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دراسة العلاقة بين تقديرات القيمة العادلة وخصائص جودة المراجعة

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ملخص البحث:

الغرض – تهدف هذه الدراسة إلى تقييم ملاءمة تقديرات القيمة العادلة واستكشاف تأثير جودة المراجعة على هذه الملاءمة من خلال مراجعة شاملة للأدبيات السابقة.

المنهجية – تعتمد الدراسة على تحليل دقيق للأبحاث السابقة التي تناولت ملاءمة تقديرات القيمة العادلة ودور جودة المراجعة في هذا السياق.

النتائج – تُظهر نتائج تحليل الأدبيات السابقة أن قابلية ملاحظة المدخلات المستخدمة في تقدير القيمة العادلة تلعب دورًا حاسمًا في تشكيل تصور المستثمرين. تُعتبر تقديرات المستوى الأول، المستندة إلى مدخلات السوق القابلة للملاحظة، الأكثر ملاءمة وموثوقية نظرًا لشفافيتها. تليها تقديرات المستوى الثاني، التي قد تتضمن تحيزًا إداريًا وإمكانية حدوث أخطاء في اختيار الأصول أو الالتزامات القابلة للمقارنة، مما يجعلها أقل ملاءمة. أما تقديرات المستوى الثالث، التي تعتمد بشكل كبير على بيانات خاصة بالشركة وحكم الإدارة، فتعتبر الأقل ملاءمة، نظرًا لزيادة عدم التماثل المعلوماتي وارتفاع مخاطر التلاعب. بالإضافة إلى ذلك، تشير الأدبيات إلى أن جودة المراجعة تؤثر إيجابيًا على ملاءمة تقديرات القيمة العادلة، مما يدعم نظرية الوكالة التي تقترح أن المراجعة عالية الجودة تعزز مصداقية وملاءمة المعلومات المالية. كما تكشف النتائج أن عمليات المراجعة التي تُجرى بواسطة شركات "Big ٤" تميل إلى إنتاج تقييمات أكثر تحفظًا، مما يزيد من ملائمة تقديرات القيمة العادلة. وأخيرًا، تشير اتعاب المراجعة الأعلى المرتبطة بتقديرات القيمة العادلة المعقدة إلى الجهد الإضافي والخبرة المطلوبة لضمان موثوقيتها وأهميتها للمستثمرين.

الكلمات المفتاحية : IFRS ١٣؛ التسلسل الهرمي للقيمة العادلة؛ ملاءمة القيمة؛ جودة المراجعة؛ حجم شركة المراجعة؛ أتعاب المراجعة.

Value Relevance of Fair Value Estimates and Audit Quality: A Critical Review

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Abstract

Purpose – This study aims to assess value relevance of fair value estimates and investigate the influence of audit quality on their relevance through a comprehensive review of previous literature.

Methodology– Through a thorough review of previous literature, we analyze literature that have explored the relevance of fair value estimates, as well as the role of audit quality in this context.

Findings – The analysis of prior literature shows that the observability of inputs used in fair value estimation plays a crucial role in shaping investor perception. Level 1 estimates, derived from observable market inputs, are typically viewed as the most relevant and reliable due to their transparency. Following that, Level 2 estimates, which involve managerial discretion and the possibility of errors in choosing comparable assets or liabilities, are considered less relevant. Lastly, Level 3 estimates, which heavily depend on company-specific data and management judgment, are seen as the least relevant, as they lead to greater information asymmetry and a higher risk of manipulation. Moreover, the literature found that audit quality positively influences the value relevance of fair value estimates. This supports agency theory, which suggests that higher-quality audits enhance the credibility and relevance of financial information. The findings reveal also that audits performed by Big 4 firms tend to produce more conservative valuations, thereby increasing the relevance of fair value estimates. Additionally, the higher audit fees associated with complex fair value estimates suggest the additional effort and expertise needed to ensure their reliability and relevance for investors.

Keywords: IFRS ١٣; Fair Value hierarchy; Value Relevance; Audit quality; Audit firm size; Audit fees.

١,١ Introduction

Financial statements serve as a bridge between a firm's management and its stakeholders, communicating the firm's operational performance and financial health (Alsughayer, 2021). Therefore, selecting an appropriate basis of the measurement is crucial to ensuring that the information presented to the users of financial statements is useful (Toluwa and Power, 2019). The measurement basis directly impacts how relevant and reliable the information is (Toluwa and Power, 2019). Value relevance refers to how accurately the financial statements reflect the company's actual value and significantly influences the decisions made by users (Karğın, 2013).

Since the 14th century, the historical cost basis, which values assets, and liabilities at their original purchase price, has been the norm for financial statements (Obasi, 2019). However, recent decades have seen growing dissatisfaction with this approach. Critics argued that historical cost fails to reflect the changing market values of assets and liabilities, diminishing the usefulness of financial statements for decision-making. While a core function of financial reporting is to provide timely and relevant information to current and potential investors (Hasan et al., 2020).

Concerns in the late 20th century about the limitations of historical cost accounting in a globalized business environment prompted accounting standard-setters, such as the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), to take action (Jordan et al., 2013). This resulted in the implementation of a series of standards mandating fair value measurement. This approach, which reflects current market prices for assets and liabilities (Toluwa and Power, 2019), has led to a significant shift away from historical cost accounting in financial statements (Palea, 2014). Notably, the IASB introduced International Financial Reporting Standards (IFRS) 13, titled "Fair Value Measurement," in 2011, which became effective in 2013 (Hameed et al., 2022).

IFRS 13 defines fair value as "*the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants*

on the measurement date" (IFRS 13, 2011, para. 9). This definition focuses on the price received for selling the asset or transferring the liability (the exit price), rather than the price paid to acquire the asset, or received when assuming the liability (the entry price) (Palea, 2014). In some cases, the exit price of the asset or liability cannot be directly observed, it needs to be estimated. An accounting estimate refers to a monetary amount that is approximated in the absence of a precise means of measurement (ISA 540, 2009).

IFRS 13 provides three widely used techniques for estimating the price of an asset or liability: the market approach, the cost approach, and the income approach. The market approach is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets and liabilities (IFRS 13, para. B5). The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost)" (IFRS 13, para. B8). Income approach converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount ", considering the market's current expectations for those future amounts (IFRS 13, para. B10).

To develop fair value estimates, the three valuation techniques—market, cost, and income—rely on inputs which defined as "the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk" (IFRS13, p.A705). Inputs can be observed or not. Observable inputs are derived from market data, reflecting assumptions that market participants would make when pricing the asset or liability (IFRS13, p.A706). Unobservable inputs, on the other hand, lack market data and are based on the entity's own assumptions, developed using the best available information about market participants' assumptions (IFRS13, p.A707). Therefore, it's essential for the entity to prioritize observable inputs while minimizing reliance on unobservable ones.

IFRS 13 introduces a fair value hierarchy, which classifies inputs to valuation techniques into three levels—Level 1, Level 2, and Level 3—prioritized in descending order.

- Level 1 inputs "mark-to-market," comprise unadjusted quoted prices for identical assets and liabilities in active markets. These markets witness transactions for the asset or liability occurring frequently and in substantial volumes, providing continuous pricing information on the measurement date (IFRS 13, para. 76).
- Level 2 inputs "mark-to-matrix," encompass inputs beyond quoted prices, as outlined in Level 1, which are either directly observable "prices" or indirectly "derived from prices" for an asset or liability (IFRS 13, para. 81). These inputs include (IFRS 13, para.82):

    a) Quoted prices for similar assets or liabilities in active markets.
    b) Quoted prices for identical or similar assets or liabilities in non-active markets.
    c) Other observable inputs besides quoted prices for the asset or liability.

- Level 3 inputs "mark-to-model," consist of inputs that cannot be directly observed for the asset or liability (IFRS 13, para.86). These inputs rely on management's judgment and assumptions, aiming to mirror the assumptions of market participants when pricing an asset or liability (Appah and Ogiriki, 2018; Acar, 2019).

The adoption of fair value has brought several positive changes to financial statements. By recording assets and liabilities at their current market value, it provides investors with more relevant and up-to-date information for decision-making (Ma and Li, 2015; Metwally, 2020). Additionally, fair value accounting incorporates changes in market conditions, allowing adjustments to reflect these fluctuations.

Financial statements are intended to provide a transparent view of a firm's operations, performance, and cash flow (Mohd-Sanusi et al., 2012; Kibiya et al., 2016). However, Agency theory suggests that information asymmetry, where management knows more than shareholders, can undermine trust in these statements due to conflicting interests (Sari et al., 2019). To address this issue and ensure that financial statements are both relevant and fair, an independent and qualified third party—typically an auditor—must examine them (Karim et al., 2022; Sari et al., 2019). Auditing serves as a control mechanism to safeguard shareholder interests by reducing information asymmetry and ensuring the statements are free of material misstatements (Qais et al., 2024). As a result, audited financial statements become a key source of information for investors in evaluating a company's health and the broader economy (Carrera et al., 2007; Firnanti and Pirzada, 2019).

The shift towards fair value accounting presents a new challenge for auditors. Traditional auditing procedures for assessing the accuracy of transactions and balances measured at historical cost are not sufficient when it comes to evaluating estimates that incorporate subjective factors (Griffith et al., 2015). Unlike historical cost, fair value relies on assumptions and predictions about future events, inherently introducing a greater degree of subjectivity into the valuation process. To address this challenge, the International Auditing and Assurance Standards Board (IAASB) introduced the International Standard on Auditing (ISA) 540 titled "Auditing Accounting Estimates, including Fair Value Estimates, and Related Disclosures." This standard offers guidance to auditors when assessing fair value estimates (Alharasis et al., 2020). The standard requires auditors to gather sufficient and appropriate evidence to assess the reasonableness of these estimates. This includes evaluating management's assertions, the methods and inputs used in the estimation, and the adequacy of related disclosures (Abdullatif, 2016). However, the potential for bias due to agency conflicts, where managers might manipulate estimates for their benefit, necessitates additional time and effort from auditors to scrutinize these estimates (Alqatamin and Ezeani, 2020).

١,٢ Research problem

While fair value accounting has become an integral component of financial statements across various industries, providing up-to-date view of a firm's financial health (Cascini and DelFavero, 2011), its reliability remains a topic of debate (Ma and Li, 2015). The primary challenge lies in acquiring fair value information through reasonable methods, which is essential for ensuring accuracy and reducing the impact of subjective factors (Ma and Li, 2015). Determining accurate transaction prices for assets and liabilities can be challenging in an unstable market. While some items may have easily observable transaction prices (level 1and 2), others do not and can only be estimated (level 3) (Ma and Li, 2015). In this case, management must use valuation techniques and make professional judgments to arrive at a reasonable estimate, which adds complexity to the estimation process (Bratten et al., 2013; Miah ,2019). These estimates are typically accompanied by degrees of uncertainty that contribute to higher potential risks, affecting the accuracy of the financial statements and increasing the probability of material risks in them (Dakheel et al., 2021).

The absence of active markets for certain assets and liabilities (level 3 estimates) creates a susceptibility to manipulation (Bagna et al., 2014). This lack of market data allows individuals with personal greed the opportunity to over or underestimate values, misrepresenting the firm's financial position (Bagna et al., 2014). The Enron scandal illustrates the risks of fair value manipulation. While multiple factors contributed to its collapse in December 2001, Enron’s extensive use of level 3 fair value estimates played a key role (Benston, 2006). Initially, these estimates aimed to reward managers for shareholder gains, not to mislead investors. However, as profits fell short of projections, Enron increasingly relied on level 3 estimates to inflate reported earnings, especially in "merchant investments." This was driven by a flawed incentive system that tied manager compensation to inflated asset valuations, leading to overinvestment in poorly designed projects (Benston, 2006). Enron also misused level 2 valuations for restricted stock, inflating asset and income values contrary to accounting standards (Haswell and Evans, 2018). The

external auditor, Arthur Andersen, enabled these practices due to financial ties with Enron. Ultimately, Enron's manipulation of fair value accounting escalated into widespread deception, culminating in its collapse (Benston, 2006).

Enron scandal highlighted the importance of reliability and relevance in financial statements. It also raised concerns about the effectiveness of audits in detecting and preventing financial statement fraud (Montenegro and Brás, 2018). Fair value accounting, with its inherent lack of objectivity in the estimating process depending on the level of fair value used, presents a unique challenge for auditors (Griffith et al., 2015). Assets or liabilities are assessed using valuation models expose auditors to greater risk and pressure (Woods et al., 2009). This necessitates that auditors not only assess the valuation models themselves, but also assess the expertise of the individuals providing the valuation information (Smith-Lacroix et al., 2012). As Christensen et al. (2012) pointed out, the managerial discretion provided by fair value estimates has increased information risks associated to subjectivity in financial statements. This, in turn, translates to more complex corporate transactions and a heavier burden on auditors.

The inherent uncertainties and subjectivity in fair value estimates, along with potential conflicts of interest between managers and shareholders, necessitate a more intensive auditing approach to ensuring the accuracy and relevance of managerial appraisals of fair value estimates (Bratten et al., 2013). This has driven a demand for high-quality audits, which refers to an auditor's ability in uncovering and reporting misstatements in financial statements (Karim et al., 2022). High-quality audits demonstrate the auditor's commitment to gathering sufficient evidence, detecting potential fraud, and preventing the manipulation of financial information (Soliman and Ragab, 2014).

Auditors with higher quality are more capable of detecting, limiting, and reporting fraud in the firms' financial statements (Gros and Worret, 2014). Their enhanced monitoring capabilities, greater reputations and exposure to litigation

incentivize them to mitigate estimation uncertainty associated with fair value estimates (Chen, 2016). Ultimately, high-quality audits, by limiting managerial opportunities for manipulation, can increase investor confidence in financial statements (DeFond and Zhang, 2014). In order to meet the demands of stakeholders for transparent and relevant fair value estimates, auditors must ensure that high-quality audits are conducted (Alharasis et al., 2022a; Sangchan et al., 2020).

Given the complexities and potential uncertainties surrounding fair value estimates, which can impact decision-making, it is essential to investigate:

١. ***How different levels of the fair value hierarchy influence their relevance***

٢. ***Whether high-quality audits enhance the relevance of these estimates.***

١,٣ Research Objective:

This research aims to:

١. Conduct a comprehensive literature review to evaluate the value relevance of fair value estimates.

٢. Examine the impact of audit quality on the relevance of fair value estimates through a detailed analysis of existing studies.

١,٤ Theoretical framework

In 1976, Jensen and Meckling introduced agency theory, which describes the relationship between a principal (owner) and an agent (manager), where the agent is entrusted with managing the principal's resources. While the agent is expected to act in the principal's best interests, information asymmetry arises because agents typically possess more information about the firm's current and future performance than principals. This imbalance encourages opportunistic behavior by managers, such as manipulating firm information for personal gain or to present a more favorable image to stakeholders (Magnan et al., 2015; Zhang et al., 2020). The use of fair value estimates, particularly level 3 estimates that rely on managerial

discretion due to limited market data, exacerbates this asymmetry, allowing managers greater opportunity to manipulate financial reports to their advantage (Palea, 2014; Matsane et al., 2022).

To overcome conflict between principals and managers caused by information asymmetry, Agency theory suggests that external auditors can act as a monitoring mechanism to mitigate managers' opportunistic behavior by providing assurance on the reliability of financial statements (Hlel and Nafti, 2022). High-quality audits are especially crucial in cases of complex fair value estimates, as they help detect errors or fraud, reducing the information asymmetry between principals and agents (Lambert et al., 2007). Additionally, high audit quality improves the credibility of financial reports, supports informed investment decisions, and promotes financial stability (Arens et al., 2012). By enhancing transparency and minimizing profit management strategies, high-quality audits build investor confidence and contribute to more stable financial markets (Oksyahra, 2019).

Therefore, in line with agency theory's emphasis on resolving conflicts between agents, a positive relationship between audit quality and the value relevance of fair value estimates is expected.

١,٥ Literature review

١,٥,١ The value relevance of fair value estimates

The objective of financial statements according to the IASB Conceptual Framework for Financial Reporting, is *"to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity"* (IASB, 2018, para.1.2). The conceptual framework also defines useful financial reports as containing the fundamental qualitative characteristics of "relevance" and "faithful representation" (IASB, para.2.4). Relevance financial information is "capable of making a difference in the decisions made by users" (IASB, para .2.6), and faithful

representation has three characteristics: “complete, neutral and free from error” (IASB, Para .2.13).

According to Song et al. (2010), financial information is considered value-relevant to investors if it is related to a company's stock price. A significant relationship suggests the information is both relevant to investors' decisions and reliable enough to be reflected in share prices (Imhanzenobe, 2022). In other words, it shows how well changes in accounting information explain changes in stock price (Outa et al., 2017). Ultimately, value relevance means the information accurately reflects and summarizes the company's true worth (Kargın, 2013; Mechelli et al., 2018).

While fair value accounting, which reflects current market values, is seen as a tool to enhance relevance and transparency of financial reports (Ma and Li, 2015; Metwally, 2020), it's a subject of ongoing debate. Proponents argue it provides more relevant information and reflects real market fluctuations, simplifying reporting (Ma and Li, 2015; Gulin et al.,2019; Metwally, 2020; Ngoc, 2020). Opponents, however, raise concerns about the verifiability of fair value estimates, potential for management errors, and the risk of manipulation due to less observable market inputs (Olamide and Ajibade ,2016; Oyewo,2020). These issues can create an information gap between investors and managers, potentially undermining the reliability of the reported fair value estimates (Liao et al.,2013; Mechelli and Cimini, 2019). This research specifically focuses on how the fair value hierarchy, which categorizes inputs by their reliance on observable data, influences the relevance of these estimates for investors.

Several studies have explored the value relevance of fair value estimates and have discovered that the extent to which fair value estimates are considered value relevant is significantly influenced by the level of observability within the fair value hierarchy. Fair value estimates based on reliable inputs, such as prices from active markets (mark-to-market), are always value relevant (Mechelli et al.,2018).

However, fair value estimates that heavily rely on internal models and managerial judgment (mark-to-model) show conflicting results.

Some studies have suggested that even less observable estimates (Levels 2 and 3) can be relevant. In a study conducted by Fiechter and Novotny-Farkas (2017), they examined a sample of banks across 46 IFRS countries from 2006 to 2009. Their findings showed that all three types of fair value assets (fair value through profit or loss (FVO), held for trading (HFT), and available for sales (AFS)) as well as both types of fair value liabilities (VO and HFT), were value relevant. Among these, HFT assets demonstrated the highest value relevance. Lawrence et al. (2016) conducted a study using Morningstar data on closed-end funds from 2009 to 2012, analyzing 2,041 fund-year observations representing 645 unique funds. Their findings indicated that the relevance of fair value estimates did not significantly differ across different levels (Levels 1, 2, and 3). This suggests that even estimates based on less observable data (Level 3) can still be informative to investors and have an impact on stock prices, as found by Sangchan et al. (2021).

These findings are consistent with Altamuro and Zhang's (2013) research, which revealed that in illiquid markets with irregular trading, valuations of mortgage servicing rights based on management input and expertise better reflected underlying cash flows compared to valuations relying solely on market inputs. Furthermore, Goh et al. (2015) examined data from US banks between 2008 and 2011, totaling 6,893 bank-quarter observations. They investigated how investors priced fair value assets that were hierarchically disclosed following the global financial crisis. The findings revealed that during this period, Level 3 fair value assets were generally priced lower than Level 1 and Level 2 fair value assets. However, over time, the difference in pricing between these estimates has narrowed, indicating a reduction in concerns about the reliability of Level 3 estimates as market conditions stabilized the financial crisis.

Investor protection and market conditions play a significant role in the value relevance of fair value estimates, as demonstrated by various studies. Liao et al. (2020) conducted an analysis on banks in 35 countries implementing IFRS from 2012 to 2016, comprising 1,227 bank-observations. Their findings indicated that fair value disclosures using the three-level hierarchy were more value-relevant in high enforcement countries compared to low enforcement countries. Similarly, Siekkinen (2016), studying 985 financial firms across 34 countries from 2012 to 2014, found that fair value assets and liabilities are relevant to investors regardless of the specific level used (Level 1, Level 2, or Level 3), especially in countries with strong investor protection. However, in countries with weak protections, Level 1 fair value assets are more relevant than Level 2 or Level 3 value assets, and the combined Level 1 and Level 2 fair value liabilities are more relevant than Level 3 fair value liabilities. Additionally, Du et al. (2014) concentrated on US banks during 2008–2009, comparing the relevance of fair value estimates between banks that made transfers between levels (Level 1to 2 or 3) versus those that did not make any transfers. They discovered a significant increase in the relevance of fair value estimates for banks involved in asset transfers between levels three categories. This suggests how dynamic market conditions can affect the valuation of fair value estimates and their value relevance.

Contrary to the idea that less observable estimates can be relevant, several studies have provided evidence to the contrary. For example, Song et al (2010) examined 431 US banks in the first quarter after SFAS 157 adoption and found that the value relevance of Level 1 and Level 2 fair value estimates is greater than the value relevance of Level 3 fair value estimates, reflected by stock market investors heavily discounting assets measured at Level 3 relative to assets measured at Levels 1 or 2. Similarly , Freeman et al. (2017) studied US banks over period 2008 – 2014 and found that all levels of fair value assets were relevant to investors. They observed that the relevance of Level 1 fair value assets was higher than that of Level 3, but

there was no significant difference between the relevance of Level 2 and 3 fair values.

Another study by Filip et al. (2019) suggested that investors find Level 1 and Level 2 fair value estimates more relevant than Level 3 estimates, which have lower value relevance due to the inclusion of model risk, underlying asset fundamentals, and difficulties in conveying the complexity of the measurement process. Magnan et al. (2015) found that Levels 3 fair values lead to an increase in forecast dispersion among analysts. This indicates that managers may exploit the use of inputs for measuring fair values that are not readily available in the market. Similarly, Arora et al. (2014) demonstrated that Levels 2 and 3 financial assets significantly contribute to short-term credit spreads and shape the overall credit term structure, suggesting that less reliable assets heighten short-term credit risk. This is further supported by Damian et al. (2020) who discovered using 68 quarterly firm observations from Q2 2014 to Q1 2017 in Romania, that reporting fair value estimates provides more explanatory power for share prices compared to historical cost accounting. Furthermore, their research indicated that only Level 1 fair value estimates were significant for investors, whereas Levels 2 and 3 were not considered value relevant.

Based on an analysis of previous studies, it can be concluded that level 1 fair value estimates are more value relevant than level 2 and level 3 estimates. This is probably because level 1 estimates—which are based on observable market inputs—have a higher degree of transparency and reliability. However, there is some inconsistency in the results regarding the value relevance of Level 2 estimates. While some studies have found no difference in value relevance between Level 1 and Level 2 estimates for US banks (Song et al., 2010; Goh et al., 2015), others (such as Freeman et al.,2017; Damian et al., 2020) have provided evidence suggesting that Level 2 fair value estimates are less relevant than those at Level 1. Regarding fair value estimates at level 3, these estimates are considered to have higher information

asymmetry compared to Level 1 and Level 2 estimates. This is because Level 3 estimates rely on company-specific data and management assumptions about market participants, making them less relevant (Palea and Maino, 2013; Altawalbeh, 2020; Matsane et al., 2022).

١,٥,٢ Audit quality and value relevance of fair value estimates

An audit is much more than just a legal obligation to produce financial statements (Hichri ,2023). Auditors utilize their in-depth knowledge of companies and their environments to deliver significant added value. They act as independent, objective supervisors, ensuring the quality of financial information disclosed to stakeholders (Abdollahi, 2020). This commitment to high-quality, relevant information makes auditing an essential element for a healthy financial system. By assuring the company's ability to effectively manage its operations, offers recommendations for improvement, audits contribute to the creation of value relevance and is thus a key factor of performance (Hakim and Omri, 2010).

The literature examining audit quality underscores the crucial role of auditors in ensuring the value relevance of financial information. Studies by Bae et al. (2017) and Salehi and Dehnavi (2018) have emphasized how audit quality can help mitigate information asymmetry and influence decision-making by users of firm information. Alfraih (2016), Tshipa et al. (2018), and Isaboke and Chen (2019) have also found that high-quality audits positively impact the value relevance of accounting information for market participants. Similarly, Abdollahi et al. (2020) demonstrated a positive and significant correlation between auditor's reports, audit firm size as indicators for audit quality, and two indicators of value relevance: earnings and book value per share. Furthermore, Robu et al. (2016) indicated that the audit process undertaken by large companies, as well as the information conveyed in the audit report, can affect stock market returns and investors. Additionally, Alkali et al. (2018) conducted a study on 126 listed firms in Nigeria from 2009 to 2013, revealing

that Big 4 auditors increase the value relevance of accounting information after the implementation of IFRS. Similarly, Busari (2019) examined Nigerian financial service firms and observed that audit quality enhances the value relevance of both consolidated and separate financial statements.

The rise of fair value accounting has created a complex situation in financial reporting. While fair value accounting aims to improve the quality of information for investors and aid in investment decision making (Siekkinen, 2017), the discretion it allows for managers can create opportunities to engage in opportunistic behavior through manipulation of financial statements (DeFond and Zhang ,2014). This has increased the burden on auditors in dealing with the complexity of fair value estimates and relying on management judgment (Christensen et al., 2012). To address this problem and reduce opportunistic behavior by managers, high audit quality is crucial, as emphasized by DeFond and Zhang (2014). A high-quality audit not only helps uncover errors and fraud but also instills confidence in the credibility of financial statements, leading to improved firm performance (Farouk and Hassan, 2014; AL-Qatamin and Salleh, 2020). With increasing reliance on fair value, robust internal controls and rigorous external audits become paramount for mitigating manipulation risks (Siekkinen, 2017). In essence, high-quality audits are crucial for ensuring reliable financial reporting considering the increasing reliance on fair value accounting.

To explore the different aspects of audit quality and their impact on the value relevance of fair value estimates, the researcher focuses on two specific characteristics of audit quality: ***the size of the audit firm and the fees charged for audit services.***

١,٥,٢,١ Audit firm size

Agency theory suggested that independent auditors bridge the information gap between shareholders and management (James and Izien, 2014; Corbella et al., 2015). To effectively handle complex clients and minimize agency costs for such firms, large audit firms are needed (Lia Dama Yanti et al., 2023). DeAngelo (1981) argued that larger audit firms act as a proxy for higher audit quality due to their diverse fee sources. With a larger client base, each client has a lower impact on the firm's profitability, reducing the need to compromise independence for individual clients. This promotes auditor independence and, consequently, enhance audit quality. Furthermore, Alzoubi (2018) and Alvarado et al. (2019) argued that larger audit firms face significant pressure to maintain a strong reputation and avoid lawsuits, motivating them to deliver high-quality audits.

Building on DeAngelo's idea, Lawrence et al. (2011) argued that larger audit firms, as assessed by Big 4 firms, provide greater audit quality for a variety of reasons. Their size enables them to spend in extensive training programs, impose standardized audit procedures, and facilitate rigorous peer review by senior partners. These combined factors contribute to a higher overall audit quality. Francis and Yu (2009) added that the large client portfolio of these large firms exposes auditors to diverse situations, enriching their knowledge and expertise. Consequently, auditors from these large firms clearly exhibit greater competence and accuracy in detecting financial misstatements (Ali and Aulia, 2015), further supporting their reputation for high-quality audits.

According to Salehi et al. (2019) and Ananda and Faisal (2023), the size of an audit firm can be determined by a variety of variables such as total revenues, number of partners, number of staff professionals, and number of offices. Larger firms with higher income, more staff, and greater capital show a strengthening position (Yanti and Wijaya ,2020). In US, Arens et al. (2012) categorize audit firms based on size:

١. The Big 4 International firms, which have branches all throughout the US and the world, consisting of Deloitte, Ernst & Young, KPMG, and Price water house-Coopers. The Big 4 provide audit and other assurance services to predominantly large organizations in the US and around the world.
٢. National firms that are large but significantly smaller than the Big 4. These firms are affiliated with other firms in another country and have worldwide capabilities.
٣. Regional and large local firms that employ more than 100 professionals. Some have only one office and service clients mostly within commuting distance.
٤. Small local firms have fewer than 25 professionals at a single office location. They typically provide audits and related services to small firms and non-profit organizations.

Serval studies, including those by James and Izien (2014), Rezaei and Shabani (2014), Pham et al. (2017), Salehi et al. (2019), Alvarado et al. (2019) and Triani and Yanthi (2020), have specifically compared Big 4 audits to non-Big 4 audits. The prevailing conclusion from these studies suggests that Big 4 audits generally exhibit higher quality compared to non-Big 4 firms. This aligns with DeAngelo's claim that auditors' incentive and capacity to deliver high audit quality increase with their size. As the following table shows, many studies have utilized a variety of size-related variables to determine whether audit firm size is a reliable indicator of higher audit quality:

Table (1)

Summary of empirical studies on audit firm size and audit quality

Authors and year	Research purpose	Sample details	Audit firm size measurer	Key findings
James and	Investiga ted how various	18 food and beverage companies		The findings indicate that there is a positive relationship

Authors and year	Research purpose	Sample details	Audit firm size measurer	Key findings
Izien (2014)	audit firm characteristics affect audit quality	listed on the Nigerian Stock Exchange market within the period (2007-2012).	Big 4	between firm size and audit quality.
Rezaei and Shabani (2014)	Explored the impact of audit firm size on audit quality	201 Iranian companies listed on the Tehran Security Exchange between 2006 and 2010.	Number of staffs	The findings of regression testing demonstrated that increasing the size of audit firms reduces the use of accruals items, thus increasing audit quality. This suggests that increased size and experience may result in higher audit quality by facilitating stricter examination and reducing opportunities for financial misstatements.
Pham et al. (2017)	Assessed the effects of audit firm characteristics, including audit firm size on audit quality.	192 companies listed on Hanoi and Ho Chi Minh Stock Exchange for the period of 2006-2014	Big 4	This study demonstrated that Big 4 auditors conduct higher-quality audits than non-Big 4 firms.

Authors and year	Research purpose	Sample details	Audit firm size measurer	Key findings
Salehi et al. (2019)	Explored factors influencing audit quality	52 studies (40 international & 12 national) published between 2000-2015.	Big 4	The findings revealed a positive association between audit firm size with audit quality, suggesting that companies engaging larger firms tend to receive higher quality audit services.
Alvarado et al. (2019)	Investigated the effectiveness of external audits in reducing earnings management practices.	3,830 listed firms across various countries (US, UK, Japan, Italy, France, Spain) from 2005 to 2009	Big 4	This study highlighted the crucial role of external audits in reducing earnings management, particularly during periods of crisis. The research revealed that Big 4 audit firms deliver demonstrably higher quality audits, leading to more reliable financial statements for their clients compared to non-Big 4 firms. This enhanced reliability translates into a significant reduction in earnings management practices, especially during challenging economic crisis.
Triani and Yanthi (2020)	Examined the factors influencing the credibility of financial	All publicly listed companies on the Indonesia Stock Exchange between 2013	The foreign affiliation of the Public Accounti	This study found that higher audit quality, reflected in increased user confidence in financial statements, is linked to larger audit firms. Here, larger firm is defined by collaborations between the Public Accounting Firm

Authors and year	Research purpose	Sample details	Audit firm size measurer	Key findings
	statements	and 2017, focusing on sectors like agriculture, mining, infrastructure, and trade in	ng Firm (KAP)	(KAP) and international organizations like Foreign Public Accounting Firms (KAPA) or Foreign Audit Organizations (OAA). The rationale behind this association is that these foreign affiliations subject the KAP to regular quality reviews, potentially leading to better quality control and ultimately, more reliable audits.

Source: The researcher

The studies suggested a positive association, with larger firms (often the Big 4) delivering higher quality audits. This aligns with the notion that larger firms have more resources, expertise, and stricter quality controls.

The positive association is also supported by studies on fair value estimates and the extent to which audit quality influences them. These studies often use "Big 4" auditors as a proxy for high audit quality. For instance, Mohrmann et al. (2019) found using a sample of consists of 875 banks between 2008 and 2011in US, that Big 4 audits lead to stricter approaches, limiting less-liquid Level 3 assets and applying higher discounts, suggesting a conservative approach. This aligns with Lee and Park (2013) finding that Big 4 clients' Other Comprehensive Income, containing subjective elements, is more relevant for investors due to enhanced auditor scrutiny. Chen (2022) further supported these findings, showing that investors value the audit

quality provided by Big 4 auditors in reducing uncertainty and enhancing the reliability of fair value estimates for financial assets in U.S. banks. Similarly, Al Ani and Mohammed (2015) observed that Big 4 audits in Oman linked to higher return on equity in the industrial sector and market fair value in finance and service sectors, suggesting firms utilize them for profit and image enhancement. Kohlbeck et al. (2017) further supported this by showing how Big 4 auditors deterred opportunistic transfers of assets to the less transparent Level 3 category. Furthermore, Oksyahra (2019) confirmed that Big 4 audits strengthened the relationship between investment property fair values and stock prices, likely due to their rigorous procedures, signifying greater investor trust in their reported values. However, Siekkinen (2017) suggested this positive association might depend on the legal environment of the company's home country.

Collectively, these studies paint a picture where Big 4 audits contribute to more conservative valuations, enhanced value relevance of fair value estimates, and potentially improved financial performance and market image, highlighting the crucial role of Big 4 in fair value accounting and its impact on market perception.

٣,٢,١,١ Audit fees

Audit fees, which comprise any payments paid to the auditor under contract for the provision of audit services (Mehrani and Jamshidi, 2011; Abdul-Rahman et al., 2017; Momodu et al., 2018; Yanti and Wijaya, 2020), are a significant external monitoring cost that helps reduce agency conflicts between owners and management (Ananda and Faisal, 2023). Audit fees are determined by several factors including the needs of their clients; legal obligation; the level of expertise and responsibilities inherent in the work performed; the degree of complexity of the work; the time required for completion; and the agreed upon fee basis (Yanti and Wijaya, 2020).

They are not just a paycheck for auditors; they are a tailored response to each client's unique circumstances. They are based on the auditor's assessment of the company's control environment and its need for high-quality audits (Jizi and Nehme, 2018). Company characteristics like size, complexity, and especially inherent business risk play a crucial role in determining the level of effort required from auditors (Tai ,2023). Clients with higher business risk demand more scrutiny, naturally leading to more effort from auditors, driving up the fees. (Tai ,2023). These fees reflect not only the additional effort and resources required for a thorough audit, but also the potential financial liability auditors may face if they miss errors or misstatements in the financial statements that could lead to lawsuits or other penalties (Hay et al., 2006).

Accordingly, audit fees represent the cost of monitoring a company's financial reporting. Alexeyeva and Mejia-Likosova (2016) emphasized the measurable nature of audit fees, making them a valuable tool for assessing the impact of regulations and audit complexities on the overall auditing process. The inherent relationship between audit fees and effort involved suggests audit fees may serve as a signal of audit quality, as suggested by DeFond and Zhang (2014). Various studies, such as those by Suseno (2013), Abdul-Rahman et al. (2017), Ganesan et al. (2019), Jayeola et al. (2020), Aljaaidi et al. (2021), and Yanti and Mediawati (2023), have found a positive relationship between audit fees and audit quality. This perspective assumes that higher fees incentivize auditors to dedicate more effort and scrutiny to the audit, leading to higher quality. Additionally, these fees can represent the auditors' commitment to their reputation, acting as a deterrent against turning a blind eye to potential financial manipulations by clients. This, in turn, helps mitigate litigation risks that could damage their reputation (Ayoola, 2022).

Examples from the US support this view, with studies finding a link between higher fees and less earnings management by companies. For instance, Frankel et al. (2002) discovered a significant negative association between audit fees and earnings management in their study on the US context. This finding was further supported by

Hoitash et al. (2007), who analyzed 13,860 firm-year observations in the US and found a significant negative correlation between audit fees and discretionary accruals. Similarly, Mitra et al. (2009) examined a sample of 6,852 firm-year observations from Big 5 client firms in the US from 2000 to 2005 and found that higher audit fees were linked to a decreased likelihood of abnormal accruals, indicating an improvement in earnings quality. Additionally, Carmona et al. (2015) conducted research on listed firms in Spain and found that higher audit fees were significantly correlated with lower discretionary accruals, suggesting higher financial reporting quality.

The research consistently shows a positive relationship between higher fees and the accuracy of fair value estimates across various industries. The uncertainty associated fair value estimates, arising from inputs and model selection, creates a higher risk of material misstatements in financial reports, fueled by potential management bias (Bell and Griffin, 2012; Bratten et al., 2013; Ettredge et al., 2014). This necessitates more complex and time-consuming audits (Alqatamin and Ezeani, 2020), leading to higher fees. Fair value estimates also provide management with substantial discretion, which can increase agency costs. Consequently, auditors assess higher risks such as (reputation, litigation, etc.) and put more effort into assessing fair value estimates. These additional efforts contribute to higher audit fees (Goncharov et al., 2014). Sangchan et al. (2020) point out the specific challenges of auditing fair values for investment properties, where complex techniques and models are used. This not only requires significant effort to understand and verify but also exposes auditors to greater litigation and audit risks. As compensation for this extra effort and risk, higher audit fees are a natural consequence. The following table provides a summary of the main findings from studies investigating the relationship between audit fees and fair value estimates in different industries:

Table (2)
Summary of empirical studies on fair value estimates and audit fees

Authors and year	Research purpose	Sample details	Key findings
Ettredge et al. (2014)	Analyzed how fair value accounting impacts bank audit fees.	US banks from 2008-2011	This study revealed a direct relationship between higher fees and increased use of fair values, especially for assets valued using the complex Level 3 inputs. This finding suggests that verifying these estimates requires more effort from auditors. Furthermore, specialized bank auditors are generally more efficient and offer lower overall fees to clients. However, when dealing with fair value assets, their expertise is in high demand and comes at a premium, resulting in higher fees for such cases.
Goncharov et al. (2014)	Explored the impact of fair value accounting on audit fees	480 firm-year observations representing 172 European real estate industry after mandatory IFRS adoption.	The study found that lower overall fair value is associated with lower audit fees, indicating a straightforward process. However, when fair value estimates become more complex and involve full recognition, it leads to higher audit fees. The complexities inherent in fair value estimation require additional effort and expertise of these situations, which ultimately impacts the final fees charged by auditors.
Yao et al. (2015)	Delved into the impact of revaluing non-current assets on audit fees	300 Australian companies from the years 2003–2007	The study discovered an increase in audit fees associated with fair value measurements of non-current assets (property, equipment, and intangibles). Additionally, using an independent valuer weakens this link, suggesting increased confidence and reduced complexity for auditors.

Authors and year	Research purpose	Sample details	Key findings
Alexeyeva and Mejia-Likosova (2016)	Analyzed how fair value measurements in European banks impact their audit fees.	177 banks from 24 European countries over the period 2008–2013	The researchers found that assets with high uncertainty (needing complex estimates) led to higher audit fees. Additionally, stronger regulation in a country was linked to even more effort dedicated to auditing these complex assets, likely due to higher risks of legal issues.
Ardakani et al. (2017)	Examined the link between using fair value accounting for non-current assets and audit fees	60 companies listed on the Tehran Stock Exchange between 2009 and 2013	The study found a significant positive relationship between several aspects of fair value accounting (revaluing the balance sheet, profit and loss statements, and cash flow statements) and the fees charged by auditors. This suggests that companies relying more heavily on fair value estimates incur higher audit costs, likely due to the increased complexity and subjectivity involved in these valuations.
Hapsari and Apandi (2018)	Examined how valuing non-current assets at fair value impacts audit fees, and whether large shareholders influence this relationship.	444 companies (excluding the financial sector) listed on the Indonesia stock exchange from 2013 to 2015	The study found that fair value indeed increases audit fees. It also revealed that the presence of a second-largest shareholder can weaken the link between fair value and audit fees, suggesting that strong shareholder oversight might mitigate the potential manipulation and uncertainty associated with fair value accounting.
Miah (2019)	Analyzed the impact of fair value	9,619 firm-year observations from US	The study found that higher fair value use led to higher audit fees. The researcher specifically examined assets such as research and

Authors and year	Research purpose	Sample details	Key findings
	adoption on audit fees.		development expenses, intangible assets, and property, which are known to be significantly influenced by subjective fair value estimates. The findings suggest that the complexity arising from these subjective estimates leads to increased effort and risk for auditors, which translates to higher fees for the companies.
Zhang (2019)	Examined the impact of fair value on audit fees	185 engineering management companies (construction, water, environment, and real estate) in China from 2015 to 2018	The study found a significant relationship between fair value accounting and audit fees in Chinese engineering companies. This suggests that auditors dedicate more effort and incur higher risk when verifying assets with increasing fair values, ultimately leading to higher fees.
Alqatamin and Ezeani (2020)	Examined the association between the estimates of fair value and external auditor's fees	32 Jordanian financial companies listed on the Amman Stock Exchange over the period 2005–2018.	The study found a positive relationship between audit fees and the proportion of fair value assets. The authors argued that companies with a higher proportion of fair value assets, requiring more complex and subjective estimates, incurred higher audit fees. This indicates that auditors dedicate more effort to address the increased risk and uncertainty associated with fair value measurements, translating to higher fees.

Authors and year	Research purpose	Sample details	Key findings
Alharasis et al (2022b)	Investigated the impact of mandatory fair value disclosure on audit fees	222 Jordanian firms during 2005–2018	The study confirmed that companies with more fair value disclosures incur higher audit fees, especially those with complex, subjective estimates (Level 3).
Clark et al. (2022)	Analyzed the impact of complex financial instruments (Level 2 and 3 fair value assets) on audit pricing for both small and large companies.	7,918 firm-year observations from Audit Analytics during the 2016–2019 in US.	The study found that companies with complex fair value assets are charged higher audit fees compared to those without such assets. The effect on fees also varies depending on the size of the company and the type of auditor. Small and large companies with complex assets face different fee increases compared to similarly sized firms without such assets. Moreover, Big 4 and non-Big 4 firms have different pricing strategies for audits involving these assets as compared to audits without them, and their pricing approaches further differ based on the size of the client.
Qingyu (2022)	Examined the impact of fair value accounting on audit fees	143 commercial bank-year observations (25 unique bank) from 2007 to 2016 in China	The study found a significant relationship between higher fees and increased use of fair value, especially for assets and liabilities valued using the less reliable Level 2 and 3 inputs. This suggests that auditors require more effort to verify subjective estimates, leading to costlier audits.
Tai (2023)	Examined the relationship between fair-valued financial	5,979 observations of non-bank listed companies in	The study discovered that while using more fair value overall leads to lower audit fees, relying on highly subjective Level 3 estimates increases fees. Further analysis revealed that using

Authors and year	Research purpose	Sample details	Key findings
	assets (especially cthose with complex Level 3 estimates) and audit fees	Taiwan during 2016-2021	basic Level 1 estimates lowers fees, while combining Levels 2 and 3 increases them.

Source: The researcher

The consistent findings from various studies indicate a positive relationship between fair value estimates and audit fees, particularly for complex assets valued using Level 3 inputs. These estimates demand greater expertise and effort to verify, increasing the risk of errors in financial reporting. As a result, auditors charge higher fees to compensate for the additional work required to validate these estimates.

Based on previous research, it can be concluded that the higher audit fees linked to fair value accounting reflect the increased effort and scrutiny auditors apply to complex fair value estimates. This additional effort is expected to enhance the relevance of these estimates.

١,٦ Conclusions

The study sought to investigate the relevance of fair value estimates in financial reporting and how they are influenced by the quality of audits, specifically considering the size of the audit firm and the fees charged. The following conclusions were drawn from the analysis:

١- The relevance of fair value estimates to investors is influenced by the observability of the underlying inputs used in their estimation. Level 1 estimates,

based on quoted prices in active markets, are generally considered more relevant due to their objectivity. Conversely, Level 3 estimates, which rely heavily on managerial judgment and discretion, may be less relevant due to the potential for manipulation or errors. Level 2 estimates, using observable inputs from similar assets or liabilities, fall somewhere in between, with a moderate level of relevance.

٢- Agency theory highlights the crucial role of external auditors in mitigating information asymmetry between principals (investors) and agents (managers). This is particularly important in the context of complex fair value estimates, which involve significant managerial discretion. High-quality audits act as a powerful monitoring mechanism to deter opportunistic behavior by managers, ensuring the reliability and credibility of financial statements.

٣- Audit quality is a cornerstone of ensuring the value relevance of fair value estimates and maintaining the integrity of financial reporting. High-quality audits help to reduce information asymmetry, mitigate the risk of opportunistic behavior by management, and enhance the reliability and credibility of financial statements. Given the complexity and managerial discretion involved in fair value accounting, auditors must exercise heightened diligence to detect errors or manipulation.

٤- Studies consistently demonstrate a positive relationship between the size of the audit firm and the relevance of fair value estimates, particularly for complex assets valued using Level 3 inputs. Big 4 audit firms, known for their expertise and resources, tend to adopt a more conservative approach in valuing these assets. This conservatism enhances the reliability and relevance of the estimates, leading to improved financial performance, market perception, and investor confidence.

٥- There is a significant positive correlation between audit fees and the relevance of fair value estimates, especially for complex assets valued using Level 3 inputs.

The increased complexity and expertise required to audit these estimates justify higher fees. This additional effort contributes to the reliability and relevance of the estimates, reducing the perceived risks of management bias and earnings manipulation.

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