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To study the effect of corporate governance on audit profession (case study: Tehran Stock Exchange – automotive industries)

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ABSTRACT

Background and Objective: The aim of the present research is to study the effect of corporate governance on audit profession in Tehran Stock Exchange – automotive industries and for this purpose 266 individuals from official accountants working in auditing organizations and institutes have been selected with the use of simple random sampling method and have responded to the author-made research questionnaire. Finally, the obtained data from the questionnaires have been analyzed with the use of single-sample t-test. **Results:** the results indicate that auditing the management structure of the auditing company, existence of the audit committee of the auditing company, existence of non-auditing services in the auditing company, existence of individuals impacts with auditing company, corporate governance rules and regulations regarding independent audit operation in Tehran Stock Exchange – automotive industries have a significant ($p < 0.05$) effect.

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INTRODUCTION

Corporate governance system is a set of instructions, structures, processes and cultural norms that companies with following them can achieve clarifying goals in working processes, responding to stakeholders and their rights. Corporate governance mechanisms reduce agency problems in companies. The quality of these mechanisms is a relative issue and differs from one company to another (Ahmadpour *et al.*, 2010). Strong corporate governance in companies is one of the most important tools for preventing corruption. Conducted studies indicate that when corporate governance becomes weak, financial corruption increases and consequently foreign and domestic direct investment degrades, expenses of government increases and economical growth decreases. In 1990s following extensive financial scandals at the level of large companies, for the first time the corporate governance subject was raised. After the financial crisis of East of Asia in second half of the year of 1997, serious questions were raised regarding the reliability of financial statements and the role large international institutes in their financial reporting. In this crisis of financial instability, abrupt exit of foreign investments and weakness of corporate governance procedures in micro and macro levels (companies and national economy) led to the downfall of companies and economy at regional level (Rahbari Kharrazi, 2004). Today preserving public interest, protecting shareholders' rights, improving information clarity and requiring companies to performing social responsibilities is among the most important ideals which have received the attention of various regulatory and administrative bodies more than the past. Realization of these ideas requires consistent regulation and appropriate enforcement mechanisms to be in place and the most important of them is corporate governance system and failing to secure public interest could be the lack of mechanisms of corporate governance for achieving the ultimate goal of company, i.e. increasing the interest of shareholders and also improving the company performance, in addition to meeting all the above mentioned criteria (Hassas Yeganeh and Baghomian, 2005). Based on conducted studies, if companies work in line with improvement of corporate governance, this can have a positive effect on performance and value of the company (Lindelof & Löfsten, 2005).

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Without any doubt emergence of joint stock companies in industrial world, which has been started from 18 century, are one of the largest economic developments and probably one the most important industrial advancement factors. Among the outcomes of this phenomenon separation of ownership from management, existence of natural differences in their utility function and as a result of them formation of conflict of Interest and following it creation of agent – owner relationship and agency theory can be named. From that time, the issue of legal interference in general and the risk of stripping the rights of minority shareholders by large shareholders who have a controlling influence in particular are among the most important issues of agent – owner in most of the countries of the world. The issue of corporate governance started from 1990s in England, United States and Canada in response to problems resulting from lack of effectiveness of the board of directors in performance of large companies. The initial basis of corporate governance have been formed with preparation of user reporting in England, reporting in Canada and regulations of Board of Directors in General Motors of U.S. (Fe'li, 2008).

Bankruptcy and scandals of companies such as Enron and WorldCom have indicated to the need to establish appropriate corporate governance systems as one of the most important issues in countries. The main reason for establishing corporate governance is the necessity of returning the trust of investors to commercial activities through clarity, responsiveness, accountability and fairness (Vadiei, 2011).

In addition, construction of Stock Exchange and at the same time the role of private sector in economical growth operation in the beginning of the third millennium have increased the importance of auditing profession as one of the principle references as the factor of trust. On the other hand, accounting crimes of some of the large companies in the world have had many negative and destructive effects on auditing profession and have opened a door of severe criticism in front of this profession and it is recognized as a misleading factor instead of a trust factor which causes adverse impacts on worldwide reputation of auditing profession. Typical instance of it is the dissolution of one of the famous auditing institute named Arthur and Anderson from business environment (Cohen, 2002).

Financial bankruptcies caused increasing concern and question marks around the auditing profession and auditor's performance. Especially the proof of collusion or failure of auditors to detect fraud caused many of companies, organizations and professional, scientific and international bodies to search for a set of methods and regulations for completing the efficiency and effectiveness of auditing operation. However, this time it is not done through theory factors such as development of auditing standards but through related factors with healthy governance of companies and business environment.

Although, corporate governance in advanced countries for provision of solutions for solving problems related to creating trust in financial markets and preventing financial bankruptcies and protecting the social level have received attention from auditing profession, nevertheless in Iran due to intense concern of necessity of implementing international regulations and standards in line with global developments, in particular the coordination of internal developments, more attention is required (Hassas Yeganeh, 2006).

Communication of corporate governance (corporate governance) by Stock Exchange about corporations and requiring them to follow them and also issuing regulations of auditors trust to companies have raised multiple questions regarding the effect of matching the principals of corporate governance on auditing profession and auditors in Tehran Stock Exchange – Automotive industries and efficiency and independence level and economic aspects related to it.

Corporate governance is a fundamental element in increasing the trust of investor, improving the competition sense and eventually improving the economical growth. This element is placed at the top of the list of international development. James Wolfensohn, the former World Bank President says in this regard: corporate governance is more important for economical growth than countries governance. Principles of corporate governance include: equality, clarity and accountability which are the same in all countries of the world. Promotion and improvement of proper and good corporate governance can be fruitful and useful for commercial companies of the world (Sina Ghods, 2009).

Since our country in recent years have moved toward privatizations of companies for economical growth increase and improvement of livelihood of citizens; then it is appropriate that beside this effective action, the required mechanisms should be as well established to make achieving this goals easier. Also auditors have a prominent role is creating trust and attracting investments in line with this. Considering the above stated problems and issues, this research intends to study and review the effect of corporate governance on auditing profession and for the purpose of clarifying the topic some instances of conducted empirical studies in line with our study will be mentioned here and then the research methodology and findings will be discussed and in the end the conclusion will be presented.

Empirical Research Background:

Zulkarnain *et al.* (2007) in their study have concluded that the auditor's independence have a positive relationship with auditing committee meetings, auditing committee report together with yearly report, the role of auditing in determining the auditing fee and the composition of auditing committee members.

Zulkarnain (2006) in his paper has studied the effect of providing non-audit services on the auditor's independence and the findings indicate that the simultaneous provision of auditing and non-auditing services by a group of auditors have a negative effect on the auditor's independence.

Dopuch *et al.* (2003) in a study have concluded that the simultaneous provision of auditing and non-auditing services cause the auditor to consider the customer's interests when he is searching the evidences and makes them to show the positive evidences stronger and in general will divert their judgment. In this way, the simultaneous provision of auditing and non-auditing services will damage the auditor's independence.

Walker *et al.* (2001) have studied the empirical relationship between auditing time length and financial scandals. For this purpose 110 American companies with financial scandal during 1980 to 1991 have been studied. The results of the studies indicate that the most of financial scandals are related to long-term association but the highest rate of financial scandals have been occurred in short-term time periods. Since the financial scandal rate in short-term has been less, the authors have concluded that rotating auditing institutes are not necessary for reducing the rate of financial failures.

Abbas Zadeh and Manzar Zadeh (1390), in a paper have studied the probability of issuance of an acceptable independent auditor report with the use of the characteristics of the board of directors of companies listed in Tehran Stock Exchange and the results indicate that there is a negative and significant between the increase in the number of board of directors and acceptable report auditor and a positive and significant relationship between increase in the ratio of ownership and acceptable audit report. No change in the members of the board of directors of the current year over the previous year have a negative and significant effect on acceptable auditor report and there is a positive and significant relationship between increase in the ratio of market value to book value of the stakeholders' rights and acceptable auditor report. Also, there is a negative and significant relationship between change in the current year auditor to the previous year and acceptable auditor report and a positive and significant relationship between increase in the asset return rate and acceptable auditor report.

Bolo *et al.* (2010), in a study have studied the change of independent auditor and transparency of information of the companies listed in Tehran Stock Exchange. Independent auditors have always been considered as one of the pillars of Capital Market. Due to the importance of their role in the market, their regular changes have been considered as one of the basic strategies for increasing information transparency by supervisory and regulating bodies of capital markets. This has become mandatory in Iran through guidelines for trustee auditing institutions of Securities and Exchange (passed on 8/5/1386 (2007) by the High Council of the Securities and Exchange. Based on this, this paper is seeking to study the change of independent auditor on information transparency of companies listed on Tehran Stock Exchange during 2005 to 2008. In line with this, the effect of change of independent auditor on corporate information transparency rating and annual adjustments has been tested and the results indicate that the change of independent auditor doesn't have any effect on corporate information transparency.

Nouresh *et al.* (2009), have studies the relationship between corporate governance mechanisms and agency costs in companies listed on Tehran Stock Exchange. In this study ownership of institutional investors, percentage of non-bound members of Board of Directors and dept ratio has been used as corporate governance mechanisms. Agency costs have been considered as a function of interaction between growth opportunities and the company's free cash flows and Tobin's Q index has been used as a criterion for measurement of growth opportunities. They found that there is a negative and significant relationship between the percentage o the non-bound members of Board of Directors and also the percentage of ownership of institutional investors with agency costs, however no relationship was found between debt ratio and agency costs.

Research methodology:

The current research is an applied study from aim point of view; descriptive from methodology point of view and survey from way of conduct point of view.

Research population and sample:

The population of the present research includes certified accountants working in auditing organizations and institutions with auditing experience in automotive industries and by visiting the website of certified public accountants, the members list of this population have been extracted up to the end of the month of Khordad of 1390 (2011) which consists of 785 individuals and from them 266 individuals have been selected with the use of simple random sampling method as the research sample and have been studied.

Data collection instrument:

The instrument for collecting data regarding the research variables is an author made questionnaire consisting of 23 questions in five-item Likert form (very low to very high). For testing the content validity of the research questionnaire, the opinions of experts and specialists have been used and the reliability of it has been tested with the use of Cronbach's alpha and it is equal to 0.81 which indicate to the good reliability of the research questionnaire.

Research findings:

In this research for the purpose of studying the effective factors on independent auditor decisions in Tehran Stock Exchange – Automotive industries single-sample t-test has been used and the results have been presented in table 1.

Table 1: The results of single-sample t-test

T measure = 3				
Variable	Mean	Df.	t	Sig.
Corporate management structure	3.725	265	18.141	.00
Corporate auditing committee	3.283	265	6.514	.00
Non-auditing services	3.857	265	21.157	.00
Impacts of individuals with company	3.397	265	11.392	.00
Corporate governance regulations	3.419	265	13.935	.00

The results of single-sample t-test indicate that from the point of view of certified accountants employed in auditing organizations and institutions, the managerial structure of company being audited, auditing committee of the company being audited, existence of non-auditing services at the company being audited, existence of impacts of individuals with the company being audited, corporate governance regulations have significant effect ($p < 0.05$) on independent auditor's operation in Tehran Stock Exchange.

Conclusion:

The world in the last 10 years has witnessed significant changes in private sector, economical development and job creation. Due to the fact that more countries have followed market based attitude in Economic Policy, therefore; awareness from significance of private agencies regarding the welfare of people has been increased and one of the raised issues during the last few decades in financial markets is corporate governance and many researchers and scholars from different disciplines such as accounting, business, economics, law and ... have studied it from different angles. Also, in the meantime with the increasing reliance on the private sector in the world economy, corporate governance has gained more importance than ever. Recent financial crisis in America, Europe and Asia have clarified for all the countries that why the raised issue of transparency and responsiveness in corporate governance is important in investors' trust and the performance of the national economy. Corporate governance is related to mechanisms that companies perform and control their business with the help of them. Although governments have a central role in formation of the legal, institutional and regulatory environment for creation of agency's strategy system, however; the main responsibility of establishing an optimal system is on the shoulders of private sectors. Such a system in turn creates this confidence that the activities of companies are in line with the society's interest and causes the trust of investors and attracts long-term investments (Vadiee & Hoseinin, 2011).

The role of corporate governance in economic development can be sought in other sectors. For instance, the importance of financing, ownership right and competition are among items that based on them the role of corporate governance in economic development can be observed. The beginning of corporate governance through sock ownership has a considerable impact on control method of companies and in this way owners have delegated the task of governing a company to managers. In fact, the separation of ownership from management has led to an organizational problem from different angles which are related to relevant costs of organizational structure and process of limitation creation on manger, costs and expenses related to monitoring such as auditing expenses. Therefore, the composition of stakeholders and especially managers' ownerships in company in terms of selection of managerial structure of the company being audited is among important issues which can create costs and opportunities in different situations in a company. This research seeks to consider a proper ownership structure that on one hand shows the management efforts in line with securing stakeholders' goals and on the other hand minimizes the agency costs as much as possible.

Necessity of independent auditor can be considered as a response to agency problems. The auditor's role is considered as a mechanism for testifying business unit management accountability and stewardship and improving accuracy and reliability of financial reporting. As a result, increased complexity of the structure and business risk, activities of globalization and separation of ownership from management, greater confidence in the financial information provided by companies is expected. Auditor's role has changed a lot over time, so they must be responsive to the demands of different groups for their services (Armstrong, 1987).

The aim of this research is to study the effect of corporate governance on auditing profession of Tehran Stock Exchange organization – automotive industries. The importance of this subject is that governance deals with the development of the relationship between company and those who take interest in its activities including auditors and the expected impacts on it.

The importance corporate governance has in the world goes back to the economic developments and the major role that corporations play in this area. This role requires control, enforcement and continuity. This topic in Iran deals with the role of companies in private sector and the importance of following their activities and

delivering their functionality to the highest possible level. In terms of scientific point of view, the reason of high importance of this topic is that it has been less studied and most of its importance is related to the role that governance can have in professional development and public space of business.

The findings of the present research indicate that from the point of view of certified accountants working in auditing institutions and organizations, the managerial structure of the company being audited, existence of auditing committee in the company being audited, existence of non-auditing services in the company being audited, existence of individuals impact with the company being audited, corporate regulations have significant effect ($p < 0.05$) on independent auditor operation in Tehran Stock Exchange Organization – Automotive industries. These findings are consistent with the findings of Zulkarnain *et al.* (2007), Zulkarnain (2006), Dopuch *et al.* (2003), Walker *et al.* (2001), Abbas Zadeh & Manzar Zadeh (2011), Bolo *et al.* (2010) and Nooresh *et al.* (2009).

Recommendations based on research findings:

Considering the performed reviews in research process and the obtained results from statistical analysis of the research data the following recommendations can be presented:

1. Continuous training of corporate governance concepts by Iranian Society of Certified Accountants.
2. Establishing a theoretical framework for corporate governance at internal level and considering more comprehensive measures of corporate governance.
3. Creating legal obligations at internal level for enforcement of corporate governance mechanisms.
4. Creating electronic information bases for rapid and on-time communication of all the news, figures and financial information to stakeholders.
5. Considering an agent from stakeholders in the Board of Directors of the company.
6. Creating appropriate mechanisms for holding on-time meetings for preparation of guidelines and MOU of Board of Directors.
7. Planning for holding training courses especially for Board of Directors and continuous learning through internal networks, internet, seminars and handouts within the organization.
8. Collection and extraction of the information about the company's operations during a specific period of time and presenting it to the members of the organization.
9. Creating efficient and effective internal control system.
10. Establishment and continuation of auditing committee activities in an effective and efficient manner and supporting it.
11. Maintaining independency and professional qualification and performance of independent and internal auditors.
- 12.

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