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Risk Management Functions and Audit Report Lag among Listed Saudi Manufacturing Companies

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Abstract

This paper examines whether the combination of risk management and audit committee functions are associated with audit report lag. Audit report lag is considered an important aspect of the financial reporting. The financial reports are the main source of information for shareholders through which they make their decisions and it assists in reducing the information asymmetry. As the internal control mechanisms substitute the external ones, the internal board committees formed by the board of directors can reduce the audit work and, consequently, reduces the audit report lag. A key committee is the risk management committee. This paper examines whether the combination of risk management and audit committee functions are associated with audit report lag. We posit that a combination of such functions in one committee refereed as audit committee affects the audit report delay. Data were obtained from 198 manufacturing companies listed on the Saudi Stock Exchange (Tadawul) for the years 2016-2018. A pooled OLS regression analysis shows that a combination of risk management and audit committee functions in a stand-alone committee named “audit committee” is associated with longer audit report lag. The outcomes suggest companies should prioritize the establishment of standalone risk management committee with activities separated from those of audit committees.

Keywords : Risk Management, Audit Committee, Audit Report Lag, Saudi Arabia

JEL Classification Code : G32, M42

1. Introduction

One of the most important aspects of the financial reporting is the timeliness (McGee & Tarangelo, 2008; Sultana, Singh, & Van der Zahn, 2015; Ika & Ghazali, 2012; Abbott, Parker, & Peters, 2012; Nelson & Shukeri, 2011). Al-Ajmi (2008) reports that shareholders in the emerging countries rely on financial reporting as a main source of

information. Khasharmeh and Aljifri (2010) argue that audit report lag (ARL) plays an important role for emerging economies as news conferences, media releases and financial analysts' forecasts are not well developed. Additionally, the regulatory bodies are not as effective as their western counterparts (Wallace & Briston, 1993; Chahine & Tohme, 2009). As a consequence, shareholders base their decisions on the timely published and audited financial statements (Piot, 2008). The critical role played by ARL as seen in prior studies has been tested in varying contexts, but has yet to be settled and are facing limited results (Leventis, Weetman, & Caramanis, 2005; Che-Ahmed & Abidin 2008; El-Bannany, 2008; Lee, Mande, & Son, 2008; Afify, 2009; Khasharmeh & Aljifri, 2010; Mohamad-Nor, Shafie, & Wan-Hussin, 2010; Hashim & Abdul Rahman, 2011). A single matter that has existed and is overlooked by researchers in the field of ARL is corporate governance mechanism (e.g., risk management committee), which handles the monitoring of financial reporting procedures and the enhancement of quality financial reporting. In fact, the risk management committee (RMC) used to play a minor role and was not regarded as having any great significance by companies. Risk management needs were incorporated into the remit of the audit committee.

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Within Saudi Arabia, the Code of Corporate Governance (2006) does not allocate risk management roles to audit committees; rather it is incorporated into the chief responsibilities of the board of directors. Under the Saudi Arabia code, a company is given the choice of whether it wishes to create a subcommittee, depending on the requirements of the business; it is not mandatory. Audit committees are regarded as being able to encompass internal controls and risk management as well as guaranteeing that financial reports have transparency and integrity. However, this is dependent on the way a company organizes its corporate governance. In addition, audit companies participate in a number of areas related to risk, including risk control, management, evaluation, and identification. In spite of this, and the fact that audit committees are supposed to protect the interests of shareholders, they frequently have become involved in corporate failings and indeed scandal. Within Saudi Arabia, existing manufacturing firms have not established a stand-alone risk management committee. Though presenting their annual reports, the risk management activities are combined with audit committee functions (Alzharani & Aljaaidi, 2015).

It further enhances the idea that a risk management committee, as the sole manager of risks, increases the efficiency of the risk management data in comparison with the audited committee taking over and handling both its role and those assigned to the risk management committee (Bates & Leclerc, 2009). Zaman's (2001) study reveals how the audit committee is expected to perform well with limited resources. The audit committee must conduct extensive research on the data they have; this requires quite some time to get finished. Also, some of these committees may not have a workforce with the proper skills to carry out their duties. Zaman's study also shows how to audit report lags come to be due to factors that are more or less controllable by the auditor. Burton (2008) documents that risk is not only a depiction characterized from a financial angle; it additionally identified with legislative, economy, politics, and market issues. This is evident as a business governed around the prior factors, which influence its growth or demise once established.

The independence of an audit committee from a risk management committee is recommended (Bugalla, Kallman, Lindo, & Narvaez, 2012). To keep up its uprightness and insurance against misbehavior, this visualizes the criticality of the independence between an audit committee from the risk management committee as a firm that separates these two tend to function with much ease as compared to a firm that grouped them as a single entity. Ng, Chong and Ismail (2013) mentioned the foundation of sovereign RMC.

Bugalla et al. (2012) have proposed that audit committees should be separated from RMC so that their integrity can be maintained and provide a buffer against financial wrongdoing. As this environment has complex dynamics, Ng, Chong and Ismail (2013) proposed that RMCs should be given

independence, something echoed by Brown and Caylor (2009), whose work noted that audit committees do not necessarily have the capabilities of being able jointly monitor all risks, financial and otherwise. In addition, Brown, Steen and Foreman (2009) stated that the audit committee must have a complete understanding of the risk management system, so that it can assume responsibility for overseeing risk. Many researchers are of the opinion that independent RMCs would enhance companies' internal control mechanisms (Yatim, 2010). Alzahrani and Aljaaidi (2015) examined the link between audit committee characteristics and the combination of risk management and audit committee activities in Saudi Arabia. Subramaniam, McManus and Zhang (2009) examined the relationship between the RMC establishments and the company's characteristics and board factors. He noted that an independent RMC favored the running of the firm as opposed to not having one, making it more or less difficult to assess risks within a stipulated time. This showed the substantial impact that an RMC has within a firm. Also, Yatim (2009; 2010) directed comparable research in the Malaysian context while Bugalla et al. (2012) came up with a method of governing and dealing with risks in the financial field that will be of help to all the auditors. Aside from this, the lack of research was brought into existence by Tufano (1996). He argued that there was no enough data that could be used to determine how risky a situation might be; all the data that was used to reach the conclusion was not enough.

The paucity of research on risk management and corporate governance is the motivation for this study: to examine the combination of risk management and audit committee activities in the setting of Saudi manufacturing companies. This is due to the vulnerability of the industrial sector to various sorts of risks in the country, region and worldwide business environments. Primarily, the study looks at whether or not the combination of risk management and audit committee activities is associated with ARL. The lack of a standalone risk management committee dealing with risk activities would affect the delay of ARL. The use of Saudi Arabia as a context to the address the study objective is based on several factors. Previous studies have not shown any link between the combination of audit and risk management committee functions and report lag in Saudi Arabia. Also, ARL is a considerable issue in emerging economies while other non-financial statements such as news meetings, media discharges, and financially-related investigators' forecasts are not very much developed as they are still undergoing a growth surge in their respective fields of development (Wallace & Briston, 1993; Chahine & Tohme, 2009). Hence, these markets have a longer time lag (Khasharmeh & Aljifri, 2010). The research adds to the audit literature by looking at the relationship in the combination of audit committee and risk management committee purposes and ARL.

The objective of this study is to examine whether the combination of audit committee and risk management

committee functions could assist in reducing ARL. Such examination is important since no previous studies examined this relationship in the Saudi context. Hence, this study aims to answer the following research question: “Could risk management committee reduce company’s ARL?”

The rest of this paper is structured as follow. The next section illustrates the research design and model specification Section four provides the results of the analysis and discussion. The final section concludes and discusses limitations and suggestion for future research.

2. Research Design and Model Specification

This hypothesis of this study is developed based on the discussions highlighted in the previous section. Specifically, this research will examine whether there is a relationship between the ARL and combining the duties of audit committees and risk managers. When separate RMCs are not present with specific responsibilities for managing risk, this may provoke delays in ARL. Therefore, the hypothesis developed by this study is stated in the following direct form:

H₁: There is a positive relationship between the combination of risk management and audit committees’ functions and the audit report lag.

The population relevant to the study is all manufacturing companies listed on the Saudi Stock Exchange (Tadawul) for the years 2016-2018. This selection is the most recent test period for which data were available at the time this study is carried out. Further, the boom of Saudi Arabia clearly emerged in early 2005 (Chahine & Tohme, 2009). A cross-sectional review of audit reports of the sampled companies listed on Saudi Stock Exchange was undertaken. Samples selected are depicted in Table 1.

Table 1: Sample Selection

	Total Observations
Total observations	201
Observations discarded (outliers, missing and incomplete data)	(3)
Final sample	198

To minimize the effect of the expunged variables and to increase the predictive ability of the model we include several control variables. The control variables are classified into two groups. Firstly, the Corporate governance control variables, namely, board of directors’ effectiveness (BDE) and audit committee effectiveness (ACE); secondly, the firm characteristics control variables, namely, firm size (SIZE), firm performance (ROA), leverage (LEV), and firm age (AGE). Prior studies have uncovered that those variables are associated with audit report lag (Knechel & Sharma, 2012; Dao & Pham, 2014; Hassan, 2016; Meckfessel & Sellers, 2017; Samaha & Khelif, 2017, Habib & Muhammadi, 2018; Farag, 2017; Wan Hussin, Bamahros, & Shukeri, 2018; Abdillah, Mardijuwono, & Habiburrochman, 2019; Mathuva, Taurigana, & Owino, 2019; Aljaaidi, Omer, & Bagulaidah, 2019; Baatwah, Salleh, & Stewart, 2019; Chae, Nakano, & Fujitani, 2020; Ha, & Nguyen, 2020; Nguyen, & Nguyen, 2020).

With regard to the corporate governance control variables, we include the board of directors’ effectiveness BDE (board size and meetings) and audit committee effectiveness ACE (audit committee size and meetings). Most prior archival studies have documented that the effectiveness of the corporate governance mechanisms is associated with audit report lag (DeZoort, Hermanson, & Archabeault 2002; Baatwah, Salleh, & Ahmad, 2015; Hassan, 2016; Farag, 2017; Samaha & Khelif, 2017; Oussii & Taktak, 2018; Wan Hussin et al. 2018; Mathuva, et al., 2019; Aljaaidi et al., 2019; Baatwah et al., 2019; Abdillah, Mardijuwono, & Habiburrochman, 2019; Dang, Pham, Nguyen, & Nguyen, 2020). With regard to the firm-specific control variables, prior studies have documented that the company size (SIZE), company performance (ROA), leverage (LEV), and company age (AGE) are significantly associated with audit report lag. (Soltani, 2002, Afify, 2009; Dao & Pham, 2014; Baatwah et al., 2015; Alfraih. 2016; Hassan, 2016; Farag, 2017; Meckfessel & Sellers; 2017; Rusmin & Evans, 2017; Samaha & Khelif, 2017; Habib & Muhammadi, 2018; Khoufi & Khoufi. 2018; Oussii & Taktak, 2018; Ocak & Özden, 2018; Akingunola, Soyemi, & Okunuga, 2018; Mathuva, et al., 2019 Abdillah et al., 2019; Aljaaidi et al., 2019; Stewart & Cairney 2019). The following is the hypothesized audit report lag (ARL) model:

$$ARL = \beta_0 + \beta_1 RMC + \text{Control variables} + \varepsilon \dots\dots\dots (1)$$

Where:

ARL	=	a number of calendar days from fiscal year- end to the date of the auditor’s report,
Test variable		
RMC	=	“1,” if the functions of the risk management committee are combined with the audit committee functions, and “0,” otherwise.

Control variables		
BDE	=	An integration of board size and board meetings,
ACE	=	An integration of audit committee size and audit committee meetings,
SIZE	=	\log_{10} of the total assets,
LEV	=	total debt to total assets,
ROA	=	net income divided by book value of total assets,
AGE	=	the number of years since the company is established,
e	=	error term.

3. Results

3.1. Descriptive Statistics and Correlation Analysis

Table 2 reports the descriptive statistics of all variables investigated in this study. The mean of the number of calendar days from fiscal-year end to date of external auditor's report (ARL) is 55 days (standard deviation of 20.915 days) with actual minimum of 9 days and maximum of 92 days. This means that the Saudi listed companies take approximately 55 days on average beyond their annual reports date before they are finally ready for the presentation of the audited financial reports to the shareholders. This evidence suggests that the ARL may be an important concern for Saudi listed companies in financial reporting policy when compared with other Arab countries. It is important to mention that the average audit report lag of Egyptian companies is 67 days as reported by Afify (2009) and similar to audit lag in Bahrain (51 days), but longer than average audit lag in United Arab Emirates (43 days), as reported by Khasharmeh and Aljifri (2010).

With regard to corporate governance variables, Table 2 shows that the mean of the board of directors' effectiveness

(BDE) is approximately 41.48 with a standard deviation of 14.55. As for the audit committee effectiveness (ACE), the average is approximately 19.54 with a standard deviation of 7.39. With respect to the firm size (SIZE), the mean is S.R 7407152584.50 with a maximum of S.R 97073302267.00, a minimum of S.R 19084462.00 and a standard deviation of 46168347.746. With respect to firm leverage (LEV), it ranges from 0.02 to 8.90 with an average of 0.44 and a standard deviation of 0.65. The firm performance (ROA) ranges from 0.00 to 0.92 with an average of 0.06 and a standard deviation of 0.10. In terms of firm age (AGE), the average is approximately 28.03 and a standard deviation is 14.19.

3.2. Multivariate Analysis

Table 3 shows the multiple regression results. As seen from Table 3, the model explains 10.7 % of the variation in ARL. In general, the model is significant ($F = 3.017$) ($\text{Sig } F = 0.005$). As for the association between the RMC and ARL, the direction of this relationship is positive and marginal significant at 5 % ($\beta = 4.726$, $t = 1.480$, $P = .070$, one-tailed significance). This result indicates a positive relationship between RMC and ARL at 10% level, which

Table 2: Descriptive Statistics

Panel A: Continuous variables				
Variable	Minimum	Maximum	Mean	Std.Deviation
ARL	9.00	92.00	55.1818	20.91528
BDE	10.00	91.00	41.48	14.55
ACE	6.00	49.00	19.54	7.39
SIZE	19084462.00	97073302267.00	7407152584.50	15434611416.22
LEV	0.02	8.90	0.44	0.65
ROA	0.00	0.92	0.06	0.10
AGE	2.00	62.00	28.03	14.19
Panel B: Dichotomous variables				
Variable	A combined function (%)		Not combined (%)	
A combination function of AC & RM	36 (35)		66 (65)	

Table 3: OLS Regression Results

Variable	Expected Sign	β	Std. Error	T-Value	P-value	Tolerance	VIF
Constant		78.030	22.883	3.410	0.001		
Test Variable							
RMC	+	4.726	3.194	1.480	0.141	0.927	1.079
Control Variables							
BDE		0.098	0.117	0.838	0.403	0.770	1.299
ACE		-0.140	0.222	-0.630	0.529	0.829	1.206
SIZE		-3.422	2.365	-1.447	0.150	0.921	1.086
LEV		4.687	2.270	2.065	0.040	0.970	1.031
ROA		-49.166	14.560	-3.377	0.001	0.921	1.086
AGE		0.200	0.113	1.771	0.078	0.831	1.203

DV= ARL $R^2 = .107$ Adjusted $R^2 = .072$ F-Ratio = 3.017 Sig F =.005

means the more the combination of the risk management committee's activities with audit committee activities, the higher the increase in the ARL. This result is consistent with agency theory prediction and the suggestions indicated by (Hermanson, 2003; Yatim, 2009; Alzharani & Aljaaidi, 2015). Thus, we accept hypothesis 1.

4. Conclusion

The findings of this study shows that the combination of risk management and audit committees activities increases the audit report lag among listed manufactured companies in Saudi Arabia. The importance of risk management committee tasks influencing audit reports in Saudi Arabia is brought to light by this result. Hence, manufacturing companies have to prioritize the establishment of standalone risk management committee with activities separated from those of audit committees. The shortcomings of the research lie in other internal corporate governance (a board of directors' characteristics, audit committee characteristics, and ownership structure). Future research should attempt at introducing these mechanisms and look at them singularly or combine them to get a better perspective on their impact. An extensive study should imitate this model to ascertain its authenticity in diverse contexts of GCC countries, regulating periods on when they are carried out, and with distinct sample sizes each time the experiment is carried out. The drawbacks may generate the necessary motivation for future research in the GCC market.

The issue of audit report lags in Saudi Arabia is addressed by the inference of these findings emphasizing the importance of splitting audit committee tasks from RMC tasks. Additional insight is useful to the Saudi government, stock market, companies, accounting, and auditing regulators

in terms of comprehending the bases influencing audit report lag. Allowing them to place countermeasures to the problems they tend to experience caused by the audit report lags. Banks usually tend to look for a way on how they can calculate the financial stability of companies that are willing to merge in the realm of Saudi Arabia by completing this exploration. The report submitted on the financial statements is highly linked to mandate bond agreements.

Additionally, a lender's maximum borrowing amount is usually based on the reports filed by the auditors' financial statements. This makes audit report lags issues of utmost importance for lending institutions in a hurry to solve the said lag issues for the good running of the firm. Reviewed monetary statements made by the auditors are used to make informed choices relating to bonds, bond ratings, and interest rates, among other decisions relating to investing by investors and financial analysts in the Saudi Arabia market.

Consequently, an increase in the understanding and forecast of companies' events is vital to these constituencies. Additionally, the findings of this study will catch the attention of researchers and academics. The lack of a formal research body addressing the issues of audit report lag in the Saudi Arabian kingdom calls for more input. Hence, this research will offer some substantial evidence about the effects on the Saudi Arabian markets; the findings' data will be used as a basis for those who will carry out further study in this field.

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