

Effects of Auditing Institutions' Size and Type of Auditors' Statements on Auditing Institutions' changes of Listed Companies on Tehran Stock Exchange

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ABSTRACT: Nowadays, not only in academic areas but also among the ordinary people and organizations, auditors' independency is receiving increased attention which brought up the discussion of obligatory auditors' change. Considering the significance of this issue, the current study aimed to investigate some effective factors in auditing institutions' change. Therefore, the effects of "the type of auditors' statements" and "auditing institutions' size" on "auditing institutions' change" were assessed in this research. Target population of the study was consisting of 110 listed companies on Tehran stock exchange which had experienced the auditing institution's change at least once, over a 5-year-period, from 2010 to 2014. The obtained findings indicated that the type of auditors' statements and auditing institutions' size are not significantly associated with auditing institutions' change.

Key words: Auditing Institution's Change, Type of Auditor's Statement, Auditing Institution's Size

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INTRODUCTION

The expansion of economic units, information technology and conflicting interests have caused supervisory needs. Globalization of world market, economics and information revolution are all beyond the government's control. Much information about economic organizations is needed to be able to make decision. Conflicting interests have made it considerably difficult to rely on the collected data. Not having direct access to the required information, besides conflicting interests, have increased the necessity of auditor independence. In fact, auditors evaluate the level of information quality to offer to the users.

The Enron scandal, revealed in October 2001 in the United States, the Parmalat scandal in Europe, and net baking fraud cases in Iran or other financial crises have all challenged auditors and auditing quality. Politicians have considered efficient auditing as a key factor to improve auditing quality and auditor independence. The most valuable property of auditors can be their independence. As a matter of face, auditors are capable of earning if they are reliable enough to be free to approach a piece of work in whatever manner they consider best.

Therefore, many solutions have been suggested by experts and authorities in order to enhance the quality of audit reports and auditing organizations' independence. They mostly stated that the public

companies should be required and forced to automatically change or rotate their independent auditing firms. To further enhance independence, The Sarbanes-Oxley Act (SOX) calls for the mandatory change of the lead engagement partner every five years (Navaei & Jahanshad, 2012). In Iran, by virtue of paragraph 2, clause 10 ratified on July 30, 2007 by auditing organizations trusted by listed companies on Tehran stock exchange, auditing firms or the lead engagement partners must be changed after 4 years, and by law they cannot be again the independent auditor or the controller of the same legal person (Securities and exchange organization website, 2012).

The importance of auditing institutions has made the researcher appraise auditing institutions' change, so the effects of the type of auditors' statements and auditing institutions' size on auditing institutions' change were assessed in this research among listed companies on Tehran stock exchange.

Independence is the main specification of auditor independence. Mautz and Sharaf (1961) and Li (1972) regarded independence as evident condition of auditing. Enhancing auditor independence can increase the validity of financial statements and investors (Ghaemi & Hemmati, 2012).

Mandatory change is also recommended to develop auditor independence. Those who support the existence of mandatory change believe that long-term contractions between auditor and employer may be the main reason of the paucity of auditor

independence. Long association between auditor and employer does not let the auditor carry out his or her work freely and in an objective manner, so the auditor may have a tendency towards the employer's viewpoints which avoids auditor independence. Furthermore, mandatory auditor change can make auditors resistant to the managers' pressure and requests (Karbasi Yazdi & Chenari Yukat, 2012).

Chung (2004) concluded that mandatory change can enhance auditor independence (Chung, 2004). On the other hand, Depoeh et al. (2001) conducted an experimental study and examined auditors' tendency to report biased statements which support the managers. They found that mandatory auditor change can improve the level of auditor independence (Dopuch et al., 2004). Some influential factors in auditing institutions' change are explained as follows.

Auditing institution's size

Auditing institutions can be generally classified into big and small institutions. Differences in these institutions' effectiveness result from the differences in their managers' stimuli to report financial statements. When managers are motivated enough to increase the amount of interest by employing accounting methods, auditor independence can cause some conflicts between managers and auditors. Big auditing institutions can avoid interest manipulation more successfully and effectively than small institutions (assuming the existence of conflict between manager and auditor) (Hassas Yeganeh & Azinfar, 2010).

Francis and Yo found that bigger institutions are more qualified to discover the momentous manipulations due to their experienced employees. Dan et al. stated that bigger institutions are not concerned about losing their managers, since a large number of managers exist in these institutions; therefore, they place more emphasis on auditing in order to achieve more popularity (Heshi & Mazaheri Fard, 2013).

Luis Henok (2005) carried out a research and found that big institutions offer better services in proportion to small institutions. However, some small institutions provide good consultations for their employers (Hassas Yeganeh & Azinfar, 2010). Pour Behbahani (2008) concluded that there is a significant difference between auditor change and auditing institution's size (Pour Behbahani, 2008). Woo and

Chye koh (2002) found that auditor change mostly occur in the organizations in which small auditing institutions had audited the data (Woo et al., 2011).

METHODOLOGY

First hypothesis

There is a significant relationship between auditing institution's size and auditing institution's change.

The type of auditor's statements

An independent statement, unbiased and fair, can drastically help to make decision and create an efficient market. The findings of conducted studies indicate that the paragraphs of auditing reports negatively affect stock prices, so the companies which receive qualified report are more likely to rotate their auditor. Wu and Chiko found that qualified statements of auditors directly influence auditor change (Woo and Chye koh, 2011). Reza Zadeh and Zarei Moravej (2009) concluded that the type of auditor's statements can be applied as a pattern to predict the firm's auditor change (Reza Zadeh and Zarei Moravej, 2009).

Chadegani et al. (2011) carried out a research which proved there is no significant relationship between the type of auditor's statements and auditor change (Chadegani et al., 2011).

Second hypothesis

There is a significant relationship between the type of auditor's statements and auditing institution's change.

Target population and research sampling

Target population of the current study was comprised of all listed companies on Tehran stock exchange from 2007 to 2011 which had the following conditions:

1. Financial year of the firm ended in March.
2. An auditor change has happened during the period of at most four years, and audited financial statements were in access from 2010 to 2014.
3. They should not belong to investment companies or mediation offices, insurance companies or banks.

Considering the aforementioned conditions, 149 companies were chosen as the target population of

the research. Among 149 companies, 39 companies had partner change, not auditor change, so they were omitted from research sample. Finally, 110 companies were regarded as the research sample.

Data collection

Auditing institution's change: Auditing institution's change stands for auditor change of a business firm during a period of at most four years and choosing among other qualified auditing institutions as the new auditor.

Auditing institution's size: In this study, like the other researches conducted by Azinfar, Pour Behbahani and Ebrahimi, the discrete variables of 0 and 1 were utilized to calculate the institution's size. In other words, big auditing institution's size was considered 1, and members of big institutions were regarded as small auditing institutions which got 0.

The type of auditor's statements: To evaluate the type of auditor's statements, auditing reports were studied in preceding and following years of auditor change. In the present study, like the studies carried out by Reza Zadeh and Zarei (2009), discrete variables of 0 and 1 were employed to calculate the type of auditor's statements. Number 1 was needed to accept

the auditor's statement and other statements which got zero were rejected.

Research hypotheses testing

A binomial test was applied to test research hypotheses. H0 indicates an insignificant relationship and H1 indicates a significant relationship between the variables.

$$\begin{cases} H_0 : P < p_0 \\ H_1 : P \geq p_0 \end{cases}$$

First hypothesis testing: There is a significant relationship between auditing institution's size and auditing institution's change.

The results of binomial test are shown in table 1 which demonstrate significance level of 0.000 (less than 0.05). Due to the fact that the proportion of findings which approve the effectiveness of auditing institution's size in auditor change to the findings which do not approve this hypothesis is about 3% to 97%, this conclusion can be drawn that there no significant association between auditing institution's size and auditing institution's change.

Table 1. Results of binomial test of the first hypothesis

The relationship between auditing institution's size and auditing institution's change	Group	Number of observation	Observed proportions for each group	Test's proportion	Significance level
H0 (ineffective)	0.00	139	0.97	0.50	0.0001
H1 (effective)	1.00	5	0.03	--	--
Total	--	144	1.00	--	--

Second hypothesis testing: There is a significant relationship between the type of auditor's statements and auditing institution's change.

The results of binomial test demonstrated in table 2 indicate the significance level of 0.001 which is less than 0.05. Owing to the fact that the proportion of

findings which approve the effectiveness of the type of auditor's statements in auditor change to the findings which do not approve this hypothesis is about 36% to 64%, this conclusion can be drawn that there no significant association between the type of auditor's statements and auditing institution's change.

Table 2 . Results of binomial test of the second hypothesis

The relationship between auditing institution's size and auditing institution's change	group	Number of observation	Observed proportions for each group	Test's proportion	Significance level
H0 (ineffective)	0.00	92	0.64	0.50	0.001
H1 (effective)	1.00	52	0.36	--	--
Total	--	144	1.00	--	--

CONCLUSION AND SUGGESTIONS

The findings of this study indicate that the variables of the type of auditor's statements and auditing institution's size are not significantly associated with the variable of auditing institution's change. Considering the conducted researches, it can be alleged that auditor change is accompanied with various positive and negative effects. Some scholars have regarded auditor change as a positive factor due to its effects on independence enhancement and auditing quality improvement. However, some researchers counted it as a negative factor in auditing quality which increases auditing costs; therefore, it is suggested to ponder over its application.

By and large, the findings of the current study demonstrate that auditor change results from many known and unknown factors, and financial statements' users should be aware of this specification. In fact, auditor change ought to improve auditor independence, and authorities should codify the policies of auditor change in a way that unqualified and illegitimate factors cannot change auditors. According to the statements of authorities in Tehran stock exchange and supervisory boards which observe the institutions' financial reports in different countries, this conclusion can be drawn that official and regular auditor change can help potential and actual investors to make decisions apropos of stock exchange. Delivered reports by the aforementioned authorities indicate that auditing institution's change brings a positive impression of this strategy to the beneficiaries' mind.

Regarding the results, it is recommended to pay more attention to the auditors who are certified accountants, and provide a competitive environment. An opportunity should be also given to the auditors to fill a highly specialized position. The assessment of changing the partners or the cadre of auditors in an auditing institution is suggested instead of auditing institution's change. In this way, auditor independence is also retained and auditing costs decrease.

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