AUDIT DELAY AND THE TIMELINESS OF CORPORATE REPORTING: MALAYSIAN EVIDENCE

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ABSTRACT

This paper investigates the determinants of audit delay in Malaysia. The sample comprises 100 companies listed in Kuala Lumpur Stock Exchange during the period 1996-2000. Descriptive statistics indicates the audit delay is more 100 days for the five years under study with a minimum standard deviation of 36 days. Eight hypotheses, relating audit delay to company size, industry classification, sign of income, extraordinary item, audit opinion, auditor, year-end and risk are tested in this study. Result from t-test of differences, chi-square test of independent and ordinary leas square regression (OLS) largely support the alternate hypotheses put forward except for extraordinary items and company size. The primary findings are that audit delay is significantly longer for company that (1) non-financial industry, (2) receive other that unqualified audit opinions, (3) have other than 31 December as financial year end, (4) audited by non big-five, (5) incurred negative earnings and (6) have higher risk. It is hoped that this study, which is conducted in an economically and culturally different context from all existing studies, can contribute toward the current literature on audit delay.

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Introduction

Timeliness is an important qualitative attribute of financial statement, which requires the information to be made available to the users as rapidly as possible. The increase in the reporting lag reduces the information content and relevancy of the documents. The recognition that the length of audit may be the single most important determinant affecting the timing of earnings announcement has motivated recent research on audit delay Whittred (1980); Givoly and Palmon (1982) and Carslaw and Kaplan (1991).

Abdulla (1996) suggested that the shorter the time between the end of the accounting year and the publication date, the greater the benefits that can be derived from the financial statement. Delay in releasing financial statement is most likely to boost uncertainty associated with the decisions made based on the information contained in the financial statements. Thus, the decision might not be of superlative quality and therefore, delayed.

Both empirical and analytical evidence found that the timeliness of financial statement have some repercussion on firms value, (Beaver, 1968; Givoly and Palmon, 1982; Chamber and Penman, 1984; Kross and Schroeder, 1984). For instance, Givoly and Palmon (1982, p. 486) contend that the price reaction to the disclosure of early earnings announcements was significantly more pronounced than the reaction to late announcements. Beaver (1968) asserted that investors might postpone their purchases and sales of securities until the earnings report is released.

Likewise, the investors would probably search for alternative source of information. Delayed disclosure may encourage a subset of investors to acquire costly private pre-disclosure information and exploit their private information at the expense of 'less informed' investors, (Bamber, Bamber, and Schoderbek, 1993).

The greater concern about the timeliness of the public information disclosure has motivated several investigations of determinants of audit delay (Ashton, Willingham and Elliot, 1987; Ashton, Graul and Newton, 1989; Newton and Ashton,1989 and Carslaw and Kaplan, 1991). Thus, The purpose of the present study is to provide further evidence on the determinants of audit delay in Malaysia. This study extends the previous studies by focusing on Malaysian setting with a more recent data. The present study also considers the econometric problems when conducting the Ordinary Least Square Regression (OLS).

Previous Empirical Evidence

Several studies have been conducted to fine ground on understanding the determinants of audit report lag. Dyer and McHugh (1975) studied three corporate namely corporate size, year-end closing date and profitability as a major explanatory factor of the audit delay. The result reveals that only corporate size appeared to account for some of the variation in total lags. Contrary to Dyer and McHugh, Davies and Whittred found that the financial year-end has little influence on the total reporting lag. They also found that companies experiencing extreme changes in the (absolute) amount of extraordinary items take significantly longer time to release both their preliminary final and final annual accounts.

Davies and Whittred further suggested variables such as extraordinary item, changes in accounting technique, changes in auditors, audit firm size and audit opinion should be considered. Courtis (1976) investigated four corporate attributes that are corporate size, age of company, number of shareholders and the length of the annual report with time lag in corporate report preparation and publication. He found companies comprising the shortest audit delay quartile reported higher levels of income. Gillings (1977) disagree with Courtis where he concluded that audit delay was shorter for (a) companies with large auditors, (b)

companies with overseas ownership, and (c) large companies. Carslaw and Kaplan (1991) extended prior research by adding two explanatory variables (owner controlled companies versus manager controlled companies, and gearing), which have not been considered in prior research. The explanatory variables used in the study, among other things include company size, industry classification, sign of income and extraordinary item. They studied 1987 and 1988 annual reports of New Zealand listed companies. Two of the nine explanatory variables used were statistically significant which are corporate size (inversely related to audit delay) and existence of loss (directly related to audit delay).

Ashton, Willingham and Elliott (1987) investigated 14 corporate attributes and found that audit delay is significantly longer for companies that (1) receive qualified audit opinions, (2) are in the industrial as opposed to financial industry classification, (3) are not publicly traded, (4) have a fiscal year-end other than December, (5) have poorer internal controls, (6) employ less complex data-processing technology, and (7) have a greater relative amount of audit work performed after year-end.

Newton and Ashton (1989) examine the association between audit delay and audit technology (structure)[1]. They found that firms using structured audit approaches tend to have greater mean delay than firms using unstructured or intermediate approaches in each of the five years, although structure explains a relatively small portion of the variance in delay. The results also indicate that unstructured firms gained more clients from 1978 to 1982 than did structured firms. They also discover that on average, longer audit delay were associated with smaller clients, non-financial clients and existence of extraordinary items.

[1] Cushing and Loebbecke (1986, p.32) refer audit structure methodology as a systematic approach to auditing characterized by prescribed logical sequence of procedures, decisions and documentation steps and by comprehensive and integrated set of audit policies and tools to assist the auditors in completing the audit. The audit technology refers to the degree of audit structure of firm's audit approach.

William and Dirsmith (1988) found that clients of structured firms experience shorter (abnormal) earnings announcements lags (EAL[2]) than clients of unstructured audit firms when the earnings announcements are "surprising." They do not specifically look at audit report lag (ARL); instead, they use earnings announcements lags as a proxy for the timeliness with which the audit is completed. Bamber *et al.* (1993) concluded that on average, clients of structured audit firms experience longer total audit report lag (as in Newton and Ashton) but, they are able to adapt more quickly when unanticipated event occurs (as in Williams and Dirsmith). Lawrence and Glover (1998)'s findings show that the Big Six firms as a whole experience a significant decrease in audit delay following the mergers from about 34 days in 1986 to 31 days in 1991. However, surprisingly, when the firms are categorized as merged and non-merged firms, audit delay for non-merged firms shows a significant decrease from 35 days in 1986 to 30 days in 1991.

Kinney and McDaniel (1993) found that firms with declining earnings that report corrections of interim earnings which were initially overstated also tend to have significantly increase audit delay. Knechel and Payne (2001) Incremental audit effort, the use of less experienced audit staff and the presence of contentious tax issues led to longer audit report lag. On the other hand, audit report lag decreases by the potential synergistic relationship between management advisory services and audit services. By providing management advisory services, it will result in knowledge spillover that can reduce the audit delay.

Research Methodology

The present study examined determinants of audit delay for Malaysian public companies for the year 1996 to 2000. Because of the need to obtained information from annual reports, the study was restricted to public companies. For this research, 500 annual reports were scrutinized which involved 100 public

[2] EAL refers to number of days between the client's fiscal year end and the date the client publicly announce earnings.

companies. Audit delay is defined as the number of days between the date of financial statement and the date of the auditors report. A model of audit delay was developed based on previous model employed by Ashton (1989) and Carslaw and Kaplan (1991). The model is as follows:-

$$AUD\_DLY_{j,t} = \delta_0 + \delta_1 AST_{j,t} + \delta_2 IND_{j,t} + \delta_3 LOSS_{j,t} + \delta_4 EXTR_{j,t} + \delta_5 OPIN_{j,t} + \delta_6 AUD_{j,t} + \delta_7 YR_{j,t} + \delta_8 DEBT_{j,t} + \varepsilon_{j,t}$$

Table 1: Explanations of Explanatory Variables and the Expected Effect on Audit Delay

Regressor	Explanatory variable	Explanation	Expected relationship
AST	Total asset	Total asset of the company	Negative
IND	Industry	Industry classification: Financial companies are assigned a 1, otherwise a 0.	Negative
LOSS	Sign of income	Sign of current year income represented by a dummy variable companies suffering losses are assigned a 1, otherwise a 0.	Positive
EXTR	Extraordinary Item	Extraordinary item represented by dummy variable: companies reporting extraordinary item are assigned a 1, otherwise a 0.	Positive
OPIN	Audit opinion	Type of audit opinion, companies receiving other than standard or unqualified audit opinion are assigned a 1, while others a 0.	Positive
AUD	Auditor	Type of audit firm represented by a dummy variable: companies audited by the Big Five are assigned a 1, otherwise a 0.	Negative
YE	Year end	Month of fiscal year-end. Companies with December year-end are assigned a 1, otherwise a 0.	Positive
DEBT	Debt proportion	The proportion of debt to total asset.	Positive

Table 1 shows the explanation of the explanatory variables and the expected relationship. The hypothesized relationship between the independent variables and audit delay, as well as the underlying rationale is discussed below.

Audit delay (AUD_DLY). The number of days between the date of the financial statement and the date of the auditors report was used to measure the audit delay. This definition was commonly being used by previous studies (Newton and Ashton, 1989; Carslaw and Kaplan, 1991; Bamber *et al.,* 1993 and Lawrence and Glover, 1998).

Company size (SIZE). The total asset of the company is used to measure the company size. In this study, the total asset refers to the sum of current assets, fixed assets as well as investment and advances. Intangible assets are also included. The total assets have commonly been used in previous studies of audit delay to measure size (Ashton *et al*., 1989; Courtis, 1976; Davies and Whittred, 1980; Garsombke, 1981; Gilling, 1977; Newton and Ashton, 1989; Carslaw and Kaplan, 1991 and Abdulla, 1996). Most prior studies found a negative association between the audit delay and the company size. This possibly due to strong internal control and ability to pressure auditors to complete the audit work in timely manner, Carslaw and Kaplan (1991). Furthermore, larger companies have more resources to pay relatively higher audit fees and able to settle the fees soon after the companies' year-end. Thus, it is likely that the audit-reporting lag for larger companies is lesser than those of smaller ones. Dyer and McHugh (1975) argued that the management of larger companies have greater incentives to reduce both audit delay and reporting delay since they are closely monitored by investors, trade unions and regulatory agencies. This larger external pressure forces them to report on a timely fashion. Therefore, prior researchers have argued that to reduce uncertainty about performance that might reduce the share price, the larger firms tend to complete their audit work as soon as possible to release the annual reports Davies and Whittred, 1980; Ashton *et al*., 1989; Carslaw and Kaplan, 1991 and Abdulla, 1996).

Industry (IND). This study classifies the companies into financial and non-financial industry based on the Kuala Lumpur Stock Exchange (KLSE) classification. The prior research that control for client industry uses the

dichotomous classification; financial versus non-financial sector. In this study, the financial service companies were coded 1 and others were coded 0, which similar with Ashton *et. al* (1987) and Carslaw and Kaplan (1991). For a financial services company, the audit delay is expected to be shorter. This is because the financial services companies seem to have little or no inventory. The lower the proportion of inventory in relation to other types of assets, the lower will be the audit delay for financial services companies. This is because auditors can skip or spent less time to audit the most difficult and tedious part of audit where material errors is frequently discovered.

Sign of income (LOSS). Several researchers have used the sign of income as an explanatory variable for audit delay (Ashton *et al.,* 1987; Carslaw and Kaplan, 1991 and Bamber *et al.,* 1993). The companies reporting a loss for the period are expected to have a longer audit delay as compared to the ones reporting a profit. Thus, a positive association is expected between the audit delay and companies reporting a loss. In this study, the companies reporting a loss will be assigned 1 whereas the remaining will be assigned 0. Ashton *et al*., (1987) stated that the sign is an indication of good or bad news resulted from a year's activity. Carslaw and Kaplan (1991) claimed that company facing a loss would require the auditor to schedule their audit in order to start the audit later than usual. By doing so, there would be a delay in conveying the bad news to the public Conversely, companies having higher profitability may require the audit to be completed as quickly as possible in order to quickly release the good news. They also argued that auditors are more cautious during the audit process in response to a company loss if the auditor believes that the company's loss increases the likelihood of financial failure or management fraud.

Extraordinary item (EXTR). Several previous studies have included extraordinary items as a function of audit delay (Newton and Ashton,1989; Carslaw and Kaplan,1991 and Bamber *et al*., 1993). Carslaw and Kaplan (1991) found that extraordinary items were positively associated with audit delay. This is probably because the auditor may need additional time to identify whether a

particular transaction falls within the ambit of extraordinary item or a mere exceptional item since the distinction between them is somehow vague. The classification of items will depend on the particular circumstances – what is extraordinary item for one company does not necessarily be extraordinary for another company due to the differences in their ordinary activities. Subject to this, it poses significant uncertainty that may lead to extended negotiation between the auditor and the company. However in Malaysia, the MASB 3 (before this IAS 8 (Revised) restricts the definition of extraordinary items into gain or losses from natural disaster and expropriation of assets only. This study expects a different finding compared from previous study as a result of the new definition of extraordinary items.

Audit opinion (OPIN). The previous study suggested that the audit delay is an increasing function of the qualified audit opinion. The qualified opinion is viewed as bad news and slows down the audit process. Furthermore, there is a possibility of a conflict to arise between the auditor and the company, which may contribute, to the delay in the release of the annual reports. Whittred (1980) found that 'subject to' qualification took additional period to make their annual reports public. Carslaw and Kaplan (1991); Ashton *et al.* (1987) and Newton and Ashton (1989) also included audit opinion as a function of audit delay investigation. Companies not receiving unqualified audit opinions are expected to have a longer audit delay compared to the ones receiving an unqualified (clean) report. Thus, a standard or unqualified audit opinion will be assigned 0 and the rest are assigned 1.

Auditor (AUD). Auditors are classified into the Big Five and the non – Big Five. The Big Five refers to Arthur Andersen, KPMG Peat Marwick, Ernst & Young, Pricewaterhouse Coopers and Deloitte & Touche. The Big Five audit firms are assigned 1 and the others are assigned 0. It is expected that the audit delay for the Big Five firms will be lesser than the audit delay for the other firms. This is because they are large firms and thus it is assumed that they are able to audit

more efficiently and effectively and have greater flexibility in scheduling the audits so that it can be completed on time.

Company year-end (YE). Several studies used company year-end as an independent variable to explain audit delay (Carslaw and Kaplan, 1991; Ashton *et al.,* 1987 and Ashton *et al.,* 1989 and Newton and Ashton, 1989). It is expected that the audit delay will be longer for companies which year-end falls during the peak season. However, from previous studies, the peak season differs from one country to another. In Malaysia, most companies have a year-end of 31 December. Therefore, it is anticipated that a large number of audits with the same year-end date, i.e. 31 December could possibly have some scheduling problems and thus lead to audit delay. As such, companies with a year-end of 31 December are assigned 1 and 0 otherwise.

Debt proportion (DEBT). Debt proportion as a function of audit delay was first introduced by Carslaw and Kaplan (1991). They have argued that the relative proportion of debt to total assets may be indicative of the financial health of the company. A high proportion of debt to total assets will increase a company's likelihood of failure and may raise in the auditor's mind additional concerns that the financial statements may be less reliable than normal. This is because a high proportion of debt is normally associated with high risk. It may result from poor financial health that could lead to mismanagement and possibility of fraud. Furthermore, a high proportion of debt may lead to liquidity or going concern problem, which requires more tentative audit. In this study, the total liabilities refer to the sum of current liabilities and long-term liabilities. The debt proportion is computed by dividing the total liabilities by the total asset computed above.

Results and Implications

The result of running descriptive statistics, comparison of means and ordinary least square regression are reported below. The implications are also highlighted in this section.

Descriptive Statistic

Table2: Descriptive Statistics for Audit Delay for 1996 - 2000

	1996	1997	1998	1999	2000
N	102	111	103	113	113
Mean	105.32	110.91	113.84	103.46	99.62
Std. Dev.	35.16	39.15	45.41	40.49	36.34
Skewness	0.43	1.21	1.87	1.05	1.26
Minimum	29	51	33	27	29
Maximum	220	270	341	260	273

From Table 2, it can be seen that the mean for audit delay increases from 105.32 days in 1996 to 110.91 days in 1997 and reaches the maximum mean delay in 1998 where the mean delay is 113.84 days. After that, in 1999 the mean delay reduces by about ten days to 103.46 and it further reduces to 99.62 days in the year 2000. Furthermore, the standard deviation for 1998 is also the highest as compared to the rest of the years where it amount to 40.49. Previous study conducted by Carslaw and Kaplan (1991) in New Zealand resulted with a mean delay around 88 days and 96 days only. This shows that the problem of timeliness of the corporate annual report is more serious compared to New Zealand companies. The maximum mean of audit delay is in the year 1997, where Malaysia is suffering from economic turnmoil and most companies are experiencing losses. This phenomenan is similar with New Zealand experience in the year 1988 which recorded a high mean of audit delay, Carslaw and Kaplan (1991).

Inference about the Difference between Two Means: Independent Samples

Table 3: Table for mean differences for dichotomous variables: **IND, LOSS, EXTR, OPIN, AUD, YE, and IND.**

Regressor	Classification	N	Mean - number of days of audit delay	Standard deviation	t-value
IND	Non financial	469	108.61	39.90	3.15*
	Financial	73	93.03	35.21	
LOSS	-ve income	131	125.93	45.71	-6.698*
	+ve income	411	100.3	35.37	
EXTR	With extraordinary item	79	112.46	38.45	-1.444
	Without extraordinary item	463	105.49	39.78	
OPIN	Standard opinion	516	105.05	39.34	-3.867*
	Other than standard	26	135.46	34.36	
AUD	Non Big Five	201	113.55	37.63	3.181*
	Big Five	340	102.42	40.29	
YE	Other than Dec year-end	239	113.97	45.92	3.945*
	December year end	303	100.62	32.75	

*significant at 0.01.

Table 3 shows results from comparison of means between the dichotomous variables. From the table, it can be seen that on average, audit delay increases with the presence of a loss and qualified audit opinion, while reduces for financial companies, companies audited by Big Five and companies having a December year-end. As for IND, the mean audit delay for non-financial companies is higher by about 15 days than those for financial companies with a mean delay of only 93.03 days. Regarding LOSS, companies suffering from losses seem to have a longer mean audit delay than those gaining a positive net income. Companies receiving a qualified audit opinion also seem to take on average 20 days more than those receiving a clean audit report. The same goes to companies audited by Big Five and those with December year-end where the average mean delay is reducing. However, there is no significant different of audit delay between companies having extraordinary items and without extraordinary items.

Ordinary Least Square Regression (OLS) Results

Table 4: Ordinary Least Square Regression (OLS) of Audit Delay

Variables	*coefficient*	*t-value*
SIZE	0.036	0.881
IND	-0.11	-2.639***
LOSS	0.224	5.239***
EXTR	0.059	1.417
OPIN	0.083	1.971**
AUD	-0.093	-2.279**
YE	-0.153	-3.698***
DEBT	0.117	2.715***
Adjusted R^2	0.139	
F	15.58***	

*** significant at 0.01
** significant at 0.05

Table 4 above presents the multiple regression results for the entire sample. It can be seen that six out of the eight explanatory variables are significant. Those variables which are significant are IND, LOSS, OPIN, AUD, YE and DEBT. The coefficients for all these six variables are in the predicted direction except for YE. Audit delay was positively associated with LOSS, OPIN and DEBT whilst negatively associated with IND, AUD and YE. This means that audit delay increases with the presence of loss, a qualified audit opinion and a high proportion of debt to total asset, which indicates a high risk. On the other hand, a decrease in audit delay was observed with financial companies, companies audited by Big Five and companies with a December year-end. Concerning the two explanatory variables that did not reach the significant level, the coefficient of EXTR was in the predicted direction whilst SIZE (logT.ASSET) was not as expected. Adjusted R square for the overall sample is 0.139 which indicates that 13.9 per cent variation in audit delay is explained by the explanatory variables namely, IND, LOSS, OPIN, AUD, YE and DEBT. Although it is relatively low, it is an improvement over the levels reported by Newton and Ashton (1989) for Canadian companies for the year 1978 to 1982. Carslaw and Kaplan (1991) reported adjusted R square of 17.0 per cent and 14.3 per cent for 1987 and 1988

respectively. Additionally, a large value of F (15.58) indicates that most of the variations in the dependent variable is explained by the regression equation and that the model is useful.

Testing of Assumption

Table 5: Correlation Matrix

	logAST	IND	LOSS	EXTR	OPIN	AUD	YE	DEBT
LogAST	-							
IND	0.216	-						
LOSS	0.054	0.059	-					
EXTR	0.002	0.132	0.172	-				
OPIN	0.067	0.063	0.256	0.044	-			
AUD	0.004	0.046	0.030	0.148	0.042	-		
YE	0.050	0.154	0.059	0.181	0.078	0.171	-	
DEBT	0.030	0.185	0.268	0.051	0.211	0.016	0.005	-

From table 5, it can be seen that the level of correlations are relatively low with no correlation exceeding 0.30. Taking Carslaw and Kaplan (1991) as a benchmark, the statistical inferences are unlikely to be adversely affected by multicollinearity as the pairwise correlation among the independent variables are less than the problematic level. According to Carslaw and Kaplan (1991), multicollinearity could be a problem if the value of correlation is more than 0.30 while according to Ashton et al. (1987), a level of more than 0.50 could be problematic. Nevertheless, it seems that in this study, multicollinearity does not pose a problem in interpreting the regression results as the highest value of correlation is 0.268 represents the correlations between LOSS and DEBT and none of them exceeding 0.30.

Conclusions

The objective of this study is to identify the factors associated with the audit delay. Analysis of sample companies listed on Kuala Lumpur Stock Exchange shows that the men of audit delay is more than 100 days. This shows that the problem of timeliness of the corporate annual report is serious compared to other country such as New Zealand with means delay around 88 days and 96 days only. The result suggests that audit delay is significantly longer for company that non-financial industry, receive other that unqualified audit opinions, incurred losses and have higher risk. This research also found that companies with accounting year-end other than 31 December and being audited by small and medium size audit firms require longer period to audit their annual report.

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