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## **Audit Tenure and Quality to Audit Report Lag in Banking**

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**Abstract:**

*This study aims to examine the effect of audit tenure, audit quality, and Non-Audit Service on audit report lag (ARL). The authors will test how the influence of industry specialization auditor moderates the relationship between tenure audit with audit report lag and test how the influence of auditor specialization industry moderates the relationship between audit qualities with audit Report lag on banking companies in Indonesia.*

*This study uses secondary data derived from the annual financial statements of listed companies listed on the Indonesia Stock Exchange between 2012 and 2016. This research uses purposive sampling method and uses multiple linier regression analysis.*

*The results of this study indicate that tenure audit has a negative and significant impact on audit report lag. Quality audit has a negative impact on audit report lag. Non-audit services have a negative effect on audit report lag. The industry specialist auditor moderates the relationship between tenure audit and audit report lag. And the industry specialization auditor moderates the relationship between audit quality and audit report lag.*

**Keywords:** *Audit tenure, audit quality, non audit services, auditor industry specialization, audit report lag.*

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## **1. Introduction**

Timeliness in the delivery of financial statements is an important criterion that should be improved by the auditor so that the information contained in audited financial statements can be relied upon by users of financial statements. The information contained in the financial statements can be said to be relevant when presented in a timely manner. This is also related to the quality of the profit presented in the financial statements. For investors, profit information is one of the components of concern in the consideration of investment decision making. By knowing the quality of corporate profits, investors can reduce the risk of mis-information (Al-Thuinebat *et al.*, 2011).

In Indonesia, there are still many cases of companies that are late in delivering their financial statements to official entities until the end of fiscal year 2016. There are several things that contribute to the lateness of the late reporting of the year such as the issue of consolidation reports and end-of-year book adjustment between one company amongst other reasons. Indonesian Stock Exchange (IDX) sets sanctions to a number of parties. The sanctions provided are written sanctions, penalties up to delisting sanctions or removal from IDX. Given the importance of timely delivery of financial reports, the time-period for completion of the audit of the audit report lag (ARL) is one of the factors influencing the timeliness and the informative value of the financial statements and is an indicator of audit efficiency (Habib *et al.*, 2011).

Given the importance of the ARL on the timeliness of financial reporting information and financial performance, it is important to examine how companies can reduce ARL. In this study, we focus on the audit firm's ownership impact on the ARL and whether selecting a specialized industrial auditor can be an effective way to influence the relationship between audit firm ownership and ARL.

The difference in research conducted by Lee *et al.* (2009) stated that the audit tenure was negatively related to the audit report lag. In a study by Mai Dao (2014) tenure audit negatively related to audit report lag and audit of industry specialization weaken the positive relationship between tenure audit and audit report lag. Then in the study of Habib *et al.* (2011), industry specialist auditors have an influence on the addition of auditor understanding supported by the duration of tenure audit on client characteristics.

Differences in results from previous studies encourage researchers to work again on the same issue. This study refers to research that has been done by Lee *et al.* (2009) and Mai Dao (2014). This study also provides moderate industry specialist variables on the tenure audit relationship to audit report lag (ARL). This study also uses object differences from previous research by adding new hypotheses regarding the influence of auditor industry specialization on audit report lag.

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## 2. Literature Review

**Tenure Audit:** Tenure audit is the length of the auditor's relationship with the client (Lee *et al.*, 2009). Research on audit tenure and its effect on various aspects has been done by several experts. Geiger and Raghunandan (2002) conducted research on the relationship between tenure audit and audit failure. Research was conducted on companies in the United States. The company's audit is one of the factors found to affect the effectiveness of auditors (Habib *et al.*, 2011; Setyawati *et al.*, 2017). In fact, empirical evidence suggests that the Public Accounting Firm works more effectively when there is a long-term client relationship (Lee *et al.*, 2009). The reason is that it takes time for the Public Accounting Firm to be more familiar with the operations of their clients (Suryanto *et al.*, 2017). Therefore, the initial audit was less efficient than the following year.

Regulations governing audit tenure based on the Decree of the Minister of Finance of the Republic of Indonesia No. 359 / KMK.06 / 2003 section 2 clarify that the term of accounting firm shall be 5 (five) consecutive years. Then in 2008, the Minister of Finance of the Republic of Indonesia subsequently issued a new Finance Minister Regulation regarding the term of accounting firm Number 17 / PMK / .01 / 2008. This regulation extends the period of service provision by accounting firm which was originally only 5 (five) years to 6 (six) years.

**Quality Audit:** Audit quality is a possibility the auditor will find and report the errors it encounters, and freedom is considered to be compromised if the auditor does not report the error. It is difficult to measure audit quality in several empirical studies that have used multiple dimensions or proxies as representative of audit quality. Some studies that use accounting firm measures as a quality audit measure have proved empirically that there is a difference between large and small accounting firms with non-Big four accounting firms. Audit quality is the quality of the audited financial statements produced by accounting firm (de Angelo 1981). If the resulting audit quality is low, the profits presented in the audited financial statements will likely contain figures that are not particularly accurate in describing the results of operations and the company's financial condition (Chen *et al.*, 2004).

**Non-Audit Services:** No assurance is a service produced by a public accountant in which it does not imply an opinion, a negative belief, a summary of the findings, or any other form of confidence as provided when providing assurance services. The types of no assurance services generated by public accountants are a compilation services, tax services, consultancy services (Quik *et al.*, 2013; Mahboud, 2017).

**Audit Report Lag:** Audit report lag (ARL) is defined as the time period between the end of the company's fiscal year and the date indicated in the independent auditor's report (Lee *et al.*, 2009). In other words, the ARL is the duration of the completion of the audit of the company's financial statements. Habib *et al.* (2011) divide the audit report delay into three parts: Preliminary lag, which is the time interval

between the date of the end of the financial year to the date of receipt of the preliminary financial report by the capital market; Auditor's signature lag, i.e. the time interval between the date of the end of the financial year to the date indicated in the independent auditor's report, Total lag, i.e. the time interval between the date of the end of the financial year to the date of receipt of the financial statements of the publication by the capital market (Suryanto and Ridwansyah, 2016).

Lee *et al.*, (2009) state that the timeliness of financial reporting is a fundamental element of adequate financial statement records. Accounting information users not only need to have financial information relevant for prediction and decision making, but information should also be new. Timeliness implies that the financial statements should be presented at a time interval, to explain changes in the firm that may affect the user's information in making predictions and decisions. The period of submission of annual financial statements has been set forth in Bapepam Rule Number XK2 which states that the submission of the Company's financial statements and annual financial statements, which must be accompanied by the usual opinion of the independent auditor, should be submitted to Bapepam no later than the end of the third month (90 days) of the Annual financial statements of the company.

***Auditor of Industrial Specialization:*** Public accountants in Indonesia have an average expertise of industry-specific auditors. This means that a public accounting firm will provide specific audit services to companies within a particular industry environment. According to Habib *et al.* (2011), the incentive earned by accounting firm to become a specialist in an industry is based on growth in emphasis by international professional standards. Incentives are one of the factors driving an accounting firm to perform its audits better.

According to Dunn and Mayhew (2004), various accounting cases occurred in multinational corporations that resulted in a decrease in the quality of auditors. There are demands for higher quality auditors and significant oversight of auditor quality (Balsam *et al.*, 2003). There is a high demand for better auditor quality and pressure from investor in improving the quality of financial reporting. Public Accounting Firms also try to restructure their division with industry specialists, with the aim of improving audit efficiency and audit quality, to be able to distinguish themselves from competitors (Mai Dao, 2014).

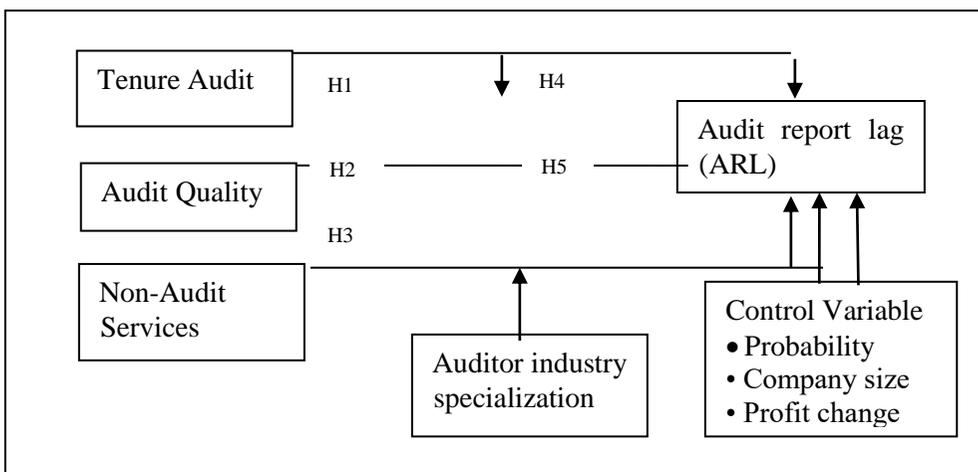
### **3. Research Methodology**

The data collection method used in this research is by collecting data from existing documents. This included obtaining a list of manufacturing companies during the 2010-2014 period of the 2012-2016 IDX Fact Book, then accessing its annual financial statements and collecting the required data. The population in this study are the banking companies listed on the Indonesia Stock Exchange and the number of banking companies listed on the Indonesia Stock Exchange based on IDX Fact Book until 2016 amounted to 42 companies. The number of observations is 5 years in the

period between 2011 - 2015 so that the sample size in this study amounted to 210 observations.

Measurement and analysis in the development of hypotheses on the relationship between independent and dependent variables is based on the regression model. The hypothesis states that the audit report lag (ARL) has been used as an independent variable in this study. Based on previous research (Habib *et al.*, 2011), this study used a regression model to examine the relationship between audit firm tenures and ARL and the moderate effects of auditor specialization.

**Figure 1.** Framework of Research



In Figure 1, the tenure audit is negatively affecting audit report lag (ARL). The test of Model 1, by identifying the value and probability of  $\beta_1$  is as follows:

$$ARL = \alpha_0 + \beta_1AQ + \beta_2TA + \beta_3NAS + \beta_4CZ + \beta_5PC + \beta_6PRO + \epsilon_{it}$$

In Model 2 the specialization of industrial auditors has an effect on the audit lag (ARL) relationship in negative or positive audit. Testing Model 2 by identifying the value and probability of  $\beta_2$  as follows:

$$ARL = \alpha_0 + \beta_1AQ + \beta_2TA + \beta_3NAS + \beta_4AIS + \beta_5CZ + \beta_6PC + \beta_7PRO + \beta_8TA * AIS + \beta_9AQ * AIS + \epsilon_{it}$$

where:

ARL : Audit Report Lag is the period of completion of the audit of financial statements based on the difference of the end date of the fiscal year up to the date of the audit report. This is measured quantitatively in the number of days producing the length of time required to obtain

- independent auditor's report on the company's annual financial statements (Mai Dao 2014)
- $\alpha_0$  : Constants.
- AQ : Audit Quality. Measured by Auditor's Size
- TA : Tenure audit, accounting firm that has a relationship with the client. Measured by cut off point for 6 years based on PMK No. 17 / PMK / 01/2008.
- AIS : Auditor industry specialization.
- NAS : Non-audit services are measured by an Ln professional fee
- AQ\* AIS : interaction of audit quality audit with industry specialization auditors
- TA\* AIS : Interaction of audit tenure with auditor of industry specialization
- PRO : Profitability of the company, with the proxy of the return on assets ratio.
- CZ : The size of a company with the proxy of a total asset logarithm.
- PC : Increase in earnings, peroxided by the net margin of the company's net income in period t-1 relative to net income of t-1 period.
- Eit : Error coefficient.

### 3.1 Research Hypotheses

The Hypotheses were developed from the literature review, hence hypothesis are as follows:

- H1: Audit quality significantly negatively affects audit report lag (ARL);*
- H2: Tenure audit KAP significantly negatively affects audit report lag (ARL);*
- H3: The provision of non-assurance services significantly positively affects the audit report lag (ARL);*
- H4: Industry specialization auditors moderate the relationship between audit quality and audit report lag (ARL);*
- H5: Industry specialization auditors moderate the relationship between tenure audit and audit report lag (ARL).*

## 4. Results

Descriptive statistical analysis gives a description of data for minimum, maximum, mean (average) and standard deviation of each research variable. The results of descriptive analysis of research variables are as follows:

**Table 1. Descriptive Statistics Results**

<b>Descriptive Statistics</b>					
	N	Minimum	Maximum	Mean	Std. Deviation
ARL	210	17,0	151,0	73,426	18,6726
AQ	210	0,0	1,0	0,469	0,5125
TA	210	1,5	5,0	3,743	1,5346
NAS	210	11,12	23,94	17,2317	4,34294
CZ	210	12,894	14,986	13,205	0,7296

AIS	210	0,00027	0,84674	0,16826	0,17272
PC	210	-0,15322	0,5367	0,154391	0,11473
PRO	210	-0,13726	0,5878	0,10869	0,1093
Valid N (listwise)	210				

In this research, it is necessary to test the classical assumption consisting of multicollinearity, autocorrelation, heterocadascity and normality.

**Table 2. Multicollinearity Test Results Coefficient<sup>a</sup>**

Model	Unstandardized Coefficients		Standardize d Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant )	5,498	0,257		13,336	0,000		
AQ	-0,064	0,049	-0,151	-1,022	0,366	0,271	3,667
TA	-0,051	0,026	-0,215	-2,423	0,007	0,321	2,512
NAS	-0,007	0,012	-0,091	-0,683	0,439	0,653	1,645
CZ	0,017	0,042	0,067	0,671	0,710	0,445	2,356
PC	-0,156	0,150	-0,083	-1,227	0,291	0,872	1,214
PRO	-0,142	0,167	-0,082	-0,674	0,202	0,623	1,562
ta_ais	0,172	0,098	0,207	1,325	0,034	0,186	5,725
aq_ais	-0,218	0,176	-0,153	-1,231	0,456	0,252	3,132
AIS	-0,165	0,142	-0,167	-1,205	0,196	0,312	5,355

a. Dependent Variable: LN\_arl

**Table 3. Autocorrelation Test Results Model Summary<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0,346 <sup>a</sup>	0,360	0,179	0,18396	2,174

a. Predictors: (Constant), AIS, CZ, TA, PC, PRO, nas, aq\_ais, AQ, ta\_ais

b. Dependent Variable: LN\_arl

**Table 4. Heteroscedasticity Test Results Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant )	20,153	22,513		0,989	0,415
AQ	-1,982	2,162	-0,086	-0,632	0,611

TA	1,814	0,887	0,262	1,419	0,189
NAS	-0,432	0,421	-0,117	-1,123	0,316
CZ	-0,532	2,223	-0,056	-0,343	0,895
PC	7,421	5,715	0,134	1,098	0,421
PRO	12,423	10,534	0,170	2,562	0,182
ta_ais	-1,246	3,186	-0,056	-0,371	0,832
aq_ais	12,336	11,527	0,228	1,501	0,361
AIS	-5,237	11,244	-0,091	-0,717	0,712

a. Dependent Variable: absUT

**Table 5. Normality Test Results**

One-Sample Kolmogorov-Smirnov Test		Unstandardized Residual
N		210
Normal Parameters <sup>a,b</sup>	Mean	0,0000000
	Std. Deviation	17,62794801
	Absolute	0,172
Most Extreme Differences	Positive	0,106
	Negative	-0,091
Kolmogorov-Smirnov Z		0,1010
Asymp. Sig. (2-tailed)		0,498

a. Test distribution is Normal.

b. Calculated from data.

By looking at Table 2, one can see that all variables have a tolerance value greater than 0.1 or 10%. The result of the tolerance test shows that there are no independent variables having tolerance value less than 0.10 (10%). The VIF calculation results also show that no independent variable has a VIF value greater than 10.

Therefore, it can be concluded that there is no multicollinearity between the variables in the regression model. The result of autocorrelation test shows DW value equal to 2,174. Since the DW value of 2.174 is greater than the upper limit of DW table ( $du = 1,810$ ) and less than  $4 - du$ , it can be concluded that there is no autocorrelation. From the table above, the asymptotic significance value of 0.498, and the value of asymptotic significance  $> 0.05$ , so it can be said that the data is normally distributed.

#### 4.1 Regression Analysis

Hypothesis testing in this study is done by looking at the significance value of each independent variable, resulting from the regression analysis. The following are Moderated Regression Analysis (MRA) results.

**Table 6. Regression Analysis Results Model 1 Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	5,476	0,451		13,813	0,000
AQ	-0,099	0,048	-0,321	-2,371	0,029
TA	-0,051	0,011	-0,217	-2,981	0,016
1 NAS	-0,007	0,009	-0,097	-1,100	0,133
CZ	0,027	0,032	0,071	0,561	0,375
PC	-0,316	0,181	-0,202	-1,171	0,143
PRO	-0,293	0,211	-0,127	-1,078	0,263

a. Dependent Variable: LN\_arl

**Table 7. Regression Analysis Results Model 2 Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	5,481	0,412		12,812	0,000
AQ	-0,072	0,051	-0,172	-2,069	0,036
TA	-0,048	0,017	-0,367	-2,868	0,009
NAS	-0,017	0,009	-0,121	-0,992	0,329
1 AIS	-0,204	0,213	-0,196	-2,188	0,041
CZ	0,026	0,046	0,082	0,486	0,528
PC	-0,163	0,116	-0,107	-1,301	0,095
PRO	-0,170	0,171	-0,092	-0,919	0,269
ta_ais	-0,125	0,076	0,210	-2,107	0,045
aq_ais	-0,311	0,195	-0,241	-2,192	0,039

a. Dependent Variable: LN\_arl

## 5. Discussion

Table 6 shows that audit quality variables significantly negatively affect audit report lag. This is seen from the value of T-hit  $2.2371 > 1.6521$  with a significance value of 0.029 which is  $< 0.05$ , so it can be concluded that audit quality has a significant negative effect on audit report lag. The result of the audit t test has a T-count value of  $2.381 > 1.6521$  with a significance value of  $0.016 < 0.05$ , so it can be concluded that the audit work has a significant effect on the audit report lag, while the T-count for non-audit services is  $1.100 < 1.6521$  with the value Significance of  $0.133 > 0.05$ , so it can be concluded that non-audit services have a negative effect and is not significant to audit report lag.

Table 6 above also shows that the control variables in this study are the flow of firm

size and changes in profit and profitability. T test results show firm size has a T-count  $0.591 < 1.6521$  with a significance value of  $0.375 > 0.05$ , so it can be concluded that firm size is influential and not significant to audit report lag. Obtaining T-statistic for earnings change is  $-1.171 < 1.653$  with a significant value of  $0.143 > 0.05$ , it can be concluded that the change in earnings does not affect the audit report lag. T testability test results have a T-count value of  $-1.078 < 1.6521$  with the value Significance of  $0.263 > 0.05$ , so it can be concluded that profitability has no significant effect on audit report lag.

Table 7 above shows that the interaction of audit quality variables with industry specialization influences audit report lag. This is seen from the value of T-count of  $2.192 > 1.6521$  with a significance value of  $0.039 < 0.05$ , so it can be concluded that the presence of moderating variables have an effect to strengthen the relationship between audit quality with audit report lag. The result of t-test of the interaction variable of audit with auditor of industry specialization has a T-count value of  $2.107 > 1.6521$  with significance value of  $0.045 > 0.05$ , so it can be concluded that moderation variables affect the relationship of audit with audit report lag.

## 6. Conclusions, Implications and Limitations

There is an influence of the audit tenure on the audit report lag. This means that tenure audit can affect audit report lag level. The t-hit result shows the negative slop, it proves that the audit tenure has an effect on the audit report lag in the negative direction. The results of this study support the research conducted by Mai Dao (2014) which provides evidence that the audit tenure affects the audit report lag. This is because the length of the engagement relationship with the client's audit firm affects the duration of the audit work of a company's financial statements because the auditor requires an understanding of the characteristics of the client company in auditing the financial statements.

Therefore the longer engagement of the auditor's work with the client will improve the efficiency of auditors' performance in performing their duties to audit financial statements. Meanwhile, according to Mai Dao (2014) there is a negative relationship between audit tenure and audit report lag. The study also stated the same thing that the auditor takes time to understand the characteristics of the client so that the longer engagement of the auditor's work with the client creates work efficiency because the auditor already understands the characteristics of the client company.

There is an influence of audit qualities on audit report lag. This means that audit quality can affect the audit report lag level. The t-hit result shows the negative slop, and it proves that the audit quality negatively affects audit report lag. The results of this study support research conducted by Habib *et al.* (2011) who found that there is an influence between audit qualities with audit report lag level in a negative direction. According to Habib *et al.* (2011) this is because KAP affiliated with the big four can produce good quality auditing reports and can complete auditing faster

because they have more resources, both quantitatively and qualitatively. Accounting firm industry specialists are believed to be able to detect errors better, improve judgments about financial statement honesty, and the more often KAP conduct checks on similar companies then the audit process will also be faster. Also, there is a reputation that they must keep, if auditing is done slowly, then of course, this will reduce their competence in the eyes of clients.

The results of this study does not support the research conducted by Lee *et al.* (2009) who found that the provision of non-audit services had an effect on the audit report lag level. However, in this study there is no proven influence of non-audit service provision with audit report lag level. The results of this study do not provide evidence that the provision of non-audit services does not affect the duration of audited financial statement auditing. This may happen because in the process of auditing the financial statements of the company, the auditor already has an operational standard in the auditing process, so that both companies have used non-audit services to improve the financial statements. The audit process is still carried out according to operational standards so it does not affect the length of the auditing process.

The results of this study support the research conducted by Mai Dao (2014) and Habib *et al.* (2011) who found that there is moderating influence of industry specialization in audit quality relationship with audit report lag because both specialist auditors and non-specialist industries have the same competence and are tied to the employment contract within a certain period of time.

The results of hypothesis 4 provides evidence that long tenure audit supported by industry specialization will improve auditor work efficiency. This research proved that auditor of industry specialization can influence to tenure audit relationship with audit report lag. The results of this study do not prove the effect of moderation of industrial specialization so that there is no difference between auditors with industry specialists and non-specialty industry auditors, both of which have the same performance

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