

## The Role of Auditing Quality as a tool of Corporate Governance in Enhancing Earnings Quality: Evidence from Egypt

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**[Abstract]** This study explores the relationship between external auditing quality as a tool of corporate governance and the level of earnings quality in Egypt. This was accomplished by reviewing the literature and previous studies related to corporate governance, auditing quality, and earnings quality, then analyzing the relationship between the characteristics of the auditing quality at auditing firms and the possibility of reducing the total accruals as one of the indicators of the quality of earnings at the industrial corporations listed on the Egyptian exchange. The study model examined the relationship between the independent variables of auditing quality characteristics and the dependent variable of total accruals by using the multiple regression of Ordinary Least Squares (OLS) Data of (60) corporations of the industrial sector for the period 2005-2010, which were arranged in a way that makes it possible to apply the Pooled Data Regression. The study concluded that there was an acceptable level of earnings quality in the industrial corporations listed on Egyptian exchange, there was an accepted level of the Auditing quality in Egyptian auditing firms, there was a positive impact on reducing the total accruals in the industrial corporations listed on the Egyptian exchange, thus improving the quality of earning for each of the specialties in a client's industry, the relationship with international audit firms, and auditor's qualifications.. On the other hand, there was a negative impact on reducing the total accruals for the client retention period.

**[Keywords]** corporate governance; auditing quality; earnings quality; Egyptian Industrial corporations

### Introduction

Financial statements provide information that can be used by interested parties to assess the performance of managers and to make economic decisions. Users may assume that the financial information they receive is reliable and fit for its purpose. Accounting regulation attempts to ensure that information is produced on a consistent basis in accordance with a set of rules that make it reliable for users. However, communications between entities and shareholders may be deliberately distorted by the activities of financial statement preparers who wish to alter the content of the messages being transmitted. This type of distortion is often referred to as "creative accounting." While opinions on the acceptability of accounting manipulation vary, it is often perceived as reprehensible (Gowthorpe & Amat, 2005).

The main target of external audit is to express an opinion about the fairness of the financial statements, and that will give confidence and credibility to the data contained in these statements, Recent years have seen many cases of the collapse of many of the major companies in various countries around the world and the loss of confidence in the information contained in the financial statements, accompanied by many of the cases against audit firms who were responsible for auditing the financial statements of these companies and for which was no indication of a lack of continuity in their reports.

The original need for corporate governance stems from the separation of ownership and control in publicly held companies. Investors seek to invest their capital in profit-making firms so that they can enjoy profits in the future. Yet, many investors lack the time and expertise necessary to operate a firm and ensure that it provides an investment return. As result, investors hire individuals with management expertise to run the company on a daily basis to see to it that the firm's activities enhance the company's profitability and long-term performance. Managers and directors are often not owners, and, thus, they will not bear the brunt in terms of lost investment and lost profits if the company fails to perform. As a result, managers and directors may take actions that hurt the value of shareholders investment "principal-agent problem" (CIPE, 2007).

The Egyptian Corporate Governance Code demands that the corporation take into consideration an external financial auditor who is efficient, has a good reputation, has adequate experience, and is independent from the

corporation and its board members, and, hence, the quality of audit; his efficiency, experience, and abilities need to be relevant to the size of corporation, the nature of its operations, and its stakeholders. The main objective of this study is to determine the relationship between the quality of external audit as a tool of corporate governance and earning quality in industrial corporations listed on the Egyptian exchange, which regularly takes steps towards the regulatory and legislative structure to support economic development, which distinguishes it from other studies conducted in other countries. In the following sections of the study will be discussed the literature review, previous studies, study methodology, which includes: the study sample, study model, hypotheses, and methods of measuring variables, and the empirical results will be discussed, and conclusion and recommendations will be made.

### Literature Review

Corporate governance has become a major issue in our increasingly global economy. To remain competitive in developing countries, attract capital, ensure sustainability, and combat corruption, companies need to put in place good governance institutions. As James Wolfensohn, former president of the World Bank, noted, "The governance of the corporation is now as important to the world economy as the government of countries." Corporate governance is a means whereby society can be sure that large corporations are well-run institutions to which investors and lenders can confidently commit their funds. It is now increasingly clear that having a transparent and fair system to govern markets, fair treatment of all stakeholders, and a chance for every entrepreneur with a good product to be successful are as important to democracy as political institutions, and they are crucial to sound market economies. Corporate governance creates safeguards against corruption and mismanagement while promoting fundamental values of a market economy in a democratic society (Tirole, 2001).

Audit quality means the ability of audit process to detect and report on the material misstatement of the financial statements and the reduction of information asymmetry between management and shareholders. The level of audit quality is linked to the quality level of the information contained in financial statements because the financial statements that have been audited by high-quality auditors rarely contain substantial misstatements, which is reflected in minimization of agency costs between shareholders and management (Issa, 2008). Audit quality is a prerequisite for many parties where management of companies need to give confidence to their financial statements by professional organizations to achieve quality in the implementation of audit processes, which ensure the fulfillment of the audit profession of their responsibility towards all the parties concerned. Finally, audit quality becomes the weighted factor in distinguishing between audit firms due to competition between them (Scott & Pitman, 2005).

Independence permits auditors to remain objective in drawing conclusions about the financial statements that they examine. Independence means "taking an unbiased viewpoint in the performance of audit tests, the evaluation of the results and the issuance of the audit report" (Arens et al., 2002). Thus, the quality of audit depends on auditor independence, which is the extent an auditor prefers to report errors and irregularities and is willing to disclose questionable accounting practices (Bartov et al., 2000).

DeFond, Raghunandan, and Subramanyam (2002) argue that a high quality auditor must be able to both objectively evaluate a firm's financial performance and withstand management pressure to issue either an unqualified or a clean audit opinion. It is widely accepted that the quality of the audit differs among audit firms. For example, Big 4 audit firms may provide higher quality than non-Big 4 audit firms; the Big 4 auditors have strong incentives to provide or maintain a high audit quality level, as these audit firms have (1) a greater number of clients; (2) more opportunity to deploy significant resources to auditing (recruitment, training and technology); and (3) can suffer more significant losses (for example, termination of other clients and related loss of reputation) when not reporting a discovered breach (Caneghem, 2004; Chung, Firth, & Kim, 2005).

Fan and Wong (2005) found that in the emerging market of East Asia, high-quality auditors play a corporate governance role in that firms with high agency conflicts are more likely to hire high-quality auditors. This is consistent with auditors playing an important role in these less-litigious environments, which are characterized by lack of traditional governance mechanisms. Most decision makers consider net

profit the most important item in the financial statements and index of the added value of the company, which is reflected in the value of its shares, but there are many factors that may lead to a lower quality of earnings, such as earnings management and the high proportion of accruals, which lead to irrational decisions because of its focus on the amount of the profits without focusing on quality (Chan et al., 2006). Usually the managers will manage the earnings towards some desired level of profit. The discretionary accruals allow revenue, expenses, gains, and losses to be shifted from one year to another (Chung et al., 2001).

The external auditor needs to know all the different creative accounting practices so it will be easy for him to discover these practices and do his qualified, efficient audit and express a right opinion about how true the financial statements he audited in order to minimize the expectation gap and increase users trust in the financial statements and the audit services, especially after the collapse of many big international corporations which have caused no trust in the external auditing. Further, year-end financial audit work by external auditors appears to play a role in moderating earnings management by minimizing managers' opportunities to manage earnings in the fourth quarter (Brown & Pinello, 2007).

Many previous studies have investigated audit quality and the relationship with earnings management (Albring et al., 2007; Lee, 2003). Some relate the audit firm size with the issue of audit quality and earnings management, Chen *et al.* (2005) found that big CPA firms are related to less earnings management, as higher quality auditors (proxy by the big four audit firms) could constrain earnings management for Taiwan firms. Vander Bauwhede et al (2003) used Belgium companies (both private and public) as a sample to examine the relations of audit firm size, public ownership, and firms' accruals management, and reported that Big 6 auditors can only constrain income-decreasing earnings management more than non-Big 6 auditors in the private client sector of the audit market, but they make no difference in the public sector.

The study by Abu-Ijela and Hamdan, (2010) investigates the existence of earnings management practices among the industrial public companies listed on the Amman Stock Exchange and tests the impact of auditing quality characteristics (the audit office size, the connection with other global offices, the client retention period, the auditing fees, and the specialization in the client's industry) on earnings management practices. The most important conclusion of the study was that industrial public companies listed on the Amman Stock Exchange have practiced earnings management each year throughout the period 2001–2006 with some variations during those years. However, the most significant variation in the practice of the earnings management between 2005 and 2006 was that in 2005, the practice was not pronounced (2%), while in 2006 practice most severe (62%).

The problem discussed in this study is exemplified through answering the following questions: Are the earning of industrial corporations listed on the Egyptian exchange characterized with quality? Are Egyptian Auditing Firms characterized by quality? Is there an impact of the quality of external audit on the earnings quality of industrial corporations listed on the Egyptian exchange?

The significance of this study stems from its being an extension of the accounting studies in the field of external audit quality and the quality of earnings by clarifying the concepts and characteristics of quality audit, the concept and indicators of the quality of earnings, and the relationship between the quality of external audit and earning quality in industrial corporations listed on the Egyptian exchange and, thus, achieve the quality of accounting information which will be reflected on the decisions of investors and the movement of the stock market in Egypt.

## Methodology

### *Sample and Data*

The population of this study consists of all industrial corporations listed on the Egyptian exchange, which published their financial reports from 2005 to 2010. The study sample included (60) industrial corporations listed on the Egyptian exchange and the related audit firms which met the following conditions: had never been merged or delisted through the period of the study; had availability of all necessary data to measure earnings quality by the Richardson et al., (2005) model. Sources of data

collection are annual reports, web sites, and direct contacts, as well, The sample-selection procedure is summarized in Table 1.

**Table 1.** *Sample Selection*

Sector	Listed companies	Excluded companies	Study sample
Food and Beverages	26	13	13
Basic resources	9	3	6
Chemical Industries	7	2	5
health care and Pharmaceutical	14	4	10
Construction and materials	27	12	15
Oil and gas	3	1	2
Industrial goods and services and automobiles	17	8	9
<b>Total</b>	<b>103</b>	<b>43</b>	<b>60</b>

### **Research Model**

The objective of the study is to determine the relationship between the quality of external auditing and the earning quality in industrial corporations listed on the Egyptian exchange. The study uses the total accruals (proxy variable) for measuring the presence of earnings quality. However, for the auditing quality, the study uses 4 characteristics to measure it as follows: specialty in client's industry, client retention period, the relationship with international audit firms, and auditors' qualifications.

$$EQ = \alpha + \beta_1 AS + \beta_2 CR + \beta_3 IR + \beta_4 AQ + \ell$$

#### **Where:**

EQ: Earning quality expressed by total accruals, the dependent variable.

$\alpha$ : Constant value.

$\beta_{1,5}$ : Slope value of independent variable.

AS: specialty in client's industry, the second independent variable, which is a dummy variable.

CR: client retention period, the third independent variable, which is a dummy variable.

IR: the relationship with international audit firms, the fourth independent variable, which is a dummy variable.

AQ: auditors qualifications, the fifth independent variable, which is a dummy variable.

$\ell$ : random error.

### **Technique of Measuring Variables**

**Measuring of Independent Variables: Characteristics of Audit quality.** The study depends on many previous studies in measuring the characteristics of the audit quality. Table 2 shows the measuring of independent variables.

Table 2. Measuring of audit Quality characteristics

Variable	Label	Measurement
Specialty in client's industry	AS	Dummy value : This was measured by scale (1,0) ,1 = If the audit firm specialization in the client’s industry; 0 = otherwise
Client retention period	CR	Dummy value : This was measured by scale (1,0) ,1 = If the audit firm retained the client more than 2 years; 0 = otherwise
Relationship with international audit firms	IR	Dummy value : This was measured by scale (1,0) ,1 = If the audit firm has relationship with international audit firms; 0 = otherwise
Auditors qualifications	AQ	Dummy value : This was measured by scale (1,0) ,1 = If the audit firm has more than 50% of employees have professional certificates; 0 = otherwise

**Measuring of Dependent Variable: Earnings Quality.** This study adopted the Richardson et al., (2005) model for measuring earnings quality, which used earnings continuity as an indicator of earnings quality; Richardson explained that earnings quality implies continuity of cash flows more than accruals continuity and developed a model to determine the range of earnings continuity in the future as the following equations show:

$$ROI_{i,t+1} = \gamma_0 + \gamma_1(ROI_{i,t} - TACC_{i,t}) + \gamma_2 TACC_{i,t} + v_{i,t+1} \dots\dots\dots(1)$$

Where:

ROI<sub>i,t+1</sub>: is return on investment for firm (i) in the next year (t+1).

γ<sub>0</sub>: is constant.

γ<sub>1</sub>: is continuity of cash flows.

γ<sub>2</sub>: is continuity of accruals.

ROI<sub>i,t</sub>: is return on investment for firm (i) in year (t).

TAAC<sub>i,t</sub>: is total accruals for firm (i) in year (t).

Earnings quality means that next year's earnings, represented in returns on investment (ROA<sub>i,t+1</sub> dependent variable in equation no.1), are affected by earnings of the current year represented in γ<sub>1</sub> coefficient more than total accruals represented in the γ<sub>2</sub> coefficient. Then, our hypothesis in the previous equation is γ<sub>2</sub>-γ<sub>1</sub><0 , which indicates continuity of earnings in the coming years is more than the continuity of accruals as γ<sub>2</sub><γ<sub>1</sub> known as earnings quality. To concentrate on the continuity of accruals in earnings quality, we modify the equation no.2 to become as follows:

$$ROI_{i,t+1} = \rho_0 + \rho_1 ROI_{i,t} + \rho_2 TACC_{i,t} + v_{i,t+1} \dots\dots\dots(2)$$

This equation might be rewritten regarding accruals continuity in equation no.1 as follows:

$$ROI_{i,t+1} = \gamma_0 + \gamma_1(ROA_{i,t}) + (\gamma_2 - \gamma_1) TACC_{i,t} + v_{i,t+1} \dots\dots\dots(3)$$

As ρ<sub>1</sub>=γ<sub>1</sub> and ρ<sub>2</sub>=(γ<sub>2</sub>-γ<sub>1</sub>), this evaluation saves us the direct evaluation for γ<sub>1</sub>-γ<sub>2</sub> in equation no.1. Our first hypothesis is still ρ<sub>2</sub><0 , as it is more negative in accruals representing earnings that imply the presence of high quality earnings.

### Data Analysis and Testing of Hypotheses

This study depends on model for measuring the relationship between the independent variables of auditing quality characteristics and the dependent variable of total accruals by using the multiple regression of (Ordinary Least Squares OLS) Data of (60) corporations of the industrial sector for the period 2005-2010 and were arranged in a way that makes it possible to apply the (Pooled Data Regression).

#### First Hypothesis

*H<sub>1</sub>: There is an acceptable level of earnings quality in the industrial corporations listed at Egyptian exchange.*

This study used the Richardson et al (2005) model for measuring earnings quality in the industrial corporations listed on the Egyptian exchange through the period 2005-2010; this model used earnings continuity in the future as an indicator of earnings quality. The study applies the Multiple Regression model of (Ordinary Least Squares OLS) according to this equation  $ROA_{i,t+1} = \rho_0 + \rho_1 ROA_{i,t} + \rho_2 TACC_{i,t} + v_{i,t+1}$  Table 3 shows the results of testing first hypothesis.

**Table 3.** Testing the First

Year	Constant $\rho_0$	Coefficient $\rho_1$	Coefficient $\rho_2$	T-Statistic	P-value (Prob.)
2005	1.42	0.86	0.024	1.61	0.052
2006	1.34	0.67	0.011	1.53	0.066
2007	2.77	0.42	-0.018	1.78	0.046
2008	2.12	0.49	-0.012	1.72	0.048
2009	3.41	0.52	-0.021	1.83	0.039
2010	3.52	0.54	-0.023	1.86	0.032

*The Value of T scheduled at 5% level of significance and freedom degree 1.67 (n-p-1, where n is the number of sample and p the number of p in the model, 60-2-1=57)*

Table 3 shows the results of testing the first hypothesis. From this table, we noted that in 2005 and 2006,  $p_2 > 0$ , which indicates that the continuity of accruals more than the continuity of cash flow, and the value of calculated T-Statistic was 1.61, 1.53 respectively, which is less than value of T scheduled at a confidence level of 95%, which was 1.67, as well as the p-value was 0.052, 0.066 respectively, which is more than 5%, which indicates to the low quality in earnings in these years. In the years 2007, 2008, 2009, 2010,  $p_2 < 0$  which indicates that the continuity of cash flow more than the continuity of accruals, and the value of calculated T-Statistic was 1.78, 1.72, 1.83, 1.86 respectively, which is more than value of T scheduled at a confidence level 95%, which was 1.67, as well as the p-value was 0.046, 0.048, 0.039, 0.032 respectively, which is less than 5%, which indicates the high quality in earnings in these years. Based on these results, we accepted the hypothesis, and we can say that there is quality of earnings in the industrial corporations listed at Egyptian exchange.

#### Second Hypothesis

*H<sub>2</sub>: There is an acceptable level of the Auditing quality in Egyptian auditing firms.*

Audit quality means the ability of the audit process to detect and report on the material misstatements of the financial statements, which reflects the efficiency of the auditing operation and the reduction of information asymmetry between management and shareholders; the reason for this is that the financial

statements that have been audited by high quality auditors rarely contained substantial misstatements (Issa, 2008). The auditing quality reflects the ability to compel the company management to implement the accounting principles, the reduction of fraud and manipulation in the financial statements, and to mitigate earnings management (Tendeloo & Vanstraelen, 2008). The majority of previous studies have identified the following auditing quality characteristics (Piot & Janin, 2005; Abu Ijela & Hamdan, 2010):

- Size of the auditing firm.
- The relationship with international audit firms.
- The client retention period.
- The auditing fees.
- Specialization in client's industry.
- Auditors' qualifications.

The Second hypothesis aims at measuring the auditing quality of Egyptian auditing firms. In order to test the auditing quality, we will test four auditing quality characteristics: Specialty in client's industry, Client retention period, Relationship with international audit firms, and Auditors qualifications. We used the Binomial test because the distribution of these variables are binomial distribution.

**Table 4.** Results of Binomial Test for Testing the Second Hypothesis

Variables	Category	Frequencies	Observed Prop.	<i>p</i> -value (2-tailed)
AS	1	259	72%	0.000
	0	101	28%	
CR	1	241	67%	0.000
	0	119	33%	
IR	1	79	22%	0.000
	0	281	78%	
AQ	1	223	62%	0.000
	0	137	38%	

Table 4 shows the results of the Binomial test for testing the second hypothesis. From this table, we noted that the high proportion of the following auditing quality characteristics: Specialty in client's industry, Client retention period, and Auditors qualifications and *p*-values are less than 0.05; based on these results, we accepted the hypothesis, and we can say that the auditing quality in Egypt is good.

### Third Hypothesis

*H<sub>3</sub>: There is an impact with statistical significance of the audit quality characteristics on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

In our study on the relation between audit quality and earnings quality, we measured earnings quality using the Richardson et al., (2005) model at the first stage after that we measured the auditing quality while examining the relation between audit quality characteristics and earnings quality through one major model to measure this relation in which the dependent variable was the earning quality. The sample of the study consists of a group of companies (Cross Section Data) during the period of time (Time Series Data); the best regression model to these data is (Pooled Data Regression), the statistical program (E-Views) was used to test the model.

The third hypothesis generates sub-hypotheses, which tackle the impact of every characteristic of the audit quality on enhancing earnings quality expressed by total accruals. The following are tests of study sub-hypotheses. Table 5 shows the results of multiple regressions for the study model.

$$EQ = \alpha + \beta_1 AS + \beta_2 CR + \beta_3 IR + \beta_4 AQ + \ell$$

**Table 5.** Results of Multiple Regressions for the Study Model

Variables	Coefficient( $\beta$ )	T-Statistic	P-value (Prob.)
Specialty in client's industry	70.3-	2.43	0.034
Client retention period	0.56	1.04	0.17
Relationship with international audit firms	0.42 -	1.81	0.042
Auditors' qualifications	-0.59	1.72	0.049

The Value of T scheduled at 5% level of significance and freedom degree 1.67 ( $n-p-1$ , where  $n$  is the number of sample and  $p$  the number of  $\beta$  in the model,  $60-4-1=55$ )

### Sub-Hypotheses

*H<sub>31</sub>: There is an impact with statistical significance of the Specialty in client's industry on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

The previous studies indicated that “auditors’ specialization in the industry of the client” helps to enhance the quality of earnings because it confirmed that the auditor's specialization in the client's industry will lead to better auditing quality, which, consequently, leads to increased monitoring and prevention of manipulation in the financial statements, thus leading to the enhancement of earnings quality (Albring et al., 2007; Vander Bauwhede et al., 2003; Lee, 2003). Table 5 shows that the relationship between the “Specialty in client's industry” and earning quality expressed by total accruals is negative because the coefficient was -0.37; in addition, the value of calculated T- statistic was 2.43, which is more than value of T- scheduled at a confidence level of 95%, which was 1.67, as well as the p-value was 0.034, which is less than 5%. *This means that we can accept the hypothesis that there is an impact with statistical significance of the Specialty in client's industry on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

*H<sub>32</sub>: There is an impact with statistical significance of the Client retention period on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

The previous studies indicated that “client retention period” does not help enhance the quality of earning because it confirmed that the auditing firms which maintain customers for a substantial period are not able to prevent fraud in the financial statements; the long relation between the company and the external auditor may make the auditor non-creative and, thus, adopt less rigid audit techniques and depend on procedures and justification of the company without verification (Issa, 2008; Lee, 2003). Table (5) shows that the relationship between the “client retention period” and earning Quality expressed by total accruals is positive because the coefficient was 0.56; in addition, the value of calculated T- statistic was 1.04, which is less than value of T- scheduled at a confidence level of 95%, which was 1.67, as well as the p-value was 0.17, which is more than 5%. *This means that we can reject the hypothesis that there is an impact with statistical significance of the client retention period on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

*H<sub>33</sub>: There is an impact with statistical significance of the Relationship with international audit firms on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

The previous studies indicated that “relationship with international audit firms” help enhance the quality of earnings because it confirmed that international audit firms were more able to provide high-quality audit services than other firms, which leads to increased monitoring and increased ability to prevent manipulation in the financial statements, thus leading to the enhancement of earnings quality (DeFond, Raghunandan, & Subramanyam, 2002). On the other hand, Hamdan and Abu Ijela (2010) did not find any impact of connection with other international auditing firms on improving the earnings quality and reduction of the earnings management. Table 5 shows that the relationship between the “relationship with international audit firms” and earning quality expressed by total accruals is negative because the coefficient was -0.42, in addition the value of the calculated T- statistic was 1.81, which is more than value of the T-scheduled at a confidence level of 95%, which was 1.67, as well as the p-value, which was 0.042, which is less than 5%. *This means that we can accept the hypothesis that there is an impact with statistical significance of the relationship with international audit firms on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

*H<sub>34</sub>: There is an impact with statistical significance of the Auditors’ qualifications on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

The previous studies indicated that “auditors’ qualifications” helps enhance the quality of earnings because it confirmed that qualified auditors who held professional certificate were better able to provide high quality of audit services than others, which leads to increased monitoring and the ability to prevent manipulation in the financial statements, thus leading to the enhancement of earnings quality (Scott & Pitman, 2005; Vander Bauwhede et al., 2003). Table (5) shows that the relationship between the “auditors qualifications” and the earnings quality expressed by total accruals is negative because the coefficient was -0.59; in addition, the value of the calculated T- statistic was 1.72, which is more than value of the T-scheduled at a confidence level of 95%, which was 1.67, as well as the p-value, which was 0.049, which is less than 5%. *This means that we can accept the hypothesis that there is an impact with statistical significance of the Auditors qualifications on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange.*

### Conclusion

Audit quality is one of the corporate governance mechanisms, which means the ability of the audit process to detect and report on the material misstatement of the financial statements and the reduction of information asymmetry between management and shareholders. The main objective of this study is to determine the relationship between the quality of external audits as a tool of corporate governance and earning quality in industrial corporations listed on the Egyptian exchange.

The problem discussed in this study is exemplified through answering the following questions: Are the earnings of industrial corporations listed on the Egyptian exchange characterized with quality? Are Egyptian Auditing Firms characterized by quality? Is there an impact of the quality of external audit on earnings quality of the industrial corporations listed on the Egyptian exchange? The population of this study consists of all industrial corporations listed on the Egyptian exchange, which published their financial reports from 2005 to 2010. The study sample included (60) industrial corporations listed on the Egyptian exchange and the related audit firms.

The study model examined the relationship between the independent variables of auditing quality characteristics and the dependent variable of total accruals by using the multiple regressions of Ordinary Least Squares (OLS). The study concluded that there was an acceptable level of earnings quality in the industrial corporations listed on the Egyptian exchange by using the Richardson et al (2005) model, and there was an acceptable level of the Auditing quality in Egyptian auditing firms. In addition, the study

found that there was an impact with statistical significance of the Specialty in client's industry on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange because it confirmed that the auditor's specialization in the client's industry will lead to a better auditing quality, which, consequently leads, to increased monitoring and prevention of manipulation in the financial statements, thus leading to the enhancement of earnings quality. On the other hand, the study concluded that there was a negative impact with statistical significance of the client retention period on enhancing the earnings quality of the industrial corporations listed on the Egyptian exchange because it confirmed that the auditing firms which maintain customers for a substantial period are not able to prevent fraud in the financial statements; the long relation between the company and the external auditor may make the auditor non-creative and, thus, adopt less rigid audit techniques and depend on procedures and justification of the company without verification.

The study also found that there was an impact with statistical significance of the Relationship with international audit firms on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange because it confirmed that international audit firms were more able to provide a high quality of audit services than other firms, which leads to increased monitoring and prevention of manipulation in the financial statements, thus leading to the enhancement of earnings quality. The study also concluded there was an impact with statistical significance of the Auditors' qualifications on enhancing earnings quality of the industrial corporations listed on the Egyptian exchange because it confirmed that qualified auditors who held professional certificate were better able to provide high-quality audit services than others, which leads to increased monitoring and prevention of manipulation in the financial statements, thus leading to the enhancement of earnings quality. Finally, the study recommended determining the maximum period for client retention in the audit firms and the importance of training and motivating auditors to gain professional certificates in view of their positive impact in raising the quality of auditing firms.

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