РАЗДЕЛ 3 КОРПОРАТИВНОЕ УПРАВЛЕНИЕ В МАЛАЙЗИИ

SECTION 3 NATIONAL CORPORATE GOVERNANCE: MALAYSIA

DOES PLACEMENT SEQUENCING OF THE AUDITOR'S REPORT IN MALAYSIAN COMPANIES' ANNUAL REPORTS MATTER?

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Abstract

This study investigates whether a firm's management decision to locate the auditor's report in the financial statements is explained by information signaling theory. We posit that a firm that conveys good news is more likely to place its auditor's report at the beginning of the financial statements than at the end, and vice-versa. Based on 698 firms listed on the Bursa Malaysia as on December 31, 2002, we find that majority of Malaysian listed firms in Malaysia place their auditor's reports at the beginning rather than at the end of the financial statements. This could be a manifestation of the importance of the auditor's report in the financial reporting framework. However, our evidence the type of news, as measured by Tobin's q, ROA and EPS, does not have any association with the location of the auditor's report. Thus, it is concluded that information signaling theory is not supported.

***Keywords**:* Auditor's report, auditor's report location, information signaling, profitability, board of directors

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Introduction

In a set of financial statements, auditor's report is regarded as an essential element of a firm's annual report because they communicate the audit findings (Arens et al., 2006). The objective is for an auditor to express an opinion regarding the truth and fairness of the firm's (or the group's) state of affairs and whether the accounting and other records have been properly kept in accordance with the requirements of the Malaysian Companies Act 1965 and prepared according to the Malaysian approved accounting standards. Given the importance of the audit report, it forms an integral part of a firm's financial statements.

The importance of the auditor's report is well recognized in Malaysia as it is addressed by the Companies Act 1965 in various sections. Section 169 of the Act, for instance, requires the audited financial statements to be laid before a firm's annual general meeting. Section 174(2) on Powers and Duties of Auditors as to Reports on Accounts, calls for an auditor to report to the members of the company an opinion on the accounts presented at the annual general meeting.

The International Federation of Accountants (IFAC) has also issued an auditing standard regarding the auditor's report in its ISA 700 - The Auditor's Report on Financial Statements[17], adopted by The Malaysian Institute of Accountants (MIA), effective from July 1, 1998. According to ISA 120 - Framework of ISAs, the objective of financial statement audit is to enable the auditor to express an opinion whether the financial statements prepared are in accordance with an identified financial reporting framework (paragraph 11).

Research studies on the auditor's report have primarily focused on the issue of audit expectation gap (e.g. Guy and Sullivan, 1988; Garcia-Benau and Humphrey, 1992; Monroe and Woodliff, 1994). One issue on auditor's report that, to the best knowledge of the authors, has never been investigated is on managerial decision to locate it in a company's annual report. Existing requirements (i.e. ISAs, FRSs and the Malaysian Companies Act) do not specify the location of the audit report. Therefore, it is entirely the prerogative of a company's management to decide on the location of the audit report. We believe that, based on a preliminary cursory survey on a sample of fifty annual reports of Malaysian companies, the decision on the location of the audit report may be dependent upon the type of news (i.e. bad or good news) that firm attempts to convey to the shareholders and users of the firm's financial statements. We, thus, postulate that if the firm attempts to convey good news, the auditor's report is placed at the beginning of the financial statements (i.e. immediately preceding the notes to accounts) and if the firm conveys a bad news, the audit report is located towards the end of the financial statements (i.e. following the notes to accounts). An indicator of a firm's conveying good news or a bad news is its financial performance. Findings of this study would provide evidence on whether managerial decision on the location of the auditor's report does convey a signal about the firm's performance. Thus, our research objective is to determine whether management uses the auditor's report as a communication tool to its shareholders or users of the firm's financial statements. Specifically, our research question is as follows: Is a firm's decision to locate the auditor's report motivated by type of the news (i.e. good or bad)?

Our empirical evidence, based on a total of 698 firms listed on the Main Board of Bursa Malaysia in 2002, nevertheless fails to support our contention that the location of the auditor's report is influenced by the type of news (i.e. good or bad news). Rather, the findings reveal that majority of Malaysian firms in our sample (i.e. about eighty percent or 560 firms) placed the auditor's report at the beginning of the financial statements (i.e. immediately prior to the notes to accounts). Of these 560 firms, forty-five firms received qualified audit report. The total number of firms that received qualified audit report altogether is fifty-two. We find that none of the profitability measures, our proxy for information signaling, is associated with location of the auditor's report. This evidence, though not supportive of information signaling theory, suggests that auditor's report is important as firms prefer to place it at the beginning rather than towards the end. Thus, the auditor's report serves as an important communication tool regardless of the firm's financial performance.

The remainder of this paper is structured as follows. In the following section, we will present the theoretical framework and hypothesis, followed by the methodology section. In the subsequent section, results will be presented and discussed. Discussion and conclusions will be provided in the final section.

Previous Studies

Usefulness of the Auditor's Report

The issue of audit expectation gap has widely been examined (for example, Liggio, 1974; Porter, 1993; Porter et al., 2005). Expectation gap arises because a discrepancy in the public expectation of the role of the auditors and the actual performance of the auditors in a financial audit especially when it concerns auditor's role in detecting fraud (see Humprey et al., 1993). In Malaysia, a study by Mohamed and Muhamad Sori (2002) reveals that the audit expectation gap exists due to various factors such as, uncertainties concerning the actual role of the auditor; satisfaction of clients with the services provided by the auditors; and audit firm's lack of independence and objectivity. So long as the expectation gap exists, the discrepancy in the interpretation made by users and the interpretation intended by the auditors is bound to occur.

Another important issue on auditor's report is on the implication of the type of the auditor's report to a user's decision. A study by Johnson et al. (1983) reveals that loan officers state that the type of the auditor's report (i.e. qualified or unqualified report) is not related significantly to the amount of loans eventually approved. Thus, this evidence may suggest that the type of the auditor's report is not related to a loan application's credit worthiness. However, the reason for such a finding might have been driven by the fact the study focuses on private loans. The loan officers have private access to the firm's information in the course of reviewing its credit worthiness.

On the contrary, Gomez-Guillamon (2003) finds that decisions made by credit banks, savings banks and land banks are influenced by the type of audit

[17] ISA 700 in paragraph 5 identifies the basic elements of the auditor's report. Auditor's report should include title, addressee, opening or introductory paragraph, scope paragraph (describing the nature of audit), opinion paragraph containing an expression on the financial statements, date of the report; auditor's address; and auditor's signature.

opinion whereby auditor's opinion affects the amount of loans given, decisions to invest or not in a company and amount to be invested. Additionally, it is revealed that the information in auditor's reports is very relevant and useful for financing decision and would impact on the attitude of the investors when financing or investing in a company. Thus, his findings contradict Johnson et al.'s (1983) evidence. This might be due to different research strategies employed by the two studies. Research by Johnson et al. (1983) used laboratory experiments whereas Gomez-Guillamon employed survey/questionnaires techniques. It is noted that the study by Johnson et al. (1983) is an exploratory study and the response rate was very low. Further, the "action" variables used (either to approve loan application and determination of the interest rate premium by bankers) may be influenced by other loan proposal characteristics which are not controlled in their research design. On the other hand, Abu Bakar et al. (2005) argue that the importance of audit report in making any decisions is depending on auditor's integrity, objectivity, and independence.

In a survey done by Anderson and Epstein (1995), auditor's report is found to be the item least scrutinized by shareholders. The statement of financial position, income statement and historical operating results are found to be the most useful to shareholders. On the contrary, in Saudi Arabia, Al-Razeen and Karbhari (2004) demonstrate that individual shareholders perceive auditor's report as more important than notes to the financial statements, cash flow statement, retained earnings statement and the board of directors' report. In Kuwait, Naser et al. (2003) reveal that auditor's report is perceived as the easiest part to understand as compared to the financial statements and notes to the accounts. It is also found that the auditor's report is the second most credible item in corporate annual report. The study shows that all individual investors indicated either strongly agreed or agreed to the statement that auditor's report is a vital part of corporate report. The importance of audit report also is evidenced from a study done by Schaub (2006) which examines investor overreaction to going concern audit opinion announcements made in the major financial press.

Another important strand of research on auditor's report is its use as a communication tool to users by the auditors. This has been suggested by Kneer et al. (1996) who investigate the influence of "new" US audit report and fraud red flags on users' perceptions of auditor's culpability. They find that the language used in the auditor's report could influence users' perceptions of auditors' responsibilities and could enhance the communication between auditors and users. The language used could reduce the level of auditor's liability or responsibility. In Malaysia, auditor's reports are prepared following the guidance in ISA 700 - The Auditor's report on Financial Statements. Our preliminary examination of a sample of fifty annual reports of Malaysian listed companies indicates that the wording and the format of the audit report are very much standardized. Thus, the wording of the auditor's report may not have any significant influence to users. Jordan and Clark (1996) propose that even if the auditor's report modification has been made because of changes in accounting principles, it will still not impact on users understanding except that it can improve uniformity among the report issued by auditors.

On the usefulness of the auditor's report, Landsittel (1987) argues that the wordings of an audit report as well as a clean opinion can create public expectation about the future financial health and viability of the firm. However, he suggests that changing the form of standard audit report would make it easier for the auditors to communicate their messages and therefore enhance users' understandability. Nevertheless, despite calls to change the auditor's report, the content of the auditor's report has not changed much since then. Perhaps, the reluctance of the accounting profession to change drastically the content of the auditor's report is largely due to the legal implications the auditor could face. Even though the long auditor's report not necessarily expand the scope of auditors, it still could explain the management duty on preparation of financial statement, independence of auditor and audit procedures carried out so that it can improve readers' understanding on audit report (Best et al., 2001).

Information Signaling Theory

Information signaling theory posits that firms with good news have additional incentives to voluntarily disclose more information in order to distinguish themselves from less desirable firms (Verrecchia, 1983). Signaling takes place when management discloses fresh or latest information about a firm's position which is relevant in the valuation process (Eddy et al. 1993). From a signaling theory perspective, companies with higher levels of profitability have greater incentives to highlight their performance to enable users to distinguish themselves from other less performing firms (Houghton and Smith, 2003). A similar finding has been documented by Abdullah and Mohd-Nasir (2004) who find that profitability is negatively associated with voluntary disclosure levels. By voluntarily disclosing additional information, the good news' firms could improve their image and credibility among accounting information users. According to Arab et al. (2004), a dividend announcement also serves as one of the signals used to inform the shareholders about the viability of the firm in the future. They believe that dividend signals are reliable because it requires cash outflow and cash is not easy to be maneuvered. Results of their study reveal that fluctuation of share value is influenced by changes in dividends. This is consistent with Moyers et al. (1996) where dividends are regarded as a powerful signal about a firm's future cash outflow and a firm's risk class.

Reluctance to disclose information is due to the fact that the information is not costless. Dartnell (2002) argues that information can be divided into two, namely proprietary information and non-proprietary information. In the former, its release could adversely affect the future cash flows of the firm, such as a firm's strategic plans and takeovers. The latter type of information, if released to the public, will not affect directly the firm's future cash flows, such as financial statements and the auditor's report. This type of information nevertheless is useful to users for predicting the future of a firm including its revenue generating potential.

Due to the cost associated with disclosing private information, companies tend to hide inside information, especially those of proprietary nature. This is because the amount of information disclosed is affected by the cost of the disclosure (Richardson, 2001). Therefore, these companies disclose information that is required of them by the existing laws. On the other extreme, there are companies that are prepared to disclose information on a voluntary basis. Thus, the levels of disclosure vary across firms. Richardson (2001) postulates that if the disclosure cost is zero, companies would be prepared to disclose all information that they have. But, when the cost of disclosure rises, the firm will be less likely to disclose that information. Further, Richardson believes that as information precision increases, the cost of the disclosure will increase to reflect the increased proprietary costs. He concludes that precise information is likely to be withheld from the market due to the increased costs of disclosure. For the firms that are concerned with litigation costs caused by investors' reaction to imprecise information, more precise information is likely to be disclosed.

Nevertheless, firms that disclose private information could distinguish themselves from other firms with less information disclosure (Dye, 1985). Dye identifies three reasons why management does not to disclose non-proprietary information. First, investors' knowledge of management's information is incomplete. Second, managers possess a vast array of private information and some of the information may be proprietary and non-proprietary information which may not be disclosed if it is part of such an array. The third reason is due to the principal-agent problem that exists between shareholders and managers, known as information asymmetry. Dye (1986) argues that when managers possess both proprietary and non-proprietary information, non-disclosure and partial disclosure may be optimal even if credible announcements of all information can be made.

Signaling and voluntary disclosure theories predict that the inclusion of earnings forecasts in the offering prospectus is intended to distinguish firms with "good news" earnings prospects relative to market expectations from those absent of forecast. The good news hypothesis states that, on average, forecasters have superior future cash flow prospects, relative to non-forecasters. To test this prediction, Clarkson et al. (1992) investigate the role of direct disclosure in the valuation on initial public offerings (IPOs). They contend that entrepreneurs of high-quality firms can credibly communicate their private information to investors and will receive above average market valuation by undertaking actions that lower quality firms find too costly to imitate. They find that earning forecast firms have good news to reveal about future cash flow prospects, relative to non-forecast firms. In a related study, Garfinkel (1993) hypothesizes that IPO under pricing is a method used by firms that possess private good news to signal about firms' quality and will enhance the price received in the upcoming security offerings. However his result fails to support the contention whereby IPO underpricing is not a signal of a firm's quality.

In a similar vein, Houghton and Smith (2003), relying on signaling theory, argue that graphs would be able to highlight selected aspects of a firm's performance. However, on the other hand, they argue, when performance is not so good, management may be reluctant to incorporate graphs into reports. Their evidence shows that graph-based disclosures are influenced by the nature of contest for take-overs, previous performance of the target and takeover bid value. Thus, it can be concluded that other than for image, graph is used as a device to influence shareholders' behavior in corporate takeover situations.

The manner in which information disclosed is linked to signaling theory because information is not costless. Information is disclosed by management as a signal to users about the firm's past performance and its future prospects. We predict that the decision to place the auditor's report is also a strategy that is used by management as a signal to users of its financial statements. In the absence of any specific regulation on the exact location of the auditor's report, the location of the auditor's report is expected to vary across firms as it can be used a tool to distinguish its firm for other firms. We posit that management decision to locate its auditor's report is not random but based on the type of signal that the firm attempts to send to users. We predict that firms that convey good news would place their audit reports at the beginning of the financial statements and firms that convey bad news would locate the audit reports after the financial statements.

Even though the format and the wordings of an auditor's report are very standardized, its contents might enable users to anticipate the type of news that the firm is trying to convey. Strong financial performance, a signal of good news, is expected to be associated with an unqualified auditor's opinion. Poor performance, a signal of bad news, could be associated with a qualified auditor's opinion (e.g. going concern). In fact, Haniffa and Cooke (2002) show that profitability is associated positively with the level of voluntary disclosure. A similar finding is also documented by Abdullah and Mohd-Nasir (2004). Similarly, the decision to locate the auditor's report is motivated by the profitability of the firm. This is because profitable firms are expected to obtain unqualified auditor's report. Thus, this would motivate management of the firm to place the auditor's report early. On the contrary, unprofitable firms are more likely to obtain auditor's opinion other than one that is unqualified. Management of these firms is more likely to defer the bad news conveyed in The Auditor's Report By Placing It Towards The End Of the financial statements.

Nevertheless, market efficiency hypothesis postulates that the value of information is not determined by its location. However, in Malaysia, the capital market is considered as semi-strong. This is evidenced in a study by Kok and Gupta (1994) which shows the usefulness of the technical analysis and fundamental analysis in stock pricing. Hence, the location of the auditor's report is expected to convey important message to users. Given the foregoing discussion, the following prediction is made:

Hypothesis: A company that conveys good news places the auditor's report at the beginning of the financial statements compared to a company that conveys a bad news which places the auditor's report after the financial statements.

Methodology

Annual reports for the year ended 2002 of all companies listed on the Main Board and the Second Board[18] of the Bursa Malaysia, as listed on 31 December 2002, were included in this study. Companies classified in finance, trust and close-end trust sectors were excluded because these companies were regulated under various Acts. To test the hypothesis, the following research model, including control variables, is developed:

$ARLOC = \alpha + \beta_1.FINPERF + \beta_2.SIZE + \beta_3.BDIND - \beta_4.GRG - Z_1.AUDOPN + Z_2.AUDTR + \varepsilon.$

Where,

Dependent variable:

ARLOC: dummy variable: 1 if the audit report placed at the beginning, 0 otherwise;

Test variable:

FINPERF: firm's financial performance (Tobin's *q*, ROA and EPS);

Control variables:

SIZE: firm's size (measured by the log natural of a firm's total assets);

BDIND: the percentage of independent directors on the board;

GRG: ratio of short-term borrowing to total assets;

AUDOPN: type of auditor opinion (1 if qualified or adverse opinion, 0 otherwise); and

AUDTR: auditor quality (1 for big-4 audit firm, 0 otherwise).

Three measures of financial performance are employed, namely ROA, EPS and Tobin's *q*. These measures are proxies for the type of news a firm is conveying in the annual report to the users. The first two measures are accounting based, while the third measure, i.e. Tobin's *q*, is market based. Tobin's *q* is used because the relationship between market value and replacement cost is argued to be very important in the investment decision making processes. This ratio of performance is better than market-to-book ratio because it neutralizes the effects of different depreciation policies (Bouteiller, 2002). We computed Tobin's *q* by using the measurement developed by Maury and Pajuste (2004) as the data is readily available. Maury and Pajuste (2004) measure Tobin's *q* as follows. The firm's market value of outstanding shares and book value of debts are combined to proxy the firm's market value. The replacement cost of assets, on the other hand, is represented by the book value of total assets. Therefore:

Tobin's *q* = Market value of outstanding shares + book value of debt Book value of assets

We included five control variables in the research model. First, firm's size is an important variable in voluntary disclosure studies (e.g. Mark and Russel, 1993; Meek et al., 1995; Eng and Mak, 2003, Mohd-Nasir and Abdullah, 2004). In a study by Mohd-Nasir and Abdullah (2004), they document a positive and significant association between a firm's size and voluntary disclosure. It is conjectured that a firm's size is positively associated with the location of the auditor's report. This is because large firms are usually followed by analysts. Second, board independence is associated with the board's monitoring incentives and transparency (e.g. Forker, 1992; Chen and Jaggi, 2000). In fact, Mohd-Nasir and Abdullah (2004) show that board independence is also associated with higher levels of voluntary disclosure among companies in Malaysia. Linsley and Shrives (2005) argue that one of the mechanisms to improve corporate transparency is through a proper location of the risk related information. Thus, we predict that board independence is associated with auditor's report being placed at the beginning of the financial statements. Third, firm's gearing ratio leads to a potential transfer of the firm's wealth from debtholders to the shareholders (Jensen and Meckling, 1976; Meek et al., 1995). Hence, this leads to agency problem between shareholders and debtholders (Jensen and Meckling, 1976). In addition, the level of leverage signifies the closeness to breaching the debt

[18] To be listed on the Main Board, the minimum issued and paid up capital is RM60million, while for Second Board is RM40million. Other requirements are uninterrupted profit record of 3 to 5 full financial years, with an aggregate after-tax profit of not less than RM30 million (Main Board) or RM12 million (Second Board) over the said 3 to 5 financial years and an after-tax profit of not less than RM8 million (Main Board) or RM4 million (Second Board) in respect of the most recent financial year.

covenants and the risk of financial distress, as evidenced in Platt and Platt (2002). It is therefore predicted that the level of gearing is negatively associated with the location of the auditor's report. Fourth, the type of auditor's opinion is also expected to be associated with the location of the auditor's report. If the auditor issued unqualified opinion, the report is expected to be located at the beginning. If the report is other than unqualified, it is more likely to be placed after the financial statements. Finally, the type of the auditor also is conjectured to have an effect on the location of the auditor's report. Auditor's incentives to compromise with the quality of the audit are negatively associated with the size of the audit firm (DeAngelo, 1981; Dye, 1993). Thus, big-4 audit firms, indicator of the auditor's independence and quality, are likely to be associated with high quality financial statements. Therefore, big-4 audit firms will lead to the auditor's reports being located at the beginning of the financial statements.

Results

As on December 31, 2002, a total of 853 companies are listed on the Bursa Malaysia. Out of these, only 698 companies (i.e. about 82 percent of the Bursa Malaysia population) are included in this study after eliminating a total of 155 companies for various reasons. Detail of the companies included in the study and the reason for exclusion of certain companies are shown in Table 1. After an analysis of outliers, another four companies are deleted.

"INSERT TABLE 1 HERE"

Out of the 698 companies, 138 companies placed the auditor's report after the financial statements, representing about twenty percent. Thus, the incidence of placing auditor's report at the end of a financial statement is not widespread. To understand the tendency of locating the auditor's report by sectors and the type of the board listings, a cross-tabulation analysis and the Chi-square test were carried out whose results are shown in Table 2.

"INSERT TABLE 2 HERE"

Results in Table 2 suggest that a firm's listing status and the location of the auditor's report are not independent, as indicated by the significance of the Chi-square test. However, the Chi-square test between sectors and the location of the auditor's report shows that they are independent. It is interesting to observe that more than ninety percent of the distressed firms locate their auditor's reports at the beginning of the financial statements. This finding, thus, supports the evidence by Skinner (1994, 1997) who find that firms with bad earnings news are more than twice as likely to pre-disclose their earnings performance than firms with good news.

Table 3 reports the descriptive statistics of all variables examined in this study.

"INSERT TABLE 3 HERE"

The means for ROA and EPS are found to be negative. This suggests that firms in Malaysia have not been fully recovered from the 1997 economic crisis. As for the Tobin's *q*, the average (and the median) is greater than "1" suggesting investors' positive outlook of the future growth of the Malaysian firms. A t-test for ROA, EPS and Tobin's *q* between PN4 and non-PN4 firms revealed significant differences in means. The mean of ROA and EPS for PN4 sub-sample is negative (ROA: -0.92, EPS: -83.35 cents). For non-PN4 firms, the mean for ROA and EPS is positive (ROA: 0.009, EPS: 7.36 cents). Thus, the negative overall mean for ROA and EPS in Table 3 is due to the significant loss experienced by PN4 firms. Surprisingly, the mean of Tobin's *q* for PN4 firms is higher than the mean for non-PN4 firms (PN4: 4.58, Non-PN4: 1.22). Thus, it seems that investors have better outlook for PN4[19] firms than non-PN4 firms. A t-test of total assets between PN4 and non-PN4 shows that total assets of PN4 firms was substantially lower than total assets of non-PN4 firms. Thus, the lower total assets, being the denominator for Tobin's *q* computation, has driven up the Tobin's *q* for PN4 firms.

A t-test is carried out to determine the differences in mean between firms that locate their auditor's report at the beginning or at the back with all independent variables. Results of the t-test are presented in Table 4.

"INSERT TABLE 4 HERE"

Results in Table 4 show that the mean for ROA, EPS and Tobin's *q* is not statistically different between firms that place their auditor's report at the beginning and at the end of the financial statements. Nevertheless, the mean for ROA, EPS and Tobin's *q* is higher for firms that place auditor's report at the beginning than firms that place it at the end. As for the control variables, only the firm's size, board independence and the type of auditors are found to have significant differences in mean.

Logistic regression analyses are carried out to test the hypothesis. Three regression models are run, each using different performance variables. Results of the analyses are provided in Table 5.

"INSERT TABLE 5 HERE"

[19] PN4 is short form from Practice Note 4/2000. Under this practice note, financially distressed companies will be categorized as PN4 companies and Bursa Malaysia required them to regularize financial affairs. Companies will fall under this category, among others, if recorded negative shareholder's equity and receipt a disclaimer audit report.

Findings in Table 5 show that performance is not associated with the location of the auditor's report. This evidence is consistent with the t-test results in Table 4. Thus, the hypothesis which predicts a significant association between the type of news the firm intends to convey and the location of the auditor's report is not supported. Therefore, signaling theory is not supported. As for control variables, four variables are found to have significant impact on the location of the auditor's reports: firm's size, board independence, gearing and the type of auditors.

Further analyses have been carried out. In Model 1, audit committee independence is included. It is conjectured that if a firm's audit committee is composed solely of independent directors, as contained in Sarbanes-Oxley Act 2002, the quality of the financial statements is high. Thus, this will be associated with locating the auditor's report at the beginning of the financial statements. Model 2 includes firms' financial status. It is predicted that PN4 firms would tend to place the auditor's report at the end of the financial statements rather than at the beginning. In Model 3, a firm's listing status is included. It is anticipated that firms that are listed on the Main Board would more likely to place their auditor's report at the beginning of the financial statements than the firms listed on the Second Board do. Finally, in Model 4, PN4 firms are excluded in the analysis because discussion in the descriptive statistics revealed that financial performance for PN4 firms are significantly lower than the performance of non-PN4 firms. Excluding these PN4 firms could remove bias in the findings. Results of these additional analyses are presented in Table 6.

'INSERT TABLE 6"

Results in Table 6 are generally similar to those shown in Table 5. All the additional variables that are included in the analyses, namely audit committee independence, PN4 status and firm's listing status, do not have any association with the location of the auditor's report. Excluding PN4 firms also does not change qualitatively the earlier findings.

Discussion and Conclusion

The importance of the auditor's report is well recognized in the literature. Naser et al. (2003) for instance show that their respondents feel that auditor's report is the easiest part to be understood in a financial statement and the second most credible item in a corporate report. In fact, Al-Razeen and Karbhari (2004) also reveal individual shareholders in Saudi Arabia perceive auditor's report to be the most important element in making investment-related decision as compared to directors' report and other components of the financial statements. However, Anderson and Epstein (1995) argue that auditor's report is not very helpful when making investment-related decisions. However, mixed evidence is offered with respect to usefulness of the auditor's report (e.g. Johnson et al., 1983; Johnson and Pany, 1984; Gomez-Guillamon, 2003).

Though the content of an auditor's report is set by the accounting profession, its location is not regulated. It is therefore the objective of this paper to examine whether the choice about the location of the auditor's report is motivated by the type of news the firm is conveying to users. We argue that the choice to locate the auditor's report is not random, rather it is done to achieve a firm's particular purpose. This is because the auditor's report, issued by the respective firms' auditors, would state whether the firm had properly kept and maintained its accounting and other records and registers required by the Malaysian Companies Act, 1965. In expressing the opinion, the auditor also need to state whether the company had prepared its financial statements in accordance with the Malaysian Companies Act and the approved Malaysian Accounting Standards. Thus, given the importance of the auditor's report and its contents, we predict that a firm's motivation to place the auditor's report either at the beginning or towards the end of the firm's financial statements is determined by the firm's financial performance (i.e. profitability), as argued by Houghton and Smith (2003) with regard to graph presentation in the annual reports. Thus, based on information signaling theory, we postulate that the higher the profitability of a firm, the more likely the firm is to place its auditor's report at the beginning of its financial statements than at the end.

Using 2002 annual reports of companies listed on the Bursa Malaysia, our findings show that the incidence of locating auditor's report at the end of a financial statement is not very common where it accounts only about twenty percent of the listed companies. Thus, majority of firms place the auditor's report at the beginning of the financial statements. When testing the hypothesis, we found that none of the profitability measures (proxies for the type of news), namely ROA, EPS and Tobin's *q*, is associated with the location of the auditor's report. Therefore, a firm's decision to place the auditor's report either at the beginning or at the end of the financial statements is not motivated significantly by a firm's profitability. Hence, information signaling theory with regard to auditor's report location is not supported. One explanation for the insignificant association between firm's profitability and location of the auditor's report is owing to the fact that the forms of the auditor's report in Malaysia are very uniform as the report is prepared according to ISA700 – The Auditor's Report on Financial Statements. Thus, it is rather difficult for the firms to communicate to users the type of news that they want to convey by the location of the auditor's report. In addition, the fact that the type of auditor's opinion is not significantly associated with location of the auditor's report could perhaps explain further the insignificant association between profitability and auditor's report location. The type of auditor's opinion is expected to have an important implication on the auditor's report location because the report is likely to be placed at the end rather than at the beginning if other than unqualified auditor's opinion is issued. This is consistent with the argument put forth by Landsittel (1987) who argues that the wording of the auditor's report as well as an unqualified audit opinion can create public expectation about the future financial health and viability of the firm. This argument is consistent with signaling theory.

For control variables, our evidence shows that a firm's size, gearing, board independence and the quality of the auditors are significantly associated with the location of the auditor's report. The direction of association between the location of the auditor's report and gearing ratio, board independence and the quality of the auditors is as anticipated. Thus, the higher gearing ratio, the more likely the auditor's report is located towards the end of the financial statements. This is consistent with the earlier evidence which suggests that gearing ratio is associated with the risk of financial distress (Platt and Platt, 2002) and the conflict between the shareholders and debtholders (Jensen and Meckling, 1976; Meek et al., 1995). The risk and the conflict motivate the management to place the auditor's report towards the end of the financial statements. A negative association between a firm's size and the location of the auditor's report is not expected as in voluntary disclosure research where its association with a firm's size is positive (e.g. Meek et al., 1995; Eng and Mark, 2003; Mohd-Nasir and Abdullah, 2004). One explanation is that in the voluntary disclosure studies, size is a proxy for information availability. Large firms are more able to have accounting systems which could gather a lot more information than smaller firms could. This ability is, however, not translated into locating the auditor's report at the beginning. Perhaps, large firms are more concerned with the financial results and thus present this information to users first than the location of the auditor's reports. Therefore, large firms would likely present the financial results and the auditor's reports are presented towards the end.

The extent of the board being independent of management is also found to lead to the auditor's report being placed at the beginning of the firm's financial statements, consistent with earlier evidence (e.g. Chen and Jaggi, 2000; Mohd-Nasir and Abdullah, 2004) which shows that board independence is associated with corporate transparency. Placing the auditor's report at the beginning by independent boards could send a signal to users that the firm is serious about promoting accountability through transparency. This is because decision on the location of the auditor's report at the beginning of the financial statements is entirely management discretion and it can be interpreted as a way of promoting corporate accountability. The firm is trying to tell the users on their business achievement and performance; regardless the amount of loss or profit that has been generated during the financial year. The positive association between the type of auditors and the location of the auditor's report is consistent with the auditor quality literature (e.g. DeAngelo, 1981; Dye, 1993). Thus, given the perceived high independence of these auditors, the clients would send this signal to users by placing the auditor's report at the beginning of the financial statements.

As a conclusion, findings of this study demonstrate that a firm's profitability is not important in predicting the location of the auditor's report. Though, it is conjectured that, based on information signaling theory, the type of news would have an important bearing on management decision to place the auditor's report, this is not supported in our study within the Malaysian setting. The contents of the auditor's report potentially convey important news about a firm's compliance with both the Companies Act 1965 requirements and FRS and more importantly the auditor's opinion on a firm's financial position. Nevertheless, our evidence reveals that corporate governance variables, namely board independence, the type of auditors and gearing ratio are important in predicting the location of the auditor's report. Thus, these corporate variables do play an important role in promoting transparency and accountability by presenting the results of the audit early rather than after the financial statements.

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Appendices

Table 1. Sample Selection

Total companies on the Bursa Malaysia Main Board as at 31 December, 2002	561
Total companies on the Bursa Malaysia Second Board as at 31 December, 2002	292
Total firms	853
Less:	
- Finance (including finance companies categorized under PN4, 8 companies)	59
- Firms listed during 2002 (Initial Public Offerings)	44
- Companies in the Technology sector	19
- Companies in the Close End Fund sector	1
- Companies in the Trust sector	3
- Annual report not available	14
- Auditor's report not found in annual report	1
- Chairman of the firm's board is not determinable	1
- Auditor's report not dated	13
Total firms in this study	698

Table 2. Cross-tabulation between Auditor's Reports Location and Sectors

Board listing[*] / Sectors[**]	Location of auditor's report At the end	At the beginning	Total firms
Main Board	101 (22.5%)	348 (77.5%)	449
Second Board	37 (14.55%)	212 (85.5%)	249
Trading and Services	35 (25.4%)	102 (74.6%)	137
Industrial Products	34 (24.6%)	171 (75.4%)	205
Consumer Products	17 (12.3%)	81 (87.7%)	98
Plantations	13 (9.4%)	27 (90.6%)	40
Properties	15 (10.9%)	65 (89.1%)	80
Construction	10 (7.2%)	36 (92.8%)	46
Hotels	0 (0%)	6 (100%)	6
PN4[a]	13 (9.4%)	62 (90.6%)	75
Infrastructure	1 (0.7%)	6 (99.3%)	7
Mining	0 (0%)	4 (100%)	4

[a] PN4 sector was introduced by the Bursa Malaysia in 2001 for distressed firms.
[*] Chi-square test between board listing and location of auditor's report (Pearson Chi-Square value: 5.89, p-value=0.015).
[**] Chi-square test between sectors and location of auditor's report (Pearson Chi-Square value: 11.69, p-value=0.232).

Table 3. Descriptive Statistics

Variables	n[b]	Range	Mean	Median[c]	SD
FINPERF:					
Tobin's Q	696	0.07-31.73	1.57	1.02	2.47
ROA	696	-5.33-0.88	-0.09	0.15	0.53
EPS (in cents)	696	-453-315	-2.41	3.85	55.79
SIZE (in log natural)	698	15.1-24.86	19.49	19.29	1.47
BDIND	698	0-1	0.39	0.38	0.13
GRG	697	0-24.98	0.70	0.27	1.93
AUDDLY (in log 10)	698	1.28-2.52	1.98	2.04	0.13
AUDOPIN	698	0-1	0.07	7.4	2.63
AUDTR	698	0-1	0.73	73.4	0.44

[b] After deletion of outliers, the number of firms range between 696 to 698.
[c] Median values for dichotomous variables represent the percentage of observations with "1" score.

Table 4. T-test results

Variables	Predicted sign	ARLOC=0 (Mean)	ARLOC=1 (Mean)	T
ROA	+	-0.094	-0.88	0.12
EPS	+	-2.57	-1.73	-0.16
Tobin's Q	+	1.46	1.61	0.70
SIZE	?	19.94	19.38	-4.03[*]
BDIND	+	0.38	0.40	1.82[#]
GRG	-	0.69	0.80	0.44
AUDOPIN	-	0.05	0.08	1.35
AUDTR	+	0.67	0.75	1.88[#]

[*]/[#] 0.05/0.10 significant levels respectively, two tailed tests.

Table 5. Logistic Regression Results (Wald statistics in parentheses)

Variables	Predicted sign	Performance Variable ROA (n=696)	EPS (n=695)	Tobin's Q (n=696)
FINPERF	+	0.23	0.001	0.12
		(0.58)	(0.20)	(1.19)
Size	?	-0.29	-0.29	-0.29
		(18.46)*	(17.94)*	(17.41)*
BDIND	+	1.49	1.36	1.50
		(3.37)* *	(2.88)* *	(3.39)**
GRG	-	-0.78	-0.11	-0.27
		(0.82)	(3.39)**	(3.60)**
AUDOPIN	-	0.53	0.51	0.52
		(1.17)	(1.10)	(1.15)
AUDTR	+	0.54	0.54	0.52
		(6.42)*	(6.36)*	(5.95)*
Model summary:				
Pseudo-R^2		0.063	0.061	0.065
Chi-square		28.14*	27.19*	29.09*
Overall correct classification (%)		71.0	70.9	70.8

*/** 0.01/0.10 significant levels respectively, one-tailed tests.

Table 6. Further Logistic Regression Analysis Results (Wald statistics in parentheses)

Variables	Predicted sign	Model 1 (n=696)	Model 2 (n=696)	Model 3 (n=696)	Model 4# (n=623)
Tobin's Q	+	0.12	0.11	0.12	0.05
		(1.19)	(0.99)	(1.27)	(0.19)
Size	?	-0.29	-0.29	-0.26	-0.31
		(17.34)*	(17.34)*	(9.61)*	(17.96)*
BDIND +		1.54	1.53	1.52	1.24
		(3.40)* *	(3.53)* *	(3.51)**	(1.76)**
GRG	-	-0.27	-0.25	-0.27	-0.17
		(3.61)**	(2.74)**	(3.65)**	(0.39)
AUDOPIN	-	0.52	0.55	0.51	0.93
		(1.16)	(1.26)	(1.11)	(1.39)
AUDTR	+	0.52	0.52	0.54	0.41
		(5.94)*	(5.99)*	(6.24)*	(3.23)*
ACIND	+	-0.08	-	-	-
		(0.04)			
PN4	-	-	-0.15	-	-
			(0.12)		
LISTING	+	-	-	-0.18	-
				(0.48)	
Model summary:					
Pseudo-R^2		0.065	0.065	0.066	0.061
Chi-square		29.14*	27.21*	29.58*	24.66*
Correct classification (%)		70.7	70.8	70.5	70.0

*/** 0.01/0.10 significant levels respectively, one-tailed tests.
Results are similar when ROA and EPS were used as the performance variable.
ACIND Dummy variable, "1" if all audit committee members are independent, "0" otherwise.
PN4 Dummy variable, "1" if a firm is categorized as PN4, "0" otherwise.
LISTING Dummy variable, "1" if the firm is listed on the Main Board, "0", if the firm is listed on the Second Board.