UNDERSTANDING THE INTERPLAY OF FIRM SIZE, AUDIT FEES, AND AUDIT FIRM SIZE IN SHAPING FINANCIAL REPORT QUALITY: EMPIRICAL EVIDENCE FROM ASEAN COUNTRIES

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ABSTRACT

This study investigates the impact of firm size, audit fees, and audit firm size on financial report quality, along with examining variations in financial report quality across ASEAN countries. A sample of 164 manufacturing companies listed in ASEAN countries during the 2018-2021 period was selected using a purposive sampling method. Pooled data regression and Kruskal-Wallis nonparametric analysis were employed for data analysis. The findings reveal that firm size and audit fees have a significant negative influence on financial report quality, while audit firm size does not exhibit a significant effect. Furthermore, notable variations exist in the quality of financial reports among ASEAN countries. These results provide empirical evidence that auditing services alone do not enhance financial report quality, underscoring the need for practitioners, academics, and regulators to undertake necessary measures for improving the quality of companies' financial reports.

Keywords: ASEAN, Audit Fees, Audit Firm Size, Financial Report Quality, Firm Size

INTRODUCTION

A financial report is a financial reporting process in which the presentation is structured based on financial position and financial performance. In general, a company makes financial reports to provide actual information about the company's performance, financial position, and changes in the company's finances so that it can be used as a decision-making tool for users of financial statements. Analysis of the information in the financial report forms the basis for users of financial reports in making decisions. A financial report is no longer considered to record transactions or ordinary bookkeeping activities. A financial report is now seen as an important tool in managing companies under the principles of good corporate governance.

To be a high-quality financial report, generally accepted financial accounting standards, such as International Financial Reporting Standards (IFRS), need to become a frame of reference in preparing financial reports. Many studies have stated that adopting IFRS improves the quality of financial reports because the focus of financial reports, which is often the basis for decision-making, is the ability to generate profits. According to Pratama & Juliarto (2021), earnings management actions will be increasingly limited by auditors and stricter regulations by using IFRS.

Despite the global adoption of International Financial Reporting Standards (IFRS), instances of financial report manipulation persist. A comprehensive survey by the Association of Certified Fraud Examiners (ACFE), spanning 133 countries and analyzing 2,110 cases, revealed that approximately 9% of these cases involved financial statement fraud. This fraud form occurs when a company intentionally distorts or misrepresents its financial statements, primarily targeting investors and creditors. Notably, while financial statement fraud constitutes a relatively small proportion of overall cases, it results in the highest median loss—reaching $593,000.

Mirza et al. (2019) asserted that the quality of financial reports remains a global concern and will continue to be a subject of academic discourse for decades. This is because financial report users rely heavily on accounting information to inform their decisions. Numerous high-profile scandals worldwide

in developed countries have been related to inadequate financial reporting practices. Examples include Enron, Ahold, Tyco, Parmalat, and Toshiba. Additionally, Southeast Asian countries grapple with significant financial statement fraud. For instance, Singapore has experienced cases involving Noble Group, Keppel Corporation, and Raffles United Holdings. Similarly, Indonesia faces challenges with PT Garuda Indonesia Tbk, PT Kimia Farma Tbk, and PT KAI. At the same time, Malaysia contends with United U-Li Corporation Berhad, Megan Media Berhad, and Transmile Group Berhad).

These corporations engage in fraudulent practices against their investors by issuing deceptive financial reports. Consequently, investors suffer significant losses due to ill-informed investment decisions based on misleading data. These instances not only undermine investors' trust in a company's financial disclosures but also highlight apprehensions about the subpar quality of financial reports among Southeast Asian firms. Beyond the extensive regulations governing financial statement presentation, other factors continue to impact the overall quality of these statements.

This research is a replication of research conducted by Ishak et al. (2018), which examines the relationship between company characteristics and the quality of financial reports. The results of this study indicate that large companies tend to practice earnings management. In contrast, companies with high leverage and companies audited by the big four audit firm are not involved in earnings management practices. Other variables are explained in research conducted by Pham et al. (2017) regarding audit firm size, audit fees, audit reputation, and audit quality in companies listed on the Vietnam Stock Exchange. The results of this study indicate that audit firms affiliated with the Big Four produce higher audit quality, and audit fees have a significant negative effect on audit quality.

Agency Theory

Agency theory is the theoretical base that underlies a company's business practices. Agency theory explains the relationship between the principal and the agent. Jensen & Meckling (1976) define an agency relationship as a relationship arising from a contract between one or more people (principal) and another person (agent). The principal engages the agent to perform work on the principal's behalf, which involves delegating some decision-making authority to the agent.

Agents as parties with information about the company's current and future conditions will not provide this information to principals for various reasons, such as constraints in the cost of presenting information, reporting time, and the desire to avoid the risk of visible weaknesses. In contrast, principals need more information related to the company's condition but cannot access internal company information for economic decision-making. This is the cause of asymmetric information. Financial reports prepared by management as agents are expected to reduce asymmetric information. To reduce asymmetric information, companies are required to produce quality financial reports.

Financial Report Quality

According to Syarli (2021), financial reports serve as a tool for conveying information about a company's financial status, performance, and alterations in financial position. The Indonesian Accounting Association (IAI) further clarifies that financial reports are designed to furnish relevant financial data about reporting entities, aiding current and prospective investors, lenders, creditors, and other stakeholders in resource allocation decisions. Additionally, financial reports aim to provide valuable insights into an enterprise's financial position, performance, and changes, benefiting a wide range of users and economic decision-makers.

For the financial information presented to be useful, it must be relevant (relevance) and faithfully represent what is represented (faithful representation). The International Accounting Standards Board (IASB) also explains several things that can improve the use of financial information in financial reports. These include comparability, verifiability, timeliness, and understandability.

Firm Size

Firm size is a scale that classifies a company's size. Firm size is one of the most important business decisions in building a business because it can affect its profitability. Dang et al. (2018) explain that various aspects can measure firm size, including total assets, average total assets, market value shares, total revenue or sales, average sales, total profit, number of employees, and others.

Audit Fees

Audit fees are all reasonable costs incurred by companies to pay for company audits. Determining audit fees requires mutual consultation between the company being audited and the accounting firm. It is necessary to determine a reasonable audit fee to ensure the quality of financial reports. Cristansy & Ardiati (2018) explain that in determining the amount of the audit fee, members must consider several things. This includes the client's needs and scope of work, the time needed in each stage of the audit, duties and responsibilities according to law, level of expertise, level of complexity of work, number of personnel, office quality control system, and the agreed basis for determining fees for services.

Audit Firm Size

Audit firm size can be categorized into two categories: big four and non-big four. The size of an audit firm can be distinguished through quantitative criteria such as the number of employees and the audit fees charged to clients. Audit firms included in the big four categories are those affiliated with Deloitte, PricewaterhouseCoopers (PwC), Ernst & Young (EY), and KPMG. The big four audit firms are known for their quality by the public.
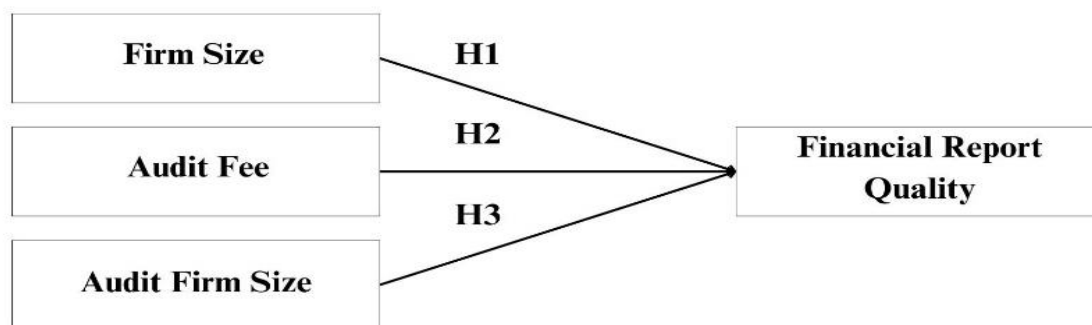

Figure 1 Research Framework

Effect of Firm Size on Financial Report Quality

A company's size has a significant negative impact on the quality of its financial reporting. Large corporations recognize that they are under public scrutiny, and the information they provide to the public is subject to increased scrutiny (Watts & Zimmerman, 1983). This encourages a lot of interference in preparing financial reports for personal gain by reducing the quality of financial reports (Lubis et al., 2019). Based on the description above, the formulation of the hypothesis that can be proposed is:

H1: Firm size has a significant negative effect on the financial report quality.

The Effect of Audit Fees on Financial Report Quality

Agency theory suggests that audit fees play a crucial role in influencing earnings management (Rahman, et al, 2023). The high-value audit fee will make the auditor tend to tolerate earnings management actions carried out by clients. The provision of high audit fees allows the creation of economic ties between the auditor and the client so that it can interfere with the independence and objectivity of the auditor (Ridzky & Fitriany, 2022). Based on the description above, the formulation of the hypothesis that can be proposed is:

H2: Audit fees have a significant negative effect on the financial report quality.

The Effect of Audit Firm Size on Financial Report Quality

Agency theory suggests that audit firm size positively influences the quality of financial reports. Research supports this notion, indicating that the size of an audit firm plays a significant role in enhancing audit quality and positively influences the quality of financial reports (Kautsar and Setyaningrum, 2023). This study explains an increase in the quality of financial reports with high and significant numbers due to the influence of the Big Four public accounting firms. Big Four public

accounting firms are believed to improve the quality of financial reports because auditors working at the Big Four have a better reputation, and professional staff at the Big Four are considered more competent than non-big Four public accounting firms (Ranosa et al., 2022). Thus, the hypothesis proposed is:

H3: Audit firm size has a significant positive effect on the financial report quality.

Differences in the Financial Report Quality in ASEAN countries

Bova, F., & Pereira, R. (2012) argue that agency theory suggests that there can be differences in the quality of financial reporting across countries due to varying institutional and regulatory environments. Generally accepted financial accounting standards are needed for a high-quality financial report to become a frame of reference in preparing financial reports such as International Financial Reporting Standards (IFRS). Each country has policies on applying IFRS as a global standard to accounting standards that have been implemented in that country before. According to the Financial Accounting Standards Board (DSAK), adopting IFRS as a country's accounting standard is also divided into five levels: full adoption, adopted, piecemeal, referenced, and not adopted at all. Differences in the level of adoption of IFRS as a country's accounting standard can occur because IFRS convergence in each country can be influenced by fundamental things such as culture, law and politics, economic power, and the country's resources. Thus, the writer hypothesizes:

H4: There are differences in the quality of financial reports in ASEAN countries

METHODS

This research is conducted at consumer goods manufacturing companies listed on the Singapore Exchange (SGX), Indonesia Stock Exchange (IDX), Malaysia Exchange, and Philippine Stock Exchange (PSE) for the 2018-2021 period. The type of research being conducted was hypothesis or quantitative testing. The data used in this study is secondary data, namely audited financial reports and annual reports, which have been processed and sourced from companies that are the object of research and refer to information collected from existing sources. The data in this study were from data presented on the official websites of each country's stock exchanges, official company websites, data banks from Bloomberg, and data banks from OSIRIS. Determining the number of samples in this study using purposive sampling. The criteria for determining the sample used in this study are as follows:

Table 1. Sampling Criteria

Information	Number of Companies
Manufacturing companies in the consumer goods sector conducting IPOs	260
Companies that do not provide complete financial information and support research variables	(58)
Manufacturing companies experiencing delisting	(0)
A manufacturing company that just made an IPO in 2018	(49)
Total companies selected as the sample	153
Total data used in the study for 4 years	612

Source: Author

The sequence of tests to be carried out is presented in the following table.

Table 2. Test Sequence

No.	Testing
1.	Descriptive statistics
2.	Pooled data estimation method
3.	Pooled data regression model selection
4.	Classic assumption test
5.	Hypothesis test

Source: Author

Descriptive Statistical Analysis

Descriptive statistical analysis is the activity of collecting, organizing, summarizing, and presenting data that aims to make data easier to read and understand for users. According to (Ghozali (2016:19) descriptive statistics are used to explain or provide an overview of the characteristics of a series of data without drawing general conclusions. Presentation of data in descriptive statistics is presented in the form of diagrams or tables and consists of the mean, median, maximum, minimum, and standard deviation values.

Classic assumption test

The classical assumption test is used to ensure that the regression model that has been obtained is the best model in terms of estimation accuracy, consistency, and unbiased. The classical assumption test consists of a normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test.

Pooled Data Regression Analysis

Pooled data regression analysis used in this study both simultaneously and partially is using pooled data regression analysis. The pooled data regression model is as follows:

$$Y = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + e$$

Information:
Y	=	Financial report quality
β0	=	Constant
X1	=	Firm size
X2	=	Audit fees
X3	=	Audit firm size
β1 β2 β3	=	Regression coefficient
e	=	Error

Pooled Data Estimation Method

The estimation of pooled data can be approached using three methods:
1. Common Effect Model: This model disregards time or individual dimensions, assuming that company data behavior remains consistent across various periods.
2. Fixed Effect Model: Differences between individuals are accounted for by adjusting intercepts. It assumes that individual-specific effects exist.
3. Random Effect Model: This model estimates pooled data while considering disturbance variables that may be correlated over time and across individuals.

Selection of Pooled Data Regression

The process of selecting a pooled data regression model involved three stages: the Chow test, Hausman test, and Lagrange multiplier test. The Chow test helps determine whether the Fixed Effect Model or the Common Effect Model is more suitable. If the results indicate acceptance of the null hypothesis, the Common Effect Model is preferred. Conversely, if the null hypothesis is rejected, the Fixed Effect Model is chosen, and the analysis proceeds to the Hausman test. The Hausman test assesses whether the Fixed Effect Model or the Random Effects Model is appropriate for estimating panel data. If the Hausman test supports the null hypothesis, the Random Effects Model is favored. However, if it rejects the null hypothesis, the Fixed Effect Model is the better choice. Finally, if both the Chow test and Hausman test favor the fixed effect model, the Lagrange multiplier test becomes unnecessary.

Hypothesis Test

We will conduct hypothesis testing to examine the impact of firm size, audit fees, and audit firm size on financial report quality. Specifically, we will employ both partial tests (t-tests) and simultaneous tests (F-tests). Additionally, we will utilize the Kruskal-Wallis test to determine whether there are significant differences in the average quality of financial reports across ASEAN countries. Table 3 below explain operational variables:

Table 3. Operational Variables

No.	Variable	Measurement
1.	Y = Financial report quality	Conservatism = $\frac{\text{Market price per share}}{\text{Book value per share}}$
2.	X1 = Firm Size	Company Size = Ln(Total Assets)
3.	X2 = Audit Fees	Audit fee= Ln(Audit Fee)
4.	X3 = Audit firm size	Dummy 0 and 1
5.	Country	Nominal scale: 1: Singapore 2: Indonesian 3: Malaysia 4: Philippines

Source: Author

ANALYSIS

Descriptive Statistical Analysis

Descriptive statistical analysis in this study was used to calculate the effect of the independent variables, namely firm size, audit fees, and audit firm size on the dependent variable, namely financial report quality

Table 4. Descriptive Statistical Analysis Results

	Y	X1	X2	X3
Means	3.469431	15.07009	7.199784	0.568627
Median	1.110500	14.97958	7.085683	1.000000
Maximum	103.2350	20.54635	11.51816	1.000000
Minimum	0.131000	10.79543	3.813712	0.000000
std. Dev.	9.194818	1.594981	1.236523	0.495673
Observations	612	612	612	612

Source: Author

Table 4 above provides insights into the variables under consideration. The highest value observed for the financial report quality variable (Y) is 103.2350, while the lowest is 0.131000. The mean value stands at 3.469431, with a median value of 1.110500. The standard deviation for this variable is 9.194818. Moving on to the firm size variable (X1), the highest recorded value is 20.54635, and the lowest is 10.79543. The mean firm size is 15.07009, with a median value of 14.97958. The standard deviation for firm size is 1.594981. Next, the audit fee variable (X2) exhibits a highest value of 11.51816 and a lowest value of 3.813712. The mean audit fee is 7.199784, with a median value of 7.085683. The standard deviation for audit fees is 1.236523. Finally, the audit firm size variable (X3) has a maximum value of 1.000000 and a minimum value of 0.000000. The mean audit firm size is 0.568627, with a median of 1.000000. The standard deviation for this variable is 0.495673.

Panel Data Regression Analysis

Chow test

Table 5. Chow Test Results

Effect Test	Statistics	df	Prob.
Cross-section F	11.298485	(152,456)	0.0000
Chi-square cross-sections	955.663260	152	0.0000

Source: Author

From the provided table 5, we observe that the Chi-Square Cross-section Statistical value is 955.663260, accompanied by a probability value of 0.0000. This probability value is less than the significance level of 0.05 (0.0000 < 0.05), leading us to accept the alternative hypothesis (Ha) and reject

the null hypothesis (H0). Consequently, in this Chow test, the chosen model is the Fixed Effect Model (FEM).

Hausman test

Table 6. Hausman Test Results

Test Summary	Chi-Sq. Statistics	Chi-Sq. df	Prob.
Random cross-sections	23.651328	3	0.0000

Source: Author

Referring to the provided table 6, the Chi-Square Statistic distribution value is 23.651328, accompanied by a Probability value of 0.0000. This indicates that the probability (0.0000) is less than the significance level of 0.05 (0.0000 < 0.05). Consequently, we reject the null hypothesis (H0) and accept the alternative hypothesis (Ha). Therefore, in the Hausman test, the chosen model is the Fixed Effect Model (FEM). Based on these results, we proceed with assessing the panel data regression using the Fixed Effect Model (FEM) to determine the outcomes of this study.

Classic assumption test

Data analysis in this study uses pooled data. Pooled data is a combination of time series data and cross-section data. Time series data is data that is collected according to time sequence at a certain period, while cross-section data is data that shows a set of observations of a particular variable from various units of observation at one point in time. Pooled data allows research to study more complex behaviors in the model so that testing on panel data does not require classical assumption tests. By mentioning the advantages, testing the classical assumptions in the pooled data model is unnecessary.

Panel Data Regression Results

Based on the pooled data regression model approach and the tests that have been carried out (chow test and hausman test) indicate that the more appropriate regression model to be used in this study is the Fixed Effect Model. The panel data regression results are presented in the following table:

Table 7. Pooled Data Regression Analysis Result

Variables	Coefficient
X1	-3.905471
X2	-3.968923
X3	-0.227654
C	91.03009

Source: Author

Based on the regression results above, a regression line equation can be obtained as follows:

$$Y = 91.03009 - 3.905471\ X1_{it} - 3.968923\ X2_{it} - 0.227654\ X3_{it} + \varepsilon$$

Hypothesis test

Partial Significant Test (t-test)

Table 8. t-Test Results

Variables	Coefficient	std. Error	t-Statistics	Prob.
X1	-3.905471	1.428253	-2.734439	0.0065
X2	-3.968923	1.330955	-2.982011	0.0030
X3	-0.227654	1.896922	-0.120013	0.9045
C	91.03009	20.86790	4.362207	0.0000

Source: Author

The purpose of this test is to assess the individual impact of independent variables on the variation in the dependent variable. Based on the table 8 provided, the study results can be summarized as follows:

1. Hypothesis 1 (H1): The effect of firm size (X1) on financial report quality (Y) yields a significance value of 0.0065, which is less than 0.05 (0.0065 < 0.05). The associated t-statistic value is -2.734439. This indicates that firm size partially exerts a significant negative influence on financial report quality, leading to the acceptance of the proposed hypothesis (H1).
2. Hypothesis 2 (H2): The effect of audit fees (X2) on financial report quality (Y) results in a significance value of 0.0030, also below the 0.05 threshold (0.0030 < 0.05). The corresponding t-statistic value is -2.982011. Partially, audit fees significantly negatively impact financial report quality, supporting the acceptance of hypothesis (H2).
3. Hypothesis 3 (H3): The effect of audit firm size (X3) on financial report quality (Y) yields a significance value of 0.9045, which exceeds 0.05 (0.9045 > 0.05). The associated t-statistic value is -0.120013. Consequently, partial audit firm size does not significantly affect financial report quality, leading to the rejection of the proposed hypothesis (H3).

Concurrent Significant Test (F-test)

The F-test examines the collective relationship between independent variables and the dependent variable. It assesses whether all independent variables together significantly impact the dependent variable. The F-test evaluates the significance of the F-statistic in the regression output. The following are the results of the F Test:

Table 9. Concurrent Significant Test (F-Test)

F-statistics	11.40388
Prob(F-statistic)	0.000000

Source: Author

Based on the table above, the Prob value (F-statistic) is 0.000000 (0.000000 <0.05). Thus, it can be concluded that firm size, audit fee, and audit firm size together have a significant influence on financial report quality.

Kruskal-Wallis test

The Kruskal-Wallis test is a nonparametric statistical method based on ranks. Its purpose is to assess whether there exists a statistically significant difference among two or more independent groups concerning a dependent variable with a numerical data scale (interval or ratio) or an ordinal scale. In this test, we consider an error rate of 5% (or 0.05). If the asymptotic significance (Aymp. Sig) is less than 0.05, we reject the null hypothesis (H0). Conversely, if the asymptotic significance is greater than 0.05, we accept the null hypothesis (H0). The results of the Kruskal-Wallis test are presented as follows:

Table 10. Average Results of the Financial Report Quality from the Kruskal-Wallis Test

	Ranks		
	Country	**N**	**Mean Ranking**
Financial Report Quality	Singapore	96	256.77
	Indonesia	148	370.00
	Malaysia	296	278.77
	Philippines	72	356.28
	Total	612	

Source: Author

The table above shows the average results of the quality of financial reports using the Kruskal-Wallis test. In the table with a total of 612 samples, each country has a different average score, namely Singapore at 256.77, Indonesia at 370.00, Malaysia at 278.77, and the Philippines at 356.28.

Table 11. Kruskal-Wallis Test Results

Test Statistics, b
Financial Report Quality

Kruskal-Wallis H	39,672
Df	3
asymp. Sig.	.000

Source: Author

The table 11 above shows the Kruskal-Wallis H value of 39,672 and Asymp. Sig. of 0.000 which is smaller than 0.05 (0.000 < 0.05). Thus, it can be concluded that the value of Aymp. Sig is smaller than 0.05 so H0 is rejected, and Ha is accepted. This means that there are differences in the financial report quality between ASEAN countries.

CONCLUSION

Based on the research that has been done, the following conclusions can be drawn:
1. Firm size has a negative effect on the financial report quality. The results of this study support previous research conducted by Ishak et al. (2018) and Lubis et al. (2019). Thus, hypothesis 1 proposed by the researcher is accepted
2. Audit fees have a negative effect on the financial report quality. This result supports previous research conducted by Ridzky & Fitriany (2022) and Pham et al. (2017). Thus, hypothesis 2 proposed is accepted.
3. Audit firm size does not affect the financial report quality. The result of this study is in contrast with research conducted by Ishak et al. (2018) and Pham et al. (2017) Thus the H3 proposed by the researcher was rejected.

Based on agency theory, there are several potential explanations for why audit firm size may not have a significant positive effect on financial reporting quality:

1. Auditor Independence: Agency theory suggests that auditors play a crucial role in mitigating agency conflicts between managers and shareholders by independently assessing the financial statements. However, large audit firms may face greater economic dependence on their clients, particularly large clients, which could impair their independence and objectivity. This potential lack of independence could undermine the effectiveness of the audit, negating the perceived benefits of a larger audit firm (DeAngelo, 1981).
2. Audit Firm Incentives: Large audit firms may have incentives to retain and attract large clients, which could lead them to compromise audit quality to maintain client relationships. This behavior, known as low-balling or fee discounting, can create economic bonding and reduce the auditor's willingness to confront aggressive accounting practices, ultimately diminishing financial reporting quality (Dye, 1991).
3. Audit Firm Complexity: As audit firms grow larger, they may become more complex organizations with hierarchical structures and bureaucratic processes. This complexity can lead to communication breakdowns, lack of coordination, and difficulties in maintaining consistent audit quality across different offices and engagements. Consequently, the potential benefits of a larger audit firm may be offset by these organizational challenges (Knechel et.al.2013).
4. Audit Team Composition: While large audit firms may have access to more resources and specialized expertise, the quality of the audit team assigned to a particular engagement can vary. The composition of the audit team, including the experience and competence of the individual auditors, may have a more significant impact on audit quality than the overall size of the audit firm (Carey& Simnett, 2006).
5. Regulatory Environment: Agency theory assumes that auditors operate within a well-defined regulatory and legal environment that supports their independence and ability to provide high-quality audits. However, if the regulatory environment is weak or lacks effective enforcement mechanisms, the potential benefits of a larger audit firm may be diminished, as auditors face fewer incentives to maintain high audit quality (Hay and Wong, 2006).

There are differences in the financial report quality between countries in ASEAN. According to Ramdani (2020), There is a non-uniformity in the form of IFRS adoption due to differences in the

conditions of each country which include conditions of legitimacy towards the international world, the anticipation of the global economy, and the professional level of a country. However, if it is related to this research, there may be significant differences in the financial report quality in ASEAN countries due to the different firm sizes in each country and the different regulations regarding audit fees in each country. Thus, the H4 proposed by the researcher is accepted.

After analyzing the research results, the researcher realized that there were several limitations in this study, namely, this research was limited to manufacturing companies in the consumer goods sector, data collection in this study was limited to the 2018-2021 period, the countries selected in this study were limited only 4 countries in ASEAN. Future researchers are expected to be able to add other variables that do not present in this study, such as audit tenure and audit capacity stress. In addition, further researchers are also expected to be able to conduct research with more sectors, longer time intervals, and more countries so that the sample can represent and clearly describe the condition of the quality of a company's financial statements in various sectors.

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