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Based on the agency theoretical background, the effectiveness of internal corporate monitoring mechanisms enhances the reliability of financial reporting and contributes to protect the interests of all shareholders. This study provides an answer to the following main question of “What are the factors that affect the prospect of receiving a modified audit opinion among Malaysian public listed companies?” to provide an insight into the issue of internal corporate monitoring mechanisms and modified audit opinion. To date, little is known about this issue, especially in the Malaysian-setting. Accordingly, twelve hypotheses are developed to examine the association between the effectiveness of the board of directors’ characteristics, audit committee characteristics and internal audit function with a modified audit opinion (a proxy for the quality of financial reporting) in the Malaysian context by using individual and aggregated tests. To examine these hypotheses, logistic regression is used to analyse the data of 136 firm-year observations of seven sectors from the main-market and ACE-market listed on Bursa-Malaysia over the period 2009-2011. Several important findings emerged that are consistent with the hypotheses that Malaysian public listed companies with a large audit committee, audit committee members with greater expertise in accounting and auditing process, outsourcing internal audit function and the investment in the internal audit function are less likely to receive a modified audit opinion. Furthermore, the results confirm the argument that the combined scores of the board of directors’ characteristics and the audit committee characteristics contribute to their effectiveness in reducing the prospect of receiving a modified audit opinion. Importantly, this study provides evidence that corporate governance reforms in Malaysia can enhance the effectiveness of monitoring mechanisms in order to avoid the Malaysian public listed companies from obtaining a modified audit opinion. Therefore, the results of this study consistent with agency theory and might-be of interest to Malaysian-regulators and policymakers as well as market participates and researchers.

**Keywords:** modified audit opinion, corporate monitoring mechanisms, Malaysia
ABSTRAK


Kata kunci: pendapat audit diubah suai, mekanisme pemantauan korporat, Malaysia
ACKNOWLEDGEMENTS

In the name of Allah and Alhamdulillah the Lord of the Worlds, Praise, peace and blessings be upon His beloved our Prophet Muhammad (SAW).

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<th>FULL LIST</th>
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<tr>
<td>ACEScoreM</td>
<td>Audit Committee Effectiveness Score</td>
</tr>
<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>AOB</td>
<td>Audit Oversight Board</td>
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<tr>
<td>BDEScoreM</td>
<td>Board of Directors’ Effectiveness Score</td>
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<td>BRC</td>
<td>Blue Ribbon Committee</td>
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<td>FASB</td>
<td>Financial Accounting Standard Board</td>
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<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
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<tr>
<td>IAF</td>
<td>Internal Audit Function</td>
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<tr>
<td>IIA</td>
<td>Institute of Internal Auditors</td>
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<tr>
<td>IIAM</td>
<td>Institute of Internal Auditors Malaysia</td>
</tr>
<tr>
<td>ISA</td>
<td>International Standards on Auditing</td>
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<td>MAO</td>
<td>Modified Audit Opinion</td>
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<tr>
<td>MCCG</td>
<td>Malaysian Code on Corporate Governance</td>
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<td>MIA</td>
<td>Malaysian Institute of Accountants</td>
</tr>
<tr>
<td>NACD</td>
<td>National Association of Corporate Directors</td>
</tr>
<tr>
<td>NYSE</td>
<td>New York Stock Exchange</td>
</tr>
<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<td>SOX</td>
<td>Sarbanes-Oxley Act of 2002</td>
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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Accounting can be described as an information system upon which the real economic situation of a particular body is enumerated. According to Ball (2008), financial reporting performs a principal role in the economic activities. The quality of financial reporting highlights the extent of how the financial statement information reveals the actual economic situation of the entity (Watkins et al., 2004). Similarly, according to Beest et al. (2009), the main aim behind financial reporting is to provide an overview of the high quality financial information regarding an entity’s economic picture in financial terms and its contribution to economic decision-making (FASB, 1999). In order to efficiently allocate capital, high quality financial reporting is imperative (Healy et al., 2001). Therefore, it can be stated that the financial reporting quality is invaluable to users of such reports including potential investors, creditors, etc., as they base their decisions upon such reports.

However, accounting information of low quality may mislead recipients into making the wrong decisions concerning investment or financing, which will eventually lead to the inefficient allocation of economic resources. Importantly, the absence of audit quality could result in a less efficient capital market, costly capital (higher interest rates for new loans or a change in debt covenant for existing loans), and, ultimately, might reduce the standard of living (Elliot, 1995; Saul, 1996; Wallman, 1995, 1996) due to inefficient
The contents of the thesis is for internal user only
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