

The Influencing Factors of Social Audit Quality: A Literature Review

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ABSTRACT

The research on the quality of social auditing has rich discussions on influencing factors, and there is a large amount of evidence obtained through empirical research. This article divides them into three perspectives: the internal of the accounting firm, the audited client and the external environment. This article uses normative research as the main methods and statistical analysis as auxiliary means to comprehensively summarize the factors affecting the quality of social auditing in China.

Keywords: *Social audit, audit quality, influencing factor*

1. INTRODUCTION

In theoretical research, the research on audit quality cannot reflect its inherent nature due to the unobservability of audit quality. Even if the company's earnings management level, audit fees, and audit scale are used to replace audit quality, the measurement standards are not consistent with their internal logic. Consequently a series of contradictory conclusions have arisen within inconsistent frameworks of interpretation. In practice, audit failures caused by the lack of social audit quality are common. In 2001, Arthur Andersen, an international "Big Five" firm, was embroiled in the "Enron Incident". Even though the Sarbanes-Oxley Act (SOX) has sounded a wake-up call to the industry about the lack of audit quality. However, looking at the status of social auditing in China, from the early years of "Yin Guang Xia" and "Xin Da di", in recent years, "Kang Mei", "Kang De Xin" and other audit failures are still emerging in an endless stream. Aiming at the dilemma of audit quality, the contribution of this article is to summarize the core views of the domestic social audit quality research literature. Moreover, this article provides a certain theoretical basis and directional suggestions for subsequent research, and research results for practical applications.

2. INFLUENCING FACTORS OF SOCIAL AUDIT QUALITY

2.1. Perspective of Accounting Firm

2.1.1. Firm size

Most scholars argue that the audit quality of the "Big Four" is higher than that of the "Non-Big Four" [1], but some scholars believe that there is no obvious distinction on audit quality among firms of different sizes [2]. From the perspective of professional competence and audit independence: The "big firm" did not show an advantage, the audit fee of big firms was even higher and there was a phenomenon of "Business Bullying". Other scholars have suggested that firm size and audit quality are only positively correlated to a certain extent. For example, studies have found that the audit quality perceived by listed companies is consistent with the substantial audit quality of big firms, while the perception of investors is not completely consistent with actual audit quality. Existing research often constructs a perfect market through perfect competition market, effective legal supervision, timely information disclosure, ignoring agency issues and other control variables. But in reality, the incompleteness of these factors makes the size of the firm is not enough to be a positive guarantee of audit quality. There are differences in audit quality among firms of different sizes, nonetheless this difference has not formed a good heterogeneous competitiveness. So scholars should avoided the "scale misunderstanding" in the perception of audit quality.

2.1.2 Firm's organizational form

At the beginning of the research, some scholars put forward that the firm's organizational form has no significant impact on audit quality [3]. Other scholars have found that partnership firms are more motivated to provide high-quality audit services. After the implementation of the firm's transformation in China in 2010, it was found that the audit quality of firms under the special general partnership system are better than those under the limited liability system in the ways of signature auditors and auditors' legal responsibilities, legal risk awareness, market perception and regional legal environment.

2.1.3. Audit tenure

"Conflict View" argues that excessive audit tenure will reduce the audit independence then damaging audit quality, but "Information View" believes that inadequate audit tenure will lead to insufficient information and inappropriate audit opinions. Early research found that the audit tenure and audit quality are in an inverted U-shaped relationship and 6 years is a watershed. Later studies found that long audit tenure will bring low audit quality in following three aspects: the length of the signed auditor's tenure, learning effects, and auditor tenure control. Mandatory rotation should be implemented. However, some scholars believe that the audit tenure does not have a significant impact on audit quality, because of the extreme fragmentation of the audit market, risk aversion behavior during rotation, and the decline in the professional competence of new auditors etc. These unfavorable factors will lead to the failure of the mandatory rotation system, so the audit quality should be improved from aspects such as avoiding firm associations and increasing audit risks [4].

2.1.4. Personal characteristics of auditors

This perspective mainly includes professional competence and audit independence. The "acquisition" stage of professional competence includes intuitive individual characteristics such as auditors' gender, age, and education level. Among them, female auditors can often suppress the earnings manipulation of the audited unit to a greater extent and issue modified auditing opinions with a greater probability, and the audit quality of the mixed group is higher than that of the other groups [5]. Senior auditors tend to have richer experience, stronger ability and better cognitive ability, except that, they have higher requirements for their own moral training, so the audit quality will increase accordingly [6]. Highly educated auditors can promote audit quality [7]. The "maintenance" stage of professional competence includes practice experience, industry expertise and ethics, among which practice experience can inhibit management's earnings management behavior and opportunistic behavior, this can improve the credibility of financial reports, and determine

audit quality [8]. In short, inadequate professional competence and poor independence are the reasons for the failures of audit in the capital market, more of which stems from the lack of audit independence.

2.2. Perspective of Audited Client

2.2.1. Earnings management

Earnings management behavior directly affects the quality of social auditing and changes positively with audit opinions. Auditors are more sensitive to positive earnings management. In the empirical research, discretionary accruals are used as a substitute variable for the degree of earnings management and analyzed by the Jones model with cross-sectional modification. Scholars habitually assume that there is a significant negative correlation between the degree of earnings management and audit quality. Research finds that high-level social audit can alleviate the positive stimulation effect of free cash flow surplus on earnings management [9]. In addition, it can weaken the positive correlation between abnormal management power and the degree of corporate earnings management. At the same time high-level social audit can also inhibit the real earnings management behavior to a certain extent [10].

2.2.2. Corporate governance

Corporate governance affects audit quality through its leading role in risk of material misstatement and audit detection risk. Companies with high governance levels have higher audit quality [11]. The stronger the board's independence, the higher the audit quality will be. Besides, there is a significant positive correlation between audit quality and the number of board meetings and director remuneration, while the attendance rate of independent directors has a significant negative correlation. The shareholding ratio of the largest shareholder and audit quality are in an inverted U-shaped relationship, and the management shareholding ratio has no significant impact on audit quality.

2.2.3. Client importance

With the importance of clients increases, the quality of audits is higher, but there will be compromises in the supervision and disclosure of accounting information [12]. Firms with a small number of clients tend to compromise with more important clients which reduces auditing quality [13]. The impact of customer importance on audit quality of a firm changes with the pass of time and the institutional environment.

2.2.4. *The nature of property rights*

Some scholars believe that the state-owned enterprise environment is more conducive to the role of social auditing. High-quality external auditing can alleviate manager-agent conflicts and this effect is more significant in state-owned listed companies. And in state-owned enterprises [14], there is no situation where audit fees are too high or too low to affect audit quality [15]. The opposite view also exists, that the audit quality of private holding companies is higher than that of state holding companies.

2.3. *Perspective of External Environment*

2.3.1. *Market environment*

Theoretically, the arrangement of a perfect audit market system should be able to promote the improvement of audit quality. Audit market concentration is positively correlated with audit quality [16], but it is not significantly reflected in the low-concentration audit market in China, which shows an inverted U-shaped functional relationship. On the contrary, some scholars believe that audit market concentration is significantly negatively correlated with audit quality [17]. In addition, the greater the competitive advantage of the area where the accountant is located, the higher the audit quality [18]. The ability of remote firms to suppress earnings management of audited entities is significantly stronger than that of local firms. The closer the auditor is to the client, the lower the company's manipulative accruals and the lower the probability of being issued an unqualified audit opinion [19].

2.3.2. *Industry supervision*

China's legal risks are low, administrative penalties are limited. In China, listed companies are not willing to pursue high-quality audits. As a result, China Securities Regulatory Commission (CSRC) has imposed administrative penalties on illegal firms and CPAs that have not significantly improved the audit quality of listed companies. However, more scholars believe that there is a significant positive correlation between government supervision and audit quality. For example, the CICPA's interview firm has a reminder and alert effect to small-scale firms[20], and the CICPA's practice quality inspection Directly affect "non-big four" firms[21]. The issuance of the annual report inquiry letter by the exchange significantly reduces the aggressiveness of the audit report, and the probability of being issued a non-standard audit opinion after receiving the inquiry letter has significantly increased.

2.3.3. *Legal risk*

The important external factors of audit failure in China are the weakening of the legal constraint environment and the low level of legal risks. Research has found that among the legal risks and adverse effects of reputation after audit failure, legal risks determine audit quality. Low legal risks will inevitably lead to low audit quality, especially in areas with underdeveloped legal systems. Low practice constraints make it easy for local auditors to lose their independence and exhibit low audit quality. Therefore, it is necessary to increase the legal liability pressure of the firm so that the audit quality level stipulated by the audit standards may approach the legal standard.

2.3.4. *Media supervision*

Existing research generally believes that media supervision can improve audit quality, and negative reports have more obvious effects [22]. Positive media reports can strengthen the effect of high-quality audits in suppressing the cost of equity capital of listed companies, while negative media reports will weaken this effect. Negative reports will significantly enhance the inhibitory effect of high-quality audits on enterprise underinvestment, while positive reports will not [23].

3. CONCLUSION

The quality of social auditing is a common topic. Although domestic research in this field has been relatively in-depth, a large number of inconsistent conclusions have led to the lack of guiding significance of the research results for audit practice. The author believes that these contradictory results come from two core issues in the field of audit quality. The first problem is the selection of substitute variables for audit quality in the theoretical community. The indirect measurement error caused by this indeterminability will inevitably lead to the lack of endogenous explanatory power of related research. The second problem lies in the field of practice. China's audit market is still facing problems such as insufficient internal demand for high quality audit service, low legal risks of social audit, and defects in the organization system of the accounting firms. The existence of these practical problems makes the current market conditions unable to build a perfect research background for the research on the influencing factors of social audit quality.

Essentially, the research on its influencing factors is an external factor in the field of audit quality research, and the core content is to build an audit quality control system that adapts to domestic conditions. After clarifying the practical resistance to the implementation of audit quality control work, we will discuss focus point which whether to focus on government supervision based on government coercive force or self-discipline supervision based on industry norms and professional ethics. Then build and

improve the audit quality control system from multiple dimensions (practice environment, internal firm, government supervision, etc.)

The contribution of this article is to discuss the audit quality evaluation system, assessing audit risk from the audit subject, object and external environment. This is the research direction with practical significance. However, this article only sorts out the arguments of social audit quality influencing factors in the past 40 years. It lacks consideration of the similarities and differences between its research methods, as well as the discussion of the extension of audit quality and audit quality control. Those are the shortcomings of this article.

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