I J A B E R, Vol. 13, No. 1, (2015): 161-175

FINANCIAL DIFFICULTIES AND PERFORMANCE AMONG FRAUDULENT FIRMS EVIDENCE FROM MALAYSIA

Noor Azira Sawal[a], Nor Balkish Zakaria[b] and NorhidayahAbdullah[b]

Abstract: *This study aims to examine the effect of financial difficulties faced by the fraudulent firms. The population for this study is 175 fraudulent firms which identified as PN17 based on media released by Bursa Malaysia from 2001 to 2012. The results of this studyshow that default risk and financial distress has significant negative effect on Tobin Q. The result of this study could pave way to any agency that monitors the misconducts among listed firms as financial difficulties may give early signal of any fraud possibility in the future.*

Keywords*: performance, default risk, financial distress*

1. INTRODUCTION

Financial frauds typically involve complex methods for misusing funds, overstating revenues and misappropriation of assets. In Malaysia, a mini Enron scandal has been alerting those corporate governance players such as directors, managers, accountants, Bursa Malaysia and other agencies. The revealed financial scandal of Transmile Group Berhad, probably become the highlight for being the highest-profile scandal among Malaysian firms that involved in financial irregularities[1]. When the financial statement can no longer portray a true picture of financial position of business, the element of financial irregularities already exist and can be connected with fraud.

On the other hand, prior studies highlight that the financial distressed firms were likely to involve in the fraudulent activities (Liou 2008; Rosner, 2003; Spathis, 2002). Fraudulent firms commit several violations such as breaching listing requirement, asset misappropriation and litigation. There could be several possible factors that contributed to the existence of fraudulent firms and these factors could be financial or non-financial. As for financial factors, the fraudulent firms may suffered financial difficulties like financial distress or high default risk. Besides

[a] Politeknik Merlimau, Melaka, Malaysia.

[b] Accounting Research Institute, Universiti Teknologi MARA, and Universiti Teknologi MARA Johor, Malaysia.

that, fraudulent firmsalso suffered non-financial problems such as poor corporate governance, weak internal control or less ethical business conduct (Law, 2011).

PN 17 classification highlights the business misconducts by Malaysian listed firm such as firms with capital inadequacy, suffers an adverse or disclaimer opinion on the latest audited financial statements, the auditors have expressed an emphasis of matter of the ability of the firm to continue as a going concern, business has ceased its operation and etc.Nevertheless, there were scarce findings that relate the financial difficulties of PN 17 firms to its worthiness. Common prior studies served evidences on the earnings quality of PN 17, initial public offering, value relevance and other ethical behaviour.

Thus, this study aims to investigate the effect of financial difficulties on firm's worthiness among these PN 17 firms. The fraudulent firms were identified based on Bursa Malaysia media released and categorised as PN17with the exclusion of any firms charged with financial litigations or under financial distressed position since the financial difficultyaspects that will be examined in this study are based on default risk and financial distress. This study hence expects to see the extent of financial difficulties that may affect the firms' performance among identified fraudulent firms in Malaysia from 2001 to 2012.

The remainder of this paper will be followed by a prior studies review section with developed hypotheses. This is then followed by methodology section that explain the research methods that have been carried out in this study and this next section is the finding and discussion section. Finally a summary section conclude the whole study.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

According to Elliot and Willingham (1980) the management fraud can be described as deliberate actions by management through misleading financial statements that impairs investors and creditors. According to Crawford and Weirich (2011) fraud can be categorized into two categories namely; financial reporting fraud and asset misappropriation. Financial reporting fraud is known as management fraud arises from misstatements with intention, amounts omitted and financial statements disclosures while assetmisappropriation involves the theft of an entity's assets.Fraudulent firms are those firms involved in various types of fraudulent activities such as financial reporting fraud, misappropriation of assets and could also be the one that involved with litigation, fraud guilty and alleged misconduct (Crawford & Weirich, 2011). According to Martin and Cullen (2006) firms that are involved in corporate misconduct adopts a 'bad barrels' or perspectives of how organizational behavior and cultures adapt with unethical behavior. Firms should compete and cooperate with other firms that could influence their behavior and norms.

In Malaysia, Securities Commission (SC) is a statutory body with enforcement and investigation powers to protect the investors. Any listed firms that committed with any fraudulent activities will be penalized by Securities Commission. Mohamed Sadique, Roudaki, Clark and Alias (2010) examine the fraud cases as reported by the Malaysian Securities Commission in 2007 and found that accounting and auditing offences were higher than the other offences compared to the previous years[2]. In this study, the fraud firms will be known as fraudulent firms as these firms commit both fraudulent financial reporting and other alleged misconduct like misappropriation of assets, involved with litigation and fraud guilty. Generally, the financial needs and problems could affect the sustainability of the firm. Successful firm will understand, anticipate, and mostly avoid financial problems or financial difficulties because it may severely result in insolvency. Ofek (1993) finds that financial difficulties may result in default debts payments, modified terms and structure of debt in financing the operation of business and the worst part, bankruptcy filings or financial distress.Thus, the effects of financial difficulties are severe and will impair the performance of firms.

2.1. Default Risk

A common proxy for financial difficulties is default risk. According to Vassalou and Xing (2004) a firm is said as default when it fails to service its debt obligation. Therefore, the default risk is the risk that firms unable to make the required payment on their debt obligation. Another key factor in determining default risk is a firm's leverage.Chow and Rice (1982) suggest that leverage increases when the potential for wealth transfer from debt holders to managers increases. However, Pearson (1995) poses an open question whether high debt could be associated with fraudulent financial statements since high structure of debt may increase the likelihood of fraudulent financial statements.Higher debt may expose the borrower a higher default risk. Creditors may also fear of the same risk and debt covenants are one of their protections to ensure the debt repayment obligation meets its schedule. However, management may manipulate financial statements, given the need to meet certain debt covenants (Spathis, 2002). DeFond and Park (1997) highlighted in their studies that the higher leveraged company lead to greater the risk on defaulting the debt agreements. The finding is consistent with the study by Zeitun, Tian and Keen (2007) which highlight that firm with higher leverage would have higher probability of default[3]. Therefore, high leverage may lead to high default risk.

Meanwhile, the default risk is connected with financial leverage. Higher financial leverage will decrease firm value due to increasing bankruptcy risk. Pioneering in the Theory of Agency Cost, Jensen and Meckling (1976) also demonstrate that by constraining or encouraging managers to act more in the interest of shareholders, the amount of leverage in a ûrm's capital structure affects

the agency conflicts between managers and shareholders. Higher financial leverage will decrease firm value by increasing bankruptcy risk. Therefore, to enhance the market value of the firm, every firm has to have a sound optimal capital structure. Chiang, Chang and Hui (2002) have used sample of construction firms in Hong Kong and investigate the relationship between capital structure and firm's performance. Their finding shows that high gearing negatively related with firm performance. The study shows that high gearing negatively related with firm performance among construction firms. Previous studies such as Foong and Razak (2012) and Whiting and Gilkison (2000) also have highlight that financial leverage has negative effect on the firm's performance.However, the findings of the study towards firms in Pakistan conducted by Rasool,Asif, Kayani and Zafar (2011) contradicted the above studies[4]. This studystates that larger firms have higher target debt levels and stable cash flows. These stable cash flows lead to lessen down the bankruptcy chances as well as the costs of default risk.This is supported by the findings of Gill and Obradovich (2012) who examine the relationship between financial leverage and firm's performance among American firms. Their finding shows that financial leverage has positive impact the firm's performance[5].

2.2. Financial Distress

Another common proxy for financial difficulties is financial distress. Rosner (2003) agrees financial distressed firms also tend to engage in fraudulent financial reporting to disguise their financial condition[6]. According to Kahl (2002), financial distress is an imperfect indicator of economy sustainability due to creditors are in control and may liquidate the firm against the will of management after a firm's default. There are many techniques and models to predict financial distress. One of the techniquesis known as Analytical Procedure (AP). Thornhill (1995) posit APs to be a useful tool for identifying fraud. AP was referred to a variety of techniques the auditors use to assess the risk of material misstatements in financial records. Besides, analysis of trends, ratios, and reasonableness tests derived from an entity's financial and operating data were also involve in AP procedures (Kaminski, Wetzel & Guan, 2004). Meanwhile, Hill, Perry and Andes (1988) use event history analysis from 1977 to 1987. Their study compares the magnitude of coefficient across the dependent variables (stable and financial distress). They find that when leverage increases, the likelihood of financial distress or bankruptcy also increases.According to Altman (1968) the model consists of five ratios selected to be the Z score model variables and highlights that Z-score below 1.10 indicates a distress condition[7].

The performance of the fraudulent firm is essential and important to be known since if a firm suffers financial difficulties,firms might embrace loss of reputation and the worst part losing the shareholders and potential investors' confidence. The fraud revelation may negatively affect the performance of the fraudulent firms

(Tan, 1999). Consequently, the share price of the firm may experience a contraction and become volatile particularly in the short run. Prior literature, Tan (1999) uses a sample of 277 firms from eight East Asian countries during the Asian Financial Crisis from 1997 to 1998 to study the relationship between financial distress and firm's performance. The result shows that financial distress is negatively related to firm's performance[8]. The study by Smith and Graves (2005) which takes 183 distressed companies (exhibited negative Z score) from London Stock Exchange for the period of 1980 to 1990 shows that there is negative relationship between financial distress and firm's performance. Chan, Munusamy, Chelliah and Mandari (2011) study the performance of Malaysian companies after suffering from a financial distress condition and the finding reveals that the distress condition companies for second time affect firm's performance negatively[9].Abidali and Harris (1995) take 11 failed and 20 non-failed companies and used a modiûed Z-score to predict the failure. Their results indicate that all the failed companies have exhibited negative Z-scores for several years before failure. The more years the company is classed as at risk, the lower the Z-score for the company and the more likely the company will fail. Thus, they conclude that the Z-score can be used to rank the solvency of the company.

Thus, this study aims to examinethe effect of financial difficulties on firm performance among the fraudulent firms. The research questions are: 1) Does the default risk affect the firm performance among the fraudulent firms? And 2) Does the financial distress position affect the performance among the fraudulent firms? Default risk and financial distress position are the proxies of financial difficulties. Using these proxies, it is hypothesized that the default risk and financial distress position will give negative relationship with firm performance. Thus, the following hypotheses are predicted:

H1: There is significant negative effect between the default risk and firm performance among fraudulent firms.

H2: There is significant negative effect between the financial distress position and firm performance among fraudulent firms.

3. METHODOLOGY

3.1. Population and Sample

This study examines 175 fraudulent firms in Malaysia whichcategorized under the PN17 Listing from year 2001 to 2012. The offences committed by these companies have been segregated into three (3) major offences namely financial reporting fraud, asset misappropriation and faced with litigation. Under Practice Notes 17 of Bursa Malaysia Listing Requirements which relates to the business operations of listed firms, it is clear that any listed firm that trigger the criteria of the Practice Notes will fall under the category of PN17 Companies[10]. In addition,

Securities Commission has taken intensive surveillance on these PN17 firms and revealed the several misconducts and breaches by directors and management. The enforcement activities are dealt with the perpetrators and actions are taken against the wrongdoers based on Securities Act 1993. Firm's financial data was downloaded from Datastream database and each firm's annual report respectively. Data is pooled and analyzed using SPSS.

3.2. Data Variables

This research will use debt to equity ratio as proxy for default risk. Zeitun, Tian and Keen (2007) measure and investigate the effect of firm's default probability by using total debt over total equity. This also consistent with the study by Foong and Idris (2012) which also use debt to equity ratio to measure leverage of 94 general insurance companies for the year 2006 to 2009 in Malaysia.The financial distress will be measured by Altman Z-score. Z-score is a discrimination and prediction model developed by Edward Altman in 1968 to measure the distance to default of manufacturing companies (Al Zaabi, 2011). Altman (1968) and Beaver (1968) were among the pioneer researchers to use the analysis prediction on probability of default among bank borrowers. Meanwhile, the firm's performance will be measured by Tobin Q. Tobin (1969) has developed Tobin Q statistic that is widely used as a proxy for the ûrm's value from the perspective of investors and acts as a forward-looking measure of the ûrm's economic performance (Wolfe &Sauaia, 2003;Anderson, Fornell&Mazvancheryl (2004). The study further employs several firm level variables which are size of the firms proxied by total assets (Belkaoui & Pavlik, 1993; Abor, 2005), firm growth proxied by changes in sales (Summers & Sweeney, 1998) and leverage proxied by debt to total assets (Cuong&Canh, 2012; Berger & Bonaccorsi, 2006).

4. FINDINGS AND DISCUSSIONS

The regression analysisis employedfor Model (1) and Model (2). Model (1) uses debt to equity ratio to measure default risk (DR) on the firm's performance (TOBINQ) while Model (2) uses Altman Z Score (ZSCORE) as a measurement of financial distress on firm's performance (TOBINQ).

$$TOBINQi_{t-1} = \beta 0 + \beta 1 DRi_{t-1} + \beta 2 SIZEi_{t-1} + \beta 3 GRWi_{t-1} + \beta 4\ LEVi_{t-1} + e \quad (1)$$

$$TOBINQi_{t-1} = \beta 0 + \beta 1 ZSCOREi_{t-1} + \beta 2 SIZEi_{t-1} + \beta 3 GRWi_{t-1} + \beta 4 LEVi_{t-1} + e \quad (2)$$

TOBINQ is the proxy of firm's performance measured by market capitalization over average total assets. DR is the proxy of default risk measured by total liabilities over shareholder's equity. SIZE is the proxy of firm size measured by total assets. GRW is the proxy of firm growth measured by changes in sales. LEV is the proxy of leverage measured by total debts over total assets. The sample is represented by N=175.

Table 4.1
Panel A: Descriptive statistics

	N	*Minimum*	*Maximum*	*Mean*	*Std. Deviation*	*Skewness*	*Kurtosis*
TOBINQ	175	.00	2.85	.5378	.56	1.87	1.57
DR	175	-8.15	10.71	.1126	3.18	-1.72	1.55
SIZE	175	.910	209.00	225.47	251.37	1.75	.178
GRW	175	.00	552.00	296.83	114.84	1.156	.95
LEV	175	.00	10.66	.55	1.72	1.81	.08

Table 4.1
Panel B: Descriptive Statistics (Z Score)

		Safe	*Grey*	*Distressed*
Z SCORE	N	31	55	89
	(%)	17.71	31.42	57.14

ZSCORE is the proxy of financial distress measured by using Atman Z score model. The Z score values are assigned to a dummy as follows: 1: Z > 2.6 represents the "Safe" zone; 2: 1.1 < Z < 2. 6 represent the "Grey" zone or 3: Z < 1.1 which represents the "Distressed" zone.

From Table 4.1 Panel A, the firm's performance (TOBINQ) had minimum value of 0.28 and 2.85 for the maximum value. The mean value is 0.54. The table also highlights that the standard deviation of 0.56.The mean and standard deviation is close and there is no normality problem. The default risk (DR) is explained by the measurement of debt to equity ratio. The minimum value for default risk (DR) is -8.15 and the maximum value is 10.71. The mean column indicates that the default risk has a mean of 0.11 and the standard deviation is 3.18. This figure shows no normality problem due to acceptable range of standard deviation. Skewness and Kurtosis results shows no normality problem since figure is below 2.

According to Table 4.1 Panel B, there are 31 firms (17.71%) of total sample firmsthat fall under category of Safe firms. In other words, even though these firms are fraudulent firms, they are still financially sound and safe. There are 55 firms (31.42%) fell under the category of Grey which shown some extent of problem in their financial position and any further financial problem may lead to financial distress. As highlight by Smith and Graves (2005) companies with a negative Z score are financially distressed and in danger of failure, while those with a positive Z score are classified as solvent. Nonetheless, 89 firms fell under the category of Distressed firms which means that these firms are having financial difficulties. This represents that more than 50% (57.14%) of the sample firms were financially distress firms. In other word, these firms were unhealthy and close to insolvency. Therefore, from the results obtained, it can be concluded that more than half of the sample firms (57.14%) in this study were having financial difficulties prior year before classified as PN17.

Table 4.2
Pearson Correlation

	TOBINQ	*DR*	*ZSCORE*	*SIZE*	*GRW*	*LEV*
TOBINQ	1					
DR	-.256**	1				
ZSCORE	-.216**	.587**	1			
SIZE	.261**	-.111	-.114	1		
GRW	-.080	.106	.472**	.157*	1	
LEV	.296**	.020	-.004	.264**	.016	1

**Correlation is significant at the 0.01 level (1-tailed).
*Correlation is significant at the 0.05 level (1-tailed).
TOBINQ is the proxy of firm's performance measured by market capitalization over average total assets. DR is the proxy of default risk measured by total liabilities over shareholder's equity. SIZE is the proxy of firm size measured by total assets. GRW is the proxy of firm growth measured by changes in sales. LEV is the proxy of leverage measured by total debts over total assets. The sample is represented by N=175

The Pearson Correlation Coefficient table (Table 4.2) shows the default risk (DR) are negatively related to firm's performance (TOBINQ) and it is significant at 0.01 level. The result is consistent with hypothesis (H1) which predicted that default risk has significant negative effect on firm's performance among sample firms. The increase in default risk will decrease the firm performance hence the market capitalization over asset (TOBINQ) will become low. On the other hand, financial distress (ZSCORE) is negatively related to firm's performance (TOBINQ) with significant value at 0.01 level. Thus, the result is consistent with hypothesis (H2). Tan (1999) highlights that there is negative relationship between financial distress and firm performance. The finding was also consistent with Whiting and Gilkison (2000) that financial distress (poor performing firm) affects the firm's performance. It can be concluded that financial distress is one of the contribution factor to the sample firms.However, the different pattern can be seen for relationship between firm size (SIZE) and firm's performance (TOBINQ) whereby the relationship is positively correlated and statistically significant at 0.01 level.This can be said that when the firm size is big, the performance of the firm is increase.For the firm growth (GRW), the relationship is negatively correlated and statistically non-significant. However, the leverage (LEV) was found statistically significant at 0.01 level with positively correlated with firm's performance (TOBINQ). The result shows that there are possible influences that firm size, firm growth and leverage have on firm performance.

The regression analysis for Model (1) in Table 4.3 highlights that default risk (DR) is negatively related with firm's performance (TOBINQ) and significant at 0.01 level. The firm size (SIZE) shows positive relationship with firm's performance (TOBINQ)and statistically significant at 0.05 level. Meanwhile, the firm growth (GRW) found to be inversely related with firm's performance (TOBINQ) and it is

Table 4.3
Multiple Regression Analysis for Model (1) and Model (2)

Independent Variables	*Model (1)*			*Model (2)*		
	Estimate (t-stat)	*t-stat*	*Expected Direction*	*Estimate (t-stat)*	*t-stat*	*Expected direction*
(Constant)	0.477	10.452		0.508	10.409	
DR	-0.041	3.302**	–			
ZSCORE				-0.048	-2.232*	–
SIZE	0.004	2.489*	+	0.004	2.365*	+
GRW	-0.007	-1.248	+	-0.002	-0.314	+
LEV	0.084	3.538**	+	0.082	3.406**	+
Adjusted R^2	0.17			0.162		

Note: ** Significant at P < 0.01 (1-tailed) and *Significant at P < 0.05 (1-tailed).
TOBINQ is the proxy of firm's performance measured by market capitalization over average total assets. DR is the proxy of default risk measured by total liabilities over shareholder's equity. ZSCORE is the proxy of financial distress measured by using Atman Z score model. SIZE is the proxy of firm size measured by total assets. GRW is the proxy of firm growth measured by changes in sales. LEV is the proxy of leverage measured by total debts over total assets.

not significant. As for leverage (LEV) variable, it shows positive relationship with firm's performance (TOBINQ) and highly significant at 0.01 level. The adjusted R^2value in the table is 0.17 shows that 17% of variation of firm's performance is explained by independent variables. The value of Durbin-Watson is more than 2. According to Sekaran(2003) Durbin-Watson of more than two shows auto correlation is not a problem.

The results for Model (2) highlights that financial distress (ZSCORE) is negatively related to firm's performance (TOBINQ) and it is significant at 0.05 level. Meanwhile, firm size (SIZE) showed positive relationship with firm's performance (TOBINQ) and statistically significant at 0.05 level. The firm growth (GRW) found to be negatively related with firm's performance (TOBINQ) and it is not significant. Leverage (LEV) was positive relatedto firm's performance (TOBINQ) and highly significant at 0.01 level.The adjusted R^2value in the table is 0.16 which shows that 16% of variation of firm's performance is explained by independent variables. The value of Durbin-Watson is more than 2. It shows that the model did not show any serious auto correlation problem.

Table 4.4 highlights the discussion of the study. Except for GRW, results for the Model (1) and Model (2) show consistent results with expected relationship. The answer for objective of the study is by looking at the relationship DR and ZSCORE with TOBINQ. Consistent with result from Table 4.4, it shows that default risk (DR) is negatively related with firm's performance (TOBINQ). The result is

Table 4.4
Findings for Model (1) and Model (2)

	Model (1)			*Model (2)*		
Independent Variables	*Expected relationship*	*Results (Significant level)*	*Supported/ Not supported*	*Expected relationship*	*Results*	*Supported/ Not supported*
DR (H1)	**–**	**–(**)**	Supported			
ZSCORE(H2)				–	–(*)	Supported
SIZE	+	+ (*)	Supported	+	+ (*)	Supported
GRW	+	**–**(Not significant)	Not supported	+	**–**(Not significant)	Not Supported
LEV	+	+ (**)	Supported	+	+ (**)	Supported

TOBINQ is the proxy of firm's performance measured by market capitalization over average total assets. DR is the proxy of default risk measured by total liabilities over shareholder's equity. ZSCORE is the proxy of financial distress measured by using Atman Z score model. SIZE is the proxy of firm size measured by total assets. GRW is the proxy of firm growth measured by changes in sales. LEV is the proxy of leverage measured by total debts over total assets. H1 represents hypothesis of Model 1 and H2 represents hypothesis of Model 2. The (-) and (+) represent negative relationship and positive relationship respectively. Significant value of * and ** indicate value of 0.05 level and 0.01 level respectively.

consistent with hypothesis (H1) which predicted that default risk has significant negative effect on firm's performance among fraudulent firms. The result is conclusive since the relationship of default risk (DR) is statistically significant at 0.01 level with firm's performance (TOBINQ).It shows that high debt to equity ratio (DR) will lead to low market capitalization over asset (TOBINQ). Some other supportive results came from Hill, Perry and Andes (1988) that highlight when leverage increase, the likelihood of bankruptcy increase as well. This is also supported by Cheng,Liu and Chien (2010) that when the firms incur highly leverage, it generates to increasing considerable agency costs of outside debt and lead to higher expected costs of bankruptcy or liquidation.Ebaid (2009) also found that leverage in firm's capital structure could alter management's behavior and operating decision. High leverage increase the probability of being default and therefore it could affect firm's performance. As for this study, the results show that the default risk has significant negative effect on firm's performance among fraudulent firms. This implies that default risk of fraudulent firms could negatively affect the firm's performance.

On the other hand, the result for relationship of financial distress (ZCORE) and firm performance (TOBINQ) also shows negative relationship with 0.01 significant value. Thus, it is consistent with hypothesis (H2) which predicted that financial distress position has significant negative effect on firm's performance among fraudulent firms. According to Tan (1999) the fraud revelation may negatively affect the performance of the fraudulent firms and the share price of

the firm may experience a contraction and become volatile particularly in the short run. This further supported by study by Smith and Graves (2005) which shows that there is negative relationship between financial distress and firm's performance. Chan, Munusamy, Chelliah and Mandari (2011) also reveal that the distress condition companies for second time affect firm's performance negatively. Moreover, Abidali and Harris (1995) indicate that the more years the company is classed as at risk, the lower the Z-score for the company and the more likely the company will fail. Therefore this implies that financial distress position of fraudulent firms could negatively affect the firm's performance.

Table 4.4 also shows that firm size (SIZE) statistically significant positive relationship with firm's performance (TOBINQ) at 0.05 level. This was consistent with the finding by Almajali,Alamro and Al-Soub (2012) which found that size and financial performance relationship is positive. Gill and Obradovich (2012) also find that firm size and firm value has positive relationship. The firm growth (GRW) has negative relationship with firm performance (TOBINQ) and statistically non-significant. Cuong and Canh (2012) shows that growth has no significant effects on firm performance and Lin (2010) also find that growth is not significantly related to firm value.As for leverage (LEV), the relationship with firm's performance (TOBINQ) is positive and statistically significant at 0.01 level. This is also consistent with Gill and Obradovich (2012) which also find that financial leverage has positively impact the value of American manufacturing firms from 2009 to 2011. Moreover, Cheng and Tzeng (2011) also find a positive relationship between leverage and firm value.

5. CONCLUSION

Financial fraud can usually be classified as either financial reporting fraud or asset misappropriation (Crawford and Weirich, 2011). In this research, the fraud firms will be known as fraudulent firms commit either fraudulent financial reporting, or other alleged misconducts like misappropriation of assets, involved with litigation and fraud guilty.The financial difficulties or financial distress severely result in insolvency. Financial difficulties may result in default debts payments, modified terms and structure of debt in financing the operation of business and the worst part, bankruptcy filings or financial distress. Financial distress may be due to borrower speciûc factors like reputation, leverage, volatility of earnings, collateral or may also be due to market specific factors like the economic condition and level of interest rates (Ehab, Rahim & Ananth, 2011).

The result of the study highlight that default risk was negatively related with firm's performance. The study is conclusive since the relationship of default risk with firm's performance is significant. The finding is consistent with Foong and Idris (2012) whereby they also obtained the finding of negative relationship between leverage and firm's performance. The same pattern also showed by the financial distress which is negatively related to firm's performance. The study is again

conclusive since the relationship of financial distress position with firm's performance is significant. The finding was consistent with Whiting and Gilkison (2000) that financial distress (poor performing firm) affects firm's performance.The result of this study could pave way to any agency that monitors the misconducts among listed firms as financial difficulties may give early signal to warn a company of the possibility of severe fraud occurrence in the future.Besides, this study could also help in formulating the guidelines on how to mitigate the effect of fraud among firms that faced financial difficulties.In addition to this, the effect of financial difficulties will give some extent of indicators to public on the tendency to commit fraud due to financial desperation. The performance of the fraudulent firms is very essential to be known as this would help in recovery process of these firms.

Acknowledgements

Authors would like to acknowledge supports from Accounting Research Institute of Universiti Teknologi MARA.

Notes

1. Transmile Group Berhad's revenue has been overstated by a total of RM530 million in 2005 and 2006.
2. Sadique *et al.* (2010) reveal that among the violation of Bursa Malaysia listing requirements reported by them were misleading of financial statements which contain material omission and incorrect figure; and other disclosure including breach of trust, manipulation of share price and unauthorized fund collection.
3. Zeitun, Tian and Keen (2007) use sample of 167 Jordanian companies in 1989 to 2003.The objective of the study is to outline the relationship between firms' financial health and the probability of default by using LOGIT models. Total debt over total equity (TDTE) is used to measure and investigate the effect of capital structure on the firm's probability of default.
4. Rasool *et al.* (2011) study the relationship between the leverage levels, performance and profitability of the 19 Pakistanis firms from 2004 to 2010. There are three sectors involved; commercial banking, cement and fertilizer sector starting. Arithmetic Mean (A.M) and standard deviation (S.D) are used to check the trend of data.
5. Gill and Obradovich (2012) use sample of 333 firms listed on New York Exchange for 3 years from 2009 to 2011.
6. Altman (1968) define financial distress ûrms as enterprises that have become legally insolvent or undergoing restructuring.
7. The function of Z-score is to address the prediction ability of corporate bankruptcy. Weights are assigned to each variable. The 5 variables appeared in the original model were liquidity, profitability, leverage, solvency and activity.
8. The eight East Asian countries are Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, and Thailand.
9. The duration of study covers two financial year periods and post to the date of reclassification back into the normal listings as a listed company.

10. Among the criteria are the firm failed to meet the minimum capital or equity of 25% or less on consolidated basis and paid up capital less than RM40 million, the external auditors have issued an adverse or disclaimer opinion on the latest audited financial statements, the auditors have expressed an emphasis of matter of the ability of the firm to continue as a going concern and the business has ceased its operation and etc.

References

Almajali, A. Y., Alamro , S. A., & Al-Soub , Y. Z. (2012), Factors affecting the financial performance of Jordanian insurance companies listed at Amman Stock Exchange. *Journal of Management Research, 4*(2), 266-289.

Abidali, A. F., & Harris, F. (1995), A methodology for predicting company failure in the construction company. *Construction Management and Economic, 13*(3), 189-196.

Abor, J. (2005), The effect of capital structure on profitability:an empirical analysis of listed firms in Ghana. *Journal of Risk Finance, 6*(5), 438-445.

Al Zaabi, O. S. (2011), Potential for the application of emerging market Z-score in UAE Islamics banks. *International Journal of Islamic and Middle Eastern Finance and Management, 4*(2), 158-173.

Altman, E.I. (1968), Financcial ratios, discriminant analysis and the prediction of corporate bankruptcy. *The Journal of Finance*, 589-609.

Anderson, F. W., Fornell, C., & Mazvancheryl, S. K. (2004), Customer satisfaction and shareholder value. *Journal of Marketing, 68*, 172-185.

Beaver, W. H. (1968), Alternative accounting measures as predictors of failure. *The Accounting Review, 43*, 113-122.

Belkaoui, A., & Pavlik, E. (1993), Effects of ownership structure, firm performance, size and diversification strategy on CEO compensation: A path analysis. *Managerial Finance, 19*(2), 33-54.

Berger, A. N., & Bonaccorsi, D. E. (2006), Capital structure and firm performance :a new approach to testing ageny theory and application to banking industry. *Journal of Banking & Finance, 30*(4), 1066-1102.

Chan, S. L., Munusamy, J., Chelliah, S., & Mandari, A. (2011). Effects of financial distress Condition on the Company Performance: A Malaysian Perspective. *Review of Economics & Finance*, 86-99.

Cheng, M. C., & Tzeng, Z. C. (2011), The effect of leverage on firm value and how the firm financial quality influence on this effect. *World Journal of Management, 3*(2), 30-53.

Cheng, Y.-S., Liu, Y.-P., & Chien, C.-Y. (2010), Capital structure and firm value in China: A panel threshold regression analysis. *African Journal of Business Management, 4*(12), 2500-2507.

Chiang, Y. A., Chang, P. C., & Hui, C. M. (2002), Capital structure and profitability of the property and construction sectors in Hong Kong. *Journal of Property Investment & Finance, 20*(6), 434-453.

Chow, C., & Rice, S. (1982), Quialified audit opinions and share prices : an investigation. *Auditing: A Journal of Practice and Theory, 1*, 35-53.

Crawford, R. L., & Weirich, T. R. (2011), Fraud guidance for corporate counsel reviewing financial statements and reports. *Journal of Financial Crime, 18*(4), 347-360.

Cuong, N. T., & Canh, N. T. (2012), The effect of capital structure on firm value for Vietnam's seafood processing enterprise. *International Research Journal of Finance and Economics*(89), 222-233.

Defond, M. L., & Park, C. W. (1997), Smoothing income in anticipation of future earnings. *Journal of Accounting and Economics, 23*(2), 115-39.

Ehab, Z., Rahim, B., & Ananth, R. (2011), Assessing probabilities of financial distress of banks in UAE. *International Journal of Managerial Finance, 7*(3), 304-320.

Ebaid, I. E. (2009), The impact of capital-structure choice on firm performance : empirical evidence from Egypt. *The Journal of Risk Finance, 10*(5), 477-487.

Elliot, R. K., & Willingham, J. J. (1980), Management fraud: Detection and deterrence. *Petrocelli*.

Foong, S. Y., & Idris, R. (2012), Leverage, product diversity and performance of general insurers in Malaysia. *The Journal of Risk Finance, 13*(4), 347-361.

Gill, A., & Obradovich, J. (2012), The impact of corporate governance and financial leverage on the value of Americans firms. *International Research Journal of Finance and Economics, 91*, 46-56.

Hill, N. T., Perry, S., & Andes, S. (1988), Evaluating firms in financial distress : An event history analysis. *Journal of Applied Business Research, 12*(3), 60-71.

Jensen, M. (1986), Agency cost of free cash flow, corporate finace and takeovers. *American Economics Review* (76), 323-329.

Kahl, M. (2002), Economic Distress, Financial Distress and Dynamic Liquidation. *The Journal Of Finance, 18*(1), 1-34.

Kaminski, K. A., Wetzel, T. S., & Guan, L. (2004), Can financial ratio detect fraudulent financial reporting. *Managerial Auditing Journal, 19*(1), 15-28.

Law, P. (2011), Corporate govrnance and no fraud occurance in organizations. *Managerial Auditing Journal, 26*(6), 501-518.

Lin, F.-L. (2010), A panel threshold model of institutional ownership and firm value in Taiwan. *International Research Journal of Finance and Economics*(42), 54-62.

Martin, K. D., & Cullen, J. B. (2006), Continuities and extensions of ethical climate theory : A meta-analytical review. *Journal of Business Ethics, 69*, 175-194.

Mohamed Sadique, R. B., Roudaki, J., Clark, M. B., & Alias, N. (2010), Corporate fraud : An analysis of Malaysian. *World Academy of Science, Engineering and Technology, 42*, 1199-1208.

Ofek, E. (1993), Capital Structure and Firm Response to Poor Performance: An Empirical Analysis. *Journal of Financial Economics*, 34(1), 3-30.

Pearson, O. (1995), Using financial statement data to identify factors associated with fraudulent financial reporting. *Journal of Applied Business Research, 11*(3), 38-46.

PN17 Practise Note 17.Criteria and Obligations of PN17 Issuers (2005), Retrieved from Bursa Malaysia *www.bursamalaysia.com*.

Rassol, W., Asif, A., Kayani, F., & Zafar, M. (2011), The impact of leverage levels on firm's performance and profitability : a case of Pakistani industries. *Information Management and Business Review, 3*(5), 242-249.

Rosner, R. L. (2003), Earning management in failing firms. *Contemporary Accounting Research, 20*(2), 361-408.

Sekaran, U. (2003), *Research methods for business: A skill building approach* (4th ed.). New York.: John Wiley & Son, Inc.

Smith, M., & Graves, C. (2005), Corporate turnaround and financial distress. *Managerial Auditing Journal, 20*(3), 304-320.

Spathis, C. T. (2002), Detecting false financial statements using published data: some evidence from Greece. *Managerial Auditing Journal, 17*(4), 179-191.

Summers, S. L., & Sweeney, J. T. (1998), Fraudulently misstated financial statements and insider trading: an empirical analysis. *The Accounting Review, 73*(1), 131-146.

Tan, T. K. (1999), Financial distress and firm performance : Evidence from the Asian financial crisis. *Journal of Finance and Accountancy*, 1-11.

Thornhill, W. T. (1995), How to investigate financial fraud. *Forensic Accounting*.

Tobin, J. (1969),A general equilibrium approach to monetary theory. *Journal of Money, Credit and Banking, 1*(1), 15-29.

Vassalao, M., & Xing, Y. (2004), Default Risk in Equity Returns. *The Journal Of Finance, 16*(2), 831-867.

Whiting, R. H., & Gilkison, S. J. (2000). Financial leverage and firm response to poor performance. *Pacific Accounting Review, 12*(2), 1-35.

Wolfe, J., & Sauaia, A. (2003), The Tobin Q as a company performance indicator. *Development in Business Simulation and Experiental Learning, 30*, 155-159.

Zeitun , R., Tian , G., & Keen, K. (2007), Default probability for the Jordanian companies: a test of cash flow theory. *International Research Journal of Finance and Economics,, 8*, 147-162.