

The Relationship Between Auditor Independence and Audit Quality

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Abstract: *This study examines the crucial connection between audit quality and auditor independence, highlighting the vital role that independence plays in guaranteeing impartial and trustworthy financial reporting. A key component of audit credibility is auditor independence, both in appearance and in reality, and any compromise to this independence can have a big impact on stakeholders' trust. The purpose of the study is to assess the effects of non-audit services, audit firm rotation, and auditor tenure on the quality of audit results. This paper examines empirical research, regulatory frameworks, and theoretical viewpoints and concludes that more independence typically results in higher-quality audits. suggestions for strengthening auditor independence as a way to protect financial reporting integrity. However, other contextual factors like the size of the audit company and the regulatory environment also have an impact on the relationship. The study's policy proposals to strengthen auditor independence as a way to protect financial reporting accuracy are presented at the conclusion.*

Keywords: Auditor Independence, Audit Quality, Audit Credibility, Audit Tenure

I. INTRODUCTION

The independence of auditors is generally accepted as a core value of the auditing profession and a vital component in guaranteeing the accuracy of financial accounts. The assurance that the auditor's conclusions are impartial, objective, and unaffected by undue influence serves to support public trust in the audit process. An audit's quality, which is determined by how well it finds and discloses material misstatements, is directly impacted by the auditor's level of independence during the engagement. Numerous financial scandals and business failures in - last few decades have raised questions about the integrity of audit procedures and highlighted possible risks to auditor independence. These occurrences have spurred regulatory reforms and research interest in how independence—both real and perceived affects audit quality.

This article examines how audit tenure, auditor-client relationships, regulatory monitoring, and fee dependency affect auditor independence and quality. This study analyses literature, empirical facts, and theoretical frameworks to improve audit effectiveness and financial reporting system trust. Client importance involves the degree of auditors being economically dependent on the client. When providing service to the client, an audit firm receives remuneration from the client, resulting in auditors being financially bonded to the client (DeAngelo, 1981a). If the client constitutes a relatively large part of an auditor's portfolio, an auditor has an incentive to retain the client to warrant a future source of revenues and profits and therefore, to compromise independence and act in favor of the client (Blay, 2005). Non-audit services can also adversely affect auditor independence. When the external auditors provide non-audit service to the client, they receive more income, which may result in greater economic dependence, as discussed earlier. Furthermore, the joint provision of audit and non-audit service by the same auditor may cause conflict of interest since he may become less skeptical in reviewing his own work.



II. LITERATURE REVIEW

Nopmanee Tepalagul,(2014) This article presents a comprehensive review of academic research pertaining to auditor independence and audit quality. This literature review is conducted based on published articles during the period 1976-2013 in nine leading journals related to auditing. We organize our review around four main threats to auditor independence, namely, (a) client importance, (b) non-audit services, (c) auditor tenure, and (d) client affiliation with audit firms. For each of the threats, we discuss findings related to the incentives, perceptions, and behaviors of the auditor and the client, as well as the effects of each threat on the actual and perceived quality of audits and financial reports. We conclude that the mixed evidence, together with recent regulatory changes, provides opportunities for future research on auditor independence and audit quality.

Zayol & Kukeng (2017) reviewed the effect of auditor independence on audit quality. The study adopted the ex post facto research design relying on secondary information obtained from

Journals, text books and other internet materials. Based on the review, they concluded that there is a strong relationship between auditor independence and audit quality. They also revealed that there are four threats to auditor independence, which they listed as client importance, non-audit services (NAS), audit tenure, and client's affiliation with CPA firms.

Erwin Kurniawan (2023) This qualitative study explores how auditor independence affects audit quality from the perspectives of auditors, corporate executives, and investors. It identifies factors like auditor tenure, fee dependency, provision of non-audit services, and regulatory frameworks as influential elements. The study emphasizes the importance of ethical guidelines and regulatory reforms in enhancing audit quality.

Christoph Wehrhahn,(2024) This structured literature review analyses 71 empirical studies from 2005 to 2022, exploring the relationships between audit committees, external auditors, and internal control systems (ICS). It highlights a dynamic network where competent audit committees can reduce external auditors' efforts, with ICS quality acting as a mediator. The study emphasizes the need for an integrative coalition of competent and incentivized monitoring bodies to ensure effective ICS and corporate governance. It suggests incorporating sustainability, fraud, and digital expertise into the roles of audit committees and auditors, urging legislators to develop stricter competency requirements for all parties involved.

Malika El Fakir (2023) This systematic review analyses 49 studies on auditor independence and audit quality. It concludes that most studies confirm a positive effect of auditor independence on audit quality and highlights the predominance of quantitative approaches in the literature. The review also notes that countries like Indonesia and Nigeria have given significant attention to these issues.

2.1 Auditor Independence And Audit Quality:

An essential part of the ecosystem of financial reporting is the independence and integrity of auditors. The reliability of audited financial statements depends on the auditor's capacity to carry out their responsibilities without undue influence in a time of growing corporate scandals and regulatory scrutiny. The conceptual foundation of auditor independence, its connection to audit quality, and the ways in which institutional and regulatory frameworks protect these values are all examined in this article.

The impartiality and objectivity of auditors throughout the audit process are referred to as auditor independence. Both independence in appearance and independence in truth are included in the definition of independence provided by the International Federation of Accountants (IFAC) (IFAC Code of Ethics, 2022). While independence in appearance refers to stakeholders' opinions of the auditor's impartiality, independence in reality represents the auditor's mental state of objectivity.

The Relationship Between Auditor Independence and Audit Quality

It is generally accepted that high audit quality requires auditor independence. When auditors retain an objective perspective, they are more likely to offer opinions that reflect the genuine financial status of a business, even in the face of client pressure. The relationship between auditor tenure and audit quality has been the subject of conflicting empirical research. Longer tenure may increase familiarity and enhance comprehension of client processes, but it may



also decrease independence. To combat this problem, several jurisdictions have implemented regulatory measures such required audit firm rotation.

Real-World Cases

Actual Situations Enron (Arthur Andersen) and Wirecard (EY) are two notable audit failures that demonstrate the negative effects of compromised independence. Conflicts of interest and inadequate control procedures were factors in both cases' misreporting and audit failures, which resulted in significant investor losses and regulatory changes.

• Research Objectives

- To investigate how auditor independence affects the calibre of audit results, with a focus on the ways in which audit effectiveness and objectivity are influenced by non- audit services, fee dependency, and audit tenure.
- To assess how audit firm procedures and regulatory frameworks support or undermine auditor independence and to identify actions that can enhance independence in order to raise the credibility of financial reporting.

III. DISCUSSION, FINDING AND SUGGESTIONS

For financial reporting to be dependable and impartial, the relationship between auditor independence and audit quality is essential. Research has repeatedly demonstrated that increased auditor independence—both in practice and appearance—improves audit quality by empowering auditors to offer dispassionate, impartial evaluations of financial statements. Long- audit tenure, reliance on a single client for income, and the provision of non-audit services are some examples of variables that might compromise independence and, in turn, the audit's quality. Empirical research findings show that, although mandatory audit rotation and limitations on non- audit services are meant to improve independence, they may cause continuity issues or a loss of specialised industry knowledge, which could have an immediate impact on audit quality. Therefore, strengthening the independence of audit committees, increasing transparency in audit fee reporting, enforcing stricter non-audit service regulations, and implementing more efficient auditor rotation policies are some recommendations to improve the relationship between auditor independence and audit quality. By taking these precautions, the independence of auditors would be protected, which would ultimately improve the dependability and legitimacy of financial audits.

3.1 CONCLUSION

An essential component of audit quality is auditor independence, which has a direct impact on the process's dependability, impartiality, and assurance. By looking at variables like audit tenure, auditor-client connections, fee dependency, and regulatory monitoring, this study has investigated the complex relationship between auditor independence and audit quality. Threats to auditor independence, especially financial dependency on clients and established auditor-client bonds, can seriously impair the effectiveness of audits, according to the results of current research and philosophical frameworks. The necessity of preserving both perceived and actual independence is highlighted by the frequent occurrence of audit failures and business scandals. It is clear that conflicts of interest and real-world difficulties can however impair audit quality even while rules are in place to protect independence. As a result, encouraging auditor independence is not just a legal need but also a moral and professional one.

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