

The Role of External Auditor’s Sectoral Specialization in Improving Financial Reporting Quality to Client: Field Study in Algeria.

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Abstract :

This research aims to investigate how an external auditor's industry-specific knowledge influences the improvement of financial reporting quality within organizations, employing a practical methodology with a questionnaire sent to a targeted sample of 70 accounting experts and controllers in Algeria, with a descriptive approach for the theoretical part. The findings indicate that external auditors' sector-specific specialization makes a substantial contribution to their thorough comprehension and knowledge of financial accounting, the company's financial environment, and sector-specific characteristics.

Mots clés:

Mot clé.1: Audit externe,
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G14 ,G30 ,M42.

Abstract :

Cette recherche vise à étudier comment les connaissances sectorielles d'un auditeur externe influencent l'amélioration de la qualité de l'information financière au sein des entreprises, en employant une méthodologie pratique avec un questionnaire envoyé à un échantillon ciblé de 70 experts comptables et commissaires en Algérie, avec une approche descriptive pour la partie théorique. Les résultats indiquent que la spécialisation sectorielle des auditeurs externes apporte une contribution substantielle à leur compréhension et connaissance approfondies de la comptabilité financière, de l'environnement financier de l'entreprise et des caractéristiques spécifiques au secteur.

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1. INTRODUCTION

Exploring the annals of economic history, the theme of financial reporting by economic entities has perennially sparked substantial debate in the finance and business sectors, primarily due to issues surrounding the lack of transparency and reliability in information. Given that a company's operations intersect with the interests of a diverse array of stakeholders—including investors, creditors, governmental entities, employees, and civil society at large—the ramifications of financial reporting are extensive.

The role of external auditing emerges as a cornerstone of trust, tasked with validating the accuracy of financial data presented by companies to investors. As a critical control mechanism, external auditing underpins the integrity and quality of disclosed information.

The interest in the services of the auditing profession has increased due to the nature of the role of the external auditor, which is represented in the critical view of the elements presented to him with the aim of satisfy the needs of users of accounting information (Tamar, 2022, p. 335), and The company's management depends on the financial and accounting statements that are prepared and certified for their reliability by an independent and neutral auditor, as they are seen as a tool to prove that it has carried out its work in a transparent manner. Stakeholders and users of financial statements and reports heavily rely on the auditors' assessments to inform their pivotal decisions. (Tounssi, 2016, p. 314)

The concept of sectoral specialization for auditors represents a contemporary and significant evolution in the field. It necessitates that auditors possess a thorough understanding of the various activities and operations within the specific sectors they monitor, and in this research, we will delve deeper into this topic to understand all its aspects.

▪ **Research question :**

Therefore, the primary question this study seeks to address is:

- **How does industry expertise among external auditors improve the quality of financial reporting for their clients, as viewed by these auditors in Algeria?**

▪ **Sub-questions :**

- Does the sectoral specialization of the external auditor contribute to reducing audit risks?
- Does an external auditor's industry specialization help reduce practices of creative accounting?

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- Does an external auditor's industry specialization increase their professional capability to identify errors and fraud?
- Does an external auditor's industry specialization aid in boosting the reliability of the accounting information disclosed in financial statements?

▪ Study Hypotheses:

We formulated these hypotheses:

Main hypothesis:

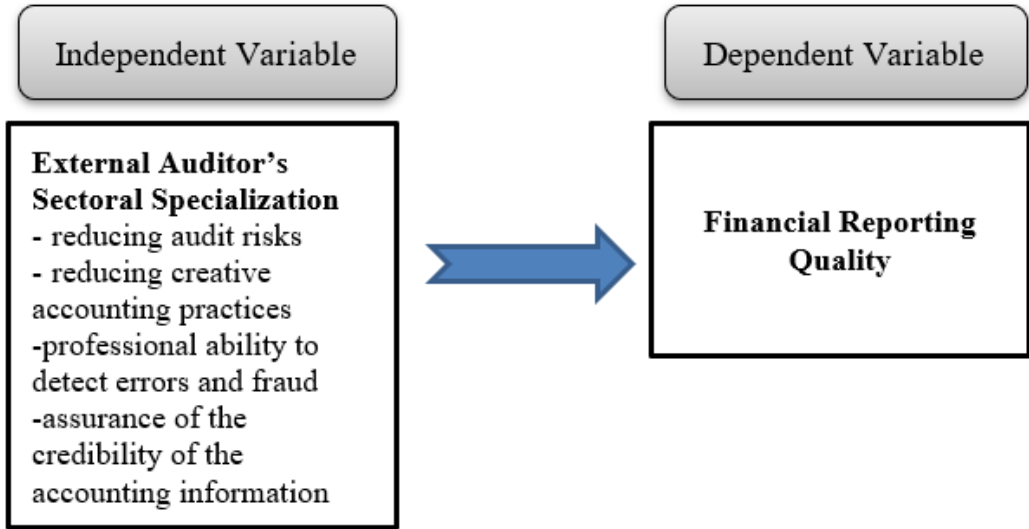
- The sectoral specialization of external auditors enhances the quality of financial reporting for clients, as perceived by external auditors in Algeria.

Sub-hypothesis:

- **H1:** The sectoral specialization of external auditors helps mitigate audit risks, as perceived by external auditors in Algeria.
- **H2:** The industry-specific expertise of external auditors aids in curbing creative accounting practices, according to the views of external auditors in Algeria.
- **H3:** The sectoral specialization of external auditors boosts their professional capacity to identify errors and fraud, based on the opinions of external auditors in Algeria.
- **H4:** The sectoral expertise of external auditors enhances the credibility of the accounting information presented in financial statements, according to the perspectives of external auditors in Algeria.

Study Model:

Figure 01: Study Model



Source: Authors based on the study of (Al-Sayed Al-Naghi & al, 2023)

▪ **Study Importance:**

The external auditor's sectoral expertise has become a contemporary pathway into the field, offering a competitive edge in the audit services market. Our study aims to underscore the practical benefits that sectorally specialized auditors bring to their clients and to stakeholders who rely on client-specific financial statements for making investment, credit, and other decisions.

▪ **Study Objectives:**

This study endeavors to elucidate the following:

- ✓ The strategy and significance of sectoral specialization for external auditors.
- ✓ Grasping the concept of financial reporting and the metrics used to measure its quality.
- ✓ Examining how the industry expertise of external auditors helps in minimizing audit risks and curbing the practice of creative accounting.

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exploration of how sectoral expertise enhances auditors' effectiveness in detecting fraud, identifying errors.

2. External auditor's sectoral specialization strategy:

2.1. Its concept:

Arens et al. (2011, p. 237) state that: "auditor specialization denotes an auditor as possessing extensive knowledge and prolonged experience in a client's particular business and sector, with an awareness of the company's operations, and specific accounting and auditing standards crucial for conducting a high-quality audit."

(Cadman & Stein , 2007, p. 03) describe sectoral specialization:" as a pathway enabling auditors to comprehensively and profoundly understand the industry of their clients, thereby equipping them to deliver superior audit services".

Building on these perspectives, sectoral specialization is considered the combination of experience, abilities, and information that an auditor obtains from working extensively with numerous companies in a certain industry. Due to this deep engagement, the auditor is more capable of pinpointing risk areas, detecting errors and fraudulent activities, and delivering superior audit services.

2.2. The importance of sectoral specialization of external auditor:

- Mitigating opportunistic behavior by management (Habib, 2011, p. 120).
- Amplifying the efficacy of management control and limiting its autonomy in selecting among alternative accounting practices (Deboskey & Jiang , 2012, p. 616).
- Boosting the effectiveness of audit procedures in detecting fraud and significant errors in financial statements (Sarwoko & Agoes, 2014, p. 273).
- Elevating the reputation of audit firms that provide high-quality services, thereby improving audit efficiency (jassim , 2022, p. 1048).

3. Financial Reporting Quality:

3.1. Its concept:

Financial information has been used as an informational tool, a management accountability tool for the business owners, a description of the company's success measurements, and a consideration to be made in decision-making.. (Othman , 2018). Moreover, financial statements serve as critical indicators of a company's financial health during a given period. For the production of high-quality financial reports, these statements need to be precisely accurate and free from major errors (Setiyawai, 2020, p. 32)

In addition, a company's financial performance is reflected in its financial statements (Hallam & Aksa, 2021, p. 80)

According to Biddle et al. (2009) , financial reporting quality (FRQ) is the capacity of financial statements to accurately convey to shareholders information about a company's performance, especially its anticipated cash flow.

Preparing reliable financial statements that reflect a true picture of the facts carried out by this institution is crucial for reporting its financial position and the results achieved during the accounting period (BOUAZZA & BOUCHIKHI , 2022)

FRQ can be delineated as the provision of comprehensive and transparent financial information that eschews any intentions to obscure or mislead its users (Jonas & Blanchet, 2000, p. 358)

According to (Oucif & Mazeri , 2022, p. 378)The quality of reporting appears when it is a good approach for making investment decisions. This requires the availability of advantages in the disclosed information, which contribute to bridging the time gap for delivering information to any users of financial reports by delivering it in a timely manner and without losing its value.

3.2. Measures of financial reporting quality :

From the viewpoint of accounting standards developers, relevance and reliability are crucial attributes that define the quality of financial information, enabling decision-makers to utilize the data effectively (Nwaobia, A.N, Kwarbai, J.D, & Ajib,A,T, 2016), Thus, a key factor in ensuring the financial statements' trustworthiness is the quality of accounting information, with all of its secondary and main features. (Mimoun, Benouali , & Belmechri, 2023, p. 10)

In addition, the feedback value of the information or the feedback of the information and the ability to change and correct current and future expectations are also required (Othman , 2018, p. 246).

The emphasis is on furnishing users with clear and precise financial reports, highlighting the importance of accuracy and predictability as hallmarks of superior financial reporting (Gajevzky, 2015, p. 70).

Researchers have identified earnings management as a significant factor that degrades the quality of financial reporting. This practice involves managers manipulating financial data to align with their personal interests, misleading stakeholders and obscuring the true economic performance of the company. According to (Tarfoui & Mayou, 2021, p. 121) that the practice of accounting earnings management arises through future motives for management .

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4. Research Methods, tools and measures:

4.1. Methodology

This study employed a quantitative approach to address the proposed hypotheses by developing a questionnaire survey to gather primary data. The questionnaire is divided into two sections:

Firstly: gathers basic information about participants such as age, educational qualifications, job designation, and years of experience.

Secondly : Assesses how the industry expertise of external auditors influences their ability to mitigate audit risks and reduce creative accounting. This also involves assessing their proficiency in detecting fraud and errors and ensuring the precision of financial statements. Data was collected using a five-point Likert scale and SPSS V25. Techniques such as mean, percentages, relative importance index (RII), Pearson’s correlation, Cronbach’s alpha, standard deviation, and T-tests were utilized.

4.2. Population and sample:

The study involved accounting professionals and audit controllers from various auditing firms across Algeria. Employing a simple random sampling method, 70 accounting experts and accounts controllers were chosen to participate in the current field study. Of these, 45 valid questionnaires were collected and analyzed, forming the final sample for the study

Table N⁰(01): Results of distributing questionnaires

Distributed forms	Missing forms	Cancelled forms	Returned forms	Accepted forms
70	25	00	45	45

Source : Authors

Table N⁰(02) : General information of the sample

Variables	Categories	Frequency	Percentage %
Age	Under than 30 years	4	8,9
	31-40 years	15	33,3
	41-50 years	15	33,3
	More Than 50 years	11	24,4
Educational level	Bachelor's degree	16	35,6
	Master	11	24,4
	Magister	2	4,4

	Phd	12	26,7
	Other	4	8,9
Job title	Accounting expert	15	33,3
	Account controller	30	66,7
Job experience	Under than 5 years	6	13,3
	6 -10 years	11	24,4
	11- 15 years	11	24,4
	More than 15 years	17	37,8

Source: Authors based on SPSS V.25 out-puts

From the table 02 it can be observed the following:

✓ **Age distribution:** More than half of the sample members are over 31 years of age, with 33.3% of all 31-40 years of age, who are between 41 and 50 years, as well as 24.4% of those over 50 years of age, while 8.9% of those under 30 years of age.

✓ **Educational level:** one third of the samplers have a of a bachelor's degree of 35.6%, 26.7% have a phd degree, 24.4% have a master ' s degree,8.9 % have other degrees different from the four options, and 4.4% have a magister degree.

✓ **Job title:** More than half of the sample members are 66.7% account controller , while 33.3% are accounting experts.

✓ **Job experience:** more than half of the sample members have more than 6 years of experience, with 24.4% of their experience being from 6 to 10 years of age, who also have 11 to 15 years of experience, with 37.8% representing those with more than 15 years of experience. This is a good indicator, while 13.3% of those with less than 5 years of experience are 13.3%.

5.1. Construct Validity

Analysis of Table 03 indicates that the Pearson correlations between each item and its respective dimension are all positive, with significance levels below 0.05.

Table N⁰ 03 : Construct validity of the questionnaire

Axis	Z	Pearson correlation coefficient	Sig	Axis	Z	Pearson correlation coefficient	Sig
Axis01	1	0,866**	0,000	Axis03	15	0,717**	0,000
	2	0,797**	0,000		16	0,800**	0,000
	3	0,874**	0,000		17	0,871**	0,000

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Axis02	4	0,785**	0,000	Axis04	18	0,811**	0,000
	5	0,888**	0,000		19	0,744**	0,000
	6	0,619**	0,000		20	0,898**	0,000
	7	0,734**	0,000		21	0,671**	0,000
	8	0,809**	0,000		22	0,796**	0,000
	9	0,800**	0,000		23	0,645**	0,000
	10	0,839**	0,000	** :Statistically significant at the 1% level.			
	11	0,797**	0,000				
	12	0,823**	0,000				
	13	0,613**	0,000				
	14	0,739**	0,000				

Source: Authors based on SPSS V.25 out-puts

Pearson correlations for each item related to its respective construct are all positive with significance levels below 0.05, confirming that the questionnaire's second part effectively assesses the intended constructs.

4.3.Reliability Test:

The questionnaire's reliability, along with its dimensions, is confirmed through the Cronbach's Alpha coefficient, where values above 0.7 indicate acceptable reliability (Sharif-Nia & Hanifi, 2023, p 4649). The subsequent table lists the Cronbach’s Alpha values for each dimension:

Table N⁰ 04: Cronbach's Alpha Test

Axes	No. of items	Cronbach's Alpha
Axis 01	7	0,900
Axis 02	7	0,889
Axis 03	4	0,813
Axis 04	5	0,808
Total	23	0,949

Source: Authors based on SPSS V.25 out-puts

Cronbach's Alpha for the items is 0.949, which is higher than the acceptable cutoff of 0.70 and indicates outstanding reliability. Each of the four axes has a unique Cronbach's Alpha score between 0.808 and 0.900, all of which are higher than 0.70, indicating the survey questionnaire excellent level of reliability.

5.3. Descriptive statistics:

Table N⁰ (05): Descriptive statistics highlight how the sectoral specialization of external auditors contributes to reducing audit risks.

N	Phrases of Axis 01	Mean	Std. Deviation	RII	Arrangement
1	Increases his ability to identify and assess the risks of substantial distortion, whether due to fraud or error based on an understanding of the enterprise and its environment.	4,16	0,976	High	6
2	Improves his ability to obtain adequate audit evidence of substantial distortions.	4,24	0,933	very high	2
3	Strengthen his capacity to form a fair opinion on the financial statements.	4,27	0,720	very high	1
4	Increases his ability to select the appropriate operational procedures for the audit process.	4,18	0,834	High	4
5	Improve his ability to identify discrepancies arising from inadequate internal controls.	4,16	0,903	High	5
6	Improve his ability to select the appropriate sample in terms of size	4,13	0,894	High	7
7	increases their ability to detect potential errors and irregularities in the financial statements processing system	4,20	0,786	very high	3
---	Axis 01	4,19	0,686	High	

Source: Authors based on the study of (Al-Sayed Al-Naghi & al, 2023) , and SPSS V.25 out-puts

Table 05 provides an overview of the first axis, the average score for this axis is 4.19, with a standard deviation of 0.686, indicating a high Relative Importance Index (RII). This indicates a strong consensus among respondents regarding the positive effect of sectoral specialization on reducing audit risk in Algeria. The third phrase has the highest recorded average for this axis, 4.27, while the sixth phrase has the lowest average, 4.13.

Table N⁰ (06): Descriptive statistics on how the sector-specific expertise of external auditors aids in minimizing creative accounting practices.

N	Phrases of Axis 02	Mean	Std. Deviation	RII	Arrangement
8	detect profit management practices made through management decisions in favour of management at the expense of contributors	3,98	0,892	High	2
9	enables him to detect the management of profits made through manipulation of accounting estimates of allocations.	4,04	0,928	High	1
10	increases his capacity to detect the manipulation of estimates in the estimated productive life of long-term assets (immobilisation).	3,89	1,071	High	4
11	enables him to detect the management of profits made through increased sales before the end of the period, such as price discounts or concessional credit terms	3,78	1,020	High	5
12	increases his ability to detect fraud carried out in a way that increases production, such as reducing the unit ' s share of fixed costs, thereby reducing the unit ' s total costs and thus reducing the cost of goods sold, as well as increasing the	3,64	1,151	High	7

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	end-of-life goods				
13	detect the manipulation of research and development expenses, repairs, maintenance, publicity and advertising	3,93	0,837	High	3
14	Identify profit manipulation through the strategic timing of buying or selling long-term assets or repurchasing company shares to meet specific profit goals.	3,69	0,973	High	6
---	Axis 02	3,85	0,765	High	

Source: Authors based on the study of (Al-Sayed Al-Naghi & al, 2023) , and SPSS V.25 out-puts

Arithmetic mean is 3.85, and standard deviation of 0.765, demonstrating once more a strong RII. This shows that participants have a strong consensus regarding the sectoral specialization's ability to reduce creative accounting practices. Phrase No. 9 has the highest mean score (4.04) on this axis, while phrase No. 12 has the lowest mean score (3.64)

Table N⁰ (07): Descriptive statistics illustrate how the sectoral specialization of external auditors enhances their professional capability to identify errors and fraud.

Z	Phrases of Axis 03	Mean	Std. Deviation	RII	Arrangemen
15	Evaluate the suitability of journal entries and other adjustments in the financial statement preparation process	3,78	0,850	High	2
16	enables him to examine the accounting estimates to ascertain whether they contain biases and to assess whether the circumstances that led to the bias present a material risk of distortion due to fraud	3,84	0,928	High	1
17	Permits him to determine if significant transactions outside the normal business activities suggest potential fraudulent financial reporting or concealment of asset misappropriation..	3,76	0,883	High	3
18	Allows him to ascertain if the analytical procedures executed towards the audit's conclusion reveal a significant risk of fraud-related discrepancies.	3,71	0,920	High	4
---	Axis	3,77	0,717	high	

Source: Authors based on the study of (Al-Sayed Al-Naghi & al, 2023) ,and SPSS V.25 out-puts

Turning to the third axis, which is shown in Table 07, significant agreement is indicated by a mean score of 3.77 with a standard deviation of 0.717, indicating a high RII and improving the auditor's capacity to spot errors and fraud. Phrase No. 16 has the greatest mean on the axis, 3.84, while phrase No. 18 has the lowest mean, 3.71.

Table N^o (08): Impact of external auditors' sectoral specialization on enhancing the credibility of accounting information disclosed in financial statements.

N	Phrases of Axis 04	Mean	Std. Deviation	RII	Arrangement
19	Accurately reflect the economic condition and financial position of the enterprise.	3,89	0,832	High	3
20	Enables him to confirm the extent to which accounting information clearly reflects the financial position and cash flows.	3,96	0,824	high	2
21	Confirm the extent to which accounting information accurately reflects the integrity of submission and disclosure, and complies with all required accounting disclosures.	4,09	0,668	High	1
22	Demonstrate the correct application of accounting standards in financial statement preparation.	3,82	0,860	High	5
23	Ensure consistency in the presentation and tabulation of accounting items, with periodic updates.	3,87	0,815	high	4
---	Axis 04	3,92	0,603	high	

Source: Authors based on the study of (Al-Sayed Al-Naghi & al, 2023) ,and SPSS V.25 out-puts

The mean for the fourth axis is 3.92, and the standard deviation is 0.603. This also has a high RII, showing that there is widespread consensus that the auditor's industry expertise enhances the accuracy of financial statement information. Phrase No. 21 has the greatest mean score of 4.09 on this axis, while phrase No. 22 has the lowest mean score of 3.82.

6. Discussion:

The study's hypotheses were evaluated using a one-sample t-test to assess the impact of external auditors' industry specialization on the quality of financial reporting in Algeria

Table N^o (09): One Sample t-test

Hypotheses	Axes	Mean	Std. Deviation	t- test Value	10
H	The industry expertise of external auditors is perceived to enhance the quality of financial reporting for their clients in Algeria.	3,96	0,617	10,402	0,000
Sub-hypotheses 01	Axis 01 : the external auditor's sectoral specialization contributes to reducing audit risks, according to the opinion of external auditors in Algeria	4,19	0,686	11,633	0,000
02Sub-hypotheses	Axis 02: According to external auditors	3,85	0,765	7,460	0,000

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	in Algeria, the sectoral specialization of external auditors contributes to reducing creative accounting practices.				
03Sub-hypotheses	Axis 03: the external auditor's sectoral specialization contributes to raising his professional ability to detect errors and fraud, according to the opinion of external auditors in Algeria .	3,77	0,717	7,228	0,000
04Sub-hypotheses	Axis04: The sectoral specialization of external auditors enhances the reliability of accounting information disclosed in financial statements, based on the perspectives of external auditors in Algeria.	3,92	0,603	10,276	0,000

Source: Authors based on the study of (Al-Sayed Al-Naghi & al, 2023)
,and SPSS V.25 out-puts

Table 09 elucidates the results as follows:

1ST Hypothesis: The analysis reveals a T value of 11.633, surpassing the critical T threshold of 2.01. With an average score of 4.19, exceeding the hypothetical median of 3 on a five-point Likert scale, and a statistical significance (Sig) of 0.000, which falls below the 0.05 threshold, it is confirmed that participants significantly recognize the reduction in audit risks due to the external auditor's industry specialization.

This is attributed to the industry-specific knowledge that equips the auditor with enhanced judgment and subjective evaluation skills, thereby reducing the likelihood of erroneous opinions about the financial statements or missing significant distortions. Consequently, the study's initial sub-hypothesis is accepted.

2nd Hypothesis:

The results indicate that the computed T value is 7.460, greater than the T critical threshold of 2.01. Utilizing a five-point Likert scale, the calculated mean of 3.85 exceeds the hypothetical median of 3, with a significance level (Sig) of 0.000, which is well below the 0.05 threshold. This indicates that the respondents are in agreement that the external auditor's sectoral specialization provides an important part in curbing creative accounting techniques. This result can be understood as the auditor's ability to limit the choice of alternative accounting methods and curb management's fraudulent activity thanks to their industrial specialization strategy. Confirming acceptance of the study's second sub-hypothesis.

3rd Hypothesis: the analysis reveals a T value of 7.228, exceeding the critical T value of 2.01. Sectoral specialization significantly improves the external auditor's ability to detect errors and fraud, according to respondents, with an average score of 3.77, above the hypothetical median of 3 on a five-point Likert scale, and a significance level (Sig) of 0.00, below the threshold of 0.05. This is explained by the auditor's improved

capacity to detect risk areas through professional skepticism, which is a basic audit premise. The auditor's industry-specific expertise facilitates the identification of significant misstatements caused by fraud or errors. Confirming acceptance of the third sub-hypothesis.

4TH Hypothesis: The computed T value of 10.276 exceeds the critical threshold of 2.01, with a significance value of 0.000, well below the 0.05 limit. The mean score of 3.92, higher than the median of 3, indicates consensus among respondents that industry-specific expertise of external auditors enhances the quality of financial statement disclosures. This improvement is due to the industrial specialization strategy, which enables auditors to ensure the transparency and reliability of the disclosed information. Consequently, the fourth sub-hypothesis is accepted.

Main Hypothesis: The Sig value is .000, falling below the standard 0.05 threshold, and the computed T value is 10.402, which is above the critical T value of 2.01. With an average rating of 3.96, it is higher than the fictitious three-point Likert scale median. The findings indicate that respondents generally concur that an external auditor's sectoral specialization greatly raises the caliber of the financial reports they provide to clients. As a result, the study's central hypothesis is accepted.

7. Conclusion :

From the field study conducted within Algerian audit offices, supported by both theoretical and empirical data, we deduce the following:

- ✓ The industry-specific expertise of external auditors substantially enhances their proficiency and understanding of the company's financial accounting and fiscal environment, as well as the unique characteristics of the industry. This specialization is vital in managing client accounting systems and ensuring adherence to relevant laws, regulations, and accounting and auditing standards.
- ✓ Sectoral specialization strategy plays a pivotal role in mitigating audit risks. It equips auditors with the capacity to identify weaknesses within the internal control system and pinpoint areas prone to significant errors and misstatements.
- ✓ Through sectoral specialization, external auditors are better positioned to curb earnings management practices that involve the manipulation of accounting estimates, thereby limiting management's ability to choose among various accounting alternatives.

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✓ Sectoral specialization affords auditors a competitive edge in the audit market, as entities audited by specialists are perceived to have financial statements with greater credibility and reliability compared to others.

Based on the foregoing, a set of recommendations can be proposed that are based on the previous results:

✓ There is a pressing need to integrate sectoral specialization strategies into university curricula, reflecting their critical importance in the field.

✓ Audit offices should concentrate their efforts on one or two sectors, enabling them to fully leverage their financial, human, and technological resources to achieve mastery over the sector.

✓ Auditors specializing in specific sectors must continually update their knowledge base and strive to acquire new information and skills relevant to their area of expertise.

✓ market regulation, which guarantee that auditors with sector-specific specialty are accommodated, should be given a higher priority by professional bodies that govern the accounting and auditing professions.

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