CHAPTER 2
DEVELOPMENT OF FINANCE, ACCOUNTING AND AUDITING

OWNERSHIP STRUCTURE, FINANCIAL REPORTING QUALITY AND THE ROLE OF AUDIT QUALITY: AN EMPIRICAL STUDY IN VIETNAM

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Abstract. *The issues of ownership structure, audit quality, earnings management, and financial reporting quality have garnered increased attention from the public, professionals, and other stakeholders, especially following numerous corporate scandals in Vietnam. Ownership structure is crucial in enhancing financial reporting quality (FRQ) by serving as an effective internal control mechanism. This study explores how different types of ownership affect FRQ and the role of audit quality. Previous literature has investigated the relationships between ownership types, audit quality, and FRQ. This study aims to integrate these variables into a comprehensive model that describes the impact of ownership structure within a company and audit quality on FRQ. The relationships tested include: ownership structure and FRQ, the mediating effect of audit quality on these relationships, and audit quality and FRQ. Analyzing panel data from 112 Vietnamese listed firms on the Ho Chi Minh City Stock Exchange from 2011-2021, the results revealed that directors' and family ownership positively affect FRQ by reducing earnings management, while institutional ownership negatively influences FRQ. Managerial ownership was found to have an insignificant impact on FRQ. Audit quality partially mediates these relationships and has a significantly positive impact on FRQ, suggesting that high audit quality deters earnings management. This study recommends enhancing the supervisory and monitoring role of institutional ownership in financial statement preparation.*

Keywords: *audit quality, financial reporting quality, ownership structure, Vietnam*

JEL Classification: G32; M42; O32

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Introduction. Financial reporting quality (FRQ) fundamentally describes a company's financial and accounting activities, serving as a crucial reference for both external and internal stakeholders when making decisions (Dobija et al., 2022; Q. K. Nguyen, 2023c; Q. K. Nguyen & Dang, 2022a, 2022b; Ud Din et al., 2021). The effectiveness of financial reporting is significantly enhanced when it exhibits reliability, understandability, relevance, and comparability. The financial crisis, highlighting directors' lack of accountability in permitting excessive risk-taking, has sparked a global debate on the enforceability of directors' obligations.

Investors require accurate and unbiased earnings information to assess cash flows accurately. Corporate scandals have underscored the necessity for reforms in corporate governance and governance structures, emphasizing the importance of improving the quality of reported earnings (Q. K. Nguyen & Dang, 2023a; Qiao et al., 2023; Suprianto et al., 2017). Various users rely on a company's financial information, including owners, customers, management, employees, government, and creditors. Management needs accurate financial data to make sound economic decisions; owners need to understand their firm's true performance to differentiate between good and bad investments; suppliers need assurance of the firm's ability to pay; and creditors need confidence that the firm can repay borrowed funds. High-quality financial and accounting disclosure is essential for maintaining a functional and dynamic capital market (Choi & Byun, 2018; Lin & Hwang, 2010; Q. K. Nguyen & Dang, 2023b).

Moreover, it has been emphasized by multiple parties that audit quality, FRQ, and corporate governance (CG) are crucial in preventing financial scandals. Understanding the interrelationships between effective CG, audit quality, and FRQ necessitates a thorough examination of their components (Baker et al., 2019; Morris & Laksmana, 2010; Q. K. Nguyen, 2022b). The role of robust CG mechanisms in enhancing FRQ is a vital topic, widely studied to assess corporate performance and the status of stock exchanges in various economies. Regulatory agencies often assert a direct relationship among CG mechanisms, audit quality, earnings quality, and FRQ. Therefore, examining the impact of ownership structure as a CG mechanism on FRQ is of significant importance (Kouaib & Jarboui, 2014; Q. K. Nguyen, 2022a).

Researching the study on ownership structure, financial reporting quality, and the role of audit quality in Vietnam is of paramount importance due to several compelling reasons. Vietnam's dynamic and rapidly evolving economy has seen substantial growth and integration into the global market, making robust corporate governance and high-quality financial reporting essential for sustaining investor confidence and economic stability (Q. K. Nguyen, 2022d, 2023b). Ownership structures in Vietnamese companies are diverse, including state-owned enterprises, family-owned businesses, and firms with significant foreign investments, each presenting unique governance challenges and opportunities (Kim & Lu, 2011; Wang, 2018). Understanding how these different ownership structures impact FRQ is critical for policymakers, investors, and regulators aiming to foster a transparent and reliable business environment. Moreover, the role of audit quality in ensuring the integrity of financial statements cannot be overstated. High-quality audits serve as a deterrent to earnings management and financial misreporting, thus playing a crucial role in enhancing the credibility of financial information. In Vietnam, where regulatory frameworks and enforcement mechanisms are still developing, investigating the interplay between ownership structure, FRQ, and audit quality can provide valuable insights into the effectiveness of existing corporate governance practices and identify areas for improvement. Additionally, such research can contribute to the global discourse on corporate governance by offering perspectives from an emerging market context, where unique socio-economic factors influence corporate behavior. Ultimately, this study can aid in developing tailored strategies that improve financial reporting standards and audit practices, thereby bolstering investor trust, attracting foreign investments, and promoting sustainable economic growth in Vietnam.

Literature review. Ownership structure plays a crucial role in shaping corporate governance practices and, consequently, the quality of financial reporting. Diverse ownership structures, including state ownership, family ownership, institutional ownership, and foreign ownership, have been found to influence financial reporting quality differently. For instance, state-owned enterprises (SOEs) often face unique governance challenges due to political interference and less stringent profit maximization objectives, potentially leading to lower FRQ (Mustapha & Ahmad, 2011; Q. K. Nguyen, 2020, 2023a; Paniagua et al., 2018). Conversely, family-owned businesses might exhibit higher FRQ due to a long-term orientation and a desire to maintain the family's reputation, although this is not always the case if the controlling family engages in earnings management to serve personal interests. Institutional investors, with their significant resources and expertise, generally demand higher transparency and accountability, thereby promoting better FRQ. However, the effectiveness of institutional ownership in improving FRQ can vary based on the level of their activism and engagement in corporate governance practices. Foreign ownership often brings with it international best practices and higher standards of financial reporting, but the impact on FRQ can be contingent on the degree of control and influence exerted by foreign investors (Q. K. Nguyen, 2024; Rashid, 2020; Shehzad et al., 2010).

The relationship between financial reporting quality and corporate governance mechanisms has been extensively studied, highlighting the importance of robust governance frameworks in ensuring high-quality financial disclosures. Good corporate governance practices, such as the presence of an independent board of directors, effective audit committees, and transparent disclosure policies, are associated with improved FRQ (Larcker et al., 2007; Law & Azman-Saini, 2012; Q. Nguyen & Dang, 2020; Weir & Laing, 2001). The board of directors plays a pivotal role in overseeing management and ensuring that financial reports are accurate and reliable. Audit committees, when composed of independent and financially literate members, can significantly enhance the quality of financial reporting by providing oversight and challenging management's judgments and estimates. Furthermore, transparent disclosure policies that comply with international financial reporting standards (IFRS) contribute to higher FRQ by ensuring that financial information is relevant, reliable, and comparable across different periods and entities. The literature suggests that firms with strong corporate governance structures are less likely to engage in earnings management and more likely to provide financial reports that reflect the true economic performance of the company. Family ownership typically has a dual impact on both managers and owners. On one hand, it can foster a long-term commitment to the firm, as the family's significant interests and wealth are closely tied to the company's success (Germain et al., 2014; Ho et al., 2023; John & Senbet, 1998; Khai, 2022). On the other hand, this type of ownership often leads to risk aversion due to the high stakes involved. Additionally, family owners can sometimes derive special benefits from managing the firm, potentially at the expense of minority shareholders. Previous research has linked family ownership with high levels of earnings quality.

Studies by Carey et al. (2000) and Basheer et al. (2021) have shown that family ownership negatively impacts financial performance. Similarly, Powell and Greenhaus (2010) found that family ownership reduces earnings quality, while Basheer et al. (2021) demonstrated that it diminishes financial reporting quality. Conversely, Reyna's research on ownership composition and earnings management (EM) practices indicated that family ownership decreases EM practices, though this effect varies with firm size. Other studies have shown mixed results: Madani et al. found no significant relationship between family ownership and FRQ, and Affan et al. Rashid (2020) reported that family ownership does not influence FRQ. However, Tandean and Winnie (2016) highlighted that family ownership significantly enhances earnings quality. These conflicting findings lead to the formation of the following hypothesis.

Audit quality is a critical component in the financial reporting process, serving as a mechanism to enhance the credibility and reliability of financial statements. High-quality audits help detect and deter financial misreporting, thus contributing to improved FRQ. The literature identifies several factors that influence audit quality, including the size and reputation of the audit firm, auditor independence, and the level of audit fees. Big Four audit firms, due to their extensive resources, expertise, and reputation, are generally associated with higher audit quality compared to non-Big Four firms (Dang & Nguyen, 2021b; Dang et al., 2022; Le et al., 2021; Lin & Hwang, 2010). Auditor independence, both in fact and in appearance, is crucial for ensuring that auditors can provide an unbiased and objective assessment of the company's financial statements. Studies have shown that higher audit fees, which often reflect the complexity and risk associated with the audit, are positively correlated with audit quality. Moreover, regulatory oversight and enforcement play a vital role in maintaining audit quality. Countries with stringent regulatory frameworks and active oversight bodies tend to have higher audit quality, which in turn leads to better FRQ.

Audited financial statements are critical for providing investors, shareholders, and other stakeholders with the information necessary to make informed financial and economic decisions. These financial reports serve as a fundamental basis for decision-making in the capital market by offering insights into past performance, predicting future profitability, and monitoring managerial behavior. The utility of financial reporting is significantly enhanced when it can serve as a reliable reference for forecasting the company's future condition, thereby guiding users in making strategic decisions that steer the company in a positive direction (Al-Rassas & Kamardin, 2015; Dang & Nguyen, 2021a; Kouaib & Jarboui, 2014; Q. K. Nguyen, 2021).

However, earnings management can occur when financial reports are prepared using the accrual method, as it allows management to manipulate earnings to improve the appearance of financial statements. Managers may engage in earnings management to mask deficiencies and present a more favorable image to users of financial reports (Q. K. Nguyen, 2024; Suto & Takehara, 2020). This manipulation undermines the integrity of financial reporting and can mislead stakeholders. To mitigate this issue, Jensen and Meckling (1976) propose that effective mechanisms are needed to oversee and control management performance, ensuring alignment with shareholder interests. Ownership structure serves as a valuable mechanism for reducing conflicts between shareholders and managers. It acts as an invisible supervisory and regulatory tool that limits earnings management by ensuring closer involvement and scrutiny of management activities. The prevalence of accounting and financial scandals has underscored the urgent need to enhance the credibility of financial reports through the establishment of robust governance structures. The interactions between corporate governance (CG), ownership structure, and financial reporting quality (FRQ) have been extensively debated in developed countries. Recently, attention has shifted towards developing countries to explore how these interactions play out in different regulatory and economic environments. This includes investigating the roles of corporate governance, governance structures, external audit quality, and reporting quality to improve financial reporting practices globally.

The interplay between ownership structure, audit quality, and FRQ is complex and multifaceted, with each element influencing the others in various ways. Ownership structure can impact the demand for and supply of audit services, thereby affecting audit quality. For example, firms with higher institutional ownership may demand higher audit quality to satisfy the rigorous monitoring and accountability requirements of institutional investors. Similarly, family-owned businesses might seek high-quality audits to enhance credibility and maintain the family’s reputation (Aljughaiman et al., 2023; Almustafa et al., 2023; Dang et al., 2020; Dang & Nguyen, 2022; Srinidhi et al., 2011). Conversely, in state-owned enterprises, the demand for high-quality audits may be lower due to political considerations and less pressure from profit-maximizing objectives. The quality of audits, in turn, influences FRQ by providing assurance on the accuracy and reliability of financial statements. Studies have shown that high-quality audits mitigate the risk of earnings management and enhance the transparency of financial disclosures. The interaction between these elements underscores the importance of considering the broader corporate governance context when examining the determinants of FRQ.

Methodology. The study's population includes all companies listed on the Ho Chi Minh City Stock Exchange from 20011 to 2021. The sample comprises all companies that provided information about their ownership structure during this period, spanning nine years and involving 180 companies. Data for both the mediator and independent variables were manually gathered from the companies' annual reports.

Measures and Model. This study will employ discretionary accruals (DACC) as a proxy for financial reporting quality (FRQ). The underlying assumption is that the level of DACC serves as a reliable indicator of earnings management (EM), making it an inverse measure of FRQ. A low level of DACC is anticipated to reflect high financial reporting quality and earnings quality. Therefore, to improve our model, the study will separate the firms take a conservative strategy (DACC < 0) and the firms engaged in the aggressive strategy (DACC > 0). This measure is formular in the literature (Q. K. Nguyen, 2022c; Parte-Esteban & García, 2014; Suprianto et al., 2017)

Table 1. Measurement the Variables

Variable	Variable type	Measurement
Financial reporting quality	Dependent variable	Discretionary accruals
Audit quality	Mediator variable	Audit fees
Institutional ownership	Independent variable	Proportion of institutions ownership to the paid capital
family ownership	Independent variable	Proportion of family ownership to the paid capital
Managerial ownership	Independent variable	Proportion of managers' ownership to the paid capital
Board's ownership	Independent variable	Percentage of director's ownership in the board to the paid capital.

Based on the table II above, the model of this study have three equations as follow:

$$EM = \beta_0 + \beta_1 BDOWN + \beta_2 FMOWN + \beta_3 INSOWN + \beta_4 MAOWN + \varepsilon \quad (1)$$

$$EM = \beta_0 + \beta_1 AFEES + \beta_2 BDOWN + \beta_3 FMOWN + \beta_4 INSOWN + \beta_5 MAOWN + \varepsilon \quad (2)$$

$$EM = \beta_0 + \beta_1 AFEES + \varepsilon \quad (3)$$

Results. Table 2 show the descriptive statistic of the variable. The results in this table show that the level of earnings management is not too high but there is a large difference between firms.

Table 2. Descriptive Statistics

	EM	AFEES	BDOWN	FMOWN	INSOWN	MAOWN
Mean	-0.000690	3.520025	0.169792	0.092606	0.239699	0.023937
Median	0.002913	9.071073	0.106135	0.005075	0.26656	0.001230
Maximum	3.900616	11.59910	1.000000	0.955000	0.999	0.693950
Minimum	-1.699076	9.007666	0.000000	0.000000	0.000000	0.000000
Std. Dev.	0.262090	1.916109	0.191903	0.296756	0.279593	0.071569
Skewness	20.65679	-0.269933	1.719261	0.769567	0.639622	6.999769
Kurtosis	655.7931	1.733996	6.256327	2.779167	2.125510	22.62369
Jarque-Bera	23376699	119.5665	1503.067	161.1116	92.59639	29526.63
Probability	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
Observations	1326					

The tables 3 show a correlation matrix which is a table showing correlation coefficients between variables. Each cell in the matrix shows the correlation between two variables. The value is between -1 and 1, where 1 implies a perfect positive correlation, -1 implies a perfect negative correlation, and 0 implies no correlation. In the context of this study on ownership structure, financial reporting quality , and audit quality, the correlation matrix helps understand the relationships among these variables. All values are low than 0.7.

Table 3. Correlation Coefficients

	EM		AFEES		BDOWN		FMOWN		INSOWN		MAOWN
EM	1.000										
AFEES	-0.290	***	1.000								
	0.000										
BDOWN	-0.052	**	0.077	***	1.000						
	0.025		0.002								
FMOWN	0.014		0.024		0.092	***	1.000				
	0.572		0.147		0.000						
INSOWN	-0.012		0.027	***	-0.247	***	-0.152	***	1.000		
	0.415		0.125		0.000		0.000				
MAOWN	-0.024		0.091	***	0.242	***	0.071	***	-0.129	***	1.000
	0.177		0.000		0.000		0.005		0.000		

Table 4 show Variance Inflation Factors (VIF) which is considered as a test to measure the multicollinearity among all variables in the analysis. Based on the data shown in Table 4, the VIF of all variables are less than 10, therefore, there is no multicollinearity problem, this study will not exclude any variable from the model.

Table 4. VIF

Variable	Centered VIF
AFEES	1.17
BDOWN	1.62
FMOWN	1.24
INSOWN	1.69
MAOWN	1.58

Table 5 presents the final results of the first equation, demonstrating the impact of the independent variables on the dependent variable. To address issues of autocorrelation and unit root in this model, all independent variables were converted to their first difference values, and the lagged value of the dependent variable was included. The Durbin-Watson (DW) statistic, shown in Table 5, which falls within the acceptable range of -2 to +2, indicating no autocorrelation issue. The model's R-squared is 0.688, and the Prob (F-statistic) is 0.000, indicating a strong model fit. Additionally, normality tests confirmed that all data follow a normal distribution.

The resuts in Table 5 find the significant roles that directors' and family ownership play in enhancing financial reporting quality (FRQ) through their impact on earnings management (EM). Directors' ownership, which typically aligns directors' interests with those of shareholders, was found to have a positive effect on FRQ by reducing the incidence of earnings management practices. This result suggests that higher levels of directors' ownership incentivize responsible financial reporting practices and mitigate agency conflicts between managers and shareholders. Similarly, family ownership emerged as a key factor positively influencing FRQ by curbing earnings management. Family-owned firms often exhibit long-term commitment to corporate success, as their substantial stakes and personal wealth are closely tied to the firm's performance. By overseeing management more closely and emphasizing long-term stability, family ownership structures contribute to improved financial transparency and credibility.

Conversely, institutional ownership was found to exert a negative influence on

FRQ in this study. Institutional investors, while typically advocating for better corporate governance and oversight, were associated with higher levels of earnings management. This finding suggests that institutional pressures for short-term performance goals might sometimes lead to compromises in financial reporting integrity. Despite these pressures, it is important to note that the impact of institutional ownership on FRQ can vary widely depending on the specific governance practices and monitoring mechanisms in place within each firm.

Managerial ownership, however, did not demonstrate a significant impact on FRQ in the study. This result implies that while managers with significant ownership stakes might align their interests with shareholders', their influence alone may not suffice to measurably improve financial reporting practices. This finding underscores the complexity of ownership dynamics and suggests that effective governance frameworks involving directors' and family ownership structures might be more crucial in fostering high-quality financial reporting. Overall, these results highlight the nuanced relationships between different ownership structures and their implications for financial transparency and governance practices within firms.

Table 5. Equation 1

Variable	Coefficient	Std. Error	t-Statistic c	Prob.
DBDOWN	-0.153	0.052	-2.967	0.003
DFMOWN	-0.925	0.127	-5.565	0.000
DINSOWN	0.579	0.025	21.566	0.000
DMAOWN	0.196	0.305	0.599	0.564
LAGEM	-0.321	0.016	-5.195	0.000
Constant	-0.005	0.000	-9.059	0.000
R-sq	**0.655**	**Adjusted R-sq**		0.756
F-statistic	**10.651**	**Prob(F-statistic)**		0.000
D-W	**1.156**			

Table 6 presents the final results of the second equation, showing the impact of the independent variables and the mediator on the dependent variable. Similar to the previous model, all independent and mediator variables were converted to their first difference values, and the lagged value of the dependent variable was included. The Durbin-Watson statistic is 1.246, within the acceptable range, indicating no autocorrelation issue. The model's R-squared is 0.626, and the Prob (F-statistic) is 0.000.

Table 6. Equation 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DAFEES	-0.014	0.002	-5.491	0.000
DBDOWN	-0.121	0.041	-2.383	0.017
DFMOWN	-0.938	0.122	-4.248	0.000
DINSOWN	0.412	0.024	20.243	0.000
DMAOWN	-0.025	0.299	-0.091	0.928
LAGEM	-0.251	0.015	-14.991	0.000
Constant	-0.004	0.000	-19.010	0.000
R-sq	0.929	**Adjusted R-sq**		0.451
F-statistic	11.344	**Prob(F-statistic)**		0.000
D-W	1.246			

The results show that board ownership (BDOWN), family ownership (FMOWN), and audit fees (AFEES) have a significant and negative impact on EM. This suggests that increases in these variables reduce EM. Institutional ownership (INSOWN), however, has a significant and positive impact on EM, indicating that higher institutional ownership increases EM. Managerial ownership (MAOWN) remains insignificant. These results confirm the hypothesis that audit fees partially mediate the relationship between the independent variables and EM, as the independent variables still have a significant impact after including the mediator.

Table 7 presents the final results of the third equation, illustrating the impact of the mediating variable on the dependent variable. The Durbin-Watson statistic is 1.257, within the acceptable range, indicating no autocorrelation issue.

Table 7. Equation 3

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DAFEES	-0.029693	0.002196	-11.44664	0.0000
LAGEM	-0.036246	0.014332	-2.928466	0.0116
C	-0.000462	0.000206	-2.240163	0.0222
R-sq	0.494680			
Adjusted R-sq	0.366220			
F-statistic	9.649046			
D-W	1.296			

The results indicate that audit fees have a significant and negative impact on EM. This implies that higher audit fees reduce EM, thereby improving FRQ. This finding supports the hypothesis that audit fees significantly impact EM, consistent with the results of previous studies.

In Vietnam, the findings of this study highlight significant implications for corporate governance and financial reporting practices. The positive impact of directors' and family ownership on financial reporting quality (FRQ) underscores the importance of internal control mechanisms within firms. By reducing earnings management, these ownership structures promote transparency and reliability in financial reporting, crucial for building trust among stakeholders in Vietnam's emerging market context. Moreover, the study's identification of institutional ownership's negative influence on FRQ emphasizes challenges in governance that need addressing. This suggests a need for more effective mechanisms to enhance institutional investors' oversight and monitoring roles in financial statement preparation, potentially through greater transparency requirements or strengthened regulatory frameworks. The mediating role of audit quality further elucidates the dynamics at play. High audit quality not only enhances FRQ directly but also acts as a deterrent to earnings management practices. This finding underscores the critical role of rigorous audit processes in upholding financial integrity and credibility, particularly in environments where regulatory oversight may be evolving. As Vietnam continues to integrate into global financial markets, these insights advocate for policies that strengthen audit standards and governance practices across listed firms. Overall, this study provides a comprehensive framework for understanding how ownership structures, audit quality, and financial reporting interact in Vietnam's corporate landscape, offering actionable recommendations to foster sustainable financial practices and bolster investor confidence.

Conclusion. The findings of this study provide valuable insights into the intricate relationships among ownership structure, audit quality, earnings management, and financial reporting quality (FRQ) in the context of Vietnamese listed firms. Against the backdrop of heightened scrutiny and regulatory reforms prompted by past corporate scandals, this research underscores the pivotal role of ownership structures in shaping FRQ through their impact on earnings management practices. Directors' and family ownership emerged as significant drivers of FRQ, positively influencing it by mitigating earnings management. These ownership structures align managerial incentives with shareholder interests, fostering long-term commitment to transparent financial reporting. In contrast, institutional ownership was found to negatively affect FRQ, highlighting potential challenges associated with short-term performance pressures that may compromise financial reporting integrity.

Furthermore, audit quality was identified as a crucial mediator in the relationship between ownership structure and FRQ. High audit quality not only enhances FRQ directly but also acts as a deterrent to earnings management practices. This underscores the importance of robust audit processes and regulatory oversight in maintaining the credibility and reliability of financial disclosures. Moving forward, enhancing the supervisory and monitoring roles of institutional ownership could play a pivotal role in improving FRQ within Vietnamese firms. Strengthening corporate governance frameworks that emphasize transparency, accountability, and independent oversight will be essential in rebuilding trust among stakeholders and ensuring sustainable business practices. In conclusion, this study contributes to the existing literature by providing empirical evidence on how ownership structure and audit quality jointly influence FRQ in the Vietnamese context. By understanding these dynamics, policymakers, regulators, and corporate leaders can implement informed strategies to foster a culture of integrity and accountability in financial reporting, thereby promoting sustainable economic growth and investor confidence in Vietnam's capital markets.

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