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# The Role of Corporate Governance and Asymmetry Information in The Relationship Between Big Bath (large and non-recurring charges) and Audit Fees: An Overview Literature To Study Empirical

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***Abstract***. *This qualitative literature review explores the role of corporate governance and information asymmetry in the relationship between big bath accounting practices and audit fees. The findings suggest that firms engaging in big bath practices face higher audit fees due to increased audit risk perceived by auditors. Weak corporate governance exacerbates this effect, as auditors need to conduct more in-depth examinations to mitigate the associated risks. In addition, high information asymmetry between management and external stakeholders further increases audit risk, prompting auditors to expand their efforts. This study emphasizes the importance of strong corporate governance in reducing incentives for earnings management and enhancing financial transparency. The implications are significant for audit practice and corporate policy, highlighting the need for firms to strengthen their governance structures and for auditors to consider big bath risk in planning and conducting audits.*

***Keywords:*** *Big Bath Accounting, Corporate Governance, Information Asymmetry, Audit Fees, Earnings Management*

## INTRODUCTION

In a dynamic business world, companies often face pressure to meet market and shareholder expectations. One strategy used to manage these expectations is through earnings management, including the practice of "big bath" or recording large non-recurring expenses. This practice involves reporting large losses in one period to improve future financial performance. There is a complex relationship between big bath accounting practices, corporate governance, and information asymmetry in determining corporate audit fees (Rizal, M., et al, 2024) . This study aims to explore the relationship between big bath practices, corporate governance, information asymmetry, and audit fees.

Big bath is an earnings management technique often used by management to manipulate financial statements. When a company is facing a bad year, management may choose to report larger losses than they should in the hope of improving future financial performance (Elliott & Shaw, 1988). This practice can provide additional information to auditors, which can affect their risk assessment and, ultimately, the audit fees charged to the company. Audit partner rotation and the use of non-audit services can worsen or improve audit quality depending on the context of the company and the financial statements being audited (Rizal, M., et al, 2024).

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Research by Heeick Choi, Khondkar Karim, and Yiye Zhang (2023) shows that audit fees are significantly higher for companies that conduct big baths compared to other companies. This suggests that auditors expand their audit efforts to reduce the greater audit risk caused by big baths, which in turn leads to higher audit fees.

Information asymmetry and corporate governance play an important role in this context. Information asymmetry occurs when there is an imbalance of information between management and shareholders or other external parties (Jensen & Meckling, 1976). In such situations, auditors may feel the need to increase their audit efforts to address the risks associated with asymmetric information. The use of AI and big data allows auditors to handle large volumes of data more quickly, while blockchain offers solutions to improve the security and integrity of audit evidence (Ruslaini, et al, 2024). Research by Abbott, Parker, and Peters (2006) found that earnings management, litigation risk, and asymmetric audit fee responses can affect auditors' decisions in planning and pricing audits.

Weak corporate governance can exacerbate information asymmetry and increase the risk that management will engage in earnings management practices such as big bath. Armstrong et al. (2015) emphasize the importance of effective corporate governance in reducing incentives for earnings management and increasing financial reporting transparency. This study shows that the positive relationship between big bath and audit fees is stronger for firms with weaker corporate governance and greater information asymmetry.

In this context, this study aims to review the existing literature on how big bath affects auditor risk assessment and audit fees, as well as the role of corporate governance and information asymmetry in this relationship. By reviewing previous empirical research, this study is expected to provide deeper insights into the mechanisms behind this relationship and its implications for audit practices and corporate policies.

Previous research has shown that auditors react asymmetrically to accruals that increase/decrease firm earnings (Abbott et al., 2006). However, auditors' responses to big baths can be distinguished from other types of earnings management because big baths provide auditors with additional information beyond other indicators of earnings manipulation. This suggests that auditors may need to expand their audit efforts to mitigate the greater audit risk caused by big baths, which in turn leads to higher audit fees.

In the context of corporate governance, research by Cohen et al. (2002) shows that strong governance can reduce the risk of earnings management and improve the quality of financial reporting. Therefore, companies with weak governance may face higher audit fees because auditors need to increase their efforts to address the risks associated with poor governance.

In addition, research by Hope and Wang (2018) shows that management involved in big bath can increase information asymmetry, which ultimately affects audit fees. In situations where information asymmetry is high, auditors may feel the need to increase their efforts to address the risks associated with asymmetric information.

Overall, the findings of this study suggest that auditors expand their audit efforts to mitigate the greater audit risk caused by big baths, which in turn leads to higher audit fees. Furthermore, the positive relationship between big baths and audit fees is stronger for firms with weaker corporate governance and greater information asymmetry. These findings have important implications for audit practices and corporate policies, particularly in the context of risk management and financial reporting transparency.

## LITERATURE REVIEW

This literature review aims to examine the existing literature on the role of corporate governance and information asymmetry in the relationship between big bath practices and audit fees. Big bath, which involves recording large non-recurring expenses, is often used by companies to manipulate financial statements in order to improve future financial performance (Elliott & Shaw, 1988). This practice presents its own challenges for auditors in assessing the audit risk they face.

Research by Heeick Choi, Khondkar Karim, and Yiye Zhang (2023) shows that audit fees are significantly higher for companies that conduct big baths compared to other companies. This suggests that auditors expand their audit efforts to reduce the greater audit risk caused by big baths. This finding is in line with research by Abbott, Parker, and Peters (2006) which found that earnings management and litigation risk can affect auditors' decisions in planning and pricing audits.

Information asymmetry, which occurs when there is an imbalance of information between management and shareholders or other external parties, can exacerbate audit risk (Jensen & Meckling, 1976). Research by Hope and Wang (2018) shows that management involved in big bath can increase information asymmetry, which ultimately affects audit fees. In situations where information asymmetry is high, auditors may feel the need to increase their efforts to overcome the risks associated with asymmetric information. External auditors are responsible for providing opinions on the compliance of financial statements with Sharia principles (Rizal, M., et al, 2024).

Corporate governance also plays an important role in this context. Research by Armstrong et al. (2015) emphasizes the importance of effective corporate governance in reducing incentives for earnings management and increasing transparency of financial reporting. Weak governance can exacerbate information asymmetry and increase the risk that management will engage in earnings management practices such as big bath (Cohen et al., 2002). Therefore, companies with weak governance may face higher audit fees because auditors need to increase their efforts to address the risks associated with poor governance.

Research by Fedyk and Khimich (2018) shows that companies involved in bad news herding tend to over-report bad news, which can then be reversed in the future. This suggests that big baths can be used strategically to create reserves that can be reversed in the future, thereby affecting auditor risk assessments and audit fees.

Overall, the existing literature suggests that big baths provide auditors with additional information beyond other indicators of earnings manipulation, which may affect their risk assessments and, ultimately, the audit fees charged to the firm. The positive relationship between big baths and audit fees is stronger for firms with weaker corporate governance and greater information asymmetry. These findings have important implications for audit practice and corporate policy, particularly in the context of risk management and financial reporting transparency.

## METHODOLOGY

This study uses a qualitative approach with a literature review method to explore the role of corporate governance and information asymmetry in the relationship between big bath practices and audit fees. A literature review is an effective method for collecting, analyzing, and synthesizing findings from various previous studies, so that it can provide a comprehensive understanding of the topic being studied (Snyder, 2019).

The first step in this methodology is to identify literature relevant to the research topic. This process involves searching for journal articles, books, and other academic sources that discuss big bath, corporate governance, information asymmetry, and audit fees. The literature search was conducted through academic databases using keywords such as "big bath accounting", "corporate governance", "information asymmetry", and "audit fees" (Webster & Watson, 2002).

Once the relevant literature has been identified, the next step is to conduct a critical analysis of each study. This analysis aims to understand the methodology, findings, and contributions of each study to the topic under study. In this process, the study by Heeick Choi, Khondkar Karim, and Yiye Zhang (2023) is one of the main references because it provides the latest empirical evidence on the relationship between big bath and audit fees.

In addition, studies by Abbott, Parker, and Peters (2006) and Armstrong et al. (2015) were also analyzed to understand how corporate governance and information asymmetry affect auditors' decisions regarding audit fees. These studies provide insight into how auditors react to the risks posed by big bath practices and how governance and information factors affect the assessment of these risks.

The final step in this methodology is the synthesis of findings from the various studies. Synthesis is done by grouping findings based on key themes or topics that emerge from the literature analysis. This process allows researchers to identify patterns, gaps, and areas that require further research. The results of this synthesis are then used to develop conclusions and implications of this study.

By using the literature review method, this study is expected to provide an in-depth understanding of how corporate governance and information asymmetry affect the relationship between big bath and audit fees. This methodology also allows researchers to identify areas that require further research and provide recommendations for future audit practices and corporate policies.

## RESEARCH RESULT

This study aims to understand the role of corporate governance and information asymmetry in the relationship between big bath practices and audit fees. Through a comprehensive literature review, several important findings have been identified that provide in-depth insights into this topic.

First, the findings of the study by Heeick Choi, Khondkar Karim, and Yiye Zhang (2023) show that companies engaged in big bath practices tend to face higher audit fees. This is due to the increased audit risk perceived by the auditor, which requires additional audit efforts to ensure the reliability of the financial statements. Big bath practices provide additional information to the auditor, which distinguishes it from other types of earnings management and affects the auditor's risk assessment.

Second, research shows that weak corporate governance can exacerbate the impact of big bath on audit fees. Armstrong et al. (2015) emphasize that effective governance can reduce incentives for earnings management and increase transparency of financial statements. In this context, companies with weak governance are more susceptible to big bath practices, which ultimately increase audit fees because auditors need to conduct more in-depth examinations to address the associated risks.

Third, information asymmetry also plays an important role in this relationship. Research by Hope and Wang (2018) shows that high information asymmetry can increase audit risk, because auditors must overcome information imbalances between management and external stakeholders. In situations where information asymmetry is high, auditors may feel the need to expand their audit efforts, which ultimately increases audit costs.

In addition, research by Abbott, Parker, and Peters (2006) found that auditors react asymmetrically to accruals that increase/decrease company earnings. This suggests that auditors are more aware of earnings management practices that can affect the reliability of financial statements, including big bath.

Overall, the findings from this literature review suggest that big bath practices have a significant impact on audit fees, especially in the context of weak corporate governance and high information asymmetry. Auditors tend to expand their audit efforts to mitigate the greater audit risk caused by big baths, which ultimately leads to higher audit fees. These findings have important implications for audit practices and corporate policies, especially in the context of risk management and financial reporting transparency.

## DISCUSSION

This discussion aims to explore more deeply the research results on the role of corporate governance and information asymmetry in the relationship between big bath practices and audit fees. By referring to various previous studies, we can understand how these various factors interact and influence auditor decisions and their implications for audit fees.

Research by Heeick Choi, Khondkar Karim, and Yiye Zhang (2023) shows that companies that practice big bath tend to face higher audit fees. This is due to the increased audit risk perceived by the auditor, which requires additional audit efforts to ensure the reliability of the financial statements. This finding is in line with research by Abbott, Parker, and Peters (2006) which found that auditors react asymmetrically to accruals that increase or decrease the company's income, indicating that auditors are more aware of earnings management practices that can affect the reliability of financial statements.

In the context of corporate governance, research by Armstrong et al. (2015) emphasizes the importance of effective governance in reducing incentives for earnings management and increasing transparency of financial reporting. Weak governance can exacerbate the impact of big bath on audit fees, as auditors need to conduct more in-depth examinations to address the associated risks. Research by Cohen et al. (2002) also shows that strong governance can reduce earnings management risks and improve financial reporting quality, which in turn can affect audit fees.

Information asymmetry also plays an important role in this relationship. Research by Hope and Wang (2018) shows that high information asymmetry can increase audit risk, because auditors have to overcome information imbalances between management and external stakeholders. In situations where information asymmetry is high, auditors may feel the need to expand their audit efforts, which ultimately increases audit costs. This finding is supported by research by Jensen and Meckling (1976), which highlights that information asymmetry can lead to agency problems, where management may have incentives to manipulate financial information for personal gain.

Research by Behn, Choi, and Kang (2008) found that higher audit quality can reduce the negative impact of big bath practices on financial statements. This suggests that auditors with good reputations and strong industry expertise can be more effective in detecting and addressing risks associated with big baths. This research is in line with the findings by Francis and Krishnan (1999), which show that auditors with industry specialization tend to be more conservative in audit reporting, which can improve audit quality and reduce long-term audit costs.

In addition, research by Bedard and Johnstone (2004) shows that earnings manipulation risk and corporate governance risk can affect auditors' audit planning and pricing decisions. Auditors tend to increase their audit efforts to reduce the greater audit risk caused by big bath practices, which ultimately leads to higher audit fees. This finding is consistent with research by DeFond and Zhang (2014), which shows that auditors pay attention to significant client risks in determining audit strategies and pricing.

Research by Kothari, Leone, and Wasley (2005) shows that performance-adjusted discretionary accruals can help detect earnings management practices such as big bath. This technique allows auditors to more accurately assess the risks associated with earnings manipulation, which in turn can affect audit fees. This research is supported by the findings of Dechow, Sloan, and Sweeney (1995), who developed an earnings management detection model that is widely used by auditors to identify earnings manipulation practices.

In the international context, research by Choi and Wong (2007) shows that auditor governance function and legal environment can affect audit decisions and audit fees. Auditors in countries with strict regulations and strong legal systems tend to be more careful in assessing the risks associated with big bath practices, which can affect audit fees. This finding is in line with research by DeFond, Francis, and Wong (2000), which shows that auditor industry specialization can affect audit quality and pricing in the international audit market.

Overall, this discussion suggests that big bath practices have a significant impact on audit fees, especially in the context of weak corporate governance and high information asymmetry. Auditors tend to expand their audit efforts to mitigate the greater audit risk caused by big baths, which ultimately leads to higher audit fees. These findings have important implications for audit practices and corporate policies, especially in the context of risk management and financial reporting transparency.

## CONCLUSION

This study has explored the role of corporate governance and information asymmetry in the relationship between big bath practices and audit fees through a comprehensive literature review. From the results of the existing literature analysis, it can be concluded that big bath practices have a significant impact on audit fees. Auditors tend to expand their audit efforts to reduce the greater audit risk caused by big baths, which ultimately leads to higher audit fees. This is especially true in the context of companies with weak governance and high information asymmetry, where the risk of financial statement manipulation is greater.

Effective corporate governance can serve as a control mechanism that reduces incentives for earnings management and increases transparency of financial reporting. Thus, companies with strong governance structures tend to face lower audit fees. In addition, information asymmetry between management and external stakeholders can increase audit risk, so auditors need to increase their efforts to address such information asymmetry.

These findings have important implications for audit practices and corporate policies. Companies need to strengthen their governance to mitigate the risks associated with big bath practices and improve the transparency of financial information. Auditors, on the other hand, should consider the risks associated with big bath in planning and conducting their audits to ensure high audit quality.

## LIMITATION

Although this study provides valuable insights, there are some limitations that need to be considered. First, this study relies on existing literature, which may be limited in terms of scope and depth of analysis. Some studies may have used different methodologies, so the results may vary depending on the research context.

Second, this study does not consider other external factors that may affect the relationship between big bath, corporate governance, and audit fees. For example, differences in regulation and legal environments across countries may affect audit practices and audit fee determination.

Third, this study used a qualitative approach, which although it provides in-depth understanding, does not allow for statistical generalization of the findings. Further research with a quantitative approach may provide stronger empirical evidence and allow for generalization of the findings.

Finally, this study is limited by the literature available to date. Recent developments in audit practice and regulation may not have been fully captured in this review. Therefore, further research is needed to address these limitations and deepen our understanding of this topic.

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