Article can be accessed online at http://www.publishingindia.com

AUDITOR'S TENURE AND QUALITY OF PROFIT IN AUTOMOTIVE AND FOOD INDUSTRIES

Arash Azadikhah Jahromi*, Fatemehsadat Mousavifard **, Ali Mosallanejad*, Abdolhossein Ayoubi*****

*Accounting Trend Audit field, Management Department, Islamic Azad University, North Tehran Branch, Tehran, Iran. Email: arash.azadikhah@yahoo.com

**M.A., English Literature Department, Islamic Azad University, Arak, Iran. Email: f.s.mousavifard@gmail.com (corresponding author)

***Information Technology Engineering (E-commerce) Department, Islamic Azad University E-Campus, Iran Email: ali.mosallanejad@iauec.ac.ir

****M.S.c, Biomedical Engineering Department, Amirkabir University, Tehran, Iran. Email: mc.hossein@gmail.com

Abstract: *In the present study, the role of accruals is evaluated in quality of profit in companies accepted in Tehran stock exchange market while the relationship between qualities of profit via accruals is studied with auditor's tenure. In this study, number of years of auditor's tenure in an organisation is considered as an index for auditor's retention. Sample consists of 61 companies involved in automotive and food industry. Results show that when an auditor's tenure is longer, and more audits are done by the auditor, productivity of company and the quality of profit are increased more. It seems there is a negative significant relationship between auditor's tenure and bracket of accruals. Any studies can be advantageous for investors and data users regarding the quality of profit and determination of effective factors on its unreal reflection for hidden or unreal profits.*

Keywords: *Accruals, Auditor Tenure, Quality of Profit, Cash flow*

JEL Classification: *M42*

INTRODUCTION

In recent three decades, quality of profit was in focus of scholars' attention, and it was defined as a goal to achieve a valid logical method to evaluate quality of profit; indeed, effective factors on it need to be determined. Argument about quality of profits, data components, and other related factors are brought in to discussion, so that future cash flow and consequently stock price determination get facilitated.

Quality of profit is discussed widely in both accounting and management of finance. In literature of accounting, financial management, management of investment, stock market instructions, and in stock workers' report, this issue is discussed directly or indirectly. Fundamentals of accounting are made on the fact that final profit fairly reflects real function of the commercial center. It should be mentioned that in other fields final profit is somehow different; for example financial analysers evaluate quality of profits in order to identify one level of profit and to predict future pure profit so that they may clarify the price of stuck of a company.

Accruals are indexes of quality of profit and play a role in evaluation of stocks. Accruals are influential in change and modification of cash flow. Based on accounting concepts, moderated cash (moderated profit) is considered as a scale for evaluation of company's function. However, accruals are usually based on presupposition and evaluations which should be modified in accruals and future profit, if they are false. Thus, quality of accruals and profits decreases based on the size of error. Accruals are the difference between company's auditory profit and its fundamental cash flow. The difference is originated from the revenue recognition principle and principle of comparison. Managers' freedom of function in using comparison and recognition principles, and using evaluation and prediction are considered as factors influential on the quality of profit. Based on their improved understanding of the company status, it is expected to provide the data so that company's status is presented in the best way. Proper reasons exist for fiddling with profit originated from financial conflict and some other accounting limitations such as (i) deficiency in evaluation of processes and future predictions and (ii) making use of different

auditory methods which cause actual profit of a financial unit to be different in different reports. Since, profit is one of the most significant evaluation scales and determiner of value of enterprises; indeed, quality of profit is on the focus of attention of scholars, investment professionals of auditory and management.

Freedom in using principles of comparison, recognition, evaluation and prediction influences the profit. On one hand, auditors are conscious of the company status, and it is expected to introduce the status of the company in the best way. On the other hand, due to some reasons such as tenure and awards, the managers need to show an ideal status of the company based on both intentional and unintentional backgrounds. Thus, quality of profits in any companies is influenced by reporting methods and managers' discretion.

LITERATURE REVIEW

Becker, DeFond, Jiambalvo, and Subramanyam (1998) and Johnson (2002) studied the quality of auditory with quality of financial reports and concluded that there is a significant relationship between them. Gul, Jaggi, and Krishnan (2007) studying the quality of profits in a company concluded that auditors with more years of tenure experience present profits with higher quality.

Noureayni and Mahdi (2006) focused on the relationship between quality of profit and future profits and concluded that there is a significant relationship between cash which is resulted from operating activities with operative and future profits.

Kurdestani (2004) studied the relationship between quality of profits and market reaction to changes in cash profit; following findings were obtained:

A. Abnormal efficiency of stocks increases (decreases) with increase (decrease) of cash profit.

B. Based on quality of profit, possibility of predicting the profit, the relationship between operating cash flow and profit and the relationship between operating cash flow and elements of profit, it can be declared that there is a significant relationship between quality of profit and market reaction and increased cash profit.

HYPOTHESES

The aim of this study is examining the relationship between auditor's tenure and quality of profit in automotive and food industries. The hypothesis for the study is as follows:

There is a significant relationship between auditors' tenure and quality of profit in companies.

DATA

This study is based on data and statistics of Tehran stock market companies and their financial output reports. In this study, financial data is achieved based on financial reports of studied companies and using data CD published by Tehran stock market. Finally, it was analysed.

METHODOLOGY

This study is a correlation one and based on gathered data regarding type and number, it was done analytically. Here, records of companies are used. In order to test the study hypothesis, regression method and OLS technique with significance of 95% were used. In order to gather data, data were originated from documents published by Tehran stock market. SPSS was also applied for statistic tests.

Study Tools and Statistical Samples

Study statistical population is all companies present in automotive and food industries in Tehran stock market. Following condition is defined for statistical population selection:

Financial data should be available along with financial reports as well as accruals. Based on the mentioned condition and availability of companies' data, 61 companies were chosen randomly as statistical sample.

Study Variables Calculation Method

Independent Variable

Auditor tenure: log of sequential years in which a company has employed an auditor.

Dependent Variable

In this study, accruals were calculated discretionally and by Ball and Shivakumar's model in the following way:

$$ACC = \alpha + \alpha\ CFO + \alpha\ CFO + \alpha\ CFOt+1+ \alpha\ 5\ Rev + \alpha\ 6PPE + \alpha\ 7ROAt-1+ \alpha\ 8\ CFO + \alpha\ 9Dum\ CFO + \alpha\ 10\ CFO\ *Dum\ CFO +$$

In this relationship:

ACC=pure flow of operating activities- pure profit

CFO=pure cash flow resulted from operating activities

Rev= change in pure sales

PPE= proprieties, instruments and pure machinery

ROA= average sum of properties

ΔCFO= change in pure cash flow resulted from operating activities

Dum^{Δ} CFO = when a negative change is observed in operating cash flow, this variable is equal to one; otherwise it is zero.

$^{\varepsilon}$=accruals

t =number of years

i= company

a_1 , a_2 and a_3 are coefficient of model.

In this relationship, all variables are divided to average of sum of properties.

FINDINGS

Data of 61 companies, members of the study statistical sample, were extracted from databases and were copied to MS-Excel. After calculations on dependent and independent variables, necessary information was saved in for statistical test.

In order to examine hypotheses, stepwise multiple regression was applied. In this method, independent variables are brought into the model one by one (or are removed from it); the way they are entered or removed is determined considering statistical points. In this equation, bracket of accruals (ABSTDA) is considered as dependent variable while the time of auditor's tenure is considered as independent variable. The main model known as Meyers' et al. (2003) is presented below:

$$\text{ABSTDA} = \alpha + \beta_1 Tenure + \beta_2 Age + \beta_3 Size + \beta_4 Size2 + \beta_5 Size3 + \beta_6 Grow + \beta_7 CFO + \varepsilon$$

In which : a_1 : regression equation fixed element(width from source)

$\beta_1 + \beta_2 ....., \beta_K$: regression correlation coefficient

ABSTDA = bracket of accruals

Tenure= log of number of continuous years in which an auditor is continuously involved with the job

Age= log of number of years being active in stock market since acceptance in it.

Size=log of sum of properties

Size2=log of sales

Size3= log of market value

Grow=previous year sales/ the year's sales

CFO= pure cash flow resulted from operating activities

t= number of the year, i= the company

Table 1 indicates that the first stage (model 1) is entrance of CFO variable (pure cash flow resulted from operating) to equation; then in the second stage (model 2), tenure variable should be inserted. Pay careful attention that stepwise regression is stopped after entrance of these variables, and other variables are not entered.

Table 1: Dependent Variable: Bracket of Accruals

Model	Input Variables	Output Variables	Method
1	Cash flow resulted from operation		stepwise
2	Auditor's tenure		

Variables which are removed from the model at any stage are presented in Table 2. In the first step (model 1), models, tenure, age, size, size 2, size 3, and grow are removed from the model, but since p-value (sig.) is related to tenure (is below significance level 0.5), it enjoys the license to enter the second stage. Removed variables of model 2 are age 2, size, size 2, size 3, and grow which stand still, because none of p-value (sig.) is below 0.5. Stepwise analysis is stopped here.

Table 2: Removed Variables from Model

Model	Beta In	T statistics	Significance level		
auditor's tenure	[a] -0.158	-2.536	0.014	-0.324	0.984
Company's life	[a] -0.036	-0.554	0.582	-0.074	0.982
Sum of properties (size of company)	[a] -0.081	-1.266	0.211	-0.168	0.997
Sales (size of company)	[a] -0.043	-0.662	0.511	-0.089	0.989
Market value (size of company)	[a] -0.070	-1.047	0.300	-0.140	0. 940
Pure growth of company	[a] 0.018	0.255	0.799	0.034	0.877
company activation year	[b] 0.011	0.161	0.873	0.022	0.898
Sum of properties (size of company)	[b] -0.056	-0.896	0.374	-0.121	0.968
Sales (size of company)	[b] -0.032	-0.514	0.609	-0.070	0.984
Market value (size of company)	[b] -0.44	-0.674	0.503	-0.091	0.913
Pure growth of company	[b] 0.008	0.116	0.908	0.16	0.874

a. Independent variable: (stable value),pure cash flow resulted from operations.

b. Stable value: pure cash flow resulted from operations and auditor's tenure.

c. Bracket of accruals.

As it is evident from Table 3, in model 1, R is 0.876 (just when CFO exists) and with entrance of tenure in model 2, R is increased to 0.889. R, here, indicates that it doesn't worth predicting the removed variables.

Table 3: Summary of Model

Model	Correlation coefficient	R coefficient of coefficient	Undefined coefficient of coefficient	Standard deviation error
1	[a] 0.876	0.767	0.762	1.03321175
2	[b] 0.889	0.791	0.783	0.98646428

a. stable value: pure cash flow resulted from operation.

b. stable value: pure cash flow resulted from operation and auditor's tenure.

Studying Table 4 or ANOVA table and p-value (sig.) which are 0.05, indicates significance of two models.

Table 4: ANOVA Table

Model	Sum of Square	Degree of freedom	Average of freedom	statistics F	Significance level
1 regression rest sum	196.389 59.781 256.171	1 56 57	196.389 1.068	183.966	0.000 [a]
2 regression rest sum	202.649 53.521 256.171	2 55 57	101.325 0.973	104.124	0.000 [b]

a. independent variable: stable value: pure cash flow resulted from operation.

b. stable value: pure cash flow resulted from operation and auditor's tenure.

c. dependent variable: bracket of accruals.

Table 5: Regression Model of These Two Models

Model	Non-standard coefficient		Stan-dard coefficient	Statistics t	Significance level
	B	Standard error	Beta		
1 stable pure cash flow resulted from operation	1.293 4.757	0.235 0.31	0.876	5.504 13.563	0.000 0.000
2 stable pure cash flow resulted from operation	2.575 4.865 -2.162	0.553 0.338 0.853	0.895 -0.158	4.657 14.412 -2.536	0.000 0.000 0.014

a. dependent variable: bracket of accruals.

Based on resulted coefficients , ultimate model is as follows:

ABSTDA = 2.575 + 4.865 CFO - 2.162 Tenure

CONCLUSIONS

Stock-holders who are the most influential group using financial statement try to find their own benefits. Profit of auditory is a symbol which causes a change in investors' believes and creates a change in behaviour. Quality of profit can effect on investors' certainty of the financial reports in financial markets. Other important factors in evaluating quality of profit can be mentioned as various accounting methods, current deficiencies in evaluation process and predictions, managers' authority in using accruals in measurement and reporting the profit.

Accruals may involve selecting an auditory standard or principle and applying evaluation and deals' timing in identifying abnormal accruals in profit. Regarding quality of profit, data content of constituting elements and other effective factor is discussed in a way that prediction of future cash flow is totally possible and determination of stock prices gets facilitated.

Hant, Financial Manager of General Mayls believes that two factors are measured in quality of profit: one flourishes in current profit adaptation with previous profits and the other one is observed in preconception of market which is observed in quality of profit in p/E.

Hegan, Financial Manager from Dinolandz company believes that quality of profit is measured via identifying or removing effects of accounting methods, abnormal accruals and market condition or temporary costs.

In this study, these accruals are considered as an index for quality of profit as dependent variable and auditor's tenure as independent variable. Findings show that accruals have a negative significant relationship with auditor's tenure.

SUGGESTIONS FOR FURTHER STUDY

1. Based on the fact that this study made advantage of Ball and Shivakumar's modified model for evaluation of accruals, it is suggested that in future studies, other models should be applied in evaluating accruals and other methods such as De Angelo and Heli for evaluation of quality of profit.

2. In future studies, it is suggested to study "the role of profession of auditors' industry on relationship between time and auditors' tenure and quality of profit in companies".

3. In future studies, the following hypothesis can be studied:

The relationship between the time of auditor's tenure and quality of profits in companies with expert auditors in comparison to companies with non-expert auditors is weaker.

REFERENCES

Azar, A. M. M. (1998). *Statistics and its application in management.* Tehran: Samt Publication.

Ball, R., & Shivakumar, L. (2006). The role of accruals in asymmetrically timely gain and loss recognition. *Journal of Accounting Research* 44(2), 207-242.

Ball, R., & Shivakumar, L. (2008). Earnings quality at initial public offerings. *Journal of Accounting and Economics* 45(2-3), 324-349.

Becker, C. L., DeFond, M. L., Jiambalvo, J., & Subramanyam, K. R. (1998). The effect of audit quality on earnings management. *Contemporary Accounting Research* 15(1), 4-24.

Gul, A. F., Jaggi, B., & Krishnan, G. (2007). Auditor independence: evidence on the joint effects of auditor tenure and nonaudit fees. *Auditing: A Journal of Practice and Theory* 26(2), 117-142.

Kurdestani, G. (2004). *The relationship between profit and market reaction to cash profit changes.* Doctorate dissertation, Tehran University, Iran.

Noureayni, N., & Mahdi, M. (2006). *Role of quality of profit on predicting future profit.* M.A. dissertation, shahid Beheshti University, Tehran,Iran.