



AUDIT FEES AND AUDIT REPORT LAG

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ABSTRACT

Over the years, shareholders and other users of accounting information look to independent parties, the auditors for the certification of financial statements with regards to truth and fairness. The auditors, in exchange for this service are paid consideration which is referred to as audit fees. The study sought to determine whether the audit fees is a determining factor of how long it takes to prepare the audit report (Audit Report Lag). Thirteen manufacturing companies in the industrial sector were selected for the study. The descriptive statistics, Hausman test and panel regression were used for data analyses. Results showed that audit fees had a negative but insignificant effect on audit report lag. It was recommended that firms should get an optimal amount for audit fees to ensure they do not spend more than necessary while not compromising audit quality.

KEYWORDS: *Audit, Audit fees, Audit report lag,*

1.0 INTRODUCTION

Financial statements serve as media through which directors provide users of accounting information with information relating to the financial position, financial performance and cash flows of the entity (Shehu & Musa, 2014). In relation to the agency theory, the management team acts as agents to shareholders and have their own interest to protect. Past scandals such as Enron, Worldcom have revealed that there are tendencies for management to window-dress information to give false impression on the performance of the firm. These tendencies continually raise the need for independent parties to review financial reports and give opinions on the truth and fairness of the reports in reporting what they purport to. The opinions given bring a level of credibility of these reports. This is supported by Fagbemi, Abogun, Uadiale and Uwuigbe (2013) when they stated that the quality of audits and audit opinions expressed on financial reports are crucial to achieving sustained investors' confidence.

Audit involves in the thorough examination of a set of information, procedures and processes to express an opinion on the state of such. It could be conducted on various aspects and functions of the organization. In this study, audit refers to the examination of financial statements by external independent parties also referred to as statutory audit. Farouk and Hassan (2014) stated that external audits performed in accordance with high quality auditing standards can promote the implementation of accounting standards by reporting entities and help ensure that their financial statements are reliable, transparent and useful. Sound audits also help reinforce strong corporate governance, risk management and internal control at firms, thus contributing to financial performance (Internal Audits Board, 2011).

External audit is conducted by external accountants (usually audit firms) expected to be independent. In exchange for their services, they are given consideration for the services they render. In



other words, they are paid for their services of thorough examination of financial statements and procedures employed in the preparation of the reports by directors to express an opinion on the truth and fairness of the financial statements. Basioudis, Geiger and Papanatasiou (2006) opine that the growing fees charged by auditors have raised more attention over the years in relation to how it will affect auditor independence.

Audit exercises have allotted periods stated in the audit plan. The end of the exercise usually approaches with the issue of an audit report which contains the auditor's opinion on the financial statements. The period it takes to issue a report is referred to as the audit report lag. It should be noted also that financial statements cannot be published or filed without the audit report. Thus, audit report lag is a cause of concern for management to ensure that they follow statutory rules [such as tax filing; submission at Securities and Exchange Commission; and Corporate Affairs Commission] and avoid penalties associated with defaults. Only a few studies are found in Nigeria to have examined the effect of audit fees (not used as a proxy to auditor independence) on audit report lag. As such, the objective of this study is to:

Ascertain the effect of audit fees on audit report lag in manufacturing companies in the industrial goods sector.

The remainder of this paper is divided into three sections. The first section examines the theory that underlies the study, explains the study concepts and shows a review of related studies. The second section outlines the study sample, scope and data analyses employed. The third section explains the findings of the study while the last section contains concluding statements and recommendations made based on findings.

2.0 LITERATURE REVIEW

Theoretical Framework

External audit has its root in the tenets of agency theory propounded by Jensen and Meckling (1976). The agency relationship is a contract under which one or more persons (shareholders) engage another person (directors and management) to perform some service on their behalf, which involves delegating some decision-making authority to the agent (Jensen & Meckling, 1976). These agents in the course of their agency activities have to choose between acting in their best interests or the best interests of shareholders. To reduce the negative impact of management looking all out for themselves to the detriment of the investment of shareholders, independent auditors are engaged to give

an opinion of the truth and fairness of financial statements prepared by directors. Shareholders have to bear agency costs to ensure that the reports given by management on their investments are true and fair. These costs include the engagement of external auditors. Watts (1998) stated that audit fees are paid to independent auditors is a bonding cost paid by agents to a third party to satisfy the principals' demand for accountability. The auditors in exchange for the fees, carry out audit procedures within projected time frame before issuing a report on the state of financial affairs reported by management.

Audit Report Lag

Financial statements are prepared by directors and dated at the end of the financial year. However, these financial statements cannot go public without the certification of independent auditors. Before these auditors or audit firm issue a report on the financial statements, they examine the books and other necessary procedures. This period taken between the end of the financial year and the date of issuance of the audit report is referred to as audit report lag. Ezat (2015) defines audit report lag as the period from the closing date of the balance sheet to the signed audit report date. This study is concerned with how long it takes for the audit report to actualize.

Audit report lag raises an important characteristic of accounting information, which is timeliness. Usman (2014) opined that timely publication of financial information of a company depends very much on the time taken to complete the audit as financial statements cannot be issued until the audit has been concluded. It should be called to mind that accounting information is only relevant when it is timely. In other words, once the reports cannot aid decision making on the part of users, it is not relevant.

All things being equal, all companies should seek to minimize their audit lag in order to enhance market efficiency (Usman, 2014; Ezat, 2015). Abdulla (1996) reported that a shorter audit report lag increases the benefits derived from the audited annual reports. As a result, companies may exert some pressure on their independent auditors to finalize the audit as quickly as possible (Ezat, 2015) though it may be for other purposes such as tax computations. Amirul and Salleh (2014) raise a concern that longer audit report lags could lead to information asymmetry and higher uncertainty associated with investment decisions. Auditors on the other hand, might be less aggressive about audit report lag because they want to exercise professionalism and due care in the engagement to avoid the risk of litigation. Ezat (2015) stated that



auditors prefer to spend more time and effort to avoid such risks which may increase the audit report lag.

Previous studies show varying spans of audit lag amongst Nigerian firms. Oladipupo (2011) found that the audit report lag spans from 16 - 284 days. Modugu, Erahbhe and Ikahtua (2012) found it spans from 30 to 276 days.

Audit Fees

Audit fees are the amount paid to financial auditors for the certification of financial statements (International Standards on Auditing, 2011). Choi, Kim, Lin and Simunic (2009) defined audit fees as fees provided to auditors that reflect the cost of the effort conducted by the public auditors and risks of litigation. Onaolapo, Ajulo and Onifade (2017) stated that audit fees differ in relation to complexity of audit, risk of the engagement, the audit firm, professionalism required and other professional factors. It includes direct work hours' fees, other direct costs (for instance extra fees of off-center mission and transportation) and allocable overhead (Abbaszadeh, 2017). Simunic (1980) attributed the fees to the contract between the auditor and client taking into consideration audit period and services. Gandia and Huguet (2019) stated that higher audit fees may be perceived as the result of a more effective monitoring by the auditor, and a consequence of the audit effort (more work hours) and the auditor experience (higher fees per hour). Onaolapo et al (2017) examined the effect of audit fees on audit quality in Nigeria using a sample of listed cement companies on the floor of the Nigerian Stock Exchange. Findings from the study show that audit fee shows a significant positive impact on audit quality

Audit Fees and Audit Report Lag

Habib, Bhuiyan, Huang and Miah (2019) opined that clients may be willing to pay higher fees for a quicker completion of audit procedures. This, Rubin (1992) states will cater for additional staff, overtime and more concentrated audit resources resulting in shorter period in which the audit report will be ready. Leventis, Weetman and Caramanis (2005) found that payment of a high audit fee can reduce the audit report lag of listed firms on the Athens Stock Exchange. Abbaszadeh (2017) reported a negative and significant relationship between the audit fees and delay in audit reports. Overall, these studies report negative association between audit fees and audit report lag. In line with this, the study hypothesis is formed:

Ho: Audit fees has a significant negative effect on audit report lag

Other studies suggest a positive association between audit fees and audit report lag. Lobo and Zhao (2013) attributes higher audit fees to extra and more

detailed audit effort needed which will tend to cause the audit process to drag, hence a longer audit report lag. Defond & Zhang (2014) also stated that high audit fees will facilitate the assignment of qualified auditors who will use more time to ensure they detect mistakes and errors in the financial statements.

Empirical Review

Modugu et al (2012) studied the relationship between company characteristics and audit delay in twenty sampled companies on the Nigerian Stock Exchange using 2009 to 2011 financial data. The study sought to determine average audit lag in Nigeria and the effects of company characteristics in predicting that lag. The company characteristics studied were: audit fees, company size and multi-nationality of firm. measure the extent of audit lag in Nigeria and to establish the impact of selected corporate attributes on audit delay in Nigeria. Audit lag for studied companies had a minimum value of 30 days and a maximum of 276 days. Averagely, Nigerian listed companies take approximately two months after year end to present audited accounts. Ordinary Least Square regression results showed audit fee is one of the major determinants of audit delay in Nigeria. It was recommended that regulatory authorities have mechanisms in place to probe abnormal audit delay.

Rahmina and Agoes (2014) investigated the effect of audit fee, audit tenure and auditor independence partially and simultaneously on the audit quality through primary data acquired from questionnaires. Distributed to audit firms in Indonesia. Respondents comprised senior auditor, supervisors, managers, and partners who had worked on the audit firm member of FAPM. Auditor independence, audit tenure, and audit fee were all found to have positive influence on audit quality.

Oladipupo and Monye-Emina (2016) examined the effect of abnormal audit fees on audit quality in the Nigerian audit market. The study employed the probit binary regression technique on analyses of 350 firm observations extracted from listed Nigerian companies. Results showed that both positive and negative abnormal audit fees had positive but insignificant impact on audit quality. This shows that abnormal audit fee does not matter to audit quality.

Onaolapo et al (2017) examined how audit quality is affected by audit fees in listed cement-producing companies in Nigeria using data from annual reports from 2010 to 2015. Audit fees, leverage ratio, client size and audit tenure were independent variables while audit quality formed the dependent variable. For analysis, Ordinary Least Squares regression was employed. Findings from the study show that audit fee



and other independent variables considered have a joint significant effect on audit quality. They recommended that policies that could improve audit quality should be adopted by government in Nigeria.

Ilechukwu (2017) examined the effect of audit fee on the audit quality of firms in the Nigerian consumer goods industry. Data were extracted from annual reports of sampled firms from 2011 to 2016. Audit fee and audit tenure were the independent and dependent variables respectively. The core explanatory variables employed were the audit fee and audit tenure. Firm size, leverage and profitability were controlled for in the pooled data ordinary least squares regression model. Findings revealed that audit fee has a positive but insignificant effect on the audit quality of consumer goods sector of quoted firms in Nigeria.

3.0 METHODOLOGY

The study was conducted on a sample of thirteen listed industrial goods companies using annual reports for 5 years from 2014 to 2018 using the *ex-post facto* research design. Data extracted from annual reports were analysed using descriptive statistics, hausman test and panel regression. The study employed a regression model:

Where: AF = Audit fees;

ARL = Audit report lag (number of days between year end and date of signed audit report);

= constant; =co-efficient; = error term

4.0 RESULTS

Table 1: Descriptive Statistics

	AUDIT FEES	ARL
Mean	53313463	87.83582
Median	10800000	89.00000
Maximum	5.39E+08	180.0000
Minimum	300000.0	37.00000
Std. Dev.	1.16E+08	20.80836
Jarque-Bera	239.5114	220.5487
Probability	0.000000	0.000000

Source: E-Views 9

Table 2: Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.485800	1	0.4858

Source: E-Views 9

The result of the hausman test show that $X^2 = 0.4858$; $p > .05$; Therefore, Random Effects Panel Regression is more suitable than Fixed Effects Panel regression.

**Table 3: Panel Regression**

Dependent Variable: ARL

Method: Panel EGLS (Cross-section random effects)

Date: 03/20/20 Time: 00:18

Sample: 2014 2018

Periods included: 5

Cross-sections included: 14

Total panel (unbalanced) observations: 67

Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	88.08445	3.805705	23.14537	0.0000
AUDIT_FEES	-5.69E-09	2.90E-08	-0.196570	0.8448
Effects Specification				
			S.D.	Rho
Cross-section random			9.690848	0.2078
Idiosyncratic random			18.92413	0.7922
Weighted Statistics				
R-squared	0.000602	Mean dependent var		58.16074
Adjusted R-squared	0.000174	S.D. dependent var		18.74889
S.E. of regression	18.80410	Sum squared resid		22983.61
F-statistic	0.039135	Durbin-Watson stat		1.911657
Prob(F-statistic)	0.843799			
Unweighted Statistics				
R-squared	0.002752	Mean dependent var		87.83582
Sum squared resid	28498.56	Durbin-Watson stat		1.541719

Source: E-Views 9

The independent variable, audit fees was found to have a co-efficient of -0.00000000569. this showed an inverse association of audit fees and audit report lag. Higher audit fees caused a reduction in time taken for audit while lower fees increased lengthened the report lag. This was however not to a significant level as depicted by p value of t statistic of 0.84 ($p > .05$). The constant value was 88, which is found to be significant ($p < .05$). Thus, when audit fees are at the barest minimum, a typical audit report lag is 88 days. This reduces though insignificantly as audit fees rise. Durbin- Watson statistics, 1.91, rules out the presence of autocorrelation ($DW < 2$). The R square statistic revealed that audit fees are responsible for just 0.06%

variation in audit report lag. The model is insignificant as portrayed by the p value of F statistics, .84 ($p > .05$).

Decision Rule: If the P-value is less than the Alpha (α) value of 0.05, reject the Null Hypothesis. If the P-value is greater than the Alpha (α) value of 0.05, accept the Null Hypothesis.

Hence, the null hypothesis is accepted that audit fees have no significant effect on audit report lag in manufacturing firms in Nigeria.

5.0 CONCLUSION AND RECOMMENDATIONS

This study serves as an exposition on the effect of audit fees on time taken for audit engagement. A



negative but insignificant association was found between audit fees and audit report lag. The implication of our findings is that auditors carry out their engagements irrespective of how much they are paid. Auditors take time to audit companies and prepare report because they want to avoid litigation costs that can accrue if they issue misleading reports and not because they feel they are underpaid. Longer audit report lags are more likely to be attributable to red flags found in financial statements prepared by directors and more thorough examinations of suspicious areas. The study is significant to top management as it provides empirical evidence on the relationship between audit fees and audit report lag; and the need for cost management as audit fees do not influence audit report lag. Future researchers can also use this work as a reference point for further research on related studies.

In line with findings, it is recommended that firms should get an optimal amount for audit fees to ensure they do not spend more than necessary while not compromising audit quality. Further studies can be undertaken on other specific factors that affect audit report lag in manufacturing companies. The study is limited to listed manufacturing industries. The findings should be treated with requisite prudence when applying it to other firms that do not fall under the sample category.

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