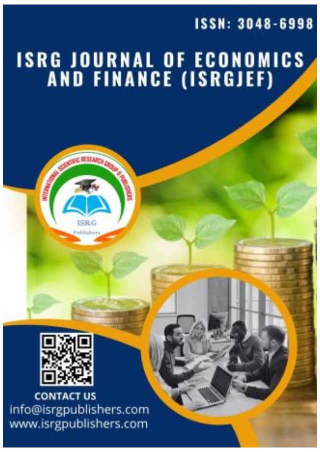
ISRG JOURNAL OF ECONOMICS AND FINANCE (ISRGJEF)



ISRG PUBLISHERS
Abbreviated Key Title: ISRG J Econ Fin.
ISSN: 3048-6998 (Online)
Journal homepage: https://isrgpublishers.com/isrgjef-2/
Volume – 2 Issue -2 (March – April) 2025
Frequency: Bimonthly

IMPACT OF COMPETITIVENESS IN THE AUDIT BUSINESS ON AUDIT QUALITY.

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| **Received:** 05.01.2025 | **Accepted:** 24.03.2025 | **Published:** 17.04.2025

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Abstract

This study assesses how audit quality is affected by competition in the audit industry. The study observed that competition pushes audit firms to use cutting-edge technology, gain industry-specific knowledge, and ensure maximum satisfaction of their clients, all of which can improve the quality of audits. It is also observed that fierce competition frequently results in cost-cutting strategies, fee undercutting, and an excessive dependence on non-audit services, all of which might jeopardize auditor independence and audit rigor. The study emphasizes how crucial ethical behavior, openness, and regulatory supervision are to reducing the adverse effects of competition. The study emphasizes the necessity of a well-rounded strategy that protects audit quality while fostering healthy competition. The study's findings state that stakeholders such as clients, audit firms, and regulators must work together to make sure that competition promotes excellence rather than compromises the integrity of the audit profession. A standard audit quality will boost public confidence in financial markets and bolster the global economy.

Key Words: Audit Business; Audit Quality; Independence; Audit Fees; Audit Tenure Rotation

INTRODUCTION

The need to draw in and keep clients, control expenses, and provide top-notch services fuels the fierce competition in the auditing industry. The foundation of the profession's legitimacy and worth, audit quality, may be significantly impacted by this competition. The auditor reviews the financial statement, regulatory framework, and internal control mechanisms; the reports are reviewed to check if the financial statements contain material misstatements or information that is misleading to the shareholders, serving as a guide to the investors and creditors in decision-making. The essence of the audit business is to ensure that companies adhere strictly to the accounting standard; the financial statement needs to be prepared in accordance with the stipulated standards. The audits are necessitated for the assessment of the efficacy of internal controls by an auditor. These safeguards are in place to ensure that the company's financial statements are correct and that assets are not stolen. The auditor is expected to disclose any lacuna in the internal controls.

The idea of high-quality audits is perhaps the most significant in auditing practice, legislation, and study. However, although being essential to understanding auditing, defining it has proven difficult, and opinions on the notion and how to quantify audit quality are divided (Francis, 2023). Nwanyanwu (2017) asserted that audit quality methods guarantee that the audited reports communicate relevant and reliable information to shareholders of an organization and the general public. These procedures differ from one audit firm to another, based on the size, nature of the work, and applicable laws. The financial scandals have shaken the global economy, eroding public trust in companies, financial institutions, and regulatory systems. These scandals were traced to fraud, corruption, and unethical practices, leading to massive financial losses, legal consequences, and reputational damage. Notably are some of the most notorious financial scandals that have left a lasting impact on the world, such as Enron, WorldCom, Lehman Brothers, Fannie Mae, Satyam, and Volkswagen, etc. The auditors were indulgent in compromising in discharging their duties.

The essence of audit quality has grown as a result of these circumstances. Audit quality can be referred to as the way an audit is performed in accordance with applicable auditing standards and regulations (Ding & Jia, 2012). To DeAngelo (1981), as in Yakubu and Williams (2020), it is posited that audit quality is largely determined by auditor independence in the likelihood of discovering and reporting any accounting system flaws. The importance of auditor independence towards financial credibility: market regulators are more concerned about the excellent audit quality that meets international standards and can be relied upon by users of financial statements (Tepalagul & Lin, 2015; Dattin, 2017; Velte & Loy, 2018). However, Saleh and Azary (2008) posited the quality of an audit is centered on how an auditor detects and reports on misstatements and the reduction of information asymmetry between the management and shareholders.

The audit practice in Nigeria is governed by various legislations like the Financial Reporting Council of Nigeria Act Cap. A15 Laws of the Federation (LFN), 2011 (FRCN Act). There are other regulatory oversight bodies such as the Securities and Exchange Commission, Central Bank of Nigeria, Corporate Affairs Commission, Nigeria Exchange Group and National Insurance Commission. The recent development recommended by the regulatory authorities in safeguarding the auditors to perform high-quality audits aims to strengthen governance practices, attract foreign investment, and enhance the sustainability of the Nigerian businesses (FRC, 2024).

LITERATURE REVIEW

The information reported in the financial statement shows the financial position and performance; users of this information vary, such as stakeholders (investors), suppliers, and shareholders for decision-making. The report must be relevant, timely, and reliable in meeting the needs of the users and restoring the confidence of shareholders, potential investors vying for the company’s share, and the suppliers who are considering sealing business with the firm. The essence of an audit in the financial statement is for the auditor to give an independent opinion based on the evidence gathered, whether the report is free of material misstatement, and if the report truly reflects the company's financial performance within the stipulated timeframe and detailed according to the relevant GAAP.

Auditors play a critical role in the growth of the capital market as investors rely on the audit report, which expresses the auditors' true and fair opinion of the financial statements. This function entails more than just analyzing financial statements; it also entails assisting market regulators and the audit committee in their oversight of management (Velte & Loy, 2018). The auditors are appointed by the shareholders to report to them directly and are required to communicate control deficiencies to management and those charged with governance. These communications add value to the company and enhance the overall quality of business processes.

Auditor Independence

Auditor independence is a critical component in ensuring that business entities' financial reporting is accurate. Auditors have a responsibility to check for any inaccuracy or fraud in a company's financial statements that could be materially deceptive (Ilesanmi, 2020).

The work of Fearnley, Beattie, and Brandt (2005) noted that auditor independence is critical to public confidence, especially in the aftermath of corporate failures. This paves the way for regulatory frameworks to protect capital markets, shareholders, and other stakeholders that rely on audit reports for economic decisions. The study of Naslmosavi, Sofian, and Saat (2013) posited that auditor opinions boost stakeholders' trustworthiness in financial statements. These add to the confidence and efficiency of stock market operations. The independence of auditors has long been recognized as a key strategy for reducing information asymmetry. This is because it assures that the auditor gives objective, trustworthy, and genuine perspectives on the financial reports generated by managers.

According to Ndubuisi & Ezechukwu (2017), auditor independence demonstrates an impartial, reasonable approach to financial statement presentation. Other academics argue that the auditors' distinct feature is their independence (Albeksh, 2017). Scholars evidence on this topic is far more concerned about challenges to the audit report's reliability (Dart, 2007). These factors include auditor tenure, non-audit services, client importance, and the relationship between auditors and their clients. Furthermore, the auditor's independence, both in reality and on the surface, merits independence.

Auditor Tenure

The scandal that occurred involving Enron and WorldCom in 2000 gave birth to the SOX Act of 2002, which barred auditors from revealing specifics of NAS, and also the 2008 financial crisis created a way for regulators clamoring for the mandatory audit firm/partner rotation. Audit tenure is the length of time an audit firm is engaged in auditing a client’s financial statements. Audit tenure relates to audit rotation as firms are now required to change audit firms/partners from time to time.

Adeyemi and Okpala (2011), in their work, emphasized that an audit firm’s tenure can lead to the loss of an auditor’s independence. An audit firm that services its client in a long-term audit association may lead to a loss of the auditors’ concentration and that of its client, which makes a true and fair independent behavior of the auditor unlikely. Deis and Giroux (1992) revealed that the longer the external auditors audit their clients, it invariably leads to a closed connection between the external auditor and clients and consequently decreases audit quality.

The work of Myers et al. (2003) revealed that financial reporting quality does not deteriorate with auditor tenure elongation, the study of Garcia-Blandon and Argiles-Bosch (2016) using samples from Spanish companies supported the views. Mansi, Maxwell, and Miller (2004) are also in support of mandatory audit rotation which they stressed that the result would impact on the capital market. Scholars like Carey and Simnett (2006), Chi and Huang (2005), Liu and Wang (2008) both ascertained that long audit partner tenure could possibly reduce audit quality when issuing GCOs. PwC portray that regulatory bodies are certain that most of the auditing firms have a close bond with their audit client's top management they are by reducing independence, transparency, prime goals and skepticism leading to a decline in the audit quality and value relevance in the financial market. Although, reducing the audit tenure increases the concentration among the big audit firms and the mandatory rotation gives birth to the Nigeria auditing firms the capability to expand and credibility and independence in the quality of audit. Thus, companies are faced with the glaring issue as whether to retain their auditors and build a solid relationship with them or whether to rotate them constantly.

Auditor Rotation

In Nigeria, the Central Bank of Nigeria directed all deposit money banks (DMBs) to replace their external auditors that have been engaged for more than 10 years spent with constituent legacy banks. The CBN directive is in accordance with paragraph 8.2.3 of the CBN Code of Corporate Governance for Banks, which states that "the tenure of the auditors in a given bank shall be for a maximum period of ten years, after which the audit firm shall not be reappointed in the bank until after another ten years." For the avoidance of dispute, the maximum term of 10 years includes the time when an audit company that later merged/changed names began auditing the bank for the first time.

According to Raiborn, Schorg, and Massoud (2006), they found that the auditor rotation could suffer setbacks when the new auditor lacks knowledge of the company's accounting information system, their operationalized format in the financials, and also lacks financial reporting practices, which will drastically reduce audit quality. Bryan and Reynolds (2016) opined that mandatory auditor rotation would only improve the audit quality of small audit firms that are not sector experts. The required auditor rotation has been a source of contention for a long time. The proponents believed that audit partner rotation was the best, while the opponents hesitated for audit firm rotation. Some argue that auditor rotation will improve audit quality and independence, while others argue that firms pay higher costs to hire new auditors, and that the new auditors' lack of familiarity with the client's accounting system leads to audit failure. The audit partner rotation involves the rotation of the audit partner in carrying out an external audit for the client.

This must be done every five (5) years, according to the FRCN Code, to ensure independence and the continuation of the external audit process—Article 15.4 FRCN Code. Supporters of this idea argue that a personal relationship between the partner (rather than the audit firm) and the company would have evolved, which could have influenced the company's independence. The rotation of audit firms would enhance great performance because partners in the same firm can influence each other's performance because they both represent the same organization. In the case of Andersen and Enron Corporation, the audit partner rotation would not have worked because Enron was a vital client for Andersen's Houston office, so changing partners would have had minimal impact.

Auditor Size

Most of the firms tend to engage the services of the high-quality auditor in other to achieve standard audits. As a result, they are more interested in large audit firms with a better reputation than small audit firms. A misstatement in the financial report can result in a decline in the company, so most firms opt for the services of a recognized audit firm to increase the quality of financial reporting. In the appointment of an auditor, certain criteria are considered; the professional competence and expertise are expected to be considered. There have been mixed results on the audit size and audit quality. The work of Bills, Cunningham, and Myers (2015) posited that small audit firms composed of professionals provide higher audit quality, similar to large firms. Choi et al. (2010) found that audit size and auditor expertise had a significant influence on audit quality.

Non-audit service

The non-audit services have an impact on the audit quality, as the audit service can affect the audit quality (Jeong, Jung, & Lee, 2005). To be more precise, auditing cost fluctuations can result from the changes in both audit fees and non-audit services (Ding & Jia, 2012). It has been argued by Houghton & Jubb (1999) that the non-audit services fee is less price-sensitive compared to the audit fee and can play an important role in enhancing the audit firm partners' wealth.

Professionals and regulators have questioned the impact of the NAS rule on auditor independence and audit quality. In nations such as the United States and the United Kingdom, there are regulations limiting the provision of NAS by audit firms. The SOX Act of 2002 prohibits auditors from delivering management advisory services, internal audits, and other services as defined by the act.

CONCLUSION AND IMPLICATION OF THE STUDY

Competitiveness in the audit business is a double-edged sword. While it drives innovation, efficiency, and specialization, it can also lead to cost-cutting, conflicts of interest, and a decline in audit quality. To maintain the integrity of the profession, audit firms, regulators, and stakeholders must work together to ensure that competition fosters excellence rather than compromise. By prioritizing quality over short-term gains, the audit profession can continue to uphold its role as a guardian of financial integrity and trust in the global economy.

The independence of auditors is critical for providing an independent assessment on the financial statements' truth and fairness. This will help to reduce company failures by providing suitable safeguards that deter and expose practices. The protection of investors is the topmost priority for regulators and other stakeholders; issues of auditor independence will continue to receive special attention. After accounting scandals involving major firms such as Enron, WorldCom, Cendant, Adelphia, Parmalat, and Satyam, etc., had drawn scholars into the limelight on the independence of auditors. The audit independence plays a vital role in the audit quality, which scholars, regulatory bodies, and stakeholders are concerned about regarding the reliability of the financial statement quality.

DOI: 10.5281/zenodo.15233819

There are certain factors that could influence the audit quality, such as audit size, etc., which are considered important factors that can affect the other factors of overall audit quality. Similarly, it has been determined that professional member firms charge higher audit fees than non-member firms, which results in high-risk clients paying high audit fees. The study emphasizes the importance of regulatory policymakers and various accounting professional bodies establishing laws based on existing research findings from scholars, professionals, and stakeholders in the field of accounting.

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