

FACTOR AFFECTING AUDIT QUALITY: A STUDY OF THE COMPANIES LISTED IN BOMBAY STOCK EXCHANGE (BSE)

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ABSTRACT

The research study aims to explore the factors of Audit Quality (AQ) by allowing input from internal and external auditors, finance managers, accountants and Chief Financial Officers (CFO's). This study also attempts to identify the major attributes that contribute to determining the Audit Quality. For the study, the survey method has been adopted and random sampling techniques were used for collecting data from auditors, finance managers and CFO's. The data has been collected from 500 companies listed in Bombay Stock Exchange (BSE). The survey questionnaire consists of scale items for fiscal and broad-spectrum supervisory aspects influencing AQ, perception regarding criteria decided by the Board of Auditing Practices and influence of activities of Audit Quality.

The result revealed that the Audit Quality is dependent upon factors like economic-risk, audit-committee experience, communication, audit firm's ethics, regulatory action risk, auditor's economic independence, their companion reputation and client loss risk. The Exploratory Factor Analysis (EFA) results prove that out of 38 quality attributes, only 8 factors affect the Audit Quality of BSE listed companies, which are further confirmed by Confirmatory Factor Analysis (CFA). In the Audit context, the research study would be helpful in preventing various financial scams, white collar crimes and enhancing the Audit Quality.

Keywords: Audit Quality, Auditors, Finance Managers, Confirmatory Factors.

INTRODUCTION

Auditing is the thorough examining of financial records, statements and provides reports to stakeholders to ensure that the company has clean financial records and abides the accounting norms. Whereas the Quality Audit (QA) is the process of systematic examination of the work carried out by the auditors and its team. It assures, the work performed by auditors is with full competency and follows the ethical standards. The legislative work of Audit emphasizes self-confidence since auditors are anticipated to deliver an external, objective-based view for preparation as well as the exhibition of annual financial accounts/statements (Dandago & Rufai, 2014). The auditors require to present their independent opinion expressed, although the audit work is vastly reliant on and embedded in, the real domain and may be converted predominantly as per country-specific environments (Elmsand, 2013).

However, the audit standards were not previously given due emphasis, and there was a lack of efforts to revise and support them in significant capital markets (Eilifsen, et al., 2008). Usually, the nation-specific standards are not adopted outside the country of origin. Therefore, it is an issue of more considerable significance of how a particular accounting and auditing standards may be adopted in different countries around the world (ICAEW, 2010). The reporting environment, including the quality of the statements audited and the evidence supporting the superiority of the Audit, is the apparent value of the Audit in different countries (Healy & Palepu, 2001; Moore, et al., 2006). It is imperative to comprehend the nationwide audit firm's antiquity of the inspection for explaining the method positioned and further compression and mandate it has (Teeceand, 1994; DeZoort, et al., 2002; Knechel, 2007).

Auditors play a vital role in protecting the interest of existing stakeholders and the investors. In contrast, the audit quality has always been key consideration of Auditor. The study provides some affecting factors of audit firms sometimes affecting audit quality, and implications of compromising the audit profession. However, quality of Audit is often related to the proficiency and freedom of auditors for detecting required information for conducting their investigation and to prepared to issue suitable audit reports to the qualification of their report (Aschauer, et al., 2016; Elifsen & Willekens, 2008).

OBJECTIVES OF THE STUDY

In India there are two big stock exchanges Bombay Stock Exchanges (BSE) and National Stock Exchange (NSE). The companies are listing in the stock exchanges with the objectives of liquidity of securities, mobilizing funds, and protecting the interest of investors. There are approximately five thousand companies are listed in the Bombay Stock Exchanges.

The study aims to investigate the factors affecting 'audit quality' of the companies listed in Bombay Stock Exchange (BSE). The research also discusses that the possible non-compliance factors of Audit quality and highly influential factors of Audit quality. The research, identify and classified the factors which will further assist in model development in future researches.

LITERATURE REVIEW

The research in the area of Auditing is existent due to intervention difficulties and statistical unevenness that is presumed to diverse among companies, and consequently, quality-segregated audits are required by in cooperation between the management of company and stakeholders (Titman, et al., 1986; Dataret, et al., 1991; DeFond, 1992). In prescribed positions, a frequently cited definition of AQ is the 'Common position that is valued by the market and discovered by a particular auditor as (a) A breach in the client's book keeping arrangement and (b) Statement for the breach' (DeAngelo, 1981)

From a manager's perspective, increasing audit fees, audit skills, and non-audit services reduce the individuality of statutory auditors and audit firms, as opposed to the fact that institutes promote their independence (Gul & Shuai, 2017). The ratio of the audit costs to the total income of the auditors is the most critical factor that influences the independence of the auditors, nevertheless of the other key figures. If this relationship is seen as more important than less necessary, it is more likely. " There are conflicts between auditors and employers that should be identified in favor of employers (DeAngelo, 1981).

The major financial scandal has occurred due to the long-term relationship between auditor and management (Aamir & Farooq, 2011). However, the maximum proportions transmit to the temporary financial scandals (Soltani, 2014). Since the rate of corruption for the long run is low; the rotation of the audit firm may not reduce the rates of financial failure (Walker, et al., 2001). Another research revealed that improvement percentage of AQ is more significant in minor firms compared to large firms; thus, a significant effect of Audit firm rotation on AQ were reported (Nagy, 2005). Further, Legislators and professional companies around the world endorsed a binding rotation of auditors at company and partner level to reduce customer reviews and accountant knowledge and create new perspectives while strengthening the independence of auditors and AQ (Mitchell, et al., 1997).

The capital market requires different levels of Auditing but excludes audit requests by defining the creation of audits based on the inputs and outputs provided by the auditor, ignoring only client contribution (DeAngelo, 1981). It reacted as better monetary earnings exist for large audit firms, with colossal information credibility (Cassell, et al., 2013; Teoh & Wong, 1993). Another viewpoint on observed AQ and subordinate audit company is the status through the internal rate of return for countries like the UK, Australia, Canada and in the US (Knechel, et al., 2012; Khurana et al., 2004). Boone, et al. (2008) further measure the level of observed AQ in to the ex-ante charge of capital risk premium.

For non-audit facilities, manufacturing specialty auditors have a controlling influence on the deficiency of AQ as supposed by the capital markets associated with non-specialist auditors (Lim & Tan, 2008). Dhaliwal et al., (2008) subordinated the equality of AQ, measured with the cost of debt (kd) and revealed a positive relationship, thus issuing loan is appreciated for auditor independence. Length of auditor term improves the perceived AQ (Mansi et al., 2004; Ghosh & Moon, 2005). Further, it reduces the kd financing (Mansi, et al., 2004). However, a non-linear AQ enlargement to begin with a knowledge module that once improves AQ is likely to decrease after a specific time since it requires greater client empathy (Boone et al., 2008).

Further, the studies have included a higher level of AQ delivered (Palmrose, 1986); benefit from economies of scale Simunic (1980); audit fees of large companies in Australia (Francis, 1984; Francis & Stokes, 1986), the quality differential in US market (Palmrose, 1986), price skimming by leading firms at Australia (Craswell, et al., 1995). Francis & Wang, (2008) found evenly spread between significant and minor audit firms that are also contradicted by Choi et al. (2008). Thus due to these studies to make a common phenomenon, this study is required.

Senan & Sharma (2017) study stated the factor affecting the independence of external auditor in Saudi Arabia. The objectives aims were analyzing the affecting factors of the independence of external auditors in the local audit firms of KSA. The result concluded that there was exists a relation between the external auditor independence and the consulting services rendered by auditor and there is relationship between independence and quality of audit.

METHODOLOGY

The methodology comprises the description of investigation strategy, sample scheme, questionnaire intention, data pool and statistical tools procedure for analysis of composed data. Insufficient exploration is carried out for assessing the AQ. The intents of current research are for investigating the examination enquiries by using secondary data and presenting empirical research. Thus it followed exploratory investigation methodology *via* review of existing pieces of literature. It further uses quantitative and problem-solving approach.

The population of the study includes all auditors, accountant and CFOs working BSE listed companies. In primary data collection, 3100 respondents were nominated using expediency sampling (using a cross-sectional design) from 500 corporations Registered in BSE (Bombay Stock Exchange). The sample composed of finance managers, accountants, auditors and company CFOs. The average age of auditors is 42.95 years, and mean age for Accounts is 38.78 (Table1). Both auditors and CFOs have an average of 16 years of work experience. Only 23.2 percent of auditors have management education, whereas 57.8 percent of CFOs has a management degree in education.

	Auditors		Accountants and CFOs	
	Mean	SD	Mean	S.D.
Age (years)	42.95	9.42	38.78	9.07
Service terms	16.04	9.91	16.22	2.84
Monthly salary (in rupees)	27894.74	3982.46	163830	111325.2
Educational qualification (years)	16.28	1.41	15.3	2.42
Education in Technical area (%)	60.50%		27.90%	
Education for Management (%)	23.20%		57.80%	

For the study the following hypothesis is being made:

H₁: There is significant relationship between observed variables and the quality of Audit exists.

The survey questionnaire consist the scale items for financial and overall governing influence sub setting AQ, perception regarding values set by the countries Accounting Board and influence of proceedings of audit board on AQ is essential. Exploratory factor analysis (EFA) along with Confirmatory Factor Analysis (CFA) is used for data analysis.

RESULT

Quantitative research design is employed by using a questionnaire contents close-ended enquiries on a Likert scale of 5-point, with strongly-disagree to strongly-agree. First, 38 scale items have been classified using Exploratory Factor Analysis (EFA). The variables are reduced and grouped into the eight-factor model with 27 scale items. This Eight-factor model is further tested using dimension model in CFA. Table 2 and Figure 1 designates that loadings on their conforming LVs that are greater than 0.7. Scale items loading less than 0.5 has been removed from the measurement model. Valuation of the dimensional model consists of the measurement of the validity and reliability by focusing on Latent Variables (LV's) in the model. The valuation embraces the association measurement between the LVs and their associated substances *i.e.*, (responses to distinct question proclamations in the survey).

Based on the scale items grouping and loading, factors are named accordingly (Table 2). The result revealed that the AQ depends upon factors including Threat of client loss, Threat of legal action, Audit Board (AB) experience, Economic risk, Communication, Ethics of Audit Company, Audit partner reputation and Economic independence of auditors.

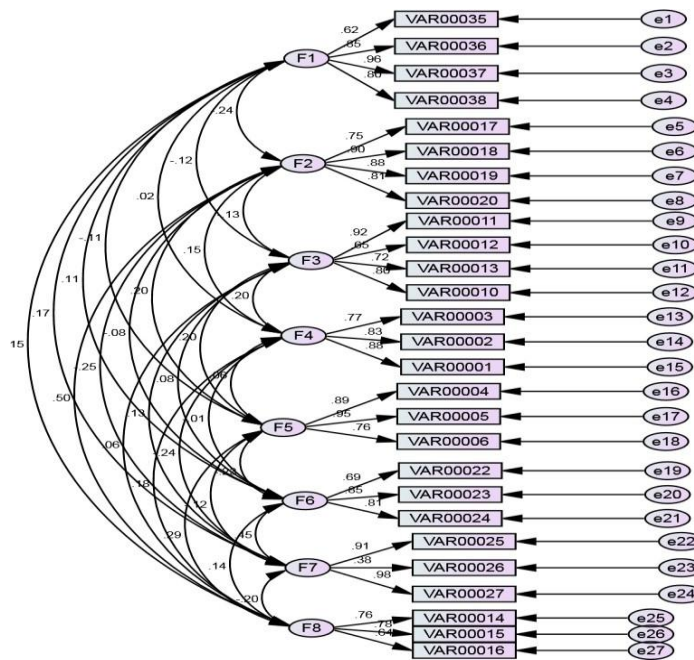


FIGURE 1
MEASUREMENT MODEL WITH STANDARDIZED ESTIMATES

Factor	Factor Name	Scale Items	Scale Variable	Std. Loading
F1	The threat of client loss	Client significance for the overall portfolio of the firm's	VAR00035	0.912
		Companion's aspiration for keeping existing standing by dropping key customer	VAR00036	0.879
		Not Big four audit firm (as Audit firm size adopted from Brivot, et al., 2018& from Gul, et al., 2013).	VAR00037	0.856
		Grater four audit firm (as taken by Berglund et al., 2018)	VAR00038	0.847
F2	The threat of legal action	Risk of exploration for auditor by the legal body (including Assessment Panel of Financial Reporting)	VAR00017	0.882
		The risk for disciplinary action by legal authority (including Board of Accounting Investigation and Discipline)	VAR00018	0.845
		The threat of exploration by the internal Reporting committee of a company	VAR00019	0.806
		The threat of losing Registration of Audit status by firm undertaking audit	VAR00020	0.777
F3	Audit Board(AB) experience	Approval of relations of appointment and the compensation of the external auditor	VAR00010	0.865
		AB's responsibility for endorsing the nomination, re-appointment and elimination from board	VAR00011	0.789
		AB confirms that satisfactory Audit can be supported for the fee taken by the firm	VAR00012	0.749
		Ensuring procedure for auditors' independence and independence with compliance with Auditing and	VAR00013	0.708

		ethical standards of the country		
F4	Economic risk	Public scandals may turn into loss to audit firm's standing	VAR00001	0.908
		Possibility of damage to audit partner's standing	VAR00002	0.904
		Probability of legal action against the firm	VAR00003	0.846
F5	Communication	Communication on all essential matters allied with the Audit, and through ethical principles with the audit committee	VAR00004	0.796
		Application of International Standards of Auditing (ISAs) under IFRS at the end period of reporting	VAR00005	0.774
		The technique of revealing statistics between auditors and 'company's management	VAR00006	0.684
F6	Ethics of audit company	Taking responsibility for making a regulatory environment for compliance with ethical standards rather than commercial considerations by Audit company.	VAR00022	0.879
		Designating ethical companion to certify compliance and ethical standards by Audit Company	VAR00023	0.854
		Independence of Audit partners for reviewing significant aspects of the audit arrangement	VAR00024	0.555
F7	Audit partner reputation	Replacement of Audit arrangement or independent review partner in less than five continuous period	VAR00025	0.879
		Replacement of former audit associates or other supervisors (not allowing for more than seven years)	VAR00026	0.854
		Implementation of sovereign inspections of public attention and publication of reports by the Audit Inspection Unit.	VAR00027	0.555
F8	Economic independence of auditors	Cost taken by firm's from companies must not be exceeding 10% (of annual fee income of firm)	VAR00014	0.82
		The client's commitment and partner's profit share is limited (below 10% of total fees)	VAR00015	0.735
		having straight or subsidiary monetary interest in the client or business so for influencing the result of audit work	VAR00016	0.727

The adaptation measures of the hypothetical model are given in Table 3. The chi-square standards obtained from the models were extremely significant ($p < 0.01$). The comparative chi-square (χ^2/df) was evaluated from the understanding of the chi-square to the size of the sample. The adaptation quality index (GFI) corresponds to several square correlations (R^2). The Comparison Fit Index (CFI) indicates the overall fit of the comparison model with a null model, and the Normalized Fit Index (NFI) changes the compactness of the model. The mean quadratic approximation error (Root Mean Square Error of Approximation) (RMSEA) gives the estimate of the observed model compared to the real model since its lowest value is treated relatively for a better adaptation of the model. RMSEA was close to the required 0.08 limit. As a result, the model adjustment indices were marginal. However, these adjustment measures were close to 0.90. Therefore the acceptance of the model cannot be refused. The fit of the model was satisfactory and not far away. However, the insurmountable has shown that the developed model is used to predict AQ assurance.

Table 3 MODEL FIT MEASURES								
Fit measures	χ^2	df	χ^2/df	GFI	CFI	NFI	RMSEA	PGFI
Default model-Hypothesized	368.396	296	1.2	0.801	0.943	0.774	0.049	0.062

CONCLUSION

The quality of Audit aims to establish user's confidence in financial reporting, but in recent periods it is anticipated from them to deliver a peripheral, objective judgment on the provision and proper justification on statements made by them (Brivot, et al., 2018). Their beliefs are exceedingly biased on and embedded trendy and challenging in some informal environments. Thus measurement of AQ was conducted in this investigation by taking views of 310 auditors, accountant and CFOs working in global companies listed in any Stock Exchange were analyzed to measure the AQ by Using Confirmatory factor analysis method.

The outcomes of the research study indicated the significant role of AQ aspect for auditors includes Risk of client loss (DeFond, et al., 2017), Risk of regulatory action (Eilifsen & Messier, 2015), Audit committee experience (Che, et al., 2018), Economic risk (DeFond et al., 2017), Communication, Ethics of the audit firm, Audit partner reputation (Gul, et al., 2013) and Economic independence of auditors (Christensen, et al., 2016). The perception of respondents will present the understanding and solicitation of the protocols, affected expressively by the appearances on relating those principles and criteria (Berglund, et al., 2018; Knechel, et al., 2013). Thus, it is significant for the occupation *i.e.*, (Auditors, Accountant and CFOs) to recognize this outcome. Advance studies are estimated by adding more respondents' into sample sizes to improve the take a broad view of the conclusions made by us in this research. Also, by taking precise audit fragments, by way of small-medium enterprises, might deliver bottomless visions (Gul, et al., 2013).

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