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AUDIT REPORT LAG AND AUDIT GOING CONCERN QUALIFICATION IN MALAYSIA

Ooi Chee Keong (a)*, Lau Yeng Wai (b)
*Corresponding author

(a) Faculty of Accountancy and Management, Universiti Tunku Abdul Rahman, Malaysia.
Email: ckooi@utar.edu.my
(b) Faculty of Economy and Management, Universiti Putra Malaysia, Malaysia. Email: wai_ly@upm.edu.my

Abstract

Time taken to complete an audit affects the timely publication of corporate financial information. Audit report lag affects a company's reputation especially when audited financial statements in the annual report are the only reliable source of information available to investors and the public at large. This paper examines audit report lag of 869 companies listed on of Kuala Lumpur Stock Exchange in year 2016. The objective of this paper is to measure the extent of audit report lag among public listed companies in Malaysia to ascertain the impact of the selected variables on audit report lag, namely audit going concern qualification, sign of current year income, type of auditor, financial year end, and type of industry. Descriptive statistics, primarily mean and standard deviation of audit report lag are 98 days and 32 days respectively. Results of t-test, Pearson Correlation Matrix, and Ordinary Least Square Regression (OLS) support the hypotheses put forward. Results suggest that all explanatory variables have a significant relationship with audit report lag except for company's financial year end. Audit report lag is found to be significantly longer for companies receiving audit going concern qualification opinion, experiencing losses, audited by non-Big Four auditors and in the non-financial industry.

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Keywords: Audit report lag, audit going concern qualification, Bursa Malaysia, financial crisis, emerging economy.

1. Introduction

Financial crisis presents a challenging environment for the operations of firms. Financial crisis have been found to adversely affect firms' overall financial performance giving rise to difficulties in maintaining liquidity and sourcing of financing, which can lead to solvency issues and bankrupcies (Yap, Mohamed, & Chong, 2014). As auditors are responsible for ensuring financial reports reflect firms' financial health and ability to continue as a going concern, public scrutiny on auditors often becomes more intense in times of financial crisis with increased likelihood of corporate failure. Extant literature suggests that while auditors flag firms with going concern problems as reflected in the increased proportion of audit reports that contain issues pertaining to going concern in times of economic crisis (Mareque, Lopez, & Pedrosa, 2017), it is yet to be better understood whether auditors expend more time and effort in response to heigthened overall audit risks (Xu, Carson, Fargher, & Jiang, 2013).

Expending more audit time can work both ways. On one hand, more audit time and effort is intuitively believed to be associated with higher audit quality. According to International Auditing Guideline (IAG) 23, more audit time to perform audit work results in a greater extent of evidence-gathering activities to dispel or confirm going concern uncertainties, which in turn, leads to a higher likelihood of reaching a correct conclusion about firms' financial reports. On the other hand, more audit time and work is translated into longer audit report lag, which is the time from the date of a firm's financial year end to the date of the audit report. In other words, more time is involved in the finalization of accounts, which does not bode well for efforts to produce timely information as prescribed in the Conceptual Framework for Financial Reporting approved by the International Accounting Standards Board (IASB). Timeliness is essential for information to be useful. Extended audit time hinders timeliness of the information released through the financial reports. The length of audit and audit report lag have been a long-standing area of research interest in line with its controversial nature (Carslaw & Kaplan, 2014).

2. Problem Statement

Extant literature suggests that firms' financial condition and performance affect audit report lag (for a review of literature, see (Abernathy, Barnes, Stefaniak, & Weisbarth, 2017). Early studies have found that an adverse audit opinion is frequently delayed as auditors need to perform more audit tests, engage in prolonged negotiations with firms regarding going concern uncertainties and even delay issuance of audit reports to allow firms to resolve their financial difficulties (McKeown, Mutchler, & Hopwood, 2011; Chen & Church, 2013; Gibbins, Salterio, & Webb 2015). Audit reports are also frequently delayed for firms reporting losses as auditors are more cautious especially when the likelihood of financial failure and/or management fraud is high (Ashton, Graul, & Newton, 2015; Carslaw & Kaplan, 2014; Bamber, Bamber, & Schoderbek, 2013).

On the contrary, recent studies suggest that difficult times like the financial crisis with increased likelihood of corporate failures and heightened overall audit risk do not appear to affect audit time and effort.

Indeed, audit clients and clients' creditors demand for timely release of audited financial statements on which several debt covenants are based (Xu, Carson, Fargher, & Jiang, 2013). Further, market response to late filings of financial reports is negative (Li & Ramesh, 2009); late filings and late announcements are typically believed to contain bad news. In times of financial crisis where the need to boost market confidence is urgent, auditors are pressured to complete audit work in a timely manner. Besides pressure to complete audit work on time, greater audit time spent beyond the optimal level has also been found to undermine the quality of audit work resulting in a higher likelihood of a future restatement (Blankley, Hurtt, & MacGregor, 2015). As audit report lag increases, time pressure adversely affects audit judgment resulting in future revision of the audited financial statements.

In Malaysia, empirical evidence suggests a reduced demand for more audit work with the onset of the Malaysian Code of Corporate Governance in 1999, which subsequently became part of the country's stock exchange listing requirements in 2001 (Wahab, Zain, & James, 2011). As a result of the Asian financial crisis in 1997, the Malaysian Code of Corporate Governance was introduced and enacted to enhance firms' corporate governance mechanism, which in turn boosted public confidence. Empirical evidence suggests that enactment of the code of corporate governance has lowered auditors' assessments of inherent and control risks for Malaysian firms resulting in reduced audit workload in certifying financial statements (Wahad et al., 2011).

3. Research Questions

In summary, there are two competing arguments on whether auditor expend more time and effort to certify financial statements in times of financial crisis. On one hand, perceived heightened overall audit risk due to firms' financial difficulties and going concern uncertainties can motivate auditors to expend more time and effort resulting in a lengthy audit report lag. On the other hand, auditors are also pressured to complete audit work speedily for timely release of certified financial statements as creditors and overall market confidence is at stake. Further, firms' enhanced corporate governance mechanism as a result of the enactment of the Malaysian Code of Corporate Governance lowers auditors' assessments of inherent and control risk, which reduce the need for more audit time and work. Whether auditors expend more time and effort in certifying financial statements of firms with financial difficulties and going concern uncertainties during the 2007 financial crisis remains an empirical question. The research questions are stated as follows.

RQ1: Is there any association between audit report lag and firms receiving an audit going concern qualification.

RQ2: Is there any association between audit report lag and firms' net income or losses.

4. Purpose of The Study

This study contributes by examining the extent of audit report lag in the context of an emerging economy, i.e. Malaysia, during the financial crisis in 2007. This study offers insights into the extent auditors

invest time in evidence-gathering activities in a less transparent economy with lower level of public scrutiny compared with more developed countries. Results suggest that auditors expend more time to reach a judgment for firms with indications of financial distress.

5. Research Method

5.1. Sample and data collection

The sample for this study comprises companies listed on the Main Board and Second Board of Bursa Malaysia, which was formerly known as Kuala Lumpur Stock Exchange (KLSE), for the financial year 2007. 869 companies from sectors such as closed-end funds, construction, consumer products, exchange traded funds, finance, hotel, industrial products, IPC, mining, plantation, properties, REIT, technology, and trading/services are included in the sample.

5.2. Audit Report Lag Model

The following model is made reference to Abernathy et al. (2017) to test the hypotheses.

AUDIT REPORT LAG= $\beta_0 + \beta_1(OPIN) + \beta_2 (LOSS) + \beta_3(AUD) + \beta_4(YE) + \beta_5(IND) + \varepsilon_0$

where ε_0 = standard error.

Details of the variables in the model above are as follows:

1. LAG - Audit Report Lag

Audit report lag refers to the numbers of days from the company's financial year end to the audit report date (Carslaw & Kaplan, 2014; Bamber et al., 2013). For example, if a company's balance sheet date is 30 June 2018 and audit report date is 26 December 2018, audit report lag is 178 days.

2. OPIN – Type of audit opinion

Type of audit opinion refers to whether the company receives a qualified audit opinion. Audit going concern qualification is an adverse opinion. More audit work is required to support such an adverse opinion, which runs counter to company's preference for timely release of financial reports to the public. Type of audit opinion is coded as 1 for audit going concern qualification, and 0 otherwise.

Examples of audit going concern qualifications, which serve as a guide in determining type of audit opinion, are as follows (Ismail, 1998).

    a.   "The accounts have been prepared on a going concern basis which contemplates the realization of assets and liquidation of liabilities in the normal course of business. As indicated in Note 24 (iv) to the accounts, the company has entered into negotiations with its financiers to restructure the Group's banking facilities…. The continuation of the Group and the Company as a going concern

is dependent on the successful completion of these negotiations as well as on the Group and the Company attaining profitable operations.

In our opinion, subject to…"

b. "The accounts of the Company and of the Group have been prepared on the basis of accounting principles applicable to a going concern notwithstanding that the Company and the Group have sustained losses and encountered cash flow problems resulting in the Company and the Group not being able to meet their liabilities on the timely basis as and when they fall due. The company has appointed professional financial advisers to assist in and advise on a restructuring plan………

In our opinion, subject to…"

c. "The accounts of the Company and of the Group have been prepared on the going concern basis. The ability of the Company and the Group to continue as a going concern is necessarily dependent upon future profitable operations, additional financing sufficient to sustain operations and the successful implementation of its scheme of financial reconstructions.

Subject to the above reservation, in our opinion…"

3. LOSS – Sign of current year income

Sign of current year income refers to whether the company suffers a loss. Companies suffering a loss are coded as 1, or else 0. It is hypothesized that companies with losses require more comprehensive audit work, which increases audit report lag.

4. AUD – Type of auditor

Type of audit firm refers to whether a brand-name Big Four audit firm is hired to perform the audit work. Larger audit firms are expected to complete their audit work more effectively and efficiently as they are at an advantage in terms of expertise and resources. Hence, Big Four audit firms are expected to be associated with a lesser degree of audit delay compared with smaller audit firms. Companies audited by Big Four audit firms are coded as 1, otherwise 0. Big Four audit firms in Malaysia consists of PricewaterhouseCoopers, KPMG, Ernst & Young, and Deloitte.

5. YE – Financial Year End

Financial year end refers to the end of the company's 12-month reporting period. Companies with a year-end during the peak season, i.e. December 31, are expected to require a longer audit time as auditors often experience scheduling problems and shortage of work force. Companies with December 31 as year-end are coded as 1 while companies with year-end other than December 31 are coded 0.

6. IND – Type of industry

Type of industry refers to whether the company is involved in the financial industry. Finance, closed end funds, and exchange traded funds are considered under the financial industry. Companies under the financial

industry are expected to have shorter audit report lag as they have little or no inventory. Further, timely reporting is of essence in a highly regulated, financial industry. Companies under the financial industry are coded as 1 while those not under the financial industry are coded as 0.

A summary of the expected relationship between the variables discussed above and audit report lag are as follows.

Table 01. Expected relationships between variables and audit report lag

	Variables	**Expected relationship with audit report lag**
OPIN	Type of audit opinion	Positive
LOSS	Sign of current year income	Positive
AUD	Type of auditor	Negative
YE	Financial year end	Positive
IND	Type of industry	Negative

6. Findings

The results of the descriptive statistics, comparison of dichotomous means, Pearson Correlation Matrix, and Ordinary Least Square Regression are reported below. The implications are also discussed under this section.

6.1. Descriptive Statistics for Audit Report Lag

For a data set, the mean is the sum of the observations divided by the number of observations. The mean is often quoted along with the standard deviation where the mean describes the central location of the data, and the standard deviation describes the spread. From Table 2 the mean obtained from this set of data is 98.62 days and the standard deviation for this set of data is 32.23.

Maximum is the largest value in the set while minimum is the smallest value in the set. Here, it can be seen that the maximum value is 528 while the minimum value is 11. The company that has such a long audit report lag of 528 days experienced a fire outbreak which caused much of its accounting records and relevant documents of the company needed for the audit work was destroyed in the fire. The missing documents had prohibited auditors from performing well thus requiring a longer audit working time. This may be the reason for the extraordinary long audit report lag.

Skewness characterizes the degree of asymmetry of a distribution around its mean. Positive skewness indicates a distribution with an asymmetric tail extending toward more positive values. Negative skewness indicates a distribution with an asymmetric tail extending toward more negative values. The skewness of this set of data is 3.33.

Table 02. Descriptive Statistics for Audit Report Lag in 2007

	N	**Mean**	**Standard Deviation**	**Max**	**Min**	**Skew**
Audit Report Lag	869	98.62	32.23	528	11	3.33

6.2. Mean difference for dichotomous variables

Table 3 presents the results from comparison of means between the dichotomous variables. It can be seen that, the audit report lag increases with the audit going concern qualification and presence of net loss. On the other hand, the audit report lag decreases with companies that are audited by Big Four auditors and companies in the financial industry. Regarding the company's financial year end, there was no significant difference between companies with December 31year-end and other than December 31year-end. As seen in Table 4, companies with an audit going concern qualification seem to have a much longer mean audit report lag compared to companies that do not receive audit going concern qualification. The mean difference is about 32 days. As for LOSS, it can be seen that companies that experienced net losses have average of 19 days more than companies that have positive net income. For companies that were audited by Big Four auditors, their mean audit report lag is shorter by 14 days compared to companies that were not audited by Big Four auditors. In addition to that, companies in the financial industry have a shorter mean audit report lag by approximately 26 days as a comparison to companies in non-financial industry.

Table 03. Mean difference for the dichotomous variables

	Variables	N	Mean	Standard Deviation	t-value	Sig
OPIN	Going Concern	57	129.13	62.60	3.910	0.000
	Others	812	96.48	27.77		
LOSS	Net Loss	174	114.39	39.70	6.159	0.000
	Others	695	94.67	28.78		
AUD	Big Four auditors	565	93.47	28.63	-6.132	0.000
	Others	304	108.18	36.17		
YE	YE 31 December	488	99.67	29.45	1.068	0.285
	Others	381	97.27	35.46		
IND	Financial Industry	42	73.24	31.33	-5.313	0.000
	Others	827	99.91	31.75		

6.3. Pearson Correlation Matrix for Audit Report Lag

Pearson Correlation is generated to examine the correlation between the independent and dependent variables. A correlation matrix of all the values of *r* for the dependent variables was constructed. The results generated are shown below in table 4.

Table 04. Pearson Correlation Matrix for Audit Report Lag and independent variables

Variables	GC	LOSS	AUD	YE	IND	LAG
GC Sig (2-tailed)	1.000					
LOSS Sig (2-tailed)	0.311** 0.000	1.000				
AUD Sig (2-tailed)	-0.042 0.219	-.0.102** 0.003	1.000			
YE Sig (2-tailed)	-0.022 0.511	-0.002 0.963	0.006 0.869	1.000		
IND Sig (2-tailed)	-0.036 0.292	-0.060 0.079	0.097** 0.004	0.004 0.895	1.000	
LAG Sig (2-tailed)	0.252** 0.000	0.246** 0.000	-0.217** 0.000	0.037 0.275	-0.178** 0.000	1.000

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

Multicollinearity will be a problem when the correlation between independent variables is 0.60 and above. From the result generated, it can be seen that correlation between GC and LOSS, GC and LAG, LOSS and AUD, LOSS and LAG, AUD and IND, AUD and LAG, and IND and LAG are insignificant. However, all the said correlation has a very small Pearson product-moment coefficient as compared to 0.60 indicating that the collinearity of all the said variables is so small that we can ignore them. As a result, these variables are still taken into account and are considered relevant in the study. The Pearson product-moment coefficient of the correlation between GC and LOSS is higher than the coefficient of the correlation between every two of the other variables. The table shows a noteworthy collinearity ($p \leq 0.01$) between GC and LOSS (0.311), between GC and LAG (0.252), between LOSS and AUD (-0.102), between LOSS and LAG (0.246), between AUD and IND (0.097), between AUD and LAG (-0.217), and between IND and LAG (-0.178). Therefore, from the results generated in Table 4, the magnitude of the correlation between variables seems to indicate no severe multicollinearity problems.

6.4. Ordinary Least Square Regression (OLS) for Audit Report Lag

Table 5 shows the results from the Ordinary Least Square Regression (OLS). From the table, we can conclude that all the variables are significant except YE. All the significant coefficients are also in the predicted direction *(Refer to Table 1)*. Audit report lag was positively associated with OPIN and LOSS. On the other hand, audit report lag is negatively associated with AUD and IND. This indicates that the audit report lag increases with an audit going concern qualification and presence of loss while decreases in companies audited by Big Four auditors and companies in the financial industry.

Companies will have a longer audit report lag when they received an audit going concern qualification report from the auditor. With the rise of such condition, auditors normally will need additional time and effort to perform additional audit work to confirm such qualification or to avoid such qualification. This explains the larger audit report lag difference between company that receive audit going concern qualification or otherwise.

When company experiences losses as a sign of their current year income, auditors may need to perform additional audit work in order to reduce the significant doubt of the company to continue as a going concern. Companies with losses may defer the announcement of the loss and may be less cooperative in supplying information to the auditors. Thus, this leads to a longer audit report lag (Carslaw & Kaplan, 2014).

From this study, it was found that companies that are audited by the Big Four auditors will generally have a shorter audit report lag. This may be due to the fact that auditors from the Big Four companies are able to perform their audit work more effectively and efficiently. Besides that, these auditors have a reputation to maintain and will work carefully to avoid unnecessary problems, particularly the slow release of audited annual reports.

The results also showed that the audit report lag is not significant for companies with a 31 December financial year end. Contrary to that, the variable is still in the predicted direction. This might be the result

from the burden that auditors were required to handle since there are many companies with a 31 December financial year end in Malaysia.

As for companies in the financial industry, these companies will have a shorter audit report lag as financial companies normally have little or no inventory or fixed assets. This leads to the implementation of an easier and less time consuming audit procedure as compared to complex procedures that need to be carried out on other industries. For example, companies in the manufacturing industry that has large amount of inventories and assets will require additional audit work done to verify the complex transactions. Therefore, companies in the financial industry will have a shorter audit delay.

The R^2 and adjusted R^2 for the sample are 0.154 and 0.149 respectively which means that approximately 15% of the proportion of variation in audit report lag is explained by the independent variables which are OPIN, LOSS, AUD, YE and IND. The explanatory power of the model is comparable with other researches such as Carslaw and Kaplan (2014) whom reported adjusted R^2 of 14.3% reported 8.8% to 12.3%. The value of F which is 31.31 shows that most of the variations in the dependent variables are explained by the regression equation and the model is useful.

Table 05. Ordinary Least Square Regression (OLS) for Audit Report Lag

	Variables	**Expected relationship** *(Refer to Table 1)*	**β**	**t-value**	**t-sig**
OPIN	Type of audit opinion	Positive	0.191***	5.792	0.000
LOSS	Sign of current year income	Positive	0.160***	2.033	0.000
AUD	Type of auditor	Negative	-0.179***	-1.959	0.000
YE	Financial year end	Positive	0.043	0.392	0.168
IND	Type of industry	Negative	-0.144***	-4.569	0.000
	R² Adjusted R² F F-significance	0.154 0.149 31.31 0.000			

$*p < .10, **p<.05, *** p<.01$

6.5. Summary of findings

As seen from all the results above, it can be concluded that audit going concern qualification is among the variables that affect audit report lag the most significant compared to the other variables. After comparing with other independent variables, companies that received audit going concern qualification has the highest mean of about 129 days with the largest mean difference of 32 days between companies that received and did not receive audit going concern qualification. It can also be seen that from the entire tests, audit going concern qualification has a significant relationship with audit report lag and moves in the predicted direction.

As a comparison with prior studies, this study was consistent with some of them. Most prior study found significance in the same explanatory variables in this study. However, some may discovered a

different relationship between the variable with audit report lag. For audit going concern qualification, Jaggi & Tsui (1999) found that companies receiving going concern opinion increase the audit report lag while Bamber et al., (2013) found a negative relationship.

For sign of current year income, this finding was consistent with Carslaw and Kaplan (2014). They found that with the existence of loss, the audit report lag will be longer.

Leventis, Weetman, and Caramanis, (2015) has investigated on the effect that type of auditors will have on audit report lag. Consistent with this study, they found a negative relationship with audit report lag.

For the type of industry, on the other hand, Ashton, Willingham, and Elliot, (2013) found a negative relationship with audit report lag. Nevertheless, it was consistent with the study conducted by Bamber et al. (2013).

7. Conclusion

7.1. Implications of findings

This paper examines the extent auditors in Malaysia expend more time and effort to certify financial reports in times of financial crisis with heightened overall audit risks. More specifically, this study examines the effects of audit going concern qualification, sign of current year income, type of auditor, financial year end, and type of industry the company on audit report lag. Results of analyses on 869 companies listed on the Main Board and Second Board of Kuala Lumpur Stock Exchange suggest that two hypothesized relationships are supported. Audit report lag is found to be longer, which suggests that auditors expend more time to perform audit work for companies with indications of financial distress, i.e. companies receiving audit going concern qualification and experiencing losses. Audit report lag is also found to be longer for companies audited by non-Big Four auditors, companies with 31 December financial year end, and companies not under the financial industry.

7.2. Limitations and Suggestions for Future Research

Findings of this study can be generalized after taking into consideration certain limitations. This study includes data for a single year, which is the beginning of the global financial crisis in 2016. Future research can be conducted to include data for subsequent years from 2008 onwards to examine whether the trend in audit report lag improves over time in line with recovery from the global financial crisis. Future research can also consider examining the underlying causes for the audit delay in Malaysia in particular and in other developing countries to ascertain generalizability of the findings. Further research can also examine the effects of other variables such as subsidiary of multinational companies, company size, changes in the auditor and audit fees for a better understanding of audit report lag.

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