

# CHAPTER 1

## INTRODUCTION

### 1.1 Introduction

This study aims to evaluate the external audit quality in the municipalities of Palestine, which are the most important public sector organizations in the country, and to assess the audit quality attributes based on the perspective of accountants and internal auditors, who are the main participants in the accounting information system and are in constant, direct contact with external auditors. The main audit quality attributes selected by this study include auditor characteristics, audit firm attributes, and the effectiveness of municipal internal control. Moreover, the study aims to explore the effect of supreme audit institutions (SAIs) on the relationships between these attributes and audit quality.

High audit quality boosts public trust in audited financial statements issued by government accountants. However, even if a government agency receives an unmodified audit opinion, public confidence will still weaken if corruption remains (Kusumawati & Syamsuddin 2018). Corruption and scandals in the public sector organizations are linked to the internal control system, which is at the heart of the accounting policies and auditing procedures. The governments can reduce the corruption when they reform public-sector accounting by adopting the International Public Sector Accounting Standards (IPSAS) or the accrual accounting basis (Cuadrado-Ballesteros et al., 2019).

In addition to the secondary data about the audit quality, the study employed the survey design to obtain the perception of accountants and internal auditors in the Palestinian municipalities on the extent of quality of the external auditing and the degree of responsiveness of auditors to their needs, as well as of audit quality attributes that make auditors more credible and efficient in audit engagements. The data are analyzed using the SmartPLS 3 software. The study provides a comprehensive model for audit quality and its three determinants of auditor characteristics (ethics, independence, and competence); audit firms attributes (audit fees and audit firm size); and the effectiveness of municipal internal control that is consistent with the components and objectives of the Committee of Sponsoring Organizations of Treadway Commission's (COSO) integrated internal control framework, such as internal audit, accounting basis, and compliance with applicable laws and regulations.

## **1.2 Research Background**

Audit firms usually provide financial audit, compliance audit, performance audit (Jeppesen et al., 2017) and other assurance or non-assurance services (Arens et al., 2017). These services may add credibility and trustworthiness to the client's financial information reports, making them more useful and beneficial for decision makers and other users. Independent private external audit firms provide their services to for-profit or non-profit organizations, including non-government organizations (NGOs) (Analoui & Samour, 2012). More recently, they started to serve public sector organizations (PSOs) in some countries (Johnsen, 2019). For example, in Palestine, the Policy Paper to Develop Mechanisms for Directing and Monitoring the Work of Local Authorities in July 2011 mentioned that the Palestinian municipalities have

given the option for voluntary external audit beside the internal auditing and the auditing of SAIs by the Palestinian Ministry of Local Government (MOLG) and recommended all the municipalities for external auditing, but did not require it as compulsory issue (MOLG, 2011). Moreover, MOLG issued a new Local Government Units Financial Regulation No. (11) of year 2019 without requiring from the municipalities to provide audited financial statements. To support and encourage the municipalities to hire external auditors and issuing the audited financial statements, the Municipal Development and Lending Fund (MDLF) as part of MOLG conducts periodical assessment of all Palestinian municipalities to determine the size of government contributions to the municipalities. This assessment includes metrics such as the release of two years of audited financial statements. Indeed, MOLG encourages all municipalities to audit their financial statements annually in order to receive extra government contributions. Moreover, most of the foreign donors of Palestinian municipalities require the audit financial statements (Rustom, 2018).

An external auditor typically conducts a financial statements audit and provides his opinion on the accuracy and fairness of the financial statements (Hay & Cordery, 2018) in a standardized written audit report. The client may either come from the public or private sector (Johnsen, 2019). The majority of PSOs offer fundamental services like infrastructure (roads, bridges, public buildings, parking), energy, water, sewage treatment, health, and other services (Avis et al., 2018; Besley & Ghatak, 2017). These critical services are provided in Palestine by PSOs, particularly the local government units (UNDP 2009), and the importance of these services has made the stakeholders of PSOs to be interested in the credibility and transparency of the information reports of the PSOs, particularly the financial statements, hence the importance of external audit (Yamamoto & Kim, 2019). For example, the

management, as one of the central stakeholders of the PSOs, is interested in the positive public's perception of the credibility of the financial reports. Consequently, the management requires a reliable independent auditor who offers top-notch audit services (Hay & Cordery, 2018). Likewise, citizens who pay taxes view such audits as crucial because they want to know where their money is going and whether it is being used in an efficient, effective, and economical manner (Bojkovska et al., 2019).

Most audit firms strive to deliver high-quality audits that have a positive impact on financial decisions in order to keep their current clients and capture new ones (Ali et al., 2019). High audit quality will give more assurance that the audited financial reports are reliable, credible, and high quality (Bala, 2019). But there are some debates on the definition of audit quality among researchers. Audit quality is defined by DeAngelo (1981) as the likelihood that an auditor will recognize and disclose an error in the client's accounting system. Lowensohn et al. (2007) mentioned that according to the Governmental Accountability Office (GAO) (1986), audit quality is defined as adherence to professional standards and the terms of the contract for the audit in question (Vu & Hung, 2023). Audit quality is a three-part process of examining the suitability of the pre-described procedures in relation to the determined objectives; conformity of the real activities with the planned activities; and effectiveness of these activities in achieving the stated objectives (Woodhouse, 2003).

The procurement of external audit services by the municipalities in Palestine is governed by procurement law and related regulations and instructions. The MOLG has been issued in 2016 a guideline on how the municipalities can prepare price quotation to hire an external auditor. The auditor must be recorded in the Palestinian Association of Certified Public Accountants (PACPA), which adopts the International Standards of Auditing (ISA) in its bylaw (Hassan, 2016). These instructions require

large municipalities to announce a public tender in a public newspaper about its plan to appoint an external auditor for specific years. After a lengthy tendering process, the municipality selects an auditor based on its evaluation of the financial and technical offers of the potential auditors. Small municipalities or village councils may distribute price quotations to many auditors to select the best auditor that satisfies the requirements of the MOLG's instructions, particularly the technical and professional requirements. Nonetheless, in general, audit fee is important in determining the successful audit tender (Elder et al., 2015).

From the start of the twenty-first century, there has been increasing awareness about the importance of SAIs, given that they audit government spending in accordance to relevant laws and regulations, accounting frameworks, and the approved budget. Furthermore, their audit evaluates the effectiveness and efficiency of public sector programs (Bojkovska et al., 2019; Carrington et al., 2019). According to World Bank report of year 2001, the majority of countries have national audit agencies like SAIs in place, which are in charge of auditing the financial statements of public sector institutions, (Gustavson & Sundström, 2018) and these agencies carry out performance audit (Carrington et al., 2019). All types of auditing, including financial, performance, and compliance audit, are typically provided by SAIs (Johnsen, 2019).

The Palestinian National Authority (PNA) created a SAI in 1994 when it issued Presidential Decree No. 22 of 1994 to set up the General Audit Institution (GAI), followed by the Act No. 17 of 1995 on the General Audit Institution, and the Financial and Administrative Control Bureau (FACB) Act No. 15 of 2004. Article 31(10) of the FACB Act No. 15 of 2004 states that local government units (LGUs), including municipalities, village councils, and other entities, shall be under the jurisdiction of

the FACB. At the end of 2019, there were 571 LGUs under the jurisdiction of the FACB in addition to 4,671 other PSOs. However, in the same year, the FACB released 125 audit reports, most of these reports were compliance audit, and 63 audit reports related to LGUs that made up 50.4 percent of the total FACB reports (FACB, 2019). But this percentage reached 51.08% in 2018 when FACB issued 139 audit reports, 71 of them related to LGUs. All of these reports related to compliance audit except three reports were related to financial and compliance audit, but there were no reports related to only financial or performance audit (FACB, 2018). This means that LGUs constitute most of the FACB's audit reports for public entities, and that compliance audit type is the most common type of auditing for public entities under the FACB. For example, in 2019, the share of compliance audit was 68%, while the remainder was shared among financial audit (11%), performance audit (8%), and financial and compliance audit (18%) (FACB, 2019). Moreover, FACB receives yearly numerous complaints. In 2018, FACB handled 237 complaints, 82 of which were related to LGUs (FACB, 2018). While in 2019, FACB received 200 complaints, 45 of which were related to LGUs, and FACB employees visited 37 LGUs for auditing and 91 LGUs to follow-up on the complaints (FACB, 2019).

In addition to FACB, there is another body under the MOLG that performs audit as a SAI, namely, the General Department of Control and Guidance (GDCG). GDCG annually examines the efficiency and effectiveness of the operating activities in most LGUs and examines the extent to which they comply with the general acts, regulations, budgetary announcement, instructions, policies, and procedures issued and approved by the MOLG and other relevant legislative bodies. In addition, GDCG follows up the complaints of the interested parties.

In addition to external auditors and SAIs, some municipalities, particularly large ones, practice voluntary internal audit. MOLG through the Policy Paper for Developing Mechanisms for Directing and Monitoring the Work of Local Authorities in July 2011 encourages all municipalities to establish an internal audit unit in their organizational structure. This type of audit is performed by the employees (internal auditors) of the entity (Dimitrova & Paneva, 2019). Internal audit examines the effectiveness and efficiency of the operating activities of the PSOs, and it is considered as part of the organization's governance mechanism (Alqudah et al., 2019).

Most municipalities in Palestine use cash basis accounting, but they are encouraged by the MOLG and donors to switch to modified or full accrual basis by providing various tools such as accounting software, standard charts of accounts, guidance of transition to full accrual basis, and manual procedures for how to apply the accrual basis accounting. Though these facilities have been available since 2004, but the cash basis accounting remains common. According to Sabri (2010), 85 percent of municipalities in Palestine used cash basis accounting, and according to Albuhaici (2013), 100 percent of municipalities in the Gaza Strip used cash basis accounting, but the MOLG Annual Performance Report for 2020 revealed that 30 municipalities of 130 in the West Bank use the accrual basis, this means that the accrual basis is used by 23% of these municipalities (MOLG, 2020). The Local Government Units Financial Regulation No (1) of 1998 was based on cash basis, but the new Financial Regulation No (11) of 2019, did not state and require specific accounting basis. Accordingly, the municipalities are allowable to use accrual basis, cash basis, or both. As a result, the accounting basis and financial process are not consistent across municipalities.

The keystone of public sector governance is the internal control system (ICS) (Reginato et al., 2016), who helps PSOs to enhance their efficiency, effectiveness,

transparency, accountability, and compliance with laws and regulations, as stated in COSO's internal control framework (Sari, 2018). ICS encompasses various elements, such as internal audit, organizing personnel, record keeping, reporting, plans, procedures, policies, and supervision (Sari, 2018), and the functions of the ICS are significantly influenced by size of the organization (Reginato et al., 2016).

MOLG is the governmental regulator for the municipalities in Palestine, and its interventions in the municipalities are represented through the enactment of public laws and regulations which control and influence most operations in the municipalities, including the audit process. This government intervention may have incurred according the public interest theory which will be discussed in details as well as other main concepts and variables of this study in the second chapter with title literature review.

The subsequent sections of this chapter are organized as follows: problem statement, research questions and objectives, significance of the study, justifications and contributions of the study, and organization of the study.

### **1.3 Problem Statement**

According to DeFond and Zhang (2014), the audit process in PSOs always adds value to the financial reports, and the auditors are regarded as key players in providing trustworthy and credible financial statements (Ismail et al., 2019). However, the Palestinian SAIs publish numerous violations each year, including allegations of fraud and corruption. For example, the FACB's annual report of 2018 mentioned many violations through its audit and complaints follow-up in 65 LGUs, including 48 municipalities. These violations reached more than 644, some of them involved suspicions of corruption and misappropriation, so many customized audit reports were

created and forwarded to relevant authorities in order to pursue legal action against the violators (FACB, 2018). The violations and the deficiencies continued in 2019 to reach 466 deficiencies in 35 LGUs, including 19 municipalities (FACB 2019), most of these municipalities have appointed external audit firms who issued unmodified audit report for these municipality. This problem continued in increasing rate in next years to reach more than 1180 violations are founded in the FACB's annual report for 2022 related to local units in 51 audit reports (FACB, 2022). This issue was a motivation for this study by raising the questions about the usefulness of the external auditing, and how to measure audit quality in these municipalities?

The reviewing process of previous external audit reports which they are available on the municipalities' websites of the most important municipalities in West Bank in Palestine since 2012 to 2020, Nablus city in the north, Ramallah city in the center, and Hebron city (the city of Allah's messenger Abraham peace be upon him) in the south revealed that Ramallah and Hebron municipalities use accrual basis since 2008, while Nablus still uses cash basis, and all these municipalities received unmodified audit reports despite of the numerous violations in the three cities as FACB's (SAI of Palestine) issued in its annual report for 2018. Accordingly, the audit reports of these cities are not relevant for the measurement of audit quality and its factors because they are standard reports and have not sufficient details for all issues related to fairness of the audited financial statements, and they are prepared according different accounting bases.

According to the Terms of Reference (ToR) for employing external auditors in Palestinian municipalities and the instructions of SAIs, the external auditors must prepare and send a detailed report of the audit notes to the municipality management (management letter). Municipal management discussed this letter with external

auditors and related personnel including the accountants and internal auditors, in order to justify these deficiencies. The management letter is confidential but available for the SAIs when they want it, and their contents are known to the main accountants and internal auditors. According to the nature of the auditors' reports (standard report) and the confidentiality of the management letters make the researchers unable to use these reports to measure the audit quality. Additionally, the actual audit quality is imperceptible both before and after an audit is conducted (Chadegani, 2011), and the auditors' efforts during an audit engagement are invisible to the naked eye (Donatella et al., 2019). Therefore, the majority of the previous studies have used variety proxies of audit quality to measure the audit quality construct in PSOs or private organizations. Because each proxy is an indirect measure of audit quality and has some limitations, they are not entirely relevant and valid measures of audit quality if they are used individually or collectively. These proxies are either related to the elements of inputs, outputs, or audit process ( Velte, 2023; Gaynor et al., 2016; Bell, et al, 2015; DeFond & Zhang, 2014) . Moreover, the proxies which used heavily in private sector as direct method such as restatement, discretionary accruals, and issuing going concern opinions are not applicable to the municipalities, particularly when the municipality uses the cash basis accounting. Accordingly, this study uses the perception of the accountants and internal auditors on the audit quality in the municipalities to examine the audit quality and its factors. The including of both accountants and internal auditors in a single study as respondents in Palestinian municipalities in developing countries distinguishes this study from others.

There are many difficulties are facing the researchers in measuring the audit quality in the municipalities through reviewing the audit reports or using direct proxies encourage the researchers to use the perception of one or more groups of the

stakeholders (accountants, internal auditors, users, external auditors) of audit quality and its determinants. Most studies have examined, developed, and derived audit quality attributes from the perspective of auditors and users of the financial statements, but a few of them have considered the perspective of accountants and internal auditors, who directly operate the accounting information system and issue the financial statements and used them to demonstrate the accountability, transparency, and to be a basis of the budgetary process. Carcello et al. (1992) examined the audit quality perspective of the auditors, users and the preparers, and they found that understanding of the perspectives of both users and preparers regarding audit quality becomes critical in an increasingly competitive climate.

Most prior studies on audit quality focus on the external audit of private sector organizations, particularly public companies. In contrast, there is a lack of studies on audit quality in PSOs (Harris et al., 2019) particularly the municipalities which differ from for-profit firms in their nature, objectives, ethics, culture, regulators, operating procedures, financial and accounting processes, governance bodies, laws and regulations, stakeholders, SAIs, and the effectiveness of internal controls (the COSO integrated framework) which their implementation may vary among municipalities. In Palestine, some municipalities establish a specialized department or section for internal audit, but others do not. Some municipalities are still using cash basis accounting, but others have transitioned to accrual basis. Moreover, compliance with laws and regulations may differ among the municipalities because it depends on the culture of the governance body and the suitability and adequacy of those regulations, as well as the severity of fines and penalties for their violation.

Supreme Audit Institutions (SAIs), independent government audit entities, perform audit (compliance and performance) for all PSOs (Johnsen, 2019). In

Palestine, FACB audits some municipalities according to a prepared plan of audit due to the limited capabilities and resources of the FACB. Therefore, the FACB requires external auditors (CPAs) who audit the public organization to meet all professional conducts and applicable ethics in the auditing of governmental organizations, and to inform FACB for any deficiencies found in any entity under the audit. Moreover, the SAIs use the external audit reports and monitor how the municipality engaged with the external auditor, also, the external auditors may use the SAIs reports and depend on them in audit process. This indicates that there is a connection between SAIs and external auditors that could have an impact on the accuracy of the audit. Previous research has not looked into the effect of SAIs as a moderator variable on the relationship between external audit quality factors and external audit quality in Palestinian municipalities. Moreover, no agreements among the researcher on the specific theory can explain effectively the link between audit quality and independent audit quality factors.

The study aims to fill a gap in the literature by examining audit quality in Palestinian municipalities from the perspective of their accountants and internal auditors through the questionnaire distributed to them in order to address the highlighted the research problem. In addition to the auditors' characteristics and audit firms' attributes, the study seeks to define the effects of new factor of audit quality, such as the effectiveness of municipal internal control and the moderating effect of SAIs on the relationships between audit quality and the selected factors of auditor characteristics, audit firm attributes, and the effectiveness of the municipal internal control.

#### **1.4 Research Questions and Objectives**

According to the research problem, the study formulates the following questions that related to external audit quality which known audit quality in this study:

1. What is the relationship between auditor characteristics and audit quality?
2. What is the relationship between audit firm attributes and audit quality?
3. What is the relationship between the effectiveness of municipal internal control and audit quality?
4. Do SAIs moderate the relationship between the audit quality and its determinants of auditor characteristics, audit firm attributes, and the effectiveness of municipal internal control?

To answer the research questions, the study formulates the following objectives:

1. To investigate the relationship between auditor characteristics and audit quality.
2. To investigate the relationship between audit firm attributes and audit quality.
3. To investigate the relationship between the effectiveness of municipal internal control and audit quality.
4. To determine whether SAIs moderate the relationship between the audit quality and its determinants of auditor characteristics, audit firm attributes, and the effectiveness of municipal internal control?

#### **1.5 Significance of the Study**

This study is important for Palestine, because PSOs are relatively new. Abushamsieh et al. (2013) reported that the Palestinian National Authority (PNA) was established in 1994 after the Oslo Accords in 1993 in West Bank and Gaza. PNA started with the establishment of necessary administrative frameworks for ministries

and governmental entities without adequate controls, procedures, and financial legislations. Numerous resolutions, instructions, and circulars were issued to create the financial system and apply rules to direct and monitor government revenues and expenditures, as well as to publish financial regulations and guidelines on current and capital expenditure. However, Palestine is still under the Israeli occupation and faces numerous financial and economic difficulties, therefore Palestine at level government, LGUs, and NGOs depends heavily on foreign aids for its expenditures (Risheq et al., 2023). This implies that these institutions must adhere to the terms of their financial donors, particularly the preparation of financial statements audited by external auditors within the parameters established by these supporting organizations (Clark et al., 2023).

The study emphasizes on the audit quality in the municipalities as the most important PSOs in Palestine, which is classified as a developing country, while most studies have largely concentrated on audit quality in private sector organizations in developed countries. According to Cohen and Leventis, (2013) and Gustavson and Sundström (2018), only a few researches have examined the factors of audit quality in PSOs. Most studies on audit quality are carried out in developed countries, while similar research in developing countries remain lacking (Ismail et al., 2019; Johnsen, 2019; Mattei et al., 2021). In order to fulfill their accountability to their stakeholders, superior governmental bodies or the public sector organizations provide general purpose financial statements and demonstrate how the funds are used in providing services to beneficiaries in the public sector organizations (Brusca et al., 2019). The accounting information system in public sector organizations does not concentrate on achieving the profits but on the effectiveness of service provision to the public (Brusca et al., 2018). Therefore, the financial accounting information system in the

public sector entities is based on a specific accounting framework for public sector accounting standards (Gamayuni, 2019). These standards may vary by countries as each one has unique conditions and financial reporting objectives. The study focuses on the unique environmental characteristics of the public sector particularly the Palestinian municipalities, may expected to influence on the audit quality and its determinants, these characteristics as follow: laws and regulations, compliance audit, performance audit, operation plan and related financial budget, supreme audit institutions, political pressure, looking to hire external auditors and setting their fees through bids, source of funds and government grants, superior government bodies' strategies, and specific accounting standards and practices. In addition, the ownership of public sector organizations is not clear as in the private sector, and some studies revealed that the nature of ownership affects audit quality (Alhababsah, 2019). Political factors, such as the strength of the opposition parties, changes in mayors who is appointed by public elections or by the superior government, and the distribution of government grants, may also have an impact on the quality of PSO audits (Cohen et al., 2013). Even so, as Dimitrova and Paneva (2019) found that there is little research on the effects of political factors on audit quality in PSOs.

The importance of the audit quality study increases after the downfall of large companies and audit firms, such as Enron and Arthur Andersen (Saputra, 2015; Singh et al., 2019), and the growth in regulators and their codes of conduct (Knechel, 2016). International Ethics Standard Board of Accountants (IESBA) has issued the International Code of Ethics (IFAC, 2018) to guide auditors in performing audit activities (Mohamed et al., 2013). Regulators refer to this code to oversee the performance of auditors (Chiu et al., 2017) and to guarantee that the audit processes are performed with an acceptable level of quality (Knechel, 2016). The compliance of

auditors with related laws, audit regulations, and professional codes of conduct, among other factors, contribute to high audit quality (Corderly & Hay, 2018; McGowan et al., 2019). But the question of whether the audit quality has improved with more audit professional regulations, remains difficult to answer, as there is no agreement among researchers about how to state and measure audit quality (Hussein & Hanefah, 2013). This may lead to expectation gaps about what factors can determine and measure audit quality in all audit engagements in either the private or public sector. The study tries to examine selected some factors of audit quality in the Palestinian municipalities by using the audit quality perception of the accountants and the internal auditors. This type of perception may distinct the study and increases its importance, because the accountants in the municipalities legally liable and responsible on the misstatements in the financial reports more than the top management as in the private sectors. Therefore, the accountants and the internal auditors need independent parties to assert the credibility their reports in order demonstrate the financial position of the municipalities to the regulators, and show the accountability and the transparency for the public and for the interested parties. Also, the Audit firms may refer to the perception of the accountants and the other users as a basis to enhance their audit efficiency (Takiah et al., 2010). And some studies have studied the perception of accountants and internal auditors on audit quality in private and public sectors particularly the municipalities in developed countries, e.g., Behn, et al. (1997), Pandit (1999), Boon et al. (2008), and Takiah et al. (2010), but this study uses this perception in Palestinian municipalities as the first study in this field. The study does not select to examine the perception of the external auditors and the auditors of the SAIs, because the audit quality perception of these groups depending on the nature of audit procedures that performed in the auditing process, and they

always accept to provide reasonable assurance instead of absolute assurance, but the accountants and internal auditors as preparers and users of the financial reports observe all audit process, communicate continuously with audit teams, interest with audit quality as a whole, and they expect from the audit process to provide correct financial statement, therefore their perception is more benefit for the regulators of audit profession and audit firms in improving the audit profession and achieving more audit quality.

In addition to the audit quality perception of the accountants and the internal auditors in the Palestinian municipalities the study reviews the reports of SAIs in Palestine which they related to the LGUs in order to support of result of perception of the effect of the SAIs role on the relationship between the audit quality and the main audit quality factors; auditor's characteristics, audit firm attributes, and the effectiveness of internal control in the Palestinian municipalities. And the study uses the SmartPLS 3 software in statistical analysis of the result of the questionnaire, this software estimates data with little or no bias. Hair et al. (2017) encouraged social sciences researchers to use SmartPLS 3 because it is a newer, more powerful, and often more flexible statistical method.

The study bridges the literature gap concerning the selected determinants of the quality of external audit in municipalities of Palestine, these determinants includes new factors related to effectiveness of municipal internal controls (internal audit, accounting basis, and laws and regulations) and the moderation role of SAIs between audit quality and audit quality factors (auditor characteristics, audit firm attributes, and effectiveness of municipal internal controls).

## 1.6 Justifications of the Study

The study introduces many benefits for different parties, such the audit quality literature, audit profession regulators, audit firms, municipalities managements, MOLG, the government and the legislative bodies, and the SAIs. The study increases the audit quality literature through examining new factors of the audit quality as the elements of the effective internal control and the role of the SAIs in the audit quality in the municipalities. Also, the study discusses the audit quality in the developing countries which they have limited studies in this aspect, particularly the Palestine which faces difficult political circumstances and weaknesses of the economic resources. Also, the study uses the public interest theory in explaining the relationship between the audit quality and its attributes, this theory is considered more relevant in the public sector. The study can be useful to audit profession regulators in developing a comprehensive audit quality framework for the public sector including current new selected attributes, and looking at other new attributes of audit quality. 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. The study investigates accountants' and internal auditors' perceptions of audit quality, and 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 clients and strengthen their market position. Because the study will suggest a comprehensive framework for audit quality while considering the PSOs 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 bases; and expanding the activities of the SAIs in all Palestinian municipalities.

## **1.7 Organization of the Study**

This study is organized into six chapters as the following:

Chapter One presents an introduction and background on the research in addition to the research problem statement, questions, objectives, significance, justifications and contributions, and organization of the study.

Chapter Two discusses the review literature of audit quality and other concepts of the study. It covers the environment of PSOs, theoretical framework, the importance of audit quality and its definitions, measures, and determinants. Furthermore, this chapter discusses the auditor characteristics, audit firm attributes, effectiveness of the municipal internal control, and SAIs. Moreover, this chapter explains how the research hypotheses are formulated, and how the conceptual framework is developed. Finally, the chapter discusses and summarizes some prior studies on audit quality.

Chapter Three describes the research methodology, the measurement of the study variables, and research design. Moreover, it describes the population and sample selection, data collection, data analysis, model fit analysis, research structure models and how to develop the questionnaire and pilot study.

Chapter Four presents analysis of survey response, construct measures, data screening, common method bias, and the measurement model. Moreover, this chapter discusses and explains the descriptive statistics, and analysis of annual SAIs reports.

Chapter Five presents an analysis and explanations of the results of the study through the discussion of the Structural Models-Stage 2 of SEM and the examining direct effect hypotheses-structural model 2.

Finally, Chapter Six presents the study's primary findings as well as the implications and limits of the study, as well as research accomplishments. This chapter includes suggestions for further research. Lastly, a general conclusion is offered.

### 1.8 Conceptual Definition of Terms

The following Table 1.1 summarizes the study conceptual definitions of terms

**Table 1.1:** Conceptual Definitions of Terms

#	The Term	The definition
1	Auditor Characteristics	Indicators of the auditor's capacity to carry out a high-quality audit, including the ethics competence and independence (including ethics) of auditors are taken into consideration (Dickins et al., 2018).
2	Audit Firm Attributes	Attributes, such as audit fee and audit firm size, are inputs of the audit process that indicate audit quality (Omer et al., 2016).
3	Effectiveness of Municipal Internal Control	The management's strategy for ensuring that operations are productive and successful, financial reporting is correct, and laws and regulations are followed (Younas & Kassim 2019).
4	Supreme Audit Institutions	National organizations in charge of monitoring the use of public funds and the effectiveness and integrity of governmental processes and policies (Hay & Cordery, 2018).
5	Audit Quality (AQ)	Audit quality as the auditor's capacity to identify and disclose misstatements, adhere to ethical and professional standards, and/or satisfy investor needs (Dickins et al., 2018).
6	Auditor Ethics	Ethics is a system of moral standards or ideals serves as both the glue that holds society together and is necessary for a society to function in organized activities (Alvin et al. (2017).

**Table 1.1, continued**

#	The Term	The definition
7	Auditor Independence	Independence as a notion comprising of two components: independence in appearance and independence of mind (Alvin et al., 2017).
8	Auditor Competence	Competence generally refers to the auditor's capability to do tasks seriously and in accordance with professional standards (Abbott et al., 2016).
9	Audit fees	Audit fees reflect the level of audit efforts that the audit firm will expend on the audit engagement, and are negotiated bilaterally between the audit firm and the client (Yebba & Elder, 2019).
10	Audit firm size	Audit firms are classified into three main classes by size: international firms (Big 4), national or regional firms, and local (small) firms. Alvin et al. (2017)
11	Internal Auditing	Internal auditing as one component of the internal control system implemented by institutions' management for the purpose of evaluating, examining, and disclosing the effectiveness of its internal controls over financial reporting (Chalmers et al., 2019; Dimitrova & Paneva, 2019).
12	Accounting Basis	Method is used by accounting systems to record financial transactions and summarize outcomes over time (Ahmed & Al-Kake, 2019).
13	Laws and Regulations	Laws and regulations include all the orders of superior authorities and regulators of the client's industry (Zuarub & Abaalal, 2015).
14	The Public Interest Theory	Public interest theory was developed from conventional conceptions of representative democracy and the role of government to enact regulations (Christensen, 2010).

## **1.9 Summary**

This chapter has discussed the research problem, questions, and objectives. It has explained the significance of this study, as well as its motivations and justifications. This study aims to examine the determinants of external audit quality in PSOs, particularly the municipalities in Palestine. This chapter has also presented briefly about the auditing process in the municipalities, and the motivations and the

justification of the study. Finally, the organization of the study provides an overview about the structure of the study.

