Why is it Interesting to Study the Duration of the Relationship (Review of the Auditor and the Subject) Auditor: Audited Entity?

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Received: 14 September 2023 / Accepted: 27 October 2023 / Published: 23 November 2023

Doi: 10.56345/ijrdv10n304

Abstract

The integrity and impartiality of the reports issued by the external auditors makes the main attention to focus on their role, because they are the persons responsible for discovering the presence of errors or frauds in the financial reports of the audited entity. We are talking about the external auditors, who are the independent professionals who must give their opinion through a report on the truthfulness, sincerity and honesty of the picture presented by the audited entity's financial statements. In relation to the role they have in the fight against corruption, the scientific research method used in this study is through questionnaires as a tool for collecting data and closely touching the awareness of the main actors on their integrity. These interviews were conducted with a sampling that represents the auditors. A total of 9 questions were conducted in order to strengthen and validate the results for our research question. The results of this study suggest that auditors' awareness of the role and importance of their integrity is key to the audit process, but there are some risks that may harm the quality of the audit and the auditor's independence, or the risk of developing complacency. The quality of the audit is positively related to the integrity of the financial reports of the audited entities and negatively related to the risk of "falling prey" of the auditors themselves. The increase in the quality of information reduces the asymmetry affecting the detection and avoidance of errors and consequently affects the increase in the quality of the audit, (F. Hakim, Omri & I. Hakim, 2010, p. 152). Audit quality is related to the ability of auditors to identify material anomalies in financial statements as well as their willingness to issue an unbiased and appropriate audit report (Turley & Willekens, 2008, p. 3).

Keywords: *audit quality, integrity, role of the auditor, independence of the auditor, risk of complacency*

1. Introduction

The problematic and economic events that have occurred in recent years have made the role and quality of auditing the center of attention for many debates.

The question that often arises is whether auditors should be rotated regularly or should they be allowed to build a long-term relationship with the client?

The relationship between auditor rotation or not and audit quality is controversial. Previous studies "An Empirical Study of Canadian Companies to Determine Clients' Preferred Relationship Approach with Their Financial Auditor" (Fontaine and Pilote 2011), Canadian Institute of Chartered Accountants (CICA). 2006. Handbook—Insurance. Toronto, Canada: CICA, Watson, K. 2009. Five Good Practices in Managing Client Relationships. International Monetary Fund Background etc. have shown mixed effects of this relationship, both positive and negative effects. In other words, there are two groups regarding this matter, one part is those who believe that there is a positive relationship between the auditors going for a long time in the same entity and the quality of the audit, and the other group supports the opposite idea, that staying for a long time negatively affects the quality of the audit. The first explanation consistent with the pro-grouping is that the short-term relationship between the auditor and the entity will weaken audit quality because auditors no longer struggle to gain new knowledge about this client (Meyer, Rigsby, and Boone, 2007, p. 66; Shockley, 1981, p. 785). According to the defenders of the first thesis, it is emphasized that in the long-term auditor-entity relationship, the quality of the audit increases due to the fact that the entity's operations and reporting issues become very familiar to the auditors (Carcello & Nagy, 2004, pg 55. Mansi, Maxwell & Miller, 2004, p. 755). On the other hand, we have the second group, who argue that long mandates reduce the independence of the auditor and his objectivity, and as a result will lead to a decrease in audit quality.

Another view of this group is that when we have a long-term relationship, mutual sympathy naturally arises between these parties, which will lead to a decrease in audit quality, because auditors become more risk-averse in order to 'close' an eye' for inappropriate managerial actions (Fairchild, 2008, p. 23) <u>what is known as the term familiarization with the subject.</u>

In summary, for the above we say that we have two positions regarding the duration: 1. An extended period, that is, the revisiting of the same auditors in the same subjects increases the quality of the audit, more information, more experience, more dialogue with the unit due to an established credibility (HILLS, 2000) less time for knowing the subject, risk assessment

2. An extended deadline reduces the quality of the audit, as the principle of independence and objectivity is violated and familiarity with it arises or is emphasized (Castarella, 2002).

1.1 Hypotheses

- The duration of the relationship (revisiting the auditor more than one time in the same entity) auditor – audited entity can improve the quality of the audit.
- Contextual factors can mitigate the duration risk

1.2 The purpose of the research

Why is it of interest to study the auditor-audited entity relationship within the duration of this report?

1.3 Research question

How does the long-term auditor-audited entity relationship affect audit quality, seen from the auditor's point if view?

1.4 The purpose of the research

The purpose of this research is to determine whether performing a long-term audit engagement may cause unethical behavior by the auditor, which may result in lower audit quality.

2. Methodology

The study method is based on primary research (qualitative and quantitative research) and secondary research (literature review).

Primary research – which is based on field data and information. The source of this information is the close observation of the functioning of the audit process as well as the questionnaire completed by the external public auditors.

Secondary research (secondary research) – which was used to study the theoretical concepts of external auditing. Many research articles have been used for this.

Ethical elements related to confidentiality have been respected, this is because the names of the interviewed persons are not mentioned in the annex. Information obtained from the literature is qualitative information. Qualitative information refers to theoretical information, explanations in words and habits. At the end of each concept, explanation or discussion taken from the literature, individual comments have been added. Based on research aspects and issues related to the relationship between the auditor and the client, as well as similar studies developed on this topic. an interview was conducted through a questionnaire that was given to a population consisting of several public auditors (of the first, second, senior and chief auditor categories). The questionnaire was distributed to 30 auditors and only 30 of them responded.

2.1 Profiles of interviewees

Person 1-15 work as first auditors at KLSH.

Persons 16-35 work as second auditors at KLSH.

Persons 36-44 work as senior auditors at KLSH.

45-50 people work as chief auditors at KLSH.

KLSH is the supreme, independent, external control institution in the Republic of Albania. Background Auditing is a systematic process of obtaining and evaluating evidence related to assertions or declarations related to economic actions and events, with the aim of determining the level of correspondence between these declarations and established criteria, and communicating them to interested parties. External auditors inspect the financial statements prepared by economic entities and give an independent opinion on whether these statements give a true and fair view of the state of the entity for the year under review. It is essential that the work done by the external auditors is not influenced by any 3 possible conflict of interest or other motives in such a way as to give the shareholders a reliable opinion.

3. Background

Auditing is a systematic process of obtaining and evaluating evidence related to assertions or declarations related to actions and economic events, with the aim of determining the level of correspondence between these declarations and established criteria, and communicating them to interested parties. External auditors audit the financial statements that are prepared by economic entities and provide an independent opinion on whether these statements give a true and fair view of the state of the entity for the year under review. It is essential that the work done by the external auditors is not influenced by any possible conflict of interest or other motives in such a way that a reliable opinion is given to the interested parties and not only

What do External Auditors do?

- Act in accordance with auditing standards
- Perform the procedures designed to obtain sufficient evidence to determine whether the financial statements:

a. individually or grouped do not contain material anomalies
b. have been prepared in accordance with the relevant legislation and Accounting Standards

- Prepare a report that contains a clear expression of their opinion on the financial statements.

Auditors report their opinion formally in an audit report. Their rights and responsibilities as in the public sector are defined by their charter, which defines most of the rights and responsibilities for external auditors, but it does not define in detail:

- The way auditors perform the audit
- The level of professional skepticism and
- The auditor's judgment on the evidence and facts found.

Role of External Auditors

While internal auditors weigh the economic actions of the entity, external auditors provide their services without matching or mixing with the people and factors that determine the strengths and weaknesses of the economic entity. Today, in most developed economic countries, external auditing is not a profession, but has become a high position of a function. Strong and perfect morals together with complete character constitute the primary qualities for all external auditors, for their distinction and importance can be equated with that of a judge.

Other necessary qualities for external auditors are:

- High level of specialized knowledge which must be updated with the dynamic developments of economic science and continuous training and research;
- Experience from their long-term "dealing" with various audit problems;
- Developed ability to criticize and understand without mediation and without wasting time;

- Willingness to plan and understand new methods and procedures, in order to be able to easily build more complicated financial statements;
- Integrity and justice in his work, do not fall prey to contrary data which accept many interpretations;
- Giving the opportunity to express oneself both in written material and orally;
- Willingness to cooperate with audited clients;
- Work, patience and continuous study.

3.1 Contextual factors can mitigate duration risk

The purpose of this study is to determine whether a long-term auditor-audited entity relationship can cause increased sympathy and the permissibility of unethical behavior by the auditor, leading to the performance of illegal and unethical actions by the entity and ultimately last in lower audit quality; or it has a positive effect by increasing the auditors' knowledge, skills and abilities to detect irregularities and fraud (the auditor remains ethical in his behavior) leading to the minimization of fraud and higher audit quality. According to Carcello and Nagy (2004, p. 57) it is specified that, in general, there is no evidence that proves that, if we have a long-term relationship, then the quality of the audit is devalued. It is even said that in the first years of cooperation between an auditor and an entity, the quality of the audit may be lower. There are certain reasons why audit quality is thought to be lower in the early years. One reason may be that in the first years of cooperation the auditor is new to the unit and does not possess much knowledge about it, operations, control systems, policies followed by the unit, accounting systems. But another reason may be that the new auditor is unaware of the fallacies of industry patterns. Under these conditions, if there is a rotation of auditors, we will encounter the same situation from the beginning every time, which means that the quality of the audit will not be maximum at any moment according to this thesis. Audit rotation is a concept supported by the idea that, according to this thesis, auditors will not be allowed to have incentives, in terms of seeking future economic growth from the audited entity, and thus will reduce the possibility of distorting the reports. in her favor. On the other hand, auditors should be confident about the concept of maintaining cooperation for a certain period of time.

3.2 The long-term auditor-audited entity relationship and its effects on the audit

According to DeAngelo 1981, pp. 188-189, the long-term audit relationship with the audited entity is important both for the audit process itself and for its quality, because the auditor needs time in order to be fully informed about the audited entity, its processes, its risks, etc. This is why an audit is difficult during the first year compared to subsequent years. Thus, referred to DeAngelo, at least three to five years of the necessary basis are needed in order to ensure good audit quality. Which means that, going for the first time in a subject gives weaker results than the second or several times. But, DeAngelo was also of the opinion that a long-term all-inclusive relationship can be dangerous, because of building a very close relationship between the audited entity and the auditor, which can affect the auditor's independence. For the same question, the answer of Carrello & Nagy, 2004 pp. 58-59 is that for the private sector the long-term relationship seems much more beneficial and can be compared to public companies, if other related factors such as objectivity and integrity are controlled.

4. Auditors' Opinion on the Effects on the Quality of Audits of the Long-Term Audit Client Relationship

Below is a qualitative analysis of the auditors' opinions, derived from the answers given in the interview conducted with them, and their theoretical interpretation.

4.1 The long-term auditor-audited entity relationship and its effects on audit quality

5 people are of the opinion that the long-term auditor-audited entity relationship is important for the quality of the audit, because the auditor needs time to get to know the entity, its specific work processes, the risks it faces, etc. This is why the first time of the audit is more difficult compared to the subsequent times. Thus, according to the first person, it is said that at least three to five years are necessary in order to ensure good audit quality. For the same question, 6 interviewees answered in such a way that the long-term relationship seems very beneficial and works very well if other accompanying factors such as objectivity and integrity are controlled. Thus, being auditors, the interviewees emphasize that, if an auditor adheres to professional behavior and integrity in an audit engagement, then nothing is at risk. 5 people are of the opinion

that the long-term relationship can be dangerous, seen in terms of naturally building close relationships between the client and the auditor, which can affect the latter's independence. 7 people have mentioned that the long-term auditor-audited entity relationship is very useful, because in addition to the experience you create in relation to that entity, during the cooperation you also learn many other things about it that in a short-term cooperation or you will overlook for time effect or you will not learn at all. In this way, the auditor can gain knowledge about the unit and understand the opinion of the personnel, which can be used during an audit engagement, especially in terms of risk assessment. It is part of the audit process to know what is happening inside the institution, but it is also worth mentioning that it is a very big plus to know what kind of person we are dealing with, how he behaves outside the work environment, the behavior he has with his close circle , his integrity and develop a special kind of relationship with him which can indirectly help in the audit process. 8 people explain that long-term relationships with the audited entity are indifferent about re-auditing the same entity, but emphasize that all the times they have re-audited have not affected in any way the independence of the audit, this is because such a type is created relationship that creates a warm and cooperative climate for the unit but without exceeding the relationships in which they are located.

In the end, regardless of the means, it is important to achieve the goal, and to keep in mind at every moment the goal for which they are in that relationship. 9 people are against the long-term relationship, their idea is that, if a report is repeated many times, then the positions will automatically be exceeded and approaches will be created, which will negatively affect the auditor's skepticism. For 6 people, according to them, it is true that in the long-term relationship a kind of affection is created between the parties, but it depends on the character of the auditor how much he will be able to manage this kind of 'feeling'. If for him the creation of this affection does not affect the independence of work, everything is fine. For 4 people, the auditor cannot establish a long-term relationship with the client because, after all, the auditing process is a job that must be kept separate from other things. Among the auditor's qualities are professional skepticism and independence, if you create closeness, a risk is created that you can tolerate something, even if it is small, but in these conditions it affects your professionalism. From the analysis made on the responses of the interviewed persons, we cannot determine a firm position regarding the effects of the duration/repetition of the relationship on the quality of the audit. However, we can say that everyone agrees with the fact that the long-term relationship creates a bond between the two parties. It is worth looking at the following to form a complete idea.

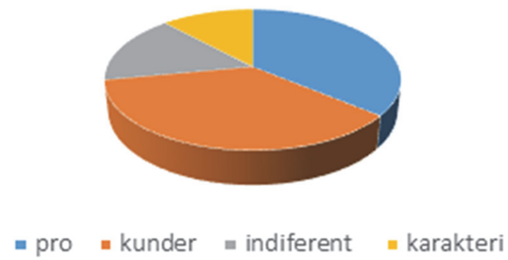

Figure 1: The effects of re-auditing within the same entity on audit quality

4.1.1 Long-term relationship enables better recognition

From the analysis made on the responses of the interviewees regarding this question, we come to the conclusion that, almost everyone agrees with the opinion that the long-term relationship between an auditor and the entity eventually results in an increase in the auditor's knowledge about the entity, which then helps in an efficient and effective audit process.

4.1.2 Complacency of the auditor

The opinions of the interviewees show that the relationship between the auditor and the audited entity developed over a long period of time makes the auditor tend to be more complacent. So there is always the risk of complacency due to long-term relationships. Although auditors are trained in such a way that they can manage such situations, it is worth noting that, this usually happens because at a certain point in time during the relationship the auditor feels closer to the entity and becomes less independent in his commitment to auditing. Due to the inclusion of the complacency factor, it is recommended to have rotation in the audit after some time. Then it depends on the character of the auditor and his experience how much he manages to manage these situations without allowing his professionalism to be compromised.

4.1.3 Auditor-audited entity relationship and bilateral monopoly

In response to the question regarding the existence of bilateral monopoly between the auditor and the audited entity, the interviewees mentioned that the existence of bilateral monopoly may be true for the private sector because both entities tend to have long-term relationships. -long with each other. According to the majority of the interviewees, it is said that it is the auditor who can have more benefits in an audit client relationship, this and due to the fact that the client can change by finding another auditor at any moment of time, especially in our country which does not make much difference in audit fees. It is worth noting that, according to the interview, the risk for bilateral monopoly does not exist for the public sector.

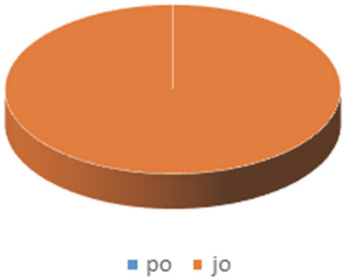

Figure 2: Bilateral monopoly risk

4.1.4 The quality of the audit during the first times of engagement

In response to this question, 80% of the interviewees mentioned that the risks of audit failure are higher during the first years and the quality of the audit will be lower due to the lack of knowledge. Similarly, during other years of the audit engagement, audit quality may also decrease as complacency increases. According to the rest of the interviewees, it cannot be said that during the first years of audit engagement, the quality of the audit will be lower; we can say that the first-time auditor does not yet have sufficient knowledge about the entity because it is the first time he is facing it. But auditors are trained to take on new audit engagements from time to time. Experience lets the auditor know where he should focus on a new audit engagement, and where he can identify risks. Thus, it is not entirely true to say that audit quality is lower during the first years.

Figure 3: Risks of failure

4.2 Conclusions regarding the impact of long-term relationship/audit review of auditors in the same entity on audit quality

Based on the analysis made on the responses of the auditors, we can say that they consider the long-term auditor-client relationship as a positive relationship seen in terms of audit quality, but taking into consideration the time factor. That is, we say that it is a positive relationship within a certain period of time, after which the quality of the audit will no longer increase, but will have a downward trend, due to the risk of complacency and the violation of independence during engagement.

5. Auditor Rotation

5.1 Regulations for the rotation of auditors.

Regarding small companies operating in our country, there is no regulation on the rotation of auditors. Vitor Caldeira, President of the European Court of Auditors (in the Audit Manual KLSH, pg 68) explains that in Sweden there are strong rules regarding mandatory audit rotation, but this only applies to public listed companies and to small companies there is no forced rotation either. According to this regulation, a firm is required to rotate its auditors after a period of 7 years. In our country, there are no such mandatory rotation rules for auditors, perhaps due to the fact that we mainly have small companies that operate. Despite the discussions that have been developed regarding the mandatory rotation of auditors and the establishment of certain time limits for their rotation, so far nothing has been decided and regulated by the regulators for SMEs. In general, every year the auditor self-evaluates if there is any risk to his independence and if there is, then he has the right to ask to be engaged in another entity.

6. Cost-Benefit Analysis of Auditor Rotation

Regarding the cost-benefit issue for the analysis of the rotation of auditors, in the conditions of the public sector we are limited as we are not in a free market where the client can find different auditors based on the offer of the most competitive prices and choose the one auditor that best fits your budget. Cost benefit analysis has no place in this form in the public sector. However, if we were to talk about the benefits of rotation, it is worth saying that it will be 'new eyes' that will be involved in the audit, and they will be able to provide a new and fresh look, different from that of the old auditors.

6.1 Concluding regarding the quality of the audit for the long-term relationship we say that:

1. The analysis shows us that the auditors consider the long-term relationship between the auditor and the audited unit as a necessary relationship for the learning and experience process, but they express reservations about the time interval;
2. There should be a time limit for the cooperation between the parties, after which the quality of the audit cannot increase, but will tend to decrease due to the risk of complacency and the violation of independence from this relationship.
3. The character and personal integrity of the auditor constitute a plus for minimizing the risk that comes from the duration.
4. On the other hand, if we see it related to costs, we say that cost-benefit analysis does not find place in this form in the public sector. However, if we were to talk about the benefits of rotation, it is worth saying that it will be 'new eyes' that will be involved in the audit, and they will be able to provide a new and fresh look, different from that of the old auditors.
5. Contextual factors are also important in the process, in addition to duration.
6. This phenomenon finds more place in the private sector.

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Supplement

Questionnaire Regarding the Long-Term Relationship Auditor Audited Unit.

1. What is the approximate number of units audited by you each year?
2. What are your thoughts regarding the long-term audit relationship audited unit?
3. In general, how many times have you returned to audit the same entity?
4. Are there any special regulations or laws regarding mandatory auditor rotation?
5. What are the cost-benefits of auditor rotation analysis?
6. According to a preliminary research we saw that the long-term relationship is beneficial in such a way
7. for an auditor to create more knowledge about the entity to be audited, what do you think about this point?
8. Also through this research we noticed that the long-term relationship makes the auditor complacent or induces feelings of sympathy for the audited entity, which can reduce the quality of the audit. How do you see this?
9. Can a bilateral monopoly be created between the auditor and the audited entity during this relationship in the long run?