FACTORS THAT AFFECT THE AUDIT QUALITY OF THE EXTERNAL AUDIT SETTING IN SRI LANKA

A.J.D.A.H. Dilrukshi[1,] and J.S. Kumari[2,*]

[1,2]*Department of Accountancy and Finance, Faculty of Management Studies, Rajarata University of Sri Lanka, Sri Lanka.*

**Corresponding author: skjayasena@mgt.rjt.ac.lk*

Abstract

Considering the significance of audit quality in enhancing the credibility of financial reporting and thereby stakeholder confidence, this study aims to examine the factors that affect the audit quality of the external audit setting. The sample size was 120 external audit practitioners in Sri Lanka. Data was collected through a self-administrated questionnaire, developed based on literature and distributed to the external audit practitioners affiliated with Big Three and Non-Big Three firms. Multiple regression analysis was performed to explore the relationships between independent and dependent variables. The results demonstrated that auditors' personnel characteristics (auditor competence and auditor mood) affect the audit quality in the external audit setting while conventional firm characteristics (audit tenure, firm size, audit fee and auditor independence) do not significantly affect audit quality in Sri Lankan context. Both auditor competence and auditor mood have strong positive relationships with audit quality. The research bridges the gap in examining the factors affecting the audit quality in the external audit setting in Sri Lanka while offering useful insights for audit firms, audit regulators, Audit Clients, and Academic researchers. As audit quality significantly impacts financial reporting accuracy and stakeholder confidence, understanding these factors is crucial for improving audit practices and enhancing the reliability of financial statements.

Keywords: Audit practitioners, audit quality, external audit

Introduction

Financial statements manipulation is a common occurrence in the modern era of globalization. Though the independent auditor is not held responsible for the fair presentation of financial statements, the auditor's profession has recently captured public attention in this respect (Putri & Mardijuwono, 2020). The significance of financial reporting quality and its role in maintaining the stability of financial markets have been brought to light by widely reported corporate failures like the Enron collapse and the global financial crisis of 2007–2008 (Kilgore & Martinov-Bennie, 2014). Because it has questioned the credibility of auditors' competence in the wider community, raising concerns about the adequacy of their performance and adherence to professional standards (Putri & Mardijuwono, 2020). Therefore, it is imperative to uphold excellence in audit performances, hence, credibility holds the potential to significantly impact the public's trust in a publicly certified accountant's proficiency and autonomy when conducting an audit on a financial statement and it offers a mechanism to assess the effectiveness of the company's operations and assist managers in examining whether employed strategies are producing desired results when deviations occur.

The reliability of financial reports is paramount for various stakeholders, including investors, creditors, regulatory bodies, and the general public, who rely on these reports to make informed decisions. Financial statement users anticipate that auditors provide an unbiased and impartial assessment regarding the compliance of a company's financial reports with the relevant accounting standards, laws, and regulations. Any perception of an insufficient audit has the potential to diminish public confidence in the financial reporting framework. A robust audit quality framework ensures the accuracy and transparency of financial information, fostering trust in the business environment. Since there is no specific industry standard framework in Sri Lanka, evaluating audit quality is difficult (Perera & Wijerathna, 2020). The absence of a specific industry standard framework in Sri Lanka intensifies the need for a comprehensive examination of factors influencing audit quality, as it directly impacts the country's ability to align with international best practices, enlarge global business interactions, and contribute to enhance the overall credibility of Sri Lanka's financial reporting system on a global scale.

In light of this, the primary objective of this research endeavor is to examine the factors that significantly affect the audit quality in the external audit setting in Sri Lanka. By generating knowledge about audit quality indicators, this study helps to identify the factors that significantly affect audit quality in the external audit setting in Sri Lanka. However, the measurement of audit quality poses significant challenges due to its inherent complexity, thus lacking a precise and universally accepted definition. The dominant researcher on audit quality, DeAngelo

(1981) has described audit quality as a combination of the probability that the auditor will discover material misstatements in the client's financial statements and the probability that they will report it, as cited in (Fadhila, 2014). Within developed nations such as the United Kingdom, the United States, New Zealand, and others, a distinct framework for audit quality has been established to serve as a comprehensive guidance for measuring audit quality (Perera & Wijerathna, 2020). Therefore, due to the absence of a dedicated audit quality framework which outline the principles, standards, guidelines, and processes that auditors and auditing firms are expected to adhere to, in order to ensure the reliability, accuracy, and integrity of financial reporting within the Sri Lankan context.

There are several studies which have been conducted on this subject area but, there are few empirical research studies that are conducted examining the factors that affect audit quality in the Sri Lankan context. However, the research studies done in the international context also have contradictory findings. Further, there have been few studies in the scope of examining factors that affect the audit quality of the external audit setting in Sri Lanka and those also having contradictory findings as well in the foreign context. Hence, the primary objective is to fill the empirical gap and examine the factors that affect the audit quality of the external audit setting in Sri Lanka, which is an initiative to develop a dedicated audit quality framework in the Sri Lankan context. In essence, this study not only responds to the existing gap in empirical research on audit quality in the Sri Lankan context but also catalyzes advancements in the regulatory framework, contributing to the nation's economic stability and fostering a conducive environment for sustainable growth. The outcomes of this research have the potential to shape the trajectory of auditing practices in Sri Lanka, establishing a robust foundation for future studies and laying the groundwork for continuous improvement in audit quality standards. Consequently, the following is the study's problem: "What are the significant factors that affect the audit quality of the external audit setting in Sri Lanka".

The rest of the paper is structured as follows. The next section provides a theoretical foundation for the study by reviewing the connected theories and prior empirical studies in relation to audit quality and factors that affect audit quality. After that, the paper explains the methodology used in this study, which comprises the population and sampling procedures, the research approach and design, the procedures of data gathering, and finally the methods of examining the gathered data. Then, it discusses the results of the research study. The last section provides conclusions and implications of the study, followed by its limitations and future research avenues linked with this empirical investigation.

Literature Review

According to Byrnes et al. (2012) it has only been a relatively short time since auditing became a formal discipline. The word audit is a form of a Latin word that means "hearing." When citizens were given the responsibility of collecting and disbursing public funds, first in Egypt and then in Greece, Rome, and other places, they were required to give a responsible official (an auditor) an oral account of their handling of those funds in public. This is how the practice of auditing began more than 2000 years ago (Porter et al., 2014). Auditing techniques were widely used as a result of the Industrial Revolution and the ensuing surge in corporate activities as cited in (Feleke, 2017). Porter (2014) reported that auditing is a systematic process of objectively gathering and assessing evidence related to claims about economic actions and events according to established criteria in which the person or organization making the claim has participated. The results are then communicated to readers of the reports in which the claims are made. Companies are unable to function without auditing because auditing offers a methodical, unbiased assessment of financial data, procedures, and controls. Feleke (2017) notes that frequently, the people who managed and controlled a business were not the same as its owners. The company is owned by the shareholders, but it will be run and managed by directors. Therefore, auditing promotes accuracy, transparency, and adherence to rules, boosting stakeholder and investor confidence. Auditing finds errors, fraud, and inefficiencies through careful inspection, enabling management to take prompt corrective action and make well-informed decisions.

DeAngelo's (1981) definition is a good place to start, Audit Quality is defined as a combination of the probability that the auditor will discover a material misstatement in the client's financial statements and the probability that they will report it as cited in (Fadhila, 2014). Following DeAngelo (1981), Kuntari et al. (2017) also note that audit quality is related to the auditor's assurance in the form of a statement that the financial statements do not present material or fraudulent errors. A variety of methodologies have been used by earlier academic researchers to identify and assess audit quality. Suseno (2013) stated that based on IAASB, audit quality is primarily determined by three factors: input, processes, and context. The input consists of two dimensions: the personal attributes of the auditor with the indicators of expertise, ethical values and mindset, and the auditing process with indicators of auditing method reliability, the effectiveness of audit tools and the availability of technical support. According to Sulaiman (2011) there are three aspects as depicted above that affect audit quality. Inputs and outcomes related to audit quality, Process and perception. Inputs to audit quality include the audit firm's characteristics and auditor ‘s characteristics when outcomes related to audit quality include financial reporting quality, case analysis and aspects of process compromise with audit procedures, judgment & and decision making and quality threatening behavior. As the third aspect of audit quality, perception compromises with users, preparers and audit expectation gap.

Theoretical Review

Agency Theory

According to Nugroho (2018) when management responsibilities and business ownership are separated, or when the owner assigns some decision-making authority to the manager, a contractual relationship is created and then managers are required under contracts to offer services to owners. The term "agency problem" describes the conflicting interests of the agent and the owner (Pakianathan, 2017). Sari et al. (2019) mentioned that it's possible that the agent doesn't always behave in the principal's best interests, there may be conflicts of interest between the owner and agent, resulting in agency costs. Adding his insight, Nugroho (2018) explained further separation of ownership and management can result in information asymmetry. The reason is explained by Pakianathan (2017) as the possibility to manipulate the system is inevitably created when management has complete access to the company's information rather than the shareholders. Therefore, the company's financial information must be subject to an audit program by an outside auditor to disclose information (Calocha & Herwiyanti, 2020). The external auditors in charge of the audit program are expected to act impartially and are not allowed to support either the principal or agent or any other party. Because, according to Fossung et al. (2022) the use of contractual mechanisms, such as external audit aims to control and mitigate the opportunistic behavior of managers. Then, services from third parties who have sufficient ability and expertise to perform audit services can reduce agency conflict (Salman & Setyaningrum, 2023). This theory is relevant to the research because it discusses the factors that affect audit quality and ways of mitigating agency costs.

Attribution Theory

According to Arifin (2022) theory of attribution describes the causes of specific actions taken by people—either themselves or others—as a result of internal or external factors that have an impact on behavior. Further, he explained that a person's behavior is influenced by both internal and external forces. According to Weiner (1985) there are two types of attribution: dispositional attribution and situational attribution where dispositional attribution relates to the internal factors that everyone poses such as attitude, self-awareness, and motivation and situational attribution relates to external factors that affect individuals such as environment, social value and situations. Meanwhile, Safeer et al. (2021) assert that both internal and external influences work together to shape Human behavior as cited in (Arifin, 2022). Attribution theory relates to judgment and explains how an auditor behaves and the factors that affect behavior.

Empirical Review

The Impact of Audit Tenure on Audit Quality

Sari et al. (2019) mention that audit tenure is the auditor's employment during which they offer the client audit services for a predetermined amount of period. According to Fadhila (2014) it may be by a specific audit partner, audit firm, or both. The audit process is made more obvious by an audit firm's ability to gain a deeper understanding of the client's operations and surroundings over an extended period. Martani et al. (2021) found that the audit firm can conduct a more effective and efficient audit after going through multiple audit series because they have accumulated knowledge about the client from the engagement periods, then having a significant effect of audit tenure on audit quality. Align with that a similar study performed on the non-profit organizations of Spanish state-owned foundations also found that there is a significant relationship between auditor tenure and audit quality, and concluded that the likelihood of an auditor producing a clean report rises with a foundation and auditor's long-term relationship (Gonzalez-Diaz et al., 2015). In contrast, a study carried out in the context of Ethiopia found that audit tenure has no or insignificant impact on audit quality (like, 2017). Because, audit tenure is already mandated, and it may view as it is no longer a consideration worthy of concern impact of auditor tenure on audit quality, (Association of Chartered Certified Accountants, 2014). The findings led to the following hypothesis being proposed for this study.

H_1: There is a significant impact of auditor tenure on audit quality of the external audit setting in Sri Lanka.

The Impact of Audit Firm Size on Audit Quality

Since most scholars reveal that the size of the audit firm significantly affects audit quality, the variable ‘Audit firm size’ is a highly subjective indicator in examining factors that affect audit Quality. Ayu et al. (2018) mention that there may be a greater requirement for audits of varying quality, because of the potential increase in agency conflicts due to the company's continued growth in size. A study that was conducted examining the effect of audit firm size on the audit quality of selected listed non-financial firms by Okoye et al. (2022) found that Audit firm size has a positive and significant effect on the audit quality of non-financial firms. Similar study in the context of Nigeria found that when hiring an audit firm, a high value should be placed on the size of the audit firm because there is a significant correlation between the firm size and the audit quality. Sawan and Alsaqqa (2012) the size of the audit firm is strongly correlated with audit quality, and Big Four firms outperform their non-Big Four competitors in every reputation-related challenge they are dealt with. Because they reveal how superiority is measured in terms of resources and audit technology, as well as the ensuing motivation to deliver the best possible professional performance. Another empirical study that compared and contrasted the relationship between audit firm size and audit quality conducted by Priyanti and Dewi (2019) found that the Accounting Firm size, whether having affiliation with Big4 Accounting Firm or not, has no impact on audit quality because a public accounting firm must adhere to proper audit procedures when auditing a company's financial statements, high-quality audits will be produced. In support of this view, Al-Khaddash et al. (2013) mention that the size of the auditing office doesn’t affect auditing quality in the Jordanian banking sector. Based on these findings, the second hypothesis of this study is;

H_2: There is a significant impact of audit firm size on the audit quality of the external audit setting in Sri Lanka.

The Impact of Audit Fees on Audit Quality

According to Yuniarti (2017), an auditor's audit fee is determined by the complexity of the services they perform, their level of experience, the assignment's risk, and other professional factors. Then the study shows that obtaining a larger audit fee makes the audit of a higher quality. In aligning with that Kuntari et al. (2017) mention that audit fee has a positive effect on audit quality. Moreover, an empirical study carried out in the context of public accounting firms in West Jakarta by Harun and Hoesada (2020) mentioned that the audit fee influences the audit quality since auditors who charge a high audit fee will examine their client's business more thoroughly to find any potential irregularities in their financial statements. Finding discrepancies is a sign of an excellent audit procedure. In contrast, a study conducted on consumer goods industry companies listed on the Indonesia Stock Exchange discovered that audit fees do not affect audit quality in consumer goods manufacturing companies listed on the Indonesia Stock Exchange, thereby leading the scholar to conclude that there is a doubt that the amount of audit fees paid by the company for the auditor's services will not have an impact on the audit's final financial statement results because the auditor's independence throughout the audit proves the audit's quality. Based on these findings, the third hypothesis of this study is;

H_3: There is a significant impact of audit fees on the audit quality of the external audit setting in Sri Lanka.

The Impact of the Independence of the Auditor on Audit Quality

According to Putria and Mardijuwono (2020), the auditor's independence is the attitude of impartiality, has no personal interest, and is not easily influenced by the parties interested in providing opinions. Baah et al. (2016) found that the link between objectivity and audit quality is strengthened by independence, which also has a major impact on audit quality and to do an audit effectively, time must be allotted for it, and there shouldn't be any unneeded restrictions. According to Suseno (2013) it showed that audit quality is strongly influenced by the independence of the auditor, thereby leading the scholar to conclude that maintaining their independence requires auditors to make decisions based only on the facts and without influence from gifts, client kindness, or other external factors. Another study conducted in the West Jakarta accounting firms by Harun and Hoesada (2020) mentioned that producing quality audits requires an independent attitude from the auditor. Because the audit report produced does not reflect reality if the auditor loses his independence. Similarly, Arfiansyah (2020) reported that independence has a positive effect on audit quality. In addition, in another empirical study that compared and contrasted the relationship between auditor independence and audit quality, Kertarajasa et al. (2019) found that auditor independence does not significantly affect audit quality. Based on these findings, the fourth hypothesis of this study is;

H_4: There is a significant impact of auditor independence on audit quality of the external audit setting in Sri Lanka.

The Impact of Auditor Competence on Audit Quality.

Since the auditor becomes the prominent determinant of how the results of an audit action can be answerable, competency becomes a casual variable of an auditor's behavior’s perspective on audit quality. According to Darmawan et al. (2017) there is a positive and significant influence partially and simultaneously from a competency variable on audit quality, thereby leading the scholar to conclude that professionals with the necessary training, expertise, and competence in the audit should conduct audits and prepare reports for them. One of another study carried out in the context of public accountant firms in Indonesia by Putri and Mardijuwono (2020) stated that auditor competency significantly positively affects audit quality. According to an empirical study conducted at a public accounting firm in Bali by Iarasdiputra and Martini (2020) auditor competence has a positive effect on audits since they are more sensitive when evaluating the information gathered during the audit process, experienced auditors have many advantages, including the ability to identify errors more precisely and to identify unusual errors. In addition, another empirical study that compared and contrasted the relationship between audit firm size and audit quality conducted in the context of Indonesia found that the competence of Public Accountants does not affect audit quality (Arfiansyah, 2020). Based on these findings, the fifth hypothesis of this study is;

H_5: There is a significant impact of auditor competence on the audit quality of the external audit setting in Sri Lanka.

The Impact of Auditor Mood on Audit Quality

An expanding amount of literature is examining the effects of auditor mood on audit quality and decision-making. Perera and Wijerathna (2020) mentioned that an auditor's physical and mental condition at the moment of performing an audit explains the auditor's mood and it may include such auditors' job satisfaction and what they think about the organization. According to Bhattacharjee and Moreno (2013) auditors can experience emotional reactions toward a client or an element of a task environment or general moods unrelated to the judgment context which can result in judgment errors. It revealed that auditors in positive moods made a positive judgment in contrast to negative mood auditors and practitioners in positive moods displayed lower judgment consensus when compared to the practitioners in negative and neutral moods. According to that Brown et al. (2016) suggested that most of the participants are stratified about the job and do not feel boarded most of the time and it positively affects the audit quality. According to DeZoort and Lord (1997) some auditors perform well under pressure. But Sweeney and Summers (2002) found that increasing workloads can lead to job burnout and Jones et al. 2010 explained that increasement in job burnout increases turnover intention poor job performance and lower levels of job satisfaction which cause lower quality of audit performance. This emphasize that including auditor mood as a factor in audit quality study is crucial due to its significant impact on auditors' decision-making and performance, which has been increasingly recognized in recent literature. While traditionally overlooked, the psychological state of auditors—encompassing job satisfaction, emotional reactions, and overall mood—directly influences their judgment accuracy, objectivity, and engagement with the audit process. As audit quality hinges on meticulous, unbiased evaluations, understanding how auditor mood affects these outcomes can provide valuable insights for improving audit practices and mitigating potential biases. Given that auditors are integral to ensuring the accuracy and reliability of financial reporting, incorporating mood as a variable helps to address a critical dimension that may otherwise impact audit effectiveness and provides a more holistic view of the factors influencing audit quality. Based on these findings, the sixth hypothesis of this study is;

H_6: There is a significant impact of auditor mood on audit quality of the external audit setting in Sri Lanka.

Methodology

To gather data, a structured questionnaire was utilized. The structured questionnaire was developed by reviewing the recent literature (Fallatah, 2017; Alsughayer, 2021; Perera & Wijerathna, 2020). Initial drafts of the questionnaire were reviewed by experts in auditing and research methodology to ensure content relevance and clarity. A pilot test was conducted with a small sample of 20 respondents from the target population to identify any issues with question wording and the overall survey design. Feedback from the pilot test was used to refine the questionnaire, enhancing its effectiveness in capturing the intended data. The reliability of the questionnaire was assessed using Cronbach's alpha, which indicated acceptable internal consistency for all constructs. The study population encompasses both Big three firm practitioners and Non-Big three firm Practitioners in Sri Lanka. A total of 140 invitations to participate in the survey were sent out, and 107 responses with a response rate of 76% were obtained for the study. In the absence of a predefined sampling framework, the researcher employed a convenience sampling method while ensuring the sample's demographic representation. While convenience sampling provided practical advantages in terms of accessibility and speed, it also introduced potential limitations. The findings may not be generalizable beyond the sample, and caution should be exercised when applying the results to broader contexts. The data was analysed using correlation and regression analysis techniques with the use of SPSS software.

Table 1 summarizes demographic characteristics of the respondents. Accordingly, the most of respondents were male (53.3%), aged between 25 – 34 (62.6%), Highest educational level presented the B.Sc. Degree (commerce/ Business/Economics) (67.3%), professional body membership presented the CASL (72%), representing the most from Non-Big Four Firms (52.3%), experience in the field was 1-2 years (42.1%). Most of respondents were senior audit trainees.

Table 1 Demographic Analysis

Variables	Category	Frequency	Percentage (%)
Gender	Male	57	53.3
	Female	50	46.7
Age	18 – 24	35	32.7
	25 – 34	67	62.6
	35- 44	2	1.9
	Over 45	3	2.8
Academic Qualification	Advanced Level	9	8.4
	Bachelor’s Degree (commerce/Business/Eco nomics)	72	67.3
	Bachelor’s Degree (Other)	18	16.8
	Master’s Degree (commerce/Business/Economics)	3	2.8
	Other	5	4.7
Professional Body Membership	CASL	77	72.0
	CMA	4	3.7
	CIMA	9	8.4
	AAT	12	11.2
	Other	5	4.7
Firm category	Big Three Firms	51	47.7
	Non-Big Three Firms	56	52.3
Working Experience	1 – 2 years	45	42.1
	3 – 4 years	38	35.5
	More than 5 years	24	21.5
Current position	Associate Audit Partner	11	10.3
	Senior Audit Partner	10	9.3
	Audit Manager	27	25.2
	Audit Supervisor	14	13.1
	Senior Audit Trainee	45	42.1

Source: Survey (2023)

Results and Discussion

Reliability and Validity Testing

The study gathered data through an online questionnaire, ensuring no missing data. The reliability of the variables in the study was assessed using Cronbach's Alpha which indicated that Audit Tenure, Firm Size, Audit Fees, Auditor Competence, Auditor Independence, Auditor Mood, and Audit Quality exhibit acceptable levels of internal consistency with Cronbach's Alpha values ranging from .676 to .895, all surpassing the recommended threshold of 0.70 and suggesting satisfactory reliability for each variable. The construct validity of the research instrument was evaluated using the Kaiser-Meyer-Olkin (KMO) measure, with all variables ranging from 0.620 to 0.866, well above the recommended threshold of 0.5. This indicated that the sample size was sufficient and the variables shared enough common variance.

Correlation Results

Table 2 shows the correlations between different audit firm attributes and audit quality. The attributes include audit tenure (AT), firm size (FS), audit fees (AF), auditor committee (AC), auditor independence (AI), auditor mood (AM), and audit quality (AQ). The correlations were measured using Pearson's correlation coefficient, which is a measure of the linear relationship between two variables. A correlation coefficient of 1 indicates a perfect positive linear relationship, while a correlation coefficient of -1 indicates a perfect negative linear relationship. A correlation coefficient of 0 indicates no linear relationship between the two variables. Audit tenure exhibited significant positive correlations with firm size ($r = 0.451$, $p < 0.01$), audit fees ($r = 0.564$, $p < 0.01$), auditor independence ($r = 0.540$, $p < 0.01$), and auditor mood ($r = 0.448$, $p < 0.01$). Firm size demonstrated positive correlations with all other variables, with significant associations observed with audit fees ($r = 0.524$, $p < 0.01$), auditor independence ($r = 0.392$, $p < 0.01$), and auditor mood ($r = 0.374$, $p < 0.01$). Audit fees also displayed positive correlations with all variables, with particularly strong associations with audit tenure ($r = 0.564$, $p < 0.01$)

and auditor mood ($r = 0.506$, $p < 0.01$). Auditor competence exhibited positive correlations with audit fees ($r = 0.338$, $p < 0.01$), auditor independence ($r = 0.232$, $p < 0.05$), and auditor mood ($r = 0.430$, $p < 0.01$). Auditor independence showed a strong positive correlation with auditor mood ($r = 0.525$, $p < 0.01$). Furthermore, auditor mood displayed a robust positive correlation with audit quality ($r = 0.604$, $p < 0.01$). Overall, the correlations suggested intricate interdependencies among these variables, emphasizing the importance of considering multiple factors in assessing audit-related dynamics.

Table 2: Correlation Analysis

Variables	AT	FS	AF	AC	AI	AM	AQ
AT	1.00						
FS	0.451^{**}	1.00					
AF	0.564^{**}	0.524^{**}	1.00				
AC	0.245^{*}	0.373^{**}	0.338^{**}	1.00			
AI	0.540^{**}	0.392^{**}	0.432^{**}	0.232^{**}	1.00		
AM	0.448^{**}	0.374^{**}	0.506^{**}	0.430^{**}	0.525^{**}	1.00	
AQ	0.269^{**}	0.218^{*}	0.323^{**}	0.517^{**}	0.201^{*}	0.604^{**}	1.00

Notes: $^{**}p < 0.01$, $^{*}p < 0.05$
Source: Survey (2023)

Multiple Regression Analysis Results

Multiple regression analysis was employed in this study which allowed for examining the simultaneous relationships between multiple independent variables and a single dependent variable. As per the results summarized in Table 3, R Square was approximately 0.471, indicating that 47.1% of the variance in the dependent variable could be explained by the independent variable(s). The model is reasonably strong as it explains a substantial portion of the variance in the dependent variable.

Further, as given in Table 2, the coefficient of audit tenure was 0.55 with a p-value of 0.514. The variable did not appear to be statistically significant at the significance levels of 0.05. Further, firm size which had -0.074 with a p-value of 0.391, and Audit fees which had a coefficient of 0.011 with a p-value of 0.893. These variables did not seem to be statistically significant. Similarly, auditor independence which had a coefficient of -0.146 with a p-value of 0.072 was not significant predictor of audit quality. However, auditor competence and auditor mood appear to be significant predictors of audit quality with coefficients of 0.348 and 0.522 respectively.

Table 3: Regression Results

	Coefficient	Std. Error	t-statistic	p-value
(Constant)	1.371	0.401	3.417	0.001
Audit tenure	0.055	0.084	0.655	0.514
Firm size	-0.074	0.086	-0.861	0.391
Audit fees	0.011	0.083	0.135	0.893
Auditor competence	0.348**	0.088	3.970	0.000
Auditor independence	-0.146	0.080	-1.821	0.072
Auditor mood	0.522**	0.092	5.652	0.000
R-Square: 0.471, Adjusted R-Square: 0.440				

Notes: $^{**}p < 0.01$, $^{*}p < 0.05$
Source: Survey (2023)

Accordingly, auditor competence and auditor mood appeared to be statistically significant predictors of the audit quality, which support the hypotheses H_5 and H_6. Audit tenure, firm size, audit fees, and auditor independence did not show statistical significance in predicting the audit quality, leading to the rejection of the hypotheses H_1, H_2, H_3 and H_4.

Conclusions

This study aims to examine impact of auditor tenure, firm size, audit fees, auditor competence, auditor independence and auditor mood on audit quality in the external audit setting in Sri Lanka. According to the regression model, 47.1% of the variance in audit quality is explained by these factors. Auditor tenure, firm size, audit fees, and auditor independence found insignificant effect on audit quality. Auditor competence's significant impact aligns with prior study indicating that higher levels of expertise and skills are crucial for accurate and reliable audits. For instance, Darmawan et al. (2017) and Putri and Mardijuwono (2020) similarly highlight that auditors with greater competency contribute positively to audit quality, emphasizing the importance of specialized knowledge and training. Auditor mood's significant effect, contrasting with other factors, reflects recent findings in study that psychological states can profoundly impact decision-making and performance. According to Perera and Wijerathna (2020) and Bhattacharjee and Moreno (2013), positive moods enhance judgment accuracy and overall engagement, aligning with the current finding that a positive auditor mood correlates strongly with higher audit quality. The lack of significance for audit tenure, firm size, audit fees, and independence in the study contrasts with some previous studies. For instance, studies like those by Sari et al. (2019) and Ayu et al. (2018) suggest these factors typically influence audit quality. However, the current study findings may reflect contextual differences suggesting that in the Sri Lankan external audit setting, auditor competence and mood are more critical determinants of audit quality than the other factors examined. This challenges the conventional wisdom that attributes audit quality solely to factors like auditor experience, firm size, fees, and independence.

Implications

Focus on auditor competence and mood, research highlights the importance of individual practitioner characteristics like competence and mood in Sri Lankan audits. The finding that auditor competence positively impacts audit quality highlights the importance of hiring and retaining highly skilled and knowledgeable auditors. Firms should invest in continuous professional development and training programs to ensure their auditors stay up-to-date with industry standards and practices. This investment will likely improve audit outcomes and enhance client satisfaction. The significant impact of auditor mood on audit quality suggests that auditors' psychological well-being and job satisfaction are crucial. Audit firms should foster a supportive work environment, provide regular feedback, and manage workloads to prevent burnout. Initiatives such as mental health support, flexible working conditions, and positive workplace culture can contribute to better audit performance.-Regulators should consider integrating guidelines or standards that emphasize the importance of auditor competence and psychological well-being in their regulations. This could include requirements for regular training, certification, and mental health support for auditors to ensure high-quality audits. Further, the research opens up new avenues for academic research. Future studies could delve deeper into the specific skills and attributes that contribute to auditor competence in the Sri Lankan context, as well as explore the factors that influence auditor mood and its impact on audit quality and use a larger and more diverse sample to improve the generalizability of the findings.

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