BOARD OF DIRECTORS' CHARACTERISTICS AND FINANCIAL RESTATEMENT

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ABSTRACT

The purpose of this study is to explore the effects of board characteristics on financial restatement. The characteristics of board of directors are board size, board independence, director's tenure, gender diversity, board competence, board ethnicity, foreign board, duality role, multiple directorship, directors having political connections, board age and founder on board. The sample comprise of 76 restatement firms and 152 non-restatement firms that are listed on the Main Market of Bursa Malaysia for the period between 2006 and 2013. This study used univariate and multivariate statistical techniques to test research hypotheses. The findings show that size of board, cross directorships, political linkages and founder on board are significantly associated with the financial restatement incidents. These findings may provide some general implication for future research that some form of board characteristics can influence the direction and magnitude of financial restatement. Furthermore, this study focuses on the Agency Theory and the Resource Dependence Theory in attempt to explain the relationship between board characteristics and financial restatement.

Keywords: Financial restatement, accounting misstatement, board of directors' characteristics, board composition, board diversity, corporate governance.

INTRODUCTION

The incidence of financial restatement has become rampant in the global arena, especially after a series of high profile accounting scandals such as Enron and WorldCom (Hasnan & Hussain, 2015). Furthermore, Wang & Huang (2014) claim that the number of financial restatement incidence is increasing over the years. According to Badertscher & Burks (2011), financial restatement occurs when companies are directed to restate their financial statements that contain accounting misstatements. Another definition of financial restatement is "corrections of accounting misstatements made previously by negligent, or in the extreme, opportunistic managers" (Baber, Kang, Liang & Zhu, 2009). United States General Accountability Office (GAO) highlights nine reasons that give rise to financial restatement including expense recognition; revenue recognition; acquisitions and mergers; securities-related issues; related-party transactions;

restructuring of assets/inventory; reclassification; in-process research and development; and others (GAO, 2002).

Financial restatement has received a great attention from researchers, regulators and practitioners which has sparked numerous debates and opinions about its causes and consequences. According to Bischoff, Finley & LeBlanc (2008), several companies suffered huge losses following the incidence of financial restatements such as a sudden drop of share prices and a decrease in market capitalization. For example in Malaysia, the most prominent case of accounting fraud that give rise to financial restatement is Transmile Group Berhad. This company experienced massive losses over millions of ringgit from the fraud scandal (Abdullah, Yusof & Nor, 2010). Based on Mahadeo & Soobaroyen (2012), they claim that ineffective monitoring functions of board of directors have resulted in several accounting scandals.

The failure of BOD in monitoring management activities and protect the interest of shareholders have caused massive losses to the companies and stakeholders following the incidence of financial restatement. Currently, in the context of Malaysia, the discussion on extensive BOD characteristics and its relation to financial restatement is still lacking. Therefore, this study covers three main category of BOD characteristics mainly board composition, board position and board diversity. The motivation for focusing on many board characteristics is as follows. First, board of directors is one form of corporate oversight function that monitors management activities. Second, selection of board of directors' characteristics goes beyond the board composition (i.e. board size, board independence, board tenure and board competence) to include board diversity (i.e. gender, ethnicity, foreign board and board age) and board position (i.e. founder, multiple directorship, political connection and duality). These may provide the new avenue for the researchers, regulators and practitioners of the importance of board characteristics on the likelihood of financial restatement. Thus, the objective of this study is to examine the relationship between board characteristics and financial restatement among Malaysian Public Listed companies.

Two underlying theories are used to describe the association between board characteristics and the likelihood of financial restatement, mainly the Agency Theory and the RDT. The Agency Theory suggests that the role of board of directors is to serve as a monitoring body for managerial activities (Chen & Hsieh, 2010). However, in some cases, the board of directors fails to monitor management actions, thus creating an agency problem to the company (Masulis, Wang & Xie, 2009). Furthermore, based on the RDT concept, the board of directors plays a significant role in providing effective monitoring function through their valuable expertise, knowledge and business experiences (Rahman & Ali, 2006). The reminder of this paper is organized as follows, prior literature and hypotheses development, research design and methodology, results of univariate and multivariate analysis and lastly, conclusion.

LITERATURE REVIEW

Many of the prior restatement studies have concerned on the role of board of directors. One of the areas is relating to board characteristics (Abdullah et al., 2010; Ueng, Koehn, & Chang, 2009), specifically on board independence (Agrawal & Chadha, 2005; Marciukaityte, Szewczyk & Varma, 2009; Wang, Lin & Chao, 2013) and CEO duality on financial misstatements (Baber, Kang & Liang, 2006; Jiang, Habib & Zhaou, 2015). Next area is the impact of directors' compensation on accounting restatements (Kim, Roden & Cox, 2013) and another part is the influence of restatement activities on directors' turnover (Srinivasan & Richardson, 2005). Hence, the focus of this study is how board characteristics impact the likelihood of financial restatement. The board characteristics include board size, board independence, director's tenure, gender diversity, board competence, board ethnicity, foreign board, duality role, multiple directorships, directors having political connections, board age and founder on board.

Board size

The MCCG 2007 recommends that "every board should examine its size in order to ensure that there are enough members to discharge responsibilities and perform various functions". Therefore, it is believed that boards of different sizes have different levels of monitoring capability (Rahman & Salim, 2010). Prior studies have investigated the role of board size as an internal monitoring mechanism that potentially minimize the agency costs. They find significant results that board size is negatively associated with earnings management (Saleh, Iskandar & Rahmat, 2005) and positively associated with firm performance (Shukeri, Shin & Shaari, 2012). In contrary, other studies claim that the size of the board of directors is positively associated with earnings management (Rahman & Ali, 2006) and earnings restatement incidence (Chen & Hsieh, 2010). However, more prior studies fail to provide evidence on the association between board size and restatement events (Ahern & Dittmar, 2012; Ku Ismail & Abd Rahman, 2011; Srinivasan & Richardson, 2005; Veronica & Bachtiar, 2005). Thus, the following hypothesis is formulated:

H1: There is a significant relationship between board size and the incidence of financial restatement.

Board Independence

Rahman & Salim (2010) describe the term, "independent" as free from any relationship which could interfere with the director's judgement. The Agency Theory suggests that independent directors play a significant role in monitoring management actions and company's activities (Rakoto, 2012). Also, the MCCG

2012 recommends Malaysian PLCs to appoint independent directors who are responsible in monitoring management on behalf of shareholders. Past researchers have explored the relationship between board independence and financial restatements (Abdullah et al., 2010; Hasnan & Hussain, 2015; Rakoto, 2012; T. Wang et al., 2013; Zhizhong, Juan, Yanzhi & Wenli, 2011). Some studies reveal that the proportion of independent directors on the board could reduce the incidence of restatement (Rakoto, 2012 and Zhizhong et al., 2011). Thus, we predict that there is negative relationship between board independence and financial restatement. This leads to the following hypothesis:

H2: There is a significantly negative association between board independence and the incidence of financial restatement.

Board Tenure

Long-serving directors are more knowledgeable and experienced in business compared to new directors (Ueng et al., 2009). They describe long-serving directors as directors serving on the board for over 15 years of tenure. Also, Kim et al. (2013) posit that directors having longer service on the board possess more knowledge and experience which could facilitate the decision-making activities. As such, the RDT theory views the board as resource providers into the firm. Prior evidence reveal that long-serving directors are in better position to improve financial disclosures thus reducing the incidence of financial restatement (Donoher, 2009) and earnings management activities (Ghosh, Marra & Moon, 2010; Peasnell, Pope & Young, 2000). However, Rahman & Ali (2006) find no significant evidence on the association between the tenure of independent directors and earnings management activities. This result supports a prior study (Ueng et al., 2009), who reveal that the incidence of financial restatement is not found to be associated with the tenure of directors. These lead to the following hypothesis:

H3: There is a significantly negative association between board tenure and the incidence of financial restatement.

Board Gender

In response to boardroom diversity approach, the MCCG 2012 recommends Malaysian PLCs to consider women candidates in the selection of board members. Adams & Ferreira (2009) claim that female directors are highly involved in board meetings, which could strengthen corporate oversight in organization and effectively reduce the agency cost. Further (Abbott, Parker & Presley (2012) state that female directors on board do contribute to formulating business strategy. They find a significant and negative association between the presence of at least one female on board and the likelihood of financial restatement. The evidence on the relationship between female board representation and firm performance is significant. For example, Mahadeo & Soobaroyen (2012) report a positive impact of female directors on firm performance. In contrast, more studies provide no significant influence of female directors on firm performance (Rose, Munch & Funch, 2013; Shukeri et al., 2012; Marimuthu, 2009) and financial restatements (Ueng et al., 2009). Hence, the following hypothesis is established:

H4: There is a significantly negative association between female board presence and the incidence of financial restatement.

Board Competence

Recent corporate governance reform requires board members to be more financially competent. For instance, based on the Bursa Malaysia Listings, Malaysian PLCs must have an Audit Committee with at least one member with qualification in the field of finance or accounting. Fostering board competency is very important to enhance corporate oversight function, particularly in monitoring management activities (Rahman, Moniruzzaman & Sharif, 2013). Based on the RDT theory, the role of board members is to serve as resource providers specifically through various competencies and experiences in order to improve performance. For example, Masulis, Wang & Xie (2012) report a negative and significant association between the presence of independent directors with industry experiences and restatements. Similarly, other studies find a negative association between financially competent board members and the incidence of earnings management (Choi, Jeon & Park, 2004; Xie, Davidson & Dadalt, 2003). Conversely, Rahman & Ali (2006) reveal insignificant influence of board competence on the incidence of restatement. As such, the following hypothesis is posited:

H5: There is a significantly negative association between board competence and the incidence of financial restatement.

Board Ethnicity

Malaysia is one of multiracial countries which attract many researchers to explore the effect of ethnic diversity in corporate financial reporting. Yunos, Ismail & Smith (2012) examined the impact of multi-ethnic groups, including Malays (also known as Bumiputera), Chinese, Indians and others on accounting conservatism and state that the presence of Malay or Chinese directors on the board led to more accounting conservatism. As such, the RDT views ethnic diversity as important resources to the firm (Singh, 2007). For voluntary disclosure, Haniffa & Cooke (2002) find a positive and significant association between Malay directors and voluntary disclosures thus suggesting that the presence of Malay directors on board could increase transparency in financial reporting. On the other hand, Johl, Subramaniam & Mat Zain (2012) report a positive relationship between the presence of Bumiputera CEO and audit fees, thus require Bumiputera CEOs to be more accountable and transparent in doing businesses and subsequently reduce the audit fees. In contrast, a recent study provides no evidence to support the relationship between the proportion of Bumiputera directors on the board and the incidence of financial restatements (Wahab, Gist & Majid, 2014). Thus, the following hypothesis is postulated:

H6: There is a significantly negative association between the proportion of Bumiputera members on the board and the incidence of financial restatement.

Foreign Board

Masulis et al. (2012) state that the effectiveness of foreign directors on board can be influenced by three primary factors, mainly; (1) location of foreign directors (2) company's resources, and (3) local legislations. In line with RDT theory, some companies demand for foreign directors who have capabilities in terms of advisory, global business networking and international market experiences (Adams, Hermalin & Weisbach, 2010). Thus, foreign directors can be used as a monitoring tool to reduce the occurrence of financial restatement. Similarly, few studies reveal that the presence of foreign directors may improve firm performance (Choi, Park & Yoo, 2007; Ujunwa, Nwakoby & Ugbam, 2012). However, evidence show that the presence of foreign directors on board could impede firm performance (Masulis et al., 2009; Kilic, 2015 and Adams et al., 2010). Also, Masulis et al. (2012) imply that foreign independent directors are less effective in oversight functions, which will increase the incidence of financial misreporting. Therefore, the hypothesis on foreign board is formulated as follows:

H7: There is a significant association between foreign board and the incidence of financial restatement.

Duality Role

Dual position of CEO and chairman of the board may affect corporate governance system. Combining both roles provides a conflict of interest in the organization. Hence, it is a critical issue which has received greater attention of researchers. Some studies report that the existence of duality role on board may weaken corporate performance (Efendi, Srivastava & Swanson, 2007; Ghosh et al., 2010). Other related studies concern financial restatement. Jiang et al. (2015) and Rakoto (2012) find that the association between CEO's dual position and restatements is significantly positive, which in turn create an agency problem. Nevertheless, Wang et al. (2013) posit insignificant finding on the relationship between CEO duality and the incidence of financial restatement. This result supports previous studies (Abdullah et al., 2010 and Shukeri et al., 2012). Thus, it is hypothesized that:

H8: There is a significantly positive association between duality role and the incidence of financial restatement.

Multiple Directorships

Few corporate governance standards have been formalized in response to multiple directorships. For example, the Practice Note 13 of Bursa Malaysia outlines a maximum number of directorships held by directors in listed companies, which limits to 10 directorships. Some companies benefit from the presence of multiple directorships on board, while others do not. Some studies claim that multiple directorships may improve the quality of financial reporting (Srinivasan & Richardson, 2005) and enhance monitoring activities (Beasley, 1996 and Saleh et al., 2005). Thus, multiple directorships can be used as a monitoring tool to reduce the agency cost. Whereas, Ahn, Jiraporn & Kim (2010) contend that directors who hold multiple directorships are busy to serve on other firms' boards and therefore, less likely to involve in strategic business decisions. By contrast, Ueng et al. (2009) posit no significant evidence on the relationship between multiple directorships and restatement incidence, thus reaffirm the findings by Hasnan & Hussain (2015). Hence, these arguments lead to the following hypothesis:

H9: There is a significant association between multiple directorships and the incidence of financial restatement.

Political Connections

Malaysia is well known for its number of politically connected firm (Faccio, 2006). Further, Sharif, Kyid & Wei (2015) state that Malaysian PLCs have a propensity to nominate independent directors, who have strong political linkages with the government and the ruling parties. They measured political connections by number of directors with current or former positions in the government or the ruling political parties. Chaney, Faccio & Parsley (2011) claim that the politically-connected firms are less likely to display credible financial disclosures compared to non-connected firms because of the protection they enjoy once connections are established. This result supports the political economy theory, which suggests political connections are a source of domestic benefit for firms. Prior empirical study by Hussin, Hasnan & Sanusi (2014) find a significantly negative relationship between political connections and the likelihood of accounting misstatements. The result implies that although politically connected firms report low quality of financial disclosures which may lead to accounting misstatements, these firms are protected from negative consequences or prosecution. On the contrary, Hasnan, Rahman & Mahenthiran (2013) fail to find any significant relationship between political connections and fraudulent financial reporting among Malaysian PLCs. Ultimately, the hypothesis for political connections is as follows:

H10: There is a significant association between political connections and the incidence of financial restatement.

Board Age

Board age diversity has been ranging between younger directors and older directors (Ali, Ng & Kulik, 2014). Moreover, both younger and older directors possess unique attributes which could enhance firm performance (Jhunjhunwala

& Mishra, 2012). Past researchers have explored the association between firm performance and board age, with somewhat mixed results. Poon, Yap & Lee (2013) obtain a significant and positive association between senior board members and firm value. This result signifies the contribution of older directors in improving business operations. Thus, there is a link between the RDT and board age in terms of the role of senior directors in providing valuable resources to the firm. In addition, Mahadeo & Soobaroyen (2012) suggest that board members should comprise of a mixed age between 36 to 55 years old, which will increase firm value. However, some evidence appears differently. For instance, Ali et al. (2014) find a negative association between age diversity and corporate performance, while, Jhunjhunwala & Mishra (2012) obtain insignificant finding. Such evidence leads to the following hypothesis:

H11: There is a significant association between senior board members and the incidence of financial restatement.

Founder on Board

Typically, founders are viewed as having a greater sense of belonging and possess a strong controlling power over their firms (Hussin et al., 2014). Founders contribute to leadership development (Chahine, Filatotchev & Zahra, 2011) and monitoring efficacy (Beneish, Marshal & Yang, 2011). Further, Hasnan & Hussain (2015) conclude that the existence of founder on board acts as a monitoring tool that can reduce financial restatements. This provides a basis to support the finding of a negative association between founders and the likelihood of restatement. On the other hand, Hasnan et al. (2013) extend Donoher (2009) and report that firms with founder on the board is positively associated with the incidence of accounting misstatements. Findings from their studies signify that founders fail to perform their oversight duties, which in turn would create an opportunity for managers to misstate financial statements and eventually increase the agency cost. Based on these arguments, founders on board can be hypothesized as follows:

H12: There is a significant association between founder on board and the incidence of financial restatement.

METHODOLOGY

The sample of this study was identified by searching few keywords relating to restatements, such as “restate”, “restatement”, “restated”, “prior adjustment”, “reclassified” and “comparative” in each annual report of Malaysian PLCs. The annual reports were downloaded from Bursa Malaysia website which comprise of 814 companies from 11 industries, such as consumer, finance, hotels, close-end funds, construction, real estate investment trusts (REITs), exchanged traded funds (ETF), plantation, properties, technology and trading services. However, 61 firms in the financial services industry[1] were excluded from the list of annual reports because those firms are practicing different[2] corporate governance principles (Abdullah et al., 2010).

Finally, a total of 76 companies were found with reporting restatements from 2006 to 2013. **Table 1 Panel A** presents a summary of total restatement cases. Consistent with past studies (Abdullah et al., 2010; Hasnan & Hussain, 2015) the final restatement companies were further classified into nine primary categories (i.e. cost/expense recognition; revenue recognition; securities-related issues; restructuring of assets/inventory; reclassification; acquisitions and mergers; related-party transactions; in-process research and development;and others) based on the restatement classifications by GAO.

Table 1 Panel A:

Financial Restatement Firms by Year

Year	Financial Restatement Firms	Percentage (%)
2013	10	13.2
2012	12	15.8
2011	6	7.9
2010	16	21.1
2009	8	10.5
2008	8	10.5
2007	5	6.6
2006	11	14.4
Total	76	100.0

[1] Consistent with prior study (Hussin et al., 2014), to avoid any confounding impacts of the financial crisis (i.e. Financial crisis in 1997/1998) or other events, this study begins with 2006 financial year. Also, this study has excluded firms in financial industry from the final sample as they are subject to different industry's rules and regulations.

[2] Hopt (2012) states that the scope of corporate governance of financial services industry is broader than other industries covering equity governance (referring to MCCG) and debt governance (to include debtholders, insurance policy holders and other creditors). On top of that, financial industry firm is subject to the regulatory requirements by the Bank Negara Malaysia (Poon, Yap & Lee, 2013).

Table 1 Panel B provides the breakdown of 76 restatement firms based on GAO's descriptions. For comparison purposes, a total of 152 non-restatement[3] companies were matched with restatement companies. This resulted in a total of 228 companies for this study. Consistent with previous literature by Hasnan et al. (2013); and Ettredge, Scholz, Smith & Sun (2010), information relating to board characteristics were hand collected from the sample of annual reports.

Table 1 Panel B:

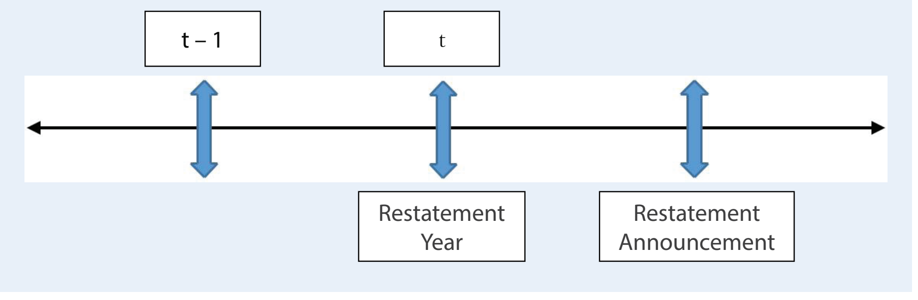
Financial Restatement Firms by GAO's Financial Restatement Descriptions

Category	Financial Restatement Firms	Percentage (%)
Revenue recognition	19	25.3
Cost or expense	17	22.7
Reclassification	13	17.4
Restructuring, assets, or inventory	16	20.8
Others	8	10.3
Related-party transaction	3	3.5
Total	76	100.0

The period of information is based on the timeline of restatement events as shown in **Figure 1**, where "t" signifies the year of restatement incidents; and "t – 1" denotes the year of information. For example, a company announcing in 2013 that it was restating its financial statements for the year 2012 would be matched with a control company based on 2011 information.

Figure 1:

Timeline of Financial Restatement



[3] As in Dechow, Larson & Sloan (2011), the purpose of developing two sets of control firms is to ensure that the findings can adequately generalize the real situation of financial restatement. The first set of control firm is matched by the firm size and industry while the second set does not.

As in prior study (Abbott et al., 2012), two types of variables are involved, mainly, one dependent variable and 12 independent variables. Also, this study adopts a logistic regression model to analyse the association between board characteristics and financial restatements. The regression model is as follows:

$RESTATEMENT = \alpha + \beta 1\ BDSIZE + \beta 2\ BDIND + \beta 3\ INDTENURE + \beta 4\ GENDER + \beta 5\ ACQLFD + \beta 6\ ECBD + \beta 7\ FORBD + \beta 8\ DUALITY + \beta 9\ CROSSDIR + \beta 10\ POLITIC + \beta 11\ AGE + \beta 12\ FOUNDER + \mathcal{E}$

The details of all variables are defined and summarized in **Table 2**.

Table 2:

Description of Variables

Variables	Operationalisation	Past Studies
RESTATEMENT (The incidence of financial restatement)	Indicator variable with a value of 1 for firms that restated their annual financial statements, 0 for control firms that did not.	(Hasnan and Hussain, 2015)
BDSIZE (Size of the board)	Likert scale of one to five: 1 = < 3 members, 2 = at least 3 members, 3 = 4 to 6 members, 4 = 7 to 9 members and 5 = 10 and more members on board.	(Hussin et al., 2014)
BDIND (Percentage of independent directors)	No of independent non-executive directors/total no of board members	(Zhizhong et al., 2011)
INDTENURE (Average years of service of independent directors on the board)	Average no of years of board service of independent non-executive directors	(Rahman and Ali, 2006)
GENDER (At least one female director on the board)	Indicator variable with the value of 1 if there is at least one woman director on the board, 0 else.	(Abbott et al., 2012)
ACQLFD (At least one member of the board is a qualified accountant)	Indicator variable with the value of "1" if at least one member is a qualified accountant and "0" otherwise	(Rahman and Ali, 2006)
ECBD (The ratio of Bumiputera directors)	Ratio of Bumiputera directors to total number of directors on board	(Rahman and Ali, 2006)

Variables	Operationalisation	Past Studies
FORBD (The ratio of foreign directors)	Ratio Foreign directors/Total no of Board of Directors	(Randøy, Thomsen & Oxelheim, 2006)
DUALITY (The dual position of CEO/ Chairman)	Indicator variable with the value of "1" if the roles of chairman and CEO are combined and "0" otherwise	Timeline of Financial Restatement
CROSSDIR (The percentage of directors having cross-directorships)	Percentage of directors having cross-directorship	(Hasnan and Hussain, 2015)
POLITIC (Directors/firms having political connections)	Indicator variable with the value of "1" if the firm is considered political connections and "0" otherwise	(Hussin et al., 2014)
AGE (The average age of directors on the board)	Average Age Board of Directors	(Bonn, 2004)
FOUNDER (Founder serves on the board)	Indicator variable with the value of "1" if there is founder on board and "0" otherwise	(Donoher, 2009)

RESULTS

Table 3 provides descriptive statistics that compare the mean value of variables for restatement firms and non-restatement firms. Panel A of Table 3 shows, on average, the board size of the firms that restated the accounts is significantly smaller than the firms that did not restate the accounts ($t = 1.824$, $p < 0.05$). Also, fewer restating than non-restating firms employ directors who held multiple directorships. The mean difference of CROSSDIR is also statistically significant ($t = 1.934$, $p < 0.05$). However, there is no significant difference of mean for BDIND, INDTENURE, ECBD, FORBD, and AGE. For BDIND, on average, the composition of independent directors on board is more than one-third of the board of directors of firms, thus fulfilling the requirements of MCCG (Abdullah et al., 2010). Results in Panel B of Table 3 indicate that, on average, the restatement samples are more likely to have at least one female director than the non-restatement samples. Further, there is no significant difference between the mean of ACLFD of restatement firms and control firms with a value of 0.95 and 0.97, respectively. However, the mean difference of DUALITY is statistically significant ($t = -2.071$, $p < 0.05$), consistent with (Abbott et al., 2012), who found that restating firms favour a duality role, thus providing univariate support for our hypothesis. Moreover, the mean difference for POLITIC of restatement samples is significantly higher (t = -2.458, p < 0.05) than its counterparts. As in Hussin et al. (2014), the mean difference for FOUNDER is also significant (t = -2.679. p < 0.05).

Table 3:

Univariate Results

Panel A: Continuous Variables

	Restatement Firms (N=76)		Control Firms (N=152)			
Variable	**Mean**	**Std. Dev.**	**Mean**	**Std. Dev.**	**Mean Diff.**	**t-value**
BDSIZE	3.610	0.655	3.770	0.635	0.164	1.824**
BDIND	0.450	0.143	0.437	0.113	-0.013	-0.684
INDTENURE	5.728	3.627	5.660	3.302	-0.068	-0.142
ECBD	0.396	0.277	0.344	0.271	-0.052	-1.348
FORBD	0.052	0.110	0.072	0.157	0.021	1.158
CROSSDIR	0.527	0.279	0.603	0.283	0.077	1.934**
AGE	55.12	5.900	55.07	4.967	-0.048	-0.061

Panel B: Dichotomous Variables

Variable	**Frequency of "0"**	**Frequency of "1"**	**Mean (restated)**	**Mean (non-restated)**	**Mean Diff.**	**t-value**
GENDER	134 (58.8%)	94 (41.2%)	0.360	0.440	0.086	1.249
ACQLFD	8 (3.5%)	220 (96.5%)	0.950	0.970	0.026	0.911
DUALITY	159 (69.7%)	69 (30.3%)	0.390	0.260	-0.138	-2.071*
POLITIC	179 (78.5%)	49 (21.5%)	0.320	0.160	-0.151	-2.458*
FOUNDER	130 (57%)	98 (43%)	0.550	0.370	-0.184	-2.679*

Notes:
N=228
* Denote significant at the 0.01 level.
** Denote significant at the 0.10 level.

The logistic regression analysis was conducted, and the results are presented in **Table 4**.

Table 4:

Multivariate Results

	Exp. Sign	B	Sig.	
BDSIZE	-	-0.680	0.014*	
BDIND	-	0.389	0.775	
INDTENURE	-	0.031	0.570	
GENDER	-	-0.269	0.411	
ACQLFD	-	-0.287	0.736	Nagelkerke R^2 0.201
ECBD	-	0.958	0.142	Observation 228 Classification 72.8%
FORBD	+	-1.000	0.393	performance - Restatement firms 40.8%
DUALITY	+	0.529	0.114	- Control firms 88.8%
CROSSDIR	-	-1.253	0.043*	
POLITIC	+	1.311	0.001*	
AGE	-	0.002	0.967	
FOUNDER	+	0.931	0.005*	
Constant		1.276	0.575	

The regression model has obtained a goodness of fit. The Omnibus Test of Model Coefficients indicates that the model is statistically significant with x2 = 37.57, df = 13, p = 0.000 and Cox and Snell R2 = 15.2 percent. Thus, the model can be used to compare restatement firms and control firms. Results in **Table 4** display that only H1, H9, H10 and H12 are supported. BDSIZE is negatively linked to the likelihood of financial restatement, consistent with a prior study (Shukeri et al., 2012), who posit that the size of board could enhance the effectiveness of monitoring function. Thus, having larger boards, more control and proper management will be emphasized and it will also reduce the agency problems. As expected, CROSSDIR is negatively associated with financial restatement, confirming the result of prior study by Saleh et al. (2005), who find that multiple directorships factor may hinder earnings management activities. As such, this study suggests that the presence of multiple directorships will be able to effectively monitor management and therefore reduce the agency costs.

Nevertheless, POLITIC is found to be positively associated with financial restatement, supporting the prior study by Chaney et al. (2011), who posit that firms with political linkages are more likely to have favourable treatment which protect them from being faced with more negative consequences following the poor quality of disclosures. Based on the political economy theory, this finding views political connection as a source of domestic benefit to the firms, particularly in terms of transparency. Also, there is significant and positive association between FOUNDER and financial restatement. According to Donoher (2009), the presence of founder on board provides ineffective corporate oversight, thus lead to misleading disclosures. This result supports the agency model, which suggests that founder on board may provide self-interest decision and eventually impose agency cost to the firm.

However, there is no evidence to support the relationship between the likelihood of financial restatement and the remaining independent variables (i.e. BDIND, INDTENURE, GENDER, ACQLFD, ECBD, FORBD, DUALITY and AGE). As in Abdullah et al. (2010), they find that BDIND, INDTENURE and DUALITY are not associated with financial restatement. Besides, FORBD and AGE have no impact on the financial restatement thus confirming the past study by Randøy, Thomsen & Oxelheim (2006). Moreover, there is also no significant influence of ACQLFD and ECBD on financial restatement (Rahman & Ali, 2006). The GENDER has not statistically related to the financial restatement, consistent with prior study (Ueng et al., 2009). Prior studies claim that such insignificant relationship could not be established because so many other predictor variables also lead to the incidence of financial restatement (Jhunjhunwala & Mishra, 2012; Ahern & Dittmar, 2012; Randøy et al., 2006). The additional sensitivity analysis was carried out to ascertain the robustness of the primary observations and the results are presented in **Table 5**.

Table 5:

Robustness Test Results

	Exp. Sign	B	Sig.		Exp. Sign	B	Sig.
Alternative 1				*Alternative 2*			
LOGBOARDSIZE	-	-3.744	0.021*	BDSIZE	-	-0.566	0.039*
BDIND	-	0.194	0.890	BDIND	-	0.220	0.870
INDTENURE	-	0.030	0.580	INDTENURE	-	0.028	0.601

GENDER	-	-0.249	0.444	GENDER	-	-0.310	0.340
ACQLFD	-	-0.471	0.577	ACQLFD	-	-0.244	0.773
ECBD	-	0.854	0.192	ECBD	-	0.783	0.218
FORBD	+	-0.944	0.417	FORBD	+	-0.841	0.460
DUALITY	+	0.481	0.149	DUALITY	+	0.604	0.068**
CROSSDIR	-	-1.283	0.038*	CROSSDIR	-	-1.217	0.049*
POLITIC	+	1.307	0.001*	POLITIC	+	1.251	0.001*
AGE	-	0.006	0.869	AGE	-	0.003	0.929
FOUNDER	+	0.967	0.004*	FOUND	+	2.555	0.065**
Constant		1.979	0.421			1.066	0.640

*Notes: *p < 0.05, **p < 0.1, two-tailed tests*

Alternative 1 of Table 5 presents as an alternative measurement for size of board. As in Kilic (2015), LOGBOARDSIZE is measured by the number of directors on the board. Alternative 2 of Table 5 shows FOUND as an alternative proxy for founder on board. For sensitivity test, FOUND is examined by the percentage of founder on the board (Hussin et al., 2014). Overall, the findings show similar observations from the primary results, thus indicating the results of this study as fairly robust.

CONCLUSION

The objective of this study is to examine the association between board characteristics and financial restatement. Results from multivariate analysis show that the size of board and multiple directorships have a negative and significant impact on the incidence of financial restatement. The board size factor is effective in monitoring management activities, thus reduce the agency costs (Shukeri et al., 2012). Similarly, firms that employ directors with multiple directorships are more effective to detect accounting misstatement that give rise to financial restatement (Saleh et al., 2005). Whereas, political connections and founder on board are positively associated with the financial restatement. Such positive association is due to the fact that the presence of both political connections and founder on board may interrupt business decisions that could lead to misleading disclosures. The findings are consistent with earlier works by Chaney et al. (2011) and Donoher (2009) respectively, which suggest that both predictor variables could create agency problems to the firm.

However, there are some potential limitations to this study. First, the database on restatement incident is not available in Malaysia. Second, this study used a small sample. Third, the findings may not be applicable to other countries due to different rules and regulations. This study implies that the quality of financial disclosures could be improved by revising current practices of board oversight mechanism. Furthermore, the findings would be useful for investors and other stakeholders in acquiring more credible financial information. It is believed that our findings have implications for corporate governance policies, specifically on the issue of quality financial reporting. Therefore, in future restatement study, it is suggested to consider the broader structure of management behaviour in the research design.

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