

Board of Directors' Independence and Modified Audit Report: An Analysis of the Malaysian Environment

(Kebebasan Ahli-Ahli Lembaga Pengarah dan Laporan Audit Tidak Baik: Suatu Analisa di Malaysia)

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ABSTRAK

Tujuan kajian ini adalah untuk menguji sama ada lembaga pengarah bebas memberi kesan ke atas laporan audit tidak baik bagi syarikat-syarikat bukan perbankan dan kewangan yang berdaftar di Bursa Malaysia. Data dikumpulkan daripada laporan tahunan syarikat-syarikat sebanyak 300 sampel bagi tempoh 2004 sehingga 2009. Kedua-dua analisa descriptive dan multivariate digunakan untuk mencapai objektif-objektif kajian. Hasilnya menunjukkan lembaga pengarah bebas memberi kesan terhadap penerimaan laporan audit tidak baik. Seterusnya, kadar hutang syarikat yang tinggi akan meningkatkan penerimaan laporan audit tidak baik sementara bagi syarikat yang mempunyai banyak cabang perniagaan, penerimaan laporan audit tidak baik berkurang. Walaubagaimanapun, saiz lembaga pengarah dan keuntungan ke atas asset tidak mempengaruhi pengeluaran laporan audit tidak baik oleh juruaudit. Hasil kajian menyediakan bukti ilmiah ke atas perkembangan dan kepentingan lembaga pengarah bebas dan kaitannya kepada laporan audit tidak baik.

Kata kunci: Lembaga pengarah bebas; laporan audit tidak baik; Malaysia

ABSTRACT

The aim of the paper is to examine whether board of directors' (BODs) independence has an effect on the modified audit report of the non-banking and financial companies listed on Bursa Malaysia. Data is collected from the annual reports of a sample of 300 companies for the period of 2004 to 2009. Both descriptive and multivariate analyses were employed to address the research objectives. The results indicate that BODs' independence is negatively related to acceptance of modified audit report. In addition, a company's higher debts or leverage may probably increase the acceptance of modified audit report; while for companies with more business segments, the acceptance of modified audit report is less. However, the size of the BODs and return on assets or asset profitability do not influence the issuance of modified audit report by the auditor. The findings provide empirical evidence on the development and importance of BODs' independence relating to modified audit report.

Keywords: Board of directors' independence; modified audit report; Malaysia

INTRODUCTION

The independence of board of directors (BODs) is increasingly becoming an issue in the corporate environment world. The composition of BODs is very important to ensure it has full power without any outside influences, including from management and other board members. The objective of this study is to examine whether the independence of BODs

affects the modified audit report issued by the auditor. The researchers are interested to relate BODs' independence and modified audit report as this type of report is a symptom of lower reporting quality (Farinha & Viana 2009). The Asian financial crisis (1997-1998) has shown the ineffectiveness of the role of independent directors in monitoring the companies' activities as expected by the shareholders (Sahlan 2011). In the United Kingdom (UK), Section B of the UK Corporate Governance Code (2012) stipulates that the board combination should include executive and independent non-executive members to avoid domination of certain members of the board in decision making. In Malaysia, Principle 3 of the Malaysian Code on Corporate Governance (MCCG) (2007) and (2012) requires the board to undertake an annual assessment of independent directors to ensure they truly bring independent and objective judgment to board deliberations. When a board is really independent, theoretically, the oversight function executed is more effective and reduces the possibility of opportunistic managerial behavior. Such directors act in the best interests of shareholders, without pressure and influence from management and others. The operational effectiveness and external issues, such as going-concern, are addressed by independent BODs and the probability of the companies receiving modified audit reports is less.

This study contributes to the knowledge that the BODs' independence impacts the acceptance of modified audit report by a company. The independent non-executive directors tend to be more concerned with their reputation and always seek for higher quality than executive directors (Fama 1980; Subramaniam, McManus & Zhang 2009). They avoid negative occurrences which can lead to the acceptance of modified audit report, which in turn can have a negative impact on their reputation. Besides, independent non-executive directors actively question management's decisions as they have no social and economic ties with management (Liew, Mat Zain & Jaffar 2012). Under the agency theory, the independent non-executive directors are the guardians of company and shareholders' interests. Independent non-executive directors will ensure that any decision made by the management is in the best interests of the shareholders. Consequently, the acceptance of modified report which results from accounting wrong-doings, non-compliance of guidelines and going-concern issues is reduced and integrity of financial statements is enhanced.

The paper is organized as follows. The second section describes the past literature and hypotheses development. The third section provides the research methodology, followed by the fourth section on analysis of results and discussion. Last section presents the conclusion and recommendations.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Studies on the relationship between BODs' independence and modified audit report in the Malaysian environment are still scarce and limited. However, there are some studies related to BODs' characteristics and modified audit report or with regards to quality of financial reporting, such as by Farinha and Viana (2009); Sahlan (2011); and Wenyaoyao and Qin (2007). The study on the effectiveness of BODs is important as it represents the highest corporate governance structure in a company (Fama & Jensen 1983). In addition, an independent board is in itself a cornerstone of good corporate governance (Saibaba 2013). Independent and non-executive directors bring in a diversity of skills and expertise. They are also seen as the check-and-balance of the BODs' effectiveness (Abdullah 2004). For the quality of monitoring, Pincus, Rusbarsky and Wong (1989) argued that BODs' independence should increase the quality of monitoring as the directors are not influenced by the management and/or affiliated with the company's employees. Other studies also support this argument, i.e., a higher proportion of independent non-executive directors will lower earnings management (Klein 2002; Peasnell, Pope & Young 2005; Sahlan 2011); and reduce the

probability of accounting fraud (Beasley 1996). Chen and Jaggi (2000) added that a board with more independent members will increase financial disclosure quality. Further, Uzun, Szcwcyk and Varma (2004), in their study, reported that the higher the percentage of independent directors on the board, the lesser the occurrences of corporate wrong-doings as well as discretionary accruals (Xie, Davidson III & DaDalt 2003). The existence of independent directors on the board can bring about independent and objective judgement, hence mitigating risks that arise from conflict of interests or undue influence from interested parties.

From the economic perspective, a company is likely to add more independent board members when the company's assets have a shorter life span and the management's incentives or agency cost is greater (Kanas & Qi 2012). Independent directors on a board can reduce the agency cost. An earlier study by Denis and Sarin (1997) found that companies with a higher proportion of independent directors on the board experience above-average stock price returns.

In terms of internal control, Kamardin and Haron (2011) argued that independent non-executive directors who are on the audit committee and have communication with external and internal auditors, play an important role in ensuring the effectiveness of the internal control system. Sahlan (2011), in his study, concluded that the presence of independent directors on the board will improve the company's financial reporting and financial disclosure. This argument is supported by the findings of an earlier study by Farinha and Viana (2009) that a higher proportion of outside directors on the board may probably reduce the acceptance of modified audit report. Wenyao and Qin (2007) also found a similar result that there is a lower proportion of independent or outside directors on the boards of companies that receive modified audit report. Thus, the following hypothesis is generated.

H₁ The higher proportion of independent non-executive directors on the board is negatively associated with the probability that the company will receive modified audit report.

The researchers also include some other factors that may contribute to the acceptance of modified audit report by a company as follows: BODs size (BODSIZE); leverage (LEV); asset profitability (ASSPRO); and business segment (BUSSEG).

Jensen (1983) argued that increasing size of the board will increase the monitoring capacity of the board, thus resulting in higher quality of financial reporting. This is because of the synergy of skills and experiences possessed by the various directors (Farinha & Viana 2009). Further, Singh and Harianto (1989) argued that it is difficult for management to influence all the directors if the size of the board is large. Saibaba (2013) also found that larger board size increases the company's financial performance in terms of market share value. However, in a different perspective, a larger board size can be related to reduced ability to coordinate, monitor and communicate among the directors, thus leading to ineffective functioning, as well as poorer financial reporting quality (Ballesta & Garcia-Meca 2005). This argument is consistent with Jensen and Meckling (1976), and was also argued by the agency theory, that a smaller board is more effective in monitoring managers. Abdul Rahman and Mohamed Ali (2006), in their study, found a small board is more effective in managing earnings management activities. For firm performance, Singh and Davidson (2003); and Mak and Li (2001) also found that a small board is likely to increase the performance of firms. There are therefore many different views on BODs size. For example, Farinha and Viana (2009); and Wenyao and Qin (2007), in their study, found an insignificant relationship between BODs size and acceptance of modified audit report. A smaller board size is seen to be better for oversight responsibility, monitoring financial reporting and related internal control (Farinha & Viana 2009). Even if more members sit on the board, its

effectiveness may be questionable because they may rely on other members to perform their tasks. Even if the size of the Risk Management Committee (RMC) is big, if there is inadequate qualified members, the effectiveness of the RMC is still questionable. Therefore, in this study, the researchers expect a positive association between BOD size (BODSIZE) and modified audit report.

Leverage refers to the total debt of a company to the total assets owned. It determines the ability of the company to meet its financial obligations. According to the agency theory, there is a conflict between principal (shareholders) and agent (manager) in a company (Jensen & Meckling 1976). The same situation occurs in leverage, where there is a conflict between debt-holders and management (DeFond 1992; Francis & Wilson 1988). High financial obligations has a negative effect on the company (Pucheta-Martinez & Feuntes 2007). The financial health of a company is also a contributing factor as to why auditors issue qualified or modified audit report (Chen & Church 1992; Carcello, Hermanson & Huss 1995; Willikens, Bauwhede & Gaeremynch 2004). Therefore, the expected sign between high leverage (LEV) and modified audit report is positive.

Larger asset profitability would lead to a lower probability of a company being issued a modified audit report by the auditor (Farinha & Viana 2009). However, Masyitoh and Adhariani (2010) found an insignificant relationship between profitability and qualified audit report. This means profitability has no effect on the decision made by the auditor to issue qualified or modified audit report. Meanwhile, Bradshaw, Richardson and Sloan (2001) found a negative relationship between performance and the receipt of modified audit opinion. The argument leads to a negative relationship between asset profitability (ASSPRO) and modified audit report.

Normally, if a company has two or more business segments, it tends to set up a Risk Management Committee (RMC) for better oversight function at board level, particularly on company's risk profile. The operation of different types of businesses needs effective monitoring by the BODs, thus the establishment of a RMC is a best practice to address the issue of risks faced by the company, particularly the business and external environmental risks (Yatim 2009, 2010; Subramaniam et al. 2009). Therefore, companies with two or more business segments (BUSSEG) are expected to have a negative relationship with the issuance of modified audit report by the auditor.

VARIABLES

- BODs' Independence
- BODs Size

DEPENDENT VARIABLE

Modified Audit Opinion

CONTROL VARIABLES

- Leverage
- Asset Profitability
- Business Segment

FIGURE 1. Theoretical framework for BODs' Independence, BODs Size and Modified Audit Opinion

Figure 1 above presents the theoretical framework for this study: BODs' Independence and BOD Size are the independent variables; Leverage, Asset Profitability and Business Segment represent the control variables; while Modified Audit Opinion is the dependent variable in the framework.

RESEARCH METHODOLOGY

We use the logistic regression analysis to examine the relationship between modified audit report and the variables proposed for BODs' independence. The model used to test the hypotheses is as follows:

$$MA = \beta_0 + \beta_1 \text{BODINDE} + \beta_2 \text{BODSIZE} + \beta_3 \text{LEV} + \beta_4 \text{ASSPRO} + \beta_5 \text{BUSSEG} + \epsilon$$

where :-

MA	-Modified Audit Report 1, if received modified audit, otherwise 0
BODINDE	-BODs' Independence proportion of independent non-executive members on the board
BODSIZE	-BODs Size number of board members
LEV	-Leverage total debt/total assets
ASSPRO	-Asset Profitability ratio between earning before interest, tax and extraordinary income and total assets
BUSSEG	- Business Segment 1, if the company has two or more business segments, otherwise 0

Variable Definition and Measurement According to Arens et al. (2009), there are five types of audit reports, namely standard unqualified or clean audit report; unqualified with explanatory paragraph or modified wording; qualified; adverse; and disclaimer audit report. For the purpose of this study, the unqualified with explanatory paragraph (modified wording); qualified (except for); adverse; and disclaimer audit reports are classified as modified audit reports. As highlighted by Masyitoh and Adhariani (2010), the auditor's opinion relevant to qualified or going concern is a red alert that the company is facing financial failure. Farinha and Viana (2009), in their study, viewed the issuance of modified audit opinion by an auditor as a symptom of lower reporting quality. If a company received a modified audit report, the data is valued as '1' in the worksheet; and if a company received an audit report other than modified audit report, the value of '0' is coded accordingly.

BODs' independence refers to the number of independent non-executive members on the board. The number of independent non-executive members is divided by the total number of

members, and a proportionate number is generated (see Fama & Jensen 1983; Farinha & Viana 2009; Pucheta-Martinez & Fuentes 2007). As for BODs size, the researchers count the total number of directors during the company's financial year.

Leverage in this study refers to the total debt of a company to the total assets owned. It is measured by the total debts divided by the total assets. For this type of variable, the researchers divided the total debts by the total assets. The result was entered into the worksheet. There are other studies which have applied this rule for the variable's measurement (see Pucheta-Martinez & Fuentes 2007; Ballesta & Garcia-Meca 2005; Yatim 2010).

The researchers also included the variable of asset profitability in this study. Asset profitability refers to the ratio between earnings before interest, tax and extraordinary income (operational profit or loss) to the total assets. The data for the earnings before interest, tax and extraordinary income was obtained from the income statement and the total assets from the balance sheet statement. After the calculation of this ratio, the result was entered into the worksheet. Farinha and Viana (2009) also applied this measurement in their study.

Lastly, for the business segment variable, the researchers calculated the number of types of businesses or segments a company owns and operates. Normally, if a company has two or more business segments, it tends to set up a RMC for better oversight function at board level. The data is obtained from the company's annual report which normally is available in the initial pages of the report. If the company has two or more business segments, a dummy value of '1' is coded and if the company is operating just one business segment, the value of '0' is coded accordingly.

Data Collection and Sampling Procedure The population frame for this study is all the public-listed companies (PLCs), excluding banking and financial institutions listed on Bursa Malaysia's website from the period of financial years ended 2004 until 2009. Banking and financial institutions are omitted from the sample as the nature and regulations of these firms are significantly different from non-financial companies. PLCs publish their annual reports, which are publicly available and can be accessed through Bursa Malaysia's website.

A match sampling approach is adopted as a control procedure (see Ballesta & Garcia-Meca 2005; Wenyao & Qin 2007; Sekaran 2003). Firstly, the researchers selected the companies with modified audit report for the period of study (2004-2009). Then, they matched the control samples which have a clean audit report based on the condition that paired companies are in the same industry, almost similar in size (total assets) and in the same financial year (Ballesta & Garcia-Meca 2005; Wenyao & Qin 2007). To ensure reliability and independence, once a control company has been matched to the corresponding company in the test sample in a particular year, it was not matched again with another company (test sample) in another year (Ballesta & Garcia-Meca 2005). Lastly, in this study, 150 samples with modified audit opinion were gathered and matched with 150 samples with clean audit opinion. Therefore, the total number of samples in this study is 300 samples.

ANALYSIS OF RESULT AND DISCUSSION

DESCRIPTIVE STATISTICS FOR SAMPLES

Table 1 presents the descriptive statistics result for all of the companies, modified audit report companies and clean audit report companies (continuous variables), together with the result of t-test. For BODs' Independence (BODINDE) variable, the result shows some differences between modified and clean audit report companies. For minimum value, modified audit report companies obtained 25 percent; while clean audit report companies obtained only 20

percent. For maximum value, clean audit report companies scored 100 percent of board members are independent non-executive directors; while only 80 percent of modified audit report companies have independent non-executive members. For mean or average value, three groups of samples (all, modified and clean audit report companies) indicate almost similar value with five members being independent non-executive members. The result of independent t-test shows this variable is statistically significant at a level of $p < 0.05$, with indication that there is a significant difference on average for this variable between two different sets of samples (modified and clean audit report companies).

TABLE 1. Result of the descriptive statistics for all (N=300), modified (N=150) and clean audit report companies (N=150) (Continuous Variables)

	All Companies				Modified Audit Opinion Co				Clean Audit Opinion Co				t-test t value	Sig (2-tailed)
	Min	Max	Mean	Std Deviation	Min	Max	Mean	Std Deviation	Min	Max	Mean	Std Deviation		
BODINDE	0.20	1.00	0.4746	0.11485	0.25	0.80	0.4604	0.11324	0.20	1.00	0.4888	0.11506	-2.162	0.031
BODSIZE	3.00	10.00	6.7800	1.54474	4.00	10.00	6.9067	1.49427	3.00	10.00	6.6533	0.19746	1.423	0.156
LEV	0.00	55.74	0.6718	3.89812	0.00	55.74	1.1830	5.47188	0.00	0.72	0.1606	0.15830	2.287	0.024
ASSPRO	-20.65	11.08	-1.689	1.50203	-20.65	11.08	-3.3526	2.10298	-1.41	0.43	0.0148	0.19204	-2.130	0.035

Variable Definition: BODINDE = proportion of independent non-executive members on board
 BODSIZE = number of directors
 LEV = total debt/total assets
 ASSPRO = ratio between earnings before interest, tax and extraordinary income and total asset s

For BODs Size (BODSIZE), the maximum value of 10 members of the board is stated for modified and clean audit report companies. As for minimum value, modified audit report companies show four members and three members for clean audit report companies. All the sample groups state seven board members on average or mean value. The result also reports that there is a significant difference for mean value between modified and clean audit report companies at 10 percent level (2-tailed).

The result of descriptive analysis shows drastic differences for maximum value for the Leverage (LEV) variable between modified and clean audit report companies. For modified audit report companies, the result shows that the debts of this group are more than 500 percent compared to total assets. As for clean audit report companies, they have only 72 percent of debts compared to the company's total assets. The difference is expected earlier by the researchers in that the higher amount of leverage contributes to the higher acceptance of modified audit report. For the result of t-test, there is a statistical difference for average or mean value between modified and clean audit report companies at five percent significance level.

For Asset Profitability (ASSPRO) variable, there are different results between modified and clean audit report samples of companies. The result of t-test also reports significant difference at $p < 0.05$ which indicates that there is a significant difference for mean or average value between modified and clean audit report companies. In terms of minimum value, the result shows that more than 200 percent losses compared to total assets for modified audit report samples; while for clean audit report samples, only 14 percent losses compared to the company's total assets.

Table 1.1. Result of the Frequency Distribution for All (N=300), Modified (N=150) and Clean Audit Opinion Companies (N=150) (Categorical/Dichotomous Variables)

	All Companies		Modified Audit Opinion Co		Clean Audit Opinion Co	
	Frequency	Percentage	Frequency	Percentage	Frequency	Percentage
MA						
Clean Audit Opinion	150	50	0	0	150	100
Modified Audit Opinion	150	50	150	100	0	0
Total	300	100	150	100	150	100
BUSSEG						
Non-Business Segment	6	2	5	3.3	1	0.7
Two or More Bus Segments	294	98	145	96.7	149	99.3
Total	300	100	150	100	150	100

Variable Definition: MA = 1, if received modified audit, otherwise 0
 BUSSEG = 1, if the company has two or more business segments, otherwise 0

Table 1.1 presents the descriptive statistics (frequency) result for all the companies, modified audit report companies and clean audit report companies (categorical/dichotomous variables). For the Business Segment (BUSSEG) variable, most companies or samples have two or more business segments with above 96 percent for both samples (modified and clean audit opinion companies).

CORRELATION ANALYSIS (PEARSON CORRELATION MATRIX) FOR VARIABLES

TABLE 2. Result of correlation (Pearson Correlation Matrix)

	Modified Audit Report	BODs' Independence	BODs Size	Leverage	Asset Profitability	Business Segment
Modified Audit Report	1	-.124*	.082	.131*	-.122*	-.095
BODs' Independence		1	-.250**	-.011	.089	-.123*
BODs Size			1	.045	-.094	.010
Leverage				1	-.485**	.014
Asset Profitability					1	-.011
Business Segment						1

** . Correlation is significant at 0.01 level (2-tailed).

* . Correlation is significant at 0.05 level (2-tailed).

Table 2 reports the result of correlation among the variables. The correlations are quite low, generally below 0.2 except for a pair of BODs' Independence and BOD Size, which are correlated at 25 percent with 0.01 level of significance with negative direction. It means that the bigger the size of the board, the lower its independence. It also indicates that even if the size of the board increases, the status of the board with independent non-executive directors still remains and does not increase. The highest correlation is between a pair of Asset Profitability and Leverage which are correlated at 48 percent at one percent level of significance and with negative direction. It shows that the higher the debts or leverage of the companies, the lower the asset profitability. The other variables that correlate are Modified Audit Report and BODs' Independence at 12 percent ($p < 0.05$); Modified Audit Report and Leverage at 13 percent ($p < 0.05$); Modified Audit Report and Asset Profitability at 12 percent ($p < 0.05$); and a pair of BODs' Independence and Business Segment at 12 percent ($p < 0.05$) significance levels. The rest of the variables do not correlate with each other. The result also reveals that there is no correlation higher than 85 percent, which means no multicollinearity problem exists in the samples.

LOGISTIC REGRESSION ANALYSIS

Table 3 reports the logistic regression result. The model consists of independent variable (BODs' Independence) and control variables (BOD Size, Leverage, Asset Profitability and Business Segment) with Modified Audit Report as dependent variable. The result reports the level of correct classification (the percentage of correct predictions) at 78.7 percent; while Cox & Snell R Square and Nagelkerke R Square report at 36 percent and 48 percent, respectively. The Chi-square's test reports at 133.954 and the model is significant at the 0.00 ($p < 0.01$) level.

For the BODs' Independence (BODINDE), the result is statistically significant at level of 10 percent (SPSS reports 2-tailed) with negative sign. This result is consistent with the findings by earlier studies, such as Farinha and Viana (2009); and Wenyao and Qin (2007), that greater independence of BODs will reduce the acceptance of modified audit report. The result also supports the argument by Kamardin and Haron (2011) that outside directors play an important role in internal control system. A board which comprises independent and non-executive members adheres more to the rules besides keeping the best interests of shareholders; they are also free from the influence and pressures of management.

TABLE 3. Result of the logistic regressions

$$MA = 0 + 1 \text{ BODINDE} + 2 \text{ BODSIZE} + 3 \text{ LEV} + 4 \text{ ASSPRO} + 5 \text{ BUSSEG} +$$

Variables	Expected Sign	BODINDE + CV
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<i>Independent Variable</i>		Coefficient	Wald test	p-value
BODINDE	-	-2.232	2.547	.111
<i>Control Variables</i>				
BODSIZE	+	.079	.620	.431
LEV	+	6.575	64.945	.000
ASSPRO	-	.179	1.081	.298
BUSSEG	-	-2.563	3.994	.046
<i>Constant</i>		1.102	.441	.507
Chi-square(sig)		133.954 (.000)		
Cox & Snell R Square		.360		
Nagelkerke R Square		.480		
Classification		78.7%		

Variable Definition: BODINDE = proportion of independent non-executive members on the board
 BODSIZE = number of board members
 LEV = total debt/total assets
 ASSPRO = ratio between earnings before interest, tax and extraordinary income and total assets
 BUSSEG = 1, if the company has two or more business segments, otherwise 0

For BOD Size (BODSIZE), the logistic regression analysis reports no statistically significant result for this variable. BOD size does not influence the acceptance of modified audit report by the companies. Small or big size boards have no relationship with modified audit report. The result is inconsistent with the previous studies by Abdul Rahman and Mohamed Ali (2006); Singh and Davidson (2003); and Mak and Li (2001); that board size has influence on earnings management activities and firm performance.

The result also reports a statistically significant result for Leverage (LEV) at a level of 1 percent with positive direction as expected earlier by the researchers. This result is consistent with a study done by Pucheta-Martinez and Feuntes (2007) that high financial obligation has a negative effect on the company. The result is also supported by the arguments of Chen and Church (1992); and Carcello et al. (1995) that financial health of a company contributes to auditors issuing qualified or modified audit report. A high percentage of leverage or debts is a signal of financial instability which will probably affect the future prospects of the company.

For the Asset Profitability (ASSPRO) variable, there is no statistically significant result, indicating that asset profitability has no association or influence on the acceptance of modified audit report. The result supports the finding of a study by Masyitoh and Adhariani (2010) that asset profitability has no effect on acceptance of modified audit report. Lastly, the logistic regression analysis reports a statistically significant result ($p < 0.05$) for the Business Segment (BUSSEG) variable with negative sign as expected earlier. The result supports the arguments by Yatim (2010); and Subramaniam et al. (2009) that the establishment of a RMC to monitor the risk profile of the company can reduce the risks faced by the companies. The companies with more business segments tend to set up a RMC specifically to monitor the risk profile of the company. Hence, the probability of the companies facing greater risks is reduced, hence reducing the acceptance of modified audit report, particularly on risk issues.

CONCLUSION AND LIMITATIONS

The result from the statistical analysis has revealed some significant findings. Firstly, the result documents that BODs' independence influences the acceptance of modified audit report. The finding contributes to the knowledge and literature on board members composition. A higher number of independent non-executive members will probably reduce the acceptance of modified audit opinion which signifies their role to act in the best interests of shareholders and investors. The statistical result shows that a company with higher percentage of independent non-executives members on the board probably will reduce the acceptance of modified audit report. This is aligned with arguments by scholars that independent or outside directors always seek to maintain good reputation and act for the best interests of shareholders, without pressure or influence from management. Effective monitoring by independent non-executive BODs on internal operations as well as external business environment will reduce negative occurrences, such as operational non-compliance and going-concern issues that contribute to the issuance of modified audit report. The result also supports the majority of corporate governance codes in many countries, such as the UK Corporate Governance Code (2012); and the MCCG (2007) and (2012), that the composition of the board should include independent members. Therefore, the regulators and policy makers should ensure all the non-banking and financial companies listed on Bursa Malaysia adhere to that code so as to have sufficient number of independent non-executive board members.

The debts borne by the company also have a major effect on the acceptance of modified audit report. The higher debts or leverage probably will increase the acceptance of modified audit report. Higher debts are seen as financial instability to the company, especially with regards to its future viability. High debt companies also face the risk of litigation by the lenders if the company fails to make loan repayment. Auditors are aware of such situation and issuing modified audit report is considered a viable step for the auditor. Companies with more than one business segment are seen to have association with modified audit report. Theoretically, the companies with more business segments or operations have to set up a RMC to monitor the company's businesses, particularly on risk issues. A RMC can reduce exposure of the company to risks and issuance of modified audit report. Consequently, a company with more business segments can probably reduce the acceptance of modified audit report.

Lastly, size of BOD and asset profitability have no influence on the acceptance of modified audit report. Small or big size boards is not a determinant of modified audit report compareghfhgd to the number of independent non-executive members on the board. Asset profitability is not a contributor to the acceptance of modified audit report. How much the assets generate profit for the company is not a major factor leading to the issuance of modified audit report by the auditors.

The study only consists of the non-banking and financial companies in Malaysia. Future studies can include the banking and financial companies as well. This study uses secondary data from companies' annual reports. Future studies can use primary data, such as information obtained via interviews with external auditors or questionnaires in order to gauge their perceptions on the independent non-executive board members when they perform their audit.

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