CHAPTER I

INTRODUCTION

1.1 Background

The promptness of financial reporting represents a fundamental qualitative characteristic that has become progressively vital in the digital era, as investors increasingly demand immediate access to information to support their investment decisions (Celestin et al., 2025). Information asymmetry between management and stakeholders is significantly impacted by the audit report lag (ARL), which is the time lag between a company's fiscal year-end and the date the audit report is signed. It is a critical indicator of financial reporting timeliness.

In Indonesia, the Financial Services Authority (Otoritas Jasa Keuangan/OJK), through Regulation No. 29/2016 Article 7 paragraph (1), mandates that publicly listed companies must submit their audited financial statements no later than the end of the fourth month (120 days) following the fiscal year-end. Non-compliance with this regulation results in administrative sanctions, including written warnings and fines (OJK, 2016). Recent empirical evidence indicates that the average audit report lag in Indonesia is approximately 86 days, or around three months, in the post-pandemic period, with notable disparities observed across different industry sectors (Puspaningsih & Fabillah, 2024). This average, whilst within regulatory compliance, suggests considerable variation in audit completion efficiency across Indonesian listed companies.

The theoretical underpinnings of audit report lag are grounded in signalling theory. Prior audit literature indicates that longer audit delays are often associated with underlying accounting issues, audit complexities, and qualified audit opinions, suggesting potential problems in the financial reporting or auditing process (Ashton et al., 1987). Also, Prior empirical evidence suggests that audit report lag is not systematically driven by managerial incentives to delay unfavourable news, but is instead largely explained by operational constraints, audit process duration, and

firm-specific characteristics (Dyer & McHugh, 1975). The lag time in audit reports is significant since it indicates transparency.

The complexity hypothesis, widely discussed in the audit literature, propose that accounting and reporting complexity arises from multiple sources and materially affects the audit process. Transactional complexity has increased due to globalisation, evolving regulatory requirements, and the proliferation of sophisticated financial instruments, all of which heighten the risk of errors, require specialised expertise, and may delay the preparation of reliable financial statements (Chavan & Pathak, 2025). Accounting complexity in the audit context is largely driven by business complexity and the presence of accounting items requiring significant estimation and professional judgement, such as asset valuation, impairment assessments, and revenue recognition. These areas are frequently identified as high-risk accounts and are more likely to be highlighted as key audit matters, reflecting the increased audit effort and judgement required when transactions are complex or non-routine (Inoue, 2022.). A further dimension of complexity is generated when new accounting standards come into effect. Evidence from interviews with audit partners and preparers shows that implementing new standards creates substantial additional workload, disrupts existing financial reporting processes, and increases both the length and complexity of financial reports, while also raising the likelihood of misstatements and delayed filings (Anding, 2025). Collectively, these findings demonstrate that accounting complexity whether arising from transactions, estimation, or new regulatory requirements demands more extensive auditor evaluation and contributes to longer audit duration.

The enforcement of PSAK 116 on Leases (aligned with IFRS 16 Leases), which took effect on 1 January 2020 in Indonesia, coincided with the onset of the COVID-19 pandemic, thereby presenting a dual challenge for both companies and auditors (Alhebri et al., 2024). This standard represents a significant transformation in lease accounting by requiring lessees to recognise Right-of-Use (ROU) assets and corresponding lease liabilities on the financial position for nearly all lease

agreements, effectively eliminating the distinction between operating and finance leases that existed under the previous standard. (Fuad et al., 2022).

Prior to IFRS 16 (accepted by PSAK 116), operating leases were off-balance-sheet, with only operational rent reported on the income statement. Morales-Díaz and Zamora-Ramírez (2018) highlight that IFRS 16 compels lessees to register practically all leases on the balance sheet, resulting in significant changes in financial position and important performance ratios, especially for lease-intensive enterprises. International evidence indicates that the adoption of IFRS 16 has resulted in substantial increases in recognised assets and liabilities, particularly for firms with significant operating lease commitments. Prior studies focusing on European listed companies suggest that sectors such as retail experience more pronounced balance sheet effects due to their extensive use of operating leases. (Magli et al., 2018). Similarly, empirical analysis of Turkish retail companies shows that capitalising operating leases significantly increases leverage ratios and alters profitability measures such as ROA and ROE are affected in a year-specific and non-uniform manner (Sari et al., 2016). These findings collectively confirm that the adoption of IFRS 16 materially reshapes financial reporting outcomes across jurisdictions.

The implementation of PSAK 116 introduces several areas of significant technical complexity that require substantial professional judgement. Firstly, determining the appropriate incremental borrowing rate (IBR) for discounting lease liabilities presents considerable challenges, particularly for entities without recent borrowing activities or those operating in markets with limited comparable debt instruments. The IBR calculation requires consideration of the lessee's creditworthiness, lease term, security provided, and economic environment, introducing substantial estimation uncertainty.

Secondly, identifying the lease term involves complex judgements regarding the likelihood of exercising extension or termination options. Determining the lease term under IFRS 16 requires management to assess whether extension or termination options are reasonably certain to be exercised, based on

economic incentives. Morales-Díaz and Zamora-Ramírez (2018) explain that assumptions regarding lease terms play a critical role in determining the recognised amounts of right-of-use assets and lease liabilities, as the standard brings most lease commitments onto the balance sheet.

Thirdly, the separation of lease and non-lease components in contracts requires detailed analysis and allocation of consideration, particularly in arrangements bundling property rental with maintenance, utilities, or other services. The practical expedient allowing combined treatment of lease and non-lease components introduces further complexity in ensuring consistency and comparability across entities. Finally, the identification of embedded leases within service contracts demands comprehensive contract review and analysis, potentially uncovering previously unrecognised lease arrangements. This identification process requires significant time and resources during initial implementation.

The adoption of PSAK 116 (aligned with IFRS 16 Leases) brings a substantial and wide-ranging transformation to financial reporting, particularly for lease-intensive sectors. As demonstrated by Gushchina (2021), the shift to IFRS 16 results in major structural revisions to the statement of financial position. For example, S-Group's total assets increased from 1,730.30 MEUR to 3,034.04 MEUR, a rise of 75.3%, while its total liabilities expanded from 1,069.60 MEUR to 2,373.44 MEUR, an escalation of 121.9% (Gushchina, 2021). Kesko exhibited similar movements, recording an increase in total assets from 4,302.90 MEUR to 6,974.03 MEUR (+62.1%) and total liabilities from 2,104.60 MEUR to 4,775.73 MEUR (+127.0**%)** (Gushchina, 2021). These figures highlight the magnitude of IFRS 16's balance-sheet impact, which in turn directly influences auditors' evaluation of materiality levels.

Changes of this scale also have significant implications for financial ratios. According to Gushchina (2021), S-Group's gearing ratio rose from 1.62 to 3.59—an increase of 121.6%—while Kesko's increased from 0.96 to 2.17, a surge of 126%. Such sharp movements demonstrate how IFRS 16 can intensify perceived financial risk, necessitating reassessment of audit risk and planning thresholds.

Profitability indicators were likewise reshaped: EBITDA for S-Group increased from 121.90 MEUR to 268.68 MEUR (+120.4%), and Kesko's EBITDA rose from 454.80 MEUR to 948.26 MEUR (+108.5%) (Gushchina, 2021). Notably, Kesko's EBITDA margin nearly doubled from 4.38% to 9.13%, reflecting a substantial recasting of performance metrics under the new leasing framework.

For auditors, these empirical findings underscore that IFRS 16 does not merely reclassify accounting entries but produces material, audit-relevant alterations that necessitate expanded professional judgement. As Gushchina (2021) emphasises, IFRS 16 fundamentally modifies assets, liabilities, and expense presentation, thereby reshaping key indicators such as leverage, profitability, and liquidity. These effects require auditors to adjust planning materiality, scrutinise management's assumptions—such as the discount rate of 3.1% used by the case companies—and enhance substantive procedures relating to lease measurement, right-of-use valuation, and remeasurement processes. Consequently, IFRS 16 introduces pervasive implications that must be incorporated into audit planning, risk assessment, and execution.

Although the study by Lopes and Penela (2024) centres on the tourism industry, the findings reveal that the adoption of IFRS 16 serves as a key catalyst for substantial shifts in assets, liabilities, EBIT, EBITDA, and interest expenses. A comparable yet more pronounced effect is anticipated within the retail sector due to its substantial dependence on leased store and warehouse spaces. The retail industry experiences amongst the greatest impacts from the implementation of PSAK 116, attributed to its extensive reliance on operating leases for store premises, storage facilities, and operational equipment (Bohusova et al., 2022). Retail companies typically maintain large portfolios of property leases for multiple store locations, distribution centres, and administrative offices, with lease commitments often representing significant economic obligations that were previously disclosed only in footnotes.

These material balance sheet reclassifications necessitate auditors to reassess materiality thresholds, potentially lowering performance materiality levels

due to increased asset and liability balances. The heightened materiality of lease-related balances intensifies audit procedures and evidence-gathering requirements.

The implementation of PSAK 116 has introduced a number of areas that require substantial professional judgement by lessee entities, as reflected in the issues identified through the Post-Implementation Review (PIR). Although the PIR does not explicitly address audit risk, the nature of the implementation challenges highlighted suggests potential implications for the assessment of inherent risk in an audit context. DSAK IAI (2025) explains that establishing the lease period under PSAK 116 involves significant managerial judgement, particularly in assessing the likelihood that the lessee will choose to extend or terminate the contract based on a "reasonably certain" threshold. This assessment necessitates careful consideration of economic incentives and contractual enforceability and has been noted as having the potential to reduce comparability between entities.

Another area requiring significant judgement relates to the measurement of lease liabilities, specifically the determination of the lessee's incremental borrowing rate. The PIR indicates that estimating this rate often involves considerable discretion and that inconsistent application may result in variations in discount rates for similar lease contracts, thereby reducing the usefulness and comparability of financial information (DSAK IAI, 2025). Further implementation challenges arise in distinguishing between different types of variable lease payments. According to DSAK IAI (2025), entities frequently experience difficulties in determining whether variable payments are dependent on an index or benchmark rate, linked to the future performance or usage of the underlying asset, or substantively fixed in nature. Such distinctions are critical, as they directly affect whether the payments are included in the initial and subsequent measurement of lease liabilities.

In addition, PSAK 116 requires lessees to remeasure lease liabilities to reflect changes in indices, interest rates or contractual modifications. The PIR describes these subsequent measurement requirements as costly and resource-intensive, often involving manual analysis of lease contracts that cannot be fully automated (DSAK IAI, 2025). Inappropriate application of these remeasurement

provisions may increase the risk of errors in the recognised amounts of right-of-use assets and lease liabilities. Complexities are also evident in accounting for lease modifications, partial terminations and sale-and-leaseback transactions. In particular, determining whether a transfer of an asset qualifies as a sale in accordance with PSAK 115 presents practical challenges and may result in errors in classification and measurement if judgement is applied inconsistently (DSAK IAI, 2025).

Overall, the findings of the PIR suggest that PSAK 116 introduces multiple decision points that rely heavily on management judgement. From an audit perspective, these areas may warrant heightened attention during audit planning and substantive testing, particularly in relation to lease term assessments, discount rate estimation, classification of variable lease payments and the remeasurement of lease liabilities.

The adoption of IFRS 16 has been associated with substantial changes in lessees' financial statements, reflecting the technical complexity embedded within the standard. Empirical evidence provided by Lopes and Penela (2024) demonstrates that the application of IFRS 16 results in significant increases in recognised assets and liabilities, as well as notable changes in performance measures such as EBITDA, EBIT and financial expenses. Their findings indicate average increases of approximately 7.49% in total assets, 9.57% in total liabilities and 17% in interest expenses, leading to material alterations in firms' financial structure and solvency ratios.

These structural changes imply that the implementation of IFRS 16 requires careful assessment of management estimates and assumptions, particularly in areas involving lease measurement and financing effects. While Lopes and Penela (2024) focus primarily on the financial reporting consequences of IFRS 16 rather than audit procedures, the magnitude of the reported changes suggests that auditors may need to exercise heightened professional judgement when evaluating the reasonableness of management's calculations and disclosures.

In addition, the determination of lease terms and the application of discount rates under IFRS 16 involve complex estimations that are influenced by economic conditions and entity-specific factors. Earlier IFRS guidance acknowledges that the assessment of economic benefits and control may require specialised knowledge in certain circumstances (IFRS Foundation, 2016). The importance of professional judgement becomes particularly evident in the context of lease modifications. The introduction of a practical expedient for COVID-19-related rent concessions by the IASB reflects concerns that the assessment of such modifications was excessively burdensome and judgement-intensive for many entities (Moscariello & Pizzo, 2022, as cited in Lopes & Penela, 2024).

Taken together, these considerations indicate that engagements involving IFRS 16 may entail increased complexity due to the scale of financial statement impacts and the judgement required in applying the standard. From an audit perspective, this complexity may necessitate greater scrutiny of estimation processes and, where appropriate, consultation with technical resources to support the evaluation of compliance with the requirements of IFRS 16 and its related amendments.

Previous literature indicates that audit report lag is affected by a range of determinants, commonly grouped into four broad dimensions, namely firm-level characteristics, factors associated with audit complexity, auditor-related attributes, and influences arising from the external environment. Variations in audit report lag (ARL) can, to a considerable extent, be attributed to firm-specific characteristics. Evidence drawn from Indonesian listed companies supports this argument. In particular, Fujianti and Satria (2020) report a significant negative linkage between company size and ARL. The estimated coefficient of –2.005 ($p < 0.001$) in their regression model suggests that firms with larger asset bases are more likely to complete the audit process within a shorter timeframe.

The authors attribute this finding to the organisational advantages typically held by larger firms, including more developed information systems, stronger internal control structures, and greater financial capacity to support the audit

process, all of which facilitate timelier financial reporting. In addition, larger companies are subject to closer monitoring by investors and regulators, which increases pressure to publish audited financial statements without undue delay.

In addition to firm size, profitability is found to significantly affect ARL. Empirical evidence from Fujianti and Satria (2020) reveals a highly significant negative coefficient of –65.950 ($p < 0.001$), implying that companies with stronger financial performance tend to complete and publish their audit reports more promptly. The study suggests that profitable firms are incentivised to disclose favourable performance in a timely manner, whereas firms reporting losses may experience longer audit delays due to greater caution in both audit procedures and financial statement disclosure.

In contrast, leverage does not exhibit a statistically significant relationship with audit report lag. The reported p-value of 0.721 indicates that debt levels do not materially influence audit timeliness in the Indonesian manufacturing sector. This finding implies that, within the examined context, organisational capacity and performance-related incentives appear to outweigh financial risk considerations in determining the speed of audit completion.

Audit complexity has long been recognised as a factor that may contribute to extended audit report lag, as it increases the volume of audit work and the level of professional judgement required during the audit process. In large and diversified corporations, audit complexity commonly arises from organisational structures that include multiple subsidiaries and more extensive operational activities, which tend to increase the scope and duration of audit procedures. Empirical evidence from Indonesian listed companies supports this relationship. Irene (2024) finds that audit complexity has a positive and statistically significant effect on audit report lag, indicating that more complex audits are associated with longer audit completion periods. The study explains that larger and more complex firms generally require greater audit effort due to the scale of their resources and the increasing sophistication of their operations and information systems.

As audit complexity increases, auditors are likely to require additional time to perform verification and evaluation procedures across multiple entities and transactions. Consequently, higher levels of audit complexity may delay the issuance of the audit report, thereby lengthening audit report lag. This finding reinforces the view that organisational complexity represents an important operational constraint on audit timeliness.

Additional indicators of audit complexity, particularly the proportion of inherently high-risk accounts such as inventories and trade receivables, increase the extent of audit effort required. Karina and Julianto (2022) argue that entities with substantial inventories and receivables are exposed to higher audit risk, as these accounts are more susceptible to misstatement and fraud, thereby necessitating more extensive verification procedures. This heightened audit effort conceptually suggests a longer audit completion period. However, their empirical findings indicate that audit complexity does not have a statistically significant effect on audit delay within the miscellaneous industry sector, as evidenced by an insignificant coefficient ($p = 0.148$). Despite the absence of statistical significance, the underlying theoretical reasoning remains valid: greater audit complexity increases audit effort, even if such complexity does not always translate into measurable audit delays across all industries (Karina & Julianto, 2022).

Within the context of new regulations such as PSAK 116 (Leases)—which introduces substantial changes to the recognition of lease-related assets and liabilities—audit complexity naturally increases. Auditors must evaluate management judgment, test estimations, and examine information systems that process lease contracts. Based on the theoretical rationale and empirical insights presented in the studies above, any standard that heightens judgment, documentation, and verification requirements is likely to extend audit timelines, especially for firms with numerous or diverse lease agreements. Thus, even though empirical evidence specifically addressing PSAK 116 remains limited, existing theory and research consistently indicate that audit complexity is a key determinant of audit report lag.

Auditor characteristics constitute an important firm-external dimension influencing audit report timeliness. In particular, audit firm size has been widely associated with shorter audit report lag, as larger audit firms—especially those affiliated with the Big Four—possess greater human resources, structured audit methodologies, and enhanced scheduling flexibility. Nasution and Trisnawati (2024) note that Big Four audit firms are able to conduct audits more efficiently and complete engagements within tighter reporting deadlines due to their superior organisational capacity.

In contrast, auditor industry specialisation does not receive strong empirical support in their study. Although specialist auditors are theoretically expected to perform audits more efficiently owing to accumulated industry-specific knowledge, Nasution and Trisnawati (2024) find that auditor specialisation does not significantly moderate the relationship between audit firm size, profitability, audit opinion, and audit report lag. This suggests that industry expertise alone may not be sufficient to accelerate audit completion across all contexts.

Audit opinion also plays a role in shaping audit timeliness. The issuance of modified or non-standard opinions typically requires additional audit procedures, extended review processes, and careful evaluation of financial statement fairness. As emphasised by Nasution and Trisnawati (2024), determining whether financial statements are fairly presented inherently demands additional time and procedural rigor. Consequently, firms receiving non-standard audit opinions are more likely to experience longer audit report lags.

Whilst an extensive body of literature has examined audit report lag and its determinants across different institutional settings, empirical evidence remains fragmented with regard to the role of lease-related accounting complexity following the adoption of PSAK 116. Prior studies predominantly focus on traditional firm-specific characteristics such as firm size, profitability, leverage, and audit opinion or auditor-related attributes in explaining variations in audit timeliness. At the same time, the growing literature on PSAK 116 and IFRS 16 has largely concentrated on their financial reporting consequences, including balance sheet expansion, changes

in leverage, and profitability ratios, rather than on their implications for audit processes and reporting timeliness.

This reveals a clear empirical gap, particularly in the Indonesian context, where PSAK 116 was implemented simultaneously with the COVID-19 pandemic. Although international evidence documents that the recognition of right-of-use assets and lease liabilities substantially increases accounting complexity and judgement requirements, limited research has empirically tested whether the value of leased assets, as a proxy for lease intensity and accounting complexity, affects audit report lag. Furthermore, existing Indonesian studies tend to examine audit opinion and audit firm size in isolation, without investigating how these auditor-related factors interact with lease-induced complexity in the post-PSAK 116 environment. This gap is especially pronounced within the retail sector, which is highly lease-intensive and therefore more exposed to the operational and reporting challenges introduced by PSAK 116.

Accordingly, this study seeks to address these gaps by empirically examining the effect of leased asset value, audit qualification opinion, and audit firm size on audit report lag in retail companies listed on the Indonesia Stock Exchange during the 2020–2024 period. By integrating lease accounting complexity with auditor characteristics, this research extends prior audit timeliness literature and provides context-specific evidence on how major accounting standard changes influence audit efficiency in emerging markets.

1.2 Research Objectives

The Objectives of this study are;

1. To analyse the effect of leased asset value on audit report lag in retail companies listed on the IDX.
2. To examine how audit qualification opinions affect audit report lag in retail companies listed on the IDX.
3. To investigate the influence of audit firm size on audit report lag in retail companies listed on the IDX.

4. To evaluate the combined effect of leased asset value, audit qualification opinion, and audit firm size on audit report lag in retail companies listed on the IDX.

1.3 Research Benefits

The findings of this research are expected to provide:

1. For Readers

   The research provides readers with a deeper understanding of the factors that influence Audit Report Lag specifically in retail companies listed on the IDX. It offers empirical evidence on how leased asset valuation, audit opinions, and auditor firm size interact to affect audit timeliness, enriching the theoretical and practical knowledge in auditing

2. For the Author

   This study serves as a comprehensive academic achievement for the author in conducting empirical research using quantitative methods, data analysis software, and integrating auditing theory with practical financial reporting issues. It enhances skills in critical thinking, research design, and professional writing

3. For Students

   Other students in accounting and auditing can benefit from this work by using it as a reference for understanding audit process complexities and determinants of audit report timeliness. It can serve as a learning model for developing quantitative research skills, hypothesis testing, and interpreting audit-related phenomena in practice

4. For Auditors and Companies

   Practitioners and companies gain insights into how specific audit factors impact reporting delays, helping auditors to streamline their audit processes and manage client expectations regarding timing. Companies can

use findings to improve transparency, corporate governance, and cooperation with audit firms, ultimately enhancing financial statement reliability and investor confidence

1.4 Research Methods

Using a quantitative approach with a causal framework, this research relies on secondary data obtained from the annual financial reports and audit opinions of retail companies publicly traded on the IDX between 2020 and 2024. The dependent variable is Audit Report Lag, while independent variables are leased asset value, audit qualification opinion, and audit firm size. Data will be processed and analysed using SPSS and Excel, with visuals and conceptual frameworks drawn using Visio.

1.5 Problem Formulation

Based on the background, the research questions to be addressed are:

1. Does leased asset value have a significant effect on audit report lag in retail companies listed on IDX during 2020-2024?
2. Does audit qualification opinion significantly influence audit report lag in retail companies listed on IDX during 2020-2024?
3. Does audit firm size affect audit report lag in retail companies listed on IDX during 2020-2024?
4. What is the simultaneous effect of leased asset value, audit qualified opinion, and audit firm size on audit report lag in retail companies listed on IDX during 2020-2024?