

A DESCRIPTIVE ANALYSIS OF FINANCIAL RESTATEMENTS IN MALAYSIA

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Received: 20 June 2017; Revised and Accepted: 19 December 2017

ABSTRACT

This study provides an overview of the issue of financial restatements among Malaysian public listed companies by investigating the trend and reasons for financial restatements for the period beginning 2005 through to 2014. Based on the Thompson Reuters DataStream database which provides restatement data for 915 Malaysian companies (9,150 company-year observations), detailed analysis shows that there is a total of 1,945 (21.26%) restatements occurring during the period. The highest number of restatement occurrences was in 2010 with 342 cases (17.58%) while the lowest was in 2008 with 41 cases (2.11%). The majority of restatement cases occurred due to changes in accounting policies with more than 75% of financial restatement cases found within four sectors: industrial products, trading and services, consumer products, and technology. The results of the study will be useful to regulating bodies such as Bursa Malaysia, Securities Commission and Malaysian Accounting Standard Board in as much as they highlight the trend and reasons for financial restatements among Malaysian public listed companies. Further investigation could be conducted for companies that regularly change their accounting policies.

Keywords: Financial Restatements; Bursa Malaysia; Accounting Policy Change.

INTRODUCTION

In the last few years, financial restatements have become an issue of great concern among practitioners, regulators and academicians (Abdullah, Yusof, & Nor, 2010; Archambeault, Dezoort, & Hermanson, 2008; Chen Ken, Elder, & Hung, 2014; Dao, Huang, Chen Ken, & Huang, 2014; Desai, Hogan, & Wilkins, 2006; Du, 2017). Numerous financial restatements have been declared (Ye & Yu, 2017), fluctuating from landmark cases such as Tyco, Qwest, and

Worldcom to several less controversial restatements (Wilson, 2008). According to GAO (2006), financial restatements cause losses amounting to billions of dollars in market capitalization. These losses are portrayed through adverse market reaction towards companies' restatement of their prior reported earnings. These misstatements have shaken the confidence of the public and investors particularly towards restated companies (GAO, 2002; GAO, 2006; Gleason, Jenkins, & Johnson, 2008; Weng, Chen, & Chi, 2017; Wilson, 2008; Ye & Yu, 2017).

The announcement of financial restatements indicates a serious failure in financial reporting, which could have dire consequences on organizations, institutional and individual investors, stock markets, and regulatory authorities (Chi & Sun, 2014). Furthermore, the nature and number of restatement cases announced by the companies reflect on the audit quality. Because of restatements, many parties in the financial market such as government agencies, financial analysts, and investors closely scrutinize the restated financial statements. A recent example of the immediate impact of financial restatements is Toshiba Corp., which announced the likely restatements of its earnings from 2013 and earlier. As a result, the company's stock dropped by 17 percent and seven (7) analysts stopped to follow and rate the company (Alpeyev & Amano, 2015). Financial restatements may occur for several reasons such as adopting new accounting standards, reflecting discontinued operations, correcting significant errors and fraud, thus confirming that the company's financial statements are materially misleading and incorrect (Abbott, Parker, & Peters, 2004).

In Malaysia, financial restatements have become an increasingly important issue, receiving much attention from the regulators because there are many cases of financial restatements discovered such as CSM Corporation Bhd, Oil Corp Bhd, Aktif Lifestyle Bhd, Goh Ban Huat Bhd, and Transmile Group (Abdul Wahab, Gist, & Nik Abdul Majid, 2014; Abdullah *et al.*, 2010; Hasnan & Hussain, 2015; Shafie & Zainal, 2016). In July 2007, as the consequences of the restatement announcement, Transmile Group' shareholders suffered a loss in their investment with a massive drop in the company's share price from RM14.40 on January 2007 to RM4.64 on 3 July 2007 and below RM0.50 since March 2010 (Oh, 2010). On 24 May 2011, the company was delisted from the Bursa Malaysia (Abdul Hamid, Shafie, Othman, Wan-Hussin, & Fadzil, 2013). Financial restatement cases are typically reported in the local newspapers under the business section (Abdullah *et al.*, 2010). The Malaysian Financial Reporting Standard (MFRS) requires companies to correct material prior period errors retrospectively in the first set of financial statements authorized for issue by restating the comparative amount for the prior period(s) presented in which the error occurred (MFRS 108, Para 42). Due to the potential adverse impact of financial restatements, this study is conducted to investigate the

trend in financial restatements in Malaysia.

The main objective of this study is to examine the financial restatements' trend among the Malaysian public listed companies for the period from 2005 through 2014. The reasons for financial restatements among the Malaysian companies are also analyzed. This study on the financial restatement provides in depth analysis into the situation of financial restatements for the study period and sheds many interesting insights to policy makers and other financial statement users.

The rest of this paper is organized as follows: The following section will explain the literature review in the financial restatements. Next, the methodology section explains the data collection process. The findings section describes the results of analysis and discussion, while the conclusion section provides the summary and implications of the study.

LITERATURE REVIEW

Financial statements are the main sources of information to many parties in the financial markets to evaluate companies' activities (Anderson & Yohn, 2002; Kim & Koo, 2014). However, these statements are prepared in accordance with Generally Accepted Accounting Principles (GAAP), which offers companies with several choices of accounting policies. These flexibilities may provide a platform for companies to window-dress their financial statements without following the GAAP, which in turn leads to financial restatements subsequently (Albring, Huang, Pereira, & Xu, 2013). The Securities & Exchange Commission (SEC) describes financial restatements as "*the most visible indicator of improper accounting and source of new investigations*" (Schroeder, 2001). Graham, Li, and Qiu (2008) stated that financial restatements changed the restated companies' historic financial numbers, and hence changed forecasting that is based on these numbers. In general, financial restatements are defined as corrections made to financial statements as a result of non-fulfilment of the GAAP (Baber, Kang, Liang, & Zhu, 2009; Myers, Myers, Palmrose, & Scholz, 2005; Palmrose & Scholz, 2000; Palmrose & Scholz, 2004).

In the literature, a large number of studies documents the adverse economic consequences of financial restatements (Dao *et al.*, 2014; Xu & Zhao, 2016). These consequences include negative market reaction towards restating companies (Anderson & Yohn, 2002; Chen Ken *et al.*, 2014; Firth, Rui, & Wu, 2011; Kravet & Shevlin, 2010; Palmrose, Richardson, & Scholz, 2004; Scholz, 2008) and increase in the cost of equity capital (Bardos & Mishra, 2014; Firth *et al.*, 2011; Hribar & Jenkins, 2004). Financial restatements also contribute to higher audit fees (Feldmann, Read, & Abdolmohammadi, 2009), higher dependency on the financial analysts' forecast revision (Barniv & Cao, 2009), increase in litigation

risk (Palmrose & Scholz, 2004), and higher management turnover for restating companies (Arthaud-Day, Certo, Dalton, & Dalton, 2006; Burks, 2010; Dao *et al.*, 2014; Desai *et al.*, 2006; Xu & Zhao, 2016). The negative consequences of financial restatements have attracted substantial attention from policymakers and motivated several regulations, involving some requirements of the Sarbanes Oxley Act of 2002 (Agrawal & Chadha, 2005). In this regard, Bardos and Mishra (2014) claim that these negative consequences may be attributed to: (1) the expected decrease in future cash flows; and (2) the increase in the cost of capital. For example, the announcement made by Enron on 8 November 2001 regarding its restated earnings for the period from 1997 to 2001 recorded a \$1.2 billion decline in stockholders' equity. The Enron's stock price decreased from more than \$30 to less than \$1 during the period of October and November 2001 (Kedia & Philippon, 2009).

According to Eilifsen and Messier (2000), audited financial statements must be restated if the following four conditions have been met. First, a material misstatement happens as a consequence of some kind of inherent risk (e.g. personnel problems, misapplication of GAAP, management's aggressive accounting practices). Second, misstatements are not detected or prevented by the company's internal control system. Third, the failure of external auditors to detect the misstatement before issuing audited financial statements. Finally, if a misstatement is later discovered and considered material, corrections, restatements, and reissuance of the original financial statements are required. However, previous studies stated that financial restatements send two bad signals about restated companies which influence their market quality. The first signal deals with the companies' future earnings prospects and the second deals with the quality of the companies' management team and information systems (Kryzanowski & Zhang, 2013). In this regard, Gomulya and Boeker (2014) used signalling theory to examine how financial restatements may promote the companies to replace their CEOs with high-qualified successor, and how the main external constituencies react to this change. They argue that restated companies represent the characteristics of signaller, CEOs successor replacement of the signal itself, and the reaction from the external parties such as financial analysts representing the role of receiver. Chakravarthy, DeHaan, and Rajgopal (2014) classified the impact of financial restatements on the company's stakeholder into explicit and implicit commitments.

In Malaysia, according to MFRS 108 Para 41, "*errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with MFRS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows*" (Malaysian Accounting Standards Board, 2015, p. 584). In addition, the MFRS require the potential current period errors discovered in that period to be corrected

before the financial statements are authorised for issue. Based on the Corporate Disclosure Guide 2012, when the listed companies discover fraud or financial irregularity in their financial statements, they should immediately assess the materiality of the fraud/financial irregularity and make an immediate announcement, if the fraud/financial irregularity is material (Bursa Malaysia, 2012). However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (Malaysian Accounting Standards Board, 2015).

There are several Malaysian studies that examined the reasons and determinants of financial restatements in the annual reports (Abdul Wahab *et al.*, 2014; Abdullah *et al.*, 2010; Hasnan & Hussain, 2015), amendments to quarterly unaudited results (Ku Ismail & Abd Rahman, 2011), and consequences of financial restatements (Chin, Tang, & Che Ahmad, 2017). Abdullah *et al.* (2010) found that the primary reason for misstating the accounts is to inflate earnings. In addition, they showed that the nomination committee of the restated companies is less independent with higher managerial ownership, and the extent of ownership by outside block holders deters companies from misstating accounts. Ku Ismail and Abd Rahman (2011) found that companies that have two or more financial experts in their audit committee are less likely to amend their quarterly reports. They also discovered that oversight, mathematical and typographical errors are the most frequent reasons for the quarterly amendments. Abdul Wahab *et al.* (2014) examined the association between non-audit services and financial restatements and they found a significant and negative relationship between non-audit services and financial restatements. Hasnan and Hussain (2015) examined how rationalization, motive, and weak governance lead to financial restatements. They found a positive relationship between financial restatements and related party transactions (RPTs), while founders and audit quality are negatively associated with financial restatements. In addition, Chin *et al.* (2017) when examining the influence of financial restatements on the companies' performance found that companies' performance is affected by the financial restatements.

METHODOLOGY

This study uses a descriptive approach to provide insights on the occurrences of financial restatements and the reasons for financial restatements among Malaysian listed companies. There are no prior studies in Malaysia that analyze the trend of financial restatements¹ and the reasons for restatements over a long period of time. Chin *et al.* (2017) examined restatements for only one year (i.e. 2008) and did not provide the reasons for restatements. Although Abdullah *et al.* (2010) provided reasons for restatements their sample was restricted to restatements that occurred

over the period from 2002 to 2005. In this study, we attempt to extend on the studies by Abdullah *et al.*(2010) and Chin *et al.* (2017) by analysing reasons for financial restatements over a longer period.

¹ Restated financial data is available from Thomson Reuters DataStream Database for accounting periods beginning January 1, 2004. Four indicator fields facilitate the use of restated content provided in DataStream Data Definitions Guide. 11556 - Indicator- Restated data exists; 11557 - Indicator – Restatement type; 11558 - Indicator – Early Release; 11559 - Restatement Reason Code.

We analysed 915 companies listed on Bursa Malaysia from 2005 to 2014. We identified whether the companies restated their financial statements or otherwise during the sample period from Thompson Reuters DataStream database. We managed to identify 1,945 cases of restatements involving 765 different companies. We analyzed the restatements by year, reasons and sectors. In this study, the sectors are classified according to Bursa Malaysia sector codes namely Industrial Product, Trading and Services, Consumer Products, Technology, Properties, Construction, Plantation, Finance, Real Estate Investment Trust (REITS), Infrastructure (IPC), Hotels, Special Purpose Acquisition Company (SPAC) and Mining.

Furthermore, the reasons for financial restatements are analyzed and classified based on the Thompson Reuters DataStream definition manual as follows:

1. Restatements due to discontinued operations, spin-offs or de-mergers.
2. Restatements due to the adoption of a new accounting policy or policies related to specific item or items.
3. Restatements due to acquisition or mergers.
4. Restatements due to a change in accounting GAAP followed by the company.
5. Restatements due to a change in accounting GAAP followed together with other events.
6. Restatements due to multiple events.
7. Restatements due to reasons other than those noted above.
8. Where the accounts are reclassified.

The data in this study have been analysed using STATA statistical software version 14 as it is more appropriate for large volumes of data.

RESULTS AND DISCUSSIONS

Table 1 reports the Malaysian listed companies during 2005-2014 by sectors and there were 915 companies available at the Thompson Reuters DataStream during the period. Table 1 shows there are 257 (28.09%) companies from the industrial products sector, 195 (21.31%) companies from the trading and services sector, followed by 133 (14.54%) companies from the consumer products sector, and 99

(10.82%) companies from the technology sector. These four sectors constitute almost 75% of the sample companies.

Table 1: Distribution of Companies during 2005-2014 by Sectors (n=915)

Sector	Frequency	Percentage
Industrial Products	257	28.09
Trading/Services	195	21.31
Consumer Products	133	14.54
Technology	99	10.82
Properties	81	8.85
Construction	46	5.03
Plantation	40	4.37
Finance	34	3.72
REITS	16	1.75
IPC	6	0.66
Hotels	4	0.44
SPAC	3	0.33
Mining	1	0.11
Total	915	100

The total number of observations during the investigation period (2005-2014) for the 915 companies is 9,150. Table 2 presents the distribution of financial restatements by year. The results revealed a total of 1,945 (21.26%) restatements occurring during 2005-2014. Detailed analysis shows that 152 (16.61%) restatements occurred during 2005 and increased almost double to 277 (30.27%) restatements in 2006. The decreasing trend was evident in 2007, where 167 (18.25%) restatements were recorded, and it fell to its lowest peak in 2008 with 41 (4.48%) restatements. These results are consistent with Abdul Wahab *et al.* (2014) who study restatement distribution from 2007 until 2009 and found that the lowest rate of restatement occurrences was in 2008. As shown in Figure 1, over the observation years, the highest rate of financial restatement occurred in 2010 with 342 cases (37.38%).

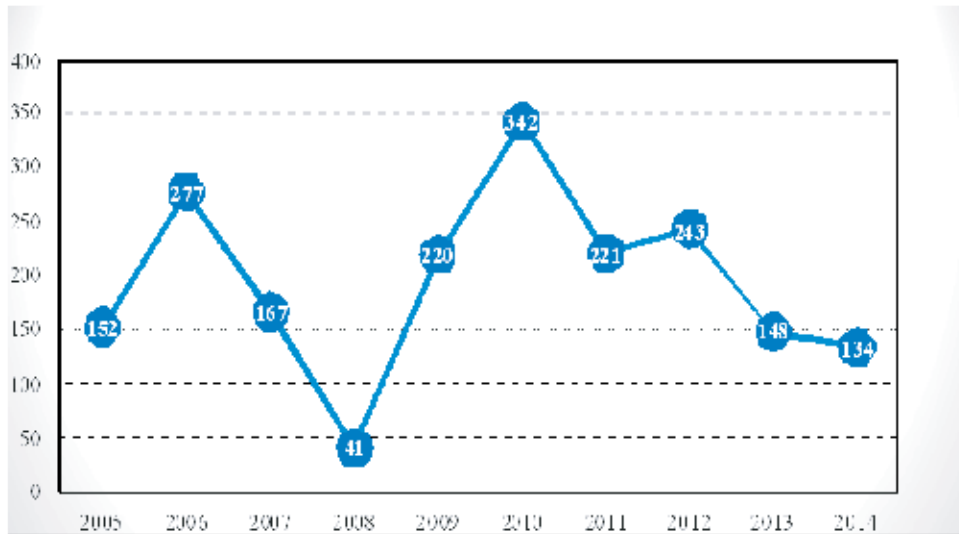


Table 2: Financial Restatements During 2005-2014 by Year (n=9,150)

Year		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Re-statements	N	152	277	167	41	220	342	221	243	148	134	1,945
	%	16.61	30.27	18.25	4.48	24.04	37.38	24.15	26.56	16.17	14.64	21.26
No Re-statements	N	763	638	748	874	695	573	694	672	767	781	7,205
	%	83.39	69.73	81.75	95.52	75.96	62.62	75.85	73.44	83.83	85.36	78.74
Total		915	915	915	915	915	915	915	915	915	915	9,150

Figure 1: Number of Financial Restatements by Year

One possible reason for the sharp increment in 2010 is the side effect of the 2008-2009 global economic crisis. Even though the crisis badly hit the United States and several developed countries, the Malaysian economy had also experienced the financial turmoil. Due to unstable business conditions during that period, more restatements by companies were observed in 2010.

Table 3 summarizes the reasons for financial restatements for the 10-year period. Out of 1,945 restatement occurrences, the three most frequently occurring reasons for financial restatements are “accounting policy change at item level” (1,104 cases, 56.76%), “other” (551 cases, 28.33%), and “reclassification” (225 cases, 11.57%). Furthermore, the two least frequently occurring reasons for financial restatements are “acquisition and mergers” (1 case, 0.05%) and “change in GAAP followed” (9 cases, 0.46%). As shown in Table 3, there are no restatement cases for “change in GAAP followed with other events”.

These results suggest that most financial restatement cases occurred due to a change in the accounting policies adhered to by Malaysian companies. This is potentially due to permission given by the MASB where a company is allowed to change its accounting policy under certain conditions. Further, restatements reasons such as “other” and “reclassified” started to increase sharply in 2010, from 21 cases to 186 and from 0 case to 3 cases respectively. The trend stabilized during 2011 - 2012 before going on a downward trend again in 2013. The fluctuation during the period might be due to the adoption of FRS standards by Malaysian companies effectively beginning 2010 (Yeow & Mahzan, 2013), which required companies to restate their financial statements. In addition, the “other” reason accounted for 28% (551 cases) of the restatement cases, which may include errors, misrepresentation and irregularities. This alarming rate of restatement cases raised questions about the quality of the auditing process among Malaysian public listed companies.

Table 3: Summary of Reasons of Financial Restatements (2005-2014, n=1,945)

Reasons	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Accounting policy change at item level	119	264	152	39	190	144	78	52	52	14	1,104
Other	33	12	14	2	21	186	115	102	48	18	551
Reclassified	0	0	0	0	0	3	21	66	38	97	225
Discontinued operations, Spin-offs or de-mergers	0	1	1	0	9	9	4	7	2	4	37
Multiple events	0	0	0	0	0	0	3	12	3	0	18
Change in GAAP followed	0	0	0	0	0	0	0	3	5	1	9
Acquisition/ Mergers	0	0	0	0	0	0	0	1	0	0	1
Change in GAAP followed with other events	0	0	0	0	0	0	0	0	0	0	0
Total	152	277	167	41	220	342	221	243	148	134	1,945

To examine industry classification and the probability of the industry-specific effect of financial restatements, this study combined financial restatements across the entire study period and grouped them by Bursa Malaysia industry codes. There were 13 industries with financial restatements during this study sample period (2005-2014). Table 4 and Figure 2 report the number of financial restatement occurrences over Bursa Malaysia sectors. The results show that more than 75% of financial restatement cases occurred in the following four sectors: Industrial products (585, 30.08%), trading and services (429, 22.06%), consumer products (302, 15.53%), and technology (176, 9.05%). The rest of the restatement cases were distributed over the nine sectors properties (7.81%),

plantation (5.40%), construction (4.52%), finance (3.80%), IPC (1.03%), hotels (0.46%), mining and REITS (0.10%) for each, and SPAC (0.05%). These results are consistent with Abdullah *et al.* (2010) who found that among the Bursa Malaysia sectors, trading and service as well as industrial product sectors reported the highest number of financial restatement. This result is also possibly contributed by the distribution of the sample (refer to Table 1), where these two sectors represent almost 50% of the sample companies included in this study.

Table 4: Number of Financial Restatements by Sector (2005-2014, n=1,945)

Sector	Frequency	Percent
Industrial Products	585	30.08
Trading/Services	429	22.06
Consumer Products	302	15.53
Technology	176	9.05
Properties	152	7.81
Plantation	105	5.40
Construction	88	4.52
Finance	74	3.80
IPC	20	1.03
Hotels	9	0.46
Mining	2	0.10
REITS	2	0.10
SPAC	1	0.05
Total	1,945	100

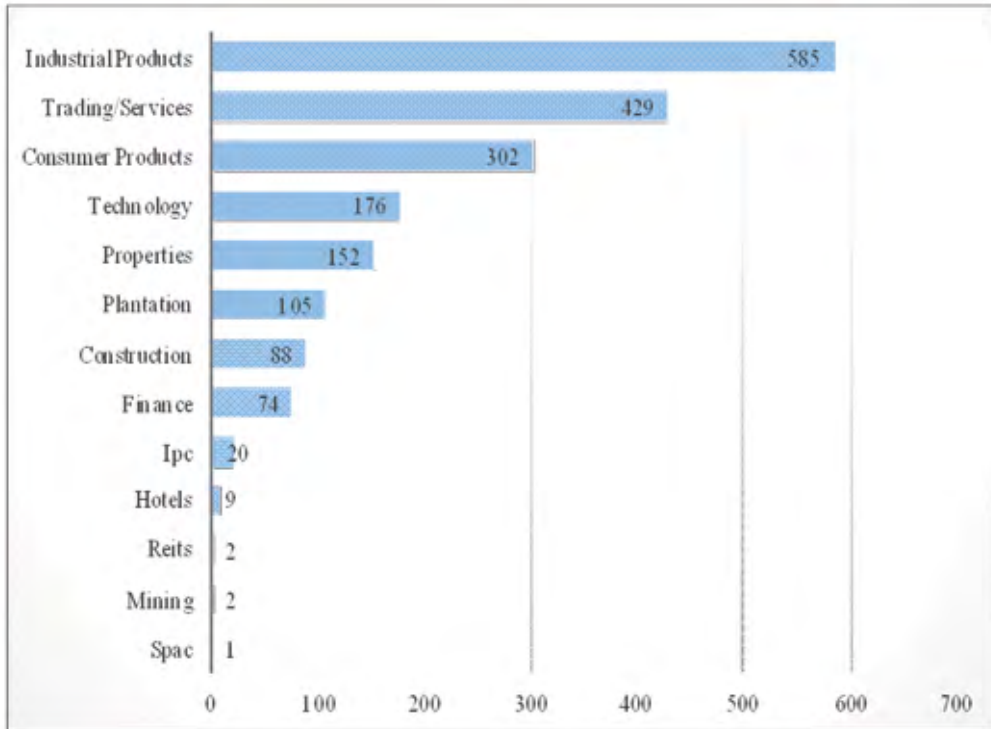


Figure 2: Number of Restatements by Bursa Malaysia Sector Codes

In addition, manufacturing industry (i.e., industrial product and consumer product sectors) displays more than 45% (30.08% and 15.53% respectively) of overall restatements occurred in all sectors. This result is consistent with the arguments of Lin, Lee, Chen, and Yur-Austin (2015) who claim that in comparison to other sectors, manufacturing companies are elaborated in changing raw material to products and, accordingly, have more complex inventory valuation. Consequently, management accountants should pay special attention to inventory valuation and cost of sales in manufacturing companies. Therefore, this result highlights the unique characteristics of industrial product sector and consumer product sector companies that are susceptible to restatements.

Further analysis has been carried out to provide the trend and reasons for restatements involving the service sector in particular. Table 5 compares the frequency of financial restatement reasons between trading and services sector with other sectors. From Table 5, the number of financial restatement cases that occurred in trading and services sector is 429 cases (22.06%) Further, Table 5 shows more than 95% of restatement cases that occurred are attributed to the following three reasons: (i) accounting policy change; (ii) other; and (iii) reclassification. There are no cases for (i) multiple events and (ii) change in GAAP followed with other events. A similar trend is also observed for other sectors.

Table 5: Financial Restatement Reasons for Trading and Services Sector with Other Sectors (2005-2014, n=1,945)

Reasons	Trading and Services Sector		Other Sectors	
	Frequency	Percent	Frequency	Percent
Accounting policy change at item level	232	54.08	872	57.52
Other	132	30.77	419	27.64
Reclassification	54	12.59	171	11.28
Discontinued operations, Spin-offs or de-mergers	5	1.17	32	2.11
Change in GAAP followed	3	0.7	6	0.4
Acquisition/Mergers	3	0.7	1	0.07
Multiple events	0	0	15	0.99
Change in GAAP followed with other events	0	0	0	0
	429		1,516	

CONCLUSION

This study capitalizes on data available on the Thompson Reuters DataStream database, where 915 Malaysian public listed companies were investigated to determine whether or not they have restatements for the period from 2005 to 2014 (9,150 company-year observations). This study found that there was a total of 1,945 (21.26% of total observations) restatements occurring during the study sample period (2005-2014), and the highest number of restatement occurrences was in 2010 with 342 cases (17.58% of total restatements) while the lowest was in 2008 with 41 cases (2.11% of total restatements). The trend is possibly due to the spillover effect of 2008-2009 global financial crisis on the Malaysian business environment. Furthermore, the results of this study indicate that more than 55% of the restatements occurred due to a change in accounting policy. Currently, Malaysian companies are allowed to change their accounting policy, subjected to certain conditions. This freedom is given to encourage businesses to present a true and fair account of their financial position. However, these changes should be monitored to avoid misapplication in the accounting policy. Hence, MASB potentially could investigate further about the trend. Moreover, this study revealed that more than 28% of the restatements occurred due to other reasons which might include errors, misrepresentation, and irregularities. Auditors could play their roles more effectively to detect these errors when they performed their audit.

In addition, this study investigates the characteristics of financial restatements in different sectors based on Bursa Malaysia sector codes. The results indicate that more than 75% of financial restatement cases occurred in the following four sectors: industrial products, trading and services, consumer products, and technology. Over these sectors, the findings indicate that the common leading reasons of financial restatements are change in accounting policies, other reasons, and reclassification. These results suggest reasons to which Malaysian companies in certain sectors should pay more attention to in order to avoid the possibility of financial restatement occurrences. Companies should be aware that financial restatements sometime may lead to negative impact such as the drop in share prices. The findings from this study will be useful to many parties in the financial markets such as Bursa Malaysia, SC and MASB by highlighting the trend and reasons of financial restatements among Malaysian public listed companies. Further monitoring actions could be taken to avoid misapplication of allowable reasons for restatements (i.e., changes in accounting policy).

This study also provides some insights about the trading and service sectors. It should be noted that the occurrences of financial restatements for these sectors is significant during the study period. The service sectors such as hotels and airways are sensitive to the dissemination of bad news. Thus, the negative impact of restatements should be avoided to maintain the sustainability of these sectors. To conclude, this study provides a different perspective by analyzing the trend of Malaysian companies' financial restatements and the reasons for restatements over a long period of time which has not been studied previously.

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