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Corporate Governance and Auditors change (Case study in Tehran stock exchange (T.S.E))

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Abstract: Typically, auditing is one of the major causes of appropriate corporate governance and the circumstances under which agency relationship is established, audit usually appears to reduce the conflict of interest. Therefore, the present study deals with the effect of corporate governance mechanisms on changing the auditors of companies listed in Tehran Stock Exchange over the course of 2006 - 2010. To these objectives, Panel Data in the form of five hypotheses were employed and considered. Results of this study revealed that there is a significant relationship between the numbers of non-Executive members of the board, separation of CEO from board chairman, receiving the non-standard audit report last year and the change of companies' auditor. But, no significant relationship was observed between the percentage of majority stock holders and the company's losses in previous years with change of companies' auditor. According to the findings, it is suggest that Iranian Capital markets activists consider the role of non-executive, number of board directors, CEO separation from the Chairman and the impact of change companies' auditor in their decision makings.

Key words: Corporate governance, auditor change, the major shareholders ownership percentage, Non – executive boards.

INTRODUCTION

Establishing Limited companies and opening ownership of companies to the public exerted a significant effect on their management. Market system, then, was organized so that the owners of the companies submit the responsibility of running the companies to the others. Obviously enough, the separation of "ownership" from the "management" extended and widened the domain of the agency problem. What is more, solving the agency problem assures the stock holders of the fact that the managers make a rich attempt to productively maximize their wealth. On the other hand, so as to ensure the economic unit's of the reality that they will discharge their accountability and responsibility to the public and stakeholders at their best, meticulous monitoring and proper supervision must be conducted.

What follows, taking a constructive care and monitoring in this field call for some suitable mechanisms, two of which are design and implementation of appropriate corporate governance in companies and economic institutions. The corporate governance is a set of a company's internal and external control mechanisms determining the significant issue that the company is managed by *"whom"* and *"how"*. Furthermore, corporate governance system striking a balance between social and economic goals and individual and group objectives motivates the companies to make some efficient and rich use of resources. By reference to the effective corporate governance and efficiency of agreements between stakeholders In order to strengthen accountability culture and enhance clarity of information in Companies and economic units, all or part of the capital which is supplied by the public lead eventually to the efficient allocation of resources and economic development. (Rezaee & Ghalibaf, 2008).

In recent decades, the issues of accountability and managers social responsibility, establishing an internal control system and how to participate and contribute to all Stockholders and utilizing the rights of all stakeholders have been the subject of global economic and financial circles. Undoubtedly, system of corporate governance is the small pace of governance and health leadership in the country's territory. Based on this, corporate governance is only part of a larger economic environment where companies work such as macro-economic policies, the amount of competition in products and markets. The framework of corporate governance depends on the legal environment, the regulatory and institutional. Appropriate system of corporate governance pursue to statutory framework establishment and appropriate mechanisms to establish a balance relationship between the interests of minority shareholders, on the one hand and controlling or majority shareholder on the other hand. Furthermore, new perspectives are trend to the more serious attention rights of all stakeholders, community, market capitalization, and the total companies. Corporate governance systems have focused on transparency and disclose of information and deleting the internal data and using the mechanisms of decentralization of companies' power and try to complete the separation of ownership and management and conservation compliance and advice of shareholders the same. For years past, economists assumed that all groups were associated with a company working for a common goal. But over the past 30 years, many cases of

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conflict of interest between groups and how face companies with these conflicts have been proposed by economists. These cases, generally, are expressed in the Agency theory in Management accounting. According to definition of Jensen and Meckling agency relationship is an agreement that owner appointed agent on behalf of itself. So, may delegate him to decide the authority. (Namazi & kermani, 2009).

Under the definitions made, corporate governance is the collection of relationship between shareholders, directors and corporate auditors, which ensure establishing a control system in order to respect the rights of minority shareholders and implementing the decisions of the Assembly and to prevent the possible any opportunities. This law was based on social responsibility and accountability system includes a set of tasks and functions which should be up by pillars of the company to cause responsive and transparent. (Jalali, 2009).

Scandals and the collapse of companies like Enron and WorldCom in United States and tell one in Australia create some serious concerns in the case of earnings management, use of profits and the ethical problems of those who prepare and audit theses reports. The legislative organizations in America and Australia responded to corporate failures and disclosure frauds by improving corporate governance.

Literature Review:

Usually, in the situation that the relationship of agency is existence, auditing is proposed to reduce conflicts of interest. In additional, one of the main factors of good corporate governance is carried audit out. Separating agent (manager) of the Employment (owner) in the agency theory and agent (manager) and stakeholders in the stakeholder theory cause to doubt, uncertainty and suspicion in the employment (the owner) and agent performance to stakeholders (managers). These suspicion led to the establishment of accountability systems which in that the agent (manager) provides report of the statements that contain messages about its function to finance language, directly to the Employment (the owner) and indirectly to the other stakeholders. Recipients of financial statements, based on the information contained in these statements may adopt decisions. Therefore, the possibility doing manipulation of information by the immoral agent (manager) and adversely affect the nature and quality of decisions, Independent auditors are invited as employment agency and stakeholders for approval and certification of financial statements of the accounting aspects of work. (Hassas yeghaneh, 2006)

Reed in 2000 showed that the companies which choose service of 6 great audit companies like to have more influential with them. They discussed that the most influential companies for reducing market suspicious of their actions lowering capital costs have more incentive to employment of high quality auditors In 2004 Reed showed that Companies with high volume trading ratio or growth potential are more tends to choose high quality auditors, and Vylnbvrg also showed that firms with higher profitability tend to choose a higher quality auditor. Mashayekh and Esmaiili(2007) studied relationship between some aspects of leadership principal and profit quality including percentage of ownership board members and number of non-bound in 135 companies listed in Tehran Stock Exchange with respect to the regulation of leadership principals for the period of 2002 until 2005. In this study to assess the earnings quality of aspects continuing profitability was used the results suggest that at 5% significant level, there is no relationship between earnings quality and the percentage ownership of board members and board number of members of non-bound. But, relationship has been observed between the non-linear accruals and the percentage ownership of board members. Furthermore, the number of non-duty executives and member of board ownership percentages that account as corporate governance mechanisms haven't important role to improve the quality of earning in the companies listed on the exchange .June Lina and Liu Ming (2009)by using the three variables of corporate governance mechanisms they found that, there is an inverse higher quality relationship between the ownership percentage of major shareholders and the auditor, but between the number of non-Executive members of the board and of the CEO separation from Chairman, they stated that a significant direct relationship. Another research by Lina Jun Ming Lyuder(2010) in chain took about relationship between impact of corporation governance with auditors' change, showed that there is a signification initial relationship between majority of stockholders percentage and auditors' change from low quality to high quality.

Rahimian and *et al* (2010) during four periods from 2005 until 2008 studied relationship between some of corporate governance mechanisms and asymmetry information in the companies listed on the exchange. The results show that there aren't significant relationships between internal auditing department and the ratio of non-bond management's board and standards of information asymmetry. While, there is negative signification relationship between major investors of ownership percentage and information asymmetry. Ahmmadpour and Kashani(2011) studied the effect of corporate governance and audit quality to funding cost on debt (borrowing) in companies listed on stock exchange. They showed that the majority equity holders in the shareholders and efficient supervision them has meaningful reduction impact on membership of companies' debt cost, while the quality of auditing hasn't this impact. Fakhari and *et al* (2011) researched the relationship between profit sharing and corporate governance in listed companies in Tehran Stock Exchange and showed that there is a significant inverse relationship between profit sharing and corporate governance index. Nahandi and Baradaran hasanzade (2011) studied relationship between corporate governance and conservatism during 8 years from 2002 until 2009.

Hypotheses Development:

As the aim of this research is study of corporate governance impact on auditor change so we will survey that whether exist of member of non-required and separate the CEO from the board cause to companies go to use the service of big audit firms? So the general of this assay is survey relationship between audit change and corporate governance on the companies listed in Tehran Stock Exchange.

Hypothesis A: There is a significant relationship between the major shareholders' percentage ownership and the auditor change from the audit organization to other audit institutions.

Hypothesis B: There is a significant relationship between the number of non-Executive members of Board and the auditor change from the audit organization to other audit institutions.

Hypothesis C: There is a significant relationship between the CEO who is the board chairman and auditor change from audit organization to another audit institutions.

Hypothesis D: There is a significant relationship between receive the Non - standard auditor reports at lag year and auditor change from audit organization to another audit institutions.

Hypothesis E: There is a significant relationship between losses of company in the lag years and auditor change from audit organization to another audit institution.

Research design

In this study, panel data and pooled data regression models (joint effect) is used. Because the dependent variable in this study was qualitative, we used logistic regression model. As well as to survey being the significant variables are used the statistical tests T, F, and the coefficient of determination. The relationships between above variables are tested in the following model and Variables definitions have shown in the figure 1.

$$\textit{Big to small}_{it} = \beta_0 + \beta_1 MSH_{it} + \beta_2\,\textit{Non-ExeBoard}_{it} + \beta_3 CEOCHR_{it} + \beta_4 Size_{it} + \beta_5 OPI_{it} + \beta_7 MB_{it-1} + \beta_8 LOSS_{it-1} + \beta_9 Second_{it} + \beta_{10} Third_{it} + \beta_{11} Fourth_{it} + \varepsilon_{it}$$

Fig. 1: variables definitions

Big to small$_{it}$	1 If the audit change from audit organization to another audit institutions, otherwise zero
MSH$_{it}$	major shareholders ownership percentage
Non-ExeBoard$_{it}$	Number of Non – Executive member in corporate board
CEOCHR$_{it}$	1 If the CEO is chairman, otherwise zero
Size$_{it}$	Natural logarithm of total assets
OPI$_{it}$	1 If the company had been received non-standard report in the previous year, otherwise zero
MB$_{it-1}$	firm market value divided by book value in the previous year
LOSS$_{it-1}$	1 if company in previous year incurred losses, otherwise zero
Second$_{it}$	1 If the auditor change was in 2008 ,otherwise it is zero
Third$_{it}$	1 If the auditor change was in 2009, otherwise it is zero
Fourth$_{it}$	1 If the auditor change was in 2010, otherwise it is zero

Research Methodology:

Methodology used in this research is descriptive, correlation and regression analysis. expost facto means that research is done based on past information. Theoretical bases of data collected from sits, libraries and use of books and articles in Persian and English. Also excel and Eviews software is used for calculations and statistical analysis.

Our statistical population in us study is all of the Tehran Stock Exchange listed companies during 2007 until 2010.among the statistical population companies have selected that following characteristics:

1. Until the end of 2005 have been listed in Tehran Stock Exchange and their fiscal year as of December.
2. Companies should not change their fiscal year during these periods.
3. Firm’s information available during this research period.
4. Investment, holding and leasing companies and banks exclude from population, because they are financial intermediary.

Test The Hypotheses And Results:

Descriptive Results:

In fig 2 and 3, we report the descriptive statistics for the used variables in our research.

	Big to small$_{it}$	MSH$_{it}$	Non-ExeBoard$_{it}$	CEOCHR$_{it}$	Size$_{it}$	OPI$_{it}$	MB$_{it-1}$	LOSS$_{it-1}$	Second$_{it}$	Third$_{it}$	Fourth$_{it}$
Mean	0.3	50.5	3.1	0.1	27.3	0.8	0.8	0.1	0.0	0.7	0.1
Median	0	51	3	0	27.30	1	0.74	0	0	1	0
Max	1	98.65	5	2	30.24	1	3.74	1	1	1	1
Min	0	19.48	0	0	24.09	0	0	0	0	0	0
Std Dev	0.47	17.40	1.43	0.35	1.24	0.36	0.71	0.35	0.13	0.46	0.27
Kurtosis	0.81	0.90	-0.42	4.96	0.20	-1.94	1.96	-2.04	7.28	-0.90	3.09
Skewness	1.65	3.76	2.65	26.70	2.92	4.77	7.67	5.17	54.02	1.81	10.53

Fig. 2: descriptive statistics

The fig 2 shows that 30 percent of studied companies have changed their auditors from Audit Organization to other institutes. According to the fig2, size of 50 percent of firms is about 27.3.furthermore, 50.5 percent of firms have major shareholders on average.

	MB$_{it-1}$	Big to small$_{it}$	CEOCHR$_{it}$	Size$_{it}$	MSH$_{it}$	Non-ExeBoard$_{it}$	OPI$_{it}$	LOSS$_{it-1}$	Second$_{it}$	Third$_{it}$	Fourth$_{it}$
MB$_{it-1}$	*1.00*										
Big to small$_{it}$	0.19	*1.00*									
CEOCHR$_{it}$	-0.09	0.24	*1.00*								
Size$_{it}$	-0.21	0.13	0.42	*1.00*							
MSH$_{it}$	-0.18	0.02	0.12	-0.13	*1.00*						
Non-ExeBoard$_{it}$	-0.22	-0.32	-0.32	-0.21	0.01	*1.00*					
OPI$_{it}$	-0.17	0.18	0.09	0.10	0.13	-0.15	*1.00*				
LOSS$_{it-1}$	0.29	0.11	-0.06	0.19	0.05	0.05	-0.03	*1.00*			
Second$_{it}$	-0.14	-0.09	-0.03	0.13	-0.01	0.18	-0.32	-0.13	*1.00*		
Third$_{it}$	-0.17	0.06	0.02	0.11	0.09	-0.10	0.10	0.07	-0.21	*1.00*	
Fourth$_{it}$	0.04	0.01	-0.06	0.01	-0.14	-0.15	-0.42	-0.16	-0.04	-0.02	*1.00*

Fig. 3: Correlation Matrix

Test of Hypotheses:

Hypotheses A:

As in fig 4 can be seen there is no significant relationship at 90% confidence level, between percentage ownership of major shareholders and auditor change. Also, first hypothesis has rejected. Correlation coefficient between two variables is 90% and this is not consistent with the results of research on Jun Lin and Ming Liu (2009).

Hypotheses B:

As seen in fig4 there is inverse significant relationship between the number of Non-Executive members of the board and auditor choice. In generally the second hypothesis of research is accepted. According to fig3 correlation coefficient between two variables is 0.32 that consisted with the results on Jun Lin and Ming Liu (2010) research.

Hypotheses C:

According to results obtained in the fig4, at the 90% of confidence level, there is a significant relationship between CEO separation from the Chairman and auditor choice. According to fig 3 correlation coefficient between two variables is 24.9% and the overall condition of the third hypothesis is confirmed that is inconsistent with the results of research by Jun Lin and Ming Liu (2010).

Hypotheses D:

According to results obtained in the Fig 4, in confidence level at 90% there is a significant relationship between the non-standard audit reports received in the previous year and the auditor change. And according to Fig 3 correlation coefficient between two variables is 18.4%. Generally, the fourth research hypothesis is confirmed, which is inconsistent with the results obtained of the research by Jun Lin and Ming Liu (2010).

Hypotheses E:

According to results obtained in the Fig 4 at 90% confidence level there is no significant relationship between the loss of companies and auditor change in the previous year. And according to Fig3 correlation coefficient between two variables is 11.4% and the overall state of the fourth hypothesis is confirmed, which inconsistent with the results obtained of research by Jun Lin and Ming Liu (2010).

variable	T statistic	coloration	probability	Level of significantly	Accept or reject
MSH_{it}	-0.11	0.019	0.90	Non sig	reject
$Non\text{-}ExeBoard_{it}$	-1.87	0.321	0.06	90%	accept
$CEOCHR_{it}$	1.78	0.249	0.07	90%	accept
MB_{it-1}	1.81	--------	0.069	90%	accept
OPI_{it}	2.26	0.184	0.023	95%	accept
$LOSS_{it-1}$	1.44	0.11	0.14	Non sig	reject
$Size_{it}$	-0.44	------	0.65	Non sig	reject

Fig. 4: regression results

Conclusion:

According to research results it seems that in Iran the most important corporate governance mechanisms, including non-Executive members of boards and CEO separation from the company's board, were impressive to change of corporate auditors of firms listed in TSE. On the other hand, some corporate governance mechanisms, such as the percentage ownership of shareholders didn't affect auditor change of the firms listed in Tehran Stock Exchange. The results show that there is no significant relationship between major shareholders' percentage ownership in capital market and auditor corporate change. It can be stated this reason that shareholders haven't sufficient knowledge about the quality of performed audits by various institutions. According to results obtained of this study, there is a significant inverse relationship in firms listed in TSE, between the number of non-Executive board members and auditor change. This indicate that members are familiar with the quality of audits performed by audit firms and the attempt of the members of its supervisory role in leading firms in which non-Executive members are bound. Separation of the Managing Board shows the company's internal controls and segregation of duties. The results of this study indicate that in firms which the CEO and board are not the same, they want to have a low quality auditor, and furthermore, there is a signification relationship between non-standard audit reports with auditor changing from large firms to small in last year. Because of the impact on non-Executive members and Separation of CEO from the Board on the selection of auditors, companies looking to improve the mechanisms of their board structure.

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