SHS Web of Conferences **34**, 04006 (2017) DOI: 10.1051/shsconf/20173404006
FourA 2016

Financial restatement and firm performance in family controlled and CEO duality companies: evidence from post 2007 Malaysian Code of Corporate Governance

Sok Fun Chin[1*], *Kin Boon* Tang[2], and *Ayoib* Che Ahmad[3]

[1]South Australian Matriculation/SACE International, Taylor's College Subang Jaya, Malaysia
[2]Faculty of Social Sciences, Nottingham University Business School Malaysia Campus, Malaysia
[3]Tunku Puteri Intan Safinaz School of Accountancy, College of Business, Universiti Utara Malaysia, Malaysia

Abstract. Do financial restatements dampen firm performance? One argument about this is that restatements hurt investor confidence in the credibility of a firm's disclosure, resulting in a decline in demand for the firm's securities, thereby, leading to a significant drop in asset price. On the other hand, agency theory suggests that family ownership could have potential benefits to a firm's performance. An increase in family ownership will have a greater concern for reputation to the controlling family in producing high quality accounting information and, thereby, reduce the likelihood of financial restatements. We evaluate these arguments by distinguishing the effects of restatements on firm performance under two corporate governance environments; family-controlled and CEO duality companies. Based on a sample of Malaysian listed companies in 2008 after the post MCCG 2007 initiative, our findings suggest that (1) restatements dampen firm performance, (2) the dampening impacts of restatements are completely mitigated in family-controlled companies, and (3) the dampening effects are more pronounced in non-family controlled companies than family-controlled companies in non-CEO duality companies. Using this evidence, we recommend that Malaysian regulators develop policies that are unique to the Malaysian markets so as to curtail accounting irregularities. They should reconsider the relevance of requiring CEO non-duality as a practice of good corporate governance and encourage more investment in family-controlled companies.

1. Introduction

*Corresponding author: sokfun.chin@taylors.edu.my

DOI: 10.1051/shsconf/20173404006

In Malaysia, the ownership and control of corporations are highly concentrated, and many are in the hands of family-controlled companies [1]. At times, external financial statements prepared as instructed by the controlling family may mislead users and hide opportunistic activities carried out by the dominant family at the expense of minority shareholders [2]. To compel the management team of listed companies to act ethically in the interest of the general public, the Securities Commissions has been issuing the Malaysian Code of Corporate Governances over the years (*viz.,* MCCG 2000, MCCG 2007, MCCG 2012 and MCCG 2016 draft) yet the accounting irregularity-financial restatement still occurs. It is common for the Chief Executive Officer (CEO) in a family-controlled company to hold the position of Chairman (CEO duality) so that this greater voting power makes it easier to appoint more members of the family to the Board of Directors [3]. Since having a separation of roles between the CEO and Chairman is accepted as part of good corporate governance in MCCG in that a person cannot dominate the decisions made by the board. Accordingly, this study is aimed at providing empirical evidence concerning financial restatement and firm performance in family-controlled companies when the CEO holds dual roles, using post MCCG 2007 data.

2. Literature Review

2.1 Financial restatement and firm performance

General Accounting Office (GAO) states that financial restatement "occurs when a company, either voluntarily or prompted by auditors or regulators, revises public financial information that was previously reported" [4,p1footnote].The firm's dismal performance may be the reason the manager restates the account; this typically happens to firms experiencing high growth and improving performance during a period of economic boom. As a result, financial analysts may be guided by unrealistic future results and expectations. When the economy slows down, managers find it hard to achieve the targets set during the boom, and thus, resort to practising accounting irregularities to meet analysts' expectations [5].

Restatement normally indicates that the manager is unable to report the firm's future prospects in a credible way, causing lenders to reassess the credit risk profile of the restating firm, thus, leading to higher interest rates, more covenant restrictions, and a higher likelihood of loans being secured than initiated before the restatement [6-7]. Also, investors, customers and suppliers tend to lose confidence in the firm's future prospects and change their terms of trade with the restating firm [8]. This means restatement will increase the cost of debt, future litigation concerns [9], and lead to meaningful declines in firm value and expected future cash flows [9]. Accordingly, we hypothesise that:

H1. Financial restatement reduces firm performance.

2.2 Financial restatement and firm performance in family-controlled companies

In a highly concentrated ownership structure, the controlling family can seek personal gain through expropriation of minority shareholders, related party transactions [10], managerial entrenchment [11], and have significant effect on the recognition of goodwill impairment[12]. Family-controlled companies often weaken the effectiveness of Anglo-American corporate governance mechanisms [13].

On the other hand, agency theory explains that the proportion of managerial ownership can reduce the agency cost between the managers and shareholders by aligning the interests of managers with those of shareholders [14]. Based on the agency theory, an increase in the family ownership is expected to reduce the opportunistic goodwill impairment recognition" [3, pp.155]. In a multi-generation family-controlled firm, if the family owners are found restating the accounts, they may lose reputation-based benefits, such as high social status and political connections [15]. As such, our testable hypothesis is stated, as below:

H2. The dampening effect of financial restatements is mitigated in family-controlled companies.

2.3 Financial restatement and firm performance in dual CEO companies

Agency theory argues that shareholder interests require protection by instituting separate roles for board chair and CEO [16], as it is commonly believed that CEO (duality) tends to allow for abuse of power for personal gain; this includes increasing compensation or other forms of perquisite consumption [17].On the other hand, Stewardship theory supports the premise that the CEO duality company will enjoy the classic benefits of unity of direction and of strong command and control ([18]. The CEO-Chair appointment is an efficient response to the firm's contracting environment, in view of the increased riskiness of a firm, industry concentration, CEOs' ability and track record, and strong governance[19].

Nevertheless, the impact of CEO duality on the issues of corporate governance and firm performance remains inconclusive. [20] found insignificant association between a CEO holding dual roles as chairman and income-increasing and income-decreasing earnings management among Malaysian firms, supporting the findings of [21]. [22] too yielded insignificant correlation between the CEO-duality role and return on equity. In an earlier study,[23] revealed significant evidence of the relationship between role duality and performance measure in return on assets and return on equity. Accordingly, the following hypothesis is developed.

H3. CEO duality has significant impact on occurrence of financial restatement.

2.4 Financial restatement and firm performance in family controlled and dual CEO companies

In Malaysia, it is common to find the CEO holding dual roles as Chairman and CEO in family-controlled companies [3; 24]. Previous studies suggest that having separate leadership helps to enhance firm performance[24-25], but the CEO duality in family-controlled firms alone does not lead to goodwill impairment recognition [3]. In addition, having a separate CEO and chairman in a family-controlled company is not an effective way to reduce the occurrence of earning management when the CEO is a member of the controlling family (Presley and Abbott 2013[26]).

3. Data and Methodology

3.1 Study period

MCCG 2007 was launched in 2007.Compare to MCCG2000, MCCG 2007 stipulated more stringent compliance in the process of the selection of the CEO candidate. This study has chosen 2008 as the research period to examine the effectiveness of MCCG 2007 in reducing the occurrence of financial restatement in family-controlled companies when qualified CEOs held dual roles.

3.2 Sample selection and operational definitions

The data, sourced from Bursa Malaysia's website. The 2008 annual reports of these firms were examined for the criteria for financial restatement to be in compliance with the General Accounting Office (GAO) definition, and the keywords, "restatement", "restate", and "prior year adjustments", were scrutinised in each annual report for evidence of restatement [27]. Under the GAO definition, restatement does not include changes in accounting policies that lead to restating accounting figures.

3.3 Firm performance (FV) measures

Four performance measures are employed. (a) *Return on assets(ROA)* measuring the percentage of net profit over total asset. (b) *Earning per share(EPS)* calculated as net profit over weighted average of common shares outstanding. (c) *Profit margin(PM)* quantifying the percentage of net profit divided by turnover. (d) *Return on equity(ROE)* measures percentage of the net profit over common shareholders' equity.

3.4 Corporate governance variables

Financial restatement (FR) is financial restatement which coded as 1 if financial restatement occurred, or 0 otherwise.
CEO duality: the CEO has dual roles are coded 1 or 0, if otherwise[18].
Family-controlled companies: The company is deemed a family-controlled company if (1) the founder of the firm is the CEO or its successor is related by blood or marriage, or (2) at least two family members work as managers, or (3) family directors have managerial ownership, either direct or indirect shareholding of a minimum of 20% in the firm[24]. There are two control variables(CV) used; (a) Debt-to-asset ratio and (b) Altman Z-Score.

3.5 Baseline models

We use the following baseline model to examine the effects of financial restatement on firm performance, where FV is firm performance which includes return on assets, earning per share, profit margin, and return on equity.

$$FV_i = c + \beta_1 FR_i + \sum_{k=1}^{n} \delta_k CV_{k,i} + \varepsilon_i \tag{1}$$

In order to examine the effects of firm performance on restatements, the following logit model is employed:

$$FR(0,1)_i = c + \beta_1 ROA_i + \beta_2 EPS_i + \beta_3 PM_i + \beta_4 ROE_i + \sum_{k=1}^{n} \delta_k CV_{k,i} + \varepsilon_i \tag{2}$$

The effects of restatement on firm performance will be further examined under two corporate governance environments; family-controlled companies and CEO duality companies.

DOI: 10.1051/shsconf/20173404006

4. Findings and Discussions

4.1 Descriptive statistics

Table 1 shows correlation between financial restatement and both variables of corporate governance (CEO duality and family-controlled companies) is negative but statistically insignificant, indicating there is no direct relationship between the corporate governance variables and financial restatement. Also, the correlation between FR and the three firm performance measures; ROA, PM and ROE is negative and statistically significant, suggesting preliminary evidence in support of H1 that restatement reduces firm performance. Next section, regression and binary analyses will be used to control corporate governance environments that may mitigate or propagate these adverse effects of restatement on firm performance.

Table 1: Means, Standard Deviations, and Correlations

	Mean	Std. Dev	FR	DU	FC	DA	ROA	EPS	PM	ROE
FR	0.0610	0.2408								
DU	0.2317	0.4245	-0.1399							
			(-1.2641)							
FC	0.6220	0.4879	-0.1166	-0.0487						
			(-1.0504)	(-0.4361)						
DA	-1.7688	49.682	0.0117	0.0550	-0.0515					
			(0.1044)	(0.4930)	(-0.4618)					
ROA	-0.0287	0.1802	-0.4915***	-0.0057	0.2151*	0.0033				
			(-5.0476)	(-0.0512)	(1.9702)	(0.0298)				
EPS	0.1667	28.9977	-0.0529	-0.0737	-0.1135	0.0800	0.4615***			
			(-0.4741)	(-0.6615)	(-1.0221)	(0.7184)	(4.6535)			
PM	-0.0854	0.9510	-0.3565***	0.0086	0.2263**	0.0002	0.7848***	0.2286**		
			(-3.4137)	(0.0771)	(2.0776)	(0.0020)	(11.327)	(2.1004)		
ROE	0.0772	0.6738	-0.1937*	0.0040	-0.0070	0.0082	0.3327***	0.1799	0.1679	
			(-1.7664)	(0.0360)	(-0.0628)	(0.0732)	(3.1551)	(1.6357)	(1.5232)	
ZS	0.6212	0.3768	-0.0346	-0.1805	0.0996	-0.0265	0.21299	0.0751	0.0945	-0.0144
			(-0.3100)	(-1.6414)	(0.8956)	(-0.2372)	(1.9485)*	(0.6742)	(0.8487)	(-0.1284)

Notes: *,**, and *** denote significant at 10%, 5%, and 1% respectively. t-statistics are reported in parentheses. FR = financial restatement; DU = CEO duality; FC = family controlled; DA = debt to asset ratio; ROA = return on assets; EPS = earnings per share; PM = profit margin; ROE = return on equity; ZS = z-score.

4.2 Firm performance and financial restatement

Table 2 presents that, with the exception of earning per share, the effects of restatement on firm performance are negative and statistically significant. Restatement will create uncertainty about the firm's future prospect and impede the firm's ability to pursue profitable investment projects and, thereby, lead to a decline in firm performance [8]. We suggest that the adverse impact of restatement on firm performance is a result of negative market reaction towards the firm's credibility, in line with [7,pp44] that argued "restatements may shake investor confidence in the credibility of corporate disclosure,

DOI: 10.1051/shsconf/20173404006

depress demand for a firm's securities, and constrain corporate opportunities thereby leading to a substantial loss in market value".

Table 2: The Effects of Financial Restatement on Firm Performance

	Firm performance measures			
Independent variables	**Return on assets**	**Earnings per share**	**Profit margin**	**Return on equity**
Financial Restatement (FR)	-0.362798 ***	-6.176407	-1.397547 ***	-0.544603 *
Constant	-0.064787 *	-2.984122	-0.129094	0.133777
Control variables				
Debt/Asset	5.15E-05	0.048249	0.000125	0.000134
Z-score	0.093913 **	5.815538	0.207919	-0.037243
$AdjR^2$	0.252462	-0.022871	0.100627	0.001083
F-statistic	10.11856 ***	0.396288	4.020900 **	1.029281

Notes: *,**, and *** denote significant at 10%, 5%, and 1% respectively. The following baseline model is estimated using multiple regressions.

$$FV_i = c + \beta_1 FR_i + \sum_{k=1}^{n} \delta_k CV_{k,i} + \varepsilon_i \quad (3)$$

4.3 Firm performance, financial restatement and corporate governance

Family-controlled

Tables 3a and 3b present the estimates for testing the relationship between firm performance and financial restatement in family-controlled and non-family controlled companies, respectively. It is interesting to note that restatements have no impact on firm performance in family-controlled companies (Table 3a). However, when the companies are not controlled by the family (Table 3b), the results show significant impacts of restatements on performance, suggesting that there is a mitigation effect from family-controlled companies. This evidence is in line with our H2.

CEO duality

Table 3c presents the estimates for the 63 non-CEO duality companies. The remaining 19 CEO duality companies are not examinable as all the companies in this sub-sample are non-financial restating companies. The coefficient for restatements is negative and statistically significant (return on assets, profit margin, return on equity), but much smaller than those in non-family controlled companies, implying that the dampening effects of restatements on firm performance are more pronounced in non-family controlled companies. The results also provide some evidence of the mitigation effects of CEO duality on firm performance in companies. This evidence is also consistent with our H3.

Table 3a: The Effects of Financial Restatement on Firm Performance in Family Controlled Companies (n=51)

	Firm performance measures			
Independent variables	**Return on assets**	**Earnings per share**	**Profit margin**	**Return on equity**
Financial Restatement	0.004669	6.082336	-0.094894	-0.462240
Debt/Asset	4.02E-05	0.043907	0.000109	9.94E-05
Z-score	0.015960	0.177551	-0.373424	-0.002101
Constant	-0.009039	-2.573681	0.328348	0.093396
$AdjR^2$	-0.059436	-0.052188	-0.018836	-0.047689
F-statistic	0.064967	0.173341	0.691876	0.241359

Notes: *,**, and *** denote significant at 10%, 5%, and 1% respectively.

Table 3b: The Effects of Financial Restatement on Firm Performance in Non-Family Controlled Companies (n=31)

	Firm performance measures			
Independent variables	**Return on assets**	**Earnings per share**	**Profit margin**	**Return on equity**
Financial Restatement	-0.604072 ***	-18.17152	-2.194797 ***	-0.614170 *
Debt/Asset	0.000378	-0.113099	0.001903	0.002397
Z-score	0.196259 **	16.38359	0.952880 *	-0.074659
Constant	-0.132700 **	-3.102051	-0.696473 *	0.181880
$AdjR^2$	0.538039	-0.016080	0.301764	0.011234
F-statistic	12.64683 ***	0.841745	5.321813 ***	1.113619

Notes: *,**, and *** denote significant at 10%, 5%, and 1% respectively.

Table 3c: The Effects of Financial Restatement on Firm Performance in Non-CEO Duality Companies (n=63)

	Firm performance measures			
Independent variables	**Return on assets**	**Earnings per share**	**Profit margin**	**Return on equity**
Financial Restatement	-0.367686 ***	-7.283374	-1.415743 ***	-0.568577 *
Debt/Asset	5.13E-05	0.051574	0.000134	0.000139
Z-score	0.086236	7.297367	0.173534	-0.172812
Constant	-0.055521	-2.723906	-0.091292	0.235065
$AdjR^2$	0.281421	-0.029044	0.101509	0.007973
F-statistic	9.093814 ***	0.416705	3.334860 **	1.166097

Notes: *,**, and *** denote significant at 10%, 5%, and 1% respectively.

DOI: 10.1051/shsconf/20173404006

5. Conclusion and Policy Implications

In this study, four measures of firm performance were used to examine the impact of financial restatement on firm performance based on a sample of Malaysian listed companies in 2008. Three out of the four measurement of firm performance suffer when there is occurrence of financial restatement. Using this evidence, we recommend that investors and analysts may need to lower their expectations on the future prospects of the restating firms after the incidence of restatement. Likewise, since companies with lower performance are likely to be involved in restatement, investors and analysts may need to be cautious when using financial reports of these firms to make decisions.

Our study also finds that the dampening impacts of restatements are completely mitigated in family- controlled companies. The dampening effects are more pronounced in non-family controlled companies than family-controlled companies in non-CEO duality companies. Therefore, our findings support the agency theory which argues that an increase in the family ownership will promote greater concern for reputation, better monitoring of manager and more incentives to produce high-quality accounting information [15].

The implications of this study suggest that the practice of CEO duality and family firms is beneficial in curtailing accounting irregularities and lead to better firm performance. The policy makers for Malaysian listed firms may want to reconsider the relevance of requiring CEO non-duality as a practice of good corporate governance, and to encourage more investment in the family-controlled companies.

References

1. C.A.Mallin. Corp Gov, 4th edn, Oxford University Press, Oxford(2013).
2. A.Prenciple., and S.Bar-Yosef. Corporate governance and earnings management in family-controlled companies. J of Acc Aud and Fin **26**, 199-227. http://dx.doi.org/10.1177/0148558X11401212 (2011).
3. N.M.Salleh., and N.Omar. CEO duality, family-control and goodwill impairment. As J of Bus & Acc, **7**(1), 143-179(2014).
4. General Accounting Office. Financial statement restatements: trends, market impacts, regulatory responses and remaining challenges. Report 03-138,P.1footnote. Government Printing Office, Washington, DC(2002).
5. P.M.Dechow., and C. M. Schrand. Earnings Quality. Research Foundation Publications
   2004(3) CFA Institute,1-152 (2004).
6. X.Chen., Q. Cheng., and A.K. Lo. Accounting restatements and external financing choices. Cont Acc Res **30**(2), 750-779(2013).
7. J.R.Graham., S. Li., and J. Qiu. Corporate misreporting and bank loan contracting. J of Fin Econ **89**, 44–61(2008).
8. S.M.Albring., S.X.Huang., R.Pereira., and X.Xu. The Effects of Accounting Restatements on Firm Growth, J of Acc & Pub Pol **32**(5), 357-376(2013).
9. Z.Palmrose., and S.Scholz. The circumstances and legal consequences of non-GAAP reporting: Evidence from restatements. Cont Acc Res **21**(1), 139-180(2004).
10. R.C.Anderson., and D.M.Reeb. Founding-family ownership and business performance: Evidence for the S&P 500. J of Fin **58**, 1301-1328(2003).
11. A.Shleifer., and R.Vishny. A survey of corporate governance. J of Fin **52**, 737-783(1997).
12. N.M.Saleh., and N.Omar. CEO Duality, Family-Control and Goodwill Impairment. As J of Bus and Acc **7**(1), 143-179(2014).

13. R.Rusmin.,G.Tower.,T.Achmad.,and J.Neilson. Concentrated family ownership structures weakening corporate governance: A developing country story. Corp Own & Con **8**(2), 94-105(2011).
14. M.C.Jensen.,and W.H.Meckling. Theory of the firm: managerial behaviour, agency costs and ownership structure. J of Fin Econ **3**(4),305-360(1976).
15. L.Ma., S., and G.Tian. Family control, accounting misstatements, and market reactions to restatements: Evidence from China. E Mar Rev, http://dx.doi.org/10.1016/j.ememar.2016.06.001 (2016)
16. L.Donaldson. and J.H.Davis. Stewardship theory or agency theory: CEO governance and shareholder returns. Aus J of Mgt **16**(1), 49-65(1991).
17. M.C.Jensen. The modem industrial revolution, exit, and the failure of internal control systems. The J of Fin **48**, 831-880(1993).
18. P.L.Rechner., and D.R.Dalton. CEO duality and organizational performance: a longitudinal analysis, Stra Mgt J **12**(2), 155-160(1991).
19. A.Ghosh., and D.Moon. When the CEO is also the chair of the board. W Paper, Zicklin School of Business, Baruch College(2009).
20. H.AHashim., and S. Devi. Board independence, CEO duality and accrual management. As J of Bus & Acc **1**(1), 27-46(2008).
21. R.A.Rahman., and F.H.Mohamed-Ali. Board, audit committee, culture and earnings management: Malaysian evidence. Mgerial Aud J **21** (7), 783-804(2006).
22. S.N.Shukeri., W.S. Ong., and S.M.Shahidan. Does Board of Director's Characteristics Affect Firm Performance? Evidence from Malaysian Public Listed Companies. Int Bus Res ISSN 1913-9004 (Print), ISSN 1913-9012 (Online) (2012).
23. A.Rahman., and R.M.Haniffa. The effect of role duality on corporate performance in Malaysia. Corp Own & Con **2** (2). 40-47(2005).
24. N. Amran., and A.Che-Ahmad. Corporate governance mechanisms and performance: Analysis of Malaysian family and non-family controlled companies. J of Mod Acc & Aud **6**(2), 1-15(2010).
25. A.Che-Ahmad., N.Aziah., A. M., and I.Zuaini. Corporate governance, ownership structure and corporate diversification: Evidence from the Malaysian listed companies. Asi Aca of Mgt J **8**, 67-89(2003).
26. T.J.Presley., and L.J.Abbott. AIA Submission: CEO overconfidence and the incidence of financial restatement. Adv in Acc, incorp Adv in Int Acc **29**, 74-84(2013).
27. S.N. Abdullah., N.Z.M.Yusof., and M.N.Mohamad-Nor. Financial restatements and corporate governance among Malaysian listed companies, Mgerial Aud J **25**(6), 526 - 552 (2010).