Universidade de Aveiro Instituto Superior de Contabilidade e Administração de Aveiro
2014

Seyed Mahmoud HosseinniaKani

Effects of corporate governance on audit quality
Efeitos do governo das sociedades na qualidade da auditoria

Universidade de Aveiro
2014

Instituto Superior de Contabilidade e Administração de Aveiro

Seyed Mahmoud HosseinniaKani

Effects of corporate governance on audit quality
Efeitos do governo das sociedades na qualidade da auditoria

A thesis submitted to the University of Aveiro to fulfill the requirements for the degree of Master of Auditing, performed under the scientific guidance of PhD Helena Inácio and MBA Rui Mota, Department of ISCA-UA at the University of Aveiro.

This thesis is dedicated to my family for their love, endless support and encouragement.

Jury

president	Professora Doutora Graça Maria do Carmo Azevedo, Professora adjunta, Universidade de Aveiro
Arguer	Professora Doutora Alcina Augusta Sena Portugal Dias, Professora Adjunta, Instituto Superior de Contabilidade e Administração do Porto
Supervisor	Professora Doutora Helena Coelho Inácio, Professora Adjunta, Universidade de Aveiro

Acknowledgments

This master thesis is the output of long hours of research and study, and the support I received from the University of Aveiro.
To my supervisors I say; thank you for the support and beneficial feedback you gave me during the master thesis. Thank you Dr. Helena Inácio and MBA. Rui Mota for the total support, the encouragement, and the patience and knowledge. Your ongoing involvement and highly beneficial comments have definitely been a key supporting for accomplishing this thesis.
To my director I would like to say; thank you Dr. Graca Azevedo for all your direct and indirect attention during my master degree.
I would like to say my sincere thanks to my family; thank you my lovely Mom, Dad and my precious unique caring brother Hassan for the whole support you gave me during my life. I would not be able to achieve in both normal and education life, without your support.
I would like to say my friendly thanks to Mohammadreza Kamali; Thank you Mohammadreza for all your compassionate supporting during my master degree. Although you weren't my official supervisor, you have been accepted as my research methodology professor. I believe that you have had also a key role in my success on research.

God bless you all,
Seyed Mahmoud HosseinniaKani

Palavras-chave

Qualidade da Auditoria, Conselho de Administração, Comissão de Auditoria, Honorários de Auditoria, Governo das socidade.

Resumo

Tem sido sublinhado pelo mundo dos negócios que a qualidade da auditoria e o governo das sociedades podem desempenhar funções críticas em vários escândalos empresariais. Compreender a importância das relações entre a eficácia do governo das sociedades e a qualidade da auditoria requer investigar os respetivos componentes. O presente estudo visa, portanto, apresentar uma revisão abrangente e sintetizar de forma comparativa os resultados dos estudos publicados sobre a eficácia dos mecanismos do governo das sociedades, assim como dos fatores que influenciam a comissão de auditoria, com vista a determinar os prováveis efeitos na qualidade da auditoria.

Embora diversos fatores que influenciam a qualidade da auditoria e as especificações do auditor tivessem sido identificados como suscetíveis de afetar significativamente a qualidade da auditoria, a dimensão da empresa de auditoria foi identificada como o fator de maior influência. Acresce que tanto o conselho de administração como as especificações da comissão de auditoria foram identificados como fatores críticos influenciadores da eficácia do governo das sociedades, a qual, por seu turno, interage com a qualidade de auditoria. De tudo isto decorre que as alterações na eficácia do governo das sociedades devem ser consideradas como fator importante na qualidade da auditoria.

Keywords

Corporate governance, Audit quality, Board of directors, Audit committee, Audit fees.

Abstract

It has been highlighted by the business world that audit quality and corporate governance can play critical roles in various corporate scandals. Understanding how the relationships between effective corporate governance and audit quality is important, requires investigating their components more precisely. So, the present study aims to carry out a comprehensive review and comparative summarizing the results of the published works on the effectiveness of corporate governance mechanisms, as well as audit committee's influencing factors, in order to investigate their probable effects on audit quality.

In this regard, despite audit quality influencing factors and auditor specifications were found to be able to affect the audit quality significantly, audit firm size has been identified as the most important factor affecting audit quality. Moreover, both board of directors and audit committees specifications were identified as critical influencing factors in the effectiveness of corporate governance which interacts with audit quality. As a consequence, changes in effectiveness of the corporate governance should be considered as an important factor, when assessing the audit quality.

Table of contents

List of tables

List of figures

List of Abbreviations

AICPA	American Institute of Certified Public Accountant
CEO	Chief Executive Officer
IAESB	International Accounting Education Standards Board
IAS	International Accounting Standard
ISO	International Organization for standardization
OECD	Organization for Economic Co-operation and Development
SEC	Securities and Exchange commission

Chapter 1: Introduction

1.1 Backgrounds and motivation

Key references have indicated that audit quality and corporate governance can play critical roles in various corporate scandals. Audit quality factors have been identified to be critical because of their effects on the audit quality. In this regard, in majority of the studies, the well-known audit quality factors such as size, industry expertise, auditor tenure, audit fees, non-audit services and auditor reputation, auditor specifications such as independence, liability and competence have been discussed (see e.g., Bauwhede & Willekens, 2004; DeAngelo, 1981a, 1981b; Eshleman & Guo, 2014; Francis, 2004; Hussein & Hanefah, 2013; Schmidt, 2012; Thornton, 2003).

Among the wide range of the indentified factors, size can be considered as the most effective indicator of audit quality (Francis & Yu, 2009; Lennox, 1999). Consequently, higher audit quality can be easier achieved by the larger audit firms (Francis, 2004), because of their ability to discover and report the misstatements (DeAngelo, 1981b). But, reaching high audit quality in small size audit firms is also attainable, since they conform with audit standards (Bauwhede & Willekens, 2004; Larn & Chang, 1994).

However, due to the existence of the auditors' related specifications such as professional competence, technical ability, auditor's liability, and auditor independence, it is more expected to reach higher audit quality in large audit firms (Hussein & Hanefah, 2013). More technical abilities and industry knowledge can be raised from the audit expertise. So, demanding for audit expertise leads to higher audit quality (Craswell, Francis, & Talylor, 1995), and thereby, enhances auditor's reputation.

In addition, audit tenure may affect audit quality, positively or negatively. Negative effects may be resulted from a close connection between the auditor and the client which can lead to fraud by ignoring the material misstatements included in financial statements (Firth, Rui, & Wu, 2012), while the positive effects can be achieved through the utilization of the clients financial statement knowledge (Dye, 1991). On the other hand, both audit fees and non-audit services may affect the audit quality, since higher audit quality requires additional procedures resulting in higher audit fees (DeFond, Raghunandan, & Subramanyam, 2002).

Audit quality influencing factors can be utilized to evaluate effectiveness of each individual factor, while one of them is investigated as a proxy of audit quality. For instance, audit fees can be considered with other factors while its fluctuation affects the audit quality (Rustam, Rashid, & Zaman, 2013). Thus, the importance of such factors have led to many calls for improvement of the audit quality in recent years (see e.g., Cahan, Godfrey, Hamilton, & Jeter, 2008; Eshleman & Guo, 2014; Laux & Newman, 2010; Schmidt, 2012).

Corporate governance can be helpful to resolve agency problems through regular system *via* monitoring and controlling the managers, in order to reach shareholders objectives (Jensen & Meckling, 1976; M. Jensen, 2001). Corporate governance provides a structure by which the objectives of the firms are arranged, and the means for achieving those goals and control performance are determined (OECD, 2004). So, corporate governance is the mechanism by which companies are directed and controlled (Cadbury, 1992).

Considering the shareholders' wealth and firms' performance, corporate governance needs to implement an effective structure. Board of directors is established in corporate governance structure to act regarding the shareholders expectation. The board of directors includes executive and non-executive directors which are elected by shareholders. They should judge independently to reach the headlines of the strategy, performance, resources, including key appointments, and standard of conduct (Hirshleifcr & Thakor, 1994).

The board of directors, as a central element of corporate governance, plays an important role in the firm. In this regard, effectiveness of the board of directors should be improved regarding the firm's objectives. Thus, such improvement may occur through considering board of directors' influencing factors. In this case, board of directors influencing factors, such as size, independence, expertise and, meetings have been investigated in some studies to improve board of directors' effectiveness and, thereby, enhance effectiveness of corporate governance (see e.g., Alzoubi & Selamat, 2012; Dahya & McConnell, 2005; Hsu & Wu, 2013; Jensen, 1993).

The board of directors have been established in corporate governance structure to fulfill shareholders objectives. Audit committee has been implemented as a financial committee of the board of directors to act in line with the firm's financial objectives. Previous studies have argued about two main tasks which can be adequately performed by effective audit committees (see e.g., Cadberry, 1992; Dezoort, Hermanson, Archambeault, & Reed, 2002; Gendron, Be´dard, & Gosselin, 2004; Lin, Xiao, & Tang, 2008; Menon & Deahl Williams, 1994). Such audit committee's main tasks are to overview the financial process and the auditor’s activities.

Considering the main tasks of the audit committee, several influencing factors (such as size, independence, expertise, authority and, meeting) can play critical roles in the effectiveness of audit committees (see e.g., Dezoort et al., 2002; Mohiuddin & Karbhari, 2010; Walker, 2004). Such influential factors have the potential to enhance the audit committee's performance, especially in financial reporting integrity, as well as monitoring functions (Alzoubi & Selamat, 2012; Be´dard, Chtourou, & Courteau, 2004; Beasley, 1996; Xie, Davidson, & DaDalt, 2003). Hence, audit committee’s influencing factors can affect the audit quality, since higher effectiveness of audit committees leads to higher audit quality (Goodwin-Stewart & Kent, 2006).

1.2 Research objectives and questions

The main objective of the present thesis is the study of the corporate governance effectiveness with special emphasis on audit quality as well as its influencing factors and understanding the effects of corporate governance. Because of its critical impact on the audit quality, decision makers need to assess the corporate governance effectiveness. In this regard, the main objectives of this study were attained by answering the following specific questions (SQ):

SQ1- What are the influencing factors of audit quality? And what are the identifiable roles of the corporate governance on the overall audit quality?

SQ2- Can corporate governance components play a significant role in the audit quality?

SQ3- Is there any relationship between corporate governance and audit quality?

1.3 Work description

SQ1 the first step was carried out to attain the answers of the mentioned questions, based on the main objective of this thesis. In this regard, it has been tend to review and summarize the scientific literature related to the audit quality factors and the general roles of corporate governance on the overall audit quality.

Answer to SQ2 is attained by categorization and interpretation of the theoretical and empirical results obtained from the literature review of the specific roles of corporate governance components such as board of directors. The study focuses on the corporate board of directors and audit committee. In this regard, audit committee and its influencing factors are reviwed in order to reach their effects on the audit quality.

SQ3 is achieved by the interpretation of identified results from SQ2. In effect, the last step is investigating the effect of the corporate governance mechanisms on the audit quality in order to find the existing relationships between the mentioned elements. Consequently, the influence of the corporate governance effectiveness on the audit quality is reached through the identified results.

1.4 Thesis structure

Second chapter of this thesis presents an overview of the audit quality and its influencing factors. In the mentioned chapter, audit quality influencing factors as well as its specifications are briefly reviewed.

Chapter 3 presents the significant roles of agency theory and the necessity of the audit quality and corporate governance in resolving agency problems. In addition, it presents the comprehensive review of the corporate governance mechanisms as well as its components. Also, the board of directors' effectiveness as well as its influencing factors are reviewed. Moreover, influencing factors of the audit committee effectiveness are comparatively investigated.

Finally, in the last chapter, the effect of audit committee and audit quality factors on the audit fees have been considered as subjects for further discussion to magnify the probable interaction of corporate governance with audit quality. It is expected that the results arising from this thesis provide a brief improvement of both audit quality and corporate governance mechanisms.

Chapter 2: Audit quality and its influencing factors

2.1 Audit quality

2.1.1 Terms and definitions

Auditors intend to issue an opinion, providing a reasonable assurance on the fairness and credibility of financial statement, detecting the material misstatements. So, audit quality has been defined as the likelihood to discover and report material misstatements by auditor's technical capabilities, as stated by DeAngelo, (1981). In this circumstances auditor's independence is also crucial when reporting the discovered errors.

Discovering and reporting material errors depends on different factors related to auditors competencies. Training and experience qualifies the auditor to discover material misstatements. Moreover, independence would be the condition to report what has been discovered (Colbert & Murray, 1995).

In addition to the auditor's independence, other individual specifications such as professional competence, specialized knowledge, liability and expertise are important factors influencing the quality of auditor professional judgment and, hence, audit quality. As the audit process increases the informational value of the accounts, auditor's report can affect the use of accounts. In order to guarantee the auditor's independent opinion, it is needed for auditors to enhance their professional judgment independency (Craswell, Stokes, & Laughton, 2002). In other words, in order to maintain the auditor's independency, auditors are obliged to improve their professional judgment and, thereby, to increase the ability of providing information value for users (Arrunada, 2000; Thornton, 2003).

Both actual quality and perceived quality have been argued as important issues in audit quality definition. Actual audit quality can be considered as the probability of reducing the risk of reporting a material misstatement in the financial statement (Palmrose, 1988). Perceived quality is the belief of financial statement users about auditor's ability to reduce the material misstatements. In this situation, greater perceived audit quality can result in investment process improvement in audited clients. It can be stated that audit quality represents how the auditing process can detect and report material misstatements of the financial statements in terms of reaching reasonable assurance (DeAngelo, 1981b). The belief of users about audit quality results from auditor's individual specifications. Such high audit quality should be associated with high information quality of the financial statements (Balsam, Krishnan, & Yang, 2003). The main reason for this is that financial statements audited by high quality auditors should be less likely to contain material misstatements. In this case, audit quality is achieved not only by discovering misstatements but also through the client who introduces adequate adjustments.

Considering client's perspective, reaching higher quality in auditing process and report can be stated as one important purpose. Due to the wealth function of the firm, shareholders are more interested in getting high quality audit reports, whereby preferred higher quality audit. Stakeholders are also concerned about audit quality. Accordingly, lack of the audit quality may decrease the probability of discovering an audit failure (Bauwhede & Willekens, 2004). In addition, the factors that have been studied in the present manuscript influence audit quality directly or indirectly. Such factors make audit quality more important to be studied.

2.1.2 Audit quality influencing factors

The importance of factors which influence audit quality has been argued in many studies. As stated before, such factors can affect the audit quality directly or indirectly which are individually consistent with some audit quality proxies. Meanwhile, this thesis aims to present a clearer attitude on the classification of the audit quality factors that may influence audit quality.

2.1.2.1 Size

The link between the request for audit services and audits to large-firms is based on the "agency theory" as well as the links between audit quality and the auditor size (Lindberg, 2001). Therefore, clients intend to choose a high quality auditor to reach the best auditing results. So, they are more interested in demanding for large audit firms with higher reputation compared with small audit firms. The higher reputation, the higher incentive to issue clean and accurate audit report, because inaccurate audit reports can lead to decline the reputation. The decline of reputation could result in attracting less clients and in the decrease of audit fees. Large auditors with higher credible clients can suffer noticeable losses compared with small auditors if they issue inaccurate reports. Therefore, the large audit firms have more incentive to issue a reliable audit report with the purpose of maintaining their reputation (DeAngelo, 1981b).

Some factors such as professional competence, auditor's qualification and supporting technical information undoubtedly can be found in large audit firm's system. Such factors can be taken into consideration when assessing the influence of audit firm's size on audit quality to facilitate the detection of the possible errors (Hussein & Hanefah, 2013). Because of the higher degree of specialization of large audit firm's employees, the technological knowledge of audit groups in large firms would be higher than in small auditors. In other words, continuing professional education is more considerable in large audit firms than in small ones (O'Keefe & Westort, 1992).

Larger audit firms support higher quality audits (Francis, 2004). Also, the utilization of high quality auditors reveals that large entities (client) prefer to choose a high level of audit quality with higher technical knowledge. So, when the firm becomes larger, a higher audit quality will be demanded with the purpose of enhancing the monitoring and bonding activities. Also, adopting such strategies will be beneficial to the client, despite some inevitable operating costs (Hay & Davis, 2004).

Several studies have investigated the relationship between audit quality and auditor size (e.g., Francis & Yu, 2009; Hay & Davis, 2004). Most of them confirmed that the large size auditors are positively correlated with audit quality (e.g., Colbert & Murray, 1995; DeAngelo, 1981; O'Keefe & Westort, 1992). On the other hand, some other surveys have mentioned that there is no difference between large audit firms and smalls one in terms of their impact on audit quality, both of them have the potential to reach an acceptable level audit quality (e.g., Bauwhede & Willekens, 2004; Jackson, Moldrich, & Roebuck, 2008; Larn & Chang, 1994).

However, it seems that larger audit firms are more qualified and committed to reach a higher audit quality. It can be attributed to their high technical information and professional competencies as well as their attempt to continue higher education of employees and to maintain firm's reputation on issuing an appropriate audit report. Such activities are necessary in order to keep their clients. In Fig. 2.1 the relationship between audit quality factors and audit size is illustrated.

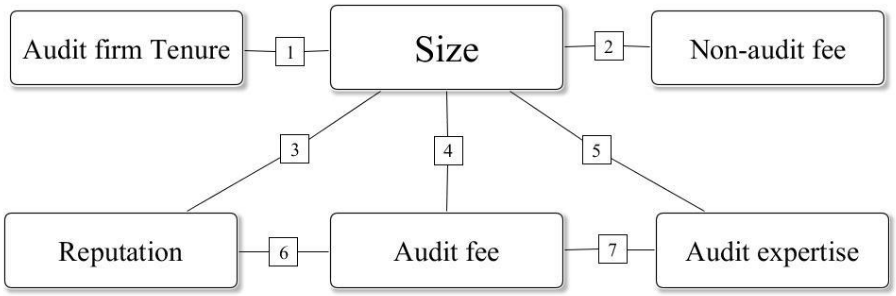


Fig. 2.1 The observed relationships between audit quality factors and size.

Note:1, 2: Not relationship has been observed between size and both audit tenure and non-audit fee. 3: (a) The larger audit firm size may reach the higher reputation in order to issuing more reliable and accurate audit report. (b) The larger audit firm with the higher reputation may demand for more audit fee (6). 4: (a) The large audit firm may earn more audit fee due to operate with higher quality of monitoring and bonding. (b) The large audit firm may demand higher audit fee in order to higher level of audit expertise (7).(c) In terms of brand name, the larger audit firm may capture more audit fee. 5: The larger audit firm may operate with higher level of auditor specialization.

2.1.2.2 Industry expertise

According to literature, it is clear that the expertise of the auditor plays an important role in improving audit quality. Demanding auditor specialization in an industry leads to a higher level of technical competence and technical information. It is mainly due to auditor's potential ability to detect financial statement errors (Arrunada, 2000). In this case, industry expertise knowledge enhances the likelihood that auditors discover errors and, thereby, affect the probability of reporting the discovered errors (Hammersley, 2006). Requesting industry expertise can represent an incentive for audit firm to invest in expertise and to desire industry-based customers.

Besides, the industries which normally use the expertise contract, accounting related technologies, are more powerful to reach a higher level of audit quality by utilizing industry expert auditors than non-expert auditors (Craswell et al., 1995). So, audit quality is positively related to specialization and industry expertise (Lowensohn, Johnson, Elder, & Davies, 2007).

In addition, audit tenure is directly related to the industry expertise, because a new industrial audit client may desire to benefit from audit expertise, technical ability and knowledge. So, auditors will be able to fulfill the lack of client-specific knowledge during the first years of audit tenure (Stanley & Todd DeZoort, 2007). In this regard, higher audit fee increases as audit expertise enhances. This is mainly due to the fact that higher audit expertise can lead to higher audit quality (Francis, 2004). In other words, additional investment on expertise can cause a positive effect on the audit fee premium (Craswell et al., 1995).

Hence, industry expertise is positively associated with audit fee and audit quality (Cahan et al., 2008). In this situation, industry expertise might reach more premium compared to non-industry expertise (Wang, O, & Iqbal, 2009). In addition, industry expertise, reinforced by auditors during the engagements, will lead to higher audit quality (Hussein & Hanefah, 2013). Such experiences can also enhance the audit reputation through market credibility.

In summary, industry expertise advantages together with general audit knowledge, can enhance the audit technical ability and audit reputation and so increase audit quality as well as leading to a higher level of audit fees.

2.1.2.3 Auditor tenure

Audit tenure has been investigated as short and large audit tenures. In this regard, studies have mentioned that the shorter the auditor's tenure, the less auditor client knowledge. As a result, lower audit quality is expected. In contrast, longer audit tenure can lead to decrease auditor's professional care, and therefore reducing audit quality.

On the other hand, with larger audit tenure it is more likely to discover misstatements using technical abilities and higher levels of knowledge. But the relationship between auditor and client may reduce independence and can reduce the probability of report misstatements. So, short audit tenure may involve the auditors with the risk of less technical knowledge and abilities. Therefore, the audit report quality can also be affected by audit tenure.

Generally, auditors have more incentive to issue a clean or acceptable audit report in the first years of their engagements. In terms of client's perspective, maintaining auditor for next period can depend on the issuing of a clean audit report. Therefore, if auditors know that clients are considering to switch them, it can influence the type of audit report (Vanstraelen, 2000). Then, such reactions can adversely affect auditor's independence, and thereby, reduce audit quality.

In fact, in the first years of the connection between auditor and client, audit failures are generally higher and rise the audit costs due to the need of additional procedures by the new auditor (Barbara, Richard, & Kurt, 2006). The auditor's mandatory rotation may cause some additional actions due to the loss of industry expertise and necessary information about financial report in the first years, which may enhance the likelihood of the audit failure (Gavious, 2007), as well as the additional costs to support the new auditor with the information about client's normal and special functions (Chi, Huang, Liao, &Xie, 2009). Such additional costs, negatively affect the relationships between the mandatory audit-firm rotation and audit quality (Chi et al., 2009). So, if there is no mandatory rotation, auditors are more likely to preserve longer tenures by satisfying clients.

The idea that long term audit tenure may lead to lower audit quality has been confirmed by previous studies (Adenuyi&Mieseigha, 2013; Chen, Lin, & Lin, 2008; Gul, Fung, &Jaggi, 2009; Gul, Jaggi, & Krishnan, 2007; Johnson, Khurana, & Reynolds, 2002). Also, long term relationships between auditors and clients may cause the familiarity between auditors and management. This can lead to reduce auditor's independence and audit quality as well (Carey &Simnett, 2006).

Therefore, as stated by legislators and business press, mandatory auditor rotation has been recommended, in order to increase the auditor's independence and to prevent fraud on issuing report (Barbara et al., 2006). Such negative relationships between auditor tenure and audit quality have been widely investigated, for instance by Carey &Simnett, 2006; Choi &Doogar, 2005.

In order to influence audit opinions, managers may switch auditors if they issue a qualified opinion. This represent an incentive for the auditor to issue an inadequate report. However, managers may not tend to switch auditors after receiving a qualified report. In fact, managers are willing, in several circumstances to receive a high quality audit report. In a situation of quasi-rent audit fees, managers will receive more satisfying reports from incumbent auditors compared to their switching by a new auditor (Jackson et al., 2008). In other words, long term relationships between auditors and clients may increase the incentive for the auditor to issue an unqualified reports (Vanstraelen, 2000).

Rotation initially can lead to lower audit quality due to the need to compensate the lack of client auditor knowledge (Francis, 2004). However, incumbent auditors may not report discovered misstatements. In this case, they are cheating by issuing a clean report which result from lower auditor independence and audit quality (DeAngelo, 1981b).

Furthermore, some relationships can be observed between audit tenure and financial reports quality, when restating or modifying the financial statements and then the audit report. Restating financial statement after rotation means that the initial financial report was consistent with the misstatement(s) and fraud(s). Accordingly, the new audit report (after restatement of financial statements) makes visible the low quality of the previous audit(Stanley & Todd DeZoort, 2007).

Thus, mandatory auditor rotation will increase the likelihood of financial statement restatement compared to non-rotation firms (Firth et al., 2012). Therefore, there is an inverse relationship between the audit long tenure and the restatement financial report (Stanley & Todd DeZoort, 2007).

In conclusion, long term relationships between auditors and client may reduce auditor's independence, and thereby, decrease the audit quality. On the other hand, mandatory auditor rotations can lead to additional costs due to the need for additional procedures by new auditors. So, this gives the incentive for restating financial reports to capture unqualified audit opinion. In this situation, auditor's impairment of independence and lower audit quality of the initial audits is notorious.

2.1.2.4 Audit fee

Audit fee as an important factor of audit quality has been used in several studies, specifically in examining the link between audit quality and the size (e.g., DeAngelo, 1981; Francis, 2004; Hay & Davis, 2004). Greater audit fees are also associated with the choice of qualified auditors (Hay & Davis, 2004). In spite of higher audit fee, some clients are more interested in using large audit firms. Clients are confident that large audit firms have greater monitoring and bonding in order to capture higher audit quality (Hay & Davis, 2004).

In terms of the auditor competence and specialization, including technical information and continuing education, large audit firms hire better professionals in comparison to small size firms. So, the larger the audit firm the higher auditor's specialization (and audit quality) is expected and therefore higher audit fees is achieved (DeAngelo, 1981b). For instance, as the demand for higher audit quality as well as additional activities are increased, higher audit fee is expected for company (Houghton & Jubb, 1999).

On the other hand, the reputation of audit firms can be negatively influenced by high-risk clients, and so, because of such influences, undoubtedly higher audit fee is charged by larger audit firms (Hogan, 1997). However, no relationship may be identified in cases of doubts regarding going concern between audit fees and "going concern opinion" (DeFond et al., 2002), and the "demanding for audit quality" (Lindberg, 2001).

Maintaining the reputation, auditors wish to perform an acceptable audit work. In summary, higher audit fee may result in greater audit quality (Eshleman & Guo, 2014) through increasing audit efforts as well as the utilization of higher qualified auditors. In terms of brand name, larger audit firms may demand higher audit fees (Basioudis & Fifi, 2004). In contrary, since large audit firms are willing to preserve their reputation they do not have incentive to receive higher fees or fee premium as a condition to conduct high audit quality work.

2.1.2.5 Non-audit service

Non-audit services as well as the audit service can affect the audit quality (Jeong, Jung, & Lee, 2005). To be more precise, auditing cost fluctuations can result from the changes in both audit fee and non-audit services (Ding & Jia, 2012). It has been argued by Houghton & Jubb (1999) that non-audit services fee is less price-sensitive compared to the audit fee and can play an important role to enhance the audit firm partners' wealth.

However, it is expected a positive relationship between qualified audit reports and both audit quality and non-audit fee (Houghton & Jubb, 1999). The regulators and AICPA have strongly highlighted the independence of the auditor. In addition to the economic theory about the auditor's independence, Securities and Exchange Commission (SEC) rules express that contrary to the actual audit, perceived auditor independence is a function of a non-audit fee ratio (Schmidt, 2012). The temptation to earn more non-audit fee could impair the auditor's independence (Frankel, Johnson, & Nelson, 2002).

In terms of quasi-rent, a higher probability of maintaining quality in both auditing and non-audit services substantially results from continuous contracts. In this case,compliance with obligations is not logic. However, it is highly related to the internal incentives of the involving parties, especially those which are the cause of the reputation acquisition. The implicit contracts mechanisms is thus beneficial to the parts (Arrunada, 2000). It can be considered as one of the quasi-rent benefits, resulting from costs reduction. This is explained by the difference between the wages paid for the current use of productive resource and their maximum best alternative applications (Chow, 1982). To enhance the effectiveness of the implicit contracting, the auditor must ensure to obtain a stream of quasi-rents, which maintains his incentive to present an acceptable performance (Arrunada, 2000).

In general, investors are not concerned about loss of auditor's independence who are auditing large clients in comparison to auditing small clients (Ghosh, Kallapur, & Moon, 2009). This is mainly due to the fact that auditors receive incentives to be specifically considered about the loss of reputation which results from independence impairment in their audits for large clients. Moreover, the auditors are less economically dependent on small clients. Thus, since non-audit services result usually from large clients, high levels of non-audit services can decrease the auditor independence and may also affect the audit quality (Francis, 2004).

2.1.2.6 Auditor reputation

In common, large audit firms have more reputation than smaller ones. So, the reputation cost in the smaller firms is considerably less than in the larger audit firms (Hogan, 1997). Hence, larger firms not only have incentives to maintain their existing level of reputation, but also they wish to enhance it by presenting accurate audit report. This is mainly due to the potential effect of audit quality on auditor reputation.

Reputation can serve as a proxy in examining the relationship between audit quality and both audit size and audit fees. Based on "capital theory", due to more credibility of larger auditors, audit firms with great reputation are considered to be more accurate (Teoh & Wong, 1993). It means that the large auditors, having more reputation, are more likely to issue accurate audit report (Lennox, 1999). This theory also reveals that more credible audit firms can demand higher audit fees, because of the market value of their audit reports (Lindberg, 2001). However, such higher audit fees, may lead to decrease auditor's independence (DeFond et al., 2002), because higher audit fees can represent clients intention to get a clear audit report.

Thereby, auditors may lose their independence and so their reputation. So, a negative effect between auditor reputation and audit fees can occur (Tomczyk, 1996). As a result, the auditor reputation as well as the audit fee can be influenced. Table 2.1 summarises the results arising from theoretical and empirical studies about the audit quality factors.

Table 2.1 Summary of the audit quality factors based on the results of previous theoretical and empirical studies.

Factor	**Observed Relationship**		
	Positive	**Negative**	**No-effect**
Size	(Colbert & Murray, 1995; DeAngelo, 1981b; Francis, 2004; O'Keefe & Westort, 1992)	Not Observed	(Bauwhede & Willekens, 2004; Jackson et al., 2008; Jeong & Rho, 2004; Larn & Chang, 1994)
Industry Expertise	(Francis, 2004; Lowensohn et al., 2007)	Not Observed	Not Observed
Auditor Tenure	(Chi et al., 2009)	(Carey & Simnett, 2006; Chen et al., 2008; Choi & Doogar, 2005; Gul et al., 2009; Gul et al., 2007; Johnson et al., 2002)	Not Observed
Audit Fee	(Eshleman & Guo, 2014)	Not Observed	(Lindberg, 2001)
Non-Audit Service	(Houghton & Jubb, 1999)	Not Observed	(Francis, 2004)
Auditor Reputation	(S. H. Teoh & Wong, 1993)	Not Observed	Not Observed

2.1.3 Auditors specifications

2.1.3.1 Independence

Auditor's independence is the capacity of auditor to act, in mind and in appearance, objectively without influences. Non-audit service as an audit quality factor can have a considerable impact on auditor's independence, and regulators have been deeply concerned about that. So, independent auditing can be considered as a fundamental specification in any active capital markets. In this regard, most of regulators have stated that non-audit services can lead auditors to lose their independence in order to capture larger non-audit service (Chen, Elder, & Liu, 2005; Gul et al., 2007; Thornton & Shaub, 2014).

As stated by Simunic (1984), auditor engagements as management consultants can compromise auditors independence. However, being worried about reputation loss as well as litigation costs can maintain auditors independent (DeFond et al., 2002).

Concerning non-audit services, SEC 2000 has mentioned two situations about auditor's independence: first, the probability that auditors become financially dependent of clients as a result of non-audit services. Such dependence can ensure the auditors to keep their engagement. Secondly, the consulting nature of many non-audit services may lead auditors to act against the audit process, as a result of the managerial roles.

As a conclusion, auditor's independence can be considered as a specification which is strongly associated with audit quality factors and, thereby, auditor's independence may strongly influence audit quality.

2.1.3.2 Liability

The impact of liability on audit quality has been investigated by various studies (e.g., Acemoglu & Gietzmann, 1997; Dye, 1993; Fargher, Taylor, & Simon, 2001; Free, 1999; Mlumad & Thoman, 1990; Narayanan, 1994). In common, audit firms have liability for their actions considering their accountability to the regulators (Chung, Farrar, Puri, & Thorne, 2010). For some reasons, the auditors may be pressured by such conditions to be serious and accurate in their functions.

Risk of litigation and litigation costs resulting from perceived audit failures (real or not real) are usually associated with auditor's liability. In this regard, litigation costs may arise from sources such as clients, investors and other financial statement users. Such costs may cause liability payments and loss of reputation. Moreover, litigation risk can put auditors under pressure to accept a client.

In addition, litigation risks can create an incentive for auditors to be more diligent on their duties. So, the auditors are responsible to issue satisfying answers to the economic players and stakeholders (Free, 1999). Because of the financial statement importance for market, logically higher degree of auditor liability is expected by the investors. Thereby, such expectations may lead to take more considerations into account, when auditors are at risk of liability payment. Then, considerable liability payment can be an insurance for investor to prevent possible audit failures (Schwartz, 1997).

Therefore, litigation risk can cause high audit quality. In this regard, audit costs will be increased due to the necessity of more skills and higher efficiency to achieve high levels of audit quality, which may result in significant drop of litigation costs. Thus, litigation costs can affect both higher audit quality and higher audit cost, directly or indirectly (Narayanan, 1994).

Considering size, more liability is expected from the large audit firms, by clients and investors. Such liabilities normally lead large audit firms to reduce litigation risks, which may be resulted from the audit failure (Ding & Jia, 2012). In other words, larger audit firms with higher liability potentially have more litigation risks and costs that may lead to higher considerations on audit services and, thereby, increase audit quality (DeFond, 2012; Lennox & Li, 2012).

Regarding auditor’s new engagement and client acceptance, some reasons may lead auditors to reject high risk clients in order to prevent litigation risks and costs. First of all there is the risk that auditors can be litigated from investors after an audit failure. Secondly, legal liability payments from auditors to investors, which arise from investor’s complaint, can be considered in this regard.

Eventually, extra litigation costs such as attorney fees and, more important, loss of reputation can force the auditor to reject a high risk client (Laux & Newman, 2010). Such client acceptances may also impair the perceived auditor independence, causing the demanding of higher audit fees (Schneider, 2011).

Therefore, the decision of accepting a high risk client can affect audit quality. This is mainly because of high litigation risks and costs, particularly when audit firm is becoming larger. So, it may lead larger audit firms to be more precise in selecting and accepting clients, in order to reduce litigation risk (Kaplan & Williams, 2012).

However, both less and more liability may put audit firm partners at risk. Less liability may lead to auditor's negative mind about their independence credibility. Moreover, higher liability may lead to higher audit costs for partners. Therefore, partners shouldn't be involved in increasing the liability (Acemoglu & Gietzmann, 1997). In conclusion, auditor's liability to investors, clients and market can reduce the litigation risks and costs by reducing audit failures and, thereby, increasing audit quality.

2.1.3.3 Professional competence

Professional competence, as stated at the first section of audit general standards, plays an important role in the audit process. Particularly, it may contain a considerable impact on the auditor's professional judgment as well as on quality. The concept of the professional competence covers two substantial aspects of auditors' competencies. The first aspect is the professional competence attainment which is required to benefit from higher education. Such merits are improved based on the principles of public accountants, acquired by education, training, exams and professional experience. Maintenance professional competence can be considered as the second aspect that requires:

a) Continuous improvement of the knowledge and skills regarding career changes and developments, in particular, the utilization of the programs which execution must be ensured. Such career changes and developments include new ideas and principles on accounting and auditing standards as well as the related rules and regulations.

b) Audit services subject to appropriate control systems in conformity with the principles and professional standards. In terms of maintaining professional competence in addition to such auditors abilities, auditor's behavior (such as professional ethics, being open-minded, keeping an aware perspective, acting as self-reliant and being decisive in their professional judgment) should be considered in evaluating auditor's competence. Such aspects need to be taken into consideration in audit plan, in order to attain the audit program and objectives and, thereby, achieving high audit quality (IAESB, 2006; ISO 19011:2011).

Table 2.2 summarises the observed relationships between specifications and factors and their impacts on audit quality.

Table 2.2 A summary of relationships between specification and factor and its impact on the audit quality.

Auditors Specifications	**Relationships with Other Factors**	**Observed Effect on the Audit Quality**	
		Positive	**Negative**
Independence	(Longe) Audit tenure	Not Observed	(Carey & Simnett, 2006)
	(Higher) Non-audit fee	Not Observed	(DeFond et al., 2002; Frankel et al., 2002; Thornton & Shaub, 2014)
	(Higher) Reputation	(Tomczyk, 1996)	Not Observed
Liability	(Loss of) Reputation	Not Observed	(DeFond et al., 2002)
	(The larger audit firm the higher liability) Size	(DeFond, 2012; Ding & Jia, 2012; Kaplan & Williams, 2012; Lennox & Li, 2012)	Not Observed
Competence	Size	(Hussein & Hanefah, 2013)	Not Observed
	Industry Expertise	(Arrunada, 2000)	Not Observed

Chapter 3: Corporate governance mechanisms

3.1 Agency theory

According to Jensen and Meckling (1976), when an individual (principal) engages another individual (agent) to perform a specific service on his behalf, conflicts of interest naturally arise. In fact, a feature of the relationship is the delegation of some decision-making authority to the agent, leading to actions taken by agents in their self-interest.

Moreover, if the principal wants to follow the agent's performance, additional costs, known by agency costs, may result (Jensen & Meckling, 1976). In this regard, "positive accounting theory" is involved in order to be reached a minimum level of agency costs.

In addition, the conflicts resulting from different reactions and behaviors on risk tolerance from the principals and the agent are expected and company's survival may be at risk (Eisenhardt, 1989). So, the main problem is that both principal and agent may indicate different action versus different levels of risk.

3.1.1 Audit role in the agency theory

Agency theory is an important economic theory, which has relevant effects on audit improvements. There are several mechanisms that help to enhance the confidence of stakeholders:

1- Reward package as an effective mechanism creating incentives to agents performing their duties;
2- Statutory mechanism, that can be a written contract, enforcing the agent to follow the purpose of the principal;
3- Audit as a substantial monitoring mechanism for principal to know whether the agent's functions are trustworthy.

Audit plays an important role to enhance trust or reliability as well as public and economic interest to strengthen accountability on financial reporting. Auditing helps to resolve conflicts between the principal and agent, in terms of information asymmetries (Healy &

Palepu, 2001). For example, the statutory auditors can play a crucial role because they act independently.

According to the International Accounting Standard (IAS), statutory auditors provide an independent opinion to shareholders on the reliability and fairness of financial statement. Moreover, auditor independence towards the agent is important for shareholders (principal) in order to obtain a higher quality audit (Watts & Zimmerman, 1983). As a result, auditing provides an independent control on agent performance and enhances the confidence and trust on the information provided by the agent.

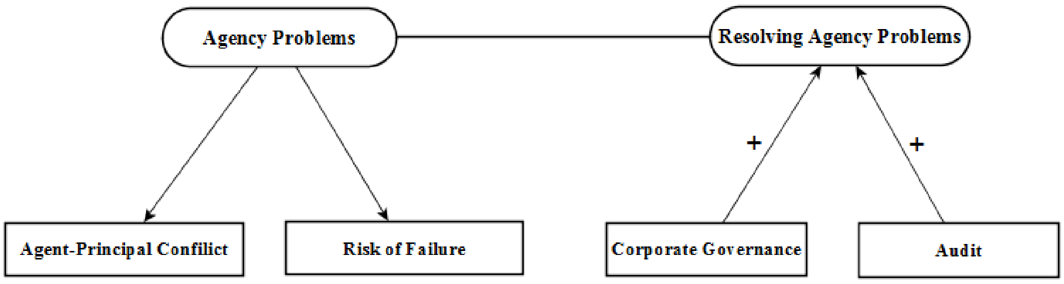
3.1.2 Agency theory problem and corporate governance

Corporate governance is helpful in order to resolve or reduce the agency problem. Corporate governance by regular mechanisms can resolve the agency problem. Such mechanism are policies, procedures, rules and laws. These aim to reduce conflicts between shareholders (principals) and managers (agents) and, thereby, decrease agency costs, in order to attain firm’s goals.

So, effective corporate governance must be organized by firms to enhance the long term shareholder value and control the accountability of managers. Given this, firms which have weaker governance to balance the organization face greater agency problems (Core, Holthausen, & Larcker, 1999). Therefore, weak corporate governance leads to conflict between owner (principal) and management (agent) because manager may act far from the firm's goals. Consequently, more control and monitoring is needed to reduce agency costs (Jensen, 2001).

Moreover, agency problems may bring private benefits to firm managers. In this regard, survival of the firm may be at risk. Therefore, effective corporate governance should be implemented to control managers' activities on behalf of stakeholders interests. So, this can be helpful in developing positive behavior between managers and shareholders and, thereby, reduce the agency problem of the firm (Khan, 2011). As a result, establishing effective corporate governance mechanisms can be helpful to reduce both agency cost and agent-principal conflicts in firms. Figure 3.1 illustrate agency problems and relationships between agency problems and both corporate governance and audit quality.

Fig.3.1 Agency problems and its relationships with corporate governance and audit.



3.2 Corporate governance effective structure

3.2.1 Corporate governance definition

Several definitions of corporate governance have been presented according to different points of view. Corporate governance is the system by which companies are directed and controlled (Cadbury, 1992). Corporate governance provides the structure through which the objectives of the firm are arranged, and the means of achieving those aims and control performance are determined (OECD, 2004). In fact, corporate governance is pointed to enhance shareholders value by monitoring managers and overall firm's performance. Such monitoring is helpful to enhance the accountability of managers and, thereby, decrease shareholders-managers problems (agency costs).

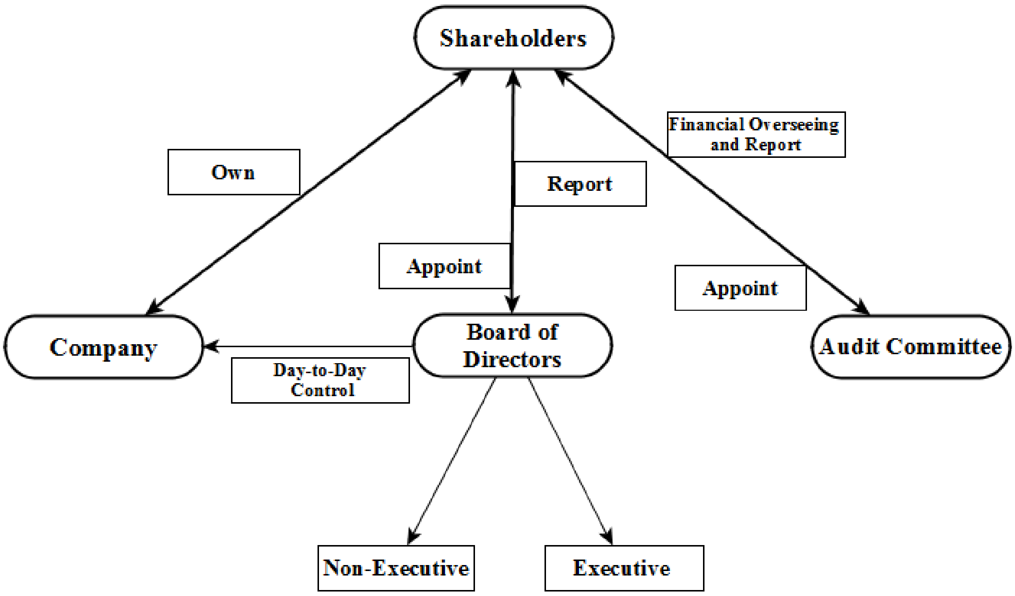
In the case of monitoring process, the board of directors, as the primary responsible for corporate governance, is nominated to control the managers and the overall performance of the firm, in line with the implementation of the applicable regulations, fulfillment the firm's goals and satisfaction of stakeholders (Shil, 2008). So, corporate governance is implemented to represent effective relationships between a firm's management, its board and shareholders. Moreover, it involves to set beneficial system, principle and process to govern a firm, in order to fulfill shareholders goals and objectives as well as stakeholders assurance in firm's performance for the long term (Claessens & Yurtoglu, 2013).

3.2.2 Corporate governance parties

Corporate governance parties are based on separation of ownerhsip matter. Parties involved in corporate governance include the regulatory body (the Chief Executive Officer

(CEO), the board of directors, management, audit committee, and shareholders) and other interested stakeholders including suppliers, employees, creditors, customers and the community, as a while. All parties of corporate governance have an interest, whether direct or indirect, in the effectiveness of firm performance. Directors and management benefit from salaries and reputation, while shareholders have their own capital and will try to maintain it. All these parties should be as effective as to maintain and enhance firms' value. Figure 3.2 shows the ownership separation and corporate governance components.

Fig.3.2 Ownership separation and corporate governance components.



3.2.2.1 Shareholders

Shareholder is an organisation or a person who owns shares in a company. So, shareholders as an owner desire to increase their wealth as well as saving the reputation of company in view of stakeholders. In this regards, they play a critical role to govern the company. A crucial shareholder's role in governance is to nominate directors and auditors to ensure that governance structure is appropriately implemented. Shareholders are accountable to elect board members in a manner which simplifies their goals achievement and interest (Cadbury, 1992).

3.2.2.2 Board of directors

The board of directors plays a key role in corporate governance. It is their accountability to support the organisation's strategy, develop directional policies and procedures, appoint, supervise and remunerate senior executives and ensure accountability of the organisation towards its shareholders (Aguilera, 2005).

In general, board's functions consist of laws, regulations and shareholder's decisions. The board of directors are responsible for the governing of company's strategy, and are accountable to act and answer to shareholders. They provide information with quality to shareholders.

So, every organisation should utilize an effective board to lead and monitor the business. considering shareholders wealth, the board should regularly control company and monitor executive management (Cadbury, 1992). Therefore, balance of power and authority should be ensured *via* division of responsibilities to prevent inappropriate individual decisions.

The board of directors may be elected based on particular responsibilities by executive and non-executive directors. Non-executive directors are independent of company. They should judge independently towards executive directors and their own interests, in order to reach the strategy and high performance levels. Non-executive directors may lose their independence in judgment after several years of engagement in company.

Thus, in order to be maintained the independent judgment of non-executive directors they should be periodically changed. Executive director/chief executive officer (CEO)[1] and chairman play important roles in the monitoring of the directors. The CEO normally is hired to implement high level of strategy and control management actions in order to achieve an overall growth of the company.

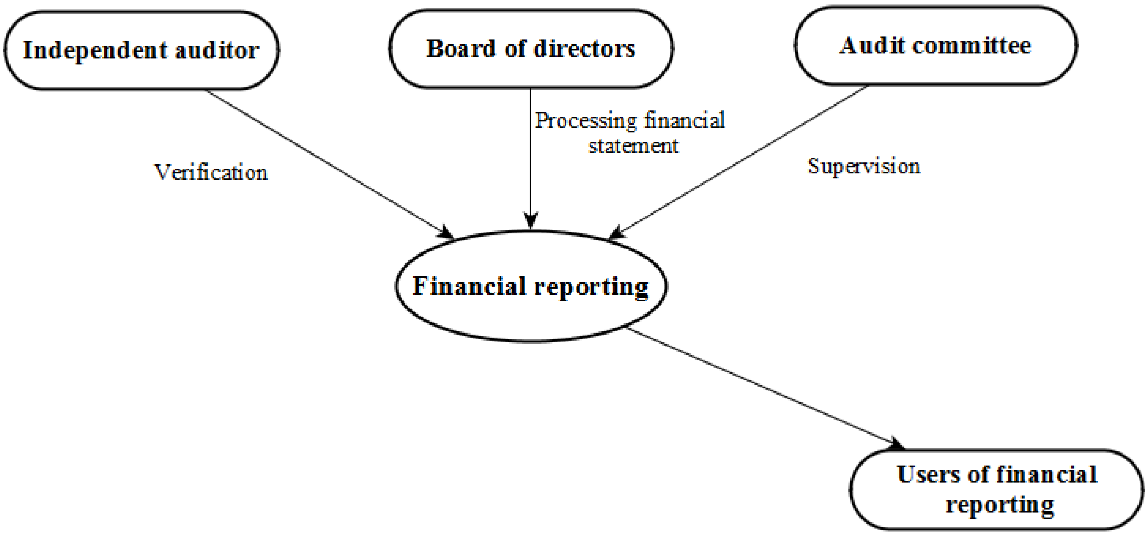
However, the chairman plays the important role of supporting good corporate governance in company. In fact, the chairman should act to ensure shareholders about company's affairs are controlled by board, and any obligation of board to the shareholders are fulfilled (Cadbury, 1992). Chairman and chief executive should be in separate task. In some small company chairman is also chief executive. In this situation, getting strong and independent members of the board is essential.

1. The diference between executive director and CEO is that executive director manages non-profit organization while CEO runs for-profit organization. Both executive director and CEO are hired by board of directors for acting the same duties. Such duties are controlling overall management and company, manage the company's budget and decision on company's sterategy in purpose to fulfill expected profit of the company and shareholders value.

3.2.2.3 Role of the auditor

The effectiveness of internal control system should be assessed by directors, and their statement should be reported as a guidance for the use of auditor (Cadbury, 1992). The auditor can be ensured through managements statement about the business going concern. In this regard, the effectiveness of audit process may increase and, thereby, enhance audit quality. Thus, the auditor should ask an adequate report from directors in order to present higher audit quality. In summary, since the audits are reassurance to all who have financial interest in firms, auditors' role is crucial for shareholders to attain their objective. Consequently, higher quality audit report can enhance the reputation of the firm from stakeholder's point of view. Figure 3.3 presents the financial reporting process which will be performed by external auditor, board of director and audit committee (Soltani, 2007, p.83).

Fig. 3.3 Financial Reporting Process



After the preparation of the financial statements by management, the independent auditor should verify them in order to issue an opinion about the financial statements and firm's internal control effectiveness. Audit committee by overseeing independence auditor's performance, attept to enhance the reliability of the financial reports for users. Board of directors should state about the internal control effectiveness as well as approving and processing financial report in their annual report. All these parties have played important roles in financial reporting process in order to enhance the confidence of financial reporting users.

3.2.2.4 Principles of corporate governance

Although Sarbanes–Oxley Act has defined some roles of corporate governance specially board of directors' accountability in listed company of U.S. stock exchanges, OECD principles of corporate governance have been considered in this study.

The principles of corporate governance have been determined as a framework for every party having the role to improve corporate governance. The principles provide a guidance for investors, stock exchange markets, corporations and other parties in both financial and non-financial companies as well as non-traded companies. The OECD principles of corporate governance are summarized in six main principles which have been explained as follows (OECD, 2004).

1) Ensuring the basis for an effective corporate governance framework

The framework goals are the promotion of transparent and efficient markets, which demands rules of law and responsibility. Such responsibility should be clearly articulated in order to obtain the public interest insurance. Supervisory, regulatory and enforcement authorities should attain their duties in a professional and objective method through authorities, integrity and resources. Also, adequate information and rules of corporate governance should be timely and transparently disclosed.

2) The rights of shareholders and ownerships functions

The framework should protect shareholder's rights which include both minority and foreign shareholders as well as the contractual rights with the resource providers.

3) The equitable Treatment of shareholders

Fair treatment of minority and foreign shareholders should be ensured through corporate governance framework. The opportunity to receive effective redress for violation of the shareholders rights should be considered.

4) The role of shareholders in corporate governance

In order to undertake economically optimal levels of investment in firm-specific human and physical capital, corporate governance should find ways to encourage the various stakeholders in the firm. Therefore, the governance framework should recognize that the interests of the corporation are served by recognizing the interests of stakeholders and their contribution to the long-term success of the corporation.

5) Disclosure and transparency

The framework should ensure that timely and adequate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company.

6) The responsibility of the board

Roles and responsibility of the board should be clarified in corporate governance framework. Also, ensure that control and monitoring of managers as well as shareholder’s interest are taken into consideration by the board of directors.

3.2.3 Corporate governance and board effectiveness

The monitoring and control roles are important duties of the board of directors. Since there are some difficulties in control and monitoring functions by shareholders, the board of directors is appointed as representative of the shareholders to fulfill monitoring functions. So, an effective board is helpful in monitoring functions to reach shareholder’s goals. Due to this approach, board effectiveness in its monitoring function should be determined by some factors. Such factors are independence, size, expertise and meeting of the board. In order to enhance the effectiveness of the board of directors as a central element of the corporate governance mechanism, literature has been studying the effects of the outside directorship on shareholders wealth (see e.g., Hirshleifcr & Thakor, 1994; Warther, 1998). Accordingly, the board of directors independence, size and composition can be improved by electing outside members.

3.2.4 Board effectiveness

The board of directors has been identified as being an important part of the corporate governance mechanisms, which can resolve manager-shareholder agency problems (Fama & Jensen, 1983). Moreover, board members are responsible in monitoring function to enhance firm’s value. Thus, for corporate governance purposes, it is crucial to establish an effective board as well as to establish its specifications, which influence its effectiveness. In this regard, literature has been reviewed to identify the influencing factors of board effectiveness, as shown in table 3.1.

Table 3.1 Summary of the influencing factors on board of directors based on the results of previous theoretical and empirical studies.

Factor	Effect	Reference
CEO turnover	Mandating turnover of CEO increase board effectiveness.	(Hermalin & Weisbach, 1988)
Independent director	More efficient monitoring by using more independent directors (outside director) than internal directors.	(Alzoubi & Selamat, 2012; Brennan & McDermott, 2004; Weisbach, 1988)
Outside shareholders	The greater the level of ownership by large outside shareholders, the more likely the firm is to nominate an outside CEO.	(Park & Rozeff, 1996)
Size	The smaller size of directors in the board the greater monitoring is expected in terms of independence.	(Jensen, 1993; Linck, Netter, & Yang, 2008; Lipton & Lorsch, 1992)
Expertise	Hiring more expertise in board of directors enhance effectiveness of board in advising and monitoring function.	(Alzoubi & Selamat, 2012)
Meeting	Frequency of meeting enhances board of directors effectiveness considering their monitoring functions.	(Carcello, Hermanson, Neal, & Riley Jr., 2002; Krishnan & Visvanathan, 2009)

The issue of corporate governance is how to reinforce the accountability of the board of directors to shareholders. Therefore, implementing an effective board of directors is necessary for shareholders to maintain firm’s value. In this regard, directors should state via report the effectiveness of the internal control system about the business going concern. Besides, the auditors should report the effectiveness of internal control systems.

3.2.4.1 Effects of the board of directors on audit quality

Shareholders concern on agency problems has been dealt through board of directors in corporate governance structure. Board of directors plays critical roles, since it is responsible to oversees the firm's manager and maintain shareholders wealth. In terms of effective board of directors and adequate relationships between independent auditors and managers, an audit committee is established to enhance the quality of the audits as well as management's financial report and, thereby, maximize shareholders wealth.

The audit committee is identified as crucial to reach effective independent assurance and guide chief executive/board of director on firm's functions. It has been stated that the firms with both independent effective board and audit committee enhance the reliability of financial reports as well as firm's value and improve the ability to attain shareholders interest (Carcello et al., 2002).

Consequently, it is necessary to point independent audit committee members, which is made up of outside directors (Imhoff, 2003).

Association between corporate governance mechanism and audit quality has been studied in several literature works (see e.g., Hay, Knechel, & Wong, 2006; Hay, Knechel, & Ling, 2008; Knechel & Willekens, 2006; Lin & Liu, 2009). The positive association between high audit quality and high quality governance structures have been approved by most studies. The importance of this issue requires being more precise on the corporate governance influence factors as well as their association with other specifications. In this regard, such factors have been analysed in this study in order to find their impact on corporate governance structures.

3.2.5 Influencing factors of the "corporate board of directors"

In the rest of corporate governance structure, there are some factors which affect its mechanism and activity. Size, independence, expertise, and activity (meeting) of the board of directors have been stated as common measures of corporate governance. Investigating all these factors is helpful to improve the understanding on the relationships between firm's performance and corporate governance.

3.2.5.1 Board size

The board of directors roles in the corporate governance of modern firms are crucial to take into consideration its influencing factors. Hence, understanding board size has been identified as helpful and an effective factor in decision making. Both small and large size boards have been discussed in literature, but the majority of studies has highlighted the effectiveness of small size board of directors (e.g., Jensen, 1993; Lipton & Lorsch, 1992).

In terms of communication and coordination problems, larger board of directors may lead to more loss than small size ones, thereby, the effectiveness of the board as well as firm performance can be declined, as stated by Jensen (1993) and Lipton & Lorsch (1992). Also, there can be differences between small and large firm's board structure. When firms are smaller, independence of boards may be increased, because of their small size (Linck et al., 2008). In terms of independence, small boards have a greater proportion of independent directors which can result in increasing the monitoring functions (Alzoubi & Selamat, 2012).

Moreover, the impact of board size on firm value as well as both firm performance and monitoring has been argued in some literature (e.g., Boone, Casares Field, Karpoff, & Raheja, 2007; Eisenhardt, 1989; Yermack, 1996). Consequently, the majority of studies has argued the negative relationships between board size and corporate governance as well as firm value (Mak & Kusnadi, 2005). Consistent with this, Lipton & Lorsch (1992) suggested that effective board size shouldn't be greater than eight or nine directors. This is due to director's remuneration which leads to more costs for larger board. Such costs have direct impact on firm's value (Mak & Kusnadi, 2005).

In addition, board in situation of ideal size may vary with firm size (Eisenhardt, 1989). Such example is complex firms, which demand for greater advisory, have larger boards including more directors (Coles, Daniel, & Naveen, 2008).

3.2.5.2 Board independence and outside members

Board composition should include independent directors in order to better monitoring managers and maintaining firm's value. Non-executive directors are recognized to be nominated as independent corporate-board directors. Such directors are helpful to reduce agency problems through their monitoring and control functions as well as specific oversee of firm's management in day-to-day (Brennan & McDermott, 2004; Cadbury, 1992; Fama & Jensen, 1983; Fama, 1980). Therefore, independent directors enhance the effectiveness of monitoring function as well as reliability of financial statements. Such reliability may be enhanced with greater portions of independent directors on board and, thereby, prevent the presentation of deceptive financial statements (Beasley, 1996).

Moreover, electing board members from outside directors is associated with higher independence, and thus effectiveness of the corporate governance (Board of directors) can be improved. Both inside and outside directors are pointed in purpose of monitoring and advisory functions. Considering the firms' performance, firms with larger gray non-executive directors on the board are less likely to fail their functions (Hsu & Wu, 2013). This situation may influence the performance of the family firms. So, gray directors in such firms may have positive impact on performance (Arosa, Iturralde, & Maseda, 2010).

However, due to the board of directors' effectiveness, outside members are able to present a greater advisory function compared with inside directors. In terms of the firm valuation, positive effect of outside directors proportion have been widely investigated, for instance by Alzoubi & Selamat, (2012) and Kim & Lim, (2010). Also, they argued about nominating outside directors with diversity of academic major or age, which positively affect the firm's value. Therefore, academic major as well as independence performance of the outside members on board are the director's specifications, which may influence firm's value.

Turnover of the CEO is a factor which may influence board of director's independence. Thus, CEO turnover can be one of the influencing measure of the board effectiveness that helps to improve corporate governance structure. Hermalin & Weisbach (1988) have argued that mandating turnover of CEO on board can increase board effectiveness. Also, they have investigated the different views of inside and outside directors on CEO rotation. Inside directors do not desire to remove CEO if their interests are tied to CEO. Outside directors compared with inside directors may have reputational incentive to rotate an ineffective CEO.

In fact, outside directors, in order to maintain their reputation, are not likely to impair their independence. So, board with outside directors may make better decision than boards with only inside directors. In this case, outside directors have more influence on board decision (Dahya & McConnell, 2005). Moreover, CEO turnover not only may help to maintain director's independence, but also is helpful in monitoring function as well as performing advising roles (Kim, Mauldin, & Patro, 2014).

3.2.5.3 Board financial expertise

Expertise is an important specification of a director which affects the board of directors' effectiveness. Considering a good corporate governance structure, board of directors need expertise and experience besides other specifications of directors, to make better decision on firm performance as well as monitoring functions. Thus, expertise of directors may be crucial when directors should rely on their own decision making as well as their monitoring function. Also, necessity of expertise in business result in enhancing the effectiveness and efficiency of advising role of outside directors in firms (Kim & Lim, 2010).

Financial expert director is a type of director in board that particularly affects the corporate financial decision. Such expertise results from director's experience as well as accounting and finance knowledge. Due to size factor, small board size with larger independent director as well as more financial expertise are more effective in their monitoring process (Alzoubi & Selamat, 2012). So, if board of directors include greater financial expertise members, then high quality audit may be demanded for director's interests (Carcello et al., 2002).

Therefore, higher level of board expertise tracks higher incentive of monitoring function in order to enhance firm's value. In addition, financial expert directors have more incentive to lead management to follow high quality accounting policies (Jiang, Ferris, & Coffman, 2009). In this regard, such expertise is crucial to improve the effectiveness of the board of directors in decision making (Defond, Hann, & HU, 2005).

In summary, financial expertise through monitoring of firms' performance as well as advisory services can improve corporate governance mechanism, and stronger board of directors in such mechanism is helpful to enhance shareholders wealth.

3.2.5.4 Board meetings

Formal meetings of the board of directors, should be held usually at appropriate times to consider policy issues and major problems, such as financial problems. The board of directors as a key element of corporate governance, should manage the meetings based on their key responsibility which is, among others, monitoring the financial reporting process and maintaining overall accordance with shareholders' interests. In effect, effectiveness of the board of directors affects the corporate governance mechanisms and firm's performance.

In this regard, meeting frequency has been identified as helpful in improving the board of directors' effectiveness (see e.g., Carcello et al., 2002; Krishnan & Visvanathan, 2009). Vafeas (1999) indicated that frequency of board meeting is negatively related to firm's value. This is due to increasing the frequency of board meeting leads to share price decline. In fact, if benefits of increasing board meeting frequency are over emphasized, board meeting frequency will be negatively related with firm value. Finally, he concluded that board activity which is measured by meeting frequency is an important matter on board of directors' operation.

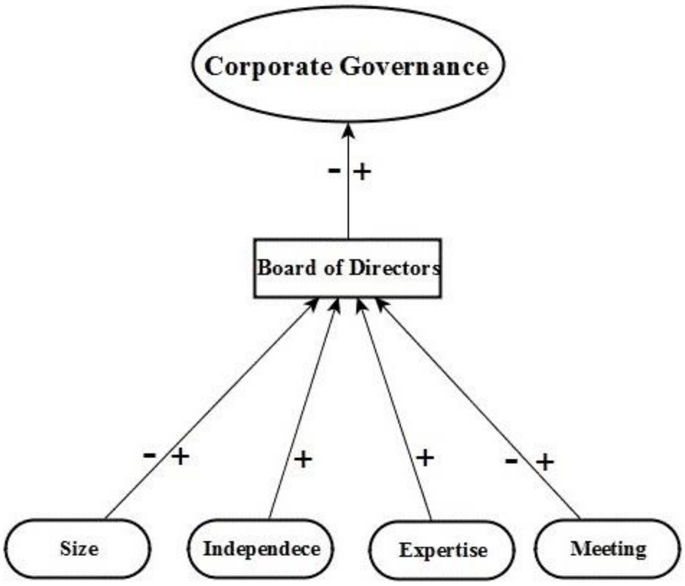
Krishnan & Visvanathan (2009) have argued that higher board of directors' meeting is positively related to audit fees, which is due to additional works leading to higher audit quality. Moreover, meeting frequency is an important dimension of board functions, especially in preventing the fraud (Chen, Firth, Gao, & Rui, 2006). Therefore, frequency of the board of directors is positively associated with fraud occurrence.

Recently, Chou, Chung, & Yin (2013) have argued about the presence in meeting of directors by themselves. They indicated that more effective directors intend to participate in the meetings themselves, not by their representatives. In addition, they concluded that firm's performance may be enhanced through high number of meetings of directors by themselves. On the contrary, high number of meetings with directors' representatives may decline firm's performance. In terms of recent regulation improvements, board activity has a positive effect on the firm's value (Brick & Chidambaran, 2010). This may be due to the fact that more frequent meeting lead to more monitoring and applying new policies and regulations.

In summary, board of directors frequency meeting leads to higher monitoring of management financial functions as well as ensuring the application of regulations, thereby, enhancing the board effectiveness. Considering the board of directors' influencing factors, its effectiveness influences the corporate governance mechanisms positively or negatively.

Figure 3.4 shows the effects of board of directors' factors on board effectiveness and also its effects on corporate governance.

Fig. 3.4 The observed relationships between board of directors' factors and bord of directors and its interaction with corporate governance.



3.3 Audit Committee

Maintaining accounting records and obtaining assurance on their accuracy and adequacy requires internal control and monitoring activities. Such control should be applied through cooperation between the board of directors and financial management. In fact, the board of directors should have implicit control over financial management function. Eventually, at the end of each period, board of directors should state the effectiveness of internal control as well as firm's going concern, *via* a report to the auditors. By adopting this approach, audit committee has been considered as a financial operating committee which cooperate with the board of directors, to be accountable on financial reporting process (Cadbury, 1992). Then, audit committee statements together with board's annual report are considered during decision making process.

3.3.1 Audit committee responsibility

The primary responsibilities of the audit committee in cooperation with board of directors can be verifying:

- "The integrity of the company's financial statements;
- The independence, integrity, qualification and performance of the external auditors;

- The performance of the company's internal audit function;
- The appropriateness of internal control systems of corporation;
- The monitoring of compliance with laws and regulatory requirements and code of conduct (Soltani, 2007, p.95)."

Audit committees play key roles in corporate governance. They perform their duties via the framework of governance rules. Their responsibility to perform the identified practice by the board should be done in line with implemented framework. The responsibilities and duties of the audit committee, is promoted by corporate governance, based on the firms' objectives and shareholders wealth. Also, importance of the financial function in organizations necessitates the audit committee accountability in order to answer the legal interests of the stakeholders (Dezoort et al., 2002).

3.3.2 Audit committee effectiveness

Audit committee is linked to (but not dependent of) the board of directors.Thus, fluctuations in its effectiveness may affect the board of directors' effectiveness regarding financial statements. In this regard, the structure of audit committee, as well as its specifications should be taken into consideration in order to enhance its effectiveness. Several studies have investigated the influencing factors on the effectiveness of audit committee (see e.g., Dezoort et al., 2002; Mohiuddin & Karbhari, 2010; Walker, 2004). In this regard audit committee composition, authority, resources and diligence have been identified as the most important factors.

Audit committee meeting as well as its composition, including independence, size and expertise, have been found as critical specifications which may influence audit committee effectiveness (Alzoubi & Selamat, 2012; Mohiuddin & Karbhari, 2010). Audit committees should have adequate authority to perform their duties as well. Their authority is associated with rules and regulations and board of directors which may influence the audit committee performance and, thereby, enhance their effectiveness (Dezoort et al., 2002).

Kamel & Elkhatib (2013) indicated that the review of changes in the accounting policies and practices, is an important function of an effective audit committee. In addition, the authority of committee acts as a consultant due to its oversight responsibility, as well as its accounting and financial knowledge (financial expertise), can improve the committee's effectiveness (Salleh & Stewart, 2012). In this study, considering the importance of audit committee, its influencing factors have been reviewed in order to find their relationships with the audit committee effectiveness.

3.3.3 Audit committee factors

3.3.3.1 Audit committee size

When the audit committee varies in its size, there are consequences on its effectiveness and good performance. In terms of monitoring functions, large audit committees may decrease performance because of coordination and communication problems in committee (Jensen, 1993). Contrary to this approach, large audit committees may present higher quality of their performance due to more committee members (Yang & Krishnan, 2005).

Moreover, small size audit committees might have less ability (because of less members) to accomplish their duties, such as monitor the overall financial operations as well as its other duties. In other words, inappropriate number of members may impair the effectiveness of audit committee functions (Vafeas, 2005).

Raghunandan & Rama (2007) concluded that increasing the number of audit committee members may provide more effective monitoring. In this regard, several studies have suggested that establishment of an appropriate size of audit committee can enhance its performance and its effectiveness (see e.g., Carcello & Neal, 2000; Davidson, Xie, & Xu, 2004; Raghunandan, Rama, & Read, 2001; Vafeas, 2005; Xie, Davidson, & DaDalt, 2003). So, audit committee size can affect audit committee effectiveness, particularly in financial reporting integrity and monitoring functions. In this regard, positive relationship between audit committee size and financial reporting quality is expected.

3.3.3.2 Audit committee independence

Audit committee should play a critical role in financial process. Audit committees should be in cooperation with auditors and management and should review and monitor the financial reporting process.

Considering the cooperation with auditor, monitoring of both audit and non-audit fee by independent audit committee is necessary to help auditors to maintain their independence.

Therefore, there may be a positive relationship between independent audit committee and audit independence (Beattie, Brandt, & Fearnley, 1999).

So, audit committee should be independent of the firm and its management, to perform with higher effectiveness to accomplish shareholder's interests and firms value. Moreover, higher quality of financial reporting process is expected if more independent members are included in audit committees (Be´dard et al., 2004).

In addition, there is a negative association between the independence of the board of directors and financial fraud (Beasley, 1996). It is also clear that more independent members in audit committee can be beneficial to enhance audit committee effectiveness, reducing financial fraudulent activities and improving firm's value

Considering the management and auditor communications, audit committee with independent members establishes effective treatment to prevent management interference in audit process. In fact, audit committee is a link between auditors and management activities (Goodwin-Stewart & Kent, 2006).

Since audit committees effectiveness affect both auditors and management behaviors (Fearnley & Beattie, 2004), their independence can influence the reviewing of non-audit services as well as auditor's activities. Such approaches can be reliable, if members are truly independent and committed to fulfill their duties in order to improve the effective governance (Sori, Mohamad, & Karbhari, 2009).

Moreover, Bronson, Carcello, Hollingsworth, & Neal (2009) have argued about the adequate amount of independence is needed for audit committee. They have suggested that the advantages of audit committee independence are attainable when the audit committee is completely independent.

In summary, independence of audit committee has been identified as an important factor which can have a significant positive relationship with audit committee effectiveness.

3.3.3.3 Audit committee expertise

The expertise of audit committee plays an important role in improving its effectiveness (e.g., Beasley, 1996; Defond, Hann, & HU, 2005; DeZoort & Salterio, 2001). Audit committees with expert members, who have special knowledge and experiences in their task, are at higher levels of their performance. This is mainly due to their potential abilities in performing their duties. Therefore, expertise in audit committees is critical. This is mainly due to the fact that audit committee's main duties are monitoring corporate financial reporting as well as the auditing process (Lin et al., 2008).

So, effective audit committees with expert members may enhance both technical information and competence of financial parties in firms. This helps to resolve some difficulties which arise from accounting and financial functions. Such difficulties are due to the possible conflicts between management and external auditors in making decision about some complex accounting issues. Since there are such conflicts, audit committees with expertise members are able to resolve the complexity of issues with their technical knowledge and experiences (Knapp, 1987). So, committee members with financial knowledge can positively enhance audit committees effectiveness (Dellaportas, Leung, & Cooper, 2012; DeZoort & Salterio, 2001). This is due to their abilities to ensure a high quality financial reporting process, and to comply with the implemented rules.

Effectiveness of audit committees with financial expertise may improve corporate governance effectiveness, through enhancing the shareholder's value. Consistent with this, Defond et al. (2005) have argued about the interaction between strong corporate governance and financial expertise in firms. Finally, they found positive interaction of this association, which can support the need of accounting financial expertise in corporate governance. In addition, corporate governance effectiveness can be improved by audit committees financial expertise.

According to Abbott & Parker (2000) audit committees without industry experts have annually two meetings are more likely to use expert auditors. So, industry expertise can be considered an important factor of auditor selection which can potentially influence the audit committee functions. In summary, expertise is an important influencing factor of audit committee that plays a critical role in audit committee effectiveness and functions.

3.3.3.4 Audit committee meeting

Previous studies have aimed to attain an optimal frequency for audit committee meetings in order to improve the audit committees effectiveness (see e.g., Abbott, Parker, Peters, & Rama, 2007; Sharma, Naiker, & Lee, 2009; Song & Windram, 2004; Yin, Gao, Li, & Lv, 2012). Anderson, Mansi, & Reeb (2004) noted that audit committee, as an important element of corporate governance, can affect the reliability of financial report. In addition, Chen (2008) concluded that the number of audit committee meetings is an important mechanism of corporate governance.

In terms of meeting frequency, a minimum of two meetings has been suggested by Menon & Deahl Williams (1994) to guarantee an effective audit committee. On the other hand, Abbott et al. (2007) and Sharma et al.(2009) identified that the frequency average of annual meetings of audit committee must be at least around four times a year to achieve an effective audit committee. In addition, single annual meeting is not adequate to reach an effective audit committee control (Deli & Gillan, 2000). Hence, optimal frequency is needed to reach the positive effects of audit committee on the firm's financial matters.

In this regard, empirical evidences have approved the positive relationship between frequency of committee meeting and the quality of a firm's financial issue (Abbott, Parker, & Peters, 2004).

Although most of the studies have concluded that an optimal number of meeting frequency improve the reporting quality as well as audit committee effectiveness, Ismail, Iskandar, & Rahmat (2008) found no influence of meeting frequency on the reporting quality.

Considering the board of directors monitoring, audit committees with more frequent annual meeting are expected to fulfill their oversight responsibility (Xie et al., 2003). In other words, more effective monitoring functions may occur as a result of higher frequency of audit committee meetings (Alzoubi & Selamat, 2012).

However, Yin et al. (2012) found a negative association between the number of audit committee meetings and the proportion of independent members in a board of directors. Also, they stated that there is a positive relationship between frequency of meeting and both audit committee and firm size.

In terms of audit process, more frequency of committee meetings may lead to higher audit fees. This is mainly due to the higher audit quality that may be demanded as a result of more committee meetings (Krishnan & Visvanathan, 2009). In this regard, demanding for higher audit quality requires additional work as well as utilizing related procedures by external auditors and, thereby, increase audit fee (Houghton & Jubb, 1999). So, the more frequency of committee meetings the higher audit quality as well as higher audit fees is expected. Table 3.2 illustrates the effects of the influencing factors on the audit committee based on the results of previous theoretical and empirical studies.

Table 3.2 Summary of the influencing factors on the audit committee effectiveness based on the results of previous theoretical and empirical studies.

Factor	Effect	Reference
Size	Large audit committees may present higher quality performance.	(Yang & Krishnan, 2005)
	Large audit committees may present lower quality performance due to board's communication problems.	(Jensen, 1993)
Independence	The more independent audit committee members the higher quality financial processes are expected.	(Be´dard et al., 2004)
	The more independent audit committee members the less financial fraud may occur.	(Beasley, 1996; Kamel & Elkhatib, 2013)
	Independence of the audit committee members is positively associated with external auditors' independence.	(Beattie et al., 1999)
Expertise	Audit committee with relevant industry knowledge leads to higher quality financial reporting process in terms of monitoring functions.	(Dellaportas et al., 2012; Lin et al., 2008)
	Higher committee's technical knowledge can help to solve auditor-management conflicts in complex accounting issues.	(Knapp, 1987)
Meeting	Audit committee meeting frequency is positively associated with the quality of financial reporting process.	(Abbott et al., 2004)
	More frequency of committee meeting can enhance the audit committee effectiveness in monitoring functions.	(Alzoubi & Selamat, 2012; Xie et al., 2003)
	The negative association between audit committee meeting frequency and director members' independence may occur.	(Yin et al., 2012)
	Both audit committee and firm's size are positively influenced by meeting frequency.	(Yin et al., 2012)

3.3.4 Effect of audit committee and audit quality measures on the audit fees

3.3.4.1 Effect of audit committee measures on Audi fees

The purpose of maintaining shareholder's interest leads to improve corporate governance mechanisms. By performing audit committee's main tasks, higher transparency of financial report as well as higher audit quality may be captured to ensure shareholders wealth. Audit committees determinants have been widely studied in order to improve audit committees main tasks, such as financial reporting process and monitoring the relationships between a firm's management and its external auditors.

In addition, audit committees can play an important role in reviewing the external auditors outputs as well as the audit fees (Cadbury, 1992). So, implementing an effective audit committee may lead to decrease the audit fees, due to its monitoring functions (Be´dard et al., 2004).

Moreover, Goodwin-Stewart & Kent (2006) considered that effective internal control is also an important element to reduce audit fees. Because the external auditor's work is reviewed by audit committee higher audit quality is expected. Higher expectation of audit quality leads to fluctuations of audit fees. In this regard, determinants of audit committee (such as size, independence, expertise and, meeting) have been stated as proxies of audit fees in the literature.

In terms of audit committee size, positive relationship between audit fees and committee size is expected. In fact, larger audit committees may elect higher quality external audit in order to achieve higher financial reporting quality, thereby leads to higher audit fees resulting from auditor's additional work. In other words, since higher audit quality is expected (by using larger audit committees) from external auditor, the auditors should spend more time to fulfill their duties, which lead to higher audit fees (Kalbers & Fogarty, 1993).

Corporate governance with more independent audit committee members demand higher quality for financial reporting from auditor, when monitoring the firm's financial reporting. Therefore, such demands from external auditor may lead to higher audit fees. So, there is a positive relationship between independent committee members and audit fees (Abbott, Parker, Peters, & Raghunandan, 2003; Rustam et al., 2013; Yatim, Kent, & Clarkson, 2006).

Moreover, Griffin, Lont, & Sun (2008) have predicted both negative and positive relationships between audit committees and audit fees. They have concluded that effective corporate governance with more independent audit committee members normally pay higher audit fees (positive relations). In addition, audit committee independence may interact negatively with audit risk which leads to decrease the audit fees (negative relations). So, independence of audit committee members affects the audit fees positively or negatively.

Audit committee expertise is an important factor which can affect audit fees. The effective audit committee attempts to include experts, who are likely to enhance financial reporting quality, through appropriate behavior in communication with auditors.

Therefore, audit committees with less financial expertise and auditing knowledge may not be able to support external auditors, adequately. Such miss-supporting may lead to additional work for external auditors which may increase audit fees (DeZoort & Salterio, 2001).

However, although positive association between audit committee expertise and audit fees hasn't been found by Rustam et al. (2013), positive relationship has been concluded in literature (see e.g., Abbott et al., 2003; Yatim et al., 2006). Frequency of audit committee meetings can enhance the review of financial reporting process as well as external auditors. This may lead to enhance the audit committee's expectation for higher audit quality. In terms of meeting frequency, external auditor are more concerned to reach higher audit quality which requires additional procedures and, thereby, increases audit fees (Krishnan & Visvanathan, 2009).

In addition, presence of external auditor at audit committee meetings (which is usual or even mandatory in some countries) and their accountability duties may increase auditor's time that leads to higher audit fees (Rustam et al., 2013).

On the contrary, Abbott et al. (2003) mentioned that meeting frequency is not associated with higher audit fees. As a result, most studies have stated a positive relationship between meeting frequency and audit fees (e.g., Krishnan & Visvanathan, 2009; Rustam et al., 2013; Yatim et al., 2006). Table 3.3 illustrates the relationships between influencing factors of audit committee and audit fees, based on the results of previous theoretical and empirical studies.

Table 3.3 Summary of the discovered association between influencing factors on audit committee and audit fees based on the results of previous theoretical and empirical studies.

Factor	Effect	Reference
Size	Audit committee size is positively associated with audit fees, since auditors normally spend more time due to their additional work.	(Kalbers & Fogarty, 1993)
Independence	There is a positive relationship between independent committee members and audit fees, resulting from higher expectation of such committee to auditor work.	(Abbott et al., 2003; Griffin et al., 2008; Rustam et al., 2013)
	Considering the negative association between audit committee independence and audit risk, lower audit fees is expected.	(Griffin et al., 2008)
Expertise	The less expertise in audit committee can lead to miss-supporting of the auditor, and, hence higher audit fees may be demanded due to the needs of auditor's additional work. (Negative relation)	(DeZoort & Salterio, 2001)
	There is a positive relationship between audit committee expertise and audit fees in terms of more monitoring of auditors' work.	(Abbott et al., 2003)
Meeting	The more frequency of meetings the more financial report reviewing and the higher expectation from external auditor, which leads to higher audit fees (positive relation).	(Abbott et al., 2003; Krishnan & Visvanathan, 2009; Rustam et al., 2013; Yatim et al., 2006)

3.3.4.2 Effect of audit quality measures on audit fees

According to International Auditing and Assurance Standards Board (IAASB), audit quality is an important issue. In order to prevent new corporate scandals, influencing factors of audit quality (such as size, audit tenure, expertise, audit fees, non-audit services, audit reputation, auditor independence and liability) have been widely studied in both theoretical and empirical studies (DeAngelo, 1981b; DeFond et al., 2002; DeFond, 2012;

Francis, 2004; F. A. Gul et al., 2007; Lennox & Li, 2012; Palmrose, 1988; Teoh & Lim, 1996). Such factors, not only have been identified as audit quality determinants, but also have been investigated in correlation with each other when one of them is considered as a proxy of audit quality. For instance, audit fees can be considered by auditor's independence, audit firm size, liability, expertise and auditor reputation, as its fluctuations affect the audit quality. In this regard, the impact of audit fees on audit quality influencing factors have been reviewed in this study, in order to analyse its effects on audit quality.

Both audit and non-audit fees have been identified as possibly increasing, since higher audit quality may need additional works (DeFond et al., 2002). It can also happen that at the first year of audit that the auditor attempts to fulfill the lack of client's knowledge by using expertise (Stanley & Todd DeZoort, 2007). Thus, enhancing audit expertise can lead to higher audit quality (Francis, 2004) and, thereby, to demand the higher audit fees. So, there is a positive relationship between audit fees and audit quality, if the effect of audit expertise is considered (Cahan et al., 2008; Craswell et al., 1995).

Larger audit firms are more likely to maintain their clients, since they are more reputable compared with small audit firms. In fact, they are attempted to issue reliable audit report to enhance audit quality. Thus, larger audit firms may demand for higher audit fees due to their reputation (DeAngelo, 1981b). In addition, as the large audit firms are more precise in bonding and monitoring functions, client may demand large audit firms to attain higher audit quality. In this regards, higher audit fees is expected by the larger audit firms (Hay & Davis, 2004).

Moreover, high risk client may influence the audit firms reputation negatively, and thus, higher audit fees may be charged by larger audit firms (Hogan, 1997; Hussein & Hanefah, 2013). Auditors are likely to fulfill an acceptable level of their tasks in order to maintain their reputation. Given this, higher audit fees may lead to higher audit quality, as a result of maintaining the reputation by using higher qualified auditor (Eshleman & Guo, 2014). As a consequence of "capital theory" higher reputable audit firms can demand higher audit fees, resulting from the market value of their audit reports (Lindberg, 2001).

However, auditor's independence may be declined, because of such higher audit fees which may lead to enhance client's incentive to receive a clean report (DeFond et al., 2002). So, a negative association between audit fees and auditor reputation may occur (Tomczyk, 1996).

Large audit fees received from a client, have been found as an important factor of audit quality which can impair the auditor independence (Teoh & Lim, 1996). Also, auditor independence can be impaired, since there is a temptation to earn more non-audit fees (Frankel et al., 2002).

In terms of client acceptance, audit firms are not likely to accept high risk clients, because of attorney fees and loss of reputation (Laux & Newman, 2010). Also, acceptance of such clients may decline auditor's independence because of demanding higher audit fees (Schneider, 2011). Consequently, higher audit fee is negatively associated with the auditor independence, due to the effects of the high risk clients acceptance on audit quality.

Table 3.4 presents the possible relationships between influencing factors of audit quality and audit fees based on the results of previous theoretical and empirical studies.

Table 3.4 Summary of the association between influencing factors on audit quality and audit fees, based on the results of previous theoretical and empirical studies.

Factor	Effect	Reference
Size	Larger audit firm may demand for higher audit fees due to their higher reputation, higher quality of bonding and monitoring functions, and maintaining their reputation from accepting high risk client.	(DeAngelo, 1981b; Hay & Davis, 2004; Hogan, 1997)
Independence	Independence of the auditors may be impaired due to their temptation for more audit fees and non-audit fees.	(Frankel et al., 2002; H. Y. Teoh & Lim, 1996)
	Higher audit fees are negatively associated with auditor independence, since high risk client acceptance can affect audit quality.	(Laux & Newman, 2010; Schneider, 2011)
Expertise	Using more expertise leads to higher audit quality and, thereby, increase audit fees.	(Francis, 2004; Stanley & Todd DeZoort, 2007)
Reputation	Maintaining auditor's reputation leads to both higher audit quality and audit fees, since using qualified auditor is required to issue more credible audit report.	(Eshleman & Guo, 2014; Lindberg, 2001)
	Negative relationship between higher audit fees and reputation may occur because of the client's incentive to receive clean audit report.	(DeFond et al., 2002)

Chapter 4: Discussion and conclusion

4.1 Discussion

4.1.1 Interaction of corporate governance (considering audit committee) with audit quality

According to the key references, both effective or weak audit committee (important component of corporate governance) strongly influence audit quality. For instance, larger audit firms with higher reputation and expertise may use additional work, which lead to higher audit fees and, thereby, enhance audit quality.

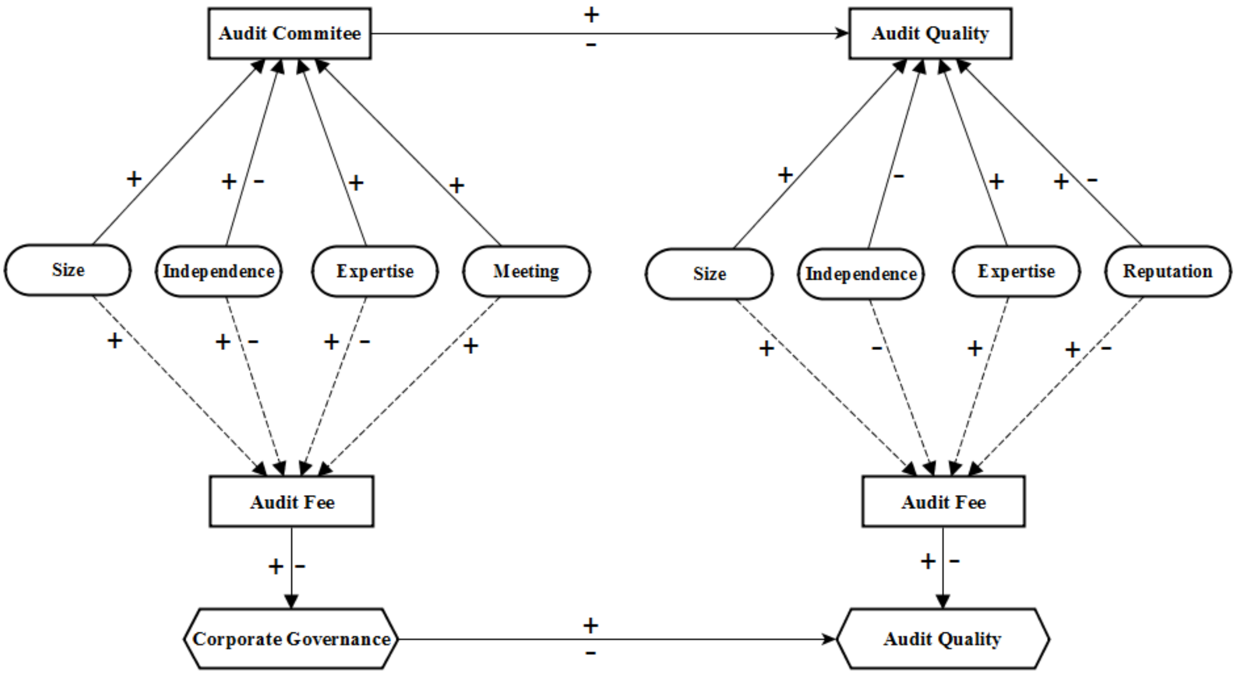
However this higher audit quality may not be due to larger audit firms with higher reputation, since effective audit committee plays an important role in defining both non-audit and audit fees. In this regard, external auditors are likely to issue adequate reports, which leads to maintain auditor independence and, thereby, enhance audit quality. This situation may cause doubts in auditor acceptance decision, because decision makers are not ensured if the higher audit quality results from effective audit committe or is affected by other factors.

Moreover, weak audit committee may lead to lower audit quality. Since temptation of higher non-audit services as well as higher audit fees may impair independence of external auditors, lower audit quality may occur. Otherwise, this lower audit quality may be resulted from lower monitoring works of audit committees in weak corporate governance mechanisms. This can cause uncertainty to the decision makers for auditors acceptance.

As a result, decision makers need to know, first, if fluctuation of audit quality is a result of both performance quality of the corporate governance and other audit quality factors, or just one of these elements. Secondly, they should be ascertained on the amount of corporate governance effectiveness to analyze audit quality and, then, to decide about auditor acceptance.

Figure 4.1 shows the association between audit committee and its factors with audit fees and the effects of audit quality factors on audit quality when they are considered as determinants of audit fees. This figure also shows that audit committee, as component of corporate governance, can affect audit quality assessment positively or negatively.

Fig. 4.1 The observed relationships between audit quality factors and audit fees and the corporate governance interaction.



Note.1-The observed relationships between audit quality factors and audit fees and their interaction with audit quality are based on table 3.4. 2-The observed relationships between audit committee factors and audit fees and their interaction with audit quality are based on table 3.3. 3-The interactions of corporate governance with audit quality is shown as a result of these relationships.

4.2 Conclusion and further research directions

4.2.1 Conclusion

Considering the main purpose of this thesis, a literature review has been conducted. The main purpose was to identify corporate governance mechanisms and its effectiveness as well as the existing relationship between corporate governance and audit quality through both a comprehensive and a comparative review.

In terms of audit quality importance and its influencing factors, size of audit firm can be considered as one of the most important factors which can affect the other factors as well as the overall audit quality.

Furthermore, the reviewed factors, including size, industry expertise, auditor tenure, audit fees, non-audit service, auditor reputation and auditor specifications, were found to be related with each other when studying the effect of each individual factor on audit quality. Also, auditor specifications such as professional competence, technical ability, independence and auditor's liability have been identified to have significant effects on audit quality. Consequently, both audit quality influencing factors and specifications significantly affect the audit quality changes.

Corporate governance helps to resolve agency (manager-shareholder) problems and effectiveness of corporate governance mechanism enhance shareholders wealth. It has been identified that corporate governance structure is important to monitor the management as well as firm performance, in order to enhance firm value.

Composition of the board has been taken into consideration in terms of its specifications. Such specifications affect the corporate governance effectiveness and, thereby, enhance firm value. Independence of the directors (outside directors) can be considered as one of the most important specifications of the board of directors. Since it considers together with size and expertise of the board members, effectiveness of the board on both advising and monitoring functions as well as firm performance can be taken into account.

As a result, implementing an effective board of directors through their specifications, not only can be helpful on corporate governance mechanisms, but also can be critical in advancing firm's performance to reach the shareholders' objectives.

Moreover, this thesis supports the improvement of the corporate governance as well as its interactions on the audit quality with the aim of the satisfying market decision makers' needs. It has been covered one of its main objectives through a comparative review of the relationship between audit committee effectiveness and audit quality. Also, the fluctuating of audit fees, which are affected by audit quality influencing factors, as well as the determinants of audit committee effectiveness, have been considered to illustrate the interaction of the corporate governance effectiveness on the audit quality.

Although, the audit committee determinants (such as size, independence, expertise and, meeting) were found important in order to enhance its effectiveness, independence of the audit committee members can be considered as the most important factor (see table 3.2).

Further, it was observed that the interactions between the audit fees and the audit quality factors can affect the overall audit quality, positively or negatively (see table 3.4).

Consequently, both size and independence, as the most important factors of the audit quality, should be taken into account when they are affected by audit fee.

According to the achieved results, audit fees fluctuations were found to be associated with the audit quality and audit committee. This shows the effect of the interaction of audit quality and audit committee factors with audit quality (table 3.3).

Finally, the interaction of the audit committee, as a corporate governance component, with audit quality has been investigated as a crucial issue for decision makers.

The results show both negative and positive effects of the corporate governance on the audit quality (see Fig. 4.1). As a result, considering such relationship, the effectiveness of the corporate governance as well as its weaknesses can be taken into account when audit quality is analyzed by its factors.

4.2.2 Further research directions

It would be necessary to perform efficient and more reliable audit quality assessments in order to improve the information quality available to third parties. Hence, further empirical studies are suggested to be carried out in order to identify and to quantify the effectiveness of the corporate governance and audit quality factors.

As the next step, four hypotheses (as followings) can be taken into consideration, to discover the probable relationships between audit committee's influencing factors and audit fees, by using statistical regression methods.

Hypothesis

H1. There is a positive relationship between audit committee independence and audit fees.

H2. There is a positive relationship between audit committee size and audit fees.

H3. There is a positive relationship between committee meeting frequency and audit fees.

H4. There is a positive relationship between committee member expertise and audit fees.

Based on the achieved results, the effects of these hypotheses on the audit quality should be examined to assess the effect of the corporate governance effectiveness on the audit quality assessment.

Table 4.1 illustrates the proposed dependent and independent variables with the expected relationships for further studies.

Table 4.1 Predicted dependent and independent variables for further studies.

Variables	predicted variables	Expected relationship	References
Audit fee	Amount of fees paid to external auditors.	Positive	(Rustam et al., 2013)
Committee Size	Number of directors serving on the audit committee.	Positive	(Menon & Deahl Williams, 1994; Rustam et al., 2013)
Committee Independence	Binary variable, =1 if at least one insider serves on the committee, and 0 otherwise.	Positive	(Abbott et al., 2003, 2007; Rustam et al., 2013)
Committee Expertise	Proportion of financial experts in committee.	Positive	(Abbott et al., 2003; Rustam et al., 2013; Yatim et al., 2006)
Committee Meeting	The number of meetings held by the audit committee.	Positive	(Goodwin-Stewart & Kent, 2006; Menon & Deahl Williams, 1994; Rustam et al., 2013)

References

Abbott, L. J., & Parker, S. (2000). Auditor Selection and Audit Committee Characteristics. *AUDITING: A Journal of Practice & Theory*, *19*(2), 47–66.

Abbott, L. J., Parker, S., & Peters, G. F. (2004). Audit Committee Characteristics and Restatements. *AUDITING: A Journal of Practice & Theory*, *23*(1), 69–87.

Abbott, L. J., Parker, S., Peters, G. F., & Raghunandan, K. (2003). The Association between Audit Committee Characteristics and Audit Fees. *AUDITING: A Journal of Practice & Theory*, *22*(2), 17–32.

Abbott, L. J., Parker, S., Peters, G. F., & Rama, D. V. (2007). Corporate Governance , Audit Quality , and the Sarbanes-Oxley Act : Evidence from Internal Audit Outsourcing. *The Accounting Review*, *82*(4), 803–835.

Acemoglu, D., & Gietzmann, M. B. (1997). Auditor independence, incomplete contracts and the role of legal liability. *European Accounting Review*, *6*(3), 355–375.

Adenuyi, S. I., & Mieseigha, E. G. (2013). Audit Tenure : an Assessment of its Effects on Audit Quality in Nigeria. *International Journal of Academic Research in Accounting , Finance and Management S Ciences*, *3*(3), 275–283.

Aguilera, R. V. (2005). Corporate Governance and Director Accountability: an Institutional Comparative Perspective. *British Journal of Management*, *16*, 39–53.

Alzoubi, E. S. S., & Selamat, M. H. (2012). The Effectiveness of Corporate Governance Mechanisms on Constraining Earning Management: Literature Review and Proposed Framework. *International Journal of Global Business*, *5*(1), 17–35.

Anderson, R. C., Mansi, S. A., & Reeb, D. M. (2004). Board characteristics, accounting report integrity, and the cost of debt. *Journal of Accounting and Economics*, *37*(3), 315–342.

Arosa, B., Iturralde, T., & Maseda, A. (2010). Outsiders on the board of directors and firm performance: Evidence from Spanish non-listed family firms. *Journal of Family Business Strategy*, *1*(4), 236–245.

Arrunada, B. (2000). Audit quality: attributes, private safeguards and the role of regulation. *European Accounting Review*, *9*(2), 205–224.

Balsam, S., Krishnan, J., & Yang, J. S. (2003). Auditor Industry Specialization and Earnings Quality. *AUDITING: A Journal of Practice & Theory*, *22*(2), 71–97.

Barbara, A., Richard, B., & Kurt, P. (2006). Findings on the Effects of Audit Firm Rotation on the Audit Process under Varying Strengths of Corporate Governance. *Advances in Accounting*, *22*(06), 1–27.

Basioudis, I., & Fifi, F. (2004). The market for professional services in Indonesia. *International Journal of Auditing*, *8*(2), 153–165.

Bauwhede, H. Vander, & Willekens, M. (2004). Evidence on (the lack of) audit-quality differentiation in the private client segment of the belgian audit market. *European Accounting Review*, *13*(3), 501–522.

Be´dard, J., Chtourou, S. M., & Courteau, L. (2004). The Effect of Audit Committee Expertise, Independence, and Activity on Aggressive Earnings Management. *AUDITING: A Journal of Practice & Theory*, *23*(2), 13–35.

Beasley, M. S. (1996). Empirical Analysis the of Board the Relation of Financial Between Composition Statement Fraud. *The Accounting Review*, *71*(4), 443–465.

Beattie, V., Brandt, R., & Fearnley, S. (1999). Perceptions of auditor independence: U.K. evidence. *Journal of International Accounting, Auditing and Taxation*, *8*(1), 67–107.

Boone, A. L., Casares Field, L., Karpoff, J. M., & Raheja, C. G. (2007). The determinants of corporate board size and composition: An empirical analysis. *Journal of Financial Economics*, *85*(1), 66–101.

Brennan, N., & McDermott, M. (2004). Alternative Perspectives on Independence of Directors. *Corporate Governance*, *12*(3), 325–336.

Brick, I. E., & Chidambaran, N. K. (2010). Board meetings, committee structure, and firm value. *Journal of Corporate Finance*, *16*(4), 533–553.

Bronson, S. N., Carcello, J. V., Hollingsworth, C. W., & Neal, T. L. (2009). Are fully independent audit committees really necessary? *Journal of Accounting and Public Policy*, *28*(4), 265–280.

Cadbury, C. (1992). *The Report of the Committee on the Financial Aspects of Corporate Governance*. London.

Cahan, S. F., Godfrey, J. M., Hamilton, J., & Jeter, D. C. (2008). Auditor Specialization, Auditor Dominance, and Audit Fees: The Role of Investment Opportunities. *The Accounting Review*, *83*(6), 1393–1423.

Carcello, J. V, & Neal, T. L. (2000). Audit Committee Composition and Auditor Reporting. *The Accounting Review*, *75*(4), 453–467.

Carcello, J. V., Hermanson, D. R., Neal, T. L., & Riley Jr., R. a. (2002). Board Characteristics and Audit Fees. *Contemporary Accounting Research*, *19*(3), 365–384.

Carey, P., & Simnett, R. (2006). Audit partner tenure and audit quality. *The Accounting Review*, *81*(3), 653–676.

Chen, C.-Y., Lin, C.-J., & Lin, Y.-C. (2008). Audit partner tenure, audit firm tenure, and discretionary accruals: Does long auditor tenure impair earnings quality? *Contemporary Accounting Research*, *25*(2), 415–445.

Chen, G., Firth, M., Gao, D. N., & Rui, O. M. (2006). Ownership structure, corporate governance, and fraud: Evidence from China. *Journal of Corporate Finance*, *12*(3), 424–448.

Chen, J. (2008). The Effect of Audit Committees on Earings- Return Association : Evidence from Foreign Registrants in the United States. *Corporate Governance: An International Review*, *16*(1), 32–40.

Chen, K. Y., Elder, R. J., & Liu, J.-L. (2005). Auditor Independence, Audit Quality and Auditor-Client Negotiation Outcomes: Some Evidence from Taiwan. *Journal of Contemporary Accounting & Economics*, *1*(2), 119–146.

Chi, W., Huang, H., Liao, Y., & Xie, H. (2009). Mandatory Audit Partner Rotation , Audit Quality , and Market Perception : Evidence from Taiwan. *Contemporary Accounting Research*, *26*(2), 359–391.

Choi, J. –H., & Doogar, R. (2005). *Auditor tenure and audit quality: Evidence from going concern qualification issued during 1996-2001*.

Chou, H.-I., Chung, H., & Yin, X. (2013). Attendance of board meetings and company performance: Evidence from Taiwan. *Journal of Banking & Finance*, *37*(11), 4157–4171.

Chow, C. W. (1982). The demand for external auditing:size, debt and ownership influences. *Accounting Review*, *57*(2), 272–291.

Chung, J., Farrar, J., Puri, P., & Thorne, L. (2010). Auditor liability to third parties after Sarbanes-Oxley: An international comparison of regulatory and legal reforms. *Journal of International Accounting, Auditing and Taxation*, *19*(1), 66–78.

Claessens, S., & Yurtoglu, B. B. (2013). Corporate governance in emerging markets: A survey. *Emerging Markets Review*, *15*, 1–33.

Colbert, G., & Murray, D. (1995). The Association Between Auditor Quality and Auditor Size : An Analysis of Small CPA Firms. *Journal of Accounting, Auditing and Finance*, *13*(2), 135–150.

Coles, J., Daniel, N., & Naveen, L. (2008). Boards: Does one size fit all • ? *Journal of Financial Economics*, *87*(2), 329–356.

Core, J. E., Holthausen, R. W., & Larcker, D. F. (1999). Corporate governance, chief executive officer compensation, and firm performance. *Journal of Financial Economics*, *51*(3), 371–406.

Craswell, A., Stokes, D. J., & Laughton, J. (2002). Auditor independence and fee dependence. *Journal of Accounting and Economics*, *33*(2), 253–275.

Craswell, A. T., Francis, J. R., & Talylor, S. L. (1995). Auditor brand name reputations and industry Specializations. *Journal of Accounting and Economics*, *20*, 297–322.

Dahya, J., & McConnell, J. J. (2005). Outside directors and corporate board decisions. *Journal of Corporate Finance*, *11*(1-2), 37–60.

Davidson, W. N., Xie, B., & Xu, W. (2004). Market reaction to voluntary announcements of audit committee appointments: The effect of financial expertise. *Journal of Accounting and Public Policy*, *23*(4), 279–293.

DeAngelo, L. E. (1981a). Auditor independence, "low balling", and disclosure regulation. *Journal of Accounting and Economics*, *3*(2), 113–127.

DeAngelo, L. E. (1981b). Auditor size and audit quality. *Journal of Accounting and Economics*, *3*(3), 183–199.

DeFond, M. L. (2012). The consequences of protecting audit partners' personal assets from the threat of liability: A discussion. *Journal of Accounting and Economics*, *54*(2-3), 174–179.

Defond, M. L., Hann, R. N., & HU, X. (2005). Does the Market Value Financial Expertise on Audit Committees of Boards of Directors? *Journal of Accounting Research*, *43*(2), 153–193.

DeFond, M. L., Raghunandan, K., & Subramanyam, K. R. (2002). Do Non-Audit Service Fees Impair Auditor Independence? Evidence from Going Concern Audit Opinions. *Journal of Accounting Research*, *40*(4), 1247–1274.

Deli, D. N., & Gillan, S. L. (2000). On the demand for independent and active audit committees. *Journal of Corporate Finance*, *6*(4), 427–445.

Dellaportas, S., Leung, P., & Cooper, B. J. (2012). Observations on audit committee characteristics. *Managerial Auditing Journal*, *27*(4).

Dezoort, F. T., Hermanson, D. R., Archambeault, D. S., & Reed, S. A. (2002). Audit Committee Effectiveness: A Synthesis of the Empirical Audit Committee Literature. *Journal of Accounting Literature*, *21*, 38–75.

DeZoort, F. T., & Salterio, S. E. (2001). The Effects of Corporate Governance Experience and Financial-Reporting and Audit Knowledge on Audit Committee Members' Judgments. *AUDITING: A Journal of Practice & Theory*, *20*(2), 31–47.

Ding, R., & Jia, Y. (2012). Auditor mergers, audit quality and audit fees: Evidence from the PricewaterhouseCoopers merger in the UK. *Journal of Accounting and Public Policy, 31*(1), 69–85.

Dye, R. A. (1991). Informationally motivated replacement auditor replacement. *Journal of Accounting and Economics*, *14*, 347–374.

Dye, R. A. (1993). Auditing Standards , Legal Liability , and Auditor Wealth. *Journal of Political Economy*, *101*(5), 887–914.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *Academy of Management Review*, *14*(1), 57–74.

Eshleman, J. D., & Guo, P. (2014). Abnormal Audit Fees and Audit Quality: The Importance of Considering Managerial Incentives in Tests of Earnings Management. *AUDITING: A Journal of Practice & Theory*, *33*(1), 117–138.

Fama, E. F. (1980). Agency Problems and the Theory of the Firm Agency Problems and the Theory of the Firm. *The Journal of Political Economy*, *88*(2), 288–307.

Fama, E. F., & Jensen, M. C. (1983). Separation of Ownership and Control. *Journal of Law and Economics*, *26*(2), 301–325.

Fargher, N., Taylor, M. H., & Simon, D. T. (2001). The demand for auditor reputation across international markets for audit services. *The International Journal of Accounting*, *36*, 407–421.

Fearnley, S., & Beattie, V. (2004). The reform of the UK's auditor independence framework after the Enron collapse: an example of evidence-based policy making. *International Journal of Auditing*, *8*, 117–138.

Firth, M., Rui, O. M., & Wu, X. (2012). How Do Various Forms of Auditor Rotation Affect Audit Quality? Evidence from China. *The International Journal of Accounting*, *47*(1), 109–138.

Francis, J. R. (2004). What do we know about audit quality? *The British Accounting Review*, *36*(4), 345–368.

Francis, J. R., & Yu, M. D. (2009). Big 4 Office Size and Audit Quality. *Accounting Review*, *84*(5), 1521–1552.

Frankel, R. M., Johnson, M. F., & Nelson, K. K. (2002). The Relation between Auditors' Fees for Nonaudit Services and Earnings Management. *The Accounting Review*, *77*(s-1), 71–105.

Free, C. (1999). Limiting Auditors ' Liability. *Bond Law Review*, *11*(1).

Gavious, I. (2007). Alternative perspectives to deal with auditors' agency problem. *Critical Perspectives on Accounting*, *18*(4), 451–467.

Gendron, Y., Be´dard, J., & Gosselin, M. (2004). Getting Inside the Black Box: A Field Study of Practices in "Effective" Audit Committees. *AUDITING: A Journal of Practice & Theory*, *23*(1), 153–171.

Ghosh, A. (Al), Kallapur, S., & Moon, D. (2009). Audit and non-audit fees and capital market perceptions of auditor independence. *Journal of Accounting and Public Policy*, *28*(5), 369–385.

Goodwin-Stewart, J., & Kent, P. (2006). Relation between external audit fees, audit committee characteristics and internal audit. *Accounting and Finance*, *46*(3), 387–404.

Griffin, P. a., Lont, D. H., & Sun, Y. (2008). Corporate Governance and Audit Fees: Evidence of Countervailing Relations. *Journal of Contemporary Accounting & Economics*, *4*(1), 18–49.

Gul, F. a., Fung, S. Y. K., & Jaggi, B. (2009). Earnings quality: Some evidence on the role of auditor tenure and auditors' industry expertise. *Journal of Accounting and Economics*, *47*(3), 265–287.

Gul, F. A., Jaggi, B. L., & Krishnan, G. V. (2007). Auditor Independence: Evidence on the Joint Effects of Auditor Tenure and Nonaudit Fees. *AUDITING: A Journal of Practice & Theory*, *26*(2), 117–142.

Hammersley, J. S. (2006). Pattern Identification and Industry-Specialist Auditors. *The Accounting Review*, *81*(2), 309–336.

Hay, D. C., Knechel, W. R., & Wong, N. (2006). Audit Fees: A Meta-analysis of the Effect of Supply and Demand Attributes. *Contemporary Accounting Research*, *23*(1), 141–191.

Hay, D., & Davis, D. (2004). THE VOLUNTARY CHOICE OF AN AUDIT OF ANY LEVEL OF QUALITY. *AUDITING: A Journal of Practice & Theory*, *23*(2), 37–53.

Hay, D., Knechel, W. R., & Ling, H. (2008). Evidence on the Impact of Internal Control and Corporate Governance on Audit Fees. *International Journal of Auditing*, *12*(1), 9–24.

Healy, P. M., & Palepu, K. G. (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting and Economics*, *31*(1-3), 405–440.

Hermalin, B. E., & Weisbach, M. S. (1988). The determinants of board composition. *RAND Journal of Economics*, *19*(4), 589–606.

Hirshleifcr, D., & Thakor, A. V. (1994). CORPORATE Managerial performance , boards of directors and takeover bidding. *Journal of Corporate Finance*, *1*, 63–90.

Hogan, C. E. (1997). Costs and Benefits of Audit Quality in the IPO Market: A Self-Selection Analysis. *The Accounting Review*, *72*(1), 67–86.

Houghton, K. A., & Jubb, C. A. (1999). The cost of audit qualifications: the role of non-audit services. *Journal of International Accounting, Auditing and Taxation*, *8*(2), 215–240.

Hsu, H.-H., & Wu, C. Y.-H. (2013). Board composition, grey directors and corporate failure in the UK. *The British Accounting Review*, *In press*.

Hussein, F. E., & Hanefah, M. M. (2013). Overview of Surrogates to Measure Audit Quality. *International Journal of Business and Management*, *8*(17), 84–91.

IAESB. Basis for Conclusions: IES 8, Competence Requirements for Audit Professionals (2006).

Imhoff, E. a. (2003). Accounting Quality, Auditing, and Corporate Governance. *Accounting Horizons*, *17*(s-1), 117–128.

Ismail, H., Iskandar, T. M., & Rahmat, M. M. (2008). CORPORATE REPORTING QUALITY , AUDIT COMMITTEE. *MALAYSIAN ACCOUNTING REVIEW*, *7*(1), 21–43.

ISO 19011:2011. (n.d.). Guidelines for auditing management systems.

Jackson, A. B., Moldrich, M., & Roebuck, P. (2008). Mandatory audit firm rotation and audit quality. *Managerial Auditing Journal*, *23*(5), 420–437.

Jensen, M. (2001). Value Maximisation, Stakeholder Theory, and the Corporate Objective Function. *European Financial Management*, *7*(3), 297–317.

Jensen, M. C. (1993). The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems. *THE JOURNAL OF FINANCE*, *48*(3), 831–880.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, *3*(4), 305–360.

Jeong, S. W., Jung, K., & Lee, S.-J. (2005). The effect of mandatory auditor assignment and non-audit service on audit fees: Evidence from Korea. *The International Journal of Accounting*, *40*(3), 233–248.

Jeong, S. W., & Rho, J. (2004). Big Six auditors and audit quality: The Korean evidence. *The International Journal of Accounting*, *39*(2), 175–196.

Jiang, L., Ferris, K. R., & Coffman, E. N. (2009). The association between financially expert independent directors and the accounting for employee stock options. *Research in Accounting Regulation*, *21*(1), 1–10.

Johnson, E., Khurana, I. K., & Reynolds, J. K. (2002). Audit-Firm Tenure and the Quality of Financial Reports. *Contemporary Accounting Research*, *19*(4), 637–660.

Kalbers, L. P., & Fogarty, T. J. (1993). Audit committee effectiveness: an empirical investigation of the contribution power. *Auditing: A Journal of Practice & Theory*, *12*(1), 24–48.

Kamel, H., & Elkhatib, S. (2013). The perceptions of audit committees' role in an emerging market: the case of Egypt. *Journal of Economic and Administrative Sciences*, *29*(2), 85–98.

Kaplan, S. E., & Williams, D. D. (2012). The changing relationship between audit firm size and going concern reporting. *Accounting, Organizations and Society*, *37*(5), 322–341.

Khan, H. (2011). A Literature Review of Corporate Governance. In *International Conference on E-business, Management and Economics* (Vol. 25, pp. 1–5).

Kim, H., & Lim, C. (2010). Diversity, outside directors and firm valuation: Korean evidence. *Journal of Business Research*, *63*(3), 284–291.

Kim, K., Mauldin, E., & Patro, S. (2014). Outside directors and board advising and monitoring performance. *Journal of Accounting and Economics*, *57*(2-3), 110–131.

Knapp, M. C. (1987). An Empirical Study of Audit Committee Support for Auditors Involved in Technical Disputes with Client Management. *The Accounting Review*, *62*(July), 578–588.

Knechel, W. R., & Willekens, M. (2006). The Role of Risk Management and Governance in Determining Audit Demand. *Journal of Business Finance & Accounting*, *33*(9-10), 1344–1367.

Krishnan, G., & Visvanathan, G. (2009). Do Auditors Price Audit Committee's Expertise? The Case of Accounting versus Nonaccounting Financial Experts. *Auditing: A Journal of Practice and Theory*, *28*(1), 241–261.

Larn, S., & Chang, S. (1994). Auditor Service Quality and Auditor Size : Evidence from Initial Public Offerings in Singapore. *Journal of Internatìonal Accounting, Auditing & Taxation*, *3*(1), 103–114.

Laux, V., & Newman, D. P. (2010). Auditor Liability and Client Acceptance Decisions. *The Accounting Review*, *85*(1), 261–285.

Lennox, C. S. (1999). Audit Quality and Auditor Size : An Evaluation of Reputation and Deep Pockets Hypotheses. *Journal of Business Finance & Accounting*, *26*(7-8), 779–805.

Lennox, C. S., & Li, B. (2012). The consequences of protecting audit partners ' personal assets from the threat of liability. *Journal of Accounting and Economics*, *54*(2-3), 154–173.

Lin, Z. J., & Liu, M. (2009). The impact of corporate governance on auditor choice: Evidence from China. *Journal of International Accounting, Auditing and Taxation*, *18*(1), 44–59.

Lin, Z. J., Xiao, J. Z., & Tang, Q. (2008). The roles, responsibilities and characteristics of audit committee in China. *Accounting, Auditing & Accountability Journal*, *21*(5), 721–751.

Linck, J., Netter, J., & Yang, T. (2008). The determinants of board structure. *Journal of Financial Economics*, *87*(2), 308–328.

Lindberg, D. L. (2001). Discussion of the demand for auditor reputation across international markets for audit services. *The International Journal of Accounting*, *36*(4), 429–432.

Lipton, M., & Lorsch, J. W. (1992). A modest proposal for improved corporate governance. *Business Lawyer*, *59*, 59–77.

Lowensohn, S., Johnson, L. E., Elder, R. J., & Davies, S. P. (2007). Auditor specialization, perceived audit quality, and audit fees in the local government audit market. *Journal of Accounting and Public Policy*, *26*(6), 705–732.

Mak, Y. T., & Kusnadi, Y. (2005). Size really matters: Further evidence on the negative relationship between board size and firm value. *Pacific-Basin Finance Journal*, *13*(3), 301–318.

Menon, K., & Deahl Williams, J. (1994). The use of audit committees for monitoring. *Journal of Accounting and Public Policy*, *13*(2), 121–139.

Mlumad, N. D., & Thoman, L. (1990). On Auditors and the Courts in an Adverse Selection Setting. *Journal of Accounting Research*, *28*(1), 77–120.

Mohiuddin, M., & Karbhari, Y. (2010). Audit Committee Effectiveness : A Critical Literature Review. *AIUB Journal of Business and Economics*, *9*(1), 97–125.

Narayanan, V. G. (1994). An Analysis of Auditor Liability Rules. *Journal of Accounting Research*, *32*(Studies on Accounting, Financial Disclosures,and the Law), 39–59.

O'Keefe, T. ., & Westort, P. (1992). Conformance to GAAS reporting standards in municipal audits and the economics of auditing. *Research in Accounting Regulation*, *6*, 39–77.

OECD. (2004). *OECD Principles of Corporate Governance*. Paris: OECD Publishing. Retrieved from http://www.oecd.org

Palmrose, Z. (1988). An Analysis of Auditor Litigation and Audit Service Quality. *The Accounting Review*, *64*(1), 55–73.

Park, S., & Rozeff, M. S. (1996). *The role of outside shareholders, outside boards, and management entrenchment in CEO selection*.

Raghunandan, K., & Rama, D. V. (2007). Determinants of Audit Committee Diligence. *Accounting Horizons*, *21*(3), 265–280.

Raghunandan, K., Rama, D. V., & Read, W. J. (2001). Audit Committee Composition, "Gray Directors," and Interaction with Internal Auditing. *Accounting Horizons*, *15*(2), 105–118.

Rustam, S., Rashid, K., & Zaman, K. (2013). The relationship between audit committees, compensation incentives and corporate audit fees in Pakistan. *Economic Modelling*, *31*, 697–716.

Salleh, Z., & Stewart, J. (2012). The role of the audit committee in resolving auditor-client disagreements: a Malaysian study. *Accounting, Auditing & Accountability Journal*, *25*(8), 1340–1372.

Schmidt, J. J. (2012). Perceived Auditor Independence and Audit Litigation: The Role of Nonaudit Services Fees. *The Accounting Review*, *87*(3), 1033–1065.

Schneider, A. (2011). Is investment decision-making influenced by perceptions relating to auditors' client dependence and amount of audit fees? *Advances in Accounting*, *27*(1), 75–80.

Schwartz, R. (1997). Legal regimes, audit quality and investment. *The Accounting Review*, *72*(3), 385–406.

Sharma, V., Naiker, V., & Lee, B. (2009). Determinants of Audit Committee Meeting Frequency: Evidence from a Voluntary Governance System. *Accounting Horizons*, *23*(3), 245–263.

Shil, N. C. (2008). Accounting for Good Corporate Governance. *JOAAG*, *3*(1).

Simunic, D. A. (1984). Auditing , Consulting , and Auditor Independence. *Journal of Accounting Research*, *22*(2), 679–702.

Soltani, B. (2007). *Auditing: An International Approach* (1st ed). pearson education.

Song, J., & Windram, B. (2004). Benchmarking Audit Committee Effectiveness in Financial Reporting. *International Journal of Auditing*, *8*(3), 195–205.

Sori, Z. M., Mohamad, S., & Karbhari, Y. (2009). Audit Committee and Auditor Independence : The Bankers ' Perception. *International Journal of Economices and Management*, *3*(2), 317–331.

Stanley, J. D., & Todd DeZoort, F. (2007). Audit firm tenure and financial restatements: An analysis of industry specialization and fee effects. *Journal of Accounting and Public Policy*, *26*(2), 131–159.

Teoh, H. Y., & Lim, C. C. (1996). An empirical study of the effects of audit committees, disclosure of nonaudit fees, and other issues on audit independence: Malaysian evidence. *Journal of International Accounting, Auditing and Taxation*, *5*(2), 231–248.

Teoh, S. H., & Wong, T. J. (1993). Perceived Earnings Auditor Response Quality and the Coefficient. *The Accounting Review*, *68*(2), 346–366.

Thornton, J. M. (2003). User Primacy, Positive Accounting Theory, and Nonaudit Services: Evidence from the SEC's Independence Hearings. *Accounting and the Public Interest*, *3*(1), 36–57.

Thornton, J. M., & Shaub, M. K. (2014). Tax services, consequence severity, and jurors' assessment of auditor liability. *Managerial Auditing Journal*, *29*(1), 50–57.

Tomczyk, S. (1996). Auditor reputation and initial public offerings by foreign companies. *Journal of International Accounting, Auditing and Taxation*, *5*(2), 249–262.

Vafeas, N. (1999). Board meeting frequency and firm performance. *Journal of Financial Economics*, *53*, 133–142.

Vafeas, N. (2005). Audit Committees, Boards, and the Quality of Reported Earnings. *Contemporary Accounting Research*, *22*(4), 1093–1122.

Vanstraelen, A. (2000). Impact of renewable long-term audit mandates on audit quality. *European Accounting Review*, *9*(3), 419–442.

Walker, R. G. (2004). Gaps in Guidelines on Audit Committees. *Abacus*, *40*(2), 157–192.

Wang, K., O, S., & Iqbal, Z. (2009). Audit pricing and auditor industry specialization in an emerging market: Evidence from China. *Journal of International Accounting, Auditing and Taxation*, *18*(1), 60–72.

Warther, V. A. (1998). Board effectiveness and board dissent: A model of the board's relationship to management and shareholders. *Journal of Corporate Finance*, *4*(1), 53–70.

Watts, R. L., & Zimmerman, J. L. (1983). Agency Problems, Auditing, and the Theory of the Firm: Some Evidence. *Journal of Law and Economics*, *26*(3), 613–633.

Weisbach, M. I. (1988). OUTSIDE DIRECTORS AND CEO TURNOVER. *Journal of Financial Economic*, *20*, 431–460.

Xie, B., Davidson, W. N., & DaDalt, P. J. (2003). Earnings management and corporate governance: the role of the board and the audit committee. *Journal of Corporate Finance*, *9*(3), 295–316.

Yang, J. S., & Krishnan, J. (2005). Audit Committees and Quarterly Earnings Management. *International Journal of Auditing*, *9*(3), 201–219.

Yatim, P., Kent, P., & Clarkson, P. (2006). Governance structures, ethnicity, and audit fees of Malaysian listed firms. *Managerial Auditing Journal*, *21*(7), 757–782.

Yermack, D. (1996). Higher market valuation of companies with a small board of directors. *Journal of Financial Economics*, *40*(2), 185–211.

Yin, F., Gao, S., Li, W., & Lv, H. (2012). Determinants of audit committee meeting frequency: evidence from Chinese listed companies. *Journal*, *Managerial Auditing*, *27*(4), 425–444.