MALAYSIAN FINANCIAL REPORTING STANDARDS AND AUDIT REPORT LAG

BY

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ABSTRACT

Based on the conceptual framework issued by the Malaysian Accounting Standards Board (MASB), the usefulness of the disclosed financial information could be enhanced by improving its timeliness, which is linked directly to the Audit Report Lag (ARL). Accordingly, many studies were conducted to examine the determinants of ARL, however, their findings show different and contradicting results. These contradictions inspired this study to investigate the determinants of ARL using a meta-analysis approach. In Malaysia, the issue of ARL is evident especially when both the Financial Reporting Foundation (FRF) and MASB decided to drive the Malaysian listed companies to full convergence with International Financial Reporting Standards starting from 1 January 2012. Thus, the Malaysian Financial Reporting Standards (MFRS) were issued. Prior studies provide evidence of an increase in ARL due to the complexity of the newly introduced standards. This has motivated this study to investigate the impact of MFRS convergence on ARL. The study used both published studies on ARL determinants, DataStream and audited annual reports published on Bursa Malaysia's website for the years 2011, 2012 and 2013 as a source of data. The meta-analysis results show a significant association between size, leverage, board independence and audit type with ARL. In addition, one-way ANOVA results indicate that there is no significant increase in ARL after MFRS convergence by Malaysian listed companies compared to before. Furthermore, panel regression was run to test the effect of MFRS convergence on ARL. The determinants of ARL, based on the meta-analysis results, were included in the panel regression. The findings of the regression indicate that the MFRS adoption and board independence have no significant impact on ARL. However, auditor type is significantly negatively associated with ARL. The findings should be of interest to regulators because the strategy of introducing new regulations gradually to the market seems to have worked, as the change in regulation does not have a significant effect on ARL.

خلاصة البحث

استناداً إلى الإطار المفاهيمي الصادر عن مجلس معايير المحاسبة الماليزي، فإنه يمكن التعزيز من فائدة المعلومات المالية المنشورة من خلال تحسين توقيتها، والذي يرتبط ارتباطاً مباشراً بالتأخير في تقرير المدقق. وفقاً لذلك، فإن العديد من الدراسات قد تناولت المحددات التي تؤثر في التأخير في تقرير المدقق، ومع ذلك، فإن النتائج التي توصلوا إليها تعد نتائج مختلفة ومتناقضة إلى حدٍّ ما. ومن ثم ألهمت هذه التناقضات هذا البحث للتعرف إلى محددات التأخير في تقرير المدقق باستخدام منهج التحليل التلوي. إنّ أهمية التأخير في تقرير المدقق واضحة في ماليزيا، لاسيما لما قررت كل من مؤسسة التقارير المالية ومجلس معايير المحاسبة الماليزي لدفع الشركات المدرجة في البورصة الماليزية التي تبنّت بالكامل المعايير الدولية للتقارير المالية، وذلك ابتداءً من ١ يناير ٢٠١٢، ونتيجة لذلك، تم إصدار معايير التقارير المالية الماليزية. إن الدراسات السابقة توفر دليلاً على حدوث زيادة في التأخير في تقرير المدقق نظراً إلى المعايير المعقَّدة التي أُدرِجت حديثاً. هذا ما حفَّز البحث الحالي إلى دراسة تأثير تطبيق معايير التقارير المالية الماليزية في التأخير في تقرير المدقق. كما استخدم هذا البحث نتائج الدراسات التي نشرت حول محددات التأخير في تقرير المدقق، ومحرِّك البحث (DataStream)، والتقارير السنوية المدققة المنشورة على موقع بورصة ماليزيا للسنوات ٢٠١١ و٢٠١٢ و٢٠١٣ كمصدر للبيانات. هذا وقد أظهرت نتائج التحليل التلوي وجود دلالة إحصائية بين حجم المؤسسة وقدرة المؤسسة على سداد ديوها واستقلالية بجلس الإدارة ونوع التدقيق مع التأخير في تقرير المدقق. بالإضافة إلى ذلك، تشير نتائج تحليل (One-way ANOVA) أنه لا توجد زيادة ذات دلالة إحصائية في التأخير في تقرير المدقق بعد التبني الكامل لمعايير التقارير المالية الماليزية من قبل الشركات المدرجة في البورصة الماليزية مقارنةً بالسابق. علاوة على ذلك، تم استعمال التحليل الانحداري لاختبار تأثير التبني الكامل لمعايير التقارير المالية الماليزية في النتائج التي تهم المنظمين لأنها تعد استراتيجية لإدخال أنظمة جديدة تدريجياً إلى السوق، ويبدو أن عمل الأنظمة فيها لا يكون لها تأثير كبير في التأخير في تقرير المدقق. لقد أضيفت محددات التأخير إلى التحليل الانحداري في تقرير المدقق ذات الدلالة الإحصائية بناءً على التحليل التلوي. تشير نتائج التحليل الانحداري إلى أن اعتماد معايير التقارير المالية الدولية واستقلالية مجلس الإدارة ليس له تأثير كبير في التأخير في تقرير المدقّق. مع ذلك، فإن النتائج تشير إلى أن هناك دلالة إحصائية سالبة بين نوع المدقق والتأخير في تقرير المدقق. إنّ نتائج هذه الدراسة تهم أصحاب القرار لأنها تعد استراتيجية لإدخال أنظمة أو معايير محاسبية جديدة تدريجياً إلى السوق؛ حيث تؤدي إلى تخفيض الضرر على التأخير في تقرير المدقق.

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 thesis for the degree of Master of Science (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.

Charafeddine Krouchi

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**DECLARATION OF COPYRIGHT AND AFFIRMATION OF
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**MALAYSIAN FINANCIAL REPORTING STANDARDS AND
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LIST OF ABBREVIATIONS

ARL	Audit Report Lag
CEO	Chief Executive Officer
CG	Corporate Governance
ESA	Egyptian Standards of Auditing
FRF	Financial Reporting Foundation
FRS	Financial Reporting Standards
GAAP	Generally Accepted Accounting Principles
IFRS	International Financial Reporting Standards
MASB	Malaysian Accounting Standards Board
MFRS	Malaysian Financial Reporting Standards
MIA	Malaysian Institute of Accountant
NPO	Non-Profit Organisations
SOX	Sarbanes-Oxley Act
TE	Transitioning Entities

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

This chapter discusses the background of the study, statement of the problem, the aim of the study, and followed by the research motivation and its significance. Finally, this chapter ends with the representation of the organization of the subsequent chapters.

1.2 BACKGROUND OF THE STUDY

One of the key sources of information in the capital market is the financial reports released by the companies. Reliable and timely information is needed by the investors to help them to make optimal decisions (Afify, 2009; Fagbemi and Uadiale, 2011; Ika and Ghazali, 2012). Therefore, the efficiency of the market relies on the quality of financial reports issued by the companies. In order to enhance the report's quality, the financial information must meet certain criteria like comprehensiveness, transparency and timeliness of the presented information[1]. Thus, the usefulness of financial reports is linked to the timely issuance of such information.

The timeliness of corporate financial reporting has been a longstanding concern for both the shareholders and stakeholders. Timely reporting also helps to reduce the information asymmetry and uncertainty, thus, could enhance decision making. Therefore, the late issuance of financial reports can result in the shareholders postponing their transactions, which can negatively affect the company (Apadore and Noor, 2013).

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[1] MASB Conceptual Framework, available at:
http://masb.org.my/images/Pronouncements/Framework/Conceptual_Framework.pdf (accessed on 06 November 2015).

The usefulness of the issued information to the users makes it the most important element to improve the reporting quality by identifying the reasons that could have an impact on the timeliness of financial reporting. Leventis, Weetman, and Caramanis (2005) and Afify (2009) provide evidence that the audit report lag is the main factor that can influence the timeliness of financial reporting. Audit report lag or audit delay, as labelled in some studies (Ashton, Willingham, and Elliott, 1987; Carslaw and Kaplan, 1991; Yaacob and Che-Ahmad, 2012) has been defined as the number of days from the end of the fiscal year until the issuance of the audit report (Apadore and Noor, 2013; Nelson and Shukeri, 2011). Due to the familiarity of the term audit report lag among researchers compared to other terms (i.e. audit delay and audit timeliness), 'Audit Report Lag' (ARL) is the term chosen for this study.

By referring to the importance of ARL, regulatory bodies try to enforce measures to reduce the time gap in the submission of the audit report to ensure market efficiency. For instance, Bursa Malaysia plans to change its Listing Requirements in terms of the time needed for the issuance of annual reports from six months to four months, which has become effective on or after 31 December 2015[2].

Referring to prior studies on ARL determinants, the majority tend to examine the relationship between ARL and corporate governance (CG) characteristics, including audit committee (Afify, 2009; Apadore and Noor, 2013; Ika and Ghazali, 2012), while others were interested in the relationship between ARL and client company characteristics (Fagbemi and Uadiale, 2011; Owusu-Ansah and Leventis, 2006). Audit firm size and industry type (Ashton, Willingham, and Elliott, 1987; Carslaw and Kaplan, 1991; Fagbemi and Uadiale, 2011) were taken as important

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[2] Bursa Malaysia Requirements, available at
http://www.bursamalaysia.com/market/regulation/rules/listing-requirements/ace-market-copy/amendments-to-listing-requirements/ (accessed on 10 July 2015).

variables in measuring ARL as well. However, only a few studies such as, Amirul and Salleh (2014), and Yaacob and Che-Ahmad (2012) tested the impact of the new accounting regulations on ARL, and these studies mainly focused on the association between the adoption of FRS rather than the MFRS convergence that started from the beginning of 2012.

The existing literature concerning the factors that can have an impact on ARL has covered many aspects, namely, corporate governance, company characteristics and audit characteristics. However, the effect of these determinants on ARL is mixed. Thus, there is a need to resolve this matter and identify the determinants of ARL using meta-analysis technique. Specifically, this study attempts to provide empirical evidence to determine whether the convergence to MFRS by Malaysian listed companies affects ARL. This study is made more comprehensive by including the determinants of ARL from the meta-analysis approach.

1.3 STATEMENT OF THE PROBLEM

On 1 August 2008, the Malaysian Accounting Standards Board (MASB) declared its plan on the full convergence to Malaysian Financial Reporting Standards (MFRS) by 1 January 2012. This shift was from the adoption of Financial Reporting Standards (FRS) to MFRS. In other words, the shift was from the FRS' adoption to the MFRS' convergence.

This adoption may have a significant impact on the timeliness of companies' financial reports due to the changes required by MFRS. This argument is supported by Yaacob and Che-Ahmad (2012) where they mentioned that the convergence to MFRS by the Malaysian listed companies has been a huge challenge to the directors due to its complexity. In addition to that, MFRS adoption requires the increase of disclosure.

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Also, it increases the risk in the audit work as accountants in the client company may not be familiar with the developments and are more likely to make mistakes. Thus, this needs more effort and time for the auditor due to the newly introduced set of standards (Hoogendoorn, 2006; Yaacob and Che-Ahmad, 2012).

Consequently, it can be predicted that the convergence to MFRS by Malaysian listed companies can have an impact on ARL. However, in Malaysia, there has been a transition towards the IFRS since 2006 with the introduction of the FRS. Therefore, due to this initial preparatory period, the ARL may not be as evident in the context of Malaysia as it is in other countries. Because of this, it would be interesting to study whether implementing the MFRS does have an effect on the ARL of Malaysian listed companies. In addition, based on prior studies, the results of ARL determinants are mixed, therefore, there is a need to resolve this issue by conducting a meta-analysis review.

1.4 AIMS OF THE STUDY

This study analyses the prior studies on ARL that contain the information needed for meta-analysis calculations, the data was collected from the annual reports of the Malaysian listed companies and DataStream for the years 2011, 2012 and 2013 in order to gather evidence about the influence of MFRS convergence on ARL. Hence, three objectives were developed:

1. To examine the association between company characteristics, corporate governance characteristics and audit characteristics with ARL, using meta-analysis review.

2. To analyse the changes in ARL before and after MFRS convergence by Malaysian listed companies.

3. To investigate the impact of MFRS convergence and corporate governance on ARL in Malaysian listed companies.

Therefore, the main research question of this study is as follows:

Research question: is there an impact of MFRS convergence on ARL of Malaysian listed companies?

From the above main research question, this study aims to answer the following sub-research questions:

1. Is there any association between company characteristics, corporate governance characteristics and audit characteristics with ARL, using a meta-analysis review?

2. Are there any significant changes in ARL before and after the MFRS convergence by Malaysian listed companies?

3. Is there an impact of MFRS convergence and corporate governance of Malaysian listed companies on ARL?

1.5 MOTIVATION OF THE STUDY

The existing literature concerning the factors that potentially may affect ARL has covered many aspects including corporate governance and company characteristics. However, there are mixed findings on the determinants of ARL, and to date, no study has sought to resolve these differences. Therefore, this study is motivated to systematically study the determinants of ARL using the meta-analysis approach that combines all previous studies on ARL determinants in one unit. This will allow for a single pattern to emerge from the diversity from prior studies' results on ARL.

In addition, prior studies have found that adopting new regulation could potentially result in increased ARL (Lee et al., 2009; McGee, 2007). Thus, this study would like to investigate whether similar findings are attained in the context of Malaysia. Since such a study has not yet been conducted on the impact of MFRS on ARL, particularly in relation to including determinants from the meta-analysis, it is hoped that this study would extend prior literature.

Timely financial reports are important to users; and although the adoption of MFRS enhances disclosure, it could result in a delay of the issuance of audit report; i.e. ARL. However, in the case of Malaysia, some transition towards the IFRS was initiated in 2006, thus, companies may be prepared for the MFRS convergence. Therefore, it would be interesting to investigate the impact of this convergence on ARL.

1.6 SIGNIFICANCE OF THE STUDY

This study looks forward to contribute in several ways: Firstly, this study contributes to the literature in ARL through providing meta-analysis review which allows to combine all former studies on ARL determinants in one unit. This will allow having one pattern of results by integrating results of several prior studies on ARL determinants. The pattern provided by the meta-analysis results will help researchers, practitioners and regulators to focus on the most significant determinants of ARL and try to reduce ARL.

Secondly, this study's sample is on listed companies in Malaysia. As listed companies have higher scrutiny from the public, it is important to promote enhanced timeliness by reducing ARL so that the financial reports are more useful in decision making. Thus, investigating the determinants of ARL in Malaysian listed companies is

important; and it becomes more important when listed companies are witnessing a very crucial event like the convergence to MFRS.

Lastly, this study may be beneficial to the listed companies themselves, auditors and regulators. For companies, some of the indicators are under their control which may make them aware of certain elements that might need improvement by the company. For auditors, testing the effect of MFRS on ARL may increase the awareness of auditors on any potential adopted future standards. For regulators, the results of this study may provide good indicators of the effect of the newly adopted standards, i.e. MFRS, in relation to ARL.

1.7 ORGANIZATION OF THE DISSERTATION

This dissertation is organized into five chapters. The current chapter presents a brief discussion of the study's background, problem statement, research objectives, research questions, motivation of the study and the significance of the study. Chapter Two provides a review of the prior literature on ARL determinants. The gap in the literature is identified at the end of the chapter.

Subsequently, Chapter Three represents the theoretical framework and research method for this study. As the main variables used in this study are corporate governance factors and MFRS, the applicability of agency theory and institutional theory are discussed in this chapter. The hypotheses are developed based on this theories. Furthermore, the research method is explained. This includes sample selection, size and data sources. The ARL determinants are discussed in more detail. Also, statistical analysis methods are described.

The research findings and the analysis of findings of the study are presented in this chapter. The study's conclusion is presented in Chapter Five. Summary and

implications of the findings are discussed in this chapter. In addition, limitations and

suggestions for future research are provided.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

In this chapter, and before discussing the literature gap, the shift to IFRS in Malaysia will be discussed. The following section will give a background on ARL literature. Subsequently, the chapter will specifically review previous studies on ARL determinants including studies on regulations' impact on ARL and provide a brief review concerning meta-analysis approach.

2.2 IFRS IN MALAYSIA

Based on the Financial Reporting Act 1997 (FRA, 1997), Malaysia established its financial reporting framework on July 1997. The Malaysian Accounting Standards Board (MASB) and Financial Reporting Foundation (FRF) were set up as a result of FRA (1997). The role of the FRF is to operate as a controller of MASB's activities. MASB functions as an issuer of the legal accounting standards in Malaysia (Abdullah, Sapiei, Ismail, and Sulaiman, 2013).

The MASB started by issuing MASB standards. However, in 2005, MASB began the initiatives to converge to IFRS. This was because Malaysia, as one of the leading capital markets in South East Asia, made an effort towards the globalization of its accounting standards (Muniandy and Ali, 2012).

The convergence to IFRS will enhance the uniformity of the standards, promote transparency and reduce the cost of issuing the standards (Muniandy and Ali, 2012). Thus, the IFRS was adopted by the Malaysian listed companies under MASB's

reinforcement. Hence, listed companies in Malaysia, with financial year end 2006 were required to start issuing their financial statements in accordance with the FRS.

On 1 August 2008, in order to converge further, both FRF and MASB decided to require the Malaysian listed companies to full convergence with IFRS by 1 January 2012, except for plantation and construction sectors, which were labelled as the Transitioning Entities (TE). Companies operating under these sectors are given until 1 January 2017 to fully converge to MFRS[3]. As a result, the FRS were renamed as Malaysian Financial Reporting Standards (MFRS), which is equivalent to IFRS[4].

After providing an overview on the IFRS convergence in the Malaysian market, a brief background of ARL will be depicted in the subsequent section.

2.3 BACKGROUND OF AUDIT REPORT LAG

This section intends to highlight on how the ARL issue was raised by identifying some earlier studies in the area.

The earliest study which mentioned ARL was conducted in Australia by Dyer and McHugh (1975). They investigated the impact of company attributes on ARL. Their research focused on preliminary lag (i.e. the number of days between the fiscal year-end and the receipt of the preliminary financial statement by Sydney Stock Exchange), audit report lag (i.e. the number of days between the fiscal year-end and the auditor's signatory date), and total lag (i.e. the number of days between the fiscal year-end and the receiving of the final annual report for publication by Sydney stock

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[3] Transitioning Entities, Available at:
http://www.masb.org.my/index.php?option=com_content&view=article&id=1905:masb-announces-the-effective-date-of-mfrs-framework-for-transitioning-entities-2-september-2014&catid=105&Itemid=37 (accessed on 21 October 2015).
[4] Malaysian Accounting Standard Board report, available at
http://www.masb.org.my/index.php?option=com_content&view=article&id=1376&Itemid=63
(accessed on 10 July 2015).

exchange). The results depicted that the total lag of 120 sample Australian listed companies between 1965 and 1971 is significantly influenced by the size of the company and the year-end closing date.

A subsequent study was conducted by Courtis (1976) in New Zealand. Courtis (1976) identified five types of reporting lags: A-lag, B-lag, C-lag, D-lag and E-lag. The A-lag represents the number of days between the end of the fiscal year and the annual general meeting. The B-lag represents the time lag between the balance sheet date and the auditor report date. The C-lag represents the number of days between the audit report signature and the annual general meeting. The D-lag represents the number of days between the audit report signature and the annual general meeting notice. Lastly, the E-lag represents the number of days between the annual general meeting notice and the annual general meeting. In Courtis' (1976) case, B-lag refers to ARL. Courtis (1976) focused on the impact of company attributes (i.e. the age of the company, the shareholders number, the number of pages in the annual reports and the type of the industry) on ARL. The results showed that the industry type is the only factor that has a significant impact on ARL.

Courtis' (1976) study did not stay long without criticism. Gilling (1977) argued that the usage of company attributes as independent variables to explain ARL is not appropriate. He suggested that the usage of audit attributes may be more useful to explain ARL. Thus, Gilling's (1977) study was the first that incorporated the audit attributes such as audit form size to examine their impact on ARL in the context of New Zeland and he found that the size of the audit firm has a significant role in determining ARL.

After the above three pioneer studies, various other literatures that tested the determinants of ARL in different periods and different contexts materialized. These

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