

The affecting factors on the quality of the audit before and after the collapse of the US energy company Enron: A Literature review

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Abstract

The research aims to study the most important factors that effect on the quality of the audit, which were covered by the accounting literature before and after the collapse of the American Energy Company Enron. It is declared that bankruptcy in late 2001 until November 2004, which is one of the complex bankruptcy cases in the history of the United States. Based on analysis of previous studies most of the factors affecting the quality of the audit are the size of the audit firm. The quality of the internal audit, experience with the customer and knowledge in the field of activity and specialization in it. The reputation of the auditor, the audit fee and the risks of auditing the auditors, the impact of increased education, independence, the impact of government and society and the confidence of shareholders in the auditor Factor for quality auditing. These factors can be considered a measure of quality.

Key words: quality auditing, Enron, auditing.

Introduction

In 2002, the United States experienced massive economic troubles, ranging from declining stock markets. The weakening of the dollar, due to the departure of foreign investment and the widening trade deficit, to the scandals of accounting firms that exploded in the form of crashes that toppled the largest American companies, especially the energy giant Enron. Enron's bankruptcy reverberated throughout the United States and even abroad. Fear spread not only in financial circles, but even within the American administration, which was quick to form a committee to assess the impact of the company's bankruptcy on the entire American economy. The collapse of Enron, which was the largest in history, goes beyond the limits of bankruptcy, because it revealed corruption that is eating away at a sector that is considered one of the main pillars of the capitalist economy, namely the accounting system. This corruption fundamentally undermined the credibility of the principle of transparency on which the system is based, which guarantees the investor peace of mind when deciding to buy shares in a company.

Most studies have attributed to the existence of a number of manipulations that were the cause of the company's collapse, including inflating profits and inflating the values of some of its assets, concealing debts and losses and recording them in accounting entries as investments, escaping paying federal taxes. All of this led investors to buy the company's shares after the deception struck them that their financial conditions are solid. The bankruptcy of the company has created difficulties for other companies and institutions in obtaining bank loans, given that banks have become more cautious in dealing with these companies, in light of the decline in confidence in the accounting companies' reports on the financial conditions of American companies. Analysts say these difficulties will translate into an increase in the cost of loans, which means a decline in investment and more bankruptcy.

Arthur Anderson, who was one of the top five voluntarily, had to hand over her license to pursue a legal accounting career in America after she was found guilty of criminal charges related to her audit of Enron, which resulted in the loss of 85,000 jobs. The Arthur Anderson scandal is considered one of the most prominent scandals that shook the world of the auditing profession, and the fall of the Global Auditing Office Arthur Anderson was only due to the execution of data on the status of the collapsed company Enron, where the Supreme Court ruling criminalized the company Arthur Anderson on charges of obstructing the achievement of justice by tearing tons of Electronic documents and information related to the collapse of Enron Energy Company, and a judgment was issued to deprive Arthur Anderson of any accounting or auditing operations, and this work was for the company representing 75% of its business, management consulting represents 25% of its business, and the rest are audits and taxes.

The collapse of Arthur Anderson was a consequence of the collapse of Enron Energy, so the highlight has become greater on the topic of audit quality studies and the factors that improve the work of auditors, in light of the criticism directed at the profession, and that the auditor has not discovered large cases of management fraud, the observer now has a greater responsibility to reveal the fraud of the administration more than it was in a previous period, especially in the period that followed the collapse of a group of companies headed by Enron Energy Company. The most important change is the increased emphasis on the observer's responsibility to assess the factors that indicate an increased risk of fraud, (DeAngelo, 1981) was the first to define the quality of the audit as “the probability that the auditor would discover the material misstatement and errors of the financial statements in the customer's accounting system and report them”. It is clear from the above definition that the function of the auditor is not limited to expressing a neutral technical opinion, but rather exceeds that of disclosing any material misrepresentations in the financial statements in light of the relative importance of the audit, and the quality of the audit was defined as “the process that brings more credibility to profit reports” (Tonh and Wong, 1993).

Literature review

Both regulators and small auditing firms claim that the size of the audit firm does not affect the quality of the audit, and therefore should not be taken into consideration when selecting an auditor. On the contrary, De Angelo (1981) believes that the quality of the audit is not independent of the size of an auditing firm, even if auditors have the same experience and techniques, and in particular, when auditors have a large number of clients, they will lose a lot when they fail to report violations detected. In customer records, this increases the quality assurance of audits by large auditing firms. Several studies have agreed with her that the size of the audit office or company is a measure of the quality of the audit, especially if the office or the audit company is one of the major offices and famous audit firms (Big Six). This measurement was chosen by studying the

ability of the office or company to claim high fees, such studies (Danos and Eichenseher 1986), (Palmrose 1986) and (Francis and Simon 1987). These studies have found that the size of the audit office or company, positively affects the quality of the audit, and that the major audit offices or companies demand high fees in exchange for higher audit quality, and that the transformation of companies into major audit offices or companies affects their stock prices in the stock market.

There are many field studies and researches that have been conducted to determine the basic characteristics of the quality of the audit, linked to many factors affecting it, such as the general reputation of the audit office or company, the size of the office or the audit company, the experience of the auditor with customer activity, and the low rate of lawsuits, (Tonh study) and Wong, 1993), which linked the credibility of the auditor's opinion on the validity and fairness of the financial statements when issuing the clean report on them, by linking the difference between the quality of the audit and the profit response factor (ERC), this study provided evidence for the opinion that auditors They provide greater credibility to the financial statements if they perform the audit well, they indicated that the quality of the audit is the process that brings more credibility to the earnings reports. (Dye) set a model for the relationship between the auditor's exposure to legal liability and the quality of the audit and the audit fee. In his model, he emphasized that the wealth of auditors is a bond to ensure that high-quality auditing is carried out, because it may be subject to prosecution, and thus lose his wealth due to his failure to do his work, This leads to a decrease in the quality of the audit (Dye, 1993). In their study, Brown and Raghunandan (1995) made a comparison between the quality of auditing in the government public sector and the private sector. The study found that the audit in the government sector is less good than it is in the private sector, and the main reason for this is that auditors in the government sector They face less risk than their private sector counterparts. In a study in which (Behn at el, 1997) surveyed (1000) companies to choose (12) properties to judge the quality of the audit, the study concluded that the most important factors in judging the quality of the audit Is the experience with the customer, and knowledge in the field of activity. A study (Behn at el, 1997) that indicated that mandatory auditor change would increase the independence of the auditor and consequently the quality of the audit would increase, since the customer's performance would increase for the first years of the auditor change.

A study (Khurana and Raman, 2004) in which he indicated that the quality of the audit is the technical ability of the auditor (ability technical auditor's) with a set of methods and control and auditing techniques, which provide him with several indicators, that can help him in preparing the technical and neutral preparation, which is a job of the offices And audit firms, and that their discovery and correction by the auditor is indicative of its independence from the customer in question and the quality of its work. (Carey and Simnett, 2006) also presented another evidence indicating that the quality of the audit deteriorates by increasing the auditor's service, because the increase in the auditor's service weakens his independence from the customer. (Weber et al, 2008) emphasizes that there is an inverse relationship between the efforts of the auditor And the quality of the audit. As for (Hassink et al, 2009), they see that society may have expectations about auditors that go beyond the responsibility required for profession regulations and standards. The auditing profession possesses wrong ideas, and one of those ideas is that auditors can provide absolute assurance about the validity of the statements corporate finance, and since then the profession has become in a critical and controversial position after the bankruptcy of the companies during the past ten years. (Prawitt et al, 2009) study which examined the relationship between internal and external auditing, in that the external auditor depends in determining his procedures and means on the extent of weakness Or the strength of the quality of the internal audit, the more quality the

internal audit, the more that reflects on the quality of the external audit. For example, the more internal auditors have the necessary knowledge, skill, and competence required to fulfill their responsibilities, the more they will understand the factors that lead to management bias in the entitlements. Accounting and limiting its ability to exercise profits management. Undoubtedly, this reflects positively on the quality of external audit

With regard to the impact of specialization in the field of activity on the quality of audit, (Tan and Lim, 2010) explained that audit firms specialized in the field of activity invest time, financial resources and technology in developing employees in specific experiences to improve the quality of audit, and so, the auditors who work in audit firms They specialize in the field of activity, in fact they have more opportunities in developing their expertise compared to those who work in non-specialized companies, because customer operations and business risks vary between experience and research, and this difference indicates that the nature of the impact of errors of financial statements and its size in experience are variable according to the field The activity, and that the experience of the professional auditors in the field of activity is a great experience in a particular activity, which allows them to acquire knowledge better regarding the customer's work, operations and risks compared to those who are not specialists. And in terms of the effect of fee dependence on the quality of the audit. Economic theory indicates that when an auditor obtains a high percentage of revenue from a particular customer, he becomes financially dependent on that customer, and this may affect the auditor's objectivity, when performing his work, and psychological research has reached the same result in what relates to the approval of pay (Tan and Lim) With a decrease in the expected losses from his prosecution due to his shortcomings in his work, and a positive relationship between it and the increase in wages, the more these efforts increase, the greater the possibility of discovering material distortions in the financial statements and adherence to auditing standards, which is reflected in the quality of the audit. (Allen and Woodland, 2010) in which they examined the relationship between the increase in educational requirements, the wages and quality of the audit, and in their study they used the 150-hour education requirement in the United States of America for the period (2000-2004), specifically they examined whether The 150-hour education requirement is linked to increased audit fees or not, and they have found that companies based in the United States of America that have applied the 150-hour requirement system earn approximately (4.8%) more than The auditing unfair from companies located in the United States of America that did not apply the requirement of 150 hours, and they concluded that the audit fees increase over time as additional education requirements are applied even after controlling for other factors that affect wages (including the length of time). However, the researchers did not find evidence that the quality of the audit was proportional to the change in response to the application of the 150-hour requirement.

(Tan and Lim, 2010) believes that auditors are supposed to be more independent when they have a large customer base, due to the loss they may experience due to the low quality of the audit, as well as their reputation being compromised through trial and prosecution, which negatively affects their revenue Due to the reluctance of customers to deal with them. A study (2011 ,JonesandGiroux) finds that there are five theoretical constants used to choose the quality of the audit, which are the reputation, the auditor's experience in the field of activity, the audit fees, demographic factors or demographics and the type of local government, and the primary focus is on the reputation and experience of the auditor, and it is expected that there are A close relationship between the quality of the audit and the reputation of the audit firm, and the assumption is that the reputation of the audit firm is associated with the quality of the audit work, and raising the quality of services will improve the reputation of the audit firm. The Jones (2011andGiroux) study finds

that the quality of the audit relates to the auditor's ability to discover and report material omission or misstatements in the financial statements.

As for (Love, 2012), it is considered that the proper implementation of the audit does not provide a guarantee that the audited financial statements do not contain material error or fraud, and according to GAAS, the audit reduces the risks of material error or fraud in the financial statements to the lowest possible level, so therefore The audit program should be designed to show material errors or fraud in the financial statements, and that the auditors must reasonableness the management's estimates and provisions when preparing the financial statements, in order to determine whether these statements are acceptable. A study (Iatridis, 2012) indicated that the quality of accounting disclosure is achieved by good auditors' reports, who reduce the information asymmetry among users of accounting information, and thus this will lead to a decrease in the cost of ownership (such as the cost of financing through preferred shares), and improve the terms of financing and enhance the Quality of audit.

Results:

The quality of auditing is multi-dimensional, and therefore it is difficult to measure. As a result, writings and research in this field include multiple measures of auditing quality. The book's directions when dealing with the factors that affect the quality of the audit are divided into two groups. The first group is called the elements of presentation and the group The second is the elements of demand, and the supply side focuses on the elements that affect the ability of the auditor to provide a high-quality audit. As for the demand side, it focuses on the elements that affect the customer and the users of the auditor's report, such as shareholders, creditors, and others. Field studies and research conducted to determine the basic characteristics For the quality of the audit, it linked it to many factors affecting it, such as the general reputation of the audit office or company, the size of the office or the audit company, the experience of the auditor with customer activity, and the low rate of lawsuits, despite the agreement of a large number of studies on these factors, but they remain Controversy among most studies. Among the most prominent of these factors that affect the quality of the audit are:

1. The size of the audit firm.
2. Quality of internal audit.
3. Experience with the customer and knowledge in the field of activity and specialization in it.
4. Auditor's reputation.
5. Auditing fees and the risks of auditing the auditors.
6. The impact of increased education.
7. Impact of independence.
8. Impact of government and society.
9. Shareholders confidence in the auditor.
10. Lenders and financing institutions rely on the auditor's report.

As for the risks arising from the failure to implement the audit of high quality in:

1. Risks related to audit offices or companies, which arise from the supply side:
Low reputation offices or audit firms.
 - Decrease in revenues that can be obtained by audit offices or companies.
 - Probability of auditing firms or audit firms to be held accountable.
 - The possibility of losing the independence of auditors or auditing firms from the client subject to control and audit.
2. The risks associated with the users of the financial statements represented by the investors, creditors, and other parties, and the failure to implement the audit of high quality leads to a weak

possibility of detecting misleading and fraud, which the administration carries out in the financial records and financial statements, and therefore their dependence on the neutral party report (observer report). Accounts) resulting from low quality controls and audits, will result in incorrect or incorrect decisions being made.

Conclusions:

The auditors' implementation of their work with high quality can limit the management's ability to manipulate and defraud, as the performance of high-quality auditing is a hindrance to these suspicious practices. Thus, the percentage of manipulation of financial statements will be less in the companies in which the auditors perform the audit with a high quality. The quality of the audit can be achieved through the auditor's detection of fraud and errors, reducing the asymmetry of information between the two parties to the agency, and enhancing the credibility of the published statements by the corporate management, to the beneficiaries of them, and the factors related to the quality of the audit that affect them are both the size of the audit company The quality of the internal audit, the experience with the client and knowledge in the field of activity and specialization in it, the reputation of the auditor, the audit fees and the risks of auditing the auditors, the effect of increased education, independence, the impact of government and society and the confidence of shareholders in the auditor is a factor governing the quality of the audit.

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