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Implication of Audit Reporting Lag on Financial Statements Restatement

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Abstract---*This study was conducted to examine the effect of audit reporting log on financial statements restatement with firm size, big four public accounting firm, loss, and auditor switching as control variabels. The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange (BEI) in 2014-2016. The sample used in 253 company data. The analysis technique used in this research is logistic regression. Data type is secondary data and processed with data processing software SPSS 20.0. The results found that audit reporting lag had positif effect on financial restatement.*

Keywords---*Audit Reporting Lag, Restatement*

I. Introduction

Company conducting audit of financial report is to ensure the quality of revenue or the company financial information that can be relied on by stakeholders. For companies, the conducted audit is intended to examine the suitability of the carried out accounting practices with generally accepted accounting principles, identify financial problems that occur so future improvements can be done and assess the fairness of the presentation of financial statements which will be contained in the audit opinion.

The audited financial statements are then submitted to the OJK with the aim of providing credibility of the information in the financial statementss so that the users of the financial statementss can be convinced. Based on PSA No. 2 SA Section 110 (SPAP, 2001) states that the auditor is responsible for planning and carrying out an audit to obtain adequate confidence about whether the financial statements have been free from material misstatement caused by error or fraud.

The audit process carried out by the auditor can be done faster or longer depending on the financial statements. Longer auditing process can cause delays in submitting financial reports to OJK. This delay can be called as audit reporting lag. Delays that happen for more than four months, in addition of harming the investors, it will also harming the concerned company. Company that's late in submitting financial statements will be the subject to fines and administrative sanctions. This is in accordance with the regulations of the Financial Services Authority No. 29/POJK.04/2016 and also written in the regulations of the Capital Market Supervisory Agency and Finance Institutions, No.X.K.2, KEP-36/PMK/2003.

Company has the risk of doing restatement in the next period because a long audit indicates that there is a prolonged negotiation between the auditor and the client due to concerns about the quality of the client's financial statements information [1]. A long audit reporting lag can indicates a disagreement between the auditor and the client, such as accounting adjusment. So that the auditor needs more time to test the company's financial information. The existence of an audit reporting lag in the previous period will encourage the auditor who is in charge for the next period to find the causes of this, the auditor in the next period has the possibility to find the errors of the company's financial information which requieres company to do restatement.

Audit reporting lag affects the restatement of the company's financial statements. Research conducted by Blankley et al. (2014) [2], unnatural audit reporting lag has a high probability of restatement in the future. One of the impacts of the restatement on audited financial statements is that shareholders and investors suffer losses on investment they make because the market's trust for the company has declined. With restatement of audited reports, companies tend to have greater bad prospects and higher risks in the future.

Skinner (1997, page 252) explains that management has an obligation to correct the statement that stated in the disclosed information if later it is discovered that the statement contains misleading information for the users of the information. In GAAS, it has also been stated that when the auditor discovers a disclosed financial statements containing misstatement or omissions material, auditor is required to advise the clients to make an appropriate disclosures in their financial statements (AICPA, 2002, Section AU 561).

Various cases related to restatement have occured in various countries. The company required to perform restatement of its financial statements because it was found that the company had manipulated the financial statements by inflating the pre-taxt profits aimed to increase the company's achievement. When company restatement their financial statements, it is mandatory for them to provide information to investors that the previously published financial statements are not reliable anymore. Restatement will raise questions from various parties regarding management integrity and adequacy of internal controls.

In Indonesia, 2002, PT Kimia Farma had experienced problems related to restatement after the Ministry of BUMN and OJK conducted an examination of the company's financial statements. Later, it was found that the profits have been presented much more higher than the actual profits by inflating the value of prices on the inventory list causing overstated. The fraud carried out begins with double recording which carried out on the unelected units for sampling by the auditor. PT Kimia Farma required to do restatement to correct the fraud based on OJK regulations and at the same time to regain the public trusts.

Restatement can be expressed in several ways. Some are reported in press releases or a series of press releases, on 8-K Form (Current Event) archieved by the SEC, and by submitting financial information improvements (10-Ks). The information provided at the initial press release and 8-Ks Form varies greatly. A company can identify that restatement may occur, restatement may occur but the impact is uncertain, or that restatement is needed and measures the changes that have been made. A more complete explanation of restatement may be found in the next press release or in the submitted financial information improvements.

The sample used in this study are manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2014-2016. The selection of manufacturing companies as research sample is because manufacturing companies are one of the sectors that has a high attractiveness for investors. In this study, an examination of the relationship between audits related to the audit reporting lag was conducted which triggered a restatement for companies listed on the Stock Exchange in 2014-2016. The purpose of this study was to determine the effect of audit reporting lag on restatement for manufacturing companies in the next period.

II. Background Theory

Agency Theory

The key element of theory agency is the existence of differences in preferences and objetives between the principal and the agent. According to agency theory, it is assumed that all individual act according to their whises. Satisfaction that is felt by the agent is not only come from the received financial compensation but also based on the conditions that arise in the agency relationship. Whereas the principla themselves is assumed to be only interested in matters related to the increasing amount of investments or the financial results of the company.

When management has more information about the company's prospects compared to the principal, this called as information asymmetry. Information asymmetry can occur in audit activites in a company that triggered monitoring cost. Monitoring cost is cost that arise and become the principal's responsibility to supervise agent behaviour in order to act in accordance with the interest of the principal and report all the activities that accurately carried out to the principal. Supervision by principal for audit activities certainly requires cost in the form of fees for auditors. Principal sees the auditor as the party that bridging the principal with his agent in managing the company, including assessing all aspects of the company.

When a company experiences a lengthy audit reporting lag, it can increase agency cost because the company receives a longer audit process more than the general audit process. Audit reporting lag encourages the possibility of restatement in the next period so that the company will has a greater agency fee once again to resolve all matters related to restatement of the company's financial statements and also to restore the company's value.

Auditing

Audit according to Arens, Elder, & Beasley (2008) is an activity of collecting and evaluating evidence regarding information that is used to determine and provide a degree of conformity between the information and the set of criteria. Competent and independent parties are needed for audit process. One of the information that requires an audit is infomation in financial statements. It aims to present a reliable financial statements. By conducting an audit, it can increase the reliability of information in financial statementss because audits that conducted by external parties aim to provide the confidence regarding the fairness of finacial statements (Tuanakotta, 2015).

Audit Reporting Lag

According to Bamber et al., 1993 audit reporting lag is the period between company's fiscal year and the date the independent auditor's report issued. This statement is in line with Ashton et al., (1989) which explains that audit reporting lag is a period of time between the end of the company fiscal's year and the date of the audit reports. So what it meant by audit reporting lag is the duration of time required by the auditor to complete the audit of the financial statements (Praditya and Fitriany, 2013).

To resolve the problems regarding audit reporting lag, the Decree of the Chairman of the Capital Market and Financial Institution Supervisory Agency was issued No: KEP-431/BL/2012 which explains that issuers or public companies must submit the annual reports no later than the end of the fourth month after the financial year ends or the same as 120 days after the financial year ends. Administrative sanctions given to issuers who violate these regulations can be in the form of written warnings or fines, obligation to pay a certain amount of money.

Financial Report Restatement

Restatement or financial statements restatement generally seen as a correction made to financial statements that have been published previously because it is not in accordance with the generally accepted accounting principles (GAO, 2002). Financial statements restatement resulting in decrease of the assets number tends to decrease the investor confidence and causing the stock prices to decline (Kusumo, 2014). Financial statements restatement can also defined as a revision and publication of one or more of the company's previous financial statements. Financial statements restatement need to be done if it's found that the information of the previous financial statements contains material errors. Based on PSAK No. 25, there are three factors that can cause restatement of financial statements, which are changes in accounting policies, changes in accounting elements, and fundamental errors.

Hypothesis Development

The audited financial statements are considered as a reliable source of information for users of financial information. However, sometimes there are differences of information contained in the year-end financial statements with the published reports resulted in a longer time frame to examine the different information in order to produce quality information. But the addition of time in the audit process can have an impact on the usefulness and the level of relevance of information.

Chan et al. (2016) [1] found that the impact of a prolonged audit reporting is the emergence of restatement on financial statements aimed at correcting material misstatement found. As suggested by Palmrose and Schol (2004), Financial statements restatement is one of the clearest indicator of a bad accounting system.

H_1: ***Company with long audit reporting lag is more likely to restatement the financial statements in the next period rather than company with a short audit reporting lag.***

III. Research Method

This type of study is quantitative research. Data analysis is quantitative or statictical in order to test the predetermined hypothesis. Based on the type of research, the approach used in this study is an explanatory approach and associative research. Explanatory research is a study that explains the casual relationship between variables that influence the hypothesis. The purpose of explanatory research is to find out the influence between variables through the form of hypothesis testing. Associative research is study that seeks the relationship between one or several variables with other variables. With this study, a theory can be built that can be functioned to explain, predict, and control a phenomenon.

The research sample used manufacturing companies listed on the Stock Exchange in 2014-2016. The sampling method used in this study was purposive sampling. The criteria set by researchers include : 1) Manufacturing companies that reported financial reports and published on the Indonesia Stock Exchange website in 2014-2016. 2) Manufacturing companies that present complete data related to this research variable.

The analysis thechnique used by this study is a logistic regression analysis technique by looking at the influence of the prolonged audit reporting lag on the restatement of manufacturing companies listed on Indonesia Stock Exchange in 2016-2017. The logistic regression model used in this research is:

$$\mathbf{R\ P/(1-P) = \alpha + \beta 1ARL + \beta 2SIZE + \beta 3BIG4 + \beta 4LOSS + \beta 5ADSWITCH + e}$$

The feasibility of the model in this research sample is tested by using the overall model fit, coeffisient of determination test, hosmer and lemeshow tes, and wald test. The above tests are conducted to find out how much influnce that the audit reporting lag has on restatement of financial statements.

IV. Results and Discussions

Based on the descriptive statistics table, Audit Reporting Lag (ARL) has a minimum value of 40 and a maximum value of 167. The minimum ARL value is owned by IGAR in 2014. The maximum value is owned by ISSP in 2014. The figure explains that the higher the ARL value is, the more probable that there will be a restatement of the company's financial statements for the concerned period. The average value of all sample companies is 80.44 with a standar deviation of 14.72. Based on the descriptive statistics table, firm size has a minimum value of 21.6849 owned by AKPI in 2016 and a maximum value of 33.0950 owned by ASSI in 2014. The average firm size owned by all sample companies is 28.346548 with a standard deviation of 1.5577594.

	N	Minimum	Maximum	Mean	Std. Deviation
ARL	253	40	167	80.44	14.728
SIZE	253	21.6849	33.0950	28.346548	1.5577594
Valid N (listwise)	253				

Based on the frequency distribution table, it can be seen that during the 2014-2016 period, the number of sample companies conducting Financial statements restatement amounted to 83 companies equivalent to 32.8%, less than the number of manufacturing companies that did not restatement their financial statements, amounted to 170 companies or equivalent to 67.2%.

Category		Frequency	Percent
	Non	170	67.2
Valid	Restatement	83	32.8
	Total	253	100.0

Based on the frequncy distribution table of the bog four public accounting firm, it can be seen that during the 2014-2016 period, the total companies that didn't use the big four were 142 companies or equivalent to 56,1%, larger that the companies that used the big four which were 111 companies or equivalent to 43.9%.

Category		Frequency	Percent
	Non	142	56.1
Valid	BIG 4	111	43.9
	Total	253	100.0

Based in the frequency loss ditribution table, it can be seen that during the 2014-2016 period, the total companies that didn't suffer losses were 192 companies or equivalent to 75.9%, greater than the company that suffered losses, which were 61 companies or equivalent to 24.1%.

Category		**Frequency**	**Percent**
Valid	Non	192	75.9
	Loss	61	24.1
	Total	253	100.0

Based on the auditor switching frequency distribution table, it can be seen that during the 2014-2016 period, the total companies that didn't make auditor changes were 119 companies or equivalent to 47%, less that the companies that made auditor changes, which were 134 companies or equivalent to 53%.

Category		**Frequency**	**Percent**
Valid	Non	119	47.0
	Switch	134	53.0
	Total	253	100.0

Based on the table below, it can be seen that the values of Cox and Snell's R Square amounted to 0.033 (3.3%) and Nagelkerker R Square amounted to 0.046 (4.6%). This shows that 4.6% of financial statements restatement can be explained by audit reporting lag, while the remaining 95.4% can be explained by other variables that are not examined in this research.

Step	**Cox & Snell R Square**	**Nagelkerke R Square**
1	0.033	0.046

Based on the table below, it can be seen that the statistical value of the Hosmer and Lemeshows Test is equal to Chi-square value of 12.294 with a significance level of 0.139, greater than 0.05, the null hypothesis is accepted and means that the model is able to predict its observation value or it can be concluded that the model matches with the observation data.

Step	**Chi-square**	**df**	**Sig.**

1	12.294	8	0.139

Based on the results of the Wald test in the table below, it can be seen that audit reporting lag variables shows the value of Sig. Wald is 0.045. The significant level is smaller than the significant level of (α) = 0.05, for the β coefficient with the value of 0.019 which shows a positive effect, it can be concluded that the audit reporting lag partially affecting the financial statements. This shows that the results of the study are in accordance with the previous hypothesis that have been formulated.

The control variable of firm size (SIZE) shows the value of Sig. Wald amounted to 0.049. The significant level is smaller that the significant level of (α) = 0.05, for the β coefficient with the value of 0.195 which shows a positive effect, it can be concluded that the firm size control variable partially affecting the financial statements restatement. The control variable of the big four public accounting firm (BIG4) shows the value of Sig. Wald is 0.604. The significant level is greater than the significant level of (α) = 0.05, for the β coefficient with the value of -0.156 it can be concluded that the control variable of the big four public accounting firm partially does not affecting the Financial statements restatement.

The control loss variable (LOSS) shows the value of Sig. Wald amounted to 0.647. The significant level is greater than the significant level of (α) = 0.05, for the β coefficient with the value of -0.148, it can be be concluded that the control loss variable partially does not affecting the financial statements restatement. Auditor switching control variable (AUDSWITCH) shows the value of Sig. Wald is 0.445. The significant level is greater than the significant level of (α) = 0.05, for the β coefficient with the value of -0.210, it can be concluded that the auditor switching control variable partially does not affecting the financial statements restatement.

		B	**Sig.**	**Exp(B)**	**95% C.I.for EXP(B)**	
					Lower	**Upper**
Step 1[a]	ARL	0.019	0.045	1.019	1.000	1.039
	SIZE	0.195	0.049	1.215	1.000	1.475
	BIG4	-0.156	0.604	0.855	0.474	1.545
	LOSS	-0.148	0.647	0.862	0.457	1.626
	AUDSWITCH	-0.210	0.445	0.811	0.474	1.389
	Constant	-7.594	0.010	0.001		

Based on the results of logistic regression statistical analysis, a significance vale of 0.045 < 0.05 is obtained, means that audit reporting lag has a significant influence on the restatement of financial statements. This finding is in line with the descriptive statistical analysis of audit reporting lag. The results of the study indicate that the hypothesis of the study is accepted, which is audit reporting lag has an influence on the restatement of financial statements. The results of this study are corresponding with the study of Chan et al. (2016) who found that the longer the audit reporting lag, the greater the likehood of financial statements restatement for the concerned year in the following period. Companies with a lengthy audit reporting lag indicates potential problems in the company's financial statements, so it takes longer to complete the audit process. Auditor in carrying out it duties must be guided by applicable professinal standards. When the audits process takes place, the auditor needs time to gather sufficient evidence to be analyzed. The process of finding audit evidence will take longer if it's found that there are many problems within the company or management that are not cooperative with the audior in the implementation of audit, ti can be stated that the company has a lengthy audit reporting lag. The circumstances where the company having many potential problems or uncooperative management can triggered future errors, so the company need to restatement the financial statements. In this study, companies that conducted restatement of financial statements amounted to 83 companies.

V. Conclusions and Recommendations

Based on the results and discussion that has been elaborated, it can be concluded from this study that audir reporting lag has an effect on financial statements restatement. Audit reporting lag has an effect on financial statements restatement because the longer the audit reporting lag of the company is, it's indicates potential problems in the financial statements that triggered the discovery of material misstatement for the concerned year in the following period.

Recommendations for further research:

1. Add another variable that is able to influence the financial statements restatement, considering the coefficient of determination in this study is only 4.6% where the independent variable is only able to explains very little part of the dependent variable in this study.

2. Future research is recommended to examine the influence of audit reporting lag on financial statements restatement in all sectors of the company.

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