Economic Consequences Qualified Audit Opinions: Evidence from listed Companies in Tehran Stock Exchange

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Abstract

The goal of this study is to answer to this question that qualified audit opinions could have what kinds of the consequences for companies? On the other side, shareholders, capital investors and creditors show what kind of reaction with regard to qualified audit opinions? With taking into consideration that audit opinions increase reliability of information that are accessible for investors and creditors, at the same time, representing of qualified audit opinions can increase the risk of information as well. This research examines the impact of qualified audit opinions on the expected return on common shareholders' and giving credibility by creditors. Statistic samples of this study are collected from 120 companies listed in Tehran Stock Exchange for the time period of 2004to 2011 and in order to examine hypothesis of this study panel data method of research was applied. Based on the findings of this study there is a Positive relationship between qualified audit opinions and the expected return on common shareholders and, on the contrary there is no relationship between qualified audit opinions and the granting of credit by the creditor.

Keywords: Qualified audit opinions, expected return on common shareholders, granting of credit, creditor.

Introduction

Capital Investors who want to buy or sale stocks, a banker who decide about verification of a lone request, and government which relies on taxing declaration to collect taxes, all use various information that are prepared by others agencies. In most cases the goals of producer and users of information are different. Recently, users of finance reports involve themselves with different news and notifications that are related to performance of uncommon rules of accounting. These chaotic and uncommon cases of accounting took several titles such as bold accounting, profit management, leveling of profit and deceptive accounting. Although the amount and size of deviation from principles and custom of accounting related to the above mentioned titles are different, the need for independent audit, in these situations, is obvious. Generally, auditing is a type of monitoring that is carried out in companies to reduce lack of information asymmetry and control of managers' freedom in presenting of financial reports[1]. Auditors grant credit to both information available to the investors and creditors, and auditors modified their opinions based on this information and release their qualified audit opinions, as a matter of fact, qualified audit opinions shows that quality of represented information is reduced and to some extent that quality and accuracy of presented information by company declined, information risk is increased and at the same extent lack of asymmetry between people inside and outside of organization grows[2]. In fact, auditors by presenting of qualified audit opinions increase company's risk for investors, shareholders and creditors.

Theoretical and Research Background

Auditing is an investigating process that can produce useful judgmental information and generally do not produce new economical information, but can verify provided economic information by the accounting process and diminish the value of the information by disaffirmation of provided information. It is expected from auditors to report unclear procedures of accounting and important errors and deviations[3]. In fact, auditors state their opinions about diversion and abuse cases according to acquired results of their investigation and based on importance of these cases express their modified audit opinions including qualified audit opinion, failure report or failed audit opinion. According to Lin at el three factors can affect the probability of receiving a modified report: i. providing a false financial statements that is important ii. related to the auditor tasks iii. related to the auditor independence, The first factor is related to the companies and their motivation; however, the next two factors are related to the auditing quality[2]. In many research reports, qualified audit opinion was considered as a standard for assessing quality of auditing, they argue that increasing of auditing risk leads to this matter that auditor increase auditing quality in order to decrease auditing risk. That its main result is growth of the portion of qualify report[4-5]. Generally, qualified audit opinions, in spite of showing financial deficiencies and limitations that exist in assessing process, financial statements are drown in an appropriate way. The qualified report can be stated due to the limitations in assessing and auditing or lack of observing accepted accounting principles and qualified audit opinions expressed by auditors only when auditors be persuaded that there is no misleading financial statements and have been

just offered in an equitable way, also failed audit opinion and failure opinion are offered when auditor believes that conditions are crucial, therefore, pertinent to other two reports, qualified audit opinion is less severe than other opinion comments, extent of importance of subject is a key factor in using of qualified opinion. Objection must be important enough to be stated in auditing report, but not important so that auditor feel it's necessary to offers failed audit opinion and failure opinion .consequently, determining the appropriateness of qualified audit opinion require professional judgment of the auditors. Qualified report can be subject to the investigations' scope and comment or can be just relevant to the comment report of auditor. If auditor cannot provide valuable evidence based on accepted auditing standard then condition related to the investigation scope and opinion, should be stipulated in auditing report and in the cases in which auditing process is limited by employer or when due to a situation auditing process is problematic, these condition of investigation should be stipulated. If financial statements do not provided based on generally accepted principles of accounting, a provision should be added to the auditing report. Accordance with international accounting standards, auditors' reports in all cases that they offer qualified opinions should be enjoy a separate explanatory comment on reasons of condition before opinion provision. If report is accepted conditionally by auditor then it can be representative of taxing problems, probability of violation and dealing trade in favor of managers. As a matter of fact, each corporative has its own risk and return. Every investor group for example, preferred stock and common stock investor, wants an amount of profit that is pertinent to its financial risk. With higher companies' financial risk the expected return of shareholders increased. Since auditor opinion indicates this matter that financial statements have essential quality, if audit opinion is not standard, information risk of company is increased and cause growth of shareholders' expected profit. Based on this explanation this hypothesis can be stated that:

H_1 :The qualified audit opinion is positively associated with the expected return on common shareholders.

On the other hand, as mentioned, creditors are another group who use financial statements to grant loans then this information can affect making decision of granting loans. Findings show that auditors' reports include information that it's important for investors and analysts of companies' risk[6]. Creditors should obtain assurance that financial statements are provided in an appropriate way, to reach to this goal independent auditors should examine financial statements[3]. Since managers manipulate accounting items to manage earnings, to get their needed funds and to attract creditors attention, then auditor face these kinds of manipulated items during process of auditing. With taking into consideration the level and importance of these cases, auditors offer qualified audit opinions that indicate low quality of financial statements and growth of business risk and default risk in these companies. Since creditors are interested in information that show ability of loan demanders in repaying of

their loans and interest rate. In fact, they are seeking information that will assist them in determining the default risk[7]. When default risk increase remarkably, creditors reject demand of credit and do not increase their own risk[8] and make plan to give or not to give credit. Qualified audit opinion, in fact, include bad news that can be helpful in determining of default risk, in other words qualified audit report shows that loan demander is along with risk[9]. Consequently, qualified audit opinion can impact decision making process of creditors to grant loans to demanders[10-12], therefore this hypothesis can be stated that:

H_2 : The qualified audit opinion is significantly associated with the Credit by creditors.

Findings of several studies[13,14] emphasis on this point that increasing quality of financial reports via decreasing information asymmetry between managers and loan givers and investors can reduce the probability of ethical risk and false selection and in turn this can lead to decrease of monitoring costs of managers' performance and finally reduction of companies' risk.

Lin et al stated that a modified audit opinion (qualified, failed and failure audit opinion) represents the information asymmetry between insiders and outside individuals of the organization. With taking into consideration of economic consequences of auditors' opinions in China they, studied two views of information asymmetry and soft budget constraints and concluded that despite of offering modified audit opinion in the Chinese companies and expression of the inside and outside information asymmetry these companies do not face financial restrictions, however, these companies secure their financial resources by government help and via political relation between shareholders and other political organization and stated that modified audit opinion illustrate low quality of information and in spite of soft budget limitation they do not encounter with financial constraints[2].

Mario conducted a survey and stated that qualified audit opinions present related information about business risk of company and type of auditor's opinion can affect business decisions and business risk[3].

David et al examined the companies in Vietnam and came to the conclusion that private companies are looking to establish their political relations to access more comfortably to bank loans and there are a lot of financial benefits for the company by creation political relations[15].

Andres et al conducted a study of 80 credit institution and came to the conclusion that continued opinions of companies affect decisions making process of them represents the companies' risks and is a warning for system[16].

Syou by investigation of conditional provisions such as ongoing activities, change in accounting principles and other issues came

to the conclusion that these cases impact on companies' stocks negatively[17].

Andres et al (2007) studied 106 credit institutions in the US and concluded that the audited financial statements as an influencing variable can affect decisions of creditors[18].

Jiangl, et al (2004) reviewed several Asian countries including South Korea, Thailand, The Philippines, Indonesia and came to the conclusion that in these countries lenders do not pay attention to auditors' opinions and financial statements of companies and do not consider them as a base of extending credit of companies[19].

Research Design

Recent study is an applied research from purpose view and descriptive from methodological aspect and from time side of research is post eventual.

Sample selection and data sources: Statistical society of this research, include all companies accepted in Tehran Stock Exchange during 1384 to 1390. In this study, for specifying statistical sample, purposeful sampling model was used so that in each stage companies which do not have following conditions, were deleted and remaining companies were selected for testing: i. Company should be active throughout the period of examination, ii. Statistical sample should include manufacturing and industry companies. iii. Companies which their financial year end by the end of Iranian calendar year. iv. Finally, after these processes a total of 120 companies were selected for testing of the hypothesis of the study[20-21].

Data Collecting: In this study, collection of data was done in two stages. In the first stage to formulating theoretical base of the study library method of research was used and in the second stage, to collect data different sources such as periodicals and website of exchange and information software of companies were used, then Excel software were applied to preparing of collected data, so that extracting of information related to the under investigation variables from the listed sources, the data were inserted in the worksheets created by the software, and then they were calculated.

Data Analysis: In descriptive statistics, data analyses have been done by using central indexes parameters such as average, median and standard deviation of the distribution. Also, to test the hypothesis the regression model panel data were used. Chaw test model was applied for selecting of regression models and panel models with fixed effect model .if in Chow test panel data is selected , no following process is needed but by selection of panel data model with fix effects, it is necessary to use Hausman test as well. Hausman test is used to determine the fixe effects model and random effects.

Also, before practicing of the model and with respect to this matter that the Companies participated in this study related to various industries and panel model is used, therefore, there is probability of anisotropy and to remove this problem by the use of regression model lower generalized squared was used. Moreover, after practicing of the model, in order to examine the non existence of autocorrelation in remaining of the model, statistical method of Watson Durbin was used.

Research Model and Variable Definitions

Dependent variable: Borrowing cash flows (BCF) : BCF is borrowing cash flows, which is obtained from the statement of cash flows, divided by the yearly beginning balance of total assets[19].

The expected return of shareholders.

The cost of capital is the at least rate of return that a company must obtain the return of investors to provide in the company.I n this study, the following research, Francis et al(2005) to measure the cost of capital, we use the following approach[7]:
$$MED\ k_{it})//p_{it}COEC_{it} = (E_{i(t+1)})$$

COEC: The expected return of shareholders common**, $E_{i(t+1)}$:** Forecasts earnings per share,**MED k_{it}** : symbol than the median profit to price firm i for year t in industry k where it is located.

The independent variable: Qualified opinion (QUAO) : which equals 1 if the firm received a qualified opinion previous fiscal year, 0 otherwise.

The Control Variable: Ultimate controller (**PRIV**): which equals 1 if the type of ultimate controller is a non-government agency or individual, and 0 otherwise

Size : The natural logarithm of the total year-end assets

Growth: Annual revenue growth rate[20]

Leverage$_{it}$ (lEV): Ratio of debt to total year-end assets[21]

Return on assets (ROA): equals net income minus financial expenses divided by year-end total assets

Investment expenditure (ICF): Cash payments to obtain fixed assets, intangible assets and other long-term assets divided by the yearly beginning balance of fixed assets[21].

BETA: Sensitivity of stock returns relative to the returns on a market portfolio, we use the following approach:
$$BETA = \frac{COV(Ri\ Rm)}{\hat{\sigma}(Rm)}$$
Where: Ri return firm i; Rm market returns; COV and $\hat{\sigma}$ is symbol of the covariance and variance .

MTB: Market to book value ratio estimated as market value divided by book value of equity

Research model: $COEC_{it} = \alpha_0 + \alpha_1 QUAO_{it-1} + \alpha_2 BETA_{it} + \alpha_3 LEV_{it} + \alpha_4 lNSIZE_{it} + \alpha_5 MB_{it} + \alpha_6 GROWN_{it} + \text{\euro}_{it}$
$BCF_{it} = b_0 + b_1 MAO_{it\_1} + b_2 PRIV_{it} + b_3 ICF_{it} + b_4 GROWTH_{it} + b_5 ROA_{it\_1} + b_6 LEV_{it\_1} + b_7 SIZE_{it} + e_{it}.$

Analysis Statistics

Descriptive statistics: According to the results of the descriptive statistics of the variables can be stated that all variables are properly distributed.

Inferential statistics: As already mentioned the objective of this study is to investigate the effect of qualified audit opinions on expected return of common shareholders and granting of credit by creditors to accepted companies in Stock Exchange of Iran. Accordingly, based on the proposed theoretical a model consists of a set of independent and control variables were developed and tested during research process.

Before estimating of the model it is necessary that Chow test would be conducted to examining use of panel data model with fix effects in contrary to mixed data used in the proposed model of this study. Hypothesis for this test are as follows: H_0: pooled data, H_1: panel data fixed effect model, The results of the F Lymr the image test is shown in figure 2.

As it is illustrated in figure-2 hypothesis of H_0 is rejected then it can be said that panel data model with fix effects is preferred. Hausman test is also used to select a model among data panel model with fix effects and panel data with random effects. Hypothesis of this test is as follow:
H_0: panel data random effect model
H_1: panel data fixed effect model

The results of the Hausman test the image test is shown in figure 3.

As it can be seen in figure no 3, Ho is rejected, consequently panel data model with fixed effects is preferred. In figure no 4 panel data with fixed effect are showed.

Table-1
Descriptive statistics

Variable	Average	median	SD	max	min
Expected return on common shareholders'	0.041208	0.033447	0.036953	0.582183	0.000146
Qualified opinion Auditing	0.583232	1.00	0.493324	1.00	0.00
Beta	0.258153	0.130400	0.676447	3.64200	-0.49420
LEV	0.645555	0.649697	0.204331	1.937754	0.096415
GROWTH	0.120448	0.132383	0.296210	1/90431	-2.0330
SIZE	12.7795	12.6536	1.5344	18.9690	9.2543
MTB	7.3072	0.6013	138.7553	3886.475	-5.6684
ICF	-0.0710	-0.0407	0.0924	0.00	-0.7380
PRIV	0.529412	1.00	0.4995	1.00	0.00

Table-2
F Lymr test

	Statistic	prob
F Lymr test: model 1	1.671568	0.00
F Lymr test: model 2	7.357499	0.00

Table-3
Hausman test

	Statistic	prob
Hausman test: model 1	63.016119	0.00

Table-4
Regression Results – OLS Model 1

$COEC_{it} = \alpha_0 + \alpha_1 QUAO_{it-1} + \alpha_2 BETA_{it} + \alpha_3 LEV_{it} + \alpha_4 lNSIZE_{it} + \alpha_5 MB_{it} + \alpha_6 GROWN_{it} + \mathcal{E}_{it}$			
Dependent variable: expected return on common shareholders			
Variable	**Panel test**		
	Coefficient	**t-Statistic**	**P – value**
C	0.216285	5.135597	0.00
Qualified opinion Auditing	0.005351	3.551931	0.0004
BETA	-0.033783	-6.812251	0.00
SIZE	-0.012512	-4.122238	0.00
LEV	-0.011289	-1.768430	0.0774
GROWTH	-0.008060	-4.607875	0.00
MTB	6.37E-06	8.272586	0.00
Prob(F-statistic)	4.779709		
P-value	0.00		
R^2	0.466215		
Adj-Rsq	0.368675		
Durbin-Watson stat	2.103365		

Table-5
Regression Results – OLS Model 2

$BCF_{it} = b0 + b_1 MAO_{it\_1} + b2PRIV_{it} + b_3ICF_{it} + b_4GROWTH_{it} + b_5ROA_{it\_1} + b_6LEV_{it\_1} + b_7SIZE_{it} + e_{it}$			
Dependent variable: borrowing cash flows			
Variable	**Panel test**		
	Coefficient	**t-Statistic**	**P – value**
C	-0.322769	-2.387363	0.0173
Qualified opinion Auditing	-0.001501	-0.182235	0.8555
PRIVE	0.110562	4.577145	0.00
SIZE	0.045183	4.763787	0.00
LEV	-0.037440	-1.515417	0.1302
GROWTH	-0.005745	-0.976807	0.3291
ROA	0.042197	2.340904	0.0196
ICF	-0.558680	-12.60579	0.00
Prob(F-statistic)	22.22392		
P-value	0.00		
R^2	0.805527		
Adj-Rsq	0.769281		
Durbin-Watson stat	1.836189		

Significance of all above models can be determined by using Fisher statistics (F) Based on results presented in figure 4 and 5 can reach to this conclusion that research model used in this study is significant, because standard variation related to statistical model of F is 0.000 which is less than five per cent. Consequently, even at the 99% confidence level significance of the model is accepted. Also, in order to evaluate the autocorrelation in the rest of models Watson Durbin method was used and based on findings there is no autocorrelation in remains.

In the first hypotheses of the study effect of qualified audit opinions on expected return of shareholders is investigated. According to acquired results of the study table no 4 it can be stated that qualified audit opinions has a significant effect on expected return of shareholders standard deviation is 0.0004.

Auditor report expresses important information about quality of provided information and financial statements, offering of qualified report is a sign of reduction of information quality and information asymmetry between individuals inside and outside of organizations. On the other hand, each company has its own risk and output. Every groups of investors such as holders of bonds, privileged and normal shares want the amount of profit that is pertinent to its risk. The higher the risk of company result in increasing of expected return of shareholders. Indeed, capital cost of company will be increased. Since auditor opinions means that financial statements have necessity quality, in the

case of presenting qualified audit opinion the expected return of shareholders will be increased as well.

The second hypothesis investigated the effect of qualified audit opinion on the granting of credit by creditors, according to acquired results presented in table no 5 from estimating model of research and its error level (0.8555) it can be stated that at the acceptable error level of 5%, variable of qualified audit opinion do not have meaningful effect on granting credit by creditors. Reasons for rejecting the hypothesis can be stated as follows: Making decision related to granting of credit is influenced by a process that is determined by government agencies in the form of instruction and binding circulars. In Iran, considering essential factors in a competitive condition, there is no credit model, so creditors are not able to make decision independently. This causes that on the current situation in Iran, qualified audit opinion does not affect credit lending decisions.

Conclusion

In this research, consequences that receiving qualified audit opinions create for companies are investigated. We have considered two effects of receiving qualified effect which are its impact on expected returns of common shareholders and granting credit by creditors. Based on the findings of this study there is a positive relationship between qualified audit opinion and expected return of common shareholders so that by presenting of qualified audit opinion with respect to financial statement, information risk of company will grow; it is no significant relationship between qualified audit opinion and granting credit by creditors.

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