

CORPORATE GOVERNANCE AND AUDIT REPORT LAG IN MALAYSIA

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ABSTRACT

This paper examines audit report lag in Malaysian public listed companies, following the implementation of the Malaysian Code on Corporate Governance in 2001. It departs from the standard audit report lag studies by incorporating characteristics of the board of directors and the audit committee. Multivariate analysis using 628 annual reports for the year ended 2002 indicates that active and larger audit committees shorten audit lag. However, we fail to find evidence that audit committee independence and expertise are associated with the timeliness of the audit report.

Keywords: Corporate governance, audit lag, audit committee

INTRODUCTION

Audit report lag, which is the number of days from fiscal year end to audit report date, or inordinate audit lag, jeopardises the quality of financial reporting by not providing timely information to investors. Delayed disclosure of an auditor's opinion on the true and fair view of financial information prepared by the management exacerbates the information asymmetry and increases the uncertainty in investment decisions. Consequently, this may adversely affect investors' confidence in the capital market. Givoly and Palmon (1982) assert that audit lag is the single most important determinant of timeliness in earnings announcement, which in turn, determines the market reaction to earnings announcement (Chambers & Penman, 1984; Kross & Schroeder, 1984). Knechel and Payne (2001) suggest that an unexpected reporting lag may be associated with lower quality information. In a study on enforcement actions by the Malaysian capital market regulators for financial misreporting and fraud, the author states that "in most cases, financial misreporting is often preceded or

accompanied by a lag in submitting the financial statements on time" (Mohd-Sulaiman, 2008).

Given the importance of audit timeliness to investors, identifying the determinants of audit lag continues to attract the attention of researchers as illustrated in recent studies by Ettredge, Li and Sun (2006), Bonson-Ponte, Escobar-Rodriguez and Borrero-Dominguez (2008), Al-Ajmi (2008), Lee, Mande and Son (2008, 2009), Afify (2009) and Krishnan and Yang (2009). Although Lee et al. (2008) suggest that the audit committee may influence audit timeliness, they do not test the predicted association. Afify (2009) documents that the voluntary establishment of an audit committee reduces audit lag in Egypt. A comprehensive review of the literature on audit committee and financial reporting by Bédard and Gendron (2010) indicates that the association between audit committee and timeliness of financial reporting is rarely investigated. We address the gap in the literature by providing evidence on the association between audit committee and audit lag.

One of the key responsibilities of an audit committee is to oversee the financial reporting process, which includes ensuring timely submission of financial statements (Bursa Malaysia Corporate Governance Guide, 2009). The Malaysian Code on Corporate Governance (revised 2007) recommends the following attributes of an audit committee as "best practices": (i) comprised of at least three members, a majority of whom are independent, (ii) all members should be non-executive and financially literate, with at least one being a financial expert, i.e., a member of an accounting association or body and (iii) meet regularly with due notice of issues to be discussed (Part 2, BBI and BBV). In addition, the Listing Requirements of Bursa Malaysia Securities Berhad (2006) mandate that the chairman should be an independent director (Para 15.11). The Bursa Malaysia Corporate Governance Guide (2009) emphasises that at a minimum, the audit committee should meet at least four times a year (Para 2.6.2).

Given that an audit committee imbued with "best practices" is expected to deliver in terms of strengthening the financial reporting system, our study attempts to present empirical evidence of the association between audit committee characteristics and audit lag. Apart from the audit committee, we also investigate whether the board composition can further explain cross-sectional variations in audit report lag. The Malaysian Code on Corporate Governance that was first issued in 2000 makes certain recommendations on how to constitute an effective board. The Code advocates that "there should be a clearly accepted division of responsibilities at the head of the company" implying that the roles of the Chairman and the Chief Executive Officer (CEO) should not be combined and held by the same person (i.e., non-CEO duality) (Part 2, AAI). The Code

also recommends that "to be effective, independent non-executive directors need to make up at least one third of the membership of the board" (Part 2, AAIH).

By examining the effect of board size, board independence, CEO duality and audit committee size, independence, expertise and diligence, proxied by frequency of meetings, on audit lag, our study extends the literature on audit committee and audit timeliness. Previous studies on audit lag in Malaysia by Che-Ahmad and Abidin (2008) and Raja-Ahmad and Kamarudin (2003) do not address the role of corporate governance, as their sample periods are prior to the introduction of the Corporate Governance Code in 2000. However, these studies provide a useful benchmark to compare audit lag pre- and post-introduction of the Corporate Governance Code in Malaysia. We expect CEO duality to reduce audit timeliness, whereas board and audit committee independence, audit committee financial expertise, audit committee diligence and audit committee size would enhance audit timeliness. We also expect shorter audit lag in the post-Code era, compared to pre-Code era. We make no prediction on the association between board size and audit lag.

Apart from contributing to the literature on audit committee and audit timeliness, our study also falls under the strand of literature that examines the consequences of the regulatory changes introduced around the world to strengthen corporate governance and corporate transparency. For example, Lobo and Zhou (2006) show that after the introduction of the Sarbanes-Oxley Act of 2002 (SOX), there is an increase in conservatism in financial reporting, and firms report lower discretionary accruals after SOX compared to the period preceding SOX. Bartov and Cohen (2009) document that the propensity to meet/beat analyst expectations declined significantly in the post-SOX period. In another study, Cohen, Dey and Lys (2008) document that accrual-based earnings management increased steadily from 1987 until 2002, followed by a significant decline thereafter. Conversely, the level of real earnings management activities declined prior to SOX and increased significantly after the passage of SOX, suggesting that firms switched from accrual-based to real earnings management methods after the passage of SOX. Laksmana (2008) shows that the disclosure of executive compensation practices in the US has generally increased over the period 1993–2002 after the Securities and Exchange Commission (SEC) introduced the Executive Compensation Disclosure Rules requiring companies to provide a report justifying their compensation policies. She also shows that the practice of compensation transparency is lower when the compensation committee has fewer members, meets less frequently and is less independent.

In Asia, Herz and McGurr (2006) show that following SOX, Hong Kong and Singapore companies have become more transparent by including greater footnote disclosures in their financial statements. Vichitsarawong, Eng and Meek

(2010) document that following the Asian financial crisis in 1997 and 1998, earnings conservatism and timeliness among companies in Hong Kong, Malaysia, Singapore and Thailand have improved due to the implementation of various corporate governance reform measures. In Malaysia, Abdul-Wahab, How and Verhoeven (2007) show that compliance with the corporate governance "best practices" improved significantly after the introduction of the Code in 2000, with the CG Index rising sharply from 19.7% for 1999–2000 to 50.7% for 2001–2002.

Our evidence indicates that audit committees with more members that meet at least four times a year promote audit timeliness. Our findings echo the results obtained by Kent, Routledge and Stewart (2010) that accruals quality is higher for larger and more active audit committees. The other board and audit committee characteristics that we tested do not seem to influence audit report lag. There is also a reduction in audit lag from 116 days as reported in Che-Ahmad and Abidin (2008) based on the year 1993 sample, to 100 days based on year 2002, as per our sample.

The rest of this paper is structured as follows. The next section reviews the literature on audit report lag and related studies on the association between audit committee, board characteristics and the quality of financial reporting, and develops the testable hypotheses. This is followed by a section outlining the design of the research. The results are presented in the subsequent section starting with the descriptive statistics for the full sample, followed by descriptive statistics for the four subsamples of firms partitioned by length of audit lag, and the correlation and regression analysis. The final section concludes and discusses limitations and suggestions for future studies.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Previous Studies on Audit Lag

Studies on audit lag began more than 30 years ago and some of the earliest studies were done by Curtis (1976) and Gilling (1977) in New Zealand, Davies and Whittred (1980) in Australia, Garsombke (1981) in the US and Ashton, Graul and Newton (1989) in Canada. Ashton, Willingham and Elliott (1987) investigate the relationship between audit lags with corporate attributes. They find that the lag is positively associated with the client's revenue and business complexity, but is negatively related with client status (represented by 1 for companies traded on an organised exchange or over the counter, and zero otherwise), quality of internal control (rated 1 if auditor judged the internal control quality as "virtually none" and five if "excellent") and relative mix of audit job (rated 1 if all audit

work performed subsequent to year end and four if most work performed prior to year-end).

Courtis (1976) and Carslaw and Kaplan (1991) report that companies which experienced losses have a longer lag. Bamber, Bamber and Schoderbek (1993) document that audit lag is influenced by an auditor's business risk associated with the client and audit specific events that are expected to require additional audit work such as extraordinary items, net losses and qualified audit opinions. They also find that large clients have a shorter audit lag.

Schwartz and Soo (1996) show that audit lag increased for companies that switched their auditor late in the fiscal year. This result is consistent with their expectation that companies change their auditor early in their fiscal year for positive reasons, whereas late auditor switching is driven by extended auditor-client negotiations or opinion shopping, which leads to longer audit lag.

Henderson and Kaplan (2000) focus on audit lag in the banking sector and their results reveal that a financial institution takes less time to issue an audit report because it operates in a highly regulated industry. Leventis, Weetman and Caramanis (2005) suggest that any attempts to regulate more closely the timeliness of audited financial reports should focus on audit-specific issues (e.g., audit fees or audit hours, proxied by the presence of extraordinary items in the income statement, the number of remarks in the subject to/except for audit opinions) rather than on the audit client's characteristics. They find that the type of auditors, audit fees, number of remarks in audit report, extraordinary items and uncertainty of opinion in the audit report are statistically significant in explaining variations in audit timeliness.

To summarise, previous research on the determinants of audit lag shows that it is influenced by a host of client, auditor and financial factors. The next subsection discusses the possible association between corporate governance and audit lag and develop the related hypotheses.

Corporate Governance and Audit Lag

Corporate boards are responsible for monitoring the quality of information contained in financial statements that are communicated to the public. The Bursa Malaysia Corporate Governance Guide (2009) reiterates that:

The board is required by law to ensure that the financial statements of the company represent a true and fair view of the state of affairs of the company and that they are prepared in accordance with applicable approved accounting standards. To

assist in discharging the board's fiduciary duties, the responsibilities for overseeing the financial reporting process is often delegated to the audit committee.

The audit committee has a heavy role in the financial reporting process, and its duties as stated in the Malaysian Code on Corporate Governance (2007) and the Bursa Malaysia Corporate Governance Guide (2009), among others, are to (i) discuss the nature and scope of the audit with the external auditor before the audit commences and ensure coordination where multiple audit firms are involved and (ii) discuss problems and reservation arising from the audit and to review the financial statements focusing on compliance with accounting standards, going concern assumption, audit adjustments, accounting estimates, unusual transactions and related party transactions.

A survey of the related literature published during 1994–2008 on the effectiveness of the audit committee in strengthening the financial reporting system by Bédard and Gendron (2010) indicates that the associations between audit committee size, independence, competency and meetings with the quality of financial reporting are stronger in the US than other countries. Based on their review, they show that the characteristics of the audit committee that have the greatest impact (with the figures in parentheses indicating the proportion of studies/analyses reviewed that show positive association between the characteristic and audit committee effectiveness) are existence (69%), followed by independence (57%), competence (51%), number of meetings (30%) and size (22%). They conclude that the effectiveness of audit committee practices may vary with "environmental factors such as concentration of ownership, enforcement level and exposure to lawsuits" (Ibid), and mimicking the best US practices regarding audit committees may not deliver the desired effect. Borrowing from the insights generated by some of the studies reviewed in Bédard and Gendron (2010) and other studies, especially in Asia, that are not covered in Bédard and Gendron (2010), we present the hypothesised association between audit committee characteristics and audit report lag below. We also borrow insights from other studies on the relationship between board characteristics and accruals quality to develop hypotheses linking board characteristics with another aspect of financial reporting quality; namely, the timeliness of audited financial statements.

Audit committee size

Bursa Malaysia requires a listed company to appoint an audit committee from amongst its directors which must be composed of not fewer than three members. Potential problems in the financial reporting process are more likely to be uncovered and resolved with a larger audit committee. This could arise if a larger

committee size increases the resources available to the audit committee and improves the quality of oversight. Li, Pike and Haniffa (2008) and Persons (2009) show that the audit committee size influences corporate disclosures. In Malaysia, Ahmad-Zaluki and Wan-Hussin (2010) provide weak evidence that audit committee size is positively associated with the quality of financial information disclosure, proxied by the accuracy of initial public offering management earnings forecast. However, most of the studies reviewed by Bédard and Gendron (2010) indicate that size of the audit committee is not an important determinant of effectiveness, and they caution that the incremental costs of poorer communication, coordination, involvement and decision making associated with a larger audit committee might outweigh the benefits. Based on the above, the following hypothesis is proposed:

H₁: There is a negative relationship between audit committee size and audit report lag.

Audit committee independence

One of the objectives of the audit committee is to give unbiased reviews on financial information, and audit committee independence can contribute to the quality of financial reporting (Kirk, 2000). Beasley and Salterio (2001) argue that companies that have the incentive and ability to increase the strength of the audit committee will do it by including more outside directors in the committee than the minimum number as required by legislation. The Listing Requirements of Bursa Malaysia stipulate that all listed companies must have audit committees comprising three members of whom a majority shall be independent. The Revised Malaysian Code on Corporate Governance 2007 reinforces the desirability of audit committee independence by excluding executive directors from membership. Meanwhile, SOX requires firms to have audit committees comprised solely of an independent director who is not an affiliate of the firm and not accepting any compensation from the firm other than the director's fees.

Many studies have uncovered empirical regularities that audit committee independence enhances the quality of financial reporting. Klein (2002), Abbott, Parker and Peters (2004), Bédard, Chtourou and Courteau (2004), Persons (2005) and Archambeault, DeZoort and Hermanson (2008) show that audit committee independence reduces earnings management, the likelihood of financial reporting restatement and financial reporting fraud. Furthermore, the likelihood that companies receive a going concern opinion is influenced by the number of outside directors in the audit committee (Carcello & Neal, 2000). Krishnan (2005) finds that independent audit committees are significantly less likely to be associated with the incidence of internal control problems over financial reporting. A meta-analysis conducted by Pomeroy and Thornton (2008) of studies

on audit committee independence and financial reporting quality concludes that the independence of the audit committee has more impact in enhancing audit quality through averting going concern reports and auditor resignations than it is at enhancing accruals quality and avoiding restatements. A more extensive review on the audit committee literature by Bédard and Gendron (2010) supports the view that independent audit committees contribute positively to the financial reporting process, which motivates the following hypothesis:

H₂: There is a negative relationship between audit committee independence and audit report lag.

Audit committee meeting

The audit committee meeting is the place for directors to discuss the financial reporting process and it is where the process of monitoring financial reporting occurs. An independent audit committee is unlikely to be effective unless the committee is also active (Menon & Williams, 1994). The National Committee on Fraudulent Financial Reporting, also known as the Treadway Commission (1987), states that an audit committee which intends to play a major role in oversight would need to maintain a high level of activity. One way to measure the diligence of the audit committee is by considering the number of meetings held. The audit committee should meet regularly, with due notice of issues to be discussed, and record its conclusions in discharging its duties and responsibilities. The Blue Ribbon Committee on audit committees in the US advocates that an audit committee is to meet at least four times per year. The Guidance on Audit Committees in the UK prescribes that the number of meetings required in a year should be no fewer than three, in view of the fact that the requirement for interim financial reporting in the UK is semi-annual.

The Bédard and Gendron (2010) analysis shows that most of the studies on audit committee meeting and financial reporting quality that they reviewed do not find significant associations. However, their studies exclude the studies of Li et al. (2008) and Xie, Davidson and Dadalt (2003). Li et al. (2008) show that audit committee meeting frequency is positively related with level of corporate disclosure. Xie et al. (2003) document that when audit committees meet more frequently, discretionary accruals are lower. In addition, Abbott et al. (2004), Vafeas (2005) and Persons (2009) document that higher level of audit committee activity is significantly related to a lower incidence of financial restatement, or reporting a small earnings increase, or fraudulent financial reporting.

Raghunandan, Rama and Scarbrough (1998) and Abbott, Parker, Peters and Raghunandan, (2003a and 2003b) argue that by meeting frequently, the audit committee will remain informed and knowledgeable about accounting or auditing

issues and can direct internal and external audit resources to address the matter in a timely fashion. During the audit committee meeting the problems encountered in the financial reporting process are identified, but if the frequency of the meetings is low the problems may not be rectified and resolved within a short period of time. Thus, it is predicted that a company that has a higher number of audit committee meetings (at least four as prescribed in the Bursa Malaysia Corporate Governance Guide 2009) will have a shorter audit lag.

H₃: There is a negative relationship between an audit committee that meets at least four times a year and audit report lag.

Audit committee financial expertise

Audit committees are responsible for numerous duties that require a high degree of accounting sophistication such as understanding auditing issues and risks and the audit procedures proposed to address them, comprehending audit judgments and understanding the substance of disagreement between the management and an external auditor, and evaluating judgmental accounting areas. Felo and Solieri (2009) classify audit committee members as financial experts if they have past employment experience in finance or accounting, requisite professional certification in accounting, or any other financial oversight experience or backgrounds which result in financial sophistication.

Previous studies show that the fraudulent financial reporting companies have few members that have expertise in accounting (McMullen & Raghunandan, 1996; Beasley, Carcello & Hermanson, 1999). DeZoort and Salterio (2001) show that audit committee members with previous experience and knowledge in financial reporting and audit are more likely to make expert judgments than those without. Xie et al. (2003), Abbott et al. (2004) and Bédard et al. (2004) document that audit committee financial expertise reduces financial restatements or constrains the propensity of managers to engage in earnings management. DeFond, Hann and Hu (2005) document that appointment of accounting financial experts generates positive stock market reaction in line with market expectation that the audit committee members' financial sophistication is useful in executing their role as financial monitors. Krishnan (2005) and Zhang, Zhou and Zhou (2007) find that firms are more likely to be identified with deficiencies in internal control over financial reporting if their audit committees have less financial expertise. All in all, these studies suggest that financially knowledgeable audit committee members are more likely to prevent and detect material misstatements. Thus, the following hypothesis is proffered:

H₄: There is a negative relationship between audit committee financial expertise and audit report lag.

Board size

One of the disadvantages associated with a large board is a communication/coordination problem, which makes a large board a less efficient monitor than a small board (Dimitropoulos & Asteriou, 2010). The directors' free-rider problem is also more intense in a large board than a small board (Jensen, 1993). Mak and Li (2001) and Dalton, Daily, Johnson and Ellstrand (1999) argue that a large board creates less participation, is less organised, and is less able to reach an agreement. Beasley (1996) shows that an increase in board size is related to higher incidence of fraud cases. Vafeas (2000) documents firms with small boards exhibit greater earnings informativeness, i.e. their reported earnings solicit a stronger investor response, as reflected by stock returns. Xie et al. (2003) also argue that a smaller board may be less encumbered with bureaucratic problems, more functional and more able to provide better financial reporting oversight. Contrary to their expectation, their evidence suggests that earnings management is more prevalent among smaller boards. In Malaysia, previous studies have yielded mixed results on the effect of board size and the quality of financial reporting. Abdul-Rahman and Mohamed-Ali (2006) show that board size and earnings management are positively related. Meanwhile, Bradbury, Mak and Tan (2006) find the opposite. The above conflicting evidence precludes a directional prediction on the effect of board size, and thus, we hypothesised:

H₅: There is a relationship between board size and audit report lag.

Board independence

Independent non-executive directors with the right skill sets who have no business and other relationships which could interfere with the exercise of independent judgment or the ability to act in the best interests of the shareholders are viewed to be in a better position to monitor management than inside directors. Because of their high degree of impartiality, they are believed to be willing to stand up to the CEO to protect the interests of all shareholders (Duchin, Matsusaka & Ozbas, 2010). Fama and Jensen (1983) argue that outside directors have incentives to carry out their tasks and not collude with managers to harm shareholders because "there is substantial devaluation of human capital when internal controls break down" (p. 35). Empirical evidence in the US, UK, Greece, Italy, China, Hong Kong, Korea and Singapore are generally supportive of their positive monitoring role. Studies indicate that inclusion of independent or outside directors in the board improves disclosure quality (Forker, 1992; Chen & Jaggi, 2000; Sengupta, 2004; Ajinkya, Bhojraj & Sengupta, 2005; Cheng & Courtenay, 2006; Cerbioni & Parbonetti, 2007; Huafang & Jianguo, 2007; Patelli & Prencipe, 2007; Petra, 2007), decreases the likelihood of financial statement fraud (Beasley, 1996; Farber, 2005), curtails the magnitude of earnings management

(Peasnell, Pope & Young, 2000; Klein, 2002; Xie et al., 2003; Jaggi, Leung & Gul, 2009; Dimitropoulos & Asteriou, 2010), lowers the incidence of related party transactions (Dahya, Dimitrov & McConnell, 2008), and enhances firm performance (Choi, Park & Yoo, 2007; Dahya et al., 2008). However, the evidence to date indicates that in Malaysia board independence does not enhance corporate transparency (Haniffa & Cooke, 2002; Wan-Hussin, 2009) and constrain financial restatements (Abdullah, Mohamad-Yusof & Mohamad-Nor, 2010), which lends credence to the view that the presence of independent directors is merely a box-ticking exercise, is ceremonial and like window dressing. We posit:

H₆: There is a negative relationship between board independence and audit report lag.

CEO duality

When the CEO also serves the dual position of chairperson of the board (i.e., CEO duality exists), this signifies the concentration of decision making power and hampers board independence and reduce the ability of the board to execute its oversight roles. Jensen (1993) advocates the separation of the positions of the CEO and chairperson to avoid conflicts of interests. The Malaysian Code on Corporate Governance (2001, 2007) recommends companies to separate the two roles to ensure proper checks and balances on the top management. A number of studies document that non-CEO duality contributes to disclosure quality. These include Forker (1992), Ho and Wong (2001), Gul and Leung (2004), Abdelsalam and Street (2007), Cerbioni and Parbonetti (2007), Huafang and Jinguo (2007) and Sarkar, Sarkar and Sen (2008). However, there are also studies in Singapore and the US such as Cheng and Courtenay (2006) and Petra (2007), respectively, that do not find that CEO duality impairs accounting quality. Al-Arussi, Selamat and Mohd-Hanfah (2009) document how CEO duality adversely affects the internet financial disclosures made by Malaysian companies. Likewise, Mohd-Saleh, Rahmat and Mohd-Iskandar (2005) document how CEO duality has an unfavourable effect on earnings quality in Malaysia. In contrast, Abdul-Rahman and Mohamed-Ali (2006), Bradbury et al. (2006) and Abdullah et al. (2010) show that a CEO who also acts as a chairperson is not associated with earnings management or restatements in Malaysia. Based on the above reasoning, it is predicted that the separation of roles between the CEO and chairperson will improve the quality of financial reporting and reduce the audit lag. The hypothesis is thus:

H₇: There is a positive relationship between CEO duality and audit report lag.

RESEARCH METHODOLOGY

Out of 856 non-financial companies listed on the main and second boards of Bursa Malaysia in 2002, a sample of 628 companies are selected, as described in Table 1. Finance-related companies are excluded due to their nature of business, and they are governed under different rules and regulations. Meanwhile, 44 Initial Public Offering (IPO) companies are removed because they are newly listed and this might affect their preparation of audited accounts. Information on audit report date is not available for 12 companies. Thirty seven companies do not have annual reports, and 89 companies are further eliminated due to incomplete or ambiguous data. The final sample represents 73% of all non-financial companies listed on the main and second boards of Bursa Malaysia.

Table 1
Sample Selection

Main Board companies	562
Second Board companies	294
TOTAL	856
Less:	
Finance companies	46
Initial Public Offerings (IPOs) in 2002	44
Unavailable audit report date	12
Unavailable annual report	37
Unavailable data	34
Unidentified data	55
Total sample	628

Annual reports for the year ended 2002 for the sample companies are examined. The sample period is chosen because the disclosures on the extent of compliance with the Malaysia Code on Corporate Governance recommendations with regards to the constitution of boards are available from the second half of 2001.

The audit report lag model used in this study is adapted from prior studies to accommodate the corporate governance variables and the Malaysian environment (see for example, Bamber et al., 1993; Lawrence & Glover, 1998; Leventis et al., 2005; Lee et al., 2009, Krishnan & Yang, 2009). The audit report lag model is as follows:

$$AUDLAG = \beta_0 + \beta_1 ACSIZE + \beta_2 ACIND + \beta_3 ACMEET4 + \beta_4 ACEXP + \beta_5 BSIZE + \beta_6 BIND + \beta_7 CEODUAL + \beta_8 BIG4 + \beta_9 DEC31 + \beta_{10} SUBS + \beta_{11} GCOPIN + \beta_{12} LNSIZE + \varepsilon$$

where

- AUDLAG = number of days from fiscal year end to the date of audit report.
ACSIZE = number of audit committee members.
ACIND = proportion of independent nonexecutive directors on audit committee.
ACMEET4 = 1, if at least 4 audit committee meetings are held during the year, 0 otherwise.
ACEXP = proportion of audit committee members who have accounting or related financial management expertise.
BSIZE = number of board of director members.
BIND = proportion of independent directors on board.
CEODUAL = 1, if CEO and Chairman is the same person, 0 otherwise.
BIG4 = 1, if the auditor is PricewaterhouseCoopers, Ernst and Young, KPMG or Deloitte, 0 otherwise.
DEC31 = 1, if fiscal year ends on 31 December, 0 otherwise.
SUBS = square root of number of subsidiaries.
GCOPIN = 1, if going concern uncertainty opinion is issued, 0 otherwise.
LNSIZE = natural log of total assets.

The audit lag model incorporates control variables such as audit firm quality, busy period, client complexity, client business risk and client size. Companies that are audited by international accounting firms are expected to have shorter audit lags because these firms have highly experienced auditors and advanced audit technologies at their disposal. Knechel and Payne (2001) show that clients with fiscal years that end during the busy period (December and January for the audit firm used in their sample) face longer lags. Number of subsidiaries is one of the measures used to indicate a client's business complexity, and Ng and Tai (1994) and Jaggi and Tsui (1999) show that there is a positive relationship between number of subsidiaries and audit lag. Geiger and Rama (2003) show that financially distressed companies require auditors to exercise a significant amount of professional judgement which may lag the issuing of the audit report. Hence, an association is expected between the issuance of going concern uncertainty opinion and the timeliness of the audit report. Ashton et al. (1989) argue that larger companies may choose to implement stronger internal controls which enable auditors to place more reliance on interim compliance tests than on substantive tests of year end balances, thus facilitating timely audit completion. Furthermore, large companies are usually owned and monitored by external parties, so the management will have incentive to minimise audit lag.

RESULTS

Descriptive Statistics and Correlation Analysis

Table 2 reports the descriptive statistics of all variables investigated in this study. The minimum audit report lag is 19 days and maximum is 332 days. On average, Malaysian listed companies take about 100 days to issue audit reports after the fiscal year ended 2002. The audit lag for our sample is shorter than the sample reported by Che-Ahmad and Abidin (2008). They examine the 1993 annual reports of 304 Malaysian non-financial companies and document audit lag of 116 days. It seems that over the period 1993–2002, audit report lag in Malaysia reduced by about two weeks.

Table 2
Descriptive Statistics

Variable	Min	Max	Mean	SD
ACSIZE	1	6	3.51	.74
ACIND	0	1	.68	.16
ACMEET4	0	1	.95	.22
ACEXP	0	1	.38	.19
BSIZE	2	17	7.64	1.98
BIND	0	1	.39	.13
CEODUAL	0	1	.13	.34
BIG4	0	1	.74	.44
DEC31	0	1	.52	.50
Number of subsidiaries	0	306	15.22	25.61
GCOPIN	0	1	.16	.37
Total assets (RM million)	3.62	62794	1165	4123
AUDLAG (days)	19	332	100.30	27.37

Notes: All the variables are defined in the Research Methodology section.

For our sample, the average size of audit committee is 3.5 people, which is comparable to Yatim, Kent and Clarkson (2006), but slightly lower than Mohd-Saleh, Mohd-Iskandar and Rahmat (2007), who document an average size of 3.7 people. There is one company with only one audit committee member, and the explanation given in the annual report of the said company is that Bursa Malaysia had given its approval for the company for an extension of time up to 30 September 2003 to comply with the Listing Requirements. About two thirds of audit committee members are independent directors, which is consistent with Abdul-Rahman and Mohamed Ali (2006). The average number of audit committee meetings is 4.8 times (not tabulated) and 95% of the sample companies have at least four audit committee meetings during the year. This is slightly higher than Mohd-Saleh et al. (2007) who show that the average number of audit committee meetings in 2001 was 4.2 times. In term of background on

audit committees, on average about 40% of audit committee members have knowledge in accounting or finance. This is slightly higher than the figure obtained by Mohd-Saleh et al. (2007) where they report that 27% of audit committee members have accounting knowledge.

The average board size for our sample is 7.6 people, in line with Yatim et al. (2006) who obtain an average board size of 7.5. On average, our sample has 40% independent directors on the board, similar to Abdullah et al. (2010) who report board independence at 43%. Eighty-seven percent of our sample companies split the role of CEO and Chairman, which is in line with Yatim et al. (2006) and Abdullah et al. (2010) who report non-CEO duality of 84% and 93% respectively. Seventy four percent of our sample companies are audited by BIG4 audit firms. Slightly more than half of our sample companies have their financial year end on 31 December 2002. Our sample companies have 15 subsidiaries, on average. Sixteen percent of our sample companies received going concern audit opinions. A review of audit reports in Malaysia by Md-Ali, Abdul-Kadir, Mohamad-Yusof and Lee (2009) show that in 2002, out of 752 companies, 105 (14%) received unqualified opinions with emphasis of matter, 21 (2.8%) companies received qualified opinion and 10 (1.3%) received disclaimer opinions.

Table 3 provides further analysis of the descriptive statistics by partitioning the sample according to the length of audit lag. Four groups are categorised; (i) less than two months, (ii) two to three months, (iii) three to four months, and (iv) more than four months. Some interesting results emerged. Fifteen companies (2.5%) failed to comply with the Listing Requirement to have their audited accounts ready within four months after the fiscal year ended. According to Bursa Malaysia, the incidence of late submission of audited accounts has reduced by 2009, with "rate of compliance by PLCs for submission of financial statements by the due time was greater than 99%" (Bursa Malaysia, Media Release, 25 March 2010). About 15% of the sample companies completed their audited accounts within two months after the fiscal year ended. Similarly, 15% of the audit firms signed off the sample companies' audited financial statements in the third month following the end of the fiscal year. The bulk of the sample companies, i.e., about two thirds, issued their auditor's reports in the fourth month after the fiscal year ended.

Table 3
Descriptive statistics partitioned by delay in month

DELAY (month)	AUDLAG	ACSIZE	ACIND	ACMEET4	ACEXP	BSIZE	BIND	CEODUAL	BIG4	DEC31	NSUB	GCOPIN	
Less than 2	N	97	97	97	97	97	97	97	97	97	97	97	
	Mean	55.08	3.66	.67	0.99	.44	7.99	.37	.12	.88	.47	15.04	.03
2 to 3	N	97	97	97	97	97	97	97	97	97	97	97	
	Mean	78.11	3.64	.69	0.97	.37	8.04	.39	.15	.85	.57	15.16	.06
3 to 4	N	418	418	418	418	418	418	418	418	418	418	418	
	Mean	113.25	3.46	.68	0.94	.38	7.52	.40	.13	.68	.52	14.67	.20
More than 4	N	15	15	15	15	15	15	15	15	15	15	15	
	Mean	172.38	3.25	.70	0.73	.38	6.25	.46	.06	.56	.44	31.19	.50
Total	N	628	628	628	628	628	628	628	628	628	628	628	
	Mean	100.34	3.51	.68	0.95	.39	7.64	.39	.13	.74	.52	15.22	.16
	Median	111.00	3.00	.67	1.00	.33	8.00	.38	0	1.00	1.00	8.00	0
	Minimum	19	1	0	0	2	0	0	0	0	0	0	0
	Maximum	332	6	1	1	2	17	1	1	1	1	306	1

Notes: All the variables are defined in the Research Methodology section, except NSUB which represents number of subsidiaries.

Table 4
Pearson Correlation

	AUDLAG	ACSIZE	ACIND	ACMEET4	ACEXP	BSIZE	BIND	CEODUAL	BIG4	DEC31	SUBS	GCOPIN	LNSIZE
AUDLAG	1												
ACSIZE	-.159(**)	1											
ACIND	.021	-.013	1										
ACMEET4	-.127(**)	.106(**)	-.065	1									
ACEXP	-.055	-.191(**)	.019	.044	1								
BSIZE	-.158(**)	.432(**)	.059	.141(**)	.005	1							
BIND	.113(**)	.084(*)	.411(**)	-.068	-.016	-.287(**)	1						
CEODUAL	-.003	-.031	-.016	.051	.102(*)	-.045	.020	1					
BIG4	-.197(**)	.039	-.035	.053	.038	-.037	-.072	-.072	1				
DEC31	-.002	.036	.054	.086(*)	.067	.052	.005	-.013	.048	1			
SUBS	.086(*)	.095(*)	-.013	.047	-.046	.219(**)	-.030	.045	-.056	-.036	1		
GCOPIN	.256(**)	-.129(**)	-.025	-.114(**)	.028	-.233(**)	.160(**)	-.029	-.028	-.071	.028	1	
LNSIZE	-.185(**)	.202(**)	.037	.076	.031	.363(**)	-.066	-.016	.099(*)	.035	.569(**)	-.130(**)	1

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

All the variables are defined in the Research Methodology section.

Of all the four groups, the noncompliance group has, on average, the smallest audit committee and board size, lowest number of audit committee meetings, highest incidence of CEO duality and receiving going concern uncertainty audit opinion, lowest incidence of being audited by BIG4 audit firms and the most number of subsidiaries. The shortest audit lag group has, on average, the highest audit committee size, highest incidence of engaging BIG4 audit firms, highest incidence of conducting at least four audit committee meetings, and lowest occurrence of receiving going concern audit opinion, among all the groups. Companies with the longest audit lag also have the highest board and audit committee independence, compared to their counterparts with the shortest audit lag. Similar to our results, Abdullah et al. (2010) also show that companies that restated their financial statements have higher board independence and audit committee independence than their counterparts that have no financial restatements.

Table 4 shows the Pearson Correlation. The highest correlation is between the two control variables, firm size and number of subsidiaries at 0.569, which suggests that multicollinearity is not a serious problem that would jeopardise the regression results.

Multivariate Analysis

Table 5 exhibits the multiple regression results. Two audit committee characteristics, namely audit committee size (ACSIZE) and audit committee with at least four meetings (ACMEET4), have a significantly negative association with audit report lag. Although audit committee independence (ACIND) and competencies (ACEXP) have the expected negative relationship with audit lag, neither of the variables are statistically significant.

The proportion of independent directors on the board (BIND) has a weak positive relationship with audit lag. Larger board size (BSIZE) also seems to exacerbate audit lag, although it is not statistically significant. Meanwhile, contrary to expectation, CEO duality reduces audit lag, albeit insignificantly. All the control variables influence audit lag in the predicted direction except for financial year end (DEC31). A top tier auditor (BIG4) and larger client (FIRMSIZE) are associated with shorter lag, whereas more subsidiaries (SUBS) and going concern uncertainty (GCOPIN) prolong audit lag. Using Malaysian data for 1993–1995, Che-Ahmad, Houghton and Mohamad-Yusof (2006) also show that clients of Big6 auditors have significantly shorter audit lags than their non-Big6 counterparts (111 days vs. 122 days).

The adjusted R^2 which is 16% is similar with that reported by Raja-Ahmad and Kamarudin (2003) and Che-Ahmad and Abidin (2008) of 14% and

20%, respectively. Our results, which show that a more active and larger audit committee is desirable in enhancing the quality of financial reporting in terms of audit timeliness, is consistent with evidence provided by Kent et al. (2010). The more frequent audit committee meetings are held, the more likely the audit committee can reach solutions on financial issues and the auditors can issue timely reports. The evidence that firms with more members in the audit committee are more likely to have good quality financial reporting is in contrast with the evidence from previous studies such as Abbott et al. (2004) and Bédard et al. (2004), but consistent with Lin, Li and Yang (2006). This suggests that larger audit committees are more likely to be able to devote adequate time and effort to ensure that the information disclosed in the financial statements is accurate and timely, and hence increase the quality of financial reporting.

Table 5
Regression Analysis

Variable	Coefficients	t-value
(Constant)	202.611	12.140***
ACSIZE	-.119	-2.705***
ACIND	-.010	-.239
ACMEET4	-.076	-2.028**
ACEXP	-.049	-1.269
BSIZE	.016	.327
BIND	.080	1.780*
CEODUAL	-.016	-.444
BIG4	-.146	-3.912***
DEC31	.048	1.287
SUBS	.226	4.944***
GCOPIN	.184	4.774***
LNSIZE	-.246	-5.160***
<i>F value</i>	<i>11.05</i>	
<i>Adj. R squared</i>	<i>0.16</i>	
<i>P value</i>	<i>.000</i>	

Dependent variable: AUDLAG.

* $p < .10$, ** $p < .05$, *** $p < .01$, based on one-tailed results.

All the variables are defined in the Research Methodology section.

CONCLUSION

Audit committee effectiveness remains one of the significant themes in corporate governance debates (Gendron & Bédard, 2006). The main objective of this study

is to examine the relationships between audit committee characteristics and the timeliness of audit reporting. The characteristics of an audit committee that we examined are size, independence, expertise and frequency of meeting. The evidence indicates that firms with more members in the audit committee and more frequent audit committee meetings are more likely to produce audit reports in a timely manner. This study also demonstrates that the boards of director variables are not as important as audit committees in determining the audit lag. The result of this study also suggests that more emphasis should be given to strengthening the independence and expertise of the audit committee. The recent proposal by Bursa Malaysia as contained in the Consultation Paper No. 3/2010, which requires that in an appointment of independent directors public listed companies must set out the reasons why they consider the independent director as being "independent", is a step in the right direction to enable investors to assess the quality of independent directors [Proposal 1.2 (10)]. This development is in tandem with emerging literature that examines whether independent directors who are without financial or familial ties to the management but who have social ties to management can effectively perform their fiduciary duty to monitor management on behalf of shareholders (Hwang and Kim, 2009; Hoitash, in press).

This study is subject to several limitations. Since the study covers a one-year period, the trend of audit lag and long term effect of corporate governance on timeliness of audit report could not be examined. Another limitation of this study is the possibility of error in the archival measure of audit committee quality. Audit committee compensation may be a better proxy for audit committee quality, but remains unexplored because the compensation data are not widely available. To enhance the explanatory power of the audit lag model, future studies may consider the strength of the firm's internal controls and ownership structure and complex transactions such as special items and related party transactions. Finally it is also illuminating to see whether audit reporting lag is associated with earnings management, and the consequences of audit lag on the cost of capital.

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