



The relationship between audit tenure and audit opinion in Tehran Stock Exchange

*Yaser Gerami*¹ and *Hamidreza Kordlouie*²

1- Department of Accounting, Electronic, Branch, Islamic Azad University, Tehran, Iran Yaser6540@yahoo.com

2- Assistant Professor, Department of Financial Management, International branch, Islamic Azad University, Qeshm, Iran

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ABSTRACT

The major goal of the present research is to study the relationship between audit tenure and audit opinion in firms enlisted in Tehran Stock Exchange. The statistical population for the present study includes all firms in Tehran Stock Exchange enlisted during the years between 2008 and 2014 and the sample comprised of 111 firms after using screening method and the deletion of incomplete observations. In this research audit tenure has been considered as independent variable to investigate about its effect on audit report types including accepted reports, conditioned reports, lack of opinion reports, and rejected reports. This research is applied regarding the goal and is descriptive-correlation type regarding the nature and content and also it is post incidental (quasi-experimental). It means that it has been done based on analyzing past and historical data (firms' financial statements). In this study panel data with fixed effects have been utilized. The results of analyzing firms' data by using multiple variable regression in an assurance level of %95 show that there has been a direct relationship between audit tenure and accepted reports and there has been a reverse relationship between audit tenure and conditioned reports and lack of opinion reports. Also these results showed that there has not been a meaningful relationship between audit tenure and rejected reports.

Keyword:

audit tenure, accepted reports, conditioned reports, lack of opinion reports, rejected reports

* Corresponding author: *Yaser Gerami*

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INTRODUCTION

The role and nature of auditing show lack of absoluteness and doubts dominating the quality of reported accounting data. Auditing is in forefront of controlling, giving opinions about supply desirability, and finally accrediting the management's claims listed in financial statements. Auditing is used as a social strategy to help supervising and controlling managers' behaviors and is considered as a means for the governments. The society expects auditing to present audit reports that lead to increase reliability and timeliness of disclosed accounting data. This is considered as a value added element which can only be added to financial data of firms through auditing profession. Thus, if auditing is a supervising means that has the responsibility to accomplish several duties, if nothing changes, audit's report regarding financial statements during pass of time and as a controlling mechanism leads to improve the data disclosure quality through in time increase of accounting data disclosure (Yasaei, 2010). Regarding the status of Stock Exchange in our society, the researcher is trying to investigate the relationship between audit tenure and audit opinions of firms. Therefore, in this part some general issues will be investigated. First the main problem will be presented and then significance of the study will be tested and following that the main purposes of the research, research questions, and novelty of questions, theoretical research framework, and the research model have been expressed.

Theoretical foundation and research literature

Studies on audit tenure are related with whether long-term relationship between audit-employer would affect audit quality or not. The cause and stimulates to these types of researches lies in discretionary or non-discretionary audit changes. The reasoning posed in changing the auditor is that do audits violate long-term incentives of long-term audit quality. Also the counterpart reason refers to the fact that auditors have strong economic incentives to maintain independence and internal structures such as personnel changes are enough to preserve independence and professional doubts of auditors (Francis, 2004). Also it is believed that longer tenure will result in more awareness of audits about business operations and reporting issues of the employers and thus audit quality is increased (Hakim & Omri, 2010; Almatliri & et al, 2009). Regarding what was pointed out we can say that audit tenure affects financial information quality positively or the investors may consider longer tenure as a negative symptom and lack of information reliability will occur. Considering these two rival statements, regardless of direct or reversed form of the relationship, it is expected that audit tenure is related with information unreliability. Audit organization, as the legislature and deviser of accounting and auditing rules and regulations, has defined professional behavior in journal 123 as: employing top staffs for an employer for several years may be considered as a threat for the independence and in such conditions independent professional accountant should do some tasks in order to assure the maintenance of independence and unbiased condition. From among control and preserving activities in this regard we can refer to the turning of top members of the team, involving an extra professional accountant to review what was done by top

members or consulting with independent ones if necessary, and finally to review work quality internally but independently.

Different types of audit opinions based on auditing standards in Iran include: accepted opinion, conditioned opinion, lack of opinion, and rejected opinion. The results of previous researches such as Kolinan & et al (2012) showed that the type of opinion by audits is known as a mechanism and efficient supervision tool that result in increasing information quality and following that earnings management will reduce in firms.

By increasing resources being controlled by management the number of beneficiaries in a firm will increase and as a result benefits' controversy will be created. As a result of controversies, the beneficiaries will incur agency problems to balance the benefits of others with themselves or to minimize the effects of controversies (Jensen & Mc Ling, 1976). The manager who is in the focal point of controversies presents some financial information and tries to reduce firm's agency costs. But due to the existence of management's authorities and the requirement to control manager's performance, the scholarly judgment of an independent auditor seems to be necessary (Gol & et al, 1998).

Therefore, if auditing is done with higher quality benefits' controversy will reduce and transparency of decision making environment will increase and in this case investment risk will decrease either. But, if audit quality is reduced, financial reporting quality will decrease and also the increase of agency problems resulting from controversies among the benefits of manager and investor will increase. In other words, it is possible that management uses the weaknesses in controlling to apply earning management and uses the shareholders' benefits to favor management and firm value will decrease. Therefore, investment risk will increase. Previous studies show that audit quality reduction reduces information transparency and annual financial reporting quality (Dunn & Mayhew, 2004; Balsam & et al, 2003). Weak financial reporting quality increases information asymmetry among those who are active in the market. When information asymmetry of a share increases in a firm, its intrinsic value will differ from the value considered by investors for the intended stocks. Thus, the real value of firms' stocks will differ from the value expected by shareholders. Regarding what was pointed out the principal issue in the present study is to investigate about the relationship between audit tenure and firms' auditor opinion.

Research literature

The basis of all researches related to audit opinion is the studies done by Symonic in the form of a PhD dissertation in America (Chicago University, 1979). The main goal of this research was to recognize factors affecting the amount of audit opinion. He presupposed that audit opinion is identified through the probability of encountering losses and legal claims against the auditor. On the whole, results of research by Symonic showed that the employer firm size, complexity of the operations by employer, and audit risk affect audit opinion.

Renew Desay achieved a positive relationship between audit opinion and the previous research results. Also considering

the first question, their results showed that big audit institutions receive higher fees than other audit institutions due to high audit quality.

Choy & et al (2009) studied the relationship between unusual audit fees and audit quality. Their results showed that negative unusual fees (surplus of standard fees than the real ones) do not have a meaningful relationship with audit quality while positive unusual fees (the surplus of real fees compared to standard ones) would have a negative relationship with audit quality. Their results showed that positive unusual fees lead to lose audits' independence and it in turn leads to audit quality reduction.

Carlo & et al (2015) investigated about reliability of auditing reports in predicting stock liquidity of American financial institutions. The goal of this analysis was to study the role of activity permanence in reports of auditors in presenting and informing the symptoms of financial crises and bankruptcy of financial entities. Findings showed that activity continuance has had a low reliability in predicting stock liquidity in auditing reports.

Nikbakht & Tanani (2008) studied factors affecting audit opinion. Their findings showed that the variables of operation amount (size) of firm, firm operations' complexity, the type of auditing entity, and inflation have had a meaningful relationship with audit opinion. But variables like audit risk, educational degree, and the experience of the incumbent supplying financial statements did not have a statistical relationship with the dependent variable (audit opinion).

Mousavi & Darougeh Hazrati (2009) carried out a research on the relationship between free cash flows and audit opinion in firms enlisted in Tehran Stock Exchange during the years between 2003 and 2008. Results of this research showed that firms with high free cash flow have had more audit opinions. Also results of their research showed that firms with free cash flows, debt levels, and dividend have had more audit opinions.

Hajiha & Fathi Moghaddam Badi (2014) studied the relationship between change in audit opinion and financial reporting delay. Results of statistic tests showed that change (improvement or development) in audit opinion has had a meaningful relationship with delay in financial reporting. Meanwhile, control variables including legal claims' cost, audit change, revision or devise of audit standards, concurrent tenure by CEO, and leverage did not have a meaningful relationship with delay in financial reporting.

Hypotheses development

Regarding what was pointed out above and research questions, the hypotheses of the present study can be presented in the form of four major hypotheses as follows:

First hypothesis: there is a meaningful relationship between audit tenure and accepted audit report.

Second hypothesis: there is a meaningful relationship between audit tenure and conditioned audit report.

Third hypothesis: there is a meaningful relationship between audit tenure and lack of audit opinion report.

Fourth hypothesis: there is a meaningful relationship between audit tenure and rejected audit report.

Methodology

The present research is correlation type regarding method and is applied regarding goal. Additionally, since historical data will be used in testing the hypotheses it can be categorized within quasi-experimental research group. This research is experience based, inference will be used and the field-library study using historical data in post incidental form will be utilized. Below the calculation method for each of the variables has been presented:

Dependent variable

Audit report type

AO₁ = the virtual variable will be equal to number 1 if firm audit report is acceptable, and if not it will be equal to 0.

AO₂ = the virtual variable will be equal to number 1 if firm audit report is conditioned, and if not it will be equal to 0.

AO₃ = the virtual variable will be equal to number 1 if firm audit report lacks audit opinion, and if not it will be equal to 0.

AO₄ = the virtual variable will be equal to number 1 if firm audit report is rejected, and if not it will be equal to 0.

Independent variable

Tenure = audit's incumbent period. The duration of audit tenure is equal to the number of consecutive years that an auditing institution has been responsible for auditing an employer firm.

Control variables

Cash: the ratio of cash and short-term investments of a firm divided by total assets of the firm in balance sheet date.

Size: firm size that is calculated through natural logarithm of assets' book value.

LogMB: natural logarithm of the ratio of market to book value of firm's assets

Growth: the percentage of changes in total assets of firm compared to the previous period

ROA: return on asset that is calculated through the ratio of net earnings to total assets.

Age: age of the firm that is calculated by the difference between establishment date and the period under investigations.

Data analysis

The table below is a representation of the descriptive analysis of research variables:

Table 4-1: Results of descriptive statistics

Variables		Average	Median	Standard deviation	Minimum	Maximum
Accepted report	AO ₁	0.480	0.000	0.500	0.000	1.000
Conditioned report	AO ₂	0.053	0.000	0.224	0.000	1.000
Lack of opinion report	AO ₃	0.068	0.000	0.252	0.000	1.000
Rejected report	AO ₄	0.399	0.000	0.490	0.000	1.000
Audit tenure	Tenure	3.2210	3.0000	2.9970	1.0000	7.0000
Cash ratio	Cash	0.041	0.030	0.042	0.001	0.461
Firm size	Size	27.364	27.226	1.380	23.847	32.270
Natural logarithm of the ratio of market to book value of	LogMB	0.110	0.056	0.704	-2.223	2.055

assets						
The percentage of changes in assets	Growth	0.314	0.113	2.431	-0.994	43.587
Return on assets	ROA	0.127	0.103	0.128	-0.240	0.631
Firm age	Age	38.376	41.000	10.842	9.000	58.000

Regarding the descriptive statistics we can divide the indexes above into central tendency, dispersion, and other indexes. Central tendency indexes are average, median.

Dispersion indexes are standard deviations and other indexes include minimum, maximum, skewness, and pulling. The results of normality test have been represented in the table below.

Table 4-2: Results of normality test

Variable		Jarque-Bera statistic	Meaningfulness level	Result
Accepted report	AO ₁	1.7455	0.0813	The distribution in normal.
Conditioned report	AO ₂	0.9569	0.1483	The distribution in normal.
Lack of opinion report	AO ₃	1.7418	0.0815	The distribution in normal.
Rejected report	AO ₃	0.8790	0.1614	The distribution in normal.

Results of Kolomogorov-Smirnov test showed that the dependent variables have had a normal distribution. Thus, parametric statistic methods were used. Below, the results of testing the hypotheses were presented as shown in the following tables:

First hypothesis

"There is a meaningful relationship between audit tenure and accepted audit report."

$$AO_{1it} = \beta_0 + \beta_1 \text{Tenure}_{it} + \beta_2 \text{Cash}_{it} + \beta_3 \text{Size}_{it} + \beta_4 \text{LogMB}_{it} + \beta_5 \text{Growth}_{it} + \beta_6 \text{ROA}_{it} + \beta_7 \text{Age}_{it} + \varepsilon_{it}$$

After testing the regression presuppositions and making sure about their application, the results of adjusting the regression equation above have been represented in table 4-2. The amount of F statistic (10.332) showed the meaningfulness of the whole regression model. As it has been indicated in lower part of table 4-1, the identification coefficient and adjusted identification coefficient in the

model above were %44.3 and %39.9, respectively. Therefore, it can be concluded that in the regression equation above, only about %39.9 of the changes in the dependent variable of the firms under investigations has been identified by independent and control variables. In this table positive (negative) numbers in coefficient column represent the direct (reversed) effect amount of each of the variables on audit's accepted report of the firms.

Test result:

Based on the table 4-2, the meaningfulness (sig) of the variable of audit tenure (0.006) has been considered to be less than the meaningfulness level in the present research (%5). Also the absolute amount of t statistic related to this variable (3.091) has been greater than t statistic gained from the table with the same freedom degree. Thus, H₀ hypothesis has been rejected in an assurance level of %95 and H₁ hypothesis claiming that there is a meaningful relationship between audit tenure and accepted audit report is approved.

Table 4-3: Results of hypotheses test

Variable		Variable coefficient	Amount of coefficient	t statistic	Meaningfulness level
Fixed amount		B0	0.266	2.355	0.042
Audit incumbent period	Tenure	B1	0.961	3.091	0.006
Cash ratio	Cash	B2	0.734	2.052	0.048
Firm size	Size	B3	0.332	3.838	0.009
Natural logarithm of the ratio of market to book value of assets	LogMB	B4	0.191	2.897	0.024
The percentage of changes in assets	Growth	B5	-0.818	-1.458	0.277
Return on assets	ROA	B6	0.501	2.987	0.0037
Firm age	Age	B7	0.811	1.347	0.302
Identification coefficient		0.443	F statistic		10.332
Adjusted identification coefficient		0.399	P-Value		0.0002
			Durbin-Watson statistic		1.984

Second hypothesis

"There is a meaningful relationship between audit tenure and conditioned audit report."

$$AO_{2it} = \beta_0 + \beta_1 \text{Tenure}_{it} + \beta_2 \text{Cash}_{it} + \beta_3 \text{Size}_{it} + \beta_4 \text{LogMB}_{it} + \beta_5 \text{Growth}_{it} + \beta_6 \text{ROA}_{it} + \beta_7 \text{Age}_{it} + \varepsilon_{it}$$

Table 4-4: Results of regression equation adjustment

Variable		Variable coefficient	Amount of coefficient	t statistic	Meaningfulness level
Fixed amount		B0	0.553	2.995	0.0093
Audit incumbent period	Tenure	B1	-0.611	-2.037	0.049
Cash ratio	Cash	B2	-0.739	-2.873	0.004
Firm size	Size	B3	-0.311	-2.987	0.0037
Natural logarithm of the ratio of market to book value of assets	LogMB	B4	-0.449	-1.247	0.366
The percentage of changes in assets	Growth	B5	0.611	2.555	0.034
Return on assets	ROA	B6	-0.219	-1.173	0.219
Firm age	Age	B7	-0.418	-2.034	0.418
Identification coefficient		0.415	F statistic		7.555
Adjusted identification coefficient		0.372	P-Value		0.014
			Durbin-Watson statistic		1.991

After testing the regression presuppositions and making sure about their application, the results of adjusting the regression equation above have been represented in table 4-1. The amount of F statistic (7.555) showed the meaningfulness of the whole regression model. As it has been indicated in lower part of table 4-1, the identification coefficient and adjusted identification coefficient in the model above were %41.5 and %37.2, respectively. Therefore, it can be concluded that in the regression equation above, only about %37.2 of the changes in the dependent variable of the firms under investigations has been identified by independent and control variables. In this table positive (negative) numbers in coefficient column represent the direct (reversed) effect amount of each of the variables on audit's conditioned report of the firms.

Test result:

Based on the table 4-1, the meaningfulness (sig) of the variable of audit tenure (0.049) has been considered to be less than the meaningfulness level in the present research (%5). Also the absolute amount of t statistic related to this variable (2.037) has been greater than t statistic gained from the table with the same freedom degree. Thus, H_0 hypothesis has been rejected in an assurance level of %95 and H_1

hypothesis claiming that there is a meaningful relationship between audit tenure and conditioned audit report is approved.

- Third hypothesis

"There is a meaningful relationship between audit tenure and lack of audit opinion report."

$$AO_{3it} = \beta_0 + \beta_1 \text{Tenure}_{it} + \beta_2 \text{Cash}_{it} + \beta_3 \text{Size}_{it} + \beta_4 \text{LogMB}_{it} + \beta_5 \text{Growth}_{it} + \beta_6 \text{ROA}_{it} + \beta_7 \text{Age}_{it} + \varepsilon_{it}$$

After testing the regression presuppositions and making sure about their application, the results of adjusting the regression equation above have been represented in table 4-2. The amount of F statistic (8.299) showed the meaningfulness of the whole regression model. As it has been indicated in lower part of table 4-2, the identification coefficient and adjusted identification coefficient in the model above were %46.3 and %43.7, respectively. Therefore, it can be concluded that in the regression equation above, only about %43.7 of the changes in the dependent variable of the firms under investigations has been identified by independent and control variables. In this table positive (negative) numbers in coefficient column represent the direct (reversed) effect amount of each of the variables on audit's lack of opinion report of the firms.

Table 4-5: Results of regression equation adjustment

Variable		Variable coefficient	Amount of coefficient	t statistic	Meaningfulness level
Fixed amount		B0	0.665	1.554	0.123
Audit incumbent period	Tenure	B1	-0.521	-2.733	0.027
Cash ratio	Cash	B2	-0.109	-2.921	0.0153
Firm size	Size	B3	-0.256	-3.576	0.002
Natural logarithm of the ratio of market to book value of assets	LogMB	B4	-0.187	-2.269	0.045
The percentage of changes in assets	Growth	B5	0.171	1.073	0.408
Return on assets	ROA	B6	-0.488	-2.673	0.023
Firm age	Age	B7	-0.711	-1.388	0.277
Identification coefficient		0.463	F statistic		8.299
Adjusted identification coefficient		0.437	P-Value		0.0064
			Durbin-Watson statistic		2.011

Test result:

Based on the table 4-2, the meaningfulness (sig) of the variable of audit tenure (0.049) has been considered to be less than the meaningfulness level in the present research (%5). Also the absolute amount of t statistic related to this variable (2.037) has been greater than t statistic gained from the table with the same freedom degree. Thus, H_0 hypothesis has been rejected in an assurance level of %95 and H_1 hypothesis claiming that there is a meaningful relationship between audit tenure and audit's lack of opinion report is approved.

- **Fourth hypothesis**

"There is a meaningful relationship between audit tenure and rejected audit report."

$$AO_{4it} = \beta_0 + \beta_1 \text{Tenure}_{it} + \beta_2 \text{Cash}_{it} + \beta_3 \text{Size}_{it} + \beta_4 \text{LogMB}_{it} + \beta_5 \text{Growth}_{it} + \beta_6 \text{ROA}_{it} + \beta_7 \text{Age}_{it} + \varepsilon_{it}$$

After testing the regression presuppositions and making sure about their application, the results of adjusting the regression equation above have been represented in table 4-5. The amount of F statistic (8.299) showed the

meaningfulness of the whole regression model. As it has been indicated in lower part of table 4-5, the identification coefficient and adjusted identification coefficient in the model above were %32.1 and %28.8, respectively. Therefore, it can be concluded that in the regression equation above, only about %28.8 of the changes in the dependent variable of the firms under investigations has been identified by independent and control variables. In this table positive (negative) numbers in coefficient column represent the direct (reversed) effect amount of each of the variables on audit's rejected report of the firms.

Test result:

Based on the table 4-5, the meaningfulness (sig) of the variable of audit tenure (0.199) has been considered to be higher than the meaningfulness level in the present research (%5). Also the absolute amount of t statistic related to this variable (1.451) has been greater than t statistic gained from the table with the same freedom degree. Thus, H_0 hypothesis has been approved in an assurance level of %95 and H_1 hypothesis claiming that there is a meaningful relationship between audit tenure and rejected audit report is rejected.

Table 4-6: Results of regression equation adjustment

Variable		Variable coefficient	Amount of coefficient	t statistic	Meaningfulness level
Fixed amount		B0	0.244	23.321	0.045
Audit incumbent period	Tenure	B1	0.709	1.451	0.199
Cash ratio	Cash	B2	-0.922	-3.711	0.001
Firm size	Size	B3	-1.034	-3.073	0.013
Natural logarithm of the ratio of market to book value of assets	LogMB	B4	-1.081	-3.838	0.0017
The percentage of changes in assets	Growth	B5	0.631	2.388	0.041
Return on assets	ROA	B6	-0.753	-2.141	0.048
Firm age	Age	B7	-0.894	-2.601	0.031
Identification coefficient		0.321	F statistic		10.773
Adjusted identification coefficient		0.288	P-Value		0.0001
			Durbin-Watson statistic		2.255

Discussion and conclusion- **First hypothesis**

"There is a meaningful relationship between audit tenure and accepted audit report."

Based on the table 4-1, the meaningfulness (sig) of the variable of audit tenure (0.006) has been considered to be less than the meaningfulness level in the present research (%5). Also the absolute amount of t statistic related to this variable (3.091) has been greater than t statistic gained from the table with the same freedom degree. Thus, H_0 hypothesis has been rejected in an assurance level of %95 and H_1 hypothesis claiming that there is a meaningful relationship between audit tenure and accepted audit report is approved. Regarding the positive sign of the coefficient of audit tenure variable, it can be concluded that there has been a meaningful direct relationship between audit tenure and accepted audit report.

- **Second hypothesis**

"There is a meaningful relationship between audit tenure and conditioned audit report."

Based on the table 4-2, the meaningfulness (sig) of the variable of audit tenure (0.049) has been considered to be

less than the meaningfulness level in the present research (%5). Also the absolute amount of t statistic related to this variable (2.037) has been greater than t statistic gained from the table with the same freedom degree. Thus, H_0 hypothesis has been rejected in an assurance level of %95 and H_1 hypothesis claiming that there is a meaningful relationship between audit tenure and conditioned audit report is approved. Regarding the negative sign of the coefficient of audit tenure variable, it can be concluded that there has been a meaningful reverse relationship between audit tenure and conditioned audit report.

- **Third hypothesis**

"There is a meaningful relationship between audit tenure and lack of audit opinion report."

Based on the table 4-2, the meaningfulness (sig) of the variable of audit tenure (0.049) has been considered to be less than the meaningfulness level in the present research (%5). Also the absolute amount of t statistic related to this variable (2.037) has been greater than t statistic gained from the table with the same freedom degree. Thus, H_0 hypothesis has been rejected in an assurance level of %95 and H_1 hypothesis claiming that there is a meaningful relationship between audit tenure and audit's lack of opinion report is

approved. Regarding the negative sign of the coefficient of audit tenure variable, it can be concluded that there has been a meaningful reverse relationship between audit tenure and audit's lack of opinion report.

- **Fourth hypothesis**

"There is a meaningful relationship between audit tenure and rejected audit report."

Based on the table 4-6, the meaningfulness (sig) of the variable of audit tenure (0.199) has been considered to be higher than the meaningfulness level in the present research (%5). Also the absolute amount of t statistic related to this variable (1.451) has been greater than t statistic gained from the table with the same freedom degree. Thus, H_0 hypothesis has been approved in an assurance level of %95 and H_1 hypothesis claiming that there is a meaningful relationship between audit tenure and rejected audit report is rejected.

Results mentioned above accord with results of the research by Richard & et al (2010), Zhang (2013), Karami & Bazrafshan (2009), Etemadi & et al (2010), and Namazi & et al (2011).

Considering the results of research hypotheses based on a meaningful relationship between audit tenure and accepted report and audit's conditioned report and lack of audit's opinion report, it can be suggested to audit institutions that are members of formal accountants assembly and supervising institutions such as formal accountants' assembly to pay attention to the results gained in the present study in order to increase efficiency and efficacy of the audits' supervision processes through issuing audit opinion, increasing transparency, and enhancing financial reporting quality.

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