# THE IMPACT OF THE AUDIT COMMITTEE EXPERTISE ON AUDIT REPORT LAG: EVIDENCE FROM MALAYSIA

BY

ABDINAIM ABDI ABDULLE

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

Kulliyyah of Economics and Management Sciences
International Islamic University Malaysia

JULY 2019

# ABSTRACT

This paper investigates the influence of the audit committee expertise on the timeliness of financial information measured by audit report lag. Timeliness of financial information is essential to investors since it impacts their investment decisions. The current study empirically examines the impact of the three audit committee expertise, namely academic accounting, professional accounting, and chief financial officer experience on audit report lag. Audit report lag is defined as the day between the date of financial year-end and the date when the audit report is signed. To achieve a credible study, data were drawn from 91 firms' annual reports among the Malaysian public listed companies for the 2016 financial year-end. Agency theory and resource dependence theory are applied to explain the research framework of the present study. The findings show that the average audit report lag is 95 days, which is lower than the prior studies conducted in Malaysia. This study suggests that there are pieces of evidence of improvement in audit reporting delays among the Malaysian public listed companies. However, contrary to expectations, the multiple regression analysis shows a significant positive relationship between the percentage of the audit committee experts and audit report lag. The findings of the study may be useful to the Malaysian regulatory bodies, such as the Securities Commission and Bursa Malaysia, to better understand the extension of audit works. In addition, the findings could also be useful for a future regulation on the annual filing of reports. This may lead to an improvement in the auditors' time pressure.

# خلاصة البحث

يتناول هذا البحث تأثير خبرة لجنة التدقيق في توقيت المعلومات المالية التي تقاس بتأخر تقرير التدقيق؛ إذ يُعَدُّ توقيت المعلومات المالية ضروريًّا للمستثمرين؛ لأنه يؤثر في قراراتهم الاستثمارية، ومن خلال منهج تجريبي تختبر الدراسة الحالية تأثير ثلاث خبرات محاسبية للجنة التدقيق؛ هي: المحاسبة الأكاديمية، والمحاسبة المهنية، وخبرة المسؤول المالي الأول في توقيت تقرير التدقيق، وتبحث أيضًا ما إذا كانت الخبرات المحاسبية الثلاث للجنة التدقيق تؤثر منفصلة في تأخُّر تقرير التدقيق؛ إذ يُعرَّف تأخير تقرير التدقيق بأنه اليوم بين تاريخ نهاية السنة المالية وتاريخ توقيع تقرير التدقيق، وقد جُمعت البيانات من 91 شركة تقارير سنوية من الشركات الماليزية العامة المدرجة للسنة المالية 2016، وطُبقت نظريتا الوكالة والاعتماد على الموارد؛ لشرح الإطار البحثي للدراسة، وأظهرت النتائج أن متوسط تأخر تقرير المراجعة هو 95 يومًا؛ أي إنه أقل مما ورد في الدراسات السابقة التي أُجريت في ماليزيا، مما يشير إلى بعض الأدلة على تحسُّن التأخير في الإبلاغ عن التدقيق بين الشركات الماليزية العامة المدرجة، ولكن؛ خلافًا للمتوقع؛ أظهر تحليل الانحدار المتعدد علاقة إيجابية مهمة بين النسبة المئوية لخبراء لجنة التدقيق وتأخر تقرير التدقيق، وقد تفيد نتائج هذه الدراسة الهيئات التنظيمية الماليزية، من مثل: اللجان الأمنية، والبور□ة الماليزية، بالإضافة إلى ذلك؛ يُمكن أن تكون النتائج مفيدة في التنظيم المستقبلي للتقارير السنوية، مما يؤدي إلى تلافي ضيق الوقت لدى المدققين.

# 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.

…………………………………..
Nazli Anum Mohd Ghazali
Supervisor

I certify that I have 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 (Accounting).

…………………………………..
Sherliza Puat Nelson
Examiner

…………………………………..
Siti Alawiah Siraj
Examiner

This dissertation was submitted to the Department of Accounting and is accepted as a fulfilment of the requirement for the degree of Master of Science (Accounting).

…………………………………..
Suhaiza Ismail
Head, Department of Accounting

This dissertation was submitted to the Kulliyyah of Economics and Management Sciences and is accepted as a fulfilment of the requirement for the degree of Master of Science (Accounting).

…………………………………..
Hassanuddeen B. Abd. Aziz
Dean, Kulliyyah of Economics
and Management Sciences

# 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 for any other degrees at IIUM or other institutions.

Abdinaim Abdi Abdulle

Signature…………………...………. Date ……..…………………

## INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

## DECLARATION OF COPYRIGHT AND AFFIRMATION OF FAIR USE OF UNPUBLISHED RESEARCH

## THE IMPACT OF THE AUDIT COMMITTEE EXPERTISE ON AUDIT REPORT LAG: EVIDENCE FROM MALAYSIA

I declare that the copyright holder of this dissertation are jointly owned by the student and IIUM.



No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below

1. Any material contained in or derived from this unpublished research may be used by others in their writing with due acknowledgement.

2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.

3. The IIUM library will have the right to make, store in a retrieved system and supply copies of this unpublished research if requested by other universities and research libraries.

By signing this form, I acknowledged that I have read and understand the IIUM Intellectual Property Right and Commercialization policy.

Affirmed by Abdinaim Abdi Abdulle

……..…………………….. ………………………..

Signature Date

*I dedicate this dissertation to my mother, Sahro Mohamud Omar, and my father, Abdi Abdulle Wardheere for their love, prayers, supporting, understanding, and endurance for all my life.*

# ACKNOWLEDGEMENTS

All glory is due to Allah, the Almighty, whose Grace and Mercies have been with me throughout the duration of my programme. Although it has been tasking, His Mercies and Blessings on me ease the herculean task of completing this research work.

I am most indebted to my supervisor, Prof Nazli Anum Mohd Ghazali whose enduring disposition, kindness, promptitude, thoroughness, and friendship have facilitated the successful completion of this work. I put on the record and appreciate her detailed comments, useful suggestions, and inspiring queries which have considerably improved this dissertation. Her brilliant grasp of the aim and content of this work has led to her insightful comments, suggestions, and queries that eventually helped me a great deal. Despite her commitments, she took the time to listen and attend to me whenever requested. The moral support she extended to me is in no doubt a boost that helped in building and writing the draft of this research work.

Lastly, my gratitude goes to my beloved mother, Sahro Mohamud Omar, and father, Abdi Abdulle Wardheere for their prayers, support, understanding, and sacrifices for all my life.

Once again, I glorify Allah for His endless mercy on me, the one of which has been enabling me to successfully round writing this dissertation. Alhamdulillah.

# TABLE OF CONTENTS

# LIST OF TABLES

# LIST OF FIGURES

## LIST OF ABBREVIATION

| | |
|---|---|
| OECD | Organization for Economic Co-operation and Development |
| NACD | National Association of Corporate Directors |
| MSWG | Minority Shareholders Watchdog Group |
| KLSE | Kuala Lumpur Stock Exchange |
| GAAP | General Accepted Accounting Principle |
| NYSE | New York Stock Exchange |
| SEC | Security Exchange Commission |
| CFO | Chief Financial Officer |
| FRC | Financial Reporting Council |
| AC | The Audit Committee |
| ACCA | Association of Chartered Certified Accountants |
| MIA | Malaysian Institute Accountants |
| MBA | Master in Business Administration |
| MCCG | Malaysian Code on Corporate Governance |
| PLCs | Public Listed Companies |
| RDT | Resource Dependence Theory |
| ROA | Return on Assets |
| UK | United Kingdom |
| US | United States |
| VIF | Variance Inflation Factor |

# CHAPTER ONE

# INTRODUCTION

## 1.1 INTRODUCTION

This chapter has been segmented into various sections to discuss relevant issues. As such, section 1.2 covers the background of the study. This is followed by section 1.3, where the researcher focuses on the problem statement. The motivations for the study are discussed in section 1.4. Research objectives and research questions are presented in section 1.5. The contributions of the study are discussed in section 1.6. The structure of the study is highlighted in section 1.7.

## 1.2 BACKGROUND OF THE STUDY

The effectiveness and efficiency of financial markets depend on investor's self-assurance. The regulatory bodies such International Accounting Standard Board (IASB) have the responsibilities to improve the regulatory frameworks to the businesses as well as attracting domestic and foreign investors. Moreover, one of the main objectives of the regulatory bodies or capital market authorities (e.g. Sarbanes-Oxley Act 2002, Security Exchange Commission, NYSE, and Financial Reporting Council in the UK, Securities Commission Malaysia and Bursa Malaysia) is to improve disclosure quality. The efficiency of the financial statement is regarded as a significant feature for the yearly quality reporting. This efficiency is normally implied in timely information (Hashim & Rahman, 2011). Besides, several accounting and auditing empirical studies conducted on corporate governance in recent years have a particularly stressed significance of investigating the influence of the audit committee characteristics in monitoring financial information (Abernathy, Beyer, Masli, & Stefaniak, 2014; Ghafran & Yasmin, 2017).

The audit committee directors have been recognized as a crucial tool of the public company's corporate governance since the 1930s when the U.S Securities Exchange Commission (SEC) was set up (Fichtner, 2010). The audit committee enhances corporate governance via supervising audit-related functions, internal control, firm's financial reporting, and risk evaluation (Collier & Zaman, 2005). According to the U.S Congress, Sarbanes –Oxley Act 2002, at least one the audit committee director must be a financial expert, and other directors ought to be financially literate. Also, SEC (2002) needs that the companies have to mention the kind of financial expertise in their annual reports. This requirement infers that the SEC believes that the audit committee that lacks accounting expertise is less effective than the one with accounting expertise (Bryan, Liu, Tiras, & Zhuang, 2013).

Furthermore, SEC (2003) states that the audit committee member should possess these characteristics: (1) able to understand GAAP and financial statement; (2) able to assess accounting information; (3) working experience in auditing, accounting, and analysing financial statements; (4) able to comprehend internal control and segregation of duties; and (5) can understand the audit committee roles.

Each country has distinctive practicing corporate governance. In Malaysia, the size of the audit committee must consist a minimum of three persons, all of whom have to be non-executive directors and the majority of them should be independent directors.[1] Additionally, a minimum of one participant must be involved in an accounting body

[1] In Malaysia context, the word "independent director" refers to two essential features; namely, independent from management and independent from "major shareholders" under Chapter 1 of the Bursa Malaysia governance guidelines (Bursa Malaysia).

(MCCG, 2012). Financial Reporting Standard Board (FRSB) documented that timeliness includes enhancing the qualitative characteristic of financial statements in the conceptual framework to boost fundamentals, relevance, and faithful representation (i.e. free from error, free from biases, and completed accounting information).

The audited financial statements provide timely, highly crucial information to the capital market participants and it is also essential for regulators. Numerous stakeholders, including shareholders, managers, external and internal auditors, and regulators, are concerned about the timeliness of audited financial statements (Krishnan & Yang, 2009). It is compulsory for companies to issue audited financial reports to their stakeholders, mainly investors, within the required period; the essentiality of the timeliness of financial reports signed by an external auditor is kept in view (Sultana, Singh, & Van der Zahn, 2014).

According to the IASB, the accounting information is enhanced when the audited reports are produced on a timely basis. Moreover, the timeliness of audit reports has several merits. For instance, it may reduce information inefficiency, improve audit output in firms with timely audit reports, and increase public confidence in audited financial statements (Mande & Son, 2011). On this basis, several studies related to timeliness suggest that the advantages of a timely audit report have, for example, enhanced financial market efficiency (Afify, 2009), decreased information inefficiency among insiders and outsiders (Owusu-Ansah, 2000), improved audit quality (Leventis, Weetman and Caramanis, 2005), role in firm value (Blankley, Hurtt, & MacGregor, 2014; Schwartz & Soo, 1996).

According to Companies Acts 1965, all Malaysian public listed companies are opting to release quarterly disclosures and are required to have the audited financial statements signed by an external auditor in order to produce timely financial reporting.

According to Chapter 9.22 (1) of the Bursa Malaysian, the declaration of interim and period report to the Stock market, also known as a stock exchange (i.e. Bursa Malaysia), should be made within two months after the end of each quarter. Also, Chapter 9.23 (1) of the Bursa Malaysia, the announcement of audited financial reports with director's reports to the stock market should be made within four months after a financial year-end. If the companies do not comply with the requirements of the timeframe provided, a penalty may be imposed. The current study focuses on the audited financial statement, also known as the audit report to determine factors influencing an audit report delay.

## 1.3 PROBLEM STATEMENT

The audit committees play a pivotal role in ensuring market confidence in high quality financial reporting through the supervision of overall procedure of financial information and the nomination of appropriate qualified members of the audit committee (PricewaterhouseCoopers, 2003). Audit committee is also recognized as an essential part of a public company's corporate governance when the U.S Securities Commission was set up in 1930s (Fichtner, 2010). Audit committee enhances corporate governance via supervising audit-related functions, internal control, firm's financial reporting, and risk evaluation (Collier & Zaman, 2005). The chair position of audit committee has exceptional responsibilities, such as controlling agenda, meeting, negotiations, establishment of proper relationship with internal and external auditors, and management and enhancement of the interaction amidst audit committee members (Bédard & Gendron, 2010).

A prior study documented that a factor which influences the timeliness of reporting is the effectiveness of an audit committee, and boosting the timeliness of financial reporting (Ika & Mohd Ghazali, 2012). It is indispensable to realise that the causes of delay in audit (Carslaw and Kaplan, 2012) may simplify the structure and function of the audit profession (Ashton, Graul, and Newton, 1989) and respond to "news-driven society" releasing relevant information as soon as possible (Sultana et al., 2014). Furthermore, there is a need to recognise a good way of comprehending the determinants of audit report lag in the developing countries due to the globalization of trade and fast advancement of international capital markets (Jaggi & Tsui, 1999).[2]

Ashton et al. (1987) indicated that late releasing of information may increase uncertainty related to the decisions from the information included in the financial reports. Thus, timeliness of financial information is essential to investors since it impacts their investment decisions and decreases information inefficiency in the stock exchanges. The concern of timelier reporting also influences policymakers where they demand to reduce the time audit work. Therefore, in constructing new policies to enhance capital markets, there is a need to probe factors influencing of timelier reporting. Moreover, the length of audit report lag has underlined the demand for robust recommendations from corporate governance to enhance the overseeing of financial reporting quality.

The responsibilities of the audit committee are to oversight financial reports and audit processes, which involves confirming timelier financial statements (Bursa Malaysia, 2009). About these responsibilities, the audit committee should have a high level of accounting erudition such as knowing audit function and comprehending the element of difference between the statutory auditor and the top management, understanding auditing concerns and assessing judgmental accounting areas.

[2] Given the crucial position of the Malaysian capital markets, knowing of audit report lag of Malaysian listed companies will specifically provide useful information to investors, particularly international investors.

Malaysian companies take a long time to issue annual reports with external audit signature, as compared the conglomerate firms in western countries (Che-Ahmad & Abidin 2008). Furthermore, Mohamad-Nor et al. (2010) found that the highest number of delay in audit report is 332 days for the financial year-end in 2002. Nelson and Shukeri (2011) documented that the maximum delay audit report was 239 in 2009, indicating an extensive reduction in the maximum delay audit report, as contradicted the result by Mohamad-Nor et al. (2010). In this circumstance, additional study may be needed to investigate the latest length of postponing an audit report to reveal the recent trend of audit reporting behaviour in the Malaysian environment. Additionally, Principle 7 of MCCG (2012) stipulates the essentialness of timeliness and high quality of disclosure. Therefore, the current research explored that to determine the role of the audit committee expertise on audit report delay in an emerging country (i.e. Malaysia) by employing the most recent data, which is for the year 2016, to determine whether any new trends have emerged after the issuance of the (MCCG, 2012).

## 1.4 MOTIVATION FOR THE STUDY

The primary inspiration for the current study is the importance attached to the timely and high quality of disclosure as stipulated in Principle 7 of the MCCG 2012, Chapter 9 on the continuing disclosure, paragraph 9.23 issue of annual audited financial statement and annual reports. Therefore, it is a part of an ongoing debate that the usefulness of the audit committee influences financial reporting quality, particularly timely information.

This study is also motivated by the trends in the length of audit report lag. Nelson and Shukeri (2011) show a considerable reduction of a maximum score on audit report lag in 2009 compared to Mohamad-Nor et al. (2010) for the period 2002 financial year-end. Hence, this study uses the latest data for the financial year-end of 2016 to determine the latest length in delaying audit reports amongst the Malaysian listed firms.

Another motivation for this study is the new listing requirement of Bursa Malaysia. There are two periods for the changes in order to provide public listed companies with an adequate grace period of compliance to the above requirement. First, the announcement of audited reports for five months after financial year-end is effective for after 31 December 2014. Second, the publication of audited report during four months after fiscal year-end is effective after 31 December 2015. The companies' obligation to produce their annual reports within the new timeframe and this new requirement may affect auditors in finishing their auditing tasks. Therefore, this study offers new findings on delaying audit report and the willingness of Malaysian firms to comply with the new regulation. The efficiency of the financial statement is regarded as an essential aspect of the quality of yearly reporting. This efficiency is normally implied in timeliness information. Decreasing audit report lag may enhance the usefulness of information of the releasing firms as information is available for informed economic decision (Hashim & Abdul Rahman, 2011).

## 1.5 RESEARCH OBJECTIVES AND QUESTIONS

The primary purpose of this study is twofold. First, this study aims to investigate whether the audit committee financial expertise influences audit report lag. Second, this study examines whether the audit committee expertise (e.g., academic accounting, professional accounting and CFO experience) separately impact the delaying of audit report.

The specific objectives of this study are as follows:

1. To determine the level of delay in the audit report in Malaysian listed firms.

2. To examine the impact of the audit committee expertise, both chair and non-chair, on the audit report lag in Malaysian listed firms.
3. To determine the impact of the audit committee expertise members (non-chair) on audit report lag in Malaysian listed companies.
4. To examine the impact of the audit committee chair expertise on the audit report lag in Malaysian listed companies.

### 1.5.1 Research Questions

The following are the research questions that this study intends to answer:

1. What is the extent of audit report lag in Malaysian listed firms?
2. Does the audit committee expertise, both chair and non-chair influence the audit report lag in Malaysian listed firms?
3. What is the impact of the audit committee expertise members (non-chair) on audit report lag in Malaysian listed companies?
4. Does the audit committee chair expertise has an impact on the audit report lag in Malaysian listed companies?

## 1.6 CONTRIBUTION OF THE STUDY

The current study contributes to theory and practice in several ways. The present study is built on resource dependence theory and agency theory. It considers examining the audit committee expertise classified by position – chair and members, as well as by accounting experts, such as academic accounting qualification, professional accounting qualification, and CFO experience. Based on resource dependence theory, this study helps to identify whether expertise is suitable for audit efficiency, hence, timely reporting in Malaysia. Concerning agency theory, this study provides whether the audit committee expertise may solve agency problems in Malaysian listed companies. The different business settings in western and developing countries suggest that agency issues may have different effects in both economies including financial reporting. Hence the present study provides some evidence on the applicability of agency theory in a developing country.

Additionally, this study highlights results that are important to academic researchers, practitioners, and standard setters. These include evaluation of how the audit committee financial expertise requirement may need adjustment, and need to address future standards. This study also stresses the extent to which auditing works may be affected by the audit committee expertise amongst companies in Malaysia. Thus, this study is expected to offer some practical implications in enhancing audit practices as well as in setting a new requirement.

## 1.7 STRUCTURE OF THE STUDY

The current study encompasses six chapters.

**Chapter one:** This chapter focuses on the background of the study, where the audit committee expertise and audit report lag are discussed; problem statement; motivation for the study; research objectives and questions, the contribution of the study, and organization of the study.

**Chapter two:** This chapter reviews the literature for this study. It explains the concepts of corporate governance, audit report timeliness, and the audit committee expertise. It also discusses previous pieces of literature that are related to factors determining audit report lag; which include corporate governance factors, audit-related factors, and firm characteristics factors. Finally, the chapter ends with highlighting the literature gap.

**Chapter three:** This chapter discusses the resource dependency theory and agency theory which are related to corporate governance and the audit committee characteristics. It is then followed by the theoretical framework along with hypothesis development. The chapter concludes with the expectation of the relationships between the independent variable, control variable, and audit report lag.

**Chapter four:** This chapter discusses the research design, sample selection, data collection, variable measurement, and data analysis, such as normality test, collinearity and multicollinearity, descriptive statistics, correlation analysis and regression design with model development

**Chapter five:** Chapter five presents the findings and results are compared to prior studies and interpreted within the theoretical framework employed.

**Chapter six:** This chapter discusses the overall findings and implications of the study. The limitations of the study are also discussed. Finally, the chapter concludes the study with recommendations for future research.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 INTRODUCTION

This chapter is divided into five main sections. Section 2.2 discusses the development of recommendations of the governance of the company; a synopsis of corporate governance at the international level to improve recommendations of corporate governance and the MCCG, in order to highlight the importance of corporate governance. Section 2.3 explains the concept of audit report timeliness. Section 2.4 presents the concept of the audit committee expertise. Section 2.5 discusses factors determining audit report lag and these factors are: corporate governance-related factors, audit-related factors, and company's characteristic-related factors. Section 2.6 highlights the research gap. Finally, section 2.7 summarises this chapter.

## 2.2 DEVELOPMENT OF THE CODES OF CORPORATE GOVERNANCE

The demand for good corporate governance has increased in the aftermath of a spate of accounting scandals, such as Enron, WorldCom, Swissair, Global Crossing and CMS Energy. It is widely claimed if there is no proper corporate governance that may have contributed to corporate failure. Hence, this section addresses the efforts towards obtaining good corporate governance from international bodies, empirical researches, and in Malaysia. It also presents the evolution of the MCCG.