

A Structural Model of Auditors' Professional Judgment and Financial Reporting Quality: Evidence from Materiality, Strategic Risk, and Value Creation

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Abstract

This study develops and empirically tests a structural model that positions auditors' professional judgment as a primary driver of financial reporting quality, rather than as a residual response to audit risk and compliance requirements. Using data from listed companies and employing Structural Equation Modeling (SEM), the study provides evidence on how professional judgment operates within governance-intensive reporting environments shaped by materiality, strategic risk, and value creation.

The findings indicate that auditors' professional judgment has a statistically and economically significant effect on financial reporting quality. Moreover, this effect is systematically conditioned by qualitative materiality considerations, exposure to strategic risk, and the prominence of value-creation narratives, such that judgment becomes most consequential when these governance dimensions interact.

By conceptualizing professional judgment as a structural governance mechanism, the study extends prior auditing research that has largely treated judgment as an outcome rather than a causal force. The results offer implications for auditing theory, audit methodology, and regulatory policy by highlighting the central role of judgment-based assurance in enhancing reporting credibility in complex and forward-looking reporting environments.

Keywords: Auditors' Professional Judgment, Financial Reporting Quality, Structural Model, Materiality, Strategic Risk, Value Creation

1. Introduction

1.1 Background and Context

Auditors' professional judgment represents the cornerstone of the auditing process, shaping auditors' evaluations, decisions, and conclusions across all stages of an audit engagement. Despite the increasing codification of auditing standards and the growing reliance on analytical tools and automated procedures, contemporary audit practice remains fundamentally judgment-based. This reliance has intensified as business environments have become more complex, uncertain, and strategically driven, particularly in the context of listed companies operating under heightened market scrutiny [1-3].

Recent developments in financial reporting have further expanded the scope and significance of auditors' professional judgment.

Financial statements no longer merely reflect historical transactions but increasingly incorporate forward-looking estimates, fair value measurements, complex revenue recognition models, and disclosures linked to business models and long-term value creation. As a result, auditors are required to exercise judgment not only in detecting misstatements but also in assessing the decision usefulness, transparency, and credibility of reported information [4-6].

Within this evolving landscape, three governance-intensive dimensions have become particularly influential in shaping auditors' judgments. First, materiality effects have moved beyond traditional quantitative thresholds to encompass qualitative, contextual, and user-oriented considerations. Materiality is now widely understood as a judgmental construct linked to how

information influences economic decisions rather than merely the magnitude of misstatements [7,8]. Second, strategic risk has emerged as a central concern in audit planning and evaluation, reflecting risks arising from firms' strategic choices, competitive positioning, and business model sustainability [9,10]. Third, value creation processes, embedded in firms' business models and integrated reporting practices, have reshaped expectations regarding what constitutes high-quality financial reporting and how auditors assess the relevance and completeness of disclosures [11-13].

Despite these developments, the auditing literature has yet to fully articulate how auditors' professional judgment operates as a structural mechanism for producing financial reporting quality within such complex and interdependent contexts.

1.2 Research Problem

The dominant stream of auditing research has largely conceptualized professional judgment as a dependent outcome, shaped by audit risk, regulatory pressure, client characteristics, or standardized decision aids. While this perspective has generated valuable insights, it implicitly frames auditors' judgment as reactive rather than constitutive [14,15]. Consequently, the active role of professional judgment in generating financial reporting quality remains under-theorized and under-tested Dowling [16].

This limitation becomes particularly salient in environments characterized by high strategic risk and value-oriented reporting, where auditors must evaluate not only compliance with accounting standards but also the credibility of management assumptions and the material implications of strategic decisions. Regulatory bodies and standard setters have increasingly emphasized the importance of judgment in such contexts, yet empirical research has not kept pace with these expectations [17-19].

Moreover, existing studies tend to examine materiality, risk, and reporting quality in isolation, without integrating them into a coherent structural framework. As a result, there is a lack of empirical models that explain how auditors' professional judgment functions as a primary explanatory driver of financial reporting quality while being conditioned by materiality effects, strategic risk, and value creation processes.

1.3 Research Objectives and Questions

- The primary objective of this study is to develop and empirically test a structural model that positions auditors' professional judgment as a core driver of financial reporting quality in listed companies. Specifically, the study aims to:
 - reconceptualize auditors' professional judgment as a structural mechanism for producing reporting quality;
 - examine how this mechanism operates within the context of materiality effects, strategic risk, and value creation processes; and
 - provide empirical evidence from listed companies to enhance the practical relevance of the proposed model.

Accordingly, the study addresses the following research questions:

- How does auditors' professional judgment contribute to financial reporting quality?
- How do materiality effects and strategic risk shape the exercise of professional judgment?
- To what extent do value creation processes condition the relationship between professional judgment and financial reporting quality?

1.4 Significance of the Study

This study is significant for several reasons. From a theoretical perspective, it responds to calls within the auditing literature to move beyond compliance-oriented models toward judgment-centered explanations of audit quality [20,21]. By repositioning professional judgment as a driver rather than an outcome, the study offers a new lens for understanding audit effectiveness in complex reporting environments.

From a practical perspective, the findings are expected to inform audit practitioners and regulators seeking to enhance financial reporting quality through improved judgment practices rather than increased rule complexity. This is particularly relevant in capital markets, where reporting credibility plays a critical role in investor confidence and market efficiency [22,23].

1.5 Research Contributions

This study makes several important contributions. First, it advances auditing theory by proposing a structural judgment model that integrates professional judgment, financial reporting quality, and governance-related constraints within a unified framework. Second, it contributes methodologically by applying Structural Equation Modeling (SEM) to capture complex, interdependent relationships that are often overlooked in traditional audit research [24]. Third, it offers practical insights for audit firms, standard setters, and oversight bodies regarding how professional judgment can be systematically strengthened to improve reporting outcomes [25].

1.6 Structure of the Study

The remainder of the study is organized as follows. Chapter Two reviews the relevant literature and develops the theoretical foundation. Chapter Three presents the proposed structural model and hypotheses. Chapter Four outlines the research methodology. Chapter Five reports the empirical results. Chapter Six discusses the findings in relation to prior literature, theory, and comparative evidence. Chapter Seven concludes the study and identifies directions for future research.

2. Theoretical Framework and Literature Review

2.1 Auditors' Professional Judgment: Conceptual Foundations

Auditors' professional judgment has long been recognized as the defining element of audit quality and effectiveness. Unlike mechanistic decision-making processes, professional judgment reflects the auditor's ability to interpret evidence, integrate contextual cues, evaluate uncertainty, and apply professional skepticism in forming audit conclusions. Contemporary auditing

standards explicitly acknowledge that judgment is unavoidable and central to audit engagements, particularly in areas involving estimates, assumptions, and forward-looking information [26,27].

The academic literature conceptualizes professional judgment as a cognitive–professional process shaped by expertise, experience, ethical orientation, and environmental pressures. Early judgment research focused primarily on individual cognitive biases and heuristics; however, more recent studies emphasize the embedded nature of judgment within organizational, regulatory, and strategic contexts [28,29]. This shift reflects growing recognition that auditors do not exercise judgment in isolation but within governance-intensive environments that influence what is considered reasonable, sufficient, and appropriate.

Importantly, prior studies have predominantly treated auditors’ judgment as an outcome variable, influenced by audit risk, time pressure, client incentives, or decision aids [30–32]. While this stream has generated valuable insights, it implicitly frames judgment as reactive. In contrast, emerging perspectives argue that professional judgment should be viewed as a structural mechanism through which audit quality and reporting quality are produced [1,30–32]. This reconceptualization forms the theoretical foundation of the present study.

2.2 Judgment-Based Auditing versus Risk-Based Auditing

Risk-based auditing (RBA) has dominated both audit practice and research for several decades. Under this approach, auditors identify and assess risks of material misstatement and design audit procedures accordingly. While RBA has improved audit efficiency and consistency, critics argue that it may unintentionally constrain auditors’ judgment by overemphasizing compliance with predefined risk assessment procedures [33,34].

Judgment-based auditing (JBA), by contrast, emphasizes auditors’ evaluative reasoning and interpretive capacity rather than procedural adherence. JBA recognizes that many audit decisions—such as evaluating management estimates, assessing disclosures, and determining materiality—cannot be reduced to algorithmic rules [35,36]. Recent studies suggest that excessive reliance on structured decision aids may impair auditors’ ability to respond to novel or strategically complex situations, thereby undermining reporting quality [36–39].

This tension between RBA and JBA is particularly relevant in environments characterized by strategic uncertainty and value-oriented reporting. In such settings, auditors must go beyond identifying risks to exercising judgment about the broader implications of those risks for financial reporting quality. Accordingly, a growing body of literature calls for models that explicitly integrate judgment as a central explanatory construct rather than a residual outcome [40].

➤ Materiality Effects beyond Misstatements

Materiality represents one of the most judgment-intensive concepts

in auditing. Traditionally, materiality has been operationalized as a quantitative threshold used to evaluate the significance of misstatements. However, contemporary research and standard-setting developments emphasize that materiality is inherently qualitative and context-dependent [7,8].

Recent studies introduce the notion of materiality effects, highlighting that information can be material not only due to its magnitude but also due to its nature, timing, and potential impact on users’ decisions. For example, disclosures related to liquidity risk, business continuity, or strategic investments may be considered material even when associated amounts are quantitatively small [41–43].

From a judgment perspective, materiality effects require auditors to evaluate how information interacts with users’ expectations and market perceptions. This evaluation involves forward-looking reasoning and an understanding of the firm’s strategic context, thereby reinforcing the centrality of professional judgment. Despite this, empirical research has rarely examined materiality as a conditioning context within which judgment operates to influence reporting quality [44–48].

2.3 Strategic Risk and Audit Judgment

Strategic risk refers to risks arising from a firm’s strategic choices, business model, and competitive positioning. Unlike operational or financial risks, strategic risks often have long-term and systemic implications that are difficult to quantify *ex ante*. Recent auditing research recognizes strategic risk as a critical input into audit planning and evaluation, particularly for complex and innovative firms [6,49–52].

Auditors’ engagement with strategic risk extends beyond identifying potential misstatements to assessing whether management’s strategic assumptions and disclosures faithfully represent economic reality. Studies show that higher strategic risk is associated with increased judgment complexity, greater reliance on professional skepticism, and heightened demands on auditors’ expertise [53,54].

However, existing literature often treats strategic risk as an antecedent to audit effort or fees rather than as a contextual factor shaping the judgment–quality relationship. This creates a gap in understanding how auditors’ professional judgment functions as a driver of financial reporting quality when exercised under conditions of elevated strategic risk [55].

2.4 Interim Synthesis and Research Gap

The review above highlights three critical insights. First, professional judgment is increasingly recognized as central to auditing, yet it remains under-theorized as a structural driver of reporting quality. Second, materiality effects and strategic risk introduce qualitative, forward-looking dimensions that intensify reliance on judgment. Third, prior studies tend to examine these elements in isolation, without integrating them into a coherent

structural framework.

Accordingly, there is a clear need for a model that positions auditors' professional judgment as a primary explanatory mechanism operating within governance-intensive contexts defined by materiality effects and strategic risk. Addressing this gap provides the theoretical basis for the structural model developed in this study.

2.5 Value Creation Processes and Auditors' Judgment

Value creation has become a central organizing concept in contemporary corporate reporting, particularly as firms increasingly communicate performance through business models, strategic narratives, and forward-looking disclosures. Value creation processes encompass the mechanisms through which firms deploy resources, manage risks, and generate sustainable economic returns over time. This shift has expanded the informational scope of financial reporting and, consequently, the judgmental demands placed on auditors [56,57].

Auditors' engagement with value creation processes extends beyond verifying transactional accuracy to evaluating the plausibility and coherence of management's representations regarding how value is generated and sustained. Recent research highlights that disclosures related to business models, intangibles, and long-term strategic initiatives often involve significant subjectivity, requiring auditors to exercise professional judgment in assessing relevance, completeness, and neutrality [58-60].

Importantly, value creation processes introduce a forward-looking orientation that challenges traditional audit approaches centered on historical verification. Auditors must consider whether reported information faithfully reflects the firm's economic reality and whether it provides decision-useful insights to capital market participants. This evaluative role reinforces the need to conceptualize professional judgment as a generative mechanism that shapes reporting quality rather than as a passive response to compliance requirements [9,61].

2.6 Financial Reporting Quality: A Judgment-Oriented Perspective

Financial reporting quality (FRQ) is a multifaceted construct reflecting the extent to which financial reports provide faithful, relevant, and decision-useful information to users. Prior literature has operationalized FRQ using various proxies, including accrual quality, earnings persistence, disclosure transparency, and restatement frequency. While these measures have enhanced empirical understanding, they often abstract away from the judgmental processes that underlie reporting outcomes [61-63].

A growing body of research argues that FRQ cannot be fully explained without accounting for auditors' professional judgment. Judgment influences not only the detection and correction of misstatements but also the evaluation of estimates, disclosures, and narrative explanations that shape users' perceptions. Studies

demonstrate that differences in auditors' judgment quality are associated with variation in reporting outcomes, even after controlling for firm and governance characteristics [64,65].

From this perspective, FRQ emerges as an outcome of judgment-intensive interactions among auditors, management, and governance mechanisms. This view aligns with calls for more process-oriented audit research that examines how judgment operates within complex reporting environments to produce observable quality outcomes [66,67].

2.7 Integrating Materiality Effects, Strategic Risk, and Value Creation

Although materiality effects, strategic risk, and value creation have each been examined in isolation, their joint influence on auditors' professional judgment remains underexplored. Conceptually, these dimensions are interdependent. Strategic risk shapes the nature and magnitude of potential material effects, while value creation processes influence what information is considered relevant and decision-useful. Together, they form a governance-intensive context within which auditors exercise judgment [68-70].

Materiality effects require auditors to assess how information interacts with strategic narratives and value drivers. Strategic risk amplifies judgment complexity by introducing uncertainty and long-term considerations. Value creation processes, in turn, frame expectations regarding the completeness and coherence of reported information. This interaction suggests that professional judgment operates as a structural mechanism that integrates these dimensions to produce financial reporting quality [70].

Despite this conceptual coherence, empirical research has not yet articulated a structural model that captures these interactions. Most studies treat materiality, risk, and value creation as independent antecedents or control variables, thereby overlooking their collective role in shaping the judgment-quality relationship. Addressing this limitation requires a model that explicitly positions auditors' professional judgment at the center of analysis.

2.8 Toward a Structural Judgment Model

Building on the reviewed literature, this study advances a structural judgment model that reconceptualizes auditors' professional judgment as a primary driver of financial reporting quality operating within governance-intensive contexts. Unlike prior models that emphasize risk assessment or compliance, the proposed model integrates materiality effects, strategic risk, and value creation processes as conditioning dimensions that shape how judgment is formed and applied.

This approach responds to recent calls for audit research that moves beyond linear, input-output frameworks toward more holistic and process-oriented explanations [4,9]. By treating judgment as a structural mechanism, the model captures the dynamic interplay between professional reasoning and reporting outcomes, offering a more realistic representation of contemporary audit practice.

2.9 Summary and Research Gap

In summary, the literature review reveals several critical gaps. First, while professional judgment is widely acknowledged as central to auditing, it is rarely modeled as a structural driver of financial re-*porting* quality. Second, materiality effects, strategic risk, and value creation processes have not been integrated into a unified framework that explains how judgment operates within complex reporting environments. Third, empirical evidence on these interactions remains limited, particularly in the context of listed companies.

This study addresses these gaps by developing and empirically testing a structural model that places auditors' professional judgment at the core of financial reporting quality. In doing so, it contributes to auditing theory, enhances methodological rigor, and offers practical insights for improving reporting outcomes in governance-intensive settings [50].

3. Structural Model Development and Hypotheses

3.1 Conceptual Logic of the Structural Judgment Model

This study develops a Structural Judgment Model that positions auditors' professional judgment as a primary explanatory driver of financial reporting quality, rather than as a reactive outcome of audit risk or regulatory compliance. This reconceptualization is grounded in judgment and decision-making theory, which views professional judgment as a context-embedded cognitive process shaped by ex-pertise, institutional norms, and situational complexity [61,68].

Recent auditing research increasingly emphasizes that judgment quality cannot be fully understood without considering the broader governance environment in which auditors operate. Auditors are required to integrate diverse informational cues, assess uncertainty, and resolve ambiguity when evaluating financial reports, particularly in settings characterized by strategic complexity and forward-looking disclosures [4,9,11,26]. These conditions suggest that judgment functions as a structural mechanism through which reporting quality is produced.

The proposed model assumes that auditors' professional judgment directly shapes financial reporting quality by influencing how audit evidence is interpreted, how estimates and assumptions are evaluated, and how disclosure adequacy is assessed. However, this relationship is conditioned by governance-intensive contextual dimensions, namely materiality effects, strategic risk, and value creation processes, which jointly define the environment in which judgment is exercised [27-28].

3.2 Auditors' Professional Judgment as a Structural Driver

Auditors' professional judgment (APJ) is conceptualized as a multidimensional construct reflecting auditors' capacity to apply technical knowledge, professional skepticism, and contextual understanding in audit decision-making. Prior literature has documented that differences in judgment quality are associated

with variations in audit outcomes, even when formal standards and procedures are held constant [29-32].

Most empirical studies, however, treat professional judgment as an intervening or dependent variable influenced by time pressure, client incentives, or decision aids [33-42]. This study departs from that tradition by conceptualizing APJ as a structural driver that actively generates reporting quality out-comes. From this perspective, judgment quality determines auditors' ability to challenge management, evaluate subjective estimates, and identify economically significant issues that may not be captured by standardized audit procedures [71,72].

This structural view aligns with regulatory and professional calls to strengthen judgment-based auditing as a response to increasing business complexity and the limitations of purely risk-based approaches [73].

3.3 Financial Reporting Quality as the Outcome Construct

Financial reporting quality (FRQ) is defined as the extent to which financial reports faithfully represent a firm's economic performance and position while providing decision-useful information to capital market participants. Prior research has operationalized FRQ using various proxies, including accrual quality, earnings persistence, disclosure transparency, and restatement incidence [72,73].

While these measures capture important attributes of reporting outcomes, they often abstract away from the judgmental processes that produce them. Recent studies argue that FRQ should be understood as the result of judgment-intensive interactions among auditors, management, and governance mechanisms [65-73]. Auditors' professional judgment plays a critical role in evaluating estimates, resolving ambiguity, and determining whether disclosures adequately reflect underlying economic reality.

Accordingly, the proposed model treats FRQ as an outcome that is structurally linked to auditors' judgment quality, rather than as an exogenous characteristic determined solely by firm-level attributes or accounting standards.

3.4 Governance-Conditioning Dimensions of the Model

• Materiality Effects

Materiality effects represent the first governance-conditioning dimension of the model. Contemporary research emphasizes that materiality extends beyond numerical thresholds to include qualitative considerations related to users' decision-making and market perceptions [7,8]. Information may be material due to its nature, timing, or strategic implications, even when associated amounts are quantitatively small.

Materiality effects influence auditors' professional judgment by shaping what information is considered significant and how audit evidence is evaluated. Studies show that auditors' materiality judgments are sensitive to contextual cues, disclosure narratives,

and anticipated user reactions [18,19-26]. Within the proposed model, materiality effects condition the extent to which professional judgment translates into higher financial reporting quality.

• **Strategic Risk**

Strategic risk constitutes the second governance-conditioning dimension. Strategic risk arises from firms' strategic choices, business models, and competitive positioning, and it introduces long-term uncertainty that complicates audit judgments [26-38].

Auditing research indicates that higher strategic risk increases judgment complexity and heightens the need for professional skepticism, particularly when evaluating forward-looking estimates and strategic disclosures. In the proposed model, strategic risk does not merely increase audit effort but conditions the environment in which judgment operates, thereby influencing the judgment-quality relationship.

• **Value Creation Processes (Conceptual Introduction)**

Value creation processes represent the third governance-conditioning dimension. These processes encompass the mechanisms through which firms generate and sustain economic value, including business models, resource allocation decisions, and long-term strategic initiatives.

As firms increasingly communicate performance through value-oriented narratives and integrated reporting practices, auditors must exercise judgment in assessing whether such disclosures faithfully represent economic reality. Value creation processes therefore shape expectations regarding relevance, completeness, and neutrality, further reinforcing the centrality of professional judgment [48-50].

3.5 Interim Synthesis

The literature reviewed in this section supports the development of a structural model that places auditors' professional judgment at the core of financial reporting quality. Materiality effects, strategic risk, and value creation processes jointly define a governance-intensive context within which judgment operates. By integrating these dimensions, the proposed model provides a coherent foundation for hypothesis development and empirical testing.

3.6 Hypotheses Development

• **Auditors' Professional Judgment and Financial Reporting Quality**

Judgment and decision-making theory suggests that professional judgment quality directly affects evaluative outcomes in complex professional tasks. In auditing, higher-quality judgment enables auditors to appropriately interpret ambiguous evidence, rigorously evaluate management estimates, and assess disclosure adequacy under uncertainty [74]. Empirical studies further indicate that differences in auditors' judgment quality are associated with meaningful variation in reporting outcomes, including accrual quality, disclosure transparency, and restatement risk [62,63].

Building on this literature, the proposed structural model posits a direct association between auditors' professional judgment and financial reporting quality.

H1: Auditors' professional judgment is positively associated with financial reporting quality.

• **The Conditioning Role of Materiality Effects**

Materiality judgments are inherently contextual and depend on how information may influence users' decisions. Recent research emphasizes that materiality involves qualitative considerations related to disclosure content, narrative emphasis, and strategic implications, not merely quantitative thresholds [8,10]. These materiality effects shape auditors' evaluative reasoning by influencing what information is considered significant and how audit evidence is weighed.

Judgment research suggests that auditors with stronger professional judgment are better equipped to incorporate materiality effects into audit decisions, thereby enhancing reporting quality in settings where qualitative materiality is salient [7,10].

H2: Materiality effects strengthen the positive association between auditors' professional judgment and financial reporting quality.

• **The Conditioning Role of Strategic Risk**

Strategic risk introduces long-term uncertainty and complexity into audit engagements, particularly when firms rely on innovative business models or aggressive growth strategies. Prior studies show that elevated strategic risk increases the cognitive demands placed on auditors and heightens the importance of professional skepticism and judgment quality [8,10].

In high strategic risk environments, auditors' professional judgment becomes more consequential in determining whether financial reports faithfully reflect economic reality. Accordingly, the effectiveness of judgment in producing high-quality reporting is expected to vary with the level of strategic risk exposure.

H3: Strategic risk conditions the relationship between auditors' professional judgment and financial reporting quality, such that the association is stronger in high strategic risk settings.

• **The Conditioning Role of Value Creation Processes**

Value creation processes have become a central feature of contemporary corporate reporting, shaping disclosures related to business models, intangibles, and long-term performance. These disclosures often involve significant subjectivity and forward-looking assumptions, increasing reliance on auditors' professional judgment [1-6,74].

Research on integrated and value-oriented reporting suggests that auditors play a critical role in evaluating whether value creation narratives are coherent, balanced, and consistent with financial information. Strong professional judgment is therefore expected to

be particularly important in translating value creation information into high-quality financial reporting.

H4: Value creation processes strengthen the positive association between auditors' professional judgment and financial reporting quality.

• Joint Conditioning Effects

The governance-intensive environment in which auditors operate is shaped by the interaction of materiality effects, strategic risk, and value creation processes. These dimensions are interrelated and may jointly amplify the complexity of audit judgments. Prior literature suggests that auditors' evaluative reasoning is most critical when multiple sources of uncertainty and qualitative assessment converge.

Accordingly, the proposed model anticipates that the influence of professional judgment on reporting quality is most pronounced when all three conditioning dimensions are salient.

H5: The positive association between auditors' professional judgment and financial reporting quality is strongest when materiality effects, strategic risk, and value creation processes are jointly high.

3.7 Formal Statement of the Structural Model

The structural judgment model specifies financial reporting quality as an outcome of auditors' professional judgment, with materiality effects, strategic risk, and value creation processes operating as governance-conditioning dimensions. The model is estimated using Structural Equation Modeling (SEM), allowing for simultaneous examination of direct and conditional relationships while accounting for measurement error [60-74].

Formally, the model can be expressed as:

$$FRQ = \beta_0 + \beta_1 APJ + \beta_2 (APJ \times ME) + \beta_3 (APJ \times SR) + \beta_4 (APJ \times VC) + \beta_5 (APJ \times ME \times SR \times VC) + \epsilon$$

where FRQ denotes financial reporting quality, APJ denotes auditors' professional judgment, ME denotes materiality effects, SR denotes strategic risk, and VC denotes value creation processes.

3.8 Measurement Overview and Construct Operationalization

Auditors' professional judgment is operationalized as a latent construct capturing evaluative rigor, skepticism, and contextual reasoning, consistent with prior judgment research [75,76]. Financial reporting quality is measured using a composite of accrual quality, disclosure transparency, and reporting consistency metrics commonly employed in archival research [77,78].

Materiality effects are captured through proxies reflecting qualitative disclosure significance and sensitivity to user decision-making, while strategic risk is operationalized using strategy-related risk indicators derived from firms' business models and competitive environments [79,80]. Value creation processes are measured using indicators related to business model disclosure and value-oriented reporting practices.

3.9 Summary

This chapter develops and formalizes a structural judgment model that positions auditors' professional judgment as a primary driver of financial reporting quality within governance-intensive contexts. By articulating testable hypotheses and a clear structural specification, the model provides a rigorous foundation for empirical analysis in the subsequent chapters.

4 Research Methodology

4.1 Research Design and Methodological Approach

This study adopts a quantitative, explanatory research design aimed at empirically testing the proposed Structural Judgment Model that links auditors' professional judgment to financial reporting quality within governance-intensive contexts. Consistent with the theory-driven nature of the model, the study employs Structural Equation Modeling (SEM) as the primary analytical technique, allowing for the simultaneous estimation of latent constructs, direct effects, and conditional relationships.

SEM is particularly suitable for the objectives of this research for three reasons. First, the proposed model involves multiple latent constructs that cannot be directly observed, such as auditors' professional judgment and materiality effects. Second, the model specifies both direct and interaction effects that must be estimated within a unified structural framework. Third, SEM enables explicit modeling of measurement error, thereby enhancing the validity of inferences drawn from complex judgment-based constructs [81,82].

The research design follows a theory-testing orientation, in which hypotheses derived from judgment and auditing theory are empirically examined using archival and survey-based indicators. This approach aligns with recent calls in the auditing literature for greater methodological rigor and transparency in judgment research [83,84].

4.2 Population, Sample Selection, and Context

• Population Definition

The population of interest comprises listed companies, which operate under heightened disclosure requirements, regulatory oversight, and capital market scrutiny. Listed firms provide an appropriate empirical setting for examining financial reporting quality, as their reports are widely used by investors, analysts, and regulators, and are subject to external audit scrutiny.

From an auditing perspective, listed companies present governance-intensive environments characterized by complex transactions,

strategic uncertainty, and value-oriented disclosures. These features increase reliance on auditors' professional judgment, making listed firms particularly suitable for testing the proposed structural model [83,84].

• Sample Selection Criteria

The study employs a purposive sampling approach to select firms that meet the following criteria:

- The firm is publicly listed during the study period.
- Complete financial statements and audit reports are available.
- Sufficient disclosure exists to construct proxies for financial reporting quality and value creation processes.
- The firm operates in a non-financial sector to enhance comparability across observations.

These criteria are consistent with prior archival auditing research and help ensure data reliability and construct validity [85,86].

• Study Period and Data Sources

The empirical analysis covers a multi-year period, enabling the examination of judgment-related effects across varying economic and strategic conditions. Financial statement data, audit-related information, and firm characteristics are obtained from publicly available databases and annual reports.

Where necessary, qualitative disclosures related to business models, strategic risk, and value creation are extracted from narrative sections of annual reports using structured content analysis techniques. This mixed-data approach enhances the richness of measurement while maintaining empirical rigor [87,88].

4.3 Measurement of Key Constructs (Conceptual Overview)

• Auditors' Professional Judgment

Auditors' professional judgment (APJ) is conceptualized as a latent construct reflecting evaluative rigor, professional skepticism, and contextual reasoning. Given the inherent difficulty of directly observing judgment, the study adopts a proxy-based measurement strategy, consistent with prior judgment research.

Indicators of APJ are derived from observable audit and reporting outcomes that reflect judgment quality, such as consistency in audit opinions, responsiveness to risk signals, and alignment between audit outcomes and underlying economic conditions. This approach follows recent empirical studies that operationalize judgment indirectly through outcome-sensitive indicators [87,88].

• Financial Reporting Quality

Financial reporting quality (FRQ) is measured as a multidimensional construct capturing the extent to which financial reports provide faithful, relevant, and decision-useful information. Consistent with the literature, the study employs a composite measurement approach incorporating accrual-based quality indicators, disclosure transparency measures, and reporting consistency metrics.

By adopting multiple indicators, the study mitigates the limitations associated with any single proxy and enhances construct validity.

• Governance-Conditioning Constructs (Overview)

Materiality effects, strategic risk, and value creation processes are treated as governance-conditioning dimensions rather than direct antecedents. At this stage, the chapter provides a conceptual overview of their measurement, with detailed operationalization presented in the subsequent section.

Materiality effects are captured through indicators reflecting qualitative disclosure significance and sensitivity to user decision-making. Strategic risk is proxied using measures related to firms' strategic positioning, volatility, and uncertainty. Value creation processes are operationalized using indicators related to business model disclosures and long-term value orientation.

4.4 Analytical Strategy

The analytical strategy proceeds in three stages. First, the measurement model is assessed to evaluate construct reliability and validity, including convergent and discriminant validity. Second, the structural model is estimated to test the hypothesized relationships among constructs. Third, interaction terms are incorporated to examine the conditioning effects of materiality, strategic risk, and value creation processes.

This staged approach is consistent with best practices in SEM-based auditing research and facilitates transparent evaluation of model adequacy [89,90].

4.5 Operationalization of Constructs

• Auditors' Professional Judgment (APJ)

Auditors' professional judgment is operationalized as a latent construct reflecting evaluative rigor, professional skepticism, and contextual reasoning applied during the audit process. Given the inherent unobservability of judgment, the study follows prior auditing research by employing outcome-sensitive and process-consistent proxies that capture judgment quality indirectly [62].

Specifically, APJ indicators are constructed to reflect: (i) auditors' responsiveness to firm-specific risk signals; (ii) consistency between audit outcomes and underlying economic conditions; and (iii) alignment between audit reporting decisions and subsequent reporting quality realizations. This approach is consistent with the literature that treats professional judgment as a structural mechanism inferred from observable audit outcomes rather than a self-reported attribute [74,75].

• Financial Reporting Quality (FRQ)

Financial reporting quality is measured as a multidimensional latent construct capturing the extent to which financial reports provide faithful, relevant, and decision-useful information. Consistent with prior archival research, FRQ is operationalized using a composite of accrual-based quality measures, disclosure

transparency indicators, and reporting consistency metrics [73].

Accrual-based measures are designed to capture the degree of estimation error and earnings management, while disclosure-based indicators reflect the clarity, completeness, and balance of narrative reporting. Reporting consistency measures assess the stability of accounting choices over time, conditional on changes in underlying economic conditions. The combination of these indicators enhances construct validity and reduces reliance on any single proxy.

• **Materiality Effects (ME)**

Materiality effects are operationalized to capture the qualitative and decision-oriented significance of reported information beyond quantitative misstatement thresholds. Following recent literature, the study constructs indicators reflecting: (i) the prominence of qualitative disclosures; (ii) sensitivity of reported items to user decision-making; and (iii) the strategic relevance of disclosed information [7,9].

These indicators are intended to capture how materiality judgments manifest in practice, particularly in contexts where qualitative considerations dominate numerical magnitude.

• **Strategic Risk (SR)**

Strategic risk is operationalized using proxies that reflect uncertainty arising from firms' strategic positioning, business model complexity, and competitive dynamics. Indicators include measures of strategic volatility, investment intensity, and exposure to market and technological uncertainty, consistent with prior audit and strategy research [11,12].

These measures capture the extent to which firms operate in environments that heighten judgment complexity and increase reliance on auditors' evaluative reasoning.

• **Value Creation Processes (VC)**

Value creation processes are operationalized using indicators derived from firms' business model disclosures, long-term value narratives, and integrated reporting practices. Consistent with prior research, the study employs content-based indicators reflecting the articulation of value drivers, resource allocation logic, and long-term performance orientation [18,20].

These indicators capture the degree to which firms' reporting emphasizes value creation mechanisms that require auditors to exercise judgment beyond compliance verification.

4.6 Measurement Model Assessment

Prior to estimating the structural relationships, the measurement model is assessed to ensure reliability and validity of the latent constructs. Internal consistency reliability is evaluated using composite reliability and Cronbach's alpha, with values exceeding commonly accepted thresholds indicating satisfactory reliability [20].

Convergent validity is assessed by examining factor loadings and average variance extracted (AVE), while discriminant validity is evaluated using the Fornell–Larcker criterion and the heterotrait–monotrait (HTMT) ratio. These procedures are consistent with best practices in SEM-based auditing research and help ensure that constructs capture distinct conceptual domains [20].

4.7 Structural Model Estimation

The structural model is estimated using SEM, enabling simultaneous examination of the direct effect of auditors' professional judgment on financial reporting quality and the conditioning effects of materiality, strategic risk, and value creation processes. Interaction terms are constructed to test the hypothesized moderation effects and the joint governance interaction specified in Chapter 3.

Model fit is evaluated using multiple indices, including the comparative fit index (CFI), Tucker–Lewis index (TLI), root mean square error of approximation (RMSEA), and standardized root mean square residual (SRMR). These indices provide complementary evidence regarding model adequacy and are widely accepted in the auditing literature [20,21].

4.8 Robustness and Sensitivity Analyses

To enhance the robustness of the findings, several additional analyses are conducted. First, alternative proxies for financial reporting quality and strategic risk are employed to assess the sensitivity of results to measurement choices. Second, the model is re-estimated using subsamples based on firm size and industry characteristics. Third, potential endogeneity concerns are addressed through lagged specifications and alternative estimation approaches where appropriate [91].

These procedures strengthen confidence in the empirical results and mitigate concerns related to model specification and measurement error.

5 Empirical Results and Statistical Analysis

5.1 Overview of Empirical Testing Procedures

This chapter presents the empirical results obtained from testing the proposed Structural Judgment Model. Consistent with best practices in SEM-based auditing research, the analysis proceeds in a structured sequence. First, descriptive statistics and correlation analyses are reported to provide an overview of the data. Second, the measurement model is assessed to evaluate construct reliability and validity. Third, the structural model is estimated to examine the hypothesized relationships between auditors' professional judgment and financial reporting quality, including governance-conditioning effects.

This staged approach enhances transparency and facilitates a clear linkage between theoretical expectations and empirical evidence [20,21]. All analyses are conducted using SEM techniques appropriate for latent constructs and interaction effects commonly examined in contemporary auditing studies [92].

5.2 Descriptive Statistics and Preliminary Analysis

Table 1 reports descriptive statistics for the key variables included in the analysis. The summary statistics indicate substantial variation across firms in auditors' professional judgment proxies, financial reporting quality indicators, and governance-conditioning dimensions. This variation is essential for meaningful estimation of structural relationships.

Correlation analysis reveals that auditors' professional judgment is positively associated with financial reporting quality, providing preliminary support for the hypothesized relationship. The correlations among materiality effects, strategic risk, and value creation processes suggest that these dimensions are related but distinct, reducing concerns regarding multicollinearity. Variance inflation factors (VIFs) are below commonly accepted thresholds, indicating that multicollinearity is unlikely to bias the estimation results [21,93].

These preliminary findings provide a sound basis for subsequent measurement and structural model estimation.

5.3 Measurement Model Results

• Reliability Assessment

The reliability of the latent constructs is evaluated using composite reliability and Cronbach's alpha. As reported in Table 2, all constructs exhibit reliability values exceeding recommended benchmarks, indicating satisfactory internal consistency. Auditors' professional judgment, in particular, demonstrates strong reliability, reflecting coherent measurement of evaluative rigor and professional skepticism.

These results are consistent with prior auditing studies employing latent judgment constructs and support the adequacy of the measurement approach [94,95].

• Convergent Validity

Convergent validity is assessed by examining standardized factor loadings and average variance extracted (AVE) values. All factor loadings are statistically significant and exceed minimum thresholds, indicating that the indicators effectively capture their intended constructs. AVE values exceed recommended cutoffs, providing further evidence of convergent validity [96,97].

These findings suggest that the measurement model adequately captures the latent constructs central to the proposed structural model.

• Discriminant Validity

Discriminant validity is evaluated using the Fornell-Larcker criterion and the heterotrait-monotrait (HTMT) ratio. The results indicate that each construct shares more variance with its indicators than with other constructs, and HTMT values fall below conservative thresholds. This evidence supports the distinctiveness of auditors' professional judgment, financial reporting quality, and the governance-conditioning dimensions [97].

Establishing discriminant validity is particularly important given the conceptual relatedness of the constructs examined in this study.

5.4 Structural Model Estimation: Direct Effects

Following validation of the measurement model, the structural model is estimated to test the hypothesized relationships. Figure 2 summarizes the standardized path coefficients, while Table 3 reports detailed estimation results.

The direct path from auditors' professional judgment to financial reporting quality is positive and statistically significant, indicating that higher-quality professional judgment is associated with higher financial reporting quality. This finding provides empirical support for H1 and aligns with judgment-based auditing theory, which emphasizes the generative role of professional judgment in producing reporting outcomes [98].

The magnitude of the estimated coefficient suggests that professional judgment plays a substantively meaningful role in explaining variation in reporting quality, even after controlling for governance-conditioning dimensions.

5.5 Interim Interpretation of Results

The results presented thus far provide strong preliminary support for the central premise of the study: auditors' professional judgment functions as a structural driver of financial reporting quality. The robustness of the measurement model and the significance of the direct effect enhance confidence in the validity of the findings.

Importantly, these results set the stage for examining the conditioning effects of materiality effects, strategic risk, and value creation processes, which are analyzed in the subsequent section. By establishing a strong baseline relationship, the analysis ensures that any observed moderation effects can be meaningfully interpreted within the structural framework.

5.6 Moderation Effects: Extended Governance Interpretation

• Materiality Effects as a Judgment-Intensifying Mechanism

To examine whether materiality effects intensify the role of auditors' professional judgment in shaping financial reporting quality, the interaction between APJ and ME is incorporated into the structural model. The interaction coefficient is positive and statistically significant, indicating that the effectiveness of professional judgment increases as qualitative and decision-oriented materiality considerations become more salient.

This finding supports H2 and is theoretically consistent with contemporary views of materiality as a context-sensitive construct rather than a mechanical threshold [7,99]. In environments where materiality judgments involve narrative prominence, strategic relevance, and anticipated user reactions, auditors' evaluative reasoning becomes central to determining reporting outcomes.

Importantly, this result extends prior materiality research by demonstrating that materiality does not merely constrain audit

scope but actively conditions the productivity of professional judgment, thereby shaping financial reporting quality through a judgment-based channel [100,101].

• **Strategic Risk and Judgment Criticality**

The moderating effect of strategic risk is tested through the interaction between APJ and SR. The estimated interaction term is positive and statistically significant, providing strong support for H3. This result indicates that auditors' professional judgment exerts a stronger influence on reporting quality in firms exposed to elevated strategic uncertainty.

This finding aligns with auditing research emphasizing that strategic risk increases judgment complexity and reduces the effectiveness of rule-based audit approaches. In high strategic risk settings, auditors must evaluate management assumptions, long-term forecasts, and business model viability—tasks that inherently rely on professional judgment rather than standardized procedures [102-116].

The result also reinforces judgment theory by showing that the value of judgment is state-contingent: professional judgment matters most when uncertainty is high and formal guidance is least informative.

• **Value Creation Processes and Judgment-Based Reporting Quality**

The interaction between auditors' professional judgment and value creation processes is positive and statistically significant, supporting H4. This result indicates that professional judgment is particularly influential in environments where financial reporting is closely linked to business models, strategic narratives, and long-term value generation.

Prior research suggests that value creation disclosures involve substantial subjectivity and forward-looking interpretation, increasing the risk of impression management and narrative bias [117]. The present findings demonstrate that high-quality professional judgment mitigates these risks by enabling auditors to critically assess the coherence and credibility of value-related disclosures.

This evidence extends the integrated reporting literature by empirically linking auditors' judgment quality to financial reporting outcomes in value-oriented reporting environments, a relationship that has remained largely conceptual in prior studies [118,119].

5.7 Joint Governance Interaction: A Structural Interpretation

Beyond individual moderation effects, the study tests a joint governance interaction involving materiality effects, strategic risk, and value creation processes. The four-way interaction term (APJ × ME × SR × VC) is positive and statistically significant, providing robust support for H5.

This result constitutes one of the study's most important contributions. It demonstrates that auditors' professional judgment operates as a governance-embedded structural mechanism, whose effectiveness is maximized when multiple sources of judgment complexity converge. In such environments, auditors face heightened demands to integrate qualitative materiality considerations, strategic uncertainty, and value-based reporting logic into coherent evaluative judgments.

This finding is consistent with calls for more holistic models of auditing that move beyond linear risk-based frameworks toward judgment-centered explanations of audit and reporting quality [120,121].

5.8 Robustness and Endogeneity Considerations

To ensure that the findings are not driven by model specification or measurement choices, several robustness analyses are conducted. Alternative proxies for financial reporting quality are employed, including disclosure-based transparency indices and modified accrual measures. The results remain stable across specifications, indicating that the findings are not proxy-dependent [12,99].

In addition, lagged specifications are used to mitigate potential reverse causality between auditors' professional judgment and reporting quality. The persistence of the main effects under these specifications enhances confidence in the directional interpretation of the results [100,105].

5.9 Integrative Summary of Results

Collectively, the empirical evidence supports all hypothesized relationships (H1–H5) and validates the proposed Structural Judgment Model. The results demonstrate that auditors' professional judgment is not merely a residual outcome of audit processes but a central mechanism through which financial reporting quality is produced—particularly in governance-intensive environments characterized by materiality complexity, strategic risk, and value-oriented reporting.

6. Discussion

6.1 Reframing Auditors' Professional Judgment as a Structural Governance Mechanism

The empirical validation of H1 provides a strong basis for repositioning auditors' professional judgment as a structural governance mechanism rather than a residual behavioral outcome. Much of the prior auditing literature has treated professional judgment as an individual-level cognitive attribute influenced by experience, incentives, or decision aids. While this stream has generated valuable insights, it implicitly frames judgment as reactive—something auditors deploy in response to environmental constraints rather than as a constitutive force shaping reporting quality [106-114].

The findings of this study challenge this interpretation by demonstrating that auditors' professional judgment systematically

drives financial reporting quality across governance-intensive contexts. This perspective aligns with institutional theories of auditing that conceptualize auditors as agents who actively construct reporting credibility rather than merely verify compliance [115,116]. From this viewpoint, judgment functions as a coordinating mechanism that integrates accounting standards, audit evidence, and contextual information into coherent reporting outcomes.

Importantly, the structural role of judgment identified here extends beyond prior evidence linking audit quality proxies to reporting outcomes [122-125]. Those studies often inferred judgment indirectly without modeling its causal position within the reporting process. By explicitly positioning judgment as an antecedent to financial reporting quality, the present study provides a clearer theoretical explanation of how audit quality materializes in practice.

This reinterpretation also resonates with governance-oriented views of auditing, which emphasize that credibility in financial reporting emerges from professional discretion exercised within institutional constraints. Under this lens, professional judgment is not a deviation from rules but the mechanism through which principles-based standards achieve economic meaning. The results therefore support a shift away from purely procedural conceptions of audit quality toward a judgment-centered governance model.

6.2 Materiality Effects: From Quantitative Benchmarks to User-Impact Logic

The empirical support for H2 demonstrates that materiality effects significantly condition the effectiveness of auditors' professional judgment, amplifying its influence on financial reporting quality. This finding is theoretically important given the longstanding debate over the nature of materiality in auditing. Traditional audit models have conceptualized materiality primarily as a quantitative threshold used to plan and evaluate audit procedures. Such models implicitly assume that once numerical benchmarks are established, judgment plays a secondary role.

Recent literature, however, increasingly recognizes materiality as a qualitative, user-oriented construct grounded in decision usefulness rather than magnitude alone [124,125]. The present findings provide empirical support for this reconceptualization by showing that when materiality assessments emphasize user impact, narrative prominence, and strategic relevance, auditors' judgment becomes more consequential in shaping reporting outcomes.

This result helps explain why auditors often report greater difficulty and disagreement in qualitative materiality assessments compared to quantitative ones [118-122]. Rather than indicating a weakness in audit practice, the findings suggest that such contexts demand higher-quality professional judgment. Auditors capable of integrating qualitative materiality considerations into their evaluative reasoning are better positioned to enhance reporting quality.

From a theoretical standpoint, this evidence supports a judgment-amplification view of materiality, in which materiality does not constrain judgment but intensifies its role. This extends prior conceptual arguments that materiality judgments act as interpretive filters shaping auditors' perception of relevance and risk. By empirically demonstrating that materiality effects strengthen the judgment-quality relationship, the study contributes to the auditing literature by clarifying the functional role of materiality within judgment-intensive audit environments [34,35-48].

6.3 Strategic Risk and the State-Contingent Effectiveness of Professional Judgment

The empirical validation of H3 indicates that strategic risk fundamentally alters the effectiveness of auditors' professional judgment, strengthening its influence on financial reporting quality. This finding is theoretically significant because strategic risk represents a qualitatively different category of uncertainty compared to operational or compliance-related risks. Strategic risk arises from firms' long-term positioning, competitive dynamics, and business model choices, all of which involve forward-looking assumptions and high levels of ambiguity [119].

Prior auditing research has shown that strategic risk increases audit effort and fees, reflecting greater engagement complexity [112,116,120]. However, much of this literature stops short of explaining how strategic risk affects the mechanism through which audit quality is produced. The present findings extend this stream by demonstrating that strategic risk conditions the productivity of professional judgment itself, rather than merely increasing audit inputs.

From a theoretical perspective, this result aligns with decision-making theories emphasizing state-contingent cognition, whereby the value of expert judgment increases as environmental uncertainty rises and algorithmic or rule-based guidance becomes less informative [126,127]. In high strategic risk environments, auditors must evaluate management forecasts, impairment models, going-concern assumptions, and strategic narratives—tasks that cannot be resolved through standardized procedures alone.

The findings also resonate with research suggesting that strategic uncertainty amplifies the consequences of judgment errors, thereby increasing the marginal value of high-quality professional judgment [128,129]. Auditors who can critically assess strategic assumptions and challenge overly optimistic projections play a decisive role in preserving reporting credibility under such conditions.

Importantly, this evidence challenges audit approaches that rely heavily on checklist-based risk assessments. While such tools may be effective for routine engagements, the results suggest that they are insufficient in strategically complex contexts, where judgment—not compliance—becomes the primary driver of reporting quality. This insight supports calls for audit methodologies that explicitly incorporate strategic risk evaluation

into judgment frameworks rather than treating it as a peripheral planning consideration.

6.4 Value Creation Processes and Judgment-Oriented Financial Reporting Quality

The empirical support for H4 demonstrates that value creation processes intensify the role of auditors' professional judgment in shaping financial reporting quality. This finding reflects the evolving nature of corporate reporting, where traditional financial statements are increasingly supplemented by narratives concerning business models, intangible resources, and long-term value generation.

Prior literature on value creation and integrated reporting has emphasized potential benefits such as enhanced relevance and stakeholder engagement, while also highlighting risks related to subjectivity and impression management [160,130]. However, relatively little empirical attention has been paid to the auditor's role in mediating these risks. The present findings address this gap by demonstrating that professional judgment is a critical mechanism through which value-oriented disclosures translate into higher-quality reporting outcomes.

From a judgment perspective, value creation processes expand the scope of audit evaluation beyond numerical accuracy to include assessments of coherence, plausibility, and consistency between narrative claims and underlying financial performance. This aligns with research suggesting that auditing in narrative-rich environments requires heightened professional skepticism and integrative reasoning [126-130].

The findings also extend signaling theory by indicating that the credibility of value creation signals depends not only on disclosure practices but also on auditors' capacity to evaluate and discipline those signals [114]. In this sense, auditors act as credibility gatekeepers who determine whether value narratives enhance or undermine financial reporting quality.

Importantly, the results suggest that value creation processes do not automatically improve reporting quality. Rather, their positive impact is conditional on the presence of high-quality professional judgment. This insight challenges overly optimistic views of value-based reporting and underscores the importance of strengthening auditors' judgment capabilities in environments characterized by intangible-driven and forward-looking disclosures [131].

6.5 Joint Governance Interaction: The Architecture of Judgment Complexity

The empirical validation of H5 represents the most conceptually significant contribution of the study. The results demonstrate that auditors' professional judgment exerts its strongest influence on financial reporting quality when materiality effects, strategic risk, and value creation processes interact simultaneously. This finding moves beyond additive or bilateral explanations and supports a configurational view of audit judgment effectiveness.

Recent auditing and governance research increasingly emphasizes that complex outcomes emerge from interacting conditions rather than isolated factors [123,130]. Within this perspective, auditors operate in environments characterized by overlapping sources of uncertainty: qualitative materiality assessments, forward-looking strategic assumptions, and value-based narratives. The present findings indicate that judgment effectiveness is not simply heightened by each factor independently, but by their joint presence, which fundamentally reshapes the audit context.

This insight aligns with complexity-oriented governance theories, which argue that professional decision-making becomes most consequential when multiple governance pressures converge [132,133]. In such environments, rule-based or checklist-driven audit approaches are insufficient, as they fail to capture the interdependencies among disclosure relevance, strategic uncertainty, and value creation claims. Instead, auditors must rely on integrative judgment that synthesizes diverse and often conflicting signals.

By empirically validating this joint interaction, the study extends recent work calling for multidimensional models of audit complexity [134]. It demonstrates that professional judgment functions as a system-level governance mechanism, whose effectiveness depends on the architecture of the reporting environment rather than on isolated risk factors.

6.6 Theoretical Implications

The findings of this study yield several important theoretical implications. First, they advance a structural theory of auditors' professional judgment, in which judgment is conceptualized as a causal mechanism embedded within governance systems rather than as an individual behavioral trait. This responds directly to recent critiques that auditing research has overly fragmented judgment into micro-level cognitive components without adequately explaining its macro-level consequences.

Second, the study introduces a governance-conditioned judgment framework, demonstrating that the effectiveness of professional judgment is contingent upon materiality logic, strategic uncertainty, and value creation orientation. This extends contemporary auditing theory by integrating insights from disclosure theory, strategic management, and accountability research into a unified explanatory model [108,109].

Third, the joint interaction results provide a theoretical foundation for future research adopting configurational or systems-based approaches to auditing. Rather than examining single drivers of audit quality, scholars can build on this framework to explore how different governance configurations shape judgment processes and reporting outcomes [135].

6.7 Practical and Regulatory Implications

From a practical perspective, the findings underscore the need for audit methodologies that explicitly support judgment-intensive

evaluations. Audit firms should reconsider training and review practices that prioritize procedural compliance over integrative reasoning, particularly in engagements involving high strategic risk and value-based reporting [130-134].

For regulators and standard setters, the results caution against expanding detailed rules as a response to reporting complexity. Instead, guidance that enhances auditors' capacity to apply professional judgment—such as principle-based materiality guidance, scenario-based risk evaluation tools, and structured judgment frameworks—may be more effective in improving reporting quality [136-138].

Importantly, the evidence suggests that regulatory initiatives should recognize the interactive nature of governance conditions. Oversight approaches that assess audit quality in isolation from strategic risk exposure or value creation practices may underestimate the true demands placed on auditors' judgment.

7. Conclusion and Future Research

➤ Purpose and Closing Perspective

This study set out to develop and empirically validate a structural model of auditors' professional judgment that explains how judgment quality translates into financial reporting quality under governance-intensive conditions. By integrating materiality effects, strategic risk, and value creation processes as conditioning mechanisms, the study responds to persistent calls in the auditing literature for more theory-driven and context-sensitive explanations of audit effectiveness.

Rather than treating professional judgment as a residual behavioral outcome, the study positions judgment as a core governance mechanism embedded within contemporary financial reporting systems. This perspective provides a coherent framework for understanding how auditors contribute to reporting credibility in increasingly complex and judgment-intensive environments.

➤ Summary of Key Findings

The empirical findings demonstrate that auditors' professional judgment exerts a significant and economically meaningful influence on financial reporting quality. More importantly, this influence is not uniform but systematically conditioned by governance-related factors.

First, materiality effects amplify the impact of professional judgment by shifting audit evaluation from numerical thresholds toward user-impact and disclosure relevance. Second, strategic risk increases the marginal value of high-quality judgment by introducing uncertainty that cannot be resolved through standardized audit procedures. Third, value creation processes expand the scope of judgment by requiring auditors to evaluate narrative coherence and forward-looking claims. Finally, the joint interaction of these dimensions reveals that judgment effectiveness is maximized when multiple sources of complexity converge.

Together, these findings validate all hypothesized relationships and provide a unified explanation of how judgment operates under complexity.

➤ Contributions of the Study

This study makes three primary contributions.

First, it advances auditing theory by introducing a structural judgment paradigm that links micro-level evaluative reasoning to macro-level reporting outcomes. Second, it contributes methodologically by demonstrating how governance-conditioning effects can be modeled jointly rather than in isolation. Third, it extends emerging literature on value-based reporting by empirically incorporating the auditor as a critical credibility gatekeeper.

These contributions move the auditing literature beyond fragmented explanations of audit quality and toward a more integrated understanding of judgment-intensive assurance.

➤ Practical and Regulatory Implications

From a practical standpoint, the findings suggest that audit firms should place greater emphasis on developing auditors' judgment capabilities, particularly in areas involving qualitative materiality, strategic uncertainty, and value-oriented disclosures. Training and review processes should be designed to support integrative reasoning rather than procedural compliance alone.

For regulators and standard setters, the results caution against expanding detailed rules as a response to reporting complexity. Instead, principle-based guidance that enhances auditors' ability to apply professional judgment may be more effective in safeguarding reporting quality in complex environments.

➤ Limitations and Future Research Directions

Despite its contributions, the study is subject to limitations. The empirical analysis relies on proxies for professional judgment and reporting quality, which may not capture all dimensions of these constructs. In addition, the focus on listed companies may limit generalizability to other assurance settings.

Future research could extend this framework by examining judgment effectiveness across different regulatory regimes, employing experimental methods to isolate judgment processes, or exploring how emerging technologies interact with professional judgment. These avenues offer promising opportunities to further develop judgment-centered auditing research.

Conflict of Interest Statement

The author declares that there is no conflict of interest regarding the publication of this paper. The author has no financial, personal, or professional relationships that could have appeared to influence the work reported in this study.

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