The Relationship between of Auditor Rotation (Voluntary/Mandatory) on Firms Auditing Quality is affected by the Size

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ABSTRACT
This research has studied, The relationship between of auditors rotation (voluntary/mandatory) on firms auditing quality is affected by the size. For this purpose, the two measures of discretionary accruals and stock market value, is used to demonstrate the quality of audit. So that, the interaction between correlation coefficient discretionary accruals and stock market value on the one hand and discretionary accruals on the other hand. In this research, information on 79 companies for during (2007-2012), as a hybrid system using a combination of regression and logistic regression analysis were used. The results showed, auditors rotation (voluntary/mandatory), not have a significant impact on audit quality.

KEYWORD
Mandatory auditor rotation, Voluntary auditor rotation, Audit quality, Audit size

INTRODUCTION
World happenings, including the economic crisis, has led to a tendency of the fundamental role of financial reporting is reliable and high quality. It shows the importance of audit quality in other aspects of financial reporting [3]. Recent financial scandals around the world such as Enron and Worldcom in America and in Europe Parlamat, has created concerns about the reliability of the financial statements. While the primary responsibility for preparing the financial statements is the responsibility of management, but in the wake of these events, the majority of the blame auditors. So commonly refer to these events as an audit failure. Also it should be noted that the independence is basis and spirit of the audit, and is not of value audit without independence is. Public confidence and capital market in the auditors, due to their independence.

The factors threatening the independence of auditors should always be examined [10]. Lawmakers to mandatory auditor rotation, showed particular interest. In general, legislators and capital market participants are interested in knowing the subject whether long-term relationship between the firms and the auditors could undermine auditor independence and audit quality? [12] So, Concerns arising from long-term relationships auditor and client on the audit quality, Caused the legislation, which restricts the relations, While, mandatory auditor rotation, as a tools to enhance the independence and audit quality has attracted the attention of legislators, there is conflicting evidence in support [15]. Due to concerns of legislation about the effects of auditor tenure, the present study deals with the relationship between auditors rotation (voluntary/mandatory) on firms auditing quality is affected by the size.

A) THEORETICAL
A,A) Audit institutions rotation
In this research, the issue of mandatory audit institutions rotation deal. Tehran Stock Exchange organization guidelines, the audit firm should be replaced every 4 years. Clause 2 of article 10 of the Tehran stock exchange, guidelines, stipulating that: ((Audit institutions and partners responsible for the audit work, after 4 years, has once again not allowed the independent auditor or the statutory inspector of a firm. People learn to accept this audit at least 2 years after the end of the 4 years old is allowed.)) [17].

A,B) Available perspectives on audit firm rotation
Effects of long-term relationships auditor and auditee on the audit quality, can be investigated from two perspectives. Long -term relationship between auditor and auditee, the auditor makes the learn client specific knowledge, it leads to increased professional competence of auditors and audit quality will ultimately increase. On the other hand, the continued selection of the auditor, the auditor may be too close to the auditees management, it will have a negative impact on auditor independence and audit quality is reduced [5].

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One of the solutions proposed, mandatory audit institute is required to change. The Supreme Audit Court America, the audit institute rotation, restrictions on consecutive years that an independent audit institute can audit the financial statements of a particular firm, has defined [1]. Therefore, the main question about mandatory auditor rotation defined, if required by the mandatory auditor rotation, audit quality is increased? [2].

Long term relationship between auditor and auditee, possible duplication of audit work to the auditors appear. This is, reduces the auditors professional competence. Shochley in 1982 believes that the continued selection of the auditor makes a lot of confidence, lack of innovation, reduce the use of exact methods in the auditors [14].

Requiring mandatory auditor rotation, audit costs will increase. Sinnett in 2004 believes that, all major auditing institutes are of the opinion that auditing costs for the first year of mandatory auditor rotation is enough, more than 20% of auditing fees in subsequent years will be [16].

Also, requiring mandatory auditor rotation, will increase the firms costs. Arrunada in 1997 believes that, management of auditee firm and its employees have a lot of time to spend to learn new auditor with topics such as : type of operation, tax status, the system of internal controls [3].

On the other hand, Li in 2007 believes that, positive effects and negative relationship between auditor and auditee, such as the acquisition of expertise about a particular audit or reduced auditor independence by getting too close to the client, thus canceling out each the others effect [12].

A,C) The effect of auditors rotation (voluntary/mandatory) on auditing quality

The separation of ownership from management in joint stock companies, conflicts of interest between managers and external stakeholders of the company’s. In order to reduce agency costs, reports prepared by management must be audited by an independent persons and qualified audit. Auditing value depends on the audit quality. Also audit quality depends on the competence and independence of the auditors. Therefore, mandatory auditor rotation was considered as a solution to increase independence. Carey and Sinnett in 2006 found that the continued selection of auditors is reduced audit quality [6]. Research results from Chung in 2004 and Fairchild et al in 2009 showed, long – term relationship between the auditor and the auditee is reduced audit quality [7].

Dan Li in 2010 believes that auditors in the audit of long have a sense of loyalty to their employer. This topic will reduce audit quality. As a result, mandatory auditor rotation is increased audit quality. On the other hand, opponents of mandatory rotation of auditors, believes that the long relationship between auditor and auditee, the auditor world understand more of the firm’s internal controls, and is increased audit quality [8]. Myers et al (2003) and Vanstraalen (2007) found that, there is a direct relationship between the persistence of selecting an auditor to audit quality [13]. Jackson et al (2008) believes that, the long relationship between auditor and auditee, no significant impact on audit quality and on the other hand, research results Gunny et al (2007) and Cameran et al (2008) and Hassas Yeganeh et al (2010) showed, the relationship between the auditor and the client is prolonged, will lead to an increase in audit quality [9].

B) Methodology
B.A) Type of research

This research, based on objective practical research, because the purpose of practical research developing practical knowledge in a particular field. On the other hand, the present study is a descriptive study.

B.B) Methods of data collection

For the theoretical basis is used of the documents, books, articles, Iran scientific evidence and scientific search on the internet. Data, statistics and information required research have been extracted of financial statements of firms in Tehran stock exchange, annual report on the Tehran stock exchange, website management research. Than in order to perform calculations and also, the analysis of data from SPSS version 19 software and STATA software were used to test hypotheses.

B.C) Statistical sample

The research statistical population, all non financial companies (manufacturing) accepted in Tehran stock exchange from 1379 to 1382. The samples in this study using a screening method and is selected according to the following criteria:
1) Full information of each of the firms included in the study during the period of investigation.
2) Firms during the study period, fiscal year have not changed.
3) Investment firms and financial intermediation are removed from the sample, because this study was not suitable for measuring the operational structure of the firms.
4) End of the financial year of the study, in Persian date Esfand 29.
5) For each industry, there must be at least 4 year-firm.
6) Book value of equity must be positive.
7) Trading intervals up to 6 months.

According to the above conditions, 79 year-firm for the period 2007 until 2012, were selected as research sample.

B.D) Research hypotheses

Hypothesis 1- Negative relationship between mandatory auditor rotation and audit quality, adjustment is affected by the auditor size. The following model was used to investigate the above relation:

Model 1: \( AudQ = \alpha_0 + \alpha_1 MROT + \alpha_2 CFO + \alpha_3 SIZE + \alpha_4 LEV + \alpha_5 BIG + \alpha_6 MROT \times BIG + \epsilon_i \)

According to above model, we expect: \( |\alpha_6| < |\alpha_1| \)

Hypothesis 2- positive relationship between voluntary auditor rotation and audit quality, adjustment is affected by the auditor size. The following model was used to investigate the above relation:

Model 2: \( AudQ = \alpha_0 + \alpha_1 VROT + \alpha_2 CFO + \alpha_3 SIZE + \alpha_4 LEV + \alpha_5 BIG + \alpha_6 VROT \times BIG + \epsilon_i \)

According to above model, we expect: \( |\alpha_6| > |\alpha_1| \)
In these models, MROT: mandatory auditor rotation, VROT: voluntary auditor rotation, ROA: range of assets that the aggregate gross revenues divided by total assets of the business unit, LOSS: loss of business unit, OPINION: independent auditors opinion on the financial statements of the auditee, BIG: audit institute size, SIZE: size of firm I and in year t, AUDQ: audit quality. For this purpose, the two measures of discretionary accruals and stock market value, is used to demonstrate the quality of audit. So that, the interaction between correlation coefficient discretionary accruals and stock market value on the one hand and on the other hand discretionary accruals.

To obtain discretionary accruals from the Jones model is used:

\[
\frac{ACCR_t}{At-1} = \alpha_1 \left( \frac{\Delta REVL_t}{A_{t-1}} \right) + \alpha_2 \left( \frac{\Delta PPE_t}{A_{t-1}} \right) + \epsilon_t
\]

\[
\alpha_0, \alpha_1, \alpha_2, \epsilon_t: \text{Company specific parameters, PPE: Property, plant and equipment, gross, } \Delta \text{REV. The difference this year compared to last year's sales and } \epsilon_t: \text{The estimated error}
\]

C) Data analysis

C.A) Descriptive statistics

Descriptive statistics, including the methods used to muster, summarization, classification and numerical description of the facts. In fact, described the data in information and overall pattern of data to make better use provides. Therefore descriptive statistics can be expressed features a bunch of information. Central and dispersion parameters are used for this purpose. These criteria are the main characteristics of the data set are expressed as a number. In this section, descriptive circumstantial evidence for the research variables presented. In this study, data relating to 79 year-firm in between (2007-2012) were collected. A summary of the descriptive statistics research variables shown in table 1, which consists of three separate sections under the headings central index (average, minimum, maximum), dispersion index (standard deviation, skewness coefficient, elongation coefficient) and normal test. Also table 2 shows the number and percentage of firms with high and low audit quality.

Table (2): firms audit quality

<table>
<thead>
<tr>
<th>Year</th>
<th>High audit quality</th>
<th>Low audit quality</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percent</td>
</tr>
<tr>
<td>2007</td>
<td>22</td>
<td>0.278</td>
</tr>
<tr>
<td>2008</td>
<td>24</td>
<td>0.309</td>
</tr>
<tr>
<td>2009</td>
<td>26</td>
<td>0.33</td>
</tr>
<tr>
<td>2010</td>
<td>20</td>
<td>0.25</td>
</tr>
<tr>
<td>2011</td>
<td>18</td>
<td>0.23</td>
</tr>
<tr>
<td>2012</td>
<td>12</td>
<td>0.15</td>
</tr>
</tbody>
</table>

Table (2) shows that in 2009 most of the firms are of high quality, so that 33% are high audit quality, the least number of firms with high audit quality is related to the year 2012, this year 12 firm with high audit quality.

C.B) The first hypothesis tests

Hypothesis 1- Negative relationship between mandatory auditor rotation and audit quality, adjustment is affected by the auditor size. The above hypothesis is statistically expressed: \( H_0: \) Negative relationship between mandatory auditor rotation and audit quality, adjustment does not affected by the auditor size. \( |\alpha_4| \geq |\alpha_1| \)

\( H_1: \) Negative relationship between mandatory auditor rotation and audit quality, adjustment is affected by the auditor size. \( |\alpha_4| < |\alpha_1| \)

Likelihood ratio test for comparison between two temporal patterns and random effects are presented in table (3):

Table (3): Likelihood ratio test

<table>
<thead>
<tr>
<th>Pattern</th>
<th>Circumstantial evidence</th>
<th>P-Value</th>
<th>Test result</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>153.05</td>
<td>0.000</td>
<td>Using fixed effects</td>
</tr>
</tbody>
</table>

As regards P-Value less than 0.05, being the null hypothesis (\( \rho = 0 \)) is rejected. In other words, random effects approach is more appropriate. The first model is used the random effects method. The result is presented in table (4):

Table (4): Analysis of Regression Model 1

<table>
<thead>
<tr>
<th>variable</th>
<th>coefficients</th>
<th>Standard deviation</th>
<th>T test</th>
<th>Significance level</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>16.59</td>
<td>7.97</td>
<td>2.08</td>
<td>0.04</td>
<td></td>
</tr>
<tr>
<td>MROT</td>
<td>0.48</td>
<td>0.51</td>
<td>0.93</td>
<td>0.35</td>
<td>1.2</td>
</tr>
<tr>
<td>CFO</td>
<td>-2.94</td>
<td>1.35</td>
<td>2.18</td>
<td>0.03</td>
<td>1.24</td>
</tr>
<tr>
<td>SIZE</td>
<td>-0.65</td>
<td>0.30</td>
<td>-2.18</td>
<td>0.03</td>
<td>1.25</td>
</tr>
<tr>
<td>LEV</td>
<td>-2.23</td>
<td>1.66</td>
<td>-1.34</td>
<td>0.18</td>
<td>1.29</td>
</tr>
<tr>
<td>BIG</td>
<td>-0.50</td>
<td>0.74</td>
<td>-0.67</td>
<td>0.50</td>
<td>1.3</td>
</tr>
<tr>
<td>MROT*BIG</td>
<td>-22.57</td>
<td>68024.16</td>
<td>0.00</td>
<td>1.00</td>
<td>1.25</td>
</tr>
</tbody>
</table>

Likelihood ratio test(Significance level) : 14.98 (0.0204)
As regards variance inflation factors (VIF) for all independent variables in the model is less than 5, there is no multi collinearity between the independent variables. On the other hand, the Significance level is less than 0.05, so, there is 95% significance relationship between independent variables and dependent variables. Wald test results for the ($\alpha_1$) and ($\alpha_6$) coefficients are presented in table (5):

<table>
<thead>
<tr>
<th>Table (5): Wald test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statistical value</td>
</tr>
<tr>
<td>0.01</td>
</tr>
</tbody>
</table>

Thus, P-Value in Wald test is more than 0.05, not reject the assumption of equality of ($\alpha_1$) and ($\alpha_6$). As a result, the first hypothesis is rejected at the 95% level.

The above hypothesis is statistically expressed:
\[ H_0: \text{Positive relationship between voluntary auditor rotation and audit quality adjustment is affected by the auditor size.} \]

\[ H_1: \text{Positive relationship between voluntary auditor rotation and audit quality adjustment is affected by the auditor size.} \]

Likelihood ratio test for comparison between two temporal patterns and random effects are presented in table (6):

<table>
<thead>
<tr>
<th>Table (6): Likelihood ratio test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pattern</td>
</tr>
<tr>
<td>2</td>
</tr>
</tbody>
</table>

As regards P-Value less than 0.05, being the null hypothesis ($\rho = 0$) is rejected. In other words, random effects approach is more appropriate. The second model is used the random effects method. The result is presented in table (7):

<table>
<thead>
<tr>
<th>Table (7): Analysis of Regression Model 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>variable</td>
</tr>
<tr>
<td>C</td>
</tr>
<tr>
<td>VROT</td>
</tr>
<tr>
<td>CFO</td>
</tr>
<tr>
<td>SIZE</td>
</tr>
<tr>
<td>LEV</td>
</tr>
<tr>
<td>BIG</td>
</tr>
<tr>
<td>VROT*BIG</td>
</tr>
</tbody>
</table>

Likelihood ratio test(Significance level): 13.36 (0.037)

As regards variance inflation factors (VIF) for all independent variables in the model is less than 5, there is no multi collinearity between the independent variables. On the other hand, the Significance level is less than 0.05, so, there is 95% significance relationship between independent variables and dependent variables. Wald test results for the ($\alpha_1$) and ($\alpha_6$) coefficients are presented in table (8):

<table>
<thead>
<tr>
<th>Table (8): Wald test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statistical value</td>
</tr>
<tr>
<td>0.00</td>
</tr>
</tbody>
</table>

Thus, P-Value in Wald test is more than 0.05, not reject the assumption of equality of ($\alpha_1$) and ($\alpha_6$). As a result, the second hypothesis is rejected at the 95% level.

D) Conclusions

The results of research hypotheses, corresponded with research Chen et al (2004) showed that there is no significant relationship between auditor tenure and discretionary accruals. Nagy et al (2005) showed that in small firms, after the collapse of Arthur Andersen auditing firms, forced to change their auditors to have another independent auditor, auditors rotation not have a significant impact on audit quality, Jackson et al (2008) showed that auditor rotation due to the high costs imposed on capital markets is not beneficial, and not have a significant impact on audit quality. and does not match with research Chia and Karlsson (2012), Gul and Basioudis (2010), Dan Li (2010) and Fairchild et al (2009).

Results in a 5% error level, indicates that auditor rotation (voluntary/mandatory), has no significant influence on audit quality and the impact of auditor quality is affected by the size. In other words, auditor rotation (voluntary/mandatory) is on audit quality has neutralizing effect.

D.A) Suggestions for research results

Based on the results of the present study, Rotation (voluntary/mandatory) auditors of Listed Companies in Tehran Stock Exchange, has no significant relationship with audit quality. Accordingly, it is recommended:

Corporate Audit, when developing regulations to increase audit quality should note that due to the high costs of switching auditors imposed on companies, perhaps the limitation of auditor rotation is not a good way to increase audit quality.

D.B) Suggestions for Future Research

1) Examine the impact of mandatory rotation of auditors on accounting conservatism.
2) Examine the impact of mandatory auditor rotation on auditor independence in appearance.

D.C) Research limitations

Since the mandatory rotation of auditors was approved in 2007, therefore, financial information between (2007-2012) were collected.

REFERENCES


