

## The impact of external audit quality on the financial performance of Saudi-listed companies

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Received: 1/6/2024

Accepted: 10/7/2024

Published: 10/31/2024

### Abstract:

This study aims to identify the impact of external audit quality on companies' financial performance as a main indicator for evaluating companies' situation. In addition to highlight the growing importance of external audit quality in gaining the confidence of users of financial statements and for the stability of the financial market. By conducting research on 30 Saudi listed companies in the production and service sector, for five consecutive years from 2018 to 2022 with a sample of 150 observations. Our findings indicate that audit firm size and auditor's opinion have a positive impact on studied Saudi companies' financial performance. However, the auditor's opinion is more significant in improving the companies' financial performance. And it is noteworthy that the results might differ in another country or different economic environment.

**Keywords:** External audit quality, financial performance, Saudi-listed companies, ISA220, auditor's report.

**JEL Classification Codes :** M41 ; M42

## 1. INTRODUCTION

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The global external auditing profession underwent significant upheaval in the aftermath of 2001 because of a series of accounting and financial scandals involving major companies such as Enron and WorldCom. These scandals resulted from collusion by the auditing firm Arthur Andersen, which misled financial statement users about the true financial situation of these companies and failed to report their losses, leading to the bankruptcy of these companies and the instability of financial markets.

In response, international and local professional organizations, including the Saudi Organization for Certified Public Accountants, enforced new auditing laws and standards to ensure quality in the external auditing profession. In the purpose of meeting the needs of various stakeholders and enhancing confidence in financial statements' accuracy and legitimacy for rational decision-making. A key focus for these stakeholders is the company's financial performance as a measure of its continuity from one perspective and as a gauge of management efficiency in managing available resources to achieve desired objectives from another perspective. Particularly considering the rising risks faced by companies. Based on this premise, the following research problem is posed:

**How does external audit quality impact the financial performance of Saudi companies under study?**

To address this, the following sub-questions were formulated:

1. Is there a significant impact of the auditing firm's size on the financial performance of the Saudi companies under study?
2. Is there a significant impact of the auditor tenure on the financial performance of the Saudi companies under study?
3. Is there a significant impact of the auditor's opinion on the financial performance of Saudi companies under study?

**1.1 Main study hypothesis:**

There is no statistically significant relationship between the external audit quality and the financial performance of Saudi companies under study.

**1.2 Subsidiary study hypotheses:**

1. There is no statistically significant impact of the auditing firm's size on the financial performance of Saudi companies under study.
2. There is no statistically significant impact of auditor tenure on the financial performance of Saudi companies under study.
3. There is no statistically significant impact of the auditor's opinion on the financial performance of Saudi companies under study.

**1.3 Study Objectives:**

- Understand the concept of external audit quality and its importance in the business environment.
- Identify various alternatives for measuring the external audit quality.

- Emphasize the importance of evaluating the financial performance of institutions and companies for financial statement users.
- Determine the relationship and role of external audit quality in improving the financial performance of the Saudi companies under study.

#### **1.4 Literature review:**

At first glance, it appears that there is no relationship between the quality of external audit and the financial performance of the company. However, in reality, researchers have increasingly focused on studying these two variables due to the contribution of external audit quality in enhancing the quality of financial information. This, in turn, helps gain investors' trust and influences their decisions in a way that enhance the company's financial performance. Because, the absence of quality in external auditing and the delay in providing timely reports significantly affect the usability of financial information (Bronson et al., 2011, p.97), thereby weakening economic stability and consistency in capital markets.

A study of (Egbnike.Francis & Abiahu M.Fidelis, 2017) explores how audit firm characteristics, such as size and reputation, affect the financial performance of banks in Nigeria. The findings revealed that audit quality has a significant effect on return on assets of Nigerian banks; Audit fee and audit report lag had no significant effect on return on assets, earnings per share and net profit margin of Nigerian banks. Another study of (Al-ahdal & Hashim, 2021) examines how audit committee characteristics and external audit quality influence the financial performance of non-financial public companies listed on the National Stock Exchange 100 in India. And It was found that there is a significant positive impact of external audit quality on firm performance, while noting that audit committee characteristics do not show a clear improvement in performance. These findings are explained by (S.Raad et al., 2022) in their study on the impact of audit quality on the financial performance of three neighboring countries, namely Iraq, Saudi Arabia and Iran. Concluding that higher audit quality reduces the agency problem between shareholders and managers, leading to improved financial performance. In this paper, we explore the impact of external audit quality on return on equity for a sample of Saudi companies in the service and production sectors, providing new insights into the relationship between audit practices and financial performance.

#### **1.5 Research methodology:**

To answer the research problem, a descriptive-analytical approach will be adopted in both the theoretical and practical aspects. The study will utilize the SPSS 26 program to determine the relationship and impact of external audit quality on the financial performance of 30 Saudi-listed companies over 5 years (2022, 2021, 2020, 2019, 2018) with a sample of 150, by using three proxies to evaluate the external audit quality (audit firm size, audit tenure and auditor's opinion), and return on equity to measure the financial performance. This analysis will be based on the reports of the external auditors

and the financial statements of these companies published on their websites and the Saudi Stock Exchange platform.

### **1.6 Structure of the study:**

To achieve the study objectives, we divided this paper into five sections as follows; Section 1 outlines the research problem and the methodology used. Sections 2 and 3 present the theoretical concepts of external audit quality and financial performance, section 4 covers the field study. And section 5 summarizes the main results and offers recommendations .

## **2. External audit quality:**

External audit is considered as a service. However, quality is understood relatively and may vary depending on the nature of the product or service. Additionally, the relativity of the concept of quality, and the difference in perception of the parties involved in the auditing process about the nature and limits of the latter's quality, entail differing visions regarding the different relevant groups, which may create a conflict of interests (Rabie, 2023, p. 137).

### **2.1 The concept of external audit quality:**

Despite the increasing interest in external audit quality by various professional and academic bodies in the field (IAASB, 2013) and (IFAC, 2011), as well as many researchers, the first of whom are (DeAngelo, 1981), (Wooten, 2003), (Siekkinen, 2017) and (Zadeh, 2022), there is not yet a unified definition of the external audit quality, due to the disagreement over the determinants of quality as well as the difficulty of measuring it. However, we can present the most important definitions of external audit quality based on the following three foundations:

**2.1.1 The extent of the auditor's compliance with professional standards:** The external audit quality is represented by fulfilling the standards and rules of professional conduct set by the American Society of Certified Public Accountants (generally accepted auditing standards), which are: general standards, fieldwork standards, and report preparation standards. As well as international or local auditing standards applied in the country. Moreover, the IFAC referred to the concept of audit quality in International Standard No. (ISA 220) "Quality Control for an audit of financial statements," while adhering to the rules of professional conduct and ethics (Belkhiri & Houame, 2023, p. 141).

**2.1.2 Auditor's detection for errors and fraud and reporting:** This definition was established according to (DeAngelo, 1981, p. 186), who defined the quality of audit services as the joint probability evaluated by the market that a particular auditor will discover a breach or errors of the client and report the breach. That is, the quality of external auditing is summed up in the extent of the auditor's competence and experience in discovering errors on the one hand, and on the other hand the degree of his independence that enables him to decide and report on those errors.

**2.1.3 Achieving the objectives of the parties concerned with the external audit process:** On this basis, the external audit quality has been defined as good performance through which the auditor seeks in each audit process to achieve appropriate efficiency, to meet the requirements of the client and society (meeting the needs of the various parties related to the client and reducing the expectations gap) (Adam & Ahmed, 2022, p. 474).

Based on the above, we can say that External audit quality is a multidimensional concept influenced by the perspectives of various stakeholders, including auditors, company managers, audit committee members, investors, stockholders, the community, and professional bodies. It can be assessed through three main approaches: adherence to professional standards, auditor competence and independence in identifying and reporting deviations, and the ability to bridge the expectation gap among all related parties.

## **2.2 Quality of external audit according to ISA 220 :**

According to (ISA 220), quality control of auditing is defined as an objective process that involves an assessment before the issuance of the audit report and the conclusions leading to the preparation of the audit report (Houli & Tahtouh, 2020, p. 615). Emphasis is placed on the significance of audit quality as a fundamental requirement for the financial statement auditing process. Quality control of auditing consists of a set of policies and procedures adopted by the auditing office to achieve audit quality, ensuring assurance for the quality of this process.

The standard outlines specific responsibilities for auditors regarding quality control procedures for the financial statement auditing process. It identifies key elements of audit quality control and the procedures that must be adhered to, as follows (Rahi, 2016, p. 269) and (Ghalem et al.,2023, p. 390) :

**2.2.1 Independence:** The concept of auditor independence refers to the auditor's ability to perform their duties freely and objectively, without external interference. This is crucial for the credibility and reliability of their reports (Ojeaga & Ezejiofor, 2023, p. 66). It aims to be included in quality control standards for auditing offices, requiring them to establish policies and procedures to ensure independence. This may include:

- Requiring all staff in the auditing office to adhere to rules and provisions of independence.
- Monitoring the extent of adherence of auditing offices to independence policies and procedures.
- Confirming (formally) the independence of the auditing office in performing the auditing mission.

**2.2.2 Staff allocation and management:** Ensure that staff assigned to auditing tasks possess the necessary experience, technical competence, and knowledge. Also, establish policies to confirm the qualifications of new staff (Al-Tamimi, 2006, p. 68) .

**2.2.3 Consultation:** Seek others’ opinions to address accounting issues during audits. Some audit offices’ policies may require consulting specialists with the necessary expertise to handle such cases.

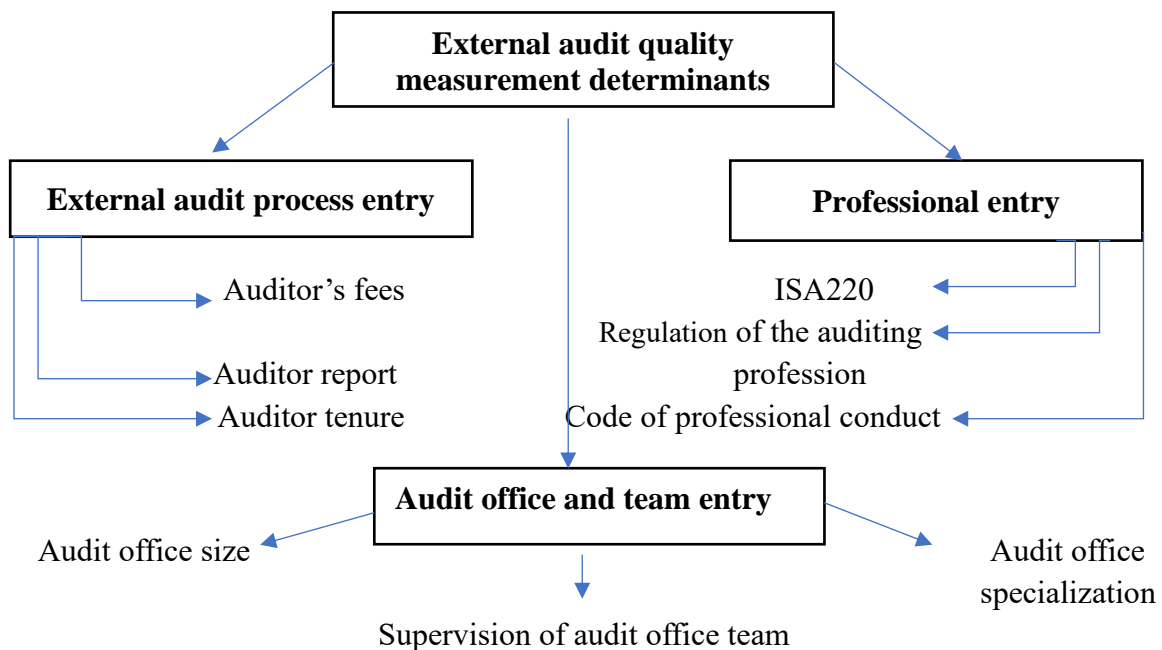
**2.2.4 Acceptance and communication with clients:** Audit offices should establish policies for accepting or continuing with clients to avoid working with organizations lacking integrity. They should contact previous auditors and inquire about management’s reputation before taking on new clients, ensuring they can provide the necessary services.

**2.2.5 Periodic examination of quality control programs :** Periodically inspect the implementation of quality control programs in the auditing office. As we should note senior management or another auditing office may conduct these examinations.

**2.3 Determinants of External Audit Quality :**

Given the significant importance of external audit quality as a fundamental support for investor confidence and various stockholders in the financial information of the organization, contributing indirectly to the economic growth and financial stability of the market, and serving as a signal for improving the market value of the company (Rabie, 2023, p. 142), it is essential to identify methods for measuring this quality in the purpose of reducing factors that may compromise it, while preserving elements that contribute to its enhancement. The following figure illustrates various approaches for measuring the external audit quality :

**Fig.1: External audit quality measurement determinants**



**Source:** Authors based on (Belkhiri & Houame, 2023),(Achour et al.,2022), (Rahi, 2016) and (Al-ahdal & Hashim, 2021).

Through the above figure, it is evident that to determine external audit quality, it is necessary to first identify the perspective aimed at measuring this quality. Notably, there are three entries or approaches:

**2.3.1 Professional entry:** This entry is adopted by professional organizations related to auditing, because the emergence of professional accounting and auditing institutes during the second half of the 18th century in Britain and the United States, such as the (AICPA), directly contributed to the evolution of the auditing profession. This was achieved through the issuance of various laws, regulations, rules, and professional standards. Therefore, to measure the quality of external audit, the commitment to these elements is assessed (Rahi, 2016, p. 272) as follows (Belkhiri & Houame, 2023, p. 141) :

- Auditor efficiency ;
- The independence of the auditor( The greater the independence of the auditor, the higher the quality of the external audit) ;
- Exercising professional skepticism ;
- Auditing quality control (applying isa 220) .

**2.3.2 Audit office and team entry:** The interest in this entry, according to its proponents, is attributed to its importance in ensuring the professional performance efficiency of auditors and increasing the confidence of the beneficiaries of their services. The lack of independence, experience, and competence would mean that the auditing profession loses its legitimacy in the business environment. Therefore, there is a need to support the auditor, preserve their independence, and avoid anything that may raise doubts among the beneficiaries in this regard. The quality of external audit is measured according to this entry as follows :

- Audit Office Size (larger firms employ qualified staff and have more resources and better technologies);
- The reputation of the audit office ;
- Lawsuits filed against the audit office;
- Auditor's specialization and office (the specialization of the audit office in a particular industry enables it to have a thorough understanding of the necessary procedures to carry out the audit task with high efficiency) ;
- Supervision of the audit team (Developing an appropriate plan helps in executing the audit process effectively ).

**2.3.3 The external audit process entry:** DeAngelo is considered a pioneer in this entry, as it establishes a link between the quality of the audit and the auditor's detection of errors and fraud that may exist in financial statements and reporting them. It's essential to note that some focus on this entry involves analyzing the procedures of the external audit process, starting with analyzing the environment of this process and the adequacy of the work and evidence that allows the auditor to accomplish his mission thoroughly (Achour et al.,2022 p. 08). The quality of external audit can be measured according to this entry as the following :

- Auditor tenure: a longer association with the client enhances the auditor's understanding and speeds up the audit process. Yet, it might reduce audit scrutiny, jeopardizing independence and the ability to uncover significant financial errors ;
- Auditor's fees: Several researchers believe that as auditor fees increase, the quality of the audit improves because it increases the auditor's effort in achieving the necessary professional competence and detecting material errors and deviations. However, others argue the opposite, as higher fees may reduce the auditor's independence ;
- Audit Report: the quality of the audit is linked to the audit report as it serves as a measure of the auditor's performance in auditing and their adherence to professional standards and rules.

### **3. Financial Performance :**

Decision-makers within an organization focus on several financial indicators to assess its financial position, strengths, and weaknesses. This informed decision-making process relies on considering financial performance as an indicator of the effectiveness of the financial policies implemented by management. Consequently, these decision-makers turn to external auditors to verify the accuracy of this financial information.

#### **3.1 Definition of company's financial performance:**

Before defining financial performance, it's essential to first address the general concept of performance, defined by researchers as the degree of achieving the objectives of a specific activity or profession measured by a specific standard (Mardiana & Dinata, 2018, p. 261).

Regarding financial performance, researchers have varied definitions based on their perspectives. Some define it as providing valuable judgments about the management of physical materials, and financial resources to achieve management goals. This is the same opinion held by Middleton Friedman, who limited the concept of financial performance to the extent of the organization's ability to optimally exploit its resources to maximize returns (Ben khalifa, 2012, p. 64). Moreover, some researchers (Mwangi, 2016, p. 04) and (Etengu & Amony, 2016, p. 330) indicated that financial performance is the process of measuring the results of the policies and operations of a company or institution in monetary terms and determining its financial strengths and weaknesses, through Establishing relationships between the items of the financial position statement and the income statement so that the results are reflected in the company's profitability, liquidity, or financial leverage.

In essence, financial performance reflects the financial health of the organization and its ability to optimize its resources to create value and achieve maximum returns.

#### **3.2 Financial Performance Evaluation :**

It is noteworthy that Internal and external stakeholders resort to financial performance evaluation to understand the current financial situation, address deviations,



assess management efficiency, and attract more potential investors through the provided financial information, reflecting the company's value. By measuring the actual performance of an organization and comparing it with plans to study strengths and weaknesses to enable it to perform better (PARIENTE, 2006). Another view (Bocco, 2010, p. 119) deems that financial performance evaluation is assessing the organization's ability to sustain and thrive in the economic environment or achieve its goals, including several steps, summarized as follows (Al-Khatib, 2009) :

- Obtaining the annual financial statements and income statements, including the preparation of budgets, financial statements, and annual reports related to the performance of companies over a specific period.
- Calculating various performance measures, such as profitability, liquidity, activity, financial leverage, and distributions, by preparing and selecting financial tools for the financial performance evaluation process.
- Studying ratio evaluations, and after extracting the results, identify deviations, differences, and weaknesses in actual financial performance by comparing it with expected performance or comparing it with the performance of companies operating in the same sector.
- Developing suitable recommendations based on the financial performance evaluation process after understanding the reasons for these differences and their impact on companies to address and rectify them.

### 3.3 Key Performance Indicators (KPIs):

KPIs are generally defined as measurable quantitative or qualitative criteria that provide an opportunity to verify changes in various aspects of the organization's activities compared to planned ones. They are specific measurable procedures used to make objective decisions or judgments about a specific situation, relying on material bases such as the number of units produced or accounting principles, including financial statements, records, and ledgers (Al-Karkhi, 2020, p. 47). Two types of indicators are typically used in financial performance evaluation: financial indicators based on financial ratios, called the accounting or traditional model, and economic indicators called the economic or modern model.

**3.3.1 Financial indicators to evaluate financial performance:** Financial performance is evaluated according to this method by calculating and analyzing various financial balance ratios and financial ratios such as liquidity and profitability, according to the following table:

**Table 01: Financial indicators to evaluate financial performance**

Indicator	Equation	Explanation
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<b>Working Capital</b>	Permanent Funds- Fixed Assets	Margin of safety of permanent funds after covering fixed assets
<b>Working capital requirement</b>	(Current assets - cash) - (Current liabilities - advances)	That part of working capital that the company needs to meet its liquidity needs at the maturity dates of its debts and short-term obligations.
<b>Net treasury</b>	working capital- working capital requirement	the liquid amounts that are available during the exploitation cycle.
<b>Liquidity ratios (general liquidity ratio)</b>	Current Assets/Current Liabilities	The general liquidity ratio shows the extent of the institution's ability to pay current liabilities from current assets.
<b>Activity ratios (asset turnover rate)</b>	Sales/Total Assets Asset	measures how efficiently an organization turnover utilizes its total assets and its ability to generate sales.
<b>Profitability ratios (return on assets (ROA))</b>	Net result / total assets	The percentage of profit achieved on each dinar invested in assets.
<b>Debt ratios (ratio of total debts to total assets)</b>	Total Debts/Total Assets	The percentage of reliance on external loans and debts to finance its assets.

Source : Authors, based on (Inta & Irina, 2012),(Vibhakar et al.,2020) and (EL-Ansary & Al-Gazzar, 2021)

**3.3.2 Economic indicators to evaluate financial performance:** The need has emerged to use new financial performance indicators, which provide direct information about how the organization or company contributes to maximizing the wealth of owners and creating value for them without the need for comparative data (Acep et al.,2022,p. 128) , and this is by relying on the economic approach, that is built on a basic premise of financial theory, which is that the rational investor evaluates the stock of the company that he wants to invest in by the value of the future cash flows that he can obtain from this stock . The financial performance is evaluated as follows :

**Table No. 02: Economic indicators to evaluate financial performance**

Indicator	Equation	Explanation
<b>Economic Value Added (EVA)</b>	NOPAT – Capital Charge	Measures remaining profits after subtracting capital costs and evaluate the cost of alternative opportunities for shareholders.
<b>Market Value Added (MVA)</b>	Price per Share x Number of Shares) – Total Equity	Measures the ability of managers to create wealth for shareholders that exceed profitability requirements.
<b>Financial Value Added (FVA)</b>	= NOPAT – (Equivalent Depreciation – Depreciation)	considers the contribution of fixed assets in generating the company's net profit

Source: Authors, based on (Bani, 2023).

#### 4. Field study framework:

In order to achieve the study's objectives and address the raised issues, we selected a sample consisting of 30 Saudi joint-stock companies of varying sizes within the production and services sectors randomly from the Saudi "Tadawul" stock exchange. This spanned over 5 years, starting from 2018 to the end of 2022, equivalent to 150 observations or samples . The data was collected through the annual reports of these companies published on the stock exchange website (Saudi Exchange, 2023) or their official website. Notably, these reports include both the external auditor's report and the final financial statements, which form the basis for measuring the study variables.

##### 4.1 Study variables:

There is two principal variables in this study as follows :

**4.1.1 Independent variable:** External audit quality, measured with the following proxies :

- **Audit Firm Size (Big4):** This variable is measured by assigning a value of (1) if the audit firm is one of the big four firms; otherwise, it takes a value of (0).
- **Audit Tenure (AT):** This variable is measured by assigning a value of (1) if the audit firm has been retained for more than five years, and (0) otherwise.
- **Auditor's Opinion (Aopin):** This variable is measured by assigning a value of (1) if the auditor's opinion is clean; otherwise, it takes a value of (0).

**4.1.2 Dependent variable:** Financial performance, by using the Return on Equity (ROE) as it is one of the most indicative indicators of companies' financial performance.

#### 4.2 Descriptive statistics:

**Table No. 03: Descriptive statistics for study variables**

Variables	Sample	Minimum	Maximum	Mean	Standard Deviation	Variance
ROE	150	-2.33	0.41	0.0151	0.28229	0.080
big4	150	0,00	1,00	0,5267	0,50096	0,251
AT	150	0,00	1,00	0.8725	0.33468	0.112
Aopin	150	0,00	1,00	0,9267	0,26156	0,068

Source: Authors, based on outputs extracted from SPSS 26.

The table above indicates that the mean of Return on Equity (ROE) for the studied companies is 0.01 with a standard deviation of 0.28. The highest value for ROE is 0.41, while the lowest is -2.33. This suggests that the financial performance of these companies is somewhat acceptable within the production and services sectors in the Saudi market. As for the mean of the audit firm size (Big4), it is 0.53 with a standard deviation of 0.50. This implies that approximately half of the Saudi companies included in the study were audited by one of the well-known international auditing firms. Regarding the mean of audit tenure (AT), its value is 0.87 with a standard deviation of 0.33, indicating that most of the studied Saudi companies changed their auditors every five years, reflecting the independence of the external auditor. Additionally, the mean of auditor's opinion (Aopin) is relatively high, reaching 0.93. This suggests that the majority of the studied Saudi companies received a clean opinion from the external auditor.

#### 4.3 Hypothesis testing:

To study the relationship and the effect size between the dependent variable "Financial Performance," measured by Return on Equity (ROE), and the independent variable "External Audit Quality," measured through Audit Firm Size (Big4), Audit Tenure (AT), and Auditor's Opinion (AOPIN), correlation coefficients need to be determined using the partial correlation method. It's worth noting that, based on the nature of the variables (nominal and quantitative), the Eta ( $\eta$ ) correlation coefficient will be applied (Al-Kamel & Abdel Badie, 2022, p. 08).

##### 4.3.1 Main hypothesis :

- Null-hypothesis: There is no statistically significant impact between external audit quality and the financial performance of the studied Saudi companies.
- Alternative-hypothesis: There is a statistically significant impact between external audit quality and the financial performance of the studied Saudi companies.

**Table No. 04: Correlation and Impact Results between external audit quality and financial performance**

Variables	Sample	Eta ( $\eta$ ) Coefficient	Eta Squared ( $\eta^2$ )	Significance
-External Audit Quality (AuditQ) -Financial Performance (ROE)	150	0.38	0.14	0.00

Source: Authors, based on outputs extracted from SPSS 26.

The table above shows a statistically significant positive relationship at a significance level of 0.05 between Financial Performance, evaluated by Return on Equity, and the independent variable External Audit Quality. This implies rejecting the null hypothesis and accepting the alternative hypothesis. According to (Bourezq & Um alKhoyout, 2021, p. 60) the impact size between External Audit Quality and Financial Performance is considered significant as shown :

Eta Squared ( $\eta^2$ ) weak when [0.01-0.059], medium when [0.06-0.139] and strong when it's more than 0.14.

#### 4.3.1.1 Linear regression model:

Given the significant positive impact between the dependent and independent variables at a significance level of 0.05, we can construct a simple linear regression model based on the following results from SPSS 26 (Table 06) and derive the equation as shown :

$$ROE = -0.317 + 0.428 * AuditQ + 0.26953$$

Table No. 06: Simple linear regression model results

Model	Beta Coefficient	R	R squared	F Value	(sig)	T Value	(sig)	Std.d
Constant	-0.317	0.307	0.094	15.441	0.000	-3.630	0.000	0.26953
(AuditQ)	0.428					3.930	0.00	

Source: Authors, based on outputs extracted from SPSS 26.

#### 4.3.2 Testing sub-hypothesis 1 :

- Null-hypothesis: There is no statistically significant impact between Audit Firm Size (Big4) and financial performance for the studied Saudi companies.
- Alternative-hypothesis: There is a statistically significant impact between Audit Firm Size (Big4) and financial performance for the studied Saudi companies.

Table No. 07: Correlation and Impact results between audit firm size and financial performance

Variables	Sample	Eta ( $\eta$ ) Coefficient	Eta Squared ( $\eta^2$ )	Significance
- Audit Firm Size (Big4) -Financial Performance (ROE)	150	0.23	0.05	0.005

Source: Authors, based on results extracted from SPSS 26.

Based on Table No. 07, we observe a statistically significant positive relationship at a significance level of 0.05 between Financial Performance (evaluated by Return on Equity) and the independent variable Audit Firm Size (Big4). This implies rejecting the null hypothesis and accepting the alternative hypothesis. However, according to (Bourezq & Um alKhoyout, 2021), the impact size between these variables is weak.

#### 4.3.3 Testing sub-hypothesis 2:

- Null-hypothesis: There is no statistically significant impact between audit tenure (AT) and financial performance for the studied Saudi companies.
- Alternative-hypothesis: There is a statistically significant impact between audit tenure (AT) and financial performance for the studied Saudi companies.

**Table No. 08: Correlation and Impact results between audit tenure and financial performance**

Variables	Sample	Eta ( $\eta$ ) Coefficient	Eta Squared ( $\eta^2$ )	Significance
- Audit Tenure (AT) -Financial Performance (ROE)	150	0.065	0.004	0.0428

Source: Authors, based on outputs extracted from SPSS 26.

The table above indicates no statistically significant correlation between audit tenure (AT) and financial performance (ROE) for the studied Saudi companies. Consequently, the null hypothesis is accepted, suggesting that there is no significant impact between the audit tenure and the financial performance of the studied Saudi companies.

#### 4.3.4 Testing sub-hypothesis 3 :

- Null-hypothesis: There is no statistically significant impact between Auditor's Opinion (AOPIN) and financial performance for the studied Saudi companies.
- Alternative-hypothesis: There is a statistically significant impact between Auditor's Opinion (AOPIN) and financial performance for the studied Saudi companies.

**Table No. 09: Correlation and Impact results between auditor's opinion and financial performance**

Variables	Sample	Eta ( $\eta$ ) Coefficient	Eta Squared ( $\eta^2$ )	Significance
- Auditor's Opinion (AOPIN) -Financial Performance (ROE)	150	0.363	0.131	0.000

Source: Authors, based on outputs extracted from SPSS 26.

According to table No. 09, a statistically significant moderate positive relationship is observed at a significance level of 0.05 between financial performance (evaluated by Return on Equity) and the independent variable auditor's opinion. This implies rejecting the null hypothesis and accepting the alternative hypothesis.

#### 4.4 Multiple linear regression model:

Based on the above, we will utilize multiple linear regression analysis to measure the impact and identify the variables most affecting the dependent variable. The resulting equation can be expressed as follows:

$$Y = \alpha + (\beta_1 * X_1) + (\beta_2 * X_2) + (\beta_3 * X_3) + \epsilon_i$$

Where:

- Y: Dependent variable representing financial performance.
- $\alpha$ : Constant .
- ( $\beta_1$ /  $\beta_2$ /  $\beta_3$ ): Coefficients of the independent variables (Audit Firm Size, Audit tenure and Auditor's Opinion).
- ( $X_1$ / $X_2$ / $X_3$ ): Independent variables (Audit Firm Size, Audit tenure and Auditor's Opinion).
- $\epsilon_i$ : Random error .

**Table No. 10: Results of the correlation analysis between audit firm size, audit tenure, auditor's opinion, and financial performance**

Model	R	R squared	Adjusted R <sup>2</sup>	Std.d
	0.384	0.147	0.130	0.26420

Source: Authors, based on outputs extracted from SPSS 26.

From the results in the table above, it is observed that the correlation coefficient value of 0.384 between audit firm size, audit tenure, auditor's opinion, and financial performance indicates a weak correlation between the independent variables and the dependent variable. Moreover, 14.7% of the variance in financial performance is explained by audit firm size , auditor tenure and auditor's opinion, while 85.3% is

attributed to other unexplored factors in the study model. The low standard error of estimate suggests that the model exhibits a weak association between the study variables.

**Table No. 11: Analysis of variance (ANOVA) for the multiple linear regression model**

Model	Sum of Squares	Df	Mean squares	F value	Sig
Regression	1.751	3	0.584	8.362	0.000
Residual	10.121	145	0.070		
Total	11.873	148			

Source: Authors, based on results extracted from SPSS 26.

The ANOVA results in table No. 11 indicate that the regression model is statistically significant ( $F = 8.362$ ;  $p < 0.05$ ), suggesting that at least one of the independent variables significantly predicts the dependent variable. This strengthens the model's credibility in explaining the relationship between audit firm size, audit tenure and the auditor's opinion with financial performance.

**Table No. 12: Significance analysis of multiple regression coefficients**

Independent Variable	Coefficient ( $\beta$ )	Standard Error	Beta	t Value	Sig
Constant	-0.364	0.106		-3.444	0.001
Audit Firm Size (X1)	0.078	0.048	0.138	1.615	0.108
Audit Tenure (X2)	0.017	0.070	0.020	0.243	0.808
Auditor's Opinion (X3)	0.349	0.087	0.324	4.033	0.000

Source: Authors, based on outputs extracted from SPSS 26.

The table above shows that the beta regression coefficient for the size of the audit firm is not significant because the significance value (sig) is 0.103, which is greater than the significance level of 0.05. Therefore, this variable has a non-significant effect on financial performance in this model, as most audit offices and firms in Saudi Arabia are experts, even if they are not among the big four. Regarding audit tenure, the beta regression coefficient is not significant, because the significance value (sig) is 0.808 which is greater than the significance level of 0.05. Consequently, we have one independent variable with a significant positive impact on financial performance, which is the auditor's opinion. The focus of investors and shareholders on the auditor's opinion plays a significant role in ensuring the reliability and accuracy of the financial statements prepared by management. A clean opinion contributes to attracting investors and funds, reflecting positively on the company's financial performance.



Based on the obtained results, we can estimate a simple linear regression equation, not a multiple one, as there is one independent variable that has a significant impact on the dependent variable. The equation can be expressed as follows:

$$\text{ROE} = -0.364 + 0.349 * \text{AOPIN} + 0.087$$

## 5. Conclusion and recommendations:

The impact of external audit quality on companies' financial performance is a crucial matter in the business environment, with significant implications for the sustainability of operations and the balance of financial and economic markets in general. This is evident from the following results:

### 5.1 Theoretical study results:

- The concept of external audit quality primarily relies on three foundations: the auditor's commitment to perform missions in accordance with professional standards, the extent of error and fraud detection and reporting, and the ability to achieve the general objectives of the external audit process towards various stakeholders.
- Despite the difficulty of measuring external audit quality, several approaches and methods have emerged to determine the measurement process. Notably, the professional approach focuses on the application of the International Standard on Quality Control ISA 220, in addition to the external auditing process approach.
- Financial performance is considered one of the most important indicators reflecting the financial health of a company, indicating its ability to continue exploitation. It is evaluated on traditional financial ratios or economic indicators such as the market value-added.

### 5.2 Field study results:

- The study sample results show that the external audit operations conducted by both international and Saudi audit firms are of high quality, as evidenced by their adherence to professional audit standards and rules. This includes the commitment to independence, confirmed by measuring the auditor's tenure.
- The correlation analysis results, using the Eta coefficient, show a strong positive significant correlation between external audit quality and financial performance, indicating a positive relationship with a significant impact between the variables. This emphasizes the importance and contribution of external audit quality in enhancing transparency and building trust among relevant parties, positively reflecting on financial performance.
- Multiple regression analysis results indicate a weak non-significant impact on financial performance for audit office size/firm and audit tenure. However, the auditor's opinion shows a significant positive impact, highlighting the importance of the auditor's opinion in decision-making for all relevant parties and attracting investors, thus improving financial performance and financial results for the company. Regarding the size of Saudi

audit offices/firms demonstrate high professional competence. Concerning the audit tenure, all studied Saudi audit offices/firms respected the legal time frame within which the auditor could work within the auditing firm. Therefore, this does not significantly affect the financial performance of Saudi companies, and the results might differ in another country or different economic environment.

### 5.3 Recommendations:

- To achieve external audit quality, auditors are advised to establish joint audit firms and offices to benefit from their collective experiences.
- The study can lead to measuring the impact of external audit quality on the financial performance of Saudi companies outside the production and service sector or even within the same sector but using other indicators, different statistical methods, or even for smaller companies.
- Gaining the trust of investors and various stakeholders in the company regarding the fairness and credibility of financial statements increases its financial performance.

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## 7.appendecies:

List of Saudi-listed companies under study:

<ul style="list-style-type: none"> <li>▪ Al marai</li> <li>▪ Armaco</li> <li>▪ Saudi paper manufacturing</li> <li>▪ Saudi Arabia Refineries Company</li> <li>▪ Mobily</li> <li>▪ Saudi Telecom Company (stc)</li> <li>▪ Cisco Systems</li> <li>▪ Elm information security</li> <li>▪ Zamil Industrial</li> <li>▪ Ma'aden</li> <li>▪ SAPTCO</li> <li>▪ Savola</li> <li>▪ City Cement</li> <li>▪ Najran Cement</li> <li>▪ Riyadh Cement</li> </ul>	<ul style="list-style-type: none"> <li>▪ CATRION Catering Holding Co</li> <li>▪ Sasco</li> <li>▪ United International Transportation Co Ltd</li> <li>▪ National Shipping Company of Saudi Arabia</li> <li>▪ Yamama Cement Co</li> <li>▪ Arab Sea Information</li> <li>▪ United Wire Factories</li> <li>▪ AYYAN Inv</li> <li>▪ Saudi Pipe Systems Co</li> <li>▪ Bawan</li> <li>▪ Takween Advanced Indus</li> <li>▪ Methanol Chemicals Company</li> <li>▪ Saudi Arabian Amiantit</li> <li>▪ Qassim Cement</li> <li>▪ Al Jouf Cement</li> </ul>
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