

PalArch's Journal of Archaeology of Egypt / Egyptology

INVESTIGATING THE KEY FACTORS AFFECTING THE AUDIT QUALITY – EVIDENCE FROM SAUDI STOCK MARKET LISTED COMPANY

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Sarah Aman, Jamaldeen Faleel. Investigating The Key Factors Affecting The Audit Quality – Evidence From Saudi Stock Market Listed Company-- Palarch's Journal Of Archaeology Of Egypt/Egyptology 18(13), 68-77. ISSN 1567-214x

Additional Keywords And Phrases: Audit Quality, Saudi Stock Market, Saudi Listed Companies, Auditor Independence

ABSTRACT

The purpose this thesis is to determine the factors such as audit firm size, auditor fees, auditor independence, audit firm reputation, auditor tenure and industry experience affects the audit quality of the Saudi Listed companies. Considering the purpose of the study, a literature review was carried out. The objective of this study will be accomplished through analysing the views of Saudi auditors which are obtained with the help of a questionnaire. The six of the most common factors mentioned in the previous studies were selected, and the relation between these six factors and audit quality was analysed with the helped of the literature review. The results showed that most of the auditors think that a positive relation is shared between the auditor independence, auditor tenure and industry expertise, while the other factors which are audit firm size, audit firm reputation and auditor fees do not share a positive relation with the audit quality of the Saudi listed companies. The auditors also chose auditor independence as the most dominant factor.

CCS CONCEPTS • Insert your first CCS term here • Insert your second CCS term here • Insert your third CCS term here

ACM Reference Format:

First Author's Name, Initials, and Last Name, Second Author's Name, Initials, and Last Name, and Third Author's Name, Initials, and Last Name. 2018. The Title of the Paper: ACM Conference Proceedings Manuscript Submission Template: This is the subtitle of the paper, this document both explains and embodies the submission format for authors using Word. In Woodstock '18: ACM Symposium on Neural Gaze Detection, June 03–05, 2018,

Woodstock, NY. ACM, New York, NY, USA, 10 pages. NOTE: This block will be automatically generated when manuscripts are processed after acceptance.

INTRODUCTION

Organizations are evaluated and examined in order to insure the accuracy and fairness of the records that are represented [1]. Audit adds value to the financial statements of the company. By increasing the credibility of its financial statements, companies can expect an increase in their growth as more and more people will invest in their companies. It plays a very important role in the development and enhancement of the global economy as well. Due to the scandals that occurred in companies like World Com and Enron Corporation previously, the users have lost their trust in the audit system [2]. Hence, it is importance to improve the Audit quality to regain their trust. These scandals realize the importance of having an affective audit system that can be achieved by analysing the factors that affect the audit quality. Audit quality cannot be measured quantitatively neither does it have a clear definition that could help conclude it qualitatively.

DeAngelo [3] has defined audit quality as the ability of an auditor to find a material misstatement or a fault in its client's financial information. The quality of an audit shows the financial position of a company. An auditor's opinion assures the users of the financial information of its quality, by depending on the quality of an audit, they make financial decisions related to the company. Hence, it is important for us to know the factors which affect the audit quality in order to improve it.

Accounting and auditing profession in KSA is a not as advanced in comparison to the developed countries like UK, USA etc. who have a rich history of practice in this profession. The Accounting and auditing profession has developed over the years. As the SOCPA mentioned on their website, it was in 1930, that this profession gained the attention of the authorities in KSA [4]. A Commercial Business Regulation law was issued in the year 1931 in which the maintenance of accounting records was stated. The Company Regulations law in 1965 required companies to have audited financial statements. This law also defined the responsibilities of the CPA and certain regulations that would oversee the CPA's assignment. In 1968, in the resolution of H.E Minister of Commerce, the auditors were required to comply with certain regulation to be able to practice auditing in Saudi Arabia [5, 6].

This resolution was followed until the CPA Regulations was issued in the year 1974. This regulation help organize the accounting and Auditing profession and by establishing a committee for certified public accounting which would govern the profession. The following years witnessed many parties trying to help develop the profession, for example, King Saud University established the Saudi Accounting Association in order to help promote accountancy thoughts and so on. In the year 1991, Saudi Organization of Certified Public Accountants was established, and this organization has helped in developing the accounting and auditing profession, as well as the standards of this profession [7].

The SOCPA hosted a number of international conferences and also conducted various studies on the profession. The SOCPA is responsible for reviewing and developing the accounting and auditing standards. Even though, Saudi Arabia witnessed a number of achievements during these years, it still has some serious issues to take care of all the listed companies in the kingdom are required to follow the accounting and auditing standards which are issued by the SOCPA [4]. The SOCPA has work under the supervision of the ministry of commerce. A quality review committee was developed by the SOCPA to achieve the effectiveness of the standards issued by them. And this committee established a program called the practice-monitoring program that ensures that the CPA's comply with the requirements of the Certified Public Accounting Regulations, accounting and auditing standards, the SOCPA rules and standards and other rules issued by competent authorities [4].

This program consists of three sections. Section 2 consists of elements of quality control which include Independence, Advancement, Acceptance and continuance of clients, Consultation, assigning personnel to engagements, Supervision, Professional development, Hiring, Compliance with CPAs Regulations and Rules, Periodic internal review (Inspection) [8]. There are many more standards set by the committee, which have to be complied with in order to improve the performance and efficiency of the CPA firms. Therefore, this study investigating the key factors affecting the audit quality based on the evidence from Saudi stock market listed company.

METHODOLOGY

A study can either use a qualitative approach or a quantitative approach. Whichever method helps the researcher answer all the research questions is chosen. This study used both qualitative and quantitative approach. On the quantitative approach, the findings of the study which is the results of the questionnaire were compared with the finding of literature review (Secondary data). The qualitative approach was conducted to obtain the primary data through question survey. The questionnaire was distributed to several auditors who were asked questions regarding the research topic.

Primary Data

Primary data allows a researcher to collect data that is relevant to the requirements of the study. In this study, Primary data was collected using a questionnaire as a tool. This collection of this data required time and efforts in making the questionnaire. After the collection of this data, it was compared with the secondary data.

Secondary data

Secondary data is data which had already been collected. In this study, secondary data was gathered from previous studies. And this data was used to find the relation between the six factors and audit quality. This data was then compared with data collected through the questionnaires.

Data Collection tool

Questionnaires allow the researcher to focus on certain aspects related to the aim of the study. In this study, questionnaires were used as a tool to collect relevant primary data. The use of this tool made it easy to compare the primary data and the secondary data. The sample size of the questionnaires was 10. The questionnaire was distributed to auditors out of which seven were external and three were internal auditors. The questionnaire consisted of factors that previous studies thought would affect audit quality. They were asked if they agreed with the findings of the literature review. They were also asked that which of the six factors do think has the most dominant effect on audit quality. All these questions were asked in context of the Saudi listed companies.

Result And Discussion

The questionnaire was distributed to auditors out of which seven were external and three were internal auditors. Most of them are working at senior level, while some are audit supervisors. Most of them worked in the auditing field for over 11 years, while 20% had work experience of 6-10 years and 1-5 years.

Audit Firm size

The auditors were asked if they agreed with the finding of the literature review which was that audit size and audit quality share a positive relation, which implies that the larger the size of the audit firm the better is, the audit quality provided by the firm. Figure 1 shows that 50% of the auditors did not agree with the statement, only 20% of them agreed, while 30% were neutral. Since, most of them disagreed, the finding of the literature review does not match with that of the primary data, hence, the majority of the responses are contradictory to the studies of DeAngelo [3], Francis [9], Hosseinnakani et al. [10], Hussein and Hanefah [11], and Lennox [12], Johnson et al. [13] as well as O’Keefe and Westort [14]. Therefore, it can be said that most of the auditors in Saudi Arabia do not agree that audit quality is positively related to the audit firm size.

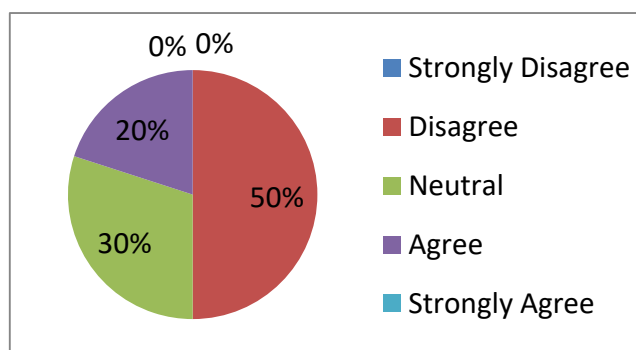


Figure 1: Respondent’s opinion on audit size and audit quality share a positive relation

Audit Fees

The auditors were asked if they agreed with the finding of the literature review which was that auditor fees and audit quality share a positive relation, which implies that the more the auditor fees, the better is the audit quality the auditor provides. Figure 2 demonstrates that 60% of the auditors disagreed with this statement, and only 10% of them agreed, while 30% remained neutral. Since, most of them disagreed, the finding of the literature review does not match with that of the primary data, hence, majority of the responses are contradictory to the studies of DeAngelo [3], Francis [9], Francis and Simon [15], Hai [16], Skinner and Srinivasan [17] as well as Hogan [18]. Therefore, it can be said that the majority of the Saudi auditors think that audit quality of the Saudi listed companies does not share a positive relation with auditor fees.

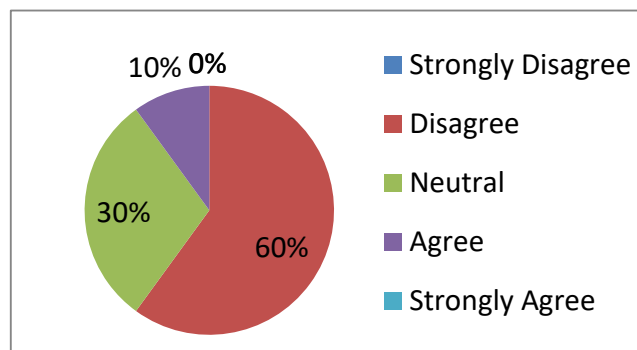


Figure 2: Respondent’s opinion on auditor fees and audit quality share a positive relation

Audit Independence

The auditors were asked if they agreed with the finding of the literature review which was that auditor independency and audit quality share a positive relation, which implies that the more the auditor behaves independently, the better is the audit quality the auditor provides. Figure 3 indicates that 60% of the auditors agreed with this statement, and 40% strongly agreed. Since, all of the auditors were in agreement with the statement, the finding of the literature review matches with that of the primary data, hence, the result is in accordance with the studies of DeAngelo [3], Francis [9], Geiger and Raghunandan [19], Defond et al. [20], as well as Sulanjaku and Shingjergji [21]. Therefore, it can be said that the Saudi auditors think that audit quality of the Saudi listed companies is positively affected by auditor independence.

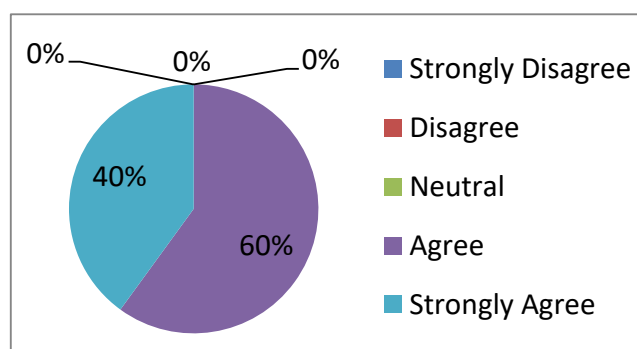


Figure 3: Respondent’s opinion on auditor independency and audit quality share a positive relation

Audit Tenure

The finding of the literature review was that auditor tenure affects audit quality negatively. The Auditors were asked if they agreed that a longer relationship between an auditor and his client, improves the audit quality. Figure 4 shows that 30% of the auditors agreed with this statement, and 10% strongly agreed, while 30% disagreed and 30% remained neutral. Since, most of the auditors were in agreement with the statement, the finding of the literature review does not match with that of the primary data. Hence, the result is contradictory to the studies of Hosseinniakani et al. [10], Geiger and Raghunandan [19], Arel et al. [22], and Al-Thuneibat et al. [23]. While it supports the studies of Johnson et al. [13] as well as Sulanjaku and Shingjergji [21]. Therefore, most of the Saudi auditors think that audit quality of the Saudi listed companies is positively affected by auditor tenure.

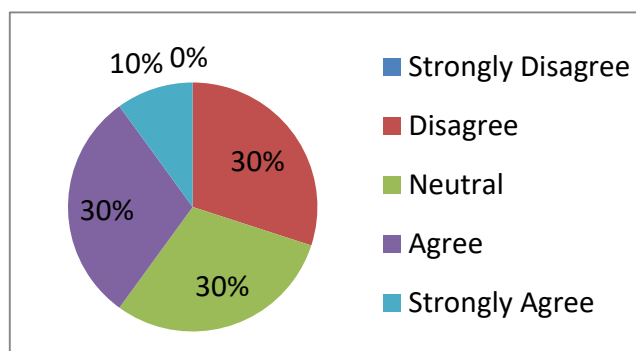


Figure 4: Respondent’s opinion on auditor tenure affects audit quality negatively

1.1 Audit firm reputation

The auditors were asked if they agreed with the finding of the literature review which was that audit firm reputation and audit quality share a positive relation, which implies that the more reputed an audit firm is, the better is the audit quality the firm provides. Figure 5 demonstrates that 30% of the auditors agreed with this statement, 70% remained neutral. Since, most of the auditors remained neutral; the finding of the literature review does not match with that of the primary data, hence, the result contradictory to the studies of DeAngelo [3], Skinner and Srinivasan [17], Hogan [18], Aronmwan et al. [24] and Al-Khaddash et al. [25]. Therefore, most of the Saudi auditors do not think that audit quality of the Saudi listed companies is not always positively affected by audit firm reputation.

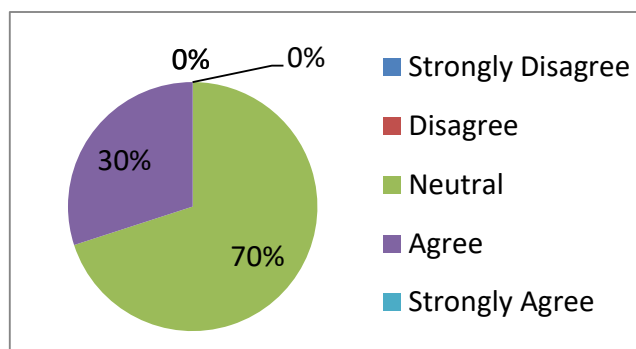


Figure 5: Respondent’s opinion on audit firm reputation and audit quality share a positive relation

Industry experience or expertise

The auditors were asked if they agreed with the finding of the literature review which was that industry expertise and audit quality share a positive relation, which implies that the more experienced an audit firm is, the better is the audit quality the firm provides. Figure 6 shows that 90% of the auditors agreed with this statement, and 10% strongly agreed. Since, all of the auditors are in agreement with the statement, the finding of the literature review does matches with that of the primary data, hence, the result is in accordance with the studies of Hosseinniakani et al. [10], Hussein and Hanefah [11] as well as Habbash and Alghamdi [26]. Therefore, it can be said that most of the Saudi auditors think that audit quality of the Saudi listed companies is positively related with the industry experience or expertise.

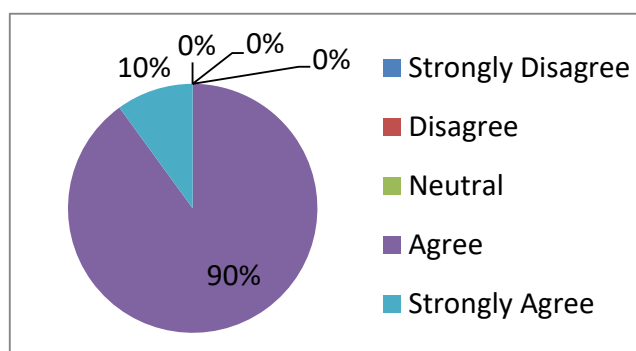


Figure 6: Respondent’s opinion on that industry expertise and audit quality share a positive relation

The most dominant factor

The auditors were asked that which of the six selected factors they thought was the most dominant one affecting the audit quality. Figure 7 shows that 80% of them think that auditor independence is the most dominant factor, while 10% chose audit firm reputation and another 10% chose industry expertise as the most dominant factor. Hence, it can be concluded that the Saudi auditors think that auditor independence plays the most important role determining their audit quality.

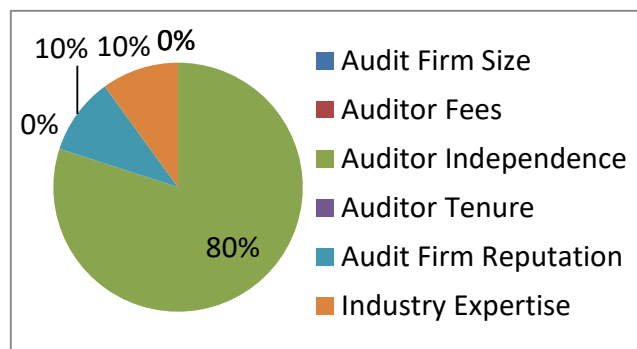


Figure 7: Respondent's opinion on most dominant one affecting the audit quality

CONCLUSION

In conducting this research work, the opinions of auditors were taken with the help of a questionnaire. The auditors were asked if they agreed with the findings of the literature review. The results showed that most of the auditors think that a positive relation is shared between the auditor independence, auditor tenure and industry expertise, while the other factors which are audit firm size, audit firm reputation and auditor fees do not share a positive relation with the audit quality of the Saudi listed companies. The auditors also chose auditor independence as the most dominant factor.

The study only used six factors affecting audit quality, and not several other factors, although there are many different factors which affect audit quality and are causing audit quality issues all around the world. This is a concern that has to be taken care of. A lot of progress has to be made to understand audit quality and the factors affecting it. Hence, audit firms should be monitored to make sure that they are implementing the required standards in Saudi Arabia. The factors affecting audit quality constantly change due to political and market indicators and hence it is not possible to completely control these factors in order to increase audit quality, but by evaluating these factors, the risk of audit quality can be minimized

Acknowledgements

The authors are grateful to the support from College of Business, Effat University.

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