

# THE IMPACT OF AUDIT QUALITY ON THE FINANCIAL PERFORMANCE OF LISTED COMPANIES IN RUSSIA

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**Abstract:** This research is aimed to aid in the development of a more efficient and professional function and image of internal audit in Russian enterprises. Shareholders should recognize the function of the internal audit in a company that safeguards their interests as one of the most essential management control systems. Corporate management should find ways to make Internal Audit a totally autonomous managerial function that will make it more efficient. Management might improve the company's performance by following recommendations. In Russia where businesses want to acquire reputation among local and global investors, such research on the relationship between audit quality and financial performance are quite significant. The purpose of this study was to assess experimentally the financial performance of companies in Russia for audit quality. First, we reviewed the relevant literature in this work. Then, a description of data and methodology explanation was given. To conclude, the results and the analysis were presented and the thoughts were concluded.

**Keywords:** Audit size, Audit independence, Audit Fees, Financial Performance, Audit quality, Audit committee.

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## I. INTRODUCTION

Recent failures in Russian companies are due to the economic crisis connected with COVID-19 which have attracted public attention and also led to doubts about the effectiveness of accountants and auditors. Nowadays, auditors in Russia are in the spotlight. The quality of the audits performed and the audit decisions formulated in the financial statements is key to achieving sustainable investor confidence. However, a number of accounting and reporting irregularities and fraud cases over the past decade have led to a comprehensive examination of issues such as the audit of financial statements, audit approach, audit quality, and profit management.

A necessary condition for decision-making in a corporate organization is the trustworthiness and the level of solidity of financial statements. This is because the decisions and contractual relationships of all the company's stakeholders, such as current and potential investors, are based on trust in the financial statements. Typically, management prepares reports based on the needs of stakeholders. However, the financial statements may be unreliable due to possible manipulation of the reports by management. So this could be a big question for the stakeholders. The audit quality and its independence can guarantee reliability and veracity of financial reports, which is necessary for the effective functioning of the markets [1]. The researchers express concern that the quality of the audit has a non-direct influence on the financial performance of companies. In this study, features of the quality of audit are measured by the main components: audit fee, industry specialization of auditor, audit committee characteristics (audit committee meeting frequency, size and independence of audit) and return on assets (ROA), which is an indicator of financial performance. In this work, we will conduct research aimed to study the influence of audit quality on the financial performance of listed companies in Russia. The purpose of this research is to determine the extent of the dependence between the determinants of audit quality and financial

performance. The decision to conduct the study is associated with the current state of audit practices in companies in Russia, where many companies have failed due to the lack of well-organized audit measures.

This work is structured as follows. The first part will be introductory part, then in the second section we will explore the main literature related to the study. The third section will present the methodology as well as the model, after which the results of the study and the relevant conclusions will be presented.

## II. LITERATURE REVIEW

### *A. Research objectives*

This study is aimed to help to increase the role and image of internal audit in Russian companies, to make it more effective and professional. It should help the shareholders to appreciate the role of internal audit as one of the most important managerial control systems in the organization which can safeguard their interests. The management of companies should look for ways of making Internal Audit a completely independent function from the management to make it more effective. By implementing recommendations, management will be able to enhance the performance of the company. Research that studies the relationship between audit quality and financial performance is important in Russia. Many Russian companies are trying to get a good reputation among local and global investors. Most of the previous research has focused on audit quality and financial performance in developed countries, but this topic has not been sufficiently covered in developing countries due to the small amount of empirical work on this relationship. The main purpose of this study is to identify the impact of audit quality on the financial performance of companies in Russia. For this purpose, the following hypotheses were developed. Owing to the problem of the study, the main objective of this study is aimed at assessing the influence of audit quality on the financial performance of listed companies in Russia.

Therefore, the following specific objectives are set out below:

- To determine the impact of audit committee's independence on the financial performance of listed companies in Russia.
- To find out the impact of audit committee's meeting frequency on the financial performance of listed companies in Russia.
- To determine the impact of audit committee's size on the financial performance of listed companies in Russia.
- To ascertain the influence of auditor size on the financial performance of listed companies in Russia
- To define the impact of auditors' fees on the financial performance of listed companies in Russia.
- To find out the impact of specialization of external auditor on the financial performance of listed companies in Russia.

### *B. Research variables*

Company's financial performance plays a very important role in the capital market. They are an important factor in attracting investors and increasing the cost of capital. A company that has high financial indicators, is more likely to get a good level of trust from investors. Audited financial statements are an indispensable tool for investors when analyzing the level of efficiency of companies [2]. Financial performance is considered to be a multi-faceted concept [3].

There are many different approaches for measuring a company's financial performance. In our work, we will use a method based on evaluating the profitability of the company. Profitability is an indicator that is measured as the share of profit before tax in the shareholders' equity [4]. Profitability can be estimated in different ways, using different indicators. For example: Return on Assets (ROA), Price Earnings Ratio (PER), as well as Return on Equity (ROE). In our study, we will use ROA as the main measurement of financial performance. It is our independent variable.

The next variable in our study is the fee of the audit. The audit pricing model that Simunik created in the 1980s specifies the fees that are paid to auditors for services. After creating this model, several scientists persistently push forward the observed results, which reflect factors that correspond to the proper testing of audit fees [5]. The amount that is paid to the auditors shows the level to which the auditor's services should eventually reach during the audit process. Stanley, investigated the relationship between profit and remuneration of the auditor, which showed that with the increase in the

cost of paying for audit work, quality also increases [6]. Services are becoming more professional compared to auditors who have lower fees. Some researchers use audit fees to measure audit quality, since audit quality does not have a quantitative way of measurement [7]. Finally, this study we have chosen audit fees as one of the measurement for audit quality which is also consistent with the research carried out by [5, 6, 7, 8, 9]. In our study, there is a limitation in the form of audit fees. This data is not in the public domain, so that is reason why we will use ones from the article accept it as a constant for our model.

Our next variable is the size of the audit. In the literature, there are two types of audit size (Big 4 and Non-big 4). Depending on the size of the audit firm, conclusions are drawn about the quality of the audit. This dimension was also discussed in another context of the study [10]. This is due to the fact that large audit firms have a better reputation than small firms. Large auditors try to do better audits, because in the situation of fraud or failure to provide complete information about the financial condition of the company, it risks losing high amounts of fees. The capital market positively evaluates a company if it is audited by a firm from Big4. There is also evidence that companies operating with Big 4 receive a higher revenue response (ERC) [11].

Deangelo (1981) states that auditors provide better quality audits than auditors of non-Big 4, which is supported by a group of comprehensive empirical studies [12]. Comprix and Huang, (2015) investigated whether the big 4 auditor provides a better audit in terms of size, and concluded that non-Big 4 auditors are less likely to restrain managers ' cautious use of discretionary accruals [13].

The next variable, which is very important for our study, relates to the frequency at which the members of the audit committee meet together. Committees that meet with greater frequency are considered to be the most effective review bodies. It is expected that the more active audit committees will be more effective control bodies. A committee that meets infrequently may be considered inactive and unlikely to be able to effectively control management. For example, in the UK, there is a specific minimum number of committee meetings-at least three meetings per year. The Chairman of the Audit Committee and the company secretary are given the right to make decisions on the frequency and timing of meetings. Despite the fact that the minimum number of meetings is only three, many chairs recommend holding more frequent meetings.

Another important variable in the study is the size of the audit committee. Many previous studies have identified the high importance of audit size for the company's performance [14]. Aanu et al. (2014) argued that there is a positive relationship between the size of the audit committee and the firm's performance. An Alcatamine study (2018) also found a similar link. Based on the above, we can conclude that the larger the size of the audit, the higher its effectiveness, because a larger number of resources can more easily cope with the raised problems.

Auditor industry specialization is also a variable of our study. An audit firm that works in a particular industry has more incentives for honest and high-quality work than other firms. Auditors ' have incentives to protect their reputation and reduce the risk of litigation [15]. Industry auditors do not want to lose clients and possible income and bonuses, because of the poor quality of the audit, and for this reason have high incentives to protect their reputation, so it can be concluded that such specialists will conduct better audits and will be more independent [16]. This, in turn, can have a positive impact on the company's financial performance.

Next variable is the independence of the auditor. Auditors should be independent from the first to the last stage of their audit procedures. It is really meaningful for stakeholders to have the confidence about protecting their interests [17]. The higher the professionalism and efficiency of the audit, the more confidence shareholders have in the financial statements. In DeAngelo (1981), the concept of auditor independence is described as the likelihood that the hired auditor will find material misstatements in the financial statements [12]. Chia-A and Karlsson (2010) argue that there is a problem of the auditor's objectivity, which leads to doubts about the effectiveness of the services provided by the auditors [18].

This model uses two control variables included Firm age and Firm size. The reason why these variables were chosen in this study is given below. Also, it is very important to note that despite the fact that the choice of control variables was based on theories and evidence, our variables are not unique and there are also other variables that can be used. It is worth recognizing that other variables can affect the company's performance no less than our variables, but they are not present in our model due to lack of evidence or lack of data.

### III. RESEARCH METHODOLOGY

#### A. Research Sample

The study examines the influence of Audit Quality on Financial Performance of listed companies in Russia over a period of three (3) from 2018 to 2020. We will research companies from the banking sector. Data will be gathered from the financial statements of domestically listed companies from the Moscow stock exchange market. The MSE had 507 listed companies by the end of January 2021. Selection of company financial statements was based on two factors, firstly, that the company is registered during the 3 years under study and secondly, that the data is available for the company.

#### B. Research model

A multiple regression equation is set up to investigate the hypothesized relationships between the dependent variable and the seven independent variables in this study. The model on the basis of aforementioned literature. Consistent with Afza and Nazir (2014), following multivariate regressions model was implemented to test our hypotheses.

The econometric form of the equation is given as [14]:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + e$$

Where Y – ROA

B<sub>1</sub> – B<sub>7</sub> – Beta coefficient

X<sub>1</sub> – Audit Fee

X<sub>2</sub> – Auditor Size

X<sub>3</sub> – Audit committee Independence (Number of non-executive members serving on the audit committee)

X<sub>4</sub> – Audit committee size (Represents the number of members on the audit committee)

X<sub>5</sub> – Audit committee meeting (Represents the number of meetings held by the audit committee during the year)

X<sub>6</sub> – Specialization of external auditor (If the firm is audited in the current year by an industry specialist in the banking sphere, firm as '1' and if no '0')

X<sub>7</sub> – Firm size Represents natural logarithm form of firm's total assets

X<sub>8</sub> – Firm age

e – Error term

1) Financial Performance (Measured as the proportion of income before tax to shareholder's equity) = ROA [4].

2) Audit Quality:

a) Audit Fee (The Logarithmic transformation of Russian-value remunerated to the auditor for the audit services) [19].

b) Auditor Size (A dummy variable, that is coded "1" if the company is audited by a Big4 and "0" otherwise) [20].

c) Audit committee Independence (Number of non-executive members serving on the audit committee)

d) Audit committee size (Represents the number of members on the audit committee)

e) Audit committee meeting (Represents the number of meetings held by the audit committee during the year)

f) Specialization of external auditor (If an audit firm 1/3 and above of the entire firms in the industry or 15% is dichotomized as '1' and if less '0')

g) Firm size Represents (Natural logarithm form of firm's total assets)

h) Firm Age (Measured as the Number of years of observation minus of years of listing) [21].

**C. Descriptive Statistics****TABLE 1: Descriptive Statistics.**

	N	Mean	Std Dev	Minimum	Maximum
ROA	78	6.40	8.78	-6.60	53.10
Auditfee	78	9562.54	3194.96	5488	18000
Auditsize	78	.46	.50	0	1
AUspecialisation	78	.50	.50	0	1
ACmeeting	78	.67	.47	0	1
ACindependence	78	1.77	1.01	0	4
ACsize	78	3.51	.70	2	5
Firmsize	78	788.36	160.55	467.00	1280.00
Firmage	78	35.50	16.80	5	77
Valid N (listwise)	78				
Missing N (listwise)	0				

Table indicates the outcome for descriptive statistic taken from the studied variables incorporated into the model.

In the table it is shown that the mean of ROA, Auditfee, Auditsize, AUspecialization, ACmeeting, ACindependence, ACsize, Firmsize, Firmage are 6.40, 9562.54, 0.46, 0.50, 0.67, 1.77, 3.51, 788.36, 35.50 and 35.5 respectively. A comparison of the average results with the maximum of values shows us the way how firms operate. ROA at is 60.4 %, which indicates a positive performance of the companies.

**D. Regression Results****TABLE 2: Summary of regression result.**

Variables	Coefficient	t-values	P-values
ROA	-2.00	-1.00	0.319
Auditfee	0.00	0.76	0.450
Auditsize	-2.00	-1.00	0.319
AUspecialization	0.81	0.40	0.688
ACmeeting	0.24	0.11	0.910
ACindependence	1.15	1.16	0.250
ACsize	-0.68	-0.47	0.637

From the table we can see that the Auditfee, Auditsize, AUspecialization, ACmeeting, ACindependence, ACsize have a significant impact on the financial performance of listed companies in Russia. P-value or significance level is 0.450, 0.319, 0.688, 0.910, 0.250, 0.637 (more than 0.05). Results show that Audit fees have significant positive effect on return on asset.

This positive figure denotes that a percentage decrease in the amount paid to auditors for audit services, then there is possibility for financial performance of the listed companies in Russia will also increase. The outcome is similar to that discovered in a study by Moutinho, (2012) who studied the effect of audit fees and the firm performance [21]. They discovered a positively and statistically significant relationship between audit fee and the ROA.

**IV. CONCLUSION**

The main purpose of the research is considered to be achieved. The study examined the relationship between audit quality and financial performance of listed companies in Russia. Series of concepts, principles and contrasting views of scholars were discussed. An extensive review of literature on audit fees, auditor size, financial performance and audit committee, audit independence was undertaken. The aims of this study were to determine the impact of audit committee's independence on the financial performance of listed companies in Russia, to find out the impact of audit committee's meeting frequency on the financial performance of listed companies in Russia, to determine the impact of audit committee's size on the financial performance of listed companies in Russia, to ascertain the influence of auditor size on the financial performance of listed companies in Russia, to define the impact of auditors' fees on the financial performance of listed companies in Russia, to find out the impact of specialization of external auditor on the financial performance of listed companies in Russia. The study found that the existence of audit committees influences financial performance by improving the performance of banks listed in Russia.

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