

## CHAPTER 6

### CONCLUSION

#### 6.1 Introduction

This chapter gives an overview of the entire study, discusses the conclusions that explain respondents' perceptions of the various research variables, and emphasizes the findings' implications for theoretical and methodological literature. The chapter also explains how audit quality in Palestinian municipalities is directly impacted by auditor characteristics, audit firm attributes, and effectiveness of municipal internal control. Furthermore, the moderation effect of Supreme Audit Institutions on the relationship between the audit quality and its determinants which they selected by this study. Besides that, the chapter explains the direct effect of selected dimensions of audit quality determinants, such as auditor Ethics, Independence, Competence, Audit Fees, Audit Firm Size, Internal Auditing, Accounting Basis, and the Laws and Regulations, on Audit Quality. This chapter discusses the limitations and make recommendations for future researchers in this field, and presents the final conclusion of the study.

#### 6.2 The Main Finding of the Study

The current study's main goal is to provide evidence on the determinants of audit quality in Palestinian municipalities. The discussions and findings of the analysis were reported in Chapters Four and Five, are summarized in the following subsections.

### **6.2.1 The Auditor Characteristics and Audit Quality**

The researcher had developed the first hypothesis of the study and three supporting hypotheses with regard to the first research question and to fulfill the first objective of this study regarding the influences of auditor characteristics and its dimensions, Ethics, Independence, and Competence, on the audit quality. H1: Auditor Characteristics (ACH) has significant positive effect on Audit Quality (AQ). The relationship between ACH and AQ was found to be significant and positive. The positive relationship indicates that the increase in the level of ACH in the audit team in audit engagement of the municipalities in terms of auditor ethics, independence, and competence will result in an increase in the level of AQ. Therefore, the results support the study hypotheses (H1a, H1b, H1c) and confirm positive relationships between the selected dimensions of ACH and the AQ. For example, the auditor ethics such as high reputation, honesty, and integrity has increased AQ in municipalities. Independence of auditor in mind and appearance will increase the AQ by increasing the trustworthiness of the users with the audited financial statements, also, the high level of education, knowledge, experience of auditor increases the AQ.

### **6.2.2 The Audit Firm Attributes and Audit Quality**

The researcher had developed the second hypothesis of the study and two supporting hypotheses with regard to the second research question and to fulfill the second objective of this study regarding the influences of audit firm attributes and its dimensions, audit fees, and audit firm size on the audit quality. H2: Audit Firm Attributes (AFA) has significant positive effect on Audit Quality (AQ). The relationship between AFA and AQ was found a small positive correlation which indicates that AFA is something that increases the level of AQ. The positive

relationship indicates that the increase in the level of AFA in terms of Audit Fees (AF) and the Audit Firm Size (AFS) will result in an increase in the level of AQ. Therefore, the results support the study hypotheses (H2a and H2b) and confirm positive relationships between the selected dimensions of AFA and the AQ. For example, AF may reflect the amount of auditors' efforts in the audit engagement which increase the AQ in municipalities. Also, the AFS reflects the variety experienced auditors in many fields and more responsible auditors which increases the AQ in the municipality.

### **6.2.3 The Effectiveness of Municipal Internal Control and Audit Quality**

The researcher had developed the third hypothesis of the study and three supporting hypotheses with regard to the third research question and to fulfill the third objective of this study regarding the influences of effectiveness of municipal internal control in the municipalities and its dimensions, internal auditing, accounting basis, and laws and regulations on the audit quality. H3: Effectiveness of the Municipal Internal Control (EMIC) has significant positive effect on Audit Quality (AQ). The relationship between EMIC and AQ was found a small positive correlation which indicates that EMIC is something that increases the level of AQ. The positive relationship indicates that the increase in the level of EMIC in terms of IA, AB, and LR will result in an increase in the level of AQ. Therefore, the results support the study hypotheses (H3a, H3b, and H3c) and confirm positive relationships between the selected dimensions of EMIC and the AQ. For example, the existence and more effective IA increase the compliance with established criteria and lead to more efficient business operations including issuing reliable financial statements, and IA can make the external auditing more efficient particularly, when there is a cooperation between the external auditors and internal auditors, and the external auditor can use

the reports of internal audit as audit evidence according to the auditing standards. The accounting basis is considered the foundation the accounting records, therefore, the nature of the accounting basis affecting the reliability and the relevancy of financial reports which considered the inputs of the auditing process, therefore, the audit quality will increase if the accounting basis was effective and efficient. As a result, shifting from cash accounting to accrual accounting will improve audit quality in municipalities because accrual accounting is more efficient and produces more comprehensive and useful financial reports. Also, the existence of effective applicable laws and regulations, as well as greater compliance with these laws and regulations, will improve audit quality in municipalities, because misstatements, whether errors or fraud, will be at a minimum, allowing the external auditor to detect any misstatements in the financial statements and report to the appropriate level of supervision on the municipality.

#### **6.2.4 The Moderating Role of SAIs on the audit quality**

The results of the study which related to fourth research question about the moderation role of the supreme audit institutions on the relationship between the audit quality and its determinants of auditors' characteristics, audit firms' attributes and effectiveness of municipal internal control. Also, the result of the study related to the fourth objective and related three hypotheses as the following:

H4a: Supreme Audit Institutions (SAI) moderates the relationship between Audit Quality (AQ) and Auditor Characteristics (ACH). The result of the study shows that the moderation effect of the SAIs on the relationship between the AQ and the ACH is positive effect, because the SAIs affect indirectly on the ACH through controlling the ToR of audit services which required specific characteristics in

candidate auditors, and monitoring the process of tendering of acquiring audit services.

H4b: Supreme Audit Institutions (SAI) moderates the relationship between Audit Quality (AQ) and Audit Firm Attributes (AFA). The study result shows that the moderation effect of the SAIs on the relationship between the AQ and the AFA is negative effect, because the SAIs monitor the process of tendering of acquiring audit services that heavily depending on the audit price competitiveness. This leads to reducing audit fees to their minimum, and this matter does not encourage the auditor to exercise the required professional care, which reflects negatively on the quality of the audit.

H4c: Supreme Audit Institutions (SAI) moderates the relationship between the Audit Quality (AQ) and the Effectiveness of Municipal Internal Control (EMIC) in the municipality. The result of the study shows that the moderation effect of the SAIs on the relationship between the AQ and EMIC is significant and positive effect, because SAIs focus on compliance auditing, which examines the extent of the compliance of the municipalities with applicable laws and regulations, and current regulations encourage municipalities to use accrual accounting rather than cash basis. SAIs also typically suggest to the relevant parties some improvements to the laws and regulations in force by reviewing them at the level of updating these laws and regulations as well as how to comply with them, which leads to making municipal internal controls more effective, which increases the quality of auditing, and this means that SAIs positively affect the relationship between the AQ and the EMIC.

### **6.3 Contributions of the Study**

The current study provides data on the factors of audit quality in municipalities by establishing a complete framework of audit quality. This framework applied the public interest theory to analyze the positive direct correlations between audit quality and chosen factors and their dimensions, which can influence the degree of audit quality in municipalities. Furthermore, this study takes into account the moderating influence of supreme audit institutions on the relationships between audit quality and its factors. According to the previous audit quality studies presented in Chapter 2, this study distinguishes itself by introducing new aspects connected to audit quality, such as the dimensions of the effectiveness of internal control in developing countries' municipalities.

In addition to the audit quality literatures, this study makes theoretical, methodological, and Managerial contributions as discussed in the following subsections.

#### **6.3.1 Literature Contributions**

This study may provide some contribution to the audit quality literature as follows:

First, in order to measure audit quality and provide a comprehensive model for audit quality in municipalities, the study collected valuable data from Palestinian municipalities that opened officially to external auditing in 2011 in addition to SAIs. According to the researcher's knowledge, this is the first study to look into audit quality in Palestinian municipalities as perceived by accountants and internal auditors who are involved in and familiar with the audit process, inputs, outputs, outcomes, and the context of the audit quality environment.

Second, the study enhanced the audit quality literature by investigating new aspects of audit quality such as the effectiveness of municipal internal control with its dimensions of the internal auditing, the accounting basis, and the applicable laws and regulations for the municipalities and their environment. These components may have been examined separately in previous studies, but to the best of the researcher's knowledge, no prior study examined them as audit quality factors in the municipalities.

Third, the public interest theory is used in this study as the main theory to explain the relationship among the variables of the study including the moderating role of the SAIs on the relationship between the audit quality and its determinants which they are chosen to be in the study model. According to the best of the researcher's knowledge, this is the first study used the Public Interests theory as main theory to explain all components of the study model.

### **6.3.2 Theoretical Contributions**

The study's uniqueness stems from the development of a comprehensive theoretical framework that investigates the most important determinants of high audit quality in municipalities. This study yielded several theoretical contributions, which are described below:

First, the Public Interests Theory is used first time to explain the relationships between audit quality as a dependent variable and selected audit quality factors in municipalities as public sector organizations in Palestine. These organizations are frequently audited by governmental bodies, as is in the most developing countries in the region, but in Palestine, municipalities are opened to external auditing by MOLG who encourages the municipalities to issue yearly audited financial statements in order

to be credible for government and the foreign donors who provide grants to municipalities. Therefore, most municipalities entered in audit engagement with external auditors according to the study's findings which show that 96% of respondents had experience with external auditing in the last four years. This intervention by the government (MOLG) is the core of the Public Interest Theory. This study as best knowledge of the researcher is first study employs the Public Interest Theory as part of the suggested conceptual framework of auditing quality in the municipalities.

Second, the findings of the study confirmed and validated the using of the Public Interest Theory. For example, the study shows that 47.8 % of all respondents mentioned that their municipalities have internal auditing department. Also, the study shows that 33.9% of the respondents use the accrual basis and 23.7% of them use the modified accrual basis and mixed accounting bases. The increasing of establishment of internal auditing departments in the municipalities, and transition from the cash basis to the accrual accounting reflects the intervention of the government according to the Public Interest Theory.

Third, the Public Interests Theory can explain the effect of the SAIs on the audit quality in the municipalities, because the using of the SAIs auditing in the municipalities represents the governmental intervention to strengthen the internal control factors including the internal auditing, accounting basis and reliable accounting information system, and the compliance with the applicable laws and regulations. The study shows that most municipalities have experience with SAIs auditing which reached to 92% among the respondents. Moreover, the study shows that the SAIs moderate positively the relationship between the audit quality and the auditor's characteristics and the effectiveness of municipal internal controls, but

negatively moderate the relationship between the audit quality and the audit firm's attributes.

### **6.3.3 Methodological Contributions**

This study has implications for research methodology by assessing the independent variables, moderator variable, and their impact on the audit quality as dependent variable. The measurements of these variables were found to have good validity and reliability in organizational research. This study contributes to the methodology by validating these measurements in a different context.

The measurements for the independent and dependent variables in this study, which total 39 items, were adapted from pertinent prior studies. Because these instruments and their items were used in other nations, strict test procedures were required to ensure that they were suitable for use in the Palestinian context through the validation of these items. However, the remaining 11 moderator variable measures were tested in the pilot study using SPSS, and the validity test of the 11 items showed that the application was valid and reliable within the parameters of the study. In addition to these measurements the study reviews the annual reports of SAIs in Palestine which they related to the municipalities in order to support of result of perception of the effect of the SAIs role on the relationship between the audit quality and its determinants; auditor's characteristics, audit firm attributes, and the effectiveness of municipal internal control in the Palestinian municipalities. As a result, this study examines the effect of the moderator role of SAIs on the relationship between audit quality and its determinants using both secondary and primary data.

Also, the study used the Smart PLS 3 software in statistical analysis of the result of the questionnaire, according to Hair et al., (2017) who encouraged social sciences

researchers to use Smart PLS 3 because it is a newer, more powerful, and often more flexible statistical method, and estimates data with little or no bias.

#### **6.3.4 Managerial Contributions**

According to result of the study which depicted all relations among the study variables, several practical contributions can be useful for several parties as follows:

First, the study can help the audit profession regulators in developing a comprehensive audit quality framework for the public sector, including the audit quality factors that were chosen, as well as looking at other new audit quality attributes.

Second, the study will be helpful for the management of the PSOs and the governance bodies in evaluating the audit bids and thus choose the best professional auditors who can provide high audit quality. Because this study provides a comprehensive model for the quality of the audit services by focusing on the inputs of the audit process.

Third, audit firms may refer to perspectives of accountants and internal auditors as a basis to enhance their audit efficiency. When this perception is known to audit firms, it assists them in developing effective strategies to satisfy your clients, allowing audit firms to differentiate their promotion and service provision strategies, and improve their audit service quality, allowing them to retain the clients and strengthen their market position.

Fourth, because the study suggested a comprehensive framework for audit quality while considering the municipalities environment, it will assist the municipal regulator (MOLG) in reviewing its regulations related to the appointment of external auditors and the issuance of audited financial statements. Furthermore, the study may

benefit the government and legislative parties in reviewing and imposing internal audit laws and regulations; adopting relevant accounting basis; and expanding the activities of the SAIs in all Palestinian municipalities.

Fifth, this study related to case of opening the municipalities to external auditing in Palestine; this is a new case in Arab countries or may in the Middle East region. The findings of this study may help other decision makers in these countries in evaluating this case and take actions to implement some findings of this study, particularly the use of accrual accounting basis instead of cash basis and enhancing the role of internal auditing in the municipalities.

Sixth, policymakers in municipalities and audit firms become more aware of the audit process's input and output when deciding on the terms of the audit engagement, and they can use the findings of this study to reach a fair audit agreement that takes in its considering the technical issues and the amount of proper audit fees. Furthermore, the policymakers learn about the role of SAIs in the quality of external auditing and how they can influence the audit process. The external auditor, for example, may use the SAIs' reports as audit evidence and indicators in assessing audit risk and the effectiveness of internal control in municipalities. As a result, auditing fees will become more affordable and minimal.

#### **6.4 Limitations and Suggestions for Future Research**

This study has some limitations, as always when doing research, which should be considered when interpreting the findings. These limitations provide a few opportunities for future research to consider:

First, to the best of the researcher's knowledge, this study is limited because of the lack of studies related to external auditing quality factors in the municipalities in

developing countries, particularly the role of SAIs on the audit quality. It is the first study conducted in Palestine and the Middle East region on examination of the effect of effectiveness of municipal internal control and the effect of moderating role of SAIs on the external audit quality in the municipalities. As a result, more research is needed to confirm the findings of this study.

Secondly, it must be acknowledged that there are constraints on what can be inferred from a perceptual-based survey because respondents' subjectivity may make it difficult for them to provide unbiased feedback. This might happen, for instance, if a respondent chooses to support his interests by providing a specific response.

Third, this study is limited in that it considers specific determinants of auditor characteristics. Because auditor characteristics are the most important predictor of external audit quality, other determinants such as auditor courage, gender, or other characteristics should be considered in future studies. In addition, future research could look at other aspects of audit firm attributes and the effectiveness of municipal internal control, such as work overload, artificial intelligence, technology level, and audit firm culture.

Finally, this study examined only one factor as a moderator of the relationship between the independent variable and the dependent variable in the study model, but other factors, such as public election of governance bodies, political, economic, and environmental factors, may act as moderators on these relationships. Future research could look into these factors and how they affect audit quality in municipalities.

## 6.5 Recommendations

Following the audit quality literature review and empirical study findings, the following recommendations may be appropriate to solve problems in improving audit quality in public sector organizations, specifically Palestinian municipalities:

First, the study recommends the Palestinian Audit Profession Council and the Palestinian Association of Certified Public Accountants to add the IPSAS and related educational material to the Profession Exam requirements, and require specific auditing training courses from who want to provide audit services to PSOs, particularly municipalities.

Second, MOLG is advised to revise and update the terms of reference (ToR) for hiring external auditors for local government units (LGUs) to include all audit quality factors discussed in this study, particularly the auditor characteristics, which must be consider in any audit team designated to conduct municipal auditing. Furthermore, the revision of the ToR must include how to evaluate the technical offer, as well as the audit period, auditor tenner, and other assurance services that the external auditors may provide.

Third, municipal management is advised to get from all candidates for auditing the municipality a technical offer prior to the financial offer for assessment. This makes it possible for the municipality to choose external auditors who are qualified and capable of producing high-quality audits without having to base its decision to accept an audit offer primarily on audit fees.

Fourth, audit firms are advised to use the findings of this study to evaluate their policies and procedures in order to meet the requirements of audit quality as perceived by accountants and internal auditors who are always involved and active in the evaluation of audit bidding and the audit firms who participate in audit bids.

Five, legislative parties are encouraged to conduct a thorough review of municipal laws and regulations in order to bring them more in line with recent changes in accounting principles and audit processes, such as using the accrual accounting basis and mandating the municipalities to issue audited financial statements yearly during specific period.

Sixth, municipalities' managements are recommended to employ competent internal auditors and conduct training courses for them to be expertise with environment of the municipality, cooperative with the external auditors and SAIs auditors, and to be able to provide consulting services to management of the municipality.

Finally, SAIs are advised to obtain audited financial statements and other external audit reports in order to minimize their efforts, to motivate municipalities to hire competent auditors, and to encourage and monitor the external auditors to be committed with the ToR of audit service.

## **6.6 Concluding**

The study related to the audit quality that is provided by audit firms in order to understand the most influential factors that raise and improve the audit quality in the municipalities. The research found three factors and their dimensions that have direct significant positive relationships influencing the audit quality: auditor characteristics with dimensions of ethics, independence, and competence; audit firm attributes with dimensions of audit fees and audit firm size; and the effectiveness of municipal internal control with dimensions of internal auditing, accounting basis, and applicable laws and regulations. Furthermore, in order to conduct a more thorough investigation, one moderator variable, supreme audit institutions, was considered in this study. The

findings revealed that supreme audit institutions moderate positively the relationship between auditor characteristics and audit quality, as well as the relationship between the effectiveness of municipal internal control and audit quality, but moderate negatively the relationship between audit firm attributes and audit quality.

To the best of researcher's knowledge, this study is one of the few studies conducted in developing countries especially in the Arab countries with a focus on the quality of external auditing in the municipalities to examine factors that have impact on improvements and prediction of the audit quality in the municipalities. Therefore, this study contributed to an expanding research stream on the audit quality by adding the Palestinian municipalities' accountants and the internal auditors' perspective. Thus, decision and policy makers in Palestine particularly Ministry of Local Government as regulators of municipalities, and the Palestinian Association of Certified Public Accountants and the Auditing Profession Council as regulators of the audit profession have to consider the findings of this research for evaluating and improving the audit quality in the public sector organizations particularly the municipalities.