

**CEO CHARACTERISTICS AND FINANCIAL
RESTATEMENT:
THE CASE OF CEO TURNOVER IN MALAYSIA**

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ABSTRACT

This study examines the incidence of financial restatement in CEO turnover firms. Using 78 CEO turnover firms from 2008 to 2010 among nonfinancial institutions, we find that the age of the CEO and forced turnover influence restatement in the year prior to CEO turnover. Specifically, older CEOs have a higher probability of restating financial statements as they may wish to hold to the last bonus/pay they would likely receive. We also document some evidence of management entrenchment hypothesis that CEO ownership may lower financial restatement. Firm characteristics such as size, Big 4 and growth as measured by market to book value have a positive relationship with restatement which suggests that big companies with high growth have a higher probability of restatement. The study also supports the argument of debt as a monitoring cost as debt is argued to constrain opportunistic earnings management behavior including restatement.

Keywords: CEO turnover, financial restatement.

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CHAPTER 1

INTRODUCTION

Financial restatement happens after a non-restated financial statement had been released and consumed by the market. This would distort shareholder's wealth and would be less forthcoming especially if it is speculated to conceal bad performance. Abdullah, Md Yusof and Mohamad Nor (2010) documented that almost 40 percent of their sample restated the cost or expenses and about 17 percent restated revenue recognition in their 2002-2005 samples which were in the pre Malaysian Financial Reporting Standard (MFRS) regime. As such, from political economy perspective, accounting information serves many functions including preempting criticisms from shareholders especially after bad performance. Consequently, the top management has the incentives to choose or change accounting policies to camouflage the real performance and as such would resort to "buying time" tactic. In such dire situation, the CEOs would choose accounting policies that would paint favorable condition in a particular year but would lead to restatement in the following year. However, it could be argued that such tactics would invariably results in CEO's turnover sooner or later as the shareholders may put the blame to the incumbent CEOs.

Few companies on Bursa Malaysia including BinaDarulAman and NWP Holdings change their CEOs shortly after financial restatements seemed to suggest that financial restatement and CEO turnover are associated although these are

anecdotal. Empirically, Land (2010) finds that her US samples from 1996 to 1999 changed the CEOs within a year of financial restatement. This is similar to Hennes et al. (2008) that find about 50% of the sample changed the CEOs in two years after financial restatement. However, Land (2010) does not discriminate types of CEO turnover, namely forced turnover or voluntary turnover and how such classifications affect the relationship of restatement and CEO turnover. This issue would improve the current model of CEO turnover and financial restatement if the nature of turnover is investigated separately. Moreover, ownership structure especially of management would increase management entrenchment that would make a proposal to remove the CEO to be more difficult. Long serving CEO is also argued to have additional influence on the board since the CEO could be seen as part of the corporate image both from insiders and outsiders.

Following the above argument, the objective of this paper is to investigate whether CEO characteristic and CEO turnover type influence company's financial restatement. Based on 78 CEO turnover companies, this study finds that CEO age, firm size, growth and Big 4 have a positive relationship with restatement. These findings indicate that older CEO, large firms and firms that audited by Big 4 are more likely involved with restatement. In contrast, leverage and CEOs forced turnover have a negative association with restatement which suggest that firms with high debt to equity ratio and terminated their CEO are less likely restated their financial statements.

This study is organized as follows. Section 2 reviews prior studies and develop the hypotheses. Section 3 discusses the research method and Section 4 presents the results and discussions. Section 5 provides the conclusion.

CHAPTER 2

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

The hypotheses development of this study is primarily based on the agency theory framework which is concerned about the separation of powers between principals and agents. This theory assumes that the agent will act in the best interest of the owners. Human capital theory and social network theory are also used as complementary theories to agency theory.

2.1 Financial Restatement and CEO Turnover

An earnings restatement occurs through two main occurrences, the discovery of an error in previous periods or a change in accounting method. There are many different types of errors that can cause earnings to be restated by a company. They can range from a simple bookkeeping error all the way to fraud by the management of the company. Errors or misjudgments are the most publicized causes of restating earnings, and if one were to simply follow the headlines in newspapers it would seem that they were the only cause of earnings restatements. However, a company may restate earnings simply because they are changing to another accepted accounting principle. This was the case with Kmart recently restating their earnings (Merrick, 2002).

Previous studies for example Land (2010) and Hennes et al. (2008) find an association between CEO turnover and financial restatement. Their studies reveal that companies have intention to change their CEOs within a year of restatement announcement while another 50% of their sample firms change the CEO in two years after restatement. The theoretical background for CEO turnover stems from research on executive compensation and firm performance using principal-agent theory. In general, turnover is defined as a rate at which people leave employment (Cascio, 2002). Turnover rate usually rises during economic expansions and fall during recession, in an inverse proportion to the unemployment rate. Branham (2000) claimed that many companies are more concerned with the turnover rate being too low rather than too high. The reason is because higher turnover rates will introduce new talents and cost savings through resetting salaries and other measures. In some cases, management must replace old skill sets with the new ones as technology or the customer base changes, or for a different demographic mix or a better distribution of age groups. In order to facilitate these requirements, some companies are now moving towards semi-annually or even quarterly reviews to speed up the process of terminating low performers who are unable to meet the new requirements of the companies.

2.2 Financial Restatement and CEO Characteristics

Human capital theory and social network theory suggest that CEOs gain their power through their educational background, skill and functional background, special expertise, experience, industry specialization, prestige, ownership, age and

longer tenure (Goodstein & Boeker, 1991; Cannella & Lubatkin, 1993). Power is defined as the capacity of individuals to exert their will (Datta & Guthrie, 1994). Dominant CEOs tend to restrict the flow of information in highly velocious environments. They may restrict the flow of information by abolishing the contribution of a member of less power (Haleblian & Finkelstein, 1993).

2.2.1 CEO Age (CEOAGE)

Demographic characteristics such as age and tenure are commonly used to determine the effectiveness in managing the firms. With regard to the age of directors, the Companies Act 1965 prohibits the appointment of a person of or over the age of 70 years as a director of a public company or subsidiary of a public company. The office of a director shall become vacant until the forthcoming annual general meeting after he attains the age of 70 years. If the vacancy is not filled at the meeting, it may be filled as a casual vacancy. In addition, Kang (2002) claims that there is a provision in the company's articles regarding the retirement by rotation of directors so as to afford the shareholders of the company the opportunity to review the director's performance. For listed companies, the election of directors is to take place every year; and for all directors including the managing directors, they need to retire at least once in every three years but they are eligible for re-election.

Some studies suggest that CEO with little experience have limited effectiveness because it takes time to gain an adequate understanding of the company. For example in CEO turnover study, Coughlan and Schmidt (1985), split their sample into two categories; CEOs aged less than 54 years and CEOs of at least 54 years of age. The 54 years figure is used as a split point since the retirement age of directors in the US companies is 55 years old. They find that in the young CEO sample (less than 54 years) where mandatory retirement has no influence, the inverse relation between stock price performance and probability of turnover is highly significant. In the old CEO sample (54 years or more), the relationship between performance and turnover becomes positive but insignificant. In contrast, Goyal and Park (2002) find that the coefficient on CEO age and the dummy for CEO ages of 53 to 55 are both positive and statistically significant at less than 1 percent level. Similarly, Barro and Barro (1990) who study on the turnover of banks' CEOs, find that the age of the CEO has a significant effect on the turnover decision. They state that the probability of departure falls until the age of 52 and then rises drastically around the ordinary retirement age of 55. Moreover, Lausten (2002) finds that young CEOs are assessed on the basis of increasing profit alone, while older CEOs are assessed based on both profit and the annual sales. In addition he also finds that young CEO (age less than 50 years) is more likely to be dismissed than older CEO (age more than 50 years).

Besides, age can also be used as a proxy for CEO's knowledge. It is commonly stated that young CEOs are less experienced, therefore they have lower

information level about the internal and external environment of the firm. For example, Lausten (2002) finds that the turnover-performance relationship for younger CEOs is based on the pre-tax accounting profits for the preceding years, whereas the relationship for older CEOs is concentrated on the proportion of the pre-tax accounting profits to the annual sales in the firms. This result suggests that young CEOs are assessed on the basis of increasing profit alone, whereas better results including both the profit and the annual sales are requested from the older CEOs.

As the age is used as proxy of effectiveness, these studies suggest that the older, the greater the understanding of the firm and its industry, and the better the performance of the firm. If older, more experienced CEOs enhance firm performance, they might also be associated with lower use of financial restatement.

H1: Firms with older CEOs will be less likely involved with financial restatement.

2.2.2 CEO Tenure (CEOTENURE)

Social network theory claims that CEOs would establish a power base over time. Shen and Cannella (2002) suggest that new CEOs confront significant challenges upon taking office. They need to adjust to their new roles and quickly develop

good working relationship with other members of their top management groups, board of directors and powerful outside stakeholders. As time passes by and once incumbent CEOs have proven their leadership capacity and established their authority in office, the challenges would then be greatly reduced. Thus, it is expected that the longer a CEO has been in the firm, the less likely he is to be turned over unless he reaches the retirement age. For example, study in CEO turnover Goyal and Park (2002) include tenure as a control variable in their study and found that the estimated coefficient on the CEO tenure is negative and significant. This result suggests that the probability of CEO turnover is less likely to occur when CEOs have longer tenure. A similar finding was derived from a study by Shen and Cannella (2002) who found that CEOs with shorter tenure are more likely to be dismissed than CEOs with a longer tenure.

As the CEO tenure is use as proxy of effectiveness, the longer the tenure of the firm's CEO, the greater the understanding of the firm and its industry, and the better the performance of the firm. CEO with longer tenure is expected to have more experience that enhances firm performance. The higher the performance of the company, the lower the incidence of financial restatements although, Dechow and Sloan (1991) prove that there is a possibility that CEOs in their final years of service are more prone to manage reported short-term earnings.

H2: Firms with longer tenure CEOs will be less likely involved with financial restatement.

2.2.3 CEO Ownership (CEOOWN)

Agency theory discusses that there will be a convergence of interest between agent and principal. One way to solve this problem and to make the top management's interest aligns with shareholders' interest is by allowing the top management to have some shares in the company. As the management owns some portion of company's share, they are now becoming the owners of the firms. As a result, they will put in their best efforts to enhance the firm's performance in order to maximize their own wealth.

The proportion of shares owned by CEO will increase the power of CEO. Similar to managerial ownership, CEO ownership will increase a firm's value due to better alignment of interests between CEO and outside shareholders. Denis et al. (1997) propose two ways in which the equity ownership can protect CEO from internal monitoring efforts by both board and shareholders. First, CEO ownership is likely to be associated with the power of CEO, either through the voting control associated with equity ownership or through the correlation between equity ownership and other conditions conducive to managerial entrenchment or both. Second, CEO ownership may inhibit the external corporate control, thus reducing the effectiveness of internal control effort. As a result, it may reduce the likelihood of financial restatement poorly performing firms with high CEO ownership.

Empirical evidences showed that managerial ownership is effective at certain ownership level (Morck et al. 1988; Denis et al. 1997). Studies by Morck et al. (1988) and Pergola (2005) found a curvilinear relationship between firm's value and the number of shares owned by management. They reported an increment in firm value when managerial ownership is between 0 percent to 5 percent and above 25 percent respectively. However, when the managerial ownership is between 5 percent to 25 percent, there is a decrement in firm's value. A similar finding is also discussed by Ghosh et al. (2007) who provides evidence that the controlling power of a CEO over firms' decision depends of the level on ownership possessed by the CEO. If the controlling power is less than 5 percent, their influence is not significant and as the controlling power is more than 25 percent, their power will be significantly increased .These findings are consistent with the management entrenchment hypothesis as the hypothesis posits that when management ownership level increases beyond a certain level, the manager's interest is aligned with the shareholders' interest because at this level the manager is also the owner of the firm. Thus, in the case of higher CEO ownership, the probability of financial restatement also declines as the interest of shareholders and CEO has been aligned.

H3: Firms with CEOs' ownership will be less likely involved with financial restatement.

2.2.4 CEO Turnover Type (FORCED)

Furtado and Karan (1990) argue that different type of turnover will have different impact on the post-succession performance which normally refers to the stock market reaction. In general, several studies like Friedman and Singh (1989) and Davidson et al. (2006), report insignificant aggregate price effects for their overall sample, but significant positive or negative effects for specific types of changes. Previous research classify turnover into two categories which are voluntary turnover and forced turnover.

Hermalin and Weisbach (2003) argue that voluntary turnover is unlikely to be related to performance. Therefore, in order to reduce additional noise in dependent variable, they suggest that CEO turnover need to be separated between forced and voluntary turnover. Voluntary turnover is defined as changes due to the age of directors who are between 54-55 years, death or illness or changes in CEO due to merger and takeover (Kang & Shivdasani, 1995; Denis et al. 1997; Maury, 2006). The voluntary turnover is normally planned; thus, it does not convey a significant effect on the firm's abnormal return. Normal retirement is an example of anticipated changes whereby CEOs announce their intentions to step down from their position at some future date. As the change is planned, the successor had already been determined and groomed within the firm. As claimed by Friedman and Singh (1989), customary retirements in generally are orderly

smooth transitions that involve successors who are well known to the incumbent management.

Weisbach (1988) defines forced turnover as a turnover of other reasons than normal retirement. Unfortunately, the identification of forced turnover is difficult because press releases often do not describe them as such. Poor performance is the most frequent used reason to determine forced turnover. Generally, forced turnover can be divided into two, which are board-initiated and manager-initiated turnovers. Market acts differently to turnovers initiated by boards as compared to turnovers initiated by managers (Furtado & Karan, 1990). Friedman and Singh (1989) discuss that board-initiated successions are more likely to occur under the conditions of poor performance. In a rational selection process has occurred, an appropriate change in company's direction is signalled. Thus, a positive stock market reaction is expected for board-initiated succession. On the other hand, board-initiated succession is not likely to occur in high performing firms. If the situation exists, it will signal that some internal political turmoil exists in the company, not the failure of CEO in performing his duty. Therefore, board-initiated performance is unwelcomed in high performing firms.

The second type of forced turnover is CEO-initiated succession. Examples of CEO-initiated successions are the illness or death of the CEO. Friedman and Singh (1989) predict that the CEO-initiated turnover will have a positive market

reaction but at the level lower than board initiated turnover. Meanwhile, when a firm's pre-succession performance is good, the CEO-initiated turnover will either signal that the CEO wishes to change organizational affiliation or positions available in the external market. A negative market reaction is expected due to unwelcome change and disruptions in external relations and patterns of authority initiated in the departing CEO's interest.

As forced turnover is commonly related with poor performance, this study expects that CEO in poor performing firms who might facing forced turnover, tend to manage company performance before they being sacks by the board of directors. They may restate financial statement to show their effectiveness in managing the company for their job security.

H4: Firm with CEOs' forced turnover will be more likely involved with financial restatement.

2.2.5 Control Variables

Firm size, firm leverage, Big 4, family business, market to book value and return on total assets are among potential firm characteristics that may play important roles in assessing the decision of CEO turnover. Firm size is measured as natural log of book value over total assets and leverage is defined as the book value of long-term debt divided by total assets. Big 4 is referred to auditor companies that

audited firms financial statement, namely Ernst & Young (EY), PricewaterhouseCoopers (PwC), KPMG and Deloitte. Family business is measured based on shares that are owned by family directors. Market to book value ratio indicates the growth of the firms and ROA is a measurement for firm's accounting performance.

CHAPTER 3

METHODS

Data on CEO turnover, CEO characteristics and financial restatement are gathered from company annual reports and Bursa Malaysia's website under the company announcement section, while data for corporate performance is gathered from Datastream. The unit of analysis for this study is individual CEO turnover in Malaysian PLCs. The population of this research comprises of companies that are traded and listed on the Main Board and Second Board of Bursa Malaysia including both good and low performing firms during the four year interval starting from year 2008 to year 2010. There were 101 cases of CEO turnover during the period. However, after omitting companies with incomplete financial data and delisted companies, we finally ended up with 78 turnover events. The following table describes the sample based on its industry classification.

Table 1: Industry Classification

Industry	Frequency	Percentage
Industrial products	19	24.4
Trading/services	19	24.4
Properties	12	15.4
Consumer Products	9	11.5
Technology	9	11.5
Construction	6	7.7
IPC	2	2.6
Finance	1	1.3
Plantation	1	1.3
Total	78	100

Table 1 explains that 48.8 percent of CEOs turnover cases comes from industrial product and trading/services industries. Both industries are consider as homogenous industry and do not depend much on research and development (R&D) and capital spending. As a result, due to less complexity in such industries, many suitable candidates can be found inside or outside of the firm. Further, in highly competitive industries that consist of a large number of homogeneous firms, there is a large pool of suitable CEOs candidates compared to a low competition industry. This is because CEO candidates of the former face similar working task and environment (DeFond & Park, 1999). In addition, Parrino (1997) claims that the cost of human specific capital of outside successor in industries comprised of similar firms (homogeneous) is lower than in heterogeneous industries. The reason is that the outsider in a homogenous industry better understands the production technologies employed at other industry firms and the product markets in which they compete.

CEO turnover is determined by comparing the names of CEOs listed in year 2007 with the CEO names in years 2009 and 2010. If there are any changes in the CEO name from the based year, then CEO turnover is considered has taken place. Later, the name of changed CEO is compared with the announcement made by the company under the section of Change in Boardroom in the Bursa Malaysia's website. The purpose of comparing information gathered from the annual reports and company announcement is to ensure that CEO turnover has actually taken place. Some difficulties arise in comparing the data since there is no specific

announcement made regarding CEO change. All changes in company top management including the Chairmen, CEO and other directors are lumped together under Change in Boardroom title. From 2008 to 2010 there were 24700 announcements regarding change in boardrooms. As there is no specific announcement made regarding CEO change, every single announcement was analysed to differentiate between CEO, chairman or other directors' change. Other information disclosed in Change in Boardroom announcement includes date of CEO change, announcement date, CEO profiles and reason for change. The information is relevant to determine the exact date of turnover and the type of CEO turnover.

To determine the type of CEO turnover, a further step was taken by examining the announcement made by the company regarding CEO turnover. Based on the reasons disclosed on the announcements, turnover events are classified as voluntary or forced turnover. Succession theory suggests that there are at least four voluntary scenarios, namely relay succession, normal retirement, early retirement and death or poor health (Friedman & Singh, 1989; Cannella & Lubatkin, 1993). A relay succession is when the apparent heir becomes the CEO and the outgoing CEO becomes the chairperson. Normal retirement is when the CEO retires due to their retirement age. For example, the age of 55 is considered as a retirement age in the UK while in Malaysia, a person should seek annual approval when he reaches the age of 70 years old (Goyal & Park, 2002; Kang, 2002). Early retirement is when the CEO relinquishes his directorship but not his

officership and his age should be less than the retirement age. Death or poor health condition of a CEO is also considered as voluntary turnover.

Regarding forced turnover, Dahya et al. (2002) and Huson, Malatesta and Parrino (2004) identify forced turnover by examining the report released by the press including the Financial Times and Wall Street Journal. They labelled turnover as a forced turnover when the news articles state that the executive was “fired” or “resigned” and in both cases the CEO must be less than 55 years old. In addition, if the announcement did not report any reason for the departure as death, poor health, or the acceptance of other position elsewhere or within the firm stated, then the departure is also classified as forced turnover. Further, removal is also considered as forced turnover since CEOs are removed before the expiration of their three years term (Kang, 2002). For the purpose of this study, classification of forced turnover and voluntary turnover will be based on the reason stated in the change of management announcement made by a company on the Bursa Malaysia’s website. The classification used is as suggested by Huson et al. (2004) and Dahya et al. (2002). A dummy variable is used to determine turnover type; “1” is for forced turnover and “0” is for voluntary turnover.

The research model of this study is:

$$P(\text{RESTATEMENT}=1) = f(\text{CEO Characteristics, control variables})$$

where the dependent variable: $P(\text{Restatement}=1)$ is the estimated conditional probability of financial statement restatement and the independent variables are:

RESTATEMENT = Equal '1' if firm published restatement annual report.

CEOAGE = Age of CEO during the year preceding CEO turnover

CEOTENURE = Number of month the CEO had held the position as at the year of the turnover year.

CEOOWN = Percentage of shares owned by CEO during the year preceding CEO turnover.

CEOOWN2 = CEO ownership square

FORCED = Turnover type is determined based on the announcements made by the companies regarding CEO turnover (Dahya et al. 2002; Huson et al. 2004). Variable takes a value of '1' for forced turnover, and '0' for voluntary turnover.

LNTA = Natural log of total assets.

LEV = Total debt/ total assets.

B4 = The big four audit firms (EY, PwC, KPMG, Deloitte)

FAMBIZ = Equals '1' if family directors have more than 5% shares in a company.

MTBV = The ratio of market value to the book value of company assets

ROA = The ratio of accounting earnings before interest and taxes to the book value of assets.

To estimate this model, logistic regression is used due to the binary nature of the dependent variable that violates the Ordinary Least Squares (OLS) regression assumptions. The dependent variable for financial restatement model is dichotomous; '1' represents firms that restate their financial restatement within a year or two years cases prior to CEO turnover and '0' represents non-financial restatement cases.

CHAPTER 4

RESULTS AND DISCUSSION

From 95 companies, 78 companies are included in the analysis after excluding incomplete data due to change of financial year and delisting exercises. Table 2 displays the descriptive statistics for both continuous and dichotomous variables. 22 companies restated (R sub-sample) their financial statements and 56 companies (NR subsample) issued non-restated financial statements.

Table 2: Descriptive Statistic

Variables	Min	max	Mean	s.d.	Median	Mean		t-test ¹
						R	NR	
RESTATE	0	1	0.28	0.453	0.00	n.a	n.a.	n.a.
CEOAGE	34	76	52.18	8.379	52	53.730	51.570	1.023
CEOTENURE	1	32	7.63	6.866	5.500	6.820	7.950	-0.651
CEOOWN	0.000	57.490	13.039	16.077	3.810	11.372	13.695	-0.572
FORCED	0.00	1	0.6154	0.489	1	0.682	0.589	0.749
LNTA	8.890	17.530	12.825	1.893	12.533	13.427	12.588	*1.786
LEV	0.00	64.880	1.316	7.299	0.473	0.444	1.658	-0.658
B4	0	1	0.55	0.501	1	0.450	0.590	-1.071
FAMBIZ	0	1	0.37	0.486	0	0.410	0.360	0.422
ROA	-64.020	52.830	0.098	13.795	2.520	4.374	-1.581	*1.738
MTBV	0.150	27.820	1.396	3.417	0.755	2.957	.782	***2.625

¹T-test is based on 22 restated companies and 56 non-restated companies

Our findings suggest that in the sample of companies with CEO turnover from 2008-2010, about 28% (22 companies out of 78 companies) restated their financial statement one year prior to CEO departure. On average, the CEO is in their 50s (almost half of the sample or 35 companies) with an average tenure of about 8 years (about 11 companies have short-tenured CEO of less than three years of service). Only 8 companies appointed the CEO below 40 years old in our CEO turnover sample which represent a minority (result is untabulated).

We also document that on average the CEOs own substantial shareholdings although the median value is lower but it is still not a negligible value. Such CEO holds huge voting rights and it is natural to expect that these high holding CEOs may pass the baton to other CEOs while they retain their board membership perhaps in a more “advisory” position such as chairman or vice chairman for example Genting Group Berhad as Tan Sri Lim Goh Thong became chairman for the group while his son replaced him as a CEO. The companies were not in huge debt or experiencing severe losses and with market value higher than book value which is expected from public listed companies. The evidence also points towards more forced CEO turnover compared to voluntary turnover. About more than a third were family controlled firms which are also as expected from Malaysian market.

Our results also suggest that restated companies are bigger in size (LNTA), are more profitable (ROA) and have higher market to book value (MTBV) than non-restated companies based on t-test. These should not be overly emphasized as it is not based on ceteris paribus basis.

Table 3 presents the correlation analysis. The evidence suggests that on correlation basis, restatement is only significantly associated with market to book value but none with the hypotheses variables. However, this should not be overly emphasized. Older CEO is associated with longer tenured CEO and lower forced CEO turnover (the highest correlation with $p=-.787$). Longer tenured CEO is associated with higher CEO shareholdings and lower forced CEO turnover. Higher CEO ownership is associated with smaller companies. None of the correlation is too high to suggest severe collinearity threats (see Nunally, 1978).

In addition, a formal test using Variance Inflation Factor yields results ranging from 1.144 (FAMBIZ) to 2.897 (CEOAGE). As such, serious threats of multicollinearity are not apparent for the chosen research model and the collected data (see Neter, Wasserman & Kutner, 1989).

Firm size has three significant correlations with employing the Big Five auditor, with lesser family business and higher profitability. The Big Four auditor is associated with profitable companies. Family business is associated with less

profitable companies and profitable companies are associated with higher market to book value which is expected.

Based on the correlation analysis, a simple chain of argument would be firms with financial restatement is correlated with higher market to book value and market to book value is correlated with more profitable firms and profitable firms is correlated with the Big Five auditor and non-family business. Non family firms are usually larger and are correlated with lower CEO ownership. Lower CEO ownership is correlated with shorter tenure which leads to younger CEO.

Table 3: Correlation Analysis

	1	2	3	4	5	6	7	8	9	10	11
1.RESTATE	1	0.117	-0.074	-0.605	0.201	-0.075	-0.122	0.048	0.196	0.288*	0.086
2.CEOAGE		1	0.391**	0.034	0.132	-0.151	0.050	0.105	0.068	-0.051	-0.787**
3.CEOTENURE			1	0.355**	-0.036	0.004	0.068	0.030	-0.008	-0.116	-0.348**
4. CEOOWN				1	-0.327**	-0.100	-0.173	0.166	-0.116	-0.181	0.074
5.LNTA					1	-0.192	0.389**	-0.246*	0.277*	0.132	-0.090
6.LEV						1	0.103	-0.087	0.133	0.007	0.087
7.B4							1	-.0106	0.292**	-0.052	-0.024
8.FAMBIZ								1	-0.224*	-0.0152	-0.046
9.ROA									1	0.501**	-0.120
10.MTBV										1	0.012
11.FORCED											1

*/** significant at 10%/5% respectively (two-tailed)

Results from the logistic regression analysis are presented in Table 4. Results from Panel A (without hypotheses variables) are qualitatively similar with Panel B and C saves for leverage. Panel B (without CEOOWN²) shows that from three hypotheses variables, only CEOAGE is significant at 1% level. This suggests that older CEOs have higher probability of restating restatement prior to CEO turnover year or increase the odd of restatement by 41% on average. As the median age from our descriptive results is 52 years old which is about three years prior to retirement, we argue that the age group of CEO of between 50-55 represents a critical group of near retirement group. These CEOs may have to tread carefully between maintaining their reputation in the labour market or pressing for the last bonus/pay they would likely receive. Thus, we expect these CEOs would be more conservative and might avoid unnecessary restatement prior to CEO turnover. This preconceived idea is not supported from the finding. It seems that the finding suggests otherwise. An alternative view is that financial restatement may not necessarily be a bad thing to be reported if it is as required by the relevant FRSs although this speculation is not yet to be tested from our study.

Panel C, however reports that CEO ownership is significant when we assume that ownership has a curvilinear effect on odd-likelihood of restatement (at 20% ownership level based on the result) similar to findings in other area e.g. firm performance and employee ownership (Gudri & Hollandtz, 2008; Kim, Kitsabunnarat & Nofsinger, 2004). Our sample includes many companies with CEO ownership exceeding the 20% threshold. As such, as CEO ownership gets

bigger, the odd-likelihood of restatement falls. Arguably, the management entrenchment hypothesis works in the background of such phenomena as the incumbent CEO would have conflict of interests and as such would be hesitant to restate previous financial statements. Introducing a proxy for management entrenchment also change the original direction of forced CEO turnover from positive to negative as theorized. As such, Panel B may suffer from omitted variable bias due to entrenchment hypothesis. As expected, these results have little similarities with the T-test in Table 2 save for size (LNTA) and market to book value (MTBV) as T-test is not on ceteris paribus basis.

Interestingly, if the outgoing CEOs are forced to leave the company, then we could observe a much lower probability of financial restatement. This contradicts our expectation as we assume that the outgoing CEOs would somehow leave the best results prior to turnover year unless the majority of them did not expect to be unseated or had little control on financial and accounting matters where the board of such companies may exert bigger control compared to the outgoing CEO. This speculation is also yet to be tested from the study. However, our Panel C shows that the direction is as expected as we suspect omitted variable bias exists in Panel B. Thus, Panel C suggests that forced turnover increases the likelihood of restatement.

Table 4: Logistic Regression

		Panel A	Panel B	Panel C
Variable	Expected sign	B (s.e.)	B (s.e.)	B (s.e.)
CEOAGE	-	-	0.348*** (0.121)	0.337*** (0.121)
CEOTENURE	-	-	-0.024 (0.067)	-0.027 (0.068)
CEOOWN	-	-	0.015 (0.028)	0.160* (0.107)
CEOOWN ²		-	-	-0.004* (0.003)
FORCED	+	-	-5.831*** (1.821)	5.947*** (1.868)
LNTA	+	0.422** 0.198	0.810*** (0.321)	0.904*** (0.338)
LEV	?	-1.308 1.310	-4.365** (2.195)	-4.805** (2.280)
B4	-	-1.518** 0.723	-2.118** (0.900)	-1.980** (0.917)
FAMBIZ	?	1.213** 0.665	1.975** (0.957)	1.820** (0.985)
ROA	-	0.014 0.033	-0.014 (0.036)	-0.016 (0.036)
MTBV	?	1.128*** 0.491	2.438*** (0.754)	2.501*** (0.787)
CONSTANT	?	-6.715*** (2.519)	-30.181*** (9.236)	-34.945*** (10.718)
Cox & Snell R ²		0.242	0.411	0.427
Correct prediction		80.8%	82.1%	83.3%

***/**/* significant at 1%/5%/10% respectively (2-tailed)

We also find that the bigger the company, the higher probability it would restate its financial statement prior to CEO departure year. The study finds that some evidence to support the argument of debt as a monitoring cost as debt is argued to constraint opportunistic earnings management behavior since it limits the amount

of funds or free cash flows. Despite that we expect that the Big Four audit firms would promote their clients to adopt new FRSs early so that this would lead to less restatement later as recently documented in Huang, Zhang, Shen and Xie (2011) in China, the evidence suggest that having Big Four auditors is associated with higher probability of restatement after controlling other factors. As such, early adoption may not take place as market wide phenomena in Malaysia and thus yield a simple explanation that Big Four is associated with higher earnings quality by signing off financial restatement when the needs arise.

A more puzzling issue is the effect of family business on financial restatement. We document that the effect is significant and positive. As family business is argued to be conservative in its business dealings and thus leads to lower financial restatement incidence, however it is not evident from the finding.

We could not find evidence that financial restatement is induced by profitability although the direction is as expected as shown under Panel B and C. However, the higher the market to book value, the higher the probability of financial restatement as also documented in the correlation analysis in Table 3.

In conclusion, we find supports for H3 (CEO ownership) and H4 (forced turnover). Meanwhile, we find the need to reinterpret our expectation of H1 (CEO age) as it is counterintuitive.

CHAPTER 5

CONCLUSION

The study investigates possible ramifications of outgoing CEO characteristics on financial restatement in Malaysia from 2008 to 2010. We find that the age of the CEO influence restatement in the year prior to CEO turnover. The older CEOs might not be perturbed with the complexities of newer financial accounting standard requirements which lead to future restatements as they are from the era of simpler accounting regime prior to FRS, or it could be that these restatements might not be bad after all. We have not discounted the possibility that older CEOs are safer from forced turnover as shown from correlation analysis. The policy to align CEO's interest with the shareholders would jeopardize shareholder's wealth as the financial information is distorted by such CEOs as they would be less likely to restate financial information.

We take cognizant that our financial restatement samples include both errors and changes to accounting policies as each situation could be different. The former may be more related to malice intention from the CEOs to mislead the shareholders through accounting trickeries and the later might be more related towards malice intention through suppressing accounting changes to later period. However, both arguments are hard to prove.

Future study could make use information on restatement due to changes accounting standards or errors and omissions. This would affect policy making especially from the SC and other regulators. From political economy perspective, more studies on family business and restatements would shed some lights to the puzzling evidence we documented in this study.

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Appendix 1

List of Companies

COMPANY NAME	INDUSTRY	CEO CHANGE YEAR
AJINOMOTO (M) BERHAD	CONSUMER PRODUCTS	2009
AKN TECHNOLOGY BHD	TECHNOLOGY	2009
BASWELL RESOURCES BHD	CONSUMER PRODUCTS	2010
BERJAYA CORPORATION BHD	TRADING/SERVICES	2010
BINA DARULAMAN BERHAD	PROPERTIES	2008
BINA GOODYEAR	CONSTRUCTION	2010
BINTAI KINDEN CORPORATION BERHAD	TRADING/SERVICES	2008
BIO OSMO BERHAD	CONSUMER PRODUCTS	2009
BRITISH AMERICAN TOBACCO (M) BERHAD	CONSUMER PRODUCTS	2009
CARLSBERG BREWERY MALAYSIA BHD	CONSUMER PRODUCTS	2010
COUNTRY HEIGHT HOLDING BHD	PROPERTIES	2008
CSC STEEL HOLDINGS	INDUSTRIAL PRODUCTS	2009
CUSCAPI BERHAD	TECHNOLOGY	2009
DAMANSARA REALTY BHD	PROPERTIES	2009
DATAPREP HOLDING BERHAD	TECHNOLOGY	2008
ECOFIRST CONSOLIDATED BHD	TRADING/SERVICES	2009
EDARAN OTOMOBIL NASIONAL BERHAD	TRADING/SERVICES	2009
ES CERAMIC TECHNOLOGY BHD	INDUSTRIAL PRODUCTS	2008
EXTOL MSC BHD- (ACE MARKET)	TECHNOLOGY	2010
FACB INDUSTRIES INCORPORATED BERHAD	INDUSTRIAL PRODUCTS	2009
FLONIC HI-TEC BHD (ACE)	INDUSTRIAL PRODUCTS	2010
FOCUS DYNAMICS TECH BHD (ACE)	TECHNOLOGY	2009
FREASER AND NEAVE HOLDINGS	CONSUMER PRODUCTS	2010
GD EXPRESS CARRIER BERHAD	TRADING/SERVICES	2008
GEFUNG HOLDING BERHAD	INDUSTRIAL PRODUCTS	2009
GLOMAC BERHAD	PROPERTIES	2009
GRAND HOOVER BERHAD	PROPERTIES	2009
GUACOLAND (M) BHD	PROPERTIES	2010
HING YIAP GROUP	CONSUMER PRODUCTS	2011
HUA YANG BHD	PROPERTIES	2010
I-BERHAD	PROPERTIES	2008
I-BERHAD	PROPERTIES	2009
IBRACO BHD	PROPERTIES	2010
IFCA MSC BHD (ACE)	TECHNOLOGY	2010
IJM CORPORATION BHD	CONSTRUCTION	2010
INGENUITY SOLUTIONS BHD (ACE)	TECHNOLOGY	2010

INIX TECHNOLOGIES HOLDINGS BHD	TECHNOLOGY	2010
KARAMBUNAI CORPORATION	PROPERTIES	2011
KAWAN FOOD BHD	CONSUMER PRODUCTS	2010
KEY ASIC BERHAD	TECHNOLOGY	2008
KEY ASIC BHD	TECHNOLOGY	2010
KNUSFORD BERHAD	TRADING/SERVICES	2008
KURNIA ASIA BERHAD	FINANCE	2008
LAFARGE MALAYAN CEMENT BHD	INDUSTRIAL PRODUCTS	2008
MEDA INC. BERHAD	PROPERTIES	2008
MEDIA PRIMA BERHAD	TRADING/SERVICES	2009
MELEWAR INDUSTRIAL GROUP	INDUSTRIAL PRODUCTS	2010
MELEWAR INDUSTRIAL GROUP BERHAD	INDUSTRIAL PRODUCTS	2008
MISC BERHAD	TRADING/SERVICES	2009
MISC Bhd	TRADING/SERVICES	2010
MMC CORPORATION BERHAD	TRADING/SERVICES	2008
MULTI-CODE ELECTRONICS INDUSTRIES (M) BHD	INDUSTRIAL PRODUCTS	2008
MUTIARA GOODYEAR DEVELOPMENT BERHAD	PROPERTIES	2009
NESTLE (M) BERHAD	CONSUMER PRODUCTS	2009
NWP HOLDING BERHAD	INDUSTRIAL PRODUCTS	2008
PANASONIC MANUFACTURING	CONSUMER PRODUCTS	2010
PARAMOUNT CORPORATION BERHAD	PROPERTIES	2008
PERISAI PETROLEUM TEKNOLOGI BHD	INDUSTRIAL PRODUCTS	2010
PETRA PERDANA BHD	TRADING/SERVICES	2010
PJBUMI BERHAD	TRADING/SERVICES	2008
PJI HOLDINGS BERHAD	TRADING/SERVICES	2008
POS MALAYSIA BERHAD	TRADING/SERVICES	2008
PULAI SPRING BERHAD	CONSTRUCTION	2008
PUNCAK NIAGA HOLDING BERHAD	IPC	2009
SAPURA INDUSTRIAL BERHAD	INDUSTRIAL PRODUCTS	2009
SCAN ASSOCIATES BERHAD	TECHNOLOGY	2009
SCOMI ENGINEERING BHD	INDUSTRIAL PRODUCTS	2009
SCOMI MARINE BHD	TRADING/SERVICES	2009
SHELL REFINING COMPANY (FEDERATION OF MALAYA) BERHAD	INDUSTRIAL PRODUCTS	2009
SILVER RIDGE HOLDING BHD	TECHNOLOGY	2009
STAR PUBLICATIONS (M) BERHAD	TRADING/SERVICES	2008
SURIA CAPITAL HOLDING BERHAD	TRADING/SERVICES	2009
TAI KWONG YOKOHAMA BERHAD	INDUSTRIAL PRODUCTS	2009
TELEKOM MALAYSIA BERHAD	TRADING/SERVICES	2008
TH PLANTATION BERHAD	TRADING/SERVICES	2009
THE NOMAD GROUP BHD	PLANTATION	2009
THETA EDGE BHD	TECHNOLOGY	2010

TIME DOTCOM BERHAD	IPC	2008
TMC LIFE SCIENCES BHD	TRADING/SERVICES	2010
TPC PLUS BHD	CONSUMER PRODUCTS	2010
TRACOMA HOLDING BERHAD	INDUSTRIAL PRODUCTS	2008
TRACOMA HOLDINGS BHD	INDUSTRIAL PRODUCTS	2010
TRADEWINDS (M) BERHAD	CONSUMER PRODUCTS	2008
TRADEWINDS (M) BHD	CONSUMER PRODUCTS	2010
TRANSMILE GROUP BERHAD	TRADING/SERVICES	2008
TRANSOCEAN HOLDING BHD	TRADING/SERVICES	2009
TSH RESOURCES BERHAD	CONSTRUCTION	2008
TSR CAPITAL BHD	CONSTRUCTION	2010
UNITED MALAYAN LAND BERHAD	PROPERTIES	2009
VASTALUX ENERGY BHD	TRADING/SERVICES	2010
VIZTEL SOLUTIONS BERHAD	TECHNOLOGY	2008
VTI VINTAGE BERHAD	INDUSTRIAL PRODUCTS	2008
WIJAYA MAJU GLOBAL BHD	INDUSTRIAL PRODUCTS	2010
YLI HOLDING BERHAD	INDUSTRIAL PRODUCTS	2008
ZELAN BERHAD	CONSTRUCTION	2008