

Is Audit Quality Implied by Accruals Quality Associated with Audit Fees and Auditor Tenure? Evidence from China

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Abstract : The Enron and Arthur Andersen scandal has raised concerns internationally about auditor independence and audit quality. Furthermore, the debate continues about the relationship between audit fees, auditor tenure and audit quality in spite of extensive empirical evidence examining audit failures and earnings management. Therefore, the purpose of current research is to determine the effect of audit fee and audit tenure both partially and simultaneously on the audit quality. Using a sample of Chinese firms, an environment where we believe it provides us with an opportunity to test whether the development of market and legal institutions affects the impact of audit fees and auditor tenure on audit quality. We employ the standard deviation of residuals from regressions relating current accruals to cash flows as proxy for audit quality. The paper documents statistically significant negative association between audit fees and audit quality. These findings are consistent with economic bonding being a determinant of auditor behavior rather than auditor reputational concerns. Further, the current paper shows a positive association between auditor tenure and audit quality in the earlier years of audit tenure. These results support the proposition that when the Learning Effect dominates the Bonding Effect in the earlier years of tenure, then audit quality is likely to be higher. Taken audit fees and audit tenure together, the results suggest that there is positive association between audit fees and audit quality in the earlier years of auditor tenure. Interestingly, the findings of our study have important implications for auditors, policymakers, multinational firms, and users of financial reports. As the rapid growth of China's economy gains global recognition, the Chinese stock market is capturing the attention of international investors. To a lesser extent, our paper also differs from the prior studies in methodology and findings in the investigation of audit quality.

Keywords : audit quality, accruals quality, audit fees, auditor tenure

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