

# The Effect of Auditor Selection on Financial Reporting Quality: Propensity Score Matching

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## Abstract

This paper investigates whether companies with a high level of pre-audit earnings quality (EQ) hire Big Four auditors (i.e. self-selection bias) and do Big Four auditors provide higher quality after controlling for the companies' pre-audit EQ. Previous empirical research on the Big Four quality effect was restricted only to audited financial statements data, so researchers could not separate pre-audit EQ from EQ which was improved during the auditing process. Our research setting enables us to calculate EQ measures on hand-collected data from both pre-audit and audited financial statements of listed companies on the Zagreb stock exchange. In contrast to existing empirical studies, our research approach aims to minimize the differences in matching characteristics between Big N and non-Big N clients to rule out differences in clients' pre-audit EQ as an explanation for the potential differences in audit quality. The propensity score matching technique is applied to address the problem of potential self-selection bias. Preliminary results show that companies with higher pre-audit EQ choose Big Four auditors. However, Big Four clients do not have significantly higher audited EQ than non-Big Four clients after matching companies on pre-audit EQ.

**Keywords:** audit quality, earnings quality, pre-audit data, propensity score matching, self-selection bias