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EXAMINING THE EFFECT OF QUALITY CHARACTERISTICS OF INDEPENDENT AUDITOR ON ABNORMAL ACCRUALS IN LISTED COMPANIES IN STOCK EXCHANGE FROM 2009 THROUGH 2012

Mohsen Rashidi^{1,2}, *Mehrdad Ghanbari^{2,3} and Rahmatollah Mohammadipour^{1,4}

¹Department of Accounting, Ilam Sciences and Research Branch, Islamic Azad University, Ilam, Iran

²Department of Accounting, Ilam Branch, Islamic Azad University, Ilam, Iran

³Department of Accounting, Kermanshah Branch, Islamic Azad University, Kermanshah, Iran

⁴Department of Accounting, Ilam Branch, Islamic Azad University, Ilam, Iran

**Author for Correspondence*

ABSTRACT

The purpose of this paper examine the impact of accruals audit quality independent variables in the study area. accruals from one side to allow managers to calculate accruals so that indicates the actual value of the enterprise is and on the other hand these items are available to managers accepted accounting principles and methods of flexibility to exploit and distorts the information content of accruals stakeholders outside companies as creditors and investors cannot be directly the opportunistic behavior of mangers to control. Therefore precise handling and high quality auditors can accruals managers reduce accruals limit other studies have also shown that this issue is survey results have shown the positive correlation between the size cpa firm and abnormal accruals and the t-statistic equal to 2.24 and 0.0009 has also achieved a significant level the competition between audit firms and abnormal accruals in t-statistic equal the -2.91 and (0.03603) there is a significant level obtained non-audit services by the audit firm and abnormal accruals in t-statistic 4.48 and (0.06259) there is not a significant level division of labor between the audit firm and the t-statistic abnormal accruals in 3.007 and (0.09941) there was not a significant level. The monitoring and audit firm abnormal accruals in the t-statistic 3.71 and (0.04769) there was a significant level international auditing and consulting firm abnormal accruals in the t-statistic 4.23 and (0.02162) there was a significant level the monitoring and audit firm abnormal accrual in the t-statistic 2.39 and (0.04944) there was a significant level the main objective of this research is setting between certain characteristics of the independent audit detection of the abnormal accruals and the main hypothesis of the study that suggests among the features of the independent audit and detect abnormal accruals and there is a significant positive certain the statistic society of the study was to examine the Tehran stock exchange listed companies in various and industries and groups the purpose of this research is based on the type of application and the based on the method of investigation is descriptive and correlational branches. In this study to measure correlation between variables in multivariate regression and fisher test showing for the significance of the models and t statistic used for significance of regression coefficients.

Keywords: *Abnormal Accrual, Independent Audit, Auditions Tuition, Non- Audit Service*

INTRODUCTION

In new financial behavioral theories, it is supposed that investor's especially inexperienced ones make mistakes systematically in accruals pricing (Gang, 2010). Researchers like Zay (2001), Jeng and Thomas (2006), Kank *et al.*, (2010) believe that inappropriate pricing is related typically to abnormal accruals not to normal ones, because observing abnormal accruals by market may lead to inappropriate pricing of stocks, so that inappropriate reaction of investors towards changes of normal accruals causes that shares of companies with different volumes of normal accruals are values in an inappropriate way and higher or lower than their actual value (Khani and Ibrahim, 2013). Audited statements are regarded as bases of companies, which are determined for public uses, because users of non-audited statements are influenced by fraud and financial scandals. Therefore, auditing financial statements are considered by users. Beneston believed that managers are more interested to report their results of performance and financial

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status unrealistically. The result is to form asymmetric information between company and users. Some issues such as profit management, and its repetition and determination finally would lead to reducing share's price. Hence it is obvious that independent auditors play a key regulative role in assuring accuracy of accounting figures and minimizing costs resulted from opportunism incentives of managers. In fact it can be said that audited statements valued by auditor's opinion would be final output of relation between management and auditors. Butler states that the role of auditors is limited; they have no autonomy of describing and analyzing whole quality of profit as much as complying financial statements with accounting standards (Tsipouridou *et al.*). Conceptually, auditing quality can be examined from three major aspects: input, output, and environmental factors except for auditing standards. There are other inputs for auditing. One of them is characteristics of independent auditor such as institute size, professional regulations, skills, division of labor and supervision, consulting, and its control. One of other important factors is auditing process. This process includes accuracy of auditing methodology, the level of effect of applied auditing methods, and the level of access to required auditing proofs. Moreover, auditing outputs have important consequences for quality of audit, because outputs are considered by users in evaluating quality of audit (Chin *et al.*, 2008). Activities like terminating auditing practice and profit management takes place often in economic mess to prevent more costs. In addition, quantitative diagnosis of profit management is more difficult (Constantinus and Lankse, 2008). Many current studies in profit management focus on discovering abnormal accruals. Moreover, a few studies have been done for examining the effect of independent audit characteristics on abnormal accruals. Respecting significance of these accruals and auditors' report, the researcher intended to examine the relation between these two.

Research Background

Foroughi *et al.*, have examined the effect of latent output on the relation between normal accruals and subsequent output of stocks. Their study indicates that there is a reverse and significant relation between normal accruals and subsequent output of stocks (abnormal accruals). In other words, by inserting this variable to research pattern, the reverse and significant relation of normal accruals and subsequent output of stocks is disappeared.

Foroughi *et al.*, (2012) examine the effect of normal accruals quality on structure of debts. They apply generalized momentum regression and concluded that companies with low quality of normal accruals would have shorter periods of debts than companies with higher normal accruals.

Haghighat and Bakhtiari (2011) studied the subject of information content increasing normal accruals anomaly comparing with operating cash flows. Their results indicate presence of normal accruals anomaly just in the whole approach of normal accruals. In addition, in the whole approach of normal accruals, operating cash flows decrease descriptive strength of abnormal accruals in subsequent output of stocks.

Alastair *et al.*, (2011) in Canada examined that "do differences of audit quality indices in big audit institutes versus small ones related to characteristics of considered unit?" One of audit quality characteristics considered by them was abnormal accruals. They found out that effects of big audit institutes on abnormal accruals on considered unit has insignificant difference towards effects of small audit institutes on abnormal accruals of unit (Alastair *et al.*, 2011).

Boone *et al.*, (2010) in U.S. found out that inclination of four big institutes for issuing report of activity continuation for clients with deteriorating situations is not different from second order auditors. There is no difference between level of profit management by clients of four big institutes and second order clients, while predicted equity risk of stock owners for clients of four big institutes differs from clients of second order institutes (Boone *et al.*, 2010).

Theoretical Considerations

Abnormal Accruals (Conceptual Definition)

Abnormal accruals are those accruals controlled by management. In other words, abnormal accruals are those can be deferred, left out, registered by management or their identification can be accelerated (Hallaj and Mehrani, 2009).

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Abnormal Accruals (Operational Definition)

Normal accruals- total accruals- abnormal accruals

$$\frac{ACC_{i,t}}{A_{i,t-1}} = \alpha_1 \frac{1}{A_{i,t-1}} + \alpha_2 \frac{\Delta REV_{i,t}}{A_{i,t-1}} + \alpha_3 \frac{PPE_{i,t}}{A_{i,t-1}} + \gamma_1 \frac{CF_{i,t-1}}{A_{i,t-1}} + \gamma_2 \frac{CF_{i,t}}{A_{i,t-1}} + \gamma_3 \frac{CF_{i,t+1}}{A_{i,t-1}} + \gamma_4 \frac{DCF_{i,t}}{A_{i,t-1}} + \gamma_5 \frac{DCF_{i,t} * CF_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t} \quad (1-1)$$

In which,

ACC_{i, t}: total accruals of company I in year T, which equals net profit prior to extraordinary items minus operating cash flows) $ACC_{i,t} = E_{i,t} - CF_{i,t}$)

ΔREV I,t: changes in income of company I in year t

PPE_{i,t}: equipment , machineries of company I in year t

A_{i, t-1}: total assets of company I in year t-1

DCF i,t: it is a dummy variable, if CG (operating cash flows) is negative, it equals 1 otherwise it equals zero.

After estimating of parameters in relation (1), abnormal accruals based on Jones model adjusted by nonlinear cash flows $AA_{i,t[NC]}$, difference of normal accruals $NA_{i,t[NC]}$ from total accruals are calculated for estimation as follows using relation (2):

$$AA_{i,t} = ACC_{i,t} - [\alpha_1 + \alpha_2(\Delta REV_{i,t} - \Delta REC_{i,t}) + \alpha_3 PPE_{i,t} + \gamma_1 CF_{i,t-1} + \gamma_2 CF_{i,t} + \gamma_3 CF_{i,t+1} + \gamma_4 DCF_{i,t} + \gamma_5 DCF_{i,t} * CF_{i,t}] \quad (2-1)$$

Offering operating definition for research variables is necessary especially for variables and concepts that have not available definition and there no consensus about them.

In order to obtain a single approach towards research variables and preventing different interpretations, operating definitions of research variables are offered.

Relying on performance of internal audit: to approve obtained results from internal audit is applied as an alternative of obtained results from content tests by independent auditors (Maham, 2009).

Independent auditor (conceptual definition): a person practicing auditing, who is not employer of audited organization (Hassasyeganeh, 2009).

Independent auditor (operating definition): a multi- variable regression model with 2 response variables would be as follows:

$$Y = \beta + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

This model is applied for two hypotheses of study, in which;

Y: variable of independent auditors' reliance on performance of internal auditors

X₁: variable of independent auditors' experience

X₂: variable of quality characteristics of internal auditing

β_{i,j}: coefficients of independent variables

MATERIALS AND METHODS

Research Methodology

Regarding research purpose, research method is a descriptive way. Descriptive method way includes a set of methods, whose purpose is to describe situations with considered phenomena. These methods are applied during present research for measuring variables correlation by multi-variable regression. In order to show significance of this pattern Fischer test was used and to show significance of regression coefficient, T statistic was used. After collecting related data of financial statements form selected sample companies, independent and dependent variables were calculated in Excel software and Eviews, and then rejecting or confirming hypothesis at confidence level of 95% is evaluated. Issues examined during this research are related to effect of quality characteristics of independent auditor on abnormal accruals in terms of subject domain and its place domain is located in Tehran stock exchange. In terms of time, this study was implemented from 2009 through 2012.

Major hypothesis: characteristics of independent auditor have an effect on identifying abnormal accruals.

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Secondary Hypotheses

1. Size of audit institute has an effect on abnormal accruals.
2. Competition among audit institutes has an effect on abnormal accruals.
3. Non-auditing services of audit institute have an effect on abnormal accruals.
4. Labor division of audit institute has an effect on abnormal accruals.
5. Supervising of audit institute has an effect on abnormal accruals.
6. Consultancy of audit institute has an effect on abnormal accruals.
7. Controlling and reviewing audit institute has an effect on abnormal accruals.

Table 1: Results from regression model fit

Variable	Coefficient	SD	T-value	Significant level
Characteristics of independent auditor	5042.85	415285.21	4/16265	0/008754
Size of audit institute	5124620/25	10350/25	2/155938	0/00012
Competition among audit institutes	715428/35	186254/9	-2/5749215	0/03215
Non-auditing services of audit institutes	31579/68	2410/81	4/32057	0/072105
Labor division of audit institute	70321/58	420183/24	3/51248	0/12587
Supervising of audit institute	406357/5	106842/9	3/90217	0/03021
Consultancy of audit institute	41050/91	102548/92	4/512305	0/025105
Control and review of audit institute	319325/1	41258/5	2/05482	0/04621

Respecting results by regression model and t-value and also obtained significance level, it can be said that at error level of 5%, there is a positive significant relation between characteristics of independent auditor and its components and abnormal accruals.

Conclusions and Suggestions

Normal accruals are regarded as one of debating subjects between investors, legislators, analyzers, and general users of statements. As Fischer states, normal accruals are regarded as meaningful interference of managers in process of outer-organizational financial reporting. One of ways for reducing normal accruals is to promote quality of auditing, because companies that manipulate and manage normal accruals are more opt to have adjusted audit reports (non-approved reports).

Respecting previous researches, it can be said that quality of audit would reduce level of discretionary accruals. Researchers apply variables 8, 6, 5, or 4 big audit institutes and expertise of audit institute form considered industrial unit for evaluating quality of audit (size of institute).

1. By regarding obtained results from testing hypothesis.1, it is suggested to managers to seek for an auditing institute with larger size proportionate to budget of enterprise.
2. By considering obtained results from hypothesis.2, it is suggested to auditors to hold courses, tests, and offering degrees to auditing institutes for increasing and establishing competitive place among auditing institutes.
3. Regarding obtained results from hypothesis.3, it is suggested to managers and investors to improve quality of auditing their financial statements to sign a contract with their considered audit institute and for other required financial services, they may sign some other contracts with other institutes. This causes increase of focus in auditing institute.
4. Regarding results from hypothesis.4, it is suggested to audit institutes not to be sensitive about labor division in order to improve quality of their practice. Instead, they rely on other characteristics and also it is suggested to managers to establish an internal control system for gaining a desirable audit process in the enterprise.

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5. By considering results from hypothesis.5, it is suggested to investors to emphasize on supervising by audit institutes for promoting quality of accruals. This supervision should be implicit or be sectional such as supervising inventory counts.

6. Respecting obtained results from hypothesis.6, it is suggested to investors and managers to choose an audit enjoyed by experienced consultants in all areas. Also, it is suggested to audit institutes make annual contracts with different experts for improving their credit.

7. Regrading obtained results from hypothesis.7, it is suggested to audit institutes that through improving content quality of checklists and respecting hierarchies for control and reviewing, auditing may be done by supervisors, managers, technical managers, and institute partners.

Suggestions for Further Readings

1. during present study, the effect of independent auditor characteristics on abnormal accruals has been examined, however this point that which characteristic has more importance and can have more effects on disclosing or lack of disclosing abnormal accruals has not been examined. Therefore, future studies can examine effect of each quality characteristic on abnormal accruals in a comparative way.

2. During present study, the level of discretionary accruals of listed companies of Iran stock exchange was examined; hence it is suggested to future researches to compare this level to other countries or developed countries.

3. Some quality characteristics of independent auditors of Iranian association of certified public accountants was examined and studies, which can be studied and compared to characteristics of audit institutes outside of Iran during future studies.

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