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Effect of Audit Quality and CEO Remuneration On Firm Performance: A Study on Pakistan Stock Exchange-Listed Non-Financial Firms

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Abstract: This study analyzes the influence of audit quality and CEO remuneration on firm performance. The first independent variable is audit quality, and the indicators/variables used for audit quality are audit fees, audit committee size, and audit firm rotation. The second independent variable is CEO remuneration, which is considered as a sum of cash-based and non-cash-based (benefits) remuneration. At the same time, the dependent variables for this study are return on assets (ROA) and earnings per share (EPS), which are considered as measures/indicators for firm performance. The data is drawn from PSX-listed non-financial firms. The sample size consists of 70 firms for this study. However, the data does not incorporate the figures of financial firms as they were not relevant for this research. The data taken for analysis is secondary data, and the time frame is 10 years from 2010 to 2019, which is extracted from annual reports of PSX-listed firms. The reason for choosing this time frame is to analyze the most recent outcomes of the variables for this research. As the cross-sectional data is 70 firms, and the time frame is 10 years, so total observations for this research are 700, and panel data analysis has been applied. By analyzing the results of the fixed-effect model, it has been discovered that audit committee size is positively and significantly related to both ROA and EPS. However, the audit fee and audit rotation are insignificant to ROA and EPS. In addition, the CEO remuneration is positively and significantly related to ROA as a measure of firm performance. However, CEO remuneration is insignificantly related to EPS as a measure of firm performance.

Keywords: Audit quality, CEO remuneration, Firm performance, Audit fees, Audit committee size, Audit firm rotation, ROA, EPS.

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INTRODUCTION

Audit quality has surely been a controversial argument over the recent decades. Auditors use their technical skills by specific laws to find out if the financial statements of a company contain any material misstatement or not and report them to shareholders of the company, and this inspection of the accounts is known as an 'Audit'. After this inspection, the users of financial statements should be confident enough to conclude that a 'quality audit' has been performed (IAASB, Framework of audit quality). A very popular definition of audit quality, mainly accepted by many intellectuals for their research, is explained by DeAngelo (1981). According to her, audit quality is market anticipation relating to finding any breach in a user's records by an audit firm and disclosing the breach too. So, audit quality relies on the likelihood that the audit firm not only finds but also reports material misstatements in the financial statements. Many studies show that a lack of audit quality always results in a firm's defamation (Elhabib, 2015; Khan et al., 2022). However, there is no universal standard to measure the desired audit quality. Therefore, audit quality is a complex subject. A quality audit by an audit firm:

- Reveals suitable values and ethics;
- Was sufficiently skilled;
- Applied quality control procedures by specific laws;
- Provided timely reports;
- Had sufficient time to perform the audit;

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- Communicated appropriately with shareholders (IAASB, Framework of audit quality).

Audit quality can be estimated by ethics, which could be virtuous and high-minded considerations or an idea provided for the society to perform their duties, which are considered to be a benchmark for the community so that the people of that community can differentiate between the good and bad deeds (Kusumawati & Syamsuddin, 2018; Khan et al., 2022). Another measurement of audit quality is audit experience which could arise directly through practice or inspection, and on the other side, it could also arise indirectly by studying (Robbins, 2003). Similarly, the computation of audit quality is also possible through auditor independence, which means that he/she is not under any influence or power of anybody, and does not rely on any other party (Kusumawati & Syamsuddin, 2018; Farid et al., 2021). The consequence of the financial statements' quality to predict future returns by investors goes higher if the concern of audit is related to large firms. The conclusion reveals no positive or negative association between audit quality and future returns from 1996 to 2001; therefore, large firms have no longer taken advantage of audit quality after 1996 (Lee et al., 2007; Zada et al., 2022).

According to a study by Brown and Raghunandan (1995), the quality of audits of public firms is somehow lower than the quality of private firms due to the risk of low legal matters. However, the auditors can overcome this matter of low audit quality in public firms by providing real, true, and genuine facts and figures. This step will surely enhance the audit quality of public organizations. Research by Copley (1998) also reveals that there is a positive and significant relationship between the declaration of actual financial statements in public companies and the audit quality. 3 A thesis conducted by Muttakin et al. (2015) on the association between earnings management and audit quality suggests that earnings management can be limited by the quality of audits being performed in those firms which are group affiliated. The impact of the relationship between firms and auditor independence has gotten great attention from many politicians and regulators (DeAngelo, 1981; Khan et al., 2022).

However, there are a few studies that do not support audit rotation and are in a view that its cost is more than the benefits. Therefore, the research aims to analyze the influence of audit quality on firm performance. Firm performance is considered to be a pertinent conviction in strategic management. Mostly it is used as a dependent variable in various business researches. The management of every firm tries to run in a performance environment to be relevant in the market. Most organizations attempt to improve their performance in the possible available circumstances (Gul et al., 2021; Zada et al., 2022). The measurement of a firm's performance depends on its' efficiency as well as its' operating market span. However, as far as the financial measurement of a firm is considered, certain considerations are used to estimate a firm's financial performance/stability (Munir, 2015; Saeed et al., 2022). A few of these considerations are:

- Return on Equity (ROE)
- Sales growth
- Cash flows
- Earnings per Share (EPS)
- Capital Employed
- Revenue generated
- Operating profit
- Share price
- Return on Assets (ROA)
- Liquidity ratios

The second independent variable in the research study is CEO remuneration which has been a subject of great controversy over the last couple of years. The CEO is the top-level executive of a firm and is in charge of designing and executing different strategies, making decisions for a firm, and governing organizational operations. The CEO is also responsible for setting the vision and direction for the management team. The CEO not only remains in touch with the employees of a firm but also engages himself with the external stakeholders to collect information (Blanding, 2011). The matter of CEO remuneration has become a hot public argument about whether the CEOs are getting paid for their services fairly or not. This argument has now been disputatious, causing great attention by the public. It seems that this argument should have a deterrent effect on the directors. A board might think that it is paying appropriately, but on the other side, this structure should be disclosed to the investors as well as the general public (Larcker, 1997; Saeed et al., 2022).

The issue regarding the CEOs' remuneration has been a great cause of debate on electronic and social media. Many cases were proved to be a subject of great controversies, such as Cedric Brown's remuneration at British Gas and Fred Goodwin's remuneration package at Royal Bank of Scotland. The relationship of CEO remuneration with firm performance is like a chaotic jumble. Some studies found this association as strongly influential, some found a weak 5 relationship, while some studies found no relationship at all (Hung & Matos, 2012). According to Askary (2007), some parts of the earlier studies believe that CEOs are skilled and experienced persons who use their technical skills to attain the aims plus targets and secure the investment of shareholders. Apart from that, there should be a list of suitable benefits and incentives given to the executives to diminish the agency's problems and enhance the firm performance (Khan et al., 2021). Many political heads and regulators in Australia were involved in a financial catastrophe due to which the society suffered a lot, and the annoyance of the public regarding the lavish executive remuneration has gone extremely high (Stiglitz, 2010; Khan et al., 2022).

According to Fels (2010), the pay structure of Australian executives is not much high, yet it was increased by almost 300 percent in large companies during the years 1993 to 2003. The Australian Commission declared that the independent pay committees should lower the conflicts of interest, including those executive members who have the authority to increase their remuneration (Australian Government Productivity Commission, 2009). Mostly the research studies on CEO remuneration focuses on the data from the non-banking sector because there is a high probability of conflict of interests between the stakeholders in banking firms due to the issues of assets and liabilities and high debt portion, leading to the concern of offering high beneficial compensation to the executives of banking firms (Becher et al., 2005). There is a study of remuneration data from 2009-to 2016. This period is chosen because the Securities and Exchange Commission of Pakistan introduced new reforms in 2007 for Pakistan stock exchange firms to disclose executive remuneration. This eight-year 6 dataset will help us to analyze the association between CEO compensation and non-financial firm achievement in Pakistan.

Research Objectives

The primary objectives of this research are:

- To identify if there is any impact of Audit Quality on firm performance.
- To identify if there is any impact of CEO remuneration on firm performance.

The Research Questions

The research attempts to find the answer to the following research questions:

- Is there any relationship between audit quality and firm performance of Pakistan Stock Exchange-listed firms?
- Do CEO remuneration have an impact on the firm performance of Pakistan Stock Exchange-listed firms?

Research Hypotheses

H1: Audit quality has a direct and positive relationship with firm performance. **H2:** CEO remuneration has a direct and positive relationship with the firm performance.

Significance of the Study

The study aims to evaluate the impact of audit quality and CEO remuneration on firm performance. This study will eventually be added to compositions by inspecting the impact of audit quality and CEO remuneration on firm performance of Pakistan Stock Exchange-listed firms. This research will help the management and the board of directors of PSX-listed firms to analyze the audit quality and reconsider the CEO remuneration, and will also help them to make beneficial decisions about the changes in audit fees, audit committee size, and audit firm rotation and the structure of CEO remuneration.

LITERATURE REVIEW

Audit Quality and Firm Performance

This study aims to analyze the influence of audit quality and CEO remuneration on firm performance. The first independent nt There has always been an important contention over the relationship between auditors' independence and/or their capacity to perform a standard quality audit. Many research works have attempted to find out empirical

evidence to analyze the relation of audit quality with firm achievements (Ogbodo et al., 2018). According to Palmrose (1988), audit quality is defined as the measure of commitment that is the likelihood that the user's financial statements are free from any material misstatement or omissions. So, high commitment correlates with high audit quality. She also predicts that when there is a high audit quality, then there is a very low probability of audit failure regarding misstatements or omissions in the financial statements. Francis (2004) claims that there are two reasons for an audit failure. The first one is not applying the appropriate accounting principles by the auditor. The second reason is a failure to provide a certified report. In both scenarios, the financial statements will be ambiguous for the users.

According to Francis (2004), audit quality harms audit failures. Great importance has always been given to audit quality because it will influence the reliability and worthiness of an audit opinion. If a substandard audit has been performed by an auditor, then the opinion regarding the financial statements could be deceptive, which will surely have an impact on the economic determination of users. Thus, by strengthening the credibility of financial statements, audit quality can play a role in preserving the economic scrutiny of users (Ullah et al., 2021). In an economic view, the audit services by an auditor can reduce the agency costs by inspecting and validating the financial statements. This validation process includes the inspection of the evidence, which ultimately becomes a pillar for an auditor 9 to give a true and fair judgment or opinion regarding the financial statements. Thus, the opinion of an auditor, which is mentioned in the audit report is supposed to strengthen the quality and standard of financial statements. The worth of an audit opinion relies on the audit quality of an auditor (Moizer, 2005). The key elements defined in the framework of audit quality are:

- Inputs
- Processes
- Outputs
- Interactions
- Contextual Factors (IAASB, Framework of audit quality)

According to a study conducted by DeAngelo (1981), audit quality as an external corporate governance monitoring can improve firm performance. Some studies prove that auditor independence is the main objective of the audit firm rotation, which ultimately results in high audit quality and improved firm performance. Ziaee (2014) stated that the financial performance of Tehran stock exchange-listed firms could be affected positively by the audit quality with high worth. Matoke and Omwenga (2016) also attempted to find the relation between audit quality and firm performance through the measures of auditor independence, size, and team attributes and the profit margin of stock exchange-listed firms in Kenya. The study used multiple linear regression analysis for evaluation purposes. This research found that the relation between audit quality and the financial achievement of a company is significantly positive, and the profitability of the firm is also directly linked to auditor independence. 10 Similarly, various findings also disclosed that there is a direct association between the quality of audits and firms' financial stability (Nadeem, Saeed & Gul, 2020).

However, there are a few findings that state that the relation between audit quality and firm performance is insignificant. Elawa and Haddad (2019) conducted a study to evaluate the association between audit quality and company financial performance by using return on equity and return on assets as proxies for performance measures. They concluded that the association between audit quality and firm financial performance is insignificant. There are three proxies used for audit quality in this research for the data analysis, which are mentioned below.

Audit Fees: Many studies show that the compensation of the auditor greatly affects audit quality. In other words, high audit fees result in a high-quality audit. The hard work of an auditor is the mirror image of the amount paid to him to perform his audit. Various studies show that audit fee is positively associated with the return on assets. In other words, organizations whose performance is not up to the mark always require a high-quality audit and are ready to pay a handsome amount to the auditor (Sayyar et al., 2015). Audit fees can be defined as the amount levied for conducting an external audit by an audit firm. The payment of audit fees levied by an audit firm depends on the risk associated with the firm whose audit is being performed, firm size, and the operational complexities (Collier & Gregory, 1996). The ownership structure is an important factor in audit fees and is linked with time-consuming and difficult audit services and high risks (Chan et al., 1993).

There are two classes of audit fees. The first class is known as the normal audit fees, which is the total cost of delivering an audit service, like the expense of labor, the loss occurred from legal issues risk, and a normal surplus

(Boone, 2012). The second class is the abnormal audit fees, which means unexpected large returns (Asthana & Boone, 2012). Various experiments also evaluate if abnormal audit fees can harm auditor independence. Schelleman and Knechel (2010) have the view that the audit fee increases if the accruals increase. Moreover, a high audit fee is charged when there is more effort in the audit service. They further show that there are many administrators and supporters of the auditor, and audit is a much time-consuming activity involving accruals, specifying the earnings management. Blankley et al. (2012) were also of the same view that audit fee is directly associated with the effort put into the audit service. Hassan and Farouk (2014) stated that the financial performance of cement firms in Nigeria could be improved if the quantity of remuneration for auditors of their respective firms is increased. Even though this could be a costly decision in the short term, it will prove to be a beneficial decision that will outweigh the cost in the long run. Due to this increment, the users of financial statements will gain confidence and faith in the audit quality. An experimental investigation conducted by Mayhew and Pike (2004) in association with corporate governance reveals that the voting rights of shareholders upon choosing the audit firm will result in higher compensation and quality of audit being performed, hence improving the financial stability of a firm.

Similarly, Nam (2011) also studied the relationship between audit fees to measure auditor independence and the performance of firms in New Zealand. The findings were that the non-audit tasks performed by auditors of an organization have a trade-off with the auditor's independence, affecting the firm performance.

Audit committee size: An audit committee is said to be a sub-committee, which is mainly composed of independent officers or non-executive officers, who are responsible for surrounding problems related to audit services, internal control, and reporting financial statements (Turley & Zaman, 2004; Faber, 2005). The reliability of the process of financial reporting can be increased by the audit committees by assisting and analyzing the relation between audit firms and their connection with management, too (Burki, Khan, & Saeed, 2020). The BRC (1999) promoted five principles regarding the job of an audit committee concerning corporate governance. They are:

- The key part of an audit committee is assisting the external and internal auditors and also the management in the process of an audit.
- The flow of information and reporting with the internal auditor should be independent.
- The flow of information and reporting with the external auditor should also be independent.
- There should be a blunt and open debate with the directors, management, and internal auditors regarding the problems affecting the discernment.
- The members of an audit committee should be hard-working, experienced, and skillful.

The members of an audit committee are out of the company's board of directors who are responsible for reporting financial matters, auditing, and administering certain other matters (Wolnize, 1995). The audit committee is an efficient evaluation structure to improve the standard of corporate disclosure, which ultimately decreases the agency cost (Khan, Kaewsaeng-on, & Saeed, 2019). Miettinen (2011) examines the impact of audit quality on firm performance. Audit committee size is used to measure audit quality. The result of the findings suggests that the audit quality has a direct and significant effect through audit committee size on firm performance. There is a significant and positive relationship between the size of an audit committee and the extent of corporate disclosure (Barakoet, 2006). The presence of an audit committee greatly affects the corporate disclosure amount (Ho & Wong, 2001). Audit committee size is negatively related to the firm financial stability (Ogbodo et al., 2018). However, the study by Woodland and Reynolds (2003) regarding the association between measures of audit quality and financial analysis by multiple regression analysis concluded that the auditor size and tenure are not directly or indirectly associated with the quality of audit being performed.

Audit firm rotation: According to Sarbanes-Oxley (SOX) Act, a firm audit rotation refers to enforcing limitations on the time frame through which a firm may be providing the service of audit of record. A compulsory audit firm rotation is always considered a feasible way of enhancing audit quality (Imhoff, 2003). A design of obligatory audit firm rotation will call their organizations to rotate external auditors at regularly occurring intervals. For instance, in Brazil and Italy, the companies usually switch their auditors after five and nine years, respectively. But in some countries, like Australia, there is no legal obligation for the firms to rotate their auditor.

However, they can rotate their audit firm whenever they want (Jackson et al., 2008). Audit firm rotation is a great initiative, and it should be executed worldwide so that the quality of audits can be strengthened (Ali, Ahmad, & Saeed, 2018). An experiment performed by Hoyle (1978) reveals that audit rotation is positively linked to audit quality. This means that if a firm is looking for a new auditor, the audit firm will compete with the others to get

the job done brilliantly and differentiate them in the efforts being made, hence improving the audit quality. He further believes that a compulsory audit rotation would avert the auditor from being too close and friendly with the managers, which would ultimately increase the auditor's independence.

Orlik (2011) suggests that a compulsory audit rotation will raise the quality of the audit being performed, smashing the unreasonable pressure on the managers to not lose the clients. Durkin (2012) also pointed out that the chairman of the Australian Securities Commission recommended an immediate and obligatory audit firm rotation on June 30, 2012, after 15 noticing that the negligence of auditors to detect errors and omissions in the financial statements of public firms was increased by 30 percent. According to him, audit firm rotation can increase the audit quality and firm performance as well. Hanson (2011), who was a member of the accounting board PCAOB, highlighted the importance of compulsory audit firm rotation after analyzing the report on the effects of audit rotation by the General Accountability Office. He insisted other members examine the ability of a firm to create an income stream and finally urged that switching the audit firm will always strengthen the ability of an auditor to perform independently. The report by the General Accountability Office on the effects of audit rotation suggested that audit firm rotation will occur high costs, and the PCAOB should monitor the Sarbanes-Oxley needs to improve the audit quality of firms by compulsory audit firm rotation.

Kwon et al. (2010) analyzed the emergence of compulsory audit firm rotation in South Korea, and they found jumbled results. According to them, there is a negative relationship between audit firm rotation and audit quality and a large return accrual at the start of auditor tenure following an audit rotation. However, they failed to find any significant result between audit quality and audit firm rotation in financially troubled companies. Cameran et al. (2014) suggest that the earnings management is relatively low in the first three years after the audit firm rotation, as compared with the other years. An auditor rotation has a positive relationship with the earnings per share, which is a strong indicator of firm financial stability (Zia, Saeed, & Khan, 2018).

Auditor independence and threats: An auditor should be in an adequately independent position so that he can freely exert his judgments, reveal his point of view and offer his suggestions fairly (Vinten, 1999; Fatima, Majeed, & Saeed, 2017). 16 According to Tepalagul and Lin (2014), auditor independence is an important aspect that greatly affects audit quality and firm performance. They also argue that there are four threats to the degree of auditor independence. They are;

- Client significance (pressure from clients)
- Auditor tenancy (audit-client relationship)
- Non-audit work (other financial services)
- Client association (bonding between auditor and client)

Agency theory: The need for audit services comes from information instability and agency disputes between management, investors, and intermediaries. In the context of the agency theory, Dang (2004) reveals that the audit of financial statements is an effectual observance mechanism that guarantees stakeholders that the financial statements are free from any misstatements or omissions. Agency theory has been substantially executed in literature to analyze the conflicts of interest between principals and agents or shareholders and management. This relationship between the principal and agent, as shown in agency theory, is important to understand the flourishment of the responsibilities of the auditor. Agency theory says that these conflicts are because of the dividing benefits of principals and agents. The agency theory supposes that an audit can control the relationship between the shareholders and the managers. Moreover, managers and shareholders should not assume that the auditor is responsible for accounting. The role of the auditor is to make sure that a quality audit has been performed (Andersson & Emander, 2005).

CEO remuneration and firm performance

Remuneration refers to a contractual obligation that is directly associated with the performance and can deal with all the problematic organizational situations (Shao et al., 2012).

Components of CEO remuneration: According to an inquiry regulated by Hughes (1996), there are three components of the chief executive officer remuneration package which are of utmost importance. They are;

- Basic salary
- Share options gain and other benefits
- Compensation settlement offered to the executive due to any official loss Bryan et al. (2000) are of the view

that there are four elements of executive compensation.

They are;

- Cash remuneration
- Non-cash remuneration such as retirement and pension benefits
- Rewards from the option of stocks
- Other grants related to the stocks

Modern drifts in CEO remuneration: A survey report was published by Hewitt Associates (2010) in which the data was taken from 708 public firms so that they could investigate segments for outside executive compensation.

The report shows that;

- 99% of the firms pay retaining fees annually out of which 79% are paid in cash.
- 56% of the organizations remunerate the fees of board meetings.
- 83% of the firms offer the executive the equity compensation. Another report presented by Wyatt data services (2009) is about a survey conducted on the working of the board regarding executive compensation. According to the report,
- 68% of the companies have raised the executive remuneration during the year 2008.
- Meeting payments have been increased up to 7%. The remuneration of the executives took a strike when a deception case was filed against a company. This shows that the increase and decrease in executive remuneration are different in a fraud company as compared to a company that is not fraud (Majdi & Rahman, 2011).

Corporate Governance and CEO remuneration: Corporate governance manages the observance and supervision of a firm and its members and also surrounds the issues of executive remuneration. Observance and supervision involve integrity, clarity, accountability, and authority of a company's operations, and these facets are looking forward to enhancing with the corporate governance codes. In short, poor corporate governance is illustrated by poor implementation of organizations (Chen et al., 2011). The structure of corporate governance is very important to preserve the shareholder's wealth. Taylor (2009) proposed that corporate misconduct in the past years has been a great cause of the demolition of shareholders' wealth and some stakeholders too. There is always a hot debate on the high level of CEO remuneration. Stakeholders are always curious to know about the pay structure of executives and its effect on corporate governance and firm performance (Fahlenbrach & Stulz, 2010).

The pay structures that fail to line up with the benefits and compensation of executives with shareholders are much more costly and are also 19 major causes of market failure. A difficulty arises for the corporate governance structures to sort out the clashes between the executives and the shareholders and enhance firm performance (Filatotchev et al., 2005; Brick et al., 2002). The Australian Securities Exchange refined the corporate governance guidelines recently with the greater declaration of CEO compensation packages to make a step to improve the firm performances in Australia and fortified it to all the listed companies. The declaration of the remuneration of all the new CEOs was considered compulsory in 2003 for all firms (Nelson et al., 2018).

CEO duality and CEO remuneration: Malaysian code of corporate governance (2007) highlighted that CEO duality always has a vigorous power of independent decision making by themselves. Due to this reason, CEO duality is positively associated with executive remuneration. MCCG set a compulsion to disclose the organizational structure and hierarchy publicly and also to maintain stability between the duties of the CEO and chairman board. When the executive officer of a company is the chairperson of the board, then the company will attain a strong leadership structure and organizational efficiency. After that, the conflicts between the CEO and the chairperson of the board will surely turn down (David et al., 1998).

However, some studies reveal that CEO and board chairman are required to be separate persons so that they can get rid of the superiority of the CEO on board. Hence, the control execution of the board will be improved, which will ultimately decrease the executive remuneration (Maassen, 2002). When the CEO and board chairperson are the same people, then there will be higher agency problems (Yermack, 1996). CEO is negatively related to firm performance as it destroys board observance over the role of the executive (Elsayed, 2007; Garcia-Torea et al., 2016). A 20 experimental study by Boyd (1995) also suggests that CEO duality is directly linked to executive remuneration.

Positive significant relationship: According to research, there is always a trade-off between the inducement of CEO and their ability to retain a position in the organization. So as a consequence, the inducement of the CEO

gets lower with an increase in the specified organizational risk as well as the market risk (Jin, 2002). Similarly, a study conducted by Rehman and Mangla (2012) reveals that the financial advancement along with the changes in the market for managerial ability has brought phenomenal changes in the remuneration packages adopted by the Pakistan stock exchange firms. Apart from that, an increase or decrease in the CEO's remuneration results in a change in the shareholder's wealth (Monem & Ng, 2013).

In the framework of pay-performance, the cash and non-cash remuneration of the CEO is associated with the previous market-based performance on TQ and EPS (Azim et al., 2011). A study performed by Ndofirepi (2015) attempted to find an association between CEO remuneration a corporate performance by using the bonus, salary, and other compensation as a tool for measuring CEO remuneration and stock price as a measure of corporate performance. They expected to see that all the remuneration variables are directly linked with stock price performance. Their results show that only the return on assets (ROA) counts as a component of fixed salary, while the bonus component is insignificant to corporate stability in South Africa. The linkage between CEO compensation and international diversification was revealed to 21 be direct and positive, showing that performance is not the most accurate variable in CEO compensation analyzers in South Africa. The findings of a thesis investigation by Lewellen et al. (1992) revealed that the CEO remuneration and firm financial performance have a direct and positive relationship. They show that the better the pay structure of the CEO, the better the firm's performance will. A study by Shaw and Zhang (2010) concludes that the performance of a firm will increase if the manager's decision and CEO's remuneration are lined up. They also concluded a positive relationship between the CEO pay package and the performance of a firm. Similarly, the study conducted by Fang Sun (2013) also shows that the efficiency of the firm is directly linked with the CEO's remuneration.

Negative significant relationship: Some studies also reveal that there could also be a negative association between corporate stability and CEO remuneration because of some characteristics of the firm. Basu et al. (2007) conducted a study and found CEO remuneration to be negatively related to the company's stability. Accordingly, this influence could be the reason for weak governance structures as well as greater agency costs. Due to these two problems, the CEO might get paid higher than the requirement, and the firm moves towards poor performance. Core et al. (1999) concluded that CEO remuneration has a negative relation with stock pricing and operating performance. Whereas, Croci et al. (2012) stated that CEO pay structure is negatively linked with the performance of the family firms. Aduda (2011) used a regression model to analyze the association between the executive remuneration of the banking sector in Kenya and firm performance. According to him, a negative, as well as non-significant relation of executive remuneration occurs with the firm stability. On the other side, Alshimmiri (2004) also analyzed the behavior of CEO compensation in Arabia. He concluded that an executive's cash remuneration is negatively related to the real estate investment trust firm's performance which was indicated by return on assets and profitability margin. Sometimes the board of directors does not evaluate and control the management of a firm adequately, resulting in the overcompensation of the CEO and throwing a negative influence on the company's stability (Brick et al., 2006). Research by Matolcsy et al. (2012) has compared the firms involving the performance of equity-based CEO pay structure with the performance of cash basis CEO pay structure. They also concluded that the association between CEO remuneration structure and firm stability is indirect and negative. Two theories are relevant to the CEO remuneration and the firm performance, which are stakeholder and agency theory. These theories tell that there is a weak and non-significant association between CEO compensation and firm performance (Kazan, 2016).

No significant relationship: In scientific research, a researcher may fail to find any significant association between the variables. A thesis by Tosi et al. (2004) on the charisma of the CEO, remuneration, and its impact on the firm performance. They did not find any significant relationship between the variables. According to them, the association of the CEO pays package with that of corporate.

CONCEPTUAL FRAMEWORK

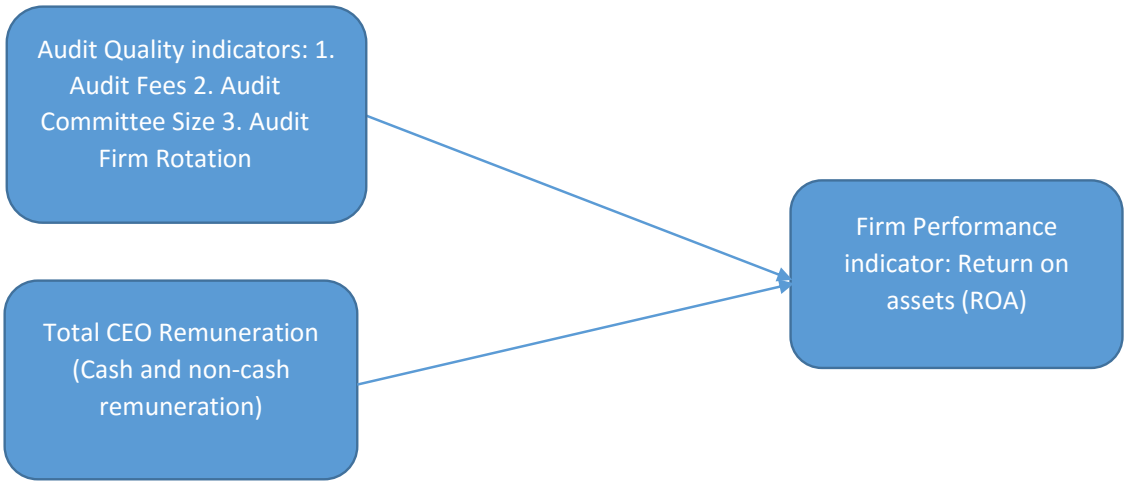

Figure 1: ROA model

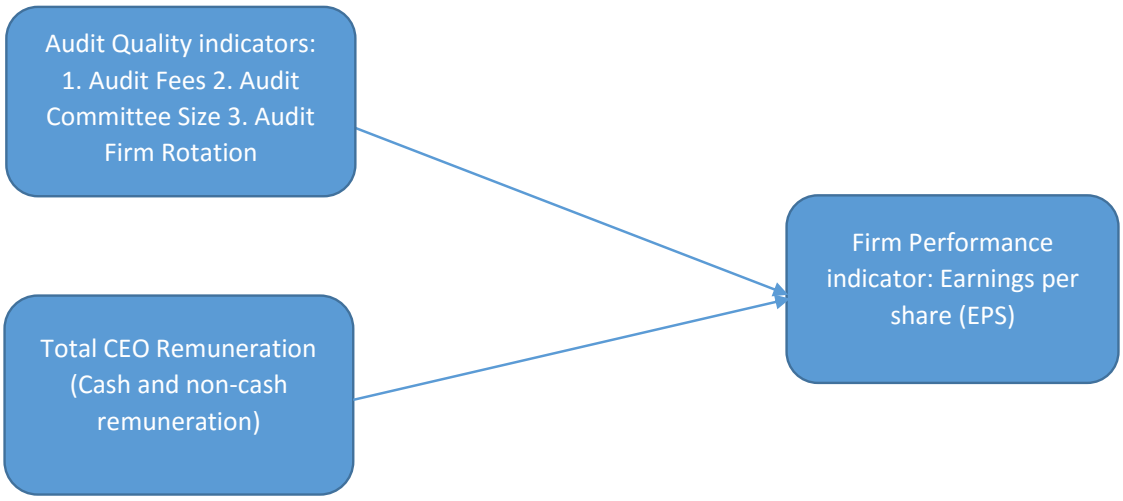

Figure 2: EPS mode

RESEARCH METHODOLOGY

Research Sample

The data is drawn from PSX-listed non-financial firms in this research. The sample size consists of 70 firms for this study. This study is purely quantitative research. However, the data does not incorporate the figures of financial firms as they were not relevant for this Firm Performance indicator: Earnings per share (EPS) Audit Quality indicators: 1. Audit Fees 2. Audit Committee Size 3. Audit Firm Rotation Total CEO Remuneration (Cash and non-cash remuneration) Independent variables 26 research. The data taken for analysis is secondary data, and the time frame is 10 years, from 2010 to 2019. The data is extracted from online available annual reports of PSX-listed firms. The reason for choosing this time frame is to analyze the most recent outcomes of the variables for this research. As the cross-sectional data is 70 firms, and the time frame is 10 years, so the total number of observations for this research is 700.

Data Collection

The data taken for analysis is secondary data in this study. As the data comprises cross-sectional units over multiple years, therefore panel data has been incorporated for the analysis in this research. The data for the

dependent and independent variables is taken from annual reports of 70 PSX-listed non-financial firms, and the time frame selected is 10 years, starting from 2010 to 2019, which is easily available at the stock exchange website and open doors website.

Research Variables

In this research, the independent variables under inspection are audit quality and CEO remuneration. Whereas the dependent variable of this study is firm performance. The proxies/indicators used for audit quality in this research are audit fees, audit committee size, and audit firm rotation and the CEO remuneration variable is the total of cash remuneration and non-cash remuneration. While the firm performance is measured with return on equity (ROA) and the earnings per share (EPS). The firm audit rotation is a dummy variable in this research, which means that if the audit firm rotation takes place, it will be equal to 1; otherwise, it will be 0. 27

Table 1: Variables Description

Category	Variable Name	Indicators/Proxies	Description
Independent Variables	Audit quality	Audit Fees	Fees paid to the Audit Firm
		Audit Committee Size	No. of Members in Audit Committee
		Audit firm Rotation	Dummy Variable
	CEO Remuneration	Total CEO Remuneration	Cash and non-cash CEO remuneration
Dependent Variables	Firm Performance	Return on Assets (ROA)	Net income/total Assets
		Earnings per Share (EPS)	Net Income/Average number of outstanding shares

Regression Model

In this study, the effect of audit quality and CEO remuneration on firm performance has been analyzed through the fixed effect model in panel regression. This study uses audit fees, audit committee size, and audit firm rotation as measures for audit quality and ROA and EPS as measures for firm performance. However, the CEO remuneration in this research comprises cash and non-cash remuneration. As there are two dependent variables (ROA and EPS for 28 firm performance), therefore there are two equations for the firm performance. The equation for Return on Asset (ROA) is;

$$\text{Perf\_RQAit } = a0 + \beta 1 \text{ AUDCOM\_SIZEit } + \beta 2\text{AUD\_FEESit} + \beta 3\text{AUDFIRM\_ROTit} + 34\text{TCEO\_REMit + eit}$$

The equation for Earnings per share (EPS) is;

$$\text{Perf\_EPSit } = \alpha 0 + \beta 1 \text{ AUDCOM\_SIZEit } + \beta 2 AU\_EFEESit\_ + \beta 3 \text{ AUDFIRM\_ROTit} + \beta 4 TCEO\_REMit + \epsilon it$$

Where, EPS (Firm performance indicator) = Earnings per share = Net income/average number of outstanding shares

ROA (Firm performance indicator) = Return on assets = Net income/total assets AUDCOM_SIZE = Audit committee size AUD_FEES = Audit fees

AUDFIRM_ROT = Audit firm rotation

TCEO_REM = Total CEO Remuneration

$\alpha 0$ = Constant

β = Coefficient of variable

ϵ = Error term

Data Analysis Tools and Techniques

The statistical tools used for this research analysis are SPSS and GRETL. As panel data is incorporated in this study, therefore panel regression model is applied to evaluate the research hypotheses mentioned in chapter one. After applying the Hausman test, a fixed effect has been chosen for the analysis. The data comprises 70 cross-sectional units (companies) over the time frame of 10 years from 2010 to 2019. So, there are total 700 observations in this research.

RESULTS AND DISCUSSION

Descriptive Statistics

Given below is a table summarizing the highest and the lowest values, average, and the standard deviation of all the dependent and independent variables. The independent variables are audit fees, audit committee size, audit firm rotation, and CEO remuneration. Moreover, the dependent variables are return on assets (ROA) and earnings per share (EPS). In comparison, the total number of observations is 700.

Table 2: Descriptive Statistics

	ROA	AUD_FEE	AUD_COM	AUD_ROT	TCEO_REM
ROA	1.0000				
AUD_FEE	0.1238	1.0000			
AUD_COM	0.2971	0.2068	1.0000		
AUD_ROT	0.0264	0.0493	0.0349	1.0000	
TCEO_REM	0.1791	0.5180	0.2531	0.0652	1.0000

The above descriptive statistics show that the minimum audit fee is Rs. 95,000, the maximum is Rs. 13,600,000, and the average is Rs. 1,583,408. At the same time, the minimum and maximum values for audit committee size are 3 and 7, respectively. The mean value of audit rotation shows that only 6.428% of firms have considered the audit firm rotation. The table also reveals that the 31 average CEO remuneration in PSX-listed non-financial firms is around Rs. 26,300,000 per year. The positive value of ROA shows that the assets are utilized well to generate profit. At the same time, the EPS indicates the profitability of a firm in terms of its' outstanding shares.

Table 3: Correlation Analysis

	EPS	AUD_FEE			
ROA	1.0000				
AUD_FEE	0.0120	1.0000			
AUD_COM	0.2021	0.2068	1.0000		
AUD_ROT	-0.0171	0.0493	0.0349	1.0000	
TCEO_REM	0.0286	0.5180	0.2531	0.0652	1.0000

The above table shows that all the variables have a positive correlation with one another, as there is no negative value in the above table. The strongest correlation is between the audit fee and CEO remuneration, which is almost 51.80%. However, the correlation of ROA with the audit committee size is also robust, equaling 29.71%. Similarly, the correlation between CEO remuneration and audit committee size is also fit, equal 25.31%, and that of CEO remuneration and ROA is almost 18%. The above table shows that there is a positive correlation between all the variables except the audit rotation, which is negatively correlated with EPS. The strongest correlation is between the audit fee and CEO remuneration, which is almost 51.80%. However, the correlation between CEO remuneration and audit committee size is also fit, equaling 25.31%. Similarly, the correlation of EPS with the audit committee size is also robust, equaling 20.21%.

Regression Results for ROA Model

The table below shows the summary of the fixed-effect model in panel regression using 700 observations, including 70 cross-sectional units and a time series length of 10 years by using SPSS software, where ROA is

considered as the dependent variable to measure firm performance, and the independent variables are audit fees, audit committee size, audit firm rotation, and CEO remuneration.

Table 4: ROA Model Summary

Model	*R*	*R* Square	Adjusted R Square	Std. Error of the Estimate	*P*-Value (*F*)
1	.316a	.115	.1025	.10144657081469	0.0001

The above table reveals that a valid model has been applied, which is confirmed by the significance of *F* statistics at a *p*-value that is less than 0.001. The adjusted R^2 value shows that 10.25% of the ROA value can be explained by audit quality and CEO remuneration. Below is the table for the detailed fixed effect statistics for ROA in the panel regression.

Table 5: Detailed Fixed Effect Statistics for ROA Model

Model	UnStandardized Coefficients		Standardized Coefficients	*T*	Sig (*p*)
	B	Std. Error	Beta		
1(Constant)	-0.060	.016		-3.654	.000***
Audit Fees	1.022E-9	.000	.015	.345	.731
Audit Committee Size	.032	.005	.268	7.164	.000***
Audit Firm Rotation	.004	.016	.010	.268	.789
Total CEO Remuneration	2.675E-10	.000	.103	2.414	.016**

The table shows that audit committee size is highly significant and positively related to ROA (firm performance) as the *P*-value is very close to zero. Similarly, the CEO remuneration is also significantly associated with ROA as a measure of firm performance, and its' *p*-value is 0.016, which is less than 0.1, which clearly shows its' significance exactly in line with the results of Lewellen et al. (1992). Whereas audit fees and audit rotation are not significantly related to ROA as their significance values are much higher than 0.1, which is accordant with the observations of Sayyar et al. (2015) and Miettinen (2011).

Regression Results for EPS Model

The table below shows the detailed statistics of the fixed-effect model in panel regression using 700 observations, including 70 cross-sectional units and a time series length of 10 years, by using GRETL software, where EPS is considered as the dependent variable to measure firm 35 performance, and the independent variables are audit fees, audit committee size, audit firm rotation, and CEO remuneration.

Table 6: Detailed Fixed Effect Statistics for EPS Model

	Coefficient	Std. Error	*t*-ratio	*p*-value
Const	-19.5941	9.65243	-2.030	0.0427**
Audit Fees	-2.0286e-06	1.74701e-06	-1.161	0.2460
Audit Committee Size	13.8983	2.64157	5.261	< 0.0001**
Audit Firm Rotation	-7.01153	8.87058	-0.7904	0.4296
Total CEO Remuneration	-7.96486e-08	6.48863e-08	-1.228	0.2201
Mean Dependent Var	25.21476	S.D. Dependent Var	60.07881	
Sum Squared Residual	2239634	S.E. of regression	57.13819	
LSDV *R*-Squared	0.122318	Within R-squared	0.061162	
LSDV *F*	(13,686) 6.676891	P-value (F)	3.93e-12	
Log-likelihood	-3818.017	Akaike criterion	7664.034	
Schwarz Criterion	7727.749	Hanan-Quinn	7688.663	
Rho	0.889513	Durbin-Watson	0.321679	

Hausman test:

Joint test on named regressors –

Test statistic: F (4, 686) = 7.36228

with p-value = P (F (4, 686) > 7.36228) = 8.28261e-006

Test for differing group intercepts –

Null hypothesis: The groups have a common intercept Test statistic: F (9, 686) = 6.00587

with p-value = P (F (9, 686) > 6.00587) = 3.97974e-008

The above table shows that the model applied is valid, which is confirmed by the significance of F statistics at a p-value which is 3.93e-12, less than 0.001. The value of R^2 shows that 12.23% of the earnings per share (EPS) value can be explained by audit quality and CEO remuneration. Hausman test was applied during the examination to analyze the most appropriate model between fixed and random effects models.

Hausman's test reveals that the fixed effect model is a more appropriate and fit model for the data and analysis.

The table also shows that audit committee size as a measure of audit quality is highly significant and positively related to EPS (firm performance) as the P-value is very close to zero, consistent with the findings of Miettinen (2011). However, if audit fees and audit rotation are considered as measures of the audit quality, then the audit quality is not significantly related to the earnings per share (EPS) as their significance values are much higher than 0.1, which is in agreement with the findings of Sayyar et al. (2015). 37 Similarly, CEO remuneration also has insignificant relation with the EPS as a measure of firm performance, and its' p-value is 0.2201, which is greater than 0.1, consistent with the findings of Tosi et al. (2004).

DISCUSSION

Insights Regarding the Research Variables

The aim of this study is to analyze the influence of audit quality and CEO remuneration on a firm of non-financial PSX listed companies. After analyzing the data, there are a few findings about the research variables and their correlations. Firstly, the minimum and the maximum audit fees in PSX-listed companies are Rs. 95,000 and Rs. 136,00,000 respectively. Whereas the average audit fee is Rs. 1,583,408. The firms which are underperforming and wish to improve their' financial performance are happy to finance a higher audit fee to the auditing firms so that their financial statements can give them a true and fair view.

The majority of the PSX listed companies are being audited by the big 4 auditing firms, which are Ferguson, KPMG, E & Y, and Yousaf Adil Saleem & co, which they have never rotated or very rarely rotated. In other words, only 6.4% of the analyzed firms have changed their auditors from the years 2010 to 2019. Some of the firms expand their audit committee size ranging from 3 to 6 members, with the increase in their audit fees.

On the other side, the average CEO remuneration, including cash and non-cash (benefits) remuneration, is Rs. 26,300,000 per year, and the trend observed in the CEO remuneration is positively related to ROA.

Various trends of association between the independent variables have also been examined in this research. The findings of this study show that all the independent variables have a positive correlation with one another. The audit fee and CEO remuneration comprise the most strongly correlated pair among all the independent variables, and their correlation is almost 51.80%. Similarly, the correlation between CEO remuneration and audit committee size is also fit, equaling 25.31%. 39 As far as the matter of the correlation between the dependent and independent variables is concerned, there is a mix of results. The correlation between audit committee size and ROA is vigorous, equaling 29.71%. And that of CEO remuneration and ROA is almost 18%. However, the correlation between audit fees and audit firm rotation with ROA is not strong. Similarly, the correlation of EPS with the audit committee size is also robust, equaling 20.21%. However, the correlation between audit fees and CEO remuneration with EPS is fragile. Whereas the audit rotation is negatively correlated with EPS.

Models and Tests

This research uses a fixed-effect model in panel regression to analyze the impact of audit quality and CEO remuneration on firm performance. Hausman's test has been run in order to find the most appropriate model between fixed and random effect models for analyzing the research data. Accordingly, the fixed-effect model has been tested as more appropriate for the data and analysis.

Significance of Findings

A fixed-effect model in panel regression is applied to examine the relationship between the dependent and independent variables using 700 observations, including 70 cross-sectional units and a time series length of 10 years, by using SPSS and GRETL software. Firstly, the effect of audit quality (using audit fees, audit committee size, and audit firm rotation as proxies) and CEO remuneration on ROA is examined. Apart from that, the effect of audit quality and CEO remuneration on EPS has also been investigated.

The results suggest that audit committee size as a measure of audit quality has a positive and highly significant impact on firm performance, including both ROA and EPS, as its' p-value is very close to zero (p-value < 0.1, which shows that the CEO remuneration is positively and significantly related with firm performance when ROA is used as a measure for firm performance 0.016. On the other side, CEO remuneration is not significantly related to EPS as a measure of firm performance as its' p-value is 0.2201. The result of a study conducted by Matoke and Omwenga (2016) also reveals that the impact of audit committee size on firm performance is positive and significant. Similarly, the findings of Farouk and Hassan (2014) also conclude that audit committee size is significantly related to the firm performance of stock exchange-listed cement companies in Nigeria, which is in accordance with the findings of this research. In addition, Elawa and Haddad (2019) found that the audit firm rotation as a proxy for audit quality does not have a significant effect on firm performance by using ROA as a measure for firm performance, which is also consistent with the findings of this research.

The findings of this research are also consistent with the findings of a study by Lewellen et al. (1992), which suggest that the CEO compensation has a direct and positive relation with ROA as firm financial performance. Moreover, the better the pay structure of the CEO, the better the performance of the firm will. In contrast to this argument, Tosi et al. (2004) found that the association of CEO compensation with firm performance is insignificant.

Answers to the Research Questions

This study is now able to answer the research questions mentioned in chapter one. There is a positive and significant relationship between audit quality and firm performance (ROA and EPS), subject to the condition that audit quality is measured with audit committee size. However, if the audit quality is measured with audit fees or audit firm rotation, then it has an insignificant impact on firm performance. On the other side, CEO remuneration has a direct and positive effect on ROA as a measure of firm performance. However, the CEO remuneration has an insignificant impact on EPS (measurement of firm performance).

CONCLUSION

In this research, the effect of audit quality and CEO remuneration on firm performance has been investigated through the proxies/indicators of audit fees, audit committee size, and audit firm rotation for audit quality on ROA and EPS for the firm performance of PSX listed non-financial firms. Whereas the CEO remuneration has been considered as a sum of cash and non-cash remuneration. The examination of the association between the dependent and the independent variables is done by fixed effects in panel regression. By analyzing 700 observations of the data content, including 70 PSX-listed non-financial companies and the time frame of 10 years from 2010 to 2019, this study appears to draw a conclusion from the findings obtained. The final results indicate that the size of an audit committee (as a measure of audit quality) has a positive and significant effect on firm performance (ROA and EPS). This suggests that firms are being audited with high audit quality, and they are enhancing the market value. However, the audit quality in terms of audit fees and audit firm rotation has an insignificant effect on ROA and EPS. This means that high audit fees and changing the audit firm are not important facets for improving firm performance. On the other side, the relationship between CEO remuneration with ROA (as a measure of firm performance) is significantly positive. However, the CEO remuneration is insignificantly related to EPS (as a measure of firm performance). This result suggests that the CEO remuneration structure has an essential role in improving the return on assets (ROA) as a measure of firm performance, while it is not an important factor for improving the earnings per share (EPS) as a measure of firm performance.

LIMITATIONS AND FUTURE DIRECTIONS

The findings of this research can be useful for the regulators to think over the issues of audit firm rotation and audit fees to intensify auditor independence. By going through the findings of this research, further investigations should be made by the future researchers on the other related areas of audit quality such as type of audit firm and audit service satisfaction, and their impact on firm performance. Similarly, this study also recommends other future studies to review other aspects of CEO remuneration like compensation structure and ownership structure.

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