PERCEPTIONS OF ACCOUNTING INFORMATION USERS ABOUT THE TYPE OF AUDIT FIRM: THE CASE OF JORDAN

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This paper deals with the preferences of creditors and investors in Jordan regarding the credibility and use of financial statements audited by accounting firms with international affiliations compared to local accounting firms. Audit firms in Jordan are divided into two groups. Group 1 consists of audit firms with affiliation with an international firm. Group 2 consists of audit firms with no international affiliation. A questionnaire elicited preferences of creditors and investors for Group 1 and Group 2 audit firms. This questionnaire was administered to a sample of investors and creditors. The results suggest that a preference by both creditors and investors for financial statements audited by accounting firms with international affiliation. The factors leading to such a preference are also indicated. The results suggest that affiliation with international audit firms, application of international standards, personal contacts and the long experience of auditors are the most important factors that make both investors and creditors prefer Group 1 over Group 2 audit firms.

INTRODUCTION

This paper examines whether financial statements audited by accounting firms with international affiliations are given more credibility by creditors and investors in Jordan than financial statements audited by local accounting firms.

This research examines some factors which may cause the international firms to have more credibility in the view of creditors and investors. The paper also examines the structure of the audit market in Jordan and the dominance of large auditing firms in many important industries in the economy.

The credibility of auditors depends on both independence and competence. The issue of independence has been examined in the literature (Firth, 1980; Dykxhoorn and Sinning, 1982). This paper deals with the issue of perceived competence of auditors in a developing country in the Middle East, specifically Jordan. The paper deals with the issue of whether larger auditing firms with international affiliations have more credibility than local accounting firms in the eyes of creditors and investors.

Previous studies in developed countries have examined reasons for the dominance of large audit firms in the USA. Balvers et al (1988) find that Big 8 firms in the USA possess technological advances over their competitors. Eichenseher and Danos (1981) suggest that big CPA firms have advantages over their competitors because of specialization and industry specific concentration. Some studies have found that clients prefer large audit firms in order to take advantage of available economies from specialized audit technologies or to be associated with the brand name of the large audit firms (See Francis and Simon [1987], and Johnson and Lys [1990]). Other studies have found evidence of a relationship between auditor quality and auditor size. DeAngelo (1981) suggests that Big 8 auditors are more likely to uncover errors in the clients' financial statements than non-Big 8 auditors. Chow and Rice (1982) argue that it is in management's best interest to choose auditors with high reputations.

The present paper attempts to examine whether it is in management's best interests to choose accounting firms with international affiliations by looking at the impact on the credibility of financial statements from the point of view of creditors and investors. The paper also examines the reasons for the preferences of creditors and investors for international affiliations.

This paper extends a study by Al-Mudhaf (1988) in which he examines the preferences of creditors and investors in Kuwait for accounting firms with and without international affiliation. Our paper extends the previous study by examining the factors leading to a preference for the international firms. Also, by doing the study in a different developing country in the Middle East, namely Jordan, it can be indicated from a comparison of the results whether they can be generalized to developing countries, at least in the Middle East. The results in Jordan regarding the preference for international firms are similar to those of Kuwait, thus suggesting that in developing countries in the Middle East there is greater credibility achieved by accounting firms from an affiliation with an international partner.

The structure of the paper is as follows. The next section describes auditing in Jordan and the makeup of the audit market including documentation of the dominance of the larger firms. The methodology of the paper is described in the next section followed by a discussion of the results and concluding remarks.

Auditing Profession in Jordan

The auditing profession in Jordan has witnessed tremendous development in the past few decades. This is due to a number of important factors, such as the social and economic development in Jordan, the considerable increase in the volume of investment, the increase in the number of public shareholding companies, and the increase in the number of qualified accountants.

TABLE 1
Number of Registered Industrial Companies in Amman Chamber of Industry

Year	1962	1974	1982	1985	1987	1990	1994
Number of registered members in Amman Chamber of Industry	100	1184	1716	2805	3938	5189	7145

Source: Amman Chamber of Industry, 1995

Table 1 above shows the increase in the number of industrial and trading companies in the capital, Amman, only. The Amman Financial Market was established in 1976 and started its business in 1978.

The importance of the auditing profession was enhanced by the increase in the demand for accounting information for decision making from various users, such as investors, creditors, and government agencies.

The question which arises that has been addressed in the literature (Matar, 1995) is whether the laws and regulations provide equal opportunities to audit firms and/or whether the market share is dominated by some audit firms because of their affiliation with one of the Big-8 accounting firms. Some authors such as Jaghoub (1993) have pointed out that there are problems in the audit market in Jordan resulting in low quality of audit services. There is no monitoring system regarding the quality of audit services provided by audit firms. There are inadequate training programs for auditors.

For the purpose of this research, audit firms in Jordan are divided into two groups. Group 1 consists of audit firms with affiliation with one of the Big-8 accounting firms. Group 2 consists of audit firms with no international affiliation.

TABLE 2
Group 1 Audit Firms

Audit Firm	International Partner
1. Saba & Co.	Deloitte & Touche
2. Allied Accountants	Arthur Andersen & Co.
3. Whinney Murray & Co.	Ernst & Young
4. Bawab & Co.	Coopers & Lybrand
5. Khlaif & Co.	KPMG Peat Marwick
6. Sawalha & Co.	Horwath
7. Al-Abbasi & Co.	Price Waterhouse
8. Talal Abu-Ghazaleh & Co.	Grant Thornton

Table 2 above lists the names of the Group 1 audit firms and their international partners.

Table 3 below shows the distribution of market share among audit firms based on the latest available information about these firms in Jordanian Shareholding Companies Guide, published by the Amman Financial Market (AFM, 1995). Table 3 shows that Group 1 audit firms have 61% of the total number of the public shareholding companies listed on the AFM. This dominance is mainly centered in the banking sector in which Group 1 audit firms control 100% of the sector. The market share of Group 2 audit firms as indicated in Table 3 is only 39% of the total number of companies listed on the AFM.

TABLE 3
Market Share of Audit Firms

Sector	Number	Group 1 Audit Firms		Group 2 Audit Firms	
		Number	%	Number	%
Banks	18	18	100	-	-
Insurance	17	13	76	4	24
Services	36	18	50	18	50
Industrial	77	41	53	36	47
Total	148	90	61	58	39

Table 4 shows the distribution of market share among Group 1 audit firms themselves.

As can be seen from Table 4, some Group 1 audit firms have a monopoly position. Three audit firms, namely Saba, Talal Abu Ghazaleh, and Al-Abbasi (which we refer to as "the big three" below) have 89% of the audits of companies audited by Group 1 firms in all sectors. The domination of the big three audit firms ranges from 77% in the insurance sector to 94% in the services sector.

TABLE 4
Market Share of Group 1 Audit Firms

Sector	Number	The Big Three		Remaining Audit Firms	
		Number	%	Number	%
Banks	18	16	89	2	11
Insurance	13	10	77	3	23
Services	18	17	94	1	6
Industrial	41	37	90	4	10
Total	90	80	89	10	11

The preceding discussion regarding the audit market in Jordan suggests the following hypotheses which are stated in the alternative form as follows:

H1: Creditors perceive financial statements audited by Group 1 auditors to have more credibility than financial statements audited by Group 2 auditors.

H2: Investors perceive financial statements audited by Group 1 auditors to have more credibility than financial statements audited by Group 2 auditors.

RESEARCH METHODOLOGY

In order to test the above hypotheses, all audit firms which verified the financial statements of companies listed on the Amman Financial Market in 1995 were identified from the Jordan Shareholding Companies Guide (1995). The number of these firms is 15. Out of these there are 8 firms with international affiliates as shown in Table 2. These were put into Group 1. There were 7 local auditing firms among the 15 firms chosen above. These were put into Group 2 which is shown in Table 5.

TABLE 5
Group 2 Audit Firms

No.	Name of Company
1.	Certified Arab Office
2.	Ma'rouf Al-Meqbel
3.	Professional Arab
4.	Ghosheh and Co.
5.	Suhail Khouri & Co.
6.	Michel Sindaha & Co.
7.	Ma'moun Faroukha & Co.

Questionnaire and Sample

A questionnaire was designed to gather information about the preferences of creditors and investors for Group 1 and Group 2 audit firms and the reasons for these preferences. This questionnaire was administered to a sample of investors and creditors. The questionnaire was in Arabic and the questions were translated into English later for the purposes of this paper.

The questionnaire consisted of 5 questions with a number of subsections. The questionnaire asked about the extent to which the respondents used financial statements in making lending or investment decisions. The questionnaire also elicited information regarding the sources, other than financial statements, that respondents used in making lending and investment decisions. The questionnaire also asked about the preferences of respondents regarding financial statements audited by Group 1 or Group 2 auditors and the reasons for the preferences.

The results of the questionnaire for investors and creditors were calculated separately and in total. The reason for that is because previous studies such as Firth (1980) and Dykxhoorn and Sinning (1981) have shown that these two groups have different attitudes toward the financial statements. Therefore, it was decided to see if the results concerning the credibility of financial statements differs between these two groups.

The creditors consisted of loan officers of banks in Jordan, the total number of which is 18. The questionnaire was administered to credit officers in all 18 banks. The number of questionnaires given out was 45 and the number received was 39, giving a response rate of 87%. The questionnaire was administered personally to both creditors and investors. Visits were made to the banks concerned to distribute the questionnaire. The questionnaire was collected personally at a later time.

The number of investors to whom the questionnaire was distributed was 53 and the number received was 46 giving a response rate of 87%. They were personal investors who were visiting brokers offices at the Amman financial market and were chosen at random. The questionnaires were collected personally from investors. The response rates for the total sample are given in Table 6.

TABLE 6
Type of Respondents Included in the Sample

Respondents	No. Given Out	No. Received	Response Rate %	Percentage of Total Sample
Creditors	45	39	87	45.88
Investors	53	46	87	54.12

RESULTS

The descriptive statistics are shown in Table 7. This information suggests that the respondents are competent to answer the questions in the questionnaire based on their experience, education/major, and age.

A five point Likert scale was employed to measure the responses for a number of key questions. Response 1 = least important; 5 = most important. Mean and standard deviation were used to measure the significance and dispersion of the responses. Moreover, t-tests were employed to test for the significance of the differences between the means of responses of investors and creditors.

TABLE 7
Description of Age, Education, Qualifications and Experience of Respondents

Age	%	Education	%	Major	%	Experi-ence	%
<25	06	High Schl	07	Accounting	31	< 3	09
26-35	37	Diploma	31	Public Adm	1013	4-6	24
36-45	40	Bachelor	48	Bus. Admin	28	7-10	12
>46	17	Master	10	Finance	02	>11	55
		Ph.D.	04	Economics	16		
				Other			
Total	100 %		100 %		100 %		100 %

The standard deviation is .74. It shows that there is a general agreement about the importance of these statements, though the dispersion among the responses of investors is relatively higher than that of creditors. The t-test result shows that creditors rely on financial statements significantly more than investors. When the median is computed for both subsamples, the results show differences between them. The medians of responses of investors and creditors are 4 and 5 respectively.

TABLE 8
The Importance of Financial Statements for Investors and Creditors

Responses	Mean	Median	S.D.	t-test
Investors	4.306	4	.80	3.57*
Creditors	4.065	5	.55	
All	4.306	4	.74	----

* The significance of t-test for 79 degrees of freedom is 2.00

With respect to the second question in the questionnaire regarding whether investors and creditors rely on sources other than the financial statements, the results show that they do.

Table 9 shows that 97% of the sample use other sources of information; 59% use personal contacts, 64% other financial information and 43% use other sources. The above figures imply that both investors and creditors rely on more than one source of information rather than just the financial statements in making their decisions.

Individuals included in the sample were asked to point out the extent in percentage terms to which they used financial statement information as compared to all the information they used.

TABLE 9
Reliance on Other Sources of Information

Rely on other than financial information	Yes	No
All sources	97%	3%
Personal Contact	59%	41%
Other financial information	64%	36%
Other sources	43%	57%

Table 10 shows that 69.3% of the input for decision making comes from financial statements.

To give validity to this research and particularly to subsequent questions, individuals were asked if they are interested in the audit reports. The positive responses amounted to 96%. Those whose responses were positive were asked further whether they prefer the financial statements audited by group 1 or group 2 or were indifferent.

Table 10
Percentage of Use of Financial Statement Information in Decision Making

% of input	20	30	40	50	60	70	80	90	100
Number of responses	1	2	3	9	16	23	18	7	6

Table 11 suggests that 62.2% of them prefer group 1 and 8.5% prefer group 2 whereas 29.3% were indifferent.

TABLE 11
Preference for group 1 or group 2 audit firms

Preference	Number	%
Group 1	51	62.2
Group 2	7	8.5
Indifferent	24	29.3

*Missing values are 3

The results regarding the factors affecting the preference of investors and creditors for one group of audit firms over another are discussed below.

To gain credibility over time, audit firms should be independent and have qualified personnel. They should comply with a code of conduct and apply accepted audit standards. Since some local audit firms lack a long record, they associate themselves with international audit firms to gain from their good reputations. The results in Table 12 suggest that reputation is the most important factor that makes both investors and creditors prefer group 1 over group 2. This may be because of the international affiliation of the firm. The response mean is 4.5 on a 5 point Likert scale which suggests that it is the most important factor. The standard deviation is .74 which is relatively low. T-test results show that there are no statistically significant differences between attitudes of investors and creditors regarding this factor. The computed t-value is 1.30. The second important factor is the application of international accounting and auditing standards. Jordan adopted these standards in 1989. Since they were not backed with legislation, companies adopted only part of them. The draft of the new Companies Law makes the application of these standards compulsory by law. Interested parties prefer audit firms that are stringent regarding the application of international audit standards and international accounting standards. Compliance with these standards facilitates their decision making. The mean of the responses shows that it is important (4.27). It is worth noting that there is a difference between the investors and creditors. The t-value is 2.33 which is significant at the 5% level. Creditors, perhaps due to their long experience, perceive the importance of this factor higher than investors. The means for creditors and investors responses are 4.5 and 4, and the standard deviations are .98 and .5 respectively.

The third factor is the long experience, which usually makes the output accurate and reliable. The response mean is 4.1 with a standard deviation of .9. The fourth factor is the affiliation with international audit firms. These firms have good reputations and long experience. Local firms gain much from the association with these firms in terms of audit quality. The response mean is 4.02 with a standard deviation of .91 and the t-value is 2.34. Again there is a significant difference between creditors and investors with respect to this factor. Creditors perceive it as more important than investors. The means of creditors and investors responses are 4.3 and 3.7 respectively.

The least important factor is personal relationship. The response mean is 2.89 with a standard deviation of 1.19. It is worth noting that the last figures suggest that there is much dispersion among the responses. The striking result is the difference in the opinions of creditors and investors. T-test result shows that there is a difference among the responses. The means for creditors and investors responses are 2.63 and 3.23 with standard deviations of 1.31 and .97 respectively. The results suggest that investors perceive personal relationship as an important factor in evaluating the credibility of auditing firms. They may receive information from family contacts or friends working for auditing firms.

TABLE 12
Factors Determining the Preference for Type of Audit Firms

Factor because of which individuals prefer Group 1 audit firms.	Mean/ investor	Mean/ Creditor	Overall Mean	Std. Dev.	t-test*
1-Affliation with International Audit Firm	3.70	4.30	4.02	.91	2.34*
2-Application of Int. Stds.	4.0	4.52	4.27	.80	2.33*
3-Reputation of the firm	4.35	4.63	4.50	.74	1.30
4-Long Exp. of Auditors.	3.87	4.32	4.10	.90	1.72*
5-Personal contact with the Audit Firm.	3.23	2.63	2.89	1.19	1.83*
6-Number of Auditors in Firm.	3.33	3.35	3.34	1.10	.05
7-Specialized in a specific industry.	3.63	4.04	3.84	.925	1.60

*significant at the 5% level. There are missing responses for some of the factors.

CONCLUSION

The results regarding the hypotheses about the preferences of investors and creditors for Group 1 or Group 2 type of audit firms suggest that both parties prefer Group 1 type of audit firms. The factors that are important for this preference are first the reputation of the audit firm which seems to be enhanced because of the international affiliation of the firm. The second factor is the application of international accounting standards and audit standards which facilitate the decision making for both investors and creditors. The least important factor is personal contacts with the audit firms. It seems that there is a discrepancy between the opinions of investors and creditors in personal contacts. Investors seem to rely on personal contacts whereas creditors do not.

The results of this paper are consistent with the study done by Al-

Mudhaf (1988) in Kuwait and suggest that these findings are consistent for developing countries at least in the Middle East and possibly other developing countries as well. The results suggest that investors and creditors in developing countries find the credibility of financial statements is increased if they are audited by firms which have some international affiliation.

The limitations of the study are that, as is the case in questionnaire studies of this type, the subjects stated perceptions could differ from their personal view's. Also another limitation is that our measure of perceived "competence" may in fact be a measure of audit quality (that encompasses both competence and independence).

We recommend that companies and accounting firms seek affiliation with international accounting firms in order to increase the reliance of investors and creditors on financial statements and make their decision making task easier. Accounting firms can get expertise either by associating with international firms or by having systematic training programs for their personnel.

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