

The Effect of Audit Tenure and Audit Firm Size on the Audit Quality: Evidence from Jordanian Auditors

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ABSTRACT

The poor of audit quality has become one of the phenomenal challenges facing the financial sector in Jordan and how to offer directives and policies to generate high-quality of auditing. The study is motivated by academic available literature on the need to examine audit attributes affecting audit quality in Jordanian auditors. This study is based on two variables that are used to understand and analyze the level of audit quality within Jordanian auditors. The two variables that are measured in this current study are: audit tenure (AT) and audit firm size (AFZ). The data were collected through the distribution of questionnaires to 200 respondents in Jordanian auditors and processed using Partial Least Squares-Structural Equation Modeling (PLS-SEM) software for the purpose of this study. By using descriptive analysis and structural equation model, the findings of the study show that there is a positively and significant effects between audit tenure and audit firm size and audit quality.

Keywords: audit quality, external audit, audit tenure, audit firm size, Jordan

INTRODUCTION

Auditing standards require auditors to plan and perform audits to obtain reasonable assurance about whether the financial statements are free of material misstatements and to express an opinion about the fair presentation of the financial statements (PCAOB 2010). The degree to which financial statement users can rely on an audit report depends on the quality of the audit performed (Christensen *et al.*, 2016). The high quality audit report will provide additional value to the financial statement that is stated in the financial report, in which investors utilizing this information for decision making (Salleh and Jasmani, 2014). Further, prior studies have indicated that auditing and the understanding about the audit quality are still central to the reliability of financial reporting and the assessment of the effective allocation of resources (Taylor, 2015). Weak audit quality has resulted in unexpected collapse of high-profile companies such as WorldCom, One-Tel, Enron and Harris Scarfe. These scandals have led investors, regulators, general public, and the academician to pay their attention to consider audit quality, to identify the underlying causes of loss of quality audit and to develop and improve audit quality (Al-sraheen, 2014).

The users of financial statements have exasperated due to auditor failure that led to global accounting scandals (Nawaiseh, 2015). A report prepared by the Jordanian Association of Certified Public Accountants (JACA) in 2014 indicated that there are weak of audit quality in Jordan, evidently is the increasing tax evasion of many Jordanian companies. Moreover, the JACA (2014) reported that they decided to punish a number of auditors by preventing them from practicing auditing services for two years with accusing of violating international auditing standards and ethical rules. The same case had already occurred in 2013. The JACA decided to punish five auditors of the association by preventing them from practicing the profession; one of them is punished for one year and the rest were punished for six months due to committing disciplinary offenses and non-compliance in ethical rules. All of these issues are evidence of poor audit quality in Jordan.

Previous studies have been done to investigate audit tenure influence in audit quality. Ilaboya & Okoye, (2015), Al-Thuneibat *at al.*, (2011) and Al-khaddash *et al.*, (2013) a name to few that investigate the effect between audit tenure and audit quality. Long audit tenure leads to a level of relationship between auditors and clients and gives auditors to turn their audit position and being more relaxed (Knechel and Vanstraelen, 2007). The implication is that actually independent auditor behaviour turns in to tough and there is the increased probability of the auditor acceding to client's stress in relation to their desire and approving an accounting policy (Mgbame *et al.*, 2012). Conversely, auditor tenure is probably to growth the general domain knowledge, that can increase the extent of the auditor's competence. The understanding of client-specific knowledge, e.g. in-depth expertise about the client's accounting system and business field, allows the auditor to properly find and evaluate the potential risks, to plot and carry out audit procedures, as well as to explicit the precise audit opinion. Also, with the ongoing tenure, the accumulated client-specific knowledge may increase the level of the auditor's competence (Lee, 2015). In Jordan, it is widely observed that most firms retain the same audit firm for long periods (Al-Thuneibat, Issa and Baker, 2011). Thus, does the audit tenure effect on the audit quality of Jordanian auditors?

Moreover, previous studies propose that larger firms may offer higher-quality audits due to the fact larger audit firms have fewer motivations to compromise their standards in order to maintain the retention of clients compare to smaller firms (Al-khaddash, Nawas and Ramadan, 2013). Large audit firms are likely to provide higher-quality audit services than small auditors. This is because an auditor's economic dependence on that client is negligible for large auditors, as they have to protect their reputation in the case of audit failures, compared to small auditors (Choi *at al.*, 2010). On the contrary, James (2014) find negative effect between audit firm size and audit quality. Whereas, the small audit firms provide high quality auditing to maintain their customers, due to the small number of customers. Hence, Previous studies investigated the effect of audit firm size on audit quality, but there is inconsistency of results from the previous studies. On other hand, the Jordanian market aims to benefit from global expertise, which is apparent in the tendency to employ big audit firms for the audit of financial statements. Therefore, it is important to uncover whether big firm auditors deliver superior quality audits; otherwise, the door should be opened for new comers in the Jordanian audit community, without the concern of competing with big auditors on the basis of their superior audit quality. Additionally, it is very important to enrich the existing literature about firm size and audit quality at the international level because auditing is a socially constructed phenomenon and therefore we need evidence from various environments. Based on the evidence from Jordan, does the audit firm size effect on the audit quality of Jordanian auditors?

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Audit quality is debatable, but difficult to understand because an audit process involves the implementation of testing procedures that could not be observed by the users of the financial statement (DeAngelo, 1981). Thus, there are some researcher define audit quality by looking at the approach of audit results or auditor or audit firm's competency. DeAngelo (1981. p186) defines audit quality as "the market-assessed joint probability that a given auditor will both discover a breach in client's accounting systems and report the breach". Accordance to the

Generally Accepted Auditing Standards (GAAS), auditor bears the responsibility to offer affordable warranty that the audited financial statements and associated disclosures are (1) supplied in accordance with the Generally Accepted Accounting Principles (GAAP), and (2) are not materially misstated from errors or fraud. Consequently, deviations from the standards also are presumed to mirror weak audit quality (Knechel *et al.*, 2013)

Auditor tenure is described as the length of the auditor-client relationship. A comparatively long relationship between the auditor and the clients may represent a threat to independence as individual ties and familiarity may additionally broaden. Hence, this could result in less vigilance at the part of the auditor and even to an obliging attitude of the latter to the top managers of the corporation (Okolie, 2014). Furthermore, according to Horne (2015) and Adu-Boateng (2012) there are two classification to determine the audit tenure: short audit tenure if the client having retained as an auditor or audit firm for three or fewer years and long audit tenure if the client having retained its auditor for eight or more years. In particular, according to Horne (2015); Carcello & Nagy (2004); Johnson *et al.*, (2002) and Myers *et al.*, (2003) tenure is set as short tenure is the first three years with the firm, and long tenure is greater than nine years.

However, the concept that auditor tenure is inversely connected to audit quality is a way from being corroborated through the empirical studies. Lys & Watts (1994) document that the chance of an auditor being subjected to legal motion is not related to the tenure. Okolie (2014) suggests that the quality of auditor reporting enhance over time, that the increasing of auditor's knowledge of the client's specialization and the processes within the organization. On the other hand, after a period of years, the independence of the auditor will fade, through friendly relationship between the auditor and the client's consequent to the long-time of engaging. It also that leads to rein audit quality, whereas long tenure is supposed to lead to less objectivity in the auditor's conduct (Al-Thuneibat *et al.*, 2011)

Adeniyi & Mieseigha (2013), Carey & Simnett, (2004), Johnson *et al.*, (2002) and Rahmina & Agoes, (2014) conducted a studies to investigate the impact of auditor tenure on audit quality and they are consistent with the hypothesis that the auditor compromises his independence most often in a long term auditor contract. Also, the length of audit tenure is a critical factor influencing auditor independence, which in turn affects the audit quality (Liu & Habib, 2012). In addition, after a period of years, the independence of the auditor will fade, through friendly relationship between the auditor and the client due to the long period of services. Also that leads to rein in audit quality, whereas long tenure is supposed to lead to less objectivity in the auditor's behaviour (Al-Thuneibat *et al.*, 2011).

On other hand, Okolie (2014) suggests that the quality of auditor reporting improves over time, because the increasing of the auditor's knowledge of the client's specialization and the processes within the organization. In addition, Adeniyi & Mieseigha (2013) noted there are some studies examine the relationship between long term auditor-client relationship and the probability of audit failure. The results indicate that risk increases early in the auditor client relation and then declines over time suggesting that longer audit tenure overtime will smoothen out any initial challenges that may impair the quality of the auditor's performance. The results of the study do not support the hypothesis that short auditor tenure improves audit quality. This study can argue that the effects of auditor tenure on audit quality are controversial. Therefore, this study which was motivated by the lack of consensus in the literature on the impact of audit tenure on audit quality will contribute to the debate by examining the effect between auditor tenure and audit quality in Jordan. Hence, due to the inconsistency in the above studies, this study proposed the following non directional hypothesis:

H1- There is a significant effect between audit tenure and the audit quality of Jordanian auditors.

DeAngelo (1981) argue that big audit firms have a superior audit quality, since they already have invested in large audit technology and staff training, and thus they are more competent and more accurate in detecting the problems related to misstatement and going concern assumptions, compare to small audit firms. Moreover, small audit firms have a stronger economic dependency to the client, because those small firms do not have a lot of clients (Olsson, 2010). Adeniyi & Mieseigha (2013) propose two key motives for why big audit firms are more independent than the small ones, namely: (1) the separation of a branch that provides audit services and non-audit services and (2) the revenues gained by an accounting firm is influenced by not only one client. Also, larger audit firms mean greater resources and the ability to serve larger clients. As a result, this increases the likelihood of discovery the breaches, compared to small audit firms (Davidson & Neu, 1993).

There are many researchers in the scope of measuring audit quality have used audit firm size as a proxy. Olsson (2010) argued that audit quality is a function of the number and extent of audit procedures performed by the auditor and that larger firms possess more resources with which to conduct tests. At the same line, DeAngelo (1981) indicates that larger firms provide higher-quality audits because larger audit firms have fewer incentives to compromise their standards to ensure retention of clients in comparison with smaller firms. Many previous studies have documented a positive association between audit firm size and audit quality, such as Sawan & Alsaqqa, (2013); Chen, Hsu, Huang, & Yang, (2013). In addition, previous studies have measure audit firm size as the Big 4 or not Big 4, thus, if the audit firm fall under Big 4 firms they are a big audit firm. But if the audit firm not falls under Big 4 they are small audit firm. Furthermore, it is determined whether the audit firm is local or global, as it's known the global firm larger than local firm (Belfagira, 2015).

On other hand, James (2014) find negative effect between audit firm size and audit quality. Whereas, the small audit firms provide high quality auditing to maintain their customers, due to the small number of customers. This study can argue that the effects of audit firm size and audit quality are controversial. Therefore, previous studies investigate the effect between audit firm size and audit quality. Hence, it suggests further study on this area. Therefore, due to the inconsistency in the above studies, this study proposed the following non directional hypothesis:

H2- There is a significant effect between audit firm size and the audit quality of Jordanian auditors.

DATA AND METHODOLOGY

This study was carried out through a survey method by developing and distribution of questionnaire. The survey questionnaires were distributed during actual visits to participants' location based on the list of population. This study collected data from Jordanian auditors by distributing questionnaire. From the total population of registered Jordanian auditors are 419 auditors. The actual sample for this study 200 auditors in Jordan. This study measured audit quality from iterant perspectives, which refer to seven elements and five elements for audit tenure, further, this study measured the audit firm size by examine five elements. As summary, the following Table 1 explained the operational definition of the dependent variable and independent variables.

Table 1: Resume of variables measurement

Variables	Operational definition	Source
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Audit quality	<ul style="list-style-type: none"> • Compliance with auditing standards. • A proper planning process. • Commitment to ethical standards. • Obtain sufficient evidence to support an audit opinion. • Assessment of the risks associated with the client financial statements. • Completed in a timely manner. • Review the work before the audit is completed. 	(Sulaiman, 2011)
Audit tenure	<ul style="list-style-type: none"> • Audit tenure is threat to auditor independence. • Take consideration the length of the relationship between the client and its auditor before auditor wants to audit the client. • The rotation will enhance auditor independence. • The rotation would add more costs to audit firm and audit clients. • The benefits of audit firm rotation exceed the likely benefits of audit partner rotation. 	(Ahmad and A, 2012)
Audit firm size	<ul style="list-style-type: none"> • The large audit firms can report the real financial situation of the clients. • The large audit firms perform more powerful, effective tests and are more credible. • The large audit firms are more attractive to investors and creditors. • The large audit firms can plan the audit process more effectively. • The large audit firms are more independent. 	(Sawan and Alsaqqa, 2013)

RESULTS

The data for this study was collected through questionnaire from the external auditors in Jordan. Total numbers of 200 questionnaires were distributed to the respondents whereas 164 questionnaires were answered and received out of 200 survey questionnaires were distributed during actual visits to participants' location based on the list of population. Therefore, a response rate of 82% was achieved by receiving filled and returned survey instruments from 400 respondents. Table 2 showing the detail about response rate.

Table 2: Response rate

Questionnaire	Frequency	Percentage
Returned:	164	82%
Completed	150	75%
Not completed	14	7%
Not Returned	36	18%
Total Questionnaire Distributed	200	100%

Present study shown the demographic results of respondents which contains, gender, age, education level, professional qualifications, length of services, Academic major and working in Big 4 audit firm. Which represent the basic information of respondents on base of 150 questionnaires in present study. Table 3 showing the results of respondent's information in detail.

Table 3: Respondent's information

Demography	Frequency (n=150)	Percentage (%)
Age (years)		
25 – 30 years	30	20%
31 – 35 years	72	48%
36 – 40 years	40	26.6%
41 and above	8	5.4%
Total	150	100%
Gender		
Male	139	93%
Female	11	7%
Total	150	100%
Education level		
Diploma	25	17%
Bachelor	97	65%
Master	25	16%
Doctorate	3	2%
Best Doctorate	0	0%
Total	150	100%
Professional qualifications		
CPA	0	0
JCPA	150	100%
CFA	0	0
others	0	0
Total	150	100%
Academic major		
Accounting	150	100%
Management	0	0
Finance	0	0
Others	0	0
Total	150	100%
Working in Big 4 audit firm		
Yes	42	28%
No	108	72%
Total	150	100%

Table 3 has shown that most of the respondents were male (93%) while, the rest (7%) were female, this is because Jordanian society does not encourage women to work. Descriptive statistic also shows that the majority of respondents age is between 25 to 30 years old (20%), the age group starts at 25, because in Jordan it is the age at which the auditor begins as an auditor. When an aspired auditors' finishes bachelor's degree at the age of 23, they need two years to complete the work of auditing and obtaining the license (JCPA). Follow by those who were Less

than 35 (48%), follow by those who were between 36 to 40 years old (26.6 %) while, the lowest percentage goes to those who were above 41 years old (5.4%), maybe because they go to work outside the country such as Saudi Arabia and Qatar to get more fees.

Furthermore, descriptive statistic of education level in the analysis indicates that most auditors were have bachelor with percentage of (65%), whereas, the second score goes for those who were diploma (17%), and then to the master (16%), However, the lower percentage was the doctorate with percentage of (2%). Descriptive statistic also shows that all respondents has professional qualifications (JCPA) with percentage of (100%). According to the descriptive statistic also shows that all respondents have academic major (Accounting) with percentage of (100%). The last descriptive statistic was the working in Big 4 audit firm, Table 3 has shown that most of the respondents were don't working in Big 4 with percentage (72%) while, the rest (28%) were working in Big 4.

By using PLS-SEM path model, there are the measurement model (also called the outer model in the PLS-SEM) and structural model (also known as the inner model in the PLS-SEM) (Hair *et al.*, 2011). Specifically, to ascertain the individual item reliability and other measurement model assessments, the study performed PLS algorithm. The individual item or factor reliability of reflective constructs was determined using the outer loadings of each construct's indicators.

Table 4: Convergent validity and reliability analysis

Construct	Items	Loadings	Composite Reliability	AVE
Audit Quality	AQ2	0.785	0.817	0.529
	AQ4	0.671		
	AQ5	0.659		
	AQ7	0.784		
Audit Tenure	AT1	0.7685	0.7554	0.5083
	AT3	0.6618		
	AT4	0.7044		
Audit Firm Size	AFZ1	0.789	0.8458	0.5247
	AFZ2	0.669		
	AFZ3	0.7206		

Note: 7 items (AQ1, AQ3, AQ6, AT2, AT5, AFZ4, AFZ5) were deleted to low items loading

As suggested by Joseph F Hair *et al.*, (2017) factor loading and AVE are used to assess convergent validity. More so, Joseph F Hair *et al.*, (2017) argued that composite reliability is used to measure the validity of data. Hence, the indicator loading, composite reliability and AVE of the reflective constructs are shown in Table 4 above. The table shows that all the indicator loadings are above 0.60 which indicate convergent validity at indicator level (Bagozzi and Yi, 1988); while the average variance extracted (AVE) values for all the variables are above 0.50 which also indicate convergent validity at construct level (Hair *et al.*,2014). Furthermore, all the composite reliability values are more than 0.80; hence all these values meet the criteria for convergent validity of data as required in quality criteria.

Moreover, the exogenous latent constructs of this study (i.e. AT and AFZ) explain 64.6 percent variance of audit quality. Following Chin (1998) recommendation, the R^2 value explained by the exogenous constructs on the endogenous construct in their direct relationships is substantial effect. It indicates that audit quality is 64.6 percent dependent on the four predictors considered in this study. The remaining 46 percent may be explained by other

factors. This study proved bootstrapping analysis enable to test statistically the research hypotheses. Table 5 contain the Std. Beta and the bootstrapping results, where the hypothesized effects below were tested:

Table 5: Result of hypothesis testing

Hypotheses	Effects	Std. Beta	Standard error	T-value	Decision
H1	AT > AQ	0.699	0.094	7.472*	Accepted
H2	AFZ > AQ	0.152	0.106	1.439	Rejected

Notes: *P<1% **P<5% ***P<10%

Based on the above Table, hypothesis 1: audit tenure has effect on the audit quality. This hypothesis got strong support as the table 5 depicted that the Std. Beta value is 0.699 and the corresponding T-statistics is 7.472 that indicates 1% significance level. So, it is accepted that audit tenure has positive and significant effect on the audit quality. This finding is consistent with the findings of Okolie (2014) and Adeniyi and Mieseigha (2013). They all found positive effect between audit tenure and quality. Whilst, hypothesis 2: audit firm size has effect on the audit quality. This hypothesis got strong support as the table 5 depicted that the Std. Beta value is 0.152 and the corresponding T-statistics is 1.439 that indicates insignificance level. So, it is not accepted that audit firm size as positive and insignificant effect on the audit quality. This finding is consistent with the findings of (James, 2014).

DISCUSSION AND CONCLUSION

The first hypothesis stated that audit tenure is positively and significantly effect on the audit quality. The result from PLS analysis supported this hypothesis. This finding is consistent with the findings of previous studies such Okolie (2014) and Adeniyi and Mieseigha (2013). They all found positive effect between audit tenure and audit quality. Specifically, Okolie (2014) suggested that the quality of auditor reporting improves over time, because the increasing of the auditor's knowledge of the client's specialization and the processes within the organization. This study provides evidence that audit tenure has a significant effect on audit quality on the Jordanian auditors. Consistent with the second research question, the third objectives of the study were to examine the effect between audit firm size and audit quality. Towards this direction, the research question hypothesized that audit firm size has effect on the audit quality. The PLS result also shown positive direction and insignificant effect. Thus, audit firm size is positively and insignificantly effect on the audit quality. This finding is consistent with the findings of James (2014).

From the findings of this research, several practical implications in audit quality and specifically in the context of Jordan can be achieved. In particular, the findings assist the Jordanian Association of Certified Public Accountants (JACA) in laying down strategies for support and motivation in the work environment of Jordanian auditors. The significant findings shown that Jordanian auditors need good working environment to offer high-quality of audit. Based on the results detected, the JACA must impose law (instead of instructions) encourages an increase the audit tenure to increase the audit quality by providing the auditor with an opportunity to understand the client's internal system. Furthermore, the research findings useful for audit firms in Jordan by conduct an analysis regarding their work environment and assessment of the auditors' work performance. Moreover, Audit firms will be able to effectively identify the most optimum way to enhance work environment quality. The results helped the audit firms to understand and improve the audit quality by increasing the audit tenure this positively affects the audit quality in Jordan.

The findings of this study have also limitations. Limitation provides the opportunities for scholar to further investigate the current study with different perspectives. First limitation of present study that only focused on perceptions of auditors which may be bias. Future research is to examine the other perceptions of interested parties, such as auditing professional associations, clients and legislators. Second limitation is that due to lack of the time and budget issues present study focused on the survey cross sectional study. Future research will be longitude study to bring the more and reliable data and comprehensive results. Third research method techniques of data collection do not provide the equal chance to all respondents. Hence, future researchers may enhance the findings of questionnaire by conducting interview with the respondents.

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