

The Effect of Change in Auditor's Opinion on Timely Disclosure of Financial Information

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Abstract

The main purpose of this research is studying the effect of change in auditor's opinion on timely disclosure of financial information. The statistical population of the current research is all firms listed in Tehran Stock Exchange during 2010 to 2012. The sample size is 101 firms after screening. Findings, using multiple regressions, show that change in auditor's opinion contributes to firms' increased timely disclosure of financial information.

Keywords: Change in auditor's opinion, timely disclosure, disclosure quality

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Introduction

Investors and creditors are the two main groups of financial information external users. Providing information to these groups is the primary mission of management and accounting systems. Firms perform this mission through disclosing information in financial reporting form. Financial statements are important parts of financial reporting. Indeed, the primary role of financial reporting is to effectively disclose information to external users through a valid and timely method. Markets participants always seek for valid and timely financial information, too, as such information reduce information

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asymmetry between enterprise management and external investors. Timeliness is one of the most significant quality characteristics of financial information. It means announcing and accessing to information as soon as possible. The shorter the time distance and announcement time of business units, the more efficacy of financial information of business units. On the other hand, the role and nature of auditing associates with uncertainties governing the quality of reported accounting information. What the society expects from auditing profession is offering auditing reports that cause increased dependability and timely disclosed accounting information. Different auditor opinions, according to Iran auditing standards, include as followings: accepted opinion, conditioned opinion, no opinion, and unacceptable opinion. Considering aforementioned, this research tries to study the relationship between changing of the type of auditor's opinion with disclosure timeliness. Therefore, relatedness is one of the qualitative characteristics of accounting information; and timeliness of the disclosed information is the component of relatedness that is critically important for users' decision-making. Thus, the research main problem is what the relationship is between a change in auditor's opinion and timely disclosure of all firms listed in Tehran Stock Exchange.

Research objectives

This study tries to examine experimental evidences and the consistence of the existed realities with views and reasons of the relation of changing auditor's opinion with firms' timely disclosures. The research focuses on helping capital market participants, decision-makers, financial analysts, and stock exchange actual and potential investors to analyze investment projects in stock exchange and financial assets.

Research hypotheses

H1: There is a relationship between changes in auditor's opinion type with timely disclosure.

H2: There is a relationship between change degrees of auditor's opinion type with timely disclosure.

Theoretical foundations

Literature review

Mahdavi Pour et al (2010) investigated effective factors of disclosing financial information through internet in websites of the firms listed in Tehran stock exchange. Etemadi et al (2011) studied the value content of mandatory disclosure. Cullinan et al (2012), in another research, examined the effect of improved auditor's opinion on disclosure's timeliness. Menon and Williams (2010) studied market and investors' responses to different types of auditors' reporting. Long and Landholm (2003) claimed that disclosing corporate governance practices causes decreasing information asymmetry enabling shareholders to effectively monitor corporate management. Haw et al (2002) studied the effect of the type of auditor's report and news type on disclosure's timing.

Auditing theoretical basics

Auditing theory

Of the auditing theoretical basics is the effect of auditors on real world and in turn, the effect of real world on them. Focusing on theoretical basics is a technical and complex function led by professional experts in auditing operations. This function is an efficient tool in accountability that controls firm's operations, in general, and assesses managements' accountability, in particular. Independent auditing operations function designed for analyzing and reporting the quality content of annual financial statements' accounting information supporting owners' and a large group of stakeholders' interests.

Disclosure

Disclosure definition

Disclosure is an accounting principle based on which all information associated to firm's activities must be properly and timely provided to different user groups. In fact, the main purpose of disclosing is to help users in making the decisions of investing, changing firms' financial position, management performance assessment, and predicting future cash flows (Yasaie, 2010).

Significance of financial reporting and accounting disclosure

Accounting information and corporate disclosure are the critical capitals of a market efficient performance. Firms provide disclosures through legal financial reporting including financial statements, attachment notes, management discussion and analysis, as well as other legal provisions. In addition, some firms legally disclose through voluntarily communications such as management predictions, conversations, and phone presentations to analysts, published materials in press, websites, and other corporate reporting. Finally, corporate disclosure can be performed through information mediators such as financial analysts, industrial experts, and financial press (Hilli and Palpu, 2001).

Financial reporting and disclosure contribution in capital market

Accounting information, including accounting disclosure, plays two significant roles in developed capital markets. Firstly, accounting information enables capital providers, including creditors and shareholders, to assess the potential return of investment opportunities, the role of assessment or Ex-ante accounting information. Secondly, accounting information makes monitoring of the granted funds possible for investors, stewardship role or Ex-post accounting information.

Research methodology

This is an applied, ex-post facto research, a retroactive study. Data collected through using library method and information of stock exchange website, and Rah Avar Novin and Tadbir Pardaz softwares. Considering data type and analysis method, the research used combinational data method.

Population and sample

The research population included all firms listed in Tehran Stock Exchange within 2009 to 2013. The sample selected by systematic method applying the following constraints:

1. Be active within research time scope;
2. Listed in stock exchange before 2009;
3. The financial year ends in March;
4. Access to research required data of such firms;
5. Not included in financial dealer companies, as well as banking and insurance enterprises.

Ultimately, final sample size according to screening method and aforementioned criteria is 205 firms.

First hypothesis test model

The desired model of testing the first hypothesis according to Cullinan et al studies (2012) is as follows:

This model focuses on studying the effect of positive changes (improvement) in the type of auditor's opinion on timely disclosure.

$$DEL_{it} = \beta_0 + \beta_1 DIMP_{i,t} + \beta_2 UE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 AS_{i,t} + \beta_5 DUAL_i + \epsilon_{i,t}$$

✓ Dependent variable

DEL is disclosure index attained by the difference of firm's financial period ending from financial statements' reporting date.

✓ Independent variable

DIMP is the positive changes of auditor's opinion, which is a dummy variable. If auditor's opinion changes in respect to previous period, it equals one; otherwise, zero.

✓ Control variables

UE= changing of net income in percent compared to previous period.

AS= auditor's changing that is a dummy variable. If auditor changes respecting to previous period, it will equal one; otherwise, zero.

DUAL= CEO duality, which is a dummy variable. If CEO is also a board member, it equals one; otherwise, zero.

LEV= Financial leverage that is the ratio of debts' book value to total assets' book value at the end of the year.

Second hypothesis testing model

The model of testing second hypothesis also relies on Cullinan et al (2012) studies:

This model concentrates on studying the effect of changing amounts (whether positive or negative) in auditor's opinion on timely disclosure.

$$DEL_{it} = \beta_0 + \beta_1 OPNCHG_{i,t} + \beta_2 UE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 AS_{i,t} + \beta_5 DUAL_{i,t} + \epsilon_{i,t}$$

✓ Independent variable

OPNCHG= the amount of changing the type of auditor's opinion.

This research encoded auditor's different professional opinions from one to five as follows:

- Accepted standard number five
- Accepted with complementary paragraph number 4
- Conditioned number 3
- Conditioned with complementary paragraph number 2
- Rejected number 1

The amount of changing the type of auditor's opinion examined using the following factor:

$$OPNCHG_t = AUDOPN_{t-1} - AUDOPN_t$$

Where, this factor attained by the difference of the corresponding number to auditor's opinion type in previous year with the number corresponding to auditor's opinion type in current year, which is always in the range of -4 and +4.

Research hypotheses testing method

Research hypotheses tested by using Chow and Hausman statistics; then, variables and tests' reliability such as Im, Shin, Lin, and Lovin tests verified. Finally, multiple regression equation, regression classic hypotheses (normality of errors distribution, normality of dependent variable distribution, errors' independency, etc), general model significant tests (F statistics), as well as coefficients' significance test (student t-test statistics) performed, too.

Normality of data distribution examined through Kolomogrov – Smirnov test (K-S). Regression model variables' coefficients tested by using student t-test. The present

research applied F-statistics for significant test of the general fitted regression model at 95%; moreover, lacking correlation between model errors tested through using Durbin-Watson test. Finally, error components' curve plotted in regression model to examine the normality of error components. Hypotheses tested by using linear regression. The research applied multiple variables regression statistical method. Panel and pooling methods were selected by Lymer F test. In the case that panel method selected, Hausman test perform to distinguish fixed effect and random effect methods. The collected data by Excel software entered into Eviews 6 software and analyzed following the required adjustments and classification based on understudied variables; then, research hypotheses were supported or rejected by using software results.

Findings and results

Data descriptive statistics

Research variables' descriptive statistics including mean, median, standard deviation, minimum, and maximum were measured according to firms' data during 2009-2013 and are shown in table 1.

Table 1 Research variables' descriptive statistics

Variables		Mean	Median	SD	Min.	Max.
DEL	Timely disclosure	68	63	23.56	35	110
DIMP	The amount of changing the type of auditor's opinion	0.309	0	1.564	0	1
OPNCHG	The amount of changing the type of auditor's opinion	2.78	0	1.675	0	4
UE	Net income change to previous period in percent	0.467	0.378	1.673	-0.226	0.758
AS	Changing auditor	0.509	0	1.564	0	1
DUAL	CEO duality	0.267	0	1.564	0	1
LEV	Financial leverage	0.656	0.654	0.096	0.491	0.822

Testing first hypothesis

The research applied the following regression model to test research hypotheses:

$$DEL_{it} = \beta_0 + \beta_1 DIMP_{i,t} + \beta_2 UE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 AS_{i,t} + \beta_5 DUAL_{i,t} + \epsilon_{i,t}$$

According to table 2, the significance level (sig) of the type of auditor's opinion variable (0.041) is less than the research significance level (5%); furthermore, t-statistics of the desired variable (2.109) is larger than t-statistics of the table with similar degree of freedom. Thus, research null hypothesis (H_0) rejects at 95% and H_1 indicating there is a correlation between changing auditor's opinion type with timely disclosure, maintains. On the other hand, regarding the negative coefficient of changing auditor's type of opinion variable, it concluded that there is a direct relationship between changing auditor's opinion type with timely disclosure.

Table 2 Results of fitted regression equation

$DEL_{it} = \beta_0 + \beta_1 DIMP_{i,t} + \beta_2 UE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 AS_{i,t} + \beta_5 DUAL_{i,t} + \epsilon_{i,t}$					
Variable		Coefficient	Value	t-statistics	Significance
Constant number		β_0	1.522	2.873	0.004
DIMP	Changing auditor's opinion type	β_1	3.234	2.109	0.041
UE	Changing of net income in percent to the period	β_2	2.467	3.838	0.000
LEV	Financial leverage	β_3	-2.311	-2.987	0.0031
AS	Changing auditor	β_4	-1.241	-2.347	0.034
DUAL	CEO duality	β_5	-0.943	-0.745	0.651
Determination coefficient		0.521	F statistics		11.276
Adjusted determination coefficient		0.476	Significance (p-value)		0.000
			Durbin-Watson statistics		1.811

Considering above results, it can be expressed that auditing is a monitoring mechanism that its final products is auditing report presented in association with uncertainties governed on the quality of the reported accounting information. High quality auditing report causes increased validity of information and quality of financial information. Since timeliness is one of the most important qualitative characteristics of information; therefore, it expects that positive changes of auditor's opinion type directly correlate with timely financial reports. Thus, considering the positive relationship of changing auditor's opinion type and timely disclosure of firms listed in Tehran Stock Exchange, capital market operators, decision makers, financial analysts, as well as potential and actual investors of stock exchange can make optimal decisions for analyzing investment projects in financial and stock assets with the minimum risk and the highest yield.

Testing second hypothesis

The research applied regression model to test research hypotheses:

$$DEL_{it} = \beta_0 + \beta_1 OPNCHG_{i,t} + \beta_2 UE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 AS_{i,t} + \beta_5 DUAL_{i,t} + \epsilon_{i,t}$$

Table 3 Results of fitted regression equation

DEL _{it} = β ₀ +β ₁ OPNCHG _{i,t} + β ₂ UE _{i,t} +β ₃ LEV _{i,t} +β ₄ AS _{i,t} +β ₅ DUAL _{i,t} +ε _{i,t}					
Variable		coefficient	Value	t-value	Significance
Constant number		B ₀	0.811	2.847	0.014
OPNCHG	The amount of changing opinion type	β ₁	1.641	2.873	0.026
UE	Net income changes in percent to previous period	β ₂	1.034	5.073	0.000
LEV	Financial leverage	β ₃	-1.098	-3.809	0.0038
AS	Changing auditor	β ₄	-0.754	-4.378	0.0021
DUAL	CEO duality	β ₅	-3.215	-0.987	0.342
Determination coefficient		0.568	F statistics		7.342
Adjusted determination coefficient		0.514	P value		0.000
			Durbin-Watson statistics		1.742

According to the table 3, the significance level of amount of changing auditor's opinion type (0.026) is less than the desired significance level (5%). Furthermore, t-statistics (2.873) of this variable is larger than the obtained t-statistics at similar degree of freedom. Therefore, H₀ rejects at 95% confidence level and H₁ indicating there is a correlation between change degrees of auditor's opinion type with timely disclosure maintains. On the other hand, considering the positive coefficient of changing degree of auditor's opinion type variable, it concluded that there is a direct relation between the amount of changing auditor opinion type and timely exposure.

Recommendations

Regarding research results, the following recommendations proposed:

Legislative institutes including stock exchange, Iran Association of Investment Institutions, brokers' community, brokerage and investing firms, all participants of

capital market, etc must focus on the effect of changing and the amount of changing auditor's opinion type on firms' timely disclosures.

Considering this research findings, it is suggested that capital market participants, decision makers, financial analysts, and potential and actual investors of stock exchange to particularly concentrate on the relations between changing and the amount of changing in auditor's opinion type and disclosure quality including timely disclosure for analyzing investing projects. As, observing these important factors lead to selecting the optimal investment portfolio with the least risk and the highest yield. In addition, it multiplies the transparency of decision-making and the obtained results.

Recommendations for future researches

The following issues proposed for future further studies:

1. Studying the effect of variables including corporate governance structure, ownership structure, shares liquidity, etc on firms' timely disclosure.
2. The present research subject matter can be investigated in different industries expecting different results regarding different nature of these activities in various industries.

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