

Impact of Audit Quality on Firm Performance: Evidence from Non-Financial Companies Listed in Colombo Stock Exchange

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Abstract

The widespread occurrence of fraud in large corporations has rendered traditional auditing and investigation methods ineffective at detecting and preventing various financial crimes worldwide. Furthermore, Sri Lanka lacks a standardized or mandatory code of best practices for audit quality. The purpose of the study is to investigate the impact of audit quality on the firm performance of non-financial companies listed in Colombo Stock Exchange. In this study, audit fee, auditor expertise, auditor independence and audit rotation are considered as proxies of audit quality while the firm performance is measured by ROA and Tobin's Q. Moreover, 94 non-financial companies listed in Colombo Stock Exchange were selected for the study as a sample (470 observations). The secondary data was collected from the annual reports of listed companies for the period of five-years from 2017 to 2021. Descriptive statistics and inferential statistics are employed to analyse the data. Correlation analysis was carried out to find out the relationship between audit quality and firm performance whereas the panel data regression analysis was used to examine the impact of audit quality on firm performance. The result of the correlation analysis indicates a significant positive relationship of audit fee and auditor expertise with ROA, and insignificant relationship with auditor independence and audit rotation. The result of panel data regression analysis reveals a significant positive impact of audit fee and audit rotation on firm performance. Additionally, auditor independence and auditor expertise have not shown any significant impact on firm performance. Listed companies don't have enough audit quality. It should be improved for achieving the high performance of listed companies in Sri Lanka. This study is fruitful to understand the impact of audit quality on firm performance in the context of developing countries.

Keywords: Auditor expertise, Audit fee, Auditor independence, Audit quality, Audit rotation, Firm performance