



## Non-Audit Services and Audit Quality: Moderating Role of Audit Partner Attributes

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### ABSTRACT

This study explores the association between Non-Audit Services (NAS) and Audit Quality (AQ), using a data sample of 66 firms taken from the Non-Financial Sector, which were listed on the Bombay Stock Exchange (BSE) for the years 2012 & 2014. Furthermore, it also examines the moderating influence of Audit Partner Attributes upon this relationship, in the sense of male and female audit partners. The reason for selecting these years is that the company act was published in 2013 so this study comprised the data for the period before and after 2013 to incorporate the change analysis. Variables, such as NAS, have been measured by dividing the NAS fee paid to the auditor by the total audit fee paid to the auditor. For calculating AQ, the proxy that is used in this study is Earnings Management (EM). Whereas, Jones, Modified Jones, and Kothari models have been used to measure earnings management. Finally, Audit Partner attributes have been measured through Gender, i.e., male and female partners. Based on descriptive statistics, the study shows that NAS impacts AQ, but it is insignificant. Companies act 2013 also has not had a significant impact on this relationship. Rules and regulations of the companies act 2013 are increasing the AQ itself, but where NAS is provided, it has a lessened impact on increasing the AQ. Overall, NAS has a negative impact on AQ but at an insignificant level, and moderating impact of audit partner attributes has no significant impact on this relationship.

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### Introduction

Non-Audit Services has now become a popular debate globally as well as in developing countries. NAS are those services provided by an auditor but not associated with an institution's audit or financial statement review. Today, so many NAS are offered by the auditor to its client.

These are certification services, valuation services, cost audit services.

Audit quality is a systematic examination of a quality system that helps to check the audit team's work. In fact, it is a complex, multi-faceted, and in essence, concept. AQ is a much more important point for creditors and shareholders of the company. Higher audit quality depicts that their auditor is independent in auditor opinion. Audit quality is influenced directly and indirectly. It is influenced by context factors which are governance, law, and regulation. It is influenced through inputs which are auditing standards and auditor attributes. It is also influenced by outputs which are the auditor's report and auditor communications.

Audit partner attribute is the partner's characteristics, features, aspects, and elements. These may be different in audit partners. Some audit partners may be richer with their professional knowledge, abilities, and expertise, and some may have a low level of knowledge of their work or fewer professional skills. These attributes also represent the Gender of the audit partner. According to the Companies act 2013, companies are more motivated to engage few types of NAS. Because of rules & regulations of the Companies Act 2013, companies are banned from availing of many types of NAS. However, more engagement in NAS activities can be used to manipulate earnings (called earnings management). To check AQ, EM is used as a proxy that shows that the higher the EM lowers the AQ.

Furthermore, the board is responsible for following NAS policy and mechanism as defined in the 2013 Act regarding companies. It has restricted many types of NAS. However, the effectiveness of the board can be increased in this regard if there are lessen NAS are adopted. Thus, there is a need to examine the NAS and AQ and the moderating role of APA before and after the Companies Act 2013. So, it will be interesting to investigate how NAS affects the AQ in the presence of APA before and after the Companies Act 2013.

### **1.1 Research Questions**

In particular, questions for research are given below:

RQ1: What is the association between NAS and AQ before and after the Companies Act 2013?

RQ2: Does APA moderate the relationship between NAS and AQ before and after the Companies Act 2013?

## **2. Literature Review**

### **2.1 Signaling & Stakeholders Theory**

Signaling theory indicates that inefficient market managers provide information to their shareholders about the market, and shareholders make the decision with the help of this information. According to Sun et al. (2010), these irregular information signals the stakeholders to make their decisions timely. Managers may hide a firm's real worth and conceal important information for their interests and benefits. Furthermore, Fernando and Lawrence (2014) suggested a theoretical structure based on the theoretical result of the stakeholder's theory in their study. This theory explains the relationship between stakeholders and the organization. According to this, stakeholder expectations & requirements must be fulfilled by the organization, and this theory highlights organizational accountability theory regarding financial or economic performance.

### **1.1. Non-Audit Services and Audit Quality**

Numerous studies have found no significant correlation between NAS fees and audit quality when measured by discretionary accruals, re-statements, earnings traditionalism, and the perception of going-concern. Previous research suggests that, in general, NAS fees do not have a negative impact on audit quality. This conclusion is supported by various studies conducted by researchers such as Lim and Tan (2008), Habib (2012), Francis (2006), Schneider, Church, and Ely (2006), DeFond and Francis (2005), and Bloomfield and Shackman (2008).

**H<sub>1</sub>: There is an impact of NAS on AQ**

### **1.2. Moderation of Audit Partner Attributes**

Although there is a lack of extensive research on the subject, some studies have suggested a direct link between NAS and AQ, including research conducted by Frankel et al. (2002), Srinidhi and Gul (2007), Ashbaugh et al. (2003), Chung and Kallapur (2003), DeFond, Raghunandan, and Subramanyam (2002), Geiger and Rama (2003), Callaghan, Parkash, and Singhal (2009), Kinney, Palmrose, and Scholz (2004), Raghunandan, Read, and Whisenant (2003), Simunic (1984), DeFond and Francis (2005), Francis (2006), Schneider, Church, and Ely (2006), Bloomfield and Shackman (2008), Lim and Tan (2008), and Habib (2012). This study, however, examines the potential moderating impact of Audit Partner Attributes on the relationship between NAS and AQ. As such, the study posits the following hypotheses

**H<sub>2</sub>: Audit Partner Attributes moderate the relationship between NAS and AQ**

## **3.0 Methodology**

The population in the current study consists of the firms listed on BSE. A sample was taken of the top 100 Companies of BSE. The data was taken of those companies in the shape of annual reports for 2012 & 2014. Audit Quality is the most essential and note able point for not only the firm's shareholders and stakeholders but also the new investors. In this study, we used EM as a proxy variable for audit quality, and to check audit quality, we used the EM Jones Model and EM Modified Jones Model. The reason to calculate EM by this model is that this model is used widely for EM calculation, and its significance can be checked in the study by Chen, 2012. NAS has been measured as an independent variable in this study. The proportionate of NAS is calculated by dividing it by Total Audit Services. Audit Partner Attributes show the characteristics of the Audit Partner in the form of Education, Expertise, Professional Knowledge, Skills and Abilities, and Gender. Audit Partner Attribute is the moderating variable in this study. To check the moderating effects of NAS on AQ, we used APA in the shape of the Gender of the audit partner in this study. We want to examine whether either Gender of the audit partner moderates the association of dependent and independent variables. Moreover, Firm Size, Leverage, Profit, Financial Re-statement, and Net Operating Cash Flows are control variables. The research framework is depicted in Figure 1.

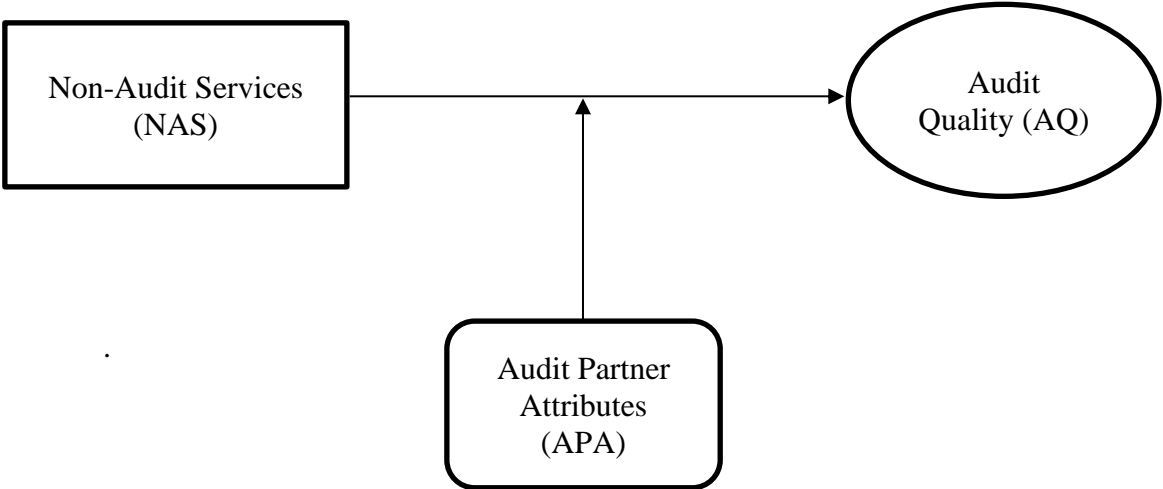


Figure 1: The moderating effect of APA

**4.0 Results**

**4.1 Regression Analysis by Regressing NAS on EM\_MJONES with Moderating effect of Companies Act 2013 on NAS and EM\_MJONES**

This regression analysis is for the years 2012 and 2014 by regressing NAS on another proxy of AQ, which is EM\_MJONES, and we also checked the moderating effect of the companies act 2013 to check the pre- and post-effects.

VARIABLES	EM MJONES
NAS	.0618548 (0.91)
NASCOACT13	.0365403 (0.40)
COACT_2013	-.039473 (-1.60)
LOSS PROFIT0 LOSS1	-.1340127 (-1.49)
LEVERAGE	.0476951 (1.09)
FIRM_SIZE	-.0123143 (-1.06)
_CONS	.0740577 (1.29)
N	132

The regression analysis shows that NAS and EM\_MJones are positively associated with each other's because the coefficient shows the value 0.0618548, but it is not highly significant. While we regressed NAS with the Companies Act 2013 on EM, we again found a positive association, but this relationship is not highly significant. Companies Act 2013 is negatively

associated with EM and has no higher significance. Loss or Profit also has a negative relationship with EM, and the relationship is not highly significant. Leverage is positively associated with EM, but the relationship is not highly significant. Firm Size is negatively associated with EM and is not a highly significant relationship.

#### 4.2 Regression Analysis for Moderating Impact of Audit Partner Attribute Gender on NAS and EM Jones Model

The table below shows the Moderating impact of Audit Partner Attributes, which is represented by Audit Partner Attribute Gender, on the relationship between NAS and EM; the regression analysis is based on the residual values drawn from the data collected:

VARIABLES	EM JONES
NAS	.092401 (1.87)*
APA GENDER	-.0207535 (-0.22)
LOSS PROFIT0 LOSS1	-.1211666 (-1.27)
LEVERAGE	.0433108 (0.93)
FIRM_SIZE	-.0165494 (-1.34)
_CONS	.1051697 (0.95)
N	132

Moderating effect examined in the above table, above table shows the moderation effect of Audit Partner Attributes Gender on the relationship of NAS and EM. EM is used as a proxy of Audit Quality. Here, NAS shows a positive relationship with EM, but moderating variable Audit Partner Attributes Gender shows a negative relationship with EM. Although this relationship is not positive, it also shows that it is not a highly significant relationship.

#### 4.3 Regression Analysis for Moderating Impact of Audit Partner Attribute Gender on NAS and EM Modified Jones Model

The table below shows the Moderating impact of Audit Partner Attribute for the Gender of the audit partner on the relationship between NAS and Audit Quality calculated through the EM Modified Jones Model; the regression analysis is based on the residual values drawn from the data collected:

VARIABLES	EM MJONES
NAS	.075432 (1.61)

<b>APA GENDER</b>	-0.0252397 (-0.28)
<b>LOSS PROFIT0 LOSS1</b>	-0.117406 (-1.30)
<b>LEVERAGE</b>	.0538675 (1.22)
<b>FIRM_SIZE</b>	-0.0146405 (-1.25)
<b>_CONS</b>	.0894399 (0.86)
<b>N</b>	132

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The above table helps us to understand the Moderating effect of Audit Partner Attributes Gender on the relationship between NAS and EM. EM is used as a proxy of Audit Quality. Here, we calculated EM with EM Modified Jones Model. NAS shows a positive relationship with EM, but moderating variable Audit Partner Attributes Gender shows a negative relationship with EM. Leverage has a positive relationship with EM\_MJones and a negative relationship with Loss or Profit and Firm Size. Although this relationship is not positive, it also shows that it is not a highly significant relationship.

## 5.0 Conclusions

This study examines the impact of NAS on Audit Quality with the moderating role of Audit Partner Attribute in the form of Gender of Audit Partner in this relationship while controlling for firm size, Leverage, Loss or Profit, and firm Size. We regressed NAS, NAS & Companies Act 2013, Companies Act 2013, Loss or Profit, Leverage, and Firm size on EM\_Jones to check the Audit Quality. We found a positive relationship between NAS, NAS & Companies Act 2013, and Leverage with EM\_Jones and found a negative relationship between Companies Act 2013, Loss Profit, and Firm Size with EM\_Jones while we regressed all these variables on EM\_Jones. Moreover, we also regressed NAS, NAS & Companies Act 2013, Companies Act 2013, Loss or Profit, Leverage, and Firm size on EM\_MJones to check the Audit Quality through EM Modified Jones Model. While we regressed all these variables on EM\_Jones, we found a negative relationship between Companies Act 2013, Loss Profit, and Firm Size with EM\_Jones and found a positive relationship between NAS, NAS & Companies Act 2013, and Leverage with EM\_Jones. Moreover, we also used the moderating variable Audit Partner Attribute Gender and regressed it on EM\_Jones and found a negative association between Audit Partner Attribute and EM\_Jones. We again used another Audit Quality proxy, the EM Modified Jones Model, and we regressed Audit Partner Attribute Gender and regressed it on EM\_MJones and found a negative association between Audit Partner Attribute and EM\_MJones.

## 5.1 Implications of the Study

This study can be implied to know about the level of NAS provision in the companies listed on BSE. This study explores the provision of NAS and their results on AQ in the top 100 companies of BSE. This study also used the moderation of Audit Partner Attribute in the shape of the Gender of the audit partner to check the effects of APA Gender on NAS and AQ. Moreover,

this study highlights that companies attaining higher NAS services show low AQ. Because higher NAS affects the independence of the auditor, and in some contexts, these are considered as bribes. This study also indicates that rules and regulations defined in the Companies Act 2013 are helping to enhance the AQ. Still, where NAS is provided, they dominate the rules and regulations defined in the Companies Act 2013 and reduce the AQ.

## 5.2 Future Directions & Limitations

This study helps to explore the NAS effects on AQ and the moderation of Audit Partner Attribute on this relation. This study explored the objective of this study. However, there is the future direction for other researchers to take other characteristics of audit partners, which are education, expertise, and experience rather than Gender. This will also help to know why NAS dominates the rules and regulations of the Companies Act 2013. Being limited to a smaller sample size, i.e., 66 firms from the non-financial sector of the BSE 100 Index, the recent study lacks a generalizability factor; thus, it happened to be a limitation to this study.

**Khurram Ashfaq:** literature search, study design, data collection

**Adil Riaz:** Literature search, Methodology

**Shahid Ilyas:** Drafting and data analysis, proofreading and editing

## Conflict of Interests/Disclosures

The authors declared no potential conflicts of interest w.r.t this article's research, authorship, and/or publication.

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