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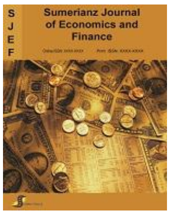


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# Effect of Audit Delay on the Financial Statements

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## Abstract

The main objective of this study is to examine the effect of audit delay on the financial statements. The specific objective is to identify specific variables relating to company and auditor characteristics that are relevant for examining audit delay in Nigeria. It also caters to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of management and for making economic decisions. The study revealed that "first time" qualifications delay the release of companies' preliminary profit and the distribution of corporate annual report. This is due to an increase in the year-end time taken to complete the audit and also an increase in auditor-client negotiation time as a result of impending qualification. We therefore recommends that the reduction of audit delay requires strong enforcement of laws and deadlines by the regulatory bodies in Nigeria, companies should evaluate and improve the internal control systems by designing a system in accordance with scale and complexity and the risk content of lending, trading, investing and other activities and also audit firms should plan their schedules to accommodate the deluge of work around the peak season and employ more staff, perhaps on a casual basis to deal with the extra workload.

**Keywords:** Audit delay; Financials statements; Auditor characteristics.
**JEL:** M41; M42.

## 1. Introduction

Financial statements communicate crucial information about the financial health of a company. Financial statements must be made available to stakeholders in time so that they can use the information reported therein to make important decisions. No matter how informative or well-prepared, the value of a financial report depreciates if it is not made available in time for users to make informed decisions. Therefore, the usefulness of published corporate financial statements depends on their timeliness as well as their accuracy. Around the world, delay in the auditing of financial statements has been identified as leading to an overall delay in their publication. While auditing is indispensable for ensuring the accuracy and transparency of published financial statements, there is a need to address the delays caused by auditing. This problem of audit delay is particularly pernicious in developing countries where regulatory norms for the timeliness of auditing are not enforced properly and where the general business culture is not attuned to observing punctuality and efficiency in matters like financial reporting. In addition, there are deficiencies in the support structure of the auditing profession, whether in terms of skilled professionals or the number of auditing firms, which further contribute to the problem of audit delay.

Audit delay caused by inefficiencies or obstacles during the process of auditing is an important factor in the timeliness of publishing financial statements. This study investigates the determinants of delay in publishing the audited reports of Nigerian companies. It aims to identify variables relating to the attributes of companies and their auditors which can cause audit delay.

One resource that can be used for decision making of users which is reliable is audited financial statement. It should be considered that information in financial statement can be used effectively when they have several quality characters. One of them is timeliness. Leventis *et al.* (2005), states that timeliness of financial statements is the focus of an increasing amount of attention by accounting researchers and regulatory bodies. It is known that information is sensitive to the passing of time and it lose its usefulness in decision making. So, less duration between year end and time of audit report, more information content are provided.

In this study, it is investigated the audit delay factors. One reason that companies justify their delaying financial reporting is that audit opinion is not reported and it is because financial report is not assert before audit opinion is reported. Timelines of corporate audited annual financial reports is considered to be a critical and important factor affecting the usefulness of information made available to external users (Almosa and Alabbas, 2008). The length of the audit process highly affects the timelines of corporate financial reporting. The timeliness of financial reporting and audit delay has investigated in various countries. McGee (2009), presented a comparative study of companies in Russia and the USA with consideration of the timeliness of financial reporting and audit delay. Naimi *et al.* (2010), examined audit delay in Malaysian public listed companies. Their study results showed that active and larger audit committee shortens audit delay. Hegazy and Al-Ghanem (2011), analyzed the factors that affect delays in the signing of audit reports in Kuwait.

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Abdelsalam and Street (2007), examined the timeliness of corporate internet reporting by U.K. companies listed on the London Stock Exchange (LSE). Their results indicated that Companies need to voluntarily focus on improving the timeliness dimension of their corporate internet reporting so that the EU and U.K. Hence, the aim of current Study is to investigate the determinants of audit delay for listed stock companies in Tehran Stock Exchange.

The objective of this paper is to identify specific variables relating to company and auditor characteristics that are relevant for examining audit delay in Nigeria. And also to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of management and for making economic decisions.

## 2. Concepts of Audit Delay

The term "audit delay" has been used to denote the elapsed time between the close of a fiscal year and the end of audit fieldwork. The latter is normally the date on which substantive audit tests are completed and the auditor leaves the client's premises. It is typically documented by the dating of the auditor's published report. Several prior studies consider the relation of various possibly causal factors to audit delay. Factors that have been investigated include: presence of accounting or disclosure issues such as extraordinary items, loss contingencies, uncertainty audit qualifications and accounting changes (Ashton *et al.*, 1987), nature, size and complexity of client operations and controls and proportion of audit work after year end Ashton *et al.* (1987) and whether the audit firm tends to follow a structured audit approach.

It has been suggested that management has incentives to exercise discretion over the timeliness of reporting (Verrecchia, 1983). In particular, it has been hypothesized that bad news is released later than good news and empirical research strongly supports this contention (Chambers and Penman, 1984). Givoly and Palmon (1982) suggested that variability in the length of the annual external audit is a factor that explains variability in reporting delay. Ashton *et al.* (1987), also examined the relation between audit delay and a set of explanatory variables. They examined 14 variables from 488 U.S. clients of Peat, Marwick, Mitchell & Co. in 1981-82 and their sample included both public and nonpublic clients from six industries.

Because the distribution of audit delay was positively skewed the authors used the log of audit delay as the dependent variable. The adjusted R-Square was approximately 26%, with five variables significantly associated with the dependent variable. These five variables were: log of revenue, quality of internal controls, operational complexity, relative mix of interim and final work and whether company ownership was public or private. The Ashton *et al.* (1987) analysis of company ownership found that audit delay was significantly shorter for public companies. That is, after controlling for other factors, public companies were audited faster than private companies. The study also separately analyzed public and private companies to explore whether the explanatory variables were differentially related to the two subsamples. The results from the two subsamples were not similar. For example, whereas company size significantly affected audit delay for private companies it was not associated with audit delay for public companies. Further, the adjusted R-Square was much larger for public than private companies. These findings suggest that company ownership may directly influence audit delay and that the relationship of other explanatory variables may be contingent upon the type of company ownership. Whittred (1980), finds that first time audit report modifications for uncertainty and for accounting defects for Australian firms from the mid-1960s to the mid-1970s were associated with significant increases in audit delay. Those with report modifications averaged 106 days while a matched sample of firms without modifications averaged 86days.

Audit report dates were obtained for the Kinney and McDaniel (1993) sample of 73 firms disclosing in their 1976-1985 annual reports correction of first, second, or third quarter earnings previously reported. Four firms were deleted because they publicly disclosed the correction prior to fiscal year end. The sample was extended by searching NAARS for 1986-1988. Sixteen additional firms were identified, for a total of 85 firms.

ARL is the period of time taken from company's financial year end to audit report date. This condition is what makes financial statements relevant and reliable in financial reporting timeliness for high decision making. Ashton *et al.* (1989), observed that delay in financial statements affects the timeliness of information provided thereby rendering decision making to be stale.

Studies on financial reporting and auditing have been conducted for over three decades. However, studies by Whittred (1980) argue that ARL is determined by company's fiscal year end at the highest of its audit season in nonfinancial companies. In contrast, he observes that longer ARL is associated with companies with qualified audit opinion or those in distressed financial situations. In the same vein, Ashton *et al.* (1987) show that ARL is determined by complexity of operation, company size, listing status, profitability and risk factors, company debts as a strong determinant of ARL. Ashton *et al.* (1989), argued that ARL is generally longer for highly structured audit firms than audit firms with critical audit process. Other scholars in extending prior research concluded that audit delay is a function of audit approach employed by the auditor.

Timeliness of financial statements is generally conceptualized in literature as the time it takes the company to present its financial reports before its shareholders in the Annual General Meeting after the closing date of such company. The International Accounting Standard Board (2008) sees timeliness as making the financial information available to users on time so as to influence their decision. Timeliness thus requires that information should be made available to the users as quickly as possible. The shorter the time between company's financial year-end to the date of the auditor's report, the more the benefits that can be obtained from the audited financial statements.

Due to the importance attached to the timeliness of financial reporting, different national regulatory authorities have recognized the need to set a maximum time financial reports should be made available to the shareholders. In Nigeria, the Company and Allied Matter Act (CAMA) 2004 requires each company to hold its annual general meeting, where the financial statements would be presented before the shareholders in a period not more than fifteen month after the last annual general meeting (S. 213, 214 & 218). This implies that the period of reporting delay allowed by the Company and Allied Matter Act in Nigeria is a maximum of six months. This is unlike the situations existing in Turkey and United State of America where for instance, the Istanbul Stock Exchange (ISE) requires audited financial statements of companies to be published within fourteen (14) weeks after the end of the year of companies. And in the USA, Security and Exchange Commission has in fact reduced the filing deadline for financial statement of companies from 90 days to60 day so as to improve the efficiency of market in USA (Lehtinen, 2013).

## 3. Causes of Audit Delay

Prior empirical studies in developed countries provided evidence that audit timeliness is an influential factor in the audit of financial statements. Further researches have been conducted on the causes of ARL by Leventis *et al.* (2005). The results of their studies show that ARL is affected by complexity of an audit as a result of client size and types of transaction information. In the same vein, Alali and Elder (2014) argue that ARL is determined by such factors as size, profitability, income restatement and abnormal fees. In recent study, Blankley *et al.* (2014) find positive association between unexpected ARLs and future restatements.

Despite the wealth of empirical research on the subject however, much remains unknown about how boards attend to their task of controlling lapses in reporting quality due to ARLs. This study examines whether size of the board of director’s through different committees, such as audit committee, risk management committee and audit quality positively influence

### *3.1. Identifying Factors of Audit Delay*

Audit delay for this study is defined as the number of days between the date of the financial statements and the date of the auditor’s report. In order to identify the source of audit delay, Courtis (2006) attempted to identify whether it was management or the auditor who was responsible for the lack of punctuality in realizing audited annual reports. Auditors, however, offered three reasons why they should not be held to blame. They argued that the main cause of lag in the actual auditing process was the company’s inability to keep its accounts up-to-date. This prevented the auditors from immediately commencing a meaningful audit review as they had to spend some weeks bringing the accounts up to book. The auditors claimed that in some cases the reports were post-dated to coincide with the publishing of the printed annual reports. The auditors argued that inefficiencies in the printing industry also caused long reporting delay. This gives rise to a debate between auditors and companies on who is to be held responsible for the delay. In Courtis’ view, however, it is wrong to lay the blame squarely on either management or the auditor despite the protestations by the auditors. Instead, Courtis argued that there is a whole complex of reasons arising from the interaction between the two which leads to audit delay. Courtis considered it unpolitic to hold either one of the two parties completely responsible for the lack of punctuality. This echoes remarks made by other authors who have argued that the length of a company’s reporting delay is the outcome of an interaction between the auditing firms’ attributes and the companies’ attributes which jointly determines the duration of the yearend audit period.

## 4. Financial Statement

Financial reporting emerged during the rapid industrialization of the 19th century, but accounting legislation did not appear until the first half of the 20th century Schröter (2008). It was not until the 1970s that special attention was given to the objectives of the financial statements by accounting professionals in various countries. A number of international reports have been published to identify the purpose of accounting information and the content of financial statements.

Informing a company’s stakeholders about its operations, profits and current status needs to be checked by an external auditor to ensure its veracity and reliability. In other words, it is not possible to release annual financial statements unless they have been subjected to an external audit and have been verified to be correct. But sending the report to auditors, conducting the audit and negotiating the final statement often turns into a long process that could contribute to delay in the actual publication of the report. Audit delay is generally defined as the excess time taken to audit a financial statement and it is measured by the length of time from a company’s fiscal yearend to the date of the auditor report. This demonstrates the vital role of the timeliness of the auditing process in determining the timing of information release.

Financial statements portray a truthful picture of the company’s financial performance and if they comply with the stipulations of the International Financial Reporting Standards (IFRS). This opinion is published through an appropriate audit report to interested parties such as investors and authorities. The audit report can thus be recognized as the end stage of the auditing process and represents the culmination of the auditor’s task.

There is no doubt that users of annual reports consider the auditor’s report to be a critical device for assuring that the information given to them fairly represents the facts of a company’s situation, or that it shows the nature of the biases if the annual report is inaccurate. The purpose of independent expert opinion given in an audit is to lend credibility to the financial statements released by a company. Auditing is useful in a number of different contexts and is comprised of two main types internal and external. Internal auditing, which is performed by an employee of the entity, aims to determine whether the existing system in the company is effectively designed to communicate management’s directives, collect necessary data, and report results to the management.

All listed companies are required to prepare their financial statements according to IAS and these statements are to be verified according to international accounting and auditing standards. In addition, listed companies are required to publish their financial statements, notes to the financial statements and auditor's report in at least two prominent domestic newspapers within a week of their ratification by the company's general assembly. Moreover, listed companies are now required to publish quarterly financial statements with a summary from an external auditor's report.

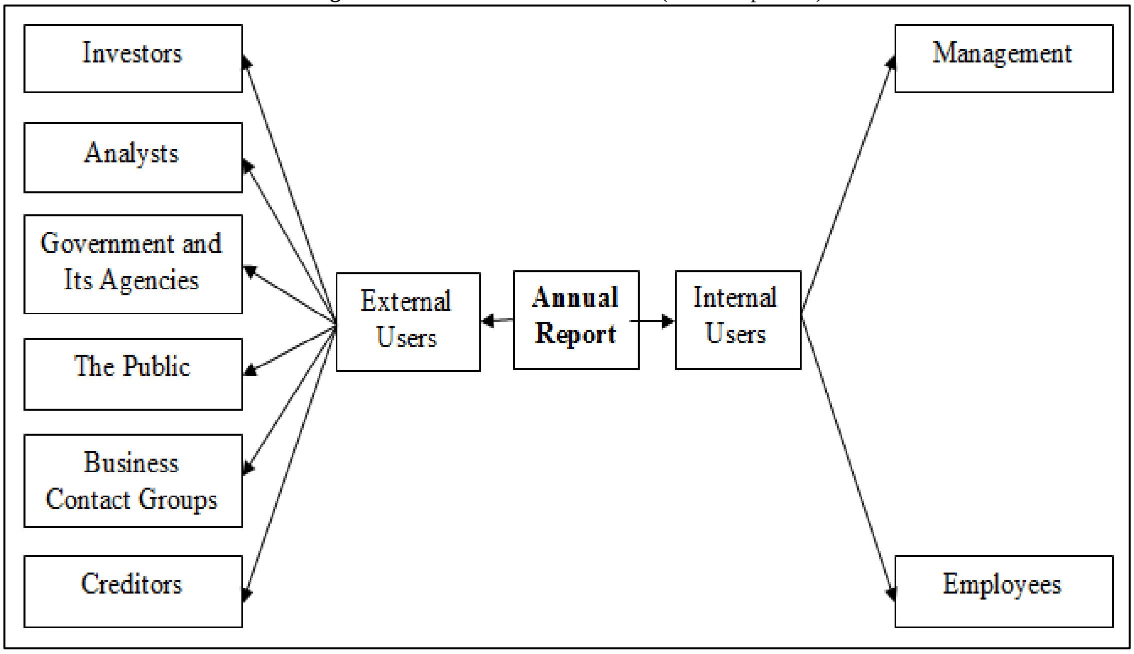
### 4.1. Users of Financial Statements

As discussed previously, one of the main objectives of financial reporting is to provide information that is useful to a variety of potential users who are interested in seeing financial and other information related to the company in order to make business decisions. Financial information users are the main reason why financial statements are prepared. This group is made of a number of possible users with different interests and different objectives and this presents a significant challenge for disclosure regulation. A particular difficulty in this area relates to identifying the best approach to balancing the different and competing needs of various user groups of financial statements (Villiers, 2006).

## 5. Audit Delay and Financial Statement

Timeliness is not only a general criterion of the usefulness of financial statements but, more specifically, timely financial reporting is crucial for share pricing and investment decision-making in the stock market.

**Figure-1.** Users of Financial Statements (Own compilation)




Canadian Institute of Chartered Accountants (CICA) (2008), claims that timely reports contribute to the efficiency of capital markets in correctly pricing securities on a continuous basis and companies must release reliable information to investors and their advisers on a timely basis. Miller and Bahnson (2002), states that the more quickly information is published, the more quickly uncertainty is removed and the inevitable result of timelier reporting is lower capital costs and higher security prices. The provision of timely information in the corporate report is of even more importance in emerging economies. This is because other sources of information such as media releases, news conferences and financial analysts are not well developed and regulatory bodies are not as effective in developing economies as they are in developed economies.

In fact, several studies have found that timeliness is not merely a good characteristic of financial reporting in theory; it also has a proven positive relationship with security prices. This has been proven by a number of studies conducted in the U.S which have found that the share price rises when a firm releases its earnings report earlier than expected, and it declines if the earnings report is released later than. Chambers and Penman (1984), used a sample of the annual earnings announcements of 100 randomly selected 64 companies listed on the New York Stock Exchange over the period 1970–1976 to investigate the relationship between the timeliness of earnings reports and share price behavior surrounding their release. The results showed that abnormal returns associated with the release of reports published earlier than expected were positive in nature, while abnormal returns associated with release of reports published later than expected were negative. Kross and Schroeder (1984), examined the association between share prices and the timing of earnings announcements in a sample consisting of 3552 quarterly earnings announcements of 297 companies covering the period 1977–1980. They found that companies which announced their earnings results early had returns that were significantly higher than the returns of companies announcing them late. McGee *et al.* (2013), explain the relationship between the speed with which financial results are announced and the effect on stock price.

From research in Australia, Whittred and Zimmer (1984) and Whittred (1980) have classified reporting delay into:

1. Preliminary Delay which refers to the interval of the number of days from the year-end to the receipt of the preliminary final statement by the Stock Exchange.
2. Auditor's Signature Delay which refers to the interval of the number of days from the year end to the date recorded as the opinion signature date on the auditor's report.
3. Total Delay which refers to the interval of the number of days from the yearend to the receipt of the published annual report by the Stock Exchange.

Ashton *et al.* (1989), studied the relationship between audit delay and audit firm structure for 300 Canadian firms. They found that longer audit delay was significantly associated with smaller clients, non-financial clients, existence of extraordinary items and structured audit firms. On average, the delay of audit report was recorded at 54 days. Carslaw and Kaplan (1991), examined New Zealand public listed companies using a model that is based on Ashton *et al.* (1987). In the study, they tested two hypothesis variables, namely, company ownership and debt proportion. Although the results were in the predicted directions for both variables, the results were not consistent for different datasets in terms of statistical significance. Debt proportion for example, was significant in 1988 but not in 1987. With respect to company ownership, a significant effect was only found for 1987, but not in 1988. Whittred (1980), examined the effect of audit qualification on the timeliness of corporate annual report by using a univariate relationship test approach. The result of the study indicated that "first time" qualifications delay the release of companies' preliminary profit and the distribution of corporate annual report. This is due to an increase in the year-end time taken to complete the audit and also an increase in auditor-client negotiation time as a result of impending qualification. In general, the study concluded that "the more serious the qualification, the greater the delay" (Whittred, 1980).

The Ashton *et al.* (1987) analysis of company ownership found that audit delay was significantly shorter for public companies. That is, after controlling for other factors, public companies were audited faster than private companies. The study also separately analyzed public and private companies to explore whether the explanatory variables were differentially related to the two subsamples. The results from the two subsamples were not similar. For example, whereas company size significantly affected audit delay for private companies it was not associated with audit delay for public companies. Further, the adjusted R-Square was much larger for public than private companies. These findings suggest that company ownership may directly influence audit delay and that the relationship of other explanatory variables may be contingent upon the type of company ownership. Whittred (1980) finds that first-time audit report modifications for uncertainty and for accounting defects for Australian firms from the mid-1960s to the mid-1970s were associated with significant increases in audit delay. Those with report modifications averaged 106 days while a matched sample of firms without modifications averaged 86 days.

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## 6. Conclusions

The timeliness of audited corporate annual financial reports is considered to be a crucial and an essential factor affecting the usefulness of information made available to various users. Thus accounting information is required to be made available within a short period of time from the end of the reported period; otherwise, it loses some of its economic value. Therefore, reducing audit delays and improving timeliness of audit reports is recognized by the accounting profession, users of accounting information, and regulatory and professional agencies as an important characteristic of financial accounting information. Using the ordinary least squares regression analysis, this study found the following; (i) a significant relationship exist between Board size and Audit report lag. (ii) A significant relationship exists between board independence and Audit report lag (iii) A non-significant relationship exist between audit firm type and Audit report lag.

In achieving improvement in the timeliness and in achieving the objective of making the financial statements readily available for making timely decisions, the Nigerian stock exchange, securities and exchange commission, the Financial Reporting council, the Central Bank of Nigeria and other regulatory bodies should put in place measures to ensure strict compliance with the laid down rules and regulations and also, the it was discovered that the time lag prescribed by the regulatory bodies are usually too much thus encouraging companies to engage in the act of delaying their financial statements. Also, companies should put in place measures of reducing the time lag between the financial year end and the Annual General Meeting (AGM). In order to boost the confidence the financial statement users have in using financial statements for decision making. Companies should however consider the cost and the benefit of timely disclosure. Furthermore, measures should be put in place to ensure that the audits of companies are carried out in due course.

The present study has sought to explain the determinants of audit delay in a Nigerian environment. The results were broadly consistent with previous studies done in Western countries. Size, complexities, directors' shareholdings, the size of auditor, audit opinion and the profitability of the companies are the major determinants of audit delay. The same results were also found in non-banking and finance sector. However, only directors' shareholdings was found to be significantly associated with audit delay at a one-percent significant level while client complexities and audit opinion were significant at the ten-percent level. Differences in regulatory framework were offered as one of the possible causes for the differences.

There are possible limitations to the design described in this study, especially regarding the measurement of directors' interest. The interests of the directors are disclosed in the director's report. However, the data may not reflect the accurate percentage of ownership as both direct and indirect shareholdings are included in total interests in many cases. Furthermore, the presence of institutional shareholders and the use of nominee companies to register shareholdings may also add noise to the analysis. However, the new amendments to the Companies Act 1965 provide clear definitions of what constitutes the "interest(s) in shares" (Cheong, 1990).

# Recommendations

In the light of the findings of the study and the critical discussion of the factors that impede the timeliness of the audit report, it is possible to make the following recommendations to reduce audit delay in Nigeria:

1. Audit delay in Nigeria seems to be longer than that found in studies of other countries. The reduction of audit delay requires strong enforcement of laws and deadlines by the regulatory bodies in Nigeria.
2. More effort is urgently needed on the part of the Nigerian companies to complete their financial statements on a timely basis. In particular, in terms of the size and nature of the company, this paper has identified that audit delay is particularly significant for large companies and non-financial companies. Although a longer delay is inevitable for large companies due to the extensive auditing work generated, many of these large companies also depend on capital from external investors; and so must realize that there is a great incentive to publish their reports early to maintain the positive interest of stakeholders. Large companies must perform more interim recording work, engage large auditing firms and pressure auditors to complete the audit work in a timely manner.
3. In addition, it was found that companies reporting extraordinary items and companies with a 31 December yearend also experienced significantly longer audit delays. Whenever a company anticipates extraordinary items in its annual report for the fiscal year, it must make a concerted attempt to expedite its reporting process and hand its report to the auditors shortly after the end of the fiscal year. Companies are also advised to shift their fiscal year-end from 31 December to a date outside the peak season, assuming their functioning or prospects are not hindered in any way by this change.
4. Maintaining a system of accountability and reporting throughout the year within the company can help reduce the amount of audit hours needed at the end of the financial year and assist auditors to do their final audit work. Moreover, companies should evaluate and improve the internal control systems by designing a system in accordance with scale and complexity and the risk content of lending, trading, investing and other activities.
5. Audit firms should plan their schedules to accommodate the deluge of work around the peak season and employ more staff, perhaps on a casual basis to deal with the extra workload.

## *Research Contribution*

In terms of this paper, its contributions mainly pertain to its investigation and application of existing theory to a new research area which has not been examined so far, i.e. audit delay in Nigeria. The following points outline some contributions made by the study:

1. As far as the researcher is aware, this is some of the few works that examines audit delay in Nigeria. Thus, this study makes a significant contribution to the existing literature on the timeliness of the audit report as well as auditing procedures in Nigeria. Moreover, the analysis in this study will provide a broad base for other researchers, in Nigeria especially, to build their studies upon.
2. The findings of this study could be compared with other developing countries who share similar socio-economic environments as well as with other developed countries.
3. To the best knowledge of the researcher, this is this some few work to investigate audit delay from the auditors' perspective to investigate the problem and arrive at conclusions.
4. The results of this study should help researchers or other parties interested in the timeliness of the audit report since they highlight the most significant factors that may cause audit delay in the Nigerian context.
5. The evidence presented in this study on the timeliness of the audit report may help regulators to take some urgent action to improve the timeliness of financial statements in Nigeria, for example, reducing the deadline for the release of financial statements to three months instead of the present six months.

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