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The causes and consequence of restatements in Indonesia

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ABSTRACT

This study examines the causes and consequence of financial restatements in Indonesia. The first part focuses on the impact of corporate governance on restatements. Thirty six restating firmsand thirty four nonrestating firms were collected during 2010-2014. Using logistic regression, the results show that audit committeewith financial expertise is negatively related to financial restatements. On the other hand, no significant results found for board of commissioners and institutional ownership.The second part of this studyfocuses on the impact of financial restatement on management turnover. Management turnover refers to the likelihood of chief director (president director) and directors losing their jobs in 24 month periods after financial restatement. The results show that restating firms executives are more likely to lose their jobs than their counterpart in nonrestating companies. More specifically, 79% of restating companies changed their executives compares to only 38% of non-restating firms. The results of this paper would be a warning for managers to credibly report financial statements in accordance with sound accounting policies because financial restatements may cause managers to lose his job. In addition, the results are beneficial for policy makers in setting the rules to promote good corporate governance. This study determines management turnover by observing annual report. If the composition of executives in current year differs from last year, then it is decided that there has been a management turnover regardless of the causes. Subsequent research should isolate management turnover causing by other factors such as retirements. This is crucial to minimize the impact of extraneous variables.

ABSTRAK

Studi ini mengkaji penyebab dan konsekuensi restatement di Indonesia. Bagian pertama berfokus pada dampak tata kelola perusahaan pada restatement. Tiga puluh enam perusahaan yang melakukan restatement selama 2010-2014 dibandingkan dengan tiga puluh empat perusahaan yang tidak melakukan restatement. Menggunakan regresi logistik, hasil pengujian menunjukkan bahwa komite audit dengan keahlian keuangan berhubungan negatif dengan restatement. Namun, hubungan yang tidak signifikan ditemukan untuk dewan komisaris dan kepemilikan institusional. Bagian kedua dari penelitian ini menguji dampak dari penyajian kembali laporan keuangan terhadap pergantian manajemen. Pergantian manajemen mengacu pada pergantian anggota manajemen yang terdiri dari direktur utama (presiden direktur) dan direktur dalam 24 bulan setelah perusahaan melakukan restatement. Hasil pengujian menunjukkan bahwa restatement menyebabkan manajer kehilangan pekerjaan mereka. Sebanyak 79% dari manajer perusahaan yang melakukan restament kehilangan pekerjaan. Sementara, hanya 38% manajer yang tidak melakukan restatement kehilangan pekerjaan selama periode sampel. Hasil dari penelitian dapat menjadi peringatan bagi manajer untuk melaporkan laporan keuangan secara kredibel sesuai dengan kebijakan akuntansi yang baik karena restatement dapat menyebabkan manajer kehilangan pekerjaannya. Selain itu, hasilnya bermanfaat bagi pembuat kebijakan dalam menetapkan aturan yang dapat mempromosikan tata kelola perusahaan yang baik. Dalam penelitian pergantian manajemen ditentukan melalui pengamatan laporan tahunan. Jika komposisi eksekutif di tahun ini berbeda dari tahun lalu, maka disimpulkan telah terjadi pergantian manajemen terlepas dari penyebabnya. Penelitian selanjutnya disarankan untuk mengisolasi pergantian manajemen yang disebabkan oleh faktor-faktor lain seperti pensiun. Ini sangat penting untuk meminimalkan dampak dari extraneous variables.

Introduction

Publicly-held companies are expected to provide a credible financial statements to help investors make informed decision about a firm's future prospects. Unfortunately, accrual accounting system that require managers to use

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discretionsin recording economics events and transactions may spark manager opportunistic behavior. Accounting method choicesare no longer based on a desire to increase financial report informativeness but to mask firm bad performane. In effect, financial reporting quality fails to reflect true economic reality of the firm.

Agency theory suggests that an effective monitoring mechanisms can be of help to mitigate opportunistic behavior of a manager. This is accomplished through establisment of good coporate governanceand monitoring system. However, accounting scandals of majorcompanies in United States during 2000-2002 have raised concerns about the adequacy of corporate governance to safeguarding a firm's asset. As largely discussed in literature, wide publication of the scandals has eroded the market confidence on financial reports quality (Jain & Rezaee2006; Cohen et al., 2008). Although fraudulent financial statements cases have been subsided in the following years, another form of accounting misapplicationemerges. This is what commonly referred to financial restatements.

Simply put, financial restatements are corrections of errors resulting from non-compliance of GAAP (Scholz2014; Palmrose et al.2004). Several factors have been identified to affect the incidence of financial restatements including accounting standards, changes in materiality level, quality of auditors, earnings management, increasing complexity of firms transactions, and meeting analyst forecasts (Plumlee and Yohn 2010).

The Empirical evidences on the association between corporate governance and financial restatements have been mixed. Using data from publiccompanies in China, Zhizhong et al. (2011) find that a strong corporate governance lowers the incidence of financial restatements. They also find that the board independence and audit committee are negatively associated with financial restatements. Abdullah et al. (2010) examine restating firms listed on Bursa Malaysia and find that the percentage of shares owned by outside blockholders is negatively associated with restatements. However,the direction of hypothesis is not consistent with observed direction. In additon, board independence and auditor quality are not significantly related to restatements. Nasr and Mohammadi (2015) examine firms listed in Tehran Stock Exchange and find a significant negative correlation between financial restatements and board independence. Audit committee is also negatively associated with restatements.

On the other hand, empirical findings on the association between corporate governance and financial restatements in the United States are mixed. Larcker et al.(2007) examine the association between corporate governance and the accounting (economic) outcomes. They find a weak correlation between corporate governance and financial restatements. Similarly, Baber et al. (2010)provide evidence that financial restatements occuring in 1997-2002 were negatively associated with corporate governance. Baber et al. (2012) find inconsistent results. They separated corporate governance practices into internal and external governance. Whereas internal governance refers to the monitoring functions of board of directors, external governance refers to the ability of stockholders to influence decisions making of management and board of directors. They specifically focus on the impact of both types of governance in the context of Sarbanes-Oxley Act (SOX). They find that corporate governance characteristics were not significantly related to the probability of restatement prior to the enactment of SOX. But the relationship between financial restatements and corporate governance characteristics after SOX were found to be significant.

In addition to seeking out the determinants of financial restatements, researchers also investigate the effect of financial restatements on firm value and management turnover. Palmrose et al. (2004) examine market reaction after the incidence of financial restatements in 1995 to 1999. They find that the average abnormal return over a two-day announcement window was about minus 9 percent and the negative returns were associated with auditor quality and management turnover. Palmrose and Scholz (2004) separated the cause of financial restatements into regular, recurring earnings from primary operations (core) or other components of earnings (noncore) and examine their impact on firm stock price. The results show that restating firms had experienced large decrease in stock price over six months following restatement announcements and some firms went bankrupt.

The incidence of financial restatements are also very common in Indonesia. But unlike their counterpart in US, business communities and accounting profession in Indonesia are not very much concerned about restatements issues. They are more concerned on fraudulent financial reporting. Two cases of fraudulent financial reporting that had received wide publication by financial press and media were accounting scandals of Bank Lippo and Kimia Farma. As far as author's knowledge, no studies ever conducted in Indonesia to investigate empirically the consequences of financial restatement on directors. One reason perhaps is data availability.Therefore,empirical studieson the causes and consequence of financial restatements in Indonesia are still interesting topics. Also, characteristics of corporate governance in Indonesia differ from other countries. It is still empirical question wether corporate governance are practice in Indonesia is associated with the incidence of restaments and management turnover.

The objectives of this study are twofold. First, this study examine the effect of corporate governance on financial restatements among Indonesian publicly listed companies. More specifically, The study investigate whether board of commissioners independence, audit committee expertise, and ownership structure are associated with the incidence of financial restatements. Second, the study examines the consequences of financial restatements for directors following a restatement. The term 'director'refers to firm executives not board of director as used in USA.

Note that the regulations in Indonesia require firms to establish separate board of directors and board of commissioners. According to the system, board of commissioners are responsible for monitoring managers while board of directors are responsible for managing and running the company. The term 'board of commissioner'"is a synonim for 'board of directors' that is commonly used in United States. But unlike developed countries, monitoring functions of board of commissioners and audit committees in Indonesia are still questionable. Lack of monitoring skills and business knowledge are often cited as the cause of its weak monitoring function. Some firms hire outside directors not for monitoring task purposes but merely to comply with the regulations. Consequently, firms fail to select competent and skilful outside board of commissioners.To eliminate terminology confusion, this study keeps the term 'board of directors'as in United States to build argument underpinning hypothesis but use the term board of commissioners to state hypothesis.

In this study, restating firms are identified by observing annual report from 2010 to 2014 manually. Thirty six companies restated their financial statements during the sample period. As control group, 34 non-restating firms are also collected. Using logistic regression, I find that audit committee's financial expertise is negatively related to financial restatements but no significant results found for board of commissioners and intstitutional ownership. As fro management turnover, the effect of restatements on management turnover are examined by comparing the number of management turnover between restating firms and non-restating firms. A firm's management includes president director, vice president director, and directors. The logistic regression analysis show that earnings restatements causing managers to lose their jobs. More specifically, 79% of managers that belongs to restating firms lost their jobs comparing to only 38% of managers of non-restating firms.

Literature Review

Investors require credible financial statements for decision making purposes. However, a series of accounting scandals occurred in 2000-2002 have raised concerns over the adequacy of firms corporate governance in preventing misleading financial statements. While misleading financial statements cases have subsided, another form of misstatement arises. Kester (2012) noted that after the release of SOX in 2002, the number of restatements in US have increased in an unprecedented level. According to The United States General Accounting Office, 919 firms restated their financial statements from January 1997 to June 2002 (Chen et al., 2013). Restatements were commonly caused by frauds or accounting errors. A deviation from GAAP leading to financial restatements is a sign that prior financial statements contained errors and potentially misled the users of financial statements. In effect, managers are held accountable for all errors and mistakes in financial statements and should take the consequences of such errors and mistakes (Palmrose & Scholz, 2004).

Hennes et al. (2012) state that the consequences of restatements are not limited to managers but firms as a whole. Moreover, restatements impose additional costs on firms, ranging from low incremental expense of revising financial statements to more significant cost due to higher cost of capital. A financial restatement occurs when financial statementsare not prepared in accordance with GAAP. Several factors have been identified as driving factors to the issuance of financial restatements. Abbott et al. (2004) described three factors contributing to financial restatements. First, inherent factors like aggressive accounting practices, incorrect application of GAAP, and personnel problems. Second, ineffective internal control to prevent or detect misstatements. Third, external auditors failure to detect misstatements. However, restatements can be initiated by companies, auditors, or driven by regulations.

Flanagan et al. (2008) conducted an exploratory study using 919 restatements cases documented by GAO (2002) between January 1, 1997 and June 30, 2002. They show that financial restatements are not always associated with fraud, some were driven by company actions such as mergers, acquisitions, discontinued operations, stock splits and currency issues. But the most dominant factor were errors in revenue and cost (expenses) recognition, and asset restructuring. Slightly different, Huron Consulting Group (2003) as cited by Abdullah et al. (2010), described five main factors causing firms to restate their financial statements: reported revenue recognition, equity accounting, reserves, accruals, and contingencies.

The role of corporate governance in reducing restatements have attracted researchers'interest from many countries. In addition to Larcker et al. (2007) and Baber et al. (2012) cited above, several studies such as (Abbott et al. (2004) and (Agrawal & Chadha, 2005) employed samples from US capital markets to assess the role of corporate governance in preventing financial restatements. On the other hand, La Porta et al. (1999) and Zhizhong et al. (2011) collected firm samples from developing capital markets.

Restatements and Board Independence

A concern over opportunistic behavior of firm managements has intensified the important role of Board of Directors. As a representative of stockholders, they must ensure the firm resources have been used and allocated efficiently for the best interest of stockholders. More importantly, they should encourage firms to adopt sound accounting policies as a basis for preparing financial statements. This is the central function of board of directors (Beasley, 1996; Carcello & Neal, 2002; Dechow et al.,1996; Klein, 2002).

Prior studies show that board monitoring function effectiveness are strongly influenced by its characteristics. Byrd and Hickman (1992) provide evidence that the expertise and experience of outside directors lower the improper use of firm resources by management. Xie et al. (2003) show that board competence and independence are negatively related to earning management. Similarly, Beasley (1996) and Dechow et al. (1996) find that the proportion of outside directors are negatively related to financial statement frauds. These findings suggest that effective monitoring can be expected from boards who can express their views and give constructive criticism openly and independently to managers. This can be accomplished through hiring independent members from outside companies. In a situation where managers exert considerable pressure on board of directors, the outside directors are expected to have courage to stand up against the management pressure, particularly with respect to the financial reporting process.

Fama and Jensen (1983) argue that outside directors have strong incentive to provide more effective monitoring function relative to inside directors because of the need to maintain good reputation as an independent director. Outside directors are expected to enhance board monitoring functions because they bring into company the experiences and expertises from previous jobs and engagements. Since financial restatement stems from accounting irreguralities and errors in applying sound accounting policies, the more outside members of board of director, the less likely financial restatetment occurs. As stated before, this study maintain the term 'board of directors' as used in US to describe conceptual arguments but uses the term 'board of commissioner' to state hypotheses. Thus, the association between board independence and financial restatement is stated in the following hypothesis:

H_1: Firms with a larger outside commissioners are less likely to issue financial restatements.

Restatements and Audit Committee Expertise

The incidence of fraudulent financial statements occurred in 2000-2002 eroded investors'confidence on firm corporate governance practice, especially the role of audit committee in maintaining financial reporting quality. Several regulations are imposed to strengthen audit committee functions. One is to make audit committee liable for misleading financial statements. Misleading financial statements may induce investors and other parties to file lawsuits against audit committees. In response to the accounting scandals, a head of Indonesian Capital Market Supervisory Board issued new regulations on 29 November 2004 stating that directors and commissioners may be held accountable individually for taking part directly or indirectly in producing misleading financial statements. Although the occurence of lawsuits against audit committees are very rare, prior studies suggest that a lawsuit against audit committee happened. Brochet and Srinivasan (2013) provide evidence that outside directors, who are also members of audit committee, are more likely to be sued and lost their jobs.

Public companies in Indonesia are required by regulations to establish an audit committee where all the members must come from outside company. Moreover, at least one of its member must have expertise in accounting and/or finance. The purpose is to improve the role of audit committees in making financial statements more relevance for investors. Accordingly, the release of financial restatements may be perceived by investors as a sign of audit committee failure to function effectively. It is unlikely that an audit committee member who has no accounting or finance background have the ability to asses the validiy of accounting policies and standards that a firms chooses to prepare financial reports. It is hard to expect audit committee members with no accounting or finance background have the capabilities in identifying unacceptable accounting policy. Prior studies found that firms having audit committee with financial or accounting expertise have less abnormal accruals, less financial restatements and less lawsuits against firms (Abbott et al., 2004; Agrawal & Chadha, 2005; Bedard & Johnstone, 2004). Therefore, it is expected that audit committees with expertise in finance or accounting are more capable of discovering accounting irregularities and lowering the probability of earnings restatements. The relationship between the background of audit committees and financial restatements is expressed in the following hypothesis:

H_2: Firms having a large audit committees with financial or accounting expertise are less likely to issue financial restatements.

Monitoring Function of Institutional Investors

Institutional investors play a significant role in monitoring managers'actions and strategies. The role of institutional investors have been discussed widely in finance and accounting literature. Previous empirical research find that the ownership structures reduce agency problem (La Porta et al., 1999; Shleifer & Vishny, 1986). In finance literature, the effect of ownership structures on various measures of performance is explained through efficient monitoring hypothesis. The hypothesis predicts the higher the concentration of ownership, the higher the motivation of large stockholders to monitor company. Investors with large ownership are more willing to play an active role in influencing operation and decisions made by firm management given the potential benefit of active involvement (Grossman & Hart, 1986). There are wide range of methods to influence firm's decisions making; from informal conversation to a threat of takeover.

Institutional investors with large ownership are very common in many countries (Shleifer & Vishny, 1986). Hartzell et al. (2014) show that institutional ownership improve monitoring process and reduce agency costs. Since financial restatements reflect poor financial statements quality, then it is expected that monitoring role of institutional investors lower the incidence of financial restatements. The role of institutional ownership in reducing financial restatements is stated as follows:

H_3: Firms with a large institutional ownership is less likely to issue financial restatement.

Managements turnover and restatements

Several studies examined the association between financial restatements and firm value. Richardson et al. (2002) provide evidence of a decrease in stock value after restatements. Hribar and Jenkins (2004) find that restating firms experienced higher cost of capital. Palmrose et al. (2004) find a negative abnormal return two days around restatements. Palmrose and Scholz (2004) show that the market participants reacted negatively to stock price of restating firms.

Studies on financial restatements were also focused on the consequences of restatements. However, the results are mixed. Studies conducted in post scandals years (after 2001) document evidence of management turnover following financial restatements (Srinivasan, 2005; Desai et al., 2006). In contrast, Agrawal et al. (1999) and Beneish (1999) who conducted studies in pre-scandals years fail to provide evidence on the association between management turnover and financial restatements. The evidence of pre scandal years suggest that investors do not consider financial restatements as something harmful to a company. Since the present study is conducted after the incidence of accounting scandals, the association between restatements and management turnover is stated in positive direction.

H_4: Financial restatement is positively associated with management turnover.

Research Method

This study consists of two parts. The first part is to examine factors that might effect financial restatements. The second part is to test the consequence of financial restatements. The following logistic regressions model are performed to test the hypothesis.

Model 1: Association between financial restatements and corporate governance:

$$Restate_{it} = \beta_0+\beta_1 Indp_{it} + \beta_2 AudCom_{it}+ \beta_3 Inst_{it}+\beta_4 Big4_{it}+\beta_5 Lev_{it}+ \beta_6 Size_{it+}+\varepsilon_{it} \quad (1)$$

Where Restate = 1 if a company restated its earnings, 0 otherwise; AudCom = the number of audit committee members with financial or accounting expertise; Inst = the percentage of shares owned by institutional investors; Big4 = 1 if a firm hired accounting firm that has affiliation with Big4, 0 otherwise; Lev = debt to asset ratio; Size = logof total assets

Model 2: Association between financial restatements and management turnover:

$$Turn_{it} = \beta_0+\beta_1 Restate_{it} + \beta 2Block_{it}+ \beta_3 Ret_{it}+\beta_4 Man_{it}+\beta_5 Roa_{it}+\beta_6 Size_{it}+ \varepsilon_{it} \quad (2)$$

Where Turn = dummy variable equals 1 if a company replace its management (president directors, vice president directors, and directors) 0 otherwise; Block = the number of stockholders who own firm's stocks 5% or more; Ret = stock return 3 months prior to restatements; Man =percentage of shares owned by management; Roa = net income to asset ratio; Size = log of total assets.

Model 1 is employed to test the hypotheses 1 to 3. Three control variables are included in the model to mitigate the possibility of errors in variables: audit quality (Big 4), leverage (*lev*), and firm size. The hypotheses one, two, and three are supported if coefficients β_1, β_2, and β_3 are negatively significant at least 5% level.

Model 2 is employed to test the hypothesis 4. Five control variables are included in the model. They are stockholders who own firm's stocks 5% or more (Block), managerial ownership (Man), stock return (Ret), profitability (Roa), and firm size (Size). The hypothesis four is supported if coefficients $\beta_4$is positivelt significant at leas at 5% level.

Data and Sample Selection

All firms listed in Indonesia Stock Exchange from 2010-2014 are included as a sample. Financial data are collected from www.idx.co.id which is an official website of Indonesian Stock Exchange. Specifically, data for financial restatements are hand collected from financial statements and note to financial statements. Financial restatements caused by mergers and acquisitions were excluded because they threaten the validity of the results. During sample period, there were 36 companies restating their financial restatements: 5 in 2010, 6 in 2011, 8 in 2012, 4 in 2013, and 13 in 2014. As a comparison, non restating firms were selected through match-pair procedures (same industry groups and similar in size). As much as 34 companies meet the criteria. The sample selection process result in 70 firms comprising restating and non-restating firms.

Descriptive Statistics

Table 1 reports summary statistics for all variabels. While panel A describes statistics for firms partitioned into restatement and non-restatements firms, panel B describes statistics for firms partitioned into turnover and non-turnover firms. Panel A reports that the mean for management turnover of restating firms and non-restating firms are 0,78 and 0,35 respectively. These suggest that 78% of restating firm directors were replaced compared to only 35% for non-restating firms. Using Mann-Whitney test, the different between these two groups are highly significant at less than 1% level. Thus, the findings provide preliminary evidence of the association between financial restatements and management turnover.

Table 1. Descriptive statistics

Panel A

	Restating firms		Non-restating firms		*Mann-Whitney*
	Mean	Median	Mean	Median	*(z-statistics)*
Turn	0,78	1,00	0,35	0,00	-3,564**
Indp	0,45	0,42	0,48	0,5	-0,82
Big4	0,53	1,00	0,38	0,00	-1,212
Inst	0,64	0,62	0,63	0,65	-0,259
Block	2,53	2,00	2,15	2,00	-0,648
Lev	0,63	0,64	0,59	0,6	-0,558
AudCom	2,06	2,00	2,56	2,00	-2,007*
Size	9,69	9,50	10,03	10,27	-0,683
Ret	0,02	-0,01	0,1	0,00	-0,976
ROA	0,02	0,02	0,02	0,03	-0,893

Source: analyzed from annual report
Notes: *Significant at 5%, **Significant at 1% , two- tailed test.

Panel B

	Restating firms		Non-restating firms		*Mann-Whitney*
	Mean	Median	Mean	Median	*(z-statistics)*
Restate	0,7	1,00	0,27	0,00	-3,564**
Indp	0,45	0,42	0,48	0,50	-1,248
Big4	0,5	0,50	0,4	0,00	-0,825
Inst	0,64	0,65	0,63	0,62	-0,695
Block	2,48	2,00	2,17	2,00	-0,506
Lev	0,6	0,63	0,62	0,61	-0,386
AudCom	2,03	2,00	2,67	3,00	-2,554*
Size	9,56	9,50	10,25	10,56	-1,331
Ret	0,05	0,00	0,10	0,00	-0,231
ROA	0,26	0,27	0,020	0,03	-0,237

Source: analyzed from annual report
Notes: *Significant at 5%, **Significant at 1%, two-tailed test.

Still from panel A, the mean for audit committee of restating and non-restating firms are 2,06 and 2,56 respectively. These suggest that non-restating firms have more audit committee members with finance or accounting background than restating firms. The difference is significant at less than 5% level. This is a preliminary evidence of the association between accounting or finance background and restatements. However, the board independence and institutional ownership between these two group are not statistically different. The same is true for control variables. Control variables are included in the model to account for differences in firm characteristics. Since Mann-Whitney test show no differences in characteristic, it suggests that the restating and non-restating firms possess similar characteristics. This adds to the validity of results.

Meanwhile, panel B shows that the means for audit committee of turnover and non-turnover firms are 2,03 and 2,67 respectively. These suggest that the non-turnover firms have more audit committee members with finance or accounting background than turnover firms. On the other hand, the statistics for board independence and institutional ownership show no significant differences. The firms characteristic reflected in control variables are not different between the two groups indicating that they possess similar characteristics.

Correlation Matrix

Panel A of Table 2 reports Pearson correlation coefficients between restatement and its determinants as reflected in Model 1. Restatements (RESTATE) are negatively correlated with audit committe (AUDCOM) expertise at 5% level of significance. However, none of other invependent variables are significantly correlated with restatements. In addition, the correlation among independent variables shows that board independence (INDP) are positively correlated with audit committe and leverage (LEV) at 5% and 1% level respectively. Also, audit quality (BIG4) is positively correlated with firm size (SIZE). Since logistic regression is employed to test the hypothesis, high correlation among independent variables poses no problem of multicolinearity. In sum, negative correlation between restatements and audit committe expertise provide preliminary evidence in support of H2. But this is not the case for H1 and H3.

Panel B of Table 2 presents Pearson correlation coefficients between management turnover (TURN) and restatements including control variables. As can be seen from the Table, management turnover is positively correlated with restatements. Again, this provides preliminary evidence in support of H4. In addition, none of other independent variables are correlated with management turnover. As for correlation among independent variables, Panel B shows that the number of stockholders who own firm's stocks 5% or more (BLOCK) are positively correlated with institutional ownership (INST) and firm size at 1% and 5% level respectively. Also, profitability (ROA) and stock return (RET) are positively correlated at 5 % level. Also, profitability and firm size are positively correlated at 5% level.

Table 2. Coefficient Correlation

Panel A: Model 1

	RESTATE	INDP	AUDCOM	INST	BIG4	LEV	SIZE
RESTATE	1						
INDP	-0,099	1					
AUDCOM	-0,266*	0,395*	1				
INST	0,019	0,187	0,107	1			
BIG4	0,146	0,136	-0,109	0,097	1		
LEV	0,071	0,352**	0,233	-0,032	0,02	1	
SIZE	-0.078	-0,088	-0,014	-0,077	-0,612**	-0,087	1

Source: analyzed from annual report
Note: *Significantat 5% ; **Significantat 1%.

Panel B: Model 2

	TURN	RESTATE	BLOCK	RET	MAN	ROA	SIZE
TURN	1						
RESTATE	0,429**	1					
BLOCK	0,100	0,124	1				
RET	-0,019	-0,126	-0,038	1			
MAN	0,106	0,118	0,366**	0,182	1		
ROA	0,080	-0,010	-0,168	0,267*	0,112	1	
SIZE	-0,157	-0,078	0,291*	-0,141	0,008	-0,253*	1

Source: analyzed from annual report
Note: *Significantat 5% ; **Signifikan at 1%.

Results and Discussion

The results for logistic regressions analysis for H1, H2, and H3 are reported in Table 3. Hypothesis one (H1) predicts a negative association between board independence and the incidence of financial restatements. The results described in Table 3 do not support the hypothesis with p-value of 0,566 and a coefficient of -1,425. Furthermore, the result for model without control variable are qualitatively similar to the one with control variables. Thus, H1 is statistically rejected. The insignificant result may be explained by low quality of outside directors. This is possible because most firms in Indonesia hire outside commissioners merely to comply with capital market regulation. Indonesian capital market regulation requires public companies to establish board of commissioners comprising at least 30% of its members coming from outside directors. It has become common practice in Indonesia to hire former state officials or retired general of armed forces and those who have an affiliation with a particular political party to become a member of board of commissioners. Unfortunately, most of them do not have skills and capability to perform monitoring function effectively.

Table 3. Logistic regression results (restatement =1)

Variables	Expected Signs	Without control variables			With control variables		
		Coefficients	SE	*p-value*	Coefficients	SE	*p-value*
Indp	-	0,044	1,000	0,984	-1,425	2,484	0,566
AudCom	-	-0,623	0,420	0,045*	-0,649	0,329	0,048*
Inst	-	0,485	1,000	0,681	0,606	1,214	0,618
Big4	-	-	-	-	0,557	0,666	0,403
Lev	?	-	-	-	1,533	1,214	0,207
Size	?	-	-	-	0,012	0,153	0,938

Source: analyzed from annual report
Notes: *significant at 5%.

Hypothesis two (H2) predicts firms with a larger audit committee members who have expertise in accounting or finance reduce the incidence of financial restatements. The argument is that the knowledge of accounting or finance they bring into a company are very important for audit committee to identify misapplication of GAAP and thus make necessary adjustments prior to the release of financial statements. The result shown in Table 3 support H2 with *p*-value of 0,045 for model without control variables and *p*-value of 0,048 (a coefficient of-0,649) with control variables. Therefore, H2 is statictically supported. The findings suggest that firms having more audit committee with expertise in accounting or finance are less likely to issue restatements. This is consistent with prior studies that firms having audit committee with financial or accounting expertise have less financial restatements and less law suits against firms (Abbott et al., 2004; Agrawal & Chadha, 2005).

Hypothesis three (H3) predicts that firms with a large institutional ownership is less likely to issue financial restatement. It is argued that the higher the concentration of ownership, the higher the motivation of large stockholders to monitor company. Large investors have adequate skills and resources to monitor and influence strategic policy that firms employed. They do this because the potential benefit of active involvement (Grossman & Hart, 1986). However, the results reported in Table 3 do not support H3 with *p*-value of 0,681 (the coefficient is 0,606) and 0,618 for models with and without control variables respectively. Thus, H3 is statistically rejected. The insignificant result may be attributable to the percentage of institutional ownership between restating and non-restating firms. As described in panel A of Table 1, the percentage of institutional ownership between this two group are statistically similar. Additionally, three control variables adding to the model have *p*-value of 0,403, 0,207, and 0,938 respectively. It means that none of control variables are associated with financial restatement.

The next analysis focuses on the consequences of financial restatements for firms' managements (directors). As described earlier, the correction of previous financial statements send negative signals to market participants. They perceives something wrong has happenedto the company. The credibility of management to manage the company's resources are in questions and putting the managers carrer in danger. In this study management turn over refers to any replacement of directors who had served as president directors, vice president directors, or directors. If the incidence of restatements induce firms to change directors then it is predicted coefficient for restatements (Restate) is positive and statistically significant. The results reported in Table 4 are consistent with this prediction with *p*-value of 0,002 and a cofficent of 1,819. Thus, H4 is statistically supported. The results suggest that restating firms are more likely to change their directors than non-restating firms.

Table 4. Logistic regression result (management turnover =1)

Variables	Expected Signs	Without control variables			With control variables		
		Coefficients	SE	*p-value*	Coefficients	SE	*p-value*
Restate	+	1,859	0,538	0,001**	1,819	0,582	0,002**
Return	?	-	-	-	-0,054	0,894	0,951
Block	-	-	-	-	0,124	0,217	0,567
Man_Own	?	-	-	-	13,874	1,861	0,173
Lev	-	-	-	-	0,741	2,361	0,754
Size	?	-	-	-	-0,156	0,141	0,27

Source: analyzed from annual report
Notes:**Signifikan at 1%

Conclusion

The study examines the role of board of directors, audit committee, and institutional ownership in lowering the incidence of financial restatements of publicly held companies in Indonesia. In addition, the consequence of issuing restements is also investigated. Using 36 companies that restated their financial restatements during 2010-2014 and 34 companies that did not restate their financial restatements as a control group, the findings show that the number of audit committee having expertise in accounting and finance are negatively associated with lower incidence of financial restatements. Meanwhile, the board of commissioner independence has no effect on financial restatements. Additionally, all control variables do not affect the financial restatements.

In addition to the determinants of restatements, this study also examines management turnover following the release of financial restatements. The definition of management turnover refers to the changes in board of directors (president, vice president, and directors) after financial restatements. It should be noted that the term directors in Indonesia contain different meaning than those in United States. In US, board of directors functions are monitoring and over seeing managers. Meanwhile, The term 'board of director' in Indonesia refers to executives or managers who manage and run the company. The party who monitor board of directors is called board of commissioners. Essentially, board of commissioners in Indonesia have nearly same task as board of directors known in the United States. The results indicate that the incidence of restatements causes firms to change the composition of firms management.

Generalization of the results must be taken cautiously because it depends on the validity of the measurement. As previously described, this study measures management turnover using a dummy variable, 1 if there is a management turnover and 0 otherwise. Whenever a composition of executives in current year differs from last year, then it is decided that there has been a management turnover regardless of the causes. Such a decision contain weaknesses because the different may be caused by normal retirement, sickness or even death. If this is the case, the significant effect of restatements on management turnover found in this study is likely to be spurious. Therefore, subsequent research should isolate management turnover that has been caused by dismissalor because of other reasons. This is a necessity to minimize impact of extraneous variables on the results and to improve external validity.

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