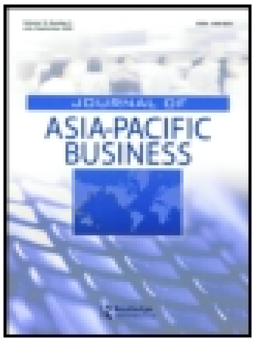

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The Effect of Audit Committee Characteristics on Financial Restatements in Malaysia

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ABSTRACT

This study investigates the influence of audit committee characteristics on the likelihood of financial restatements by firms in Malaysia. Annual reports of 350 firms that have restated their financial statements in the year 2008 and 2009 are analyzed. An additional 350 firms that did not restate their financial statements are considered, resulting in a total of 700 observations. Regression analysis identifies audit committee characteristics such as its independence, size, expertise and activity as statistically significant in explaining the likelihood of financial restatements. This article highlights the important role of the audit committee in mitigating financial restatements by firms in Malaysia.

KEYWORDS
audit committee; financial restatements; corporate governance; Malaysia

Introduction

A sudden surge in accounting disgraces in the past few years has resulted in the loss of public trust in large firms and auditors across the world. According to Abdullah et al. (2010), the issue of financial restatements continues to gain prominence as the number of restatements continues to grow following high-profile cases in recent years such as Tesco Plc‘s overstatement of their revenues in year 2014 after a shortfall of £250m was discovered in its estimated profits and the case of Enron, which restated their earnings after announcing a US$618 million loss in its 2001 third quarterly report. In both cases, share prices dropped drastically following the discoveries, resulting in huge losses to the shareholders of the firms. In most cases the restatements highlight the ineffectiveness of corporate governance and control in the firms.

However, it is also known that Enron and Tesco are firms with good corporate governance practices whereby the audit committees comprise mainly of independent directors. The role of the independent director in overseeing firm’s operations to avoid financial restatement is debatable.

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Following this, concerns over the validity of the financial reports and the occurrence of financial restatements have been widely discussed according to the General Accountability Office (GAO). The role of the audit committee in monitoring financial statements is crucial in ensuring that shareholders' trust on the financial report remains intact.

The examples above also suggest serious issues faced by corporations across the world in ensuring their financial reports are accurately prepared according to the approved standards. 'Revised Malaysian Code on Corporate Governance (henceforth RMCCG 2007) clearly mentions that audit committees have an important role in facilitating the financial reports' compliance with approved financial reporting standards. To ensure this, the RMCCG2007 requires that all members of the audit committee to be financially literate and at least one be a member of an accounting association or body. This requirement is to ensure that the directors would be able to understand and interpret financial statements accurately, as part of their duty to monitor the firm's internal control system.

Prior studies in Malaysia find mixed results on the effectiveness of the audit committee in reducing financial restatements and earnings management activities (Ahmad, Houghton, & Yusof, 2006; Alkdai & Hanefah, 2012; Mohammad, Yusoff, & Nik,2015; Mohammad, Wasiuzzaman & Salleh, 2016; Mohd-Saleh, Iskandar, & Rahmat, 2007; Nelson & Devi, 2013; Rahmat, Iskandar, & Saleh, 2009; Mohd-Saleh, Iskandar & Rahmat, 2005). In developed countries, studies conducted by Abbott, Parker, and Peters (2004) suggest the role of audit committee independence in reducing financial restatement.

Because prior studies focuses on the time frame before RMCCG2007, the implications of the new rulings that require that the audit committee be fully independent of the management have not been fully investigated. RMCCG2007 execution is an important yardstick in understanding the implications of internal governance reforms in the Malaysian stock market where the RMCCG2007 is embedded in Bursa Malaysia Listing Requirements. In extending the research of Abdullah et al. (2010), this study incorporates the implications of the RMCCG2007 on the effectiveness of the audit committee in reducing financial restatements among Malaysian firms. There is a need to improve audit committee's effectiveness in Malaysian firms because Malaysia is categorized as a common-law country with unique institutional setting (LaPorta et al., 1999) where there are multiple races, family firms, and politically connected firms that influence the roles of audit committee's members. Because restatement of earnings have negative repercussions on the firms' shares and reputation, this article seeks to investigate the influences of audit committee characteristics on the likelihood of financial restatements in Malaysia.

The results of this study find several factors influencing the likelihood of financial restatements in Malaysia. OLS regression analysis identifies audit committee independence, audit committee size, audit committee expertise and audit committee activity (meeting) as statistically significant in explaining the likelihood of financial restatements.

The rest of the article is structured as follows. A review of past literature is carried out in the next section, which also includes the hypotheses formed for this study. Data and research methodology are discussed in the following section, where the model specification is also discussed. This is followed by a section on the results, and the final section concludes the study.

Literature review and hypothesis formulation

Financial restatements are generally viewed as amendments made to the financial statements due to noncompliance with generally accepted accounting principles. The General Accountability Office (GAO, 2006) states that "a financial restatement occurs when a company, either voluntarily or prompted by auditors or regulators, revises public financial information that was previously reported" (p.). Huron Consulting Group (2003) reports three primary causes of accounting errors: (1) problems in applying the accounting rules, (2) human and system errors, and (3) fraudulent behaviors. Their study also suggests the leading causes of restatements to be revenue recognition, equity accounting, reserves, accruals, and contingencies.

Unfortunately, the increase in incidences of financial restatements in previous years has caused a high level of anxiety over financial reporting quality. For instance, Moriarty and Livingston (2001) state that a study in relation to restatements through a union of superior firm financial managers of the Financial Executives International finds that the restatements quantity rose significantly from 1997 to 2000. With greater sophistication and governance over firm's operating activities, the issue of increasing financial restatements is perplexing. Generally the market's reaction to the publishing of financial statements that fails to exceed analyst expectations increases the propensity for restatements. Although the effects of restatement may be unintentional, the roles of audit committees in reducing the incidence of financial restatement are imperative.

Several steps have been taken by the regulator to improve the effectiveness of independent directors' roles in the audit committees.[1] However, a review of some empirical studies on the roles of independent directors in Malaysia finds mixed results. For instance, Rahmat et al. (2009) find that independent directors in audit committees of 73 financially distressed firms in year 2001 were less effective compared with nonfinancially distressed firms. Similarly, for the same period of study, Mohd-Saleh et al. (2007) find that independent directors reduce earnings management. Both studies suggest that independent directors are significant in Malaysia. However, data used for both of these studies are during the year of corporate governance implementation and are therefore biased in their sample selection year because year 2001 was the year of the implementation of the Malaysian Code of Corporate Governance 2000 (henceforth MCCG 2000) . Proponents of independent audit committees believe independent directors are effective because they have more insider information (Bedard, Chtourou, & Courteau, 2004; Chau & Gray, 2010; Ghosh, Kallapur, & Moon, 2009; Kang, Cheng, & Gray, 2007) and are deemed experts in decision control (Fama, 1980). Prominent studies in the West support this suggesting that audit committee independence effectively deter earnings management (Abbott, 2000; Marra, Mazzola, & Prencipe, 2011). Even though misstatement may not be as severe as earnings management practices, it may be evidence of directors' inclination to mislead stakeholders on reported financial figures.

An important task of independent audit committee is to ensure that financial reports are prepared according to the prescribed accounting standards. In a sample of 159 U.S. public companies that restated earnings, Agrawal and Chadha (2005) report that the probability of earnings restatement was low in firms whose boards have an independent director with a background in accounting or finance

Therefore, based on these studies, the current research intends to investigate some of the audit committee's characteristics and its influence over financial restatement.

Independence of audit committee

One of the most important considerations in RMCCG2007 is the role of the independent audit committee to ensure that financial reports are produced based on the approved accounting standards. An audit committee that is made of directors who are fully independent is able to create stronger auditor independence and reduces financial statement fraud (Abbott, Parker, Peters, & Rama, 2003; Beattie, Fearnley, & Brandt, 1999). Abbott et al. (2004) find the level of audit committees' independence is negatively associated with financial restatement occurrence. In a different study in Malaysia, Salleh, Steward, and Stuard (2006) find earnings management activities to be less in highly independent audit committees. Both prominent studies suggest the pertinent roles of audit committees' independence in improving financial reporting process. In Malaysia, using data prior to RMCCG2007, Abdullah et al. (2010) find that audit committee independence facilitates financial reporting and reduces financial restatement. Independent audit committees are believed to be more effective because the independent directors have more information about the organization compared with outside directors (Bedard et al., 2004; Chau & Gray, 2010; Ghosh et al., 2009; Kang et al., 2007). Independent directors are also deemed experts in decision control (Fama, 1980). By having the necessary expertise, independent directors, particularly those in the audit committee, are key to upholding the integrity and credibility of published financial statements (Ahmed, 2013; Chau & Gray, 2010; Jaggi et al., 2009; Piot & Janin, 2007).

However, the existence of affiliated independent directors in audit committees may be ineffective in reducing earnings management and financial restatements. In 2013, KPMG (2013) finds that 45% of the independent directors on Malaysian boards are either retired civil servants or former politicians. This suggests that independent directors in the audit committees are employed due to their connection rather than to provide able stewardship in the company's governance and financial reporting process. Therefore, the presence of 'independent' directors on audit committees may have an insignificant impact on financial restatements or may even result in higher occurrence of financial restatements. Based on the previous literatures, the present research posits that:

Hypothesis 1: Increasing number of independent directors in the audit committee is associated with a lower likelihood of financial restatement.

Audit committee meeting

Prior literature presents two perspectives with respect to the number of audit committee meetings as a corporate governance mechanism. The first view is that audit committees meeting are beneficial in terms of effective management monitoring, strategy discussion and implementation, and ability for directors to consult together and share opinions (Vafeas, 1999). This is supported by Adelopo and Jallow (2008) who state that audit committee meeting frequency signals audit committee's activity and may indicate a measure of its effectiveness. An implication of this argument is that audit committees that meet more frequently are more likely to perform their duties in accordance with shareholders' interests (Vafeas, 1999). Higher audit committee meeting frequency, all other things being equal, may improve board propensity to detect financial reporting irregularities, improve business monitoring, enhance board strategic functions, and may mediate lapses in internal control and risk management procedures (Adelopo & Jallow, 2008). As a result the function of board meeting frequency as one of corporate governance mechanism is consistent with agency theory, hence reducing the likelihood of financial restatements.

The second view however states that higher frequency of audit committee meetings might indicate presence of problems. However Xie, Davidson, and

DaDalt (2003) argue that a board that seldom meets may not focus on these issues and may perhaps only "rubber-stamp" management plans. Xie et al. (2003) find that the frequency of audit committee meetings is negatively associated with earnings management practices in the US firms listed in the Standard & Poor 500 index. They suggest that audit committee's activity influences members' ability to serve as effective monitors.

Hypothesis 2: Increase in the number of audit committee meetings negatively influences the likelihood of financial restatement.

Audit committee size

An increase in the audit committee size will increase the public confidence over the firm's financial reports and accountability of the audit committees' members (Braiotta, 2000; Kalbers & Fogarty, 1993). Currently there is no specified number of audit committee members; there is a need to understand its influence on its effectiveness in detecting financial irregularities. Al-Najjar (2011) finds that large audit committees are more effective in monitoring top management and the quality of financial reports, therefore the probability of financial restatements are reduced. Audit committee effectiveness is increased with the increase in size due to the existence of experienced and knowledgeable members (Anderson, Deli, & Gillian, 2003; Beasley & Salterio, 2001). Additionally, larger audit committees are able to effectively carry out their responsibilities as they are willing to devote greater resources and authority (Madi, Ishak, & Manaf, 2014). Therefore, there is a greater possibility of uncovering and resolving potential issues in corporate reporting. In Malaysia, Madi et al. (2014) find a positive association between audit committee size and corporate voluntary disclosure, implying improved corporate reporting.

However, Pincus, Rusbarsky, and Wong (1989) and Eichenseher and Shields (1985) argue that larger audit committees lose concentration and are less participative than smaller ones, therefore the corporate governance function is improved therefore reducing the likelihood of financial restatements. Therefore,

Hypothesis 3: The bigger the size of the audit committee size, the lower the likelihood of financial restatement.

Audit committee expertise

In developed countries, studies have found that presence of audit committee members with financial knowledge is negatively associated with financial restatements (Abbott et al., 2004; DeZoort & Salterio, 2001). The increase in the role of the audit committee coupled with the high level of qualification among the audit committee members help improve financial reporting process and audit committees' competency in reducing financial restatement (Abdullah et al., 2010; Salleh et al., 2006). DeZoort and Salterio (2001) assert that directors of the audit committee who have better audit qualifications and prior experience are more likely to give more accurate opinions as compared to associates, particularly on auditing and financial reporting tasks. The fourth hypothesis is as follows:

Hypothesis 4: Increase in the number of the audit committee members who possess financial expertise results in a lower likelihood of financial restatement.

Data and research method

To test the hypotheses stated above, this study is conducted on firms listed on the Bursa Malaysia for the year 2008 (total firms: 993) and 2009 (total firms: 980). Data for the variables used are gathered from the firms' annual reports. To find evidence of restated statements, some keywords are searched in each firm's annual reports such as "restate, " "restated, " "restatement, " and "prior year adjustments." As a result, 235 firms for the year 2008 and 115 firms for the year 2009, resulting in a total of 350 firms, are considered as the firms that have restated their annual reports based on the definition of GAO. Refer to Table 1 for sample selection.

Table 1. Sample Selection.

Sample Selection Processes	Year	Year
Item	2008	2009
Main market firms	4	778
Ace market firms	0	109
Main board firms	658	68
Second board firms	210	15
MESDAQ firms	119	10
Total number of firms	991	980
Less finance firms	42	38
Less trust firms	0	0
Less close-end fund firms	1	1
Less real state investment trust firms	0	3
Less exchange-traded funds firms	0	1
Total number of listed firms observed	948	937
Number of firms found as a result of a keyword search	430	389
Less restatement not within the restatement definition of GAO	195	274
Total restatement firms	235	115
Percentage from the total number of listed firms observed	24.79	12.27

MESDAQ: Malaysian Exchange of Securities Dealing and Automated Quotation; GAQ: General Accountability Office.

Table 2. Reasons of Restatement.

Reason of Restatement	2008	2009	Total Incident of Restatement	Percentage
Cost or expense	114	72	186	34.1
Others	70	25	95	17.4
Revenue recognition	39	35	74	13.6
Restructuring, assets or inventory	109	49	158	29.0
Acquisitions and mergers	2	1	3	0.6
Reclassification	12	17	29	5.3
Total number of restatements	346	199	545	100

Following the methodology by Arthaud-Day, Certo, Dalton, and Dalton (2006), this study uses the match-pair process, where a control group sample is created. This control group includes firms that have not restated their annual reports, having similar financial year-end, roughly equal in size with the matched restated company, categorized in the same Bursa Malaysia classification of sector, and are listed on the same Bursa Malaysia board. The process of matching produces a total of 700 firms in the final sample.

Table 2 depicts the types of restatement the firms in the sample have committed. From the observation the highest restatement occurs on costs and expenses figures. The percentage of restatement due to costs and expenses misstatements is 34.1% followed by firms' restructuring of assets or inventory which is around 29%. The lowest is restatement due to acquisitions and mergers. This is similar to the observation by Abdullah et al. (2010) who find 39% firms restating their financial statements due to changes in costs and expense figures. This is followed by other factors at 34%. The fact that items on costs and expenses rank as the highest restatement category raises the question of audit committees' effectiveness in vetting the financial reports. There are several circumstances that led to financial restatement or material inaccuracy. Firstly, it can be the result of accounting errors due to the internal database used to support the accounting system or it may be simply a case of misrepresentation or incompetency in managing the accounting data. Secondly, it may signal failure to adapt to new accounting standards or generally accepted accounting principles. Finally, it may indicate a symptom of fraud practices and this will have severe repercussions on stakeholder's confidence and shares prices.

Table 3 shows the distribution of variables used in this study. It can be observed that audit committees' independence (AUCI) is slightly higher in nonrestated firms. This can explain the lower level of restatement incidence in these firms, but the highest number of AUCI in restated firms and nonrestated firms are merely three members indicating that firms have merely complied with MCCG (2000) requirement for the minimum number of audit committee members, which is three. Consistently, audit committees size (ACSIZE) is also in average around three members. Number of meeting (NOAM) is on average four to five times in a year for both types of firms, but

Table 3. Distribution of AUCI, NOAM, ACSIZE, and NOEXPERT.

	Nonrestated Firms		Restated Firms	
	No. Observation	Percentage	No. Observation	Percentage
AUCI				
2	57	16.3	99	28.3
3	272	77.7	235	67.1
4	20	5.7	15	4.3
5	1	0.3	1	0.3
NOAM				
1	2	0.6	3	0.9
2	1	0.3	1	0.3
3	7	2	4	1.1
4	111	31.7	188	53.7
5	179	51.1	119	34
6	26	7.4	20	5.7
7	11	3.1	9	2.6
8	3	0.9	4	1.1
9	4	1.1	1	0.3
10	2	0.6	0	0
11	1	0.3	0	0
12	1	0.3	0	0
13	2	0.6	0	0
14	0	0	0	0
15	0	0	0	0
16	0	0	1	0.3
ACSIZE				
2	1	0.3	4	1.1
3	236	67.4	292	83.4
4	90	25.7	48	13.7
5	20	5.7	4	1.1
6	2	0.6	1	0.3
7	0	0	1	0.3
8	1	0.3	0	0
NOEXPERT				
0	23	6.6	30	8.6
1	229	65.4	294	84
2	84	24	26	7.4
3	14	4	0	0

Note: AUCI = number of independent directors who are audit committee members over the total members of the audit committee; NOAM = number of meeting by the audit committee; ACSIZE = number of members in the audit committee; NOEXPERT = number of audit committee members who have financial or accounting experience in the past

there is one restated firm that has 16 meetings. In terms of expertise (NOEXPERT), a higher number of members with financial expertise is observed in nonrestated firms, whereby more than 24% of the nonrestated firms have more than one expertise compared to restated firms with only 7.4% experts on average.

Logistic regression analysis is then conducted based on the equation:

$$\begin{aligned}\text{RESTATEMENT} = {} & \alpha 0 + \beta_1\text{AUCI} + +\beta_2\text{NOACM} + \beta_3\text{ACSIZE} \\ & +\beta_4\text{NOEXPERT} + \beta_5\text{LEV} + \beta_6\text{SUB} + \beta_7\text{FOREIGN} \\ & +\beta_8\%\text{OUTSIDER} + \beta_9\text{AUREP} + \beta 10\text{BSIZE} \\ & +\beta 11\text{GROWTH} + \text{e}\end{aligned}$$

where,

RESTATEMENT =	Financial restatement
AUCI =	Audit committee independence
NOACM =	Audit committee meeting
ACSIZE =	Audit committee size
NOEXPERT =	Audit committee expertise
LEV =	Firm leverage
SUB =	Firm total subsidiaries
FOREIGN =	Firms' percentage of foreign subsidiaries
OUTSIDER =	Percentage of nonexecutive directors
AUREP =	Auditor reputation
BSIZE =	Board size
GROWTH =	Firms' growth
e =	residuals.

The measurement of the variables above is provided in Table 4.

Table 4. List of Variables and Measurement of Variables.

Variables	Acronym	Operationalization
Dependent variable		
Likelihood of financial restatement	RESTATEMENT	1 if the financial statements of the firm is restated, 0 otherwise.
Independent variables		
Audit committee independence	AUCI	Number of independent directors who are audit committee members over the total members of the audit committee.
Audit committee meetings	NOAM	Number of meeting by the audit committee.
Audit committee size	ACSIZE	Number of members in the audit committee
Audit committee expertise	NOEXPERT	Number of audit committee members who have financial or accounting experience in the past.
Control variables		
Leverage (%)	LEV	Percentage of total liabilities to total assets
Number of subsidiaries	SUB	Log number of total subsidiaries invested by the company.
Percentage of foreign subsidiaries (%)	FOREIGN	Total number of foreign subsidiaries divided by the total number of subsidiaries invested by the company.
Percentage of nonexecutive directors (%)	OUTSIDER	Number of outside board of directors as percentage of the total board of directors
Auditor reputation	AUREP	Number of board of directors who had experience working in a Big 4 company.
Board size	BSIZE	Log number of directors on board.
Growth	GROWTH	Market to book ratio of the company.

Table 5. Descriptive Statistic.

Variable	Restatement	Minimum	Maximum	*M*	*SD*
AUCI	Restated	2.00	5.00	2.7657	0.53204
	Nonrestated	2.00	5.00	2.9000	0.47124
NOAM	Restated	1.00	16.00	4.5829	1.10883
	Nonrestated	1.00	13.00	4.9314	1.31375
ACSIZE	Restated	2.00	7.00	3.1686	0.48783
	Nonrestated	2.00	8.00	3.4000	0.67285
NOEXPERT	Restated	0.00	2.00	0.9886	0.40041
	Nonrestated	0.00	3.00	1.2543	0.63419
LEV	Restated	0.01	1.47	0.2865	0.20523
	Nonrestated	0.01	1.06	0.2536	0.19772
SUB	Restated	0.00	324.00	21.1771	32.32380
	Nonrestated	0.00	115.00	14.0514	15.46482
FOREIGN	Restated	0.00	88.89	18.2018	21.76208
	Nonrestated	0.00	100.00	14.6349	20.61367
OUTSIDER	Restated	0.00	100.00	59.7692	17.66235
	Nonrestated	22.22	100.00	58.3974	13.25751
AUI	Restated	0.00	2.00	0.0457	0.24686
	Nonrestated	0.00	1.00	0.0143	0.11884
BSIZE	Restated	4.00	15.00	7.6600	2.05270
	Nonrestated	3.00	14.00	7.4914	1.84614
GROWTH	Restated	−71.77	30.60	6.6188	10.97816
	Nonrestated	−30.93	36.84	4.4439	10.79904

Note: RESTATEMENT is 1 if the financial statements of the firm is restated, 0 otherwise. AUCI is the number of independent directors who are audit committee members over the total members of the audit committee. NOAM is the number of meeting by the audit committee. ACSIZE is the number of members in the audit committee. NOEXPERT is the number of audit committee members who have financial or accounting experience in the past. LEV is the percentage of total liabilities to total assets. SUB is the log number of total subsidiaries invested by the company. FOREIGN is the total number of foreign subsidiaries divided by the total number of subsidiaries invested by the company. OUTSIDER is the number of outside board of directors as percentage of the total board of directors. AUREP is the number of board of directors who had experience working in a Big 4 company. BSIZE is the log number of directors on board. GROWTH is the market to book ratio of the company.

Results and discussion of findings

Table 5 depicts descriptive statistics of the restated and nonrestated firms. The statistics indicate the average audit committee independence of the restated firms is 2.76 independent members whereas that of the nonrestated firm is 2.9 independent members. The average number of audit committee meetings for restated firms is 4.58 times, which is lesser than the nonrestated firms at an average of 4.93 times. The average number of audit committee size for the restated firms is 3.16 members, which is fewer than the nonrestated firms at an average of 3.4 members. Moreover, the restated firms have an average number of 0.98 financial/accounting experts, which is less than one whereas nonrestated firms have an average expertise of 1.25 audit committee members respectively. In general, the audit committee is stronger in firms that do not restate their statements as it is bigger in size, more independent, meets more often and has more qualified members.

Table 6. Spearman Correlation Matrix.

Variable	AUCI	NOAM	ACSIZE	NOEXPERT	LEV	SUB	FOREIGN	OUTSIDER	AUI	BSIZE	GROWTH
AUCI	1.000										
NOAM	.009	1.000									
	.812										
ACSIZE	.276**	.056	1.000								
	.000	.139									
NOEXP	.110**	.031	.074	1.000							
ERT	.003	.415	.050								
LEV	−.049	−.011	−.088*	.021	1.000						
	.192	.779	.020	.587							
SUB	.116**	−.003	−.022	.025	.020	1.000					
	.002	.937	.568	.503	.591						
FOREIG	.032	−.092*	−.019	−.018	−.008	.295**	1.000				
N	.396	.015	.612	.641	.834	.000					
OUTSID	−.007	−.033	.003	−.037	.032	.033	−.003	1.000			
ER	.854	.383	.941	.323	.404	.386	.941				
AUI	−.057	.041	−.028	−.036	−.093*	−.036	−.052	−.038	1.000		
	.132	.280	.466	.344	.014	.338	.167	.310			
BSIZE	.155**	−.040	.050	.043	−.062	.117**	.022	−.162**	.001	1.000	
	.000	.295	.186	.251	.104	.002	.553	.000	.972		
GROWT	−.022	−.060	.030	−.045	−.050	−.011	.008	−.029	.097*	.015	1.000
H	.568	.111	.428	.230	.184	.771	.823	.446	.010	.696	

Note: RESTATEMENT is 1 if the financial statements of the firm is restated, 0 otherwise. AUCI is the number of independent directors who are audit committee members over the total members of the audit committee. NOAM is the number of meeting by the audit committee. ACSIZE is the number of members in the audit committee. NOEXPERT is the number of audit committee members who have financial or accounting experience in the past. LEV is the percentage of total liabilities to total assets. SUB is the log number of total subsidiaries invested by the company. FOREIGN is the total number of foreign subsidiaries divided by the total number of subsidiaries invested by the company. OUTSIDER is the number of outside board of directors as percentage of the total board of directors. AUREP is the number of board of directors who had experience working in a Big 4 company. BSIZE is the log number of directors on board. GROWTH is the market to book ratio of the company.

* Correlation is significant at the 0.05 level (2-tailed), ** Correlation is significant at the 0.01 level (2-tailed).

Table 7. Result of the Logistic Regression.

Variable	Predicted sign	Coefficient	*SE*	*p* Value	χ^2Value
Panel A: Without control variables					
AUCI	Negative	-0.284	0.170	0.094*	0.752
NOAM	Negative	-0.266	0.076	0.000***	0.766
ACSIZE	Negative	-0.638	0.161	0.000***	0.528
NOEXPERT	Negative	-0.972	0.170	0.000***	0.378
Panel B: With control variables					
AUCI	Negative	-0.400	0.179	0.025**	0.670
NOAM	Negative	-0.244	0.078	0.002***	0.783
ACSIZE	Negative	-0.617	0.160	0.000***	0.540
NOEXPERT	Negative	-0.996	0.175	0.000***	0.369
LEV	Positive	1.099	0.444	0.013*	3.000
SUB	Positive	0.017	0.005	0.001***	1.017
FOREIGN	Positive	0.006	0.004	0.154	1.006
OUTSIDER	Positive	0.007	0.005	0.225	1.007
AUI	Positive	0.965	0.515	0.061	2.625
BSIZE	Positive	0.061	0.045	0.175	1.063
GROWTH	Positive	0.018	0.008	0.023*	1.018
Nagelkerke R^2		21.7%			
Model summary statistics					
Hosmer & Lemshow goodness-of-fit statistic		13.662			

Note: RESTATEMENT is 1 if the financial statements of the firm is restated, 0 otherwise. AUCI is the number of independent directors who are audit committee members over the total members of the audit committee. NOAM is the number of meeting by the audit committee. ACSIZE is the number of members in the audit committee. NOEXPERT is the number of audit committee members who have financial or accounting experience in the past. LEV is the percentage of total liabilities to total assets. SUB is the log number of total subsidiaries invested by the company. FOREIGN is the total number of foreign subsidiaries divided by the total number of subsidiaries invested by the company. OUTSIDER is the number of outside board of directors as percentage of the total board of directors. AUREP is the number of board of directors who had experience working in a Big 4 company. BSIZE is the log number of directors on board. GROWTH is the market to book ratio of the company.

Table 6 presents the results of the Spearman correlation analysis. The results indicate that there is a significant positive association between audit committee size (ACSIZE), audit committee expertise (NOEXPERT), total subsidiaries (SUB) a proxy for firms' complexity, board size (BSIZE) with audit committee independence (AUCI). In addition, a significant negative correlation is observed between audit committee meetings (NOACM) and the percentage of foreign subsidiaries (FOREIGN), as another proxy for firms' complexity. Based on the Spearman correlation analysis there are no issues of multicollinearity in the variables used in this study because most of the correlations are less than 80% (Hair, Black, Babin, & Anderson, 2009).

The result of logistic regression is summarized in Table 7. In Panel A, the dependent variable represented by financial restatement variable is regressed against the independent variables excluding the control variables. Panel B incorporates control variables in the regression to analyze the implications of the full model on the hypotheses developed earlier. In this study, firms with restated financial statements are coded as one and the matched control firms are coded as zero. The statistic of Hosmer and Lemeshow in Agresti (1996) is insignificant with the p value of > .05, thus fulfilling the goodness of fit of the model. The explanatory strength of the model measured using Nagelkerke R^2 is 21.7 that is lower compared to Abdullah et al. (2010). However the results are based on the year of observation of 2008 and 2009 that is different from Abdullah et al. (2010) who conducted their study after the implementation of MCCG (2000).

As presented in Panel B of Table 7, there is a negative association between audit committee independence (AUCI) and financial restatement at 5% significant level. This indicates that firms with more independent directors in the audit committee are less likely to be involved in financial restatement and proves that the role of the independent director in the audit committee significantly improves financial reporting process and the accountability of the financial statement (Abbott et al., 2004; Beasley, 1996). Recent study by Salleh and Haat (2014) using 280 companies listed in Bursa Malaysia in year 2008 to 2009 also find audit committee independence reduces earnings management. Even though this study focuses on financial restatement, but the findings by Salleh and Haat (2014) suggest an effective audit committees improve audit effectiveness.

The final result on audit committee expertise also supports the requirement of RMCCG2007 for qualified audit committee members in the audit committee. The result is positive and significant at 1% significant level. Thus, the increase in audit committee members possessing financial expertise significantly reduces the likelihood of financial restatement. Further, similar results are found by Abbott et al. (2004) based on Blue Ribbon Committee recommendation that audit committees expertise is an important deterrent for financial restatement. Even though the findings of this study is in contrast to Abdullah et al. (2010), the samples chosen which is year 2008 and 2009 suggest the efforts made in improving audit effectiveness materialized post-MCCG (2000). The current study focuses on specific firms that have restated earnings whereas most studies in Malaysia generally observe audit committees qualification on earnings management practices and earnings quality. As such, the results were unable to capture the significant roles of audit committees in mitigating the occurrence of these activities (Abdul Rahman & Mohamed Ali, 2006; Wan Ismail, Dunstan, & Zijl, 2010). Based on the findings presented in Table 7, it can be summarized that the audit committee plays a pivotal role in improving financial reporting process and earnings quality of the reported financial figures.

Summary and conclusions

The main objective of this research is to investigate the implication of audit characteristics on firm's financial restatement after the implementation of

RMCCG2007 due to its heavy emphasizes on the role of the audit committee in improving firm's corporate governance. In summary the results provides consistent evidence that audit committee size, the number of meetings it conducts, its members' independence experiences have positive repercussions on firm's financial restatement. The results suggest that efforts made by RMCCG2007 in improving the roles and functions of the audit committee have proven to be effective. However there are several limitations of this study.

Firstly, because Malaysia is unique and has different races that influence the country politically and economically, ethnicity has a major influence on how certain decisions may affect the business networking and rent-seeking activities in major investment projects. Being a multiethnic country, board decision making may be influenced by the ethnic representation on the board. Ethnic Malays are argued to be politically influenced and may be subjected to higher audit fees due to their weaker governance structures, and some have argued otherwise. However some papers argue that ethnic Malay representation on the board may be due to their competency rather than political networking (Gomez & Jomo, 1997; Yatim, Kent, & Clarkson, 2006).

One of the main issues surrounding corporate governance implementation in Asian countries including Malaysia is the institutional factors that influence managers' reactions and shareholders anticipation of corporate decision making. Because Malaysia is also unique in terms of gender, race, and religion of directors, future studies should look into the implications of these factors on financial restatement. These factors influence managerial ethics, values, and decision making. The uniqueness of the board composition in Malaysian firms is not extensively studied. In the context of gender, for instance, market reactions to female directors in Malaysia have not been probed thus far (according to the author's knowledge). Furthermore, the Islamic values and teachings possessed by these independent directors may have implications toward managerial belief and attitudes. Because corporate governance in Malaysia has entered into new phases with the introduction of the Revised Malaysian Code of Corporate Governance 2007 (RMCCG 2007), there is a need to ensure that corporate governance is effective in mitigating financial restatement occurrence in Malaysia.

This study includes several opportunities for future research, specifically with regards to different methodology, sample periods, or current regulations related to corporate governance. In extending the current research, the roles of audit committees can be extended toward earnings management practices. For instance, Mohd-Saleh et al. (2007) investigate the implication of audit committee characteristics and earnings management on Malaysian firms' pre-RMCCG (Mohd-Saleh et al., 2007). Findings suggest that audit committee mitigates earnings management. After the implementation of MCCG (2012) and the imposition of assessment test and 9-year tenure for independent directors, studies on these have become imperative.

Secondly, the findings of this research might not be generalizable to other developing countries which have a different ownership and regulation structure. A comparative study can be conducted in the future, to look into these differences particularly in family owned firms. Thirdly, the data used was only for the year 2008 and 2009, immediately after RMCCG2007 implementation. Thus, the findings may not be generalizable to periods after the recently implemented MCCG2012.

The findings of this study have important implications for policy makers in understanding the significance of corporate governance in developing countries like Malaysia. It provides valuable input for regulatory bodies like the Securities Commission, the Bursa Malaysia, and Malaysia Institute of Corporate Governance in formulating guidelines and policy in improving firm's financial reports. Finally, investigating the effects of audit committee characteristics on restatements would add to the existing knowledge of the area and contribute toward a better understanding of the audit committee characteristics that significantly affect financial restatement.

Note

1. "Bursa Malaysia Listing Requirements 15.09 states that:

(1) A listed issuer must appoint an audit committee, from amongst its directors, which fulfills the following requirements:
  (a) the audit committee must be composed of not fewer than three members;
  (b) all the audit committee members must be non-executive directors, with a majority of them being independent directors; and
  (c) at least one member of the audit committee-
(i) must be a member of the Malaysian Institute of Accountants; or
(ii) if he is not a member of the Malaysian Institute of Accountants, he must have at least three years working experience and-
  (aa) he must have passed the examinations specified in Part I of the First Schedule of the Accountants Act 1967; or
  (bb) he must be a member of one of the associations of accountants specified in Part II of the First Schedule of the Accountants Act 1967; or
(iii) fulfils such other requirement as prescribed or approved by the Exchange."

Disclosure statement

The authors report no conflicts of interest. The authors alone are responsible for the content and writing of the article.

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