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Study Relation between Ownership Concentration and Auditing Characteristics in TSE

Abolfazl Ghadiri Moghadam[a]; Amir Noroozi Sarang[bc]; Mohammad Reza Sahraneshin[b]; Monireh Bahre[b]; Marzieh Pordeli[b]; Mojtaba Tajdeh[b]

[a]Associate Professor, Department of Accounting, Faculty of Economics and Business Administration, Ferdowsi University of Mashhad (FUM) , Mashhad, Iran
[b]Accounting, Islamic Azad University, Mashhad Branch, Mashhad, Iran.

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ABSTRACT

The present study aimed to evaluate the relationship between type of major ownership of firm and audit characteristics in Tehran Stock Exchange (TSE). Based on the review of literature, ownership structure is effective on audit quality of firms. Two criteria of ownership structure including major ownership and ownership of the largest shareholder are applied as independent variables. Also, two criteria of audit properties including auditor size and auditor fee are used. The previous studies predict a positive association for ownership concentration and audit quality. The evidences by financial data of the firms listed on TSE during 2004 to 2012 showed that the largest shareholder had positive association with fee and auditor size. The results of study supported this hypothesis that ownership concentration of the largest shareholder had supervisory role in audit quality of firms.

KEYWORDS: Auditing Quality, Auditor Fee, Ownership concentration.

1. INTRODUCTION

Separation of ownership from management leads to creation of benefits conflict between owner and agent (manager). Managers do not work always for the benefit of shareholders and sometimes they use firm assets illogically. Thus, there is benefits conflict between owner and manager. The benefits conflict between the manager and shareholders can lead to agency problems as costly based on agency theory. Agency costs are increased as the result of separating ownership and control. These benefits conflict indicates required motivation for management to optimize the benefits and some measurements (for example, financial statements distortions) including investor loss. Under these conditions, a control mechanism is necessary guaranteeing the transparency of reported information in financial statements. In a liberal economy in Iran, this mechanism is presented in the form of financial audit by independent auditors (Kouki and Moncef, 2009).

Based on agency theory, the structure of corporate governance mechanisms should lead to higher financial reporting quality. Since ownership concentration observed as an important determinant of corporate governance mechanisms (Mashayekh and Abdullahi, 2012), Seems be able to play an essential role in relation to the identity of the owners and controllers of auditor change and improve information quality. Ownership concentration may increase oversight and eliminate hitchhiker problem, causing positive changes in the company. The major shareholders and owners, the administrator may control the rights to use personal interests, leading to exploitation of other shareholders (see also: Ebrahimi Kordlor and Erabi, 2011). The possibility of non-specific effects on various aspects of corporate ownership concentration causing offered various theories in relation to its behavior major shareholders and authors in their studies sometimes have reached contradictory conclusions. In this paper, review by control important factors such as auditor and owner size, in empirical base examine relationship between ownership concentration as an external mechanism of corporate governance and the auditing characteristics among member companies in Tehran Stock Exchange.

2. Research background and Research hypothesis

According to Han et al. (2009) Institutional, investors' has ability to influence corporate policies and governance mechanisms in order to reduce the cost of monitoring. Because of the large shareholder investment decisions are sensitive to the costs associated with maintaining such a large investment in a company, especially has low-cost variability for them. On the other hand, the shareholders of the Company enjoy on special interest due to

*** Corresponding Author:** Abolfazl Ghadiri Moghadam; Associate Professor, Department of Accounting, Faculty of Economics and Business Administration, Ferdowsi University of Mashhad (FUM), Mashhad, Iran (aghadiri@um.ac.ir).

their influence (Truong and Heaney, 2007). Thus, there are two opposing views on the role of large landowners in companies.

2.1 Active monitoring hypothesis (Convergence of interests)

According to Jensen and Meckling (1976) increasing convergence of interests can be caused by large landowners and reduce agency costs. In this case original owner behaves in order to maximize the value of the company (Jung and Kwon, 2002). Scholars claim that institutional investors with large ownership have plenty of incentive to monitor corporate performance, because they potentially have the most gain from the monitor and enjoy more of the voting rights, which appropriate measures to facilitate as necessary. When main shareholder ownership is high, their monitoring increases on the company's overall financial reporting process for his own personal benefit (Han et al. 2009). In this relation (Han et al. 2009) investigated on this thread that how institutional ownership will affect the quality of audited financial statements. Their evidence shows that the rate of long-term institutional ownership is high; firms are more likely to employing auditors Four-Big. To this Thread suggests that long-term institutional investors with high quality audits know as a way to improve corporate governance, whereas they also reduce regulatory costs. Also Mahdavi et al (2012) in an investigation during the 2002-2010 periods, find that there is a significant positive correlation between ownership concentration (by using Herfindal index) and size of the audit firm. In other words, companies that have greater ownership concentration, use the higher quality audit services.

Jung and Kwon, (2002) in support of the interest convergence hypothesis (proactive monitoring) indicated that by increasing original owner ownership lead to increase profit awareness. Sajjadi et al (2010) in Iranian capital market that ownership structure (fragmented) is negatively related to the quality of financial reporting. In another investigative Ebrahimi Kordlor and Erabi (2011) found that external ownership concentration leads to improved quality of earnings. Mashayekh and Abdullahi (2012) also demonstrated that the concentration of ownership, improve firm performance. As well as Mahdavi and Midri (2006) showed that high ownership concentration is related to more efficient firms.

2.2 Opportunism hypothesis

The ownership structure literature suggests that large shareholders entrenchment (major shareholders ownership) is same as management entrenchment (ownership Management). Whereas ownership concentration could decrease the cost of first kind of agency (interests of shareholders - executives contrary), it can also rise represent other issues. Scholars argue that ownership concentration is a source of conflict between large shareholders, which company's assets are in their control, and minority shareholders which are provide the necessary funds (risk type2). In this context, there are mainly two types of agency costs because large shareholders has too much power that able them to impose their choice, even when this option is contrary to maximizing corporate value (Vito et al. 2008). For example, La Porta et al (2002) showed that in developing countries, shareholders can control the rights of minority shareholders from exploitation by fraudulent behavior (Lin and Liu, 2010). Fan and Wong (2002) findings and Byun et al (2011) about content of earnings information and Zhong et al (2007) about earnings management are in support of the hypothesis. Fan and Wong (2002) showed that the managers has controlling interests report accounting information for their own purposes, causes reported profit for outside investors not be reliable. In another research conducted by Hasas Yegane and Shahriary (2011) shows that by increasing ownership concentration (major shareholders) will decrease the conservatism. They also stated that their findings about major shareholders are according to opportunistic hypothesis.

2.3 Prior Research and hypothesis

Xingze (2012) investigated the corporate governance and audit fee based on a Chinese firm data. The results showed that there was a negative association between corporate governance and auditor fee. The higher the corporate governance, the lower the audit fee. Ben & Lesage (2011) investigated the ownership concentration and audit feel in four countries. They considered the impact of law supporting investors in their study (US and England were considered as the countries with higher investor protection level and Germany and France were considered as the countries with a lower investor protection level). They divided ownership concentration into controlling and managerial shareholders. The results of their study showed that in the countries with investors protection law, agency issue was higher among the shareholders and managers and in the countries without strong investors protection level, agency issue was higher between the controlling shareholders and minority.

Rahman Khan et al., (2011) in the paper “corporate ownership concentration on audit fees in emerging economies” used Bangladesh as a case. Prior studies have indicated that audit fees in Bangladesh are significantly low. In addition, the Bangladeshi private sector is dominated by high ownership concentration. Agency theory predicts that in an efficient market, managers in a highly concentrated ownership situation will have sufficient incentives to have more rigorous audits performed. However, managers in emerging economies, where the markets are not as strong, may not have similar incentives. The results indicated that audit fees had a significant negative relationship with sponsor and institutional ownership concentrations.

Rajabi and Mohammadi Khashuyi (2008) investigated the relationship between agency costs from the view of corporate governance and pricing the independent audit services of 2005 in Iran stock market. They found that presence of controlling institutional shareholders had negative and significant relation with auditor fee.

Alavi, Robati and Yusefi Asl (2012) investigated the relationship between free cash flow and audit fee based on the opportunities of growth, dividend and financial leverage. The results of their study showed that audit fee is high in the firms with high free cash flow and high growth opportunities compared to the firms with low free cash flow and high growth opportunities. The results of study showed that in the firms with high free cash flow and high growth opportunities, by increasing liabilities, the mean audit fee is increased.

Omifar and Atashigolestani (2014) in a study evaluated the impact of ownership concentration on auditor turnover and found that by increasing largest shareholder ownership, negative auditor turnover probability is increased (changing from auditor organization to small institution). This issue indicates that ownership structure can affect audit quality. In this study, it is predicted that there is a negative association between ownership concentration and audit quality.

H1: There is a significant relationship between ownership concentration and auditor fee.

H2: There is a significant relationship between ownership concentration and auditor size.

3. RESEARCH METHODOLOGY

This is a retrospective descriptive study that uses logistic regression analysis to test the research hypothesis. In this study, to collect scientific sources and research literature use library methods. Research data has been collected from the... database and the financial statements from Management and Research Libraries Tehran Stock Exchange website. To calculate the variables and test research hypotheses use Excel and SPSS18 software.

3.1 Sample study

Statistical population of the study consists of all the listed companies in Tehran Stock Exchange during the period 2005 to 2012 (period of 8 years). In this study to choose the sampling method in accordance with most accounting study uses convenient purposeful sampling. In convenient purposeful sampling, elected members of the statistical population which that the researcher intends to comply with criteria or certain criteria. In this study, the statistical sample beginning with the completely statistical population and selected after considering the following criteria:

1. Companies that are listed before 2005,
2. During research have not changed their fiscal year,
3. Doesn't including investment and holding companies (funds),
4. Mandatory auditor change doesn't due to the act the council[1],
5. Required research information to be available.

After implementing the aforementioned to determine intervention criteria, it's collected 1249 firm-year observation between the years 2005 to 2012. Eventually, to eliminate the deviation caused by specified values, to deleting observations with more than 3 standard deviations from the mean for all variables. Thus, the final sample for this study was observed after the removal of outliers in 1221 year- company observation dropped that these observations is basis of analysis of research hypotheses.

3.2 Research Model

For examine relation between ownership's type and auditing characteristics, we use from two model that audit fee and auditor type are dependent variables and ownership concentration also firm's size and leverage are as independent variables that follow bellow:

$$\text{AQuality} = \alpha + \beta_1\text{Block} + \beta_2\text{Big} + \beta_3\text{FSize} + \beta_4\text{ROA} + \beta_5\text{LEV} + \beta_6\text{Liq} + \beta_k \sum_{k=7}^{15} Years + \beta_j \sum_{j=16}^{29} Industries + \varepsilon.$$

[1]According to these instruction, auditing institution and partners responsible for auditing, each one aren't allowed legal entity that again after four years accept independent auditor and statutory auditor position of the company.

3.3 Research Variable

Auditor Fee: As first dependent variable, it is one if auditor fee's ratio (to assets) were over than mean, otherwise zero.

Auditor size (**AuSize**): In order to Sajjadi et al(2010) be use from a dummy variable, if the firm auditor before the auditor change is "auditing organization" is defined the number one otherwise to be zero.

Biggest shareholder (**Big**): Measure of ownership concentration as research independent variable in a shape of largest ownership shareholder percentage is measured in the company auditor change year.

Major shareholders (**Block**): Known as a measure of ownership concentration that is measured by using total percentage of common shares ownership shareholders by more than 5% ownership in the company auditor change.

Firm size (**FiSize**): Another important control variable is the size of the client company. Lin and Liu (2010) argue the analysts and the financial press follow carefully change the corporate auditors; they are less motivated by their auditor to a smaller auditor change. To be expected by increasing the size of the company decrease transition probability auditors (a negative relationship). To measure this variable, use the natural logarithm of sales revenue in the year of auditor firms' change.

Leverage (**LEV**): In this study financial leverage is represented types of capital structures. There are studies suggesting that financial leverage has a positive significant relationship with the auditor change (Rezazadeh and ZareiMoravej,2010).This variable is calculated by total debt divided to total assets at the auditor change end year.

Year (**Years**): Dummy variables intended to control the impact of each year. Thus, is defined as one for the subjected year and zero for other years.

4. Research statistic alanalysis

4.1 Descriptive statistics

In this section, descriptive statistics of study variables is presented. As shown, about 25% of observations have large auditors (0.246) and the mean of audit institution fee is 429 million Rials. Also, the mean of ownership concentration for major ownership and largest shareholder is 72, 5%, respectively and it indicates ownership concentration in Iran capital market. Minimum main ownership is 20% and mean of leverage is 1.8 times of assets. Table 1 depicts other descriptive statistics of variables.

Table 1. Descriptive statistics

Statistics	Ausize	Fee	%Big	%Block	Fmsize	Lev	ROA	Liq
N	638	638	638	638	638	638	638	638
Mean	.246	429	50.14	72.75	12.525	1.807	0.108	0.12
Median	.431	2027	21.50	20.48	1.230	.932	0.2135	2.3256
Min	0	11	0.2	.0	9.155	.003	-0.3479	0.2022
Max	1	4072	0.9	100	16.435	7.23	0.5676	3.3867

4.2 Results analysis

Table 2 indicates the results of study. Statistical power test supports significance of model (P=0.000) and it indicates the suitable fitness of model. The predictability of model is 76%. The results show that there is a positive and significant association (P=0.077) between ownership of largest shareholder and audit fee. In other words, by increasing main ownership, fee or audit effort is increased. These evidences are inconsistent with the study hypothesis. Regarding control variables, the results show that firm size and auditor fee are associated positively (p-value=0.000). In other words, by increasing firm size, auditor fee is increased. The results show that there is a negative and significant association between return on assets and auditor fee (p-value=0.032). According to the results, by increasing firm profitability, audit fee is reduced. The results with other variables are not significant. The sign of major ownership variable is opposite to main shareholder variable and it indicates the effect of ownership type on fee and different audit quality.

Table 2. The first hypothesis's results

Variable	β	Std. Err	Wald	Sig.
Block	-0.005	0.007	0.607	0.218
Big	0.008	0.006	2.133	0.077
FmSize	0.932	0.104	79.602	0.000
ROA	-1.975	1.065	3.437	0.032
LEV	-0.213	0.618	0.119	0.372
Liq	0.048	0.278	0.029	0.432
Constant	-12.390	1.529	65.671	0.000

Regarding the second dependent variable, the results show that largest shareholder has positive association with auditor size (as a criterion of audit quality). The results in this regard are similar to the previous results about auditor fee. In other words, according to the evidences, the main shareholder has positive association with audit and auditor size. Despite the results of first model, block holder variable is associated positively with auditor size and this is not significant.

The results of control variables show that firm size is only associated with auditor size. According to the results in Table 3, by increasing firm size, larger audit institutions are much more applied and other variables are not similar to the first model as significant.

Table 3. The first hypothesis's results

Variable	β	Std. Err	Wald	Sig.
Block	0.005	0.005	0.795	0.186
Big	0.013	0.004	10.132	0.001
FmSize	0.551	0.061	80.426	0.000
ROA	-0.450	0.763	0.348	0.285
LEV	-0.475	0.444	1.145	0.142
Liq	-0.094	0.195	0.230	0.215
Constant	-8.892	0.969	84.147	0.000

5. DISCUSSION AND CONCLUSION

This study evaluates the relationship between ownership concentration and audit properties of the firms listed on TSE by auditor fee and auditor size criteria. High volume of concentrated ownership in Iran capital market requires that we can investigate the audit quality structure in these firms. By collected observations of financial information of the firms listed on TSE during 2004 to 2012, we investigated the audit quality in the firms regarding their ownership structure. The results of the study showed that increasing the ownership of the largest shareholder at first improved audit quality in Iran capital market, second its effect was higher compared to major ownership. These results were consistent with the hypothesis of active supervision (Jensen, M. C., & Meckling, 1976; Han et al., 2009) from the largest shareholder and opportunistic theory (Vito et al., 2008, Hassasyegane and Shahriari, 2010) from block holders. The results of the study showed that firm size had positive association with audit quality (Lin and Liu, 2010). From theoretical aspects, the results of the study can be added to the review of literature of ownership concentration in markets with concentration structure and can clarify the role of this type of ownership in quality of audit in firms. On the other hand, from applied dimensions can be considered by auditors, creditors and investors in their contracts with firm. For investors, investment in the firms with ownership concentration of greatest shareholder can improve quality of reporting of their required firms.

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