




The Impact of Audit Firm Size, Auditor Independence and Financial Expertise on Earning Quality: Mediating Role of Audit Quality

Atif Aziz¹ , Syed Muhammad Salman², Muhmmad Hassan³, Muhammad Kamran Younus⁴, Humayun Fareed Uddin⁵

¹ Professor, IQRA University Karachi, Pakistan. Email: atif.aziz@iqra.edu.pk

² Assistant Professor, Iqra University, Karachi, Pakistan. Email: smsalman@iqra.edu.pk

³ Scholar, Department of Commerce, University of Karachi, Pakistan.

Email: muhammadshasan87@gmail.com

⁴ Department: Economics and Finance, Muhammad Ali Jinnah University, Karachi, Pakistan.

Email: kamranhbk23@gmail.com

⁵ Lecturer, Karachi Institute of Economics and Technology, Karachi, Pakistan. Email: humayunfuddin@gmail.com

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ABSTRACT

Earning quality of organization depends upon the audit quality and could be achieved using auditors' expertise and firm size and this aspect demands the emphasis of new researchers. Hence, the current article investigates the effects of auditors' independence, audit firm size and auditors' financial expertise on earning quality of the manufacturing industry in Malaysia. The article also explores the mediating role of audit quality among auditors' independence, audit firm size, auditors' financial expertise and earning quality of the manufacturing industry in Malaysia. The study gets the data from the audit department of Malaysian manufacturing companies. The article checks the nexus among variables using smart-PLS. The outcomes revealed that the auditors' independence, audit firm size and auditors' financial expertise have a positive association with earning quality. The outcomes also exposed that audit quality significantly mediates among auditors' independence, audit firm size, auditors' financial expertise and earning quality of the manufacturing industry in Malaysia. The regulators could get the guidelines to achieve high quality earnings and audits using auditors' independence and financial expertise.



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Corresponding Author's Email: atif.aziz@iqra.edu.pk

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1. Introduction

According to Nesadurai (2019), Malaysia is positioned as a thriving rising market in Southeast Asia. Its dynamic business climate and rapid economic growth make it a fascinating place to investigate the critical aspects impacting earning quality and the credibility of financial reporting (Jasni, Yusoff, Zain, Md Yusoff, & Shaffee, 2020; Shittu, Hassan, & Nawaz, 2018). In light of Malaysia's dedication to maintaining economic growth and cultivating investor trust, the goal of this research is to break down the intricate connections among crucial components, including auditor independence, audit firm size, auditors' financial expertise, and the moderating function of audit quality.

This study places a strong emphasis on auditor independence, which is widely acknowledged as a crucial component of reliable financial reporting. The goal of the study is to evaluate how auditor independence directly affects earning quality in Malaysian corporate environments. In light of Malaysia's positioning as a centre for a variety of industries, such as technology, manufacturing, and finance, it is critical to comprehend the role that auditor independence plays in enhancing the accuracy of financial statements in order to maintain the Malaysian market's appeal to international investors. Another important factor that is being examined is the size of the audit firm, especially in light of Malaysia's varied economic sectors. Bigger audit companies often have access to more resources, industry knowledge, and skills (Hao, Shah, Nawazb, Barkat, & Souhail, 2020; Nguyen, Elmagrhi, Ntim, & Wu, 2021).

This raises the question of how audit procedures' scope affects the comprehensiveness and efficacy of financial audits conducted in Malaysia. The study is to explore whether larger audit companies result in a better earning quality and how this dynamic plays out in different industries given the many sectors that contribute to Malaysia's economic tapestry (Jianjun et al., 2021; Nawaz, Basheer, & Afridi, 2019).

Recognizing the value of specialized knowledge in navigating Malaysia's complex business ecosystem, the financial expertise of auditors adds a complex viewpoint to the research. With Malaysia's technology-driven sectors, conventional manufacturing, and the constantly changing financial sector posing a variety of issues, the research aims to comprehend how auditors' financial competence enhances the accuracy of financial evaluations. The goal of the study is to determine how financial competence affects earning quality in the setting of Malaysia by looking at its role. The study's main focus is on audit quality's mediating function. Making sure financial statements are genuine and precise is crucial as Malaysia strives to maintain its competitive position in the global market. The goal of the research is to determine how audit quality influences the relationship between the dependent variable (earning quality) and the independent factors (auditor independence, audit firm size, and financial expertise). Comprehending the ways in which audit quality enhances the general dependability of financial reporting in Malaysia requires this investigation.

The key objectives of this research are to systematically look into and assess how important factors such as auditor independence, audit firm size, and auditors' financial expertise affect earning quality in the particular context of Malaysia. The purpose of the study is to evaluate how these factors directly affect the accuracy and dependability of financial statements in the context of Malaysian company. Furthermore, the research aims to understand the supporting role of audit quality in converting the impacts of auditor-related elements into achieving superior results. Through an analysis of these dynamics, the research aims to expand knowledge of best practices in financial reporting worldwide by offering insightful information on the minute details of Malaysia's auditing environment. This research also fills up a number of gaps in the literature by focusing on Malaysia. Firstly, there is a shortage of thorough studies that explicitly examine the relationship between auditor independence, audit firm size, auditors' financial expertise, and audit quality's mediation effect on earning quality in the Malaysian corporate environment. Although certain components of this framework have been investigated separately, the Malaysian context has not yet fully examined these variables' linked dynamics in their entirety. Furthermore, a thorough grasp of how these factors function in various businesses is hindered by the literature's frequent lack of comprehensive attention on Malaysia's many economic sectors.

In the next section of this research, we will look into the relevant literature review, provide a research methodology, and conduct a full empirical analysis to test the proposed hypotheses.

2. Literature Review

The independence of the auditor is essential to maintaining the quality of earnings and is a fundamental component of financial reporting integrity. An auditor's ability to evaluate a company's financial accounts objectively depends on their ability to uphold a high degree of independence, free from any inappropriate influence or conflicts of interest (Daoust & Malsch, 2020). In order to make sure that the reported results accurately represent the organization's actual financial situation, independence is crucial. According to Safipour Afshar, Pourheidari, Al-Gamrh, and Afshar Jahanshahi (2019) study, independent auditors are more likely to discover inconsistencies, mistakes, or instances of financial manipulation early on and take appropriate action without giving in to outside pressure. This dedication to objectivity fosters trust in the accuracy of financial information among stakeholders, including creditors, investors, and the general public. The improved credibility of financial statements is a clear indicator of the beneficial effects of auditor independence on earning quality (Francis & Li, 2019). These declarations are crucial for investors to use in making well-informed judgements, and when auditors operate independently, there is less chance that information provided is false. Building confidence in the marketplace, a thorough and objective audit process adds to the overall transparency of financial reporting (Salehi, Ammar Ajel, & Zimon, 2023). Yen, Thuy, Tien, and Anh (2019) Finds that businesses that have independent auditors are seen as more reliable and responsible, which can draw in more investors and possibly reduce capital costs.

Additionally, (Mandal, 2023) finds that the independence of auditors serves as a disincentive to fraud within companies. One of the most effective obstacles against financial misconduct is the fear of being discovered by watchful, impartial auditors (Kassem & Turksen, 2021). This promotes the general stability and well-being of the financial markets in addition to shielding investors and shareholders from any losses. When independent auditors find evidence of earnings management or manipulation, they can take prompt action to stop the spread of fraudulent financial stories. Beyond only meeting legal obligations, auditor independence has a favourable effect on earning quality as it makes a significant contribution to the legitimacy and dependability of financial reporting, boosting investor confidence and discouraging dishonest behavior (Safipour Afshar et al., 2019). Therefore, we propose a hypothesis that,

H1: Auditor independence has a positive impact on earning quality.

When it comes to financial reporting, the size of an audit firm has a big impact on earning quality. Bigger audit companies may carry out more exhaustive and complete audits since they often have access to a larger reservoir of resources, knowledge, and experience (Dagilienė & Klovienė, 2019). The auditors can examine financial accounts more closely due to this increased capability, which helps them spot possible mistakes or abnormalities that smaller audit practices would miss. Larger audit companies' depth and breadth of experience strengthen the audit process and raise the standard of earnings evaluations as a whole (Kadous & Zhou, 2019). Furthermore, the idea of trustworthiness and reputation is linked to the beneficial effect of audit company size on earning quality. Bigger audit companies are frequently linked to a reputation for dependability and expertise (Alareeni, 2019). The simple affiliation with a respectable audit company has the potential to enhance investor trust regarding the precision of financial reports (Kang, 2019). Given these companies' high requirements and thorough review procedures, investors could find financial reports audited by larger firms to be more reliable. According to Shahid and Abbas (2019a), a company's financial condition may be seen more favourably as a result of the heightened investor confidence, which might draw in further investment and lower the cost of financing.

Furthermore, the degree of specialisation and sector expertise that larger companies may offer is another way in which audit company size influences earning quality. Larger audit companies are better able to comprehend the specifics of many sectors due to their diversified

teams and specialised professionals, which enhances the accuracy of financial evaluations (Ruiz-Barbadillo & Martínez-Ferrero, 2022). With this specialised understanding, auditors may approach audits more delicately and identify details unique to their business that could affect the quality of profits. According to Cook, Kowaleski, Minnis, Sutherland, and Zehms (2020), greater investor trust and more thorough audits are facilitated by the resources, experience, and reputation that larger audit firms bring to the table. As protectors of financial integrity, audit firms' size affects how accurately earnings evaluations are made as well as how the investing community views a company's financial standing in general (Drempetic, Klein, & Zwergel, 2020). Therefore, we make a hypothesis that,

H2: Audit firm size has a positive impact on earning quality.

The accuracy and dependability of financial accounts are shaped by the auditors' financial expertise, which is a key factor in determining earning quality. Auditors are better able to negotiate the intricacies of financial reporting when they possess a thorough grasp of accounting principles, financial rules, and industry-specific peculiarities (Austin, Carpenter, Christ, & Nielson, 2021). With this knowledge, they can evaluate a company's finances critically, spot any dangers, and find any irregularities that might compromise the accuracy of its earnings reports. Having a thorough understanding of finance enables auditors to examine intricate transactions with objectivity, guaranteeing that the financial statements authenticate the transactions and that any discrepancies are immediately resolved (Singh, Lai, Vejvar, & Cheng, 2019). Additionally, according to Kateb (2024), the interpretation and execution of accounting rules are positively impacted by the financial expertise of auditors in terms of earning quality. Competent auditors are skilled at negotiating the constantly changing world of accounting principles and financial rules (Maresch, Aschauer, & Fink, 2020).

The consistency and comparability of financial statements are facilitated by their capacity to correctly and consistently interpret and apply these standards Chen and Gong (2019). As a result, financial reporting is more transparent and gives stakeholders a better idea of how well a firm is doing financially. In order to identify and stop financial misstatements or fraudulent activity right away, Jeppesen (2019) finds that auditors' financial skills is essential. A sophisticated comprehension of financial complexities enables auditors to pose relevant queries, carry out more focused audit processes, and identify disparities that could be signs of financial manipulation (Griffith, Kadous, & Young, 2021). This proactive strategy sustains investor trust in the accuracy of reported results while also protecting the integrity of financial statements. Therefore, we say that,

H3: Financial expertise of auditors have a positive impact on earning quality.

In the complex link between auditor independence and earning quality, audit quality plays a crucial mediating role. Audit quality is the means by which auditor independence is translated into the guarantee of earning quality, even if auditor independence is the cornerstone of an objective review of financial statements (Boskou, Kirkos, & Spathis, 2019). According to Safipour Afshar et al. (2019), a number of variables, including professional distrust, adherence to auditing standards, and the thoroughness of methods used, affect an independent auditor's capacity to provide a high-quality audit. Strong audit quality guarantees that the auditor is not only impartial and free from undue influence, but also has the skills and diligence needed to find any possible irregularities or misstatements in financial reporting (Boskou et al., 2019). The influence of audit quality on the accuracy and transparency of financial information highlights the function that it plays as a mediator (Al-Dmour, Zaidan, & Al Natour, 2023). According to Shivaram, Suraj, and Zheng (2021) study, maintaining independence and performing excellent audits improves the likelihood of receiving quality ratings. The auditor's capacity to detect substantial misstatements, evaluate internal controls, and analyse the suitability of accounting principles is directly impacted by the quality of audit methods (Al-Dmour et al., 2023). By giving stakeholders a more realistic

picture of a company's financial performance, this evaluation enhances the general reliability of financial statements. Therefore, we say that,

H4: Audit quality works as a mediator between auditor independence and earning quality.

In the context of financial reporting, audit quality plays a critical mediating role in the relationship between audit firm size and earning quality. An audit firm's capabilities, knowledge, and resources are frequently correlated with its size (Dagilienė & Klovienė, 2019). Alareeni (2019) Says that bigger audit companies usually have more specialised industry insights, a larger pool of highly qualified individuals, and in-depth technical understanding. However, the effect of these characteristics on earning quality is only visible when seen through the prism of audit quality. The greater audit quality of a larger audit firm is demonstrated by its capacity to carry out more thorough and exacting analyses of financial statements (Leventis & Humphrey, 2021). Larger organisations are better equipped to negotiate complicated financial environments, identify possible risks, and spot deviations that might undermine earning quality due to their depth of experience and advanced audit procedures (Dagilienė & Klovienė, 2019). Furthermore, Shahid and Abbas (2019b) finds that investor confidence is impacted by the general view of financial statement dependability, which is shaped by the legitimacy and reputation of an audit firm's size. To put it simply, audit quality is the pivotal factor that guarantees the benefits coming from the audit firm's size are converted into a significant improvement in earning quality (Shivaram et al., 2021). The mediating function of audit quality in balancing audit firm size with the quality of earnings statements is highlighted by the efficiency of the audit process, the accuracy of financial evaluations, and the early discovery of serious misstatements. Therefore, we propose that,

H5: Audit quality works as a mediator between auditor firm size and earning quality.

In the complex link between auditors' financial expertise and financial reporting quality, audit quality plays a crucial mediating role. The foundation for a sophisticated comprehension of accounting principles and industry nuances is provided by auditors' financial competence (Singh et al., 2019). Nevertheless, this expertise is transformed into a guarantee of earning quality through the lens of audit quality. An expert auditor with extensive financial expertise is in a good position to handle complicated transactions, interpret accounting rules correctly, and spot possible dangers or financial statement fraud (Tang & Karim, 2019). How well auditors use their experience throughout the audit process demonstrates the mediating function of audit quality. A high-quality audit is defined by rigorous audit methods, comprehensive risk assessments, and a sharp sense of professional distrust (Kesimli, Kesimli, & Achauer, 2019). These elements ensure that the auditors' financial competence is translated into a thorough analysis of financial statements. Consequently, this enhances the precision and consistency of receiving quality ratings, so fostering trust among interested parties and improving the clarity of financial statements. Essentially, audit quality serves as a channel by which the auditors' financial expertise protects and enhances the reported earnings quality, so strengthening the accuracy of the financial reporting process (Kesimli et al., 2019). Therefore, we make a hypothesis that,

H6: Audit quality works as a mediator between financial expertise of auditors and earning quality.

3. Research Methods

The article investigates the effects of auditors' independence, audit firm size and auditors' financial expertise on earning quality and also explores the mediating role of audit quality among auditors' independence, audit firm size, auditors' financial expertise and earning quality of the manufacturing industry in Malaysia. The study gets the data from the audit department of

Malaysian manufacturing companies. The variables are measured with items and extracted from past literature such as auditors' independence has six questions Tuan Mansor, Mohamad Ariff, and Hashim (2020), audit firm size has eight items Younis and Sundarakani (2020), auditors' financial expertise has five questions Saputra and Kawisana (2021), earning quality has four question Elsidig Ahmed (2020) and audit quality has six questions (Albawwat & Frijat, 2021).

The article chosen the employees of audit department of Malaysian manufacturing companies as respondents. In addition, the auditors were selected using purposive sampling. The surveys were distributed to the auditors using personal visits to the organizations. The researchers distributed 521 surveys but received only 291 valid responses. These valid responses have 55.85 percent response rate. Moreover, the article checks the nexus among variables using smart-PLS. The article used the smart-PLS because it is the best tool for the analysis of primary data (Hair, Hult, Ringle, Sarstedt, & Thiele, 2017). Three predictors were used named auditors' independence (AI), audit firm size (AFS) and auditors' financial expertise (AFE) while one predictive construct was used named earning quality (EQ) and one mediating construct was used named audit quality (AQ). Figure 1 shows these variables.

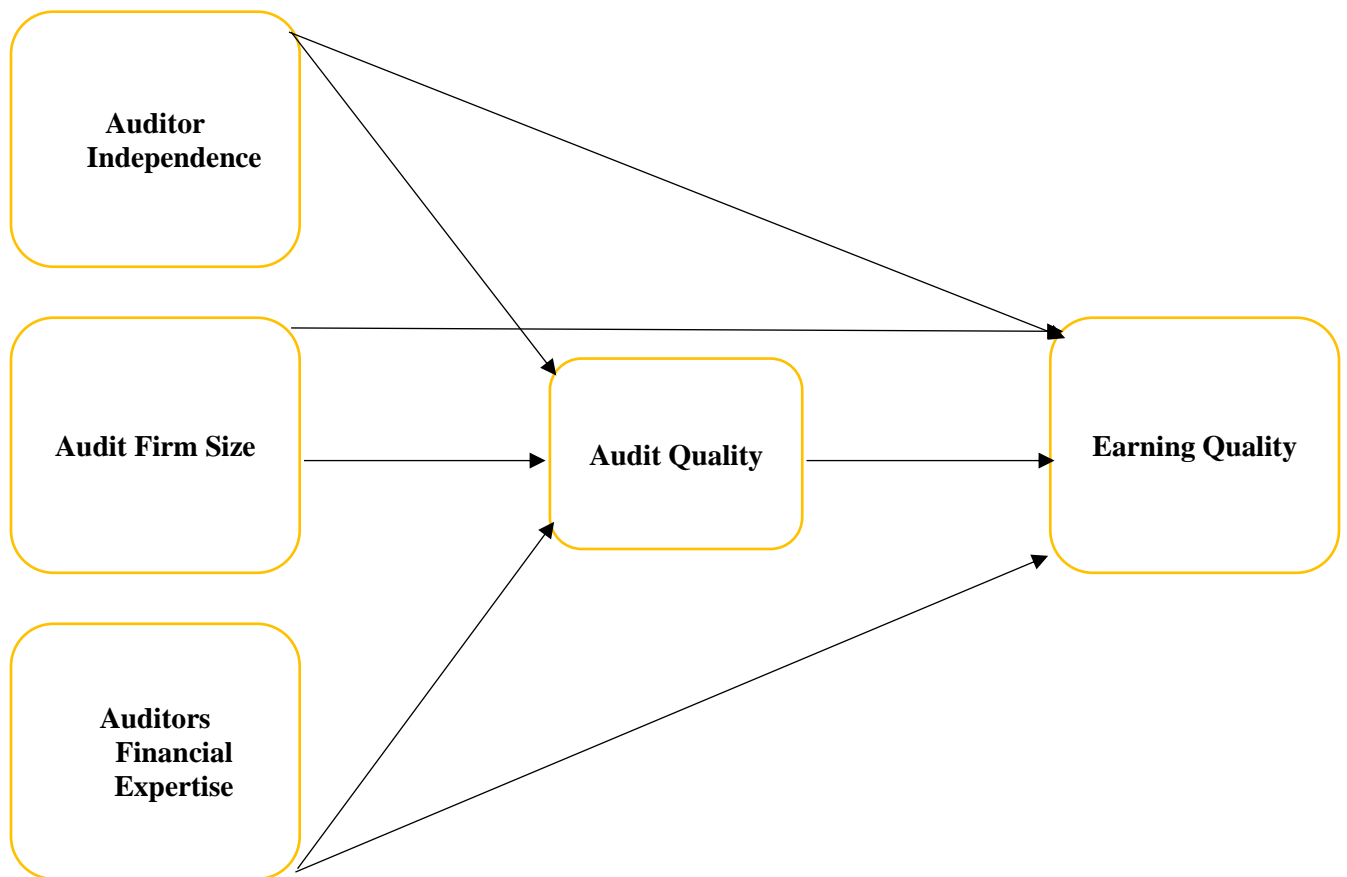


Figure 1: Research model

4. Research Findings

The study examines the correlation between items called convergent validity. It is checked using loadings and average variance extracted (AVE) and both have values more than 0.50. In addition, it is also checked using Alpha and composite reliability (CR) and both have values more than 0.70. These figures exposed high correlation among items. Table 1 shows these values.

Table 1
Convergent Validity

Constructs	Items	Loadings	Alpha	CR	AVE
Auditors Financial Expertise	AFE1	0.929	0.935	0.953	0.834
	AFE2	0.920			
	AFE4	0.902			
	AFE5	0.902			
	AFE5	0.902			
Audit Firm Size	AFS1	0.706	0.857	0.891	0.577
	AFS2	0.751			
	AFS3	0.740			
	AFS4	0.766			
	AFS6	0.788			
	AFS8	0.801			
Auditor Independence	AI1	0.902	0.898	0.923	0.671
	AI2	0.661			
	AI3	0.734			
	AI4	0.938			
	AI5	0.762			
	AI6	0.881			
Audit Quality	AQ1	0.880	0.806	0.862	0.558
	AQ2	0.780			
	AQ4	0.706			
	AQ5	0.671			
	AQ6	0.677			
	AQ6	0.677			
Earning Quality	EQ1	0.760	0.797	0.810	0.517
	EQ2	0.709			
	EQ3	0.704			
	EQ4	0.700			

The study also examines the correlation between variables called discriminant validity. It is checked using Heterotrait Monotrait (HTMT) ratio and have values not more than 0.90. These figures exposed low correlation among variables. Table 2 shows these values.

Table 2
Discriminant Validity

	AFE	AFS	AI	AQ	EQ
AFE					
AFS	0.344				
AI	0.265	0.740			
AQ	0.370	0.706	0.509		
EQ	0.440	0.686	0.712	0.700	

In addition, the direct path shows the direct association among variables. The outcomes revealed that the auditors' independence, audit firm size and auditors' financial expertise have a positive association with earning quality and accept H1, H2 and H3. Table 3 shows these associations.

Table 3
Direct Path Analysis

Relationships	Beta	Standard deviation	T statistics	P values
AFE -> AQ	0.129	0.036	3.605	0.000
AFE -> EQ	0.147	0.047	3.144	0.002
AFS -> AQ	0.842	0.038	22.221	0.000
AFS -> EQ	0.228	0.095	2.400	0.017
AI -> AQ	0.116	0.047	2.468	0.014
AI -> EQ	0.305	0.061	4.967	0.000
AQ -> EQ	0.219	0.072	3.049	0.002

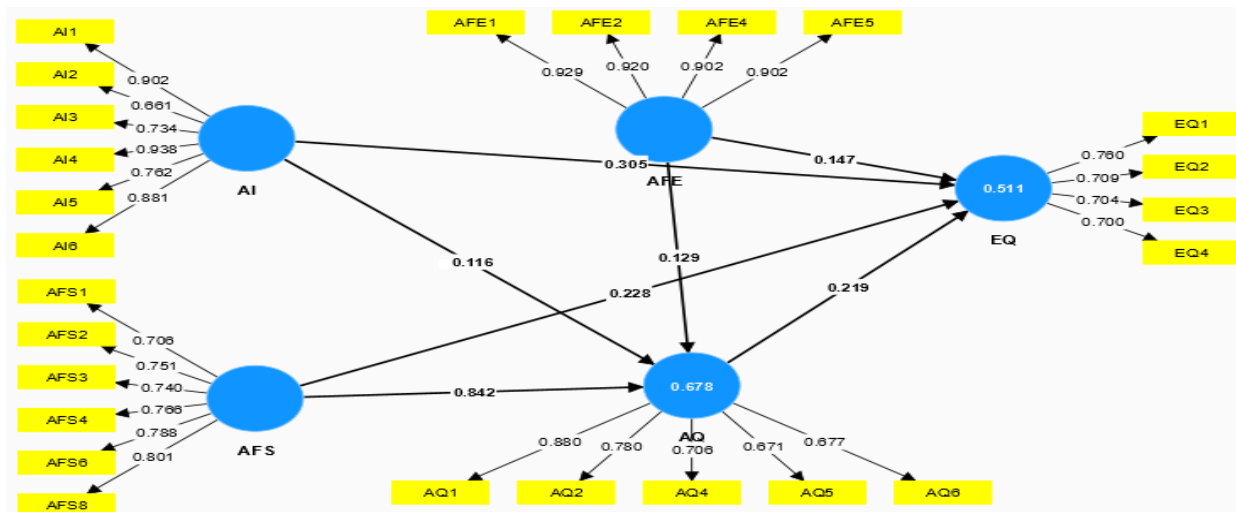


Figure 2: Measurement Model Assessment

In addition, the indirect path shows the indirect association among variables. The outcomes also exposed that audit quality significantly mediates among auditors’ independence, audit firm size, auditors’ financial expertise and earning quality of the manufacturing industry in Malaysia and accept H4, H5 and H6. Table 4 shows these associations.

Table 4
Indirect Path Analysis

Relationships	Beta	Standard deviation	T statistics	P values
AFE -> AQ -> EQ	0.028	0.013	2.197	0.028
AFS -> AQ -> EQ	0.185	0.062	2.986	0.003
AI -> AQ -> EQ	0.025	0.012	2.083	0.047

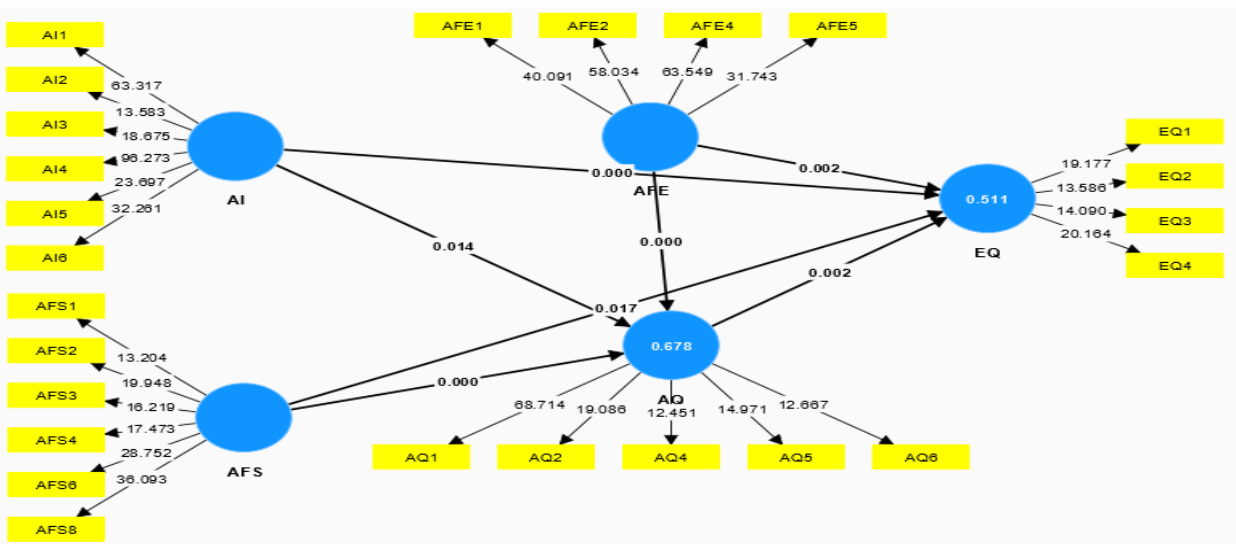


Figure 3: Structural Model Assessment

5. Discussions

In the Malaysian context, the study provides a comprehensive understanding of the complex dynamics influencing the auditing surroundings in this dynamic and diverse country in Southeast Asia. As an essential component of eliable financial reporting, auditor independence has a big influence on earning quality in Malaysia (Safipour Afshar et al., 2019). The results show

that auditors' strong commitment to independence standards enhances the accuracy and dependability of financial accounts. This emphasises how crucial it is to support an independent culture within the auditing profession in Malaysia, since stakeholders and investors from across the world want more dependability and transparency from financial reporting.

The paper also clarifies how the size of the audit firm affects the quality of earnings throughout Malaysia's various economic sectors. Studies like (Alareeni, 2019) and (Dagilienė & Klovienė, 2019) explore that bigger audit companies have more resources and experience, which helps them gain higher quality. Due to the size of these larger organisations' audit operations, financial statements may be examined more thoroughly and effectively, which improves the quality of earnings (Ruiz-Barbadillo & Martínez-Ferrero, 2022). This conclusion is especially important given the diversity of Malaysia's businesses, which include manufacturing, technology, and finance. It follows that, as Malaysia seeks to establish itself as a major participant in the international market, supporting bigger audit companies with their improved skills might help to improve the general dependability of financial reporting in a variety of industries. Furthermore, one important component affecting earning quality in Malaysia is the auditors' financial expertise. Auditors with specialised expertise are essential in managing the complexities of sector-specific difficulties as businesses like technology and finance continue to change (Austin et al., 2021). According to the study, earning quality is strongly correlated with auditors who possess a high level of financial understanding as (Jeppesen, 2019) and (Griffith et al., 2021) supports the hypothesis. This emphasises how crucial it is for Malaysian auditors to pursue ongoing professional development in order to keep current with changing industry trends and produce accurate and perceptive financial audits.

The investigation of the mediating function of audit quality is arguably the most insightful feature of the study. It is discovered that audit quality serves as a vital link between the dependent variable (earning quality) and the independent variables (auditor independence, audit firm size, and financial expertise). Translating the positive effects of auditor-related elements into dependable earning quality outcomes depends critically on the quality of the audit process, which is defined by thorough inspection, efficient risk assessment, and adherence to auditing standards (Boskou et al., 2019). This highlights the need of maintaining a high degree of audit quality in Malaysia's financial reporting structure in addition to supporting the expansion of bigger audit firms, encouraging auditor independence, and promoting financial knowledge.

5.1. Implications

The study has several implications for different stakeholders in the financial reporting industry, particularly in the setting of Malaysia. First of all, since auditor independence directly affects the accuracy of financial accounts, the results highlight how crucial it is to maintain and advance it. Malaysian regulatory agencies may use these findings to update and strengthen regulations that guarantee auditors remain unbiased in their evaluations, promoting an accountable and transparent culture. Furthermore, the positive relationship between higher earning quality and the size of audit firms implies that promoting the expansion and presence of larger audit firms could lead to more efficient financial audits, especially in industries where complex financial transactions are typical. This knowledge can help auditing companies optimise their processes and competencies to suit the expanding needs of Malaysia's varied sectors. The report also highlights how important it is to develop financial skills among auditors, especially in light of Malaysia's changing economic sectors. Initiatives for professional development and ongoing education may be customised to give auditors the specific expertise needed to successfully negotiate the complexities of diverse sectors. Lastly, the mediating function of audit quality emphasises the necessity of a persistent dedication to high-quality audit processes. The regulators could get the guidelines to achieve high quality earnings and audits using auditors' independence and financial expertise.

5.2. Limitations

It is important to recognise certain limitations even if the study makes an important contribution to our understanding of the determinants determining earning quality in Malaysia. Even with its reliability, the study methodology might not fully capture every minute detail unique to each industry within the diversified Malaysian economy. Furthermore, the study only offers an overview of the current situation and does not take into consideration future adjustments to the regulatory environment or the status of the economy that might have an influence on the correlations between the variables over time.

Author's Contribution:

Atif Aziz: Contributed to the development of the research idea and design.

Syed Muhammad Salman: Contributed to the development of the study's research methodology.

Muhammad Hassan: Focused on reviewing the existing literature related to intellectual capital disclosure.

Muhammad Kamran Younus: Contributed to refining the research idea and scope.

Humayun Fareed Uddin: Contributed to shaping the overall research concept.

Conflict of Interests/Disclosures

The authors declared no potential conflicts of interest w.r.t the research, authorship and/or publication of this article.

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