Audit Report Lag: A Study of the Bangladeshi Listed Companies

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Abstract

Financial statements are prepared to provide useful information in making business and economic decisions. This information is important for users, especially investors as they use the statements to assess financial condition and performance of the related companies. However, this information is only useful when it is up to date and can be retrieved by investors on timely basis. It is contended that, when the time taken to produce the audit report increased, the usefulness of the information disclosed in company annual reports would decline. The delay in the production of audited financial statements not only affects the usefulness of the information but also the relevancy and reliability of the documents. Despite the importance of timely release of financial information, little has been done to investigate the cause of audit report lag–that is, the main reason of financial reporting delay, especially in developing countries like Bangladesh. Thus, the main purpose of this study is to identify factors that affect the timeliness of audit reports of the Bangladeshi listed companies. Based on a sample of 87 listed companies, the results of the study indicate that the time taken to conclude the audit work is around 101 days. The shortest is 14 days, while the longest is 272 days. The multivariate results show that type of auditor, financial company, profitability and company size significantly reduced the time taken to prepare audit report. On the other hand, type of audit report and leverage significantly increase the time taken to conclude the audit work.

Keywords: Audit Delay, Audit Report Lag, Financial Reporting, Auditor

JEL Classification Code: M41 M42

Introduction

Financial statements are prepared to provide useful information in making business and economic decisions (Dogan et al. 2007). This information is important for the users, as they use the statements to assess the financial condition and performance of related companies. This is especially true in emerging capital markets as the audited financial statements in the annual reports are likely to be the only reliable source of information available to the market (Leventis et al., 2005). Due to limited availability of financial information beyond the financial statements, the investors significantly rely on the information of the audited financial statements. Hence, the timely release of these financial statements in emerging market is vital to ensure constant flow of capital. As asserted by Carslaw and Kaplan (1991), one important qualitative attribute of the financial statements is timeliness which requires the information to be available to the financial statement users as rapidly as possible. However, as required by laws and regulations, a company

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can only release financial statements only after being verified by the external auditor. Consequently, the speed of financial statements to be released to the public is significantly determined by the speed of audit work.

In Bangladesh, the listed companies are required by Dhaka Stock Exchange (DSE) and other regulatory bodies to publish their audited accounts within a specified period of time after the end of the fiscal year. In particular, the listed companies must ensure that they issue their annual audited accounts together with the auditor's and the director's reports to DSE for public release within a period not exceeding more than four months from the date of financial year end. The companies which fail to issue the audited financial statements within the time frame allowed can be delisted from DSE as well as slapped with a huge amount of fine. Inevitably, it will also result in loss of confidence by the investors.

Despite the importance of timely release of financial information, little has been done to investigate the cause of audit report lag, that is, the main reason of financial reporting delay. Prior studies of audit report lag or audit delay in Bangladesh, can be regarded as outdated (i.e. Che-Ahmad & Abiding, 2008- the study examines the determinants of audit delay in 1993-1995) or lack of generalisability, due sample size issue (i.e. Raja-Ahmad & Kamaruddin, 2003 – the study examines 100 companies over the period 1996-2000).

Thus this study aims to investigate into the issue, first by utilizing recent data (i.e. 2007) and then by examining the population of the listed companies. The main objective is to provide answer to the following research question – *what are the determinants of audit report lag of Bangladeshi listed companies?* The results of this study shall enhance our understandability of the issues as well as help the companies and the relevant authorities to formulate ways to speed up the release of the audited accounts.

The remainder of this paper is organized as follows. The next section provides a brief overview of the prior empirical studies of audit report lag and outlines the testable hypotheses. Section 3 outlines the methods employed and Section 4 presents the results and discussion. Finally, Section 5 concludes the study.

Prior studies and hypotheses development

Accuracy and timeliness are the two criteria indicating the usefulness of corporate reports (Hossain and Taylor, 1998). According to Abdulla (1996), the usefulness of the information disclosed in the annual reports will decrease or becomes less important if the time taken to complete the auditing process of financial statements increases. Previous studies on audit report lag include: Ashton et al. (1987) and Bamber et al. (1993) - USA; Carslaw and Kaplan (1991) - New Zealand; Abdulla (1996) – Bahrain; Hossain & Taylor (1998) – Pakistan; Jaggi and Tsui (1999) - Hong Kong; Owusu-Ansah (2000) – Zimbabwe; Imam et al. (2001) - Bangladesh; Raja Ahmad & Kamarudin (2003) and Che-Ahmad & Abidin (2008) - Malaysia, Leventis et al. (2005) and Owusu-Ansah & Leventis (2006) – Greece; Wah Lai & Cheuk (2005) – Australia.
Among the important determinants identified (and the relevant hypotheses) are as follows:

Type of auditor

It is contended that the bigger audit firms take less time in auditing financial statements compared to smaller audit firms (Raja Ahmad and Kamarudin, 2003; Ibrahim et al. 2004 and Owusu-Ansah and Leventis 2006). In Bangladesh, the big audit firms refer to the so-called 'Big Four'. Arguably, the Big Four represent the high quality auditors, part of that because they have good reputation to protect as well as vast resources. The auditors with brand name reputation tend to provide high quality services as a way to protect and maintain their reputation (Gilling, 1977).

Moreover, given their resources to the audit listed companies and long experience in the market, they are able to complete auditing in less time (Ashton et al. 1989). According to Chan et al. (1993) and Leventis et al. (2005), the Big Four take less time to conclude the audit because they are able to hire high quality staff. They are also able to employ a large number of employees to perform audit works and thus can afford to use sophisticated audit technologies, which will result in minimization of audit report lag. Based on the above discussion, the following hypothesis is proposed:

H1: *There is a negative association between Big Four auditors and audit report lag, ceteris paribus.*

Auditor change

Auditor change is referred to as the breakdown in auditor-client relationship. Following the change, a new auditor needs to be appointed. As the relationship is still new, it is important for auditor to spend more time to gain understanding of the client's business in order to assess the inherent risk. In addition, they also need to communicate with former auditors and company's manager in order to get information about the company transactions (Ettredge et al. 2005). Inevitably, this process, including the time taken to search for the new auditor, will add time to the audit work. Given that argument, the following hypothesis is proposed:

H_2: There is a positive association between auditor change and audit report lag, ceteris paribus.

Type of audit report

Auditors are required to form their opinion whether the financial statements prepared by the companies are true and fair or not. In general, the auditors will express qualified or unqualified opinion. It is expected that the companies, which received qualified audit opinion, will have longer audit delay as compared to the companies with unqualified audit opinions (e.g. of Ashton et al., 1989; Leventis et al., 2005). It is because the auditors will take more time in auditing financial statements if they identify differences between the company's balance sheet and the profit and loss account with the accounting records and returns (Owusu-Ansah and Leventis, 2006). In addition, negotiation will arise between the auditors and their clients. Audit delay will longer if the qualifications are more serious, as additional works are required to be performed in order to explain suspicious transaction in financial statements (Whittred, 1980). Moreover, when auditor issued qualified opinion in their reports, they need to spend more time as more procedures are needed to be taken to confirm the opinion. Based on the above discussion, the following hypothesis is proposed:

H3: There is a positive association between qualified opinion and audit report lag, ceteris paribus.

Financial companies

Financial companies, i.e. banks or companies, which operate businesses that involve in investment, are heavily regulated. These companies are required to maintain accounting records and prepare financial statements on daily basis. Due to the nature of the business, it is expected that the companies will have exceptional internal control systems. Due to these elements, it is expected that the financial companies will experience shorter audit time.

Moreover, the fact that there is little or no inventory held by financial services companies, the audit work becomes relatively easier and hence result in less time taken to complete the audit fieldwork. Based on the above discussion, the following hypothesis is proposed:

H_4: There is a negative association between financial companies and audit report lag, ceteris paribus.

Business risks

Client's financial condition is one of the factors that relates to business risks (Ettredge et al., 2005). Business risk will increase if the client's financial position is weak. According to Colbert et al. (1996), business risks (as an addition to audit risk), cause the auditor to be exposed to loss as a result of litigation, adverse publicity, or other events arising in connection with financial statements that he has examined. Profitability can be used as an indicator of potential business risk, that is, to assess whether companies are having good or bad financial condition (Ashton et al., 1987). According to Raja Ahmad & Kamarudin (2003), the companies having profit may require auditor to quickly perform audit work in minimum days, in order to quickly inform the public about their good condition. In addition, as the business risk (subsequently, the litigation risk) of the profit making companies is relatively low; the auditor is expected to perform less detailed audit work. Thus it is expected that companies with good financial results will experience shorter audit delay.

Meanwhile, prior studies indicate that companies with high proportion of leverage are more likely to fail, and cause auditor to face higher litigation risk (Owusu-Ansah, 2000). Due to high litigation risk, the auditor can be expected to perform relatively detailed audit work and hence, longer time will be taken to complete the audit work of highly leveraged companies.
Based on the above discussion, the following hypotheses are proposed:

H5: There is a negative association between profitability and audit report lag, ceteris paribus.

H6: There is a positive association between leverage and audit report lag, ceteris paribus.

Extraordinary items

An extraordinary item is one of the variables that are expected to give an impact when completing audit work (Carslaw and Kaplan, 1991; Bamber et al. 1993 and Raja Ahmad and Kamarudin, 2003 and Leventis et al. 2005). Extraordinary item can be defined as a non- recurring event that materially affects the financial results of the entity during the reporting period. Extraordinary items are not part of the company's normal operations. As a result, additional audit time will be needed to complete an audit work (Owusu-Ansah, 2000) According to Carslaw and Kaplan (1991), audit lag will increase when the company declares its extraordinary items in financial statement because extra works are needed to be done. Furthermore, one company may consider an item as an extraordinary one but another company may not consider the same. Consequently, the auditor may take extra times to discuss with the company in order to negotiate the situation. As a result, the company will experience longer report lag. Based on the above discussion, the following hypothesis is proposed:

H7: There is a positive association between extraordinary items and audit report lag, ceteris paribus.

Company size

Company size has a significant association with audit report lag in developed and developing countries (Hossain and Taylor, 1998). According to Carslaw and Kaplan (1991), internal control of big company is stronger as compared to small company. When internal control is effective, probability of errors or misstatements in financial statement is low. Due to strong internal control, the auditor will spend less time to perform substantive tests. Moreover, as asserted by Ashton et al. (1989), management of the big companies may have incentive to reduce report lag since they are closely monitored by investors, trade unions and regulatory agencies (Dyer and McHugh, 1975). As such, the following hypothesis is proposed:

H_8: There is a negative association between company's size and audit report lag, ceteris paribus.

Research Methods

To determine the factors that influence the time taken to conclude the audit work, eight independent variables were tested. They are types of auditor, auditor changes, types of audit report, industry classification, business risk (profitability and leverage), extraordinary items and company size.

Sample size and source of information

The present study utilized the companies listed under DSE during 2007 financial year-end. A number of 87 were selected to be included in the study. Four excluded companies were the newly listed companies. The other 18 were excluded due to unavailability of data at the time of data collection. Information on audit report date and auditor were hand-collected from the annual reports.

Model

To investigate the association between the audit report lag and the independent variables, the following OLS regression was estimated:

$$ARL = \beta0 + \beta1BIG4 + \beta2AC + \beta3AR + \beta4IND + \beta5ROE + \beta6LEV + \beta7EOT + \beta8Assets + \varepsilon$$

The dependent variable, i.e. audit report lag (ARL) is defined as the number of days from the end of the accounting year to the date of the audit report. Meanwhile, the independent variables included in the study are shown in Table 1:

Table 1: Description of independent variables

Variable	Description	Measurement	Expected sign	Source
BIG4	Type of auditor	Dummy variable, where '1' is for companies audited by the Big Four, '0' if otherwise	Negative	Annual report
AC	Auditor Change	Dummy variable, where '1' is for companies change its current auditor, '0' if otherwise	Positive	Annual report
AR	Type of Audit Report	Dummy variable, where '1' is for companies receiving qualified opinion, '0' if otherwise	Positive	Annual report
IND	Industry Classification	Dummy variable, where '1' is for financial companies, '0' if otherwise	Negative	Annual report
ROE	Profitability	Total of return of equity	Negative	Datastream
LEV	Leverage	Total leverage for the company (debts divide with assets)	Positive	Datastream
EOT	Extraordinary items	Natural log of total extraordinary items for companies	Positive	Datastream
Assets	Company size	Natural log of total assets of the company	Negative	Datastream

Results

The time taken to complete the audit of the listed companies in Bangladesh is within the range of 14 days to 272 days, with the average of 101 days (median=109 days). Thus, this indicates that the Bangladeshi companies generally do not have difficulty to meet 120 days deadline.

Although comparable to the previous Bangladesh study (i.e. Ahmad, 2009), the Bangladeshi audit report lag however is far longer than Australia (see Wah Lai and Cheuk, 2005 - 73 days), Canadian (see Ashton et al. 1989 - 55 days), New Zealand (Carslaw and Kaplan, 1991 - 88 days), and Zimbabwe (Owusu-Ansah, 2000 – 62 days). This difference suggests that the Bangladeshi auditors normally take a longer time than the other auditors from other countries to complete the audit. The observed delay is probably influenced by the fact that the companies in Bangladesh need to comply with listing requirement by DSE, which allow the companies to publish their annual audited reports within 120 days following the end of the financial year where the time given is longer compared with that in some other countries which is not more than 90 days. However, some countries took more time to issue audit report than that in Bangladesh. For example, Greece auditors took around 113 days to conclude the audit work (see Owunsu-Ansah and Leventis, 2006 - earlier Greece study by Leventis et al., 2005 report a total lag of 98 days). Studies in Malaysia (Iman et al. 2001), Pakistan (Hossain and Taylor, 1998) and Hong Kong (Jaggi and Tsui, 1999) indicate total lag of 150 days, 171 days and 106 days respectively.

Big Four audited more than 61% of the listed companies, while only 5% of the companies change their auditor and less than 4% received qualified audit report. Overall, slightly more than 4% of the sample is represented by the financial companies.

Multivariate results

The regression results on the total sample for the year 2007 are shown in Table 2:

Table 2: Results of regression analysis

Variable	Coef.	t-value
Big4	-0.034	-4.746*
AC	0.020	1.288
AR	0.067	3.724*
IND	-0.046	-2.626*
ROE	-0.001	-4.443*
LEV	0.092	4.586*
LgEOT	-0.001	-1.164
LgAssets	-0.033	-4.926*
Constant	2.186	67.868*
Adj-R^2	0.185	
F-stat	25.721	
F-sig.	0.000	

**Significant at $p \leq 0.01$*

The model reports an adjusted R^2 of 18.5%, which is comparable to the other previous studies. From the results, it can be concluded that the audit report lag is negatively related to type of auditor (Big4), financial company (IND), profitability (ROE) and size (Assets). The results also indicate that the audit report lag is positively related to leverage (LEV) and qualified opinion (AR).

Type of auditor, which is classified as Big Four, has a significant negative relationship with audit report lag. The results of this study is consistent with Leventis et al. (2005) which state that the auditor which is not Big Four spends longer time on auditing the listed companies. The multivariate results also indicate that the auditor of company with qualified audit opinion, will experience longer time to complete the audit of financial statement. The result for this study is consistent with the arguments by Ashton et al. (1989), Raja Ahmad and Kamarudin (2003), Leventis et al. (2005) and Owusu-Antah and Leventis (2006). As discussed earlier, the auditor might need to spend more time and effort to audit the financial statements as well as to confirm such qualification. According to Whittred (1980), qualified audit opinion is expected to lengthen audit report lag since such opinions will not be issued unless auditors have spent considerable time and effort to pursue extra audit procedures or evidence.

As expected, the companies in financial industry have significant negative relationship with audit report lag. The result for this study is also consistent with the arguments by Ashton et al. (1987), Bamber et al. (1993) and Raja Ahmad and Kamararudin (2003) where they contend that the companies which are involved in financial industry mostly have small inventory and fixed assets. Because of that, auditor work becomes easier because its assets are not difficult to be audited in comparison with the assets of non-financial company.

The results of profitability (ROE) and leverage (LEV) are consistent with prediction, thus provide support to the contention that business risk can significantly affect the time taken by auditor to sign off the audit report. Jaggi and Tsui (1999) come out with similar result as they found that the company which associates with higher risk will force auditor to consume more time to finalize the audit of financial statements.

The present study also indicates that the company size can negatively affect the audit report lag. The result of this study is consistent with the arguments made by Dyer and McHugh (1975), Carslaw and Kaplan (1991) and Owusu-Ansah (2000). According to the studies, stronger control systems are more likely to be found in big company, which then will result in less time taken to audit the financial statements.

Summary and conclusions

The main objective of this study is to investigate the determinant factors of audit report lag in Bangladesh. A sample of 87 listed companies was taken from the population for the year 2007. On an average, the time taken to conclude the audit work is around 101 days. The shortest is 14 days, while the longest is 272 days. The multivariate results indicate that audit report lag is negatively related to type of auditor (Big4), financial company (IND), profitability (ROE) and size (Assets). The results also indicate that audit report lag is positively related to leverage (LEV) and qualified opinion (AR).

The study is not without limitations and thus, the results need to be interpreted with care. First, the inclusion of time series data might improve the prediction power of the model. Second, the role of Board of Directors and its sub-committee (e.g. audit committee) are not discussed and included in the study. Given the important role of the board with regard to the financial reporting process, the inclusion of some of the board characteristics might offer us more insight.

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