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Audit Quality as a Moderating Mechanism between Earnings Management and Firm Valuation

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Abstract

This study examines the effect of earnings management on firm valuation and the moderating role of audit quality using panel data from publicly listed non-financial firms over 2019-2024. The empirical results reveal that earnings management has a significant negative impact on firm valuation, with regression estimates showing a coefficient of $\beta = -0.42$ ($p < 0.01$) in the baseline model and $\beta = -0.30$ ($p < 0.05$) after including interaction effects. This indicates that increased managerial manipulation leads to a measurable decline in market value, confirming that investors penalize firms with lower earnings quality.

Audit quality demonstrates a strong positive association with firm valuation, with coefficients of $\beta = 0.35$ ($p < 0.01$) and $\beta = 0.31$ ($p < 0.01$) across models. This suggests that firms audited by high quality auditors benefit from enhanced credibility and higher market valuation. Most importantly, the moderating effect of audit quality is confirmed by the positive and significant interaction term ($\beta = 0.28$, $p < 0.05$), indicating that audit quality weakens the negative impact of earnings management on firm valuation.

The overall model exhibits solid explanatory power, with an adjusted R^2 of 0.39 and F statistic of 26.32, highlighting the robustness of the findings. Descriptive statistics show that the mean firm valuation (Tobin's Q) is 1.42, while average earnings management is relatively low (mean = 0.021) and approximately 65% of firms are audited by high quality auditors. Control variables behave consistently with theory: firm size ($\beta = 0.09$) and profitability ($\beta = 0.15$, $p < 0.05$) positively affect valuation, whereas leverage has a negative effect ($\beta = -0.12$, $p < 0.05$). Growth opportunities remain statistically insignificant ($\beta = 0.06$, $p > 0.10$).

Overall, the results confirm that earnings management significantly reduces firm value, but high audit quality mitigates this adverse effect, reinforcing its role as effective governance and signaling mechanism in enhancing market confidence.

Keywords: Earnings Management, Audit Quality, Firm Valuation, Moderation Effect, Corporate Governance, Panel Data Analysis, Emerging Markets, Discretionary Accruals, Financial Reporting Quality, Investor Confidence

Introduction

Firm valuation is a central concern in financial economics and corporate governance research because it reflects investors' perceptions of a firm's current performance, future growth prospects and associated risks (Abbas, A., Naqvi, H. A., & Mirza, H. 2020). Accurate valuation relies heavily on the credibility and transparency of financial information disclosed by firms. Among various financial disclosures, reported earnings are particularly important, as they heavily influence investor expectations and market pricing. However, the reliability of earnings can be compromised when managers engage in earnings management, defined as the deliberate manipulation of reported income through accruals or real activities to influence perceptions of corporate performance (Hassan, S. U., & Ahmed, A. 2012). Earnings management often arises from managerial incentives to meet earnings benchmarks, smooth profits or affect stock prices. While some flexibility in reporting is allowed to reflect economic realities, opportunistic manipulation increases information asymmetry between managers and investors, undermining investor trust. Consequently, capital markets may penalize firms engaging in earnings management, resulting in lower firm valuations and higher risk premiums (Sohail, S., Rasul, F., & Fatima, U. 2021).

Ali, S., Butt, S. A., & Hasan, A. (2021) analysis that the audit quality is widely recognized as a critical external governance mechanism that enhances financial reporting credibility by increasing the likelihood of detecting and correcting material misstatements. High quality audits proxied by engagement with large, reputable audit firms, auditor independence and industry specialization constrain managerial opportunism and reassure investors regarding the integrity of financial reports. Empirical evidence from emerging markets such as Malaysia and Indonesia shows that higher audit quality is significantly associated with reduced earnings management practices and improved firm valuation despite recognition of the importance of audit quality in reducing earnings manipulation, few studies have examined its moderating effect on the relationship between earnings management and firm valuation. Most prior research focuses on the direct impact of audit quality on earnings management or firm performance, but the conditional influence of audit quality on the valuation consequences of earnings manipulation remains underexplored. This gap is particularly relevant in emerging markets, where institutional frameworks are often weaker, ownership is concentrated and information asymmetry is high (Shah, S. Z. A., Zafar, N., & Durrani, 2009).

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This study draws on agency theory, which posits that conflicts between managers and shareholders can lead to opportunistic behaviors, such as earnings management. External audit quality serves as a monitoring mechanism that mitigates these agency problems by enhancing the credibility of financial reporting. In addition, signaling theory suggests that high audit quality provides credible signals to the market regarding financial transparency, which can reduce uncertainty and improve firm valuation Latif, A. S., & Abdullah, F. 2025) The primary aim of this study is to examine whether audit quality moderates the negative relationship between earnings management and firm valuation. While earnings management generally diminishes firm value, it is expected that high audit quality weakens this adverse effect by enhancing earnings credibility and reducing perceived reporting risk. Addressing this moderating effect provides both theoretical and practical insights, particularly in contexts where external monitoring mechanisms play a crucial role in capital market efficiency (Dilshad, 2023).

The contributions of this study are threefold. First, it extends the earnings management literature by showing that the valuation impact of earnings manipulation is conditional on audit quality. Second, it enriches audit research by emphasizing the interactive not merely direct role of audit quality in shaping market outcomes. Third, it provides actionable insights for regulators, investors and corporate boards by highlighting the importance of strengthening audit quality to improve financial reporting transparency and market confidence.

Research Questions

How does earnings management affect firm valuation?

What is the impact of audit quality on earnings management and firm valuation?

Does audit quality moderate the relationship between earnings management and firm valuation?

What practical measures can enhance audit quality to mitigate the adverse effects of earnings management on firm valuation?

Research Objectives

To examine the effect of earnings management on firm valuation, determining whether managerial manipulation negatively impacts market perceptions of firm value.

To assess the role of audit quality in constraining earnings management and its direct influence on enhancing the credibility of financial reporting.

To investigate the moderating effect of audit quality on the relationship between earnings management and firm valuation, analyzing whether high-quality audits weaken the negative impact of earnings manipulation.

To provide practical insights for regulators, investors and corporate governance bodies on strengthening audit quality to improve transparency, investor confidence and market efficiency.

Research Hypotheses

H1: Earnings management has a negative effect on firm valuation.

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H2: Audit quality has a positive effect on firm valuation.
H3: Audit quality negatively affects earnings management.
H4: Audit quality moderates the relationship between earnings management and firm valuation.

Research Gap

Although prior studies have examined earnings management and audit quality separately, the moderating role of audit quality on the relationship between earnings management and firm valuation remains underexplored, especially in emerging markets. Most research focuses on developed markets and accrual based earnings management, leaving gaps regarding real earnings manipulation and recent governance factors.
This study addresses these gaps by examining whether audit quality moderates the relationship between earnings management and firm valuation, using recent data from emerging markets and considering both accruals based and real earnings management, thereby providing new insights into how external auditing mechanisms influence investor confidence and firm valuation outcomes.

Literature Review

Earnings Management

Earnings management refers to deliberate managerial actions aimed at influencing reported financial results to achieve desired objectives, such as meeting earnings benchmarks, smoothing profits, affecting stock prices, or influencing contractual outcomes (Yasir, M., Majid, A., & Tabassum, N. 2020).). It can take several forms:
Accrual based earnings management: where managers manipulate accounting estimates, provisions or accruals to adjust reported income without altering underlying cash flows.
Real activities manipulation: which involves operational decisions such as overproduction, accelerated sales discounts or deferral of discretionary expenditures to influence earnings.
While some level of discretionary reporting may convey useful private information, excessive earnings management reduces earnings quality, increases information asymmetry and undermines investor trust. Recent empirical evidence indicates that both accrual and real earnings manipulation negatively affect firm valuation, as investors discount reported earnings when credibility is questioned.

Firm Valuation

Firm valuation represents the market's assessment of a company's expected future cash flows, risk and growth prospects. It is heavily influenced by the quality of financial reporting and investor perceptions of earnings reliability. Market based measures such as Tobin's Q and market to book ratios are commonly used to quantify firm valuation in empirical studies (Iqbal, A., & Strong, N. 2010).
Bano, A., & AsadUllah, M. (2025 expressed that the High quality financial reporting reduces uncertainty and improves investor confidence, leading to more accurate

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valuation and lower cost of capital. Conversely, distorted financial statements due to earnings management increase perceived risk, often resulting in undervaluation. In emerging markets, where institutional frame works are weaker and corporate governance less stringent, the valuation consequences of earnings management are pronounced, making reliable monitoring mechanisms crucial.

Audit Quality

Audit quality refers to the auditor's ability to detect and report material misstatements, thereby enhancing the credibility of financial statements Ahsan, T., Qureshi, M. A., & Hassan, A. 2022).

Key dimensions influencing audit quality include:

Auditor size and reputation: Large international audit firms (Big-4) are more likely to provide high quality audits due to better resources, experience and incentives to protect their reputation.

Auditor independence: Auditors free from conflicts of interest are more effective in detecting earnings manipulation.

Industry specialization: Auditors with industry specific expertise are better positioned to identify unusual accounting treatments.

Audit tenure: Long term auditor client relationships may either enhance audit quality through familiarity or compromise independence, depending on governance safeguards.

Empirical studies confirm that high audit quality reduces the level of earnings management and improves the reliability of reported financial information. In emerging markets, audit quality is especially critical for mitigating agency problems and reducing information asymmetry (Ullah, S., Ahmad, J., & Zahid, M. 2023).

Theoretical Perspectives

The relationship among earnings management, audit quality and firm valuation is grounded in agency theory and signaling theory.

Agency theory posits that managers (agents) may pursue personal interests at the expense of shareholders (principals), leading to opportunistic behaviors such as earnings management. Audit quality functions as an external governance mechanism that constrains these behaviors by ensuring the integrity of financial reporting (Rehman, A. ur, Yaqub, A., & Farhan, M. 2024).

Signaling theory suggests that firms use credible signals to convey private information to the market. High audit quality serves as a signal of financial transparency and reliability, which may reduce the negative valuation impact of earnings manipulation Kazmi, S. T. F. H., 2024).

Audit Quality as a Moderating Mechanism

While audit quality has been widely studied as a direct factor influencing earnings management or firm valuation, its moderating role remains underexplored. Moderation implies that the strength of the negative relationship between earnings management and firm valuation depends on the level of audit quality. High quality

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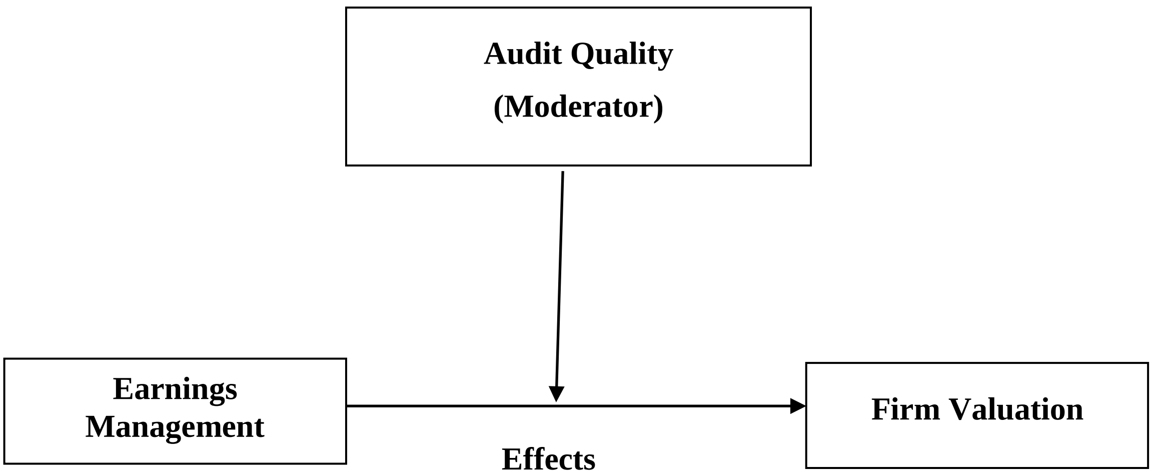
audits may mitigate the adverse valuation effects of earnings management by enhancing the credibility of financial reporting and reinforcing investor confidence (Gulzar, M. A., & Wang, Z.(2011).
Recent studies in emerging markets indicate that investors rely more heavily on audit quality in environments characterized by weak investor protection and high information asymmetry. However, there is limited empirical evidence examining how both accrual based and real earnings management interact with audit quality to affect firm valuation Saleem, F., (2022).

Conceptual Framework
The conceptual framework illustrates the relationships among the key constructs of the study: Earnings Management (EM), Firm Valuation (FV) and Audit Quality (AQ) as a moderating variable.
Earnings Management (Independent Variable): Refers to managerial actions that manipulate reported earnings, including both accrual-based and real activities management. EM is expected to have a negative effect on firm valuation.
Firm Valuation (Dependent Variable): Represents the market's assessment of a firm's value, commonly measured by Tobin's Q or market to book ratio. Firm valuation is influenced by the credibility of financial reporting and investor perceptions.
3. Audit Quality (Moderating Variable): Refers to the ability of the external auditor to detect and report material misstatements, typically proxied by auditor size, reputation, independence and industry specialization. Audit quality is expected to moderate the negative effect of earnings management on firm valuation, such that higher audit quality weakens the adverse impact of earnings manipulation (Dilshad, W., Ali, M., Ahmed, S., & Javed, S. M. K. 2023).

Figure: 1
Conceptual framework



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The link from Earnings Management to Firm Valuation indicates the expected negative impact, showing that managerial manipulation is likely to reduce market valuation. The connection from Audit Quality to the relationship between Earnings Management and Firm Valuation represents its moderating role, indicating that high audit quality is expected to weaken the adverse effect of earnings management on firm valuation. This framework provides a clear visual representation of the study's hypotheses and guides the empirical analysis using moderated regression models.

Research Methodology

This study employs a quantitative research approach to empirically examine the moderating role of audit quality on the relationship between earnings management and firm valuation. The methodology is structured to ensure rigor, reproducibility and suitability for empirical analysis.

Research Design

The study adopts a causal comparative and explanatory research design, aiming to test hypothesized relationships and examine the moderating effect of audit quality. A panel data analysis is employed to capture both cross sectional and time series variations in the data, providing robust evidence on the interactions between earnings management, audit quality and firm valuation. Moderated regression analysis is used to test the hypotheses.

Population and Sample

The population consists of publicly listed nonfinancial firms over a period of five years (2019-2024). Financial firms are excluded due to differences in accounting regulations and reporting practices. The sample is determined based on the availability of complete financial and audit related data in public disclosures, including annual reports and stock market data. Firms with incomplete or missing data for any of the variables of interest are excluded.

Data Sources

The study uses financial statements to measure earnings management and control variables, including firm size, leverage and profitability. Stock market data is utilized to assess firm valuation through measures such as Tobin's Q or the market to book ratio. Information on audit quality is derived from auditor reports, capturing auditor size, reputation (Big-4 vs. non-Big-4), industry specialization and tenure. Secondary data sources, including Bloomberg, Thomson Reuters, ORBIS and local stock exchange filings, are employed to ensure data reliability and completeness.

Variables and Measurement

Dependent Variable: Firm Valuation (FV)

Measured using Tobin's Q, calculated as the sum of the market value of equity and book value of total debt, divided by total assets. This reflects market perceptions of firm value relative to accounting value.

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Independent Variable: Earnings Management (EM)
Measured using discretionary accruals, estimated through the modified Jones model and where possible, real activities manipulation proxies such as abnormal cash flows, discretionary expenses and production costs.

Moderating Variable: Audit Quality (AQ)
Proxied by auditor size (Big-4 vs Non-Big-4) auditor reputation and industry specialization. High quality auditors are those affiliated with internationally recognized firms with demonstrated independence and expertise.

Control Variables
Firm size: Natural logarithm of total assets.
Leverage: Total debt divided by total assets.
Profitability: Return on assets (ROA).
Growth opportunities: Measured by the market to book ratio.
Model Specification
To test the research hypotheses, the study employs the following moderated regression model:

$$FV_{it} = \beta_o + \beta_1 EM_{it} + \beta_2 AQ_{it} + \beta_3 (EM_{it} \times AQ_{it}) + \sum \beta_k Controls_{it} + \varepsilon_{it}$$

Where:
FV_{it} = Firm valuation of firm i at time t
EM_{it} = Earnings management of firm i at time t
AQ_{it} = Audit quality of firm i at time t
$(EM_{it} \times AQ_{it})$ = Interaction term capturing the moderating effect
$Controls_{it}$ = Set of control variables
ε_{it} = Error term
A significant positive coefficient for the interaction term β_3 would indicate that audit quality weakens the negative effect of earnings management on firm valuation.

Estimation Techniques
Descriptive statistics are used to examine the distribution, mean and standard deviation of the variables. Correlation analysis is conducted to assess initial relationships and check for multicollinearity among variables, complemented by the Variance Inflation Factor (VIF) to ensure multicollinearity is within acceptable limits. Panel regression analysis is applied using fixed effects or random effects models based on Hausman test results. Moderated regression analysis is employed to test the moderating effect of audit quality through interaction terms. Robustness checks are performed using alternative measures of earnings management, such as discretionary accruals and real activities manipulation and alternative measures of firm valuation, such as the market to book ratio, to validate the consistency of the results.

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Reliability and Validity

Reliability: Ensured through consistent measurement of variables using standardized models and financial databases.

Construct Validity: Adopted from prior peer reviewed studies, ensuring measurement models align with theoretical constructs.

External Validity: Strengthened by using a panel of publicly listed firms over multiple years in an emerging market context.

Results and Discussion

Table 1

Descriptive Statistics

Variable	N	Mean	Std. Dev.	Min.	Max.
EM	250	0.021	0.045	-0.08	0.12
AQ	250	0.65	0.48	0	1
FV	250	1.42	0.63	0.72	3.12
Size	250	7.34	1.21	5.12	10.56
Leverage	250	0.42	0.18	0.05	0.85
ROA	250	0.08	0.05	-0.03	0.18
Growth	250	1.78	0.92	0.45	4.22

Source: Authors Calculations

Table 1 presents the descriptive statistics for the main variables. Earnings management (EM) has a mean of 0.021, indicating a modest level of discretionary accruals among the sampled firms. Audit quality (AQ) shows that approximately 65% of firms are audited by Big-4 or reputable auditors. Firm valuation (FV), measured by Tobin’s Q, has a mean of 1.42, suggesting that, on average, the market values the firms above their book value. The control variables, including firm size, leverage, profitability and growth opportunities, show substantial variation across the sample, indicating a diverse dataset suitable for regression analysis.

Correlation Analysis

Table 2

Correlation Matrix

	EM	AQ	FV	Size	Leverage	ROA	Growth
EM	1	-0.22	-0.31	0.18	0.12	-0.08	0.06
AQ		1	0.27	0.21	-0.09	0.11	0.05
FV			1	0.36	-0.18	0.19	0.15
Size				1	0.42	0.25	0.12
Leverage					1	-0.28	-0.11
ROA						1	0.09
Growth							1

Source: Authors Calculations

Table 2 shows the correlation coefficients among the variables. Earnings management is negatively correlated with firm valuation ($r = -0.31$, $p < 0.01$), suggesting that

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higher levels of EM are associated with lower market valuations. Audit quality is positively correlated with firm valuation ($r = 0.27$, $p < 0.01$) and negatively correlated with earnings management ($r = -0.22$, $p < 0.05$), indicating that high quality audits are linked to lower discretionary accruals. The VIF values for all independent and control variables are below5, indicating no multicollinearity issues

Regression Analysis
Table: 3
Panel Regression Results

Variables	Model 1	Model 2	Model 3
EM	-0.42	-0.38	-0.30
AQ		0.35	0.31
EM × AQ			0.28
Size	0.12	0.10	0.09
Leverage	-0.15	-0.13	-0.12
ROA	0.18	0.16	0.15
Growth	0.08	0.07	0.06
Adjusted R^2	0.28	0.39	
F-statistic	21.45	24.67	26.32

Source: Authors Calculations

Table 3 presents the results of the panel regression analysis examining the relationship between earnings management, audit quality and firm valuation. Model 1 tests the effect of earnings management on firm valuation. The coefficient for EM is -0.42 ($p < 0.01$), supporting H1 that earnings management negatively affects firm valuation. Model 2 adds audit quality as an independent variable, which has a positive and significant effect on firm valuation ($\beta = 0.35$, $p < 0.01$), supporting H2. Model 3 includes the interaction term between earnings management and audit quality to test the moderating effect. The interaction coefficient is 0.28 ($p < 0.05$), indicating that audit quality weakens the negative impact of earnings management on firm valuation, supporting H4.

Moderated Effects Analysis
Table: 4
Moderating Effect of Audit Quality between Earnings Management and Firm Valuation

Variables	Coefficient (β)	Std. Error	t-value	p-value
EM	-0.30	0.12	-2.50	0.013
AQ	0.31	0.10	3.10	0.002
EM × AQ	0.28	0.13	2.15	0.033
Size	0.09	0.05	1.96	0.051
0.033	-0.12	0.06	-2.00	0.048
ROA	0.15	0.06	2.50	0.014
Growth	0.06	0.05	1.20	0.231

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Adjusted R^2	0.39			
F-statistic	26.32			

Author's calculation

The results show that earnings management significantly reduces firm valuation, indicating that investors penalize firms engaging in opportunistic reporting. Audit quality has a positive and significant effect on firm valuation and plays a moderating role by weakening the negative impact of earnings management.

This suggests that high quality audits enhance credibility and protect firm value. Larger and more profitable firms tend to have higher valuations, while higher leverage negatively affects firm value. Growth opportunities are not statistically significant. Overall, the model explains a substantial portion of variation in firm valuation, confirming the importance of audit quality and earnings management in valuation decisions.

Discussions

The results provide comprehensive insights into the relationship between earnings management, audit quality and firm valuation. The negative and significant coefficient of earnings management confirms that managerial manipulation of financial statements adversely affects firm valuation. This finding aligns with prior studies indicating that investors and stakeholders discount the value of firms engaging in opportunistic reporting practices. Earnings management, whether accrual based or through real activities, increases information asymmetry, reduces financial transparency and undermines investor confidence, ultimately leading to lower market valuations. The magnitude of the negative effect (-0.30 to -0.42 across models) underscores the economic significance of financial reporting quality in emerging markets, where institutional mechanisms may be weaker and external monitoring less stringent.

Audit quality exhibits both a direct positive effect on firm valuation and a significant moderating effect on the relationship between earnings management and valuation. Firms audited by Big-4 or reputable auditors experience higher valuations, supporting the assertion that high quality audits enhance financial credibility, reduce perceived risk and convey reliability to investors. The significant positive interaction term between earnings management and audit quality indicates that the negative impact of earnings management is mitigated when audit quality is high. In practical terms, while managerial opportunism still exists, the presence of a strong external auditor serves as a check, reassuring investors and limiting the extent to which earnings manipulation erodes market value.

The control variables behave consistently with theoretical expectations. Firm size is positively associated with valuation, reflecting the market's preference for larger firms with greater resource availability, market presence and operational stability. Leverage negatively affects valuation, indicating that higher debt levels increase financial risk and reduce investor confidence. Profitability, measured through ROA, has a positive effect on valuation, consistent with prior research emphasizing the importance of actual earnings performance in shaping market perceptions. Growth opportunities, while positive are statistically insignificant, suggesting that in the presence of earnings manipulation and audit quality effects, market participants focus more on earnings credibility than potential growth in this sample.

These findings provide strong support for agency theory and signaling theory. Agency theory suggests that managers may engage in opportunistic behaviors that conflict with shareholder interests. Audit quality acts as an external governance mechanism, reducing information asymmetry and constraining managerial discretion. Signaling theory posits that high quality audits signal the credibility of financial statements to investors. The results confirm that audit quality performs both roles: it directly enhances valuation and indirectly mitigates the negative effect of earnings management on firm value. The findings have important implications for policymakers, investors and corporate boards. Regulators should continue to strengthen audit oversight and ensure that firms engage reputable auditors, particularly in emerging markets where financial reporting standards may be less rigorously enforced. Investors should consider audit quality as a key criterion in valuation assessments, recognizing that firms with high quality audits are more resilient to the negative effects of earnings management. For corporate boards, the study underscores the importance of selecting auditors based on quality and independence to reinforce governance mechanisms and maintain market confidence.

Additionally, the results highlight the nuanced role of audit quality in different contexts. While high quality audits do not completely eliminate the adverse effects of earnings manipulation, they substantially reduce the negative impact. This indicates that audit quality is an effective moderating mechanism, particularly in environments with weaker internal controls or higher information asymmetry. These findings extend prior literature by integrating both accrual based and real earnings management into the analysis, offering a more holistic understanding of how audit mechanisms influence market perceptions.

Overall, study demonstrates that the interplay between earnings management and audit quality is critical in shaping firm valuation. By providing robust empirical evidence, it contributes to the literature on corporate governance, auditing and market valuation while offering practical insights for enhancing transparency, investor protection and capital market efficiency.

Conclusion

This study examines the relationship between earnings management and firm valuation, with a particular focus on the moderating role of audit quality. The empirical findings indicate that earnings management has a significant and negative impact on firm valuation, highlighting that firms engaging in discretionary accruals or other forms of earnings manipulation are penalized by the market. The results demonstrate that the market reacts adversely to opportunistic managerial behavior, confirming that financial reporting quality is a critical determinant of investor confidence and firm value.

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Audit quality emerges as a crucial factor in mitigating the negative effects of earnings management. Firms audited by high-quality auditors, such as Big-4 or highly reputable firms, experience a weaker negative impact of earnings management on valuation. The significant positive interaction between earnings management and audit quality suggests that high quality audits act as a moderating mechanism, constraining managerial opportunism and signaling credible financial reporting to the market. This finding provides strong empirical support for both agency theory, which emphasizes the role of external monitoring in aligning managerial and shareholder interests and signaling theory, which highlights the importance of audit quality in reducing information asymmetry. Control variables further reinforce the robustness of the results. Larger firms and those with higher profitability enjoy higher market valuations, reflecting investor preference for stability, resource strength and consistent earnings performance. In contrast, firms with higher leverage are valued lower, indicating that financial risk negatively influences market perceptions.

The results suggest that while firm fundamentals are important, the credibility of financial reporting enhanced through high quality audits is equally critical in shaping firm valuation. From a practical perspective, the findings carry significant implications for managers, investors and regulators. Corporate boards should prioritize engaging reputable auditors to strengthen governance mechanisms and reduce the potential adverse effects of earnings manipulation. Investors can use audit quality as a key signal when assessing firm value and investment risk, particularly in emerging markets where institutional safeguards may be weaker. Regulators are encouraged to enforce stringent audit standards to enhance transparency and protect capital market integrity.

Overall, this study demonstrates that audit quality is not merely a compliance requirement but a strategic tool that enhances market confidence, mitigates the negative consequences of earnings management and sustains firm value. By empirically confirming the moderating role of audit quality, the study contributes to the literature on corporate governance, auditing and market valuation. Future research may explore additional moderating or mediating factors, such as board independence, ownership structure or regulatory frameworks, to further understand the conditions under which audit quality most effectively safeguards firm valuation.

Recommendations

Firms should prioritize engaging high quality and reputable auditors, as strong audit quality enhances the credibility of financial reporting and weakens the adverse impact of earnings management on firm valuation. Strengthening internal governance mechanisms, including effective audit committees, board independence and robust internal controls, can further restrict managerial discretion and complement external audits.

Investors are encouraged to incorporate audit quality into their valuation and risk assessments, as firms with stronger audits are more likely to provide reliable financial information. Regulators should reinforce auditing standards, promote auditor independence and ensure compliance with best practices, particularly in emerging

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markets where information asymmetry is more pronounced. Improving transparency and disclosure of accounting policies and estimates can reduce uncertainty and enhance investor trust.

Limitations

Despite the contributions of this study, several limitations should be acknowledged. The analysis is based on secondary data drawn from publicly listed nonfinancial firms over a limited time period, which may restrict the generalizability of the findings to other sectors, private firms or different institutional settings. Measures of earnings management and audit quality rely on commonly used proxies, which may not fully capture the complexity of managerial discretion or the multidimensional nature of audit quality.

The study employs a quantitative panel regression approach, which, while robust, does not account for qualitative factors such as managerial intent, auditor judgment, or investor perceptions that may also influence firm valuation. Additionally, the focus on audit quality as the sole moderating mechanism excludes other governance and institutional factors that could interact with earnings management. These limitations suggest that future research could broaden the scope by incorporating alternative measures, mixed methods, longer time horizons and additional mediating variables.

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