THE IMPACT OF CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURE ON AUDIT REPORT LAG: EVIDENCE FROM MALAYSIA

BY

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A dissertation submitted in fulfilment of the requirement for the degree of Master of Science in Accounting

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ABSTRACT

Timeliness is an essential characteristic of financial reporting to promote investors' confidence in the capital market and to enable them to make decisions. The delay in releasing the annual financial report, which is highly influenced by the length of the audit process, would make the financial information less useful as it has lost its relevancy. In addition, a new regulation on shortening the timeframe for the issuance of annual reports which was proposed by Bursa Malaysia triggers the idea of this study to extend the literature on audit report lag. Thus, the main objective of this study is to examine the impact of corporate governance mechanisms and ownership structures on audit report lag among Malaysia's listed companies. The audit report lag is measured based on the number of days between the date of financial year end to the date of auditor report. The corporate governance mechanisms consists of board multiple directorships, audit committee size, audit committee meetings, and audit committee qualifications. Meanwhile, the types of ownership structures are managerial ownership, government ownership and foreign ownership. The resource dependence theory and agency theory are applied to explain the framework of this study and tested on the sample of 243 Malaysian listed companies for the financial year ended 2012. The results show that boards with multiple directorships, government ownership, auditor type, audit opinion and firm performance have significant negative associations with audit report lag, while audit committee meeting is found to be positively significant with audit report lag. However, the other four variables (managerial ownership, foreign ownership, and audit committee size and audit committee qualification) are found to have insignificant relationships with audit report lag.

خلاصة البحث

التوقيت هو السمة الأساسية لإعداد التقارير المالية لتعزيز ثقة المستثمرين في سوق رأس المال وتمكينهم من اتخاذ القرارات. التأخير في الإفراج عن التقرير المالي السنوي، والذي يتأثر بشدة من مدة عملية التدقيق، من شأنه أن يجعل المعلومات المالية أقل فائدة. وبالإضافة إلى ذلك، القوانين الجديدة لتقليص الفترة الزمنية لإصدار التقارير السنوية التي اقترحتها بورصة ماليزيا تعطي الفكرة لهذه الدراسة لتمديد الدراسات المتعلقة بالتأخير في الإفراج عن تقرير تدقيق الحسابات. وهكذا، فإن الهدف الرئيسي من هذه الدراسة هو اختبار مدى تأثير آليات حوكمة الشركات وهياكل الملكية على التأخير في الإفراج عن تقرير تدقيق الحسابات بين الشركات المدرجة في بورصة ماليزيا. يتم قياس التأخير في الإفراج عن تقرير تدقيق الحسابات على أساس عدد الأيام بين تاريخ نهاية السنة المالية حتى تاريخ الإفراج عن تقرير مدقق الحسابات. آليات حوكمة الشركات تتكون من مجلس بمناصب متعددة، حجم لجنة التدقيق، اجتماعات لجنة التدقيق، ومؤهلات لجنة التدقيق. وفي الوقت نفسه، أنواع هياكل الملكية هي الملكية الإدارية، الملكية الحكومية، والملكية الأجنبية. يتم تطبيق نظرية الاعتماد على الموارد ونظرية الوكالة لشرح إطار هذه الدراسة والاختبار على عينة تتكون من 243 شركة مدرجة في البورصة الماليزية للسنة المالية المنتهية 2012. تظهر النتائج أن مجلس بمناصب متعددة، الملكية الحكومية، نوعية المدقق، رأي المدقق، وأداء الشركة لديها دلالة إحصائية سلبية على التأخير في الإفراج عن تقرير تدقيق الحسابات، في حين تم العثور على أن اجتماع لجنة التدقيق لديه دلالة إحصائية إيجابية على التأخير في الإفراج عن تقرير تدقيق الحسابات. ومع ذلك، وجدت المتغيرات الأربعة الأخرى (الملكية الإدارية، الملكية الأجنبية، حجم لجنة التدقيق، و مؤهلات لجنة التدقيق) لديها تأثير ضئيل على التأخير في الإفراج عن تقرير تدقيق الحسابات.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Siti Masitah Binti Ibrahim

Signature………………………. Date…………………………..

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

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LIST OF ABBREVIATIONS

AT	Agency Theory
BSE	Bahrain Stock Exchange
FASB	Financial Accounting Standard Board
IASB	International Accounting Standard Board
IDX	Indonesia Stock Exchange
IFRS	International Financial Reporting Standards
MASB	Malaysian Accounting Standard Board
MCCG	Malaysian Code of Corporate Governance
MFRS	Malaysia Financial Reporting Standards
MNC	Multinational firms
OECD	Economic Co-Operation and Development
RDT	Resource Dependence Theory
SEC	Securities Exchange Commission
SSE	Sydney Stock Exchange
TSE	Toronto Stock Exchange

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

In this chapter, the framework of the study is briefly presented. It begins with Section 1.1 that introduces the background of the study. Section 1.2 discusses the research problem and is followed by the objective and motivation of the study in Sections 1.3 and 1.4, respectively. Subsequently, Section 1.5 discusses the significance of the study and ends with Section 1.6 that outlines the structure of the dissertation.

1.1 BACKGROUND OF THE STUDY

In general, financial reporting is a primary source of accounting information for users to evaluate the performance of an organization and to make the right decisions. One of the main criteria of the usefulness of accounting information is timeliness, where this information is required to be available within a reasonable period of time from the end of the reported period, otherwise it may lose some of its relevance. The worldwide accounting standard setters such as the Financial Accounting Standard Board (FASB) and the International Accounting Standard Board (IASB) have long recognized timeliness as a part of the conceptual framework of financial reporting to protect the relevance and reliability of corporate financial statements.

In the capital market, timely corporate financial information is crucial to shareholders, since they depend on this information to facilitate decision making especially in their investments. Undue delay in releasing financial information increases uncertainties related to investment decisions (Ashton, Graul and Newton, 1989). Besides, timeliness of financial information is also viewed as a way to reduce information asymmetry among shareholders and to mitigate insider trading, leaks and rumours about the performance of companies within the capital market (Al-Ajmi, 2008), in which the information is valuable to shareholders in their decision-making.

In order to increase the informational efficiency of markets, the regulatory authority has issued rules concerning the timeframe for information submission. The Securities Exchange Commission (SEC), which is the regulatory body in the United States, for instance, has reduced the regulatory filing deadline of Form 10-K[1] delays in releasing financial reporting from 90 days to 60 days (Owusu-Ansah et al., 2006).

In Malaysia, the Bursa Malaysia Listing Requirement has issued several requirements for companies listed in Bursa Malaysia in order to produce timely financial reporting. According to Chapter 9.23(1) of the Bursa Malaysia Listing Requirement, all public listed companies are required to issue their annual reports to Bursa Malaysia within **six months** after the close of the financial year. Also, Bursa Malaysia emphasizes the timely annual audited financial statements through Chapter 9.23(2), in which all listed companies should announce their annual audited financial statements that include the auditors' and directors' report to Bursa Malaysia within **four months** from the close of the financial year-end. If the listed companies are able to issue their annual reports within a period of four months from the close of the financial year end, then the requirement of Chapter 9.23(2) is void. These requirements emphasize on timely and quality of financial disclosure by listed companies for users in making decisions. However, if companies failed to meet the submission date, a penalty will be imposed.

[1]The audited financial statements together with auditor report and management report in the non-Us stock exchange

Recently, The Starbiz (August 2, 2012) reports that three Malaysian public listed companies Patimas Computers Bhd, Hytex Integrated and West Global Telecommunications Bhd failed to release their audited reports for year 2011 within the required timeframe. According to Ng (2012), according to industry expert opinion, the failure of listed companies to release the audited financial reports on time is unacceptable for whatever reasons and this may indicate that there could be unresolved accounting, management and other issues in the organization. This problem would affect capital market efficiency as investors would be less confident as a delay in releasing financial reports would lead to the loss of relevant information in influencing shareholders to make the right decisions. Hence, given the importance of timeliness of financial reporting to investors in the capital market, it is significant to improve financial reporting quality by identifying the determinants of delay in financial reporting that influences the timeliness of financial reporting.

The importance of financial reporting timeliness to investors are reported in a number of studies, among which are Givoly and Palmon (1982), Owusu-Ansah (2000), Leventis, Weetman, and Caramanis (2005), Che-Ahmad and Abidin (2008), Afify (2009), and Nelson and Shukeri (2011). Further, these studies provide evidence that a delay in the release of financial statements is caused by the length of auditing works. This is because the financial statements cannot be issued until an audit has been completed and concluded by the independent auditor. Thus, audit report timeliness is found as an important factor for financial reporting timeliness and it has become a main concern for researchers to further investigate the possible factors that may influence audit timeliness.

In order to ensure the quality of financial reporting, it is imperative for corporate governance to improve financial reporting quality (Cohen et al., 2004). The role of corporate governance mechanisms such as the board and audit committee are significantly associated with the quality of the financial reports, as it potentially affects the auditor's risk assessments (Abbott, Parker and Peters, 2004). The importance of corporate governance and disclosure requirements has been introduced in the Malaysian Code of Corporate Governance (2000) and the Bursa Malaysia Revamped Listing Requirement (2001). Afterwards, it was revised and a new code, the Malaysian Code of Corporate Governance (2007) was established to strengthen the roles and responsibilities of the board of directors, the audit committee and the internal audit functions.

Recently, after taking into account the changing market dynamics, the Malaysian Code of Corporate Governance (2012) was revised to enhance the effectiveness of the corporate governance framework. The MCCG 2012 was made effective on 31 December 2012 and companies are encouraged by the Security Commission (SC) to make an early transition to adopt the principles and recommendations as elaborated in this new code. The MCCG 2012 has included some of the best practices from the 2007 Code and presents eight principles emphasizing on the roles and responsibilities of the board, as well as strengthening board composition, reinforcing board independence, fostering board commitment, upholding integrity in financial reporting, recognizing and managing risks in order to ensure timely and high quality disclosure, and strengthening the relationship between company and shareholder. The code focuses on the strengthening of the role of the board in ensuring to improve the timely availability of quality and credible financial information. Given the strong corporate governance, companies will be able to reduce inherent risk which will lead to less audit effort (Tsui, Jaggi and Gul, 2001; Yatim, Kent and Clarkson, 2006) and possibly affect audit timeliness.

In addition, the effectiveness of corporate governance is influenced by the variation of ownership structures. Unlike the dispersed shareholding of the Anglo-Saxon world, Malaysia is a developing country with an emerging capital market, characterized by concentrated shareholding which could add complications to corporate governance (Abdullah, 2006). Given the concentrated ownership structure, it could improve the overall governance of a corporate environment and which in turn will reduce the need for extensive external audit effort (Knechel and Willekens, 2006). Through efficient and effective auditing, it potentially affects audit report timeliness (Afify, 2009). As such, the focus of this study is to further investigate whether the existence of corporate governance mechanisms namely the board of directors and the audit committee, and ownership structure are effective in influencing audit report timeliness in Malaysia.

1.2 RESEARCH PROBLEM

Prior studies have provided empirical evidence that the timeliness of financial reporting is most influenced by the timeliness of audit reporting. In Malaysia, a number of prior studies have reported on audit report lag. Mohamad Nor, Shafie, & Wan Husin (2010) reported the maximum audit report lag is 332 days after the financial year end 2002. Nelson and Shukeri (2011) found the maximum audit report lag in 2009 was 239 days, which shows a large reduction of maximum audit report lag compared to Mohamad Nor et al. (2010) for the period of 2002. In this situation, a further study may be required to examine the latest length of audit report lag to observe the trend of financial reporting behaviour in the Malaysian environment.

In addition, the length of audit report lag has highlighted the need for strong corporate governance in order to strengthen the quality of financial reporting. It is crucial for organizations to have an effective corporate governance mechanism to safeguard the rights of the investors in getting timely information as it loses its relevance when there is delay in reporting. Accordingly, corporate governance mechanisms such as the board of directors and the audit committee have been suggested in assessing the strength of governance in organization (Kamardin and Haron, 2011; Yatim, Kent, and Clarkson, 2006; Abdullah, 2006). It is expected that the corporate governance will have some impact on the roles played by the board of directors and the audit committee. These act as a monitoring mechanism on behalf of the shareholders in monitoring firm managers to mitigate agency conflict issues. Given strong monitoring mechanisms, less conflict may arise in companies which may thus improve the quality of financial reporting and shorten the length of auditing work. As a result, companies may release their financial reports in a more timely fashion. Thus, both of these corporate governance mechanisms are subjects for further investigation in examining their relationship with audit timeliness.

Apart from the board of directors and the audit committee, the effectiveness of corporate governance in organizations seems likely to be influenced by the variation in ownership structures (Li, 1994). In an emerging capital market such as Malaysia, concentrated ownership by individuals, families and significant equity holdings by the government are the features that distinguish the ownership structures of Malaysian companies from companies in the developed capital markets such as in the US and UK (Abdullah, 2006). This concentrated ownership structure may present corporate governance issues, particularly which involve minority shareholders that may not be similar to the issues in those developed countries (Abdullah, 2006; Mustapha and Ahmad, 2011). In addition, this ownership structure potentially provides evidence of the existence of monitoring differences by the shareholders on corporate affairs, including the financial reporting process (Yatim et al., 2006). The presence of ownership structure provides important monitoring mechanisms to ensure the management acts in the interest of the shareholders, in order to ensure and preserve the timeliness of financial reporting. Thus, this concentrated ownership structure may be a motive for further research in terms of examining the relationship between ownership structure and audit timeliness in Malaysia.

In addition, research that focuses directly on audit report timeliness and ownership structure in Malaysia are still limited. In a previous study conducted by Che Ahmad and Abidin (2008) ownership structure is considered as their variable of interest. However, this study examined only one type of ownership structure (i.e. managerial ownership), which may not reflect the impact of the various ownership structures in Malaysian companies on audit report lag. Besides, the Malaysian Accounting Standard Board (MASB) plans to move to full IFRS (International Financial Reporting Standards) convergence by 1 January 2012 through the issuance of MFRS (Malaysia Financial Reporting Standards). In this regard, Malaysia public listed companies will be affected by the IFRS convergence in 2012 and may take a while to familiarise with this new accounting standard. Companies may require a longer time to prepare their financial statements and this would bring a significant effect on auditors in completing their works, and hence may lead to audit report lag. Thus, this study shall examine the relationship of the corporate governance mechanisms (i.e. the board of directors and the audit committee) and the various types of ownership structure with audit report lag, by employing the most recent data, which is for year 2012, after the full adoption of MFRS, to see whether any new trends have occured and any variations in the results compared to previous studies.

1.3 OBJECTIVE OF THE STUDY

The main objective of this study is to examine the impact of corporate governance mechanisms and ownership structure on audit timeliness among public listed companies in Malaysia. The Bursa Malaysia requirement that listed companies disclose MCCG practices in their corporate annual reports, provides an avenue for a viable research related to corporate governance effectiveness. Previous studies have reported that the presence of corporate governance effectiveness would ensure the timely financial reporting through proper monitoring by the board of directors and the audit committee. The expectation is clear that corporate governance mechanisms would have an impact on the auditor business risk hence shortening the length of completing auditing hours (Sharma, Boo and Sharma, 2007). Accordingly, this study extends the literature of audit report delay, which is to examine the presence of the board of directors and the audit committee in discharging their roles for corporate governance effectiveness, that may influence audit efficiency which in turn reduces audit report lag, and leads for financial report timeliness.

Further, based on prior studies, Afify (2009) and Nelson and Shukeri (2011) suggest that one should include ownership structure as a variable in an audit report lag predictive model in order to further examine the impact of corporate governance quality on audit timeliness. In addition, prior studies have reported that ownership concentration has an effect on audit timeliness (Bamber, Bamber and Schoderbek, 1993; Leventis et al., 2005; Afifiy, 2009) in non-Asian countries. These researchers argue that the concentration of company's ownership will lead to reduced auditor business risk and effect to shorten the audit delay. Thus, this finding could be a benchmark in the present study to further investigate the impact of ownership structure on audit report lag, by looking at the concentration ownership in Malaysia.

Therefore, this study shall further examine the relationship of corporate governance mechanisms, which are, the board of directors, the audit committee and ownership structure with the audit report lag. Based on the above research objective, this study intends to provide the answer to the following research questions:

RQ1: Do corporate governance mechanisms and ownership structure influence audit report lag in Malaysia's public listed companies?

RQ2: What are the other factors that influence audit report lag in Malaysia's public listed companies?

1.4 MOTIVATION OF THE STUDY

Many prior studies either in developed or developing countries have investigated company attributes, auditor characteristics and corporate governance as determinants of timeliness of financial reporting. Prior studies in Malaysia have reported that the relationship between corporate governance and audit timeliness is only focused on the characteristics of the audit committee such as size, meetings, and qualifications (Mohamad Nor et al., 2010; Nelson and Shukeri, 2011) and board of director attributes such as independence (Mohamad Nor et al., 2010; Nelson and Shukeri, 2011), size and CEO duality (Mohamad Nor et al., 2010). However, only a handful of studies examine the influence of various ownership structures on audit timeliness in Malaysia such as Che Ahmad and Abidin (2008) who considered only one type of ownership structure as their variable of interest in their study. Thus, due to the limited study on the impact of ownership structure on audit report lag in Malaysia, this study attempts to identify whether the different types of ownership structures such as managerial ownership, government ownership, and foreign ownership can influence the length of auditing works which will enhance timely financial reporting.

This study is also motivated by the changes in the length of audit report lag. Nelson and Shukeri (2011) found a large reduction in terms of the maximum score on audit report lag in 2009 compared to Mohamad Nor et al. (2010) for the period of 2002. Thus, this study uses the latest data from year 2012 after full adoption of the MFRS, to examine the latest length of audit report lag among Malaysian public listed companies. In addition, this study also is motivated by the new listing requirement of Bursa Malaysia, in which the timeframe allowed for the issuance of annual reports in paragraph 9.23(1) of the Listing Requirement will be shortened from six months to four months. The changes would be introduced in two phases in order to provide the public listed companies with sufficient grace period of compliance to the above requirement, which are (1) the issuance of the annual report within 5 months from the close of the financial year is applicable for annual reports issued for financial year ending on or after 31 December 2014; and (2) the issuance of the annual report within 4 months from the close of the financial year is applicable for annual reports issued for financial year ending on or after 31 December 2015. It is expected that this new requirement would be effected on auditors in completing their auditing work as companies need to issue their annual reports within the new timeframe. Thus, it may contribute to changes in the length of audit report lag. Therefore, this study serves as a new benchmark on the audit report timeliness and the readiness of Malaysian public listed companies to comply with the new regulation.

In addition, this study shall extend from previous studies by Nelson and Shukeri (2011). on the relationship between corporate governance and audit report lag Their study suggest that the difference in ownership structure might be a better platform to explain the impact of internal governance on audit report lag in ensuring the timeliness of financial reporting.

1.5 SIGNIFICANCE OF THE STUDY

This study focuses on the issue of financial reporting quality particularly on timeliness quality. It investigates the association between the corporate governance mechanisms (board multiple directorships, audit committee size, audit committee meetings and audit committee qualifications) and ownership structure (managerial ownership, government ownership and foreign ownership) with audit report lag. It is hoped that this study will contribute to the existing literature on audit timeliness, by providing evidence on the effectiveness of corporate governance mechanisms and ownership structure on auditing practices, utilising recent data in Malaysia which is from the year 2012. Thus, this study expects to provide additional insights on the impact of board multiple directorships, audit committee characteristics and ownership structure on the audit report timeliness of public listed companies in Malaysia.

In addition, this study may be beneficial to Malaysian listed companies to improve their corporate governance system if the result of this study shows that the audit report lag is significantly determined by the different types of ownership structures. This study foresees that the ownership structure may improve the monitoring mechanism of the organization in reducing agency problems and may reduce the audit report lag. Thus, this study may contribute to companies by investigating whether there are differences in the monitoring mechanism among different types of ownership structures. It also hoped that the findings of this study will have a significant implication to regulators by means of providing evidence on the effectiveness of corporate governance with the presence of ownership structure due to better monitoring of management. Thus, the regulator may consider the different types of ownership structure in the standards setting, particularly in reducing audit report lag in order to release financial reports within the timeframe.