The Impact of Accounting Firm Ownership Structure on Audit Quality: An Analysis with Auditor Reputation as a Mediating Variable

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Abstract

Audit quality plays a critical role in ensuring capital market stability while the property rights organizational structure of accounting firms influences audit quality through governance mechanisms, auditor independence, and risk-bearing capacity. Existing research suggests that partnership-based and limited liability accounting firms differ in incentive structures and reputational dynamics; however, their heterogeneous effects on audit quality and underlying mechanisms remain insufficiently explored. This study utilizes data from Chinese A-share listed companies (2007–2023) to construct an analytical framework integrating the relationship between accounting firm ownership structure, auditor reputation, and audit quality for empirical examination. The findings indicate that: 1) Partnership-based accounting firms exhibit significantly higher audit quality than their limited liability counterparts, with auditor reputation acting as a partial mediator; 2) These effects are particularly pronounced in state-owned enterprises (SOEs), firms with lower analyst coverage, and companies with superior internal control quality. Through detailed mediation analysis and rigorous robustness checks, this research enhances understanding of how organizational characteristics influence audit quality differences, offering actionable insights for emerging markets focused on audit profession modernization. The findings contribute to regulatory reforms, guide partnership structure improvements, and science-based auditor selection criteria.

Keywords: *Ownership Structure of Accounting Firms, Auditor Reputation, Audit Quality*

1. Introduction

The separation of ownership and management in modern corporations gives rise to agency problems, as managers may pursue personal interests at the expense of shareholders (LaPorta et al., 2000; Lamoreaux, 2016). Research suggests that in concentrated ownership structures, conflicts between majority and minority shareholders intensify, increasing regulatory challenges (Zeng & Ye, 2005). Audit services play a crucial role in reducing information asymmetry and enhancing financial reporting quality (DeFond & Zhang, 2014). However, audit quality varies across firms with different ownership structures, as governance mechanisms, auditor incentives, and risk-bearing capacities differ (Clark & William, 2000).

Existing studies examine the impact of ownership structure on audit quality through dimensions such as audit scope, earnings management, issuance of modified opinions, financial restatements, audit fees, and audit delays (Tan & Li, 2016; Zeng & Zhang, 2010). Additionally, regulatory changes in China's audit market have reshaped firm structures, impacting audit quality (Wang & Dou, 2015).

Since the 1980s, China has undergone substantial audit market reforms, with the 2007 industry reform encouraging firms to scale up and professionalize. In 2010, the Ministry of Finance and the China Securities Regulatory Commission mandated that securities-qualified firms transition to partnership-based models to enhance competitiveness and audit quality. By 2023, partnership-based firms dominated the Chinese audit market. Studies suggest that these structural reforms have improved audit quality (Gao & Wang, 2016; Han, 2016; Jiang & Jiang, 2013).

In recent years, frequent financial fraud cases have been associated with audit collusion between high-profile enterprises (e.g., Kangmei Pharmaceutical, Kangdexin Composite Material, BlueSky Agriculture, and Evergrande Real Estate) and prestigious auditing firms. Basioudis and Francis (2007) pioneered a three-dimensional framework to classify auditor reputation based on its perceived scope in capital

markets. Auditor reputation reflects the market's evaluation of their historical professional conduct, wherein a strong reputation signals credibility and incentivizes certified public accountants (CPAs) to enhance professional competence, thereby improving audit quality. However, the transmission mechanism linking auditor reputation to audit quality may vary across accounting firms with divergent ownership structures (Donelson et al., 2020).

Given this background, this study seeks to answer: 1) How does the ownership structure of accounting firms impact audit quality? and 2) What role does auditor reputation play in this relationship? Using A-share firms from 2007–2023, this study constructs an empirical framework linking the ownership structure of accounting firms, auditor reputation, and audit quality. Auditor reputation is measured by Big Four affiliation, firm size, and specialization, while audit quality is assessed through financial restatements and audit delay. The study also explores the heterogeneity of this effect based on ownership structure, analyst coverage, and internal control quality. Robustness checks include substituting audit fees as an alternative measure of audit quality. The findings contribute to audit research and provide practical insights for regulators, investors, and accounting firms.

2. Objectives

This study examines how accounting firms' ownership structures affect audit quality, with emphasis on auditor reputation as a mediator. Key objectives include:

1) Analyze the impact mechanism of accounting firm ownership structure on audit quality.
2) Investigate the mediating role of auditor reputation between ownership structure and audit quality.
3) Conduct heterogeneity analysis to examine how different firm characteristics influence the research findings.
4) Provide empirical insights for policymakers, investors, and accounting firms.

The ultimate goal is to establish a research framework of "Ownership Structure of Accounting Firms – Auditor Reputation – Audit Quality", offering theoretical and empirical support for firms, regulators, and the audit market.

3. Materials and Methods

3.1 Theoretical Foundation

This study adopts an economic perspective to examine the linkage between audit service quality and reputation, grounded in the multifaceted characteristics of auditing within economic theory. Key frameworks include principal-agent theory, reputation theory, deep pocket theory, and supply-demand theory. Audit services possess attributes of both general commodities and public goods, with their delivery inherently dependent on interactions between clients and providers. Principal-agent theory elucidates the role of auditing in reducing agency costs, while reputation theory underscores how prestigious firms maintain market recognition through high-quality audits. Deep pocket theory highlights the impact of a firm's financial capacity on audit liability. Supply-demand theory and information asymmetry theory further reveal the interplay between audit quality and auditor reputation in market dynamics. Collectively, these theoretical frameworks form the foundation for the subsequent empirical analysis.

3.2 Literature Review

Existing scholarship on auditor reputation, organizational ownership structures of accounting firms, and audit quality predominantly treats auditor reputation as a moderating variable. Studies indicate that partnership-structured firms prioritize reputation cultivation more than limited liability entities, thereby enhancing audit quality (Robertson & Houston, 2010). Notably, limited liability partnerships (LLPs) are increasingly recognized as optimal for accounting firm development. Donelson et al. (2020) posit that auditor reputation reflects a firm's audit service capability, with empirical evidence confirming a significant positive correlation between reputation and audit quality. Special general partnerships (SGPs), which face heightened

legal liabilities, litigation risks, and reputational penalties, tend to enforce stricter regulation of certified public accountants (CPAs) and audit teams to ensure superior audit quality and client trust (Jiang & Li, 2015). Audit quality is widely regarded as the cornerstone of firm sustainability and a strategic objective for long-term growth. Comparative analyses suggest that SGPs are more inclined than limited liability firms to enhance audit quality and market share through reputation-building initiatives (Sun, 2016).

3.3 Data Sources

The empirical data are primarily sourced from the CSMAR, WIND, CNRDS, RESSET, DIB, and EBSCO databases, supplemented by publicly available resources such as the Chinese Institute of Certified Public Accountants (CICPA) website, the Ministry of Finance portal, the *China Statistical Yearbook*, and other official platforms. Data processing and analysis utilize Excel 2010, Stata 18.0, and SPSS.

The sample comprises annual reports of A-share listed companies on the Shanghai and Shenzhen stock exchanges from 2007 to 2023. To ensure data validity, the following filters are applied: 1) exclusion of financial and insurance firms; 2) removal of samples with missing financial data; 3) exclusion of newly listed (IPO) firms; 4) elimination of ST and ST* companies; 5) exclusion of samples with incomplete key variables; and 6) winsorization of continuous variables at the 1% level to mitigate outliers.

The final dataset contains 23,548 firm-year observations (2,915 firms and 218 audit firms). Firms audited by the same accounting firm before and after its organizational restructuring (e.g., transitioning from a "limited liability" to a "special general partnership" structure) are treated as consistent entities.

3.4 Methodology

This study adopts an archival research approach, integrating financial reports, auditor information, analyst tracking data, and other variables into a structured dataset. Statistical analyses—including descriptive statistics, correlation tests, regression models, robustness checks, and heterogeneity analysis—are conducted using Stata 18.0. A linear regression framework is employed to assess the direct effect of ownership structure on audit quality and the mediating role of auditor reputation, validating the "Ownership Structure of Accounting Firms – Auditor Reputation – Audit Quality" pathway.

3.5 Hypothesis Development

3.5.1 Ownership Structure and Audit Quality

Partnership-based accounting firms (e.g., special general partnerships) impose unlimited joint liability on partners, heightening legal accountability and litigation risks. This incentivizes higher audit quality compared to limited liability firms. Thus, the following hypothesis is proposed:

H1: The ownership structure of accounting firms significantly affects audit quality.

3.5.2 Auditor Reputation and Audit Quality

High-reputation audit firms prioritize quality to safeguard their market standing, often implementing stricter internal controls and audit procedures to ensure independence and reliability. Thus, the following hypothesis is proposed:

H2: Auditor reputation significantly improves audit quality.

3.5.3 Ownership Structure and Auditor Reputation

Partnership structures enhance reputation-building through rigorous quality oversight and shared accountability mechanisms, distinguishing them from limited liability firms. Thus, the following hypothesis is proposed:

H3: The ownership structure of accounting firms significantly influences auditor reputation.

3.5.4 Mediating Role of Auditor Reputation

Ownership structure indirectly affects audit quality via auditor reputation, which serves as a signaling mechanism to reinforce market credibility and client trust. Thus, the following hypothesis is proposed:

H4: Auditor reputation mediates the relationship between ownership structure and audit quality.

3.6 Research Framework

Guided by principal-agent theory, reputation theory, deep-pocket theory, supply-demand dynamics, and information asymmetry theory, this study constructs an integrated framework (Figure 1) to analyze how ownership structure impacts audit quality through auditor reputation. The framework further examines heterogeneity across client firms.

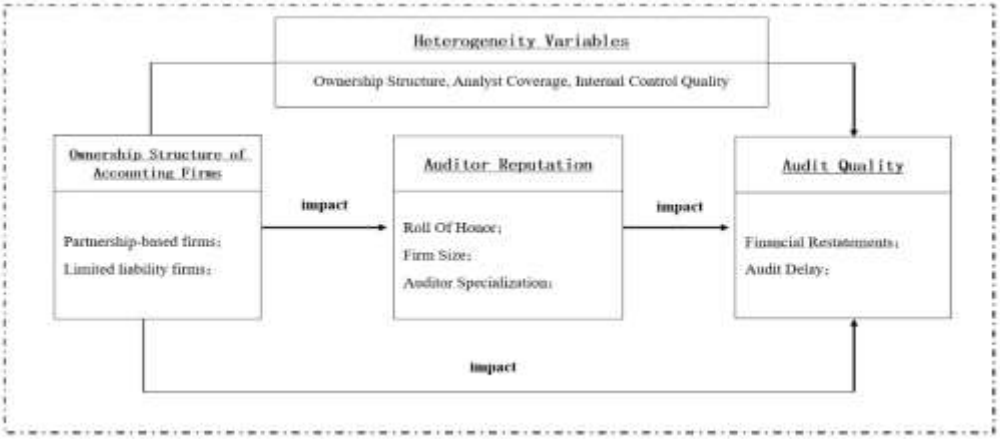

Figure 1 Research Model

3.7 Variable Definitions and Measurement

To ensure the validity of the model and test the hypotheses, key variables are defined and measured as follows: the dependent variable (audit quality), independent variable (ownership structure), mediator (auditor reputation), control variables, and heterogeneity- related variables. Detailed definitions and measurements are provided in Table 1.

3.8 Research modeling

To test Hypothesis H1, this study adopts the model framework of Wang and Dou (2015) and incorporates empirical findings from prior research on audit quality determinants. The baseline fixed-effects regression model is specified as:

Model (1):

$$AQ = \alpha i + \beta 1\ OF\ it + \beta 2\ SIZE\text{-}C\ it + \beta 3\ CR\ it + \beta 4\ LEV\ it + \beta 5\ ROE\ it + \beta 6\ GOA\ it + \beta 7\ LOSS\ it + \varepsilon\_\{1it\}$$

To investigate the mediating role of auditor reputation (AR) in the relationship between ownership structure (OF) and audit quality (AQ), a stepwise regression approach for testing mediation effects is employed. The procedure involves three sequential models:

Step 1: Validate the direct effect of OF on AQ using Model (1).

Step 2: Estimate the impact of OF on AR using Model (2):

$$AR = \alpha i + \beta 1\ OF\ it + \beta 2\ SIZE\text{-}C\ it + \beta 3\ CR\ it + \beta 4\ LEV\ it + \beta 5\ ROE\ it + \beta 6\ GOA\ it + \beta 7\ LOSS + \varepsilon\_\{2it\}$$

Step 3: Examine the association between AR and AQ using Model (3):

$$AQ = \alpha i + \beta 1\ AR\ it + \beta 2\ SIZE\text{-}C\ it + \beta 3\ CR\ it + \beta 4\ LEV\ it + \beta 5\ ROE\ it + \beta 6\ GOA\ it + \beta 7\ LOSS\ it + \varepsilon\_\{3it\}$$

Step 4: Test the integrated mediation mechanism via Model (4):

$$AQ = \alpha i + \beta 1\ OF\ it + \beta 2\ AR\ it + \beta 3\ SIZE\text{-}C\ it + \beta 4\ CR\ it + \beta 5\ LEV\ it + \beta 6\ ROE\ it + \beta 7\ GOA\ it + \beta 8\ LOSS\ it + \varepsilon\_\{4it\}$$

In the above equation, "i" denotes firm, "t" denotes time, and "αi" denotes individual fixed effect; β1 to β8 are the regression coefficients; ε1 to ε4 are random disturbance terms.

Table 1 Variable Definition List

Variable	Name	Code	Variable Type
Independent Variable	Ownership Structure of Accounting Firms	OF	Partnership-based firms = 1, Limited liability firms = 0
Mediating Variable	AR: Auditor Reputation	ROH	Partnership-based firms = 1, Limited liability firms = 0
		SIZE-A	Firm Size: The annual revenue of the accounting firm is used as a proxy variable
		CPA	Auditor Specialization: The number of certified public accountants (CPAs) within an accounting firm serves as the proxy variable
Mediating Variable	AQ: Audit quality	RESTATE	Financial Restatements: If the audit opinion was later restated, AQ = 0 (low quality); otherwise, AQ = 1
		AD	Financial Restatements: If the audit opinion was later restated, AQ = 0 (low quality); otherwise, AQ = 1
		COST	Natural log of the firm's annual audit fees
Mediating Variable	Firm Size	SIZE-C	Natural log of total assets at year-end
	Current Ratio	CR	Current Assets / Current Liabilities × 100%
	Current Ratio	LEV	Total Liabilities / Total Assets × 100%
	Return on Equity	ROE	Net Profit / Shareholders' Equity × 100%
	Asset Growth	GOA	(Total Assets at Year-End – Total Assets at Previous Year-End) / Total Assets at Previous Year-End
Heterogeneity Variables	Loss Indicator	LOSS	If the firm reports a loss, LOSS = 1; otherwise, LOSS = 0
	Ownership Structure	OWNED	If the firm is state-owned, OWNED = 1; otherwise, OWNED = 0
	Analyst Coverage	ANALYST	If the number of analysts covering the firm is above the industry median, ANALYST = 1; otherwise, ANALYST = 0
	Internal Control Quality	IC	If the firm's internal control index is above the industry median, IC = 1; otherwise, IC = 0

4. Results and Discussion

4.1 Descriptive Statistics

The mean value of accounting firm ownership structure (OF) is 0.773, with a standard deviation of 0.419. The mean financial restatement (RESTATE) frequency is 0.12, with a standard deviation of 0.326. Audit delay (AD) has a mean of 33.764 days, a median of 33 days, ranging from 11 to 602 days, with a standard deviation of 19.434. Audit fees (COST) have a mean of 137,930 (10K CNY), a median of 136,650 (10K CNY), ranging from ¥ 120,000 to 190,000 (10K CNY), with a standard deviation of 0.851.

These results indicate that 77.3% of A-share listed companies prefer partnership-based accounting firms for their annual audits, likely due to their higher audit quality.

4.2 Correlation Analysis

The Pearson correlation analysis results for key variables are presented in Table 2. The correlation coefficients between ownership structure (OF) and the audit quality proxies (RESTATE, AD, COST) are 0.193, -0.160, and 0.263, respectively, all of which are significant at the 10% level:

1) OF and RESTATE (positive correlation, 0.193): Partnership-based firms are less likely to issue financial restatements after an unqualified audit opinion, indicating higher audit quality.

2) OF and AD (negative correlation, -0.160): Partnership-based firms have shorter audit delays, suggesting better audit efficiency and quality assurance.

3) OF and COST (positive correlation, 0.263): Partnership-based firms adopt more rigorous audit procedures and lower materiality thresholds, leading to higher audit costs and consequently higher audit quality.

Table 2 Correlation Analysis

Variables	RESTATE	AD	COST	OF	ROH	INC	CPA
RESTATE	1.000						
AD	-0.098*	1.000					
COST	0.105*	-0.097*	1.000				
OF	0.193*	-0.160*	0.263*	1.000			
ROH	-0.029*	0.013*	0.480*	-0.010	1.000		
INC	0.165*	-0.144*	0.367*	0.620*	0.244*	1.000	
CPA	0.129*	-0.113*	0.199*	0.486*	-0.008	0.832*	1.000
SIZEC	0.088*	-0.079*	0.707*	0.165*	0.398*	0.275*	0.144*
CR	-0.013*	-0.012	-0.179*	0.029*	-0.076*	0.004	0.015*
LEV	-0.006	0.019*	0.068*	-0.056*	0.033*	-0.041*	-0.038*
ROE	-0.002	0.003	-0.007	-0.013*	-0.001	0.002	-0.001
GOA	-0.001	0.000	-0.008	-0.020*	-0.004	-0.016*	-0.012
LOSS	0.004*	-0.007*	0.001*	0.026*	-0.027*	0.003	-0.009

4.3 Regression Analysis and Robustness Tests

4.3.1 Regression Analysis of Ownership Structure and Audit Quality

Using 2007–2023 sample data and Model (1), a multiple regression analysis is conducted to examine the impact of accounting firm ownership structure (OF) on audit quality (AQ). Table 3 presents the regression results of ownership structure (OF) on financial restatements (RESTATE), audit delay (AD), and audit fees (COST). The regression coefficients for OF in all models are statistically significant at the 1% level, indicating that ownership structure strongly explains audit quality. Hypothesis H1 is supported.

Table 3 Regression Analysis of Ownership Structure and Audit Quality

	RESTATE	AD	COST
OF	0.096***	-3.301***	0.364***
	(16.123)	(-9.641)	(48.101)
Controls	Control	Control	Control
_CONS	-1.206***	117.947***	7.000***
	(-17.322)	(29.508)	(79.295)
N	23548	23548	23548
R^2	0.051	0.041	0.413
F	159.567	126.752	2074.479

4.3.2 Regression Analysis of Auditor Reputation and Audit Quality

Table 4 presents the regression results of auditor reputation (AR) on financial restatements (RESTATE), audit delay (AD), and audit fees (COST). The regression coefficients of AR in all models are significant at the 1% level, demonstrating that auditor reputation strongly influences audit quality.

These findings align with the reputation mechanism in audit markets, suggesting that high-reputation firms enforce stricter audit standards to minimize misstatements and earnings management.

Hypothesis H2 is supported.

Table 4 Regression Analysis and Robustness Tests for Auditor Reputation and Audit Quality

	RESTATE	AD	COST
ROH	-0.077***	3.120***	0.203***
	(-4.212)	(2.966)	(8.734)
INC	0.049***	-1.975***	0.162***
	(12.898)	(-9.127)	(33.896)
CPA	-0.000	0.001**	0.000***
	(-1.433)	(2.166)	(-6.533)
Controls	Control	Control	Control
_CONS	-1.553***	131.360***	5.591***
	(-22.838)	(33.616)	(64.849)
N	23548	23548	23548
R^2	0.056	0.044	0.416
F	135.654	104.864	1631.104

4.3.3 Regression Analysis of Ownership Structure and Auditor Reputation

Table 5 presents the regression results of ownership structure (OF) on three measures of auditor reputation: 1) Big Four affiliation (ROH): Regression coefficient -0.005, T-value -2.007, significant at the 5% level; 2) Firm size (INC): Regression coefficient 1.519, T-value 106.815, significant at the 1% level; and 3) Auditor specialization (CPA): Regression coefficient 575.711, T-value 75.584, significant at the 1% level.

The results confirm that ownership structure significantly affects auditor reputation, though some effects deviate from theoretical expectations.

Hypothesis H3 is supported.

Table 5 Regression Analysis and Robustness Tests for Ownership Structure and Auditor Reputation

	ROH	INC	CPA
OF	-0.005**	1.519***	575.711***
	(-2.007)	(106.815)	(75.584)
Controls	Control	Control	Control
_CONS	-0.222***	3.441***	-1777.570***
	(-8.183)	(20.722)	(-19.991)
N	23548	23548	23548
R	0.008	0.527	0.347
F	22.542	3282.324	1566.285

4.4 Mediation Effect Analysis

The Sobel-Goodman mediation test confirms the significance of the mediation effect: 1) ROH (Big Four Affiliation): Mediation effect 2.6%; 2) INC (Firm Size): Mediation effect 19.8%; and 3) CPA (Auditor Specialization): Mediation effect 11.0%.

These results demonstrate that auditor reputation (AR) mediates the relationship between ownership structure (OF) and audit quality (AQ), supporting Hypothesis H4.

4.5 Heterogeneity Analysis

To explore variations across different firms, this study incorporates three additional variables: firm ownership type (OWNED), analyst coverage (ANALYST), and internal control quality (IC).

The analysis confirms that ownership structure and auditor reputation significantly impact audit quality across different corporate environments. These findings provide empirical support for optimizing audit firm governance, enhancing audit market regulation, and informing corporate audit selection decisions.

4.6 Summary of Hypothesis Testing

Table 6 summarizes the results of all hypothesis tests, confirming the robustness of the findings across multiple analyses.

Table 6 Variable definition list

Hypothesis	Statement	Correlation Analysis	Regression Analysis	Mediation Analysis	Robustness Test	Heterogeneity Test	Final Conclusion
H1	OF significantly affects AQ	Y	Y	Y	Y	Y	Y
H2	AR significantly affects AQ	Y	Y	Y	Y	Y	Y
H3	OF significantly affects AR	Y	Y	N/A	Y	Y	Y
H4	AR mediates the OF–AQ relationship	N/A	N/A	Y	Y	Y	Y

Note: Y is established; N/A is not applicable;

5. Conclusion

5.1 Research Findings

5.1.1 Empirical Findings

Firms audited by partnership- structured accounting firms exhibit lower financial restatement probability, reduced audit delay, and higher audit fees, indicating superior audit quality. The positive effect of partnership structures on audit quality is more pronounced for state-owned enterprises (SOEs), firms with low analyst coverage, and firms with robust internal controls, suggesting that client characteristics moderate the impact of organizational forms on audit outcomes. These results not only validate the theoretical mechanism linking ownership structures to audit quality but also offer actionable insights for audit market governance, client selection strategies, and regulatory policymaking.

All three auditor reputation proxies—Big Four affiliation (ROH), firm size (INC), and specialization (CPA)—show significant positive correlations with audit quality, confirming that higher reputation enhances audit rigor, accelerates audit timelines, and justifies fee premiums.

Organizational form (OF) significantly influences auditor reputation (AR), though the direction partially deviates from theoretical expectations:

1) Lower Big Four representation (ROH) in partnership firms suggests potential limitations in global resource integration or a strategic focus on localized operations rather than relying on international brand prestige.

2) Larger operational scale (INC) reflects partnerships' competitive advantage in market penetration and service diversification.

3) Higher specialization (CPA) underscores partnerships' superior expertise in deploying skilled audit teams to deliver quality-assured services.

Organizational form (OF) affects audit quality (AQ) both directly and indirectly through auditor reputation (AR), with partial mediation effects confirmed. Firm size (INC) demonstrates the strongest mediation effect (19.8% of total effect).

In summary, this study empirically validates the "Ownership Structure–Auditor Reputation–Audit Quality" transmission mechanism and identifies auditor reputation as a critical mediator.

5.1.2 Theoretical Contributions

This research advances auditing literature by analyzing how ownership structures shape auditor reputation through a constraint-based governance lens. By constructing an integrated "Ownership Structure–Auditor Reputation–Audit Quality" framework and employing mediation analysis, we elucidate the intermediary role of reputation in linking organizational forms to audit outcomes. Furthermore, we extend prior work on audit pricing by revealing how ownership characteristics interact with reputation signals to influence market perceptions of quality. These insights bridge gaps between institutional economics and auditing theory, offering a nuanced understanding of audit market dynamics.

5.2 Policy and Practical Implications

1) For accounting firms: Partnership firms should optimize talent management to strengthen reputation, scale, and specialization.

2) For SOEs: Prioritize partnership auditors to enhance financial transparency and stakeholder trust.

3) For regulators (e.g., CSRC, CICPA): Refine market competition mechanisms and intensify oversight of non-SOEs' audits.

4) For all firms: Strengthen internal governance to improve audit efficacy.

5.3 Limitations and Future Research

While this study advances understanding of ownership structure's impact on audit quality, limitations persist in sample representativeness, variable measurement (e.g., reputation proxies), and dynamic effects. Future research should:

1) Explore long-term dynamics between audit firm governance and market competition, including mergers and market concentration;

2) Investigate AI's role in audit quality under ESG frameworks and big data integration;

3) Conduct cross-country comparisons to assess how legal systems, capital markets, and accounting standards moderate the ownership structure–audit quality relationship.

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