INVESTIGATING THE EFFECT OF CORPORATE GOVERNANCE MECHANISMS (COMPANY OWNERSHIP STRUCTURE) ON AUDIT QUALITY

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ABSTRACT
Audit quality plays a key role in the efficiency of capital markets. It is thus important to identify the factors affecting audit quality. A company's ownership structure and the final composition of the investors of a company are among these factors. The purpose of this study is to determine the impact of ownership structure on audit quality. Considering the fact that institutional investors need quality financial reporting (QFR) for their professional analysis, there is this attitude that these groups of owners, by leveraging the management, encourage them to use audit quality services. In this study, two elements including, audit firm size and auditor tenure were used as indicators of audit quality with equal weighting. Logistic regression analysis was used to test the research hypotheses. After observing the effects of the control variables, leverage and firm size, the results indicate that the institutional ownership and Ownership concentration has an effect on audit Quality.

KEY WORDS: Audit Quality, Institutional Ownership, Ownership concentration, audit firm size.

An important new feature of capital markets, particularly in developing countries, is major investors and most of the companies owned by their proprietary rights. Our country is not an exception to the rule. Investors are the main actors in the financial markets, and the presence of major investors, including big governmental organizations and financial institutions in capital markets requires that the investors become confident about whether the company's performance is in line with maximizing the investors' value within the laws and regulations or not(Hasah ygane and Moayyri, 2008). Investors need auditors' opinion in order to understand that their decision making allocations is based on credible and reliable financial information. Researching on the theory of demand for audit quality is thanks to the fact that there is no information asymmetry between managers and investors. An important issue is the reliability of the aforementioned data which comes from the conflicting interest and lack of direct access to information. Ownership structure is defined by determining the texture and combining the investors of a company and major equity owners of that company. The ownership structure of the companies in terms of stock concentration for major stockholders is divide divided into concentrated and non-concentrated. Many economic theorists believe that each type of ownership can affect the performance of any companies. Therefore, providing high quality and precise audit reports to investors and also the way of measuring the effect of each type of ownership on the company's performance are among the issue which are considered interesting from shareholders, managers, and researchers points of view.

LITERATUREREVIEW
Various definitions of quality audits were carried out and the most famous of them is as follows: Danjelo defines audit quality as the probability of detection and significant reporting deviations in the financial statements. This definition considers two factors involved in audit quality. In fact, audit quality is a function of the ability to detect significant deviations and manipulations performed in the reported earnings(Titman&Troman, 1986, Daivid son & Neo, 1993). Paving the way for ownership concentration in these companies, owners are the infrastructural problems on which ownership structure is evolved. The contradiction of benefits among the stockholders and managers, applying absolute control from the major stockholders, reduction of control power and supervision of minor stockholders on company affairs and limiting the decisions taking only to the managers can affect the quality and performance of auditing of companies. The final value of audit activities is to assist users to identify the quality of information. Therefore, the users of this information must accept the

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competence of the auditor in order to accept his comments; otherwise the purpose of the audit cannot be fulfilled. On the other hand, the crisis of financial reporting in recent years which was the reason of the collapse of many companies shifted the attention of researchers and professional associations to increase the quality and reliability of the audit report and to reduce negligence (Mojtahedzadeh and Aghaei, 2004). According to the above-mentioned, it is necessary to identify the variables that affect audit quality in Iran's capital market.

As in combination of ownership, most of the companies listed in TSE, there are major stockholders with high ability of supervising compared to minor stockholders in terms of corporate governance theory, this study investigated this issues that “Is the number of major stockholder and their ownership affect the audit quality of the company?

In this section, a brief description of previous researches, both inside and outside of Iran, carried out in connection with the research topic is presented: Allam Mohammed et al (2013), in a study entitled: "the effect of audit committee characteristics on performance", came to the conclusion that greater audit companies are less negligent. Azibi et al (2010), in a study entitled: "auditor choice and institutional investor characteristics after the Enron scandal in France", came to the conclusion that there is a significant and positive relationship between foreign institutional investors and audit quality. Velori et al. found that institutional owners to increase audit quality apply the services of specific industry auditors.

Zureigat, Qasim Mohammad, (2013) in a study entitled: "the effect of ownership structure on audit quality", investigated the effect of ownership structure on audit quality in Jordanian companies. The results indicate that there is a positive and significant relationship between institutional ownership and audit quality. Asbaugh and Warfield in a study in Germany showed that there is a positive association between ownership concentration and audit quality. Aghaei and Kuchaki (1996) found out that the quality of auditing companies are different from each other and they cannot be directly observed and decide which of them has the higher quality audit. But the size, history, and brand of auditing companies can be the distinguishing criteria of audit quality. Saqafi and Motamedi (2011) examined the relationship between audit quality and investment efficiency in companies with high investment opportunities. The results show that the companies with high investment opportunities use higher quality auditors and they usually experience a higher level of investment efficiency. However, on the contrary, the higher audit quality does not have any effect on discretionary accruals. Ahmadpoor et al (2010) examined the impact of corporate governance and audit quality on the cost of debt financing (borrowing). The results show that the presence of institutional investors among the composition of the investors of a company and monitoring their performance has a significant effect on the cost of corporate debt, while audit quality does not take effect.

RESEARCH METHODOLOGY
Methodology

This is an applied research; basically this is a descriptive correlational design which was conducted in terms of the variables.

Statistical Population, Statistical Sample and Sampling Method

The population of this study is all companies listed in Tehran Stock Exchange. To determine the sample, a purposive sampling (systematic elimination) was used. These companies have been selected from the population:

1. Companies which have participated in the exchange during fiscal years 2007 to 2012.
2. These companies should not be banks, investment companies, intermediaries, insurance, financial and monetary institutions.
3. The end of their fiscal year should be March and their financial year during the research should not change much.
4. Within the scope of the research, the trading halt for more than 6 months are not allowed.

After sampling limitations, 88 companies were examined during 2007 to 2012 (432 year-company). In this study, the quantitative data, companies that are members of the Stock Exchange, were collected through TadbirPardaz Rah AvarNovin databases and official site of Securities and Exchange Organization of Iran. Excel and SPSS were used for data processing.

Research Hypotheses

Given the studies cited in the field of auditing and corporate governance, caring about audit quality is of utmost importance. This issue is in different degrees of importance for owners. Therefore, our research hypothesis can be expressed as follows:

1. Institutional Ownership has a significant and positive effect on audit Quality.
2. Ownership concentration has a significant and positive effect on audit Quality.

Hypothesis Test and Analysis Methods

To investigate the role of ownership structure and culminating in the institutional owners on companies listed in Tehran Stock Exchange, logistic
regression tests were used between institutional ownership and Ownership concentration and audit quality during the sampling period.

**Operational definition of concepts and research variables**

**Dependent variable**: indicators of audit quality

Thanks to the fact that audit quality has different dimensions and it is inherently imperceptible, there is no auditing feature which is considered as the index to measure. Most previous studies used auditor's reputation as an index to measure audit quality. Studies conducted by Shah, Abid Ali et al (2012) and Antonius (2013) shows that large audit firms will enhance the quality of audit reports. Auditor industry specialization is among other common indicators (Rusmin, 2010). Auditor industry specialization has more specialized knowledge about that particular industry and this is the competence and quality of audit work. Some researchers like Zhang & Vang (2012) and Mohammed Hamdan (2013) used this criterion. Some researchers like Antonius and Nopmanee used auditor tenure as a measure of audit quality. According to the audit quality criteria used in previous research, in this study, for the calculation of audit quality, audit firm size and audit tenure criteria were used.

**Audit Firm Size**: from auditors' points of view, auditor's ability and economic incentives can have an influence on audit quality. It should be noted that the professional and experienced auditors have greater understanding towards mistakes in financial statements, and this can increase the quality of audit decisions. The most important index of fame of auditor is the size of audit institution. From theoretical views, there are some reasons for expected direct relationship between auditor fame and ability of supervision of auditor. The big audit institutions vividly have more resources to guide audit tests. Most of the empirical studies of quality are based on the hypothesis that bigger auditors (with trademark) compared to smaller auditors (without trademark) have more supervision ability. For the variables of audit firm size, if the auditee's company have been audited over the course of 6 years of research, the dummy variable in audit firm size would be equal to one, otherwise its value is considered zero.

**Independent Variables**:

Institutional ownership: according to the definition used in this study and others studies (like Azibi et al), institutional ownership refers to the total ownership shares of banks and insurers, holdings, investment companies, pension fund, enterprise funds and investment funds, organizations, institutions and government-owned companies and generally major corporate shareholders. \[
S_{i,t} = \left( \frac{1}{\sigma} \right)
\]

Ownership concentration: Ownership concentration refers to the case that considerable amount of company stock dedicate to major stockholders. To calculate the ownership concentration, Herfindahl–Hirschman Index was used. This index is called Herfindahl indicator and it is a statistical measure for concentration degree. The percentage of each of the institutional owners is the sum of squared terms (the percentage of ownership of each institution).

\[
\sum_{i=1}^{k} s_{i,t}^2
\]

**Control variables**:

A) **Size**: to calculate the size of the audited company, the natural logarithm of company's value at the end of the period was used.

\[
\text{SIZE}_{i,t} = \ln ( MV_{i,t} )
\]

B) **Financial Leverage**: it is the ratio of total debt to total assets.

**Logistic Regression Model for Testing Hypotheses**:

In this research, to test the relationship between variables, logistic regression model was used based on the model used by Astami and Tover (2006) and Zurigat.

The model used for the first hypothesis: \( AQ = a + B_1IO + B_2SI + B_3LE \)

The model used for the second hypothesis: \( AQ = a + B_4CO + B_5SI + B_6LE \)

**RESULTS AND DISCUSSION**

**The results of the first hypothesis**

Table (1) shows the results of the first hypothesis for independent and control variables. According to the regression coefficient (2.684) and the significant level (0.002), we can conclude that institutional ownership has a positive and significant effect on audit Quality. Thus, the first hypothesis is accepted with 95% confidence.

### Table 1: Logistic Regression Coefficients Table

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficients</th>
<th>Standard</th>
<th>Wald Test</th>
<th>Degree of</th>
<th>Significant</th>
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Two control variables like audit Quality and financial leverage have significant and inverse relationship with audit Quality. This means, the greater the company and its financial leverage, the lesser the audit Quality. Moreover, when the impact of company's size is evaluated individually on audit firm size, the regression coefficient of 0.75 is positive. This means, the greater the company's size, the lesser the audit firm size.

Statistical analysis of the results of the regression models in Table 1 are as follows:

\[ \text{AQ}=17.975+2.383 \text{OC}-.806 \text{ SI } -4.137 \text{ LE} \]

To evaluate the adequacy of the aforementioned regression equation, the coefficient of determination were calculated by using Lisrel model and the results showed that the coefficient of determination is equal to 0.845. Therefore the proposed model is very good.

### The results of the second hypothesis

Table (2) shows the results of the first hypothesis for independent and control variables. According to the regression coefficient (2.383) and the significant level(.006), we can conclude that ownership concentration has a positive and significant effect on audit Quality. Thus, the first hypothesis is accepted with 95% confidence.
compared to other investors with limited number of company share. Thus, by considering the above items in the companies with high ownership concentration, using audit services of audit organization as audit organizations have considerable fame and credit. According to the research findings, it could be concluded that with regard to the implementation of Article 44 in relation to privatization, along with allocating the companies’ stocks to institutional investors, Paving the way for ownership concentration in these companies, managers should be encouraged to use the services of a quality audit, so that through reducing Information asymmetry, proper context for collecting dead capital and utilizing these financial resources in economically justified schemes is provided. The findings of this study are in line with the findings of similar studies undertaken in other countries such as Asbaugh and Warfield(2003) Azibi et al(2010).

REFERENCES