

THE EFFECT OF AUDIT QUALITY ON AUDIT REPORT LAG OF INDUSTRIAL GOODS COMPANIES IN NIGERIA

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Abstract

This study examined the effect of audit quality on audit report lag of industrial goods companies in Nigeria. The study specifically examined the effect of Audit quality on audit report lag of manufacturing companies in Nigeria and the effect of Auditor's independence on audit report lag of manufacturing companies in Nigeria. The study is anchored on agency theory. The ex-post facto was adopted as the research design. The sample comprised of fourteen (14) consumer goods firms quoted on the Nigerian Stock Exchange (NSE) as at 31st December 2018. The study used secondary data obtained from annual reports and accounts. The data were analysed using multiple regression technique. The results showed that Audit quality has a positive and significant effect on audit report lag while Auditor's independence does not significantly affect audit report lag of industrial goods companies in Nigeria. It was recommended that firms should engage the quality audit firms with requisite experience in their sector and have the required resources- human and material to avoid delays in meeting the regulatory guideline for audit report timeliness and that audit firm are given all they require to carry out their audit without undue interference and limitations.

Keywords: Audit Report Lag, Audit quality, Auditors Independence, Agency Theory.

Introduction

The multiple cases of institutional failure across the globe in recent times have brought the attention of stakeholders to the makeup of corporate governance. The consequences of ineffective governance systems have severally led to corporate failure which not only affects the shareholders but also, the employees, suppliers, consumers and nations as a whole. Wahid, (2012) highlighted the unfortunate consequence that resulted from the corporate scandals that stormed the United States which led to the collapse of Enron, WorldCom, Dot-Com Bubble, Tyco and Xerox together with the subsequent liquidation of HIH insurance in Australia in the year 2001 and Parmalatin Italy which is known as the biggest bankruptcy in Europe with estimated loss totalling \$20 billion and Oceanic Bank in Nigeria in 2009 among others.

The collapse of these corporations leaves a question on the credibility and quality of audit reports produced by professional auditors who are expected to identify possible threats to the going concern of their clients. A typical example as highlighted by Adekunle and Asaolu (2013) is the case of WorldCom and Enron and the arraignment of their professional auditor's M/S Arthur Andersen as architects of the biggest audit fraud across the globe and the subsequent winding up of the audit firm as one of the then "Big 5" audit firm cast doubts in the auditing and accounting profession and the financial reports they produce.

The sudden collapse of these high profile corporate organisations and unending scandals in the corporate world have attracted so much attention leading to intensified debate on improved quality of audit as a means of reducing audit delay. The importance of audit timeliness to investors and other stakeholders while maintaining audit quality cannot be overemphasized as the effectiveness of audit function in avoiding future corporate scandals has become imperative. In a situation where disclosure of auditor's opinion on the true and fair view of financial information comes late, it defeats the purpose of information asymmetry and increases the uncertainty stakeholders face in making investment decisions.

Marziana (2012) as cited in Ilaboya and Iyafekhe, (2014) posited that financial reporting should be seen as a part of the process of accountability whereby the shareholders are informed of significantly updated information based on the economic event as occurred in the last financial year as promptly as possible. However, the length of time taken by the auditors to execute the audit may likely have an effect on the timeliness with which audited financial statements are released to the users (Almosa & Alabbas, 2008).

The requirement, that annual financial statements and accounts be subjected to external audit, can conflict with the requirement of timely reporting. This is due to the nature of auditing as a time consuming activity, the release of the earnings announcement and the financial statements will be delayed. According to Boyne and Law (1991) the annual report is a vehicle for discharging accountability and also the most comprehensive report at the disposal of the public and is therefore the main instrument of disclosure.

Bamber, Dchederbek and Bamber (1993) concluded that audit delays are increasing function of extent of audit work; decreasing function of incentives to provide a timely report, and increasing function of the extent to which an auditor employs a structured audit approach.

Audit delay is found to be a decreasing function of client ownership concentration or company control (Bamber *et al.* 1993). This has become a worrisome situation in the minds of investors and stakeholders who needed audit report for decision purposes. The delay in the audit report can make investors lose confidence in the report presented and compound the agency problem. Meanwhile, various forms of “bad news” have been found to be associated with longer audit report such as Companies reporting net losses (Bamber *et al.* 1993). Companies in financial distress or similar financial condition companies receiving modified and qualified opinions in the auditors’ reports have comparatively longer delay and weak corporate governance structures (Soltani 2002). It is also the case that longer audit report lag will increase the chances of leaking information to outside parties before time.

Audit report lag is simply the number of days between the accounting year end of a company and the audit report date. The information contained in the audit report of companies are significant for investor decision making and therefore should not just be sufficiently accurate but also available when needed to enable users make informed decisions.

Dibia, and Onwuchekwa (2013) rightly noted that inordinate audit lag jeopardises the quality of financial reporting by not providing timely information to investors and prospective investors. Also, whenever, there is a delay by the auditor in forming an opinion on the true and fair view of financial information prepared by the management, there is an increases the information asymmetry and the uncertainty in investment decisions (Mohamad-Nor, Shafie and Wan-Hussin, 2010). As a result, the confidence of the investors in the capital market may be adversely affected as previous experience has disclosed that delays in audit significantly affects the investors’ chance of being defrauded and informed decisions maybe difficult to reach.

The call for high quality and timely financial information has become imperative across the globe due to the increasing affiliation of business organizations and sale of shares in the capital market. Accordingly, the business organizations are being obliged to satisfy the information demands of investors and prospective investors to provide them with timely information in the annual financial reports. Recognizing the importance of timely release of financial information, regulatory agencies (such as the Securities and Exchange Commission, Corporate Affairs commission, Banks and Other Financial Institutions Act, Insurance Act) in Nigeria have set statutory maximum time limits within which listed

companies are required to issue audited financial statements to stakeholders and also file such report with relevant regulatory bodies. For instance the Corporate Affairs Commission (CAC) and Securities Exchange Commission require companies registered in Nigeria, to file their annual reports within 90 days of their accounting year-end, similarly such requirement is also applicable for banks by the Central Bank of Nigeria.

From the foregoing, this study examines how audit quality affects audit report lag of industrial goods companies in Nigeria. The study formulates the following hypothesis in the null form as follows:

H₀: Audit quality has no significant effect on audit report lag of manufacturing companies in Nigeria

H₀: Auditor's independence does not significantly affect audit report lag of manufacturing companies in Nigeria.

Review of Related Literature

Conceptual Framework

1. Audit Report Lag

Audit report lag has been described as the number of days from the accounting year end of a company and the independent audit report date (Durang, 2019). Thus, Audit report lag refers to the duration of the completion of an audit of a company's financial statements (Wiyantoro & Usman, 2018). It is a very essential indicator as companies, regulators and investors rely significantly on it to make their decisions. Therefore, delay in the audit report can make investors to lose confidence in the report presented and compound the agency problem. Wermert, Dodd, and Doucet, (2000), opine that the two events result to Audit Delays include the length of time taken by the organization prepare a draft un-audited financial statements ready for the external audit and the actual time it takes the external auditors to carry out an independent audit and investigation of the draft un-audited financial statements before forming and issuing their opinion in the form of an audited report. Habib and Bhuiyan (2011) divided audit report lag into three parts as follows; Preliminary lag, which is the time interval between the date of the end of the financial year to the date of receipt of the preliminary financial report by the capital market; Auditor's signature lag, refers to the time interval between the date of the end of the financial year to the date indicated in the independent auditor's report, and lastly Total lag, is the time interval

between the date of the end of the financial year to the date of receipt of the financial statements of the publication by the capital market.

Studies on audit lag can be traced back to couple of decades and the most common variables investigated are client size, the Big4, firm switch, Age, year end, profit after tax, audit fee and industry.

2. The Big4 and Audit Report Lag

The type of Audit firm employed by companies has been used by some researchers as an indicator for audit quality and an explanatory variable for audit report lag. The basis of this approach is the belief that the big four audit firms (KPMG, EY & Young, PWC, Akintola Williams and Deloitte) have better access to advance technologies and specialist staff when compared to non-big 4 audit firms. Such possible differences in audit procedures and technologies can lead to differences in audit report lags between the two groups of audit firms (Schwartz and Soo 1996).

3. Board Size and Audit Report Lag

Corporate boards are responsible for monitoring the quality of information contained in financial statements that are communicated to the public. One of the disadvantages associated with a large board is communication/coordination problem which makes large board as less efficient monitoring of prompt reporting of financial statements than small board (Dimitropoulos and Asteriou, 2010). There tends to be lesser participation and organization when the board size is large and reduces the ease and flexibility of reaching an agreement about audit process and procedures.

Theoretical Framework

1. Agency Theory

The study is anchored on the “agency theory”. It is widely opined that the Agency theory was developed and utilized by Jensen and Meckling (1976) to analyse the relationship between the owners of the organization and the managers within the nexus of contract. They defined the agency relationship as a contract under which one or more persons (the principal(s)) engages another person (the agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent. The agency theory arises when management and ownership of a company are separated (Graaf,

2011). The agency problem exists because managers (agents) have different goals and motives compared to the shareholder (principal) (Graaf, 2011). Shareholders on one hand, are focused on creating profit and value for the company, to maximize the return on their investment while managers on the other hand, are more interested in creating value and wealth for themselves. Managers will always try to maximize their utility, but this utility does not have to be the same as the utility wanted by the shareholders. In most cases, the agent will not always act in the best interests of the principal. The agents could also hide information for selfish purpose by non-disclosure of important facts about the organization (Barako, Hancock, & Izan, 2006). Owners face moral dilemmas because most times they cannot ascertain or evaluate the decision made by their agents (Barako, 2007).

Agency theory is therefore concerned with resolving these problems that occur in agency relationships (Jensen & Meckling, 1976). Jensen and Meckling (1976) acknowledge that agency problem is common to all organizations (private organisations, public organisations, and governmental bodies such as the federal, state and local government) and it exists in all corporative efforts at each level of management in firms. Jensen and Meckling (1976) focused exclusively on the positive aspects of the agency relationship as it applies to corporations. The problems that result from conflict within agency relationship involves conflicts of goal and the problem of risk sharing in case of diverse risk preference between the two parties involved in an agency relationship. According to Rachagan and Satkunasingam, (2009), three conflicts which arise from these problem is found between the company's owners and its managers, the majority and minority interest holders as well as the company and the other stakeholders who have interest in the company. Consequently, the cost of minimisation of the conflict of interest between the two parties and the cost of risk sharing in case of divergent risk preference of parties (Eisenhardt, 1989).

2. Empirical Review

Modugu, Erahbhe and Ikhatua (2012) examine the relationship between audit delay and company characteristics in Nigeria. A sample of 20 quoted companies was selected for a period of 2009 to 2011. Ordinary Least Square technique was adopted in the analysis. The result show that multi-nationality connections of companies, company size and audit fees paid to auditors are the major determinants of audit delay in Nigeria. The study also reveals that audit report lag for each of the companies takes a minimum of 30 days and a maximum of 276

days for Nigerian companies to publish their annual reports. Nigeria listed companies take approximately two months on the average beyond their balance sheet date before they are finally ready for the presentation of the audited accounts to the shareholders at the annual general meetings.

Fagbemi and Uadiale, (2011) studied a sample of forty-five audited financial statements of quoted companies. The data collected were analysed using descriptive and inferential statistics. Findings show that the average number of days for which financial reports are ready after the year end is one hundred and forty-one days. The earliest time for which audit report is made ready after year end is thirty-one days afterwards. The result indicates a relationship between corporate reporting timeliness and company affiliation with a foreign entity. However, the results found no correlation between timeliness of financial statements, business complexity and business leverage.

Ilaboya and Iyafekhe (2014) examined the effect of board size, board independence, audit firm type, audit committee size, audit committee independence and firm size on audit report lag. The sample comprised of forty (40) manufacturing firms listed on the Nigerian Stock Exchange. The study relied on secondary data obtained from financial statements and accounts for the financial years 2007 to 2011. The data was analyzed using Ordinary Least Squares (OLS). The results showed that board size, audit firm type, firm size had a significant effect; while, board independence and audit committee size had no significant effect on audit report lag. Board independence, firm size and board size were negative.

Azubike and Aggreh (2014) examined the effect of company size, profitability, complexity and audit firm type on audit report timeliness. The study utilised the cross-sectional research design. The study relied on secondary data; obtained from annual reports and accounts of the sampled companies. The duration of the study was from 2010 to 2012. The study utilised Ordinary Least Squares for data analysis. The results of the study showed that board size and board independence had a significant positive effect on audit report lag; however, audit firm type had a non-significant negative effect on audit report lag.

Iyoha (2012) examines the impact of company attributes on the timeliness of financial reports in Nigeria a sample of 61 companies' annual reports for ten (10) years were selected. The data were analyzed and results estimated using Ordinary Least Square (OLS) Regression. The findings reveal that the age of

company is the major company attribute that influences the overall quality of timeliness of financial reports. The study also observed a significant difference in the timeliness of financial reporting among industrial sectors. For instance the banking sector was found to be timelier in financial reporting than other sectors.

Ahmed and Che-Ahmad (2016) studied the effects of board size, board committees characteristics and audit quality on audit report lags using fourteen (14) banks listed on the Nigerian Stock Exchange. The study relied on secondary data; obtained from annual reports and accounts from 2008-2012. The study employed Ordinary Least Squares (OLS) to validate the hypotheses. The results showed that audit quality has a significant impact on ARL. Other variables, such as, board size, board meetings, total assets, and board gender have a significant positive association with ARL. However, the study found no significant relationship between audit committee size, risk management committee size and board expertise on ARL.

Oladipupo, (2011) investigated the extent of audit lag in Nigeria. Forty companies were selected. Both univariate and multivariate analyses were performed on the data collected. The study observed that; audit delay ranged from 16 to 284 days; Nigeria listed companies take approximately four months on the average beyond their balance sheet date before they are finally ready for the presentation of the audited accounts to the shareholders; That profitability, total assets, total debt, total equity, audit fees and industry type have no significant impact on audit delay.

Methodology

The study employed the Ex-post facto research design to get data for this study. Fourteen manufacturing companies were selected for this study from the industrial goods sectors. Audit report lag is measured as the difference between the accounting year and when the financial report. Audit independence is measured by the audit fees paid for the respective years for each of the companies studied. Audit quality was measured by whether the companies used the Big-4 audit firms in carrying out the audit of their accounts. Regression analysis was carried out to determine the effect of Audit quality and Auditor's independence on audit report lag of manufacturing companies in Nigeria. The following regression model is formulated for the study:

Model Specification

The following empirical model was specified and tested econometrically in the study:

$$ARL = f(ARQ)$$

$$ARL = \alpha_0 + \alpha_1 ARQ + \alpha_2 AI + \mu$$

Where: ARL=Audit report lag; ARQ=Audit report quality; AI=Audit independence;
 α_0 =Constant; $\alpha_{1,2}$ =Coefficient; μ =error term

Data Presentation and Results

Dependent Variable: AUDIT_LAG				
Method: Least Squares				
Date: 03/28/20 Time: 22:41				
Sample (adjusted): 1 68				
Included observations: 67 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
A_Firm (Audit quality)	-8.058985	6.603160	-2.220474	0.0268
AUDIT_FEES (Audit Independence)	-0.035235	1.843091	-0.019117	0.9848
C	83.83511	27.71907	3.024456	0.0036
R-squared	0.366493	Mean dependent var		87.83582
Adjusted R-squared	0.065441	S.D. dependent var		20.80836
S.E. of regression	20.74016	Akaike info criterion		8.945763
Sum squared resid	27529.87	Schwarz criterion		9.044481
Log likelihood	-296.6831	Hannan-Quinn criter.		8.984826
F-statistic	6.217387	Durbin-Watson stat		1.741980
Prob(F-statistic)	0.030276			

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The constant of the regression equation (83.84) has a significant value of 0.00 ($p > .05$). Audit quality had a negative coefficient of -8.06 ($p < .05$). This implies that Audit quality has a negative and significant effect on audit report lag of manufacturing companies in Nigeria. Audit independence had a negative coefficient of -0.035 ($p > .05$). The implication of this is that Auditor's independence does not significantly affect audit report lag of manufacturing companies in Nigeria, however the relationship is negative even though it is not significant. The R^2 of 0.3665 means that 36.65% of changes in audit report lag is as a result of the quality of the audit. The F-Statistic indicates that the model is statistically significant at 5% level of significance. The F statistic = 6.2174 has a p value of $0.03 < 0.05$. In the first hypothesis, the alternate hypothesis is thus accepted while the null hypothesis is accepted in the second hypothesis. This implies that the audit firm used in the auditing the accounts of the company significantly determine the timeliness of the audit report in the sense that when the firm use the big-4 audit firms, audit report lag is relatively reduced, the study also reveal that the audit independence has a negative but not significant relationship on audit report lag implying that the higher the audit fees the lower the time it takes to produce the audit report, however, the relationship is not significant therefore, audit fees paid to the audit firms does not significantly determine audit report lag.

Conclusion and Recommendations

In conclusion, the study found that audit report lag of industrial goods firms in Nigeria affect certain corporate governance and firm related variables as is also evident in previous related studies. The study was anchored on the Agency theory and empirical findings reveal that Audit quality has a negatively significant effect on audit report lag while Auditor's independence does not significantly affect audit report lag of industrial goods companies in Nigeria. The implication of these findings is that the use of any of the Big-4 audit firms tends to reduce delays in audit due to their ability to acquire the requisite human and material resources needed to carry out an audit exercise and produce the audit report on schedule. Also, when an audit firm is adequately remunerated, they tend to operate independent of the company and sufficient resources can be channelled to ensure the audit exercise is without delay and that audit report lag is reduced to the barest minimum. This factor however was not significant enough in this study showing that other factor could have contributed to the

timeliness of the audit report. Based on the foregoing, the following recommendations were made:

1. Firms should engage the quality audit firms with requisite experience in their sector and have the required resources- human and material to avoid delays in meeting the regulatory guideline for audit report timeliness.
2. The auditor's independence cannot be wished away as companies should ensure the audit firm are given all they require to carry out their audit without undue interference and limitations.

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