



Litigation Risk, Reputation Protection, and Audit Quality
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ABSTRACT

Litigation risk and reputation protection are often cited in the literature as incentives for high quality audit services. This study examines whether reputation protection can motivate Big 4 auditors to provide higher quality audits in a low litigation risk audit market. We measure audit quality using accounting related enforcement actions against clients by securities regulators. Based on 7,011 firm-year observations of non-state-owned listed companies in China for the period of 2007 to 2015, we find no significant differences in either the frequency or severity of accounting related enforcement actions between Big 4 and non-Big 4 clients. Our findings indicate that reputational concerns alone cannot motivate Big 4 auditors to provide superior quality audit services in China's low litigation risk audit market. Given the large number of low litigation risk jurisdictions across the world, our findings highlight the importance of legal reforms for improving audit quality.

Keywords: Audit quality, Enforcement Actions, litigation, reputation, China

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