Dependency of Financial Information Disclosure Quality on Auditor Expertise, Tenure, and Size: Evidence from the Iraq Stock Exchange

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Article Info

Article type:

Original Research

Abstract

Objective: The objective of this research is to examine the impact of auditor expertise, tenure, and size on the quality of information in the context of the Iraq Stock Exchange. We aim to explore the extent to which the lack of quality in information reporting can adversely affect investors' ability to make more precise and effective decisions, thereby increasing transaction costs.

Methodology: From a target population of 127 financial companies active in the Iraq Stock Exchange between 2015 and 2023, we selected 46 companies using a systematic elimination method. By employing a descriptive correlational research design, we attempted to explain the relationship between the target variables under investigation and the quality and transparency of financial information disclosure.

Findings: We found that auditor expertise, tenure, and size play a crucial role in ensuring the quality of financial information reporting.

Conclusion: Our findings can have significant implications for investors, company managers, and auditing institutions. The results highlight the necessity of selecting auditing firms that utilize concise and practical planning schemes to ensure the quality of financial information reports of companies trading on the Iraq Stock Exchange (ISX).

Keywords: *auditor industry expertise, auditor size, auditor tenure, financial information disclosure quality, Iraq Stock Exchange (ISX).*

1 Introduction

Financial statements, as outputs of accounting systems, assist in highlighting the accountability of company managers to shareholders and stakeholders. The timely disclosure of all pertinent information about companies provides investors with a valuable resource to make correct decisions in the financial world. Therefore, the primary task of the financial disclosure system is to prevent conflicts of interest by offering high-quality financial reporting that objectively reflects the economic reality of a company's activities. Factors such as relevance, faithful representation,

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timeliness, understandability, and verifiability can help analysts effectively evaluate a company's performance and outlook, as low-quality financial disclosure is often misleading or incomplete (Jerry & Saidu, 2018; Sohail & Aziz, 2019; Wang et al., 2007; Wruck & Wu, 2021; Zager et al., 2016).

Hence, companies use annual reports to present vital financial information to investors, customers, employees, and the media. These reports are integral parts of financial communication strategies aimed at attracting and retaining investors. Agency theory argues that managers, as agents, and shareholders, as principals, must maximize proper incentives and adequate monitoring to prevent information asymmetry, emphasizing reliable and trustworthy auditor reports (Dranove, 2011). Financial information, as a summary of a company's yearly activities, plays a pivotal role in readers' understanding of financial statements, containing essential information that informs investors and creditors about the company's performance and profitability. Consequently, these statements are considered crucial financial parameters for assessing the financial health of target companies and making investment decisions (Diouf & Boiral, 2017; Nguyen & Nguyen, 2020; Sohail & Aziz, 2019).

The dependency of financial and commercial companies on auditing firms stems from the fact that auditing financial statements can reduce the information asymmetry between users and providers of financial statements. As Fernando et al. (2008) maintained, auditing is a practical source of reducing information risk for investors and stock exchange operators seeking profits from buying and selling securities such as stocks, bonds, and derivatives (Fernando et al., 2008). The relationship between factors affecting the quality of financial information disclosure has garnered significant attention in relevant literature (Abeysekera et al., 2021; Ewert & Wagenhofer, 2019; Ho et al., 2023; Jerry & Saidu, 2018; Schauer, 2002; Sohail & Aziz, 2019; Wruck & Wu, 2021). Among these indicators, the relationship between auditor industry expertise, auditor tenure, and the size of the auditing firm has been extensively examined concerning the quality of financial and accounting information disclosure.

Here, a conceptual explanation of these indicators is necessary. Auditor industry expertise refers to an auditor's specialization in developing fair inspection and analysis of a company's financial statements. The main objective of such auditing is to determine the extent to which a company's financial statements reflect the overall integrity of its financial position (Diouf & Boiral, 2017; Djamil, 2000).

Notably, providing an appropriate professional opinion, supported by objective evidence and judgment, can significantly impact audit quality. On the other hand, auditor tenure refers to the length of time the auditor has conducted an audit of a company. As DeAngelo (2000) states, the longer an auditor audits, the lower the audit quality. Finally, auditor size is defined by three different but complementary criteria: the wealth of audit partners, the size of the partners' client portfolios, and the number of audit partners in the firm. Generally, auditors with more clients are less likely to report potential violations in specific client records successfully (DeAngelo, 1981).

Overall, research in this area aims to improve our understanding of the factors contributing to high-quality financial reporting and provide insights for policymakers, regulators, and professionals on enhancing the transparency and credibility of financial statements. However, what sets our study apart from other researchers is that, to the best of our knowledge, no previous research has attempted to adopt a multidimensional approach considering key indicators such as auditor industry expertise, tenure, and size and their impact on disclosure quality. In summary, this study aims to examine the dependency of the quality of financial information disclosure on auditor expertise, tenure, and size, using evidence from the Iraq Stock Exchange.

2   Methods and Materials

This study employed a descriptive-correlational research method. The objective of this research design is to explain the relationship between two or more variables. The aim of this research is to describe the conditions or phenomena under investigation to reveal useful information about the existing conditions and the relationship between variables, meaning the goal of this research is to examine the relationship between accounting and auditor variables. From a target population of 1,200 financial companies active in the Iraq Stock Exchange between 2015 and 2023, 120 companies were selected using a systematic elimination sampling method. This probability sampling method involves randomly selecting sample members from a larger population based on a random starting point and a fixed periodic interval. In this case, each member of the population under study was selected.

Several procedural models were used in this research. The first model was by Robin and Zhang (2015).

The following steps were used to measure the research variables:

Quality of Information Disclosure (MAT): In this study, accounting metrics based on accruals were used to estimate the quality of information disclosure. Using the modified Jones model (1997), annual accruals were calculated as they act as an indicator of the quality of financial information disclosure. The total accruals were obtained by subtracting operating income from operating cash flow. Finally, discretionary accruals (DACC) were measured based on the following equation:

$$DACC_{i,t} = \frac{TA_{i,t}}{A_{i,t-1}} - NDA_{i,t}$$

After calculating discretionary accruals, financial information disclosure can be measured using the following relationship:

$$OPAQUE_{i,t} = Abs(DACC_{i,t-1}) \\ + Abs(DACC_{i,t-2}) \\ + Abs(DACC_{i,t-3})$$

Auditor Industry Expertise (SPECIn): In this study, the auditor's market share was used to calculate industry expertise. To this end, the total assets of owners in a specific auditing firm in a particular industry were divided by the total assets of owners in that industry. Entities whose market share was higher than the threshold below were considered experts. Those not considered experts were assigned a zero value.

Auditor tenure is defined as the number of years the auditor has been employed by the audit unit. Therefore, in this study, to calculate this variable based on the number of years the auditor has audited the company, the tenure from two years before the audit period should be considered.

The calculation criteria for the auditing firm size were important. If the Iraqi Financial Organization (State Audit Organization) audited the unit in question, the value was one; otherwise, it was zero. Various factors were considered to calculate the size of the auditing firm:

Size: This variable is obtained through the natural logarithm of the company's total assets.

Age: This variable is obtained through the natural logarithm of the company's age.

Market-to-book ratio (MTB): This variable is obtained by dividing the market value by the book value of the stock.

Financial leverage (LEV): This variable is obtained by dividing the total debt by the company's total assets.

Profitability (ROE): This variable is obtained by dividing net profit by total equity.

Sales growth: This variable is obtained through the company's sales growth rate compared to the previous year.

Working capital (WC): This variable is obtained by dividing current assets minus current liabilities by the company's total assets.

Return on assets (ROA): This variable is obtained by dividing earnings before interest and taxes by the company's total assets.

Consequently, the following conditions were also considered:

The audited financial information of the companies under study must be available.

The business units under study must be active in the stock market during the research period.

They should not be part of banks and financial institutions (investment companies, financial intermediaries, and holding companies).

Information related to the companies under study was reviewed using various tools, including the Iraq Stock Exchange and company websites.

To determine whether the time series X_t has a stationary process (order of integration zero) or a divergent process (order of integration one), the Levin-Lin test was used. Similar to the examination of variable stationarity, the appropriate method for data consolidation must be applied here. The ARCH statistic was used to examine group heteroskedasticity among the model's fixed-effects regression residuals. Additionally, the F and Hausman tests were used to determine whether to use the fixed or random effects method. To decide whether to use the combined or panel method in model estimation, the F Limer test was employed to check whether the null hypothesis could be rejected. Then, multiple regression tests were used to confirm or reject the research hypotheses using Eviews9 software.

3   Findings and Results

As shown in Table 1, the mean value of information disclosure quality is equal to 79.036. This figure indicates that most disclosure quality values are close to this number. It can also be concluded that half of the information disclosure quality values are less than the estimated mean, and the other half are more. The highest and lowest values for this variable are 91.976 and 65.005, respectively. The standard deviation is 7.788, indicating the deviation of disclosure quality (based on minimum and maximum values). The highest and lowest values for this variable are 28 and 13, respectively. The standard deviation is 4.586, indicating the deviation in earnings quality. The mean

auditor industry expertise is 0.476. This figure indicates that most values of auditor industry expertise are close to this value. The mean of this variable is 0. The highest and lowest values for this variable are 1 and 0, respectively. The

standard deviation is 0.499, indicating the deviation of auditor industry expertise. The mean auditor tenure is 0.499. This figure indicates that most values of auditor tenure are close to this value. The mean of this variable is 0.

Table 1

Descriptive Statistics of Research Variables

Variables	Mean	Median	Maximum	Minimum	Standard Deviation	Skewness	Kurtosis
Information Disclosure Quality	79.036	79.067	91.976	65.005	7.788	-0.069	1.821
Auditor Industry Expertise	0.476	0	1	0	0.499	0.095	1.009
Auditor Tenure	0.499	0	1	0	0.500	0.003	1.000
Auditor Size	0.490	0	1	0	0.500	0.036	1.001
Size	6.490	6.475	7.109	5.880	0.350	0.051	1.834
Age	1.994	1.995	2.109	1.880	0.065	-0.012	1.795
Market-to-Book Ratio	0.461	0.466	0.609	0.310	0.086	0.052	1.805
Financial Leverage	0.161	0.161	0.209	0.110	0.028	-0.059	1.806
Profitability	0.408	0.407	0.509	0.310	0.058	0.024	1.776
Sales Growth	0.699	0.709	0.879	0.510	0.107	-0.066	1.786
Working Capital	0.747	0.747	0.879	0.610	0.079	-0.011	1.755
Return on Assets	0.214	0.214	0.329	0.090	0.070	-0.056	1.785

As the results of the conditional test show, there are no strong conditions among the variables that could create

problems in the estimation of the examined hypotheses. Therefore, these variables can be used for testing.

Table 2

Correlation Matrix of Research Variables

Variables	Information Disclosure Quality	Auditor Industry Expertise	Auditor Tenure	Auditor Size	Size	Age	Market-to-Book Ratio	Financial Leverage	Profitability	Sales Growth	Working Capital
Information Disclosure Quality	1										
Auditor Industry Expertise	0.049	1									
Auditor Tenure	0.035	-0.034	1								
Auditor Size	-0.020	0.017	0.049	1							
Size	0.019	-0.030	0.037	0.017	1						
Age	-0.029	-0.006	-0.020	0.002	0.004	1					
Market-to-Book Ratio	-0.065	-0.031	0.044	0.009	-0.001	0.055	1				
Financial Leverage	0.015	-0.024	0.018	-0.025	0.024	0.010	-0.067	1			
Profitability	0.021	-0.011	-0.054	0.016	-0.023	0.012	0.035	-0.028	1		
Sales Growth	0.026	-0.012	0.019	0.005	0.025	-0.050	-0.029	-0.003	-0.013	1	
Working Capital	0.058	0.032	-0.031	-0.021	0.001	0.021	-0.030	-0.016	-0.050	-0.012	1

Before estimating the model, it is necessary to examine the stationarity of its variables. A variable is stationary when its mean, variance, and covariance remain constant over time. Generally, if the origin of time changes for the variable

and its mean, variance, and covariance do not change, the variable is stationary; otherwise, it is non-stationary. The Levin-Lin-Chu unit root test was used to examine the stationarity of the variables.

Table 3

Stationarity Analysis of Research Variables

Variables	Statistic	Significance Level
Information Disclosure Quality	-34.042	0.0000
Auditor Industry Expertise	-17.284	0.0000
Auditor Tenure	-18.209	0.0000
Auditor Size	-22.588	0.0000
Size	-30.701	0.0000
Age	-41.472	0.0000
Market-to-Book Ratio	-33.397	0.0000
Financial Leverage	-33.581	0.0000
Profitability	-32.660	0.0000
Sales Growth	-36.173	0.0000
Working Capital	-31.540	0.0000
Return on Assets	-27.098	0.0000

Based on the results observed in Table 3, the test statistics are below 5%. Therefore, considering that the significance level is less than 0.05, the research variables have the necessary stability. One of the assumptions of linear regression is that all residuals have equal variance. In practice, this assumption may not be true, and for various reasons such as incorrect model function shape, the presence of outliers, structural breaks in the sample population, and so on, we witness heteroskedasticity. To examine this problem, various tests have been introduced by economists. In this research, the homogeneity of residual variances was tested using the Pagan et al. test. The results show that there is no homogeneity of variances in the research models. As a result, the null hypothesis is not rejected.

One of the important assumptions about the residual term is that its distribution is normal. The Jarque-Bera test was used to test the normality of the error term. According to the results obtained, the Jarque-Bera test statistic for all three models is not significant at the 5% probability level. Therefore, the null hypothesis that the error term is normally distributed is confirmed in all models.

Hypothesis 1: There is a significant relationship between auditor industry expertise and the quality of financial information disclosure.

The significance level for testing the above hypothesis for the variable auditor industry expertise in Iraq was less than 0.05, so the null hypothesis can be rejected at a 95% confidence level. In other words, there is a significant relationship between auditor industry expertise and the quality of financial information disclosure in Iraq. The coefficient of determination R^2 is 0.420, meaning that auditor industry expertise accounts for 0.420 units of changes in the quality of financial information disclosure. The overall F statistic was 5.615, indicating a significant effect of the variable, which equals 5.615, necessary to demonstrate the power of the regression equation in prediction. The Durbin-Watson statistic, used to identify the independence of errors, was 2.049, indicating no autocorrelation between error components. Thus, the relationship between the main independent and dependent variables was significant.

Table 4

Analysis of Hypothesis 1 Results

Variables	Coefficient	Standard Deviation	T	Significance Level
Auditor Industry Expertise	0.219	0.085	2.585	0.009
Size	1.133	0.829	1.365	0.172
Age	1.905	4.538	0.419	0.674
Market-to-Book Ratio	0.827	3.427	0.241	0.809
Financial Leverage	27.321	10.117	2.700	0.007
Profitability	2.427	5.078	0.477	0.632
Sales Growth	1.532	2.719	0.563	0.573
Working Capital	6.634	3.713	1.786	0.074
Return on Assets	0.425	4.171	0.102	0.918

Constant	87.914	11.378	7.726	0.000
Coefficient of Determination R^2	0.420	F	5.615	
Adjusted R^2	0.407	Significance Level	0.066	
Durbin-Watson	2.049			

Hypothesis 2: There is a significant relationship between auditor tenure and the quality of financial information disclosure.

The significance level for testing this hypothesis was less than 0.05 for the variable auditor tenure in Iraq, so the null hypothesis can be rejected at a 95% confidence level. This indicates a significant relationship between auditor tenure and the quality of financial information disclosure in Iraq. In this case, the coefficient of determination R^2 is 0.461,

indicating that auditor tenure reflects 0.416 units of change in the quality of financial information disclosure. The overall F statistic was 5.247, indicating a significant effect of the variable, which equals 5.247, demonstrating the power of the regression equation in prediction. The Durbin-Watson statistic, used to identify the independence of errors, was estimated at 2.047, indicating no autocorrelation between error components.

Table 5

Analysis of Hypothesis 2 Results

Variables	Coefficient	Standard Deviation	T	Significance Level
Auditor Industry Expertise	0.106	0.048	2.836	0.032
Size	0.868	0.374	0.739	0.459
Age	3.021	6.065	0.498	0.618
Market-to-Book Ratio	1.644	4.681	0.351	0.725
Financial Leverage	6.462	14.460	0.446	0.655
Profitability	3.850	7.004	0.549	0.582
Sales Growth	2.145	3.902	0.549	0.582
Working Capital	0.721	5.155	0.139	0.888
Return on Assets	4.708	5.819	0.809	0.419
Constant	84.038	15.440	5.442	0.000
Coefficient of Determination R^2	0.416	F	5.247	
Adjusted R^2	0.408	Significance Level	0.018	
Durbin-Watson	2.047			

Hypothesis 3: There is a significant relationship between the size of the auditing firm and the quality of financial information disclosure.

The significance level for testing this hypothesis was less than 0.05 for the variable auditor size in Iraq, so the null hypothesis can be rejected at a 95% confidence level. This indicates a significant relationship between the size of the auditing firm and the quality of financial information disclosure. Therefore, both coefficients significantly differ from zero, in other words, they are statistically significant.

The coefficient of determination R^2 is 0.409, indicating that auditor size accounts for 1.109 units of changes in the quality of financial information disclosure. The overall F statistic was 5.765, indicating a significant effect of the variable, which equals 5.765. This demonstrates the power of the regression equation in prediction. The Durbin-Watson statistic, used to identify the independence of errors, was 2.041, indicating no autocorrelation between error components.

Table 6

Analysis of Hypothesis 3 Results

Variables	Coefficient	Standard Deviation	T	Significance Level
Auditor Industry Expertise	0.705	0.382	2.327	0.026
Size	1.109	0.829	1.337	0.181
Age	1.719	4.534	0.379	0.704
Market-to-Book Ratio	0.995	3.427	0.290	0.771
Financial Leverage	26.770	10.117	2.646	0.008

Profitability	2.699	5.071	0.532	0.594
Sales Growth	1.424	2.717	0.524	0.600
Working Capital	6.567	3.705	1.772	0.076
Return on Assets	0.580	4.158	0.139	0.889
Constant	87.811	11.367	7.724	0.000
Coefficient of Determination R^2	0.421	F	5.765	
Adjusted R^2	0.409	Significance Level	0.041	
Durbin-Watson	2.041			

4   Discussion and Conclusion

The main objective of this research was to examine the impact of auditor industry expertise, auditor tenure, and auditor size on the quality of financial information disclosure among various companies listed on the Iraq Stock Exchange. The results obtained based on statistical evidence indicated that financial information disclosure is significantly influenced by such impactful variables. Specifically, the Iraq Stock Exchange has experienced significant growth and development in market investment, trading volume, and the number of listed companies over the past decade. Existing economic indicators point to a positive trend of development and expansion as a fundamental financial market in Iraq. With such promising potentials for further growth, careful considerations regarding imminent investor risks must be adopted. Among these risks, the health and transparency of the financial statements relationship are of high priority.

The relationship between the quality of financial information reporting appears to be a complex and multifaceted concept in which factors such as auditor industry expertise, auditor tenure, and the size of the auditing firm play a critical role in attracting investors, shareholders, and stakeholders. It is not surprising that auditors with higher levels of expertise, knowledge, and experience can produce more transparent statements. Similarly, auditors with longer tenure at a specific company have a better understanding of the company's financial status and processes, leading to better financial statements. Additionally, the size of the firm is crucial in determining the quality of financial information disclosure. Larger firms with more resources and complex monitoring systems can produce more accurate and transparent financial reports. Naturally, smaller firms offer the advantage of closer relationships between auditors and management, ultimately leading to more accurate and transparent disclosures.

In the final analysis, it can be emphasized again that the interaction between auditor expertise, tenure, and firm size plays a pivotal role in determining the quality of financial information reporting. Through meticulously planned procedures, training, and collaboration, relevant firms and business companies should design accurate and high-quality reporting processes to ensure stakeholders and investors are provided with reliable and transparent information. Further research in this area is necessary to fully understand the impact of these variables on the quality of financial information disclosure and develop the most effective measures aimed at improving financial statement standards.

Authors' Contributions

All authors have contributed significantly to the research process and the development of the manuscript.

Declaration

In order to correct and improve the academic writing of our paper, we have used the language model ChatGPT.

Transparency Statement

Data are available for research purposes upon reasonable request to the corresponding author.

Declaration of Interest

The authors report no conflict of interest.

Ethical Considerations

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In this research, ethical standards including obtaining informed consent, ensuring privacy and confidentiality were observed.

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