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The Audit Report Lag of Subsidiaries: The Role of Deadline Determined by Parent Company[1]

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Research Paper

INTRODUCTION

Lawmakers worldwide stress the significance of timely financial reporting, which pertains to the prompt availability of information when needed. Inadequate timeliness can diminish the usefulness of information for users in making informed decisions and assessments (Abernathy, Kubik, & Malesi, 2018). A critical aspect of timeliness is the "reporting delay." As financial information loses relevance for decision-making as time passes, a shorter duration between the fiscal year's end and the financial statements' publication date (reporting delay) enhances the information's value (Durand, 2019).

One factor that may contribute to delays in the issuance of audit reports is the policies established by the parent company, particularly in relation to the preparation of consolidated financial statements. Typically, subsidiaries are required to provide audited financial statements to the parent company before the deadline for the consolidated statements. Consequently, when the parent company sets an earlier deadline for subsidiaries to submit their audited financial statements, the subsidiaries are compelled to adhere to this timeline. As a result, the deadline imposed by the parent company is identified as a factor that can influence delays in the audit report, specifically in the initial stage of the audit process, such as the delay in audit planning for subsidiaries.

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In the years following 2001, both the parent and subsidiary companies listed on the Tehran Stock Exchange have experienced growth. Furthermore, recent developments have seen the financial reports of non-listed subsidiary companies of main listed firms being disclosed through the Publishers' Comprehensive Information System (KODAL). Despite these developments, the impact of the general assembly meeting date of the parent company on the timing and delay of audit reports for subsidiary companies remains unexplored in existing research. This gap motivates us to investigate how the timing of the main company's assembly influences the timing of audit report delays for subsidiary companies.

This study not only fills a gap in current literature but also contributes to theoretical and practical knowledge in the field. The policies of parent companies are likely pivotal in determining the timing of subsidiary company general assemblies. However, despite indications of their importance, there exists a notable gap in research exploring the influence of parent company policies on audit report delays for subsidiary firms at both international and domestic levels. Therefore, this study aims to provide novel insights into the significance of parent company policies in relation to audit report delays for subsidiary companies, thus enhancing the existing body of research on this body of knowledge. Secondly, the present study demonstrates a lower susceptibility to omitted correlated variables bias by employing techniques and designs to capture endogeneity problem. Consequently, the findings presented in this study can be considered highly reliable and robust, offering valuable insights into the literature and for wide range of users and policymakers.

MATERIALS AND METHODS

The dataset for this research comprises both listed and non-listed companies, specifically subsidiaries of listed companies where the main listed company discloses their audited financial statements on the KODAL site, as mandated by the Securities and Exchange Organization. The selected companies must meet the following criteria:

1. It is not a part of the financial industry entities such as banks, investment companies, holding companies, insurance companies, and leasing companies, due to differing financial disclosure norms and decision-making processes.
2. Maintenance of a consistent fiscal year throughout the research timeframe.
3. To be a subsidiary company of a parent company which is listed on TSE.

Based on these criteria, a total of 160 companies were identified as the research sample. Over the 8-year research period (2014 to 2021), a total of

1,119 company-year observations will be analyzed to respond the research question.

RESEARCH MODEL

To examine the research hypothesis, we employed regression model (1) constructed based on prior studies (e.g., Knchel and Sharma, 2012; Habib et al., 2018) and tailored to suit the Iranian context. The model below will be applied utilizing subsidiary data to account for the characteristics of the subsidiaries.

$$LnARL_{it} = \beta_0 + \beta_1\, LnPrntDline_{it} + \beta_2\, AudPvt_{it} + \beta_3\, Audchg_{it} + \beta_4\, Audopn_{it} + \beta_5\, Busy_{it} + \beta_6 Size_{it} + \beta_7 Lev_{it} + \beta_8 Curr_{it} + \beta_9 Loss_{it} + \beta_{10}\, InvRec_{it} + \beta_{11} LogAge_{it} + \beta_{12}\, TACC_{it} + \beta_{13}\, Conown_{it} + \beta_{14}\, Pvtown_{it} + \beta_{15}\, ListedFirm_{it} + \beta_j\, IndustryDum + \beta_j\, YearDum + \varepsilon_{it}$$

THE DEPENDENT VARIABLE

LnARL: represents the delay in the issuance audit report, as elucidated by Knechel and Sharma (2012). This delay comprises three components: the delay in planning and starting the audit project, the delay in carrying out the audit project, and the delay in issuing the audit report. A longer delay indicates a decline in the relevance of the financial information in the audited financial statements, which can be detrimental to decision-making processes. In this study, $LnARL$ is calculated as the natural logarithm of the duration between the end of the client firm's fiscal year end and the date of the audit report for a subsidiary company.

INDEPENDENT VARIABLE

LnPrntDline: reflects how the financial reporting schedule of parent companies influences that of their subsidiaries. This influence stems from the necessity for parent companies to consolidate the audited financial statements of their subsidiaries with their own financial statements. In this research, $LnPrntDline$ is defined as the natural logarithm of the difference between the end of the main company's financial year and the date of its general assembly meeting in the current year.

RESULTS AND DISCUSSION

Audited financial statements serve as crucial external sources of information that companies must furnish to users. Timely financial reporting is integral to the concept of disclosure, enhancing the value of these reports. Timeliness in reporting helps mitigate information asymmetry and curtails the proliferation of rumors regarding a company's health and financial performance. The significant factor impacting the timeliness of financial reporting is the delay in submitting the audit report. Researchers over the past four decades have extensively explored various factors influencing audit report delays.

The financial reporting date of the parent company plays a pivotal role in the delay of the subsidiary company's audit report due to the requirement of preparing consolidated financial statements. Subsidiaries are typically mandated to provide audited financial statements before the parent company, meeting reporting deadlines. The policies set by the parent company regarding financial reporting deadlines can significantly affect the timing of the subsidiary's audit report issuance. This dynamic relationship underscores the importance of coordination and adherence to reporting timelines within corporate groups.

CONCLUSION

The results of the present study indicate a direct correlation between the timing of the parent company's annual assembly, the delay in the previous year's audit report of the main company, and the delay in the 4-year audit report of the main company with the delay in the audit report of the subsidiary company. These findings offer valuable insights for audit firms and authority bodies within the country, including the Securities and Exchange Organization (SEO), Iranian Association of Certified Public Accountants (IACPA), and Iran Audit Organization (IAO). Audit firms, when planning audits for subsidiary companies, should take into consideration the reporting schedules of the parent company and accord priority to auditing the subsidiaries of the parent company to ensure timely submission of audit reports.

In line with practices in the United States, the SEO should seek to expedite financial reporting by major companies as a means to mitigate delays in audit reporting within large corporations. This approach would naturally contribute to reducing delays in the submission of audited financial statements by both parent companies and their subsidiaries. Parent companies, in selecting their auditors, should exercise caution to avoid engaging auditors who exhibit constraints or inefficiencies in audit planning processes, thereby forestalling delays in the presentation of audited financial statements for subsidiary companies and the parent company itself. Moreover, the IACPA could conduct thorough evaluations of audit files associated with significantly delayed audits, as such occurrences may suggest the presence of questionable relationships between auditors and clients.

Keywords: Audit Report Lag, Parent Company, Subsidiary Company, Deadline of the Parent Company’s General Assembly.
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