Audit Report Delay, Debt Maturity Structure and Earnings Management

Saeed Alipour[1], Maryam Talebolelm[2]

1. Assistant Professor, Department of Accounting, Ardabil Branch, Islamic Azad University, Ardabil, Iran (Corresponding Author) saeed.alipour@iau.ac.ir
2. Accounting ph.d student, Department of Accounting, Rasht Branch, Islamic Azad University, Gilan, Iran. talebolelm.m@gmail.com

Abstract

We examine the relation between Audit Report Delay, firms' debt maturity structures and the propensity to manage earnings. Our results indicate that (i) firms with more current debt are more susceptible to managing earnings, (ii) this relation is stronger for firms facing debt market constraints (those without investment grade debt) and (iii) auditor characteristics such as auditor quality and tenure help diminish this relation. Overall, our results indicate that earnings management by firms is influenced by the relative amount of short-term debt used in firms' capital structures.

Keyword: Audit Report Delay, Debt Maturity Structure and Earnings Management

1. Introduction

In their discussion of the classic agency problem Jensen and Meckling (1976) note that although the introduction of debt in the capital structure of the firm presents a new set of agency problems, the existence of debt helps to mitigate the agency costs of equity. Jensen (1980) discusses the reduction in equity-related agency costs brought about by the elimination of free cash flow resulting from an increase in the relative amount of debt financing. Additionally, certain types of lenders (e.g., banks) may provide a monitoring function for their borrowers, thereby further reducing the agency costs of equity.

Although lenders (such as banks) have the potential to enhance firm monitoring, Diamond (2004) shows that lenders avoid active enforcement of debt contracts when the enforcement costs outweigh the benefits. The absence of lender enforcement encourages borrower misconduct and leads to inefficient allocations of resources. He recommends the use of short-term debt to overcome lender passivity in enforcing debt contracts because short-term debt can provide better incentives to lenders to monitor borrowers. As illustrated in Flannery (1986) and in Diamond (1991) borrowing short-term comes with inherent liquidity risk. Firms may be denied renewals of short-term loans or repayment may be required before the maturity of their projects. The cascading effect of relatively early repayment and/or lack of renewals (hereafter referred to as debt runs) can lead to significant liquidity crises for borrowers, and can even cause bankruptcies. The threat of such possible debt runs induces lenders to monitor borrowers, and at least ex-ante provides borrowers with incentives not to misbehave.

Although the debt run scenario increases diligence on the part of lenders, it may also increase a very specific form of managerial misbehavior. For a debt run scenario to be probable borrowers must have sufficient amounts of debt

coming due in the near future and they must be facing the revelation of bad news. Managers of firms with significant short-term debt financing who find themselves facing bad news may take actions to avoid or delay the impact of the bad news. Specifically, managers may manage earnings to make their firms look more worthy to lenders.
We investigate the impact of debt maturity structure on firms' propensities to manage earnings. We provide evidence on the following questions: Does the quantity of short-term debt, intermediate-term debt, and/or long-term debt matter in determining the quality of firms' reported earnings? Are there possible factors that mitigate such relations? We focus our investigation on the quality of firms' reported earnings and examine the relation between earnings quality and firms' short-term, intermediate-term, and long-term debt levels. We employ absolute values of discretionary accruals based on a modified Jones (1991) model, and total accruals as a percentage of cash flows to measure earnings management. Using a sample of 125 firm-years from 2016 to 2022, we find a positive and significant relation between earnings management and debt usage. We find that the greatest (least) earnings management occurs for firms that have relatively more short-term (long-term) debt financing. A one standard-deviation increase in short-term debt (total current liabilities) increases discretionary accruals by 1.69% and increase total accruals by 2.28%. Our evidence supports the idea that debt maturity significantly impacts the tendency of firms to manage earnings.

2. Literature Review

2.1. Effect of good corporate governance on audit report delay

Good Corporate Governance (GCG) is a set of relationships between company management, the board of commissioners, shareholders and other stakeholders (OECD, 2005). GCG is basically concerned with the way all stakeholders strive to ensure that managers and other internal employees always take appropriate steps or adopt mechanisms that protect stakeholder interests. GCG can affect the delay in the company's audit report. (Cohen & Leventis 2013), (Nor et al. 2010), (Ilaboya & Christian, 2014), (Afify 2009), (Apadore & Noor 2013), (Hashim & Rahman 2011), (Azubike & Anggreh 2014), (Lailah, F. 2016) shows that, Good corporate governance has an effect on the delay in audit reports .

2.2 Effect of legal compliance pressure on audit report delay

The pressure of legal compliance means the pressure of submission, obedience, the condition of a person being submissive to the rules of the game (law) that apply in this case the written law. This obedience or obedience is based on the awareness that written laws or statutory regulations have various kinds of juridical powers. With the pressure of legal compliance, the company has hope of a reward and an effort to avoid punishment that may arise if someone violates the provisions of the law. Lailah, F (2016) shows that GCG has a significant effect on audit report delays (ARL) before and after using legal compliance as a moderating variable. Na'im (1999) proves that companies that do not comply with punctuality regulations are caused by low profitability, financial difficulties, insignificantly influencin behavior on (timeliness) of company financial reporting.

2.3 The effect of good corporate governance moderated by legal compliance pressure on audit report delays

GCG monitors the work carried out by external auditors and puts pressure on legal compliance not to delay the financial reporting of public companies. SEC (regulators) in several countries have established regulations regarding the time limit for the presentation of financial statements in order to reduce delays in the presentation of financial statements by many public companies (Lambert et al. 2013). The Indonesia Stock Exchange has also set rules regarding the deadline for the presentation of financial statements for listed companies, which is April 30 of the following year after the date of the end of the financial statements. The deadline for presenting these financial statements is a pressure for companies to reduce audit report delays, because companies that do not comply with these regulations will be subject to sanctions (POJK No.29/POJK.04/2016.

2.4 Effect of financial performance on audit report delay

Financial performance, Vuko and Cular (2014), the results of the study show that there is a significant positive effect on the delay in audit reports. The results of the research by Sawitri & Budiartha (2018), Suparsada & Putri (2017) conclude that financial performance has a negative influence on the delay in submitting audited financial statements. Cullinan (2003) research results show that financial performance with audit report delays has a significant negative relationship. The auditor is responsible for upholding professional scepticism in all planning and conducting audits, in short the auditor must remain vigilant of the possibility of material misstatement whether due to fraud or errors in all planning and audit implementation.

2.5 The effect of the size of audit firm (KAP) on audit report delay

The size of an Audit Firm (KAP) can be measured based on the number of employees, number of clients, and reputation. Large Audit Firms have a large number of employees, can audit more efficiently and effectively, have a flexible schedule that allows them to complete audits on time, and have a stronger incentive to complete their audits faster in order to maintain their reputation. The size of the KAP is based on the number of partners in a KAP, which is divided into large, medium and small KAPs. The more the number of partners in one KAP, it can be said that the reputation of the KAP is getting higher because with many partners, there will be more opportunities to discuss among partners in solving audit cases and maintaining audit quality control standards so that the audit quality is higher and more trusted by the public. The KAP size measure of the length of delay in audit reports according to Ashton et al. (1989) Hossain and Taylor (1998) Ahmad and Kamarudin (2003); Che-Ahmad and Abidin (2008) found that there is a significant relationship between KAP size and audit report delay.

2.6 Effect of late audit report on investor reaction.

The delay in audit reports can affect market participants to react more quickly in decision making so that the information has value in the eyes of investors. The longer the delay in the publication of the audited annual financial statements, the potential for economic uncertainty expected by the market will be. The timely submission of audited financial reports is one of the prerequisites for increasing the company's stock market price on the Indonesia Stock Exchange. Givoly and Palmon (1982), Owusu-Ansah (2000) asserted that late submission of financial statements is the single most important determinant of the timeliness of submitting audited financial statements related to earnings information, which in turn, determines the market reaction to earnings information. The length of time for completion of the audit will affect the market reaction to delays in the submission of financial statements.

2.7 The effect of independent auditors' reports on investor reactions.

The Independent Auditor's Report (LAI) is issued in relation to the going concern paragraph (SA570, 2013) – going concern is generally included in the paragraph emphasizing a matter (emphasis on matters – eom) (SA706,2013). Based on signal theory, the company will provide a signal for users of financial statements in the form of information related to the company's financial performance, one of which is an independent auditor's report provided by a public accountant. The independent auditor's report with a going concern paragraph by the company is considered a negative signal for investors because the company is facing a problem that will have an impact on the survival of the company. The published information will provide a signal for users of financial statements, especially investors in making decisions. The provision of an unqualified opinion with a going concern paragraph (SA570, 2013) – going concern – will affect the reaction of investors. The reaction of investors to the acceptance of going concern audit opinion. Blay and Geiger (2001) Herbohn, et al. (2007) Menon and Williams (2010) found that investors reacted significantly negatively to the acceptance of going concern audit opinions.

3. Method

This research is focused on empirically testing the hypothesis of the model developed based on the proposed theoretical model. Identification and integration of the determinant variables that affect the delay in audit reports such as good corporate governance, financial performance and the size of the public accounting firm. The moderating variable is legal compliance pressure. Furthermore, the effect of delay in audit reports on investor reactions with other endogenous variables is independent auditor reports.
A summary of variable operationalization can be seen in the following table :
Table 1: Variables Measurement, sub-variables and Operational Variables

No	Variable	Proxy	Indicator	Measurement	Scale
1.	delays in audit reports (ARL)		Length of Audit Completion	The date in the Independent Auditor's Report minus the financial year closing date. Ln Day Length	Nominal
2.	Good Corporate Governance (GCG)	DK	Board of commissioners size	∑ Board of commissioners	Nominal
		KKA	Audit committee expertise	∑ Audit committee expertise / ∑ Audit committee (%)	Ratio
3.	Legal compliance pressures (TKH)		Pressure from the Indonesia Stock Exchange and OJK which have set rules regarding the deadline for presentation of financial statements for registered companies	2 = On time 1 = Late	Ratio
4.	Financial performance (KK)	DER	Debt to equity ratio	$DER = \frac{Total\ Liabilitas}{Total\ Ekuitas}$	Ratio
		RES	Restatement	2= restatement 1= no restatement	Nominal
		SUB	Number of subsidiaries *(Subsidiary)*	∑ Number of subsidiarie.	Nominal
		UP	Total aset	Ln Total Aset	Nominal
5.	the size of the public accounting firm (KAP)		group number of partners in one public accounting firm	1=Partner 1, 2=Partner 2 s.d. 10, 3=Partner 11 s.d. 20, 4=Partner ≥ 20	Interval
6.	Independent auditor's report (LAI)		Independent Auditor's Report with going concern paragraphs	2= Opinion modification with going concern 1 = No	Nominal
7.	investor reactions (RI)	*PRICE*	Stock price	Stock price at the end of the month the financial statements are published.	Nominal

3.1. Research Hypothesis

The statistical hypothesis is expressed as follows:
• H1: Good corporate governance has a positive and significant influence on the delay in audit reports.
• H2: the pressure of legal compliance has a positive and significant influence on the delay in the audit report.
• H3: Good corporate governance moderated by legal compliance pressures has a positive and significant influence on late audit reports.

- H4: Financial performance has a positive and significant influence on audit report delays.
- H5: Size of the public accounting firm has a positive and significant influence on the delay in audit reports.
- H6: Delay in audit reports has a positive and significant influence on investor reactions.
- H7: Independent auditor's report has a positive and significant influence on investor reactions.

3.2. Methods

The research population is all companies listed on the Indonesia Stock Exchange (IDX) from 2014 to 2020 as many as 641 issuers listed on the IDX in 2016. In 2022 there are 180 companies that have not submitted audited financial statements, so the population after deducting those that have not submitted audited reports to 1260 issuers.

The target population of the research are companies in the mining, oil and gas industry (29), which are listed on the IDX in 2022. The total population of the research target is 33 companies, both on the main board and on the developer board. The research sample consists of 16 companies (issuers) listed on the development board, namely issuers are still in the early stages and have net tangible assets of at least ID 5 billion. According to the criteria determined from 29 companies in the mining, oil and gas industry, which are listed on the IDX development board, there are 15 companies in the sample with seven years of observation. So the total sample of this study amounted to 100. Data collection techniques using secondary data obtained from the sample company websites and audited financial reports that have been published on the IDX website and then processed or calculated to obtain research variables determined according to the background of the research problem, research questions, and research objectives to be realized. The data collected from secondary data is tabulated, then it will be processed using SmartPLS3.0.

The statistical tool used for evaluating and interpreting the secondary data into meaningful information for resulting analysis is PLS Structural Equation Modelling (SEM PLS- SmartPLS3.0 program). Data analysis methods used are:

- Outer Model Analysis (Validity Test and Reliability Test)
- Inner Model Analysis (Determination-RSquare Adjusted Coefficient)
- Hypothesis Test (t test).

4. Conclusion

This study shows that Good Corporate Governance has a negative effect on the delay in audit reports, legal compliance pressures regulated and determined by the Financial Services Authority have an impact on shortening audit report delays, good corporate governance moderated legal compliance pressures does not strengthen the effect on audit report delays, Financial performance has a significant positive effect on the delay in the audit report, The size of the public accounting firm has no effect on the delay in the audit report, The delay in audit reports has a negative effect on investor reactions, The independent auditor's report has a negative effect on investor reactions,

Good Corporate Governance through audit report delays has no effect on investor reactions, Legal compliance pressure through audit report delays has a significant positive effect on investor reactions, Good Corporate Governance moderated legal compliance pressures through audit report delays does not strengthen the effect on investor reactions, Financial performance through the delay in audit reports has no effect on investor reactions, The size of the public accounting firm through the delay in audit reports has no effect on investor reactions.

The recommendations Corporate to restructuring the number of subsidiaries. evaluate which subsidiaries are experiencing losses and deficits and need to be liquidated or merged into other subsidiaries, It is expected to increase paid-in capital, especially those with negative equity, carry out debt restructuring by reducing the principal debt or you can also convert debt into equity, and pay attention to the completion of financial reports with external auditors so that they can submit audit reports in accordance with a predetermined time, which is a minimum of 90 days.

OJK is expected to make maximum regulations on subsidiary companies that can be established by parent companies. The rule was made to nourish the parent company, expected to make regulations on the amount of debt that is reasonable for companies to obtain a maximum of 2X equity, and expected to review the policy regarding the reporting period considering that there are still many companies, especially the mining, oil and gas industry sectors, which are late in submitting their audit reports, until the report submission deadline is approaching. Investors expected to look at the company's fundamental factors such as audited financial reports and pay attention to DER and the number of subsidiary companies, more in-depth analysis regarding the company whose shares will be purchased. Don't get involved in buying cheap stocks. Choose stocks that have strong fundamentals, If you have already purchased shares and the company is subject to suspension or delisting, then there are two options, namely selling the delisted shares on the negotiating market or waiting for the delisted company to buy back its shares, and diversify stock investment to reduce the impact of losses.

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