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## Article

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## The Effect of Audit Committee Characteristics and Auditor Changes on Financial Restatement in Iran

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### ABSTRACT

The present study aims to realize and become more familiar with the impact and the functions of audit committee and its characteristics, including the expertise and independence of members, related experiences, and change of auditor on the quality of financial reporting in companies listed on the Tehran Stock Exchange (TSE).

The required data are gathered from 105 listed companies on the TSE during 2012-2016 and logistic regression model is used for the hypothesis testing.

The findings of the study indicate a positive and significant impact of audit committee characteristics, except audit independency which represents a negative association, and changes of auditor on financial restatement.

The innovation of the present study relative to other conducted studies lies in the simultaneous evaluation of audit committee characteristics and change of auditor on the quality of financial reporting. Such results could be appropriate for Stocks and Securities practitioners to comply with the chart of the audit committee, to necessitate the use of corporate governance principles, and to voluntarily provide a corporate governance report.

**Keywords:** financial reporting quality, audit committee characteristics, financial restatement.

**JEL classification:** M42; M48; M41.

**MSC2010:** 62J05; 62J86; 62M10.

# El efecto de las características del comité de auditoría y los cambios de auditor en el restablecimiento financiero en Irán

## RESUMEN

El presente estudio tiene como objetivo comprender y familiarizarse más con el impacto y las funciones del comité de auditoría y sus características, incluida la experiencia y la independencia de los miembros, las experiencias relacionadas y el cambio de auditor sobre la calidad de la información financiera en las empresas que cotizan en la Bolsa de Valores de Teherán (TSE).

Los datos requeridos se recopilan de 105 empresas que cotizan en el TSE durante 2012-2016 y se utiliza el modelo de regresión logística para la prueba de hipótesis. Los hallazgos del estudio indican un impacto positivo y significativo de las características del comité de auditoría, excepto la independencia de la auditoría que representa una asociación negativa, y los cambios de auditor en la reexpresión financiera.

La innovación del presente estudio en relación con otros estudios realizados radica en la evaluación simultánea de las características del comité de auditoría y el cambio de auditor sobre la calidad de la información financiera. Dichos resultados podrían ser apropiados para que los profesionales de acciones y valores cumplan con el organigrama del comité de auditoría, requieran el uso de principios de gobierno corporativo y proporcionen voluntariamente un informe de gobierno corporativo.

**Palabras clave:** calidad de la información financiera, características del comité de auditoría, reexpresión financiera.

**Clasificación JEL:** M42; M48; M41.

**MSC2010:** 62J05; 62J86; 62M10.



## 1. Introduction.

The history of the audit committee in America dates back to 1940. Since then and after the occurrence of McKesson Robbins Fraud, the American Stock Exchange suggested all listed companies on the New York Stock Exchange to introduce the independent auditors as a group of unbounded managers of the board and negotiate with them about signing audit contract and determining an audit fee. The organization names this unbounded group as the audit committee. In 1971, the bill passed by the American Stock Exchange. The organization believed that the presence of an audit committee is the most appropriate way to support the interest of investors in public companies. Following that in 1978, the New York Stock Exchange obliged the listed companies to establish an audit committee. In compliance with this policy, the companies listed on the American Stock Exchange were also recommended, but not obliged, to set up an audit committee. According to latest research studies, an audit committee is created in more than 90% of large public American corporations. The legal and professional authorities are seriously concerned about the responsibility of public companies to beneficiaries to protect their interests. The main role of the audit committee is to supervise the process of financial reporting in companies. Although audit committee provides the most reliable protection from the public interests, previous studies on audit committee not only indicate various types of expertise and skill of board members but show the lack of sufficient experience and financial expertise among a large number of audit committee members in finance and accounting (Alzeban & Sawan, 2015).

The audit committee is one of the most effective committees that by influencing the corporate governance, is in association with the board of directors and help the board shoulder its supervisory responsibilities on management, lessen the information asymmetry among managers and shareholders, lower the agency costs, and present a transparent financial report. The members of the audit committee are mostly the unbounded members of the board, who interact between independent auditors and the internal auditors (Habib & Bhuiyan, 2016).

Bédard and Gendron (2009) also believe that the audit committee is able to prevent from financial restatement directly, through monitoring the financial reporting, and indirectly, by supervising the internal controls and independent auditing. In general, by improving the information quality and imposing stringent control, we would be able to foster the trust of the investors of the quality of financial reporting and the efficiency of the financial markets.

Our findings contribute to prior literature in some ways. Firstly, we contribute to the disclosure literature by highlighting how audit committee can influence the financial reporting quality. Whereas Cai et al. (2014) find that firms imitate the voluntary disclosure policies of other firms, and Cheng et al. (2018) find that when the disclosure is mandated, board connections inform connected firms on how to best avoid the same deficient practice.

Secondly, many empirical studies examine the costs and benefits of legislation and primarily on disclosing (e.g. Hochberg et al., 2009), specifically in developing countries, whereas this is the first empirical analysis which examine the quality of financial statements incorporated with audit committee in an emerging country. We achieve the objective of the study by demonstrating how audit committee members affect firms' internal control and reporting practices.

The rest of the paper is organized as follows. Section 2 describes the related literature and develops hypotheses. Section 3 discusses the data and specifies the empirical methods. Section 4 presents the results. Section 5 discusses the findings and concludes the paper.

## 2. Theoretical principles and literature review.

The exact definition of the competencies of the audit committee plays a leading role in the effectiveness of the committee. The authorities of the committee are actually defined by the written regulations dictated to the committee. Based on these regulations, the authorities, responsibilities, and scope of power are defined clearly. The main responsibility assigned to the audit committee in most countries under the business law, which is even compulsory in some of them, is to study and investigate the audited financial statements before they are passed by the board of directors. In other words, in most countries, the main objective of the audit committee is to exercise a strict supervision on financial reporting process of the firm. In addition to the mentioned functions, audit committee takes other responsibilities, as well.

According to Lindsell (1992), audit committees would higher the firm standards in case they employ experienced, expert, and responsible manager for a conscious, decisive, and fearless competition. This is while they are in line with the process of financial reporting, monitor the responsibilities of the managers to maintain the effective system of internal control, support the auditors to present the findings and viewpoints freely, and help them independently settle the disputes between auditors and managers.

By the increase of the number of frauds, which led to the bankruptcy of large corporations some concerns were aroused on the quality of financial reporting. The U.S. Congress established a special committee to draw up some strategies to combat fraud and corruption, which result in the formulation of the Sarbanes Oxley Act. The act emphasizes the role of the audit committee, ensures the quality of financial results, and expands the committee (Sultana & Van der Zahn, 2015).

The law has led to the advent of a well-built regulatory authority, named public company accounting supervisory board to monitor accounting and auditing. The role of the board is to provide new auditing standards, set the required accounting principles, establish the standards of quality control for auditors, and publish the professional code of ethics. The Sarbanes Oxley Act developed special regulations for the audit committee (Keinath & Walo, 2008).

The agency theory defined how the audit committee could affect the quality of financial reporting. According to the agency theory, it is assumed that all parties to the contracts should act based on their own personal interests. Shareholders are not able to monitor and control the manager due to the constraints of the corporate governance structure and other limitations. A close supervision is possible when shareholders are able to monitor the decisions of the management effectively, but they could engage themselves to such a process due to high costs and in some cases due to lack of experience and knowledge (Salehi & Shirazi, 2016). By doing this, the board is obliged to design and set the supervisory mechanisms due to its commitment to the shareholders. The board usually employs a group of experts and specialists to monitor the managerial activities of its agencies. The audit committee is a marginal committee within the framework of corporate governance, to which the board assigns some of its supervisory duties (Dezoort et al., 2002).

Sun et al. (2014) believe that the presence of an audit committee, besides enhancing the quality of corporate governance mechanisms, could increase the quality of financial reporting. Cohen and Zarowin (2010) indicated that the presence of an audit committee could lower the earnings management, compared with before the existence of such a committee among the American companies.

Restatements may apprise the investors of the critical economic status of the firm presenting the restatement. Within the past decades, financial restatements brought more concerns on the quality of financial reporting and caused numerous problems within the internal control and corporate governance system of the firms. Within a study on the impact of corporate governance on financial restatement, Zhizhong et al. (2011) discovered that by having an independent and efficient audit committee and external governance, like major shareholders and powerful independent auditors, we would be able to prevent financial restatements and errors.

According to the definition of Jiang et al. (2015), should a company restates its financial statements within a fiscal year and this results in a change to the items of the balance sheet and profit and loss statement, an earnings management-driven restatement occurs and in case the restatement is due to causes a change in the cash flow, a cash flow management-driven restatement will happen. In this regard, Afshad et al. (2011) investigate the attributes of and the market reaction to restatements disclosed via two restatement disclosure venues (8-Ks and 10-Ks/10-Qs) in USA. They document that stealth restatements have less severe restatement attributes than 8-K restatements. Specifically, restatements not affecting net income, with longer filing delays, and not subject to SEC investigation are more likely to be stealth. In addition, their results suggest that restating firms that changed audit firms since the end of the restatement period and their current auditor is one of the big four accounting firms are more likely to disclose 8-K restatements. Gondhalekar et al. (2012) also investigate both the short- and long-term share price reaction to announcements of financial restatements cited in the U.S. Their study suggest that the average cumulative abnormal return (CAR) for restated companies is significantly negative for the three-day window surrounding the day of announcement. The average CAR for the one-year period prior to the announcement and for each of the four years after the announcement are negative as well. Huang et al. (2011) study the impact of corporate governance on financial restatements in China, with a view to providing reference to strengthen the corporate governance and improve the quality of financial information. Their finding suggest that accounting misstatements related to performance could be prevented or restrained by strong internal governance. These governances include a board of higher percentage of outside directors and an audit committee that could oversee the accounting and financial reporting process on behalf of all shareholders, and outside governance, such as a big stockholder and a strong outside auditor from the Big4 accounting firms. However, the matched test shows the effect of audit committee on controlling restatements is endogenous, which relies on the effects of other governance factors. Eshagniya and Salehi (2017) examine the effect of financial restatement on changing the auditor in the following years. The results of their paper present that restatement does not cause auditor changes and that as the severity of a restatement increases, the auditor change in the following year of restatement also does not increase. Restating companies having strong governance do not go for auditor changes as compared with other companies. Sharma (2005) examines the effects of independent audit committee member characteristics and auditor independence on financial restatements. The empirical results of her study suggest that independent audit committees are more effective overseers of the corporate financial reporting and auditing processes when: they comprise majority experts, they meet regularly, their members are reputable, and audit committee members are appropriately compensated. On the other hand, external auditors are not deemed to be effective overseers of the corporate financial reporting process when the non-audit services and total fees generated by the client are higher but are effective when audit firm tenure is long. The results support the SEC's concerns regarding the provision of non-audit services impairing auditor independence. The results also support the Sarbanes-Oxley Act of 2002 which under Section 201 prohibits external auditors from providing certain non-audit services to its audit client. Overall, these results support the regulatory efforts to increase the quality of financial reporting by enhancing the corporate governance process related to audit committees and auditor independence.

## **2.1. Reasons for financial restatement.**

There are several reasons for financial restatement. In general, these reasons are divided into four general groups of environmental structure and the firm's terms of activity, managerial characteristics and corporate governance structure, characteristics of accounting standards, and audit quality of financial statements.

The first reason is related to environmental structure and the firm's terms of activity. Francis et al. (2012) found that firm size, financial performance, type of industry, and non-financial indices of firm performance influence the financial restatement.

Within their study, Hennes et al. (2014) concluded that there is a significant and direct relationship between the fame and credit of an auditor and the range of financial restatements. In

addition, they noticed that if the auditor has a great fame and credit, most of the restatements are similar to the error of the previous year, not frauds.

#### 2.1.1. Managerial characteristics and corporate governance structure

Aier et al. (2005) declared that the experience and educational level of managers has a negative and inverse association with the financial restatements, such that restatement in companies with more experienced and specialized managers is largely less than of the other companies.

Efendi et al. (2007) state that companies with financial restatements suffer from a weaker corporate governance structure, while the CEOs of such companies are the directors of the board, at the same time. Assigning an unbounded board of directors would guarantee that important issues related to the interest of shareholders are not fully covered in the board sessions. In case the CEO is the director of the board, he/she would control the agenda during the meetings and does not disclose the important information completely, so the board is not able to evaluate the performance of the board, appropriately (Abdullah et al., 2010).

Normally, the separation of the roles of CEO from the director of the board is to the benefit of the shareholders.

#### 2.1.2. Characteristics of accounting standards

Eshagniya and Salehi (2017) showed that only in few cases the financial restatement is due to the type of characteristics of accounting standards and non-transparency of the entire standard texts.

#### 2.1.3. Audit quality and financial statements

Wilson (2008) carried out a study on the decrease of the information content of profit after the financial restatement. Based on the result of the study investors believe that the profits of restatement have relatively less information content.

#### 2.1.4. Features of the audit committee

Lin and Hwang (2010) illustrate that some of the features of audit committee could increase its effectiveness. Such features, on which most of the experimental studies are concentrated, include financial expertise, independence, and experience. Moreover, these features are in particular related to the improvement of financial reporting quality (Martinov-Bennie et al., 2015).

Salehi and Shirazi (2016) conducted a study on the effects of audit committee features on the quality of financial reporting and found a positive and significant relationship between these two factors.

#### 2.1.5. The financial expertise of audit committee members

The Blue Ribbon Committee declares that the financial expertise of the audit committee could lead to the growth of effectiveness. The Sax law has also obliged the boards of companies in 2002 to establish an audit committee among the independent managers and to assign at least one financial expert. Abdullah et al. (2014) and Amer et al. (2014) argue that the financial expertise of audit committee members increases the chance of detecting significant distortions.

In order for close monitoring of the reporting process of a firm, the audit committee members should be financially informed and experienced to be able to interpret the financial statements. Financial expertise armors the audit committee members with cognizant questions and confronts the managers with challenges. This, in turn, gives rise to the transparency of reporting and lessens the agency problem derived from the information flow (Klein, 2007).

A considerable portion of studies on the audit committee is concerned about the consciousness and access of committee members to financial reporting. The advocates of the agency theory argue that the presence of some financially expert members could elevate the capability of the audit committee to be ensured of the project, qualification, and competency of independent auditors and also broadens the understanding of the auditor during the audit procedures. In addition, the presence of financially expert members in the audit committee would lower the conflict between managers and their auditors (Sultana & Van der Zhan, 2015).

Corporate governance in companies with financially expert members in their audit committee will be enhanced (Defond et al., 2005). This is while an audit committee with no financial expertise depends on independent auditors to rely on and trust to the information and accounting digits (profit) requires for the customer.

Moreover, Sultana & Van der Zhan (2015) indicated that the knowledge and financial and accounting education of the audit committee members could improve the quality of financial reporting.

Within a study on the relationship between the quality of financial reporting and the features of the audit committee, Abbott, Park, and Parker (2000) noted that distorted presentation of financial statements is lower in companies with the audit committee and financial experts.

After conducting several studies on the capital market, Defond et al. (2005) concluded that the presence of an audit committee with independent, specialized, and experienced members in the field of accounting and auditing has a substantial impact on the published information in the market.

Abbott et al. (2002), Agrawal and Chadha (2005), Abdullah et al., (2010), Amer et al. (2014), Bhardwaj and Rao (2015), and Bansal and Sharma (2016) suggested that the presence of members with accounting and financial expertise in the audit committee has a significant relationship with the financial restatements.

So, the first hypothesis is formulated as follows:

**H<sub>1</sub>:** There is a positive and significant relationship between the financial expertise of audit committee and financial restatements.

## **2.2. Independence of audit committee.**

In modern auditing, much emphasis is put on non-executive (independent) managers of the audit committee and these independent managers attempt to be ensured that the decisions of executive managers are in accordance with the interests of shareholders (Abdullah et al., 2014).

The American Stock Exchange stresses that it is better to have no audit committee than having a committee all members of which are executive managers because they project no accurate image of the status of the firm (Bansal & Sharma, 2016).

The independence of audit committee, which is one of the salient features of the committee, is of great importance. The independence of audit committee has attracted the law-makers and scholars (Abbott et al., 2004).

To perform their monitoring role and to protect the interests of shareholders, the audit committee members should be independent of firm management. The view of the advocates of the agency theory, by arguing that audit committee has a higher percentage of unbounded managers in performing its duties, is less in risk and, besides, an independent audit committee could settle the conflicts (Jackson et al., 2009).



Independence is one of the major characteristics of the audit committee, which is emphasized heavily. An independent audit committee could limit the role of firm managers, prevent the manipulation of financial results, lower the number of distorted and biased financial statements (Bedard et al., 2004), and finally improve the quality of financial reporting in firms (Goodwin, 2003).

The results of Abbott et al. (2004), Carcello et al. (2011), Lary and Taylor (2012), Bansal and Sharma (2016), and Poretti (2018) indicate a significant association between audit committee independence and financial restatement. Moreover, Marciukaityte et al. (2009) observed that the probability of optional restatements has a positive relationship with the independence of audit committee members and Nabar et al. (2009) realized that companies with financial restatements have weaker corporate governing bodies, like the board of directors and audit committee with inferior independence.

The results of Abbott et al. (2004) are based on the theory that an independent audit committee has no personal and financial reliance on the executive management. Hence, it is probable that an independent audit committee is disagree with the management in some certain cases but it is expected from the independent managers to seek for a high-quality audit and to attempt more consistently to minimize frauds and earnings management.

In contrast, the findings of Chan et al. (2012) suggest a negative relationship between the independence of audit committee and audit fees.

The results of Beasley & Salteiro (2001), Carcello and Neal (2000), Qasim (2018) were undoubtedly based on the theory that independent audit committees have no personal or financial reliance on the management. Thus, it is possible that an independent audit committee opposes the management in some certain cases. So, it is expected from the independent managers of the executive section to seek for high-quality audit and to try for fewer frauds and earnings management. So, the second hypothesis is proposed as follows:

**H<sub>2</sub>:** There is a positive and significant relationship between the independence of audit committee and financial restatements.

### **2.3. The experience of audit committee.**

The experienced members of the audit committee analyze the results of what obtained by the independent auditor at the presence of executive managers, including any limitation within the scope of consideration of an independent auditor, any disagreement between the independent auditor and the management, key accounting and auditing judgments, errors, financial reporting amendments, and audit fee and settle the disputes between the firm managers and an independent auditor (Van der Nest et. al, 2008; Zainal, 2016).

Audit committees, as the guiding activities, may be a combination of members who gained experience in major and different areas, like financial reporting, auditing, industrial management, risk management, and technology (Samaha et al., 2015).

To fulfill the main responsibilities of the audit committee, it is better for all members of the committee to have a financial experience and to be able to comprehend the issues of financial reporting and complications derived from the business activity of firms. Asking for financial and accounting experience for the maximum of committee members is not something weird. Audit committees, in addition to the so-called specializations, should make use of knowledge of industrial experts and other specialists to solve the unique problems of companies and/or their related industries (Habib & Bhuiyan, 2016).

In 1998, Dezoort (1998) expressed some advantages for the experienced members of the audit committee. First, since the experienced members of the audit committee have trained previously, their

performance and feedback are assessed and they have sufficient technical knowledge in their field of specialization. Second, the experience members make more effective use of the suspicious cases during their evaluations, while inexperience members may not even recognize the issue. Third, the experienced members of the audit committee, by relying on their own experience, have better systematic performance, understanding, and interpretation in detecting the particular cases and judging about them. Fourth, there is more consistency and consensus among experienced members of the committee, this means that in case of the presence of similar environmental information and factors, more balanced judgments will be made. Hence, the experience of the members will increase their judgment ability.

In sum, companies with less experienced committee members are less capable of performing their monitoring duties (Hundal, 2013).

So, the third hypothesis will be proposed as follows:

**H<sub>3</sub>:** There is a significant and positive relationship between the related experience of the audit committee and financial restatement.

## 2.4. Auditor Change.

The bankruptcy of large corporations at the beginning of the present century caused the reliability of financial statements to gain an increasing growth in the public opinion. After the downfall of the Enron company, the crash of the American Stock Market in 2001, and with regard to the Sarbanes-Oxley Act on the one hand, and the corporate governance regulations of the European Union on the other hand, it is specified that the listed companies on the American Stock Exchange change their audit manager within a certain interval to prevent the recurrence of financial distortions of companies, like Enron and WorldCom. Although at that time most of the scholars believed that change of auditor does not prevent from financial corruption, the critical setting of the American Stock Exchange and the collapse of the financial market made an excuse to limit the auditors (Zhang, 2018).

By accumulating the evidence of the first year of auditor change, we observed some errors due to lack of knowledge and information on customers, so the chance of an unreasonable audit is high. Hence, the first year of auditor change in the audit committee is called the critical period (Kalelkar, 2016).

So, the fourth hypothesis will be designed as follows:

**H<sub>4</sub>:** There is a significant and positive relationship between auditor change and financial restatements.

## 3. Research methodology.

The present study is practical, in terms of objective and correlational-descriptive, in terms of nature and method because on the one hand, it analyzes the status quo and on the other hand, it determines the relationship among different variables using the regression analysis.

### 3.1. Research models and variables.

This paper is concerned about the relationship between audit committee features, auditor change and financial restatements and audit fees. The following model is used to test our hypotheses:

$$RET_{i,t} = \beta_0 + \beta_1 ACE_{i,t} + \beta_2 ACI_{i,t} + \beta_3 ACT_{i,t} + \beta_4 ACH_{i,t} + \beta_5 TENURE_{i,t} + \beta_6 SIZE_{i,t} + \beta_7 LEVE_{i,t} + \beta_8 AFEES_{i,t} + \beta_9 BIG_{i,t} + \beta_{10} A-REP_{i,t} + \beta_{11} INDUSTRY_{i,t} + \varepsilon_{i,t}$$

The following definitions are presented for models' variables:

### 3.1.1. Dependent variable

**RET (Financial restatement):** is a two-dimensional (dummy) variable with the value of 1 for restated financial statements and 0 otherwise. It is notable that based on Iranian Accounting Standards, which is the only applicable set of standards in our sample selection, companies are allowed to restate their financial statements in presence of two conditions. (1) If an error was occurred by company in former years and is discovered in current year. (2) Applying a change in accounting procedures in which the financial effect of these changes is applicable in former years through restating financial statements, in order to provide comparability between different periods, change in amortization procedures of fixed assets, and change in evaluating procedures of inventories are to examples in this regard.

### 3.1.2. Independent variable

**ACE (Audit Committee Expertise):** is equal to the proportion of financially expert members to the total members of the Audit Committee, in accordance with the code 6 of article 1 of the Audit Committee Charter. The financial expertise of members is included of a university degree, an internal or international professional certification in finance-related majors (accounting, auditing, financial management, economics, or other financial or economic management discipline), along with the ability of analyzing financial statements and reports and internal control applied in financial reporting. The importance for the financially expert audit committees' members was emphasized in the Smith Report (2003).

**ACI (Audit Committee Independence):** is equal to the proportion of independent members to total members of the Audit Committee (Chan et al., 2012). An independent member, according to paragraph 1 of Article 1 of the charter of audit committee is defined as someone who has no connection or in/direct interests to affect ones unbiased decisions, who causes no partiality of his/her interests or a special group of shareholders or stakeholders, or who causes to not regulate the mutual interests of shareholders.

**ACD (Audit Committee Experience):** is equal to the proportion of financially experienced member to total member of the Audit Committee (Krishnan & Visvanathan, 2008).

**ACH (Auditor Change):** is a proxy for auditor change in respect to prior year. In this article, in case of auditor change, we assign 1, and 0 otherwise.

### 3.1.3. Control variable

**SIZE (Firm size):** is the total value of all share of i company in the year<sub>t</sub> that is the indicative proxy of management ability and the quality of accounting systems. In case the firm is affiliated with large corporations 1, and 0 otherwise.

**LEVE (Financial leverage):** is equal to total debts divided by total assets of the company.

**A-FEES (Audit fees):** is equal to the natural logarithm of audit cost.

**BIG (The size of audit firm):** in this paper, auditors (audit firms) are divided into two groups. Given that the Iranian National Audit Organization, due to the presence of excessive number of staffs and more power, are considered as large auditors and other audit institutes are recognized as small auditors (small audit firms). In this study, for companies audited by the Iranian National Audit Organization, we assign 1 and 0 otherwise.

**A-REP (Type of audit report):** is the auditor opinion. If the auditor opinion of fiscal year is unqualified, we assign 1 and 0 otherwise.

**INDUSTRY (industry specialization):** In company (i) in year (t) shows the range of concentration and skill of the auditor in the desired industry and the ability to explore the threats and risks related to each industry. Therefore, the focus of this study is on industries the number of population of which is growing in the Stock Market. Basic metal industries, chemical products, automotive and part manufacturing, pharmaceutical materials and products, cement, plaster, and lime and other non-metallic mineral products are classified in this section. To measure the industry specialization we use Market Share Based on Company Size (Total Assets). The market share with regard to the total assets of the company is calculated in the following method:

**Total assets of all clients any special audit firm in a particular industry**

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**Total assets of all employers in the industry**

Only institutions are regarded as industry specialized in this research whose market share (meaning the result of the above equation) is more than  $[1/2 * (\text{companies in the industry} / 1)]$  is (Palmrose, 1986).

**TENURE (Auditor tenure):** from 30<sup>th</sup> of July, 2007 the Securities and Exchange Organization of Iran, by implementing the 24<sup>th</sup> resolution of the Supreme Council, passed the guideline of accredited audit institutions of Securities and Exchange Organization to advocate the rights and interests of investors, to organize and develop the securities market, and to strictly monitor the capital affairs. According to this guideline, the regular change of institutions and audit partners is necessary during a 4-year period. The provision of the aforesaid guideline is for all companies listed on the TSE. Based on this guideline and the study of Namazi et al. (2010), to calculate an auditor tenure in the regression model for companies that did not change their auditors for 4 years, number 1 and 0 otherwise.

### **3.2. Statistical population and sampling method.**

The population under study should have the following unique qualifications. The information of these companies is studied for a period of 5 years during 2012-2016.

The sample of the study is selected from the statistical population of companies listed on TSE through systematic elimination method, such that those with the following features will be included:

1) The statistical population of this study comprises all listed companies on the TSE during 2012-2016 (5-year period) with the following qualifications:

- Being listed on the TSE until the end of 2010;
- Should not change their financial year end during the term of study;
- Should be active during the term of study and their stocks being transacted;
- Should completely present their financial information during the term of study; and,
- Should not be affiliated with investing, banks, and financial intermediaries.

In this paper, the screening (elimination) method is used for determining the statistical population, such that the qualified companies are selected and evaluated as the sample of the study and other companies were eliminated.

The sample of study obtained after placing the above-mentioned limitations on the statistical population and then the information related to the research variables will be achieved.

The required data and information, concerning their nature, are extracted from financial statements of companies as well as data software of TSE used as the financial information database of listed companies. Some websites, like Codal.ir, were also used for gathering data and information.

This paper is among correlational-retrospective studies. Research data, concerning the type and nature, were initially gathered through library method, then using the financial statements. After, given the unavailability of some data, some software, including Rah-Avaran Novin were used. Finally, the collected data entered the Excel Software and analyzed by the Eviews Software.

## 4. Research findings.

### 4.1. Descriptive statistics.

First, we describe how the required number of companies remained for fitting in Table 1.

**Table 1. The statistical simple.**

<b>Calculation</b>	
Total number of stock companies	805
Inactive firms	308
Leasing and insurance companies	87
Companies with change of time period	184
Inactivity for 6 months	88
Companies with no available information	33
Companies remained in the study	105

Source: Own elaboration.

In Table 2, auditor change, experience related to the audit committee, auditor tenure, financial restatements, type of auditor report, and audit firm size are two-sided nouns or apparent variables (fuzzy or dummy), are specified with code 1 and 0. Frequency, frequency percentage, and mode are used to describe these variables regarding their measurement scale.

**Table 2. Frequency, frequency percentage.**

<b>Variable</b>	<b>Frequency</b>		<b>Frequency percentage</b>		<b>Total No.</b>	<b>Mode status</b>
	0	1	0	1		
Auditor change	107	418	20	80	525	1
Experience related to audit committee	184	341	35	65	525	1
Auditor tenure	143	382	27	73	525	1
Financial restatement	15	510	3	97	525	1
Type of auditor report	272	253	52	48	525	0
Audit firm size	390	135	74	26	525	0

Source: Own elaboration.

As can be seen in Table 2, number 418 for no change in auditor position and number 328 for auditor tenure of more than 4 years indicate that the business firms were not willing to change their financial affairs. This may be due to the familiarity of the department with the accountant and the friendship of accountant with the activity of the business unit. Moreover, number 510 for financial restatement and 273 in a conditional report of the auditor are among several problems derived from lack of change in the accounting department of a business firm.

The descriptive statistics of research variables, including mean, standard deviation, etc., are presented in Table 3 by separating the variables and years.

**Table 3. Descriptive statistics of the entire year-company.**

Variable	Minimum	Maximum	Mean	Standard deviation
Auditor change	0	1	0	0/40
Audit fee logarithm	1.09	9.08	6.09	1.05
Type of report	0	1	0.49	0.50
Financial expertise of audit committee members	0	1	0.66	0.42
Related experience of audit committee members	0	1	0.65	0.47
Independence of audit committee members	0	1	0.52	0.34
Type of audit firm	0	1	0.26	0.43
Financial leverage	0.104	1.76	0.62	12.90
Financial restatement	0	1	0.98	0.231
Firm size	10.49	19.25	14.09	1.46
Auditor tenure	0	1	0.73	0.44

Source: Own elaboration.

Type of industry is a control variable, which should be controlled and considered altogether in industries. As mentioned in Table 3, the 66% calculated mean for the financial expertise of audit committee members indicates that most companies are trying to establish an audit committee composed of specialized members in the field of finance and accounting. In addition, the 65% mean of related experience of audit committee members also shows that related members were maintained in audit committee composition. 98% mean of financial restatements reveals that most of the companies have restated their financial statements. 73% mean of auditor tenure is also indicative of the weak behavior of most of the companies to change of auditor.

Now, we evaluate the inferential statistics and fitting of research hypotheses.

#### 4.2. Results of research hypothesis testing.

By entering the research data into the Eviews Software, we carry out the model fitting procedure. Within these analyses, to check whether the hypotheses are in/significant, we should consider the probability level of final output. If the probability level of a variable is less than 0.1, the hypothesis will be rejected.

For the combined data, first, we should select an appropriate model, integrated data or panel data model, for model estimation. Hence, the F-Limer and Breusch-Pagan tests are used in this paper, the results of which are presented in Table 4.

**Table. 4 F-Limer and Breusch-Pagan tests.**

Exp.	F-limer						Breusch-pagan						Result
	Sectional		Time		Sectional-Time		Sectional		Time		Sectional-Time		
	Statistic	Prob	Statistic	Prob	Statistic	Prob	Statistic	Prob	Statistic	Prob	Statistic	Prob	
Model	0.98	0.53	0.58	0.97	0.78	0.93	0.15	0.69	0.39	0.34	0.96	0.16	Pooled

Source: Own elaboration.

In order to allocate the model type, we use F-limer, Breusch-pagan and Housman tests for Cross-section and time. The F-limer tests pooled-ability against the panel with fixed effect of the model. In this regard, the results of Table 4 suggest that based on statistic and prob. the H0 hypothesis which indicates pooled-ability is not rejected. Furthermore, in order to support the F-limer test, we use Breusch-pagan test that examine the pooled-ability against the panel with random effect of the model. The results of Table 4 also suggest that based on statistic and prob. the H0 hypothesis that indicates pooled-ability is not rejected. Therefore, the model type is pooled and we avoid applying Housman test. Furthermore, since the dependent variable of the study is dummy variable (1 and 0), therefore the lpm, logit and probit modeling are applied. The statistical results of these models are presented in Table 5.

**Table 5. The empirical results of hypotheses testing.**

Variable	LPM		LOGIT		PROBIT	
	Coefficient	t-Statistic	Coefficient	t-Statistic	Coefficient	t-Statistic
ACE	0.0004	<b>3.017***</b>	0.0004	<b>1.8449*</b>	0.0011	<b>2.384**</b>
ACI	-0.0007	<b>-2.245**</b>	-0.0003	<b>-2.344**</b>	-0.0004	<b>-3.480***</b>
ACD	0.0002	<b>1.845*</b>	0.0002	<b>1.944*</b>	0.0002	<b>2.543**</b>
ACH	0.0002	<b>2.876***</b>	0.0002	<b>2.489**</b>	0.0001	1.238
TENURE	0.0000	-1.017	0.0001	<b>2.905***</b>	0.0001	<b>2.375**</b>
SIZE	0.0003	<b>3.013***</b>	0.0002	<b>2.301**</b>	0.0002	<b>2.539**</b>
LEVE	0.0005	<b>2.605***</b>	0.0003	<b>2.649***</b>	0.0005	<b>3.608***</b>
A_FEES	-0.0091	<b>-4.327***</b>	0.0000	<b>-2.519**</b>	0.0000	<b>-2.319**</b>
BIG	-0.0002	-0.894	-0.0002	-1.456	-0.0003	-1.580
A_REP	0.0001	<b>2.20**</b>	0.0002	<b>3.160***</b>	0.0002	<b>3.565***</b>
INDUSTRY01	0.0000	0.407	-0.0001	-0.904	0.0001	0.607
INDUSTRY02	0.0005	1.456	-0.0002	<b>-3.432***</b>	-0.0002	<b>-2.936***</b>
INDUSTRY03	0.0009	<b>3.469***</b>	0.0004	<b>2.299**</b>	0.0008	<b>3.047***</b>
INDUSTRY04	0.0003	0.717	-0.0002	-0.704	-0.0002	-0.565
INDUSTRY05	0.0010	<b>2.229**</b>	0.0003	1.263	0.0007	<b>1.893*</b>
INDUSTRY06	-0.0003	<b>-3.369***</b>	-0.0004	<b>-3.502***</b>	-0.0003	<b>-2.698***</b>
D.W=1.76			McFadden R-squared=0.141		McFadden R-squared=0.148	
R <sup>2</sup> =0.64			S.D. dependent var=0.180		S.D. dependent var=0.180	
Adj-R <sup>2</sup> =0.61			LRstatisc=18.4		LRstatisc=19.41	
F-statistic=516.8			Prob(LR statistic)=0.047		Prob(LR statistic)=0.035	
Prob(F-statistic)=.00						

In above Table the \*, \*\*,\*\*\* are significant at the 0.10, 0.05, and 0.01 levels, respectively.

Source: Own elaboration.

Reported results of first hypothesis in Table 5 suggest that audit committee expertise is positively associated with financial restatements in three logistic statistical methods, it means that auditor expertise leads to more accurate financial statements, which is arisen from more correction in comparing items. Our findings, in this regard, is in line with the findings of Bansal and Sharma (2016), Bhardwaj and Rao (2015), Schmidt and Wilkins (2013), Abdullah et al., (2010), Persons (2009), Agrawal and Chadha (2005), and Abbott et al. (2002).

The presented results of second hypothesis suggest a negative and significant association between audit committee independence and financial restatements. This means that higher audit independency

cause less restatements in financial statements, the results of this hypothesis is significant in all three logistic methods. The findings in this regard is in contrast with the findings of Poretti et al. (2018), Qasim (2018), Bansal and Sharma (2016), Lary and Taylor (2012), Carcello et al. (2011), Marciukaityte et al. (2009), Nabar et al. (2009), Abbott et al. (2004), Bedard et al. (2004), and Goodwin (2003).

The results of third hypothesis also demonstrate a positive and significant association between auditor experience and financial restatements in three logistic methods. This also means that professional experience aids auditors to perform high quality services in which more errors or correction is found in prior years. In this line of study, Zainal (2016), Sultana and Van der Zahn (2015), Hundal (2013), Van Der nest et al. (2008), and Vafeas (2005) report similar conclusions.

The statistical results of fourth hypothesis also indicate that auditor change has positive impact on restating financial reports. It is notable that this association is meet only in PLM and LOGIT methods, therefore our results for this hypothesis is less strong than former hypotheses. Our findings are consistent with the results of Kalelkar (2016), Díaz et al. (2015), Files et al. (2014), Stewart and Munro (2017), Srinivasan (2005). Further results of control variables suggest that firm size, financial leverage and auditor reports are positively associated with financial restatements in three logistic methods. While auditor tenure has positive impact on restating financial statements only in LOGIT and PROBIT methods. Furthermore, audit fees has negative impact on financial reports which means cheaper audit contracts results in less work by auditors in audit services. Finally, the results of industry specialization suggest that second sixth industries are negatively associated, and third and fifth industries ore positively associated with restating financial reports.

## **5. Conclusion.**

The objective of this study is allocating the impact of audit committee characteristics on restating financial reports in and emerging market. The paper also aims to determine the effect of auditor change on financial restatements in accounting reports.

The results of this study show that financial expertise and experience of audit committee members lead to more restating in financial statements. These findings suggest that more experience and expertise of audit committee members provide deeper understanding of financial events specially their consistency with applicable accounting standards in Iran. We also document that independency of audit committee members has negative impact on financial restatements. It means that providing non-audit services, which decrease auditor's independency, leads to increasing the scope of auditors in financial structure of clients, as a consequence, more non-audit services results in finding more errors in financial reports. Finally, we conclude that there is a positive and significant relationship between auditor change and financial restatements. It supports the idea demonstrating each audit firm has its own prospective which results in more correction and errors in financial statements of former years.

Our study provides detail information to regulators on the effectiveness of the audit committee in reducing financial restatements. Our evidence contributes to regulators in revising policies and standards considering other critical characteristics such as expertise and experience. In way that, how much expertise and experience is required for the members of an effective audit committee. The results of the study clarifies about auditor independence and its effect on financial restatements, in a way that, restricting the provision of non-audit services to audit clients which leads to improving auditor independence will not, obligatorily, results in fairer information in financial statements. Therefore, the regulators, considering our findings, can improve the quality of financial reporting. Our findings also is useful for board of directors of companies, in a way that, in order to provide fair information about financial condition of companies, how often the audit firms should be changed, and moreover, audit firms which are specialist in their specific industry must be appointed, our investigation presents these two factors as an effective mechanism in this regard.



Future research may begin by using various measures of independent variables to test the robustness of the results. Future research can examine the effectiveness of corporate governance rules and specific (TSE) market rules on improvement in financial reporting quality, specifically by examining their decreasing effect on financial restatements.

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