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Convergence to IFRs and Audit Report Lag in Malaysia

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Abstract
The Financial Reporting Foundation (FRF) and the Malaysian Accounting Standards Board (MASB) have decided to bring Malaysia to full convergence with the International Financial Reporting Standards (IFRS) by 1st January 2012. This has inspired the study to investigate the effect of the convergence of IFRS proxied by the implementation of new accounting standards (FRS 4, 7, 123 & 139) on the audit report lag (ARL) in Malaysia since the requirement of the IFRS is much complicated. The samples of the study were drawn from the public listed companies on the main market of Bursa Malaysia. The study reveals that the ARL increases as new accounting standards implemented. Significantly, the ARL in Malaysia is found to be longer compared to other developed and developing countries.
Keywords: IFRS, Audit Report Lag, Malaysia

1. Introduction

In line with the changes of global accounting standards, as a developing country, Malaysia is also now being recognized as an IFRS-compliant financial reporting framework through its new MASB approved accounting framework, known as the Malaysian Financial Reporting Standards (MFRSs) (KPMG, 2012). The convergence to IFRS is expected to grant considerable advantages to many parties such as the public listed companies, shareholders, regulators, financial professionals as well as local and international investors (Thomas 2009). It is anticipated that, through this single and dominant accounting standards, it would diminish the barriers of comparisons among the countries as it promotes the same accounting practices across countries. Despite of the great benefits granted through the convergence of IFRS, there is a concern on the challenges that need to be faced by companies and auditors during the transition to IFRS. According to Najihah Marha and Che-Ahmad (2011), in general IFRS are complicated and require more detailed disclosures. Consequently, it results in increasing the audit report lag which is negatively related to the timeliness of financial reporting. Although Malaysia has been adopting the IFRS since the year 2006, on per standard basis, nevertheless the remaining standards to be adopted are even more challenging (PWC, 2009). Therefore it is worthwhile to examine the relationship between the convergence to the International Financial Reporting Standards (IFRS) and the audit report lag (ARL) in the Malaysian context. Additionally, there are very limited studies that examine the effects of this IFRS on the audit report lag in Malaysia.

2. Significance of Study

Audit report lag, which is also known as an audit delay (Raja Adzrin and Khairul Kamaruddin 2009) is found to be most influential factor in the timeliness of financial statements (Owusu-Ansah 2000, Leventis et al. 2005). This is owing to the fact that, financial statement cannot be issued or released to the public until an audit has been duly performed and concluded (Ayoib and Shamharir 2008). Additionally, Bamber et al. (1993) reported that over 70 per cent of all companies wait until at least the annual audit report date before announcing earnings. As such, annual audit report plays significant roles on the timeliness of financial statements. Furthermore, a study by Knechel and Payne (2001) stated that the value of information from audited financial statements generally declines as the audit report lag increases because users will obtain financial information from other potentially more costly sources. Therefore, this audit report lag has a negative relationship with the timeliness of financial reporting. It means that, the longer the audit delay, the lower the quality of timeliness of financial report. Since in this global market the timeliness of financial information is perceived as the most influential factors for high quality of reporting (IASB, 2005), therefore, the study would like to draw the attention of all interested parties such as the practitioners, the auditors, the shareholders, the regulators as well as other interested parties, to see the effect of convergence to IFRS on the audit report lag (ARL) in Malaysia. Although Malaysia has been adopting the IFRS since the year 2006, however it is not often to find literature that state

explicitly whether there is an increase or decrease in the ARL of Malaysian companies prior to and post adoption of the IFRS. In view of this, the study would like to fill in this research gap by providing information on the trend of the audit report lag in Malaysia before and after the adoption of the IFRS in Malaysia. This is crucial as it provides an understanding of the effect of implementation of new accounting standards in Malaysia, in line with the convergence to IFRS. Furthermore, as Malaysia has been moving towards the global accounting standards, therefore it is essential to have insight on the differences of the ARL across countries.

3. Literature Review and Development of Hypothesis

3.1 Literature review

A recent study done Najihah and Che-Ahmad (2011) has proven that, convergence to IFRS has resulted in increasing the audit report lag (ARL) in Malaysia. It is found that, in general IFRS are complicated and require more detailed disclosures. Consequently, it results in increasing the audit report lag which is negatively related to timeliness of financial reporting. According to Ayoib and Shamharir (2008), prior to adoption of the IFRS, the ARL is reported at a mean of 114 days, with a minimum delay of 20 days. The longest delay is reported to be at 442 days. This study covers a period of the year from 1993 to 2000. Another study on ARL prior to adoption of IFRS is conducted by Raja Azdrin and Khairul Anuar (2003) whom reported that the minimum and maximum number of ARL is at 29 days 273 days respectively, with a mean of ARL of 100 days. Post adoptions of the IFRS, Izsmi et.al (2010) have examined the ARL for the public listed companies for the year 2006. It is reported that, the minimum number of days for ARL is 20 days, while the maximum is at 486 days. The mean of ARL is at 114 days. In comparison with the pre-adoption period, the ARL is proven to have an increasing function in terms of the maximum number of days as well as a slight increase in the mean of the ARL. Nonetheless, in a study conducted by Ummi Junaidah and Rashidah (2010), the ARL is found to be lower than study conducted by Izsmi et.al. The researchers study the ARL for companies listed during the year 2007 to the year 2009, of which the ARL is ranging from minimum 36 days to a maximum of 184 days, with a mean of 113 days. This indicates a huge decrease in the maximum number of days of the ARL compared with the studies done by Iszmi et.al (2010), yet the mean is only differed by one day. In accordance to the study on ARL by Siti Norwahidah and Sherliza (2011), it is found that the maximum number of ARL is 239 days, showing an increase compared to the above study. While the minimum and the mean of ARL are reported at 36 days and 99 days respectively. The most recent study by Najihah Marha and Ayoib (2011) shows that, the length of ARL period ranging from the minimum of 20 days to the maximum of 364 days, and the mean is at 100 days. Based on these findings it can be seen that, the overall maximum number of days for the ARL is ranging between 184 days to 442 days (post and prior adoption). Whereas, the overall mean of ARL in Malaysia is ranging between 99 days to 114 days (post and prior adoption).

3.2 Development of Hypothesis

As in accordance to study conducted by Habib and Bhuiyan (2011), it shows that, the implementation of IFRS in New Zealand has increased the audit report lag. This finding is also supported by Najihah Marha and Ayoib (2012), which found that the convergence to IFRS does trigger longer audit delay. Habib and Bhuyan (2011), reported that new accounting standards have resulted in longer audit delays. This finding is consistent with Najihah Marha and Ayoib (2011) study, where it is found that implementation of new accounting standards is the possible reason for the lengthening in audit timeliness. This is due to the additional workload is required as auditors are now exposed to more complicated financial statements (Bernhurt, 2008). Moreover, the obstacles lie on the IFRS appears not only on the part of accounting treatment but also to the difficulty to adhere to the detailed reporting and disclosure requirements (Griffin, Lont and Sun, 2009). Consequently, it affects the ability of the preparer to provide financial information on a timely basis and on the part of the auditors; it has resulted in requiring more audit hours and audit efforts by the auditors to comply with such standards (Stovall, 2010). In Malaysia, there are four more new accounting standards being adopted in the year 2010, which are the FRS 4, 7, 123 and 139 in conjuction with the full convergence to IFRS by year 2012. Because of this, it is expected that, there is a positive association between the audit report lag and the implementing of new accounting standards (proxy for convergence to IFRS). Therefore, the following hypothesis is developed:

H1: Convergence to IFRS proxied by implementation of new accounting standards is positively related to the audit report lag.

4. Research Methodology

4.1 Sample and Data Collection

The unit analysis of the study was the companies that listed on the main market of the Bursa Malaysia in which 257 companies were selected. The annual reports of companies covering period from the year 2009 and 2010 (n=771) were utilized in order to obtain information on the audit report lag and other control variables for the study.

4.2 Regression Analysis

The study applied panel data analysis for regression. According to Klevmarken (1989), panel data suggest that individuals, firms, states or countries are heterogeneous. Time-series and cross-section studies do not control for this heterogeneity thus might result in obtaining biased results. Hence, by using a panel data analysis, it allows for controlling for individual heterogeneity and therefore leads to more accurate results. There are several techniques that can be used to analyze the panel data, which are the random-effect model, fixed-effect model and ordinary least square model. The Hausman Test was conducted in order to select between the random effect and the fixed effect model. The significant value of chi-square of the Hausman test indicates there is no existence of correlation between the composite error term and the independent variables, thus random effect model should was selected. The Breush Pagan Lagrangian Multiplier (LM) test for random effects was then conducted to determine the existence of unobserved effect in the random effects model. The random effects model is valid only when the variance of the model is not zero (0). Otherwise ordinary least square method should be the most appropriate technique to conduct regression analysis for the study. In this study the random effect model is executed with robust to treat for heteroskedasticity problem by using STATA 11 software. Table 1 and Table 2 present the results of both Hausman Test and LM Test which support the study to conduct random effect model. The following shows the model equation of the study.

$$ARL = \beta 0 + \beta 1\ (IFRS)\ it + \beta 2\ (FYE)\ it + \beta 3\ (FINPOST)\ it + \beta 4\ (SIZE)\ it + \beta 5\ (AUDOP)\ it + \beta 6\ (AUDTEN)\ it + ai + uit$$

Subscript it represents panel data notation; i = cross-sectional units, t = period from 2009 -2011. (Please refer to Table 3)

The model of the study also includes other independent variables that need to be controlled to generate unbiased result. (Please refer to Table 3 for summary of operationalization of variables)

5. Result, Findings & Discussions

5.1 Descriptive Analysis

Table 4 shows that, the ARL is reported as increasing function from the year 2009 to the year 2011, with a mean of 96 days to 99 days. From the total sample of n=771, 64% were audited by the big 5 audit firms (PWC, Ernst & Young, Deloitte, KPMG and BDO) while the remaining were audited by the non big five audit firms (small and medium audit firms). Companies audited by the big five experienced a lower mean of ARL which is 93 days, with a minimum number of 32 days and a maximum of 122 days. Whereas companies that were audited by the non big five is experiencing a total of mean of 106 days (min 37 days and max 149 days). Table 5 shows there is no early adoption of the FRS (4, 7 123 & 139) that mandatory to be adopted in the year 2010. Most of the companies adopted the new standards by the year 2011. Table 6 represents the descriptive statistics for control variables. For the financial year-end (FYE) 63% of the total sample is fall under the non - peak period while the remaining fall under the peak period. Financial position (FINPOST) indicates that, there is only 19.8% of the sample that experiencing loss, compared to another 80.2% for companies that in profit condition. Size is measured by the total sum of the companies' non-current assets and current assets. The companies' size ranging from less than RM50 million to more than RM10 billion. Most of the sample fall within the range of RM100 million up to RM500 million which represented by 46.7%. Out of n=771 only 7.5% of the total sample is classified as having not clean audit report, while the remaining of 92.5% for the clean audit report. In regard to audit tenure 68% of the sample is fall under the category of the audit tenure more than 5 years, while the remaining is less than 5 years.

5.2 Regression results

The output of the regression analysis is presented in Table 7. It shows that the model is significant in determining the ARL (Prob > chi2 = 0.000) .The overall R-square, which represents the goodness of fit of the model is given at 0.1444 or 14.44%, which means that, in this model, the variance in the dependent variable is explained by the independent variables for only 14.44%, while the remaining of 85.56% is unexplained. The IFRS is found to have a positive effect with the ARL (coefficient is at 1.9594) and this positive effect is significant at 0.05 level (p=0. 0230). Thus, the hypothesis of the study is supported. It means that, the convergence to IFRS proxied by implementation of new accounting standards results in increasing the ARL. For control variables, the financial year-end (FYE) is reported to have a positive effect with the ARL (coefficient is at 1.8787). Nevertheless, this effect is not significant. The financial position of a company (FINPOST) is also found to have a positive relationship with the ARL and this relationship is significant at 0.1 level as the coefficient is at 2.5884 and the p value is at 0.062. On the other hand, the size of the companies (SIZE) is proven to have a negative relationship with the ARL, where the coefficient is at -12.0521 and significant at 0.01 level (p-value is 0.000). For audit opinion (AUDOP), the result shows that, there is positive a relationship between the AUDOP and the ARL as the coefficient is reported at 5.9867and significant at 0.01 level (p-value is 0.006). As for the audit tenure (AUDTEN) the result indicates that there is a positive effect (coefficient is at 0.6853) on the ARL but not

significant as the p-value is 0.101. Overall, IFRS, FINPOST and AUDTEN are positively related with the ARL and significant at 0.1 level. On the other hand, the SIZE is found to have a negative effect on ARL and significant at 0.05 level. As for the AUDOP, it is reported to have a positive relationship ARL, and significant at 0.05 level.

5.3 Findings and Discussions

The findings of the study reveals that as Malaysia is moving towards full convergence to IFRS, the audit report lag (ARL) is found to have an increasing function, where the mean of the ARL increases from the year 2009 to the year 2011 (from 96 days to 99 days). This finding is consistent with the study done by Najihah Marha and Ayoib (2011) and Habib and Bhuiyan (2011), which also have proven that IFRS in general are complex which consequently has led to an increase in the audit report lag (ARL). The Figure 1 shows the overall patents of the ARL in Malaysia, prior to and post adoption of the IFRS. The maximum number of ARL prior to the adoption of IFRS is 442 days compared to the post adoption which is only 149 days. This indicates that, there is a tremendous decrease in the maximum number of the ARL despite of the adoption of new accounting standards. When the mean of the ARL is analyzed, it can be seen that there is only a slight decrease from the pre to post (114 days to 99 days) adoption of IFRS. In view of this, it signifies that, although the results of the regression analysis in this study have proven that convergence to IFRS does trigger longer ARL, nevertheless, the ARL is not really increase but rather lessen in comparison to the prior adoption. The study looks beyond the Malaysian context of ARL. This is parallel with the convergence to IFRS, where it brings the Malaysian companies to standing in the global market; hence comparison of the ARL across countries would rather be carrying a great weight. More significantly, the investors around the world value the timeliness of financial information as an essential for information to be useful (Leventis, 2005). The following Figure 2 presents the comparison of the mean of ARL across countries. The comparison is divided into two categories which are between Malaysia and the developed countries and also between Malaysia and other developing countries. From the Figure 2, it is apparently shown that, the mean of Malaysian ARL (99 days) is far higher compared to the mean of the developed countries such as US, 52days (Paul et.at 2010), Canada 54 days (Ashton et.al 1989) and New Zealand, 87 days (Habib & Bhuiyan 2011). From this the study confirmed that, the level of Malaysian ARL is still far behind from those developed countries. When the ARL of Malaysia is compared with other developing countries such as Oman, 51 days (Saeed Rabea Ali 2011) and Indonesia 73 days (Zaitul 2010), it reveals that, not only Malaysia is far left behind in providing financial information in comparison with the developed countries, it also lacks behind when compared to other developing countries whose ARL is comparable with the developed countries. These are the fact that would like to be highlighted by the study so as to provide insight on the level of competitiveness of the Malaysian companies globally once Malaysia has fully converged with the IFRS. This is believed to consequently affect the growth of the Malaysian economy since the local companies are found to be unable to attract foreign investors due to late issuance of the financial information.

6. Conclusion

The study has added value to the literature by providing insight on the patent of the Malaysian ARL prior to and post of convergence to IFRS. It highlighted the effect of the convergence of IFRS on the Malaysian ARL. The mean of Malaysian ARL has been maintained at 99 days to even more than 100 days since before the adoption of the IFRS. The findings of the study have also proven that, there is not much effect on the ARL of Malaysia due to implementation of new accounting standards. Nevertheless, this ARL is proven to be much longer compared to both developed and other developing countries. Thus it signals to the level of competitiveness of the Malaysian companies in the global market, where timeliness of financial reporting is the measure of high quality of financial information (IASB 2005). Nonetheless, there are limitations of the study, where it ignores the management lag which is also has strong influence on the ARL. Besides, to see the actual effect of the convergence of IFRS on the Malaysian ARL, it is best to be tested by using longitudinal data for more accurate results. the length of period for the study

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Table 1: Hausman Test Result for Model 1

Test Summary	Chi-Sq. Statistic	Chi-S.q. d.f	Prob
Random Cross Section	6.78	5	0.2374

Table 2: Breusch and Pagan Lagrangian Multiplier (LM) Test

Test Summary	Chi-Sq. Statistic	Chi-S.q. d.f	Prob
Random Cross Section	515.35	1	0.000

Table 3: Variables with expected sign and Description

Variables	Expected sign	Description
ARL		Audit Report Lag (the length of time between the company's financial year-end and the date of auditor's report)
IFRS	+	Convergence of IFRS (proxies by implementation of new accounting standards FRS 4, 7, 123 and 139) (coded 1 for adoption of at 3 of the new standards and 0 otherwise)
FYE	+	Financial Year-End of Companies (coded 1 for peak period and 0 for non peak period)
FINPOST	+	Financial Position of Companies (coded 1 if loss and 0 for profit)
SIZE	-	Size of Companies (natural log of the total assets)
AUDOP	+	Audit Opinion (coded 1 if not clean audit report and 0 for clean audit report)
AUDTEN	-	Length of audit-client relationship
β		β0 is the constant coefficient of regression, β1 is regression coefficients of the independent variables, β2- β6 are regression coefficients of control variables
ai		Unobserved company level effect
uit		Disturbance term

Table 4: Audit Report Lag (ARL) by year comparison

Year	Variable	N	Min	Max	Mean	Std. Dev
2009	ARL	257	39	121	96.65	23.659
2010	ARL	257	35	121	97.59	22.211
2011	ARL	257	32	149	99.5	22.759
	Valid N (listwise)	771				

Table 5: Adoption of IFRS by Year

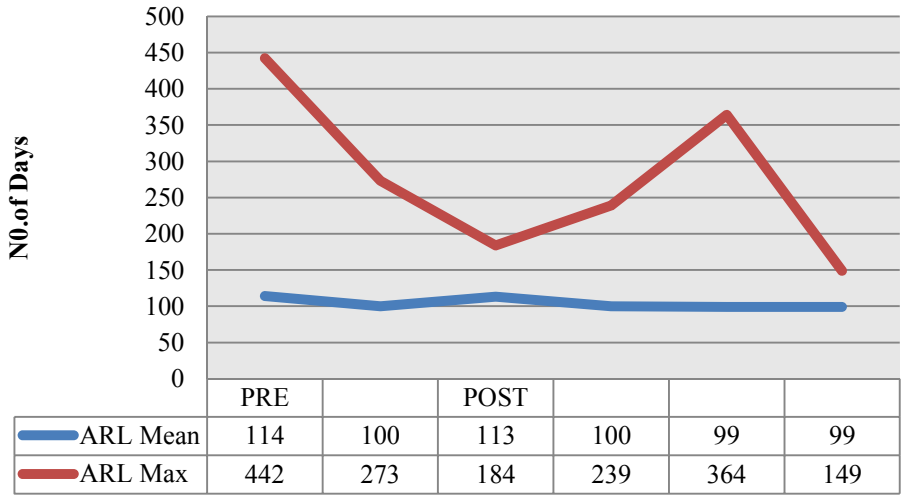
Year			Freq	Percent	Valid Percent	Cum. Percent
2009	Valid	Not Adopt	257	100	100	100
2010	Valid	Not Adopt	113	44	44	44
		Adopt	144	56	56	100
		Total	257	100	100	
2011	Valid	Not Adopt	1	0.4	0.4	0.4
		Adopt	256	99.6	99.6	100
		Total	257	100	100	

Table 6: Descriptive Statistic for independent variable (IFRS) and control variable

Variables	N	Min	Maxi	Mean	Std. Dev
IFRS	771	0	1	0.52	0.5
FYE	771	0	1	0.37	0.483
SIZE	771	34,145,920	41,060,188,000	1,673,825,933	4,790,292,528
FINPOST	771	0	1	0.2	0.399
AUDOP	771	0	1	0.08	0.264
AUDTEN	771	1	10	6.68	2.704

Table 7: Regression Analysis Result

Variables	**Coef.**	**Std.Err.**	**Std. Dev**	**P value**
IFRS	1.9594	0.86	2.28	0.0230
FYE	1.8787	2.72	0.69	0.4890
FINPOST	2.5884	1.39	1.87	0.0620
SIZE	-12.0521	2.30	-5.23	0.0000
AUDOP	6.3072	2.15	2.93	0.0030
AUDTEN	0.4365	0.41	1.06	0.2880
_cons	196.8825	19.80	9.94	0.0000
Wald chi2(6)	49.96			
Prob > chi2	0.000			
Overall R square	0.144			



	PRE		POST			
ARL Mean	114	100	113	100	99	99
ARL Max	442	273	184	239	364	149

Figure 1: The Trend of Audit Report Lag (ARL) in Malaysia
Prior to and Post Adoption of IFRS

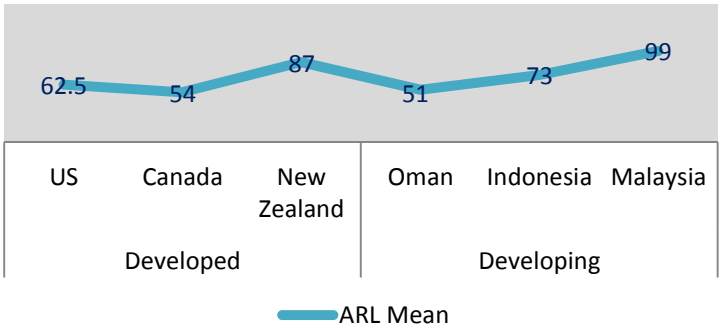


Figure 2: Comparison of ARL across Countries

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