THE MODERATING ROLE OF KEY AUDIT MATTERS IN THE RELATIONSHIP BETWEEN AUDIT COMMITTEE CHARACTERISTICS AND AUDIT REPORT LAG

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Abstract

The audit committee roles are essential to corporate governance because they are accountable in many aspects of financial governance. In order to understand the relationship between audit committee meeting (ACM) frequency, audit committee size (ACZ), and audit report lag (ARL) in Jordan, this study looked at the moderating effect of key audit matters (KAMs). A correlational research strategy was employed in the study. The data gathered from the 144 Jordanian enterprises for the period of 2016 to 2020 were disclosed in their published annual financial reports. The results show that, in terms of audit committee characteristics, there is no association between ARL and ACZ. Moreover, there is a non-significant relationship found between ACM and ARL. Furthermore, the outcome shows that KAMs and ARL are not significantly associated. On the connection between ACZ and ARL, however, the interaction impact of KAMs shows no moderating effect. Furthermore, the results show that the relationship between ACM and ARL is unaffected by the use of KAMs as a moderating variable. Given their influence on investor decisions, the study hereby advises businesses to pay close attention to the date of the external auditor’s report.

Keywords: Audit Report Lag, Key Audit Matters, Audit Committee Size, Audit Committee Meeting, Jordan

1. INTRODUCTION

The delay in releasing financial statements is seen as a negative sign of the financial statements’ reliability and dependability by users of financial statements. The necessity of timely reporting of financial statements should be emphasized, given the penalties and regulatory fines involved with late submission of financial statements (Pawlewicz, 2018). Long delays in the audit and the opinion report supplied in the financial statements may negatively affect the company's strength and credibility and may cause investments to be redirected to other firms or marketplaces. The lag in the auditor’s report also
reflects one of the features of accounting data: the timely financial report and data disclosure and distribution to the users. As a result, audit report lag (ARL) reflects the financial disclosure and transparency (Abernathy et al., 2017).

Timely disclosure of financial information has an impact on the quality of accounting information. As per the Financial Accounting Standards Board (FASB), one of the primary qualitative criteria for the quality and usefulness of financial information is timeliness1. Additionally, market players’ demand for timely information in order to make investment decisions has resulted in initiatives to minimize audit reporting latency (Shin et al., 2017). Furthermore, the company’s image and strength are fully dependent on the openness of disclosure and the accuracy of the financial figures disclosed. The better the transparency of the disclosure, the bigger the demand for investment in the firm, since investors choose fewer risky investments and a high degree of confidence in the company to invest in (Wen et al., 2022).

In the Jordanian market, there has been a delay in the publication of financial statements by listed companies; since the regulation stipulates that financial disclosure must occur within 90 days of the fiscal year’s end (Amman Stock Exchange — ASE). Generally, investors must wait at least 30 days for the disclosure announcement, however, if they have to wait longer, their investment choices in the business will be limited. As a result, companies must adhere to the practice of timely financial report disclosure. One of the causes for emerging nations’ lack of access to established markets is the delay in submitting financial results. In the same vein, the New York Stock Exchange (NYSE) emphasized the need to have audit committees and issued Bulletin No. 165, which required corporations to report their audit committees and how they are structured (Zeff, 2021). In 1987, the Securities and Exchange Commission (SEC) requested that firms determine the number of audit committee meetings (ACMs) and clarify the audit committee’s roles and tasks (Gebrayel et al., 2018). The creation of audit committees was deemed one of the prerequisites for listing by the NYSE in the same year, and it should be followed (Namakavaran et al., 2021). The Sarbanes-Oxley Act of 2002, which defined the authority of audit committees, their role in following up on the audit, and their relationship with the external auditor, reaffirmed this requirement (Khemakhem et al., 2021). Following the same governance structure, Jordanian public listed companies are also required to form an audit committee to oversee the financial matters of the companies.

As a result of the foregoing, the current study recognizes the importance of audit committees as a tool of corporate governance for increasing confidence in financial reports, as well as their impact on increasing the level of transparency in disclosure, which considers disclosure timing to be an essential part of maximizing transparency, which is consistent with most previous literature (Chalu, 2021; Gontara & Khilif, 2021). Hegazy et al. (2022) state that the standard mandates that an auditor of a public corporation include material audit findings (key audit matters or KAMs) in the audit report. It is anticipated that the International Standard on Auditing (ISA) 701 will improve audit quality and transparency (Segal, 2019). It should also detail the main conclusions of the audit as well as the financial statement sections that contain the greatest percentage of management-selected discretionary items, making them the riskiest (ISA 701). By disclosing information asymmetries between investors and auditors and giving investors context regarding the company’s financial reporting, KAMs are anticipated to increase the trust and legitimacy of financial reporting, much like any other auditing and accounting standard change (Holm & Zaman, 2012; Rautiainen et al., 2021).

The KAMs (or “critical audit matters”, CAMs) reporting is a relatively new issue, and there is currently no empirical data on the impact of KAMs. Testing results indicate that the disclosures made by KAM appear to focus the user’s attention on the financial statement (Gimbar et al., 2016). Thus, the purpose of this study is to investigate how KAMs mediate the relationship between the most important audit committee characteristics (meeting frequency and size) and audit report delay. This study aims to investigate how improving the transparency of financial audit reports may affect the relationship between audit committee characteristics and the timeliness of the report.

The remainder of the article is organized as follows. Section 2 provides a review of the relevant literature on audit committee size (ACZ) and meetings, and hypotheses development. Section 3 analyses and discusses the research method. Section 4 presents the research results and their discussion. The final Section 5 presents the conclusions of the study and some recommendations for future research.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Theoretical background

2.1.1. Audit report lag

Audit report lag (ARL) has been defined in a number of earlier studies and publications as a postponement in the release of an auditor’s report (Rusmin & Evans, 2017). In order to publish and link financial data consumers like management and investors, this is the time frame between the end of the fiscal year and the signing of the auditor's report and disclosure in the annual report (Alqaraleh et al., 2020). DeFond and Zhang (2014) claim that when companies switched auditors around the end of the fiscal year, audit delays increased. Abernathy et al. (2018) further divided the report’s release delay into three categories: 1) the period of time between the end of the fiscal year and the first financial report being made available to the stock market is known as the preliminary lag; 2) the interval between the end of the fiscal year and the date stamp of the independent audit report constitutes the second lag; 3) the total lag is the amount of time that passes between the end of the fiscal year and the date that appears on the independent audit report. Additionally, the majority of the literature asserts that the issue of ARL is tied to the nature of economies, whether emerging or advanced, as well as the procedures, rules, and laws in those countries,
which are largely concerned with corporate governance standards (Ikisan et al., 2021; Nouraldeen et al., 2021; Thuneibat et al., 2022). ARL in previous studies reflect timeliness which is one of the quality elements of financial statements. Most of the previous research investigates how corporate governance mechanisms affect the ARL. Baaitwah et al., 2019; Baaitwah et al., 2015). However, with the recent development to enhance financial statement transparency independent audit reports should include KAM. And lack of research was conducted to investigate the role of KAM in the relationship between audit committee characteristics and the ARL.

2.1.4. Key audit matters

According to the International Auditing and Assurance Standards Board (IAASB) (2015, as cited in Eriksson & Thunell, 2023), KAMs are valuable information in audit reports that have been enhanced by standard setters and regulators in recent times. According to Svanstrøm et al., 2020), the disclosure of KAMs is thought to be the biggest risk factor for substantial misstatements disclosed to users. As a result of its increased communicative and informative value, this could result in an improvement in the audit report quality. As such, it will aid users in comprehending the functions and obligations of auditors (Sirois et al., 2018; Bédard et al., 2019).

Furthermore, KAM disclosures may affect the market in a variety of ways. Klevak et al., 2023) discovered, for instance, that businesses with more thorough KAM disclosures had lower market returns and higher stock return volatility. They therefore assert that consumers interpret the KAM disclosures as a sign of ambiguity. Goh et al. (2022) provide a further example in which they report finding weaker stock price synchronization and higher abnormal trading volume following the demand for an enlarged audit report.

2.1.5. Study theories

The relationships that exist between agents and principals are explained by the agency theory. In a specific business transaction, the agent acts on behalf of the principal and is always required to act in the principal’s best interests. Principles and agents can have opposing goals, and not every agent will act in the principal’s best interests. Enterprises may experience a range of issues and dissatisfaction due to the ensuing miscommunications and disputes (Uribe et al., 2020; Olssen & Peters, 2005).

Thus, corporate governance methods may be used to modify the agent’s operating standards, so restoring the principal’s interests. By designating the agent to represent the principal’s interests, the principal must overcome the agent’s ignorance of the assignment’s performance. Agents must be compensated for working in the best interests of the principal (Raelin & Bondy, 2013).

Additionally, when applied to corporate governance processes, the agency theory refers to a certain kind of agency relationship that exists between a company’s shareholders and management. As principles, shareholders pick executives to act and make decisions on their behalf. The goal is to advocate for the owners’ interests and to conduct business in their best interests. In today’s dynamic economic climate, agency theory has attracted substantial attention and is seen and analysed from a number of perspectives. Thus, the most effective corporate governance tools for overseeing a business’s management on behalf of investors are the establishment of an audit committee structure and KAMs (Velte & Issa, 2019).

On the other hand, stakeholder theory supports the study’s findings, since the audit committee is tasked by the business with the responsibility of quickly and transparently presenting annual reports. This conforms to stakeholder theory, which has been proven via prior research (Rusmin & Evans, 2017).
2.2. Hypotheses development

2.2.1. Impact of audit committee size on audit report lag

A larger audit committee improves the timeliness of audit reports, according to prior research that found a substantial negative association between audit report latency and ACZ (Raweh et al., 2019; Ahmad et al., 2023). Nevertheless, Wan-Hussin and Bamahros (2013) and Baatwah et al. (2015) found no correlation between the audit report’s delay and the audit committee’s size. Furthermore, it has been demonstrated by Salleh et al. (2017) and Rahmansyah et al. (2021) that the ARL is significantly impacted by the size of the Audit committee. Given the above conversation and the differences in viewpoints, the following theory is established:

H1: Audit committee size impacts the audit report lag.

2.2.2. Impact of audit committee meeting on audit report lag

The frequency of meetings of the Audit committee indicates its ability to promptly address shortcomings in internal control by taking several preventative and remedial measures (Khlif & Samaha, 2016; Al-Tarawneh et al., 2023). Furthermore, Rochmah Ika and Mohd Ghazali (2012) showed that holding ACMs more frequently could help shorten the time it takes to produce audit reports. Accordingly, it was found that holding ACMs more frequently improves the timeliness of reporting (Alqaraleh & Nour, 2020).

According to Aljaaidi et al. (2015), there is a reduction in audit report delays in Jordan when ACM occur frequently. Meanwhile, a number of studies (Sultana et al., 2015; Salleh et al., 2017) have shown no correlation between ACM and ARL. This finding leads to the development of the following theory:

H2: Audit committee meeting audit report lag.

2.2.3. KAMs as a moderating variable

Since there was a positive correlation between each KAM and ARL, Bédard et al. (2015) observed a 19% increase in the time required to release the auditor's report following the inclusion of KAMs in the audit report. Reid et al. (2016) found no evidence of a significant relationship between KAMs and audit report delay in their research of UK enterprises. To investigate the impact of KAMs on ARL, the following hypothesis was developed:

H3: Key audit matters moderate the relationship between audit committee size and audit report lag.

H4: Key audit matters moderate the relationship between audit committee meetings and audit report lag.

H5: There is a significant relationship between KAMs and audit report lag.

3. RESEARCH METHODOLOGY

Since the quantitative technique is more suited to empirically addressing the research problems than the qualitative approach is, this study employed the quantitative method, which entails data collecting and a series of analyses at different stages to answer the research questions.

To achieve this goal, information was collected from the recently released annual reports of 144 Jordanian companies listed on the ASE for the period 2016 to 2020. The data was analysed using the SPSS Statistics. The total of observations is 720 (e.g., 144 * 5).

This study primarily used secondary data on audit committee characteristics, audit committee chair characteristics, auditor characteristics, KAMs, and ARL that were manually collected from data of Jordanian companies listed on ASE, and from the Thomson ONE data stream database. Four variables will be quantified in the following manner:

- Audit report lag (ARL) is the dependent variable in this study, which is the number of days between the conclusion of the company’s fiscal year and the date of the audit report (Ghafran & Yasmin, 2018; Salleh et al., 2017).
- Audit committee size (ACZ) is evaluated in this study as the total number of audit committee directors (Salleh et al., 2017; Wan-Hussin & Bamahros, 2013; Alqaraleh & Nour, 2020).
- Audit committee meetings (ACM) are used to approximate the unmonitored audit committee's level of diligence. This variable is measured by the total number of ACMs that occur over the year. In the past, this figure was frequently used to assess audit committee performance (Krishnan & Visvanathan, 2008; Salleh et al., 2017; Alqaraleh & Nour, 2020).
- Key audit issues (KAMs): Given the limited research on this subject, the quantification of crucial audit concerns has emerged as a recent method. This study will utilize the independent auditor’s...
report to measure significant audit matters. It aims to note the quantity and nature of items evaluated in the KAMs section, impacting investors' confidence in the financial statements.

Additionally, a multiple regression equation is constructed to test the hypotheses using 3 models where Model 1 and Model 3 are the direct relationship between dependent and independent variables, while Model 2 is the moderating effect of KAMs. Three research models are presented below:

**Model 1**

\[ ARL_{it} = \beta_0 + \beta_1 ACZ_{it} + \beta_2 ACM_{it} + \epsilon_{it} \]  

\[ \text{(1)} \]

**Model 2**

\[ ARL_{it} = \beta_0 + \beta_1 (ACZ_{it} \times KAM_{it}) + \beta_2 (ACM_{it} \times KAM_{it}) + \epsilon_{it} \]  

\[ \text{(2)} \]

**Model 3**

\[ ARL_{it} = \beta_0 + \beta_1 KAM_{it} + \epsilon_{it} \]  

\[ \text{(3)} \]

where,
- \( ACM \) stands for audit committee meeting;
- \( ARL \) stands for audit report lag;
- \( ACZ \) for audit committee size;
- \( KAMs \) for key audit matters;
- \( \epsilon_{it} \) for the error term.

4. EMPIRICAL RESULTS AND DISCUSSION

4.1. Descriptive statistics

Table 1 displays the descriptive statistics results for each variable in the study. As shown, the average ARL is 66 days, with a range of nearly 30 days among the businesses under analysis, and a minimum of seven and maximum of 254 days. This means that, on average, the audit report is released in 66 days. The results suggest that Oman’s audit report lag (ARL) is comparable to that of the United Kingdom, which is 64 days (Ghafran & Yasmin, 2018). Furthermore, when compared to developing markets such as Malaysia, where the average ARL is 103 (Wan Hussin et al., 2018), shows that Jordan has a shorter ARL. It is believed that the main cause of this variance in ARL is that different countries have different reporting dates. As for audit committee size (ACZ), the range between zero to a maximum of six directors, and an average of three members. Although the organizations reported an average of five ACM annually, this figure varied greatly from zero to twenty meetings a year.

4.2. Univariate analysis

Table 2 illustrates the correlation matrix analysis (univariate analysis). According to this investigation, the ACZ and ACM are not significantly associated with the ARL. Finally, there is no correlation between KAMs and ARL. Additionally, univariate analysis demonstrates that the study’s model is not multicollinear, as the highest correlation between explanatory variables is 0.271, which is less than the -0.073 correlation.

4.3. Regression results

The model’s explanatory power (\( F = 1.158 \) and \( R^2 = 0.069 \)) indicates a limited ability to explain the variability in ARL. Consequently, the findings do not support \( H1 \), suggesting no association between ARL and ACZ. This aligns with previous studies by Ahmad-Zaluki and Wan-Hussin (2010) and Ilaboya and Christian (2014) that also demonstrated a weak relationship between ACZ and the quality of financial information disclosure.

Additionally, this study discovered that there is a non-significant connection between ACM and ARL at p-values > 0.10. \( H2 \) was not supported. This finding agrees with Salleh et al. (2017) and Raweh et al. (2019). Also, this study discovered that there is a significant connection between ACZ and ARL at p-values > 0.10. This finding agrees with Juwita et al. (2020) and Aldoseri et al. (2021). In addition, Table 3 demonstrates that KAMs have no significant association with ARL. \( H3 \) was not supported.

This shows that KAMs did not moderate the association between ACZ and ARL. Thus, this indicates that KAMs as a moderating variable have no influence on the link between ACM and ARL. This discovery is in direct conflict with \( H4 \) and \( H5 \).
5. CONCLUSION

This study aims to evaluate the moderating impact of KAMs on the association between the ACZ, frequency of meetings, and audit report lag of the audit committee in Jordan. Examining the causes of audit report lag is crucial, and this is especially true in societies where investors might obtain their only source of financial information from audited annual reports. This study used a sample of 144 publicly traded companies on the ASE between the years 2016 and 2020 and found that the relationship between the size of the audit committee and the delays in audit reports is not significant. Additionally, by shortening the ARL, the study shows that ACM had no influence on reporting. Furthermore, the findings show that the link between KAM and ACZ was unaffected by the interaction between the two. Moreover, the results show that the link between ACM and ARL is unaffected by the use of KAMs as a moderator.

Regulators, companies, and investors in Jordan may find the results helpful in assessing internal corporate governance practices like the audit committee. These results might also assist investors in making better-informed investing choices. Because the research is based on data from the Jordanian market, where some experts have identified notable disparities in corporate governance system structures, the findings should be interpreted cautiously, according to the report. Consequently, the generalizability of the findings may be limited by these two limits. Our research leads us to the conclusion that more investigation is needed to get over these limitations. Furthermore, future studies should look into the connection between the usage of external auditors and audit reporting delays.

Audit report timeliness is one potential implication of the study that it may shed light on how the effectiveness of an audit committee can affect the timely issuance of audit reports. An effective audit committee may streamline the auditing process and reduce delays in audit report issuance, which can be important for stakeholders who rely on timely financial information. Also, the study suggests that KAMs play no moderating role in this relationship. This implies that the disclosure of KAMs in the audit report may not affect the timing of the report’s issuance.

The study’s findings may highlight the importance of transparent disclosure regarding KAMs and their impact on the audit process. It could lead to discussions about how much detail and explanation should be provided in the audit report about KAMs and how this might impact audit report lag. Also, regulatory bodies may take an interest in the study’s findings. It could influence the development of regulations and guidelines related to audit report timeliness and the disclosure of KAMs. For example, it might prompt regulators to consider whether there should be stricter requirements for disclosing KAMs in certain circumstances.

REFERENCES


