THE EFFECT OF AUDIT CHARACTERISTICS ON FINANCIAL REPORTING QUALITY AND THE MEDIATING ROLE OF AUDIT QUALITY: EVIDENCE FROM MALAYSIAN PUBLIC COMPANIES

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ABSTRACT

Our paper examines the effect of audit characteristics on financial reporting quality (FRQ) and the role of audit quality (AQ) as a mediator. The study adopted 201 companies listed in Malaysian Bursa from 2017 to 2019 to achieve our objective. The study used Stata to analyze the data to estimate the effect proposed in the hypotheses. Findings show that only audit fees affected FRQ positively. At the same time, audit fees and company size have positively influenced AQ. On the other hand, AQ has improved the link between audit characteristics and FRQ since the results show a positive effect of audit tenure, audit fees, and audit company size on FRQ through the mediator. This research can help the Institute of Internal Auditors and the Association of Certified Fraud Examiners improve their rules and regulations by enhancing audit characteristics, technical competence, and functionality to help organizations improve AQ. The study's findings are relevant to governments and investors worldwide worried about FRQ and want to guarantee that operations in Malaysia and other emerging markets are closely monitored.

Keywords: Audit characteristics, Financial reporting quality, Audit quality, Malaysian companies.

Submission: 22nd January 2023
Accepted: 30th January 2024
https://doi.org/10.33736/ijbs.6920.2024

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1. INTRODUCTION

Malaysia was rocked by the 1 Malaysia Development Berhad (1MDB) case, and financial reporting quality (FRQ), audit quality (AQ), and audit characteristics (AC) have become hot topics in the auditing industry. Moreover, the financial reporting quality (FRQ) is considered the fundamental pillar for the financial markets, and the resources are allocated efficiently through the information. When a company's performance is not disclosed, and the reported earnings are not actual, the individual employees, firms, stakeholders, and the economy will face massive losses. Since several financial reporting fraud cases involving billions of dollars are publicized yearly, and some organizations go bankrupt, almost every country has implemented legislation mandating all enterprises to audit their financial reports yearly (Association of Certificate Fraud Examiners, 2017). Toshiba, Cendant, Satyam Computer Limited, WorldCom, and Enron are just a handful of the multibillion-dollar companies shattered by financial reporting deception (Mahama, 2015). Financial statements have always been a fundamental means of communicating information for all related parties and an essential tool that assesses the firm's financial performance to observe the management's decision-making behaviors (Nguyen, 2023). Consequently, it has been highlighted by several parties that external auditors, audit quality, and FRQ can play crucial roles in the various financial scandals.

An external audit is an external body appointed by the shareholders to investigate the company's financial accounts. The primary responsibility of the external audit is to prepare the annual statutory audit of the financial accounts and decide whether the accounts accurately reflect the company's financial position. However, the impact of external audit quality on FRQ is not direct. External auditors do not directly produce financial reporting but only examine and comment on a firm's financial reporting. A higher-quality external audit can quickly detect fraud, errors, or earning management activities (Azzam et al., 2020), and the unfavorable conclusions of external auditors can directly affect the company's executive members. Therefore, under the pressure of external audit, executive members tend to improve the quality of internal control, giving more consideration to regulatory compliance in the decision-making process. Salehi et al. (2022) believe that the main objective of the external auditor is to ensure the AQ by highlighting violations in the client's accounting system if fraud or misleading is discovered during the audit process. Besides, AQ reflects the level of assurance obtained by the audit firms through data that express the fact that the financial reports reflect the actual companies' economic situation of the company (Ngo & Nguyen, 2022). Therefore, the main goal of most auditing firms is to provide an efficient auditing service and to confirm that the financial statements are empty from manipulation; thus, improving AQ is to improve FRQ.

According to Zarinah (2007), financial data is a fundamental instrument for analyzing Malaysian investors' actions. Investors will remain exposed to financial reporting misstatements and fraud if auditors fail to conduct AQ. As a result, MSC will continue to be concerned about the quality of the information in financial reports, particularly for Malaysian publicly traded companies, to maintain their standard. According to the chairman, quality is essential for the state's security market efficiency, economics, and financial reporting output. Nonetheless, 1 Malaysia Development Berhad's (1MDB) misconduct has disreputed Malaysia in the auditing world's eyes.

As a result of the departure of three key Big 4 audit firms, notably Ernst & Young, Dutch company KPMG in the Netherlands, and Delloite in the United Kingdom, this corporation's FRQ and AQ have become dubious. This argument explains why and how 1MDB's financial reports for two crucial years (2013 - 2014) were not quoted because the words were no longer trusted (2013 - 2014) were not cited because the words were no longer trusted (Nation, 2018). According to Sukumaran (2019), the Malaysian Securities Commission reprimanded and penalized Deloitte for violating audit reporting regulations and failing to deliver certified financial reports, totaling roughly US$535,000. Apart from 1MDB, other firms implicated in an FRQ fraud case include Welli Multi Corporation Berhad, fined RM400,000 and sentenced to 6 months in prison after publishing a false financial report that was audited. Due to these incidents, stakeholders, management, and the general public have reservations about the AQ and FRQ. As a result of these instances, stakeholders, management, and the general public have voiced misgivings regarding the AQ and FRQ. According to the discussion above, our paper aims to examine the effect of audit characteristics on FRQ and the role of AQ as a mediator. Although AQ and audit characteristics (Audit Tenure, Audit Fees, Audit Firm Size, and Audit Partner Rotation) have been highlighted as significant drivers of FRQ in the past, there is little evidence to support AQ as a mediator for FRQ. As a result, this study aims to determine if AQ can be employed as a mediator in the context of audit characteristics and FRQ to assist researchers in learning more and filling a research gap.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Audit Tenure and FRQ

The possibility of fraudulent financial statements is associated with the auditor's ignorance of the client's company; according to Carcello and Nagy (2004), critics of firm audit rotation expect that the rate of false financial reporting will be highest early in the audit-client relationship and lowest after a lengthy period of audit tenure. Furthermore, Chu et al. (2018) argued that the accuracy of earnings predictions improves as an auditor's tenure grows and they get more client-specific experience; in this regard, they show in their study that a more extended auditor–client relationship leads to less financial reporting bias. Kalabeke et al. (2019) studied 280 non-financial Pakistan companies over the 2008-2017 period. They stated that organizations with additional extended audit firm tenures are negatively associated with earnings management activities, suggesting a more distinguished FRQ. This could be justified that the longer the duration between the auditing firm and the client, the better the auditor competency, which will make the auditor more informative about their clients' environment in business; thus, better audit quality will be performed and better financial reporting quality by being more conservative. Moreover, the financial reporting quality information was also important to be recognized by the shareholders to optimize their business activities (Sadaa et al., 2022). As a consequence, the study hypothesized that:

H1: Audit tenure is influencing FRQ positively.

2.2. Audit Fee and FRQ

The higher amount paid as audit fees implies that the auditors offer more professional auditing services to the clients instead of paying lower fees. On the other hand, the accounting literature review indicates that most variables used in audit fee determination models are based on business

and monitoring factors readily observed and factored in by market participants (Xu et al., 2023). The key benefit of using audit fees is that it may provide continuous variables that can capture elusive AQ fluctuations while not restricting the sample to small enterprises (Fredriksson et al., 2018). Furthermore, audit fees can give fee premium catches, in which customers are prepared to pay for anything value connected to financial report quality authentication, enhancing supervisory control via excellent AQ or lowering the danger of fraudulent activity in the organization. The audit fees increase, the audit quality may increase, restatements and accruals may decrease, and auditors may be better at detecting earnings management as they may have incentives to work with better performance, thus causing a higher financial reporting quality. According to Cahan and Sun (2015), Audit fees show a favorable relationship with FRQ, which supports the premise. Therefore, the study assumes that:

H2: Audit fees are influencing FRQ positively.

2.3. Audit Firm Size and FRQ

According to previous research, the size of an audit company is linked to a successful FRQ. Compared to small audit firms, Francis and Yu (2009) found that large ones had more excellent "in-house" expertise dealing with publicly traded corporations. To maintain a high level of AQ, larger audit firms must spend on training and technology to keep auditees up to speed on the latest information and guarantee that they deliver a clean and clear financial report (Comprix & Huang, 2015). When distinguishing between Big 4 and non-Big four audit firms. Many significant corporations, mainly publicly traded ones, advise hiring Big Four firms to investigate quality issues (Jain & Agarwalla, 2022). The Big 4 audit firms may be more independent. They may provide a higher quality of audit than the non-big 4 audit firms, as they have better technologies, financial resources, more competent auditors, and a reputation they want to preserve. Thus, they are more likely to detect and report misstatements in the client's financial statements, causing high financial reporting quality. This leads to the conclusion that big audit firms are better at detecting severe problems in financial reports than small ones. As a result, the following hypothesis was developed:

H3: Audit firm size influences FRQ positively.

2.4. Audit Partner Rotation and FRQ

Audit rotation proponents argue that it can help improve the FRQ. Some research, such as that undertaken by Hamilton et al. (2005), has validated this claim, indicating that audit partner rotation can reduce discretionary accruals, resulting in improved profit management in the financial report. Furthermore, Horton et al. (2021) discovered that changing audit partners enhances earnings-based FRQ and market perceptions of earnings in the United States. In this context, Rong (2017) claimed that requiring audit partner rotation will introduce fresh viewpoints and reduce the chance of auditors delivering incorrect judgments only to appease their clients. As a result, the hypothesized will be as follows:

H4: Audit partner rotation is influencing FRQ positively.

2.5. Audit Tenure and AQ

Effective audits depend on accumulating considerable knowledge in customer-specific work over a lengthy relationship with the client. In this regard, Chu et al. (2018) argue that as the auditor's

tenure increases and they gain more client-specific knowledge, the accuracy of earnings projections improves, lowering the estimated costs of any misstatement, especially overstatement. Hiring the same audit firm for a long time is beneficial. Longer audit tenure enables the audit firm to become more familiar with the client's business and environment, thus streamlining the audit process. The audit firm can conduct a more effective and efficient audit after it has passed several audit cycles because they had gained institutional knowledge of the client throughout the engagement periods (Kim et al., 2023). As a result, her downward bias will be reduced; in other words, a longer auditor tenure increases the quality of reporting. To believe that a lengthy connection with a customer implies an underlying desire for knowledge is essential for high-quality audits of interlocking businesses. As a result, the study hypothesized that:

H5 Audit tenure influences AQ positively.

2.6 Audit Fee and AQ

Many explanations for the positive association include: one, the high audit fees may reflect additional time and auditor's effort in achieving high audit quality or compensate for potential future litigation (risk pricing theory). Two, the high audit fees increase the auditor's investment in reputation, which the firm may be unwilling to tarnish for client's financial manipulations, resulting in high audit quality (reputational theory). With the growth of agency problems, investors are looking for high-quality audits (Yatim et al., 2006). On the other hand, auditors impose audit fees based on the complexity of the company's data to ensure that financial reports are distortion-free. So, it was found that auditing firms charge higher fees for a higher quality audit. Cho et al. (2021) also found that auditors are more committed to providing a high level of audit quality, especially since they will receive more audit fees. This makes them keep providing acceptable services for fear of losing their high fees (Ganesan et al., 2019). Accordingly, we assume that:

H6 Audit fees is influences AQ positively.

2.7. Audit Firm Size and AQ

The audit firm size is a cautious indicator of AQ. According to El Guindy and Trabelsi (2020), AQ might rise in tandem with audit company size since it is assumed that the larger the audit firm, the more information accessible to undertake the audit service. Previous studies indicate that large audit firms have a greater chance of giving high audit quality based on their great experience and brand reputation than small audit firms (Choi et al., 2010). The Big 4 audit firms may be more independent. They may provide a higher quality of audit than the non-big 4 audit firms, as they have better technologies, financial resources, more competent auditors, and a reputation they want to preserve. Thus, they are more likely to detect and report misstatements in the client's financial statements, causing high financial reporting quality (Lin et al., 2014). The four major audit firms, Ernst & Young, Delloite, PricewaterhouseCoopers (PWT), and KPMG, are commonly included in audit firm size analyses. In contrast, other audit companies are classified as non-big 4 audit firms. Thus, our hypothesized is:

H7 Audit firm size influences AQ positively.

2.8. Audit partner rotation and AQ

The rational argument for mandatory auditor rotation and audit quality is that restricting the number

of years an audit partner works with a client limits the extent of familiarity between the audit partner and the firm. In this regard, Martani et al. (2021) argue that audit partner rotation develops more independence and skepticism since familiarity risks between auditors and their respective consumers are reduced. This is crucial because a lack of auditor independence and skepticism is often regarded as the primary cause of most audit failures. According to the conclusions of Australian research for a 9-year financial report, when the partner's interpersonal interaction with the client's corporate CEO is extensive, the AQ suffers. On the other hand, Aguilar et al. (2018) suggested that mandated audit partner rotation has destroyed a client's specialized knowledge. When a partner or business changes, one of the causes for the absence of quality grows. This research is based on the theory that implementing audit partner rotation will provide fresh viewpoints, reducing the risk of auditors delivering incorrect judgments to gratify their clients (Rong et al., 2017). As a result, our hypothesis is:

H8 Rotating audit partners influences AQ positively.

2.9. The effect of AQ on FRQ

Discretionary accruals are the most often utilized metric of FRQ. Kasznik (1999) developed this model based on the study of Jones (1991). At the same time, AQ is determined by unusual working capital accruals (Singh et al., 2021). On the other hand, AQ is a metric based on unusual working capital accruals (Fredriksson et al., 2018). The difference between actual capital accruals for the current year and the capital accruals level expected for the prior year's capital accruals to the sales ratio for each business year is calculated using the AQ proxy. It is expected to reverse the computation of abnormal working capital accruals against future earnings, shifting profit across reporting periods. A better level of FRQ is assumed to be reflected in a higher level of discretionary accruals. Early research, such as (DeFond & Zhang, 2014), shows that corporations willingly engage in external audits when significant agency issues exist. Later research used auditor reputation or brand name as a measure of AQ, discovering that agencies choose auditors with a better reputation. As a consequence, our hypothesis is:

H9 AQ influences FRQ positively.

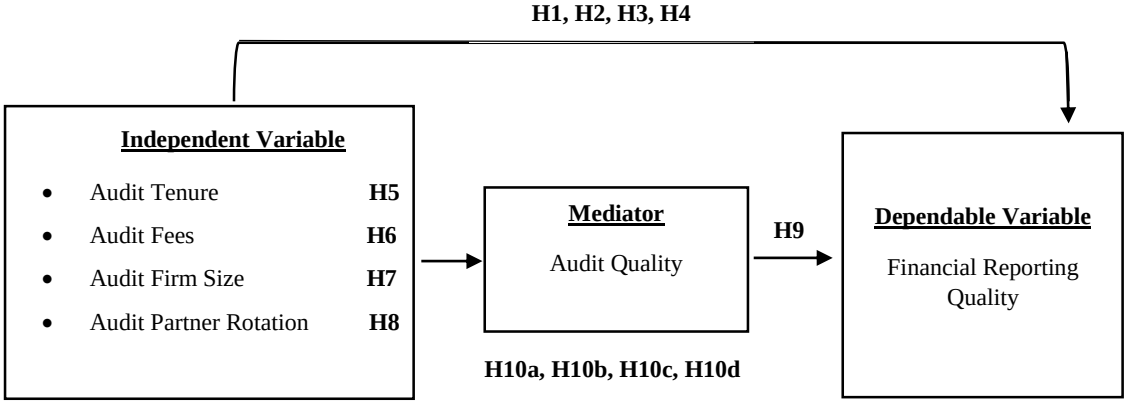
2.10. Audit Quality as a Mediating

Examining the connection between audit quality and FRQ is based on the belief that auditor characteristics play a primary role in defining audit quality, which may impact FRQ efficiency. As a result, our study designs and tests a model that demonstrates relationships between auditor characteristics and FRQ (Salma et al., 2019), auditor characteristics and audit quality (Martani et al., 2021), and audit quality and FRQ (Ngo & Nguyen, 2022). Audit quality is assumed to mediate the connection between auditor characteristics and FRQ in the suggested model. The mediating role helps preserve the links between audit characteristics and FRQ, influencing audit quality. The association between the auditor characteristics as independent variables influences audit quality as a mediating variable, subsequently impacting FRQ as a dependent variable. The findings support audit firms' claims that audit fees reflect auditors' effort to produce high-quality audit reports or vice versa. The impact of AQ on FRQ perception has been studied extensively. The outcomes of these investigations are likewise highly similar, indicating a favorable relationship between AQ and FRQ. For example, audit partner rotation, audit fees (Cahan & Sun, 2015), and audit tenure (Chu et al., 2019) have all been linked to FRQ development in research concentrating on AQ.

In other words, these investigations have discovered a relationship between audit characteristics and FRQ. According to research on audit firm size, big audit firms are expected to provide perfect AQ because of more in-house competence in auditing big organizations, mainly publicly traded ones (Francis & Yu, 2009). In this regard, our study seeks to develop the type of influence that explains the relationship between auditor characteristics and FRQ through audit quality and the arguments of the agency theory theorists. The study believes that:

H10a: The relationship between audit tenure and FRQ will improve through AQ.
H10b: AQ will improve the relationship between audit fees and FRQ.
H10c: AQ will improve the relationship between audit firm size and FRQ.
H10d: AQ will improve the relationship between audit partner rotation and FRQ.

Figure 1: Theoretical Framework



3. METHODOLOGY

3.1 Sampling

Publicly traded corporations were chosen as the study's topic because their annual reports are more reliable and thorough. The necessary information may be found in publicly traded firms' annual reports and abstracts on the Bursa Malaysia website. In comparison to non-listed corporations, it is publicly available. According to the Bursa Malaysia report, there are 751 listed firms in the study population (Bursa, 2017). On the other hand, the sample size comprises 201 enterprises from eleven non-financial industries (construction, consumer products and services, healthcare, industrial products and services, plantation, property, energy, technology, telecommunication and media, transportation and logistics, and utilities). The companies that took part in the study were

chosen based on the following criteria: (1) All complete annual reports for the fiscal year ending 31 Dec 2014 are available; (2) no firms were dissolved, either willingly or involuntarily; and (3) no businesses were acquired or merged with another business.

3.2 Data Collection

Data on the Malaysian economy was gathered from Bursa Malaysia. Finally, data on audit characteristics and any missing financial data from the firms' annual reports were manually obtained. As a result, the study's final sample included 603 firm-year observations (201 publicly traded businesses) with all the data needed to perform the analysis. Table 1 provides a more detailed explanation of the sample size by sector.

Table 1: Summary of the sample size by sectors

sector	Sectors	Freq.	Percent
Non-financial companies	Consumer	141	23.38
	Plantation	36	5.97
	Construction	39	6.47
	Energy	24	3.98
	Healthcare	12	1.99
	Industrial product	183	30.35
	Property	81	13.43
	Technology	33	5.47
	Telecom	15	2.49
	Transport	27	4.48
	Utilities	12	1.99
Total	11	603	100.00

Table 1 shows the sample size from eleven non-financial sectors; Table 1 shows that the industrial production sector has the highest percentage, 30.35%, and the utilities and healthcare sectors have the lowest percentage, 1.99%.

3.2. The Measurements of Variables.

3.2.1. Dependent Variables (FRQ)

Accruals and other running accounting figures are frequently utilized to affect a company's performance (Kusnadi et al., 2016). As a result, an auditor must guarantee that the financial reporting process is efficiently controlled and that the company's management obtained a high FRQ to appropriately depict their firm's true performance. Perhaps this is to ensure that any instances of unethical management performance manipulation are discovered as soon as feasible. Dechow and Dichev (2002) created a widely used indicator of discretionary accrual quality, which incorporates short-term accruals by mapping historical, present, and future cash flow. As a result, used as a significant indication of FRQ (Sadaa et al., 2023a). The following is a presentation of the model:

$TA_{i,t} = \beta_0 + \beta_1 \Delta Sales_{i,t} + \beta_2 PPE_{i,t} + \beta_3 \Delta CFO_{i,t} + \varepsilon_{i,t}$

where $TA_{i,t}$ *= Total Accruals = change in non-liquidity current asset – change in current liabilities + change in short-term bank debt – depreciation*

$\Delta Sales_{i,t}$ *= Change in sales*

$PPE_{i,t}$ *= Property plant and equipment*

$\Delta CFO_{i,t}$ *= Change in cash flow from operations*

The lagged gross asset takes terms.

3.2.2 Mediating Variables (AQ)

Anomalous working capital accruals are the difference between actual working capital for the current year and the working capital level expected for the previous year's working capital to sales ratio for each business year, according to the proxy for AQ (Fredriksson et al., 2018). As a result, abnormal working capital accruals will be reversed against future earnings, causing profit to shift between reporting periods. The abnormal working capital accruals are computed to determine the AQ (DeFond & Zhang, 2014; Fredriksson et al., 2018; Ahmed et al., 2021). The method for calculating abnormal working capital accruals is as follows:

$$AWCA_{i,t} = WC_{i,t} - \left[\left(\frac{WC_{i,t-1}}{S_{i,t-1}}\right) \times S_{i,t}\right]$$

Where:

AWCA is Abnormal working capital accruals for the company$_i$ in time$_t$
WC is Noncash working capital accrual computed as (current assets - cash and short-term investment) –(current liabilities – short-term loans) for the company$_i$ in time$_t$
S is the total number of sales to the customer from a company$_i$ at time$_t$ or (t – i)
This metric calculates the absolute value of abnormal working capital accruals to proxy for AQ.

3.3.3 Independent and Control Variables

This section discusses the independent and control variables measurement. The company's annual report provided all the data for assessing the independent and control variables.

Table 2: Measurement of Independent and Control Variables

Variables	**Measurement**
Independent variables	
Audit Tenure	(AUDTEN) How often has the firm been audited by the same auditor (in logs)?
Audit Partner Rotation	(AUDPARTNE) Dummy variable 1 if there is rotation in audit partner; otherwise 0 (Martani et al., 2021).
Audit Fees	Ln(AFF) = Natural Logarithm for companies' audit fees given to their auditors.
Audit Firm Size	(AUDFIRM) Dummy variable 1 if the auditor is one of the Big 4 audit firms, and "0" otherwise.
Control variables	
Profitability	Net income before interest and taxes divided by total assets.
Firm Size	FSIZE": Total revenue of the company reflected in the annual report.

3.4 Empirical model

To test the relationship among the independent, dependent, and mediating variables, the study employed the followings models:

$$FRQ = \beta_0 + \beta_1 FSIZE_{it} + \beta_2 ROA_{it} + \beta_3 AUDTEN_{it} + \beta_4 AUDFEES_{it} + \beta_5 AUDFIRM_{it} + \beta_6 AUDPARTNE_{it} + \varepsilon_{it} \quad (H1,H2,H3,H4)$$

$$AQ = \beta_0 + \beta_1 FSIZE_{it} + \beta_2 ROA_{it} + \beta_3 AUDTEN_{it} + \beta_4 AUDFEES_{it} + \beta_5 AUDFIRM_{it} + \beta_6 AUDPARTNE_{it} + \varepsilon_{it} \quad (H5,H6,H7,H8)$$

$$FRQ = \beta_0 + \beta_1 FSIZE_{it} + \beta_2 ROA_{it} + \beta_3 AQ_{it} + \varepsilon_{it} \quad (H9)$$

$$FRQ = \beta_0 + \beta_1 FSIZE_{it} + \beta_2 ROA_{it} + \beta_3 AUDTEN_{it} + \beta_4 AUDFEES_{it} + \beta_5 AUDFIRM_{it} + \beta_6 AUDPARTNE_{it} + \beta_7 AQ_{it} + \varepsilon_{it} \quad (H10a,H10b,H10C,H10d)$$

Where AUDTEN: audit tenure; AUDFEES: audit fees; AUDFIRM: audit firm size; AUDPARTNE: audit partner rotation; AQ: audit quality; FSIZE: firm size; ROA: return on assets

4. FINDINGS

Table 3: Descriptive data

Variables	***Mean***	***Med***	***Max***	***Min***	***Std. Dev.***	***N***
FRQ	0.11728	0.0597	0.91413	0.00076	0.3626	603
FSIZE	5.6707	5.6182	7.9685	3.9156	0.6380	603
ROA	2.8291	3.7100	57.3500	-76.4300	10.8962	603
AUDTEN	8.4245	7.0000	19.0000	1.0000	5.6576	603
AUDFEES	2.3989	2.3010	4.2625	0.8451	0.4708	603
AUDFIRM	0.4444	0.0000	1.0000	0.0000	0.4973	603
AUDPARTNE	0.3018	0.0000	1.0000	0.0000	0.4594	603

AQ	-0.0038	0.0000	4.5324	-7.0000	0.4569	603

The dependent variable FRQ has a mean of (0.1173) and a standard deviation of (0.3626), as shown in Table 3, with a Min value of (0.00076) and a Max of (0.91413). Furthermore, the independent variable, audit tenure (AUDTEN), mean is (8.4245) with a standard deviation of (5.6576). Audit fees (AUDFEE) show the mean is (2.3989), with a standard deviation of (0.4708). Audit firm size (AUDFIRM) show the mean is (0.4444), with a standard deviation of (0.4973). The mean shows that 44.4 percent of the companies employed Big 4 to audit their business, while 55.6 percent of companies employed local audit firms. Finally, the mean value related to the audit partner rotation (AUDPARTNE) is (0.3018), while the standard deviation is (0.4594). As for the mediator variable, AQ, as shown in Table 1, is about (-0.0038), with a standard deviation (0.4569), while the min value was (-7.000) and Max (4.5324).

Table 4 shows the correlation matrix; this analysis aims to see whether there are any issues with multicollinearity between the independent, control, and mediator variables.

Table 4: Correlation Matrix

	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**
FRQ	1.0000							
FSIZE	0.0724	1.0000						
ROA	0.1456	0.2758	1.0000					
AUDTEN	-0.1376	0.3552	0.1611	1.0000				
AUDFESS	0.0510	0.6618	0.1355	0.2593	1.0000			
AUDFIRM	-0.1530	0.5089	0.1931	0.4447	0.4705	1.0000		
AUDPARTNE	-0.0173	-0.0651	-0.0216	-0.0385	-0.0545	-0.0719	1.0000	
AUDQ	0.0091	-0.0249	-0.0056	0.0191	0.0356	0.0465	-0.0089	1.0000

Table 4 The correlation matrix in this study sheds light on the level of correlation between the independent and the dependent variables. It also investigates the issue of multicollinearity among independent variables. The strength of the association between the variables was evaluated and explained using the Pearson correlation analysis, as shown in Table 4. If a correlation in the correlation matrix created by all the independent variables is more significant than 0.80, multicollinearity, as a general rule, may be an issue (Sadaaet al., 2023b).

This study tested the Variance Inflation Factor (VIF). In the analysis, the VIF and the reciprocal of VIF (Tolerance) are investigated; a VIF value higher than 10 and a tolerance value below 0.1 indicates multicollinearity. In our findings, all variables had a VIF value below 10, with the highest VIF value (2.667) and lowest tolerance (0.375) recorded in ROA.

Table 5: Variance inflation factor

	VIF	**1/VIF**
FRQ	1.743	.574
FSIZE	1.75	.571
ROA	2.667	.375
AUDTEN	1.254	.80
AUDFESS	1.953	.512
AUDFIRM	1.188	.842
AUDPARTNE	2.043	.765
AUDQ	1.382	.724
Mean VIF	1.748	

Table (6) shows that R^2= 23.12%; in addition, the Value of Durbin Watson statistic (D-W) is (1.7523), which means there is no problem of serial correlation, Hausman test value is (0.0703), which represents the random impact model is more appropriate to test the effect, the Value of Breusch Pagan Test for Heteroscedasticity is (0.0703) which mean there is no problem of heteroscedasticity.

Table 6: The impact of Independent and Control Variables on FRQ

Variables	**Coefficient**	**t-Statistic**	**Prob.**
C	0.918	6.224	.000
FSIZE	0.249	6.744	.000
ROA	-0.198	-1.021	.308
AUDTEN	-0.002	-4.607	.000
AUDFEES	0.275	5.816	.000
AUDFIRM	-0.051	-1.431	.153
AUDPARTNE	-0.034	-1.101	.271
N		603	
R^2		0.2312	
Adj R^2		0.2301	
D-W		1.7523	
Hausman Test		0.0703	

Breusch Pagan Test for Heteroscedasticity	0.3892

* Significance (Sig) at a 10% level; ** Sig at a 5% level; *** Sig at a 1% level.

Table 6 also shows a positive link between AUDFEES and FRQ at level 5%, which states that when the AUDFEES increase FRQ will increase. At the same time, AUDTEN negatively impacts FRQ at level 5%, which points out that FRQ will decrease when AUDTEN increases. FSIZE also has affected FRQ positively. On the other hand, AUDFIRM, AUDPARTNE, and ROA have not affected FRQ.

Table 7: The impact of Independent and Control Variables on AQ

Variables	**Coefficient**	**t-Statistic**	**Prob.**
C	0.716	4.855	0.000
FSIZE	-0.194	-5.260	0.000
ROA	-0.154	-0.796	0.376
AUDTEN	-0.021	-3.593	0.000
AUDFEES	0.215	4.536	0.000
AUDFIRM	0.340	6.116	0.018
AUDPARTNE	-0.027	-0.859	0.331
N		603	
R^2		0.3927	
Adj R^2		0.3916	
D-W		1.8921	
Hausman Test		0.8223	
Breusch Pagan Test for Heteroscedasticity		0.1865	

* Sig at a 10% level; ** Sig at a 5% level; *** Sig at a 1% level.

Table (7) shows that R^2= 39.27%; in addition, the Value of Durbin Watson statistic (D-W) is (1.8921), which means there is no problem with serial correlation, the Value of the Hausman test is (0.8223), which represent the random effect model is more appropriate to test the effect, the Value of Breusch Pagan Test for Heteroscedasticity is (0.1865) which mean there is no problem of heteroscedasticity.

Table 7 indicates that AUDFEES and AUDFIRM have affected FRQ positively at level 5%. The findings indicate that FRQ will increase when AUDFEES and AUDFIRM increase. At the same time, the findings show that AUDTEN has a negative effect on FRQ. AUDPARTNE does not affect FRQ. Moreover, FSIZE influenced FRQ negatively, and ROA has not affected it.

Table 8: The effect of AQ on FRQ

Variable	Coefficient	t-Statistic	Prob.
C	0.854	5.792	0.000
FSIZE	0.231	6.275	0.000
ROA	-0.184	-0.950	0.303
AQ	0.320	3.025	0.007
N		603	
R^2		0.1917	
Adj R^2		0.1908	
D-W		2.1108	
Hausman Test		0.5529	
Breusch Pagan Test for Heteroscedasticity		0.2846	

* Sig at a 10% level; ** Sig at a 5% level; *** Sig at a 1% level.

Table (8) shows that R2= 19.17 percent; additionally, the value of the Durbin Watson statistic (D-W) is (2.1108), indicating that serial correlation is not a problem, the Hausman test has a value of (0.5529), suggesting that the random effect model is better for assessing the effect. The Breusch Pagan Test for Heteroscedasticity has a value of (0.2846), indicating that heteroscedasticity is not an issue.

Also, Table (8) shows a statistically positive significant impact between AQ and FRQ at level 5%, which states that FRQ will also increase when AQ increases. Further, FSIZE has affected FRQ positively, and ROA has had no effect.

Table 9: The effect of Control, Independent, and AQ on FRQ

Variable	Coefficient	t-Statistic	Prob.
C	0.132	3.837	0.000
FSIZE	0.599	2.085	0.038
ROA	1.929	1.783	0.076
AUDTEN	0.108	2.316	0.026
AUDFEES	0.266	2.055	0.037
AUDFIRM	0.353	7.763	0.000
AUDPARTNE	0.063	1.310	0.191
AQ	0.309	2.885	0.010
N		603	
R^2		0.5401	

Adj R^2	0.5392
D-W	1.9270
Hausman Test	0.1116
Breusch Pagan Test for Heteroscedasticity	0.4827

* Sig at a 10% level; ** Sig at a 5% level; *** Sig at a 1% level.

R2= 54.01 percent, as seen in Table 9. Furthermore, the value of the Durbin-Watson statistic (D-W) is (1.927), indicating that serial correlation is not a problem, and the value of the Hausman test is (0.1116), indicating that the random impact model is more appropriate for testing effect. The value of the Breusch Pagan Test for Heteroscedasticity is (0.4827), indicating that heteroscedasticity is not a problem.

Table 9 also states that AUDTEN, AUDFEES, and AUDFIRM positively affect FRQ through AQ at level 5%, which supports hypotheses 10a, 10b, and 10c. Meanwhile, there was no effect of AUDPARTNE on FRQ through the mediator. Moreover, the control variables have affected FRQ positively.

5. RESULTS AND DISCUSSION

This study employed a data set of 201 Malaysian public businesses and 603 observations from 2015 to 2017 to investigate the connection between audit features and FRQ, with AQ as a mediating variable. As the critical measure of FRQ, the study used the discretionary accruals model. On the other hand, irregular working capital accruals were employed as a proxy for AQ (DeFond & Zhang, 2014; Fredriksson et al., 2018). We used a Hausman evaluation regression analysis to estimate the independent and mediating variables to test their hypothesis. In this context, there is a direct impact between audit characteristics and FRQ.

Contrary to hypothesis 1, which said AUDTEN has a positive effect on FRQ, the results shown in Table 6 overturned this hypothesis, as there was a negative influence (Coeff, -0.002; Prob, 0.000) between AUDTEN and FRQ. This contrasts with the study of Chu et al. (2018), who claimed that a more extended auditor–client connection is associated with lesser financial reporting bias. Long tenures with an audit firm are linked to a danger to the auditor's independence due to familiarity, leading to complacency, a lack of innovation, and less rigorous audit procedures, negatively influencing FRQ. In terms of hypothesis 2, table (6) shows that at the 5% level (Coeff, 0.275; Prob, 0.000), there is a positive relationship between AUDFEES and FRQ, which means that as AUDFEES rise, FSQ rises, which is similar to the study by Asthana et al. (2019), which argued that higher audit fee pay is a valuable mechanism for improving FRQ. Furthermore, Table (6) shows that AUDFIRM has no direct influence on FRQ (Coeff, -0.051; Prob, 0.153). This illustrates that the size of an audit firm has no impact on the quality of financial reporting. The current 1MDB incident, which three major audit firms audited, reinforces this conclusion since FRQ became a hot subject in the auditing industry when audit firms failed to deliver a qualified financial report because the report did not meet the requirements. Reflects the financial statement's accuracy and fairness (Star, 2018). Table 6 also shows that AUDPARTNE has no direct impact on FRQ (Coeff, -0.034; Prob, 0.271). This contradicts the belief that changing audit partners will provide fresh

insights and reduce the possibility of auditors delivering incorrect judgments to gratify their clients (Rong, 2017).

Table (7) reveals that AUDFEES has a positive connection with AQ (Coeff, 0.215; Prob, 0.000), as predicted by hypothesis 6. According to previous research, paying more outstanding audit fees results in higher AQ; conversely, because audit expenses are so high, firms will put more financial pressure on the audit firm to deliver better AQ (Aldegis et al., 2023). Meanwhile, AUDFIRM positively connects with AQ (Coeff, 0.340; Prob, 0.018), as predicted by hypothesis 7, since larger audit firms are more concerned with keeping their brand name and preserving a good reputation among their clients. Contrary to hypothesis 5, which stated that AUDTEN had a favorable influence on AQ, AUDTEN harms AQ. AUDTEN has a substantial negative connection with AQ (Coeff, -0.021; Prob, 0.000), as seen in Table (7). In addition, Table (7) shows that, contrary to hypothesis 8, AUDPARTNE does not influence AQ (Coeff, -0.027; Prob, 0.331).

Furthermore, Table (7) proves the existence of a positive impact relationship between AQ measured by AWCA and FRQ measured by discretionary accruals (Coeff, 0.320; Prob, 0.007), which is consistent with the opinion that the auditors may use a negative AWCA to avoid large earnings shocks and end up with small increases in earnings and the impression of smoother earnings growth, which is consistent with hypothesis 9. Auditors may also employ a positive AWCA to transform falling sales into moderately positive profit growth. Consequently, whether corporations are concealing a much more significant variance or a reduction in profits, the market is likely to discount the value of profits that it perceives to be lesser quality, implying solid earnings and a high FRQ.

To fill out the weakness of the previous literature, this study employed AQ as a variable that mediates the relationship between audit characteristics and FRQ. As predicted, the mediating function of AQ was successful in mediating between AUDFEES and FRQ, implying that higher audit fees would encourage auditors to put in more effort to maintain AQ, which would have a favorable impact on the FRQ. Additionally, Despite the negative relationship of the direct impact of AUDTEN on the FRQ in Table 6 and AQ in Table 7, AQ succeeded in mediating the relationship between the AUDTEN and FRQ (Coeff, 0.108; Prob, 0.026). This indicates that AQ can be affected by factors other than supporting efficient financial report production and is not affected by AUDTEN. Besides, despite the negative impact of AUDFIRM on FRQ, this negative effect disappears with the mediation of AQ (Coeff, 0.353; Prob, 0.000); the AQ succeeded in mediating the relationship between AUDFIRM and FRQ. This showed that AQ presented by the Big 4 audit firm has an effect on the relationship between AUDFIRM and FRQ, which means with a Big-4 auditing firm, the auditor can maintain the AQ measured by the abnormal working capital accruals, which supports the ability to produce good audit reports. Finally, in addition to the negative direct relationships demonstrated by Table 5 between AUDPARTNE and FRQ and the negative relationship presented by Table 6 between AUDPARTNE and AQ, AQ could not mediate the relationship between AUDPARTNE and FRQ (Coeff, 0.063; Prob, 0.191). This finding contradicted the theory that audit partner rotation might result in a high learning curve for auditors unfamiliar with new client operations. The audit profession fought back by promoting the auditor expertise hypothesis, which holds that a longer audit term lowers information disparities between clients and auditors by allowing auditors to develop the client-specific knowledge needed to

improve AQ over time (Singh et al., 2021). As a result, hypotheses 10a, 10b, and 10c were accepted, whereas hypothesis 10d was rejected.

6. IMPLICATION AND LIMITATION

The theoretical implications of this study are addressed in the context of the relationship between audit features and financial report quality through mediating AQ. As a result of the study's findings, this study enhances our understanding of the determinants that impact financial reporting. An in-depth analysis of audit characteristics provides insight into their distinct and combined impact on the quality of financial reports. They examine the audit quality as a mediator, highlighting the importance of evaluating the audit process's quality when analyzing its influence on financial reporting results. Furthermore, the study's practical importance arises from its findings, which have major implications for audit companies in evaluating the utility of audit characteristics and designing ways to improve AQ. Additionally, this research can help the Institute of Internal Auditors and the Association of Certified Fraud Examiners improve their rules and regulations by enhancing audit characteristics, technical competence, and functionality to help organizations improve AQ. The study's findings are relevant to governments and investors worldwide worried about FRQ and want to guarantee that operations in Malaysia and other emerging markets are closely monitored. On the other hand, the research's principal constraint is the three-year study period based on data from 201 non-financial firms registered as public corporations on the Principal Board of Bursa Malaysia. A more extended study period might lead to results that may be somewhat different.

7. CONCLUSION

Due to increased financial reporting fraud and other types of financial reporting misbehavior that threatens the viability and effectiveness of capital markets, audit firms, business management, and shareholders have begun to discuss FRQ and AQ. This research aimed to see how to audit characteristics that affected the FRQ and AQ as a metric in non-financial businesses listed on the Malaysian stock exchange. According to this study's findings, the audit company's size and the rotation of audit partners have little to do with the FRQ; nevertheless, the audit duration has a substantial negative link with the FRQ. Audit fees have a favorable influence on financial report quality as well. On the other hand, audit fees and audit firm size have a favorable influence on AQ. In contrast, audit time has a negative impact, and audit partner turnover has no effect, according to the study. Furthermore, the study emphasizes the need to consider AQ as a mediator between audit characteristics and FRQ, as some audit characteristics are incompatible with FRQ improvement. Audit time, fees, and firm size benefit FRQ due to the AQ mediation function. At the same time, the audit firm's age and non-audit-related fees have no bearing on the audit's quality. More data and factors can be used in future studies to evaluate potential negative correlations. In the prospective study, the researchers can use the most recent annual reports abstracted for the PLC to provide more empirical evidence. The Malaysia Institute of Accountants is constantly developing better audit policies based on the country's economic development to improve AQ and the quality of financial statements.

ACKNOWLEDGMENTS

We would like to thank Universiti Sains Malaysia and WEBE for the financial assistance through research grants 304.PPAMC.6501060.W110.

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