

The impact of audit quality on performance of enterprises listed on Hanoi Stock Exchange

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ABSTRACT

This paper performs an empirical investigation on the effect of audit quality on performance of companies listed in Hanoi Securities Trading Floor, Vietnam. For the purpose of the article, the study conducts a comprehensive analysis of data based on 228 companies listed on Hanoi Securities Trading Floor using software SPSS 22 and Smart PLS 3.0. The results indicate that audit quality positively impacted the financial performance of the companies listed on Hanoi Securities Trading Floor. The results also indicate that audit quality also positively impacted to customer loyalty and employee satisfaction. The study also provides some recommendations for the improvement of the audit quality in Vietnam.

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1. Introduction

The impact of audit quality on financial performance of companies has received significant attention from researchers. Previously, it has been shown by researchers that audit quality impacted financial performance of companies (Heil, 2012; Miettinen, 2011). Bouaziz (2012) investigated the relationship between audit committee and financial performance and reported that audit committee significantly impacted financial performance of the companies as long as the financial performance variables were measured by return of assets and return on equities. Other researchers, had more opportunities to access in auditor training processes and to carry out various tests. They reported that the bigger audit firms tend to provide audit services with higher quality (e.g. Mohammad, 2015). This is supported by Farouk and Hassan (2014) who found the size of audit firms and independence of auditors significantly impacted the financial performance of the firms. Zureigat (2010) investigated the impact of financial structure on audit quality in companies listed in Jordan. Using data of 198 companies as a sample, his logistics regression analysis stated that there was a significantly positive relationship between audit quality and financial structure. Miettinen (2011) investigated the relationship between audit quality and financial performance.

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Audit quality is measured by audit size and frequency of meetings in audit committee. The results indicated that audit quality directly impacted the performance of the firms and it also played as a mediator affecting financial performance through audit size.

With more than 750 listed companies, up to now, stock market capitalization reached over 3.9 billion Vietnam Dong, equivalent to 71.6% of GDP in 2018; the Unlisted Public Company Market (Upcom) has 804 stock codes, capitalization value reached nearly 894,000 billion Vietnam Dong; listed value of the Government bonds reached over 1.1 million billion Vietnam Dong, equivalent to 20.3% of GDP in 2018 (Ministry of Finance, 2019). Of which, there are 374 companies which listed in Hanoi Stock Exchange (HNX) with market capitalization reached nearly 190 thousand billion Vietnam Dong, decreased by 13% compared to 2017 year-end. The average commercial value reached over 788 billion Vietnam Dong/session, increased by 12% of quantity and 28% of value compared to the same period of the last year. For stable development and good financial performance, companies listed in the Hanoi Stock Exchange should take more various measures including improvement of audit quality to increase quality of audit report for building customer confidence and employee satisfaction as well as improvement of financial performance.

The article is purposed to test the effect of audit quality on financial performance through two mediate variables consisting of customer loyalty and employee satisfaction.

2. Literature review and developing research hypotheses

2.1. Financial performance

Financial performance of companies listed in stock exchange plays an important role, this is a premise to attract capital and minimize capital cost of a company. A company with high financial performance will create prestige with investors. On the other hand, on the stock exchange, investors and managers will depend on audited financial statements of companies to specify business efficiency of listed companies. Therefore, good quality of financial statements in companies listed in the stock exchange will positively impact to financial performance of the companies. Financial performance was a multi-dimensional concept (Santos & Brito, 2012; Salleh et al., 2006). There are various approaches to effectively measure financial performance. In our research, financial performance is approached according to theory of stakeholders and is measured in two aspects of profitability and growth rate. Profitability is always specified by net profit by calculation of accountant (Bédard & Gedron, 2010). Profitability is measured by different rates, such as Return on equity (ROE), Price Earnings Ratio (PER) and Return on assets (ROA). Benefit measurement is necessary for all companies (Hamdan et. al, 2013). Benefit is calculated by balance of income and cost. Income is an amount earned from business activities of a company. Growth rate expresses extension of a company size regarding assets, business capital, market share, etc.

2.2. Audit quality

Independent audit is an examination of accounts and financial records by an independent audit firm. Independent audit is carried out by an independent individual or firm with audited company. All accounts information of a company should be examined every year after a financial year is ended. The role of an auditor is to give opinions of customer's financial statements, also to give letter of management as an advice to management board of the audited company. This will help the management board improve organization and working methods for enhancing business effectiveness of an organization.

Auditor is responsible for reviewing and assessing internal control systems which are maintained by organization, a good internal control system will prevent important incorrect report of financial statements. Professional auditors do not accept major documents in questionnaire and it is more likely that errors are discovered during the auditing. According to Barth et al. (2008), audit is an investigation or finding of evidence to allow that one opinion is formed based on financial faith and justice and other information of one person or people who are independent of the preparer aiming to increase of information reliability. According to Bouaziz (2012), audit is very important to avoid conflict of potential

benefits between managers and stakeholders. Audit report is a communication between auditor and information user. Therefore, the report should be easy to understand, objective and not make misunderstanding to users for the process of making decisions of financial issues. Audit quality is associated with the quality of audit process aimed at preparing audit reports with quality, objectively and helping users make informed decisions based on audit reports.

2.3. Audit quality and financial performance

Some studies have proven that audit quality improved financial performance of a company. Afza and Nasir (2014) mentioned that independent audit quality improved operational performance of a company in the view of investors. They realized that some companies which are audited by big audit firms will release reliably, appropriately and authentically financial statements, aiming at consolidating confidence of investors in such companies. However, Bouaziz (2012) stated that high audit quality can decrease agent cost when an auditor provides reliability and sufficient index for financial statements resulting in decrease of monitor cost and supporting of higher efficiency in business activities of a company. Similarly, Hanim Fadzil et al. (2005) and Farouk and Hassan (2014), reported a positive relationship between audit quality and company performance. Therefore, it is expected that audit quality will positively impact to financial performance.

Hence, we will give research hypotheses as follows:

H₁: Good audit quality positively influences customer loyalty.

H₂: Good audit quality positively influences employee satisfaction.

H₃: Good audit quality positively influences corporate financial performance.

H₄: Customer loyalty positively influences financial performance.

H₅: Employee satisfaction positively influences financial performance.

2.4. The Lending Credibility Theory

The theory specified that main functions of audit is consolidated the reliability of a financial statements. The reliability of users will be increased when using audited financial statements instead of financial statements represented by management board. Therefore, the management board should use audited financial statements to improve confidence of stakeholders in its management activities. Users will be benefited from increasing confidence; such benefits often are considered as quality of investment decisions improved basing on reliable information (Hayes et al. 2005). Audited financial statements strengthened principal agent relationship and unbalanced information. Akinbuli (2010) declared that an audited financial statement can improve confidence of stakeholders in management activities. It means that companies with reliably and consistently financial statements will be easily invested and borrowed by investors and creditors.

2.5. The Policeman Theory

According to the theory, an auditor plays a role of security officer to ensure accuracy and preventability and fraud detection. The theory will help an auditor detect and prevent misrepresentation and fraud in organizations. Management board should establish and maintain strong internal control system to strengthen prevention, detection of fraud and any abnormal case in an organization. An auditor is not responsible for detecting fraud unless a specific agreement is made and signed by the auditor and management board of audited company to do so. However, if audit process is worked in process, auditor will detect fraud occurred by audited company. Key responsibility of an auditor is to verify the truthfulness of a financial statements and provide reasonable assurance. However, fraud detection is also a hot topic in a discussion about auditor's responsibilities and such discussion will be often organized after fraud events in financial statements are found and pressured to increase responsibilities of auditors in fraud detection (Hayes et al, 2005).

3. Research methodology and research model

3.1. Research sample

Research sample is important in a research (Henseler et al. 2009). The bigger the sample size, the more accuracy of the analyzed data and the better presentation for entire research. However, based on the characteristics of a research, scientists have provided criteria for selection of various sample size. Smart PLS, the second generation software with advantages of data processing for small sample size is used, therefore, our scale of research sample is 228 companies listed in Hanoi Stock Exchange.

3.2. Research model

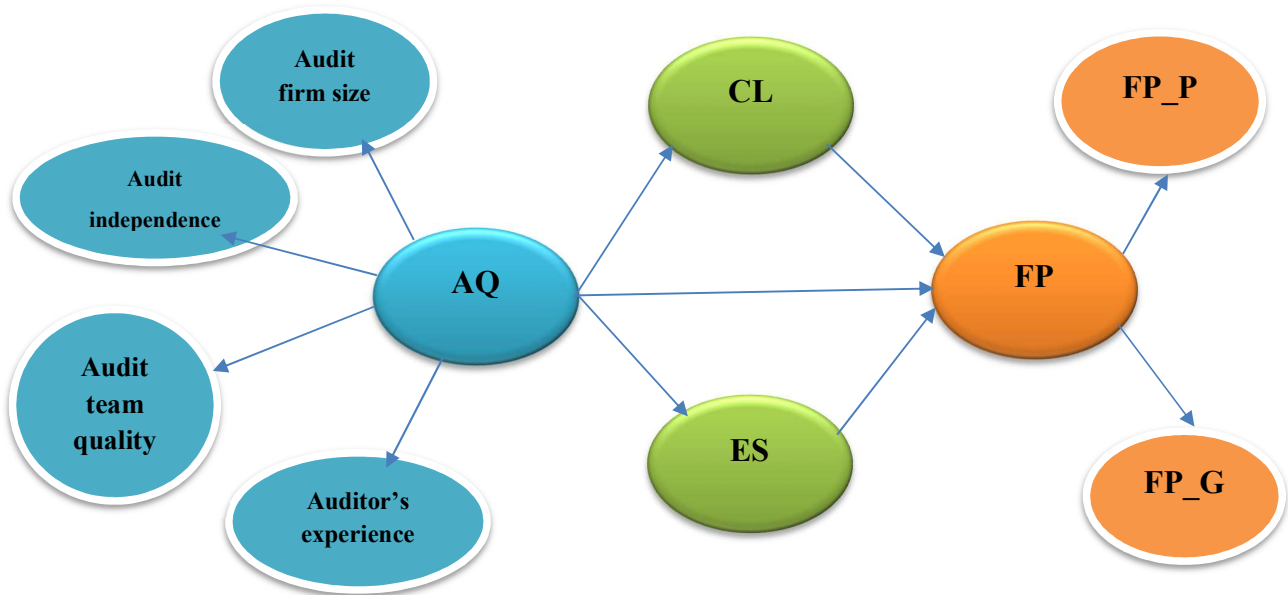


Fig. 1. Research model

In this study, audit quality is measured through 4 aspects including audit firm size, independence of auditor, qualification of auditor group and experiences of auditor. Non-financial performance includes two aspects: Customer orientation is customer loyalty and orientation to employee is employee satisfaction. Financial performance means final latent variable that is measured through 2 aspects including profitability and growth rate.

Latent variable and scale

Audit firm size

Audit firm size can impact the benefit report of a company. Branch network of audit firm can impact benefit report of a company. The number of partners of audit firm impact the benefit of a company.

Independence of auditor

Remuneration of auditor is associated with financial performance of the company. Management of the company can impact decision-making of auditor and management board will keep one auditor when financial activities operating effectively.

Qualification of auditor group

Qualification of audit partners can impact audit quality of the reported financial result. Membership of professional organizations impact the audit quality of reported financial result. The number of qualified auditors impact to quality of reported financial statements.

Audit experience

Length of service of audit firms impact the quality of the reported financial statements. The number of qualified auditors in a group will impact the quality of reported financial statements. Experiences of an auditor working in international environment impact the audit quality of reported financial performance.

Financial performance

This item is measured by two aspects including profitability and growth rate as defined in the research of Santos & Bristo (2012).

Non-financial performance

Non-financial performance includes 2 variables: customer loyalty (CL) and employee satisfaction (ES). Such observed variables are measured by scale of Defond and Jiambalvo (1993) and Sayyar (2015). The observed variables of the scale are measured by 5-point Likert scale.

Loyal customer (customer loyalty)

The measure of customer loyalty is measured by the following questions:

Your company has regular and periodic assessment measures for customer services.

Your company develops products and services based on sufficient information of market and customer.

Your company always considers benefits of customer as top priority.

You believe that your company's existence is for providing customer services.

Employee satisfaction

You are proud to tell anyone that you are working in the company.

You will introduce everyone to your company with good words.

Leaders of your company are qualified and committed to solve problems faced with by the company.

You are trusted to make significant decisions in daily activities.

You are satisfied with salary paid by the company.

3.3. Analysis method

To analyze data, SPSS 22 and Smart PLS 3.0 are used. First, after data is collected, it is classified and imported in excel table, then they are imported to SPSS 22 software to test the reliability of scale and remove scales that do not satisfy some requirement conditions. Finally, we enter reliable data to Smart PLS 3.0 software to test the research hypotheses.

Standard for scale reliability test is based on Cronbach Alpha coefficient and item-total correlation. The scale is satisfied when Cronbach Alpha coefficient is greater than 0.7 and item-total correlation is bigger than 0.3. Next, we assessed convergent value and differentiation value as well as appropriateness of research model and research data.

4. Research result

Result of scale reliability test pointed out that all scales are satisfied conditions including Cronbach Alpha coefficient >0.7 and item-total correlation >0.3 . Therefore, all scales are satisfied to carry out the next analysis.

The result of scale reliability test are in Table 1 as follows:

Table 1
Construct Reliability and Validity

	Cronbach's Alpha	rho A	Composite Reliability	Average Variance Extracted (AVE)
Audit firm size	0.755	0.718	0.773	0.776
Employee satisfy	0.838	0.848	0.839	0.836
FP_G	0.932	0.942	0.930	0.772
FP_P	0.923	0.941	0.926	0.809
Financial performance	0.949	0.950	0.949	0.850
Quality of audit	0.920	0.922	0.920	0.898
audit team quality	0.530	0.795	0.765	0.752
auditor's experience	0.874	0.874	0.757	0.875
auditor's independence	0.829	0.768	0.720	0.821
customer loyalty	0.945	0.947	0.945	0.774

From Table 1 shows that potential variables are satisfied with Cronbach Alpha coefficients > 0.7 and AVE coefficient > 0.5. Thus, these potential variables are satisfied to be included in the next analysis as shown in Table 2 below.

Table 2
Discriminant Validity (Fornell-Larcker Criterion)

	Audit firm size	Employee satisfy	FP_G	FP_P	Financial performance	Quality of audit	audit team quality	auditor's experience	auditor's independence	customer loyalty
Audit firm size	0.881									
Employee satisfy	0.231	0.914								
FP_G	0.201	0.235	0.878							
FP_P	0.182	0.248	0.393	0.899						
Financial performance	0.241	0.280	0.325	0.358	0.921					
Quality of audit	0.114	0.223	0.379	0.386	0.512	0.947				
audit team quality	0.066	0.186	0.271	0.382	0.415	0.452	0.867			
auditor's experience	0.004	0.229	0.233	0.274	0.379	0.471	0.244	0.935		
auditor's independence	0.050	0.152	0.124	0.103	0.356	0.473	0.274	0.023	0.906	
customer loyalty	0.159	0.356	0.272	0.284	0.339	0.236	0.154	0.194	0.127	0.880

The results of Table 1 and Table 2 show that research variables and scale are satisfied to implement for the next analysis. The authors examined the research hypotheses and the results are given in Fig. 2. As we can observe, audit quality significantly impacts the financial performance at high level of 0.367 and 1% significance level (P-value = 0.000). Also, audit quality positively influences non-financial performance at medium level. More specifically, audit quality positively impacts the employee satisfaction at impact level of 0.221 and 1% significance level (P-value = 0,000). Moreover, audit quality positively impacts the employee satisfaction at medium level of 0.197 and 1% significance level (P-value = 0.000). Employee satisfaction positively impacts the financial performance at impact level of 0.094 and 5% significance level (P-value = 0,040). Customer royalty positively impacts the financial performance at the impact level of 0.174 and 1% significance level (P-value = 0,000). Therefore, all hypotheses are supported.

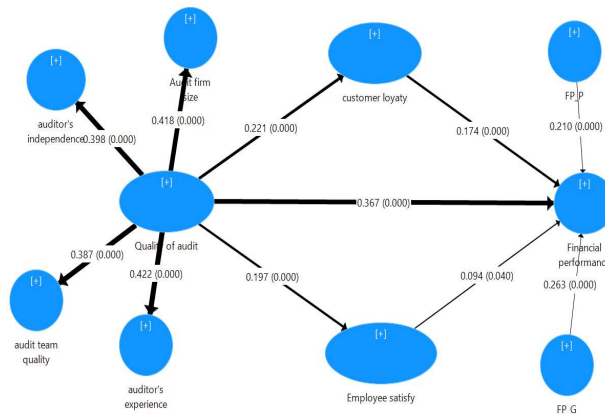


Fig. 2. Result of testing the hypotheses

5. Conclusion

The results have shown that audit quality significantly impacted the financial performance and non-financial performance of the companies listed on Hanoi Securities Trading Floor. Theory of security and theory of loan are supported by the result as well. Also, the research results are consistent with the findings released by Chi and Huang (2005) and Alali (2011). Therefore, authors propose some recommendations for improving audit quality of audit firms as follows:

Improvement of extensive professional experiences of auditor/auditor group: Auditors should acknowledge that, extensive professional experiences are the most key important factor to help them carry out a quality audit and thus, auditors are able to face with less occupational risks or avoid making mistakes or lawsuits, if any, affecting their occupational prestige. Therefore, auditors are required to regularly improve extensive professional experiences to meet requirement of extensive audit. Scope of business in a listed company is different, such as: trading in bank sector, financial consultancy, real estate, construction, while survey results have shown that this is an important external factor influencing the audit quality of an auditor. Therefore, auditing the listed companies is involved with a complicated auditing environment requiring dynamics, qualification, legal knowledge, etc., therefore, auditors should accumulate experiences by themselves of specific sector for understanding scope of business and financial statements of listed companies.

Completion of quality control system of audit firm, of which specially paying attention to set up an effective quality control process as well as giving prominence to role of independent auditor in an audit firm for each audit (the most appreciated two criteria in Management policy). Quality control in internal audit firm improves quality of audit services, assurance services and related services. According to ISA 220, internal control system in an audit firm for each audit should include: (i) To agree, maintain customer relationship and audit contract; (ii) To assign auditor group; (iii) To implement audit; (iv) To monitor; (v) Audit documents, records. Quality control of entire company should comply with VSQC1, accordingly, quality control system of an audit firm should include policies and procedures for the following contents: (i) Responsibilities of Board of Directors for quality in audit firm; (ii) Requirements of occupational ethics; (iii) Maintenance of customer relationship and service contracts; (iv) Human resources; (v) Implementation of contract service; (vi) Monitor; (vii) Control of service contract quality.

We hope the results of this survey are useful for researchers to do similar studies by extending the ideas given in this research.

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