Studies in Social Sciences and Humanities
Vol. 1, No. 2, 2014, 60-67

Audit Delay and Accountability Index: Evidence from Malaysian Local Governments

Marziana Mohammad[1], Wan Mohammad Taufik Wan Abdullah[2], Mohmmad Sakarnor Deris[3]

Abstract

This paper investigates the determinants of audit delay in Malaysia. The sample comprises three local authorities which are Kedah, Perak and Kelantan during the period 2008 – 2010. The research was conducted based on secondary data which are obtained from the Auditor General Report and Financial Management Performance of the departments or agencies for the respective local authorities in Kedah, Perak and Kelantan. The number of days between the date of the financial statement year end and the date of certificated by the auditor is used to measure the audit delay. The result indicated that the financial management performance of most of the departments or agencies in the sample based on the Accountability Index was at a satisfaction level while most of them did not publish the financial statements on time. However, this study cannot be generalized to other local authorities in Malaysia, since it is meant for Kedah, Perak and Kelantan only.

Keywords: Audit Delay, Accountability Index, Timelines, Local Authorities

1. Introduction

Good accounting information is usually characterized by qualitative factors such as adequacy, comparability, relevance and reliability in order for the information provided to be useful for decision making by the decision makers which include significant stakeholders. Apart from that, the accounting information should also be seen as being transparent and timely. Transparency is a very important element of financial reporting which might affect investment decisions made by an informed investor. Besides, timeliness of the audited financial reporting is considered to be a critical and important factor affecting the usefulness of information made available to external users (Almosa and Alabas, 2007; Aljifri and Khasharmeh, 2010). Timelines is an important qualitative attribute of financial statement. The issuance of Governmental Accounting Standards Board (GASB)'s states that for financial reports to be useful, they must be issued soon enough after the reported events to affect decisions.

Timeliness in financial reporting is a significant characteristic of accounting information. Stale information is of little use to decision makers in deciding significant decisions for themselves and the organization. Studies into the timeliness of accounting information have become an important issue now more than ever before as a result of phenomenal changes in both modern technology and business practices worldwide (Errunza and Losq, 1985; Owusu-Ansah and Leventis, 2006). Financial reporting should also be seen as a part of the process of accountability whereby the public is informed of significant updated information based on the economic events occurring in the last financial year as promptly as possible. In Malaysia, the process of getting the financial information from any local authority takes time. This is because the users have to wait until the financial accounts are published in the official government gazettes. As a result, there is a possibility of lack of interest in the financial accounts of local authorities as any potential issues fade with the passage of time (Tayib, Coombs and Ameen, 1999). Therefore, local authorities have to

[1]College of Business Management and Accounting, UniversitiTenagaNasional (UNITEN), Malaysia
[2]College of Business Management and Accounting, UniversitiTenagaNasional (UNITEN), Malaysia
[3]College of Business Management and Accounting, UniversitiTenagaNasional (UNITEN), Malaysia

take the responsibility to ensure that their financial reports are made available in a timely manner because they are accountable to the public at large. This is very important because it allows the users to evaluate the capability of local authorities in managing their affairs and resources efficiently and effectively.

Public accountability embraces all aspects of government action and direction. In financial management, the most elementary form of public accountability is the requirement that local authorities give an account of their activities to the public and provide justification of what has been done. As is identified in the literature, there has been extensive research concerning the audit delay done in the private sector but very little is known about local authorities especially Malaysian local authorities. Thus, it is our interest to develop a current study concerning the audit delays and accountability index among local authorities in Malaysia. This study enriches the existing literature on Public Sector Accounting studies in Malaysia. The aim of this study is to examine the trend of the accountability index of the local authorities in Malaysia. Meanwhile, this study also aims to investigate the relationship between the audit delays and the accountability index attained by local authorities of the respective states selected in the sample of the study. This study contributes to the Government Audit and Public Sector Accounting literature by looking at the pattern of accountability index attained by the local authorities of the selected states in the sample for the period under study. It provides supporting evidence on whether the financial reports provided by the local authorities to the interested users reflect public accountability upheld by the government.

The remainder of the paper is organized as follows. First, it discusses previous research findings based on a literature review. Next, it describes the research design in conducting the study. It further provides the results of the analysis and discussion. The final section reports conclusions and provides suggestions for future research.

2. Literature Review

Timeliness is an important qualitative attribute of high quality accounting information. The term is vital and may influence whether information is useful to those who read financial statements or otherwise. Its significance has been emphasized in the Statement of Financial Accounting (SFAC 2, FASB 1976, in Delaney, Epstein, Adler and Foran, 1997). Meanwhile, the Governmental Accounting Standards Board (GASB) identifies timeliness as one of the six qualitative characteristics that financial information is expected to possess if it is to communicate effectively, along with relevance, reliability, understandability, comparability and consistency (Concepts Statement No. 1, Objectives of Financial Reporting). Timely information may be defined as information that is available soon enough after the reported events take place in order to affect decisions or assessments of accountability. In the context of audited annual financial reports, the issue of timeliness centers on the amount of time that elapses between the end of the fiscal year being reported and the date the financial report becomes available to the public.

The provision of timely information in corporate reports assumes greater importance (Wallace, 1993) in emerging economies. This is often attributed to the fact that non-financial statement sources of information such as media releases, news conferences and financial analysts' forecasts are not well developed and the regulatory bodies are not as effective as in developed countries. Users of financial information should be able to reach information they need in a timely manner in order that they can make reasonable decisions. Within this context, the timing of information is at least as significant as its content for financial information users. The significance of timely financial reporting to stakeholders cannot be overemphasized. Jaggi and Tsui (1999) noted that stakeholders and investors need timely information for reducing the asymmetric dissemination of financial information and for the growth of investing community as a whole. Specifically, Ismail and Chandler (2003) said that unnecessary delay in releasing financial statements results in greater market inefficiency while Ahmad and Kamarudin (2001) also noted that it reduces the relevance of the documents and their information content. In addition, the study of Ashton, Willingham and Elliott (1987) on timeliness of corporate reporting suggested that audit delay increases uncertainty associated with investment decisions.

However, the substantial body of literature regarding 'audit timing' or the period between the end of the fiscal year and the date of the audit report, that has developed in the corporate sector Ashton *et al.* (1987) is not matched in the government sector. The available studies of governments have settled on three groups of influencing factors; competency of the government's financial management, competency of the auditor, and characteristics and complexity of the government (Dwyer and Wilson, 1989). More recently, Merritt Research Services (2010) published averages for issuers of municipal bonds in its database, covering the financial years 2007-2009. Average audit timing for general purpose governments (168 days to 178 days) was found to be about a month or more longer than for many types of special-purpose governments (ranging from 110 days for toll roads to 152 days for school districts and airports). Little, if any, literature existed until recently on the topic of how users of governmental financial information view timeliness. In a broader study of bond analyst views on disclosure, Robbins and Simonsen (2010) asked survey respondents to label audited financial statements received within three months, six months, nine months, and so on as completely useful, somewhat useful, less useful, or no longer useful. They found that 70 percent of respondents considered audited financial statements received within 9 months to be completely useful. On the other hand, 89 percent identified as no longer useful audited financial statements received after 10 months. In another study, Pane and Jensen (2002) found that the mean audit delay is 100 days for 410 municipalities in the U.S. Additionally, McLelland and Giroux (2000) found that the mean audit delay is 124 days among the 209 U.S. cities councils.

In Malaysia, the Local Government Act 1976 requires the audited accounts with the auditor's observations be published in the government gazette as stated in Section 60(4) (Tayib*et al.*, 1999). The study noted that financial reports for local authorities appear in the government gazette after approximately one year after the end of the financial year to which they relate. There are also cases where such information has taken up to six years to actually appear in the government gazette. Tayib*et al.* (1999) also dictated that taxpayers in local authorities with high arrears are almost unanimous in their desire to know more about their council's financial affairs. The study also indicated that the taxpayers are more willing to pay their local taxes more quickly if such information were to be made readily available. However, this willingness is reduced due to the long time taken for the financial information to be published in the government gazette.

Theoretical Arguments and Hypotheses Development

This study proposes that audit delay is affected by two factors as shown in the model as follows:

$$\text{Audit delay} = f(Accountability\ Index, City\ Size)$$

Accountability Index

To promote the timeliness of financial reporting in government local authorities, municipalities and local authorities receive benefits from participation in the Government Finance Officers Association (GFOA)'s Certificate of Achievement for Excellence in Financial Reporting Award. The GFOA awards the Certificate of Achievement for Excellence in a Financial Reporting Award. This award was previously entitled the 'Certificate of Conformance Award' (Dwyer and Wilson, 1989). The award is designed to give recognition on excellent achievement in the process of preparing financial reporting. In Malaysia, to ensure the level of compliance with the stipulated legislation as laid down in the federal Constitution and Audit Act 1957 and related procedures, the Audit General Department executes an audit on the effectiveness of financial management of the Government States Department and Agencies. They are finally ranked based on the accountability index according to their achievements which are based on the overall total marks obtained. Previous studies found that audit delay is reduced for cities that had received excellent achievement in the process of financial management (Dwyer and Wilson, 1989; Johnson, 1998). Based on these arguments, the following hypothesis is developed:

H1: There is a significant relationship between the accountability index and audit delay.

Municipal Characteristics

Prior research has reported inconsistent results regarding how a city's size influences audit delay. McLelland and Giroux (2000) indicated a positive relationship exists between audit delays and population.

On the other hand, other studies by Dwyer and Wilson (1989) and Johnson (1996) did not find a significant relationship between size and audit delay. This study likewise examines the city size as larger cities could experience longer audit delays due to increased levels of financial activity. However, larger cities could also experience shorter delays due to increased financial control and scrutiny from stakeholders and constituents. Thus, the second hypothesis is developed as follows:

H2: There is a significance relationship between city size and audit delays.

3. Research Methodology

Purposive sampling was employed in this study which covered the local authorities in Kedah, Kelantan and Perak. The reason why those local authorities are chosen is because they are reported as those who have performed badly in submitting the statement of accounts to the Auditor General Office as reported in the Auditor General Report 2008. The data for the four-year period from 2008 until 2010 were collected from the State Auditor General Report.

There are four operational variables which comprise one dependent variable and two independent variables as described in Table 1.

Table 1: Variables Measurement

Variables	**Measurement**
Dependent Variable Audit Delay • Account preparation delay • Date of certification	The length of time taken to prepare financial statements The length of time taken from the submission date to the date of the audit certificate
Independent Variables Accountability Index City Size	The mean of accountability index achieved by the states The size of population for each state

4. Data Analysis and Interpretations

Descriptive Analysis

Table 2shows the descriptive statistics results for selected samples from annual reports for the period of 2008 until 2010 in Kedah, Perak and Kelantan. In the Audit General Report, the National Audit Department has carried out financial management performance of the departments or agencies based on the Accountability Index for auditing the financial statements that had been submitted. The Accountability Index is based on the four levels which are excellent (4 star), good (3 star), satisfactory (2 star) and unsatisfactory (1 star). From the results, the highest mean of the accountability index for the three states is good performance which is in Kelantan (3.21), followed by Kedah (3.17) and lastly, Perak (3.05).

Based on the results, in the 2008 Audit General Report it indicated that the highest percentage which received the excellent award in their accountability index was Kedah which was 14.29 percent and this was followed by Perak which was 7.69 percent. Then in 2009, Kelantan showed the highest percentage which was14 percent followed by Kedah with 11.11 percent which received the excellent award in their financial performance. However, Perak received an unsatisfactory accountability index (2.70 percent) for the Perak Council of Islamic Religion and Malays Customs.

For 2010, the highest percentage received the excellent award in their financial management performance was Kedah (23.53 percent), followed by Kelantan (21 percent) and Perak (5.26 percent). Therefore, the trend of the accountability index for the three years from 2008 until 2010, the highest average mean was Perak (3.00) which was good, followed by Kedah (2.96) and last was Kelantan (2.90) which means a satisfactory level.

Table 2: Summaries of Accountability Index

Years	Accountability Index	Kedah (N=9)		Perak (N=10)		Kelantan (N=6)	
		Percentage	Mean	Percentage	Mean	Percentage	Mean
2008	Excellent	14.29%	2.86	7.69%	3.08	-	2.36
	Good	57.14%		53.85%		36%	
	Satisfactory	28.57%		38.46%		64%	
2009	Excellent	11.11%	2.86	2.70%	2.86	14%	3.14
	Good	63.89%		83.79%		86%	
	Satisfactory	25%		10.81%		-	
	Unsatisfactory	-		2.70%		-	
2010	Excellent	23.53%	3.17	5.26%	3.05	21%	3.21
	Good	70.59%		78.95%		79%	
	Satisfactory	5.88%		15.79%		-	
Average			2.96		3.00		2.90

Correlation Analysis

Table 3 depicts the correlation between accounts preparation delay, date of certificate with city size and the accountability index. This analysis is to measure the second objective which is to investigate the significant relationship between all dependent variables with the independent variable. Based on the results for the state of Kedah, in terms of accounts preparation delay it only had one significant relationship with the mean accountability index which had a p-value of less than the 0.01 level (correlation value -1.000). In terms of the date of receiving the certificate also it had one significant relationship with the city size which was a p-value of 0.003 (correlation value .866).

For Perak state, the results indicated that there was only one significant relationship between accounts preparation delay with city size and the accountability index. The p value was less than 0.01 which was (correlation value -.0845) a significant relationship with city size and (correlation value 0.845) for the mean of accountability index. The p value was 0.002 which is less than the p value at the 0.01 level. However, Kelantan state reported that all the dependent variables had a significant relationship with the independent variable. In terms of accounts preparation delay, this had a significant relationship with city size (correlation value -.866) and the mean accountability index (correlation value -.866) that the p value is less than 0.05 which is p value 0.026.

Then in terms of the date of certification it was reported that there was a significant relationship with city size and the accountability index (correlation value -.866) that the p value was less than 0.05. Therefore, the alternate hypotheses H1 and H2 were accepted. This result is consistent with previous studies, for example McLelland and Giroux (2000) who found a positive relationship between audit delay and population. However, Dwyer and Wilson (1989) and Johnson (1996) did not find a significant relationship between size and audit delay.

According to Dyer and McHugh (1975) the management of larger companies has greater incentives to reduce both audit delay and reporting delay since they are closely monitored by investors, trade unions and regulatory agencies. Besides, professional city managers have greater incentive to signal competent professional performance by producing a timely audited financial report (Dwyer and Wilson, 1989).

Table 3: Correlation Analysis

Dependent variable	Independent Variable	
Kedah	City Size	Accountability Index
Accounts Preparation Delay:		
Correlation Coefficient	.000	-1.000**
Sig. (2-tailed)	1.000	.
N	9	9
Date of Certificate:		
Correlation Coefficient	.866**	-.500
Sig. (2-tailed)	.003	.170
N	9	9
City Size:		
Correlation Coefficient	1.000	.000
Sig. (2-tailed)	.	1.000
N	9	9
Perak	City Size	Accountability Index
Accounts Preparation Delay:		
Correlation Coefficient	-.845**	.845**
Sig. (2-tailed)	.002	.002
N	10	10
Date of Certificate:		
Correlation Coefficient	.	.
Sig. (2-tailed)	.	.
N	10	10
City Size:		
Correlation Coefficient	1.000	-.429
Sig. (2-tailed)	.	.217
N	10	10
Kelantan	City Size	Accountability Index
Accounts Preparation Delay:		
Correlation Coefficient	-.866*	-.866*
Sig. (2-tailed)	.026	.026
N	6	6
Date of Certificate:		
Correlation Coefficient	-.866*	-.866*
Sig. (2-tailed)	.026	.026
N	6	6
Date of Certificate:		
Correlation Coefficient	1.000	1.000**
Sig. (2-tailed)	.	.
N	6	6

*Correlation is significant at the 0.05 level (2-tailed)
**Correlation is significant at the 0.01 level (2-tailed)

5. Conclusion

The results provide important new insights into the determinants of municipal audit delays. Supposedly the issuance of the timely financial reporting is significant to municipalities, and so the government must identify and comprehend what factors they should consider to control in minimizing audit delays. The findings suggest that audit delays are significantly associated with city size and the accountability index achieved by the respective states in the sample. However, we would also like to highlight that the characteristics that influence audit delays may be different between the samples of states selected to be the sample of the study and other non-selected states. Overall, the findings provide beneficial information to the governments regarding the potential determinants of audit delays. Future research may consider which parties are liable for the audit delay, either on the hands of the preparers or auditors.

References

Ahmad, R. and Kamarudin, A. (2001). Audit delay and timeliness of corporate reporting: Malaysian evidence, available from internet at www.hicbusiness,orgbiz2003proceedings/Khairul%20Kamarudin5202.pdf [Accessed on 31 March 2012)

Aljifri, K. and Khasharmeh H. (2010). The timeliness of annual reports in Bahrain and United Arab Emirates: An Empirical Comparative Study. The International Journal of Business and Finance Research, 4(1), 51-71

Almosa, A.S. and Alabas, M. (2007).Audit Delay: Evidence from listed joint stock companies in Saudi Arabia. King Khalid University, Abha, Saudi Arabia, available from internet at www.kku.sa/conference/SSEFP/Presentations [Accessed on 15 April 2012]

Ashton, R.H., Willingham, J.J. and Elliot, R.K. (1987).An empirical analysis of audit delay. Journal of Accounting Research, 25(2), 275-292.

Delaney, P.R., Epstein, J.R., Adler, J.R. and Foran, M.F. (1997). GAAP 1997: Interpretation and application of generally accepted accounting principles, USA, John Wiley and Sons Inc. .

Dyer IV, J.C. and McHugh, A.J. (1975).The timeliness of the Australia annual report. Journal of Accounting Research, (Autumn), 204 220

Dwyer, P.D., Wilson, E.R., (1989). An Empirical investigation of factors affecting the timeliness of reporting by municipalities, Journal of Accounting and Public Policy 8(1), 29-55

Errunza, V. R. and Losq, E. (1985).The behavior of stock prices on LDC markets. Journal of Banking and Finance, 9(4), 561-575

Ismail, K., Nor, I. and Chandler, R. (2003). The timeliness of quarterly financial reports of companies in Malaysia, available from internet at http://papers.ssrn.com/sol.3/papers.cfm?abstract_id=415047 [Accessed on 19 April 2012]

Jaggi, b. and Tsui, J. (1999). Determinants of audit report lag: Further evidence from Hong Kong. Accounting and Business Research, 30(1), 17-28.

Johnson, L.E., (1996). Factors influencing municipal audit delay. Accounting Enquiries 6(1), 121 – 148

Johnson, L.E., (1998). Further evidence on the determinants of local government audit delay. Journal of Public Budgeting, Accounting & Financial Management 10, 375-397.

Mark Robbins and Bill Simonsen (2010). The quality and relevance of municipal ond disclosure: What bond analysts think. Municipal Finance Journal 31, 1-20.

McLelland, A.J., Giroux, G., (2000). An empirical analysis of auditor report timing by large municipalities, Journal of Accounting and Public Policy 19(3), 263 – 281

Merritt Research Services (2010). Just how slowly do municipal bond annual audit reports waddle in after the close of the fiscal year? Available from internet at http://www.merrittresearch.com/about/research_team/anselm.htm [Accessed on 20 April 2012]

Owusu-Ansah, S. and Leventis, S. (2006). Timeliness of corporate financial reporting in Greece. European Accounting Review, 15(2), 273-287.

Payne, J.L., Jensen, K.L. (2002). An examination of municipal audit delay. Journal of Accounting and Public Policy 21, 1-29.

Tayib, M., Coombs, H.M., Ameen, J.R.M. (1999). Financial Reporting by Malaysian Local Authorities: A Study of the Needs and Requirements of the Users of Local Authority Financial Accounts.The International Journal of Public Sector Management 12.

Wallace, R.S.O. (1993). Development of accounting standards for developing and newly industrialized countries. Research in Accounting in Emerging Economies, 2: 131-156.