THE ASSOCIATION BETWEEN MANDATORY FINANCIAL RESTATEMENTS AND THE TURNOVER OF FIRM EXECUTIVES

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Abstract

Prior studies have examined the relationship between financial restatements and the turnover of firm executives and find that financial restatements lead to the turnover of firm executives. They often concern the above effects in developed countries such as America rather than those in developing countries. Besides, financial restatements externally prompted are more serious. However, past research little explores this type of financial restatement. Therefore, this study aims to examine the association between mandatory financial restatements and the turnover of firm executives--the chairman and the CEO in Taiwan. The findings show that there is positive relationship between mandatory financial restatements and the turnover of the CEO. However, we do not find there is positive association between mandatory financial restatements and the turnover of the chairman. The implications are as follows. As the CEO has power to make firm major decisions, including financial reporting, he should be responsible for financial restatements. The chairman is the leader of a firm. Replacing the chairman may significantly affect firm normal operation. Hence, firms are not easily to replace the chairman unless there is concrete evidence showing that he should be responsible for the financial restatements.

Keywords: Financial restatements, turnover, executives

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1. Introduction

Many accounting scandals in America and Taiwan lead to the emphasis on the quality of corporate governance mechanisms. People have recognized that strong corporate governance mechanisms can bring positive income for firms and their stakeholders. Prior studies have shown that there are positive links between good corporate governance mechanisms and firm competitiveness (OECD, 1999) and stock return (Gompers et al., 2003). Weak corporate governance structure can deteriorate firm operation no matter whether firm financial condition is good or bad (Lee and Yeh, 2004).

Agency theory is often regarded an important theory to discuss corporate governance. It proposes that there is interest of conflict between managers and stakeholders, particularly shareholders (Jensen and Meckling, 1976). Firms implementing bad corporate governance practices are more likely to manipulate financial reporting as the executives have more advantage and more self-serving incentive to do so (Davidson et al., 2005; Lee et al., 2007). By the way, firm executives can achieve predetermined personal goals and firm performance and may thus get rewards. Among all kinds of financial scandals, financial restatements should be the most serious one. Financial restatements represent that firms disclose incorrect financial information and may thus harm the interest of financial statements' users. Past studies indicate the financial restatements can bring material negative effects on firms. Anderson and Yohn (2004) find that there is negative association between financial restatements and stock market evaluations. This implies that investors regard that financial restatements are bad news and thus put lower evaluation on the stocks of firms announcing to restate financial statements.

Once firms restate financial statements, this means the quality of financial statements is questionable. Financial information disclosed in financial statements is a major way for the users of financial statements to make essential decisions such as investment or loan decisions. Hence, the users of financial statements would pay more attention to financial restatements. Although past studies have discussed the link between corporate governance mechanisms and financial restatements (Agarwal and Chadha, 2005), there is only little evidence showing what the effects of financial restatements bring.

Prior studies only provide some support that financial restatements are related to the compensation setting of firm executives or are related to their turnover (Desai et al., 2006; Cheng and Farber, 2008). However, the literature only focuses on developed countries like America and ignores to examine whether financial restatements in developing countries have effects on the compensation of firm executives or have effects on their turnover. Hence, this paper uses the sample in Taiwan to explore the association between financial restatements and the turnover of firm executives. As the chairman is the leader of a firm and the CEO is responsible for daily operating activities, this paper examines the two

executives. Particularly, we consider that there is a need to examine a certain type of financial restatements—mandatory financial restatements, which are prompted by the SFB (Securities and Futures Bureau) to restate financial statements in Taiwan. Mandatory financial restatements have higher severity, revealing a serious breach of public trust (Arthaud-Day et al., 2006). Moreover, we focus on two important executives of a firm since they play crucial roles in firm operation, one is the chairman and the other is the CEO. The chairman is the leader of a firm, who is responsible for firm major activities. Except the chairman, there is still another vital actor in a firm—the CEO. The CEO often has power to make important firm decisions, including decisions of financial disclosure. Therefore, we highlight on whether mandatory financial restatements have effects on the turnover of the chairman and the CEO.

Our findings are as follows. The findings show that mandatory financial restatements are positively related to the turnover of the CEO rather than the chairman. This shows that once firms are prompted by the SFC to restate financial statements, the CEO should be responsible for the event and thus be replaced. In addition, we find firm performance is more significantly related to the turnover of firm executives than the quality of corporate governance.

The remainders of the paper are organized as follows. We discuss literature review and hypotheses in Section 2, followed by the description of research methodology in Section 3. In Section 4, we examine the results and analyses. The last section depicts the conclusions, the limitation and future research directions.

2. Literature Review and Hypotheses Development

2.1. Corporate governance and accounting scandals

Past studies have examined whether firm governance practices are directly linked to accounting scandals such as financial fraud and financial restatements. For example, Beasley (1996) finds that there is positive relation between corporate governance structure and financial fraud. Recent evidence shows that weak corporate governance mechanisms would increase the probability of financial restatements. For instance, Agrawal and Chadha (2005) examine the effects of corporate governance mechanisms (audit committees and the percentage of independent directors etc.) on the occurrence of financial restatements and find that the composition of the board and audit committee is vital to the quality of financial reporting.

2.1.1. The reasons for the turnover of firm executives

Although many studies explore the link between corporate governance and accounting scandals, there is limited research discussing what effects of accounting scandals on firm executives. The compensation of these firm executives may reduce and firm executives may be replaced due to these accounting scandals. Except financial restatements, when examining the reasons why firms replace their executives, prior research documents that firms often replace their executives when the firms have trouble in firm operation (Daily and Dalton, 1995; Hambrick & D'Aveni, 1992). Even though firm performance is a crucial factor to affect the decisions of replacing firm executives, there is some evidence showing that the turnover of firm executives may be affected by the quality of corporate governance (Coffee, 1999). In an organization, governance power distribution should be balanced between the board and the managers. When only one of the two parties holds the power may signal weak governance, particularly for governance power is held in managers. A powerful CEO or powerful management prefers to select particular persons as directors (Shivdasani and Yermack, 1999).

2.1.2. Financial restatements and the turnover of firm executives

There are more and more accounting scandals in the recent years. The famous one in America is the Enron event, which leads to the decline of stakeholders' trust (Abdel-khalik, 2002; Sarra, 2002; Gordon, 2003). Therefore, people emphasize on the quality of financial reporting. The quality of financial statements affects the interest of decision makers much. Once firms disclose incorrect financial information, stakeholders would make biased judgment and thus make error decisions.

Prior research has examined the link between accounting scandals and the turnover of firm executives. However, there is no consistent evidence (Beasley, 1996; Agrawal et al., 1999). Due to data availability and more financial restatements in the recent, there are more studies begin to examine whether financial restatements lead to the turnover of firm executives (Desai et al., 2006; Srinivasan, 2005). Desai et al. (2006) investigate the link between financial restatements and the turnover of top managers. They suggest that firms regard that top mangers should be responsible for financial restatements and thus firms restating financial statements often replace these top mangers to increase firm reputation and restore investors' trust. Srinivasan (2005) find that financial restatements lead to job loss of directors no matter whether directors are in internal labor markets or they are looking for the jobs in external labor markets.

In Taiwan, there are two types of financial restatements. One is that firms restate financial statements voluntarily, and the other is firms are prompted by the SFB to restate financial statements. The error of financial reporting of the latter is more serious than the former. This is because that when firms do not restate financial statements proactively

reveals that there should be more material error in the process of preparing financial statements and internal control weakness. Therefore, firm executives should bear more accountability on the deterioration of the quality of financial information and thus get real punishment. Although prior studies have provided good support that financial restatements are positively related to the turnover of firm executives, these studies do not show whether there are same findings in developing countries, like Taiwan. For developing countries, they have weaker corporate governance practices and their accounting standards often follow those in the developed countries such as America. Therefore, whether mandatory financial restatements lead to the turnover of the top managers in developed countries is still a question. In order to separate the roles of the chairman and the CEO, we develop the following hypothesis.

H1: Firms with mandatory financial restatements have more turnover of the chairman than those with non-financial restatements.

H2: Firms with mandatory financial restatements have more turnover of the CEO than those with non-financial restatements.

3. Research Design

3.1. Sample selection and data sources

The sample in this study is collected from firms initially announcing to restate financial statements, which are prompted by the SFB. These firms are in the Taiwan Stock Exchange (TSE) and Over-The-Counter (OTC) during 1998 and 2005. We explore the turnover of firm executives during one year before and one year after the year of restatement announcement, hence there are three years to measure the turnover of firm executives. In order to examine potential effects of firm performance on the turnover of firm executives, we observe firm performance over three years before and two years after the year of restatement announcement. As a result, the sample firms should survive over more than six years. We exclude financial institutions due to their uniqueness in firm operation and the regulation in law. The final sample is thirty-one. Regarding the match sample, we choose samples not announcing any financial restatements during two years before the year of restatement announcement. We use the matched standard--1:1 to match sample based on their industries and firm size. The data of financial restatements is collected from Taiwan Economic Journal (TEJ) database and we also make reference from the annual reports of firms. As for the turnover of firm executives, we collect the data from the website--Market Information System, which publishes important firm information such as firm important decisions in time. Control variables are also collected from TEJ database. Table 1 reports industry distribution of the sample companies. The electronic industry firms have the highest percentage (38.71%).

Table 1. Industry Distribution of the Sample Companies

Industry	Frequency	Percent (%)
Food	2	3.23
Textiles	8	12.9
Electric and machinery	4	6.44
Steel and iron	2	3.23
Rubber	2	3.23
Automobile	2	3.23
Electronic	24	38.71
Construction	6	9.68
Transportation	4	6.44
Tourism	2	3.23
Miscellaneous	6	9.68
Total	62	100.00

3.2. Logistic models and variable measurement

We use the logistic models to examine the hypotheses. The models are as follows.

$$CHAIR\ (\ CEO\ ) = \alpha 1 + \beta 1 RESTATE + \beta 2\ OUDIRP + \beta 3 DUAL + \beta 4\ EXEHOL + \beta 5 BLOHOL + \beta 6 ROA + \beta 7 STOCK + \beta 8 LEV + \beta 9 GROWTH + B10 SIZE + \varepsilon$$

Where:

CHAIR = 1 if there are any changes of the chairman in the time window and 0 otherwise;

CEO = 1 if there are any changes of the CEO in the time window and 0 otherwise;

RESTATE = 1 if the firm is prompted by the SFB to restate financial statements and 0 otherwise;

OUDIRP = the percentage of outside directors;

DUAL = CEO duality, equals 1 if the CEO is the chairman of the board and 0 otherwise;
EXEHOL = the shareholding of firm executives;
BLOHOL = the shareholding of blockholders;
ROA = net income before tax divided by total assets;
STOCK = stock return;
LEV = the ratio of total liabilities divided by total assets;
GROWTH = the average annual sales growth rate for 2 years prior to the year of restatement announcement;
SIZE = 1 if mandatory financial restatement firms hire Big 4 audit firms and 0 otherwise.

3.2.1. Independent Variables

This paper aims to examine the association between mandatory financial restatements and the turnover of firm executives. Hence, we use a dummy variable—RESTATE as the proxy of independent variable. RESTATE equals 1 if firms are prompted by the SFB to restate financial statements and 0 otherwise.

3.2.2. Dependent variable-the turnover of firm executives

We investigate the turnover of firm executives--the chairman and the CEO. Dependent variables include CHAIR and CEO. CHAIR refers to 1 if there are any changes of the chairman in the time window and 0 otherwise. CEO refers to 1 if there are any changes of the CEO in the time window and 0 otherwise. We measure the turnover of firm executives during different time windows: (-1), (0), and (1), (0) of which represents the year of restatement announcement.

3.2.3. Control variables

Prior literature indicates that the following variables might affect the turnover of firm executives and financial restatements (Agrawal and Chadha, 2005; Srinivasan, 2005), including firm governance condition, firm performance, firm growth and firm size. The variables related to corporate governance entail the percentage of outside directors, the CEO duality, the shareholding of firm executives and the shareholding of the blockholders. Corporate governance research has suggested that the above are vital corporate governance variables. Regarding firm performance, we use ROA and stock return to control firm performance. In addition, the evidence has shown that firms restating financial statements incline to seek higher firm growth and have smaller firm size (Palmrose and Scholz, 2004), therefore we also control the two variables. All control variables are measured in one year before the year of restatement announcement.

4. Empirical Results

4.1. Descriptive statistics

Table 2 displays the descriptive statistics of sample with mandatory financial restatements and not with financial restatements. In the sample of mandatory financial restatements, restatement firms have higher leverage ($p < 0.05$) and firm executives have lower shareholding and worse ROA ($p < 0.1$). Furthermore, mandatory financial restatement firms prefer to hire Non-Big 4 audit firms to audit financial statements ($p < 0.01$). However, we do not find there are any significant differences between mandatory financial restatement firms and non-restatement firms in the percentage of outsider directors, the CEO duality, the holding of the blockholders, firm size, firm growth and stock return.

In order to know whether there are any differences of firm performance—ROA and stock return between mandatory restatement firms and non-restatement firms, we examine firm performance over three years before the year of restatement announcement and two years after the year of restatement announcement. The results are shown in Table 3. The findings indicate that there are significant differences between mandatory restatement firms and non-restatement firms during multiple years.

Table 2. Descriptive statistics

Variables	Mandatory restatement firms		Non-restatement firms		Differences	
	Mean	Median	Mean	Median	Mean (t value)	Median (z value)
OUDIRP	38.70	40.00	50.89	30.00	-0.735	-0.296
DUAL	0.42	0.00	0.48	0.00	-0.503	-0.506
EXEHOL (%)	0.64	0.29	1.96	0.67	-1.796*	-1.047
BLOHOL (%)	13.84	12.17	14.99	13.39	-0.439	-0.535
ROA (%)	-6.87	-4.20	0.57	1.60	-1.781*	-1.788*
STOCK (%)	-9.30	-31.59	-10.49	-18.28	0.085	-0.655
SIZE	6.18	40.00	6.18	6.31	-0.004	-0.120
LEV	0.54	0.00	0.43	44.89	2.016**	-2.302**
GROWTH (%)	16.61	0.29	3.17	2.88	1.074	-0.500
BFIRM	0.26	1.00	0.52	1.00	-2.902***	-2.740***

OUDIRP is the percentage of outside directors; Dual is the CEO duality, which equals 1 if the CEO is the chairman of the board and 0 otherwise; EXEHOL is the shareholding of firm executives; BLOHOL is the shareholding of blockholders; ROA equals net income before tax divided by total assets; STOCK is stock return; LEV is financial leverage, which equals total liability divided by total assets; GROWTH is the average annual sales growth rate for 2 years prior to the year of restatement announcement; SIZE is firm size, which equals the nature log of firm market value; LEV equals the ratio of total liabilities divided by total assets; GROWTH equals the average annual sales growth rate for 2 years prior to the year of restatement announcement; BFIRM equals 1 if mandatory restatement firms hire Big 4 audit firms and 0 otherwise. All variables are measured one year before the year of restatement announcement. ***Significant at the 0.01 level, **significant at the 0.05 level, and *significant at the 0.10 level.

Table 3. Firm performance for mandatory restatement versus non-restatement firms

	ROA				STOCK			
Year	EXPERIM	CONTORL	t value	z value	EXPERIM	CONTORL	t value	z value
-3	1.25	3.89	-1.457	-1.535	-7.66	-14.12	0.488	-0.401
-2	-4.40	1.11	-1.739***	-1.246	-14.51	5.06	-1.154*	-0.528
-1	-6.87	0.57	-1.781	-1.788*	-9.30	-10.49	0.085**	-0.655
0	-7.76	1.45	-2.848 ***	-2.534**	-21.24	8.35	-1.927	-2.048***
1	-2.03	-0.24	-0.650	-0.753	14.64	15.46	-0.054	-0.077
2	-1.43	2.28	-1.935	-1.837*	27.58	31.64	-0.186*	-1.626

EXPERIM refers to mandatory restatement firms ; CONTORL refers to non-restatement firms ; Year 0 refers to the year of restatement announcement. Year -3 (-2; -1) and 2 (1) refer to three (two; one) years before and two (one) years after the year of restatement announcement. ROA equals net income before tax divided by total assets; STOCK refers of stock return. ***significant at the 0.01 level, **significant at the 0.05 level, and *significant at the 0.10 level.

4.2. Correlation analysis

Table 4 presents Pearson correlation between variables. The correlation analysis indicates that mandatory restatement firms have higher leverage ($p < 0.05$), are positively related to the turnover of the chairman and the CEO, are negatively related to ROA, and are negatively associated with the shareholding of firm executives ($p < 0.1$). Firms with small size have more percentage of outside directors ($p < 0.1$). The results also indicate firms with higher leverage have more turnover of the CEO ($p < 0.01$) and have worse ROA. Besides, firms with worse firm performance—ROA and stock return are more likely to replace the chairman or the CEO.

Table 4. Correlation analysis

	RESTATE	CHAIR	CEO	OUDIRP	DUAL	EXEHOL	BLOHOL	ROA	STOCK	SIZE	LEV	GROWTH
RESTATE	1											
CHAIR	0.23*	1										
CEO	0.34***	0.24*	1									
OUDIRP	-0.09	0.17	0.14	1								
DUAL	-0.06	-0.18	-0.20	0.04	1							
EXEHOL	-0.23*	-0.19	-0.20	-0.03	-0.06	1						
BLOHOL	-0.06	0.06	0.08	0.16	-0.09	0.07	1					
ROA	-0.22*	-0.33***	-0.31**	0.07	0.03	0.08	0.05	1				
STOCK	0.01	-0.34***	-0.01	-0.08	0.07	-0.06	0.16	0.33***	1			
SIZE	0.00	-0.18	-0.02	-0.21*	-0.04	-0.12	-0.10	0.10	0.01	1		
LEV	0.25**	0.17	0.35***	0.01	-0.06	-0.04	0.17	-0.42***	-0.18	0.07	1	
GROWTH	0.14	-0.15	-0.07	0.07	0.02	0.04	-0.03	0.20	0.02	0.10	-0.06	1

RESTATE equals 1 if firms are prompted by the SFB to restate financial statements and 0 otherwise; CHAIR is the turnover of the chairman, equals 1 if is there are any changes of the chairman in the time window; CEO is the turnover of the CEO, equals 1 if there are any changes of the CEO in the time window (including three years over one year before and one year after the year of restatement announcement as the time window); OUDIRP is the percentage of outside directors; Dual is the CEO duality, which equals 1 if the CEO is the chairman of the board and 0 otherwise; EXEHOL is the shareholding of firm executives; BLOHOL is the shareholding of blockholders; ROA equals net income before tax divided by total assets; STOCK is stock return; SIZE is firm size, which equals the nature log of market value; LEV is financial leverage, which equals total liability divided by total assets; GROWTH is the average annual sales growth rate for 2 years prior to the year of restatement announcement. All variables are measured one year before the year of restatement announcement. There are several exceptions. RESTAE is measured in the year of restatement announcement; ROA and STOCK are measured in one year before the year of restatement announcement. ***Significant at the 0.01 level, **significant at the 0.05 level, and *significant at the 0.10 level.

4.3. Logistic analysis

Table 5 shows the results of H1 to H2. When we investigate H1 and H2, the link between mandatory restatements and the turnover of firm executives—the chairman and the CEO, we observe their turnover over one year before and one year after the year of restatement announcement. The results of H1 do not show that mandatory restatement firms have more turnover of the chairman than non-restatement firms during time windows. We conclude that the replacement of the chairman is an essential firm decision due to his leadership in a firm. Mandatory restatement firms are not easily to replace the chairman unless there is concrete evidence showing that the chairman is directly related to the restatements.

Concerning the results of H2, the findings show that mandatory restatements have significant effects on the turnover of the CEO in the year of restatement announcement (β=2.157, $p < 0.1$). As for the results of control variables, it is surprising that there are no effects of corporate governance mechanisms on the turnover of firm executives. Mandatory restatement firms incline to have bad firm performance. They have worse ROA and stock return during time windows. Therefore, our results suggest that firm performance may play more essential roles in replacing firm executives than the quality of corporate governance. In addition, the findings suggest that firm size and firm growth are significantly related to the turnover of firm executives, however the direction is uncertain. This reveals no matter whether firm size and firms seeking growth or not would replace firm executives if there is a need for them to do so.

Table 5. Logistic analysis

		Time windows					
		(-1)		(0)		(1)	
Variables		CHAIR	CEO	CHAIR	CEO	CHAIR	CEO
INTERCEPT		-3.897	0.526*	5.042	-2.130	-9.228	-66.735*
RESTATE	+	8.732	-0.493	0.369	2.157*	-2.208	0.526
OUDIRP	+	0.028	-0.003	-0.002	0.003	0.003	-0.005
DUAL	-	-1.143	-81.189	-2.035	-0.791	-0.353	-0.336
EXEHOL	-	-0.321	0.000	-0.695	-0.192	-0.018	-0.812
BLOHOL	+	-0.006	0.001	0.049	-0.038	-0.053	0.000
ROA	-	-0.007	-0.035*	-0.016**	-0.018	-0.007	-0.035*
STOCK	-	-0.011	-0.006*	-0.020	0.004	-0.003	-0.006*
SIZE	?	-0.942	8.397*	-0.608	-0.188	1.100	8.397*
LEV	?	-0.003	0.144	-0.010**	0.017	-0.002	0.014
GROWTH	+	-0.038	0.022	0.013	0.001	-0.005	0.002
LR stat.		25.37	37.58	16.68	12.61	14.826	14.293
Probability		0.0047***	0.000***	0.0817*	0.2465	0.4136	0.1385
Pseudo-R^2		0.5805	0.6859	0.3816	0.2301	0.3760	0.3761

RESTATE equals 1 if firms are prompted by the SFB to restate financial statements and 0 otherwise; CHAIR is the turnover of the chairman, equals 1 if is there are any changes of the chairman in the time window; CEO is the turnover of the CEO, equals 1 if there are any changes of the CEO in the time window; OUDIRP is the percentage of outside directors; Dual is the CEO duality, which equals 1 if the CEO is the chairman of the board, 0 otherwise; EXEHOL is the shareholding of firm executives; BLOHOL is the shareholding of blockholders; ROA equals net income before tax divided by total assets; STOCK is stock return; SIZE is firm size, which equals the nature log of market value; LEV is financial leverage, which equals total liability divided by total assets; GROWTH is the average annual sales growth rate for 2 years prior to the year of restatement announcement. All variables are measured one year before the year of restatement announcement. There are several exceptions. RESTATE is measured in the year of restatement announcement. ROA and STOCK are measured in one year before the time window; CHAIR and CEO are measured in the time window. Time windows (-1), (0) and (1) represent the turnover of firm executives is measured in one year after the year of restatement announcement, in the year of restatement accouchement and in one year after the year of restatement announcement, individually. ***Significant at the 0.01 level, **significant at the 0.05 level, and *significant at the 0.10 level.

4.4. Sensitivity analysis

We take further analysis to assure that the above results are robust. We examine the turnover of the chairman and the CEO over time windows: (-1, 0), (0, 1) and (-1, 1), shown in Talbe 6. Time windows (-1, 0) refer to the time of the turnover of firm executives, which are between one year before the year of restatement announcement and the year of restatement announcement. Time windows (0, 1) refer to the time of the turnover of firm executives, which are between one year after the year of restatement announcement and the year of restatement announcement. Furthermore, time windows (-1, 1) refer to the time of the turnover of firm executives, which are over one year before the year of restatement announcement and one year after the year of restatement announcement.

When observing the turnover of firm executives in time windows (-1, 0), we find that there is no significant relation between mandatory restatement and the turnover of the chairman. However, the results indicate that there is significant relation between mandatory restatements and the turnover of the CEO. When examining the turnover of firm executives in time windows (0, 1), the findings point out that there are no significant differences in the turnover of the chairman or the CEO between mandatory restatement firms and non-restatement firms. As for time windows (-1, 1), the results indicate that there are no significant association

between mandatory restatement firms and non-restatement firms.

The results of sensitivity analysis support the results of the hypotheses. We only find that mandatory restatements are significantly related to the turnover of the CEO in time windows (-1, 0). As initially we only find that mandatory restatements are significantly associated with the turnover of the CEO in the year of restatement announcement and are no significant relation with the turnover of the chairman.

In sensitivity analysis, we find there is little evidence showing that corporate governance is positively linked to the turnover of the CEO. There are positive association between the percentage of outside directors and the turnover of the CEO in time windows (0,1) (β=0.029, $p < 0.1$). Besides, the CEO duality is negatively related to the turnover of the CEO in time windows (-1, 1) (β=-1.244, $p < 0.1$). Hence, we reassure that corporate governance does not play vital roles in the process of decision making of replacing firm executives. Moreover, the findings also indicate that mandatory restatement firms have lower firm performance than non-restatement firms.

Table 6. Sensitive analysis

		(-1, 0)	(0, 1)	(-1, 1)			
Variables		CHAIR	CEO	CHAIR	CEO	CHAIR	CEO
		Coefficient	Coefficient	Coefficient	Coefficient	Coefficient	Coefficient
INTERCEPT		6.690	-7.545	-1.304	-1.441	5.570	-3.209
RESTATE	+	1.361	2.130***	-0.562	0.119	0.950	0.995
OUDIRP	+	0.025	-0.000	-0.007	0.029*	0.008	0.018
CEODUAL	-	-1.543	-1.232	-2.132	-1.422	-1.472	-1.244*
EXEHOL	-	-1.074	-0.397	-0.664	-0.154	-1.294	-0.218
BLOHOL	+	0.047	-0.007	0.028	-0.028	0.051	0.008
ROA_1	-	-0.093	-0.038			-0.074	-0.058
STO_1	-	-0.032**	0.015			-0.025**	0.006
ROA				-0.100*	-0.044		
STO				-0.003	-0.012		
SIZE	?	-1.350*	0.529	0.257	-0.139	-1.021	0.114
LEV	?	-0.045	0.053**	-0.030	0.011	-0.033	0.024
GROWTH	+	-0.005	-0.001	-0.007	-0.004	-0.001	-0.003
LR stat.		28.69	30.49	14.97	17.61	26.02	21.71
Probability		0.0014***	0.0007***	0.1332	0.0618*	0.0037**	0.0167**
Pseudo-R2		0.4709	0.4186	0.2914	0.2567	0.3929	0.2692

RESTATE equals 1 if firms are prompted by the SFB to restate financial statements; CHAIR is the turnover of the chairman, equals 1 if is there are any changes of the chairman in time windows and 0 otherwise; CEO is the turnover of the CEO, equals 1 if there are any changes of the CEO in the time window and 0 otherwise; OUDIRP is the percentage of outside directors; Dual is the CEO duality, which equals 1 if the CEO is the chairman of the board and 0 otherwise; EXEHOL is the shareholding of firm executives; BLOHOL is the shareholding of blockholders; ROA equals net income before tax divided by total assets; STOCK is stock return; LEV is financial leverage, which equals total liability divided by total assets; GROWTH is the average annual sales growth rate for 2 years prior to the year of restatement announcement; SIZE is firm size, which equals the nature log of market value. All variables are measured one year before the year of restatement announcement. There are several exceptions. RESTATE is measured in the year of mandatory restatement announcement. ROA_1 and STO_1 are ROA and stock return in one year before the year of restatement announcement; ROA and STO are ROA and stock return in the year of restatement announcement; CHAIR and CEO are measured in time windows. Time windows (-1, 0) represent the turnover of firm executives is measured between one year before the year of restatement announcement; Time windows (0, 1) represent the turnover of firm executives is measured between one year after the year of restatement announcement; Time window (-1, 1) represent the turnover of firm executives is measured over one year before and one year after the year of restatement announcement. ***Significant at the 0.01 level, **significant at the 0.05 level, and *significant at the 0.10 level.

5. Conclusion

The importance of corporate governance has been emphasized in the global world. People have recognized why the quality of corporate governance practices is vital to firms' survival and the interest of stakeholders. Accounting scandals are the major reason why people put emphasis on corporate governance. Hence, a majority of studies have discussed the relationship between corporate governance mechanisms and accounting scandals. Financial restatements should be the most serious type of accounting scandals. As the time trend and the material economic effects that financial restatements bring to the users of financial statements and firms (Palmrose and Scholz, 2004), financial restatements have become an essential research issue nowadays. A number of studies begin to examine the link between corporate governance and financial restatements (Agrawal and Chadha, 2005) and find that there is negative relationship between both.

There is still not much discussion on what the effects of financial restatements have on firm executives, who are responsible for disclosing decisions of financial information. Recent studies attempt to explore the above effects and often find that firm executives should be responsible for financial restatements and thus be replaced. Prior research often uses the sample in developed countries like America. However, there is no clear evidence showing whether the conclusions remain in developing countries, like Taiwan.

According to the above, this study aims to investigate whether financial restatements have effects

on firm executives in Taiwan. We explore whether firm executives should be replaced due to financial restatements. We examine two important actors in a firm—the chairman and the CEO. Particularly, we explore a certain type of financial restatements--mandatory financial restatements due to the materiality. We also explore whether corporate governance would affect the decisions to replace firm executives.

Our results find that mandatory financial restatements are only directly related to the turnover of the CEO rather than that of the chairman. Furthermore, the results indicate that corporate governance has little effects on the turnover of firm executives. The implications are as follows. The cost to replace the chairman of a firm is too expensive. As mandatory restatement firms should take some actions to communicate positive messages to the market, they would choose to replace the CEO to signal their efforts in improving the quality of financial statements. The CEO should pay attention to the quality of financial statements otherwise they may be fired. The chairman faces lower risk in the loss of job if firms have mandatory financial restatements someday. Also, we conclude that firm performance is more important factor to affect the turnover of firm executives than corporate governance. The limitation of this paper is we examine multi-period firm performance. Therefore, the number of the sample in this study is limited. Future research may focus on a single year or two years to enlarge the observations and may examine other developing countries such as Korea to offer a different research context to support our conclusions further.

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