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Audit Fees, Detection of Accounting Misstatements and Financial Reporting Quality: Examining the Audit Fee Pressure Theory and Agency Theory

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ABSTRACT

The purpose of this study is detection of accounting misstatements can play mediating role in the relation between audit fees and financial reporting quality in Iran Stock Exchange. This research is based on the concepts of agency theory and audit fee pressure theory. This study examines research hypothesis by using the panel data of 708 Year- companies accepted in Tehran Stock Exchange during 2013-2018. The linear regression and Sobel test are also used to test hypothesis. In this study, in order to measure the quality of auditing, the indicators of accounting Misstatements detected and undetected by auditors have been used, which can be a very important distinguishing feature from previous research in this field, because Only in this case can the quality of the audit mediate the audit fee and the quality of the financial reporting. Findings show that the quality of auditing in Iran has not decreased under the pressure of auditing fees; the increase in detection of accounting misstatements has led to a decrease in discretionary accruals and an increase in the quality of financial reporting; In verifying the expected relationships, auditing fees have had a positive effect on the quality of financial reporting. The results indicate that companies can't reduce the quality of auditing, and exceed the low quality of their financial reporting by using the pressure of audit fees. Thus, the results of this study support the appropriate status of audit quality in the Iran Stock Exchange.

Keywords:

Audit Fee, Audit Quality, Fee Pressure Theory, Agency Theory, financial reporting quality.

1. Introduction

Today, the increasing demand of users of financial information for transparent and reliable information has made it more relevant and a key topic in accounting research. The quality financial reporting not only play a special role in meeting the information needs of users and helping them make the right decisions, but it also reduces the agency costs of stakeholders by elevating the position of accounting information systems. Based on the FASB conceptual framework, quality financial reports is defined as those that are "more complete, neutral, and free from error and provide more useful predictive or confirmatory information about the company's underlying economic position and performance" (Gaynor et al., 2016). Although financial reporting quality is not directly observable, prominent commentators have highlighted its importance as a key factor in capital markets (Pomeroy & Thornton, 2008). Conflict of interest between management and owners reinforces the idea that honesty and integrity may not be observed in the preparation of management reports, since managers tends to disclose positive information and withhold bad news. However, the rise of financial crises and scandals worldwide has highlighted the important role of reliable, quality financial reports as well as the significance of audit quality (Nabatdoust & Mohammadzadeh, 2016), since auditing is an important factor in reducing opportunistic management behavior in preparation of financial statements (Chen et al., 2010; Vadii et al., 2019). The quality of audit services is crucial to ensuring the mission of auditing, i.e. certification of financial statements, is performed at the highest level of reliability. Audit quality and the quality of financial statements have always been two important issues in capital market research. Previous studies have shown that higher audit quality increases the quality of financial reporting by reducing discretionary accruals (Ewert & Wagenhofer, 2005; Kim et al., 2010; Chi et al., 2011; Badavar & Taghizadeh, 2013). Therefore, auditing of financial statements is one of the most important ways of ensuring the transparency of corporate information (Salehi et al., 2017). Audit fee is an important aspect of auditing that affects the quality of audit engagements (Nikbakht et al., 2016).

Agency theory and signaling theory are examples of the differing views on the need for auditing and how audit fees are determined. Audit fees have a significant effect on the planning and quality of audit engagements. Low-quality audits erode users' confidence in financial information. This will in turn reduce the credibility of the audit process on a large scale and cause financing problems for companies operating in the capital market. Therefore, audit fee can an indicator of audit quality and, thereby, of financial reporting quality (Fakhari et al., 2018). The inconsistencies of previous studies on audit quality have been partially due to the different methods of measuring this variable. The present research uses detected misstatements as the measure of audit quality, which distinguishes this research from previous studies in the literature, since only in this case can audit quality mediate the relationship between audit fee and financial reporting quality. In view of the above, this study investigates the effect of audit fees on financial reporting quality and the mediating role of the detection of accounting misstatements.

In the remainder of this paper, first the theoretical background and the research are provided, followed by the methodology, the findings, and discussion and conclusion.

2. Research Theoretical Framework

Contemporary accounting standards require auditors to not only review information to assess the risk of misreporting, but also to establish whether the information is consistent with audited information, and to modify audit reports in case of material inconsistencies between audited information and other accompanying reports (Financial Reporting Council, 2016; International Federation of Accountants, 2012; Public Company Oversight Board, 2013). In fact, audit quality can be viewed as the ability of an auditor to detect and report financial misstatements (DeAngelo, 1981; Davidson & Neu, 1993). Therefore, in the present research, audit quality is measured in terms of auditor's success in detecting material misstatements. In audit practice, auditors collect audit evidence through the implementation of audit procedures to detect material misstatements in financial statements. When auditors detect material misstatements, they either communicate with the management of the client to adjust the detected misstatements (i.e. audit adjustment), or they reflect the unadjusted material misstatements in the form of modified audit opinion. Thus, the process of realizing audit quality can be summarized as detecting, adjusting, and reporting

material misstatements and achieving audit quality. If we convert the above conceptual-level audit stages into specific audit variables, they can be made to correspond to the audit adjustment, the audit opinion, and the quality of audited financial statements. In the realization process of audit quality, hard work is necessary for auditors to carry out a successful audit. Dy (1993-1995), Hillegeist (1999) also suggest that hard-working auditors are theoretically more likely to detect overstated earnings. Therefore, audit effort is a vital factor that affects audit quality. Accordingly, the impact of audit effort on audit quality can be divided into three aspects: audit adjustment, audit opinion, and the quality of audited financial statements (Xiao et al., 2020).

Auditors' ability and effort to detect material misstatements seem to be directly linked to audit fees. Audit fees are affected by client characteristics (Palmrose, 1986) and business risk (Bentley et al., 2013), which makes auditors exercise more care and control in their procedures due to the risk of failure to detect material misstatements (Clinch et al., 2010). As audit risk increases, so does the risk of litigation against auditors, which requires them to change their routine procedures for gathering audit evidence. This can increase auditors' risk management effort and thus increase their budgeted hours, resulting in an increase in audit fees (Kazemi-Olum et al., 2020). Therefore, audit fee can be a significant determinant of audit quality, and the present research investigates the relationship between audit fee and audit quality. Xiao et al. (2020) found that audit effort significantly inhibits earnings management and increases the quality of audited financial statements. They also showed that audit effort has a significant effect on audit quality by affecting audit process and audit output. Sheikh and Siddiqui (2020) found a significant negative relationship between audit fee and audit quality. Conversely, Ndubuisi and Ezechukwu (2017) found that high audit fee increases audit quality. Similarly, Nikbakht et al. (2016) found that there is a significant positive relationship between changes in audit fee and audit quality.

Prior research has shown that conducting quality audits can provide assurance of the credibility of financial reports. Therefore, audit quality improves financial report quality (DeFond & Zhang, 2014; Bala et al., 2018). Studies have also shown that audit fee can increase the quality of financial reports by increasing audit quality (DeFond & Zhang, 2014; Gaynor et al., 2016), since the assumption is that the fee charged by auditors affects audit accuracy and effort (Abbott et al., 2003; Mitra et al., 2009; Gaynor et al., 2016). On the other hand, companies with low quality financial statements may pay higher audit fees in order to influence the opinion and evaluations of auditors. Using agency theory, Lu (2006) found that opinion shopping is driven by agency costs. Similarly, Amiri and Fakhari (2020) showed that managers may pay higher audit fees in order to pressure auditors into issuing a more favorable opinion. Some studies have also shown that fee pressures may encourage auditors to cut down on audit procedures (Cook & Kelley, 1988), or accept questionable evidence from the client, which will increase audit risk and can have a negative impact on audit quality (Margheim & Kelley, 1992). Therefore, changes in audit fee are likely to result in changes in audit effort, which can either increase or decrease the likelihood of detecting financial misstatements, thereby affecting audit quality and, ultimately, financial reporting quality. Assad and Turki Alshurideh (2020) investigated the moderating effect of audit quality on the relationship between financial reporting quality and investment efficiency. They found evidence of a significant positive relationship between financial reporting quality and investment efficiency and of the direct and moderating effect of audit quality on investment efficiency. Yasser and Soliman (2018) showed that there is a significant positive relationship between audit tenure and earnings management. Safari et al. (2011) examined the relationship found a negative relationship between earnings management through discretionary accruals and audit quality.

High-quality financial reports are an important source of information that can improve users' decision making (Safari Graily & Ranaei, 2017). Quality auditing can encourage managers to provide high-quality financial reports, which facilitates oversight and assessment of the performance of the firm (Safari Graily & Dehghan, 2017). Biddle et al. (2009) high-quality accounting information can reduce and even prevent earnings management. This is because high audit quality improves the quality of a firm's financial reporting in the long run by reducing the potential for fraud and earnings management, thus increasing the accuracy of accounting information and allowing users of financial information to analyze the firm's

performance more confidently (Mamashli & Karshenasan, 2019). Auditors play a significant role in this regard by detecting accounting fraud and material misstatements (Royaie & Azinfar, 2012). Shakhatreh et al. (2020) argued that audit fees have a significant positive effect on disclosure quality and reduce possible violations by managers. Bala et al. (2018) showed that high audit fees can increase financial reporting quality by reducing the level of discretionary accruals. Abdulmalik and CheAhmad (2016) found a significant positive relationship between audit fees and financial reporting quality. Rashidi Baghi (2019) stated that disclosure of high-quality financial information reduces the likelihood of accrual manipulation by the management, resulting in lower audit risk and, consequently, lower audit fees. Based on these arguments, the present research examines the mediating role of audit quality in the relationship between audit fees and financial reporting quality.

3. Research Conceptual Model

The literature review revealed that audit fee is directly linked to auditors' effort to detect material misstatements in financial statements, which can improve detection of accounting misstatements by auditors. This is likely to result in a reduction in accruals and an increase in financial reporting quality. Therefore, the conceptual model of the research is shown in Figure 1.

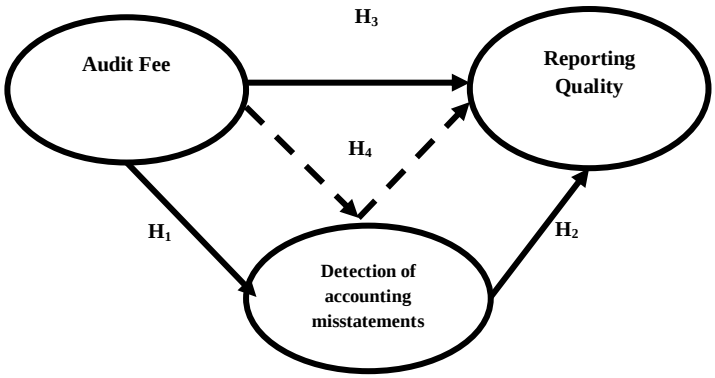

Fig.1. Conceptual Model

4. Research Hypotheses

The present research tests the following hypotheses:

H_1. Audit fee has a significant effect on detection of accounting misstatements.

H_2. The detection of accounting misstatements has a significant effect on financial reporting quality.

H_3. Audit fee has a significant effect on financial reporting quality.

H_4. The detection of accounting misstatements moderates the effect of audit fee on financial reporting quality.

5. Research Methodology

The present study uses a descriptive-correlation design and can be classified as an ex post facto research given that is uses data from firms listed on the Tehran Stock Exchange (TSE). The required data is collected from Rahavard Novin Software and CODAL website and from the audited financial statements of and audit reports of TSE-listed firms. The statistical population consisted of all TSE-listed firms during the period 2013-2018. After applying the following constraints, 118 firms were selected as the sample (708 firm-year observations):

- Firms that have been active on the TSE over the studied period;
- Firms with available data and with no more than a six-month trading halt over the studied period;
- Firms that disclose audit fee information;
- Firms whose fiscal year ends on the calendar year-end (March 20) and with no change in their fiscal year; and
- All firms excluding financial intermediaries, insurance firms, banks, credit institutions, and

investment, holding and leasing companies (due to the specific nature of their activities).

In addition, due to fundamental changes in Iranian accounting standards since the beginning of 2019, especially Standard No. 2, the calculation of cash flow from operating activities in cash flow statements has significantly changed. This makes it difficult to compare cash flow information for 2019 with the period before, and therefore, 2018 is selected as the end of the period covered in this research.

After data collection, Microsoft Excel is used to aggregate, classify, and process the data and calculate the values for different variables. Then, multivariate linear regression models with panel data are used to test the first three hypotheses, and the data are analyzed in Stata 15. In addition, due to the presence of a mediating variable, the Sobel test (online) is used to test the fourth hypothesis.

6. Research Models

The regression models below are used to test the hypotheses following Salehi et al. (2017), Mitra et al. (2009), Fakhari et al. (2019), Nikbakht et al. (2016), Vakilifard et al. (2016), and Pourkarim et al. (2018).

Model(1): $AQ_{i,t} = \beta_0 + \beta_1 LAF_{i,t} + \beta_2 OCF_{i,t} + \beta_3 BIG_{i,t} + \beta_4 LEV_{i,t} + \beta_5 SIZE_{i,t} + \beta_6 AGE_{i,t} + \beta_7 GROWTH_{i,t} + \beta_8 LOSS_{i,t} + \beta_9 TENURE_{i,t} + \varepsilon_{i,t}$.

Model(2): $FQRi,t = \beta_0 + \beta_1 AQ_{i,t} + \beta_2 MBV_{i,t} + \beta_3 LEV_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 OCF_{i,t} + \beta_6 LOSS_{i,t} + \beta_7 ACIND_{i,t} + \varepsilon_{i,t}$.

Model(3): $DA_{i,t} = \beta_0 + \beta_1 AQ_{i,t} + \beta_2 MBV_{i,t} + \beta_3 LEV_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 OCF_{i,t} + \beta_6 LOSS_{i,t} + \beta_7 ACIND_{i,t} + \varepsilon_{i,t}$.

Model(4): $FQRi,t = \beta_0 + \beta_1 LAF_{i,t} + \beta_2 LEV_{i,t} + \beta_3 AG_{i,t} + \beta_4 MBV_{i,t} + \beta_5 OCF_{i,t} + \beta_6 LOSS_{i,t} + \beta_7 BIG_{i,t} + \beta_8 SIZE_{i,t} + \varepsilon_{i,t}$.

Model(5): $DA_{i,t} = \beta_0 + \beta_1 LAF_{i,t} + \beta_2 LEV_{i,t} + \beta_3 AG_{i,t} + \beta_4 MBV_{i,t} + \beta_5 OCF_{i,t} + \beta_6 LOSS_{i,t} + \beta_7 BIG_{i,t} + \beta_8 SIZE_{i,t} + \varepsilon_{i,t}$.

AQ_{it} = detection of accounting misstatements of firm i in year t; FRQ_{it} = financial reporting quality of firm i in year t (adopted from Kothari's model); DA_{it} = discretionary accruals of firm i in year t (based on the Modified Jones Model); LAF_{it} = log of audit fee of firm i in year t; $SIZE_{it}$ = firm size, calculated as the natural log of total assets of firm i in year t; OCF_{it} = operating income less accruals in year t divided by total assets; MBV_{it} = a proxy for growth opportunities of firm i in year t, calculated as market to book value of equity; BIG_{it} = size of the audit firm, which takes the value of 1 if firm i is audited by the Iranian Audit Organization (IAO) or by MofidRahbar Audit Firm, and 0 otherwise; LEV_{it} = financial leverage of firm i in year t, calculated as total debt divided by total assets; $LOSS_{it}$ = a dummy variable that takes the value of 1 if firm i has reported a loss in year t, and 0 otherwise; AGE_{it} = age of firm i in year t, calculated as the natural log of the number of years since the firm's IPO; $GROWTH_{it}$ = revenue growth of firm i in year t; $TENURE_{it}$ = auditor tenure for firm i in year t, which takes the value of 1 if auditor tenure is 4 years or higher, and 0 otherwise; $ACIND_{it}$ = audit committee independent in firm i and year t, which is equal to the percentage of non-executive directors on the audit committee; AG_{it} = asset growth ratio of firm i in year t, which is equal to change in current year's total assets compared to last year; ε_{it} = error term.

7. Research Variables

7.1. Audit Fee

The basis for determining audit fee is the audit budget, which is calculated in relation to the progress of auditors' work. Audit fee varies for each auditor depending on their experience and expertise as well as the amount of responsibility they have. Usually, audit fee is made up of a base hourly rate plus direct costs (e.g., offsite audits and travel expenses) and allocable overheads (Auditing Standards, 2018). In this research, the independent variable is the natural log of audit fee. Audit fee information is extracted from the accompanying notes to the financial statements in sections on selling, general and administrative expense (SG&A) or other expenses (Duellman et al., 2015).

7.2. Detection of Accounting Misstatements

In this study, detection of accounting misstatements is determined using pairwise comparison of data related to auditors' success rate in detecting material misstatements. To this end, an Excel file is created to input the number of misstatements detected by auditors, the number of undetected

misstatements, and the sum of these misstatements. Auditors' success rate is calculated as the ratio of detected misstatements to the total number of misstatements. Detected misstatements are obtained from the audited financial statements and audit reports of the sample firms, while the number of undetected misstatements is determined based on annual adjustments in their financial statements, which are presented in the explanatory notes accompanying consolidated statement of profit or loss and other comprehensive income. Therefore, detection of accounting misstatements is calculated using the following equation:

detection of accounting misstatements

$$= \frac{\textbf{Detected Misstatements}}{\textbf{Detected Misstatements} + \textbf{Undetected Misstatements}}$$

7.3. Financial Reporting Quality

The dependent variable in this study is financial reporting quality, which is measured using the model of Kothari et al. (2005) and the Modified Jones Model (1995). The reason for choosing the Modified Jones Model is that it is more suitable for TSE-listed firms among the five most common discretionary accrual models (Bozorg Asl & Ghaffarpour, 2012). In the Modified Jones Model, first the total accruals are calculated as follows:

$$\mathrm{TA_{i,t}}/\mathrm{A_{i,t-1}} = \alpha_1(1/\mathrm{A_{i,t-1}}) + \alpha_2(\Delta\mathrm{REV_{i,t}}/\mathrm{A_{i,t-1}}) + \alpha_3\left(\mathrm{PPE}/\mathrm{A_{i,t-1}}\right) + \varepsilon_{i,t}$$

where $TA_{i,t}$ is total accruals for firm i in year t; $\Delta REV_{i,t}$ is changes in sales revenue of firm i between t and $t-1$; PPE is gross property, plant and equipment of firm i in year t; $A_{i,t-1}$ is the book value of total assets of firm i in year $t-1$; $\varepsilon_{i,t}$ is the residual; and α_1, α_2, and α_3 are estimated parameters for firm i. After estimating these parameters using ordinary leas
squares (OLS), non-discretionary accruals (NDA) is calculated as follows:

$$NDA_{i,t} = \alpha_1(1/A_{i,t-1}) + \alpha_2\left[\left(\Delta REV_{i,t} - \Delta REC_{i,t}/A_{i,t-1}\right)\right] + \alpha_3\left(PPE/A_{i,t-1}\right) + \varepsilon_{i,t}$$

Where $\Delta REC_{i,t}$ is changes in the receivables of firm i between t and $t-1$.

Finally, discretionary accruals are calculated as follows:

$$DA_{i,t} = \left(TA_{i,t}/A_{i,t-1}\right) - NDA_{i,t}$$

The reason for choosing the model of Kothari et al. (2005) is that it is one of the most commonly used models for estimating discretionary accruals (Karami et al., 2010). It also produces more accurate and robust results compared to the Modified Jones Model (Ansari et al., 2013).

$$TAccr_{i,t} = \alpha_0 + \alpha_1\left(1/A_{i,t-1}\right) + \alpha_2\Delta Rev_{i,t} + \alpha_3 PPE_{i,t} + \alpha_4 ROA_{i,t} + \varepsilon_{i,t}$$

Where $ROA_{i,t}$ is the return on assets of firm i in year t, calculated as net income divided by total assets. The residual of the regression above is a proxy for discretionary accruals. In the present research, the absolute value of the discretionary accruals is multiplied by -1, with higher values indicating higher financial reporting quality (Taghizadeh & Zeinali, 2015; Kothari et al., 2005).

8. Research Results

8.1. Descriptive Statistics

Descriptive statistics include measures of central tendency and dispersion and are reported for a sample of 708 firm-year observations between 2013 and 2018. Since the same number of firm is used in the research models, the descriptive statistics are not separated by research model and are reported together in Table 1. Based on these results, mean detection of accounting misstatements is 0.4730, indicating that the success rate of auditors in detecting misstatements is about 47% in the studied sample. The findings also show that mean financial reporting quality values obtained from Kothari's model and the Modified Jones Model are -0.101 and -0.104 based on, respectively, indicating that there is no significant difference between these models in terms of estimated discretionary accruals. Unlike many studies in the past, the present research measures detection of accounting misstatements as a qualitative variable. The maximum and minimum success rate of auditors in detecting misstatements is 1 and 0, respectively. In other words, in some firms, the auditors have managed to detect all material

misstatements, while in some others, auditors have failed to do so completely, resulting in adjustments in the next fiscal year

Table1: Descriptive statistics of the quantitative variables

symbol	Variable role	Observations	Maximum	Minimum	Standard deviation	Average
LAF	dependent	708	9.348	4.343	0.80	6.977
AQ	In.de/De/mediation	708	1	0	0.4218	0.4730
FQR	independent	708	-0.00004	-0.86	0.119	-0.101
DA	independent	708	-0.0001	-0.924	0.117	-0.104
OCF	control	708	0.840	0.728	0.156	0.0187
MBV	control	708	9.43	0.715	1.562	2.776
AGE	control	708	4.129	2.484	0.361	3.634
ACIND	control	708	1	0	0.197	0.672
LEV	control	708	0.952	0.061	0.204	0.546
SIZE	control	708	19.334	11.078	1.422	14.124
GROWTH	control	708	2.3502	-0.5244	0.4518	0.2255
AG	control	708	1.2507	-0.2417	0.2726	0.1889

Table 2 shows the descriptive statistics of the qualitative variables of the research, including dummy variables that take the value of zero or one. As the data show for 708 firm-year observations, audit tenure has been less than four years in approximately 83% of the sample firms. Also, 27.68% of the sample firms are audited by IAO or by MofidRahbar Audit Firm, and approximately 12% of the firms have reported losses in the studied fiscal period.

Table2: Descriptive statistics of the qualitative variables

symbol	Existence		Absence	
	Number	Percentage	Number	Percentage
TENURE	119	16.81	589	83.19
BIG	196	27.68	512	72.32
LOSS	86	12.15	622	87.85

8.2. Hypothesis Testing

Since the research hypotheses are tested using linear regression models, it is necessary to examine the classical assumptions of linear regression models before reporting the estimation results. First, Chow test is used to choose between pooled OLS and fixed effect in panel data analysis. The results show that p-values for all the models Except Model (2) are less than 0.05, indicating that fixed effect is more appropriate for estimating the panel data. As for Model (2), we test for random effects using the Breusch-Pagan test (Lagrange multiplier). The results of the Breusch-Pagan test for heteroskedasticity show that the p-value is greater than 0.05, which indicates that pooled OLS is more appropriate for Model (2), and thus, there is no need to perform the Hausman test. The estimation results for this model are provided in Table 4. However, the Hausman test is used to choose between fixed and random effects for the other models. According to the results, the p-value for all models except Model (3) is less than 0.05, which indicates that fixed effects is more appropriate. As for Model (3) where the p-value of the Hausman test is greater than 0.05, the Wiggins & Poi test is used to test for heteroskedasticity. The estimation results for this model are provided in Table 5. On the other hand, the modified Wald test of heteroskedasticity is used for the other models. The p-values of this test are less than 0.05, indicating the presence of heteroskedasticity in the residuals. This problem is solved in the final estimation of these models using the generalized least squares (GLS) technique. Finally, the Wooldridge test is used to test for serial correlation of residuals. According to the results, the p-values for the first four models are less than 0.05, which indicates the present of serial correlation in these models. This problem is solved in the final estimations using a specific command for autocorrelation correction. However, in Model (5), the p-value of the Wooldridge test is

greater than 0.05, indicating the absence of serial correlation. The results of all the tests above are provided at the bottom of the respective tables for each hypothesis.

8.2.1. Analysis Results for the First Hypothesis

In the first hypothesis, the effect of audit fee on detection of accounting misstatements is examined. The estimation results for the first model are reported in Table 3. As can be seen, the coefficient and p-value of audit fee in Model (1) are 0.065 and 4.67, respectively. In Table 3, the positive (negative) numbers in the coefficient column indicate the direct (inverse) effect of each variable on detection of accounting misstatements, and p-values less than 0.05 are statistically significant

Given that the p-value in Model (1) is less than 0.05 and the coefficients are positive, the first hypothesis is accepted. That is, there is a significant positive relationship between audit fee and detection of accounting misstatements. Variance inflation factors (VIFs) are less than 10, indicating the absence of multicollinearity between the variables. As noted earlier, due to audit fee pressure, audit fee can affect the quality of audit engagements. The assumption is that managers of firms with low financial reporting quality seek to leverage higher fees to influence auditors' opinion and reduce the number of detected misstatements. Therefore, contrary to the audit fee pressure hypothesis, the results show that audit fee pressure does not affect auditors' ability and effort to detect material misstatements. In other words, managers cannot affect detection of accounting misstatements by increasing audit fees.

Table3: Results of testing the first hypothesis

symbol	Coefficients	standard error	Statistic Z	Sig.
LAF	0.065	0.0139	4.67	0.000
OCF	0.151	0.0399	3.80	0.000
BIG	0.0342	0.0363	0.94	0.346
LEV	-0.1165	0.0608	-1.91	0.056
SIZE	0.0421	0.0123	3.41	0.001
AGE	0.0276	0.0483	-0.57	0.567
GROWTH	0.0433	0.0137	3.14	0.002
LOSS	-0.0413	0.0261	-1.58	0.114
AudTenure	0.0454	0.0185	2.45	0.014
cons	-0.417	0.256	-1.63	0.103
R- squared	%15			
Wald chi	26.02			
p-value	0.0010			
Chow Test	3.23	Significance level	0.0000	Accept panel data pattern
Hausman Test	27.76	Significance level	0.0010	Fixed effects cons
wald statistic	9177.99	Significance level	0.0000	heteroscedasticity
Wooldridge's statistic	19.896	Significance level	0.0000	Existence auto correlation

8.2.2. Analysis Results for the Second Hypothesis

In the second hypothesis, the effect of detection of accounting misstatements on financial reporting quality is examined using two models (Kothari's model and Modified Jones Model). The estimation results for the second and third models are reported in Tables 4 and 5. Auditors' ability to detect material misstatements is used as a proxy for detection of accounting misstatements. As the data show, the coefficient and p-value of detection of accounting misstatements in Model (2) are 0.0419 and 2.46, respectively. Also, the coefficient and p-value of detection of accounting misstatements in Model (3) are 0.0173 and 2.93, respectively. In Tables 4 and 5, positive (negative) values in the coefficient column indicate the direct (inverse) effect of each variable on

financial reporting quality, and p-values less than 0.05 are statistically significant.

Given that p-values in Models (2) and (3) are less than 0.05 and the coefficients are positive, the second hypothesis is accepted. That is, there is a significant positive relationship between detection of accounting misstatements and financial reporting quality (in both Kothari's model and the Modified Jones Model). Also, VIF is less than 10, indicating the absence of multicollinearity between the variables.

The results of estimating the regression model above indicate that detection of material misstatements (high audit quality) increases the quality of financial reports issued by the firm and assists users of information in making the right decisions. Audit quality plays a key role in certification of financial statements and gaining the trust of investors, while reducing opportunistic management behavior (Mamashli & Karshenasan, 2019). High levels of discretionary accruals are an indicator of low-quality financial reporting, and auditors' ability and effort to detect material misstatements and deter accrual manipulation by the management increases financial reporting quality. High audit quality plays a key role in alerting users of financial information about opportunistic behavior of managers and increases users' confidence in the accuracy of financial information.

Table 4: Results of testing the second hypothesis (Model 2)

symbol	Coefficients	standard error	Statistic Z	Sig.
AQ	0.0419	0.0170	2.46	0.014
MBV	-0.0063	0.0047	-1.32	0.186
LEV	0.1255	0.0301	4.17	0.000
SIZE	0.0257	0.0069	3.72	0.000
OCF	-0.1024	0.0240	-4.25	0.000
LOSS	0.0322	0.0185	1.74	0.081
ACIND	0.0563	0.0426	1.32	0.186
cons	-0.6186	0.1130	-5.47	0.000
R- squared	%18			
Wald chi	53.63			
p-value	0.0000			
Chow Test	1.18	Significance level	0.1106	Pooled data
Breusch–Pagan test	23.00	Significance level	0.0000	heteroscedasticity
Wooldridge's statistic	28.612	Significance level	0.0000	Existence auto correlation

Table 5: Results of testing the second hypothesis (Model 3)

symbol	Coefficients	standard error	Statistic Z	Sig.
AQ	0.0173	0.0058	2.93	0.003
MBV	-0.0065	0.0018	-3.56	0.000
LEV	0.0358	0.0165	2.16	0.031
SIZE	0.0150	0.0022	6.68	0.000
OCF	-0.0789	0.0178	-4.42	0.000
LOSS	-0.0107	0.0079	-1.35	0.178
ACIND	0.0430	0.0152	2.82	0.005
cons	-0.3521	0.0385	-9.13	0.000
R- squared	%18			
Wald chi	66.14			
p-value	0.0000			
Chow Test	2.00	Significance level	0.0000	Accept panel data pattern
Hausman Test	11.96	Significance level	0.1018	random effects
Wiggins & Poi Test	74.18	Significance level	0.0000	heteroscedasticity
Wooldridge's statistic	27.682	Significance level	0.0000	Existence auto correlation

8.2.3. Analysis Results for the Third Hypothesis

In the second hypothesis, the effect of audit fee on financial reporting quality is examined using both Kothari's model and the Modified Jones Model. The estimation results for Models (4) and (5) are provided in Tables 6 and 7. As the data show, the coefficient and p-value for audit fee in Model (4) are 0.1373 and 8.94, respectively. Also, the coefficient and p-value for audit fee in Model (5) are 0.1139 and 7.91, respectively. In Tables 4 and 5, positive (negative) values in the coefficient column indicate direct (inverse) effect of each variable on financial reporting quality, and p-values less than 0.05 are statistically significant.

Table 6: Results of testing the third hypothesis (Model 4)

symbol	Coefficients	standard error	Statistic Z	Sig.
LAF	0.1373	0.0153	8.94	0.000
LEV	0.0712	0.0288	2.47	0.014
AG	-0.0546	0.0181	-3.01	0.003
MBV	-0.0019	0.0037	-0.50	0.615
OCF	-0.0712	0.0220	-3.23	0.001
LOSS	0.0281	0.0169	1.66	0.097
BIG	-0.0824	0.0147	-5.57	0.000
SIZE	-0.0140	0.0067	-2.09	0.037
cons	0.8946	0.1040	-8.60	0.000
R- squared	%38			
Wald chi	166.43			
p-value	0.0000			
Chow Test	1.95	Significance level	0.0000	Accept panel data pattern
Hausman Test	64.06	Significance level	0.0000	Fixed effects cons
wald statistic	49866.75	Significance level	0.0000	heteroscedasticity
Wooldridge's statistic	14.749	Significance level	0.0002	Existence auto correlation

Given that p-values in Models (4) and (5) are less than 0.05 and the coefficients are positive, the second hypothesis is accepted. That is, there is a significant positive relationship between audit fee and financial reporting quality (in both Kothari's model and the Modified Jones Model). Also, VIF is less than 10, indicating the absence of multicollinearity between the variables.

When determining audit fees, auditors consider the quality of accounting information and the factors affecting it, one of which is accrual quality (Waez et al., 2018). Low accrual quality indicates high cash flow risk, where accruals are less likely to be realized as cash flows. This can encourage auditors to adjust their procedures and plans for gathering and evaluating evidence. This will affect the audit process by increasing audit hours, and as a result, auditors are more likely to demand a higher fee from the client (Cho et al., 2015). The results show that financial reporting quality can be a function of audit fee. These findings are consistent with the "confirmation" hypothesis, which posits that managers may try to increase audit fees as an attempt to influence auditors and validate their disclosures, while reducing monitoring costs. On the other hand, shareholders also achieve their goal, which is higher quality financial reports (Fakhari et al., 2019).

Table 7: Results of testing the third hypothesis (Model 5)

symbol	Coefficients	standard error	Statistic Z	Sig.
LAF	0.1139	0.0144	7.91	0.000
LEV	0.0460	0.0305	1.51	0.132
AG	-0.0546	0.0177	-3.08	0.002
MBV	-0.0047	0.0037	-1.26	0.206
OCF	-0.0820	0.0266	-3.08	0.002
LOSS	0.0088	0.0136	0.64	0.520
BIG	-0.0659	0.0143	-4.58	0.000
SIZE	-0.0054	0.0051	-1.06	0.291
cons	-0.8374	0.0960	-8.72	0.000
R- squared	%31			
Wald chi	110.62			
p-value	0.0000			
Chow Test	1.92	Significance level	0.0000	Accept panel data pattern
Hausman Test	40.50	Significance level	0.0000	Fixed effects cons
wald statistic	37835.18	Significance level	0.0000	heteroscedasticity
Wooldridge's statistic	1.846	Significance level	0.1769	Absence auto correlation

8.3.4. Analysis Results for the Fourth Hypothesis

In the fourth hypothesis, the mediating role of detection of accounting misstatements in the relationship between audit fee and financial reporting quality is examined. The significance of the mediating variable is examined using the Sobel test and based on estimation of Models (1) and (2), and the results are provided in Table 8. Estimation of Model (1) revealed that there is a significant positive relationship between audit fee and detection of accounting misstatements. Based on the results in Table 3, the path coefficient between the independent variable and the mediator is 4.67. Moreover, estimation of Model (2) revealed that there is a significant positive relationship between detection of accounting misstatements and financial reporting quality as measured using Kothari's model. Based on the results in Table 4, the path coefficient between the mediator and the dependent variable is 2.46. Given that the value of the Sobel test statistic is 2.1765 and its p-value is less than 0.05 (0.029), the fourth hypothesis is accepted, that is, the mediating role of detection of accounting misstatements in the relationship between audit fee and financial reporting quality (Kothari's model) is statistically significant. Therefore, audit fee affects financial reporting quality through detection of accounting misstatements.

Table 8. Results of testing the third hypothesis

Type of test	Model DA		Model FQR	
	p-value	Test statistic	p-value	Test statistic
Sobel test	0.013	2.4819	0.029	2.1765
Aroian test	0.014	2.4421	0.032	2.1384
Goodman test	0.011	2.5238	0.026	2.2166

The Sobel test is also used to examine the significance of the mediator based on estimation results for Models (1) and (3). As noted earlier, the relationship between audit fee and detection of accounting misstatements in the first model was positive and significant. Based on the results in Table 3, the path coefficient between the independent variable and the mediator is 4.67. Moreover, estimation of Model (3) revealed that there is a significant positive relationship between detection of accounting misstatements and financial reporting quality as measured using the Modified Jones Model. Based on the results in Table 5, the path coefficient between the mediator and the dependent variable is 2.93. Given that the value of the Sobel test statistic is 2.4819 and its p-value is less than 0.05 (0.013), the fourth hypothesis is accepted, that is, the mediating role of detection of accounting misstatements in the relationship between audit fee and financial reporting quality (Modified Jones Model) is statistically significant. Therefore, audit fee affects financial

reporting quality through detection of accounting misstatements. The results of other tests reported in Table 8 ($p < 0.05$) support the significant positive mediating role of detection of accounting misstatements in the relationship between audit fee and financial reporting quality.

9. Discussion and Conclusion

Excessive use of discretionary accruals reduces the quality of information provided by firms, which can result in higher cost of capital and incorrect decisions. This increases the detection risk of auditors and may lead to loss of credibility, in which case auditors increase the scope of their procedures in order to mitigate the risk of litigation and thus demand higher audit fees (Gul et al., 2018). Hence, audit fee can play an important role in the quality of financial reports by affecting the quality of audit services. On the other hand, transparency and good quality of financial information are the basis of optimal economic decisions of investors, creditors and users of information in general, and the important goal of auditors is to protect the interests of shareholders against significant distortions and errors in financial statements. Considering the position and role of auditing firms in users' decisions, auditing fees and consequently the quality of auditing firms are considered as key factors in improving the quality of accounting reports. The present research investigated the relationship between audit fee and financial reporting quality along with the mediating role of detection of accounting misstatements.

The results of testing the first hypothesis indicated that detection of accounting misstatements in Iran has not decreased due to audit fee pressure. An increase in audit fees may increase auditors' efforts to detect material misstatements and thus improve detection of accounting misstatements, and a decrease in audit fees may reduce the quality of the services provided by auditors and thus reduce detection of accounting misstatements. Therefore, the results indicate that firms cannot use audit fee pressure to reduce detection of accounting misstatements, or mask their low quality financial reporting. This is inconsistent with the audit fee pressure hypothesis and suggests the adequate quality of auditing in the Tehran Stock Exchange. The results related to the first hypothesis are consistent with the findings of Ndubuisi and Ezechukwu (2017), Listya and Sukrisno (2014), Blankley et al. (2012), and Nikbakht et al. (2016), but do not support the results of Yuniarti (2011).

The results of testing the second hypothesis show that detection of accounting misstatements (the number of misstatements detected by the auditors) affects financial reporting quality. High quality audits detect as many material misstatements as possible, thus increasing the quality of financial reports and reducing the potential for opportunistic behavior by the management. This reduces users' risk of making poor investment decisions and increases their confidence in the accuracy and reliability of financial information. The results related to the second hypothesis are consistent with the findings of Safari et al. (2011), Lawrence et al. (2011), Mamashli and Karshenasan (2019), and Assad and Turki Alshurideh (2020).

The results of testing the third hypothesis show that changes in audit fees lead to changes in financial reporting quality. Managers' self-interest and attempt at masking their poor performance will impose agency costs on firms. As a result, managers may try to influence auditors' opinions and withhold negative news about the firm by paying higher audit fees. This finding supports the agency theory and the predictions in the theoretical background of the present research. The results related to this hypothesis are consistent with the findings of Shakhatreh et al. (2020), Bala et al. (2018), Abdulmalik and CheAhmad (2016), Paul et al. (2013), Asthana and Boone (2012) and Chen et al. (2019). However, these results are not consistent with Coulton et al. (2016).

Finally, the results of testing the fourth hypothesis show that detection of accounting misstatements plays a mediating role in the relationship between audit fee and financial reporting quality. That is, audit fees can increase the quality of a firm's financial reporting by increasing its detection of accounting misstatements. Therefore, it can be concluded that it is possible to change audit effort by changing the audit fee, which can lead to an increase or decrease in the detection of misstatements and affect financial reporting quality through audit quality. The results related to this hypothesis are consistent with the findings of DeFond and Zhang (2014) and Gaynor et al. (2016).

In conclusion, it can be argued that audit quality is an important and influential factor in certification of financial statements and gaining the trust of users of financial information. Moreover, high audit quality can

lead to optimized pricing and lower cost of capital by improving the quality of financial information. Therefore, the findings of the present research contribute to and expand the auditing literature, and have several implications for practitioners and researchers. It is recommended that managers be more sensitive to the quality of information they provide and enhance it through the use of quality auditors in order to gain investors' trust. The results of this study raise awareness in users of financial information regarding the importance of detection of accounting misstatements, and suggest that users need to have reasonable assurance of the firm's audit quality before using its reports as the basis for their decision making. In addition, it is recommended that regulators and other authorities use existing standards and criteria to provide a ranking of firms' audit quality, which will be helpful for users in their investment decisions. Furthermore, in accordance with the provisions of Articles 4 and 5 of Audit Fee Regulation, a guideline can be developed that outlines how to determine a cap for audit fees based on a set of financial criteria as well as audit budget and other factors in order to protect owners' interests and prevent managers from trying to conceal their poor performance. Finally, to promote financial transparency, it is recommended that firms separately disclose audit fee information in their financial statements and accompanying notes as it is the most important factor affecting audit quality. Non-disclosure of audit fees by firms is the most important limitation of the present research and other studies related to audit fees. Future research can examine the mediating effect of audit quality on other factors such as changes in stock prices or dividends.

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