External Audit Quality: A Comprehensive Literature Review of Determinants, Indicators, and Implications

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Abstract: This paper presents a comprehensive literature review on external audit quality, a critical construct underpinning the integrity of financial reporting and the credibility of corporate governance. Despite its foundational importance, audit quality remains a conceptually contested and empirically complex domain, shaped by multifaceted interactions among auditor attributes, client characteristics, institutional environments, and emerging technologies. Drawing on seminal and contemporary scholarship, this review synthesizes key theoretical frameworks and empirical findings to elucidate the determinants, proxies, and consequences of audit quality. The analysis reveals consistent associations between audit quality and factors such as auditor size, independence, industry specialization, and legal enforcement, while highlighting nuanced effects for variables such as tenure and audit fees. The review also evaluates the effectiveness of common measurement proxies, including discretionary accruals, restatements, and composite indices, and examines the role of audit quality in curbing earnings management, enhancing financial performance, and reinforcing stakeholder trust. The paper concludes by identifying key gaps in the literature and offering policy and practice-oriented recommendations aimed at improving audit effectiveness in a dynamic global environment. This synthesis provides a structured foundation for future research and contributes to ongoing debates regarding regulatory reform and audit innovation.

Keywords: Audit quality, auditor independence, earnings management, financial reporting, audit fees, big four auditors, corporate governance, legal risk, artificial intelligence, audit regulation, audit quality indicators, stakeholder trust.

1. Introduction

The quality of external audits represents a cornerstone of modern financial reporting systems and corporate governance structures. As capital markets expand and stakeholder scrutiny intensifies, the reliability of financial disclosures has become increasingly dependent on the integrity and effectiveness of independent audits. High-quality audits enhance the credibility of financial statements, reduce information asymmetry, and reinforce investor confidence, contributing to the efficient functioning of financial markets and the broader economy.

Despite its fundamental role, audit quality remains a conceptually contested and empirically elusive construct. Scholars, practitioners, and regulators have long grappled with questions surrounding its definition, measurement, and determinants. While early theoretical models emphasized the dual role of auditor competence and independence, subsequent research has evolved to incorporate a broader array of contextual, procedural, and technological factors. As such, audit quality is now widely understood as a multidimensional phenomenon influenced by a constellation of interrelated variables.

In recent years, developments in data analytics, artificial intelligence, and global regulatory reforms have further complicated the landscape, introducing new opportunities and challenges for auditors and oversight bodies alike. Moreover, a growing body of international research has drawn attention to how legal systems, cultural norms, and institutional frameworks mediate the effectiveness of audit practices across jurisdictions.

Against this backdrop, this literature review seeks to synthesize the theoretical and empirical contributions to the field of external audit quality. The review is organized into four major sections. First, it explores foundational and contemporary

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frameworks for conceptualizing audit quality. Second, it examines the determinants of audit quality at the auditor, client, and institutional levels. Third, it reviews common proxies used in empirical research and assesses their validity. Finally, the review analyzes the consequences of audit quality for financial reporting, earnings management, firm performance, and stakeholder trust.

By offering a comprehensive and integrative overview of the literature, this paper aims to clarify the state of current knowledge, identify areas of consensus and contention, and highlight promising directions for future research and policy development. Ultimately, it seeks to contribute to a more nuanced understanding of how audit quality can be enhanced and sustained in an evolving global audit environment.

The paper is structured as follows. Section 2 provides a comprehensive review of the conceptual foundations of external audit quality, tracing its evolution from early theoretical definitions to multidimensional frameworks that incorporate auditor behavior, process integrity, and technological advancement. Section 3 analyzes the determinants of audit quality, including auditor-specific factors (such as size, tenure, and independence), client-related characteristics (such as governance and complexity), and broader institutional influences (such as legal environments and regulatory oversight). This section also considers emerging challenges linked to technological innovation and cross-jurisdictional variation. Section 4 synthesizes the literature by identifying key themes, theoretical tensions, and areas of convergence and divergence across studies, and it outlines avenues for future research. Section 5 concludes the paper by highlighting the implications of the review for academic inquiry, policy development, and audit practice.

2. External Audit Quality

Audit quality is a fundamental pillar of financial reporting integrity and corporate governance. It reinforces investor confidence, enhances market efficiency, and promotes the transparency of corporate disclosures. Despite its critical role, the concept remains complex both theoretically and empirically. The academic literature reflects longstanding debates regarding the definition, measurement, and improvement of audit quality, underscoring its multidimensional character and the diverse expectations of stakeholders. This section synthesizes the principal theoretical constructs and empirical findings, offering a comprehensive overview of key developments in audit quality research.

2.1. Conceptual Frameworks of Audit Quality

Early definitions of audit quality emphasized the auditor's role in mitigating information asymmetry and enhancing the credibility of financial statements. Wallace (1980), as cited in Watkins *et al.* (2004), characterized audit quality by its capacity to reduce informational bias. DeAngelo (1981) offered a seminal definition, positing that audit quality is the joint probability that an auditor both detects and reports material misstatements, contingent on competence and independence. Subsequent contributions by Palmrose (1988) and Titman and Trueman (1986) focused on assurance and reliability as key elements.

Recent perspectives extend beyond this foundational view. DeFond and Zhang (2014) proposed a tripartite framework categorizing audit quality indicators into input, process, and output dimensions. Other scholars, such as Dichev *et al.* (2013), critiqued traditional proxies for their noise and suggested broader, multidimensional measures. Knechel (2016) and Aobdia (2019) expanded this construct further by incorporating elements of professional skepticism, auditor judgment, and procedural effectiveness.

2.2. Determinants of Audit Quality

2.2.1. Auditor independence and fees

Auditor independence is critical to audit quality, yet it is susceptible to economic influences. DeAngelo (1981) and Simunic (1980) warned that client dependence may compromise objectivity. Empirical studies corroborate this view, with Frankel *et al.* (2002) and Reynolds *et al.* (2004) linking abnormally high fees to diminished audit quality. Conversely, DeFond *et al.* (2002) argue that higher fees might reflect greater audit effort in complex scenarios.

2.2.2. Legal and institutional risk

Audit quality is shaped by the legal environment. Lennox and Li (2019) found that greater litigation risk induces more rigorous audits. Moorthy and Sarath (2017) cautioned that excessive legal pressure might foster defensive auditing, potentially reducing audit informativeness. Francis *et al.* (2005) highlighted the moderating effect of investor protection.

2.2.3. Auditor attributes

Research comparing Big N and non-Big N firms generally concludes that larger firms deliver higher audit quality due to greater resources, standardization, and reputational stakes (Francis *et al.*, 1999; DeFond *et al.*, 2016). Industry specialization further enhances quality (Krishnan, 2003a; Ferguson *et al.*, 2003). However, the effects of auditor tenure remain mixed (Johnson *et al.*, 2002; Myers *et al.*, 2003).

2.2.4. Technological innovation

Emerging technologies such as AI and big data are reshaping audit practices. Studies by Gao *et al.* (2020) and Lamboglia *et al.* (2020) show improved fraud detection and risk assessment, while Fedyk *et al.* (2022) caution against overreliance on automated systems at the expense of human judgment.

2.2.5. Proxies and frameworks

Audit quality is frequently measured using proxies like discretionary accruals (Dechow *et al.*, 1995), financial restatements (Palmrose *et al.*, 2004), and going concern opinions (Geiger and Raghunandan, 2002). Composite indicators, as advocated by Francis (2011) and Christensen *et al.* (2016), offer a more holistic assessment, although divergence remains between academic and regulatory metrics (Audousset-Coulier *et al.*, 2016).

2.3. Consequences of Audit Quality

2.3.1. Financial reporting quality

Audit quality constrains earnings management and enhances the reliability of financial statements (Becker *et al.*, 1998; Francis & Wang, 2008). Cross-country analyses affirm its role in improving earnings informativeness and reducing restatements (Ball *et al.*, 2012).

2.3.2. Firm performance

Empirical evidence suggests that audit quality positively influences firm valuation, financial health, and market performance (Okolie, 2014; Khan *et al.*, 2021; Al-Attar, 2017).

2.3.3. Stakeholder trust

High audit quality reduces information asymmetry and supports capital market integrity. It is pivotal in promoting transparency and investor trust (DeFond and Zhang, 2014; Christensen *et al.*, 2016).

2.4. Synthesis and Future Directions

Despite substantial scholarly engagement, audit quality remains a complex and evolving construct. Key challenges include the development of valid proxies, the integration of emerging technologies, and the adaptation to diverse institutional contexts. Future research should prioritize longitudinal and cross-national analyses and pursue comprehensive frameworks that incorporate technological, regulatory, and behavioral dimensions. This literature review offers a structured foundation for advancing the theoretical and empirical understanding of audit quality in contemporary settings.

3. Factors Influencing the Quality of External Audit

The quality of external auditing is essential for upholding the integrity and transparency of financial reporting systems. It serves as a mechanism for mitigating agency problems, enhancing stakeholder confidence, and ensuring compliance with

regulatory frameworks. Given its multifaceted nature, audit quality is shaped by a constellation of determinants spanning auditor attributes, client characteristics, institutional frameworks, and emerging technologies. This section synthesizes key empirical and theoretical insights into these determinants.

3.1. Auditor-specific Determinants

3.1.1. Auditor size

Audit firm size has been widely documented as a robust determinant of audit quality. DeAngelo (1981) posited that larger firms – especially those within the Big Four – possess stronger incentives to maintain high-quality audits due to reputational concerns. Empirical evidence supports this notion, showing that larger firms consistently deliver superior audit outcomes (Francis and Wilson, 1988), attributed to enhanced resource availability, methodological standardization, and lower client dependence (Clinch *et al.*, 2011).

3.1.2. Auditor rotation and tenure

The relationship between auditor tenure and audit quality remains contested. On one hand, extended tenure may erode independence and lead to auditor complacency (Karjalainen, 2011; García-Blandón *et al.*, 2020). On the other hand, long-term engagements can foster deeper client knowledge and audit efficiency (Bell *et al.*, 2019). Regulatory interventions, such as those in the Sarbanes-Oxley Act and EU audit reform, mandate rotation to preserve objectivity.

3.1.3. Auditor independence

Independence is central to audit effectiveness. Factors such as economic ties, provision of non-audit services, and interpersonal relationships pose threats to auditor impartiality (Sun *et al.*, 2020). Theoretical models and empirical findings consistently reinforce the necessity of independence for audit credibility (Knechel, 2016; Christensen *et al.*, 2016).

3.1.4. Audit fees and effort

Audit fees reflect engagement complexity and resource requirements. While higher fees may signal greater audit effort (Daigle *et al.*, 2005; Choi *et al.*, 2008), abnormally low fees may imply underinvestment in audit procedures – a practice referred to as “low-balling”. Conversely, excessive fees can also compromise independence if they result in economic bonding.

3.1.5. Provision of non-audit services

The literature presents mixed findings on the effects of non-audit services. Frankel *et al.* (2002) and Beck and Wu (2006) argue that such services impair independence. However, others contend that non-audit services may enhance audit quality through increased client familiarity and better risk assessments (Alareeni, 2019; Ernstberger *et al.*, 2020).

3.1.6. Industry specialization

Auditor specialization in a particular industry is associated with improved audit quality. Specialized auditors are better equipped to understand industry-specific risks and apply appropriate audit procedures (Ferguson *et al.*, 2003; Xi *et al.*, 2019). This expertise is reflected in higher audit fees and stronger market responses (Krishnan, 2003b; Eshleman & Guo, 2020).

3.2. Client-specific Determinants

3.2.1. Corporate governance

Robust governance mechanisms, including active audit committees and independent boards, enhance audit quality by fostering auditor independence and oversight (Carcello and Neal, 2000; Klein, 2002). Strong governance environments typically reduce opportunities for earnings manipulation.

3.2.2. Internal control systems

The presence of effective internal controls facilitates audit planning and execution by reducing detection risk and increasing the reliability of client-provided data (Ghadhab *et al.*, 2019; Gerrard *et al.*, 1994). Such systems also support compliance with regulatory requirements.

3.2.3. Client size and complexity

Larger and more complex firms necessitate more sophisticated audit procedures and typically engage top-tier auditors. This demand leads to enhanced audit quality due to rigorous scrutiny and advanced risk assessments (Reynolds and Francis, 2001).

3.3. Institutional and Regulatory Determinants

3.3.1. Legal environment

The legal context significantly influences audit outcomes. Jurisdictions with stronger investor protections and stricter penalties for audit failures are associated with higher audit quality (Francis and Wang, 2008). Legal enforcement serves both as a deterrent against malpractice and as an incentive for diligence.

3.3.2. Regulatory oversight

Audit quality is positively affected by institutional oversight mechanisms. Bodies such as the Public Company Accounting Oversight Board (PCAOB) in the US have been effective in enforcing standards and promoting audit integrity (Moroney, 2016; Christensen *et al.*, 2016).

3.3.3. Cross-border and cultural contexts

Differences in legal systems, cultural attitudes toward regulation, and enforcement rigor affect audit quality across jurisdictions. Comparative studies reveal that contextual variables significantly mediate the auditor-client relationship and audit outcomes (Dang *et al.*, 2017; Raak *et al.*, 2019).

3.4. Emerging and Contextual Factors

Technological disruptions, particularly those arising from AI adoption, cybersecurity concerns, and auditor workload stress, represent evolving influences on audit quality. These factors necessitate adaptive strategies and continuous upskilling for audit professionals.

3.5. Summary and Future Research Directions

Audit quality is shaped by a complex interplay of auditor competencies, client attributes, institutional settings, and technological advancements. While certain determinants – such as auditor size, independence, and specialization – are consistently linked to improved audit outcomes, others (e.g., tenure and non-audit services) demonstrate more nuanced effects. Future research should employ longitudinal designs and explore these relationships across diverse regulatory and cultural contexts to better inform policy and practice.

3.6. Audit Quality Indicators in Empirical Research

Audit quality, as a latent and inherently multidimensional construct, cannot be directly observed. Consequently, empirical research has relied extensively on a variety of proxies to infer audit quality across both input and outcome dimensions. These indicators are instrumental not only in evaluating the determinants of audit quality but also in assessing its implications for financial reporting and corporate governance.

3.6.1. Accrual-based measures

One of the most common proxy categories is based on accruals, particularly discretionary accruals, which serve as inverse indicators of audit quality. Lower levels of discretionary accruals are typically interpreted as evidence of more effective audit constraints on earnings management (Dechow *et al.*, 1995; Francis & Yu, 2009). Similarly, the frequency and magnitude of financial restatements have been used to signal audit failure, as they often reflect lapses in the detection of material misstatements (Palmrose *et al.*, 2004).

In addition, the incidence of firms narrowly avoiding losses or marginally surpassing analysts' forecasts is considered indicative of earnings manipulation, which audit quality should ideally mitigate (Burgstahler and Dichev, 1997). These signals are widely used in empirical research to detect earnings management behaviors and, by extension, assess audit effectiveness.

3.6.2. Judgment-based and outcome-oriented indicators

More direct indicators of audit quality include auditor judgments, particularly the issuance of going concern opinions. Geiger and Raghunandan (2002) contend that the failure to issue such opinions in financially distressed contexts constitutes a clear sign of audit deficiency. Thus, the presence – or absence – of such opinions offers a tangible lens into auditor objectivity and diligence.

3.6.3. Input-based proxies

Proxies based on auditor attributes, such as affiliation with Big N audit firms, are frequently employed as indicators of quality. Big N firms are presumed to maintain higher audit standards due to superior resources, global networks, and greater reputational risk (Francis *et al.*, 1999; DeFond and Zhang, 2014). Other inputs, such as audit partner experience and workload, have also been shown to influence audit performance (Donovan *et al.*, 2014).

Measures of economic incentives – such as audit fee concentration and abnormal fee levels – are also used to assess auditor independence. Research suggests that when a large proportion of an audit firm's revenue is derived from a single client, independence may be impaired, potentially reducing audit quality (Reynolds *et al.*, 2004; Choi *et al.*, 2010). Additionally, auditor tenure is examined for its dual implications: while familiarity may enhance efficiency, prolonged relationships may erode independence (Myers *et al.*, 2003).

3.6.4. Contextual and geographic proxies

Location-based and industry specialization proxies also feature prominently in the literature. Auditors based in major financial centers are assumed to have greater access to professional development resources and peer learning opportunities, which may enhance audit quality (Francis and Yu, 2009). Similarly, auditors with industry-specific expertise are found to deliver higher quality audits due to their superior understanding of client business models and risk structures (Balsam *et al.*, 2003; Krishnan, 2003).

3.6.5. Composite and multidimensional approaches

Recognizing the limitations of single proxies, recent scholarship increasingly advocates for composite indices that combine input, process, and outcome indicators to yield more robust assessments. Dichev *et al.* (2013) criticize traditional proxies for their inherent noise and limited explanatory power, recommending a shift toward multidimensional frameworks. Minutti-Meza (2014) echoes this call, proposing the development of composite constructs that enhance the validity and reliability of audit quality measurement.

3.6.6. Regulatory vs. academic perspectives

A notable divergence exists between regulatory and academic approaches to audit quality measurement. While academics often rely on econometric proxies, regulatory bodies favor more observable, engagement-level indicators such as inspection results and audit deficiencies. Audousset-Coulier *et al.* (2016) highlight this discrepancy, noting that regulators frequently use firm-level metrics that may not capture nuances in individual audit engagements.

3.6.7. Conclusion

The literature affirms that audit quality is best captured through a triangulation of input-, process-, and outcome-based proxies. No single measure can comprehensively reflect all facets of audit quality. Therefore, the use of integrated, multidimensional, and context-sensitive indicators is essential for improving both academic research and practical audit oversight. Bridging the gap between academic methodologies and regulatory priorities remains a critical avenue for future inquiry.

3.7. Audit Quality and Audit Fees

The relationship between audit fees and audit quality has been a subject of extensive scholarly investigation due to its implications for auditor independence, assurance credibility, and market confidence. While audit fees reflect the complexity and scope of an audit engagement, concerns persist regarding whether fee structures can undermine auditor objectivity, particularly when fees appear excessive or deviate from predicted levels.

3.7.1. Theoretical underpinnings

From a theoretical standpoint, Simunic (1980) models audit fees within a competitive market framework, positing that fees should correspond to the cost of audit effort and engagement risk. Deviations from expected fee levels may thus signify client-specific risks or agency conflicts, rather than strictly reflecting audit quality. DeAngelo's (1981) seminal work emphasizes that auditor independence diminishes with increased economic dependence on a client, particularly when audit and non-audit services are bundled.

3.7.2. Empirical evidence

Empirical findings on the audit fee–quality relationship are nuanced. DeFond *et al.* (2002) suggest that higher audit fees can be interpreted positively, as they may indicate greater auditor effort and professionalism, especially in high-risk or complex engagements. However, Frankel *et al.* (2002) report that firms paying abnormally high fees are more likely to engage in earnings management, suggesting that excessive fees may compromise auditor skepticism and increase the risk of collusion.

This duality is further highlighted by Reynolds *et al.* (2004), who show that high fee dependence – measured as the proportion of total fees derived from a single client – can jeopardize independence, particularly in settings where audit committee oversight is weak. Similar concerns are raised by Kinney *et al.* (2004) and Chaney *et al.* (2004), who find that economic bonding through fee dependence may reduce auditors' willingness to issue unfavorable opinions or challenge aggressive accounting practices.

3.7.3. Distinction between audit and non-audit fees

A critical differentiation in the literature is between audit and non-audit fees. Ashbaugh *et al.* (2003) and Chung and Kallapur (2003) argue that while audit fees may reflect legitimate engagement complexity, high non-audit fees raise red flags about auditor independence. The provision of advisory or consulting services may lead to conflicts of interest, as auditors may become financially reliant on these more lucrative services.

3.7.4. Regulatory responses and market perceptions

In response to concerns over fee-induced bias, regulatory reforms have emphasized transparency and structural safeguards. Mandatory fee disclosures, as documented by Dao *et al.* (2012), increase market scrutiny and act as a deterrent to opportunistic fee-setting practices. Recommendations for auditor rotation and limitations on non-audit services aim to mitigate long-term economic dependence and restore public confidence in audit objectivity.

3.7.5. Contextual moderators

Several studies emphasize the role of institutional context and governance structures in moderating the fee–quality relationship. Srinidhi and Gul (2007), Caramanis and Lennox (2008), and Asthana and Boone (2012) find that strong audit committees and rigorous legal enforcement can buffer the adverse effects of fee concentration. Conversely, in weak regulatory environments, even moderate fee irregularities may be sufficient to undermine audit credibility.

3.7.6. Summary

The literature on audit fees and audit quality reflects a fundamental tension between economic incentives and professional integrity. While audit fees are often indicative of engagement complexity and auditor diligence, abnormal or disproportionate fees – particularly when associated with weak governance – pose significant threats to auditor independence. A transparent fee structure, supported by effective oversight and regulation, is essential to preserving audit quality and maintaining the credibility of financial reporting.

3.8. Audit Quality and Legal Risk

The interplay between legal risk and audit quality has been a prominent theme in the auditing literature. Legal liability serves as both a deterrent to auditor negligence and a motivator for professional diligence. Empirical and theoretical frameworks suggest that greater exposure to litigation and regulatory sanctions leads auditors to adopt more rigorous procedures, thereby enhancing audit quality.

Lennox and Li (2019), using evidence from the US market, demonstrate that auditors operating under high litigation risk engage in intensified audit testing and documentation practices. These behaviors reflect heightened professional skepticism and a stronger adherence to independence, ultimately contributing to audit quality.

Moorthy and Sarath (2017) extend this perspective by modeling the effect of anticipated legal penalties on auditor behavior. While their model affirms that moderate legal pressure induces diligence, it also cautions that excessive legal threats may prompt defensive auditing – where compliance outweighs informative assurance. This trade-off highlights the need for a balanced regulatory framework that maintains audit usefulness.

Overall, legal risk functions as an external governance mechanism that can enhance audit quality. However, its impact is conditional on institutional context, enforcement strength, and auditor risk preferences. Excessive liability may lead to overly conservative audits, reducing the informativeness of financial disclosures. Hence, carefully calibrated legal frameworks are essential to ensure both audit rigor and relevance.

3.9. Audit Quality and Big N Auditors

Audit firm size, particularly the dichotomy between Big N and non-Big N auditors, remains a central determinant of audit quality. Big N firms are associated with superior resources, expertise, and global oversight mechanisms, which collectively contribute to enhanced audit performance.

Francis *et al.* (1999) and Palmrose (1988) find that Big N auditors are linked with lower discretionary accruals and reduced litigation risk – key indicators of audit quality. DeFond *et al.* (2016) reinforce these findings, attributing the superior outcomes to methodological standardization and reputational incentives.

Nonetheless, Lawrence *et al.* (2011) challenge the universality of Big N superiority, arguing that the audit quality differential diminishes when controlling for client size and complexity. Khurana and Raman (2004) further suggest that the value of Big N audits is particularly pronounced in environments with weaker legal systems, where they serve as substitutes for institutional investor protection.

In summary, while Big N affiliation generally correlates with higher audit quality, the effect is moderated by contextual and client-specific variables.

3.10. Audit Quality and Relationship Duration

Auditor tenure, or the length of the auditor–client relationship, has nuanced implications for audit quality. Longer tenures can enhance auditor familiarity and efficiency, but may also compromise independence.

Geiger and Raghunandan (2002) show that newly appointed auditors are more likely to issue going concern opinions, suggesting stronger independence early in the engagement. Conversely, Johnson *et al.* (2002) and Myers *et al.* (2003) provide evidence that longer tenure can reduce discretionary accruals and improve audit outcomes – up to a point.

Davis *et al.* (2009) argue that audit quality may deteriorate with excessively long tenures, leading to complacency. Cahan and Zhang (2006) question the universal benefits of mandatory rotation, especially in jurisdictions with weaker institutional support.

These findings underscore the importance of maintaining an optimal tenure that balances auditor familiarity with the preservation of independence.

3.11. Audit Quality and Financial Reporting

Audit quality is integral to the credibility and transparency of financial reporting. High-quality audits curtail earnings manipulation and reinforce stakeholder trust in financial statements.

Kothari *et al.* (2005) refine accrual-based methods to detect earnings management, illustrating that rigorous audit oversight limits opportunistic reporting behavior. Ball *et al.* (2012) further reveal that the benefits of audit quality are more pronounced in jurisdictions with robust legal and governance structures.

Thus, audit quality significantly contributes to financial reporting integrity, particularly when supported by strong institutional frameworks.

3.12. Audit Quality and Earnings Management

The literature consistently demonstrates that high audit quality – often indicated by Big Four affiliation – constrains earnings management. Becker *et al.* (1998) and Francis *et al.* (1999) show that Big Four auditors are linked to lower discretionary accruals in the US, a finding corroborated globally.

International studies, including Jeong and Rho (2004) in Korea and Lin and Hwang (2010) in Taiwan, confirm that Big Four audits reduce financial manipulation. European research (e.g., Vander Bauwhede *et al.*, 2003) emphasizes the mediating role of institutional quality. Similar evidence emerges from emerging markets such as Jordan (Al-Thuneibat *et al.*, 2011) and Greece (Tspouridou and Spathis, 2012).

Collectively, these findings highlight the critical role of audit quality in mitigating earnings management, especially under strong legal regimes.

3.13. Independence and Audit Fees

Auditor independence is foundational to audit quality and is influenced by fee structures. DeAngelo (1981) posits that economic dependence on clients – manifested through audit or non-audit fees – can impair objectivity.

Empirical studies yield mixed results. Frankel *et al.* (2002) associate high fees with earnings management, implying weakened independence. In contrast, Reynolds *et al.* (2004) argue that fee levels alone are insufficient to infer bias, emphasizing the role of oversight mechanisms.

These findings suggest that transparency in fee disclosures and governance safeguards, such as audit committee oversight, are essential for maintaining auditor independence.

3.14. Audit Planning, Supervision, and Audit Quality

Effective audit planning and supervision are vital for ensuring audit quality. Structured audit procedures facilitate risk identification, resource allocation, and adherence to professional standards.

Frankel *et al.* (2002) highlight that planning and supervision reduce risks associated with economic dependence. Reynolds *et al.* (2004) find that formalized frameworks correlate with fewer restatements and higher audit reliability.

Therefore, planning and supervisory rigor play a pivotal role in safeguarding audit integrity, especially in complex audit environments.

3.15. Artificial Intelligence and Audit Efficiency

The adoption of artificial intelligence (AI) in auditing has markedly enhanced audit efficiency. Early studies (Wright and Wright, 2002) recognized AI's potential, which has since been substantiated by empirical work.

AI supports risk identification, full-population testing, and real-time analytics, thereby streamlining audit cycles (Chen *et al.*, 2013; Han *et al.*, 2016). Efficiency gains also translate into cost reductions and improved organizational performance (Stoel and Havelka, 2021).

However, as Haenlein and Kaplan (2019) caution, these benefits require appropriate training and integration with professional judgment to avoid overreliance and maintain audit quality.

3.16. Artificial Intelligence and Audit Quality

AI holds promise for elevating audit quality through enhanced fraud detection and data processing capabilities. Empirical evidence (Gao *et al.*, 2020; Lamboglia *et al.*, 2020) shows that AI improves audit reliability when embedded within ethical and regulatory frameworks.

Nonetheless, concerns persist regarding overdependence on algorithmic tools, which may erode auditor judgment (Fedyk *et al.*, 2022; Rahman and Zhu, 2023). To mitigate these risks, scholars advocate for balanced integration and institutional oversight.

Thus, while AI can augment audit quality, its success depends on harmonizing technological adoption with ethical standards and human expertise.

3.17. Audit Fee Irregularities and Audit Quality

Deviations from expected audit fees, whether excessive or discounted, raise concerns about audit quality. Kasai and Takada (2012) link fee discounting in Japan to reduced audit scope and rigor, while Cao *et al.* (2022) find that abnormal fees in China correlate with audit deficiencies.

Governance perspectives (Crittenden *et al.*, 2003; DeFond and Lennox, 2011) argue that discretionary fees signal weak oversight and impaired objectivity. Market reactions to fee irregularities further suggest a loss of stakeholder trust (Ettredge *et al.*, 2011).

Overall, maintaining justifiable and transparent audit fees is critical to sustaining audit quality and public confidence.

3.18. Audit Fees and Audit Quality

Audit fees represent a complex variable in quality assessments. While higher fees may indicate extensive audit effort, they can also signal economic dependence.

Empirical findings are mixed. DeFond *et al.* (2002) report that high fees enhance perceived quality, whereas Frankel *et al.* (2002) and Reynolds *et al.* (2004) warn of compromised independence. Governance structures (Srinidhi and Gul, 2007) and institutional settings moderate these effects.

Thus, the impact of audit fees on quality is contingent upon oversight mechanisms and contextual factors.

3.19. Audit Fees and Earnings Management

The relationship between audit fees and earnings management reflects both opportunity and risk. Theoretical models (DeAngelo, 1981; Magee and Tseng, 1990) suggest that higher fees may denote greater audit effort.

However, empirical evidence (Choi *et al.*, 2010; Sharma *et al.*, 2011) reveals a non-linear association, where both high and low abnormal fees correlate with increased earnings manipulation. Contextual moderators include legal enforcement and governance quality (Donatella *et al.*, 2018; Lin and Hwang, 2010).

Overall, audit fees may constrain or enable earnings management depending on institutional strength and the magnitude of fee deviations.

3.20. Audit Quality and Firm Performance

High-quality audits are instrumental in improving firm performance by reducing information asymmetry and enhancing investor confidence. Empirical studies across markets consistently link audit quality to improved stock performance and valuation (Okolie, 2014; Al-Attar, 2017).

In emerging markets, audit quality strengthens governance and mitigates agency costs, contributing to financial stability (Ugwunta *et al.*, 2018). Thus, audit quality is a critical mechanism for aligning managerial and shareholder interests.

3.21. Cross-country Evidence on Audit Quality and Financial Performance

A broad body of cross-country research supports the positive relationship between external audit quality and financial performance. In the US and UK, high-quality audits reduce litigation risk and enhance earnings reliability (Palmrose, 1986; Lennox, 1999).

Similar trends are observed in developing economies. Studies from Jordan (Butat *et al.*, 2009), Pakistan (Afza and Nazir, 2014), and Oman (Al Ani and Mohammed, 2015) show that audit quality improves profitability and governance. In Asia, Ching *et al.* (2015) and Hua *et al.* (2016) report that audits improve financial discipline and access to capital.

Recent findings (Khan *et al.*, 2021; Hyarat *et al.*, 2023) emphasize the roles of tenure, independence, and regulatory quality in enhancing audit effectiveness. Collectively, these studies affirm audit quality as a cornerstone of corporate financial health worldwide.

4. Conclusion and Implications

4.1. Conclusion

This literature review has examined the complex, multifactorial nature of external audit quality, drawing on a broad range of conceptual frameworks, empirical studies, and regulatory contexts. Audit quality is shown to be foundational to the integrity of financial reporting, the effectiveness of corporate governance, and the stability of capital markets. It is influenced by a wide spectrum of auditor-related attributes (e.g., size, specialization, independence), client-specific factors (e.g., governance, complexity), institutional frameworks (e.g., legal systems, regulatory oversight), and emerging technological innovations such as artificial intelligence.

The review identifies a dynamic tension between factors that can both enhance and impair audit quality. For instance, audit tenure promotes familiarity but may erode independence; high audit fees signal greater effort but may also reflect economic bonding; and legal liability encourages rigor but can result in overly defensive audits. These trade-offs underscore the need for nuanced evaluation and context-aware policy responses.

Measurement of audit quality remains a central challenge, with researchers increasingly advocating for multidimensional indicators that incorporate input, process, and outcome dimensions. Furthermore, as the audit profession integrates data analytics and AI into practice, new paradigms for evaluating audit quality will be necessary – ones that balance automation with professional judgment.

4.2. Policy Implications

The findings of this review offer several implications for policymakers, regulators, and standard-setting bodies:

- Regulatory calibration: Legal liability and enforcement mechanisms must strike a balance between deterrence and audit informativeness. Excessive litigation risk may lead to defensive auditing, while weak enforcement undermines accountability. Policymakers should tailor frameworks that incentivize high-quality audits without stifling their informational value.
- Independence safeguards: Audit regulators should monitor fee structures and non-audit service provisions to prevent economic dependence that compromises independence. Mandatory fee disclosures, audit firm rotation policies, and caps on non-audit services can enhance transparency and auditor objectivity.
- Oversight harmonization: Greater alignment between academic audit quality indicators and regulatory inspection criteria could improve consistency in audit evaluations and policy effectiveness. Regulatory bodies may benefit from incorporating research-based, composite audit quality indices into their assessment models.
- Global context sensitivity: Given the contextual variability in audit quality determinants, international regulatory coordination (e.g., through IFAC or IOSCO) should aim to develop flexible, principle-based standards that accommodate jurisdiction-specific legal and cultural environments.

4.3. Practical Recommendations

For practitioners and firms, several actionable recommendations arise from this review:

- Invest in technological capacity: Audit firms should continue integrating AI and data analytics but must also train staff to exercise critical judgment alongside automated tools. Ethical frameworks and internal controls should guide AI deployment.
- Enhance auditor–client governance: Stronger audit committees, increased board independence, and internal control systems improve audit quality by providing better oversight and facilitating auditor effectiveness.

– Monitor auditor tenure and rotation: Firms and regulators should manage auditor tenure strategically – avoiding both excessively short and overly prolonged engagements – to balance efficiency gains with the preservation of auditor independence.
– Focus on industry expertise: Auditors with sector-specific knowledge deliver higher quality audits. Firms should prioritize assigning audit teams with relevant domain expertise, especially in high-risk or complex industries.
– Encourage audit quality culture: Firms should promote a culture that values skepticism, diligence, and ethical standards. Internal evaluations and quality control reviews should reinforce these principles throughout the audit engagement lifecycle.

This conclusion reinforces that enhancing audit quality is not solely a technical challenge but also an institutional and strategic imperative. Addressing its drivers and constraints requires a coordinated effort among researchers, practitioners, regulators, and corporate actors. By building on the rich body of evidence reviewed in this paper, future work can contribute to more transparent, reliable, and trusted financial reporting ecosystems.

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