

The Influence of Client Importance, Auditor Professionalism on Audit Quality

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Abstract

With the gradual improvement of relevant laws and regulations, it makes the relationship between client importance and audit quality widely concerned. This paper uses five years of data from 2016 to 2020 in the A-share market as a sample to test and analyze the impact of different clients' importance to accounting firms on audit quality and the moderating role of auditor's professional competence in both using an empirical approach. After the empirical test, it is found that the importance of the client plays a suppressive role on audit quality, and the stronger professional competence of the auditor can positively lead to the negative effect of both to some extent.

Keywords

Client Materiality; Audit Quality; Economic Dependence; Auditor Professionalism.

1. Introduction

With the gradual improvement of the audit market order, the importance of auditing has been widely noticed. Accounting firms issue legal and compliant audit reports for the current year's financial statements, which play a role in assisting the audited entity and relevant investors to make better decisions with valid information. It is worthwhile to think deeply about how to ensure that audit quality is efficient and how important the client is among the factors affecting audit quality. The main business income of accounting firms is almost all from audit fees, it is clear that the firm is financially dependent on the client, especially specific clients, and there is a certain possibility that the accounting firm in order to stabilize the client relationship and the ethics of issuing low-quality audit reports.

Therefore, this paper takes A-share listed companies on the main board of SSE and SZSE from 2016-2020 as the research sample to investigate in depth what kind of influence relationship exists between the importance of the audited client to the accounting firm on the audit quality, and to study the moderating effect of the professional competence of the audited auditor on the relationship between the two in appeal.

2. Literature Review

Currently, the academic community is divided on the impact of client materiality on audit quality, with the main inquiry in the literature that suggests a negative correlation between the two falling into the following two main sections.

A part of scholars explored from the perspective of accounting firms. Chen Yan (2021) finds that audit rotation has a positive effect on audit quality improvement under certain client quality, especially significant in the year in which the rotation is performed. However, this state is limited to the same change of accounting firm and its affiliated auditor, otherwise audit rotation does not improve audit quality. Yuan Rongli et al. (2014) studied the relationship with audit quality at the individual level of CPAs and found a non-linear positive U-shaped relationship between the tenure of signing CPAs and audit quality. Meanwhile, the scholar

argues that tenure within 3 years of industry expertise helps to improve audit quality, and professional competence occupies an important position in the relationship between tenure and audit quality.

Another part of scholars explores from the perspective of clients themselves. Yu et al. (2008) studied the sample from 2003 to 2006 based on A-share market data, and he argued that the importance of clients showed a very significant positive correlation with audit quality, and showed that the audit environment in China has been gradually and effectively improved with the development of society and the improvement of the system, and the firm's attitude towards important clients has become more rigorous. Li Minghui et al. (2013) argued that when the governance level of the company is low, the firm is likely to be influenced by the important clients and reduce the audit quality. He argues that to a certain extent, the link between corporate governance and external audit is more of an outcome relationship. Chen Bo (2013) investigates the relationship between the two on audit quality based on economic dependence and reputational benefits, and the scholar argues that due to the economic dependence of accounting firms on audited clients, especially for specific clients in the top 25% of importance, auditors are more likely to condone irregularities and illegal surplus manipulation by clients, but the scope of this finding exists only among non-Big 4 accounting firms. Yu Yachen (2020) concluded that client importance has a significant negative effect on internal control audit quality, i.e., the more important the client, the lower the internal control audit quality. It is further found that the financial risk of listed companies has an inverse moderating effect on the relationship between the two.

In summary, there are still many views in the academic community on the impact of client importance on audit quality. Therefore, in this paper, we refer to the existing literature to explore the impact of client importance on audit quality based on economic dependence theory, and further analyze whether the auditor's professionalism plays a moderating role between the two, in order to enrich the research on the factors influencing audit quality.

3. Theoretical Analysis and Research Hypothesis

First, based on the economic dependence hypothesis, on the one hand, it is known that the audited client and the accounting firm do not exist in isolation, and the audited fee and the business income of the accounting firm are interlinked and mutually constrained. On the other hand, the market competition has intensified, and in the environment where there are more porridge and less money, firms may be forced to issue unfair and low-quality audit reports due to economic pressure. It also suggests that, to a certain extent, the financial dependence of accounting firms on their clients tends to undermine audit independence. Based on this, this paper proposes the first hypothesis.

H1: The importance of the client affects the quality of the audit; the higher the importance, the lower the quality of the audit.

Second, based on the theory of reputation effect can be seen. In order to avoid the dilemma of audit failure, high compensation and reputation damage when facing clients with high financial risk, auditors will treat the audited clients rigorously in the process of audit, strictly control the audit quality and reduce the risk of material misstatement for the sake of maintaining their own reputation. However, due to the uneven development of the auditing industry, the professional competence of auditors varies widely among them. Referring to the existing literature, it is clear that the audit quality of auditors from international Big 4 firms is significantly higher than that of non-Big 4 auditors when dealing with clients of comparable importance. Therefore, this paper proposes a second hypothesis.

H2: International Big Four auditors are able to reduce the negative impact of client materiality on audit quality.

4. Study Design

4.1. Sample Selection and Data Sources

The data in this paper are obtained from the CSMAR database and selected from the SSE and SZSE main board A-share companies for a total of five years from 2016 to 2020, with the following filters: (1) exclude ST and delisted companies. (2) Excluding companies with missing and incomplete data. (3) Excluding financial and insurance companies. After the above screening, a total of 10,300 samples were finally obtained. At the same time, in order to prevent the influence of outliers on the analysis results, stata 16.0 was used to shrink the data after the tailing process. And the final data were statistically analyzed by using SPSS 26 and stata16.0.

4.2. Metrics of the Main Variables

4.2.1. Measure of Audit Quality

Audit quality (AQ) as an explanatory variable exists in various measures in the existing references. Based on the existing theories, if the financial reports provided by the audited entity are of high quality, then the quality of the audit report issued by the accounting firm is also positively related to it. It also reflects whether the accounting firm has sufficient professionalism to identify problems in the financial statements and the ability to communicate with clients to adjust them. Therefore, the size and professionalism of the accounting firm is used to measure the quality of audit with reference to the existing literature.

4.2.2. Measure of Customer Importance

There are three main measures of client importance (IMP) as an explanatory variable that exist in existing references, using client-specific audit fees/accounting firm revenue; client-specific log of assets/accounting firm client log of assets, etc. In this paper, we use the ratio of audit fees incurred by the audited client to the log of assets of all clients of the firm for the year to assess the importance of the client with reference to existing methods.

4.2.3. Measure of the Auditor's Professional Degree

Referring to existing studies, whether the auditor is attributed to the international Big Four is often used as a measure.

4.2.4. Control Variables

Financial risk (Lever) as a control variable uses the ratio of the audited client's total liabilities to total assets to measure financial risk. If the relevant ratio is higher, it indicates the higher financial risk of the audited entity. Meanwhile, referring to the existing literature on factors affecting audit quality, this paper selects: audit opinion type (AS), i.e., whether the audit opinion is standard unqualified; audited firm size (Size), i.e., the logarithm of the audited client's assets at the end of the year, and profitability (ROA), nature of ownership (SOE) and equity concentration (Share) as control variables. See Table 1 for specific definitions.

Table 1. Definition of main variables

Variable classification	Variable Name	Variable Symbols	Variable Description
Explained variables	Audit Quality	AQ	When the accounting firm is a "Big Four" firm, it indicates a high-quality audit and takes the value of 2; when the "Big Eight" firm, it indicates a medium quality audit and takes the value of 1; otherwise, it is a low quality audit and takes the value of 0.

Explanatory variables	Customer Importance	IMP	Log of assets of specific clients / log of assets of all clients of the firm, the larger the ratio, the more important the audit client
Control variables	Auditors' professional degree	Big4	When the auditor is from the "Big Four", the value is 1, otherwise, the value is 0.
	Financial Risk	Lever	The ratio of total liabilities to total assets; the greater the gearing ratio, the higher the financial risk faced by the listed company
	Type of audit opinion	AS	When the audit opinion is standard unqualified opinion, the value is 1; otherwise, the value is 0.
	Size of audited clients	Size	Logarithm of total assets at the end of the year
	Profitability	ROA	Net profit/total assets
	Nature of ownership	SOE	When the ultimate controller of the company is state-owned, the value is 1; otherwise, the value is 0
	Shareholding Concentration	Share	Shareholding of the company's largest shareholder

4.3. Research Model

Referring to the empirical test model of client importance and audit quality proposed by Li, Ming-Hui (2013), the following research model is constructed and used to test the impact of client importance on audit quality.

Model I.

$$AQ_{it} = \beta_0 + \beta_1 IMP + \beta_2 Lever + \beta_3 AS + \beta_4 Size + \beta_5 ROA + \beta_6 SOE + \beta_7 Share + \varepsilon$$

On the basis of model 1, in order to better investigate the moderating effect of auditor's professionalism on the relationship between client importance and audit quality, the IMP*Big4 cross product term is introduced and model 2 is developed to test its rationality.

Model II.

$$AQ_{it} = \beta_0 + \beta_1 IMP + \beta_2 Big4 + \beta_3 IMP*Big4 + \beta_4 Lever + \beta_5 AS + \beta_6 Size + \beta_7 ROA + \beta_8 SOE + \beta_9 Share + \varepsilon$$

5. Analysis of Empirical Results

5.1. Descriptive Statistics

Based on the descriptive statistical analysis of the main variables in Table 2, it is clear that audit quality (AQ) has a relatively high mean value of 0.7617476, a median value of 1, and a standard deviation of 0.5658269. The minimum value of client importance is 1.468747 and the maximum value is 4.80954, which indicates that the economic dependence of accounting firms on their clients varies widely and provides better data support for the study of this paper. The mean value of financial risk is 0.4532078, the standard deviation is 0.3538318, the minimum value is 0.008359, and the maximum value is 28.5477, which indicates that the financial risk faced by the audited clients varies widely and is conducive to testing hypothesis 2 proposed in this paper.

Table 2. Descriptive statistical analysis of the main variables

variable	N	mean	p50	sd	min	max
AQ	10300	0.7617476	1	0.5658269	0	2
IMP	10300	2.618114	2.599233	0.3836081	1.468747	4.80954
Big4	10300	0.0693204	0	0.2540105	0	1
Lever	10300	0.4532078	0.441698	0.3538318	0.008359	28.5477
AS	10300	0.9638835	1	0.1865891	0	1
Size	10300	22.58964	22.45311	1.341545	16.64923	28.41591
ROA	10300	0.0293528	0.0332598	0.3312321	-29.60879	7.446082
Share	10300	34.37078	32.26	14.85676	2.87	90
SOE	10300	0.1401942	0	0.3472052	0	1

5.2. Correlation Analysis

According to the correlation statistics chart presented in Table 3, it is clear that the correlation between audit quality and the importance of the audited client is -0.163, which is a negative but not significant relationship. This also confirms the hypothesis proposed in this paper that the higher the importance of the client, the less effective the audit quality can be guaranteed. It also indicates that the financial dependence of accounting firms on their clients does not utilize to guarantee independence. Also, based on the table it can be seen that the correlation coefficient between each coefficient is large, but the maximum VIF value obtained in the multiple regression is below 3, so it can be considered that there is no more significant problem of multicollinearity between the relevant variables.

Table 3. Statistical analysis of correlation

	AQ	IMP	Big4	Lever	AS	Size	ROA	Share	SOE
AQ	1								
IMP	-.163**	1							
Big4	.597**	-.184**	1						
Lever	0.018	-.188**	.048**	1					
AS	.056**	0.007	.034**	-.144**	1				
Size	.224**	-.594**	.314**	.227**	.103**	1			
ROA	.028**	.030**	0.014	-.763**	.122**	.051**	1		
Share	.157**	-0.004	.148**	0.015	.092**	.193**	.044**	1	
SOE	.025*	-.054**	0.012	.063**	.054**	.148**	-0.006	.101**	1

5.3. Multiple Regression Results

The analysis using multiple regression leads to Table 4, the regression results of Model 1. From the table below, it can be seen that when audit quality (AQ) is the dependent variable, the importance of the client (IMP) is less than 0.05, which indicates that there is a significant negative relationship between the importance of the client and audit quality. It also confirms hypothesis 1 that the higher the importance of the client, the lower the audit quality, and the financial dependence of the accounting firm on the audited client does significantly affect the audit independence, thus making the audit quality not guaranteed.

Table 4. Client materiality and audit quality

	Significance
IMP	0.000
Lever	0.001
AS	0.627
Size	0.000
ROA	0.001
Share	0.000
SOE	0.002

According to the results of the regression analysis of Model 2, i.e., Table 5, the significance of IMP*Big4 is less than 0.05 and the coefficient of IMP*Big4 is 0.52, which indicates that the auditors of the "Big Four" have a moderating role in the importance of clients and audit quality, and can play a positive role in the negative impact of client importance on audit quality. The coefficient of IMP*Big4 is 0.52. It also indicates that the auditor's professionalism and competence are important for audit quality to a certain extent.

Table 5. Client importance, auditor professionalism and audit quality

	B	Significance
IMP	0.644	0.000
IMP*Big4	0.520	0.000
Lever	-0.019	0.323
AS	-0.004	0.863
Size	0.140	0.000
ROA	-0.035	0.088
Share	0.001	0.047
SOE	-0.012	0.316

5.4. Robustness Test

To further test the proposed hypothesis, this paper confirms the expected results by changing the way in which the client importance indicator is defined. The logarithm of the client's assets previously identified is changed to the logarithm of the client's main business revenue compared to the logarithm of the revenue of all clients of the accounting firm to redefine the importance of the client and multiple regression analysis is performed on the two models proposed. The final results show that there is still a more significant negative relationship between audit quality and client importance even if the measure of client importance definition is changed. At the same time, the auditor's degree of expertise positively moderates the negative relationship between client importance and audit quality, and the results still hold.

6. Research Conclusions and Policy Recommendations

Based on the research results with the help of existing literature, this paper uses a multiple regression analysis model to study the relationship between the importance of the audited client and the audit quality, that is, whether the degree of economic dependence of the accounting firm on the client affects the audit results, using the A-share listed companies on the main board of SSE and SZSE for a total of five years from 2016 to 2020 as the research sample. fairness of audit results. After empirical testing and analysis of the data, it is clear that there is a negative relationship between the level of audit quality and the client getting importance, the more the accounting firm relies on the audited client and the stronger the client importance,

then the lower the audit quality. In practice, it is said that accounting firms are very likely to reduce audit quality and issue non-fair audit reports in order to keep their clients and maintain stable client relationships. At the same time, empirical evidence shows that the auditor's degree of expertise moderates the relationship between client importance and audit quality, which indicates that the auditor and the accounting firm are resistant to the problem of economic dependence affecting audit independence.

To sum up, in order to better ensure the quality of audit, it is imperative to strengthen the improvement of market order. From the perspective of the firms themselves, they should develop a sense of the big picture, pursue long-term sustainability, strictly comply with laws and regulations, and regulate their operations. From the perspective of accounting firms, in order to reduce the economic dependence on specific clients, firms can actively expand their business scope and develop more clients. At the same time, auditors should also be careful to follow professional norms, take the initiative to improve their professional skills, cherish their reputation and ensure that audit independence is not interfered by external factors. From the government's point of view, the relevant regulatory authorities should take the initiative to understand the market situation and use it as a basis to improve the existing standards and laws and regulations, etc.

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