

## THE TIMELINESS OF KELANTAN LOCAL AUTHORITIES' FINANCIAL REPORTS

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### ABSTRACT

*The main objective of this study was to examine audit lag of local authorities in Kelantan. In particular, this study investigated accounts preparation lag, audit lag and the association of audit lag with three factors; types of audit report, number of audit incidents and preparation lag. The findings of the 11-year period showed that only 13.28% financial reports were completed within five months while 2.34% took more than 11 months. Furthermore, this study also revealed that 46.97% of audit lag of local authorities in Kelantan were within requirement of Act 171 which is 10 months. However, there were still 13.64% of audit lag which exceeded 12 months. Finally, the correlation test showed that only preparation lag was significantly associated with audit lag. The results of our study increase the understanding of how Kelantan local authorities manage to prepare their financial report in timely manner.*

**Keywords:** *Timeliness, preparation lag, audit lag, financial reports, local authorities*

## Introduction

According to Van and Chee (2002), financial reports present financial information that useful for users in decision-making. Therefore, financial reports can be seen as an important document in all organizations even though they are a private, public or non-profit organization. It is used to records all accounting transactions that are involved by the company. It also acts as a medium to communicate the financial performance and position of the company to external users such as shareholders, government and creditors. Besides, the financial report was used by the management team to evaluate the company's achievement. Thus, financial reports are seen as crucial in every organization and should be prepared in timely manner.

In the public sector, financial reporting is known as the 'Public Accounts' (Abd Rauf, Yatim, Che Salleh, Yusoff, Poobalan, and Othman, 2005). This is because the government is expected to be a guardian of the public fund. It, among others, helps fulfill the government's duty to be publicly accountable (1987, p.180). Thus, the Governmental Accounting Standards Board (GASB) sees it as a document that provides information useful for many purposes.

Generally, Malaysia has a three-tier government: the federal government, state government and local government, otherwise known as the local authority. As part of government entity, local authorities need to prepare financial reports to execute their accountability in managing public funds. Abdul Aziz and Abdul Wahid (2003, p. 9) state that financial reporting is prepared to enable the assessment of government financial success, conditions and compliance with relevant rules and regulations. Consequently, it facilitates the public to evaluate how well the government's financial resources are being spent.

Besides, the local authorities must ensure the quality and usefulness of the financial reports to the users. According to Ahmed (2003), timely financial report is one of the criteria for high quality and useful financial reports. In the budget speech for 2004, the former Prime Minister also highlighted the need for timeliness in financial reporting as a medium for enhancing accountability and transparency of government agencies' operations. Thus, in order to ensure timely financial reports, it should be available to the users as soon as possible after the end of the financial year.

Basically, there are three main laws which regulate the powers, duties, responsibilities and functions of local authorities in the Peninsular Malaysia. In terms of accounting purposes, local authorities have to act in accordance with LGA. It outlines the requirement for a local authority to keep proper records and books of accounts (Tayib, Cooms and Ameen, 1999).

The timeliness of financial report is affected by the preparation of the reports and audit function. For local authorities in Malaysia, it is stated in Act 171 that every local authority needs to prepare the financial report and it should be audited and finally gazetted to public. According to Section 52(4) of Act 171, local authorities must submit their financial reports to the Auditor General Office before or on 31<sup>st</sup> May each year. Hence, local authorities were given five months after the financial year end to prepare financial report.

As for the private sector, the financial statement must be audited by the auditor in order to ensure that they provide a true and fair view on its financial conditions and operating results. Based on Section 52 and Section 60 Act 171, it can be concluded that all local authorities are responsible for the preparation of the financial statements, while the auditor is appointed to certify that the financial information provided by the company is true and fair. As a result, by having the certified financial report, the information is reliable for the users and shows the true performance and financial position of the local authorities.

In terms of audited financial reports, the auditor needs to audit the reports and submit them to the local authorities before or on 31<sup>st</sup> October in each year respectively [Section 60(2)]. These are the guidelines to ensure that financial reports of local authorities in Malaysia are gazetted in timely manner. Therefore, it gives the local authorities 10 months after the financial year end to publish their audited financial reports.

Previous researchers have conducted several researches on local authorities, where they used audit lag to identify the timeliness of local authorities' financial reports (Abdul Aziz and Awg Drahan, 2003; Ahmad, 2005 and Mustafa and Yaacob, 2009). However, the researchers found that most of the local authorities in Malaysia failed to comply with Section 52(4) and Section 60(2) of Act 171. Thus, this research tries to investigate whether

local authorities in Kelantan reported the same result since there is no such research done in Kelantan.

In addition, prior studies also investigated the factors that contributed to untimely financial reports. It is due to the fact that understanding the factors may facilitate the local authorities to find out the reasons for untimely financial reports and this will help them to resolve the problem and hence comply with the Act as stipulated by the government.

Timely financial report by local authorities has become a public issue in most countries including Malaysia. However, studies conducted in Malaysia are basically done separately for each state which is Sarawak, Selangor, Pahang, and Johor. Thus, the result cannot be generalized to all local authorities in Malaysia. The study on timeliness of financial reports of local authorities, especially in Kelantan thus far, has not been as rigorous as researches conducted on the financial reports of the other states. Therefore, the researcher would like to study on the timeliness of Malaysia's local authorities' financial reports, with a special focus on Kelantan to investigate whether there is a state that gazettes their financial reports on time. Furthermore, Kelantan was chosen because it is the only state that is managed and controlled by a different management team (opposition party) since the year 1990.

Given the importance of the timeliness of financial reports, this study was carried out to identify the accounts preparation lag and the audit lag of the local authorities in Kelantan during the 11-year period (1997-2007) since the completed financial reports were only available from year 1997 onwards. Preparation lag was calculated to identify whether the local authorities prepare and submit their financial reports as required by Section 52(4) of Act 171. Besides, audit lag was calculated to determine whether Kelantan local authorities' financial reports are certified before or on 31<sup>st</sup> October in each year respectively. An audit lag was also used in previous studies to identify the timeliness of local authorities' financial reports. In addition, it also investigates the factors that might influence the timeliness of financial reporting by local authorities in Kelantan.

## Literature Review

### The Usefulness of Financial Reporting

Every entity must present their accounting information in the financial report. The main focus and reason why we need to have a set of accounts is because of the investors or users of the accounts (Hooper & Davey, 2004). Since a financial report is an important tool in making various decisions, the information provided therein should be useful. As mentioned by Ahmad and Abdul Aziz (2005), useful financial reporting provides the users with quality financial accounting information which finally will help them in making economic and financial decisions. Thus, there are several characteristics that the financial report needs to have to ensure that it is useful and beneficial to the users which are: adequacy (Buzby, 1974), comprehensiveness (Barrett, 1976), informativeness (Alford, Jones, Leftwich and Zmijewski (1993) and timeliness (Imam, Ahmed and Khan, 2001).

GASB 1987 outline six basic characteristics of useful financial reporting for states and government entities. They are understandability, reliability, relevance, timeliness, consistency, and comparability. In addition, GASB also stress that, to be a useful financial report, it must be published soon enough after the reported events to affect decision. Besides, Jones (1992) state that a good and useful financial report should have appropriate qualities such as having relevance and freedom from bias (neutral), and is reliable, comparable, understandable, complete, objective, consistent and timely. Furthermore, Abdul Aziz and Heald (2004) in their study state that timeliness is an essential characteristic of effective financial reporting in both the public and private sectors.

Similarly, timeliness is also recognized as an important feature of financial accounting information by several parties such as the accounting profession, the users of accounting information, and the regulatory and professional agencies (Soltani, 2002). According to Che-Ahmad, and Abidin (2008), even though there are several factors affecting the usefulness of the financial report, timeliness is considered to be critical and the most important qualitative attribute. Overall, previous studies reveal that timeliness is one of the important attributes to ensure the usefulness of the financial reports (Iman et al., 2001; Che-Ahmad and Abidin, 2008; Abd Aziz and Heald, 2004).

## **Relevant Literature on Audit lag**

An audit is an important process to go through by the public and private sector before the financial reports can be published (Awg Drahman, 2002). This is because it will increase the credibility of the financial reports. However, the timeliness of the audited financial report must be met by all entities to ensure it is useful to the users of the financial statement.

Timely financial reporting has been discussed greatly by numerous researchers. Abdul Aziz and Heald (2004) in their study investigated the timeliness of Scottish local authority financial statements over the study period 1989-90 to 1995-96. By using 65 local authorities in Scotland as a sample, the study revealed that over the period, the lowest minimum audit lag was about 3 months (in 1992-93) and the highest audit lag was about 32 months (1989-90). Furthermore, only 9.5% of accounts had been certified within six months, 69.5% within 12 months and 2.9% remained uncertified after 24 months.

In Malaysia, a study conducted on the Sarawak local authorities by Awg Drahman (2002) showed that the usefulness of local authorities' financial report depends on its timeliness. The researcher found that in terms of audit lag, from 1990 to 1999, 7.6% of the accounts were certified within six months, 38.8% certified between six to nine months, 49.2% certified between nine to twelve months and 4.4 % certified exceeding twelve months. This indicates that there were still a number of Sarawak local authorities' accounts which were not certified one year after the balance sheet date. Furthermore, over the 10-year period, the shortest audit lag was 2.9 months in 1997 (Samarahan District Council) and the longest audit lag was 15.6 in 1999 (City of Kuching North Commission). These results revealed that the Sarawak local authorities still take quite a long time to prepare and certify their annual accounts.

In addition, Ahmad (2005) investigated the audit lag experienced by local authorities in Johor from the period of 1990 to 2001. The results revealed that none of the local authorities in the sample completed their audited annual reports below six months. Only 3.33% of audit lag was between 10 to 12 months, 7.78% had the lag of between 12 to 24 months and 88.89% of audit lag for Johor local authorities within the 12-year period were

longer than 24 months. The researcher found that there was a significant association between type of local authority and audit lag. This indicates that district councils seem to have shorter audit lag compared to city councils and municipalities. In addition, there is an association between audit lag and number of audit incidents. Local authorities with more audit incidents tend to have longer audit lags.

### **The Types of Audit Reports in Government Entities**

In the Malaysian public sector, there are three types of audit reports issued by the Auditor General; Clean Report (CR), Comment Shorts of Audit Qualification (CSAQ) and Audit Qualification (AQ). The study on audit incidents in 51 local authorities in Malaysia from 1990 to 2000 was conducted by Abdul Aziz and Abdul Wahid (2003). The sample included local authorities from Selangor, Sarawak, Perak and Negeri Sembilan. The findings revealed that within the period of study, 169 CRs, 384 CSAQs and 8 AQs were issued to all local authorities in those four states. Only local authorities in Sarawak did not receive any AQ reports within the period of study. In Perak, out of 166 reports, only 14 CRs, 3 AQs and the rest of 149 CSAQs were issued to the local authorities. In addition, 5 CRs, 4 AQs and 57 CSAQs were issued to Selangor local authorities while, 4 CRs, 1 AQ and 61 CSAQs were issued to Negeri Sembilan local authorities. Sarawak local authorities received 147 CRs and 117 CSAQs within the period of study.

Ahmad (2005) also examined the types of audit reports issued to 15 Johor local authorities from 1990 to 2001 and found that out of 180 audit reports, only 11 CRs, no AQ and 169 CSAQs were issued to the local authorities in the period of study. Based on the previous study, most of the audit reports issued to local authorities in Perak, Selangor, Negeri Sembilan, Sarawak and Johor were CSAQ reports. Only local authorities in Sarawak and Johor did not receive any AQs. It shows that even though there are errors in financial reports prepared by local authorities in Sarawak and Johor, they are considered as immaterial.

## **Research Methodology**

### **Data Collection**

The hard copy audited financial reports of 12 local authorities in Kelantan examined were; *Majlis Perbandaran Kota Bharu (MPKB)*, *Majlis Daerah Tanah Merah (MDTM)*, *Majlis Daerah Machang(MDM)*, *Majlis Daerah Ketereh(MDK)*, *Majlis Daerah Kuala Krai(MDKK)*, *Majlis Daerah Dabong(MDD)*, *Majlis Daerah Gua Musang(MDGM)*, *Majlis Daerah Tumpat(MDT)*, *Majlis Daerah Pasir Mas(MDPM)*, *Majlis Daerah Pasir Puteh(MDPP)*, *Majlis Daerah Jeli(MDJ)* and *Majlis Daerah Bachok(MDB)*. The research covered the period between 1997 and 2007. In total, 132 financial reports were collected.

However, not all data needed were obtained. Four financial reports from *Majlis Daerah Pasir Mas* for year 2000 and 2001 and *Majlis Daerah Tumpat* for year 2004 and 2005 did not include the signature date of the Chairman and the Secretary. Therefore, preparation lag could only be calculated and analyzed based on the 128 financial reports.

### **Measurement**

#### ***Preparation lag***

Preparation lag is the time taken by the local authorities in Kelantan to prepare and complete the financial statement. The preparation lag was calculated from the year-end date which is 31<sup>st</sup> December every year to the signature date of Chairman and Secretary of the council. The lag was calculated in months. The signature date was obtained from the financial reports. In this study, preparation lag was classified into four groups. The first group is less or equal to 5 months. The second group is between more than 5 months to 8 months. The third group is between more than 8 months to 11 months, while the last group is for preparation lag which is more than 11 months.

### ***Audit lag***

Audit lag is the time taken to prepare and audit the financial reports before it can be published in *Gazette*. The audit lag was calculated in months from the year-end date (31<sup>st</sup> December) until the date when the Auditor General signed the audit certificate. The signature date was obtained from audit reports were attached in the audited financial reports. Audit lag was also classified into four categories. The first group is less or equal to 10 months. The second group is between more than 10 months to 13 months. The third group is between more than 13 months to 16 months, while the last group is for an audit lag which is more than 16 months.

Types of audit report

Generally, there are three types of audit report in the Malaysia public sector, which are CR, CSAQ, and AQ. However, there were only two types of audit reports issued by the auditor to the local authorities in Kelantan which are CR and CSAQ. For this study, local authorities that received CR were coded as 1 while local authorities that received CSAQ report were coded as 2.

### **Development of Hypotheses**

#### ***Type of audit report***

The purpose of audit is to ensure that financial information published in a financial report is accurate and can be relied on by the users. At the end of the audit, the auditor is required and obligated to issue an audit opinion based on evidence that is obtained during the process of auditing. Soltani (2002) finds that there is evidence that qualified audit opinions were released later than unqualified opinions. Furthermore, he also states that the more serious the qualification, the greater the delay. However, Ahmad (2005) does not find any significant association between types of audit report and audit lag. Based on previous studies, the research argued that local authorities with clean report (CR) had a timelier financial reporting as opposed to those with Comment Short of Audit Qualification (CSAQ). Hence, the research's hypothesis is:

**H1: There are significant differences in terms of audit lag for different types of audit report.**

### ***Number of audit incidents***

Normally, in CSAQ and AQ reports, the auditor will include the notes regarding audit incidents that occurred in the account prepared by the staff of the council which caused the auditor not to issue a CR. Audit incidents can result from non-compliance with the applicable statutory provisions and the relevant professional standards. According to Ahmad (2005), there is a significant association between the number of audit incidents and audit lag. His study reveals that local authorities that incur more audit incidents will tend to have longer audit lag. This is consistent with a study conducted by Jakubowski (1995). Thus, this research would investigate if there is any association between audit lag and number of audit incidents. It is hypothesized that local authorities with more audit incidents tend to have longer audit lag since they need more time. Thus, the next hypothesis is:

**H2: Number of audit incidents has a significant association with audit lag.**

### ***Preparation lag***

According to Awg Drahman (2002), the longer time taken to complete financial reports will directly affect the time taken to certify the accounts. When the auditor receives the account late, it will prevent them from completing and certifying the financial reports on time. Corresponding with Awg Drahman's (2002) study, it is hypothesized that local authority that has longer preparation lag tends to have longer audit lag. Thus the hypothesis is:

**H3: Local authority with longer preparation lag has longer audit lag.**

## **Data Analysis and Findings**

In this study, preparation lag and audit lag were calculated and analyzed using formulas created in Microsoft Excel 2003. Furthermore, to examine the association between audit lag and all the three factors, the research used Spearman's Rho Rank Correlation. This technique is a nonparametric alternative to the parametric Bivariate Correlation. Analysis was conducted using SPSS.

## Analysis on Audit Lag for Local Authorities in Kelantan

The main objective of this study was to examine audit lag for local authorities in Kelantan for the years from 1997 to 2007. Audit lag for each local authority in Kelantan reveals that the longest audit lag was 18.40 months and the shortest was 6.50 months.

### ***Audit lag of Kelantan local authorities***

Table 3 shows that 62 (46.97%) out of 132 financial reports were obtained from Kelantan local authorities in less than 10 months. This result indicates that almost half of the local authorities in Kelantan complied with Section 60(2) of Act 171. Besides, another 59 certified financial reports were obtained between 10 to 13 months. Nine of them were obtained between 13 to 16 months and two were obtained after 16 months. These results revealed that there are still local authorities that are unable to get their audited financial reports in a timely manner, hence affecting the timeliness of their financial reports. According to Imam et al. (2001), timeliness is one of the important attributes for good quality financial reports. So, untimely financial reports will illustrate that the quality of the financial reports is not good and at the same time reduce the usefulness of the information. Cumulatively, from 1997 to 2007, more than 50% of local authorities in Kelantan failed to obtain the financial reports within the time stated in Act 171.

Table 1: Summary of Audit Lag of Kelantan Local Authorities from 1997 to 2007

| Audit Lag (in months) | No. of Accounts Prepared | %       | Cumulative (%) |
|-----------------------|--------------------------|---------|----------------|
| Less than 10 months   | 62                       | 46.97%  | 46.97%         |
| 11 to 13 months       | 59                       | 44.70%  | 91.67%         |
| 13 to 16 months       | 9                        | 6.82%   | 98.49%         |
| More than 16 months   | 2                        | 1.52%   | 100.01%        |
| Total                 | 132                      | 100.00% | 100.00%        |

Besides, the results also shows that year 1997 and 2001 stated the worst results when there were local authorities that exceeded 16 months to obtain their certified financial reports. These local authorities were *Majlis Daerah Bachok* for the year 1997 and *Majlis Daerah Pasir Mas* for the year 2001. Meanwhile, the best results occurred in year 2002 when 10 (83.33%) out of 12 financial reports were obtained by the local authorities in less than 10 months, and *Majlis Daerah Tumpat* and *Majlis Daerah Bachok* (16.67%) obtained their audited financial reports in 10 to 13 months.

The research also investigated the average audit lag of local authorities in Kelantan within the 11-year period. The result shows that the longest average audit lag was 11.48 months which was in 2001 and the shortest average audit lag was in 2002 (9.19 months). The average audit lag had reduced drastically in 2002 with an average audit lag of 9.19 months. Among the local authorities that contributed to these changes were *Majlis Daerah Tanah Merah*, *Majlis Daerah Kuala Krai*, and *Majlis Daerah Pasir Mas*. In this year *Majlis Daerah Pasir Mas* was able to reduce the audit lag from 16.37 months to 10.53 months. This situation might have resulted from the low average preparation lag in that year. In addition, the figure also illustrates that the earlier the accounts submitted to Auditor General's Office, the earlier the audited report can be obtained by the local authorities.

#### ***Audit lag of Kelantan local authorities individually***

This study also investigated on the audit lag of each local authority. Table 4 identifies which local authority had the shortest and longest audit lag within the period of this study. In 2002, *Majlis Daerah Jeli* had the timeliest financial reports (6.50 months) for the eleven consecutive years from 1997 to 2007. Meanwhile, *Majlis Daerah Bachok* was the least timely local authority (18.40 months) for the duration. Within the 11-year period, in 1998 and 2004 two local authorities had the shortest audit lag: *Majlis Perbandaran Kota Bharu* and *Majlis Daerah Machang* in 1998, and *Majlis Daerah Dabong* and *Majlis Daerah Jeli* in 2004 respectively.

Table 2: Most Timely and Least Timely Local Authority in Kelantan from 1997 to 2007

| YEAR | MOST TIMELY LOCAL AUTHORITY |  | LEAST TIMELY LOCAL AUTHORITY |   |
|------|-----------------------------|--|------------------------------|---|
|      | Audit lag in months         | Local Authority  | Audit lag in months          | Local Authority                                       |
| 1997 | 7.47                        | Majlis Daerah Jeli                                     | 18.40                        | Majlis Daerah Bachok                                  |
| 1998 | 9.07                        | Majlis Perbandaran Kota Bharu<br>Majlis Daerah Machang | 13.17                        | Majlis Daerah Bachok                                  |
| 1999 | 8.30                        | Majlis Daerah Jeli                                     | 12.93                        | Majlis Daerah Bachok                                  |
| 2000 | 7.83                        | Majlis Daerah Jeli                                     | 14.37                        | Majlis Daerah Kuala Krai                              |
| 2001 | 8.00                        | Majlis Daerah Machang                                  | 16.37                        | Majlis Daerah Pasir Mas                               |
| 2002 | 6.50                        | Majlis Daerah Jeli                                     | 11.50                        | Majlis Daerah Tumpat                                  |
| 2003 | 8.90                        | Majlis Daerah Machang                                  | 11.00                        | Majlis Daerah Bachok                                  |
| 2004 | 8.53                        | Majlis Daerah Dabong<br>Majlis Daerah Jeli             | 12.77                        | Majlis Daerah Pasir Puteh                             |
| 2005 | 8.57                        | Majlis Daerah Machang                                  | 10.33                        | Majlis Daerah Tanah Merah<br>Majlis Daerah Gua Musang |
| 2006 | 8.43                        | Majlis Daerah Tanah Merah                              | 13.10                        | Majlis Daerah Kuala Krai                              |
| 2007 | 8.47                        | Majlis Perbandaran Kota Bharu                          | 10.57                        | Majlis Daerah Dabong<br>Majlis Daerah Jeli            |

The results also revealed that *Majlis Daerah Machang* was the only local authority in Kelantan that successfully complied with Section 60(2) of Act 171. The local authority obtained all 11 audited financial reports (100%) in less than 10 months. In addition, even though *Majlis Perbandaran Kota Bharu*, *Majlis Daerah Dabong*, *Majlis Daerah Jeli*, *Majlis Daerah Tumpat*, and *Majlis Daerah Ketereh* failed to obtain the audited financial reports in less than 10 months, they were still able to obtain it not exceeding 12 months. *Majlis Daerah Bachok* and *Majlis Daerah Gua Musang* got the worst results when both of the local authorities recorded that one (9.09%) out of 11 audited financial reports exceeded one year.

Additionally, Figure 2 illustrates the average audit lag for each local authority in Kelantan from 1997 to 2007. Among the 12 local authorities in

Kelantan, *Majlis Daerah Bachok* had the longest average audit lag which was 11.89 months. Meanwhile, *Majlis Daerah Machang* had the shortest audit lag for the 11-year period (8.75 months). Overall, the average audit lag did not have a big difference among all the 12 local authorities in Kelantan.

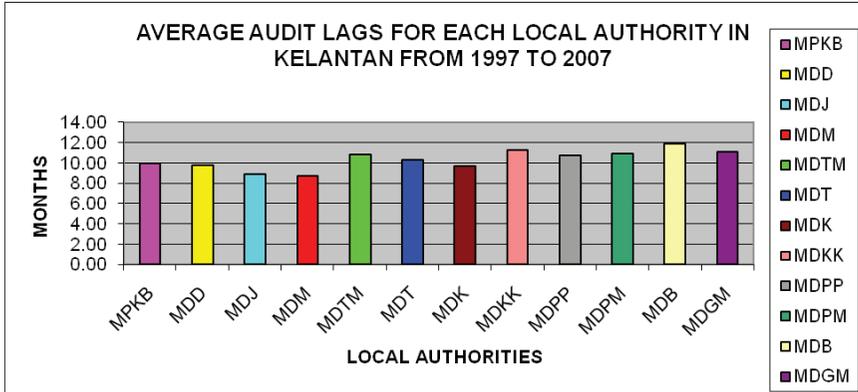


Figure 2: Average Audit Lag of Individual Local Authority in Kelantan from 1997 to 2007

## Analysis on Preparation Lag for Local Authorities in Kelantan

### *Preparation lag of Kelantan local authorities*

Table 1 indicates that out of 128 financial statements, only 17 financial reports (13.28%) were completed in less than five months, 94 financial reports (73.44%) and another 14 financial reports (10.94%) were prepared within more than 5 months to 8 months and more than 8 months to 11 months respectively. The rest, which was three financial reports (2.34%), took more than 11 months to be completed. These findings revealed that most of the local authorities (86.72%) failed to comply with Section 52 (4) of Act 171. This failure may cause the auditor to be unable to complete the audit and submit the audited financial reports to local authorities before or on 31<sup>st</sup> October each year as regulated. Cumulatively, from 1997 to 2007 only 13.28% of local authorities were able to prepare the financial reports within the time stated in Act 171.

Table 3: Summary of Preparation Lag of Kelantan Local Authorities from 1997 to 2007

| Preparation Lag (in months)     | No. of Accounts Prepared | %      | Cumulative Percentage (%) |
|---------------------------------|--------------------------|--------|---------------------------|
| Less and equal to 5 months      | 17                       | 13.28% | 13.28%                    |
| More than 5 months to 8 months  | 94                       | 73.44% | 86.72%                    |
| More than 8 months to 11 months | 14                       | 10.94% | 97.66%                    |
| More than 11 months             | 3                        | 2.34%  | 100.00%                   |
| Total                           | 128                      | 100%   | 100%                      |

The results also show that year 2002 stated the best results when 4 out of 12 financial reports, which are *Majlis Perbandaran Kota Bharu*, *Majlis Daerah Jeli*, *Majlis Daerah Tanah Merah* and *Majlis Daerah Pasir Puteh* were able to prepare the reports in less or equal to 5 months (33.33%), six financial reports (66.67%) took more than 5 months to 8 months and there were no financial reports prepared in more than 8 months. In year 2007, there was no financial report prepared in more than 8 months. In addition, in year 2003 and 2004 all local authorities exceeded the five-month period to prepare the financial reports and send it to the Auditor General's Office for auditing.

This research also investigated the average preparation lag of local authorities in Kelantan within the 11-year period. The longest average preparation lag was in 1997 (7.58 months) and the shortest average preparation lag was 5.54 months in 2002. The average preparation lag had reduced drastically in 2002 (5.54 months). Among the local authorities that contributed to these changes were *Majlis Daerah Tanah Merah*, *Majlis Daerah Kuala Krai*, *Majlis Daerah Pasir Puteh* and *Majlis Daerah Gua Musang*.

**Preparation lag of Kelantan local authorities individually**

Other than investigating the preparation lag of Kelantan local authorities as a whole, the research also attempted to see the preparation lag of each local authority in Kelantan. Table 2 shows which local authority has the shortest preparation lag (most timely local authority) and longest audit lag (least timely local authority) for the 11-year period. *Majlis Daerah Jeli* is

the timeliest in preparing financial reports which was 3.70 months in 1999 whereas Majlis Daerah Tanah Merah had the least timely preparation of financial reports which was 11.80 months in 1997 for 11 conservative years (1997-2007).

Table 4: Most Timely and Least Timely Local Authority in Kelantan from 1997 to 2007

| YEAR | MOST TIMELY LOCAL AUTHORITY |                               | LEAST TIMELY LOCAL AUTHORITY |   |
|------|-----------------------------|-------------------------------|------------------------------|---|
|      | Preparation lag in months   | Local Authority               | Preparation lag in months    | Local Authority                                   |
| 1997 | 4.87                        | Majlis Daerah Pasir Mas       | 11.80                        | Majlis Daerah Tanah Merah                         |
| 1998 | 3.77                        | Majlis Perbandaran Kota Bharu | 8.37                         | Majlis Daerah Gua Musang                          |
| 1999 | 3.70                        | Majlis Daerah Jeli            | 8.97                         | Majlis Daerah Bachok                              |
| 2000 | 4.67                        | Majlis Daerah Jeli            | 11.10                        | Majlis Daerah Gua Musang                          |
| 2001 | 4.23                        | Majlis Perbandaran Kota Bharu | 11.00                        | Majlis Daerah Gua Musang                          |
| 2002 | 4.00                        | Majlis Daerah Pasir Puteh     | 6.57                         | Majlis Daerah Gua Musang                          |
| 2003 | 5.60                        | Majlis Perbandaran Kota Bharu | 9.63                         | Majlis Daerah Bachok                              |
| 2004 | 5.57                        | Majlis Perbandaran Kota Bharu | 8.70                         | Majlis Daerah Pasir Mas                           |
| 2005 | 4.23                        | Majlis Daerah Ketereh         | 7.03                         | Majlis Daerah Tanah Merah<br>Majlis Daerah Bachok |
| 2006 | 4.97                        | Majlis Perbandaran Kota Bharu | 9.80                         | Majlis Daerah Bachok                              |
| 2007 | 4.93                        | Majlis Daerah Pasir Puteh     | 6.03                         | Majlis Daerah Tumpat<br>Majlis Daerah Bachok      |

In addition, Table 2 also illustrates that *Majlis Perbandaran Kota Bharu* was the timeliest local authority in preparing the financial reports for five times which were in 1998, 2001, 2003, 2004 and 2006. Meanwhile, *Majlis Daerah Bachok* had the least timely preparation of financial reports for five times which were in 1999, 2003, 2005, 2006 and 2007. These results might be due to the lack of capable staff and manual preparation of financial reports by *Majlis Daerah Bachok*.

Furthermore, the researcher found that *Majlis Perbandaran Kota Bharu*, *Majlis Daerah Dabong*, *Majlis Daerah Jeli* and *Majlis Daerah Ketereh* were able to prepare the financial reports in less than 8 months. These local authorities perform better than other local authorities that needed more than 8 months to get the financial reports ready, especially *Majlis Daerah Tanah Merah*, *Majlis Daerah Bachok* and *Majlis Daerah Gua Musang* which had 9.09% of preparation lag more than 11 months. In addition, *Majlis Perbandaran Kota Bharu* recorded the best results when 5 (45.45%) out of 11 financial reports were prepared in less than 5 months and the remaining (54.55%) were prepared in 5 to 8 months. In addition, within the 11-year period, four local authorities, which were *Majlis Daerah Dabong*, *Majlis Daerah Tumpat*, *Majlis Daerah Kuala Krai* and *Majlis Daerah Bachok* were unable to prepare any financial reports in less than 5 months.

The research also investigated the average preparation lag for individual local authorities in Kelantan within the 11-year period. The result shows that *Majlis Perbandaran Kota Bharu* had the shortest average preparation from 1997 to 2007 (5.04 months). This might be due to its status since *Majlis Perbandaran Kota Bharu* is the only municipal council and is the biggest council in Kelantan. This provides a good example to other local authorities and perhaps it can maintain a good reputation year by year. Meanwhile, *Majlis Daerah Bachok* had the longest average preparation lag which was 8.23 months. Overall, the results for preparation lag of the local authorities in Kelantan were still not satisfactory since on average all the local authorities in Kelantan reported preparation lag of more than 5 months. This is due to the financial reports being prepared without using specific accounting software (Microsoft Excel) as most of the local authorities in Kelantan do.

## The Correlation Results

The first hypothesis of this study is to examine the association between audit lag and three factors which were type of audit report, number of audit incidents, and preparation. In order to determine the association, the research conducted Spearman's Rank Correlation Coefficient test was conducted.

Based on the correlation result presented in Table 5, there is no significant relationship between audit lag and types of audit reports ( $p > 0.05$ ). Therefore, hypothesis 1 (there are significant differences in terms of audit lag for different type of audit report) is rejected. This result is consistent with the findings of Ahmad (2005). This might be because most of the local authorities (81.06%) in Kelantan received a CR report. However, this is contrary to the studies conducted by McLelland and Giroux (2000) and Payne and Jensen (2002) where the audit lag have a significant relationship with types of audit reports.

Table 5: Association of Audit Lag and Type of Audit Reports

|                      |                         | Value | Asymp.<br>Std.<br>Error(a) | Approx.<br>T(b) | Approx.<br>Sig. |
|----------------------|-------------------------|-------|----------------------------|-----------------|-----------------|
| Interval by Interval | Pearson's<br>R          | .223  | .104                       | 2.614           | .010(c)         |
| Ordinal by Ordinal   | Spearman<br>Correlation | .142  | .095                       | 1.637           | .104(c)         |
| N of Valid Cases     |                         | 132   |                            |                 |                 |

This research also found that there was no significant relationship between audit lag and numbers of audit incidents incurred by local authorities as shown in Table 6 where the p value of Spearman Rho Rank Correlation is more than 0.05 ( $p = 0.066$ ). This indicated that hypothesis 2 which stated that the number of audit incidents has significant association with audit lag was rejected. This finding was contrary to the findings revealed by Jakubowski (1995) who concludes that when more audit incidents are incurred, more audit procedures are needed and this will consequently lead to a longer audit delay.

Table 6: Association of Audit Lag and Audit Incidents

|                      |                      | Value | Asymp. Std. Error(a) | Approx. T(b) | Approx. Sig. |
|----------------------|----------------------|-------|----------------------|--------------|--------------|
| Interval by Interval | Pearson's R          | .357  | .170                 | 4.353        | .000(c)      |
| Ordinal by Ordinal   | Spearman Correlation | .161  | .096                 | 1.856        | .066(c)      |
| N of Valid Cases     |                      | 132   |                      |              |              |

Finally, this research found that there was a significant relationship between audit lag and the preparation lag. Based on Table 7, p value is less than 0.05 (p=0.000). Hence hypothesis 3 is supported. This indicates that local authorities with longer preparation lag tended to have longer audit lag compared to local authorities that had shorter preparation lag. This finding is consistent with the study conducted by Awg Drahman (2002) whereby whenever a local authority takes a longer time to complete and submit the financial reports, it will give effect to auditor. The auditors will be unable to complete the audit in timely manner since they received the account late.

Table 7: Association of Audit Lag and Preparation Lag

|                      |                      | Value | Asymp. Std. Error(a) | Approx. T(b) | Approx. Sig. |
|----------------------|----------------------|-------|----------------------|--------------|--------------|
| Interval by Interval | Pearson's R          | .664  | .072                 | 9.975        | .000(c)      |
| Ordinal by Ordinal   | Spearman Correlation | .468  | .080                 | 5.938        | .000(c)      |
| N of Valid Cases     |                      | 128   |                      |              |              |

## Conclusion and recommendations

The findings show that throughout 1997 to 2007, only 13.28% of local authorities prepared their accounts within five months. This reveals that most of the local authorities failed to prepare timely accounts as required by Section 52(4) of Act 171. The result is not as good as that for the local authorities in Sarawak where 62% of the local authorities were able to

prepare their accounts within five months (Awg Drahan, 2002). However, it is better compared to the local authorities in Pahang where only 4% of the councils comply with Section 52(4) of Act 171 (Mustafa and Yaacob, 2009). In addition, there are still a number of local authorities in Kelantan (2.34%) which prepared their accounts in more than 11 months.

On average, the preparation lag for the 11 year period is not consistent; it fluctuates from time to time. However, from year 2001 to year 2002, the lag was reduced drastically to 5.54 months. The findings also show that the municipal council (MPKB) had the shortest preparation lag in average compared to the district council. This might be due to the adequate and skilled staff that it had as compared to other district councils. Overall, the results of local authorities in Kelantan were still not satisfactory since, on average, the local authorities prepared and completed their accounts in more than five months. Yet, this situation is difficult to improve since there is no action taken on the local authorities that submit the accounts late to the Auditor General's office for auditing. Therefore, it is hoped that Ministry of Housing and Local Government (MHLG) will take an action to those who not comply with the LGA 1976 such as by imposing compound. A failure to complete and submit the accounts as required will result in postponement of obtaining audit certificate and finally increasing the audit lag.

The findings on audit lag show that most of Kelantan local authorities (53.03%) needed more than 10 months for their accounts to be certified. This includes two accounts that were certified in the period of more than 16 months. Only 62 (46.97%) out of 132 accounts were certified within the requirement of Section 60(2) of Act 171, which requires the auditors to complete an audit and submit the preceding financial year annual observations to local authorities before or on 31<sup>st</sup> October in each year. Abdul Aziz and Awg Drahan (2003) conduct a study on audit lag in four states in Malaysia which were Perak, Negeri Sembilan, Selangor and Sarawak. They found that accounts that were certified in more than 12 months for those states were 5.5% in Sarawak (15 accounts), 83% in Negeri Sembilan (73 accounts), 54.6% in Selangor (60 accounts) and 44.2% in Perak (73 accounts). In addition, Mustafa and Yaacob (2009) in their study on Pahang's local authorities reveal that 62% of the councils exceeded the 12 months period for accounts certification. Hence, relative to these results, the local authorities in Kelantan perform better than those in Perak, Negeri

Sembilan, Selangor and Pahang where only 13.64% of the local authorities needed more than 12 months to get the audited financial reports.

On analyzing the association between audit lag and three factors which are types of audit report, number of audit incidents, and preparation lag, only one hypothesis is accepted, that is hypothesis 3. The results indicate that there was a significant association between audit lag and preparation lag; when preparation lag increased, the audit lag would also be increased.

## **Research and Practical Implications**

The results of this research may provide valuable contribution to academicians, local authorities and government. This research contributes to the development of financial reporting knowledge especially on Kelantan local authorities since this research was the first of such ever conducted in Kelantan.

The findings revealed that Kelantan local authorities failed to prepare the accounts and get their financial reports certified in a timely manner. This may provide valuable information to the government. Regulatory action needs to be taken by federal government for late submission of accounts by the local authorities. For example, local authorities that submit the accounts after 31<sup>st</sup> May should be penalized, such as having their budget reduced. This will, among others, make local authorities realize that it is important to prepare the financial reports within the appropriate period and make them more serious and focus in preparing the financial reports.

The positive significant relationship between preparation lag and audit lag signal that local authorities need to prepare the financial reports in timely manner to ensure it can be certified as soon as possible. Accounting software can help the local authorities to prepare timely financial reports. It is hoped that by having an accounting software, the local authorities will be able to prepare the financial report within the requirement of LGA 1976. This will help them to decrease preparation lag and accounts can be submitted to the Auditor General's Office for auditing in a timely manner.

Lack of staff with accounting skills and knowledge is another problem faced by the local authorities. This situation might affect their ability to prepare the financial reports in a timely manner. Due to this, local authorities need to hire more staff with appropriate accounting skills and knowledge. It is also important for the staff to be familiar with the latest development in accounting regulations to make sure that the financial reports prepared adhere to all standards and procedures.

In terms of data collection, it was very difficult for the researchers to get the necessary information since there was an improper filing system in the Kelantan State Audit Department and respective local authorities. To solve this problem, all local authorities need to have proper filing system to make sure that all information is available for access when it is needed. It can be kept in a database if there is limited space to keep the hard copy.

### **Limitations of the Study**

Accessibility of data is one of the limitations in this study. Due to time constraint, it is difficult to do this research for all local authorities in Malaysia since there is no data system or software available to extract the data needed. In addition, not all data needed are available. Four of the financial reports collected did not state the signature date of Chairman and Secretary of the council. Furthermore, only non-parametric testing could be conducted due to the small population size. It would be interesting if a regression analysis could be conducted. Finally, the findings cannot be generalized to all local authorities in Malaysia since this study was only conducted on 12 local authorities in Kelantan.

The research suggests that future research could be conducted in other states which enables more interesting parametric tests such as a regression analysis to be used. This research also can be extended and improved by including other variables such as usage of specific audit software. Besides, the data also can be collected by interviewing the relevant parties such as the accountants and auditor of the financial reports.

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