



INVESTIGATING THE ROLE OF EXTERNAL AUDIT ON THE QUALITY OF FINANCIAL REPORTS, COMPANY PERFORMANCE, AND EARNINGS POWER

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Article history:	Abstract:
Received: 7 th August 2023 Accepted: 7 th September 2023 Published: 10 th October 2023	This study aims to investigate the effects of external audit quality on the performance of Tehran Stock Exchange companies. The effects of the quality of external auditing on the quality of financial reports have been studied. The effects of profit power on corporate performance were also studied. To present the results of the different models selected in this study, market-based measurement and accounting for corporate performance was used. In order to verify the objectives of the study, three research hypotheses were developed based on 151 companies with a total of 1208 annual company observations from Iran, which were used. This study has shown that the quality of the external auditor and profit power are good governance mechanisms that reduce the agency problem and thus increase corporate performance. In particular, this study finds a positive and significant effect of external auditor quality on firms' performance with respect to accounting and market-based measures. Therefore, this study advises companies to improve the quality of external auditors, because this helps companies increase the stability of their economy in the future. This study also shows the positive and significant impact of the quality of external auditing on the quality of financial reports. Finally, this study showed that there is no relationship between the power of profit and the performance of companies.

Keywords: " external audit "; " financial reports"; " earnings power"; " company performance".

INTRODUCTION

Existing studies mostly argue that company performance is a key determinant of market value, both at the individual level and at the level of economic well-being of countries (Mehari and Aemiro, 2013; Tran et al., 2021). In this regard, academic accounting studies highlight several factors that may affect the performance of these companies. Factors such as governance mechanisms and their impact on company performance have been largely investigated in developed (Ducassy & Montandrou, 2015; Buallay et al., 2017) and developing countries (Pham and Islam, 2021). Studies on developed countries highlighted corporate governance mechanisms such as ownership structure and its types (Buallaly, 2017) and board characteristics such as independence and size (Christensen et al., 2010). Also, developing countries document several studies that show the effects of ownership structure and its types (Al-Smadi et al.,

2014; Pham and Islam, 2021), audit quality (Ali al-Smadi et al., 2014), demographic factors of auditors and its effect on auditors' skepticism (Sayed Hussin et al., 2019), size of the board of directors (Alsmady, 2018), composition of the board of directors, and CEO duality (Arora et al. Sharma, 2016).

The agency relationship was used as the basis of the argument (the conflict between the agent and the principle in companies and its effect on the performance of companies) (Shleifer and Vishny, 1997). Moreover, managers have more information about companies than existing shareholders and future buyers of companies' shares (Myers and Majluf, 1984), causing the problem of information asymmetry. Thus, managers used this information to increase their wealth. A good control mechanism is needed to reduce agency conflict and information asymmetry problems. In this regard, corporate governance is the mechanism and structure established by the company to control



managers and help achieve the goals set by shareholders and other stakeholders. One of the primary goals was to increase the performance of companies (Fama 1980). Thus, high corporate performance and sustainable wealth creation for shareholders require a good corporate governance system (Shleifer and Vishny, 1997). In this regard, quality audit (Ching et al., 2015) and accounting information (Ball & Shivakumar, 2005; Hutagaol-Martowidjojo et al., 2019) are significant for decision-makers and the performance of companies.

Hence, this study contributes to the body of literature by examining these issues in a crucial region such as Iran. The motivation of the present study is to highlight the significant economy of Iran. It was recommended that further studies should be conducted to investigate other factors that can affect the performance of companies and the global economy (Alsayegh, 2020; Gerged, 2021). Also, given the recent economic growth of the Gulf Cooperation Council countries, they face many challenges such as the weakening of the real GDP, the increase in unemployment (Alsayegh et al., 2020), and probably the destruction of oil and gas resources (Kabbani and Mimoune, 2021). In this regard, the International Monetary Fund (IMF) announced that the countries of the Persian Gulf Cooperation Council need comprehensive reforms to help improve the performance of companies and the economy in the coming years.

There are several current relevant studies in the Persian Gulf Cooperation Council region, such as Pillai & Al-Malkawi (2018), Alsayegh et al. (2020), and Al-ahdal et al., (2020). Previous studies of corporate governance recorded in the GCC countries have highlighted several governance mechanisms to solve the problem of agency relationships and information asymmetry. Pillai and Al-Malkawi (2018) examined the impact on internal governance, i.e. public shareholders, audit types, CEO duality, board size, and corporate social responsibility on financial and non-financial companies listed on the GCC stock exchange. The results revealed the significant effect of internal governance on the performance of companies. Abdullah and Ismail (2017) also investigated dispersed and concentrated ownership on the performance of GCC companies and found that dispersed ownership is a better governance mechanism compared to the effects of concentrated ownership on corporate performance. Al-Malkawi (2014) found that ownership concentration negatively affects the GCC performance and CEO duality, while it does not affect the board size.

Although Al-Malkawi et al. (2014) found that external ownership positively affects the performance of

companies, Zeitun (2014) did not confirm the results of the effect of external and institutional ownership on the performance of companies. Alsayegh et al. (2020) investigated environmental, social, and governance (ESG) impacts on sustainability performance in Asian countries, including the GCC countries. They found that ESG significantly affects the performance of these companies, such as board structure, executive compensation, board committee activities, and political participation. Al-ahdal et al. (2020) examined the effects of board accountability, audit committees, transparency, and disclosure on India and the GCC countries. Their results did not support positive impacts on corporate performance. The audit and audit committee of the board of directors had little impact on the performance of the companies. Transparency and disclosure also had a slight negative impact on the performance of companies. Zeitun (2014) examined the impacts of types of ownership and concentration on the performance of GCC companies. Ownership concentration and state ownership positively affected the performance of companies.

Studies conducted on other Persian Gulf countries regarding audit quality (Assad & Alshurideh, 2020) documented the quality of financial reporting, audit quality, and investment efficiency in the Persian Gulf Cooperation Council countries. The results indicate a significant positive relationship between the quality of financial reporting and the audit quality on investment efficiency. Hasan et al. (2018) investigated internal corporate governance and audit quality in GCC countries and suggested that regulators should force companies to have good audit quality to have more reliable information. Khasharmeh and Desoky (2018) conducted a study in Bahrain to examine auditor independence and audit quality and suggested that non-audit services to audit clients may harm audit independence and quality.

Zureigat (2015) also examined the impacts of audit quality on observing the international reporting standards in Saudi Arabia and the results confirmed a significant positive effect among the variables. In the Gulf Cooperation Council oil and gas business, Mnif and Ben Hamouda (2020) investigated the impact of audit quality on management preferences between actual and accrual earnings management. The results indicate that when experienced auditors are appointed, organizations tend to change from accrual earnings management to actual earnings management. The effects of audit quality on the performance of GCC companies were not examined in the GCC research. Thus, this study fills the gaps and evaluates the impact of audit quality (provided by the four large audit companies) on the performance of GCC companies.



A review of the literature was inconclusive and did not reveal any significant governments in the GCC region. The reliability of accounting information is a significant governance function that can affect the performance of companies. Zhai and Wang (2016) examined accounting information quality as a governance function and found that accounting information quality was a good governance mechanism, while other governance mechanisms of companies listed on the China Stock Exchange were weak. In this regard, Zhongsheng and Hanwen (2008) and Francis et al. (2009) supported the claim that resource allocation is more efficient when accounting information is of higher quality (Sayed Hussin et al., 2019). Biddle and Hilary (2006) argued that the quality of accounting information plays a significant role in investment efficiency. This study found that better accounting information reduces information asymmetry between managers and foreign capital providers. Also, the quality of accounting information led to the reduction of defects in contracts between the agent and the principles and supervision of managers and their opportunistic behaviors (Zhai and Wang, 2016). In this regard, further investigations are needed to examine the impact of accounting information on the performance of GCC companies (Dalwai et al., 2015). Audit quality is a significant mechanism of corporate governance that helps to resolve agency conflicts (Assad and Al-Shurideh, 2020). Higher audit quality leads to higher reliability of accounting numbers for decision-makers, as well as better monitoring of managers' opportunistic behavior (Al-ahdal & Hashim, 2017). Thus, the audit quality has been investigated from various aspects by academic researchers (Al-Ahdal and Hashem, 2021).

Fooladi (2012) examined the audit quality on the performance of Malaysian companies and found a significant positive impact on the performance of companies. Audit fees cannot help create a higher client-auditor relationship. Also, similar results were found among Indian stock companies (Al-Ahdal and Hashem, 2021), Hanoi stock trading floor (Phan et al., 2020), and Tehran stock companies (Ziai, 2014), and cement companies in Nigeria (Farouk et al., 2014). Moreover, earnings power signals to investors that companies are in a good status to invest more in the future. As stated by Fatma and Hidayat (2019), the concept of "earnings power refers to the level of corporate profit that a company is expected to earn in the future". Therefore, earnings power is another significant factor for investors to evaluate the future-oriented financial stability of companies.

Also, this indicator correlates the previous period with the future period of the companies' performance. In addition, the earnings power shows to several parties

that the managers of those companies were managing their business in the best possible way on behalf of investors, creditors, and government decision-makers (Herawaty and Solihah, 2019). Thus, managers are committed to maximizing the performance of companies based on the principal-agent contract. Thus, this study aims to fill the gaps in external auditor studies in various ways. Since a limited number of studies have been conducted on the quality of accounting information in the Tehran Stock Exchange, the present study investigates the role of external auditors on the performance of the companies listed on the Tehran Stock Exchange.

This study also fills the gaps by evaluating the impact of the external auditor's role (provided by the four large audit firms) on corporate performance. Additionally, the studies conducted in Iran did not investigate the effects of earnings power on the performance of companies. Hence, the present study investigates the impact of earnings power on the performance of companies listed on the Tehran Stock Exchange. This issue has not yet been investigated in the Tehran Stock Exchange. Therefore, the present study fills the gaps left by other studies by achieving the following goals:

Investigating the impact of external auditors on the performance of the companies listed on the Tehran Stock Exchange companies.

Investigating the impact of external auditors on the quality of financial reporting in the companies listed on the Tehran Stock Exchange.

Investigating the moderating role of earnings power on the quality of financial reporting in the companies listed on the Tehran Stock Exchange

Explanation of hypotheses and research background

Investigating the relationship between external auditor quality and company performance

Several studies suggested that audit quality increases the company's performance (Al-ahdal and Hashem 2021; Phan et al., 2020; Sayyar 2015; Ching et al., 2015). In this regard, Afza and Sajid (2014) argued that the quality of external audits improved the company's success due to investors' perception. They also argue that companies audited by major auditing firms present accurate, complete, and credible financial statements, thereby strengthening their trust in these companies. Jusoh et al. (2013) suggested that high audit quality may lead to reduced agency costs since auditors have acted as an indicator for the legitimacy and integrity of financial reporting, leading to reduced monitoring costs and improved performance of companies. In this regard, Sayyar (2015) examined the impact of audit quality, measured by audit fees and audit turnover, on the companies listed on the Malaysia Stock Exchange from 2003 to 2012.



Ching et al., (2015) found that audit quality positively affects the performance of Malaysian companies, measured by return on assets. A similar result was found in Vietnam by Phan et al. (2020), who investigated the impact of audit quality on the profitability of companies. Jusoh et al. (2013) examined the effects of management and institutional ownership and audit quality on the performance of Malaysian public joint-stock companies from 2003 to 2009. Farouk et al., (2014) examined the impacts of audit quality on financial performance in specific industries, namely cement businesses in Nigeria between 2007 and 2011. Ugwu et al. (2020) investigated the effects of audit quality on the financial performance of all public joint-stock companies in Nigeria.

This study examined the audit quality based on the size of the audit firm, the duration of the joint audit, and the audit fee. The results revealed a positive relationship between the size of audit firms and the performance of companies, measured by return on assets. Tarmidi et al. (2019) examined investors' reactions to equity investment decisions in a specific industry, namely manufacturing companies listed on the Indonesian Stock Exchange from 2013 to 2017. The results revealed that investors negatively react to the audit quality and the company's performance. These results highlight the need to investigate the impact of audit quality on company performance, which helps the market attract more investments. Also, Mahendri and Irwandi (2017) examined the effect of audit quality on Internet-based financial reporting in 82 industrial companies listed on the Indonesian Stock Exchange. This study concluded that audit quality does not have a significant impact on the financial reporting of the studied companies.

Ziaei (2014) investigated the relationship between audit quality and company performance in the Tehran Stock Exchange and found a positive and significant correlation between them. Recently, Hazaea et al. (2020) examined the impact of audit quality on financial performance in Arab countries, namely Yemen, and found that audit quality positively affects the performance of companies. Afza and Sajid (2014) investigated corporate governance mechanisms that may affect corporate performance in Pakistan, including the quality of external audits. This study confirmed previous results and reported a positive relationship between audit quality and financial performance, as measured by return on assets and Tobin's Q. Daewy and Monalisa (2016) used audit quality as a moderating variable for the relationship between corporate social responsibility and financial success. It was measured by return on assets, return on equity, and price to book value (PBV). Due to the

lack of solid empirical results about the impact of audit quality on the performance of companies, we propose the following hypothesis:

Hypothesis 1: There is a significant relationship between the quality of external auditors and the performance of companies listed on the Tehran Stock Exchange.

Explaining the relationship between external auditor quality and financial reporting quality

According to the agency theory, managers as clients of shareholders may make decisions that are not necessarily in line with maximizing the wealth of shareholders. Based on this theory, control mechanisms with sufficient supervision should be established to protect shareholders against conflict of interest. Chen et al. (2011) considered the issue of financial reporting quality of the information provided as a practical solution. The transparent and high-quality flow of information reduces information asymmetry. Paying attention to the concept of audit quality is one of the crucial approaches to increasing the quality of accounting information (Karamanova and Vafis, 2005).

According to the studies, higher quality audit improves the accuracy of accounting information and gives users, especially investors, the opportunity to more confidently analyze the company's financial status and performance results. Based on the demand theory, companies try to show that the quality of information in their financial statements is more desirable by using more famous auditors. The asymmetry of information between the capital owners (beneficiaries) and the client (manager) causes mental confusion and there is a concern that the client pursues his interests at the expense of the capital owner. Based on the agency theory, the capital owner and client should reduce the mental confusion for the interest of both parties so they follow arrangements that align with their interests. One of these arrangements is independent auditing, which is a monitoring tool to improve information about the company's financial status and performance and increase information symmetry.

With increasing the demand for the agency between managers and capital owners, the agency costs and the need for independent audits with higher quality will be higher. Other studies conducted on audit quality have focused on the supply of audits with the desired quality by independent auditors (Mark Pichar, 2005). Considering financial reporting as a process with different participants at each stage, a capital market participant who receives financial reporting information primarily uses that information along with other information to make a judgment (for example, about the risk of bankruptcy or the gap between an outcome and a prediction or a decision (for example, where and



how much to invest). Thus, the primary purpose of financial reporting information in capital markets is to make judgments and support certain decisions. Thus, the quality of financial reporting is primarily due to the view that high-quality information leads to higher-quality judgments and decisions.

In means that high-quality financial reporting information compared to low-quality information is more useful in the decision (Francis et al., 1988). One of the negative and major outcomes of low-quality financial reporting is the increase of information asymmetry, and thus, inconsistent selection and moral hazard. It is believed that high-audit quality can increase the quality of accounting information by reducing information asymmetry. Chambers and Pine (2008) examined the association between audit quality and the reliability of accruals. In this study, to measure the audit quality, they used the indicators of auditor independence, auditor expertise in the credit risk industry, and legal claims raised for audit firms. The results revealed a positive and significant relationship between audit quality and the reliability of accruals in the years of adoption of the Sarbanes-Oxley Act.

Beaty et al. (2010) examined the relationship between the quality of financial reporting and investment efficiency in conditions of access to private information between 1995 and 2006 in 3033 manufacturing companies. They expected that obtaining proprietary information and applying direct restrictions on investment through reducing information asymmetry could increase investment efficiency if the quality of accounting information increases. They state that companies with low-quality accounting information have a potential tendency to lease assets rather than purchase them. The results showed that although external lenders reduce the importance of the quality of accounting information by concluding restrictive contracts and obtaining proprietary information, restrictions in the investment process increase investment efficiency and reduce the impact of accounting information quality on investment efficiency.

Taghizadeh Khanghah (2013) examined the impact of auditor expertise in the industry on the relationship between the characteristics of the board of directors and the investment efficiency of companies listed on the Tehran Stock Exchange. To measure the characteristics of the board of directors, two indicators of financial expertise of the board of directors and independence of the board of directors were used. He also used the Bidel et al.'s (2009) model to measure the investment efficiency. The results revealed that the auditor's expertise in the industry increases the efficiency of the investment by improving the characteristics of the board of directors through the

reduction of information asymmetry and inconsistent selection costs. Yadavar Nahandi and Taghizadeh Khanghah (2013) investigated the relationship between audit quality and investment efficiency in 100 companies listed on the Tehran Stock Exchange from 2006 to 2011. They used 4 mechanisms of auditor's expertise in the industry, auditor's reputation, auditor's tenure, and auditor's independence to measure audit quality. The results revealed a positive and significant relationship between audit quality and investment efficiency. Accordingly, with the increase in audit quality, investment inefficiency decreases. Due to the lack of solid empirical results regarding the impact of audit quality on the performance of companies, we propose the following hypothesis:

Hypothesis 2: There is a significant relationship between the quality of external auditors and the quality of financial reporting in the Tehran Stock Exchange

Explaining the moderating role of earnings power on the relationship between the quality of external audit and the quality of financial reporting of companies

Investors need the best return on their invested money. The financial statement has an instrumental variable that can provide information about the future returns of companies. For example, earnings power measures a good prospect of higher returns (Fatma and Hidayat, 2019). In this regard, companies tend to obtain the best earnings and it is the primary goal of an earnings-oriented organization. Moreover, financial statement analysts will be concerned with the power of earnings of companies to determine and predict future returns. Thus, companies with good earnings power will influence the quality of financial reporting (Müller, 2013; Herawaty and Solihah, 2019b). Zarb (2016) investigated the financial reporting quality of the airline industry before and after the financial crisis from 2008 to 2009. They compared US and non-US companies and used a measure of earnings power to investigate. The sustainability of companies' earnings indicates the quality of financial reporting of companies. Hence, when companies increase the quality of their financial reporting, assets are used more efficiently and in turn positively affect the quality of financial reporting (Biggs, 1984). Thus, we proposed the following hypothesis:

Hypothesis 3.: Earning power moderates the relationship between external audit quality and financial reporting quality in the Tehran Stock Exchange.

METHODOLOGY

The temporal domain and the statistical population of the research



In this study, the temporal domain used to test the hypotheses includes 8 years from 2014 to 2021. The statistical population of the study included all the companies listed on the Tehran Stock Exchange. The statistical sample was a limited number of members of the statistical population representing the main characteristics of it (Azar and Momeni, 2020, p. 5). In this study, so that the statistical sample to be a good representative of the desired statistical population, the systematic elimination method was used. For this purpose, the following 2 criteria were considered, and

if a company meets all the criteria, it is selected as a research sample and the rest are excluded.

- 1) Do not have changes in the financial period and activity.
- 2) Financial and intermediary companies such as banks, investment companies, insurance companies, and similar ones that have a different nature of activity are not included in the statistical population.
- 3) Their information is available.

By applying the above conditions, 151 companies listed on the Tehran Stock Exchange were selected according to the following table:

Table 3.1. Screening process of the statistical population

Description	Subset	Eliminated	Total companies
Statistical population			698
Money and financial services (Financial intermediary, investment, bank, insurance, intermediary financial institutions, etc.)	Investments	(76)	
	insurances	(26)	
	Financial and monetary intermediation	(23)	
	banks	(18)	
	Intermediary financial institutions	(17)	
	Other financial intermediation	(2)	
	Total		
Non-manufacturers (multi-sector, service, transportation, mass production, contracting, etc.)	real estate mass production	(34)	
	Transportation, storage, and communication	(18)	
	Computer (consultation and software preparation)	(16)	
	Supply of electricity, gas, steam, and hot water services	(12)	
	Hotel and restaurant	(7)	
	Technical and engineering	(6)	
	Industrial multidisciplinary	(5)	
	communication devices	(3)	
	Information and communication	(3)	
	Telecommunications	(2)	
	Industrial contracting	(2)	
	retail	(2)	
	Other transportation	(1)	
	Other engineering activities	(1)	
	Artistic activity	(1)	
	print	(1)	
	Computer products	(1)	
Oil and gas extraction except for exploration	(1)		
Total		(116)	
Lack of access to information (trading break, no share trading, cancellation of acceptance, and no access to financial indicators...)	Trading break for more than 3 months	(89)	
	Lack of access to information	(14)	
	Entry after 2012	(168)	



	Total		(271)
Change of financial year or change of activity	Change in fiscal year	(14)	
	Total		(14)
The number of final sample companies			143

Research models and variables

Model 1

$$Performance_{i,t} = b_0 + b_1 AuditQ_{i,t} + b_3 Epowr_{i,t} + b_4 \Delta ROA_{i,t-1} + b_5 \Delta ROA_{i,t-2} + b_6 Leve_{i,t} + b_7 \log(ASS)_{i,t} + b_8 SD_{i,t} + b_9 AG_{i,t} + b_{10} Lag(ROE)_{i,t} + e_{i,t}$$

Model 2

$$InforQ_{i,t} = b_0 + b_1 AuditQ_{i,t} + b_3 Epowr_{i,t} + b_4 \Delta ROA_{i,t-1} + b_5 \Delta ROA_{i,t-2} + b_6 Leve_{i,t} + b_7 \log(ASS)_{i,t} + b_8 SD_{i,t} + b_9 AG_{i,t} + b_{10} Lag(ROE)_{i,t} + b_{11} MV-equity_{i,t} + e_{i,t}$$

Model 3

$$InforQ_{i,t} = b_0 + b_1 AuditQ_{i,t} + b_2 Epowr_{i,t} + b_3 Epowr_{i,t} * AuditQ_{i,t} + b_4 \Delta ROA_{i,t-1} + b_5 \Delta ROA_{i,t-2} + b_6 Leve_{i,t} + b_7 \log(ASS)_{i,t} + b_8 SD_{i,t} + b_9 AG_{i,t} + b_{10} Lag(ROE)_{i,t} + e_{i,t}$$

The dependent variables

Company performance (market-based criteria):

Tobin's Q = total market value of the company / total assets.

M/B = market value* / book value**

* Share price × number of shares available.

**Total assets - total liabilities

(Gentry and Shen, 2010; Singh et al., 2018; Falatah, 2012; Al-Ghamedi and Rhodes, 2015; Lab Bo Lab et al., 2021).

Company performance:

(based on book value)

EPS = (net earnings - preferred dividends) ÷ weighted mean common shares during the period.

(Gentry and Shen 2010; Ahmad and Hamdan 2015).

Quality of accounting information

InforQ=

$$\Delta WCI_{i,t} = \gamma_0 + \gamma_1 * CFO_{i,t-1} + \gamma_2 * CFO_{i,t} + \gamma_3 * CFO_{i,t+1} + \gamma_4 * \Delta Sales_{i,t} + \gamma_5 * PPE_{i,t} + \epsilon_{i,t}$$

Where $\Delta WCI_{i,t}$ is the change in non-cash working capital from year t – 1 to year t, CFO represents the company's cash flow in years t-1, t, and t+1, respectively.

(Francis et al., 2005; Ding et al., 2016; Demeyer et al., 2018).

independent variable

Audit quality:

AuditQ: if the audit firms are one of the large audit firms, it will be 1, otherwise, it will be 0 (Mnif and Ben Hamouda 2020; Al-ahdal and Hashem, 2021).

Moderator variable:

Earnings power:

Epowr= operating income divided by total assets

Control variables

Change in return on assets:

$\Delta ROA_{i,t-1}$ = change in return on assets from t to t-1

Change in return on assets:

$\Delta ROA_{i,t-2}$ = change in return on assets from t to t-2.

Financial Leverage:

Leve = ratio of debt to assets

Company size:

$\log(ASS)$ = natural logarithm of total assets

The standard deviation of earnings

SD = three-year standard deviation of earnings for the company and year i, t.

Company age:

Time that the company listed on the Stock Exchange

ROE:

Net earnings on equity

Results

Descriptive Statistics:

TABLE 2. Descriptive Statistics of Main Variables

Variable	Mean	Std. Div	Median	Min	Max
Q Tobin	3.294	2.474	2.377	0.734	10.102
M/B	6.104	5.338	4.247	-5.782	20.557
EPS	1170	1437	603	-310	5047
InforQ	-0.346	0.810	0.492	-4.296	-0.001
Epowr	0.925	0.492	0.805	0.296	2.114
$\Delta ROA_{i,t-1}$	0.036	0.131	0.020	-0.715	0.614
$\Delta ROA_{i,t-2}$	0.060	0.158	0.040	-1.345	0.675
Leve	0.574	0.284	0.551	1.691	0.010
Log(ASS)	14.884	1.563	14.625	11.116	21.323
SD	0.191	0.188	0.140	0.004	2.163
Firm Age:	3.005	0.411	2.995	1.609	4.317
ROE	0.195	2.583	0.283	-.167	10.045

TABLE 3. Descriptive Statistics of Qualitative Variables

Variable	Status	Frequency	Percentage %
AuditQ	0	704	58.83
	1	504	41.17
	Total	168	100.00

Tables 2 and 3 show the descriptive statistics of independent and dependent variables. The mean and median of Tobin's Q and the market value are greater than one, indicating that all the companies' values are not reflected in the balance sheet. More than half of the companies in Iran are audited by large auditing firms. There is a one-to-one correspondence between the financial leverage greater than one and the market value of a negative book, and it is a sign of negative equity.

Test of classical assumptions of regression models

The first assumption: the mean of errors is zero.

Non-fulfillment of this assumption can be caused by the absence of intersection in the regression model. If there is an intersection in the regression model, this assumption will be generally fulfilled and there will be no need to test since the intersection causes the mean of the dependent variable and the mean of the fitted values of the model to be almost the same (Aflatouni, 2018). Therefore, since there is an intersection in both models of the present study, this assumption is fulfilled. The second assumption: the variance of the errors has a constant value (heterogeneity of variance test). Another classical assumption is the heterogeneity of variance test. In this study, the Pagan test was used to examine this assumption. Given the significant effect of heterogeneity of variance on the estimation of the standard deviation of coefficients and the problem of statistical inference, it is necessary to examine the presence or absence of heterogeneity of variance before making any estimation

Table 4: The results of examining the heterogeneity of variance of research models

Model	Statistic	Sig	Result
First	1.25	0.29	heterogeneity of variance
Second	1.35	0.22	heterogeneity of variance
Third	1.85	0.09	heterogeneity of variance

Since the level of significance is greater than 5%, there is no **heterogeneity of variance**.

The third assumption: there is no autocorrelation between the residuals (Durbin-Watson test, serial autocorrelation)

Table 5: The results of serial autocorrelation

Model	Durbin-Watson
First	1.55
Second	1.60
Third	1.61

Since the values obtained for the Durbin-Watson are between 1.5 and 2.5, there is no serial autocorrelation in the rest of the models.

The fourth **classical** hypothesis of regression states that the explanatory variables of the model do not have a significant correlation with the error term. Since the values of the explanatory variables are created in the outside world (they are exogenous), but the values of the error term are obtained from the

relationships within the model (they are endogenous), this assumption is mostly fulfilled (Aflatouni, 2018). The fifth assumption: the statistical distribution of the error term is normal (the test of the normality of the residual terms of the research models)

Another classical assumption is the normality test of the residual terms of research models. In this study, the **Jarque-Bera test** was used to examine this issue.

Table 6: The results of examining the normality of the residual terms

Model	Jarque-Bera statistic	Sig
First	1.52	0.171
Second	1.73	0.096
Third	1.85	0.087

The Jarque-Bera statistic in the model is less than 0.05, indicating the normality of the residual terms in the model.

Testing the stationarity of variables

In this study, the Levene, Lin, and Chu (LLC) test was used to determine the stationarity of the research

variables. The results of this test indicate that the independent and dependent variables of the research were stationary during the research period since the significance level for this test is less than 5%.

Table 7: The results of testing the stationarity of variables

	Jarque-Bera statistic	sig
All variables	- 23/85	0.00

Results of testing the first research model

The first hypothesis of the study states that there is a significant relationship between the quality of external auditors and the performance of companies. Based on the results of the table and the relationship between the quality of the external auditor and the performance of the companies for the market index, it is significant at the confidence level of 99%. Therefore, the first hypothesis of the study is accepted at the level of error of 1% for the Tobin Q index and market value. Also, for the performance index based on the book value, the results revealed that it is

significant at the 95% confidence level. Therefore, the first hypothesis of the study for the EPS indicator is accepted at the error level of 1%.

These results indicate that by controlling the effects of control variables, with increasing the deviation of earnings and changes in the return on assets in the company, the performance of the companies for all three indices increases. Based on the results of the regression model test, it can be seen that the significance level of the F statistic, indicating the significance of the whole regression, is less than 1%. It means that the model is significant at the

confidence level of 99%. The adjusted coefficient of determination of the model indicates that about 25% of the variation in the dependent variable is explained by the variables on the right side of the model. Also,

since the Durbin-Watson value is between 1.5 and 2.5, there is no serial autocorrelation problem between the research variables.

TABLE 8. The results of the first models

	Variable (<i>Q Tobin</i>) 2SLS Regression					Variable (<i>M/B</i>) 2SLS Regression					Variable (<i>EPS</i>) GLS Regression			
	Equation (1):					Equation (2):					Equation (3):			
	Coef	Std. Err	Statis tic	Pro b	VIF	Coef	Std. Err	Statis tic	Prob	Coef	Std. Err	Statis tic	Prob	
AuditQ	0.780 ***	0.2 23	3.497	0.0 00	1.18 3	2.125* **	0.40 6	5.234	0.00 0	369.65**	187.7 74	1.968	0.04 9	
Epowr	-0.120	0.3 28	-0.366	0.7 13	1.08 3	-0.026	0.55 2	-0.047	0.96 1	341.330	276.3 07	1.235	0.21 7	
$\Delta ROA_{i,t-1}$	1.846 **	0.9 29	1.987	0.0 47	1.06 5	1.839	2.28 4	0.805	0.42 0	1136.335	781.8 64	1.453	0.14 6	
$\Delta ROA_{i,t-2}$	3.605 ***	0.8 63	4.177	0.0 00	1.36 7	6.183* **	2.01 0	3.075	0.00 2	6049.506 ***	726.3 61	8.328	0.00 0	
Leve	- 0.858 **	0.4 32	-	0.0 47	1.04 6	- 1.467* *	0.71 8	-	0.04 2	-38.886	364.2 68	-	0.91 5	
Log(AS S)	- 0.172 *	0.0 94	-	0.0 70	1.13 7	-0.589***	0.13 1	-	0.00 4.498 0	301.817* **	79.33 3	3.780	0.00 0	
SD	3.055 ***	0.9 75	3.131	0.0 01	1.23 1	5.760* **	2.00 0	-	0.00 2.879 4	665.425	820.8 8	0.810	0.41 7	
Firm Age:	2.084 ***	0.3 78	5.508	0.0 0-	1.54 2	2.481* **	0.48 5	5.115	0.00 0	-33.705	318.4 38	-	0.91 5	
ROE	-0.013	0.0 32	-	0.7 05	1.87 1	-0.023	0.07 66	-	0.76 0.302 8	-0.696	27.44 0	-	0.97 9	
_cons	0.400	1.1 80	0.340	0.7 35	----	0.400	1.18 0	0.340	0.73 5	-	1409. 808	-	0.00 4	
F Statistic	2.86(0.000)					19.265(0.000)					6.995(0.000)			
R ²	0.301					0.127					0.516			
Adjusted R ²	0.197					0.120					0.442			
Durbin-Watson Statistic	1.557					1.623					1.687			
AIC	761.46					792.156					721.090			

The results of testing the second and third models of the research

The second hypothesis of the study states that there is a significant relationship between the quality of the external auditor and the quality of financial reporting. Based on the results of the table and the relationship between the quality of the external auditor and the quality of financial reporting, it is significant at the

confidence level of 99%. Thus, the second hypothesis of the research is accepted at the error level of 1%. Also, the third hypothesis of the study states earnings power moderates the relationship between the quality of external audit and the quality of financial reporting. Since the significance level of earnings power* quality of external audit was more than 0.05, it is not confirmed. Based on the results of testing the

regression model, it can be seen that the significance level of the F statistic, indicating the significance of the whole regression, is less than 1%. It means that the model is significant at the confidence level of 99%, the adjusted coefficient of determination of the model shows that about 25% of the variation in the

dependent variable is explained by the variables on the right side of the model. Also, since the Durbin-Watson value is between 1.5 and 2.5, it can be stated that there is no serial autocorrelation problem between the research variables.

Table 9. The results of the second and Third models

Variable (BF)	2SLS Regression					GLS Regression			
	Equation (1):					Equation (2):			
	Coef	Std. Err	Statistic t	Prob	VIF	Coef	Std. Err	Statistic t	Prob
AuditQ	0.568***	0.033	17.533	0.000	1.183	0.627***	0.053	11.677	0.000
Epowr	0.175***	0.049	3.554	0.000	1.083	0.195***	0.053	3.644	0.000
Epowr * AuditQ	-	-	-	-	-	0.041	0.042	-0.966	0.334
$\Delta ROA_{i,t-1}$	-0.221	0.990	-1.591	0.118	1.367	-0.230	0.139	-1.649	0.099
$\Delta ROA_{i,t-2}$	0.094	0.129	0.730	0.465	1.046	0.098	0.129	0.757	0.448
Leve	-0.075	0.064	-1.163	0.244	1.137	-0.074	0.064	-1.157	0.250
Log(ASS)	-0.043***	0.014	-3.044	0.002	1.231	-0.042***	0.014	-2.957	0.003
SD	-0.414***	0.146	-2.836	0.004	1.542	-0.413***	0.146	-2.827	0.004
Firm Age:	-0.083	0.056	-1.462	0.143	1.871	-0.084	0.056	-1.493	0.136
ROE	-0.002	0.004	-0.500	0.617	1.183	-0.002	0.004	-0.504	0.619
_cons	0.400	1.180	0.340	0.735	----	0.811	2.055	0.390	0.694
F Statistic	7.779(0.000)					7.723(0.000)			
R ²	0.547					0.543			
Adjusted R ²	0.479					0.472			
Durbin-Watson Statistic	1.603					1.600			
AIC	761.46					761.40			

DISCUSSION AND CONCLUSION

This study investigates the effects of external audit quality on the performance of the companies listed on the Tehran Stock Exchange companies. This study also investigated the effects of external audit quality on the quality of financial reporting. It also investigated the effects of earnings power on the performance of the companies. To present the results of the various models selected in this study, market-based measurement and accounting of the companies' performance were used. To confirm the objectives of the study, 151 companies and a total of 1208 companies, years, and observations from Iran were used. According to Shleifer and Vishny (1997), inherent agency problems among companies require a strong audit to reduce the impact of inflation on the performance of companies and economic health. Myers and Majluf (1984) also stated that managers have more information about their companies than current shareholders and potential buyers, which leads to the problem of information asymmetry in the market. Herawaty and Soliha (2019) stated that earnings power is a good indicator for the manager of a company to manage it efficiently and it may be used to monitor the actions of managers.

To present the results of the various models selected in this study, market-based measurement and accounting of the companies' performance have been used. To verify the objectives of the study, three research hypotheses. It is used based on 151 companies with a total of 1208 company year observations from Iran. This study revealed that external auditor quality and earnings power are good governance mechanisms that reduce the agency problem and thus increase the performance of companies. This study also found the positive and significant impact of external auditor quality on the performance of companies and market-based measurements. Therefore, this study recommends companies improve the quality of external auditors since it helps companies to increase the stability of their economy in the future. Also, this study shows the positive and significant impact of external audit quality on the quality of financial reporting. These results strongly support organizations to use a large audit firm to obtain critical assurance services and ensure observing the highest auditing standards. The quality of financial reporting and auditing helps to reduce information asymmetry and reduce managerial control over companies' operations. This governance



mechanism encourages managers to be more disciplined to achieve shareholder goals while reducing the risk of shark behavior that may have a detrimental impact on the performance of companies. Finally, this study shows the lack of relationship between the earnings power in the performance of companies.

PRACTICAL RECOMMENDATIONS

The performance of companies can be improved with an effective governance mechanism, such as external audit quality. Large auditing firms are vital in regulating the behavior of managers and increasing the reliability of financial information. Moreover, the quality of accounting information is critical for the external user to make good investment decisions. These conditions will affect both individual companies and Iran's economy in the future. The results of this study provide valuable feedback to policymakers, governance regulators, companies, accountants, and auditors, and suggest reforming and improving the quality of their financial reporting. These results also recommend large audit firms that demonstrate high-quality audit quality. This helps companies to monitor their management more effectively and also improves the disclosure of their financial statements. Increasing confidence in financial statements, as a result of increasing faith in financial statements, will increase investment prospects in the region. The results also pave the way for more studies in this field, especially in areas such as analyzing the relationship between the quality of financial reporting and audit quality, and investment potentials in Iran. These countries may benefit from a more stable market due to concerns about future oil supply shortages.

LIMITATIONS AND FUTURE RESEARCH

The present study suffers from several significant limitations. The first limitation is an increase in the number of temporary companies and the recent period, which includes the COVID-19 pandemic and its effect on the performance of companies. There are limited findings on financial reporting quality, external audit quality, and earnings power. Other internal and external governance mechanisms also affect it, such as optimal board size, duality, board independence, audit committee specificity, and ownership, so they are highly recommended for future studies. Moreover, audit quality was measured using a dummy variable as a criterion for large accounting and auditing firms. However, other studies used other measurements such as audit fees and industry expert auditors, so they are recommended for further studies. It is strongly recommended to use different control variables at the national level to achieve an estimate with a smaller margin of error.

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