



Examining the Effect of Some Auditing Features with Restatement in the Firm's Profit and Loss Figures

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ABSTRACT: The right flow of information at this market leads to make the accurate and reasonable decision from the participants and finally economic development and social relations improvement. Financial reporting is the most important resource of information. Auditor's assessment about these reports could make important role in taking financial decision by internal and external users of the organization. Given the importance of issue in this research has been attempted; we proceed to examine the effect of some auditing features with restatement in the firm's profit and loss figures. In this study the effect of factors such as the size of the audit firm, change auditor and type of auditor's assessment were examined with restatement of financial statements. 130 companies among the listed companies in Tehran Stock Exchange were examined in a 5-year period from 1386 to 1391. The results of this study indicate that there is a significant positive relationship between auditor's assessment and auditor turnover with restatement of financial statements. But there is not significant relation between auditing firm size with restatement of financial statements.

Keywords: Auditor's Opinion, Auditor Change, Size of the Audit firm, Restatement of Financial Statements

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INTRODUCTION

Increasing expansion of economic units, Development of communications technology and the existence of conflict of interest create supervisory requirements. The issue of information revolution and globalization economy even is out of control of government, This condition has caused the audit profession attempt gradually to don't fall behind and consistent with technology changes move along with society needs. In this environment, users need to different information for making decision such as financial information about firms. But the important issue is the uncertainty about the reliability of aforementioned information and it comes from a conflict of interest. Indeed, the role of auditing is data quality assessment for users (Setayesh, 2009). In terms of history, the role of auditor in reporting of financial statements is restricted to presentation assessment or fair display of financial status and operation results. Management is responsible for reporting financial status and operation results of the business unit, While the role of the auditor is assessment assertions or management representation and impartial expenditure report on fairness of financial statements degree with predetermined criteria that type of auditor's opinion is very important in approval or disapproval of these reports in decision making, decision makers and transparency of information. Current and future investors decide based on prospect of the company survival that arise from financial statements and other available information. Brian et al. (2011) express audited financial statements are basis of companies that is set

for public use, because non-audited financial statements influence users by fraud and scandal of firm. Followed by corporative financial scandals and financial crises over the past two decades, finger has been pointed towards auditors and auditing quality. On the other hand, Policymakers again concentrated on the importance of effective and efficient auditing as one of the key components of efficient capital markets and attempted to identify the key drivers of auditing quality. One of the key drivers for improving auditing quality is auditor independence. Auditor independence, It is an essential in providing suitable accounting and auditing quality. In today's world also the importance of auditor independence such as real independence and external independence has been well understood. Issue of mandatory rotation of auditors and auditing firms got noticed in order to enhance independence of auditors and is been important. The process of mandatory rotation of auditors and auditing firms, It means change of auditor or audit firm after several periods auditing of examination units that is done based on regulations or general authorization. Since the auditor's report in the decision-making process of users of financial statements is considered as one of the useful information, therefore, in this research we examine the relation of some of the most important factors affecting on the auditing work such as the type of auditor's opinion and auditor's size and displacement with restatement in the firm's profit and less figures and we are looking for how these variables can be

contributed in presenting transparent and reliable reports to decision-makers.

Conceptual foundations and research background

One of the qualitative characteristics of financial information is being reliable. The information is reliable that be lack of error and important tendentious orientations and honestly represent what that is claimed it or in a manner reasonably expected to express (Section 12 of Chapter 2 Theoretical concepts of financial reporting in Iran). Audited financial statements are always worthy. Because report the results of depending reliability of the content of financial statements (Hassan Yeganeh, 2005). One of the objectives of financial reporting is showing information that be beneficial for investors, creditors and other current and potential users in investment and attest decisions-making and other decisions. One of the important criteria that mentioned groups use to estimate the profitability power of company, Predicting future profits and risks related to it and also evaluating management performance, is current and past profits.

Auditing can be one of the prevention ways and reducing deviations in the financial reports and prevent reducing the profit, because, reporting profit in the audited financial statements has information content and high quality (Hanif, 2010). One of the today challenges is earnings management. Earnings management is one of the up setter factors of financial reporting quality and all firm beneficiaries notice to it. Because any intervention that distort the accuracy of reported profit has an effect on users' decision making (Zengn and Ozkan, 2010). On the other hand, according to the agency theory, Auditor plays an important role in reducing information asymmetry between shareholders and managers. With the formation of agency relationship, agency costs resulting from conflict of interest is created between the parties that has a reverse effect on the firm value, that is, if the market expect to have such costs, firm value will decrease. Therefore, the company seeks to control and reduce such costs that the firm strategic planning mechanisms can help to reducing and controlling agency costs and its negative effects on firm value.

Incomplete information about the quality and economic value of the company lead to more incurring the risk to shareholder. Logical investors request the stock premium to tolerate agency risk which effectively increases the cost of stockholder's equity of firm.

Restatement of financial statements figures

All companies that have failed in recent years, have acted their restatement of financial statement. In most cases, restatement of financial statements has been indicated problems with the internal control system and corporate governance in companies that their reputation and value have been damaged in the market and even sometimes it has led to their bankruptcy. One of the qualitative characteristics of financial statements is its comparability. To achieve this feature, Consistency in accounting procedure during each financial period and also from one financial period to next financial period is essential. On the other hand, it has been emphasized in another part of the accounting standards: Financial statements should be included comparative prior period items; except in cases that an accounting standard may be permitted or required, then according to the requirement to represent comparative figures and maintain the consistency of the way from a period to another period, It is always expected that the presented figure for each financial elements in the current period financial reports, be equal with restatement figure for the same case in the financial reports of the next year, however, in some cases, based on reasons that are referred to them later, This equality does not exist. Not being equal of primary presented figure of financial statement items with restatement figure, is Often caused by one or more cases of factors of change in accounting policy, errors, done estimates revision by management, and change the classification of items. Among the four mentioned factors, Only the first two factors; that is, change the classification of items and correction of errors are belonging to the classified annual adjustments and their effect are retroactive. In fact, the purpose of numbers of restatement in this research is changes that may have been occurred as a result of one of the two mentioned factors, and done changes has not been considered due to classification changes and changes in estimates in counting the number of occurred restatements. In the accounting literatures have been explained various reasons for restatement of financial statements that most of them had significant relationship with amount of restatements.

Alastair et al. (2011) in Canada investigated this issue that "does the differences in audit quality indicators in the big audit firms against not big audit firms is related to the characteristic of test unit". They found, the effects of the big audit firms on unusual accruals of test units in comparison with the effects of not big audit firms on unusual accruals of test unit, has no significant difference.

Boone et al. (2010) In the United States, found, tendency of four big firms to issue a report of going concern for employers who have financial gravity is

not different from second class auditors. There is no difference between level of earnings management by employers of four big firms and employers of second class firms; while risk premium of predicted equity employers of four big firms and employers of second class auditing firms is different.

Wilson (2008), tested reducing in the information content of profits after restatement. The results showed that partly, Profit after restatement has less information content. For companies that have restated due to adjustment results from revenue recognition and companies that have experienced high reduction in the price of the shares on restatement date, Reducing in the information content of profits, have been more noticeable. Also, the results were indicated the firms that attempted to change their auditor and members of the board immediately after the restatement have been suffered less reduction in the information content.

MATERIAL AND METHODS

This research in terms of purpose is among the applied research. Given that this research in terms of purpose was applied, from aspects of the data collection method is a correlation. From method of descriptive statistics including mean and Variance and Standard Deviation and quartiles will be used to explain variables. Further tests of T, F and regression also are used for testing hypotheses. However, the default regression tests such as data normality and lack of autocorrelation of variables and so on also will be used. For hypotheses testing used from the method of "synthetic data"; because to investigate the relationship between the characteristics of the auditors and the type of Independent Auditors' Report, the independent and dependent variables are examined from two different aspects. On the one hand, these variables are tested among the various companies and on the other hand, during the period of 1386 to 1391.

Research hypotheses

1. There is an important relationship between auditor' turnover with the amount of restated figures in the annual adjustments of firm.

2. There is an important relationship between firm's sizes with the amount of restated figures in the annual adjustments of firm.

3. There is an important relationship between the types of external auditor's opinion with the amount of restated figures in the annual adjustments of firm.

RESULTS

Examining hypotheses testing

First hypothesis

• **There is an important relationship between auditor's turnovers with the amount of restated figures in the annual adjustments of firm.**

$r = 0$ H_0 :

$r \neq 0$ H_1 :

The first hypothesis results are observed in table 2-4. Examining significant fitted model shows that there is a positive and significant error level of 5% relationship between auditor displacement with the restatement of profit and loss figures and also restatement of balance sheet figures, therefore can be explained the H_0 hypothesis is rejected and the H_1 hypothesis of research is accepted ($\text{sig} < 0.05$). These results show as auditor displacement is increased, the restatement of figures also increases. Examining the fitted regression coefficients Determination shows auditor displacement explain 3.5 and 3 percent of profit and loss restatement changes and restatement of balance sheet figures in the examined companies respectively. Also given that the significant level of t-statistic of auditor displacement regression coefficient in both of two fitted models is less than 5%, thus, auditor displacement variable in the error level of 5% has a positive and significant effect on restatement of figures in the companies. As if one unit auditor's turnover occurs, profit and loss restatement figures and restatement of balance sheet figures will increase 0.775 and 720 units respectively.

Table 1. Testing first hypothesis of research

Independent variable	Restatement of profit and loss figures			Restatement of balance sheet figures		
	Slop of line	t	Sig.	Slop of line	t	Sig.
Intercept	10.067	56.07	0	10.818	60.238	0
Auditor's turnover	0.775	2.36	0.02	0.720	2.223	0.028
Determination coefficient	0.043			0.038		
Adjusted determination coefficient	0.035			0.03		
F-statistics	5.570(0.02)			4.940(0.028)		
Durbin-Watson	1.7			1.518		

Second hypothesis

• **There is an important relationship between firm sizes with the amount of restated figures in the annual adjustments of firm.**

$r = 0$ H_0 :

$r \neq 0$ H_1 :

As can be seen, the table 2-4 shows the results of second hypothesis of the research. Examining the results of significant fitted model shows that the significant level of F-statistic for both of two models is higher than 5% and is not significant. That is, there is no an important relationship between the firm size with profit and loss restatement figures and also

restatement of balance sheet figures. So, with confidence higher than 95% we can accept the H_0 hypothesis and reject the H_1 hypothesis of research ($\text{sig} > 0.05$). Also, examining the coefficients explain the regression models determination too. The firm size could not explain the percent of restatement figures changes of companies. However, given that the variable regression of firm size of coefficient significant level of t-statistics has been obtained higher than 5%, so the variable of firm size in the error level of 5% has no significant effect on the restatement figures in the companies.

Table 2. Testing second hypothesis of research

Independent variable	Restatement of profit and loss figures			Restatement of balance sheet figures		
	Slop of line	t	Sig.	Slop of line	t	Sig.
Intercept	10.235	24.380	0.000	11.118	26.691	0
Size of auditing institute	0.074	0.164	0.870	-0.09	-0.202	0.840
Determination coefficient	0			0		
Adjusted determination coefficient	-0.008			-0.008		
F-statistics	0.027(0.87)			0.041(0.840)		
Durbin-Watson	1.694			1.543		

Third hypothesis

• **There is an important relationship between the types of external auditor's opinion with amount of restated figures in the annual adjustments of firm.**

$r = 0$ H_0 :

$r \neq 0$ H_1 :

Examining the third hypothesis of coefficient determination of research shows that the type of auditor's opinion in the company has been able to explain 6.8 and 8.5 percent of profit and loss restatement changes and restatement of balance sheet figures respectively. Furthermore, the results of significant regression models showed the significant

level of F-statistics (9.146 and 11.590) is less than 5% and significant, that is, there is an important relationship (negative) between the types of external auditor's assessment with amount of restated figures in the annual adjustments of firm in the confidence level higher than 95%. Therefore, the H_0 hypothesis is rejected and the H_1 hypothesis is accepted. Examining variable regression coefficient of the type of auditor's opinion shows if an unit of increase or variable of the type of auditor's opinion changes, profit and loss restatement figures and restatement of balance sheet figures will decrease or change -0.907 and -1.007 respectively. That is, as the type of auditor's opinion is increase, the restatement figures decrease.

Table 3. Testing third hypothesis of research

Independent variable	Restatement of profit and loss figures			Restatement of balance sheet figures		
	Slop of line	t-statistics	Sig.	Slop of line	t	Sig.
Intercept	10.685	54.629	0	11.459	59.992	0
Type of auditor's opinion	-0.907	-3.024	0.003	-1.007	-3.404	0.001
Determination coefficient	0.068			0.085		
Adjusted determination coefficient	0.061			0.078		
F-statistics	9.146(0.003)			11.590(0.001)		
Durbin-Watson	1.647			1.531		

DISCUSSION

Auditing is from the substantial elements of accountability to users' auditing information. Because accountability is required the existence of reliable and valid information and reliability to information is required to consider them by an independent guy apart from producer of information. In accountability process, auditing makes added value by validating information. When capital flows are directed toward superior economic activities that owners' decisions about investments rely on reliable, related and timely information. In this process, auditing plays key role in determining amount of information validity. This research surveys the effect of some auditing properties with restating of loss and profit figures of accepted companies in stock exchange.

According to above explanations, the results of research hypotheses are following:

- **There is a significant relationship between auditor's turnovers with amount of restated figures in annual adjustments of company.**

According to statistical results, there is a significant positive relationship between audit turnovers with restating of loss and profit figures and restating of figures in balance sheet. Whatever audit's turnover increase, restating figures will be increased. About analyzing this hypothesis, there are criticisms that increasing auditor's turnovers will harm auditor's capabilities in role of validating to financial statements in recent years. In other side, legislative authorities concerns that increasing the frequency of auditor turnovers will decrease user's trust to all financial statements and not only the financial statements in the company which has been changed its auditor. In summary, changing auditor consist of replacing auditor from a private auditing institute to else private auditing institute which is a member of engaged auditors in stock exchange. Again, due to the necessity of providing comparative figures and consistency maintenance from one period to another period, it is always expected that provided figures for any financial components in financial reports in current period are equal with restated figures for same financial components in next year, but there is not this equality in some cases. Lack of equality in initial provided figures in financial statements with restated figures is due to changing in accounting procedures, errors, reviewing in done estimations by manager and changing in classifying items.

Among four abovementioned factors, only the first two factors (i.e. changing in accounting procedure and correction of errors) are components of classified annual adjustments and their effects are retroactive effect. In fact, number of restatements in this study is

occurred changes in result of one of the two mentioned factors and done changes have not been considered because of changing in classification and changing in estimations of numbers of occurred restatements. Generally, annual loss and profit account is the account records residual cumulative profit at the beginning of period and it is transformed with other permanent accounts from previous year to New Year. In current year, it is possible to two main reasons we lend that balances in last year are needed to modify or an error has been occurred related to identifying incomes and costs related to previous year or we have done the changes in accounting procedures which its effect is necessary on previous results (it occurs more rarely). The effect of annual adjustments should be reflected via correcting cumulative profit (loss) balance at the beginning of period in financial statements. Comparative figures of financial statement should be restated too. Generally and with above explanations, how auditor' turnover be more, the necessity of restating of financial statements will be more. This indicates that how companies use more auditor's job rotation, auditor' capability in validating financial statements will decrease and it is possible he/she make mentally mistakes. In other side, users' trust to all financial statements will decrease, not only the financial statement in the company which has been took over its auditor. Because financial statement is needed to restate and it should be amended permanently. The result of this research is compatible with the research done. They showed that there is a significant relationship between auditor' turnover and restatement of financial statements. In another side, this result is compatible with the research done, so that they noted that there is a significant direct relationship between restating financial statements and auditor's turnover. But this research is not compatible with the results of research conducted which the possibility of restating financial statement will decrease with increasing tenure.

- **There is a significant relationship between auditing institute size with amount of restated figures in annual adjustments.**

It should be noted in statistical analysis of this hypothesis that there is not a significant relationship between auditing institute size with restating profit and loss figures and also restating figures in balance sheet. So it can be said with higher from 95% confidence that H_0 is accepted and H_1 is rejected ($\text{sig} > 0.05$). The size of auditing company could not explain a percentage of changes in restating figures. In analysis of this hypothesis should be noted that while accounting regulatory reference emphasize on this

point that auditing quality is not related to company size. Many claim that big institutes make greater quality in auditing than small institutes. Previous researches reached to a combination of two hypotheses, perhaps measuring of auditing quality had been not a simple work. The income of auditing institute was determined as base for this variable. In another words, we classified auditing institutes in term of size with respect to institute income. Reason of lack of a significant relationship between restating figures in financial statements with size is that company size is not an influential factor for measuring auditing quality. The result of this hypothesis is compatible with the results of Alastair et al. (2011) researches which note that there is not a significant relationship between company size and auditing quality. Also, this research is compatible with the research conducted. They showed that there is not a significant relationship between the size auditing institute and auditing quality.

• **There is a significant relationship between types of independent auditor's opinion with amount of adjusted figures in annual adjustments.**

It should be noted that in statistical analysis of this research that there is significant (negative) relationship between the types of independent auditor's opinion with adjusted figures in annual adjustments with in confidence level higher than 95%. So H_0 is rejected and H_1 is accepted. In other words, whatever the type of auditor's opinions increase in companies, the restatement of figures will decrease. It should be noted in statistical analysis that a neutralized auditing report contributes to decide efficiently and create an efficient market. The main role of an independent auditor is to make trust and validate to financial statements. Naturally, high quality financial information has positive effect in making decision and optimized allocation of resources and efficient market, in turns, it leads to growth and develop social welfare. In another side, according to provided explanations about restated financial statements in first hypothesis, it can be said that whatever independent auditor states more acceptable opinion about financial statements, they will be amended lesser. Because an independent auditor do her/his legal duties based on rules and regulations. Statistically, this study uses virtual data for measuring type of auditor's opinion. Acceptable opinion is equal with 1 and other opinions are zero. According to this, whatever auditor's opinion is higher, her/his opinion will be more acceptable and the restatement of financial statement will be decreased due to mistake or procedure change. The result of this research is not compatible with Louise Henock's (2005) study. He showed that there is not a significant relationship

between the size of auditing institute with quality of services and opinion. But this research is compatible with the research conducted by Fuerman (2006). He showed that larger auditing firms make lesser mistakes in assessment.

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