

IMPACT OF AUDIT QUALITY ON FINANCIAL REPORTING TIMELINES OF CONGLOMERATES IN NIGERIA

¹IBRAHIM ALI, ²ZAINAB YERIMA & ³ADAMU DANLAMI AHMED

^{1,2,3}Department of Accounting, Faculty of Arts and Social Sciences,
Gombe State University, Gombe State, Nigeria

E-mail: awhilewithalee@gmail.com¹; zainabyerima02@gmail.com²;
adamud.ahmed63@yahoo.com³

ABSTRACT

Timely financial reporting is one of the qualitative objectives of financial reporting. The essence of financial reporting is for disclosure of relevant information required by stakeholders for different purposes on a timely basis. Timeliness is therefore crucial and hence the need to determine factors affecting financial reporting timeliness. This study therefore examines the impact of audit quality on financial reporting timeliness of conglomerates in Nigeria. Data for the study were obtained from the annual report of the sampled companies from 2010 to 2016. Audit quality was measured using modified Jones model discretionary accruals while financial reporting timeliness was measured as the number of days from the financial year end to the date of AGM. The data were analyzed using OLS and random effect regression and the study observed that audit quality has positive and significant impact on financial reporting timeliness of conglomerates in Nigeria. The study also recommends that auditors should place more emphasis on audit quality so as to improve financial reporting timeliness of corporate entities.

Keywords: Audit Quality, Financial reporting timeliness, Discretionary Accrual, Audit lag.

1. INTRODUCTION

Good corporate governance and the law require that entities' financial statements be audited and published at regular intervals. This promotes public accountability and transparency. Poorly conducted audit leads to the provision of a low quality financial report which can mislead users of financial information. The information in the audit, which is required by the various stakeholders (such as investors, creditors, government, becomes relevant when it is presented precisely, accurately and timely. Givoly and Palmon (1982) opined that the value of the timeliness of financial reporting is an important element for the benefit of the financial statement.

Audit quality refers to an audit carried out the result of which indicates that the auditor has been able to detect material misstatements/exceptions in the client's financial statement and ensures that they are rectified timely. Audit quality is a

function of the auditor's ability to detect material misstatement (technical capabilities) and reporting the errors (auditor independence) (De Angelo, 1981). Titman and Trueman (1986) found that high audit quality would improve the reliability of financial statement information and allows investors to make more precise estimate of the firm's value.

Financial reporting timeliness is one of the most important objectives of financial reporting. The information contained in financial statement is a key guide for informed decision making. However, delay in financial reporting is inimical to the facilitation of such decision making. Timeliness in Accounting refers to the need for accounting information to be presented to the users in time to fulfill their decision making needs. Financial information presented timely is generally more relevant to users.

The essence of financial reporting is for disclosure of relevant information required by stakeholders for different purposes. Timeliness is therefore crucial and hence the need to determine factors affecting financial reporting timeliness. Owusu-Ansah (2000) posited that timely reporting is a function of audit related and company specific factors. Audit related factors are those factors that are likely to impede the auditor in carrying out the audit assignment and issuing out the audit report timely while company specific factors are those that either enable the management to produce more timely report or reduce cost associated with undue delay in reporting. Thus, company specific factors include company size, profitability, gearing and company age.

This study focused on audit related factor and relevant studies had been conducted in developed countries on how audit related factors specifically, audit firm size; audit independence; qualified audit reports affect financial reporting timeliness. Among these studies are the studies of Soltani (2002), Al-jami (2008), Al-Ghanem (2011) and My, Hoang and Hong (2015). Where these previous studies examines the effect of audit related factors individually on financial reporting timeliness, this study advances on this studies by considering audit quality measured by discretionary accruals as a composition of all audit related factors that enhances the quality of audit service. The objective of this study therefore is to assess how the quality of an audit may lead to timely or delayed financial reporting.

The study is made into five sections, the first section gives an introduction on the study, In the second part of the paper, extensive definitions of the key variables were conducted and review of extant empirical work, the subsequent part showcase the methodology used in analyzing the data collected followed by analysis and

discussion of the data. A brief conclusion was presented in the last section, stating the findings, as well as recommendations.

2. LITERATURE REVIEW

Concept of Audit Quality

There are several definitions of audit quality, which remain contentions within academic cycles. So far, the objective of a particular research study determines which definition best suits the requirement. There is the need for a universal definition which will be unanimously agreed by scholars.

De Angelo (1981) stated that the quality of audit services is defined to be the market assessed joint probability that a given auditor will both discover a breach in the client's accounting system, and report the breach. This is the most widely used definition of audit quality. In the same vein, Sayyed (2013) opine that audit quality could be a function of the auditor's ability to detect material misstatement and reporting the error.

Audit quality has also been defined as meeting investor's needs for independent and reliable audits and robust audit committee communications on financial statements, including related disclosures; assurance about internal control; and going concern warnings (Sayyed (2013).

Audit quality is also viewed as a component of the quality of accounting information disclosed and higher disclosure quality leads to lower information asymmetry between traders (Clinch, Stokes & Zhu, 2010).

Titman and Trueman (1985) earlier observed that a high-quality audit is an audit that improves the reliability of financial statement information and allows investors to make more precise estimate of the firm's value. A higher quality audit therefore increases the probability that the financial statements more accurately reflect the financial position and results of operations of the entity being audited.

Determinant of Audit Quality

Earnings quality is being observed as a determinant of audit quality, as high quality of audit alleviates the degree of earnings management and enhances the informativeness of financial reports.

Recent stream of literature argues that audit quality is the quality of the audited earnings as a result, many research papers have used earnings quality as a substitute definition for audit quality and this kind of definition conforms to the statement made by Titman and Trueman (1986).

It has also been recently found that audit firm tenure can be differentiated by the market perception of audit quality. The research study of Hakim and Omri (2010) has also adopted audit firm tenure as one of the three observable measures to assess audit quality. It mainly examines whether the length of relationships between auditors and clients could impair auditor independence. That is the major argument to call for auditor rotation on a regular basis.

According to Hakim and Omri (2010) audit quality improves with tenure because auditors can easily detect errors and frauds of the company based on familiarity of its business operations and reporting issues.

In view of these therefore, this study also consider the view that audit quality is a function of earnings quality which was used as proxy for audit quality in the study.

Concept of Financial Reporting Timeliness

Financial reporting timeliness has been a burning issue within accounting cycle for decades. Hitherto, financial reporting was generally made through the print media and therefore takes months to reach stakeholders in diverse geographical location. With the advent of the world wide web (the internet), audited financial statement get to its intended audience on real time basis. Timely financial reporting is one of the qualitative objectives of financial disclosure. The essence of financial reporting is for disclosure of relevant information required by stakeholders for different purposes. Timeliness is therefore crucial. Financial reporting and mandatory disclosures became ever more important following the dramatic collapse of Enron and Worldcom in the United States of America in 2001 and 2002 respectively and the collapses were adjudged as the biggest audit failure in history (Bratton, 2002).

Timeliness in Accounting refers to the need for accounting information to be presented to the users in time to fulfill their decision making needs. Financial information presented timely is generally more relevant to users.

Owusu-Ansah (2000) conceptualizes timeliness to denote a quality of being available at a suitable time and being well timed. The key variable in timeliness is the delay in release of annual reports.

Determinants of Financial Reporting Timeliness

In line with the previous research, various measures had been used to determine financial reporting timeliness of corporate entities.

Dyer and McHugh (1975) defined financial reporting timeliness as reporting time lead which is determined as the difference between the financial year end of a reporting entity and audit report date, preliminary earnings announcement date or final report date.

Owusu-Ansah (2000) also posited that final report lead time is the number of calendar days between a company's financial year end and the date on which its financial report is received by Zimbabwe stock exchange (ZSE).

Soltani (2002) opined that financial reporting timeliness is a function of audit delay and that this can be determined as the difference between the financial year end of a corporate entity and the date of annual general meeting (AGM). The argument made was that the date the report is being made to the public is the AGM date this is because the reports are being approved at the AGM before being made public. Therefore, the AGM date should be the date the report is assumed to be made to the public.

Al-jami (2008) observe that there are three measures of financial reporting timeliness which were describe as reporting lag. These are auditor's lag which is defined as the number of days from the year-end to the time when the auditors sign the report, after making their opinion about the companies' accounts, the interim period also defined as the number of days from the opinion signature date on the auditors' reports to the publication date, that is, the date annual reports are made available to the public and lastly, the total period defined as the number of days between the financial year-end and the publication date. This period represents the sum of the auditors' signature period and the interim period.

Audit Quality and Financial Reporting Timeliness

Owusu-Ansah (2002) carried an empirical investigation of the timeliness of annual reporting by 47 non-financial companies listed on the Zimbabwe Stock Exchange. The results of a descriptive analysis indicate that 98% of the companies in the sample reported promptly to the public (i.e., submitted their audited annual reports to the Zimbabwe Stock Exchange by the regulatory deadline). A two-stage least squares regression identified company size, profitability and company age as statistically significant explanators of the differences in the timeliness of annual reports issued

by the sample companies. No evidence was found to support the monitoring costs theory argument, which suggests that highly geared companies are timely reporters. Furthermore, the empirical data indicate that audit reporting lead time is significantly associated with the timeliness with which sample companies release their preliminary annual earnings announcement, but not with the timeliness of their audited annual reports.

Soultani (2002) conducted a study on timeliness of corporate and audit reports in the French context. The study was analyzed by examining the trend in reporting delay of companies, the effect that qualified reports have on the timeliness of corporate reporting, and the relationship between reporting behavior and types of audit reports over a 10-year period. The data are taken from more than 5000 annual reports of French publicly held companies for the years 1986–1995. These bear witness to an improvement in timeliness of corporate and audit reports. This improvement is greater for reports from consolidated accounts of groups than those from annual accounts of companies. There is also evidence that qualified audit opinions were released later than unqualified opinions and that, in general, the more serious the qualification, the greater the delay

Ahmed (2003) the study examines the timeliness of corporate annual reporting in three South Asian countries, namely, Bangladesh, India and Pakistan. Base on a large sample of 558 annual reports for the year 1998. A multivariate regression analysis indicates that financial year-end date is a significant determinant in each country. The size of the audit firm, as measured by the factor loading of audit fees, number of reporting entity audited by an audit firm and international linkage, indicates large audit firms take significantly less time in India and Pakistan. Profitability and corporate size are significant determinants only in Pakistan. There is no statistical evidence to support monitoring hypothesis, as proxied by Zmijeski's financial condition index. The 2nd stage regression results suggests that only audit lag is significantly associated with the time taken by companies to submit their annual reports to the Stock Exchange

Abdelsalam and Street (2007) studied corporate governance and the timeliness of corporate internet reporting of U. K. listed companies. Primary analysis of the study provides evidence of a significant association between timely corporate internet reporting and the corporate governance characteristics of board experience and board independence. Subsequently, the study also provide evidence that boards with less cross directorships, more experience in terms of the average age of directors, and lower length in service for executive directors provide more timely corporate internet

reporting and that board independence is negatively associated with timely corporate internet reporting.

Aljami (2008) studied audit and reporting delays. The study empirically investigate the timeliness of annual reports of an unbalanced panel of 231 firms-years of financial and nonfinancial companies listed on the Bahrain Stock Exchange. The study found that the determinants of timeliness of annual reporting are company size, profitability, and leverage. No evidence was found to support the effect of accounting complexity or auditor type (Big Four or non-Big Four). Furthermore, the corporate governance proxies were found to be the determinants of the period between the auditors' signature dates and the publication dates

Alkhatib and Marji (2012) studied “Audit Reports Timeliness: Empirical Evidence from Jordan. The study sample includes 137 firms listed on the Jordanian Stock Exchange, their findings show that services sector profitability ratio, type of audit firm, and the company size were negatively correlated with audit timeliness, where leverage was the only variable that has a significant correlation.

Sakka and Jarbai (2016) conducted a study on Audit Report Timeliness: Empirical evidence from Tunisia. The study examined the relationship between corporate governance, external auditor’s characteristics index, and timeliness in light of the recent amendments to the Financial Security law (2005) in Tunisia. The study uses panel data methodology of 28 Tunisia companies listed on the Tunisians Stock Exchange over the period 2006 – 2013. The study concludes that the good structures of corporate governance play a role in improving the quality of timeliness of financial reports. On the empirical tests, they appear to indicate that whenever the audit report publication date proves to be short the external auditor’s characteristics index is discovered to be high.

Al-Ghanem (2011) studied an Empirical analysis of audit delays and timeliness of corporate financial reporting in Kuwait. The study focuses on 149 and 177 companies listed on the Kuwait Stock Exchange market in 2006 and 2007 respectively. Six explanatory variables are investigated. The result show that company size is the only variable that negatively correlates with audit delay and subsequently reporting timeliness, for the period tested. The result further shows that variable industry classification, leverage percentage change in earnings per share, type of auditors, and liquidity all show no significant correlation with audit delays in 2006 for listed companies in Kuwait.

My, Hoang and Hong studies "The effect of audit firm and firm performance on the timeliness of the financial report: A case study of Vietnamese Stock Exchange. The study uses data collected from 100 companies with largest market capitalisation and high liquidity on Ho Chi Minh City Stock Exchange in 2014. The Result shows that the audit firm and firm performance measured by Return on Equity (RoE) index positively affect the timeliness of financial report. Conversely, the study show that firms' performance measured by Return on Asset (ROA) index negatively affects the timeliness of financial report of listed companies.

Based on the reviewed literature as well as the divergent result found by different authors, it is observed that none of the studies examined the impact of audit quality proxied by discretionary accruals on financial reporting timeliness. This study therefore capitalizes on this gap thereby extending the findings from previous studies.

3. METHODOLOGY

This study examined the impact between audit quality and financial reporting timeliness of listed conglomerate companies in Nigeria for a period of 7 years (2010-2016). There are 6 listed conglomerate companies on the Nigerian Stock Exchange website as at December, 2016. Out of the 6 companies, four companies are selected as sample for the study. The selected companies are those that their annual reports and accounts were obtained for complete 7 years period. The companies include; AG Leventis PLC, Chellarams PLC, John Holt PLC and UAC of Nigeria PLC. This study utilized documentary firm – level data collected from the annual reports and accounts of the sampled firms. Panel data methodology using OLS, and random effect regression methods were used in analyzing the data using STATA 13.0.

Model Specification

In this study audit quality is measured by estimating earnings management. It is argued that when a client has the opportunity to manage its earnings, the auditor is likely to be influenced by the client and therefore the quality of the audit will be lower (Becker et al., 1998; Francis et al., 1999).

A common proxy for earnings management is the absolute value of discretionary accruals. To estimate to what extent a company was able to manage its earnings, the modified Jones-model was used. Dechow, Sloan and Sweeney (1995) compared several models to detect earnings management and found that this modified Jones-model has the most power to do so. This study therefore, used modified Jones-Model as proposed by Dechow et al. (1995) and Karsemeijer (2012) to estimate the discretionary accruals. With this method total accruals are calculated from the cash

flow statement using the income before extraordinary items and cash flows from operations:

$$TA_{it} = EXBI - CFO \quad (1)$$

Where:

TA_{it} = total accruals in year t

EXBI = income before extraordinary items (in year t)

CFO = cash flows from operations (in year t)

Discretionary accruals are then estimated using the total accruals that are obtained from equation 1 in the following model:

$$TA_{it} = \beta_1(1/A_{it-1}) + \beta_2(\Delta REV_{it} - \Delta REC_{it}) + \beta_3(PPE_{it}) + \varepsilon_{it} \quad (2)$$

Where:

TA_{it} = calculated total accruals (in year t)

A_{it-1} = Assets (in year t-1)

ΔREV_{it} = change in revenue from year t-1 to year t

ΔREC_{it} = change in receivables from year t-1 to year t

PPE_{it} = property, plant and equipment (in year t)

The variables ΔREV_{it} , ΔREC_{it} and PPE_{it} are scaled by total assets in year t-1.

After estimating β_1 , β_2 and β_3 with the model, the discretionary accruals were estimated using the residual value or error term (ε). Therefore, the discretionary accruals as used in this study is the difference between total accruals and the fitted normal accruals, defined as $DA_{it} = (TA_{it} / Asset_{it-1}) - NA_{it}$. The results obtained from model 2 (absolute values) are used as input to investigate if there exists, a relationship between Audit quality and financial reporting timeliness. This association was tested with the following regression model including the control variables:

$$Tperiod_{it} = \beta_0 + \beta_1 DAC_{it} + \beta_2 ASIZE_{it} + \varepsilon_{it} \quad (3)$$

Where:

i. DAC = estimated discretionary accruals from the modified Jones model.

ii. β = is the individual effect taken to be constant over time and specific to the individual cross-sectional unit.

iii. $Tperiod_{it}$ = measure of financial reporting timeliness which is the difference of days between the financial year end of a company and the date of annual general meeting which is the day when the annual report is made available to the public.

iv. $ASIZE_{it}$ = Audit firm size in firm i at a time t, measured by Dummy variable, if Auditor is big 4 (Deloitte, PWC, Ernst & Young and KPMG) = 1, else 0 (Asthana & Boone, 2012 and Kimeli, 2016).

4. RESULTS AND DISCUSSION

Descriptive Statistics

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
lntperiod	28	5.263655	.3827224	4.49981	5.860786
da	28	.6141297	.0327737	.545522	.681072
afsize	28	.6071429	.4973475	0	1

Source: Researcher’s computation using STATA v.13

Table 1 provides the summary statistics of the dependent and independent variables in order to effectively appreciate the nature of the results. It provides a basic insight into the nature of the data upon which analysis is done. The summary statistics include measures of central tendency, such as mean, measures of dispersion (the spread of the distribution) such as the standard deviation, minimum and maximum of both the dependent variable and explanatory variables. From Table 1, total period (TPERIOD) show a mean of 5.263655, a standard deviation of .3827224 which is an indication that the firms may not differ on the extent of their financial reporting timeliness. The mean of discretionary accrual is .6141297 and a standard deviation of .0327737. This also shows that discretionary accruals are widely dispersed.

Correlation Analysis

Table 2: Correlation test

	lntper~d	da	afsize
lntperiod	1.0000		
da	0.4717	1.0000	
afsize	0.2237	0.7188	1.0000

Source: Researcher’s Computation Using STATA V.13

The correlation result indicates that there is a positive association between lntperiod and discretionary accruals. It is also found that, Audit Firm size is positively related to discretionary accruals. The respective cases indicate the significance of the relationship given by 1.0000. It is also indicated in the results that the explanatory variables are not highly correlated.

Regression

Table 3: Regression Result

Lntperiod	OLS				Random Effect			
	Coefficient	Std error	T	p>/t /	Coefficient	Std error	Z	p>/z /
Constant	.7624004	1.706107	0.45	0.659	.8307489	1.426186	0.58	0.560
Da	7.511018	2.909158	2.58	0.016	7.192441	2.44402	2.94	0.003
Afsize	-.1836227	.1917046	-0.96	0.347	.0260466	.2056042	0.13	0.899
F	4.17				16.40			
P- Value	0.0274							
R ²	0.25							
Wald Chi ²								
P- Value								
R Squared :								
Within								
Between								
Overall					0.4647			
					0.0912			
					0.2165			

Source: Researcher’s computation using STATA v.13

Table 3 shows the results of both the OLS and Random Effect regression. The OLS shows the F-Value of 4.17 and its P-Value is 0.0274 which means that the overall model is fit. Further, both the OLS and the Random Effect showed the value of R² as 0.25 which is the multiple coefficient of determination that gives the proportion or percentage of the total variation in the dependent variable explained by the explanatory variables jointly. Hence, it signifies that approximately 25% of total variation in financial reporting timeliness of listed conglomerates in Nigerian is caused by audit quality and audit firm size.

The regression results as shown in table 3 indicate that audit quality (discretionary accruals) in both the OLS and Random Effect regressions has positive and significant impact on financial reporting timeliness because the level of significance is 0.003 which is below 5%. This implies that as audit quality improves, financial reporting timeliness also improves. This findings is consistent with the study of Sakka and

Jarbai (2016), My, Huang and Hong (nd) and contradict the findings of Alkhatib and Marji (2012).

Post Residual Diagnostic Test

Multicollinearity Test

Table 4: Variance Inflation Factor

Variable	VIF	1/VIF
afsize	2.07	0.483391
da	2.07	0.483391
Mean VIF	2.07	

The VIF for da and afsize are 2.07 & 2.07 respectively. This indicates that, the VIFs are less than 10 respectively. Thus, the study concludes that there is no problem of multicollinearity. That multicollinearity exists only when the VIF is greater than 10.

Heteroscedasticity Test

Table 5: Heteroscedasticity

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of lntperiod

chi2(1) = 0.79

Prob > chi2 = 0.3742

The Breusch Pagan/ Cook-Weisberg Test of Heteroskedasticity on da and afsize given the Chi2 Prob of 0.3742, indicates that the data are homokesdasticity. Thus, the p-value of 0.3742 which is greater than 0.05 makes the study to accept the hypotheses that the residuals are not heteroskedasticity but homokesdasticity and are desirable.

5. CONCLUSION AND RECOMMENDATION

This study examined the impact of audit quality on financial reporting timeliness of conglomerates in Nigeria. This study has provided empirical evidence that audit quality has a positive and significant impact on financial reporting timeliness. This implies that as audit quality improves, financial reporting timeliness will also improve significantly. The study therefore recommends that auditors should place more emphasis in audit quality so as to improve financial reporting timeliness of corporate entities.

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