THE ROLE OF BIG 4 AUDIT FIRMS IN THE REDUCTION OF AUDIT REPORT DELAY IN SAUDI ARABIA: EMPIRICAL EVIDENCE

دور أفضل مكاتب التدقيق العالمية الأربعة في التقليل من تأخر اصدار تقرير مراجع الحسابات الخارجي في المملكة العربية السعودية: دراسة تطبيقية

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Abstract :

This paper examines whether audit quality is associated with audit report lag. We posit that hiring a Big 4 audit firm reduces external audit report lag. Data was obtained from 82 listed companies in Saudi Stock Exchange (Tadawul) for the year 2013. An OLS regression analysis shows that, audit quality is associated negatively with shorter audit report lag. The outcomes of this study have significant implications to the auditor independent issues in the setting of Saudi Arabia.

Keywords: audit quality; audit report lag; Saudi Arabia.
jel classification: M42

الملخص:

تهدف هذه الدراسة إلى اختبار علاقة جودة التدقيق الخارجي بتأخر إصدار تقرير مراجع الحسابات الخارجي. حيث تفترض هذه الدراسة بانَّ طلب الشركات لدرجة جودة خدمة التدقيق الخارجي من قبل أفضل أربعة مكاتب التدقيق الدولية يقلل من فترة تأخر إصدار المراجع الخارجي لتقرير التدقيق. تم جمع البيانات لعدد 82 شركة من الشركات المدرجة في السوق المالي السعودي (تداول) لعام 2013م. أوضحت نتائج تحليل الانحدار (المربعات الصغرى الاعتيادية) وجود علاقة طردية ذات دلالة إحصائية بين جودة مراجع الحسابات الخارجي وتأخر اصدار تقرير المراجعة الخارجية.

كلمات البحث الدالة: جودة التدقيق ، وتأخر اصدار تقرير مراجع الحسابات الخارجي، والسعودية.

1. Introduction

Audit report delay indicates to the time period from a company's financial year end to the date of the auditor's report (Walker and Hay, 2013; Imam, Ahmed and Khan, 2001). It represents one of the most crucial factors that influence the timeliness of earning announcements (Givoly and Palmon, 1982; Ashton, Willingham and Elliott, 1987). Majority of the companies (over 70 %) do not declare their earnings until the issuance of auditor's report (Bamber, Bamber and Schoderbok, 1993). Therefore, Audit Report Lag (hereafter ARL) provides a key role in the transference of audit information to the market (Dopuch, Holthausen and Leftwich, 1986; Lai, Cheuk and Hom, 2005) and has been associated with the market reactions (Chambers and Penman, 1984). Likewise, researchers (e.g., Newton and Ashton, 1989; Afify, 2009) indicated that ARL is considered as one of the critical indicators of audit efficiency and thus, efficient auditors should perform more timely audits. Moreover, researchers and professional agencies consider the timeliness of financial reporting (ARL is the most influential factor in timeliness) as an important characteristic which reflects the relevancy and reliability of financial information and financial information becomes less relevant with the passage of time (FASB, 1980; Hendriksen and Van Breeda, 1992; Lawrence and Glover, 1998; McGee and Tarangelo, 2008).

Along the same line, researchers (e.g. Prickett, 2002; Kulzick, 2004) argued that the timeliness of financial reporting reflects one of the important aspects of transparency of financial information and therefore, represents one of characteristics of good corporate governance identified by international organizations such as OCED and World Bank (McGee and Yuan, 2008). Furthermore, Khasharmeh and Aljifri (2010) argued that ARL has greater importance especially for emerging economies since other non-financial statements such as news conferences, media releases and financial analysts' forecasts are not well developed. In addition, the regulatory bodies in these markets are not as effective as in western developed countries (Wallace and Briston, 1993; Chahine and Tohme, 2009).

Due to the importance of ARL, several previous studies have examined this issue in different settings and these studies are still suffering of inconclusive and limited results (Leventis et al., 2005; Che-Ahmed and Abidin, 2008; El-Bannany, 2008; Lee et al., 2008; Afify, 2009; Khasharmeh and Aljifri, 2010; Mohamad-Nor et al., 2010; Hashim and Abdul Rahman, 2011; Mohamad-Nor et al., 2010; El-Bannany, 2008). One of the issues ignored by the extant research in the discipline of ARL is audit quality. It is evidenced that brand-names are considered a higher audit quality providers (Boon, McKinnon and Ross, 2007; Moizer, 1997; Copley, Gaver and Gaver, 1995; Palmrose, 1988; Simunic and Stein, 1987; Dopuch and Simunic, 1980). Healy and Lys (1986) document that brand-name auditor indicates of higher audit quality and it also refers a dissipating by the audit quality provider if there is a fail in supplying the contracted-for quality. Consequently, there will be a potential loss of reputation, audit fees and client base (Chaney et al., 2004; Citron & Manalis, 2001; Woo & Koh, 2001; Bedard et al., 2000; Francis & Wilson, 1988; DeAngelo, 1981; Burton and Roberts, 1967). Further, Healy and Lys (1985) indicate that internationally operating companies choose Big Eight because of their quality and geographic dispersion. Therefore, it worth to mention that Big 4 audit firms may have lesser audit report delay compared to non-Big 4 audit firms. Therefore, the current study examines the association between audit quality and ARL among Saudi listed firms. This is due to the importance of ARL especially for the emerging markets such as Saudi Arabia, since the information in these markets is limited and these markets have a longer time lag (Errunza and Losq, 1985; Khasharmeh and Aljifri, 2010). Further, ARL has a greater importance especially for emerging economies since other non-financial statements such as news conferences, media releases and financial analysts' forecasts are not well developed. In addition, the regulatory bodies in these markets are not as effective as in western developed countries (Wallace and Briston, 1993; Chahine and Tohme, 2009). Hence, this study aims to answer the following research question: "Could audit quality reduce company's ARL?

This study contributes to the audit literature by examining association of audit quality and ARL. The findings of the study would have implications for many parties in Saudi Arabia. It provides supporting evidence for the external auditors in Saudi Arabia on whether audit quality could significantly decrease ARL. Furthermore, this study could assist managements of companies in Saudi Arabia to focus on the important role of audit quality and the reduction of timeliness of financial reporting. Finally, this study could assist regulators in Saudi Arabia to focus on the important audit quality in reducing timeliness of financial reporting.

The rest of this paper is structured as follows. The next section reviews the literature on audit committee activity and ARL, and develops the testable hypothesis. This is followed by the design of the research. It further provides the results of the analysis and discussion. The final section concludes and discuses limitations and suggestion for future research.

2. Literature Review and Hypothesis Development

2.1 Audit Quality and Audit Report Delay

Market perceives audit quality as a different product using the brand-name classifications (e.g, Houqe et al., 2015; Chi & Weng, 2014; Chou, Zaiats & Zhang, 2014; Becker et al. 1998). Empirically, several studies find that audit firms with a well-recognized brand-names are considered a higher audit quality providers (e.g, Boon, McKinnon and Ross, 2007; Moizer, 1997; Copley, Gaver and Gaver, 1995; Palmrose, 1988; Simunic and Stein, 1987; Dopuch and Simunic, 1980). Healy and Lys (e.g, 1986) document that brand-name auditor indicates of higher audit quality and it also refers a dissipating by the audit quality provider if there is a fail in supplying the contracted-for quality. Consequently, there will be a potential loss of reputation, audit fees and client base (e.g, Chaney et al., 2004; Citron & Manalis, 2001; Woo & Koh, 2001; Bedard et al., 2000; Francis & Wilson, 1988; DeAngelo, 1981; Burton and Roberts, 1967). Further, Healy and Lys (1985) indicate that internationally operating companies choose Big Eight because of their quality and geographic dispersion. In DeAngelo's formulation, differential audit quality is a passive by-product of client-specific quasi-rents.

In addition, Palmrose (1988) indicates that non-Big Eight firms as a group had higher litigation occurrence rates than the Big Eight. The value of external audits derives from users' expectations auditors will detect and correct/reveal any material omissions or misstatements of financial information. Failure to do so, termed an audit failure, typically results in litigation when client/users incur losses in conjunction with materially false or misleading financial information. This suggests that (under ceteris paribus conditions) users can view auditors with relatively low (high) litigation activity as higher (lower) quality suppliers. There is also evidence that the Big Eight firms command price premiums (e.g, Rubin, 1988; Simon and Francis, 1988; Francis and Simon, 1987; Palmrose, 1986; Francis and Stokes, 1986; Francis, 1984). Simon and Francis (1988) report that Big Eight fees have been consistently estimated at 16 percent to 19 percent higher than non-Big Eight audit fees across several independent studies. Big Eight price premiums are consistent with Klein and Leffler's (1981) claim that price is an indicator of quality. Further, Francis and Simon (1987) report that the Big Eight price premium holds with respect to both other national firms and local-regional firms and that non-Big Eight national firms do not command a price premium over local-regional firms. Based on these studies, Francis and Wilson (1988) use a two-category representation of audit quality with Big Eight firms defined as brand name higher-quality supplier.

Researchers disputed that the audit delay for firms audited by big audit firms is shorter than for firms which are audited by not big audit firms for various reasons: First, big audit firms utilize additional qualified staff, possess superior technology to complete their audit job earlier compared to smaller firms (Chan, Ezzamel & Gwilliam, 1993; Crasewell *et al*., 1995; Hossain & Taylor, 1998; Leventis *et al*., 2005). Second, big audit firms have specialized experience in auditing listed firms compared to smaller ones, which leads to achieving proficient audit work in less time (Ashton et al., 1989). Third, big audit firms possess strong incentive to enhance the market share in the audit market and sustain their reputation. This will guide them to achieve their work earlier compared to smaller firms (Krishnan, 2005; Leventis et al., 2005; Afify, 2009).Therefore; the hypothesis developed by this study is stated in the following direct form:

H_1: There is a positive relationship between audit quality and the audit report lag.

3. Research Design and Model Specification

The population of interest comprises all companies listed on Saudi Stock Exchange (Tadawul) for the year 2013. This selection is the most recent test period for which data were available at the time this study is carried out. A cross-sectional review of audit reports of the sample companies listed on Saudi Stock Exchange was undertaken. Samples selected depicted in Table 1.

Table 1 Sample Selection in 2013

	Total Observations
Total listed companies	172
Banks & Insurance companies	(47)
Observations discarded (outliers, missing and incomplete data)	(43)
Final sample	82

The audit report lag model used in this study is adopted from prior studies to accommodate the audit quality in the Saudi setting. We include several control variables which have been found to be associated with audit report lag. These variables are board of directors' effectiveness *(BDEFE)* firm size (*SIZE*), firm performance (*ROA*), and leverage (*LEV*).

The control variables are based on prior researchers regarding audit report lag. Several empirical studies in different disciplines have reported an association between weaknesses in governance and poor financial reporting quality (Carcello & Neal, 2000; Klein, 2002). The board of directors has to fulfill two functions: (1) monitoring management and (2) providing expert advice (Houqe & Zijl, 2008; Kirkos et al., 2008). Therefore, the effectiveness of board of directors may influence negatively the ARL. With regard to the association of firm size and ARL, researchers (e.g., Henderson and Kaplan, 2000; Ahmed and Kamarudin, 2003; Che-Ahmed and Abidin, 2008; El-Bannany, 2008; Lee et al., 2008; Afify, 2009; Mohamad-Nor et al., 2010; Hashim and Abdul Rahman, 2011) found a negative association between firm size and audit report lag. With regard to the association of firm performance and audit report lag, several empirical studies (Mao & Pham, 2014; Dyer & McHugh, 1975; Carslaw & Kaplan, 1991; Bamber *et al*., 1993; Almosa & Alabbas, 2007) reported a positive association. Finally, It is a matter of dispute whether the relative proportion of debt to total assets could be indicative of financial health of the company (Carslaw and Kaplan, 1991) and a prominent proportion of debt could result in liquidity or going-concern problems which necessitate more tentative audit (Ahmed and Kamarudin, 2003). Moreover, Che-

Ahmed and Abidin (2008) indicated that the amount of long-term debt may also raise the agency cost as suggested by Jensen and Meckling (1976) which leads to the increase of audit efforts and hence, increase in the length of audit engagement. Furthermore, studies (Carslaw and Kaplan, 1991; Ahmed and Kamarudin, 2003; Abdullah, 2007; Lee et al., 2008; Baatwah *et al*., 2015) showed that firms with a high proportion of debt have longer ARL. Hence, this study adopts the positive effect of debt ratio on audit report lag.

The following is the hypothesized Audit Report Lag (ARL) model:

ARL = $\beta 0$ + $\beta 1$ AC_ACTIVITY + $\beta 2$ SIZE + $\beta 3$ ROA + $\beta 4$ LEV + ε

Where:

ARL Audit Report Lag: a number of calendar days from fiscal year- end to the date of the auditor’s report

Test Variable

AUQ "1" Big 4 audit firm, "0" Non-Big 4 audit firm

Control Variables

BDEFE An integration measurement of the number of board of directors and the number of board of directors' meetings held during the year

SIZE Firm size, natural Logarithm of total assets of the company

ROA Return on assets, net income divided by book value of total assets

LEV Leverage, total liabilities to total assets. Total liabilities refer to the sum of current liabilities and long- term liabilities.

4. Results

4.1 Descriptive Statistics and Correlation Analysis

Table 2 reports the descriptive statistics of all variables examined in this study. The mean of the number of calendar days from fiscal-year end to date of external auditor’s report (*ARL*) is 41.26 days (standard deviation of 19.741 days) with actual minimum of 5 days and maximum of 138 days. This means that the Saudi listed companies take approximately 41 days on average beyond their annual reports date before they are finally ready for the presentation of the audited financial reports to the shareholders. This evidence suggests that the *ARL* may be an important concern for Saudi listed companies in financial reporting policy when compared with other Arab countries. It is important to mention that the average audit report lag of Egyptian companies is 67 days as reported by Afify (2009) and similar to audit lag in Bahrain (51 days) but longer than average of audit lag in United Arab Emirates (43 days) as reported by Khasharmeh and Aljifri (2010).

Table 2: Descriptive Statistics

Panel A: Continuous Variables				
Variable	**Minimum**	**Maximum**	**Mean**	**Std.Deviation**
ARL	5	138	41.26	19.741
BDEFF	00.	108.00	41.000	19.06649
SIZE	86470	55141948981	1812469323	6279879161
ROA	0.000	.38540	0.086521	0.0846869
LEV	0.0216	1.0976	0.347614	0.22153030
Panel B: Dichotomous Variable				
Big 4	52 (63.4%)			
Others	30 (36.6%)			

With regard to board of directors' effectiveness (*BDEFE*), Table 2 displayed that the mean of the board of directors' effectiveness is approximately 41.000 with a standard deviation of 19.06649. As for the firm size (*SIZE*), The mean is S.R 1812469323 with a maximum of S.R 55141948981, a minimum of S.R 86470 and a standard deviation of 6279879161. The firm performance (*ROA*) ranges from .38540 to 0.000 with an average of 0.086521 and a standard deviation of 0.0846869. With respect to firm leverage (*LEV*), it ranges from 1.0976 to 0.0216 with an average of 0.347614 and a standard deviation of 0.22153030. With regard to audit quality, 52 (63.4%) companies of the sample are audited by Big-4 audit firms, and 30 (36.6%) companies are audited by Non-Big-4 audit firms.

With respect to multicollinearity assumption, Table 3 shows the Pearson Correlation among the independent variables in this study. The highest correlation reported by this study is between audit quality and leverage at .430, which suggests that multicollinearity is not a problem for the regression results.

Table 3: Pearson Correlation Matrix

	AUQ	BDEFF	SIZE	ROA	LEV
AUQ	1				
BDEFF	-.024	1			
SIZE	.099	.161	1		
ROA	.119	.189	-.052	1	
LEV	**.430	-.161	.124	*-.227	1

*correlation is significant at the 0.05 level

** Correlation is significant at the 0.01 level

4.2 Multivariate Analysis

Table 4 shows the multiple regression results.

Table 4: OLS Regression Results: The Impact of AUQ on ARL

Variable	Expected Sign	*t*-Value	*P*-value	Tolerance	VIF
Constant		1.255	0.214		
Test Variable					
AUQ	-	2.785	0.007	0.644	1.552
Control Variables					
BDEFF		0.194	0.847	0.940	1.064
SIZE		-1.764	0.082	0.943	1.070
ROA		-1.711	0.092	0.827	1.209
LEV		0.243	0.809	0.595	1.682

DV= ARL R^2 = .208 Adjusted R^2 = .147 F-Ratio = 3.414 Sig F =.008

As seen from Table 4, the model explains 20.8 % of the variation in ARL. In general, the model is significant (*F* = 3.414) (Sig *F* = 0.008). As for the association between audit quality *AUQ* and *ARL*, the direction of this relationship is positive and significant at 1% (*t* = 2.785, *P* = .007). This result indicates to the inverse impact of *AUQ* on *ARL* which means a higher audit quality increases the possibilities of ARL. This result is inconsistent with agency theory prediction and the extant research (Chan, Ezzamel & Gwilliam, 1993; Crasewell *et al*., 1995; Hossain & Taylor, 1998; Leventis *et al*., 2005; Ashton *et al*., 1989). Thus, hypothesis 1 is not supported.

With respect to the control variables, firm size *SIZE* is significant in the expected direction (*t* = -1.764, *P* = .082) as reported previously by the previous studies (Henderson and Kaplan, 2000; Ahmed and Kamarudin, 2003; Che-Ahmed and Abidin, 2008; El-Bannany, 2008; Lee et al., 2008; Afify, 2009; Mohamad-Nor et al., 2010; Hashim and Abdul Rahman, 2011). As for firm performance *ROA*, a significant and negative association has been reported (*t* = -1.711, *P* = .092), given an inconsistent result with the previous studies (Mao & Pham, 2014; Dyer & McHugh, 1975; Carslaw & Kaplan, 1991; Bamber *et al*., 1993; Almosa & Alabbas, 2007). Regarding to *LEV*, no association has been reported for the relationship of *LEV* with *ARL* as previously found by Baatwah *et al*. (2015) in the Omani context.

5. Conclusion

The result of this study shows that audit quality is related positively to audit report lag among listed companies in Saudi Arabia. Such result provides evidence about the role of Big 4 audit firms in reducing audit report lag in the context of Saudi Arabia. This result indicates to ineffective role of hiring Big 4 audit firms in reducing the time of issuing audit reports. This circumstance exists due to possible interpretations such as there is an obvious indication of weak levels of enforcement and a dominance of three groups of shareholders, namely; government and its agencies, family, and domestic corporations in which these dominant groups are a result of the weakness of investor protection and the absence of well-developed markets for sound management practices and corporate control (Chahine, 2007; Chahine & Tohme, 2009; Harabi, 2007; Hawkamah and IFC, 2008; Omran et al., 2008; Saidi & Kumar, 2007). Another interpretation of this circumstance could be related to concentration of Big 4 audit firms in Saudi Arabia market. So that there is no differentiation in the quality of audit service offered by Big 4 and non-Big 4 audit firms. Thus, the consequence of these issues is that Big 4 audit firms spend much time on auditing and, then, giving the audit report.

Limitations of the study lie on the other internal corporate governance mechanisms (i.e., board of directors characteristics, audit committee characteristics and ownership structure). Future line of research should put an effort to introduce these mechanisms. Further research should replicate this model to determine its validity in different contexts of GCC countries, in different time periods, and with different sample size. These limitations may motivate more future research in the GCC market.

One important implication of these findings relates to the issue of audit report lag in Saudi Arabia. Saudi government, stock market, companies and accounting and auditing regulators would gain some new insights from this study in terms of understanding the determinants influencing audit report lag. The results of this study would benefit banks in the way that they can assess the creditworthiness of incorporating companies in Kingdom of Saudi Arabia. The numbers incurred in the audited financial statements are based on to mandate bond covenants. Moreover, credit decisions made by lenders are determined based on audited financial statements. Therefore, audit report lag issues are of the utmost important for any lending institution. Investors and financial analysts depend on audited financial statements to make decisions related to bonds, bond rating, interest rate, and all other decisions related to investments in Kingdom of Saudi Arabia market. Accordingly, increased understanding and prediction of companies' events is important to this user group. Further, the results of this study will be of interest to the researchers and academic community due to a lack of formal research body addressing the issues of audit report lag in Kingdom of Saudi Arabia and, therefore, this study will provide with substantial information about issues in the markets of Saudi Arabia to count on, in the future, as premise data.

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