Journal of Humanities Insights *2(4): 199-201, 2018*
Research Paper

Relationship Between Auditor Switching and the Inclination of Audit Opinion Report Toward Unqualified Mode in the Companies Listed in Tehran Stock Exchange Market

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Received: 27 October 2018 Accepted: 27 November 2018 Published: 01 December 2018

Abstract

Unqualified audit opinion report takes on a considerable importance in the capital market and typically results in increased stock quotes. Thus, in order to obtain unqualified audit report or reduce audit paragraphs, companies may take measures to influence auditors' reports. Considering the competitive audit market and companies' employment of auditors, one of the measures is to change the independent auditors. The present study investigates the effect of independent auditor switching on auditors' opinions and audit report paragraphs. The study adopts an applied-descriptive method assuming a secondary analysis design. The data was collected through field study whereby notes were taken from Tehran Stock Exchange Market archive. The populations of the study consisted of the companies enlisted in Tehran Stock Exchange Market, which had experienced independent auditor switching in 2010. Kolmogorov-Smirnov test was run to examine the normality of the data. Bimodal test and Wilcoxon test were run to analyze the qualitative data and non-parametric quantitative data, respectively. The results showed that companies with qualified audit opinion reports mostly tended to change their independent auditors; however, auditor switching did not typically result in the inclination of audit opinion toward unqualified reports, reduced audit paragraphs and elimination of annual audit paragraph.

Keywords: Independent Auditor Switching; Unqualified Opinion; Audit Paragraphs; Qualified Opinion

How to cite the article:
M. Hematfar, Relationship Between Auditor Switching and the Inclination of Audit Opinion Report Toward Unqualified Mode in the Companies Listed in Tehran Stock Exchange Market, J. Hum. Ins. 2018; 2(4): 199-201, DOI: 10.22034/jhi.2018.86982

1. Introduction

Audit is an inseparable part of reporting financial information, which helps the users make wise decisions and judgments. Social developments and complexities also call for audit as a necessary part of reporting process [1]. However, company managers may seek to influence auditors to prepare unqualified audit opinion reports, which may help increase demands for company share. One of the measures that an auditee may take is to change the auditor. Thus, auditors may relent to conform to auditees' desires in order to continue working for their employers or gain new audit contracts [2,3]. Various groups and individuals use audited financial statements including current shareholders, potential investors, banks, financial institutes and financial analysts. In practice, the economic role of audit is to minimize distrust and uncertainty toward the information upon which logical decisions are to be made.

Increased quality of reported financial information may help the users make better decisions [4, 5]. The users of financial statements may confidently rely on the financial information reported in financial

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statements when their validity is approved by an independent, qualified, and unbiased third person. In current socio-economic systems, independent auditors are responsible for assessing and commenting on financial statements [6,7].

It is important to study auditor switching as it affects auditor independence. According to Knapp and Elikai (1998), auditor switching often results in decreased investors' trust in a company's financial statements, particularly when auditor switching coincides with negative indications, discouraging news and uncertainty about the replaced auditor [8]. When the users of financial statements lose their trust in the financial information provided, not only are audit goals failed to achieve but also the audit process loses its validity at the macro level. Moreover, this may prevent the optimal allocation of capital in the securities market and increase costs of capital and financing. Research has shown that explanatory paragraphs exert adverse effects on stock quotes. In this regard, the companies with qualified audit opinion reports may seek to change their auditors [9].

Auditor switching phenomenon has attracted the attention of academics and professional activists over the last years. It is particularly important as it helps recognize the status of audit market and competitiveness in audit profession [10]. Disclosure requirements and market reaction to auditor switching are developed to discourage auditees from deriving favorable audit reports or utilizing specific accounting methods. Besides, the requirements are in place to empower the auditors to report their opinions with higher independence, which do not necessarily correspond to auditees' preferences [11].

The present study aimed to investigate the association between independent auditor switching by the companies listed in Tehran Stock Exchange Market (TSE) and subsequent changes in the replaced auditor report including the inclination of opinion report toward the unqualified mode, decreased audit paragraphs and elimination of annual audit paragraphs. In general, the study set to investigate the independence of the replaced auditor considering the customer retention policy and new employers.

2. Methodology

The population of the study consisted of all companies enlisted in TSE market that changed their independent auditors in the 2010 fiscal year. The data used in the study included independent audit reports on the enlisted companies published by TSE market for the fiscal year that entailed non-compulsory auditor switching and two preceding years (i.e., fiscal years 2010, 2009 and 2008). The data was obtained from the comprehensive database of TSE listed companies (www.rdis.ir). Wilcoxon test was run to examine research hypotheses.

3. Results

Considering the results of frequency statistics, a number of 48 listed TSE companies experienced independent auditor switching in 2010, of which 36 companies had qualified audit opinion reports. The results thus showed that the majority of the companies (about 75%) had qualified audit opinion reports before auditor switching. A number of 44 replaced auditors issued the same reports as the predecessor auditors in the previous year (about 92%). However, about 8 percent of the replaced auditors issued different audit opinion reports with 4 percent being inclined toward unqualified reports. Besides, from among the companies that changed their auditors, a number of 36 companies had audit paragraphs. In this regard, 24 companies did not reduce their audit paragraphs (about 67%) while 12 companies reduced their audit paragraphs (about 33%). From among the 36 companies with qualified audit opinion reports before auditor switching, 30 companies did not eliminate annual audit paragraph from their audit reports after auditor switching (about 84%) while 6 companies did so (about 6%).

The results showed that the companies that changed their independent auditors did not have favorable audit opinion reports ($Z=3.46$, $P\geq0.05$). Auditor switching, however, did not result in the inclination of audit opinion reports toward unqualified reports ($Z=5.28$, $P\leq0.05$). The results of Wilcoxon test showed that auditor switching did not lead to reduced audit paragraphs ($Z=0.472$, $P\geq0.05$). Auditor switching did not result in the elimination of even one annual audit paragraph ($Z=2.2$, $P\geq0.05$).

4. Discussion and Conclusion

The results of testing the first hypothesis at 95% confidence level, assuming that the companies that changed their independent auditors did not have favorable audit opinion reports, showed that the companies changed the auditors in order to derive unconditional reports from replaced auditors or to reduce audit paragraphs. The results of testing the second research hypothesis at 95% confidence level, assuming that auditor switching resulted in the inclination of audit opinion toward unqualified reports, showed that the replaced auditors managed to maintain their independence in presenting audit reports so that auditees failed to attain one of their likely goals, i.e., obtaining unqualified audit opinion reports. Considering the third research hypothesis, assuming that auditor switching resulted in reduced audit paragraphs, the results showed that, at 95% confidence level, the replaced auditors maintained their independence in presenting audit reports so that, in companies with qualified audit opinion reports, the new auditor reports also included the same audit paragraphs. Regarding the fourth research hypothesis, assuming that auditor switching resulted in the elimination of at least one annual audit paragraph from audit reports, the results showed that, at 95% confidence level, the replaced auditors maintained their independence so that, in companies with qualified audit opinion reports, the new auditors did not eliminate annual audit paragraphs. In the end, considering the multifaceted nature of the topic, it is recommended that future studies investigate the relationship between the replaced auditor ranking in the official accountants community and changes in the auditor opinion reports. The researchers may study the effect of higher or lower ranking of the replaced audit organization comparing with the previous one on variations in audit opinion reports and the number of audit paragraphs. It is also recommended that future studies investigate the difference between voluntary and compulsory auditor switching in presenting auditor opinion reports.

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