td>
</tr>
<tr>
<td><strong>Control variables</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(FOREIGN) (-)</td>
<td>-0.912*</td>
<td>-0.094</td>
</tr>
<tr>
<td>(LEV) (-)</td>
<td>-0.732**</td>
<td>-0.108**</td>
</tr>
<tr>
<td>(ROA) (-)</td>
<td>-3.186***</td>
<td>-0.495****</td>
</tr>
<tr>
<td>(ROACHG) (-)</td>
<td>-0.018***</td>
<td>-0.284***</td>
</tr>
<tr>
<td>(ADOPT) (+)</td>
<td>-0.359***</td>
<td>0.095***</td>
</tr>
<tr>
<td>(FIRMSIZE) (+)</td>
<td>0.676***</td>
<td>0.097***</td>
</tr>
<tr>
<td>(AMORT_{t-1})</td>
<td>0.271</td>
<td>0.041</td>
</tr>
<tr>
<td>(AMORT_{t-2})</td>
<td>-0.307</td>
<td>-0.021</td>
</tr>
<tr>
<td>(AMORT_{t-3})</td>
<td>0.611</td>
<td>0.101***</td>
</tr>
<tr>
<td>(CEOCHG)</td>
<td>0.010</td>
<td>0.001</td>
</tr>
<tr>
<td>(CEOTEN)</td>
<td>-0.061</td>
<td>-0.009</td>
</tr>
<tr>
<td>(INDPBOD)</td>
<td>-0.007</td>
<td>-0.001</td>
</tr>
<tr>
<td>(INDPAC)</td>
<td>0.002</td>
<td>0.000</td>
</tr>
<tr>
<td>(BIG , N)</td>
<td>-0.085</td>
<td>-0.016</td>
</tr>
<tr>
<td>(Constant)</td>
<td>-4.103***</td>
<td>-0.344***</td>
</tr>
<tr>
<td>(R , Square^a)</td>
<td>9.9%</td>
<td>5.6%</td>
</tr>
<tr>
<td>% Correct</td>
<td>78.8%</td>
<td></td>
</tr>
<tr>
<td>Total observations</td>
<td>948</td>
<td>948</td>
</tr>
<tr>
<td>Significance Statistic^b</td>
<td>7.239</td>
<td>3.125</td>
</tr>
<tr>
<td></td>
<td>(0.511)</td>
<td>(0.000)</td>
</tr>
</tbody>
</table>

Note: ***, **,* represent 1%, 5% and 10% significance levels respectively, one tailed if directional prediction is made, two tailed if otherwise. Z-statistics are based on robust Huber-White (robust) standard errors.

\(IMP\) is an indicator variable equal to one if impairment loss is recorded and zero if otherwise; \(IMPTA\) is an indicator of the magnitude of goodwill impairment recorded as a per centage of total asset. \(CEO\) - a dummy variable of one if the CEO is also the chairman of the firm, otherwise zero; \(FAM\) - a dichotomous variable equal to one if the firm is a family-controlled firm and not having CEO duality, and zero if otherwise; \(CEOFAM\) - A dichotomous variable if the CEO is also the chairman of the firm and is a family controlled firm, otherwise zero.

\(FOREIGN\) - percentage of foreign shareholdings; \(LEV\) - prior year total liability to prior year total assets ratio; \(ROA\) - return on assets measured as earnings before tax over beginning total assets. \(ROACHG\) - changes in return on assets; \(ADOPT\) - dummy variable of one if the firm is in the year of transition; \(FIRMSIZE\) - natural logarithm of total assets; \(AMORT_{t-1}, AMORT_{t-1}\) and \(AMORT_{t-3}\) - Amortisation of goodwill over total assets; \(CEOCHG\) -dichotomous variable of 1 if there is a change in CEO, zero if otherwise. \(CEOTEN\) - Number of years of service by CEO; \(INDPAC\) - proportion of independent directors on the audit committee; \(INDPBOD\) - proportion of independent directors on the board of directors; \(BIG \, N\) - dichotomous variable equal to one if the firm is audited by a Big N audit firm, zero if otherwise. \(^a\)Nagelkerke R Square for logistic regression. \(^b\)H-L statistics in logistic and F-statistics for OLS regressions.
that the combined effect of CEO duality and family control does have a significant effect on the magnitude of recorded goodwill impairment, and that it is stronger than the family control effect alone. This result suggests that if there is a practice of CEO duality in family-controlled firms, the firms have additional incentives to recognize goodwill impairment loss. This association gives an indication that considering the effect of CEO duality, family-controlled firms do have a higher tendency to record goodwill impairment. Thus, the argument adapted from agency theory on the dominance of CEO who is also a Chairman of the board in family controlled firms is supported. The perspective taken by this study that managers use accounting numbers (in this case impairment of goodwill) to influence contractual outcomes is generally proven.

In terms of the goodness of fit, the H-L test shows an insignificant p-value of the chi-square. Hosmer and Lemeshow (1989, p.141) report evidence from extensive simulation indicating that when the model is correctly specified, the distribution of the statistic is well approximated by a chi square $\chi^2$ distribution. The p-value for the HL test statistic is large. The insignificant p-value of the chi-square indicates that the goodness of fit for both models in Table 4 is sufficient.

Out of seven control variables used in the study, the variables LEV, ROA, ROACHG, ADOPT and FIRMSIZE are highly significant in both Model 1 and Model 2. The variables ROA and ROACHG are negatively associated with variable IMP, which shows consistency with prior research by Jordan and Clark (2007) in which firms with a very low (high) return on assets are more (less) likely to impair goodwill. This is because firms with lower ROA have a greater tendency to discontinue their unprofitable segment of operation and/or to reduce the book value of goodwill accordingly to match the recoverable amount of the assets. For firms with a very low (high) change of ROA, they are more likely to recognize goodwill impairment. The same reason as above applies for firms with a larger negative value of change of ROA; they are more likely to impair goodwill as they have a higher tendency to satisfy the first test\(^8\) in the impairment testing requirement. In the logistic regression, the variable ADOPT is negatively significant, which does not support prior studies, such as by Henning et al. (2004), and Benz and Heltzer (2005), who find that firms are less likely to impair

\(^8\) The first test requires a testing of whether the recoverable amount of cash generating units is lower than the book value of the CGU. If it is lower, then there is an indication that goodwill should be impaired.
goodwill in the first year of adoption. However, when the value of impairment is taken into account in the OLS regression, the result shows that a higher amount of impairment of goodwill is recorded in the first year of adoption. It also appears that FOREIGN is only significant in the logistic model, indicating that foreign ownership is related to the decision whether or not goodwill impairment will be recorded. The results also suggest that the lagged 3-year goodwill amortisation affects the impairment value negatively. However, it is not related to the goodwill impairment decision in the logistic regression. Given the inconsistencies in the findings (anomaly) for foreign ownership and lagged 3 years impairment charge on goodwill impairment, further investigation into the issue is encouraged.

For sensitivity analysis, we repeat the above regression to look at the possibility whether the magnitude of impairment within a sample of firms with impairment losses can be explained by our variables. To do this, we eliminate observations with no impairment recorded and end up with 201 observations. The results do not require us to change our conclusion.

6. Conclusion

Studies of CEO duality have been largely inconclusive. Although non-duality of CEO is recommended for a better governance structure and proper monitoring, the practice of CEO duality is still common among family-controlled firms (Chen et al., 2005). Some of the proponents of CEO duality argue that the practice has a positively significant association with performance for non-family-controlled firms (Lam & Lee, 2008). In addition, from the perspective of minority shareholders, the more powerful the dominating family members on the Board, the more risk of expropriation by the majority shareholders (Shleifer & Vishny 1997). Therefore, using the context of goodwill impairment as a tool to manage earnings, an issue that is engulfed in much controversy, this paper investigates whether the existence of CEO duality in family controlled firms affects goodwill impairment recognition. Based on the theory of agency cost, it is believed that family firms with duality of CEO are more likely to record goodwill impairment due to the significant control over the management.

The results in this paper highlight the potential effect of CEO duality in family-controlled firms that could result in the recognition of goodwill impairment. Both hypotheses – that family-controlled firms alone, and as a combined variable with CEO duality affect goodwill
impairment choices – are supported. Thus, our findings could enrich the view from the agency theory perspective that CEO duality is associated with the practice that tends to expropriate the minority shareholders, particularly in family controlled firms that later results in poor performance, and, finally, is reflected through the impairment of goodwill. Our findings using Malaysian data are also consistent with Lam and Lee (2008) who find that the potential cost of CEO duality, such as agency cost, managerial entrenchment and expropriation, would outweigh the potential benefits. The effect is aggravated when the existence of CEO duality is in family firms.

This study makes a significant contribution to knowledge by looking at the interplay between family control and the effects of CEO duality on goodwill impairment decisions. Despite strong corporate governance in Malaysia, the high level of ownership concentration and family control coupled with the dominance of CEOs who also serve as Chairman of the Board may provide greater incentive for the management of firms to manage earnings. Malaysia provides a good setting to investigate this issue since the corporate governance scenario is similar to some other Asian countries. Such an investigation could shed some light on the issue for which the literature is still lacking.

The implications of this study suggest that the practice of CEO duality in family firms would result in a higher likelihood of goodwill impairment recognition, which is related to earnings management activities. This paper supports the argument of other empirical papers that CEO duality in family firms is related to poorer performance indicated by goodwill impairment. Therefore, the importance for family firms to follow the recommendation of the Code on Corporate Governance to separate the roles of CEO and the chairman should be followed since there is strong evidence that duality of CEO resulted in higher likelihood of goodwill impairment, at least from the perspective of this study.

This study cannot be generalised to be used in other countries with a different environment. It also does not take into account some specific effects of the Malaysian environment, such as ethnicity and political connection variables on the intention to impair goodwill. Such an investigation requires a different theoretical framework and research approach. The results of this study can be further improved by considering the acquisition characteristics that are made by the CEO with dual roles as the goodwill value resulting from this process determines
the subsequent impairment to be recorded. Specific investigation on the
effect of goodwill amortisations prior to the impairment period charge
may also be interesting to explain the anomaly found in this study. The
effect of the types of CEO category, as suggested by Anderson and Reeb
(2003), can be investigated. Future research may also study the impact
on the capital market in the event of an announcement of acquisition of
target firms, which raises the need to recognise goodwill as part of the
business combination for firms with CEO duality. Last, but not least,
this paper provides new insights into the body of literature concerning
corporate governance and family controlled firms.

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