

AUDIT COMMITTEE CHARACTERISTICS AND FINANCIAL RESTATEMENT INCIDENCE IN THE EMERGING MARKET

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Abstract

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This paper discusses issues concerning audit committee characteristics that lead to the occurrence of financial restatements in Malaysian public listed companies (PLCs). The audit committee characteristics were measured using size, independence, frequency of meetings, audit tenure, gender, expertise, age, ethnicity, legal qualifications, and political connections. The data in this study were extracted from the annual reports of 100 firms that had restated their financial statement between 2006 and 2015, and a total of 200 non-restatement firms were matched and observed as control firms. Using univariate and multivariate statistical analysis, the results evince that there is a significant association between audit committee size and frequency of meetings as well as ethnicity and political connections of the audit committee members and the occurrence of financial restatements in Malaysian PLCs. However, the remaining audit committee characteristics show insignificant association with the occurrence of financial restatements. Consistent with Wan Mohammad, Wasiuzzaman, and Nik Salleh (2016), the results show that larger and more rigorous audit committees can strengthen the monitoring role and consequently reduce the occurrence of financial restatements. In addition, the results evince that Malay members in the audit committee have widespread political connections, which negatively affect the decisions by the audit committee, thereby increasing the occurrence of financial restatements.

Keywords: Audit Committee Characteristic, Financial Restatement, Emerging Market, Malaysia

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1. INTRODUCTION

A financial statement is the main instrument for a firm to disclose its financial condition to the shareholders; it is also one of the key references for investors in their decision-making process. Thus, it is crucial to ensure the accuracy of its information in order to guarantee the credibility of financial reporting. The audit committee is responsible, among others, to ensure that the financial statement complies with the relevant standards and regulations and it is free from errors and irregularities. The revised Malaysian Code on Corporate Governance, MCGG (Securities Commission of Malaysia, 2021) states that the audit committee has an important role in establishing a sound internal control system in an organisation.

Since shareholders rely on the audit committee for the accuracy of the information reported in the financial statement, one of the audit committee's crucial roles is monitoring management practices in order to protect shareholder value (Kim, Segal, Segal, & Zang, 2013; Mohammad, 2015; Jerubet, Chepng'eno, & Tenai, 2017). Hence, the audit committee's role in monitoring management, specifically in the financial reporting process and the verification of the financial statement is paramount (Madi, Ishak, & Abdul Manaf, 2013; Mohammad, 2015). To uphold the credibility of the financial reporting process (Haq, 2015), the audit committee must play the role of watchdog to ensure that good corporate governance is in place (Ali, Besar, & Mastuki, 2017). Effective monitoring by the audit committee would lead to higher quality information and reduce the possibility of unethical practices or the manipulation of the financial statement by management (Bala & Kumai, 2015).

Notwithstanding the above, Hasnan, Rahman, and Mahenthiran (2013) argued that since the top managers are directly involved in the financial reporting process, they can override the procedures laid down under the internal control system, thus providing a loophole for them to issue a misleading financial statement. Such a circumstance increases the number of financial restatement cases and high-profile corporate scandals in both developed and emerging countries.

The issue of financial restatement has become an ongoing debate among practitioners, regulators, and academicians globally (Bhuiyan & Ahmad, 2022; Kibiya, Che Ahmad, & Amran, 2016; Qasem, Aripin, & Wan Hussin, 2017). Over the years, the number of restatement cases has increased and has caused a massive amount of market capitalisation losses (Government Accountability Office [GAO], 2013) due to the adverse market reaction to financial restatement announcements (Moses, Ofurum, & Egbe, 2016). As financial restatements have adverse effects on the public and economy, understandably, the confidence of the public and investors in such financial restatement firms has been significantly undermined (Haq, 2015).

Jamil (2018) posited that financial restatement cases in Malaysia are on an increasing trend. The issue of financial restatement has become important, one that has prompted attention from the regulators in order to find a satisfactory solution to the problem (Salleh, Baatwah, & Ahmad, 2017). Hence, the current study examines the role of

the audit committee characteristics in influencing the occurrence of financial restatements in Malaysian PLCs.

In the Malaysian context, several studies have discussed the issue of financial restatements. For instance, financial restatements and corporate governance (Nahar Abdullah, Zalina Mohamad Yusof, & Naimi Mohamad-Nor, 2010; Aziz, Mohamed, Hasnan, Sulaiman, & Abdul Aziz, 2017; Hasnan, Mohd Razali, & Mohamed Hussain, 2021); characteristics of non-audit services and financial restatement (Abdul Wahab, Gist, & Nik Abdul Majid, 2014); management motives and financial restatements (Hussain, Sanusi, Mahenthiran, & Hasnan, 2016); audit committee independence, financial expertise and financial restatements (Mohamad Zainal, 2016); and value relevance of financial restatements (Ali, Besar, & Mastuki, 2018). Some studies have also examined the association between audit committee characteristics and financial restatements, such as Ali et al. (2017) and Wan Mohammad, Wasizzaman, Morsali, and Zaini (2018). However, the results have been inconclusive. For instance, prior related studies had found mixed results for the association of the audit committee's size and expertise with the financial restatement. In addition, very few studies were attempted to identify the relationship between both audit committee's ethnicity and political connection with the financial restatement. Hence this study contributes to the literature by providing more robust evidence to support both inconclusive and limited studies on the relationship between audit committee characteristics and the occurrence of financial restatements.

Following prior research that studied financial restatement (Nahar Abdullah et al., 2010; Hasnan, Marzuki, & Shuhidan, 2017; Wan Mohammad et al., 2018), the sample in this study was selected based on the GAO financial restatement category description. A total of 100 restatement firms that meet the selection criteria were included in the study. The selection criteria are based on the step introduced by Nahar Abdullah et al. (2010), in which the keywords "restate", "restatement", "restated", "prior adjustment", and "comparative" are searched in each of the annual reports to find the incidents of financial restatements. The final sample for this study is 300 companies that consist of 100 restatement firms and 200 non-restatement firms which are matched by total assets.

Thus, the main objective of this study is to investigate the effect of audit committee characteristics (audit committee size, audit committee independence, audit committee meeting frequency, audit committee members' tenure, audit committee members' gender, audit committee members' expertise, audit committee members' age, audit committee members' ethnicity, legal qualifications of audit committee members and political connections of audit committee members on the incidence of financial restatements).

This paper is structured as follows. The introduction and justification for the research are presented in Section 1. Section 2 explains the relevant literature and hypotheses development on the topic of study. Meanwhile, the research methodology to conduct this research is described in Section 3. Sections 4 and 5 include results and

discussion, particularly on the relationship between audit committee characteristics and the occurrence of financial restatements. A conclusion is provided in Section 6 with some limitations and recommendations for future research on financial restatement incidence.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Definition of financial restatement

The definitions of financial restatement as provided by several world agencies are as follows.

According to GAO (2002), "A financial restatement occurs when a company, either voluntarily or prompted by auditors or regulators, revises public financial information that was previously reported" (p. 1).

Financial Accounting Standards Board (FASB, 2005) states, "Any error in the financial statements of a prior period discovered subsequent to their issuance shall be reported as a prior-period adjustment by restating the prior period-financial statements" (p. 10).

Generally, financial restatement is viewed as the revision of a previously issued financial statement that needs amendments due to the non-compliance with the generally accepted accounting principles (Yin & Sun, 2021; Mohamad Zainal, 2016; Wan Mohammad et al., 2018). Financial restatement may occur either due to negligence or in extreme cases, by the opportunistic behaviour of the management (Mohammad, 2015).

2.2. Classification of financial restatement

Previously, the GAO classified the financial restatement into nine categories (i.e., acquisitions and mergers, cost or expense, in-process research and development, reclassification, related party transactions, restructuring assets or inventory, revenue recognition, securities valuation related, and other reasons). Later, the GAO adopted the classification scheme developed by academic scholars (Palmrose, Richardson, & Scholz, 2004), and GAO (2013) classifies financial statement restatement into six categories (i.e., revenue recognition, core expenses, non-core expenses, reclassifications and disclosures, underlying events and other reasons).

Dechow, Ge, Larson, and Sloan (2011) documented that the most common types of misstatements involve revenue, cost of goods sold, or operating expenses. Financial restatements involving these items have been classified as "core restatements" in most prior studies because it directly affects the main operations of the firm (Palmrose et al., 2004).

According to Ernst&Young (2015), the incidence of financial restatements may involve errors and related corrections that are classified into two categories: material errors, known as Big R, and immaterial errors, known as Little R. Big R involves material corrections of the previously issued financial statement that requires the firm to make clarifications to their investors in the form of a restatement (Ernst&Young, 2015; Mohamad Zainal, 2016; Hasnan et al., 2017). On the other hand,

Little R includes non-material corrections that only require the firm to disclose them as footnotes in the current financial statement (Ernst&Young, 2015).

2.3. Audit committee characteristics that lead to financial restatements

Most of the financial restatements have been attributed to the firm's top management because they have a significant influence in managing the firm's financial reporting activities. According to KPMG (2015), the audit committee has three key areas of responsibility: the first is to assess the risk and control environment within the firm; the second is to oversee the financial reporting by monitoring management; and the third is to evaluate the audit process, whereby the audit committee needs to ensure that both internal and external auditors have followed the standards and requirements.

Karajeh and Ibrahim (2017) emphasised that the audit committee plays an important role in monitoring the preparation of the financial statement and management practices in order to protect shareholder value. Kibiya et al. (2016) stressed that a strong audit committee is essential for the well-being of the business. Supporting the argument, Hidayah, Sukirman, Wahyudin, and Mahmud (2018) found that better-performing audit committees can reduce fraud through good corporate governance mechanisms.

If audit committee members tolerate the manipulation of the financial statement, it will be likely that a financial restatement will become necessary. Studies have proposed many factors that influence the occurrence of financial restatements (Nahar Abdullah et al, 2010; Abdul Wahab et al., 2014; Hussain et al., 2016; Mohamad Zainal, 2016; Ali et al., 2017, 2018; Wan Mohammad et al., 2016). This study focuses on audit committee characteristics that are unique to the Malaysian market as highlighted by Wan Mohammad et al. (2016) and Ali et al. (2017).

Prior studies have concurred that audit committee size influences the firm's financial reporting quality (Eyenubo, Mohammed, & Ali, 2017; Karajeh & Ibrahim, 2017). The argument behind such a belief is that larger audit committees are better able to provide effective monitoring in the preparation of the financial statement, thus reducing the probability of a financial restatement (Wan Mohammad et al., 2018). Effective monitoring can be achieved through broader knowledge and expertise shared among the audit committee members (Moses et al., 2016). Madi, Ishak, and Abdul Manaf (2014), and Mohamad Zainal (2016) added that a larger audit committee provides more ideas, opinions, resources, knowledge, and authority that facilitate the members to detect and resolve potential issues and make more informed decisions.

However, some scholars have argued that a smaller audit committee is associated with greater monitoring (Kibiya et al., 2016; Jerubet et al., 2017), as it allows quick and effective communication among the audit committee members (Badolato, Donelson, & Ege, 2014). Abbott, Parker, and Peters (2004) and Wan Mohammad et al. (2018) all found a positive and significant association between audit committee size and the incidence of financial restatements. Such a finding suggests that a larger

audit committee reduces the concentration and participation of the members that consequently increases the probability of financial restatements.

Hence, given the conflicting results on audit committee size, we state the following non-directional hypothesis:

H1: There is an association between audit committee size and the occurrence of financial restatements.

Mohammad (2015) defined the "independence" of the audit committee as the committee not having any relationship or association that could affect its judgment. The independence of the audit committee members is essential as it is rooted in the regulations. The MCCG recommends that firms should have at least three members in the audit committee, the majority of whom should be independent directors. Some scholars have added that the majority of the audit committee members must be non-executive directors in order to increase the effectiveness of the audit committee (Dhaliwal, Naiker, & Navissi, 2010; Ferchichi & Skanji, 2017). It has been argued that the requirement to have a majority of independent members in the audit committee would reduce the conflict of interest issues among the top management (Ali et al., 2017). In addition, an audit committee comprising more independent directors would be able to reduce the occurrence of financial restatements (Wan Mohammad et al., 2018).

Abbott et al. (2004) posited that the level of audit committee independence is negatively associated with the occurrence of financial restatements. Supporting this, Nahar Abdullah et al. (2010), Alwi, Wan Ismail, and Kamarudin (2013), Madi et al. (2014), Mohammad (2015), Ali et al. (2017), and Wan Mohammad et al. (2018) found that earnings management activities are less in firms with a greater proportion of independent directors in the audit committee. This suggests that the independence of the audit committee can result in greater transparency in the financial reporting process. Although a few studies have claimed that there is no significant association between low audit committee independence and poor financial reporting (Abdul Rahman & Haneem Mohamed Ali, 2006; Har Sani Mohamad, Majd Abdul Rashid, & Mohammed Shawtari, 2012), Kamarudin and Wan Ismail (2015) found that lesser independence in the audit committee increases the likelihood of fraudulent financial reporting and misstatements.

Therefore, it is hypothesised that:

H2: There is a negative association between audit committee independence and the occurrence of financial restatements.

Another important factor that influences the effectiveness of the audit committee is the number of meetings held in a particular year. It refers to the frequency of the meetings attended by audit committee members in order to discuss and debate issues on the internal control system as well as the firm's financial and employee-related issues (Madawaki & Amran, 2013). Hence, an audit committee that frequently meets can better perform its monitoring role, which consequently may reduce any wrongdoing by the management (Hidayah et al., 2018).

In relation to financial restatement, Masmoudi (2021), and Karajeh and Ibrahim (2017) suggested

that regular audit committee meetings may help to identify and solve issues at an early stage. Kamarudin and Wan Ismail (2015) documented that their fraudulent sample firms are associated with weak corporate governance and a lower number of audit committee meetings. In addition, Kamarudin, Wan Ismail, and Samsuddin (2012) revealed that a lesser number of audit committee meetings can increase the probability of financial restatements.

Wan Mohammad et al. (2018) posited that there are two views concerning the frequency of audit committee meetings. On the one hand, frequent audit committee meetings are seen as beneficial for management monitoring, implementing strategies, and greater opinion sharing and discussion (Alagla, 2019; Masmoudi, 2021; Salleh et al., 2017). On the other hand, frequent audit committee meetings are associated with the presence of harm and difficulties that need attention. In their study, Wan Mohammad et al. (2018) found a negative relationship between audit committee meeting frequency and the incidence of financial restatements.

Hence, following the above-mentioned study, it is hypothesised that:

H3: There is a negative association between audit committee meeting frequency and the occurrence of financial restatements.

Audit committee members' tenure refers to the length of time that the independent directors have served on the audit committee (Ong, 2013). It is expected that the members who serve on the audit committee for a longer period would develop better governance competencies (Ong, 2013), thus accumulating additional knowledge and greater experience to serve the firm (Sharma & Iselin, 2012). Sharma and Iselin (2012) also evinced that independent directors who sit in the audit committee for a longer tenure may reduce earnings management activities. Perhaps, it is due to the experience and better understanding of the firm's internal control system, operations, risk portfolio, and business environment (Ong, 2013; Mohammad, 2015; Baatwah, Ahmad, & Salleh, 2018).

However, Sharma and Iselin (2012) argued that a longer tenure may lead to the development of a strong bond and close relationship between the audit committee members and the management, which subsequently could negatively affect their independence. This could promote an unhealthy environment, whereby the decisions made by the audit committee may be influenced by the management. Persons (2005), who examined audit committee tenure using a more severe type of misstatement, i.e., fraudulent financial reporting, found that longer audit committee members' tenure helps to reduce the likelihood of fraud occurrences. Persons (2005) argued that by knowing the internal and external risks over the long-run, audit committee members can make better decisions, and understand the operations of the firm well.

Therefore, it is hypothesised that:

H4: There is a negative association between audit committee members' tenure and the occurrence of financial restatements.

The issue relating to gender diversity among the top management has been discussed and has become one of the debatable topics among researchers in recent years (Thiruvadi, 2012; Garcia-

Sanchez, Martínez-Ferrero, & García-Meca, 2017; Mohamed, 2015). Although one could argue that this is a rather sensitive issue, Garcia-Sanchez et al. (2017) claimed that gender diversity may benefit the firms because it is indicative of greater creativity and innovation, as men and women have different ways of thinking. Bilic and Sustic (2011) posited that women are more ethical in performing their duties, thus helping to improve corporate governance, strengthen external functions (Thiruvadi, 2012) and increase information disclosure (Fakhari & Rezaei Pitenoei, 2017).

Qi and Tian (2012) posited that women are more trustworthy than men and less likely to manipulate any information disclosure. As argued by Schrand and Zechman (2012), men are more likely to be over-confident, making them more valiant to commit wrongdoings than women. Thus, an audit committee that is dominated by men faces a greater opportunity for manipulation of financial statement items, which then increases the probability of financial restatements (Garcia-Sanchez et al., 2017).

Ammer and Ahmad-Zaluki (2017) found that the presence of female directors in the audit committee may enhance the independence of the committee as well as the protection of the shareholders' interests. They argued that females have better concentration, take fewer risks, and are more ethical than males, thus helping to develop a better quality of reporting that can easily gain greater confidence from potential investors.

Hence, the following hypothesis is developed:

H5: There is a negative association between audit committee members' gender and the occurrence of financial restatements.

One of the primary roles of the audit committee is to oversee the firm's financial reporting process (Al Lawati & Hussainey, 2021). The MCCG states that all members of the audit committee should be financially literate and at least one of the members should be a member of an accounting association or body. The main objective of this mandatory requirement is to ensure that each individual can provide financial advice to produce high-quality financial reporting (Naimi Mohamad-Nor, Shafie, & Wan Hussin, 2010). Salleh et al. (2017) argued that experience alone may not be sufficient to be considered as a financial expert as it requires both experience and knowledge. Ong (2013) and Feng (2014) found that an audit committee with at least one member with financial expertise may reduce the opportunity for earnings management and result in better earnings quality. In addition, Baatwah et al. (2018) evinced that a greater number of audit committee members with accounting and auditing knowledge contribute to better financial reporting timeliness due to the quick response and effective action to correct errors and irregularities during the preparation of the financial statement.

In relation to financial restatement, Madi et al. (2013) said that financial and accounting expertise leads to higher financial reporting quality and reduces the firm's involvement in earnings management, consequently decreasing the probability of financial restatements. Wan Mohammad et al. (2018) found that highly qualified and competent audit committee members may help to improve the financial reporting process and reduce the occurrence of financial restatements.

As a result, it is hypothesised that:

H6: There is an association between audit committee members' expertise and the occurrence of financial restatements.

Another characteristic of the audit committee included in this study is the age of the individual members. Research relating to the age of audit committee members and their performance is relatively scarce, especially in emerging countries. Moreover, researchers have different views on this issue. Mwangi (2010) argued that older members possess more experience than their younger counterparts which could help to identify weaknesses in the internal control more effectively, thus leading to the right decisions (Abbott et al., 2004). However, Qi and Tian (2012) disputed that older members may have the less physical and mental stamina to implement new ideas that are needed to overcome any challenges. Deloitte (2014) concluded that audit committees with older members can provide a wealth of knowledge due to their years of experience; however, younger members can introduce new and fresh ideas from different perspectives that are better aligned with current developments.

With regards to the financial restatements, Qi and Tian (2012) found a negative relationship between the age of audit committee members and involvement in earnings management. This suggests that older members in the audit committee have a higher level of integrity and empathy towards the issue of earnings management that allows them to monitor the financial reporting process more effectively, and consequently, reduce the occurrence of financial restatements.

Thus, it is hypothesised that:

H7: There is a negative association between audit committee members' age and the occurrence of financial restatements.

Malaysia comprises different ethnic groups — Malays, Chinese, Indians, and others — which can be divided into two categories — Bumiputera and non-Bumiputera (Alwi et al., 2013). Bumiputera comprises the Malay ethnicity, while the non-Bumiputera comprises the Chinese, Indian, and other ethnicities. KPMG (2013) mentioned that nearly half of the independent directors in the top 100 firms in Malaysia constitute Malay retired civil servants or former politicians. Such an indicator is believed to influence the overall business environment in Malaysia (Kamarudin & Wan Ismail, 2015; Wan Mohammad et al., 2016).

Wan Mohammad et al. (2016) claimed that ethnicity has been found to be a major influence in terms of business networking and the decision-making of the audit committee. In the same study, they found that most of the firms owned by Malays have political connections, and Chinese-owned firms take advantage of this by having Malay directors to gain access to projects as well as to support and finance their business operations. Hence, having Malays directors solely, for this reason, may lead to higher earnings management in firms with Malay audit committee members. If this holds true, the effectiveness of Malay directors in the audit committee is indeed questionable.

In a study by Jamil (2018), Malay directors are argued to be politically influenced, and firms having Malay directors are subject to higher audit fees due

to poor governance. However, Kamarudin and Wan Ismail (2015) claimed that Bumiputera firms are better at implementing corporate governance mechanisms than Chinese firms. Perhaps, the contradictory findings in terms of the corporate governance level in both studies could be due to the implementation of the MCCG to merely meet the requirements in form rather than in substance (Nahar Abdullah et al., 2010). Arguably, having Malays in the audit committee creates harm rather than adds value to the firm. In relation to financial restatement, Mohamed Yunus (2011) found a positive association between audit committee members' ethnicity and the incidence of financial restatements.

For that reason, it is hypothesised that:

H8: There is a positive association between audit committee members' ethnicity and the occurrence of financial restatements.

Besides having a financial and accounting background as discussed earlier, Krishnan, Wen, and Zhao (2011) claimed that the audit committee would also perform better when the members possess legal qualifications or at least legal working experience. Ong (2013) posited that members of the legal profession understand the implications and the seriousness of any breach of the prescribed duties. According to Feng (2014), accounting and legal expertise complement each other and truly benefit the monitoring role of the audit committee in the financial reporting process, hence contributing more positively to the quality of financial reporting as opposed to having members with only accounting expertise.

Hence, the hypothesis is formulated as follows:

H9: There is a negative association between the legal qualifications of audit committee members and the occurrence of financial restatements.

Another unique and interesting feature in the Malaysian environment is the political connections of firms. Mitchell and Joseph (2010) and Wan Mohammad et al. (2016) found that the majority of Malaysian firms with strong political connections are dominated by Bumiputera. In addition, Bliss and Gul (2012) discovered that Malaysia is one of the countries with the highest number of government bailouts and has strong political connections to access the necessary financing. Agrawal and Knoeber (2012) mentioned that higher political donation or financing is associated with poorer corporate governance; they argued that this indicates the presence of agency problems within a firm.

In relation to financial restatements, Hasnan, Rahman, and Mahenthiran (2013) found that the selective prosecution by the Malaysian government creates an opportunity for firms with political connections to avoid legal action relating to their fraudulent financial statement. Jamil (2018) speculated that a firm or audit committee with political connections would suffer from an increase in the complexity of the audit process. Thus, it is not surprising that political connections have a positive effect on audit fees, as found by Ariningrum and Diyanty (2017) and Jamil (2018) because these firms

possess higher risks of misstating their financial statement (Abdul Wahab et al., 2014).

Therefore, it is hypothesised that:

H10: There is a positive association between political connections of audit committee members and the occurrence of financial restatements.

3. RESEARCH METHODOLOGY

3.1. Sample selection

The sample in this study consists of PLCs on the Main Market of Bursa Malaysia between 2006 and 2015 but excludes finance, investment, trust, and fund firms since these industries are regulated differently by the Bank and Financial Institution Act 1989 (Nahar Abdullah et al., 2010; Hasnan et al., 2013). The final sample in this study consists of 100 restatement firms and 200 non-restatement firms. The sample of the non-restatement control group was formed using a match-pair procedure based on financial year-end, firm size, and the industry group to which each pair of restatement and non-restatement firms belong. A similar method was adopted in prior studies by Arthaud-Day et al. (2016), Ali et al. (2018), and Wan Mohammad et al. (2018). The categorisation of financial statement restatement is based on GAO's financial statement restatement category descriptions (GAO, 2013).

3.2. Data collection

Data for each sample were retrieved from the Bursa Malaysia website. After choosing the selected sample firms, the annual reports were downloaded for the years from 2006 to 2015. Next, the restatement sample was identified by searching a few keywords relating to restatements, such as "restate", "restatement", "restated", "prior adjustment", and "comparative" in each annual report of the selected sample firms (Nahar Abdullah et al., 2010; Hasnan et al., 2013).

3.3. Measurement of the dependent variable

Following prior research by Nahar Abdullah et al. (2010), Hasnan et al. (2017), and Wan Mohammad et al. (2018), the occurrence of financial restatements was measured using a dummy variable coded "1" for restatement firms and "0" for non-restatement firms.

3.4. Measurement of independent variables

The 10 independent variables in this study are audit committee characteristics, i.e., size, independence, frequency of meetings, audit tenure, gender, expertise, age, ethnicity, legal qualifications, and political connections. Table 1 describes the measurement of independent variables included in the study.

Table 1. Measurement of independent variables

<i>Variable</i>	<i>Description</i>
<i>RESTATE</i>	The dummy variable coded 1 for the restatement sample and 0 for the non-restatement sample (Nahar Abdullah et al., 2010; Hasnan et al., 2017; Wan Mohammad et al., 2018)
<i>SIZE</i>	The total number of audit committee members at the year-end (Ali et al., 2018)
<i>IND</i>	The ratio of independent non-executive directors to the total number of audit committee members (Karajeh & Ibrahim, 2017)
<i>MEETING</i>	A total number of audit committee meetings held in a financial year (Hidayah et al., 2018)
<i>TENURE</i>	Mean tenure of audit committee members (Othman, Ishak, Arif, & Aris, 2014)
<i>GENDER</i>	A total number of female directors on the audit committee (Mohammad, 2015)
<i>EXPERT</i>	The dummy variable coded as 1 if at least one of the audit committee members possesses relevant and recent financial expertise and coded as 0 if otherwise (Ong, 2013)
<i>AGE</i>	Dummy variable coded as follows: 1) 35-40 years 2) 41-46 years 3) 47-52 years 4) 52 years and above (Mwangi, 2018)
<i>ETHNIC</i>	The ratio of Bumiputera members to the total number of audit committee members (Wan Mohammad et al., 2018).
<i>LEGAL</i>	A total number of audit committee members having legal qualifications (Ong, 2013)
<i>POLITIC</i>	The dummy variable coded as 1 if at least one of the audit committee members has political connections and coded as 0 if otherwise (Jamil, 2018)

3.5. Measurement of control variables

Three control variables were included in the study, i.e., firm size, firm industry, and financial year-end. The measurement of the control variables are as follows:

Table 2. Measurement of control variables

<i>Variable</i>	<i>Description</i>
<i>SIZE</i>	Total assets divided by total liabilities (Hasnan et al., 2017)
<i>INDUSTRY</i>	Type of industry: 1) Industrial products 2) Construction 3) Plantation 4) Consumer products 5) Trade/services 6) Properties 7) Technology (Jerubet et al., 2017)
<i>YEAR-END</i>	Matched financial year-end of sample firms (Hasnan et al., 2017)

Model 1

$$RESATE_i = \alpha + \beta_1 SIZE + \beta_2 IND + \beta_3 MEETING + \beta_4 TENURE + \beta_5 GENDER + \beta_6 EXPERT + \beta_7 AGE + \beta_8 ETHNIC + \beta_9 LEGAL + \beta_{10} POLITIC + \varepsilon \quad (1)$$

4. RESULTS

Table 3 presents the descriptive statistics of all independent variables, whereby Panel A is for continuous variables, Panel B for dichotomous variables, and Panel C for categorical variables. As presented in the table, the number of audit committee members (*SIZE*), number of audit committee meetings held in a financial year (*MEETING*), legal qualifications of the audit committee members (*LEGAL*), the existence of Malays in the audit committee (*ETHNIC*), and political connections of audit committee members (*POLITIC*) show significant differences between restatement and non-restatement firms.

With regards to the size of the audit committee, the mean value of non-restatement firms is slightly higher compared to the restatement firms (mean diff.: 0.150). The result is consistent with Mohamad Zainal (2016), who suggested that larger audit committees are better able to perform their monitoring role. In relation to the number of

3.6. Model and analysis

In this study, a logistic regression model was developed to analyse the relationship between the various audit committee characteristics (i.e., size, independence, frequency of meetings, audit tenure, gender, expertise, age, ethnicity, legal qualifications, and political connections) used as determinants of financial statement restatements. The following regression model was employed to determine the extent of the influence of each of the variables included in the current study on the occurrence of financial misstatement proxied by financial statement restatement. A similar method of analysis was also adopted in prior studies by Hasnan et al., (2017), Karajeh and Ibrahim (2017), Ali et al. (2018), and Wan Mohammad et al. (2018). Hence, in order to test the hypotheses, the logistic regression analysis was conducted in the year immediately preceding the restatement year, presented as:

meetings held by the audit committee in a financial year, the mean value for restatement firms is 4.78, whereas, for non-restatement firms, it is 5.05. This suggests that on average, sample firms have met the minimum requirement by the MCGG that the audit committee should meet at least four times a year; non-restatement firms held more than five audit committee meetings in a year. Another significant difference is also found in the number of audit committee members who possess legal qualifications. A mean value of 0.42 is reported by non-restatement firms compared to 0.29 by restatement firms. This suggests that non-restatement firms have a higher number of audit committee members with legal qualifications and expertise. This finding is consistent with Krishnan et al. (2011) who posited that members with legal background would make the audit committee more alert to the legal liabilities in the event of any breach of regulations. The mean proportion of Bumiputera members on the audit committee of restatement firms is 1.437, which is higher than non-restatement firms with only 0.741. This suggests that Malay

ethnicity is common in restatement firms compared to non-restatement firms. Last but not least, the political connections of audit committee members are higher for restatement firms by 0.075. The average value for non-restatement firms is only

0.13, while restatement firms report at 0.21. This suggests that the existence of political connections amongst audit committee members of restatement firms is higher than in non-restatement firms.

Table 3. Descriptive statistics analysis on audit committee characteristics (Panel A: Continuous variables)

Variable	Restatement firms (n: 100)		Non-restatement firms (n: 200)		Mean diff.	t-value
	Mean	Std. Dev.	Mean	Std. Dev.		
SIZE	3.27	0.529	3.42	0.697	0.150	1.895*
IND	0.846	0.155	0.852	0.165	0.006	0.302
MEETING	4.78	1.282	5.05	1.196	-0.275	-1.790*
TENURE	5.64	3.477	5.72	3.306	-0.080	-0.191
GENDER	0.21	0.456	0.25	0.499	0.040	0.694
LEGAL	0.29	0.518	0.42	0.629	0.130	1.904*
ETHNIC	1.437	1.076	0.741	0.808	-0.696	-5.708***

Table 3. Descriptive statistics analysis on audit committee characteristics (Panel B: Dichotomous variables)

Variable	Frequency		Mean		Mean diff.	t-value
	Of "0"	Of "1"	Restatement	Non-restatement		
EXPERT	246 (82%)	54 (18%)	0.07	0.11	0.040	1.104
POLITIC	271 (90.3%)	29 (9.7%)	0.21	0.13	0.075	1.595*

Table 3. Descriptive statistics analysis on audit committee characteristics (Panel C: Categorical variable)

Variable	Restatement firms (n: 100)		Non-restatement firms (n: 200)		Mean diff.	t-value
	Mean	Std. Dev.	Mean	Std. Dev.		
AGE	3.69	0.615	3.66	0.653	-0.30	-0.390

Note: *, ** and *** denote significance at 0.10, 0.05 and 0.01 levels, respectively.

Table 4 presents the 10 significant correlation values among the tested independent variables in the study. Despite having several independent variables significantly correlated to one another, there was no multicollinearity issue. This is because none of them had a variance inflation factor (VIF) exceeding 4 but lower than 2. VIF exceeding 4 requires further attention while exceeding 10 is serious multicollinearity. The highest significant correlation at the 1% level is found between *IND* and *SIZE* (-0.317). The negative correlation between these variables suggests that the proportion of independent directors is lower in larger audit committees. Such finding is unfavorable since the MCCG recommends that the majority of the audit committee members should be independent but the result seems to support that firms have only met the minimum requirement.

Next is the correlation between *AGE* and *TENURE* (0.297); the positive correlation suggests that older audit committee members tend to have longer audit tenure. This finding is consistent with Ong (2013) and Kibiya et al. (2016), who found a positive relationship between audit committee age and audit committee tenure and suggested that an increase in the audit committee members' age increases the length of audit committee tenure.

Next, for the correlation between *LEGAL* and *SIZE* (0.252), the positive correlation suggests that a higher number of audit committee members with legal qualifications is found in larger audit committees. Ong (2013) posited that audit committee members with more legal qualifications may prevent the incidence of financial restatements. Thus, the correlation between these variables is favorable.

The next correlation is between *MEETING* and *SIZE* (0.158), which suggests that a higher number of audit committee members is likely to result in frequent audit committee meetings, consistent with Ali et al. (2017). Since the needs of each director

differ, frequent meetings are required as the number of audit committee members increases. Thus, it is not surprising for larger audit committees to meet frequently as they need to discuss and share ideas and opinions.

For the correlation between *POLITIC* and *MEETING* (0.157), the finding suggests that the existence of members with political connections increases the likelihood of frequent audit committee meetings. As argued by Abdul Wahad et al. (2014), politically-connected firms have higher risks of misstating their financial statement; thus, holding frequent audit committee meetings is necessary for firms with political connections. Perhaps, the politically connected members are more likely to hold frequent audit committee meetings as a precaution as they have been commonly associated with unfavorable events, such as fraud and corruption.

Other correlations that are significant at the 5% level include correlation between *GENDER* and *SIZE* (0.146) and between *LEGAL* and *GENDER* (0.142). The result indicates that female directors are more common in larger audit committees, and most of the female directors in the audit committee have legal qualifications. There are also correlations between *ETHNIC* and *MEETING* (0.119) and between *ETHNIC* and *EXPERT* (-0.116). This suggests that Malay directors are less likely to possess financial and accounting expertise but more likely to hold audit committee meetings.

Finally, for the correlation between *AGE* and *EXPERT* (-0.114), the finding is that an increase in the age of the audit committee members results in a decrease in the financial expertise of the audit committee members. This is similar to Qi and Tian (2012), who found that older audit committee members have the less physical and mental stamina to upgrade themselves with the new standards and qualifications.

Table 4. Pearson correlation matrix among the audit committee characteristics

	1	2	3	4	5	6	7	8	9	10
1	1.00									
2	-0.317*	1.00								
3	0.158**	-0.023	1.00							
4	0.029	-0.016	0.037	1.00						
5	0.146*	0.060	0.031	0.092	1.00					
6	0.022	0.079	0.026	-0.092	-0.043	1.00				
7	-0.067	0.009	0.067	0.297**	-0.049	-0.114*	1.00			
8	0.112	-0.093	0.119*	0.029	-0.052	-0.116*	0.44	1.00		
9	0.252**	-0.086	0.023	0.013	0.142*	-0.131	0.11	-0.064	1.00	
10	0.014	0.008	0.157**	0.086	-0.014	-0.095	0.106	0.006	0.097	1.00

Note: 1) SIZE: number of audit committee members, 2) IND: percentage of independent directors, 3) MEETING: number of times the audit committee meets, 4) TENURE: average years of independent directors serving on the audit committee, 5) GENDER: number of female directors in audit committee, 6) EXPERT: at least one member has financial expertise, 7) AGE: age categories, 8) ETHNIC: ratio of Bumiputera in audit committee, 9) LEGAL: number of audit committee members with legal expertise, 10) POLITIC: at least one member has political connections.

* and ** denote significance at the 0.05 and 0.01 levels, respectively.

5. DISCUSSION

Table 5 presents the logistic regression analysis results for the relationship between audit committee characteristics and the occurrence of financial restatements. As stated in the Table, the goodness of fit is obtained with a highly significant value of the Chi-square from the Omnibus Test of Model Coefficients, $\chi^2(12, n = 300) = 55.36, p < 0.001$. This value indicates that the model can distinguish between the restatement and non-restatement firms. The model has a Nagelkerke R-square value of 0.234, which means that 23.4% of the variation in the incidence of financial restatements is explained by the independent variables. This model also correctly classifies 71.7% of the cases into two groups: restatement firms (35.0%) and non-restatement firms (90.0%). The logistic regression model was also tested for any existence of endogeneity where an independent variable may be significantly related with the error term. The test was run with the Hausman test for endogeneity where the null hypothesis is $H_0: \text{Cov}(x, e) = (0)$. Based on Table 5, no significant relationship was found between the error term and independent variables in the model, hence there is no endogeneity issue in the model.

As shown in Table 5, only four out of the ten independent variables show a statistically significant association with the occurrence of financial restatements. The four significant predictor variables are audit committee size, audit committee meetings, audit committee members' ethnicity, and audit committee members with political connections. However, the findings fail to support hypotheses H_2, H_4, H_5, H_6, H_7 , and H_9 .

Table 5 shows a negative association between SIZE and the occurrence of financial restatements at the 5% level. This indicates that the larger the audit committee, the lower the incidence of financial restatements. Jerubet et al. (2017), Karajeh and Ibrahim (2017), and Wan Mohammad et al. (2018) found that larger audit committees can offer more expertise, ideas, skills, and knowledge, thus helping in making better decisions for the firm. Besides, a larger audit committee possesses a mix of expertise coming from diverse backgrounds and professions that can benefit the committee with ideas from different perspectives. Hence, having superior team members enables larger audit

committees to detect irregularities in the financial statement more effectively, which could help to mitigate the probability of financial restatement occurrences. Therefore, hypothesis H_1 which states that there is an association between audit committee size and the occurrence of financial restatements is supported.

With regards to the frequency of audit committee meetings, this study finds a negative association between MEETING and the occurrence of financial restatements at the 5% level of significance. This finding indicates that frequent audit committee meetings are likely to reduce the occurrence of financial restatements. Mohamad Zainal (2016) posited that frequent audit committee meetings may assist firms to identify both financial and non-financial problems at the early stage and enable them to take corrective action before the problems aggravate and affect the firm's operations. In addition, more frequent audit committee meetings are conducive to effective management monitoring, tactical strategy implementation, and opinion sharing (Wan Mohammad et al., 2018). Interestingly, audit committee meeting frequency has a positive correlation with SIZE, ETHNIC, and POLITIC (Table 4). The SIZE, ETHNIC, and POLITIC variables are highly debatable issues; thus, correlations among these variables indicate that audit committee members respond to the individualities of the committee. The finding suggests that larger audit committees have Malay directors who are politically connected and tend to hold more audit committee meetings, which means that the audit committee members efficiently react to any changes to ensure their effectiveness. Perhaps, the inter-correlation amongst these variables contributes to the negative association between audit committee meeting frequency and the occurrence of financial restatements because frequent meetings allow audit committee members to discuss and deliberate issues more competently. As a result, hypothesis H_3 which states that there is a negative association between audit committee meeting frequency and the occurrence of financial restatements is supported.

In relation to the ethnicity of the audit committee members, there is a significantly positive relationship between ETHNIC and the occurrence of financial restatements at the 1% level. A similar finding is also found by Wan Mohammad et al.

(2016) who examined the relationship between ethnicity and earnings management and find that a higher number of Malay members in the audit committee increases earnings management activities. In addition, it is worth noting that Table 4 depicts that the *ETHNIC* variable is negatively correlated with the *EXPERT* variable at the 5% level (-0.116). Hence, lacking financial and accounting expertise may mean that Malay directors are less competent in dealing with the issues that lead to the occurrence of financial restatements. Thus, hypothesis *H8* which states that there is a positive association between audit committee members' ethnicity and the occurrence of financial restatements is supported.

Surprisingly, Table 5 reveals that the *POLITIC* variable is negatively related to the occurrence of financial restatements at the 5% level. The negative association is contradictory to expectations and it suggests that audit committees with politically connected members reduce the probability of financial restatements. Although prior studies have claimed that political connections increase the complexity of the financial reporting process and negatively affect financial reporting quality (i.e., Abdul Wahab et al., 2014; Kibiya et al., 2016; Jamil, 2018), the result from this study reveals that political connections prevent the probability of financial restatement occurrences. Thus, other features of this variable are examined. As reported in Table 4, the *POLITIC* variable is positively and significantly correlated with the *MEETING* variable. One could argue that these firms (i.e., politically-connected firms) possess higher risks and consequently require frequent meetings. However, as the association between political connections of audit committee members and the occurrence of financial restatements is negative, it can be argued that the positive correlation between the *POLITIC* and *MEETING* variables suggests that politically connected audit committee members have taken the precaution of holding frequent audit committee meetings so as to avoid the occurrence of financial restatements. Therefore, using sample firms in this study, hypothesis *H10* which states that there is a positive association between political connections of audit committee members and the occurrence of financial restatements is not supported.

As mentioned earlier, the other six predictor variables, namely — *IND*, *TENURE*, *GENDER*, *EXPERT*, *AGE*, and *LEGAL* — show no significant association with the occurrence of financial restatements; therefore, all six hypotheses are rejected. In relation to the *IND* variable, previous studies, such as those by Nahar Abdullah et al. (2010), Ali et al. (2017), and Ong (2013) also found insignificant associations between audit committee independence and the occurrence of financial restatements. Nahar Abdullah et al. (2010) argued that one plausible reason for the insignificant finding is due to the implementation of the MCCG. The Code states that the Malaysian PLCs need to have a majority of independent directors in the audit committee; therefore, it is difficult to distinguish between restatement and non-restatement firms in terms of their audit committee independence because most firms have met the requirement to avoid the penalty

for non-compliance. As evinced in Table 3, Panel A, there is no significant difference in the mean value of restatement and non-restatement firms. The finding suggests that the majority of the sample PLCs have a comparable proportion of independent directors in their audit committees.

The insignificant result for the association between the *TENURE* variable and the occurrence of financial restatements is consistent with the finding of Ong (2013). The length of the audit committee tenure does not influence the occurrence of financial restatements. Sharma and Iselin (2012) argued that a longer audit committee tenure helps the members to obtain a better understanding and enables them to discover any breaches or irregularities in the financial reporting, thereby helping to prevent financial restatements. However, the finding in this study seems to suggest that audit committee tenure does not add value to the monitoring role of the audit committee in relation to financial restatements.

Another predictor variable that shows the insignificant result with the occurrence of financial restatements is *GENDER*. Although not significant, the finding is consistent with a prior study by Kamarudin and Wan Ismail (2015), that the presence of female directors on the audit committee has no effect on the occurrence of financial restatements. Despite the arguments made by prior studies that women are more ethical than men in performing their duties (Bilic & Sustic, 2011), the finding from this study proves that gender diversity does not influence the occurrence of financial restatements. Perhaps, the presence of female directors in the audit committee is still rare in Malaysian PLCs given the evidence that the mean value of restatement and non-restatement firms is comparable at 0.21 and 0.25, respectively (Table 3, Panel A).

With regards to the insignificant result of the *EXPERT* variable, the finding suggests that audit committee expertise fails to influence the occurrence of financial restatements. Out of 300 sample firms, only 18% or 54 firms have financially literate audit committee members, while the other 82% or 246 firms do not have any financial or accounting-related expertise. Having fewer members with financial expertise, the effectiveness of the audit committee is doubtful due to the lack of professionalism and competency in performing the monitoring role (Bala & Kumai, 2015), particularly in relation to the occurrence of financial restatements. The insignificant result is however consistent with prior studies by Dhaliwal et al. (2010) and Abbott, Parker, and Presley (2012). The finding indicates that the majority of the sample firms do not even meet the minimum requirement by the MCCG which recommends that at least one of the audit committee members should be financially literate. Perhaps, the non-compliance with the requirement has led to the insignificant finding in this study.

Regarding the *AGE* variable, consistent with the result in Abbott et al. (2004) and Qi and Tian (2012), there is no significant association between the age of audit committee members and the occurrence of financial restatements. Table 3,

Panel C, states that the mean values of restatement and non-restatement firms are 3.69 and 3.66, respectively, which means that on average, audit committee members are aged above 47 years (Table 1). As discussed earlier in the correlation section, *AGE* is negatively correlated with the *EXPERT* variable. This suggests that older audit committee members are reluctant to equip themselves with relevant expertise to enable them to

carry out their duties effectively. Hence, possibly, the inter-correlation between these variables influences the insignificant finding in this study.

Lastly, there is also an insignificant result for the *LEGAL* variable. This finding is similar to Ong (2013). This suggests that the presence of members with a legal background does not help to reduce the occurrence of financial restatements.

Table 5. Logistic regressions analysis on audit committee characteristics

<i>Variable</i>	<i>B</i>	<i>S.E.</i>	<i>Wald</i>	<i>p-value</i>	<i>Exp (B)</i>	<i>VIF</i>
<i>SIZE</i>	-0.712	0.260	7.519	0.006*	0.491	1.266
<i>IND</i>	-0.641	0.890	0.519	0.471	0.527	1.142
<i>MEETING</i>	-0.254	0.110	4.981	0.026*	1.289	1.092
<i>TENURE</i>	0.003	0.042	0.005	0.946	1.003	1.129
<i>GENDER</i>	-0.033	0.288	0.013	0.908	0.967	1.078
<i>EXPERT</i>	-0.289	0.514	0.317	0.573	0.749	1.076
<i>AGE</i>	-0.010	0.232	0.002	0.966	0.990	1.133
<i>ETHNIC</i>	0.898	0.158	32.242	0.000**	2.455	1.130
<i>LEGAL</i>	-0.272	0.264	1.062	0.303	0.762	1.127
<i>POLITIC</i>	-0.820	0.395	4.309	0.038*	0.440	1.069
Constant	0.888	1.583	0.315	0.575	2.430	
R ²	0.234					
n	300					
Classification rate	71.7%					
- Restatement firms	35.0%					
- Non-restatement firms	90.0%					
Hosmer & Lermeshow test	0.934					

Note: All *p*-values are two-tailed. * and ** denote significance at 0.05 and 0.01 levels, respectively.

6. CONCLUSION

In conclusion, the issue of financial restatements is a debatable issue that has received attention from the regulators, practitioners, and academicians because of its adverse impact on the firms, the individuals involved, and society as a whole. The occurrence of financial restatements could negatively affect the capital market and result in huge losses.

Therefore, Malaysian PLCs should comply with the requirements of the MCCG – to have at least three persons on the audit committee (*SIZE*) and convene audit committee meetings at least four times in a financial year (*MEETING*). There must also be ethnic diversity in the audit committee (*ETHNIC*) to enhance the credibility of members' monitoring role. In addition, the audit committee should consider increasing the frequency of audit committee meetings if there are politically connected audit committee members (*POLITIC*).

The study and its findings will be relevant for international readers as they reflect the current trend of audit committee attributes among corporations within emerging economies. Furthermore, Malaysia's study gives meaningful guidance representing emerging economies due to its multi ethnicities background, availability of

a rigorous system of corporate governance supported by authorities and foreign investor-friendly policies.

This study primarily focuses on attributes of the audit committee whose roles are seen as very critical in preventing potential misstatements and fraud in an organisation that could lead to financial restatement. This is because organisation will encounter tremendous difficulty to prevent misstatements and fraud if Audit Committee does not exist since it is full independence and tasked to monitor potential risks with assistance from internal auditors. Due to such reason, the study did not consider other factors beyond the attributes of the audit committee that can affect financial restatement due to the important roles of the audit committee. A limitation of the study relies on the fact that the sample on which we tested our hypotheses was composed of 100 restatement firms and 200 non-restatement matched firms. Thus, further studies could analyse a broader sample.

In addition, a promising scope for future research is a further investigation into the effect of audit committee remuneration and audit committee transparency on the likelihood of financial restatements in emerging markets, because they are directly engaged in management practices.

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