




The Moderating Role of Market Competition on the Relationship Between Auditor Experience and Audit Expectation Gap with Audit Quality and Audit Fees in Companies Listed on the Iraq Stock Exchange




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Abstract: This study examines the impact of the audit expectation gap on audit quality and audit fees in Iraq's competitive market. The primary objective of the research is to analyze the relationship between the expectation gap, auditor experience, and market competition with audit quality and audit fees. To conduct this study, statistical models and data related to auditors and audit firms in Iraq were utilized. The results indicate that auditor experience has a positive and significant effect on audit quality, and market competition can enhance the impact of auditor experience on audit quality. Additionally, the audit expectation gap has a negative and significant relationship with audit quality. Moreover, market competition exacerbates the impact of the audit expectation gap on audit fees. Based on its findings, this research recommends that audit firms focus on enhancing auditor experience and managing market competition. Furthermore, it is suggested that future research incorporate more diverse criteria for assessing the expectation gap and market competition to achieve more comprehensive results.

Keywords: Audit expectation gap, audit quality, audit fees, market competition, auditor experience.

1. Introduction

Audit quality, which determines audit performance, is influenced by multiple factors, including auditor capabilities (such as knowledge, experience, adaptability, and technical efficiency) and professional execution (such as independence, impartiality, professional care, conflict of interest management, and professional judgment). Since auditors must respond to the demands of a wide range of stakeholders, these dynamics have led to the creation of an audit expectation gap — a gap resulting from the difference between public expectations of the auditing role and the actual objectives that the profession seeks to achieve [1]. Additionally, perceptions of audit service quality constitute part of this expectation gap. Examining the factors that influence the perception of both

providers and users of audit services regarding audit quality can help explain part of this expectation gap and contribute to its reduction [2-4].

Previous studies on audit quality have typically examined the influencing factors in a fragmented manner, and no comprehensive framework or model has yet been developed in this regard. Despite the emphasis of professional standard-setting bodies in developed countries on the necessity of evaluating and studying professional judgment, most prior research has focused on statistical data based on corporate performance and financial report outcomes. In inferential studies, the focus has primarily been on individuals' judgments based on their professional roles, which highlights an expectation gap based on role perception [5-8]. Developing and revising the factors affecting audit quality within an analytical framework or conceptual model—one that studies both the individual characteristics of professionals (such as skills and experience) and the professional environment surrounding them—could yield more credible results compared to merely analyzing financial report data.

Huang and Chang (2010) argue that high audit market concentration leads to economies of scale and intense competition among audit firms, thereby reducing audit fees. Other studies have demonstrated a direct relationship between audit market concentration and audit quality [9]. Newton et al. (2013) suggested that increased audit market concentration reduces client loss risk and enhances auditor independence and audit quality [10]. However, Hassasyeganeh et al. (2016) believe that auditor reputation and bargaining power can increase audit fees. Given the conflicting findings of previous studies, understanding the impact of audit market concentration on the relationship between auditor experience, expectation gap, audit fees, and audit quality is of particular importance [11]. Considering the status of the Audit Organization in Iraq and the large number of small firms, this study examines the impact of audit market concentration on the relationship between auditor experience, expectation gap, audit fees, and audit quality, while accounting for the existing competitive conditions. The goal of this research is to expand the theoretical foundations of audit market concentration and its effect on audit fees and audit quality using more precise criteria—criteria that have not been examined in previous studies [6-8, 12-20].

Accordingly, the main research question is formulated as follows:

- Do auditor experience and the expectation gap affect audit quality and audit fees?
- Does market competition influence the relationship between auditor experience, the expectation gap, audit quality, and audit fees?

Hypothesis 1: The audit expectation gap has a negative and significant effect on audit quality.

Hypothesis 2: Market competition intensifies the impact of the audit expectation gap on audit quality.

Hypothesis 3: Auditor experience has a positive and significant effect on audit quality.

Hypothesis 4: Market competition strengthens the effect of auditor experience on audit quality.

Hypothesis 5: The audit expectation gap has a negative and significant effect on audit fees.

Hypothesis 6: Market competition exacerbates the impact of the audit expectation gap on audit fees.

2. Methodology

The present study is applied in terms of its objective and quasi-experimental in terms of research method. The reasoning approach used in this study is both deductive and inductive. The study follows a positivist approach in theoretical terms and is classified as descriptive and correlational in statistical methodology.

In this research, multiple linear regression is used to test the hypotheses. To conduct these tests, financial report data of companies were extracted from the Iraq Stock Exchange website.

The statistical population of this study consists of companies and banks listed on the Iraq Stock Exchange during the years 2015 to 2022. The study sample was selected using the systematic elimination sampling method, wherein companies were chosen based on the following criteria:

- Availability of data for the selected variables.
- The companies must have been listed on the Baghdad Stock Exchange before 2015 and must not have been delisted during the study period.

From the selected 61 samples, 33 are companies and 28 are banks.

Research Models and Variables

Models for Hypotheses 1 and 2

$$AQ_{it} = \beta_0 + \beta_1 AE_{it} + \beta_2 AGE_{it} + \beta_3 \text{Aud-Spec}_{it} + \beta_4 \text{Aud-Switch}_{it} + \beta_5 \text{Auditortype}_{it} + \beta_6 \text{Aud-gndrit} + \beta_7 \text{MTBit} + \beta_8 \text{LNTA}_{it} + \beta_9 \text{LEV}_{it} + \epsilon_{it}$$

$$AQ_{it} = \beta_0 + \beta_1 AE_{it} + \beta_2 \text{CPT}_{it} + \beta_3 \text{CPT}_{it} * AE_{it} + \beta_4 AGE_{it} + \beta_5 \text{Aud-Spec}_{it} + \beta_6 \text{Aud-Switch}_{it} + \beta_7 \text{Auditortype}_{it} + \beta_8 \text{Aud-gndrit} + \beta_9 \text{MTBit} + \beta_{10} \text{LNTA}_{it} + \beta_{11} \text{LEV}_{it} + \epsilon_{it}$$

Models for Hypotheses 3 and 4

$$AQ_{it} = \beta_0 + \beta_1 \text{EXPAudit}_{it} + \beta_2 AGE_{it} + \beta_3 \text{Aud-Spec}_{it} + \beta_4 \text{Aud-Switch}_{it} + \beta_5 \text{Auditortype}_{it} + \beta_6 \text{Aud-gndrit} + \beta_7 \text{MTBit} + \beta_8 \text{LNTA}_{it} + \beta_9 \text{LEV}_{it} + \epsilon_{it}$$

$$AQ_{it} = \beta_0 + \beta_1 \text{EXPAudit}_{it} + \beta_2 \text{CPT}_{it} + \beta_3 \text{CPT}_{it} * \text{EXPAudit}_{it} + \beta_4 AGE_{it} + \beta_5 \text{Aud-Spec}_{it} + \beta_6 \text{Aud-Tenure}_{it} + \beta_7 \text{Aud-Switch}_{it} + \beta_8 \text{Auditortype}_{it} + \beta_9 \text{Aud-gndrit} + \beta_{10} \text{MTBit} + \beta_{11} \text{LNTA}_{it} + \beta_{12} \text{LEV}_{it} + \epsilon_{it}$$

Models for Hypotheses 5 and 6

$$\text{LnAfee}_{it} = \beta_1 AE_{it} + \beta_2 AGE_{it} + \beta_3 \text{Aud-Spec}_{it} + \beta_4 \text{Aud-Switch}_{it} + \beta_5 \text{Auditortype}_{it} + \beta_6 \text{Aud-gndrit} + \beta_7 \text{MTBit} + \beta_8 \text{LNTA}_{it} + \beta_9 \text{LEV}_{it}$$

$$\text{LnAfee}_{it} = \beta_0 + \beta_1 AE_{it} + \beta_2 \text{CPT}_{it} + \beta_3 AE_{it} * \text{CPT}_{it} + \beta_4 AGE_{it} + \beta_5 \text{Aud-Spec}_{it} + \beta_6 \text{Aud-Switch}_{it} + \beta_7 \text{Auditortype}_{it} + \beta_8 \text{Aud-gndrit} + \beta_9 \text{MTBit} + \beta_{10} \text{LNTA}_{it} + \beta_{11} \text{LEV}_{it} + \epsilon_{it}$$

Research Variables

Dependent Variable

The dependent variable in this study is audit quality, which is measured as follows:

AUDQUALITY (Audit Quality): In this study, audit quality is measured based on the **negative absolute value of residuals** from the **Dechow and Dichev (2002) model**, as shown below:

$$\text{WCA}_{it} = C + \lambda_1 \text{CFO}_{it-1} + \lambda_2 \text{CFO}_{it} + \lambda_3 \text{CFO}_{it+1} + \lambda_4 \Delta \text{REV}_{it} + \lambda_5 \text{PPE}_{it} + \epsilon_{it}$$

Where:

- **WCA** = Working capital accruals
- **CFO_{it-1}, CFO_{it}, CFO_{it+1}** = Cash flows from operations in the previous, current, and next year, respectively
- **ΔREV** = Change in revenue
- **PPE** = Net property, plant, and equipment
- **ε** = Model residuals

In this model, **working capital accruals (WCA)** are calculated as:

$$\text{WCA}_{it} = \Delta \text{CA}_{it} - \Delta \text{CASH}_{it} - \Delta \text{CL}_{it}$$

Where:

- ΔCA = Change in current assets
- $\Delta CASH$ = Change in cash and cash equivalents
- ΔCL = Change in current liabilities

This model is analyzed at the **industry level**, and all variables are standardized by the **mean total assets** to control for firm size.

LnAfeeit (Audit Fee): The **natural logarithm** of the audit fee in the examined year.

Independent Variables

Auditor Experience (EXPAudit): The number of years an auditor has been listed in the official auditing firms registry in Iraq.

Audit Expectation Gap (AE): This variable is derived from the absolute errors in Model 2, following Salehi et al. (2020).

Other explanatory variables include:

- **ASP:** Absolute changes in stock price three days before and after the disclosure of financial statements and audit reports.
- **Profit and Loss:** A binary variable equal to 1 if the company reports a profit and 0 otherwise.
- **Industry:** Classified based on the official Iraq Stock Exchange classification.
- **Change Board:** A binary variable equal to 1 if at least one board member is changed, 0 otherwise.
- **Inflation:** Extracted from quarterly reports of the Central Bank of Iran.
- **Earnings Persistence:** Measured by the negative absolute value of residuals from Model 3.
- **Price-Earnings Ratio:** Stock price divided by earnings per share.
- **Liquidity:** Calculated as follows:

$$\text{Liquidity} = (\text{BAS}) / ((\text{AP} + \text{BP}) / 2)$$

Where:

- **BAS** = Bid-ask spread (difference between buying and selling price)
- **AP** = Average asking price for stock sales
- **BP** = Average bid price for stock purchases

Other financial indicators include:

- **Debt Ratio:** Total debt divided by total assets.
- **Dividend Per Share:** Total declared dividends divided by total shares outstanding.
- **Capital Structure:** Computed as:

$$\text{Capital Structure} = \text{BD} / \text{ME}$$

Where:

- **BD** = Book value of total debt
- **ME** = Market value of equity
- **Capital Increase:** A binary variable equal to 1 if capital increases and 0 otherwise.
- **Forecast Earnings Per Share:** A binary variable equal to 1 if actual earnings exceed forecasted earnings and 0 otherwise.
- **Turnover:** Number of traded shares divided by total outstanding shares.
- **Return on Assets (ROA):** Net profit divided by total assets.
- **Stock Returns:** Calculated as follows:

Stock Return = (Price End of Year - Price Start of Year + Dividends) / Price Start of Year

- **Exchange Rate:** Extracted from the Central Bank of Iran.
- **Oil Price:** Average annual oil price.
- **Election:** A binary variable equal to 1 if a presidential election occurs in year t , 0 otherwise.
- **Current Ratio:** Current assets divided by current liabilities.
- **Quick Ratio:** (Current assets - inventories) divided by current liabilities.

Moderator Variable

Market Competition (CPT): In this study, market competition is measured using the Auditor Herfindahl-Hirschman Index (Audit_HHI). A lower value indicates higher competition. Following Shleman and Lawson (2019), this index is multiplied by negative one so that a higher value represents greater market competition.

The index is calculated as follows:

$$\text{Audit_HHI} = \sum (S_i / S)^2$$

Where:

- S_i = Total audit fees received by auditor i
- S = Total audit fees received by all auditors in the respective industry

Control Variables

- **Age:** Years since the company's establishment.
- **Auditor Specialization (Aud-Spec):** Defined using the **market share** approach. If an audit firm's market share exceeds **1.2 times (1 / number of industry firms)**, it is considered specialized (value = 1), otherwise, 0.
- **Audit Switch (Aud-Switch):** Equals 1 if the auditor has changed from the previous year, otherwise 0.
- **Audit Tenure (Aud-Tenure):** Length of the auditor-client relationship.
- **Audit Type (Auditortype):** Equals 1 if audited by the Iraqi Court of Audit, otherwise 0.
- **Financial Leverage (LEV):** Total liabilities divided by total assets.

3. Findings

In Table 1, the dependent variables of the study, audit quality and audit fees, have mean and median values that are close to each other. The first independent variable, auditor experience, indicates that approximately 50% of auditors have at least 12 years of experience. The next independent variable, audit expectation gap, shows that more than half of the companies have a negative expectation gap. Regarding auditor gender, the data suggest that Iraqi companies show a very low tendency to employ female auditors.

Table 1. Descriptive Statistics of Quantitative Variables

Variable Type	Variable	Mean	Median	Minimum	Maximum
Dependent	Audit Quality	-0.28	-0.23	-0.80	0.00
	Audit Fees	10.72	10.66	7.18	14.19
Independent	Auditor Experience	11.77	12.00	5.00	19.00
	Audit Expectation Gap	0.04	-0.01	0.28	0.74
Moderator	Market Competition	0.23	0.19	0.00	0.69
Control	Auditor Specialization	0.61	0.83	0.001	1.00
	Firm Age	3.52	3.43	2.70	4.33

Market-to-Book Ratio	21.78	21.77	15.28	27.38
Financial Leverage	3.14	2.42	0.30	8.48
Auditor Tenure	0.32	0.23	0.01	0.97

Table 2. Descriptive Statistics of Control Variables

Variable Type	Variable	Number of Zeroes	Number of Ones	Percentage of Zeroes	Percentage of Ones
Control	Auditor Type	64%	36%	146	85
	Auditor Gender	10%	90%	23	208
	Auditor Change	17%	83%	38	193

Table 3. Results of Hypothesis 1 and Hypothesis 2

Variable	Symbol	Coefficient (H1)	t-statistic (H1)	p-value (H1)	Variance Inflation (H1)	Coefficient (H2)	t-statistic (H2)	p-value (H2)	Variance Inflation (H2)
Intercept	β	-0.256	-0.66	0.508	-	2.15	2.13	0.0345	-
Audit Expectation Gap	AE	-0.20	-7.26	0.000	1.32	-0.20	-4.51	0.000	2.79
Market Competition	CPT	-	-	-	-	-0.12	-1.37	0.170	2.84
Market Competition * Audit Expectation Gap	CPT * AE	-	-	-	-	-0.91	-2.32	0.010	1.34
Auditor Specialization	Aud-Spec	0.12	2.26	0.020	1.54	0.12	2.26	0.020	2.74
Auditor Type	Auditortype	0.01	0.37	0.700	1.96	0.01	0.74	0.450	1.32
Auditor Gender	Aud-gndr	0.09	1.49	0.130	1.19	0.10	1.59	0.110	1.33
Auditor Change	Aud-Switch	0.04	0.87	0.380	1.27	0.03	0.76	0.460	1.45
Auditor Tenure	Aud-Ten	-0.007	-0.57	0.550	1.27	-0.007	-0.77	0.440	1.65
Firm Age	Age	0.05	1.16	0.240	1.12	0.05	1.09	0.270	1.13
Firm Size	Size	0.01	0.37	0.700	1.27	0.01	0.19	0.840	1.74
Financial Leverage	LEV	-0.006	-0.14	0.590	1.27	-0.006	-0.14	0.990	1.42
Market-to-Book Ratio	MTB	0.04	0.85	0.390	1.27	0.05	1.12	0.250	1.16

Hypothesis 1: Audit Expectation Gap and Audit Quality

The results indicate a significant relationship between the audit expectation gap and audit quality at a 5% error level. Since the calculated p-value (0.000) is less than 0.05, the third hypothesis concerning the relationship between the audit expectation gap and audit quality is confirmed.

Given that the coefficient for the audit expectation gap is -0.20, the relationship is negative and statistically significant.

Hypothesis 2: Market Competition as a Moderator

The results demonstrate that market competition moderates the relationship between the audit expectation gap and audit quality at a 5% error level. The p-value for the interaction term (market competition * audit expectation gap) is 0.01, which is less than 0.05, confirming Hypothesis 2.

Since the coefficient for the interaction term is -0.91, and it shares the same sign as the independent variable, market competition amplifies the negative impact of the audit expectation gap on audit quality.

Table 4. Results of Hypothesis 3 and Hypothesis 4

Variable	Symbol	Coefficient (H3)	t-statistic (H3)	p-value (H3)	Variance Inflation (H3)	Coefficient (H4)	t-statistic (H4)	p-value (H4)	Variance Inflation (H4)
Intercept	β	-0.256	-0.66	0.508	-	2.15	2.13	0.0345	-
Auditor Experience	EXPAud	0.03	15.49	0.000	1.32	0.03	9.33	0.000	2.79
Market Competition	CPT	-	-	-	-	-0.06	-0.537	0.590	2.84
Market Competition * Auditor Experience	CPT * AE	-	-	-	-	0.004	0.03	0.960	1.34
Auditor Specialization	Aud-Spec	-0.05	-1.45	0.140	1.54	0.04	0.56	0.570	2.74
Auditor Type	Auditortype	0.01	0.16	0.870	1.96	0.01	0.41	0.680	1.32
Auditor Gender	Aud-gndr	0.01	0.17	0.830	1.19	0.01	0.23	0.810	1.33
Auditor Change	Aud-Switch	0.05	1.62	0.100	1.27	0.05	1.57	0.830	1.45
Auditor Tenure	Aud-Ten	-0.008	-1.05	0.290	1.27	-0.05	-1.13	0.250	1.65
Firm Age	Age	0.05	0.56	0.570	1.12	0.01	0.40	0.680	1.13
Firm Size	Size	0.01	0.049	0.960	1.27	-0.05	-0.08	0.930	1.74
Financial Leverage	LEV	-0.006	-0.538	0.590	1.27	-0.01	-0.43	0.660	1.42
Market-to-Book Ratio	MTB	0.06	1.73	0.080	1.27	0.07	1.918	0.050	1.16

Hypothesis 3: Auditor Experience and Audit Quality

The results indicate a significant relationship between auditor experience and audit quality at a 5% error level. Since the p-value (0.000) is less than 0.05, Hypothesis 3 is confirmed, supporting the relationship between auditor experience and audit quality.

Given that the coefficient for auditor experience is 0.03, the relationship is positive and statistically significant.

Hypothesis 4: Market Competition as a Moderator

The results indicate that market competition does not moderate the relationship between auditor experience and audit quality at a 5% error level. The p-value for the interaction term (market competition * auditor experience) is 0.96, which is greater than 0.05, leading to the rejection of Hypothesis 4.

Table 5. Results of Hypothesis 5 and Hypothesis 6

Variable	Symbol	Coefficient (H5)	t-statistic (H5)	p-value (H5)	Variance Inflation (H5)	Coefficient (H6)	t-statistic (H6)	p-value (H6)	Variance Inflation (H6)
Intercept	β	-0.256	-0.66	0.508	-	2.15	2.13	0.0345	-
Auditor Experience	EXPAud	0.03	15.49	0.000	1.32	0.03	9.33	0.000	2.79
Market Competition	CPT	-	-	-	-	-0.06	-0.537	0.590	2.84
Market Competition * Audit Expectation Gap	CPT * AE	-	-	-	-	0.004	0.03	0.960	1.34
Auditor Specialization	Aud-Spec	-0.05	-1.45	0.140	1.54	0.04	0.56	0.570	2.74
Auditor Type	Auditortype	0.01	0.16	0.870	1.96	0.01	0.41	0.680	1.32
Auditor Gender	Aud-gndr	0.01	0.17	0.830	1.19	0.01	0.23	0.810	1.33
Auditor Change	Aud-Switch	0.05	1.62	0.100	1.27	0.05	1.57	0.830	1.45

Auditor Tenure	Aud-Ten	-0.008	-1.05	0.290	1.27	-0.05	-1.13	0.250	1.65
Firm Age	Age	0.05	0.56	0.570	1.12	0.01	0.40	0.680	1.13
Firm Size	Size	0.01	0.049	0.960	1.27	-0.05	-0.08	0.930	1.74
Financial Leverage	LEV	-0.006	-0.538	0.590	1.27	-0.01	-0.43	0.660	1.42
Market-to-Book Ratio	MTB	0.06	1.73	0.080	1.27	0.07	1.918	0.050	1.16

Hypothesis 5: Audit Expectation Gap and Audit Fees

The results indicate a significant relationship between the audit expectation gap and audit fees at a 5% error level. Since the p-value (0.000) is less than 0.05, Hypothesis 5 is confirmed, supporting the relationship between audit expectation gap and audit fees.

Given that the coefficient for the audit expectation gap is -3.82, the relationship is negative and statistically significant.

Hypothesis 6: Market Competition as a Moderator

The results indicate that market competition moderates the relationship between the audit expectation gap and audit fees at a 5% error level. The p-value for the interaction term (market competition * audit expectation gap) is 0.000, which is less than 0.05, confirming Hypothesis 6.

Since the coefficient for the interaction term is positive and has the same direction as the independent variable, market competition amplifies the impact of the audit expectation gap on audit fees in an increasing direction.

4. Discussion and Conclusion

Based on the hypothesis analysis, it is evident that auditor experience affects audit fees. In this research, auditor experience influencing audit fees includes factors such as the reputation of the audit firm partner, professional auditing experience in a specific industry, price-cutting in audit fees, the presence of competitive audit markets, value-added services in audited financial reports, explicit agreements between clients and audit firms regarding fair audit fees, fairness in audit fees for audit work, specialized skills of the audit partner in report presentation, and the presence of multiple specialized audit firms in the financial job market. Additionally, it is determined that auditor experience impacts audit quality. Since failure to detect significant misstatements weakens the audit services market, audit firms, especially large audit firms, strive to hire experienced auditors to achieve their goals and maintain credibility. It is recommended that audit firms emphasize quality control measures and, if feasible, establish dedicated quality control units. This necessity implies the formation of large audit firms that, in addition to increasing revenue potential, enable the hiring of experienced and specialized personnel and improve quality by investing in higher service standards. Furthermore, it is suggested that the concept of professional oversight be reconsidered and more effective methods be implemented. The benefits of quality control should also be publicly communicated to encourage audit firms to improve service quality [10, 21].

In Iraq, due to inflationary conditions and market price instability, annual audit fees tend to increase. Moreover, Iraqi companies are still in a growth phase and have not yet reached full maturity. As a result, the volume of corporate operations is expanding, necessitating greater auditor effort and leading to higher audit fees.

Young audit firms may attempt to lower fees by completing audits more quickly, but experience remains an essential factor in a profession that heavily relies on judgment. Experience fosters expertise in diverse subject areas, professional conduct, and critical auditing skills. It is suggested that ranking systems and other methods be

developed to ensure that well-established, reputable audit firms handle economically significant audits affecting a broader segment of society.

The confirmation of the audit expectation gap in this study, between audit service providers and users regarding audit quality determinants and regulatory impacts, underscores the need to develop professional standards and guidelines aligned with user awareness levels and informational needs to narrow the reasonable expectation gap.

Considering the impact of firm size and quality rankings on survey responses in this research and the expectation gap between audit service providers and users regarding audit regulations, a performance gap among professionals is evident. Holding training programs within audit firms or general public courses for financial managers, organized by professional bodies, could address technical and informational needs in the audit process for independent auditors and financial statement preparers.

One of the primary limitations of this study is the use of various measures for the audit expectation gap, including different survey instruments and models. This research solely relied on the model presented by Salehi et al. (2022), while other criteria were suggested for future studies. This choice introduces limitations in comparison and deeper analysis, as alternative measures might have yielded different results in assessing the expectation gap.

The second limitation relates to the assessment of market competition metrics. This study used only a single index to measure market competition, which could influence the research findings. If different competition indices were used, the results regarding the relationship between market competition and the audit expectation gap might differ. Therefore, future studies should employ a more diverse set of market competition metrics to obtain more comprehensive results.

Authors' Contributions

Authors equally contributed to this article.

Ethical Considerations

All procedures performed in this study were under the ethical standards.

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Conflict of Interest

The authors report no conflict of interest.

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