



**The Effect of Auditor Attributes on Perceived Audit
Quality: Evidence from Jordan**

by

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DECLARATION OF THESIS

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LIST OF ABBREVIATIONS

AE	Auditor Experience
AF	Audit Fees
AFZ	Audit Firm Size
AI	Auditor Independence
AICPA	American Institute of Certified Public Accountants
AQ	Audit Quality
AR	Auditor Reputation
AT	Audit Tenure
RIAW	Reliance on Internal Audit Work
ER	Ethical Rules
GAAP	Generally Accepted Accounting Principles
IAA	The Internal Audit Effectiveness
IFA	International Federation of Accountants
IS	Industry Specialization
ISA	International Standards of Auditing
JACPA	Jordanian Association of Certified Public Accountants
JD	Jordan Dinar
JESC	Jordanian Economic and Social Council
KPMG	Klynveld Peat Marwick Goerdeler
LCER	The Level of Compliance Toward Ethical Rules
NAS	Non- Audit Services
SEA	The Skills and Experience of Auditor
SEC	Securities and Exchange Commission
SOX	Sarbanes Oxley

Kesan Atribut Juruaudit Ke Atas Saranan Kualiti Audit: Bukti Dari Jordan

ABSTRAK

Kelemahan kualiti audit dan bagaimana membangunkan polisi dan dasar pengauditan yang berkualiti merupakan satu fenomena yang mencabar yang dihadapi oleh sektor kewangan di Jordan. Kajian ini didorong oleh permasalahan pengelakan cukai di Jordan dengan melihat perspektif kualiti audit dikalangan juru audit sebagai satu jalan penyelesaian. Oleh itu, tujuan kajian ini adalah untuk mengkaji kesan atribut auditor ke atas saranan kualiti audit daripada juruaudit di Jordan. Kajian ini berdasarkan kepada empat pemboleh ubah yang digunakan untuk memahami dan menganalisis tahap kualiti audit bagi juruaudit di Jordan. Empat pemboleh ubah yang diukur adalah: tempoh audit, saiz firma audit, tahap pematuhan kepada peraturan etika dan keberkesanan audit dalaman. Data dikumpul melalui pengagihan soal selidik kepada 200 responden di Jordan dan dianalisa menggunakan perisian Partial Least Squares-Structural Equation Modeling (PLS-SEM) untuk tujuan kajian ini. Dengan menggunakan analisis deskripsi dan Structural Equation Modeling, penemuan penyelidikan menunjukkan bahawa terdapat kesan positif dan signifikan di antara tempoh audit, saiz firma audit, tahap pematuhan terhadap peraturan etika dan kualiti audit. Sebaliknya, keberkesanan audit dalaman menunjukkan hubungan negatif tetapi tidak signifikan dengan kualiti audit. Sebagai tambahan, kajian ini mengendalikan analisis lanjut dengan mengawal responden berdasarkan kepada firma audit Big 4 dan responden daripada firma audit bukan Big 4. Merujuk kepada keputusan kajian, tahap pematuhan terhadap peraturan etika memberi kesan positif dan signifikan kepada kualiti audit bagi juruaudit di firma Big 4 manakala memberi kesan negatif dan signifikan kepada juruaudit dari firma bukan audit. Sebagai tambahan, berdasarkan kepada profil demografik, majoriti responden adalah daripada firma audit bukan Big 4 dan ini akan mengedukahkan keputusan yang unik.

Keyword: tempoh audit, saiz firma audit, tahap pematuhan kepada peraturan etika, keberkesanan audit dalaman, Jordan

The Effect of Auditor Attributes on Perceived Audit Quality: Evidence from Jordan

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. This study is motivated by the problem of tax evasions in Jordan focusing on the perspective of audit quality among Jordanian auditors as one of the possible solution. Thus, the purpose of this study is to examine the attributes affecting audit quality for Jordanian auditors. This study is based on four variables that are used to understand and analyze the level of audit quality for Jordanian auditors. The four variables that are measured in current study are: audit tenure, audit firm size, the level of compliance toward ethical rules and the reliance on internal audit work. 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, audit firm size, the level of compliance toward ethical rules and audit quality. On the other hand, the reliance on internal audit work indicates a negative and insignificant effect with audit quality. In addition, this study conducted further analysis by control the respondents based on Big 4 audit firms and non-big 4 audit firms. Based on the results, the reliance on internal audit work indicate a positive and significant results for auditor from Big 4 audit firm but negative and significant results for auditors from non-big 4 audit firm. Furthermore, based on the demographic profile majority of the respondent is from non-big 4 audit firm which could provide a unique result. The findings suggest that the non-big 4 audit firm must improve the communication between the internal and external auditors to enhance audit quality in Jordan.

Key words: audit tenure, audit firm size, the level of compliance toward ethical rules, reliance on internal audit work, Jordan.

CHAPTER 1 : INTRODUCTION

1.1 Background of the Study

Jordan is a small country with limited natural resources (water and energy) and suffers from a lack of agricultural land (Alasfour, 2017). As in most non-oil counties, taxes are considered the main source of government revenue in Jordan. Since the adoption of the first IMF economic adjustment program in 1989, the Jordanian government has made significant efforts aimed at reforming the efficiency of the tax system. However, like of other third world countries, Jordan is facing trouble of tax evasion (Hindriks and Myles, 2008). Tax evasion ultimately leads to the loss of revenue to the Treasury that could have been collected to contribute to the reduction of the country's fiscal deficit, adding that it adversely affects the investment environment in Jordan. Thus there is abundant of previous studies that made several key recommendations to curb tax evasion (Bae, 2017). Among others, the drafting of tax laws, raising tax awareness, tightening control, combating corruption and governance.

Despite the large number of studies related to the phenomenon of tax evasion in Jordan, limited studies focus on the perspective of auditor's role. According to Bae (2017), Auditors play a major role in accounting operations, so that income tax can be influence by auditors' thinking. On the other hand, it is probable that the managers plot some tax schemes so quietly that even the external auditors may not notice (Bae, 2017).

The anti-tax evasion provisions in the Income Tax Law apply not only to the taxpayer himself, but also to anyone who willfully aids or assists a taxpayer in evading a tax. The aiding and assisting language requires two elements for conviction: an act of aiding and willfulness. Thus, the law attaches liability to any person who knowingly participates in tax evasion such as auditors, accountants, lawyers, and tax preparers.

Considering the role of auditing in the financial market, information asymmetry and the agency problem should be mitigated by effective monitoring. Pittman and Fortin (2004) argue that the monitoring role of auditing mitigates information asymmetry and enhances the credibility of financial statements. Also, Lennox (2005) suggests that the auditor's monitoring function plays an important role in the agency framework. Furthermore, the auditors are susceptible to increased audit risk because they are concerned about audit failure which increases litigation risk or reputational depreciation (Bae, 2017). The Price water house Coopers audit guidance proposes that auditors should conduct analytical reviews on a firm's effective tax rate to evaluate the extent of materiality and inherent risk in controls tests and substantive tests (PwC Audit Guidance 5700 Income Tax). Thus, one of the most important ways to solve the tax evasion problem is to improve audit quality.

Clearly, 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.

The report highlighted about the importance role of the auditor in providing fair audit report that show the financial situation and the actual income of the client, which contributes in increasing treasury revenues and also reducing tax evasion. Since income taxes may quantity to half of a public company's net income, an auditor must examine the validity of accrued taxes and the related note disclosures so that it will offer adequate assurance to the investing public approximately the appropriateness of these items and disclosures (Kanagaretnam, Lee, Lim, & Lobo, 2017). Consequently, any information approximately questionable tax transactions have a tendency to be hidden in those accounts and disclosures, auditors additionally have to examine if their clients have interaction in potentially abusive tax transactions which could be challenged if this practice was exposed through the tax authority. Moreover, auditors could require clients to disclose effectively the tax-related items on the financial statements (Kanagaretnam et al., 2017). In particular, the weakness of auditing in Jordan provides opportunities to taxpayers to evade taxes through concealment of taxable income and non-examination of tax-related items on the financial statements (Alimat, 2013).

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. It was of the impersonating of these persons as auditors and issued audit reports on the financial statement of

some companies without having the license as an auditor. According to the Article 21 (2014) of the Jordanian Profession Law, any person may not practice auditing unless they have a license. Hence, all above issues indicated that there is poor on audit quality in Jordan. This study sought to improve the quality of auditing in Jordan through by academic available literature on the need to examine audit attributes affecting audit quality in Jordan.

Previous studies have examined many audit attributes that effect on audit quality such as audit reputation (Al-khaddash, Nawas, & Ramadan, 2013), industry specialization (Taylor, 2015), audit tenure (Adeniyi & Mieseigha, 2013), audit fees (Yuniarti, 2011), audit firm size (Skinner & Srinivasan, 2012), auditor independence (Widenius, 2016), the skills and experience of auditor (Suyono, 2012), non- audit services (Ilaboya & Okoye, 2015), ethical rules (Qtaish, Baker, & Othman, 2014). Thus, this study continued to the literature by examined the effect of audit tenure, audit firm size, the level of compliance toward ethical rules and auditor reliance on internal audit work on audit quality. This because there are inconsistent results between audit tenure, audit firm size and audit quality also because it is widely observed that most firms retain the same audit firm for long periods in Jordan (Al-Thuneibat et al., 2011). Moreover, there is a dearth in the literature that discuss potential the effect of the level of compliance toward ethical rules and the reliance on internal audit work on the audit quality.

To summarize, considering the significance of audit quality that improve the confidence of capital market participants as well as plays an important role in the

effective allocation of economic resources. Hence, audit firms must provide the users of financial statement with credible information to enhance their decision making.

1.2 Background of Audit in Jordan

In Jordan, the absence of an effective auditing professional bodies since 1987 has push the government bore the full responsibility for regulating auditing practice (Al-Farah at al, 2015). However, through the growing number of auditing firms in Jordan.

The absence of pressure from the Jordanian accounting bodies for self-regulation opened the way for the government to usurp the regulatory role (Al-Farah et al., 2015). Thus, the government commenced regulating the auditing market through legislation. Between 1961 and 2003, the government issued three laws to regulate the local auditing profession. In 1961, the first auditing law was issued with the intention of introducing a licensing mechanism for entry to the auditing profession. This was amended in 1985, introducing a written examination as a prerequisite to receiving an auditing license. The 1985 law gave the permission for auditors to establish an Auditors Association. In 2003 a further law aimed at lifting the quality of Jordanian auditors to compete with those worldwide was issued with new requirements for licensing (Al-Farah et al., 2015).

The JACPA was founded in 1988 by JACPA By-Law No. 42 (1987), issued in accordance with Article 18 of the Auditing Profession Law No. 32 (1985). The Association was linked to the BAP and chaired by the president of the Audit Bureau.

As such, the JACPA aimed to raise the educational and technical standards of the accountancy and audit profession in Jordan. To attain these goals, the JACPA faced the need to: develop the technical level of the Association's members, monitor the professional code of ethics, encourage and support scientific research in different fields of the auditing profession, determine and prescribe the generally accepted auditing standards, and raise the awareness of the rules and principles of accounting. To this end the JACPA has worked diligently toward the development of the auditing profession in Jordan. The most significant achievement for the JACPA was the recommendation for adoption of IFRS, which took effect from January 1990.

Currently the JACPA can establish a disciplinary committee to impose one or more of the following sanctions upon members for malpractice: admonishment, warning, suspending the auditor's license for a period not exceeding two years, and termination of the auditor's license. Accordingly, the JACPA possesses the authority to inspect the audit firm's working papers through a specialized inspection committee. Moreover, the Association can now draft its own rules and regulations and has the right to maintain a special record for all auditors.

For the first time, the JACPA now has the power, the means, and the authority to play a vital role in the development of the auditing profession. This new authority should encourage the Association to start exercising its power in the best manner. Enhancement of the quality of the profession should be built on a strong professional base, requiring Jordanian auditors to engage their Association to exert pressure towards the technical advancement of the profession.

1.3 Problem Statement

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 (JACPA) in 2014 indicated that there are weak of audit quality in Jordan, evidently is the increasing tax evasion of many Jordanian companies.

Moreover, the JACPA (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 JACPA 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. It was of the impersonating of these persons as auditors and issued audit reports on the financial statement of some companies without having the license as an auditor. According to the Article 21 (2014) of the Jordanian Profession Law, any person may not practice auditing unless they have a license.

The ethical rules are necessary for the existence and continuity of organizations. Therefore, conducting professional ethics and conduct, enabling professionals to fully perform their profession in honesty, integrity, confident, and objectively are important (Qtaish et al., 2014).

Generally, following ethical rules are essential in determining the success of the audit process. The deterioration of these ethics leads to fraud, deception, loss of public trust, mistrust and preference for personal interests over others' interests. So, auditors must commit to hold ethics and professional conduct in order to obtain a high quality audit report (Svanberg & Öhman, 2013). However, based on the issues reported by JACPA (2014), there is need to empirically analyses whether the level of compliance toward ethical rules effect on the audit quality of Jordanian auditors?

Despite compliance toward ethical rules, previous studies have been done to investigate the influence of audit tenure towards audit quality. Ilaboya & Okoye, (2015), Al-Thuneibat at al., (2011) and Al-khaddash et al., (2013) a name to have investigated 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 & Vanstraelen, 2007). Farther, long auditor-client relationships have the potential to create closeness between the auditor and the client, enough to deter the auditor's independence and reduce the audit quality (González-Díaz at al., 2015). 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. This adversely influences the auditor's independence and capability to offer real and fair audit report (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 et al., 2011). Thus, does the audit tenure effect on the audit quality of Jordanian auditors?

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 et al., 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?

Despite many audit attributes has been identified influence audit quality, however less attention has been paid to the relationship between external and internal audit (Cohen, 2008). Since the external auditors' reliance on the internal audit work during audit process, so the internal audit work impacts the external audit efficiency and effectiveness (Dezoort at al., 2001). As suggested by Cohen (2008) the role of internal auditor work in influencing external auditor evaluation and reliance on the internal audit work is a useful area for future research. This is because the objectivity of the important of the internal audit is not only to the organization, but also to the external auditor. However, does the reliance on internal audit work effect on the audit quality of Jordanian auditors?

Overall, the high quality of audit will help Jordanian government to avoid tax evasion, thus raising the level of treasury revenues. Similar to most non-oil countries, taxes are considered the main source of governmental revenues in Jordan (Alasfour, 2017). Consequently, the momentum of this study stemmed from the arguably nature of the audit process and the value of the audit report. In addition, the Jordanian situation is very under-researched on the topic of audit quality, and accordingly this study could doubtlessly make a significant contribution to specific, auditing practice in Jordan.

1.4 Research Questions

Based on the problems discussed above, the central question for this study would be what is the auditor attributes that effects on the audit quality in Jordan. Specifically,

- 1- Does the level of compliance toward ethical rules effect on the audit quality of Jordanian auditors?
- 2- Does the audit tenure effect on the audit quality of Jordanian auditors?
- 3- Does the audit firm size effect on the audit quality of Jordanian auditors?
- 4- Does the reliance on internal audit work effect on the audit quality of Jordanian auditors?

1.5 Objectives of the Study

The purpose of the current study is to examine the effects of audit tenure, audit firm size, the level of compliance toward ethical rules, reliance on internal audit work and audit quality in Jordan. Particularly, this study is going to achieve the next objectives:

- 1- To examine the effect of level of compliance toward ethical rules on the audit quality of Jordanian auditors.
- 2- To investigate the effect of audit tenure on the audit quality of Jordanian auditors.

3- To explore the effect of audit firm size on the audit quality of Jordanian auditors.

4- To seek the effect of reliance on internal audit work on the audit quality of Jordanian auditors.

1.6 Significance of the Study

The main motivation of this research is to investigate the audit attributes that influence the audit quality in Jordan. This study is aimed at analyzing the challenges of the audit quality in Jordan. This study extended the literature by examining the internal audit effectiveness in relation to external audit quality. By using primary data collection, previous studies focused on audit quality in perspective of public listed firm while this study used primary data collection to measure the audit quality from the perspective of external auditors in Jordan.

In terms of audit attributes, previous study has focused on attributes that influence audit quality such as: audit fees (Yuniarti, 2011), audit tenure (Adeniyi & Mieseigha, 2013), audit firm size (Al-khaddash et al., 2013), auditor reputation (Widenius, 2016), auditor independence (Adeniyi & Mieseigha, 2013) and non-audit services (Ilaboya & Okoye, 2015), without highlighting the effect of the reliance on internal audit work on the external audit quality. Hence, this study extended the literature by examining the determinant of external audit quality in Jordan by introducing the reliance on internal audit work.

Internal auditors usually perform a wide variety of auditing and inspection procedures to assess whether the different functions within the organization are