

A REVIEW OF THE EMPIRICAL DETERMINANTS OF AUDIT DELAY

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Abstract

Timeliness in financial reporting is considered to be a significant characteristic of accounting information. Since audit delay has been found to be the single most important factor in determining the timing of financial reports releases, this concept paper discuss the determinants of “audit delay”, the number of calendar days from fiscal year-end to the audit report date. The first section sheds some light on the significance of studying the determinants of audit delay. Next, it reviews the literature on audit report delay (ARL) and its determinants.

Keywords: Audit Delay, Timeliness, Company

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1. Introduction

The usefulness of published corporate financial reports depends on their accuracy and timeliness. Timeliness is recognized as an important characteristic of accounting information by the accounting profession, the users of accounting information and the regulatory agencies (Zeghal, 1984). The concept of usefulness of published corporate financial reports has been adopted as an important objective by many regulatory bodies such as the Accounting Principles Board (1970), the Canadian Institute of Chartered Accountants (1972), the Institute of Chartered Accountants in England and Wales (1975), and the Financial Accounting Standards Board (1979) (Hossain and Taylor, 1998). Therefore, now than ever before timeliness of financial statements has become the focus of an increasing amount of attention by accounting researchers and regulatory bodies (Leventis et al., 2005).

The significance of a timely audit is due to the fact that publication of the financial reports is linked to the completion of auditing processes (Leventis et al., 2005). Put in another way, it is not possible to release annual financial statements unless they be subjected to external audit. Moreover, it is believed that, timely reporting contributes to the prompt and efficient performance of stock markets in their pricing and evaluation functions (Owusu-Ansah, 2000). Consequently, the delay in the publication of financial reports may lead to an increase in the degree of non-verification that accompany investment decisions and

also lead to the appearance of unofficial information that contributes in misleading the decisions makers

Carslaw and Kaplan (1991) have contend that decisions based on the information in financial statement may be affected by the timeliness of information release. Therefore, there is no value in accounting information if it is not available in time for making informed decisions. This means that the information may lose its relevance if there is undue delay in it being reported. This delay has been regarded as the most important determinant of the timeliness of the earnings announcement (Bamber et al., 1993, Chambers and Penman, 1984, Givoly and Palmon, 1982, Han and Wild, 1997, Kinney Jr and McDaniel, 1993, Sinclair and Young, 1991). More specifically, companies wait until at least the annual audit report date before announcing earnings. This demonstrates the vital role of timeliness of audit reports in determining the timing of information release. According to Abdulla (1996) the longer the period between year end and publication of annual report, the higher the chances that the information will be leaked to certain interested investors. In addition, undue delay in releasing financial statements increases uncertainty associated with investment decisions (Ashton et al., 1987b). Audit delay is generally defined as the length of time from a company's fiscal year end to the date of the auditor report.

2. Significance of the study

The significance of this study flows out from the negative impacts that accompany the delay in issuing the auditor's report from delay in issuing the financial reports, the matter that negatively reflects on the published accounting information of which timeliness is considered one of their important characteristics (Ashton, Willingham & Elliott 1987). Further, timeliness is one of the elements of information validity for purposes of taking decisions by investors and lenders and other parties related to the company. Timeliness may have negative repercussions on the public that deals with company's financial reports.

3. Literature review

Existing research on the audit report delay has been conducted in different countries, in different domains, and for different purposes including Australia (Dyer Iv and McHugh, 1975, Davies and Whittred, 1980, Whittred, 1980, Lai and Cheuk, 2005), New Zealand (Courtis, 1976, Gilling, 1977, Carslaw and Kaplan, 1991), Canada (Graul and Newton, 1989, Ashton et al., 1989b, Newton and Ashton, 1989), the US (Garsombke, 1981, Ashton et al., 1987b, Bamber et al., 1993, Schwartz and Soo, 1996, Knechel and Payne, 2001, Knechel and Sharma, 2008), Bangladesh (Ahmed, 2003, Imam et al., 2001, Karim et al., 2006), Spain (Bonsón-Ponte et al., 2008), Greece (Leventis and Weetman, 2004, Leventis et al., 2005, Owusu-Ansah and Leventis, 2006), Zimbabwe (Owusu-Ansah, 2000), Pakistan (Hossain and Taylor, 1998), France (Soltani, 2002). Moreover, the most common variables investigated in these studies are client size, industry, and year-end, reporting a loss, presence of an extraordinary item, client complexity, auditor size and type of audit opinion issued. While these studies on audit delay share many similarities, they also present peculiarities that differentiate them. Studies in the above countries show differences in respect of periods, methodology, variables introduced and conclusions obtained. Interestingly, none of previous studies on audit delay had queried audit practitioners what corporate attributes that they believe are the most likely the causes of audit delay.

4. Determinants of timeliness of audit reporting

4.1 Size of company

The size of company measured by total assets is the most popular factor of audit delay that has been used in previous studies (Ashton et al., 1989b, Courtis, 1976, Davies and Whittred, 1980, Gilling, 1977, Newton and Ashton, 1989, Carslaw and Kaplan, 1991, Abdulla, 1996). Most of these prior studies found a negative association between the audit delay and the company size. This is possibly due to the

ability of larger companies to pressure auditors to complete the audit work in a timely manner (Ahmad and Kamarudin). In addition, larger companies may have their audit reports completed earlier than smaller ones because larger companies may have stronger internal controls, which affect the audit work due to the tendency for the auditor being expected to rely more on internal controls and reduce the extent of substantive tests (Almosa and Alabbas).

4.2 Nature of company's activity

It is expected that non-financial firms are more likely to have audit delay compared to financial firms (Ashton et al., 1987b, Bamber et al., 1993, Ahmad and Kamarudin). To justify why the audit delay is expected to be shorter for financial institutions, these studies have argued that the financial services companies appear to have little or no inventory. Inventories are difficult to audit and represent an area where material errors frequently occur. Thus, the lower the proportion of inventory in association to other types of assets, the shorter the audit delay is expected to be (Carslaw and Kaplan, 1991).

4.3 Internal control system in the company

One of the main factors, which is likely to decide the total input required for an external audit is the quality of internal control systems (Givoly and Palmon, 1982). It has been argued that companies which have stronger internal controls, which in turn should reduce the propensity for financial statements errors to occur and enable auditor(s) to rely on controls more extensively and to perform less interim work, are likely to have shorter audit delay (Carslaw and Kaplan, 1991). Ashton et al. (1987b) stated that audit delay is significantly longer for companies that have poorer internal controls.

4.4 Company year-end

Several studies used the timing of company year-end as an independent variable to explain audit delay (Carslaw and Kaplan, 1991, Ashton et al., 1987b, Ashton et al., 1989b, Newton and Ashton, 1989, Ahmad and Kamarudin). A company that has a financial year-end similar to the others is expected to experience longer audit delay (Che-Ahmad and Abidin, 2009). This is due to the fact that a large number of audits with the same financial year-end date may cause scheduling problems for the auditor (Carslaw and Kaplan, 1991). Ashton, Graul & Newton (1989a) found that audits conducted during the "busy season" had shorter delays than those conducted during the other months.

4.5 Audit firm size

Another explanatory variable is the size of audit firm. Several studies have examined empirically the association between the attribute of the audit firm (size of audit firm or international link of the auditing firm) and audit report lag. Whereas Gilling (1977) found a significant positive relationship between the audit delay and the size of the auditing firms. Garsombke (1981), Carslaw and Kaplan (1991), Davies and Whittred (1980), Hossain and Taylor (1998) and Almosa and Alabbas(year) found that there is insignificant relationship between the audit firm size and audit report lag. Moreover, it is expected that larger audit firms may be able to complete audits on a timelier basis because they may have more resources and use more qualified audit staff.

4.6 Extraordinary items

Extraordinary items, by definition, reflect non-recurring events arising from something other than the company's normal operations (Ashton et al., 1989a). Several prior studies have investigated the association of extraordinary items with audit report lag (Ashton et al., 1989b, Newton and Ashton, 1989, Bamber et al., 1993). These extraordinary items are expected to require additional time to audit, discuss and negotiate with the management (Leventis et al., 2005).

4.7 Type of audit opinion

Several authors (Whittred, 1980, Carslaw and Kaplan, 1991, Ashton et al., 1987b, Newton and Ashton, 1989, Ahmad and Kamarudin, Leventis et al., 2005, Bonsón-Ponte et al., 2008) have introduced qualifications or reservations expressed by the auditor as one of the factors that may determine the delays observed in auditing. The qualified opinion is viewed as representing a negative view of the companies' financial affairs and thus slows down the audit process (Che-Ahmad and Abidin, 2009). Bamber, Bamber & Schoderbek (1993) argued that a qualified opinion is not likely to be issued until the auditor has spent considerable time and effort in performing additional audit procedures. Moreover, Leventis et al. (2005) have argued that "auditors are expected to extend tests when they find or suspect irregularities, and partly because auditors might wish to take more time to audit transactions as a defence against any potential future litigation".

4.8 Profitability

Several researchers have used profitability as an explanatory variable for audit delay (Ashton et al., 1987a, Carslaw and Kaplan, 1991, Bamber et al., 1993, Ahmad and Kamarudin, Almosa and Alabbas). They argued that companies reporting a profit for the period are expected to minimize audit delay compared

to the ones reporting a loss. Therefore, a negative association is expected between the audit delay and companies reporting a profit. The argument behind this is that companies with a profit are expected to attempt to invite the auditor to complete the audit engagement as quickly as possible to release their audited financial reports (Hossain and Taylor, 1998).

5. Conclusion

Delay in the publication of financial reports, especially, in emerging markets has numerous negative impacts on those who deal with these reports. This is mainly due to the limited availability of financial information beyond the financial statements in these markets. Therefore, a better understanding of factors affecting the timeliness of audit reports will immensely enhance the efficiency of audit work leading to informed decisions. Further, the availability of reliable and timely financial information for decision making reduces the information asymmetry prevailing between corporate entities and their stakeholders in emerging markets.

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