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Client Attributes and the Audit Report Lag in Nigeria

Richard Oreoluwa Akingunola[1]
Department of Banking and Finance, Olabisi Onabanjo University, Ago-Iwoye, Nigeria

Kenny Adedapo Soyemi
Department of Accounting Olabisi Onabanjo University, Ago-Iwoye, Nigeria

Rasaq Okunuga
Department of Accounting Olabisi Onabanjo University, Ago-Iwoye, Nigeria.

Abstract

This study examines the effect of client attributes on the audit report lag of listed firms in Nigeria during the period 2010 – 2015. We found that firm size, company age and profitability have a significant impact on the audit report lag. However, auditor type remained significant in our estimation. It is recommended that the government should enforce stringent policies and regulations to reduce the audit report lag of companies in Nigeria. In addition, the Nigeria Stock Exchange, Securities and Exchange Commission, Financial Reporting Council of Nigeria and the Central Bank of Nigeria should ensure strict compliance with financial reporting rules and regulations. Professional accounting bodies should also encourage audit firms to complete the audit engagement within a reasonable time period.

Keywords: *Audit report lag, big4 firms; client age; client size; profitability; Nigeria.*

Introduction

The stakeholders of a company are interested in timely and credible financial reports (Leventis et al., 2005). The directors of a company are its stewards who are responsible for preparing financial statements and are accountable to the shareholders. For enhancing the credibility of financial reporting a professional audit firm must certify the financial information before final disclosure. The audit report lag is the time gap between the accounting year end, financial statements preparation and the audit report (Carslaw & Kaplan, 1991).

[1]Corresponding author: Richard Oreoluwa Akingunola; Email: richakingunola@gmail.com

An audit report is important for investors, regulators and other users of financial information. A delay in issuing the audit report adversely affects the credibility and quality of financial reporting. Furthermore, the accounting profession considers the timeliness of financial reports important for investors, regulators and professional agencies (Soltani, 2002). According to International Accounting Standard Board (IASB, 2008), the timeliness of financial reports refers to the publication of financial reports within the stipulated time period. In Nigeria, the need for credible and timely financial information has increased. This is due to the exposure of Nigerian businesses to international capital markets (Dibia & On wuchekwa, 2013). Businesses are required to provide timely financial information to foreign investors. In developing countries, financial information sources are less credible as compared to developed countries (Dibia & Onwuchekwa, 2013). Moreover, regulatory bodies in developing countries are also less effective in monitoring and regulating statutory requirements (Dibia & Onwuchekwa, 2013). Thus, it is important for businesses to publish their financial reports in a timely manner in accordance with the requirements of regulatory bodies. This will help investors and stakeholders to make rational investment decisions.

Previous research has highlighted the importance of a short audit report lag for maintaining the quality of financial reporting (Leventis et al., 2005; Dibia & Onwuchekwa, 2013; Soltani, 2002). A short audit report lag is also necessary for providing fair, efficient and transparent financial information. Timely information also protects investors and improves the quality of financial reporting.

Owusu–Ansah and Yeoh (2005) argues that timely reporting is an important device for minimizing insider trading, leaks and rumours in emerging capital markets. Other studies have also emphasized that timely financial information and audit report reduces information asymmetry and rumours about a company's financial health (Leventis et al., 2005; Soltani, 2002). Investors due to a delay in the audit report seek information from unconventional sources which negatively affects the image of an organization (Jaggi & Tsui, 1999). Many earlier studies from emerging economies have focused on the timeliness of financial reporting but have not adequately examined the audit report lag (Courtis, 1976; Abdulla, 1996; Carslaw and Kaplan, 1991; Ahmed, 2003; Owusu-Ansah & Yeoh, 2005; Iyoha, 2012).

The delay in the disclosure of the auditor's report increases the information asymmetry and uncertainty in investment decision making. Therefore, this study investigates the impact of client attributes on the audit report lag of Nigerian firms.

Literature Review

In order to understand the impact of client attributes on the audit report lag of listed companies, it is necessary to provide an overview of the following terms.

Firm size: Previous research has found that firm size has an influence on the audit report lag (Leventis et al., 2005). Large firms have greater resources to enforce a strong internal control system and have a continuous audit (Ng and Tai, 1994). As large companies have greater resources, therefore, they are in a better position to complete their audit assignments more efficiently than smaller firms. In addition, larger firms are under greater pressure to release timely financial information in order to avoid public criticism (Owosu- Ansah & Yeoh, 2005; Ahmed, 2003).

Auditor type: An audit by the Big4 firms will have an influence on the audit report lag of listed companies in Nigeria (Ahmed, 2003). Big4 firms refer to large accounting firms, i.e. KPMG, Ernst & Young (E&Y), Deloitte and Touche' and Price Waterhouse Coopers (PWC). Previous research suggests that Big4 firms have a lower audit report lag as compared to others (Ahmed, 2003). In addition, Big4 firms complete their audit assignments more efficiently and effectively as compared to smaller firms (Soltani, 2002).

Profitability: The profitability of a firm is a measure of its performance during the fiscal year. Prior research has found a positive association between profitability and the audit report lag (Carslaw and Kaplan; 1991, Alamosa and Alabbas, 2007). On the contrary, studies have also reported a negative association between profitability and the audit report lag (Abdulla, 1996). In general, firms tend to announce strong financial results and delay the announcement of weak results (Al-Ajimi, 2008).

Firm age: The age of a firm has a positive association with the timeliness of financial reporting (Soltani, 2002). Mature firms tend to have a strong internal control environment. Moreover, young firms have less experience with accounting controls and have a greater probability of failure (Hope & Langli, 2008).

Theoretical Framework

Extant literature has explored the concept of corporate governance using the agency theory (Azman & Kamaluddin, 2012). Agency theory suggests that firms employ corporate governance mechanisms to reduce the conflict of interest between shareholders and managers (Yunos, et al., 2011; Habbash; 2010). In the agency setting, corporate managers take decisions on behalf of the principal for maximizing their personal interests. Therefore, it is argued that corporate managers should give priority to shareholders interests rather than personal interests. Previous research suggests that corporate governance mechanisms help ensure timely reporting of financial information (Al-Ajimi, 2008; Shukeri & Islam, 2012).

The theory suggests that the agent may engage in opportunistic behaviour at the expense of the principal. In addition, low management interest in operations will adversely affect the performance of the firm. Shukeri and Nelson (2010) indicates that effective corporate governance enhances management control over the firm and reduces opportunities for corporate mismanagement and audit report lags. Thus, corporate governance is considered as a mechanism for controlling managerial behaviour (Shukeri & Nelson, 2010).

Jensen and Meckling (1976) suggests that agency problems result due to the inability of the principal to directly monitor the agent. In order to reduce agency problems, the principal requires the financial report to be certified by a professional and independent accounting expert. Prior research indicates that agency costs comprise of costs associated with monitoring and controlling agent behavior. Therefore, external audits are a mechanism for regulating opportunistic managerial behavior and provide credibility to the financial reporting framework (Shukeri & Nelson, 2010). When agency problems are pervasive, auditors will spend more time conducting the audit and increase the audit report lag (Leventis et al., 2005).

Empirical Review

A firm's attributes determine its internal governance mechanisms and also affects its performance (Karunna, 2009). Engel (2002) categorizes firm attributes into three classes, i.e. controllable, partially controllable and uncontrollable attributes. Uncontrollable attributes fall outside the direct control of the firm and include organization size and structure. Partially controllable attributes cannot be changed by the firm in the short run such as an organization's resources and maturity. In addition, controllable attributes are within the complete control of the firm.

Ashton, Willington and Elliot (1987) examined the audit report lag of companies in the US. The results indicate that audits delays are significantly associated with opinions, internal controls, audit technology and industry type. Ashton, Graul and Newton (1985) investigated firms listed on the Toronto Stock Exchange. They found that audit firm size, net income, extraordinary items and industry type are related to audit delays. Moreover, Newton and Ashton (1989) examined the audit delay among Canadian big-eight firms and found that structured audit approaches increased the audit report lag while unstructured audit approaches reduced the same. Abdulla (1996) empirically examined the association between the time lags in disclosure and five corporate attributes of 26 Bahraini companies. The study found a significant negative relationship between the timeliness of financial reporting and firm profitability, dividends and size. It also reports an insignificant relationship between timeliness and industry type.

Jaggi and Tashi (1999) empirically examined the association between the audit report lag, auditor business risk and audit firm technology of companies in Hong Kong. The result indicate that there is a positive association between the audit report lag and the financial risk index of companies. This implies that financially weak companies tend to have long audit report lags. It is also argued that companies audited using a structured audit approach have longer audit report lags.

Soltani (2002) investigated the timeliness of corporate and audit reports in France for the period 1986-1995. The study argues that the timeliness of the audit report is affected by the nature of the audit and the type of audit opinion. Leventis et al., (2005) examined the audit report lag of companies listed on the Athens Stock Exchange. The study reports a significant association between audit report lag and the type of auditor, audit fees, number of remarks in the report, presence of extraordinary items and the level of uncertainty. This indicates that the appointment of an international audit firm and the payment of a high audit fee can reduce the audit report lag of listed firms.

Modugu, Erahbhe and Ikahtua (2012) examined the relationship between the audit report lags and company attributes in Nigeria. A sample of 20 quoted companies was selected for the period 2009 to 2011. The result suggests that multinational companies, company size and audit fee influence the audit report lag in Nigeria. The study also found that the audit report lag ranges from 30-276 days for companies in Nigeria. Moreover, most listed companies in Nigeria present their financial statements at the Annual General meeting with a delay of two months.

Fagbemi and Uadiala (2011) examined a sample of forty-five audited financial reports from companies in Nigeria. They report that there is no correlation between the timeliness of financial statements, business complexities and business leverage. The results also indicate that a relationship exists between financial reporting timeliness and company affiliation with a foreign entity. Iyoha (2012) examined the impact of company attributes on the timeliness of financial reporting in Nigeria over a period of ten years. The results indicate that the age of a company is a major attribute that influences the overall quality of financial reports. The study also indicates that there is a significant variation in the timeliness of financial reporting among industrial sectors. Oladipupo (2011) investigated the extent of the audit report lag in Nigeria. Both univariate and multivariate analysis were performed on the data. The study found that the audit report lag ranged from 16 - 284 days. Most listed companies in Nigeria present their audit report to shareholders with a delay of about four months. It also reports that profitability, total assets, total debt, total equity, audit fees and industry type have no significant impact on audit report lag.

Dibia and Onwuchcka (2013) also examined the audit report lag of quoted companies in Nigeria. A sample of sixty firms were investigated over the period 2008 to 2011. The results suggest that total assets and company age had a significant impact on audit report lag in Nigeria. The findings also indicate that firm size has no significant relationship with the audit report lag in Nigeria. Ng and Tai (1994) examined the relationship between audit delay and company attributes in Hong Kong for the years 1990 and 1991. The study found that the degree of diversification and turnover of a firm were significantly related to the audit report lag. Owusu-Ansah and Yeoh (2005) conducted an empirical study on the timeliness of financial reporting by 47 non-financial companies listed on the Zimbabwe Stock Exchange. The results indicate that company size, profitability and company age are significant factors affecting the timeliness of annual reports issued by companies.

Methodology

The study has utilized financial data for listed companies from Nigeria. The sample was selected on the basis of following criteria. First, the firm must be listed and active on the Nigeria stock Exchange between January, 2010 and December, 2015. Second, the firm must belong to an industry comprising at least three firms. Third, the firm must have financial data available for the sample period. As a result, the final sample consisted of 27 listed companies from Nigeria. The study used OLS regression analysis. The time period of the study is significant as it includes high-profile audit scandals in Nigeria and abroad.

Variables Description and Measurement

The study has used a dependent variable and four independent variables. The dependent variable is the audit report lag while the independent variables include firm size, audit firm type, company age and profitability. A summary of the variables description and measurement is presented in Table 1.

Table 1: Variables Description and Measurement

Variable	Symbol	Measurement
Dependent Variable		
Audit report lag	AUDLAG	The number of days between the balance sheet date and the date of the auditor's report.
Independent Variables		
Firm Size	FSIZE	The natural logarithm of total assets
Auditor Type	AUDTY	A dummy variable which takes a value of 1 for big4 audit firms and 0 otherwise.
Company age	COA	Total number of years the company has been in existence
Profitability	ROA	The ratio of net profit to total assets

Model Specification

The model examines the effect of client specific attributes on the audit report lag in Nigeria. The model was based on Iyoha (2012) and Leventis et al., (2005). The regression model is presented below:

$$AUDLAG_{it} = \beta_0 + \beta_1 FSIZE_{it} + \beta_2 AUDTY_{it} + \beta_3 COA_{it} + \beta_4 ROA_{it} + \mu_{it}$$

Where,
AUDLAG = Audit report lag
FSIZE = Firm size
AUDTY = Audit firm type
COA = Company age
ROA = Return on Assets
μ = error term.

Results and Discussion

Descriptive Statistics

Table 2 provides a summary of descriptive statistics for all the variables in the study.

Table 2: Descriptive Statistics

	AUDLAG	FSIZE	AUDTY	COA	ROA
Mean	78.7248	8.62e+07	0.84126	39.80423	0.100523
Minimum	56	2039412	0	0	-0.21333
Maximum	146	1.12e+09	1	91	1.68092
Std. Dev.	14.9384	1.53e+08	0.3663	21.61606	0.14123
Observations	189	189	189	189	189

The descriptive statistics reported in Table 2 show that the audit report lag has a mean value of 78.72. This indicates that Nigerian firms have an audit report lag of approximately 79 days. Moreover, the audit firm type has a mean value of 0.8412 which indicates that approximately 84% of the sample companies were audited by the Big4 audit firms. This implies that listed companies tend to hire reputable and experienced auditors. Similarly, the mean value of company age is 39.8042. This suggests that the average age of the sample companies is 39 years. Furthermore, the mean value of the ROA is about 10%.

Correlation Analysis

Table 3 presents the correlations between the variables used in the study.

Table 3: Correlations Matrix

	AUDLAG	FSIZE	AUDTY	COA	ROA
AUDLAG	1.0000				
FSIZE	-0.0302	1.0000			
AUDTY	0.0989	0.1618	1.0000		
COA	-0.0603	-0.1284	0.3413	1.0000	
ROA	0.0214	0.0685	0.1057	0.0263	1.0000

The results indicate that auditor type and ROA are positively associated with the audit report lag. This implies that firms with a high ROA tend to have a high audit report lag. Similarly, firm size and company age have a negative association with the audit report lag. This implies that large and mature firms have a lower audit report lag. The relatively low correlations between the variables do not indicate any issue related to multi-collinearity.

Regression Results

The study examines the effect of client attributes (i.e. firm size, audit firm type, company age and profitability) on the audit report lag of Nigerian firms. The regression results are reported in Table 4. The adjusted R-squared value is 0.1167 which indicates that approximately 11.67% of the variation in audit report lag is explained by client attributes. In addition, the F-statistic is 5.22 which indicates that the overall model is statistically significant at the 1% level. Thus, client attributes jointly explain the audit report lag of Nigerian companies.

The regression results indicate that company age and ROA have a positive and statistically significant effect on the audit report lag. The finding is consistent with previous studies and implies that mature and profitable firms have a higher audit report lag. In addition, firm size has a negative and significant effect on audit report lag. This suggests that large firms have a shorter audit report lag. Furthermore, audit firm type has an insignificant effect on the audit report lag. Thus, Big4 audit firms do not systematically influence the timeliness of the audit report.

Table 4: Regression Results

	Coef.	Std. Error	t-stat	p-value
FSIZE	-10.7912	4.0668	-2.65	0.009
AUDTY	1.2149	10.2441	0.12	0.906
COA	2.9673	0.6880	4.31	0.000
ROA	15.0429	8.3774	1.80	0.074
Constant	144.9427	55.2789	2.62	0.010

Dependent Variable: AUDLAG, Adjusted R^2 = 0.1167, F= 5.22, $P<0.05$

Diagnostic Analysis

The presence of heteroskedasticity was checked through the Breusch–Pagan and White tests. Both the test statistics are insignificant which suggests that heteroskedasticity was not present at the 5% level of significance.

Conclusion

The audit report lag of listed companies undermines the usefulness of financial information for decision making. Therefore, this study has examined the influence of client attributes (i.e. firm size, audit firm type, company age and profitability) on the audit report lag of listed firms in Nigeria. The results indicate that company age and ROA have a positive and statistically significant effect on audit report lag. The finding is consistent with previous studies and implies that mature and profitable firms have a higher audit report lag. In addition, firm size has a negative and significant effect on audit report lag. This suggests that large firms will have a shorter audit report lag. Furthermore, audit firm type has an insignificant effect on the audit report lag. Thus, Big4 audit firms do not systematically influence the timeliness of the audit report. The study has several implications for regulators and policymakers in Nigeria for improving the overall quality and usefulness of financial information reported by listed firms. Future studies may also consider the non-firm specific determinants of the audit report lag in other African countries.

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