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Corporate Governance and Audit Opinion Shopping: Evidence from Iran

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ABSTRACT

Sustainability and development of the audit profession is a function of the quality of auditors' services and adherence to professional standards such as independence plays a key role in this. Consequences of neglecting the quality of services and non-compliance with ethical standards can create irreparable crises. The phenomenon of audit opinion shopping is one of the unethical issues in the auditing profession that plays a role in destroying the general face of auditing and its specialized role. The purpose of this study was to investigate the relationship between the elements of corporate governance includes institutional ownership, ownership concentration, board size, and board independence and the audit opinion shopping in companies accepted in Tehran Stock Exchange (TSE). To achieve this goal, 120 companies listed on the Tehran Stock Exchange were selected between 2001 to 2016 and were tested using logistics regression. The results showed that there is a positive and significant relationship between the ownership concentration and the audit opinion shopping and there was no significant relationship between the other independent variables and the audit opinion shopping.

Keywords:

Institutional Ownership, Ownership Concentration, Board Size, Board Independence, Audit Opinion Shopping.

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1. Introduction

Having clear and comparable financial information is a key element of accountability and informed economic decision making and is one of the essential requirements for economic development and achieving an efficient capital market. Also, the disclosure of information has several economic consequences, including improving stock market liquidity, reducing corporate capital costs and increasing users, and increasing users' ability to predict information, which ultimately leads to an increase in the value of the company. (Poorheidari and Hoseynpour, 2012). But access to quality disclosed information requires special mechanisms. One of these mechanisms is the existence of an appropriate corporate governance system at the level of companies and enterprises that most countries have tried to strengthen and improve. Appropriate leadership leads to timely and quality reporting by companies. The purpose of the corporate governance system is to ensure that opportunistic behavior does not occur through the reduction of agency problems and potentially asymmetric information between the agent (manager) and various stakeholders (shareholders, creditors, etc.) (Namazi et al., 2014).
The role of auditing is to reduce existing conflicts on agency problems. Audit plays a vital role in reducing conflicts between ownership and decision-making. The auditor must move in the interests of investors, but what everyone agrees on is that the auditor has entered into a social contract by concluding an audit contract, and must perform his or her duties in such a way that the whole community can benefit from those services. In contrast, firms to be audited always tend to receive favorable audit opinions because receiving other audit opinions can have adverse consequences such as devaluing the company's stock, reducing the benefits of company managers such as rewards and retention, increasing the cost of capital, and so on. Therefore, this is a potential hypothesis that corporate managers will take measures to obtain favorable opinions, including pressure on auditing institutions and opinion shopping. Audit Opinion shopping occurs when a company by influencing its auditor, obtains a better audit opinion than what the quality of its financial information justifies (Ruiz Barbadillo et al., 2006). If such behavior occurs, it will lead to a high degree of information asymmetry between managers and investors, and the audit supportive effects of investors will be weakened (Xie et al., 2010). Research shows that corporate executives due to disagreements with the auditor and receiving qualified audit reports and to receive the desired audit reports changes, auditors.

In the U.S., the Securities and Exchange Commission defines opinion shopping as the practice of seeking an auditor willing to support a proposed accounting treatment that helps a company achieve its reporting objectives even though doing so might impair reliable reporting (SEC, 1988). The audit opinion shopping means a change of the auditor by the client to receive an improved auditor's auditing opinion. If the new auditor adjusts the auditor's opinion according to the client's wishes, this phenomenon is called opinion selling from the auditor or opinion shopping from the business unit management (Chen et al., 2016).

Experimental studies (such as Krishnan and Stephens, 1995; Lennox, 2000 and 2002; Ruiz Barbadillo et al., 2006; Chan et al., 2006; Xie et al. 2010; Tang, 2011; Stanisic et al., 2015) have shown factors Such as auditor's switch, audit fees, auditor's tenure and maintaining a long-term relationship with a client, the structure of the board and audit committees have been among the influencing factors the opinion shopping. Corporate governance, by establishing a strong oversight mechanism, provides the basis for reducing the opportunistic actions of managers. It seems that the relationship between corporate governance mechanisms and the opinion shopping can be a topic of much debate in the professional literature. Much of the managers' immoral and opportunistic behavior can be controlled by strengthening the corporate governance system. Opinion shopping and willingness to accept such a position by audit firms can be controlled by corporate governance mechanisms.

In this research, after stating the theoretical foundations and background of the research and presenting the relevant model and performing statistical and analytical methods, the main question of this research on whether corporate governance is related to audit opinion shopping is answered.

2. Literature Review

2.1. Corporate Governance

The concept of corporate governance refers to the sovereignty that is exercised over a publicly owned corporation, and accordingly, how the company

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responds to shareholders, as well as other stakeholders is formed. For this reason, it is considered as important both in terms of company functions as well as the whole society and it has attracted much attention in recent years. This has caused different groups to express different definitions based on their interests or mental patterns (Mahdavi and Alizadeh, 2015). The Organization for Economic Cooperation and Development (OECD) considers corporate governance to be the structure of relationships between key groups, including shareholders, board members and managers, and the responsibilities that come with it. According to this organization, such a structure provides a competitive environment for achieving the company's primary goals and setting the criteria and mechanisms for monitoring and control (Hassas Yeganeh and Kheirollahi, 2008). In a comprehensive definition of the corporate governance system, it can be said that a set of relations between stakeholders, managers, and auditors of the company implies a control system to observe the rights of minority shareholders and implement the enactments of public assembly and prevent possible abuses. This law is based on the system of accountability and social responsibility and includes a set of tasks and responsibilities which should be carried out by the company's elements to provide responsibility for accountability and information transparency. Improvement of the corporate governance system causes long - term value creation of companies. Establishing effective and efficient corporate governance will put the interests of managers and owners in line; improve the company's performance and provide the ground for its growth and expansion. In other words, the mechanisms of corporate governance can be used to align the interests of managers and owners (Hemmati et al., 2013). Among them, ownership structure and board structure are the most important factors influencing corporate governance. Accordingly, in the present study, the four constructors of the corporate governance system, including institutional ownership, ownership concentration, board size, and board independence, are examined, and each of which is described below.

2.2. Institutional Ownership

Institutional investors are institutions that buy and sell large volumes of corporate stocks. According to existing literature, banks, insurance companies, pension funds and investment companies are regarded as institutional investors. Institutional investors use their voting rights to influence decision-making and board structure and can be a source of oversight of company management performance. The presence of institutional investors in the stakeholder's composition as one of the most effective external mechanisms affecting the corporate governance system has become increasingly important in recent years. Institutional shareholders have the potential to influence the activities of the manager’s directly through ownership and indirectly through the exchange of their shares (Mahdavi and Alizadeh, 2015). The higher the level of institutional ownership, the better the management's oversight is performed, and the relationship is a positive one (Maug, 1998). As the level of institutional ownership in the company increases, the information asymmetry between company managers and other stakeholders will decrease (Kim and Zhang, 2010). Bushee (1998) stated that institutional investors implicitly monitor the company through data collection and pricing based on the managers' decisions and explicitly through the management of the company's performance. Yu (2006) also found that the more shares available to institutional shareholders, the lower the earnings management. Therefore, it is expected that the increase in the level of institutional ownership of companies will have an inverse relationship with the audit opinion shopping.

2.3. Ownership Concentration

Absolute control of major shareholders in the management of the company's affairs is called ownership concentration (Badavar Nahandi et al., 2010). The concentration of ownership refers to a situation in which a significant amount of the company's shares are in the hands of major shareholders and shows what percentage of the company's shares belong to a limited number (Etemadi et al., 2009). One of the supervisory features of a corporate governance system is ownership concentration. In publicly-owned corporations, the ownership structure can be dispersed or centralized. Dispersed ownership, for this reason, causes the agency problem that will weaken the ability and motivation of shareholders to supervise and control management. Dispersed stakeholders are not capable of effectively controlling management, and on the other hand, they do not have adequate expertise and

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information to make accurate decisions. In contrast, the increase in ownership concentration by large shareholders provides sufficient incentive to monitor managers, and holders of more shares are motivated to bear the fixed costs of collecting information and intervening in management oversight (Ramsay & Blair 1993; Demestz & Lehn 1985). On the other hand, based on the developed agency framework, ownership concentration is expected to lead to a reduction in Opportunistic earnings management (Jensen & Meckling 1976). Therefore, it is expected that the increase in ownership concentration of companies will have an inverse relationship with the audit opinion shopping.

2.4. Board Size

The board of directors is responsible for maintaining the interests of shareholders and is essentially created for employment, dismissal, supervision and rewarding and management, all of which are aimed at maximizing value for shareholders (Mahdavi and Alizadeh, 2015). In the research literature, two views on the role and impact of the board on the company's performance are presented. The first view is that the smaller board will improve the company's performance. When the board is composed of a large number of members, the agency's problems increase and it becomes more difficult to effectively control and monitor the CEO. Furthermore, it is difficult to plan, make coordinate, decision-making and hold regular meetings for the large board. On the contrary, the second view states that the smaller board does not enjoy the advantages and benefits of the opinions and recommendations available on the larger board (Hemmati et al., 2013). The larger board is more alert on the agency's problems because more people will monitor the management works (Kiel & Nicholson, 2003). When the board is larger, the probability of members with more expertise increases and they are expected to do better in preventing or restricting opportunistic behavior of management (Davidson et al, 2003). Therefore, it is expected that the increase in the board size of companies will have an inverse relationship with the audit opinion shopping.

2.5. Board Independence

With the separation of ownership and management in corporations, managers manage the company as a shareholder representative. Establishing a representative relationship in this way can lead to conflicts of interest between shareholders and managers, and it is likely that managers will take steps that are in their best interests and contrary to the interests of shareholders; therefore, it will be necessary to have a proper management mechanism to eliminate these issues. One of the tools used in this mechanism is the use of non-executive directors in the board composition. The effectiveness of decision-making separation by management and control by the board of directors is because the non-executive directors do not tend to collude with the executive directors due to their benefits and since the executive directors have executive positions in other companies and have a high incentive to gain a reputation as specialists in decision-making and gaining job opportunities in future; therefore, the lack of alignment between the executive and non-executive directors cause to improve the company's management oversight, improve company performance, and reduce agency costs. On the other hand, the existence of non-executive members in the board composition decreases the information asymmetry between the internal and external elements of the company (Mahdavi and Alizadeh, 2015). It is expected that the higher the board's independence, the lower the agency problems. The high independence ratio of board members will promote the company performance and reduce the likelihood of cheating and the provision of misleading financial statements (Hemmati et al., 2013). Therefore, it is expected that the increase in the board independence of companies will have an inverse relationship with the audit opinion shopping.

2.6. Empirical Research

Archambeaulta, & DeZoortb (2001) in research entitled "Auditor Opinion Shopping and the Audit Committee: An Analysis of Suspicious Auditor Switches" examined whether the effectiveness of the audit committee is related to the suspicious auditor switches or not. They selected 60 American companies as a sample of their research. Their findings indicate that suspicious Auditor Switches: (1) It is less likely despite the audit committee, (2) If there is a smaller

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percentage of independent directors in the audit committee, it will increase, (3) In case of fewer members with experience in accounting, auditing, or finance will increase, (4) If the number of meetings of the audit committee is less, it will increase, and (5) If the audit committee is smaller (the number of members is less), it will increase.

Lennox (2002) in research entitled "Opinion Shopping and Audit Committees" during 1996-1998 in the USA studied the role and function of auditing committees in the dismissal of auditors who are motivated by opinion shopping, suggesting that the audit committees are more likely to disapprove of auditor dismissals and the audit committees who did not accept opinion shopping are more likely to leave the audit committee. He pointed out that either senior manager would dismiss members of the audit committee who opposed the opinion shopping or that the members of the audit committee would resign because they did not want to cooperate with the directors in audit opinion shopping. He also concluded that the audit committees were not effective in the companies to be studied because the auditors had been dismissed despite the disapproval of the audit committees and that the American companies were successful in audit opinion shopping.

Biedma-Lopez et al. (2010) in research entitled "Do independent audit committees prevent auditor opinion shopping?" studied the effects of the audit committee on the dismissal of the auditor and selecting the new auditor after receipt of a qualified audit report by Spanish companies. The result of their study on 110 sample companies from 1998 - 2005 indicated that the more independent audit committees will reduce the likelihood of auditor change by the firm after receiving a qualified audit report and reduces the management's ability to apply the change. Besides, in case of dismissal of the auditor after submitting the qualified audit report, the independent audit committee will prevent employing the auditor who is more dependent on the client. They also found a significant positive relationship between the audit committee's independence and auditors' dismissals after offering desirable opinions. They said that in such cases, more independent audit committees would select auditors who would be less economically dependent on the company than previous auditors.

According to the studies conducted and despite the existence of numerous studies in Europe and the United States and East Asia on the subject of audit opinion shopping, until the writing of this article on the subject under study, the only research in Iran was conducted by Mashhadi Gharaghaya et al. (2019) entitled with "Machiavellianism, Love of money, Customer orientation culture and opinion shopping by Client". Using questionnaires collected from 120 auditors working in private audit institutions members of the Iranian Association of Certified Public Accountants, they found that audit opinion shopping by the client is influenced by the Machiavellianism and Customer orientation culture of the auditors.

3. Methodology

3.1. Research Hypothesis

Based on archived research and analysis of Archambeaulta, & DeZoortb (2001), Lennox (2002), Biedma-Lopez et al. (2010), and Xie, z. et al, (2010), the following hypothesis was formulated.

1) The increase in institutional ownership reduces audit opinion shopping by audit clients.
2) The increase in ownership concentration reduces audit opinion shopping by audit clients.
3) The increase in board size reduces audit opinion shopping by audit clients.
4) The increase in board independence reduces audit opinion shopping by audit clients.

3.2. Research Method

The present study is applied research in terms of purpose and descriptive research in terms of nature and method. In terms of the data used in this study, they are all quantitative data, and in terms of time, they are retrospective or, in other words, post-event research, and in terms of logic, they are inductive research. Considering that the dependent variable of the research (audit opinion shopping) is dichotomous, logistic regression has been used. The data is also sorted in Excel and then the research model has estimated using Eviews10 software.

3.3. Statistical Population

The statistical population of this study includes all accepted companies in Tehran Stock Exchange from 2001 to 2016. To harmonize the research data, the following items were considered:

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1) Companies must have been accepted in Tehran Stock Exchange before 2001.
2) The financial period of the companies during the mentioned years should be the end of March.
3) Companies must not change activities or change the fiscal year between the years studied.
4) The information desired by the companies should be available.
5) It should not be one of the intermediary companies, banks, and investments companies.

Based on the above-mentioned limitations, the statistical population consists of 120 companies listed in the Tehran stock exchange.

3.4. Research Model and its Variables

To investigate the research hypotheses, the following model which is derived from the Xie et al. (2010) model has been used.

$$OpShop_{i,t} = \alpha_0 + \beta_1 InsOwn_{i,t} + \beta_2 MajOwn_{i,t} + \beta_3 BoardS_{i,t} + \beta_4 BrInd_{i,t} + \beta_5 Loss_{i,t-1} + \beta_6 Lev_{i,t} + \beta_7 Opinion_{t-1} + \varepsilon_{i,t}$$

In the above model, the variables are as follows.

A. Dependent variable

OpShop: Equals to the audit opinion shopping variable. To calculate the audit opinion shopping if, after the auditor's change, the type of audit opinion this year (new auditor's opinion) is more favorable than the previous auditor's opinion, it is considered as the audit opinion shopping and score 1 and for other points, 0 is considered. The desirability of the audit opinion is based on the rating of 0 = unqualified opinion, -1 = qualified opinion and -2 = disclaimer or adverse opinion (Xie et al. 2010).

B. Independent variables

InsOwn: It is equal to the percentage of shares belonging to investment institutions, investment and insurance funds, etc., which are classified as institutions. Its threshold is ownership of at least 5% of corporate shares by institutions (paragraph 27 of Article 1 of the Securities Market Law).

MajOwn: Equivalent to the total percentage of shares owned by major shareholders. Its threshold is the ownership of at least 5% of the shares of companies by shareholders (Aghaee and Chalaki, 2009).

BoardS: equal to a variable of the board size which is determined based on the number of the board members of the companies.

BrInd: equals to the board's independence variable, which has been measured based on dividing the number of independent members of the board by the total number of board members.

C. Control variables

Opinion $_{i,\,t-1}$: It is equal to the type of audit opinion of the previous year. If the audit opinion of the previous year is qualified, the score is 1 and otherwise the score is 0. One of the factors that can cause audit clients to try to audit opinion shopping is to receive a qualified audit opinion in the previous year. Therefore, the type of audit opinion of the previous year is given as a control variable in the model (Lennox, 2000).

Loss $_{i,\,t-1}$: It is equal to the loss of the audit client in the previous year. If the audit client had a loss in the previous year, a score of 1 and 0 for other cases have been considered. Another factor that can increase willingness to audit opinion shopping is that the audit client had a loss in the previous year. Therefore, the loss of the audit client in the previous year is mentioned as a control variable in the model (Krishnan & Stephens, 1995).

Lev: It is equal to the ratio of total debt to total assets. One of the factors that indicate the financial crisis of companies is the high financial leverage and it is expected that the higher ratio of financial leverage will increase the audit opinion shopping. Therefore, the financial leverage of the audit client is also mentioned as a control variable in the model (Lennox, 2000).

4. Results

4.1. Descriptive research statistics

Descriptive statistics of research variables for 1920 years-firm is given in Table 1.

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Table 1. Descriptive Statistics of Research Variables

Variable Mark	Mean	Median	Maximum value	Minimum value	Standard deviation	Skewness	Kurtosis
Audit opinion shopping OPSHOP	0.01	0.000	1	0.000	0.13	6.89	48.54
Institutional ownership INSOWN	31.38	19	100	0.000	32.42	0.65	1.95
Ownership concentration MAJOWN	73.93	80	100	0.000	21.38	-1.45	5.05
Board Size BoardS	5.12	5	*8	**3	0.46	2.06	14
Board Independence BRIND	0.65	0. 6	***1	****0.000	0.17	-0.67	3.91
Previous year loss LOSS $_{t-1}$	0.02	0.000	1	0.000	0.17	5.54	31.71
Financial leverage LEV	0.6	0.63	*****1	0.02	0.18	-0.48	2.91
Previous year opinion Opinion $_{t-1}$	0.53	1	1	0.000	0.49	-0.15	1.02

* The largest number of board members belonged to Frosilis Iran Company in 2015 and 2016.
**The lowest number of board members belonged to Sazeh Pooyesh Company in 2001.
*** The most Board Independence has been related to Khuzestan Steel Company during 2011-2016.
**** The lowest Board of Independence has related to Mahram Company in 2016.
*****The highest financial leverage has related to Navard Aluminum Company in 2013.

4.2. Research Model Estimation

The results of the research model estimation are given in Table 2.

According to the table, the probability of LR statistics is less than the 5% error level, which indicates that this model is significant at the 95% confidence level. The McFadden coefficient indicates that 11% of the dependent variable changes are explained by independent logistic regression variables. The dependent variable is audit opinion shopping and as results show considering the significance level of 5%, there is a positive and significant relationship between the ownership concentration and audit opinion shopping and there is a positive and significant relationship between the previous year audit opinion and audit opinion shopping and there is no significant relationship between the dependent variable of audit opinion shopping and other variables. Also considering that the probability of the statistic for the Hosmer-Lemeshow test is 25% and higher than 5%, therefore, the estimated model has good fitting.

Table 2. Model estimation results

Variables	Coefficient value	Statistic z	Significance level
Constant coefficient	-8.84	-3.92	0.0001
Institutional ownership	0.003	0.64	0.5186
Ownership concentration	0.02	2.04	0.0409
Board Size	-0.06	-0.19	0.8442
Board Independence	1.69	1.61	0.1057
Previous year loss	0.32	0.42	0.6724
Financial leverage	0.30	0.30	0.7607
Previous year opinion	2.86	3.93	0.0001
McFadden coefficient of determination = 0.11	Statistic LR = 41.87	Statistical probability LR = 0.000001	
Hosmer-Lemeshow Goodness of Fit Test = 10.1		Hosmer-Lemeshow Significance level = 0.25	

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5. Discussion and Conclusion

The issue of auditor's opinion has been considered in many types of research. Among the vast elements that affect the quality of audit service, the independence of auditors is so important. In literature, independence has been considered in different ways, but the focus on auditor behaviors can affect the issue of audit quality. The effect of the auditor's judgment is affecting the quality of his or her service. Among the various components of the research, institutional ownership (first hypothesis), board size (third hypothesis), and board independence (fourth hypothesis) were not confirmed. The significance levels for these variables were 0.5186, 0.8442, and 0.1057, respectively, and according to the results, these three components are not significantly related to audit opinion shopping.

In the first hypothesis, the purpose was to examine the relationship between institutional ownership and audit opinion shopping by the audit client. Contrary to the expectation that increasing the institutional ownership will reduce the audit opinion shopping, the results of the present study show that there is no significant relationship between the institutional ownership and the audit opinion shopping during the period under study. It was thought that the existence of institutional ownership would document at least one negative relationship and the presence of institutional ownership will reduce the likelihood of the purchasing audit opinion by the audit client and the auditors' tendency to selling audit opinion.

In the second hypothesis, the purpose was to examine the relationship between ownership concentration and audit opinion shopping by the audit client. Contrary to the expectation that increasing the concentration of ownership will reduce the audit opinion shopping, the results of the present study show that there is a positive and significant relationship between the ownership concentration and the audit opinion shopping during the period under study. In other words with increasing ownership concentration, audit opinion shopping has increased.

In the third hypothesis, the purpose was to examine the relationship between the board size of directors and audit opinion shopping by the audit client. Contrary to the expectation that increasing the board size of directors will reduce the audit opinion shopping, the results of the present study show that there is no significant relationship between the board size and the audit opinion shopping during the period under study.

In the fourth hypothesis, the purpose was to examine the relationship between board independence and audit opinion shopping by the audit client. Contrary to the expectation that increasing the board's independence will reduce the audit opinion shopping, the results of the present study show that there is no significant relationship between the board independence and the audit opinion shopping during the period under study.

The results of the four hypotheses are in line with the results of the study by Lennox (2002). He also concluded that audit committees had not been effective in the companies under his study and that American companies were successful in audit opinion shopping. Also, the results of the present study are inconsistent with the results of the research of Archambeaulta & DeZoortb (2001) and Biedma-Lopez et al. (2010). In their research, they found a negative relationship between corporate governance elements and audit opinion shopping.

Among the control variables used in the model, there is a positive and significant relationship between the type of audit opinion in the previous year and the audit opinion shopping. This suggests that the audit clients made a greater effort to the audit opinion shopping after receiving a qualified audit report in the previous year. Also, no significant relationship was found between other control variables and audit opinion shopping.

Although there was no restriction in this study that prevented the performance of the work, there is a limitation to the review of the purchasing audit opinion behavior by the audit client and the reciprocal sales behavior of the audit opinion by the auditor and its indicators in experimental research and it is not yet possible to say for sure that the improvement in the type of audit opinion after the change of auditor reflects the unethical behavior of the audit client and the new auditor's cooperation with the audit client to achieve these unethical goals and ignored relationships are not included. On the other hand, considering the long period of research, it should be noted that the corporate governance act was not approved in the major part of this research and was implemented by companies on a voluntary.

Given that, according to the findings of the present study, ownership concentration increases the audit

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opinion shopping, so investors and analysts are advised to pay special attention to this subject in the analysis of investment programs in financial assets and securities, Because this important factor can lead to the selection of the optimal investment portfolio with the least risk and the highest return, it can also make the decision-making environment transparent.

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