RESEARCH ARTICLE

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Do the Financial Report Qualitities have Effect on Timeliness of Financial Reporting? The Case of Indonesian Listed Firms

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This research aimed to analyze the effects of financial report quality on the timeliness of financial reporting and also to investigate whether independent board committees have moderating effect on timeliness of financial reporting. Financial report quality represents by income smoothing practices. The data used in this research is secondary data and sample selection using purposive sampling methods on the Indonesian manufacturing listed firms for the years from 2012 to 2014. Hypothesis testing result showed that the financial report quality has significantly effects on the timeliness of annual financial statements. Similarly, independent board commissioners have moderating effect on timeliness of financial reporting.

Keywords: Timeliness Financial Reporting, Financial Reporting Quality, Income Smoothing Practices, Independent Board Commissioner.

1. INTRODUCTION

Timeliness is one important factor in presenting relevant information. Information would have benefits if it is delivered on time to the users for decision-making. Conversely, the benefits of the financial statements will be reduced if the report was not available on time. The information in financial statements should be provided on time for the decision maker before the information is losing its ability to influence decision-making.

Indonesia public listed company are obliged to submit financial statements prepared in accordance with generally accepted accounting standards and audited by public accountant on time. To achieve these objectives, the Indonesian government through the Ministry of Finance and Capital Market Supervisory Agency (or known as Bapepam in Indonesia) has established such as Law No. 8 of 1995 and renew with rules from Bapepam No. 36/PM/2003 that the financial statements must be submitted no later than the end of the third month (90 days) after the date of the financial statements. Because the purpose of a public company is to provide information that will be used by investors in decision-making, the timing becomes the most important characteristics of accounting information.

Company must have financial statements to report on the efforts made and the results achieved in the implementation of its activities. This is because the financial statements can be beneficial to many parties. Therefore management should always evaluate the implementation of activities and maintain transparency in order to provide financial information that is open and honest. Especially for public listed company, they have a responsibility to give an idea to the public regarding resource management and compliance with laws and regulations.

Management can do creative accounting when preparing the financial statements to show the good performance of company. One form of creative accounting is the income smoothing (IS) practice in which a company's management takes steps to reduce and store earnings during the good years and defer them for use during the business-downturn years or vice versa.[1] Smoothing of reported income may be defined as the intentional dampening or fluctuations about some level of income that is currently considered to be normal for a firm. In this sense smoothing represents an attempt on the part of firm's management to reduce abnormal variations in income.[2]

2. LITERATURE REVIEW

Agency Theory and Signaling Theory were selected as these two theories provide comprehensive framework to understand IS practices and timeliness financial reporting. From the Agency Theory perspective, a company consists of a nexus of contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling those resources.[3,4] The principal and the agent enter into a contract that defines their relationship. In negotiating such a contract, both the principal and the agent will recognize that the other party is a self-interested individual. An agency problem arises because the agent may not act in the best interest of the principal and vice versa.

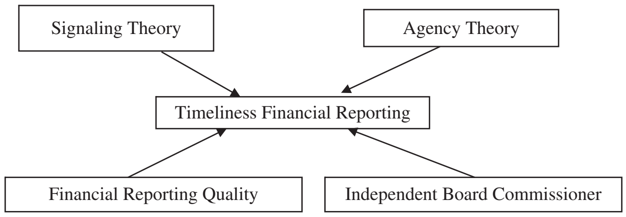

Fig. 1. Research theoretical framework.

Signaling Theory argued about how company should give a signal to the users of financial statement. This signal contains information about what has been done by the management to realize the wishes of the owner. The signal may be information that states that the company is better than any other company. Signaling theory explains why companies have an incentive to provide information on external financial reports, because there is asymmetry of information (asymmetry Information) between the company and outsiders.[5] To reduce the information asymmetry is to give a signal to the outside, one of them relabels financial information that will reduce uncertainty about the future prospects of the company.[6]

Income smoothing practices is defined as the intentional dampening of fluctuations about some level of earnings that is currently considered to be normal for a firm.[7] On the other researcher defined IS as an attempt on the part of the firm's management to reduce abnormal variations in income to the extent allowed under sound accounting and management principles.[8] The IS practices will not only result non real company financial reports but in the long term it could also lead to an extreme and complex manipulations.[8,9] There are two different types of smoothed income streams: those that are naturally smoothed and those that are intentionally smoothed by management.[7,14] Therefore, in this research if income smoothing practice high, it is considered that the company's financial reporting quality relatively low, otherwise if income smoothing practice is considered low, the quality of the company's financial statements relative good. The theoretical framework of this research was figured by linking Agency and Signaling theory with research variables are figured below.

3. RESEARCH METHODOLOGY

The income variability approach was used to determine the income smoothing index. The index was computed by employing the coefficient of variation of sales and income method.[10,11] This index was used to determine the presence of income smoothing. In this method, the coefficients of variation were used to measure the variability of sales and income. The smoothing index compares income variability with sales variability to control for the effects of real smoothing (due to actual economic transactions/events) and naturally (inherently) smooth income streams[10,11] and as shown in the following:

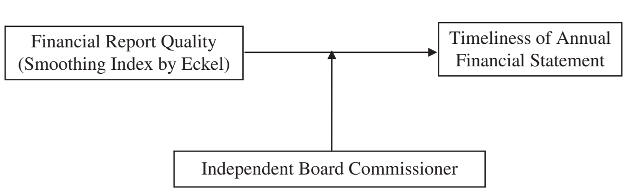

Fig. 2. The diagram of hypothesis testing.

Table I. The explanatory variables and measurement.

Variable	Represented by	Measured as
Timeliness financial report	TLS	• On time submission = 1 • Not on time submission = 0
Financial report quality	FRQ	• Smoother group = positive smoothing (Score of Eckel's index <1) • Non-Smoother group = negative smoothing (Score of Eckel's index ≥1)
Independent board committee	IBC	The % of independent board committee form total board committee

$$\text{Income smoothing index } (CVI_S) = (CV_i/CV_S)$$

Where: $CV_i = (\sigma\Delta \text{ income})/(\mu\Delta \text{ income})$, $CV_S = (\sigma\Delta \text{ sales})/(\mu\Delta \text{ sales})$.

If the CV_i (the coefficient of variation for income) is less than the CV_s (the coefficient of variation for sales), the ratio will be less than one, then suggesting that the firm is an income smoother.[7]

4. HYPOTHESES DEVELOPMENT

Timeliness is one important factor in presenting relevant information. The information in financial statements should be provided in time for the decision maker before the information is losing its ability to influence decision-making. The shorter the interval between the end of the accounting period to the date of submission of financial statements, the more relevant the information obtained from the financial statements. The longer the period between the ends of the year with the submission of financial statements, it will reduce the value of such information to users of financial statements.

Financial report is essential and must be accounted for a company therefore management should always evaluate the implementation of activities and maintain transparency and faithfulness in order to provide high quality of financial information. Therefore, for the purpose of this study, the sample companies were classified as smoothers or non-smoothers, which depended on whether their income smoothing indices were respectively less than or more than 1.[1,11] Such dichotomous measurement of income smoothing has been used successfully in some previous studies.[14] Accordingly, the hypothesis is:

H_1: There is a significant relationship between the IS practices and the time lines of financial report.

Table II. Timeliness of annual financial report.

	Research period					
	2012		2013		2014	
Companies status	Total	% (%)	Total	% (%)	Total	% (%)
On time submitted	85	67	99	76	114	79
Not on time submitted	42	30	31	24	30	21
Total	127	100	130	100	144	100

Because management actions may not always be in the best interest of owners, Agency Theory predicts that organizations will seek to put in place mechanisms that align the interests of the managers of the firm (the agents) with the interests of the owners of the firm (the principals). Independent non-executive directors are generally considered better in monitoring than other directors because they have the ability to act with a view to the interests of the company. As the board size varies, the proportion of independent non-executive directors on the boards would give an indication of the board's relative independence. According to the Independent Commissioner Guidelines from the JSX listing requirements[12, 13] one of the independent commissioner's tasks is to ensure a company's financial statement transparency and faithfulness. It implies that independent commissioners should notice that management could engage in earnings management or income smoothing activities. Moreover, JSX listing requirements (IDX, 2000 and 2002) stated that the number of independent board members must be $\geq$30% of the board size. Therefore hypothesis is:

H_2: Independent board of commissioner have moderating effect between the IS practices and the time lines of financial report.

The regression model can be expressed as follows:

$$\mathrm{TLS} = \beta_0 + \beta_1 \mathrm{FRQ_{it}} + \beta_2 \mathrm{IBC_{it}} + \mathrm{B}_3(\mathrm{TFRQ_{it}} * \mathrm{IBC_{it}}) + \varepsilon$$

5. RESEARCH FINDING AND DISCUSSION

Table III shows the total number of companies that timely and not timely in submitting annual financial statements for the period 2012, 2013 and 2014. It is known that from year to year during the research period, the number of companies that submission the annual financial statements on time tends to increase which in 2012, 85 companies (67%) to 99 companies (76%) in 2013. Thus, during the study period decreased the number of companies who do not timely submit an annual financial report that in 2014 as many as 30 companies (21%).

To test the reliability of the estimated model, the study used the Hosmer and Lemeshow (H-L) goodness-of-fit test in testing the difference between the model's predicted values and the observed values. If the H-L goodness-of-fit test is greater than 0.05, as wanted for well-fitting model, then one fails to reject the null hypothesis that there is no difference between the observed and model-predicted value. This implies that the model's estimates fit the data at an acceptable level.

Table III shows that for the three period, from the year 2012 up to 2014, the financial report quality significantly affect to timeliness of financial reporting submission since at $\alpha = 0.1$, $p = 0.004$ for the period in 2012, $\alpha = 0.5$, $p = 0.039$ for the period in 2013 and also significant at $p = 0.054$ on 2014. Results support the first hypothesis that there is a significant relationship between the timeliness of financial reporting submission and the financial reporting quality. Companies that have a large degree of income smoothing practices that will make management more careful in preparing the financial statements, the financial statements of future expectations that will meet all the needs of the information required by the owner of an external company. With the preparation of a more cautious then require a longer time to submit its annual financial statements.

Independent board practices have been prominently discussed in the literature since the board has a vital role to play in a company as its function is to manage and direct the manager.

Table III. Logistic regression result.

Variables	B	S.E.	Wald	df	Sig.	Exp (B)
				Year 2012 ($N = 127$)		
Financial report quality (FRQ)	1.577	0.453	12.121	1	0.004**	4.847
FRQ × Independent board commissioner	−0.039	0.023	2.868	1	0.068*	0.840
Constant	−0.709	0.450	2.183	1	0.137	0.499
−2 log-likelihood value						136.103
Omnibus test (model chi square)						74.211 ($df = 3$) ($p > 0.000$)
Hosmer and Lemeshow (goodness of fit test)						19.350 ($df = 8$) ($p > 0.321$)
Cox and Snell R square						0.548
Nagelkerke R square						0.715
				Year 2013 ($N = 130$)		
Financial report quality (FRQ)	4.039	1.960	4.278	1	0.039**	5.347
FRQ × Independent board commissioner	−0.045	0.059	0.398	1	0.088*	0.964
Constant	−6.337	2.007	9.337	1	0.002	0.002
−2 log-likelihood value						106.163
Omnibus test (model chi square)						88.295 ($df = 3$) ($p > 0.000$)
Hosmer and Lemeshow (goodness of fit test)						10.677 ($df = 8$) ($p > 0.256$)
Cox and Snell R square						0.469
Nagelkerke R square						0.642
				Year 2014 ($N = 144$)		
Financial report quality (FRQ)	−1.399	0.596	5.502	1	0.054*	4.247
FRQ ∗ Independent board commissioner	−0.064	0.106	0.366	1	0.075*	0.938
Constant	−11.467	4.471	6.003	1	0.070	0.009
−2 log-likelihood value						87.646
Omnibus test (model chi square)						14.405 ($df = 3$) ($p > 0.000$)
Hosmer and Lemeshow (goodness of fit test)						9.613 ($df = 8$) ($p > 0.331$)
Cox and Snell R square						0.527
Nagelkerke R square						0.718

Notes: The table indicated significance at 0.01 (***), 0.05 (**) and 0.1 (*) levels.

For this reason, as stated in H_2 this study hypothesized that Independent board of commissioner have moderating effect between the IS practices and the time lines of financial report submission. The logistic regression tests generated results that over three periods, from 2012 up to 2014, the existence of independent board committee was statistically significant as a moderating effect at $p = 0.068$ and on year 2013 at $p = 0.088$ with $\alpha = 0.1$ and on 2014 at $p = 0.075$ with $\alpha = 0.1$ have low significant effect (Table III). Arguably, for the Indonesia case, this low significant association could be attributed to at least three factors. First, Indonesian companies adopted a two-tier board system: the Board of Commissioners that performs the supervisory and advisory roles, and the Board of Directors (including management) that performs the executive role.[13] There have been criticisms about the effectiveness of the board of directors as well as of the board of commissioners. In practice, it is often found that the duties of the two boards are not clear and blurred.[12,14]

6. RESEARCH LIMITATION AND SUGGESTION FOR FUTURE

There are some limitations of this research, first this study uses only one independent variables and one moderating variable, there are supposed many other variables that influence the timeliness of financial report. Second, data analysis was performed using only manufactured listed company, therefore this study can only represent a manufacturing company, it can not represent for the other business sector. Third, the period used in this study only three years, that can't be represented in the sample before and after the study.

There are some suggestions for further research such are: first, researchers can use the object of study on the entire company listed in Indonesian Stock exchange, not just manufacturing company, so that research results can represent all the companies listed on the Indonesia Stock Exchange. Second, the period of research observation is extended to produce better research results. Third, by adding other variables such as the age of the company, the public accountant opinion and the audit committee audit, all that variables may affecting the timeliness of the annual report.

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