# AUDIT COMMITTEE INDEPENDENCE, FINANCIAL EXPERTISE AND FINANCIAL RESTATEMENTS: EMPIRICAL EVIDENCE IN MALAYSIA

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# ABSTRACT

This study examines the effect of audit committee characteristics namely audit committee independence, accounting background of the chairman of audit committee and financial expertise of audit committee members on the financial restatements of the public listed companies in Malaysia. Many studies that investigated the relationship between audit committee characteristics and financial restatements were done in foreign countries. Therefore, this study contributes to the literature in this field of study in Malaysia. The theoretical foundation of this relationship was supported by agency theory. The main source of information for this study was obtained from the annual reports for the fiscal year 2014. By using the logistic regression analysis, the results show that there is negative relationship between the audit committee independence and financial restatements. However, with regards the results for the accounting background of the chairman of audit committee and the financial expertise of audit committee members show that the relationship are not statistically significant. In order to get better understanding of the relationship between audit committee characteristics and financial restatements, this study also has discussed the implications and suggestions for future research.



**Keywords**: corporate governance, financial restatements, audit committee independence, accounting background of the chairman of audit committee, and financial expertise of audit committee members.

## ABSTRAK

Kajian ini mengkaji kesan ciri-ciri jawatankuasa audit iaitu kebebasan jawatankuasa audit, latar belakang perakaunan pengerusi jawatankuasa audit dan kepakaran kewangan dalam kalangan ahli-ahli jawatankuasa audit, terhadap pernyataan semula kewangan syarikat-syarikat senaraian awam di Malaysia. Banyak kajian yang dijalankan di luar Negara telah mengkaji hubungan antara ciri-ciri jawatankuasa audit dan penyataan semula kewangan. Oleh itu, kajian ini memberi sumbangan kepada kesusasteraan dalam bidang pengajian ini di Malaysia. Asas teori hubungan ini disokong oleh teori agensi. Sumber utama maklumat untuk kajian ini diperoleh daripada laporan tahunan bagi tahun fiscal 2014. Dengan menggunakan analisis regresi logistik, keputusan menunjukkan bahawa terdapat hubungan negatif antara kebebasan jawatankuasa audit dan penyataan semula kewangan. Namun, untuk dapatan latar belakang perakaunan bagi pengerusi jawatankuasa audit dan kepakaran kewangan ahli jawatankuasa audit menunjukkan bahawa tiada hubungan yang signifikan secara statistik. Dalam usaha untuk mendapatkan pemahaman yang lebih baik mengenai hubungan antara ciri-ciri jawatankuasa audit dan penyataan semula kewangan, kajian ini juga membincangkan implikasi dan cadangan untuk kajian pada masa hadapan.



**Kata kunci**: tadbir urus korporat, penyata semula kewangan, kebebasan jawatankuasa audit, latar belakang pengerusi jawatankuasa audit dan kepakaran kewangan ahli jawatankuasa audit.

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| | |
|---|---|
| AC | Audit Committee |
| CCM | Companies Commission Malaysia |
| CSRC | China Securities Supervisory Commission |
| FPLC | Federation of Public Listed Companies |
| HLFC | Level Finance Committee on Corporate Governance |
| IFRS | International Financial Reporting Standards |
| JSX | Jakarta Stock Exchange |
| MAICSA | Malaysian Association of The Institute of Chartered Secretaries and Administrators |
| MCCG | Malaysia Code on Corporate Governance |
| MIA | Malaysian Institute of Accountants |
| MICG | Malaysian Institute of Corporate Governance |
| MICPA | Malaysian Institute of Certified Public Accountants |
| MID | Malaysian Institute of Directors |
| MSWG | Minority Shareholder Watch-dog Group |
| SCM | Securities Commission of Malaysia |
| SEC | Securities Exchange Commission |

# CHAPTER 1

# INTRODUCTION

## 1.1 Research Interest

Financial restatements issue has received considerable attention from the regulators in Malaysia. In 2007, cases involving The Maxbiz Corp Bhd., Transmile Bhd., and Megan Media Holdings Bhd. signaled accounting irregularities cases in Malaysia. As the financial restatements issue affects the investors' confidence in Malaysia companies, therefore it should be addressed. According to Abbott, Parker & Peters, (2010), audit committee is seen as an independent body to an organization that provides the assurance that the company is practicing good governance to the external parties. The audit committee liaises much with the external and internal auditors Abbott et. al. (2010), as these two parties are the frontlines to ensure that good governance practices are in place, thus the likelihood of errors in the financial statement is reduced.



The audit committee establishment is to protect the interests of the stakeholders, especially the minority shareholders in addition to monitor and to fulfill the governance structure of a public company. Raghunandan & Rama (2003) found that the tasks and roles of the audit committee members are increasingly important, over the years. Companies nowadays operate under greater risk environment and are subjected to higher level of public scrutiny. With the increase in public's awareness on financial restatement issues, audit committee members have to be diligent in discharging their duties.

It is mandatory to have an audit committee for public listed companies in many jurisdictions around the world. In Asia, for instance, the Jakarta Stock Exchange (JSX) mandates that an independent director must chaired the audit committee and comprises of not less than three members with the majority of whom are independent directors (Siagian & Tresnaningsih, 2011). In China, the China Securities Supervisory Commission (CSRC) issued the Standards of Corporate Governance for Listed Companies in 2002 which requires public listed companies to have an audit committee (Luan, & Tang, 2007).

In Australia, mandatory audit committees for publicly listed firms were introduced in 2003 (Siagian & Tresnaningsih, 2011). In the United States, the Securities Exchange had imposed stricter mandatory requirements on audit committees in the post Sarbanes-Oxley Act era of 2002 (Zaman, Hudaib, & Haniffa, 2011).



The committee serves as a mechanism under the good corporate governance practice. In Malaysia, all public listed companies on the Bursa Malaysia are required to have an audit committee with a minimum of three members, with a majority of independent directors. This means they must not be involved in the decision making and the day-to-day operations of the company.

Their duties, as listed under the Malaysia Code on Corporate Governance (MCCG) 2012 include, but are not limited to:

- Appointment, resignation or dismissal of external auditor and audit fees
- Discuss the scope of audit with the external auditors prior to the commencement of audit
- Review quarterly and year end financial statements
- Discuss, with the external auditors, matters arising from interim and final audit
- Review external auditor’s management letter and management’s response
- Work closely with the internal audit function
- Consider major findings on investigations and management’s response

Looking at the duties of the audit committee, a certain degree of good governance can be asserted if all duties of audit committee are discharged to the fullest. When there is good governance, the occurrence of financial restatements should be minimized. Financial restatements refer to the use of judgment by the managers of the companies to conceal or alter transactions in order to mislead the shareholders or stakeholders on the underlying performance of the company (Healy & Wahlen, 1999).

Despite all responsibilities and duties of audit committee have been laid out, the fraudulent financial reporting still occur. Therefore, the purpose of this study is to examine which of the audit committee characteristics that have significant relationship to the occurrence of financial restatements.

## 1.2 Background of the Study

Over time, the audit committees and audit profession had received continuous attention due to the happenings of financial collapses of large multinationals and numerous cases of financial restatements or creative accounting, which went undetected despite audits. The most notorious case involving financial restatements was the collapse of Enron, which was founded by Kenneth Lay. According to Solomon (2007), from the merger of two American gas pipeline companies, Enron was created in 1985. In 1997 the company sales constituted close to a fifth of the North American wholesale market with $4 billion of sales.

However, several years before 2001, the company faced signs of distress and in late autumn that year, the company was suffering serious financial problem with a possible takeover. The fall was largely due to the audit and accounting function in Enron which were fraudulent and opaque. The auditors were guilty of acting slowly and inadequately, as special-purpose vehicle created to offload liabilities from Enron's balance sheet went undetected. Furthermore, even after investigation was launched by the Securities Exchange Commission (SEC), David Duncan, who is the audit partner in-charge of Enron, was found to have ordered discarding of certain papers of documents (Solomon, 2007).

Another case that can be observed is that of Maxwell. Its scandal was said to be the greatest fraud of the 20th century (Stiles & Taylor, 1993). Robert Maxwell, the founder, was discovered misappropriating funds out of his two public listed companies to finance his own activities but the auditors failed to notice the movement of funds. An estimated £1 billion was lost in terms of shareholders' value when the public companies owned by Maxwell crashed.

Meanwhile, it is also interesting to note that despite the corporate governance reforms in recent years in Malaysia, corporate scandals continue to surface. One notable case of governance failure is that of Transmile Group Berhad. In 2007, four former directors of the company (2 of them being the audit committee members of the company at the time when the offence was committed) were charged with furnishing misleading quarterly financial results for the year ending 31 December 2006 to Bursa Malaysia.



In early 2007, a director of Megan Media Holdings Berhad was charged with submitting a false financial statement to Bursa Malaysia which consisted of inflated revenues in its quarterly financial statements in year 2006 and 2007. Apart from that, in 2007, two directors of Suremax Group Berhad were sentenced to jail for share manipulation.

## 1.3 Problem Statement

In the Malaysian context, it is still unclear which of the characteristics of audit committee leads to occurrence of financial restatements. One of the mechanisms that give rise to accounting scandals is the occurrence of financial restatements. Since the current and projected value of a company can be linked to the reported earning figure, managers of companies are increasingly pressured to engage in financial restatements (Healy & Wahlen, 1999). According to Healy & Wahlen (1999), financial restatements happen when managers mislead stakeholders regarding the underlying performance of the company by using their judgements in financial reporting.

Therefore, through out this study, financial restatements is defined as when frauds are involved in the occurrence of managers using judgment in financial reporting to modify or alter financial reports to mislead shareholders or stakeholders about the underlying economic performance of the company (Healy &Wahlen, 1999).

Financial restatements poses severe threat to a company as upon discovery of such practice, investors' confidence in the financial reporting of the company can be eroded and it impedes the efficient flow of capital in the financial market (Jackson and Pitman, 2001). Financial restatements lower the investors' confidence in the financial reporting of the company as the actual value of the company is not reflected.

However, the occurrence of financial restatements should be reduced if there is an effective and functioning audit committee (Jackson & Pitman, 2001). As the audit committee serves as a governing mechanism to protect the interest of the shareholders, any irregularities in the company's reporting process should be identified and addressed. Therefore, in order to overcome this issue, one of the task entrusted to independent directors are to represent such shareholders in protection of their interest and value.

Besides, regarding the chairman of audit committee, the draft of Malaysian Code on Corporate Governance (2016) specifies that a person with accounting expertise or relevant work experience should be in this position. It is important for the chairman to be able to lead discussions and deliberations and ultimately be satisfied that the end result fairly reflects the understanding of the audit committee. Thus, audit committee chairman with accounting background should be appointed in order to make the company more transparent as they have the expertise, knowledge and relevant skills.



In addition to that, the main objective of mandatorily requiring a member with accounting expertise to be appointed to the audit committee is to make sure that the committee can rely on this said director for experts advised relating to financial and accounting matters. Therefore, when the audit committees are staffed with more members with finance or accounting expertise theoretically it should be able to prevent financial restatements. Therefore, the purpose of this study is to examine the relationship between audit committee independence, accounting background of the chairman of audit committee, financial expertise of audit committee members and financial restatements.

## 1.4 Research Questions

The research questions for this study are as the following:

1. Is there a relationship between audit committee independence and financial restatements?
2. Is there a relationship between the accounting background of the chairman of the audit committee and financial restatements?
3. Is there a relationship between financial expertise of audit committee members and financial restatements?

## 1.5 Research Objectives

The objectives of this study are as the following;

To investigate

1. The relationship between audit committee independence and financial restatements.
2. The relationship between the accounting background of the chairman of the audit committee and financial restatements.
3. The relationship between financial expertise of audit committee members and financial restatements.

## 1.6 Significance of the Study

By selecting Malaysian companies for analysis, this study contributes to the literature of relationship between audit committee characteristics and financial restatements. Most previous studies focus on the effects of the proportion of outside directors and the existence of audit committee on the level of financial restatements. This study extends the current literature on audit committee independence and financial restatements in Malaysia.

To my knowledge, based on published articles, regarding the relationship of the accounting background of the chairman of audit committee and financial restatements, this study can be considered as the first study to examine it. A person with accounting expertise or relevant work experience should be appointed as the chairman of audit committee as specifies by the draft of Malaysian Code on Corporate Governance (2016) that has just been released. Therefore, it is expected that the findings of this study can contribute in making recommendations for corporate governance practice by providing more valuable information to Malaysian accounting regulators.



The finding of this study also contributes to the literature of the relationship between the financial expertise of audit committee members and financial restatements in Malaysia. Thus, this study contributes to the evidence whether the differences in accounting environment in other countries may results in the significant different in the relationship between the audit committee characteristics investigated and financial restatements.

## 1.7 Scope and Limitation of the study

This study examines the relationship between audit committee characteristics namely audit committee independence, accounting background of the chairman of audit committee, financial expertise of audit committee members and financial restatements. Thus, the dependent variable of this study, is financial restatements and the independent variables are audit committee independence, accounting background of the chairman of audit committee, and financial expertise of audit committee members.

This study utilizes the annual reports of the public listed Malaysian companies in Bursa Malaysia for the year 2014, thus this may imposed some limitation to the methodology employed. The cross-sectional data is selected based on year 2014 as this is the latest information available.

# CHAPTER 2

# LITERATURE REVIEW

## 2.1 Review of Related Literature

The past and present literature relating to the topic of this study is presented in this chapter, which is to investigate the relationship audit committee independence, accounting background of the chairman of audit committee and financial expertise of the audit committee members, and financial restatements.

Therefore, these audit committee characteristics namely audit committee independence, accounting background of the chairman of audit committee and financial expertise of the audit committee members are use to determine if they can influence the occurrence of financial restatements, which is the occurrence of managers using judgment in financial reporting to modify or alter financial reports to mislead shareholders or stakeholders about the underlying economic performance of the company (Healy & Wahlen, 1999).

## 2.2 Financial restatements

According to Jensen & Meckling (1976), the likeliness of managers that tend to be engaged in activities that benefit themselves as the result from the separation between ownership and controls is suggested by agency theory. The maximum value of the companies is not achievable arising from the conflict between the interest of the owners and the management. The difference between the maximum value of the company which ought to be achieved as against the value created as a result of agency relationship gives rise to agency cost (Palliam & Shalhoub, 2003).

In order to fulfill the management's own interest, financial restatements or manipulation may surface. Financial restatements was defined by Healy & Wahlen (1999) as the occurrence of managers using judgement in financial reporting and in structuring transactions to alter financial reports to mislead stakeholders about the underlying economic performance of the company. Financial restatements can be detrimental to company's value (Jiraporn, Kim, & Davidson, 2008) as a result of its implications towards the quality of financial reporting.

Prior studies have provided evidence of numerous motivations that drives managers towards financial restatements, for instance the quality of accounting figures (Davidson, Jiraporn, Kim, & Nemac, 2004), distribution of company's ownership (Hsu & Koh, 2005), CEO duality in which two leadership positions are held (Davidson et al., 2004), adoption of International Financial Reporting Standards (IFRS) (Tendeloo &

Vanstraelen, 2005), tax incentives (Dhaliwal, Gleason, & Mills, 2004) and the hiring of senior executives from the company's external accounting companies (Geiger, North, & O'Connell, 2005). These studies have pointed out that financial restatements practices are hiding the truth of the company's actual value and eventually shareholders' or stakeholders 'interest will deteriorate.

The practice of financial restatements poses severe threats to a company as upon discovery of such practices, investor's confidence in the financial reporting function of the company can erode and it impedes the efficient flow of capital in the financial market (Jackson & Pitman, 2001). The reliability of the reported earnings is tarnished as the figures do not reflect the actual performance of the company. In the past, several high profile audit failures have prompted international investigations into the issue of financial restatements (Arya, Glover, & Sunder, 2003; Imhoff, 2003). Focus has been placed especially relating to the impact of audit quality on constraining the magnitude of financial restatements (Becker, DeFond, Jiambalvo & Subramanyam, 1998).

In addition to that, according to Paterson & Valencia (2011), users of financial statements and the capital markets rely on the auditor's expertise and independence to ensure that the quality and integrity of financial reporting is maintained. Therefore financial restatements indicate audit failures (Paterson & Valencia, 2011).

## 2.3 Corporate Governance in Malaysia

In the case of Malaysia, most companies are owned and controlled by founding families (Solomon, 2007). Corporate governance issues have been cited as the cause in which Malaysia succumbed to the financial crisis of 1997 (Abdullah & Mohd Nasir, 2004). This has inspired corporate governance reform among East Asia countries.

In 1998, in anticipation of the implementation of a Code on Corporate Governance in Malaysia, the Malaysian Institute of Corporate Governance (MICG) was incorporated under the Companies Act 1965. The founding members of the MICG were the Federation of Public Listed Companies (FPLC), Malaysian Institute of Directors (MID), Malaysian Institute of Accountants (MIA), Malaysian Association of The Institute of Chartered Secretaries and Administrators (MAICSA) and Malaysian Institute of Certified Public Accountants (MICPA). The MICG serves to be a better governance tool to improve the corporate governance scene in Malaysia (Liew, 2007). The main objective of the MICG was to promote awareness of corporate governance among corporations and the investing public.

At the same time, the Malaysian government also set up the High Level Finance Committee (HLFC) to set out the framework and best practices for corporate governance in Malaysia. The main objective of the committee was to promote high standards of earnings quality in order to strengthen investor protection and enhance the standing of Malaysian companies.

Such development in the corporate governance to ensure the earnings quality has attracted research interest from Kean & Cheah (2000), who came out with the potential impact of first code of practice for Malaysian corporate governance. The mandatory nature of the code is the most significant characteristic. Currently, in Malaysia the corporate governance practice is much governed by the Malaysian Code on Corporate Governance (2012).

However, as this study focuses on sample collected under year 2014, the Malaysian Code on Corporate Governance (2012) is adopted as this is the code under which companies adhered to in year 2014. After all, the changes in MCCG 2012, as compared to MCCG 2007, do not affect the variables or areas investigated under this study.

It is interesting to note that despite the corporate governance reforms in recent years in Malaysia, corporate scandals continue to surface. One notable case of governance failure is that of Transmile Group Berhad. In 2011, four former directors of the company (2 of them being the audit committee members of the company at the time when the offence was committed) were charged with furnishing misleading quarterly financial results for the year ending 31 December 2006 to Bursa Malaysia.



In early 2011, a director of Megan Media Holdings Berhad was charged with submitting a false financial statement to Bursa Malaysia which consisted of inflated revenues in its quarterly financial statements in year 2006 and 2007. Apart from that, in 2011, two directors of Suremax Group Berhad were sentenced to jail for share manipulation.

In 2010, two former directors of MEMS Technology Berhad were convicted of furnishing misleading financial statements for the 12 month period ended 31 July 2007 to Bursa Malaysia. The misleading financial statements include fictitious sales amounting to 41% of the company's total revenue. In that same year of 2010, a former director of LFE Corporation Berhad was charged with defrauding the company to finance his purchase of the company's shares. All these corporate scandals surface year after year despite the presence of governance tools and mechanisms.

Several Malaysian researchers on corporate governance have placed the fault on poor governance practice. Maijoor (2000) stated that poor governance practice is one of the major reasons leading to the collapse of Malaysian companies. He also mentioned that the cost of poor corporate governance is borne heavily by minority shareholders, which is the case in emerging markets such as Malaysia. In fact, the opinion of Liew (2007) was that in emerging markets, majority shareholders do not feel obliged to provide returns to shareholders.

Thus, Muniandy & Ali (2012) stated that four regulators in Malaysia have the duty to review audited reports. They are Companies Commission Malaysia (CCM), Bursa Malaysia, Securities Commission of Malaysia (SCM) and Malaysian Institute of Accountants (MIA). This is to ensure the financial reporting quality is maintained in order to protect the shareholders interest and value.

## 2.4 Audit Committee and Corporate Governance

To protect shareholders' interest and for good corporate governance practice, the Cadbury Report (1992) recommended that all companies should establish an audit committee. Despite the wide adoption of audit committee concept, corporate failures as a result of corporate governance issue continue to occur. To improve audit committee system, Smith Report (2003) emphasized on the independency and objectivity of external auditor, to monitor the company's organization as the critical role of audit committee.

The report specified that the main role of audit committee is to monitor the integrity of the company's financial statements, review company's internal control system, monitor the effectiveness of the company's internal audit function, make recommendations to the board as to the appointment or removal of external auditors and their remuneration, monitor independence of external auditor, among others (Smith, 2003). The Smith Report also highlighted the need for audit committee to be proactive and raise relevant issues of concern with board of directors. It also states that all members of the audit committee should be independent, non-executive directors.

Baber, Liang & Zhu (2012) also suggest that the role of audit committee is crucial in demanding better monitoring from external audit and this is to ensure good and sound financial reporting. Thus, the level of audit committee independence in constructing their measure of internal governance is significant in reducing the occurrence of financial restatements, (Baber et. al 2012).

## 2.5 Development of Audit Committee in Malaysia

All companies listed on Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange) need to form audit committees as mandated by The Malaysian Securities Commission. In 1993, grace period of one year (1994) was given to companies to implement this requirement. A survey done by Kuppusamy, Nazim, & Shanmugam (2003) showed that by 1998, all companies have complied with the requirement.

In the aftermath of the 1998 financial crisis in Malaysia, the Malaysian Institute of Corporate Governance (MICG) was establish to pioneer corporate governance awareness in the country. The MICG developed the Malaysian Code on Corporate Governance in year 2000 and by year 2001, the Code was made mandatory for all public companies. The mandatory nature was to create an environment that demands higher standards of conduct and disclosures. One provision under the code was the mandatory establishment of the audit committee. As such, the development of audit committee in Malaysia seems to replicate that in the United Kingdom and other developed countries.

## 2.6 Financial restatements and Audit Committee

Investors and creditors must have faith in a company before entrusting their assets to the company. One way to ensure such faith is to consistently report earnings which are reliable and faithfully represented. Good governance should ideally lead to good earnings quality. When a company practices good financial reporting quality, there will be better clarity and consistency in disclosures and therefore reducing the chances of manipulation and fraud (Thiravudi & Huang, 2011).

In this respect, an audit committee serves as a tool to achieve good governance. Audit committee, which is an external governance mechanism, can serve as a function to prevent or reduce aggressive financial restatements (Thiravudi & Huang, 2011). The formation of an audit committee is a governance mechanism to effectively reduce the conflicts arising from the separation of ownership and control (Abbott & Parker, 2000). Klein (2002) stated that the audit committee is a vital institution that complements the board of directors in the function of overseeing transparency and integrity of company's financial reporting process.

Wild (1996) stated that the main objective for the establishment of the audit committee is to enhance earnings and financial reporting quality. Kanagaretnam, Lobo, & Whalen (2007) found that the quality of corporate governance is negatively related to information asymmetry around financial restatements.

Wild (1996) stated that an effective audit committee needs to have members who are well-informed, and which a majority of them must be independent directors. They must also have the required authority and access to resources to protect the interest of shareholders by ensuring reliable financial reporting practices, good internal accounting controls and proper risk management practices.

Based on past literatures in the area of audit committees, the effectiveness of an audit committee is measured using three broad areas. First is the ability of the committee to continuously maintain the independence of external auditors (Abbott, et al, 2010). The second proxy assesses the committee's effectiveness by determining its ability to promote shareholders' interest by purchasing audit services of higher quality (Carcello, Hermanson, Neal, & Riley, 2002). Thirdly, the effectiveness of the committee is measured by its ability to maintain the integrity of the financial statements which is proxied by the extent of restatements (Aier, Comprix, Gunlock & Lee, 2005), fraud disclosures (Farber, 2005) and abnormal accruals (Klien, 2002).

In Malaysia, the Putrajaya Governance Committee 2006 places great emphasis on the function of audit committee in improving the financial reporting process. It particularly states that the effectiveness of an audit committee can be improved via certain mechanisms, including their independence, financial literacy and expertise, time for meetings and relevant discussions with the related parties.

When good governance is in place, agency cost will be reduced and managers will have lesser incentives to manage earnings (Klien, 2002; Xie, Davidson, & Dadalt, 2003). Rainsbury, Bradbury, & Cahan (2008) reported that independent audit committee members with financial expertise are one of the assurances of effective monitoring of financial reporting process.

Peter & Cotter (2009) investigated whether the presence of an audit committee have any association with better earnings quality in the context of Australian public companies and the result shows that audit committees' formation reduces the chances of earning's management's intention. Carcello, Hollingsworth, & Klein (2008) found that for audit committees with higher percentage of independent non-executive directors, financial restatements practice is less likely to occur. On top of that, the study also evident that audit committees with at least one member with financial expertise reduces the chances of financial restatements and larger boards are associated with better earnings quality.

Klein (2002) reported negative relationship between audit committee independence and discretionary accruals but found no significant relationship between discretionary accruals and all independent audit committee. Xie et al. (2003) found that companies with audit committees with corporate members and investment bankers who meet often have lesser chances of financial restatements. Carcello et al. (2008) discovered that independent members of the audit committees with financial expertise are most effective in deterring financial restatements practices.

## 2.7 Agency Theory

Many issues of corporate governance are cause by agency theory, (Ugurlu, 2000). This theory suggests that the separation between management and ownership has led to a principal-agent conflict and managers may act in manners that benefit themselves at the expense of the owners or the principals (Ugurlu, 2000). Such differences between the interest of the owner and that of the manager will lead to information asymmetry and therefore result in agency cost (Farrer & Ramsay, 1998).

One of the ways to minimize such cost, as suggested by Farrer & Ramsay (1998), is to offer managers a share of ownership of the company by way of offering the company's shares to the managers. Mat Nor & Sulong (2007) however found that the managers' incentive to pursue own benefits increases when they own a small portion of the company' shares, while such incentive decreases when they hold a greater number of shares (Fleming, Heaney, & McCosker, 2005). Crossnan (2007) stated that the main reason for the existence of the board of directors is to minimize such principal-agent problems.

Another means of reducing the problems arising from agency theory is to engage independent directors to sit on the board (Hart, 1995). Almost all public listed companies comprises of many small shareholders. These minority shareholders are in no position to control the company and do not have the power to influence decisions made by the board. As a result, all these minority shareholders collectively are unlikely to monitor the company.

This class of shareholders is also being disadvantaged due to their lack of industry and professional knowledge as well as information asymmetry. As a result, each shareholder will hope that other shareholders will do the monitoring function but unfortunately every shareholder thinks the same way and this results in no-monitoring or almost zero monitoring (Hart, 1995). Therefore, in order to overcome this issue, one of the task entrusted to independent directors are to represent such shareholders in protection of their interest and value.

Furthermore, the Malaysian government's initiative in setting up the Minority Shareholder Watch-dog Group (MSWG) aims to protect the minority shareholder's interests and according to Ammer & Abdul Rahman (2009), institutional investors in Malaysia also play an active role in term of monitoring the board of directors and management.



In addition to that, the main objective of mandatorily requiring a member with accounting expertise to be appointed to the audit committee is to make sure that the committee can refer to the experts advised relating to financial and accounting matters. Thus, when the audit committees are staffed with more members with finance or accounting expertise theoretically it should be able to prevent financial restatements.

# CHAPTER 3

# HYPOTESES DEVELOPMENT AND METHODOLOGY

## Introduction

Chapter 2 discusses the past relevant literature on audit committee independence, accounting background of the chairman of the audit committee, financial expertise of audit committee members and the occurrence of financial restatements also the agency theory that supports this study. These audit committee characteristics are expected to have influence on the occurrence of financial restatements.

This chapter also justifies the methodology used in order to achieve the research objectives and answering the research questions. Therefore, the first section of this chapter presents the research framework based on the agency theory and, the methodology uses also been discussed under this chapter.

## 3.1 Research Framework

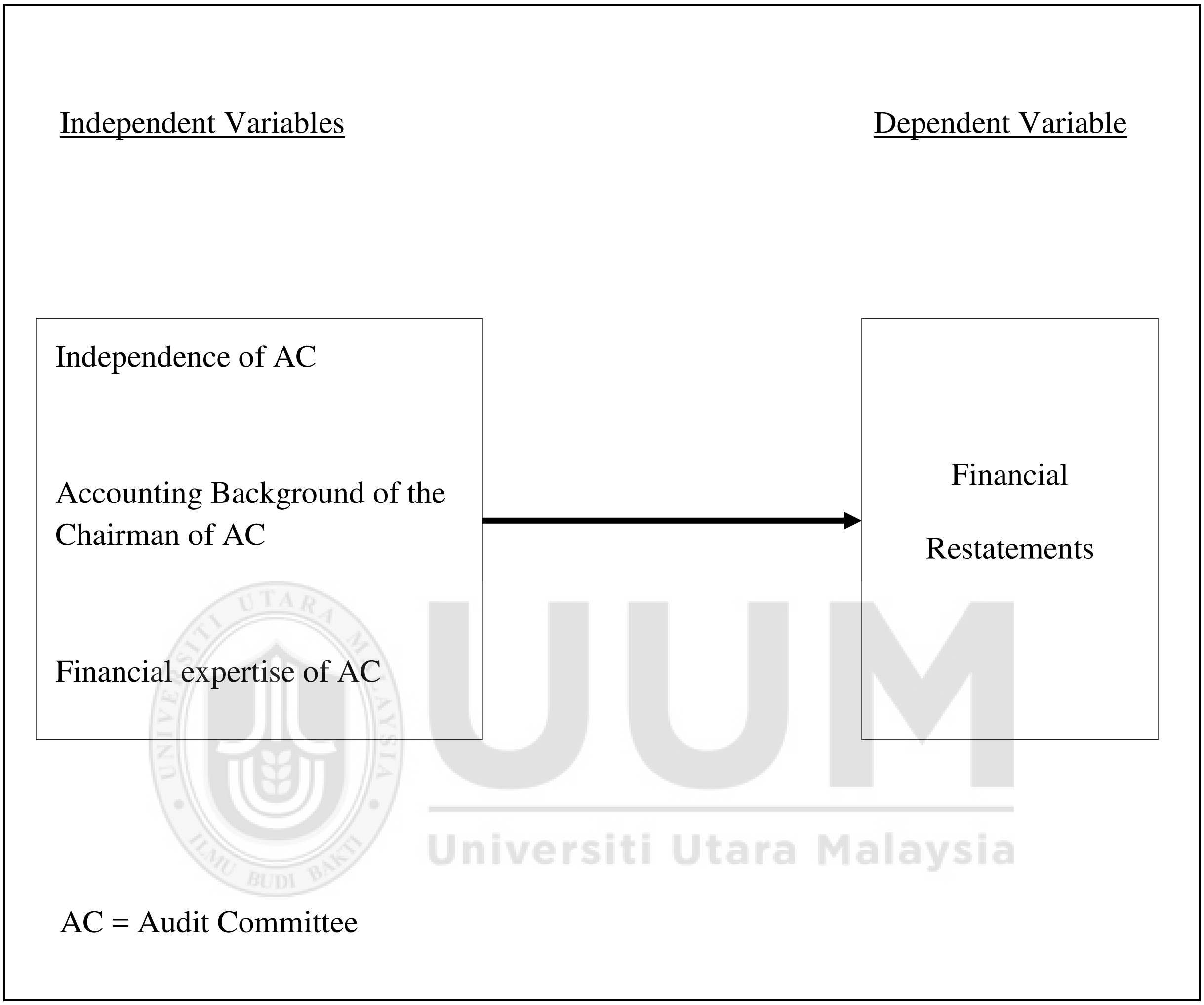


Figure 3.1
*Research Framework*

The Figure 3.1 above shows the research framework of this study with the independent variables in relation to financial restatements, which is the dependent variable.

## 3.2 Financial Restatements

Financial restatements refer to the altered presentation in part or in full of an earlier financial statement. Restatements can occur under many circumstances, including omission of information, mathematical error, and incorrect facts provided, or even errors in the application of accounting principles (Anderson, Mansi, & Reeb, 2004).

Financial restatements are meant to provide more reliable information for the users of the financial reports and more importantly for the protection of shareholders 'interest. However, the management can use this for their interest, that is, they can use their insider knowledge of the coming restatement announcement to their own benefit (Lin et al, 2006). Anderson, et. al., (2004) state that financial restatements clearly show that the previous financial reports issued are not credible, which could possibly lead to serious economic implications. Huang, Zhang, Shen & Xie (2011) found that accounting misstatements can be restrained by strong governance, such that by having an audit committee to oversee the financial reporting process.

### 3.3 Audit Committee Characteristics

Consistent with the arguments before, this study seeks to examine the effectiveness of certain characteristics of the audit committee to reduce the chances of financial restatements in a company in the Malaysian perspective.

#### 3.3.1 Audit Committee Independence

Audit committee independence is important for the committee to discharge their duties effectively. The Malaysian Code on Corporate Governance (2007) states that, the board of a company should establish an audit committee that comprising of at least three members with a majority of whom should be independent. Furthermore, all members should be non-executive directors. An independent non-executive director is one who has no family relations to other directors of the company and is not involved in the operations or management of the company.

Abbott, Parker & Peters (2004) think that the requirement to have a minimum number of independent on-executive directors on the audit committee is an effort to uphold the status of the committee and increase the organizational influence of this governance mechanism. Turley & Zaman (2007), in their study, showed that audit committees possess influence and power in an organization.

An independent audit committee is crucial to perform its financial reporting oversight. The more independent the audit committee is, the more it be able to perform financial reporting oversight effectively, and as the audit committee is not influenced by the management.

Thus, the objectivity is ensured if there is independence in the committee (Kolins, Cangemi, & Tomasko, 1991). Furthermore, as independent directors also usually serve as directors in other public companies, and therefore care about their reputation, they will discharge their duties more diligently (Nguyen &Nielsen, 2010). This is supported by the Cornett, Marcus, & Tehranian (2008), who found that independent directors bring greater wealth of experience to the companies as they are eager to build a reputation in the market through monitoring performance.

It can be concluded that an audit committee is fully independent when all members of the committee comprises of only independent non-executive directors. The common expectation that an independent board would ensure more reliable financial reporting is supported by Abbott, Park, & Parker (2000) and Beasley, Carcello, Hermanson, & Lapides (2000). Abbott & Parker (2000) documented that there is a negative relationship between occurrences of earnings restatement with audit committees that only consist of independent directors.

Chen & Jaggi (2000) found that the independence of directors is positively associated with comprehensiveness of financial disclosures. On top of that, Bedard, Chtourou & Courteau (2004) reported that a reduced financial restatement is positively associated with a composition of fully independent non - executive directors.

Cornett, et al. (2008) found that independence of directors has a negative association with financial restatements activity by large banks in the United States. Dimitropoulos & Asteriou (2010) found that there is strong association between independence of directors with improved financial performance and a lesser use of financial restatements. This is also supported by Luan & Tang (2007) who found that appointment of independent directors is positively related to the company performance. Siagian & Tresnaningsih (2011) researched on 80 public companies in Jakarta from 1999 to 2004 and found that independent audit committees improve earnings quality.

However, some past researches have indicated that there is no relationship between independence of audit committee and financial restatements. In Malaysia, for example, the argument of audit committee independence being associated with monitoring effectiveness is not empirically supported (Abdullah & Mohd-Nasir, 2004). Peasnell, Pope & Young. (2005) found no significant association between audit committee independence and management of earnings.

Lin et al. (2006) found no strong relationship between independence and occurrence of earnings restatement in their study of United States' companies. Iyengar, Land & Zampelli (2010) found no strong evidence of significant association between earnings quality and independence of audit committee in United States corporations too.

The main objective of appointing independent directors is to bring their expertise and knowledge to the companies and it is expected that independent director's skills would make the company more transparent. Since, the integrity and reputation of independent directors affect adversely financial restatements, it is expected that the extent to which audit committee independence is associated negatively with the incident of financial restatements. Thus, the hypothesis H1 is as follow:

**H1: There is a negative relationship between audit committee independence and financial restatements.**



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### 3.3.2 Accounting Background of the Chairman of Audit Committee

As a member of the audit committee, one is expected to be able to ask tough and probing questions to ensure that the management is faithfully representing the activities of the companies (Spira, 2003). The presence of a member with financial expertise in the committee adds value to the shareholders of the companies in respect of technical accounting issues.

A person with accounting expertise or relevant work experience should be appointed as the chairman of audit committee as specifies by the draft of Malaysian Code on Corporate Governance (2016). It is important for the chairman to be able to lead discussions and deliberations and ultimately be satisfied that the end result fairly reflects the understanding of the audit committee. As many of the audit committee's duties are involved with financial aspects, the chairman of audit committee needs to be someone who is financially sound.

Thus, audit committee chairman with accounting background should be appointed in order to make the company more transparent. It is expected that the extent to which accounting background of chairman of audit committee is associated negatively with the incident of financial restatements. Thus, the hypothesis H2 is as follow:

**H2: There is a negative relationship between accounting background of the chairman of the audit committee and financial restatements**

### 3.3.3 Financial Expertise of Audit Committee Members

At least one of the audit committee members should be a member of an accounting organization and should be financially educated as specifies by the Malaysian Code on Corporate Governance (2007). Audit committee play an important role in ensuring the integrity of the financial reporting therefore the audit committee should be able analyze and understand financial statements so that they can effectively fulfill their duties.

A financially literate team of audit committee should garner more trust on the part of shareholders as the latter will perceive the financial reports and in particular the earnings figures reported as more reliable and less likely to produce erroneous financial reports, be it quarterly reports or year end financial statements, when the audit committee team is financially literate. For example, Raghunandan & Rama (2003) discovered that shareholders are likely to support ratification of appointment of auditors if there is a financial expert on the committee. Davidson et al. (2004) found that there are positive stock price reactions when appointments of members with financial expertise to the audit committee are announced.

Furthermore, Lee, Mande, & Ortman (2004) suggest that auditors are more likely to enjoy working with audit committees with financial expertise on the board. All these suggest the importance of having such financial expertise on the committee. Carcello & Neal (2003) found that financial literacy of audit committee members is indeed proxy to the integrity of annual financial statements. In relation to earnings, Abbott et al. (2004) reported a negative relationship between the audit committee's financial expertise and occurrence of financial restatement.

In addition to that, DeZoort & Salterio (2001) stated the financial expertise of audit committee members increases the likelihood that any material misstatements detected will be corrected timely. Bedard et al. (2004) discovered that there is a negative relationship between having a member with financial expertise on the board and financial restatements.



However, the findings from a study conducted in United States by Lin et al. (2006) showed the financial literacy of audit committee members and occurrence of earnings restatement has no strong relationship. This finding contradicts with the Abbott et al, as they found that the relationship between financial expertise of audit committee members and financial restatements is negative. Johari, Saleh, Jaafar & Hassan (2008) also discovered that audit committee's knowledge in accounting and finance does not make any difference in financial restatements practices.

The main objective of mandatorily requiring a member with accounting expertise to be appointed to the audit committee is to make sure that the committee can rely on this said director for experts advised relating to financial and accounting matters. Thus, when the audit committees are staffed with more members with finance or accounting expertise theoretically it should be able to prevent financial restatements. It is expected that the extent to which financial expertise audit committee members is associated negatively with the incident of financial restatements. Thus, the hypothesis H2 is as follow:

**H3: There is a negative relationship between financial expertise of audit committee members and financial restatements.**

### 3.4 Methodology

This section discusses the methodology used in this study. This involves the research design, measurement of the variables and the statistical research method.

#### 3.4.1 Research Design

This study is done according to the quantitative data analysis. The association or the relationship between the audit committee characteristics such as audit committee independence, accounting background of the chairman of audit committee and financial literature or the existence of financial experts among the audit committee members, and the financial restatements can be analyzed through the quantitative data analysis.

#### 3.4.2 Sources of Data and Unit of Analysis

This study uses secondary source of data which include the annual reports for the fiscal year 2014, obtained from www.bursamalaysia.com, and the companies' websites. The basic source of information for this study involves the organizations that consist of non financial publicly listed companies in Malaysia. All financial companies are excluded from the analysis of this study because they are highly regulated companies.

### 3.4.3 Sample & Sampling Techniques

The sample companies consist of the non financial publicly listed companies in Malaysia that made amendments to their financial reports in 2013 which is identified through annual report for the fiscal year 2014. This procedure is similar with the procedure followed by Abdullah, Mohamad Yusof & Mohamad Nor, (2010) and Abdul Wahab, Willie & Nik Abdul Majid (2014). The companies are selected by screening the annual reports of more than 800 public companies listed on Bursa Malaysia. The details are obtained from www.bursamalaysia.com. These companies are then screened for availability of the necessary financial information. The final sample excludes the companies which financial information is not completely available, and companies which were delisted.

The sample of companies which has restated its financial results were identified using the keywords, “restate”, “restated”, “restatement” and “prior year adjustment” in the annual report as the evidence of based on the GAO definition (Appendix A). This procedure is similar with the procedure followed by Abdullah et. al. (2010). After identifying the sample of company which has restated its financial results, the information related to this study were identified from the downloaded annual report for the year 2014.

These restatements sample are then matched with a non-restatements sample, also known as control sample, based on the industry involved and company's size (total assets). The total assets of the control sample can be varied within 10 percent and varied by no more than 20 percent at the most (Minutti-Meza 2011). The control sample is then screened for the absence of amendments in financial statements report.

The sample is selected based on annual reports for the year 2014 as this is the latest information available. Furthermore, this study seeks to determine whether there are any differences between the latest findings as compared to those conducted several years ago in Malaysia such as research done by Abdullah et. al. (2010) and Abdul Wahab et. al. (2014) with other jurisdictions around the world.

### 3.4.4 Data analysis and Model Specification

The final sample consists of 34 public listed companies that restated their financial statements and 34 control samples amounted to 68 companies. Hypothesis H1, H2 and H3 which examines the relationship between audit committee independence, accounting background of the chairman of audit committee and the financial expertise of audit committee members are then were tested using the logistic regression model. Data obtained were analyzed using STATA version 13 and Statistical Package for Social Sciences (SPSS) version 24, which are the statistical tools commonly used for business and management research. In testing the hypothesis, this study follows a well established model used by Abdullah et. al. (2010) and Abdul Wahab et. al. (2014).

Model 1

$$\begin{aligned} \text{RESTATE (0, 1)} \quad = \quad & \beta0 + \beta1(\text{INDTAC}) + \beta2(\text{ACCCHAIR}) + \beta3(\text{FINEXP}) \\ & + \beta4(\text{LOGASSETS}) + \beta5(\text{DEBT\_EQ}) + \beta6(\text{LOSS}) \\ & + \beta7(\text{BIG\_4}) + \varepsilon \end{aligned}$$

Where,

**Dependent Variable**

RESTATE = The company that restated its financial statements for the year 2013 (Based on Gao definition, refer to Appendix A)

**Hypotheses Variables**

| | | |
|---|---|---|
| INDTAC | = | The number of independence audit committee in term of fraction over total of audit committee members |
| ACCCHAIR | = | Accounting background of the chairman of audit committee |
| FINEXP | = | The number of financial expertise of the audit committee members (Chairman of audit committee included) |

**Control Variables**

| | | |
|---|---|---|
| LOGASSETS | = | The natural log transformation of total assets |
| DEBT_EQ | = | The ration of total debt to total equity |
| LOSS | = | If the company recorded loss during the year |
| BIG_4 | = | If the company is audited by the big 4 auditing firms (PricewaterhouseCoopers, Deloitte Touche Tohmatsu Limited, Ernst & Young and Klynveld Peat Marwick Goerdeler (KPMG)) |
| $\varepsilon$ | = | Error term |
| $\beta 0$ | = | constant (i = 0), regression coefficients (i =1, 2, 3,…,7) |

These independent variables are used because they have the ability to affect the effectiveness of an audit committee's function. These independent variables adopted were only the internal characteristics of the audit committee because the study seeks to investigate the characteristics which are closest to the composition of the audit committee, thereby giving a conclusion which can better reflect the characteristics of the audit committee towards financial restatement.

## 3.5 Measurement of Variables

Table 3.1 shows the measurements for the each of the variables.

Table 3.1:
*Operationalization of Variables*

| Variables | Type | Measurement / Operationalization |
|---|---|---|
| RESTATE | Dependent | An indicator variable which is recorded as “1” if sample company had restatements for the financial year under study, 2013, “0” otherwise. |
| INDTAC | Independent | Measured by the number of independence audit committee member in term of fraction over total of audit committee members. |
| ACCCHAIR | Independent | An indicator variable which is recorded as “1” if the chairman of the audit committee has the accounting background, “0” otherwise. |
| FINEXP | Independent | Measured by the number of audit committee with accounting or financial background (chairman included). |
| LOGASSETS | Control | Measured by the natural log transformation of total assets. |
| DEBT_EQ | Control | Measured by total liability over total equity |
| LOSS | Control | An indicator variable which is recorded as “1” if the company recorded loss during the year, “0” otherwise. |
| BIG_4 | Control | An indicator variable which is recorded as “1” if the company were audited by Big 4 auditing firms, “0” otherwise. |

## Conclusion

The sections in this chapter have discussed the research framework, the hypotheses development and the model used to test the hypotheses. The audit committee characteristics namely audit committee independence, accounting background of the chairman of the audit committee and the financial expertise of the audit committees are expected to have influence on the occurrence of financial restatements. All these hypotheses variables are expected to have negative relationship with the financial restatements.

This chapter also justifies the methodology used in order to achieve the research objectives and answering the research questions. The next chapter discusses the results and findings from the logistic regression model.

# CHAPTER 4

# RESULT AND DISCUSSIONS

## Introduction

The results for the analyses that are related to this study are presented in this chapter: the companies that restated their financial statements, the audit committee characteristics such as audit committee independence, the accounting background of the chairman of audit committee and the financial expertise of the audit committee in Malaysia.

## 4.1 Analysis of the Restated Companies

The sample consists of all non finance companies listed on Bursa Malaysia in 2014 with the total of 816 companies. The total number of companies found as a result of keyword search such as "restate", "restated", "restatement" and "prior year adjustment" is 143 companies. From these 143 companies only 34 companies were identified as the companies which restated their financial statements according to the GAO definition, representing less than 5 percent of the listed companies. Thus it could be concluded that the incidence is not high. Companies from certain industry may be more prone to restate their accounts.

Based on Table 4.2, it is noted that majority of the restatement companies were classified under trading and services. On the other hand, construction companies made up the least number of restatement companies. Thus, companies that appear to be more prone to restatements than companies from other sectors are companies that classified under trading and services sector.

Table 4.1
*Restatements Based on Bursa Malaysia Sectorial Classification*

| **Industrial** | **2013** | **%** |
|---|---|---|
| **Trade & Services** | 12 | 35 |
| **Industrial product** | 5 | 15 |
| **Consumers** | 5 | 15 |
| **Plantations** | 5 | 15 |
| **Technology** | 4 | 12 |
| **Construction** | 3 | 8 |
| **Total** | **34** | **100** |

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## 4.2 Descriptive Statistics

The mean, standard deviation, minimum, and maximum of the variables were computed using SPSS version 24. Descriptive statistic can provide overview of the variables. Table 4.2 shows the descriptive statistics for the sample of the study showing the mean, standard deviation, minimum, and maximum. It represents all variables including the dependent variable which is companies that restated the financial report (RESTATED), the independent variables that consists of the number of independence audit committee member in term of fraction over total of audit committee members (INDTAC), accounting background of the chairman of audit committee (ACCCHAIR) and members of audit committee who have the accounting and financial background (FINEXP).

The control variables used are the natural log transformation of total assets (LOGASSETS), debt to equity ratio (DEBT_EQ), if the company recorded loss during the year (LOSS) and if the company is audited by the Big Four auditing firms (BIG_4). For further analyses or sensitivity analyses of this study, the number of independence audit committee member was tested in term of dummy variables (ALLIND) was used if all members are independence audit committee members and absolute number of independence audit committee member (IND). These additional tests were conducted in order to obtain a richer explanation and ensure the robustness of the results in achieving consistent findings.

Table 4.2
*Descriptive statistics*

| VARIABLES | MEAN | STD.DEV. | MIN | MAX |
|---|---|---|---|---|
| **RESTATED** | 0.5 | 0.504 | 0 | 1 |
| **INDTAC** | 0.901 | 0.149 | 0.5 | 1 |
| **ACCCHAIR** | 0.721 | 0.452 | 0 | 1 |
| **FINEXP** | 1.676 | 0.679 | 1 | 3 |
| **LOGASSETS** | 13.318 | 1.624 | 10.884 | 17.595 |
| **DEBT_EQ** | 0.552 | 0.702 | .003 | 3.394 |
| **LOSS** | 0.235 | 0.427 | 0 | 1 |
| **BIG_4** | 0.471 | 0.503 | 0 | 1 |
| **ALLIND** | 0.676 | 0.471 | 0 | 1 |
| **IND** | 3 | 0.646 | 2 | 5 |



**Notes:**
Model: RESTATE (0, 1) = β0 + β1(INDTAC) + β2(ACCCHAIR) + β3(FINEXP) + β4(LOGASSETS) + β5(DEBT_EQ) + β6(LOSS) + β7(BIG_4) + ε

Where (RESTATE) records "1" if sample company had restatements for the financial year 2013, "0" otherwise; (INDTAC) is measured by the number of independence audit committee member in term of fraction over total of audit committee; (ACCCHAIR) records to "1" if the chairman of the audit committee has the accounting background, "0" otherwise; (FINEXP) is measured by the number of audit committee with accounting or financial background; (LOGASSETS) is measured by the natural log transformation of total assets; (DEBT_EQ) is measured by total liability over total equity; (LOSS) records "1" if the company recorded loss, "0" otherwise; and (BIG_4) records "1" if the company were audited by Big 4 auditing firms, "0" otherwise.

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Based on Table 4.2 from the total observation of 68 companies the mean score for RESTATED is 0.5 with the standard deviation of 0.5037. The minimum value for restated is 0 and maximum value is 1. This indicated that equal numbers of restated and non restated companies were observed. The table also shows that the mean and standard deviations for the number of independence audit committee member in term of fraction over total of audit committee members (INDTAC), are 0.901 and 0.149.

The minimum and maximum number of independence audit committee member in term of fraction is 0.5 and 1 shows that the majority of audit committee members consist of an independence director the value of 1 indicated that all members are independence members.

The mean for accounting background of the chairman of audit committee (ACCCHAIR) is 0.721 while its standard deviations recorded 0.452. The minimum value for accounting background of the chairman of audit committee is 0 and maximum value is 1. This means from the total observation of 68 companies the majority of the chairman of audit committee has the accounting background.

The result also shows that the mean and standard deviations of the members of audit committee who have the accounting and financial background (FINEXP) is 1.676 and 0.679 respectively. The minimum number of the audit committee with the accounting and financial background is 1 and 3 as the maximum number of audit committee who has the financial background.

This is coherent with the requirements as prescribed or approved by Bursa Malaysia which stated that the committee shall include at least one member who must be a member of the Malaysian Institute of Accountants (MIA) or if he is not a member of the MIA, he must have at least three (3) years working experience in accounting field.

In term of the control variable the natural log transformation of total assets (LOGASSETS), the result shows that the mean for (LOGASSETS) is 13.318 with the minimum of 10.884 and the maximum of 17.595. The standard deviation is 1.624. This shows that there is a wide variation in the natural log transformation of total assets across the companies in the sample. The mean and standard deviation for the debt to equity ratio (DEBT_EQ) is 0.552 and 0.702 respectively with the maximum of 0 .003 and the minimum of 3.394.

In relation to the control variable (LOSS), a value of one is given if the company recorded loss during the year and zero otherwise. The result shows that the mean for the variable (LOSS) is 0.235 with the standard deviation of 0.427. The dichotomous measure used, leading to minimum of zero indicating that the company does not recorded a loss and the maximum value of one indicating that the company recorded a loss.

With regards to the variable if companies are audited by the Big Four auditing firms (BIG_4), the results show that the mean proportion is 0.471 and the standard deviation is 0.503 with the minimum value of zero and maximum value of one. This shows that almost half of the companies in the sample were audited by the Big Four auditing firms.

In addition to that the mean and standard deviation of the variable used for further analyses which is the number of independence audit committee member that was tested in term of dummy variables (ALLIND) is 0.676 and 0.471 respectively. The results also show that the minimum value is zero and the maximum value is one, indicating that all members are independence audit committee members.

Secondly, with regards the absolute number of independence audit committee member (IND), the mean number of independence audit committee is three with the minimum value of two and the maximum of five. The standard deviation for variable (IND) is 0.646.

Again this is in compliance of the requirements as prescribed or approved by Bursa Malaysia which stated that the majority of the committee shall consist of the independence audit committee member.

## 4.3 Logistic Regression Analysis

Logistic regression analysis is one of the most widely used statistical techniques in various applications of most science disciplines (Hair, Anderson, Tatham, & Black, 2010). Logistic regression analysis is one of a multivariate statistical technique that can be used to examine the relationship between a set of independent variables and a single dependent variable. Before undertaking the logistic regression analysis, the data for this study were examined to fulfill various multivariate assumptions to ensure the reliability of the subsequently drawn conclusions. Four main multivariate assumptions namely multicollinearity, normality, heteroskedasticity, and autocorrelation are tested before the main analysis is done.

### 4.3.1 Multicollinearity Test

Pearson correlation analysis and variance inflation factor (VIF) are performed in this study in order to ensure there is no serious multicollinearity problem between the independent variables that are tested.

### i) Pearson Correlation Analysis

In determining the strength of the relationships between each independent variable and the dependent variable, Hair, et al, (2010) suggested that while the correlation of 0.165 indicates that there is no relationship, the correlation of ±1.0 indicates the existence of a perfect relationship. Table 4.3 provides a summary of the results from the correlation analysis.

Cohen's (1988) criterion was followed in interpreting the correlation between 0 and 1.0. When the correlation (r) is between ±0.1 and ±0.29, the relationship is said to be small, the relationship is described as medium when r is between ±0.30 and ±0.49,. Finally, the relationship is said to be strong when the correlation is above ±0.50. In general, all correlations in Table 4.3 are less than 0.50 and the relationship among all variables in the study can be described as medium.

Table 4.3
*Pearson Correlation Analysis*

| | INDTAC | ACCCHAIR | FINEXP | LOGASSETS | DEBT_EQ | LOSS | BIG_4 |
|---|---|---|---|---|---|---|---|
| **INDTAC** | | | | | | | |
| **ACCCHAIR** | **0.217*** | | | | | | |
| **FINEXP** | **-0.060** | **0.236*** | | | | | |
| **LOGASSETS** | **0.028** | **-0.211*** | **0.047** | | | | |
| **DEBT_EQ** | **-0.100** | **-0.283**** | **-0.041** | **0.268**** | | | |
| **LOSS** | **-0.308**** | **0.036** | **0.112** | **-0.093** | **-0.037** | | |
| **BIG_4** | **-0.160** | **0.062** | **0.059** | **0.416***** | **0.156** | **-0.176** | |

**Notes:**

Significant at 0.10 (one – tailed)*
Significant at 0.05 (one – tailed)**
Significant at 0.01 (one – tailed)***

Model: RESTATE (0, 1) = β0 + β1(INDTAC) + β2(ACCCHAIR) + β3(FINEXP) + β4(LOGASSETS) + β5(DEBT_EQ) + β6(LOSS) + β7(BIG_4) + ε
Where (RESTATE) records "1" if sample company had restatements for the financial year 2013, "0" otherwise; (INDTAC) is measured by the number of independence audit committee member in term of fraction over total of audit committee; (ACCCHAIR) records "1" if the chairman of the audit committee has the accounting background, "0" otherwise; (FINEXP) is measured by the number of audit committee with accounting or financial background; (LOGASSETS) is measured by the natural log transformation of total assets; (DEBT_EQ) is measured by total liability over total equity; (LOSS) records "1" if the company recorded loss, "0" otherwise; and (BIG_4) records "1" if the company were audited by Big 4 auditing firms, "0" otherwise.

### ii) Variance inflation factor (VIF)

Table 4.4 shows that the tolerance values for all variables range between 0.733 and 0.913. Moreover, the values of VIF for all variables range between 1.095 and 1.364. These results indicate that the tolerance values for all variables of this study are more than 0.1, and, consequently, the VIF are below the threshold value of 10, as suggested by Hair et al. (2010). In other words, the tolerance and VIF values of the variables included in this study are within the recommended values. Therefore, it was concluded that the issue of multicollinearity is not seriously present in this study.

Table 4.4
*Multicollinearity analysis*

| | **Collinearity Statistics** | |
|---|---|---|
| | **Tolerance** | **VIF** |
| **INDTAC** | .827 | 1.210 |
| **ACCCHAIR** | .763 | 1.310 |
| **FINEXP** | .913 | 1.095 |
| **LOGASSETS** | .733 | 1.364 |
| **DEBT_EQ** | .864 | 1.157 |
| **LOSS** | .852 | 1.173 |
| **BIG_4** | .764 | 1.308 |

### 4.3.2 Normality Testing

The normality assumption was examined using the STATA version 13. Skewness is a measure of the symmetry in a distribution. A skewness equal to 0 will have a symmetrical dataset. Relative size of the two tails is measure by skewness. Kurtosis is the amount of probability in the tails and a measure of the combined sizes of the two tails. According to Bai, J. (2003), the dataset has heavier tails than a normal distribution (more in the tails), if the kurtosis is greater than 3. If the kurtosis is less than 3, then the dataset has lighter tails than a normal distribution (less in the tails).

The results for normality testing shows that the skewness for this sample distribution is -.0.023 thus it would be an acceptable skewness value for a normally distributed set of test scores because it is very close to zero. Meanwhile the kurtosis value for this sample distribution is 1.942 which is within the acceptable range. Thus, it can be concluded that the data approximately follows normal distribution.

### 4.3.3 Heteroskedasticity Testing

The variability of a variable is unequal across the range of values of a second variable that predicts it refers to heteroskedasticity. The Breusch-Pagan / Cook-Weisberg test was used in order to ensure that the heteroskedasticity issue is not present in this study. According to (Breusch & Pagan, 1979) the heteroskedasticity is assumed and the null hypothesis of homoskedasticity is rejected, if the p-value below an appropriate threshold with the chi square value is significant. The results show that the $chi^2$ value for the seven independent variables is 5.16 and the Prob > $chi^2$ is 0.6409. The value is non significance therefore it shows that the heteroskedasticity issue is not present in this study.

### 4.3.4 Autocorrelation Testing

The cross-correlation of a signal with itself at different points in time refers to autocorrelation. It is the similarity between observations as a function of the time lag between them. As the cross sectional data was used in this study therefore, the autocorrelation should not be an issue compared to if the time series data is used. The Durbin – Watson statistic is the traditional test for the presence of first-order autocorrelation. The results form Durbin – Watson test has confirmed that autocorrelation is not present in this study with the value of 2.164 which is within the acceptable range of $\pm$ 2.

## 4.4 Evaluation of the Model

After all assumptions are found to be satisfied, the logistic regression analysis is run to examine the relationships of audit committee independence, accounting background of the chairman of audit committee and the existence of accounting and financial expert within the audit committee on the occurrence of financial restatements.

Model 1

$$\text{RESTATE (0, 1)} = \beta 0 + \beta 1(\text{INDTAC}) + \beta 2(\text{ACCCHAIR}) + \beta 3(\text{FINEXP}) + \beta 4(\text{LOGASSETS}) + \beta 5(\text{DEBT\_EQ}) + \beta 6(\text{LOSS}) + \beta 7(\text{BIG\_4}) + \varepsilon$$



As revealed by the results in Table 4.5, the value of Wald $Chi^2$ in this model 1 is 18.20. Also, the results in Table 4.5 show that this model is significant since the Prob > $Chi^2$ is significant which is 0.011. Thus, indicating the validity of the model used. The value for Pseudo $R^2$ is 0.315 and the overall percentage correct prediction for model 1 is 75 percent.

Audit committee independence (INDTAC) shows the largest beta coefficient in model 1 with the value of 6.749. This indicates that the variable (INDTAC) has the strongest predictive power to explain the dependent variable. The t value for variable (INDTAC) is 2.68 and at the 0.01 level of significance the variable is found to be significant with the value of 0.007. The negative sign for both beta coefficient and t value indicate the negative relationship. Therefore, this variable (INDTAC) made a significant predictive power to explain the dependent variable (RESTATED).

The beta coefficient of debt to equity ratio (DEBT_EQ) is less than the audit committee independence (INDTAC) with the value of $\beta = 1.720$, $t = 2.60$, and at the 0.01 level of significance the variable is found to be significant with the value of 0.009. Therefore, this variable (DEBT_EQ) also made a significant predictive power to explain the dependent variable (RESTATED).

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On the other hand, accounting background of the chairman of audit committee (ACCCHAIR) shows the values for $\beta=0.039$, with $t=0.05$, and $p>0.10$, members of audit committee who have the accounting and financial background (FINEXP) shows the values for $\beta=0.053$, with $t=0.11$, and $p>0.10$, and the control variables which are the natural log transformation of total assets (LOGASSETS) shows the values for $\beta=0.092$, with $t=0.39$, and $p>0.10$, if the company recorded loss during the year (LOSS) shows the values for $\beta=0.938$, with $t=1.25$, and $p>0.10$ and variable (BIG_4) shows the values for $\beta=0.416$, with $t=0.55$, and $p>0.10$ are not making a significant predictive power to explain the dependent variable (RESTATED).

In general the result from Table 4.5 shows that the independent variables that consists of the number of independence audit committee member in term of fraction over total of audit committee members (INDTAC), and control variable debt to equity ratio (DEBT_EQ), are significant predictors of dependent variable (RESTATED) with variable (INDTAC) has negative relationship to the dependent variable (RESTATED).

On the other hand, accounting background of the chairman of audit committee (ACCCHAIR), members of audit committee who have the accounting and financial background (FINEXP), and the control variables which are the natural log transformation of total assets (LOGASSETS), if the company recorded loss (LOSS) and if it is audited by the Big Four auditing firms (BIG_4), are statistically insignificant to the dependent variable (RESTATED).

Table 4.5
*Logistic Regression results*

| Variables | Expected Direction | Standardized Coefficients Beta | t-value | Sig. |
|---|---|---|---|---|
| **INDTAC** | - | -6.749 | -2.68 | 0.007*** |
| **ACCCHAIR** | - | 0.039 | 0.05 | 0.962 |
| **FINEXP** | - | 0.053 | 0.11 | 0.913 |
| **LOGASSETS** | - | -0.092 | -0.39 | 0.693 |
| **DEBT_EQ** | + | 1.720 | 2.60 | 0.009*** |
| **LOSS** | + | 0.938 | 1.25 | 0.213 |
| **BIG_4** | - | -0.416 | -0.55 | 0.582 |
| Wald $Chi^2$ | | | | 18.20 |
| Prob > $Chi^2$ | | | | 0.011 |
| Pseudo $R^2$ | | | | 0.315 |
| Overall percentage of correct prediction | | | | 75.00% |

**Notes:** Significant at 0.10 (one – tailed)*
Significant at 0.05 (one – tailed)**
Significant at 0.01 (one – tailed)***

Model: RESTATE (0, 1) = $\beta0 + \beta1$(INDTAC) + $\beta2$(ACCCHAIR) + $\beta3$(FINEXP) + $\beta4$(LOGASSETS) + $\beta5$(DEBT_EQ) + $\beta6$(LOSS) + $\beta7$(BIG_4) + $\varepsilon$
Where (RESTATE) records “1” if sample company had restatements for the financial year 2013, “0” otherwise; (INDTAC) is the number of independence audit committee member in term of fraction over total of audit committee members; ACCCHAIR) records “1” if the chairman of the audit committee has the accounting background, “0” otherwise; (FINEXP) measured by the number of audit committee with accounting or financial background; (LOGASSETS) measured by the natural log transformation of total assets; (DEBT_EQ) measured by total liability over total equity; (LOSS) records “1” if the company recorded loss, “0” otherwise; and (BIG_4) records “1” if the company were audited by Big 4 auditing firms, “0” otherwise.

Based on the findings from the logistic regression analyses conducted in this chapter, it can be concluded that only the hypothesis H1 is supported while H2 and H3 are not supported.

### 4.5 Further analyses

In order to examine whether the main results are sensitive to different variables and different measurements further analyses are carried out. The number of independence audit committee member was tested in term of dummy variables (ALLIND), with the value of one if all members are independence audit committee members and zero otherwise in Model 2, and absolute number of independence audit committee member (IND) in Model 3. In this way, the additional tests were conducted to obtain a richer explanation and ensure the robustness of the results in achieving consistent findings.



Model 2

$$\text{RESTATE}(0, 1) = \beta 0 + \beta 1(\text{ALLIND}) + \beta 2(\text{ACCCHAIR}) + \beta 3(\text{FINEXP}) + \beta 4(\text{LOGASSETS}) + \beta 5(\text{DEBT\_EQ}) + \beta 6(\text{LOSS}) + \beta 7(\text{BIG\_4}) + \varepsilon$$

First the number of independence audit committee member was tested in term of dummy variables (ALLIND). As per revealed by the results in Table 4.6, the value of Wald $Chi^2$ in this model 2 is 18.05. Also, the results in Table 4.6 show that this model is significant since the Prob > $Chi^2$ is significant which is 0.012. Thus, indicating the validity of the model used. The value for Pseudo $R^2$ is 0.300 and the overall percentage correct prediction for model 2 is 73.53 percent.

In the Model 2, the beta coefficient shows the largest value of 1.906 which is the number of independence audit committee member was tested in term of dummy variables (ALLIND). This means that this variable has the strongest predictive power to explain the dependent variable. The t value for variable (ALLIND) is 2.51 and at the 0.05 level of significance the variable is found to be significant with the value of 0.012. The negative sign for both beta coefficient and t value indicate the negative relationship. Therefore, this variable (ALLIND) made a significant predictive power to explain the dependent variable (RESTATED).



The beta coefficient of debt to equity ratio (DEBT_EQ) is less than the variable (ALLIND) with the value of $\beta = 1.694$, $t = 2.59$, and at the 0.01 level of significance the variable is found to be significant with the value of 0.009. Therefore, this variable (DEBT_EQ) also made a significant predictive power to explain the dependent variable (RESTATED).

On the other hand, accounting background of the chairman of audit committee (ACCCHAIR) shows the values of $\beta$=0.138, with t=0.17, and p>0.10, members of audit committee who have the accounting and financial background (FINEXP) shows the values of $\beta$=0.007, with t=0.01, and p>0.10, and the control variables which are the natural log transformation of total assets (LOGASSETS) shows the values of $\beta$=0.097, with t=0.43, and p>0.10, if the company recorded loss during the year (LOSS) shows the values of $\beta$=0.954, with t=1.28, and p>0.10and variable (BIG_4) shows the values of $\beta$=0.406, with t=0.54, and p>0.10 are not making a significant predictive power to explain the dependent variable (RESTATED).

These results are consistent with the main finding that only the hypothesis H1 is supported while H2 and H3 are not supported. Table 4.6 shows the results for further analysis using the dummy variables (ALLIND) for the number of independence audit committee member.

Table 4.6
*Further analysis using the dummy variables (ALLIND) for the number of independence audit committee member.*

| **Variables** | **Expected Direction** | **Standardized Coefficients Beta** | **t-value** | **Sig.** |
|---|---|---|---|---|
| **ALLIND** | - | -1.906 | -2.51 | 0.012** |
| **ACCCHAIR** | - | 0.138 | 0.17 | 0.868 |
| **FINEXP** | - | 0.007 | 0.01 | 0.988 |
| **LOGASSETS** | - | -0.097 | -0.43 | 0.671 |
| **DEBT_EQ** | + | 1.694 | 2.59 | 0.009*** |
| **LOSS** | + | 0.954 | 1.28 | 0.202 |
| **BIG_4** | - | -0.406 | -0.54 | 0.588 |
| Wald $Chi^2$ | | | | 18.05 |
| Prob > $Chi^2$ | | | | 0.012 |
| Pseudo $R^2$ | | | | 0.300 |
| Overall percentage of correct prediction | | | | 73.53% |

**Notes**: Significant at 0.10 (one – tailed)*
Significant at 0.05 (one – tailed)**
Significant at 0.01 (one – tailed)***

Model: RESTATE (0, 1) = β0 + β1(ALLIND) + β2(ACCCHAIR) + β3(FINEXP) + β4(LOGASSETS) + β5(DEBT_EQ) + β6(LOSS) + β7(BIG_4) + ε
Where (RESTATE) records "1" if sample company had restatements for the financial year 2013, "0" otherwise; (ALLIND) records "1" if all members are independence audit committee members, "0" otherwise; (ACCCHAIR) records "1" if the chairman of the audit committee has the accounting background, "0" otherwise; (FINEXP) measured by the number of audit committee with financial background; (LOGASSETS) measured by the natural log transformation of total assets; (DEBT_EQ) measured by total liability over total equity; (LOSS) records "1" if the company recorded loss, "0" otherwise; and (BIG_4) records "1" if the company were audited by Big 4 auditing firms, "0" otherwise.

Finally, the measurement using the absolute number of independence audit committee member (IND) in Model 3 was also tested.

Model 3

$$\text{RESTATE } (0, 1) = \beta 0 + \beta 1(\text{IND}) + \beta 2(\text{ACCCHAIR}) + \beta 3(\text{FINEXP}) + \beta 4(\text{LOGASSETS}) + \beta 5(\text{DEBT\_EQ}) + \beta 6(\text{LOSS}) + \beta 7(\text{BIG\_4}) + \varepsilon$$

From the result in Table 4.7, the value of Wald $Chi^2$ in this model 3 is 15.47. This indicates that 15.47 percent of the variation in the dependent variable is explained by variations in the independent variables. Also, the results in Table 4.7 show that this model is significant since the Prob > $Chi^2$ is significant which is 0.031. Thus, indicating the validity of the model used. The value for Pseudo $R^2$ is 0.257 and the overall percentage correct prediction for model 3 is 75 percent.



In the Model 3, the beta coefficient shows the largest value of 2.010 which is the debt to equity ratio (DEBT_EQ). This means that this variable also makes the strongest predictive power to explain the dependent variable. At the 0.01 level of significance (DEBT_EQ) shows the value of $p<0.01$. Therefore, this variable (DEBT_EQ) made a significant predictive power to explain the dependent variable (RESTATED).

The variable (LOSS) also made a significant predictive power to explain the dependent variable (RESTATED) with the value of $\beta$=1.322, with t=1.86, and p = 0.063. The beta coefficient of the absolute number of independence audit committee member (IND) is less than the variable (LOSS) with the value of $\beta$ = 0.818. t = 1.66, and at the 0.10 level of significance it shows the value of p = 0.098. The negative sign for both beta coefficient and t value indicate the negative relationship. Therefore, this variable (IND) also made a significant predictive power to explain the dependent variable (RESTATED).

On the other hand, accounting background of the chairman of audit committee (ACCCHAIR) shows $\beta$=0.690, with t=0.94, and p>0.10; members of audit committee who have the accounting and financial background (FINEXP) shows $\beta$=0.336, with t=0.94, and p>0.10, and the control variables which are the natural log transformation of total assets (LOGASSETS) shows $\beta$=0.137, with t=0.60, and p>0.10, and the variable (BIG_4) shows $\beta$=0.080, with t=0.11, and p>0.10 are not making a significant predictive power to explain the dependent variable (RESTATED).

Once again the results from Model 3 is consistent with the main finding that only the hypothesis H1 is supported while H2 and H3 are not supported.

Table 4.7

*Further analysis using the absolute number of independence audit committee member (IND).*

| Variables | Expected Direction | Standardized Coefficients Beta | t-value | Sig. |
|---|---|---|---|---|
| **IND** | - | -0.818 | -1.66 | 0.098* |
| **ACCCHAIR** | - | -0.690 | -0.94 | 0.347 |
| **FINEXP** | - | 0.336 | 0.73 | 0.465 |
| **LOGASSETS** | - | -0.137 | -0.60 | 0.547 |
| **DEBT_EQ** | + | 2.010 | 2.95 | 0.003*** |
| **LOSS** | + | 1.323 | 1.86 | 0.063* |
| **BIG_4** | - | 0.080 | 0.11 | 0.910 |
| Wald $Chi^2$ | | | | 15.47 |
| Prob > $Chi^2$ | | | | 0.031 |
| Pseudo $R^2$ | | | | 0.257 |
| Overall percentage of correct prediction | | | | 75.00% |

**Notes:** Significant at 0.10 (one – tailed)*
Significant at 0.05 (one – tailed)**
Significant at 0.01 (one – tailed)***

Model: RESTATE (0, 1) = β0 + β1(IND) + β2(ACCCHAIR) + β3(FINEXP) + β4(LOGASSETS) + β5(DEBT_EQ) + β6(LOSS) + β7(BIG_4) + ε

Where (RESTATE) records "1" if sample company had restatements for the financial year 2013, "0" otherwise; (IND) is the absolute number of independence audit committee member; ACCCHAIR) equal to "1" if the chairman of the audit committee has the accounting background, "0" otherwise; (FINEXP) measured by the number of audit committee with accounting or financial background; (LOGASSETS) measured by the natural log transformation of total assets; (DEBT_EQ) measured by total liability over total equity; (LOSS) equal to "1" if the company recorded loss, "0" otherwise; and (BIG_4) equal to "1" if the company were audited by Big 4 auditing firms, "0" otherwise.

In conclusion, the results from further analyses support the main findings which are to support H1 while H2 and H3 are not supported. This means there is negative relationship between the audit committee independence and financial restatements. All three different measurements used, give the same results. This finding is consistent with Abbott et.al. (2000), Chen & Jaggi (2000), Bedard et al. (2004), Cornett et al. (2009), Dimitropoulos & Asteriou (2010) and Siagian & Tresnaningsih (2011), which found that independence of directors has a negative association with financial restatements activity.

The findings from this study also consistent with the two well established studies conducted in Malaysia which are Abdullah et. el (2010) and Abdul Wahab et. al (2014), which found that the audit committee independence has a significant relationship with financial restatements. However, the value for Pseudo $R^2$ and the overall percentage correct prediction in this study is lower than the value found in with Abdullah et. el (2010) and Abdul Wahab et. al (2014). This is because this study use a cross-sectional data for 2013 instead of several years and the number of variables investigated is lower when compared to Abdullah et. el (2010) and Abdul Wahab et. al (2014).

However, with regards the results for the accounting background of the chairman of audit committee and the financial expertise of audit committee members show that it is not statistically significant.

These findings show there is no strong relationship between financial expertise of audit committee members and financial restatements thus, the findings support Johari et al. (2008) and Lin et al. (2006) but contradict with that of Abbott et al. (2004) and Carcello and Neal (2003).

The reasons behind these findings might be because of the audit committee members do not have access to or provided with sufficient information, especially on financial matters of the company. Therefore, the audit committees are unable to assess the financial condition comprehensively.

# CHAPTER 5

# CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Conclusions

In order to ensure the company can be managed properly the audit committee is established. In order to protect the interest of stakeholders, the audit committee, internal auditors and external auditors should play their role. Therefore, it is important to have an audit committee who is qualified, and experienced. If the audit committee fails, the structures, and systems of the organization will also fails.

This study seeks to investigate the relationship between financial restatements and audit committee independence, accounting background of the chairman of audit committee and financial expertise of the audit committee members. The findings from this study show that the audit committee independence has a significant relationship with financial statement restatements. The relationship is negative, means that when there are more independence members in the audit committee, the chances of occurrence of financial restatements are reduces.

For other characteristics of audit committees under this study, which are the accounting background of the chairman of audit committee and audit committees staffed with more members with finance or accounting expertise does not necessarily prevent financial restatements.

Theoretically, this finding contradicts with the notion that the main objective of mandatorily requiring a member with accounting expertise to be appointed to the committee is to make sure that the committee can rely on this said director for experts advised relating to financial and accounting matters. However, studies done in other countries using some similar variables indicate mix findings. This could be attributed to the different business and regulatory environments.

In short it can be concluded that the objectives of this study have been achieved and the findings shows that the restatement of financial results by companies are not fully attributable to the function and role of the accounting background of the chairman of audit committee and financial expertise of audit committee members except for the audit committee independence. In this respect, the relevant government bodies can play a role by actively engaging independent directors by providing the necessary support and trainings so that these directors are fully aware of their responsibilities.

## 5.2 Limitations of the study

This study uses a cross – sectional data for the year 2013 obtained from the annual reports for the year 2014. Future studies can stretch across years because a study that stretches over years may provide a more valuable insight as it takes into account the effect of regulatory and economic changes that occur under the years under study.

Furthermore, the characteristics of audit committees that are investigated under this study are limited to the independence, accounting background and financial expertise. To determine whether, there are any differences between male and female audit committee members, the characteristics of audit committees can be further expanded to areas such as gender of the audit committee member.

For certain, audit committee does not solely responsible for the occurrence of financial restatements. In ensuring the quality and reliability of financial statements prepared by the company, auditors, both internal and external, also play equally vital roles.

## 5.3 Practical and Policy Implication of the study

The finding from this study contributes to the literature of the relationship of audit committee characteristics and financial restatements. In particular, the audit committee independence, accounting background of the chairman of audit committee and financial expertise of the audit committee members. This study provides further evidence on audit committee independence which proved to have a significant relationship with financial statement restatements. The relationship is negative, means that when there are more independence members sitting on the audit committee, the chances of occurrence of financial restatements are reduces.

Based on published articles, this study can be considered as the first study to examine the relationship between the accounting background of the chairman of audit committee and financial restatements. The draft of Malaysian Code on Corporate Governance (2016) that has just been released specifies that a person with accounting expertise or relevant work experience should be appointed as the chairman of audit committee. Therefore, it is expected that the findings of this study can contribute in making recommendations for corporate governance practice by providing more valuable information to Malaysian accounting regulators.

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## APPENDIX A

| Category | Description |
|---|---|
| Acquisitions and mergers | Restatements of acquisitions or mergers that were improperly accounted for or not accounted for at all. These include instances in which the wrong accounting method was used or losses or gains related to the acquisition were understated or overstated. This does not include in-process research and development or restatements for mergers, acquisitions, and discontinued operations when appropriate accounting methods were employed. |
| Cost or expense | Restatements due to improper cost accounting. This category includes instances of improperly recognizing costs or expenses, improperly capitalizing expenditures, or any other number of mistakes or improprieties that led to misreported costs. It also includes restatements due to improper treatment of tax liabilities, income tax reserves, and other tax-related items. |
| In-process research and development | Restatements resulting from instances in which improper accounting methodologies were used to value in process research and development at the time of an acquisition. |
| Other | Any restatement not covered by the listed categories. Cases included in this category include restatements due to inadequate loan-loss reserves, delinquent loans, loan write-offs, or improper accounting for bad loans and restatements due to fraud, or accounting irregularities that were left unspecified. |
| Reclassification | Restatements due to improperly classified accounting items. These include restatements due to improprieties such as debt payments being classified as investments. |
| Related-party transactions | Restatements due to inadequate disclosure or improper accounting of revenues, expenses, debts, or assets involving transactions or relationships with related parties. This category includes those involving special purpose entities. |
| Restructuring, assets, or inventory | Restatements due to asset impairment, errors relating to accounting treatment of investments, timing of asset write-downs, goodwill, restructuring activity, and inventory valuation, and inventory quantity issues. |
| Revenue recognition | Restatements due to improper revenue accounting. This category includes instances in which revenue was improperly recognized, questionable revenues were recognized, or any other number of mistakes or improprieties that led to misreported revenue. |
| Securities related | Restatements due to improper accounting for derivatives, warrants, stock options and other convertible securities |

Note: Announcements involving stock splits, changes in accounting principles, and other financial statement restatements that were not made to correct mistakes in the application of accounting standards were excluded.
Source: GAO (2006)

**APPENDIX B**

**List of restated companies for the year 2014**

| INDUSTRY | NO | NAME |
|---|---|---|
| CONSUMER | 1 | CHEE WAH CORPORATION BERHAD |
| | 2 | GOLDIS BERHAD |
| | 3 | PENSONIC HOLDINGS BERHAD |
| | 4 | LII HEN INDUSTRIES BERHAD |
| | 5 | QL RESOURCES BERHAD |
| CONSTRUCTION | 6 | KUMPULAN JAKSON BERHAD |
| | 7 | GAMUDA LAND |
| | 8 | HO HUP CONSTRUCTION COMPANY BERHAD |
| IND PRO | 9 | FOCUS LUMBER BERHAD |
| | 10 | LYSAGHT GALVANIZED BERHAD |
| | 11 | KIM HIN INDUSTRY BERHAD |
| | 12 | PRESS METAL BERHAD |
| | 13 | WEIDA (M) BERHAD |
| PLANTATION | 14 | PLS PLANTATION BERHAD |
| | 15 | CEPATWAWASAN GROUP BERHAD |
| | 16 | NPC RESOURCES BERHAD |
| | 17 | SIN HENG CHAN (MALAYA) BERHAD |
| | 18 | TSH RESOURCES BERHAD |
| TECH | 19 | CUSCAPI BERHAD |
| | 20 | DATAPREP HOLDINGS BERHAD |
| | 21 | JCY INTERNATIONAL BERHAD |
| | 22 | MMC BERHAD |
| TRADE&SERV | 23 | ANALABS RESOURCES BERHAD |
| | 24 | BARAKAH OFFSHORE PETROLEUM BERHAD |
| | 25 | BERJAYA CORPORATION BERHAD |
| | 26 | DELEUM BERHAD |
| | 27 | EMAS KIARA INDUSTRIES BERHAD |
| | 28 | IPMUDA BERHAD |
| | 29 | KELINGTON GROUP BERHAD |
| | 30 | PERISAI PETROLEUM TEKNOLOGI BERHAD |
| | 31 | PETRON (M) REFINING & MARKETING BERHAD |
| | 32 | PERMAJU INDUSTRI BERHAD |
| | 33 | SURIA CAPITAL BERHAD |
| | 34 | TMC LIFE SCIENCES |