



An Investigation of Financing Costs Factors on the Auditor's Qualified Report in the Companies Listed in Tehran Stock Exchange

Mahmoud Hematfar, Hossein Soheili*

Department of Accounting, Borujerd Branch, Islamic Azad University, Borujerd, Iran

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ABSTRACT

The purpose of this study was to an investigation of financing costs factors on the auditor's qualified report in companies listed in Tehran stock exchange. The criteria considered in this study were the audit firm size, auditor's specialization in the partner level, auditor's selection tenure and audit fees. For this purpose, five hypotheses were developed and data related to 85 companies of Tehran stock exchange for the period 2009-2014 were used. To test them, the multivariate regression technique was applied to panel data. The results of the first hypothesis indicated that there was no significant relationship between the audit firm size and qualified audit report. According to the second and third hypotheses, there were significant positive and negative relationships between auditor's specialization in the partner level and audit firm with the qualified report, respectively. The fourth one regarding the relationship between the auditor's selection tenure and qualified audit report was rejected. The fifth hypothesis results also indicated that there was a significant negative relationship between audit fees and qualified audit report.

1 Introduction

The present study in an analysis of factors and decisions related to the qualified audit report. Jensen [16] declare that conflict interest and inability of managers in the direct observation of agents' activities result to an ethical danger and natural conflict of interest between mangers and agents which that also results to the agency cost. The role of company administration structures in reducing these costs has been considerably investigated through guarantying the valid reporting of financial statements information. The independent auditor acts like a surveillance system (supervision, control) and therefore it is a vital and necessary part of the company administration structure. The auditors are considered as kind of control because on independent auditor can only achieve publicity and reputation by independently investigating and approving the financial statements presented by the company management. This question that, presenting the appropriate audit options, do the auditors properly do their independent role or not, has been widely considered.

Because of the sensitivity of the adjusted audit report, most of the academic studies have been done during the years to identify the probable effective factors on the adjusted reports. The kind of auditor's opinion is one of the standards measuring the audit quality. De Angelo [11] knows the auditor's opinion as a result of direct audit of financial statements provided by the management. On

* Corresponding author. Tel.: +989370947371
E-mail address: Dr.hematfar@yahoo.com

the other hand, companies are also fond to gain the accepted opinion of audit and try in this way to agree with their own audit or even change him. Therefore, it can be mentioned that the kind of auditor's opinion depends on himself and the client can have a little effect on it. Consequently, issuing the qualified report by the auditor can be a sign of exact investigation and his resistance against the client's attempts to effect on his opinion. According to the different conditions, there are numerous options related to the auditors' opinions. The most current kind of audit opinion is the standard accepted one. But the auditors also issue the adjusted reports such as the accepted ones with the explanatory paragraphs which they are supposed any report except the accepted one. In the special situations, the auditors should present newer reports as conditional, banned or no-opinion. This duality between the accepted and adjusted opinions enable the researchers to investigate the determinants of such choice.

Getting public of ownership of business, financing through public partnership and privatizing the public sectors are among principal factors of fundamental changes in Iran's economic environment; in such conditions, the desirable quality and transparency of financial and nonfinancial information, which are the basis of the economic decisions-making of potential renders and investors, are of great importance. Because of sensitivity of the qualified audit report, most of academic studies have been done during the years to identify the probable receivers of qualified reports. Moreover, reporting decisions of activity tenure beat among the subset of qualified audit opinion in the field of empirical studies. This proper group of audit reporting is of great importance for a company because it is more probable that companies receiving the opinions of activity tenure fail in the future, that is, issuing the activity tenure opinion can cause the company failure itself and it is because of its effect on the present and potential investors, obliges, suppliers and customers (Geiger et al., [14]).

On the other hand, these empirical studies provide some evidences for the legislative organizations and exchange to develop legal standards. In this study, it has been also tried to present an analysis of factors related to the decisions of qualified audit report. According to the above explanations, the principal problem of this study is to investigate the factors affecting on the qualified audit report to be able to give more information to managers and investors in decision-making through its results.

2 Literature Review

Defond et al. [12] stated that different factors influence the reception of qualified (adjusted) report: the first case is the wrong presentation of financial statements as significant and the other cases are related to the auditor's task and his independence:

In fact, the first case is related to the exchange companies and their motivations for this task and the two next ones relate to the audit quality. Many studies have stated the qualified report share as the audit quality standard, they discuss that an increase of audit risk results to an increase of the auditor's independence and quality, so this risk causes the qualified report share to increase although the audit quality is important in determining the likelihood of qualified opinion and this subject has more importance when the financial statements have not been correctly presented. Generally, the auditor's qualified opinion explains that the financial statements are desirably indicated except the present weaknesses of financial statements or present limitations in the scrutiny scope.

Audit characteristics effective on the qualified audit opinions

Audit firm size:

De Angelo [11] presents a two-dimensional definition of audit quality in that an auditor is considered independent if he can identify an important error and report it to the audit services customers. Many academic studies have provided evidences showing that big audit companies present more qualitative audits. From the audit report perspective, it can be expected that companies examined by the bigger audit firms to issue more exact opinions than smaller ones (that is, they

commit less 1 and 2 type errors). Allocating more resources to programming and evaluation of risk, the auditors of bigger audit firms do more audit attempts in a more surveying and less procedural approach. So they can measure better the business failure risk of a customer and use stricter quality standards for their personnel when they do the processes. The auditors of bigger audit firms provide more accurate audit opinions and it is more probable to issue a qualified audit opinion. It is needed to mention that more accurate audit opinions do not necessarily mean the adjusted ones. Moreover, the bigger audit firms probably select the customers that pay less attention to the audit quality.

Auditor's specialization in the partner and audit firm levels:

Considering the auditor's specialization aspect in the individual level or the audit partner, it can be stated that the audit partner prepares an audit plan and finally determines a report which should be provided for the client.

According to the logical aspect of the case, it can be expected that the audit partner has a great direct effect on the audit quality. On the other hand, by revealing the name of the audit partner in the signed audit report for the clients and users of financial statements, it can be a factor to increase the risk of losing the auditor's reputation and his money assets in facing with the failure. Therefore, identifying the name and signature of the audit partner in the report presented by the audit firm increases their motivation in order to increase the audit quality. However, investigation the aspect related to the auditor's specialization in the company level, it can be stated that the auditors' motivation is not as strong as before, because, in this case, the total audit firm is the counterparty of clients not a specific person. By increasing the specialization in the individual level, the auditor's industrial specialization in the audit firm level also increases. The advantages of auditor's specialization in the industry in the audit firm level accumulates and increases because the industry specialization facilitates the transition of obtained knowledge and created technology from a client to the same other ones. Therefore, it is expected that the skilled auditors in the industry provide more qualitative audits than the unskilled ones (Mayhew and Wilkins [18]).

The skilled auditors of industry are more interested in expressing the adjusted opinions (especially the activity tenure opinions) from several ways. First, because of their better knowledge on their customers' industries, the skilled auditors of the industry can evaluate the ability of likelihood of the customer's activity tenure of an especial industry better. Second, the industry experts spend considerable resources to a quire reputation and publicity by providing more quality of the audit, and they preserve this quality by "stating an activity tenure audit opinion on the basis of less likelihood of the customer's work failure than the unskilled ones.

Selection tenure of Audit Company

By accrediting to the financial statements and other examining information, the independent auditors cause the companies' informational transparency. Recent financial scandals all over the world, from Anron and verldcome in America to parliament in Europe, have created worries in relation to the capability of reliance to the financial statements. While the main responsibility of providing the financial statements is on behalf of the company management, these events are generally reminiscenced as an audit failure. In fact, the public believe that the causes of these events are the lack of independence and weak audit quality. In the wake of these events, legislators and accounting standards setters tried to formulate acts in order to enhance the auditors' independence and audit quality.

For this reason, in July 2002, Sarbanes Oxley Act (part 203) forces the audit firms to change their partners and mangers after every five years auditing on a client (American Congress, 2002). So, one of the procedures to increase the audit independence and quality is to formulate acts in respect of the auditor's rotation. The flow of audit company and audit partners is one of the main policies which are conducted in many jurisdictions in all over the world in order to investigate the issues about the audit

quality. The such warrant has been criticized because the long-term selection tenure necessarily endangers the audit independence because of the auditor's reputation problems, and the audit quality can be reduced because of the lack of knowledge specific to the customer if the flow becomes compulsory (Geiger and Raghinandan [14]). The long-term selection tenure can have a positive relationship with the audit quality which it is because of higher audit costs in the primary periods of the auditor's selection and an increase of information on the customer and industry which is achieved in the frequent audits (Mayers et al. [19]). But if sox worry about obligating the flow is justified, it can be expected that there is a negative relationship between the selection tenure of the audit company and issuing the qualified audit opinion through the reduced independence and the capacity reduction of the audit opinion to present critical evaluation in order to do the appropriate audit judgments.

Audit Fees

The audit fees are a reflection of the audit quality for the foreign users from the financial statements. They state that the independent audit forms an important part of the financial reporting system. Using the independent auditor may indicate a client's management obligations to the investors and the audit fees can be considered as a cost which the client pays to the auditor in turn for the fulfilment of the obligations. On the other hand, the amount of the audit fees also depends on the amount of work done for investigating the financial statements. The difference in the audit fees of different institutions is due to the difference in the amount and quality of their works and this fee must cover the costs invested by the institutions. To increase the audit quality, the possibility of being covered the accounting errors and frauds will decrease. In other words, the auditing is planned and supervised as best as possible and all present errors being higher than the importance level are identified are reported; so, the possibility of issuing the qualified report becomes more.

3 Background of the Research

Etemadi et al. [1] examined the informational content of the auditor's qualified report. The findings of their study indicated that there is no significant difference between the abnormal returns of distributing the audit qualified and accepted report.

Khani and Haghighi [3] compared the independent auditors' opinions and the financial variables in predicting the bankruptcy and concluded that the independent auditors' opinion can simultaneously predict the bankruptcy better than the financial variables in the next fiscal year in terms of uncertainty about the activity tenure and qualified report. Carcello and Palmrose [20] found that the adjusted reporting amount for the companies which have no litigation was significantly higher in the univariate analysis but it was not so in the multivariate test.

Kaplan and Williams [21] found that the auditors can reduce the possibility of a group litigation through presenting the qualified audit reports to their customers being under the financial pressure by using the simultaneous equations approach. The empirical evidence of the relationship between the qualified audit report and the auditor's change (1-type error studies) presents a more convincing evidence representing that the customers turn to other auditors in response to the qualified opinions.

Dastgir [2] could not document a significant reaction of the market to the qualified audit opinions but Khodadadi and Hajizadeh [4] reported a negative reaction of the market to such opinions.

Rajabi and Rajabi [5] compared the auditor's precision against the model precision about decisions related to the activity tenure but they don't find any evidence to support that the auditors' decision-making in relation to the activity tenure is lower than the statistical modeling.

In china, Firth et al. [13] compared the effect of partner's rotation and audit firm on the audit quality in compulsory and discretionary situations (according to different states of china). They considered the modification of the auditor's opinion and presentation of unaccepted audit report (adjusted audit report) as a standard for the audit quality. The findings of their studies indicated that

there is a direct relationship between the audit partner's compulsorily rotations and the audit firm discretionarily rotation and the presentation of audit unaccepted report. However, in examining the relationship between the audit firm discretionarily rotation and the modification of audit report, the level of error had been further considered. Moreover, based on the study's findings, there was no significant relationship between the discretionary rotation of the audit partner and compulsory rotation of the audit firm and the audit modified opinion. The auditors may not issue the qualified audit opinions for big companies because they can hurt their independence due to the pressures of audit fees or customers ([9-11]).

Chase [7] interviewed with the active auditors and found that they consider the condition of activity tenure in the previous year as an important determinant in issuing the qualified audit opinion for the present period. Dang [8] indicated that the customer should show a considerable improvement in his performance when an activity tenure opinion is issued in order to avoid receiving another one.

4 Methodology of the Research

The present study is descriptive-correlative. Given that this study can be used in the investors' decision-making process, it is applicable.

4.1 Research Hypotheses

Considering that the purpose of this study is to investigate the factors affecting on the qualified audit opinion in the exchange companies, its hypotheses follow as: Hypothesis: 1: There is a significant relationship between the audit firm size and qualified opinion.

Hypotheses 2: There is a significant relationship between the auditor's specialization in the partner's level and qualified opinion.

Hypotheses 3: There is a significant relationship between the auditor's specialization in the audit firm level and qualifies opinion.

Hypotheses 4: There is a significant relationship between the auditor's selection tenure and qualified audit opinion.

Hypotheses 5: There is a significant relationship between the audit fees and qualified audit opinion.

4.2 Data Collecting Method

In the present study, the library method has been used to collect data and information. The statistical and image archive CDs of Tehran stock exchange organization, official website of Tehran stock exchange company and other related websites, accounting information of exchange companies and other information sources have been used.

4.3 Research Variables

The variables of this study consist of dependent, independent and control ones which are as follows:

Dependent Variables

In this study, the qualified audit report (MAO) has been used as the dependent variable. If the client receives the qualified audit report, he accepts number 1 unless he accepts 0.

Independent Variables:

In this study, the independent variables are as follows:

Audit Firm Size:

In this study, the audit firm size is an imaginary variable which if the firm has been investigated by the audit organization, it accepts number 1 unless it accepts 0.

Auditor's specialization in the audit firm level:

The auditor's specialization in the audit firm level defines as the sum of assts of all the clients of a special audit firm in a special industry divided by the sum of assets of the clients in this industry. If the auditor is a specialist, he will accept number 1 unless he will accept 0.

Auditor's specialization in the partner's level:

The auditor's specialization is calculated in the individual level as below:

$$EXPERT - MS_{L_{ik}} = \frac{\sum_{i,j,k=1}^J SALE_{ijk}}{\sum_{i,k=1}^L \sum_{j=1}^J SALE_{ijk}} \quad (1)$$

Which it is the sum of the assets of all the clients of a special audit firm in a special industry divided by the sum of the assets of the clients in this industry. Then, the obtained numbers in each industry are ranked respectively. If the audit is in the first or second ranks, it will accept number 1 unless it will accept 0.

Auditor's selection tenure:

According to Myers et al. [19] the auditor's selection tenure is the number of consecutive years which an auditor is responsible for auditing a company. The companies' audit reports are used to collect the data of the auditor's selection tenure.

Audit Fees:

The audit fees are a reflection of the audit quality for the foreign users of the financial statements. Reichelt and Wang [22] stated that the independent auditor forms an important part of the financial reporting system: using the independent auditor may indicate a client's management obligations to the investors and the audit fees can be considered as a cost which the client pays to the auditor in turn for the fulfilment of the obligations. In this study, the audit fees, which has been considered as the independent variable, has been directly derived from the notes with the financial statements and has been showed by the sign of Ln Fee.

Control variables:

In this study, the control variables consist of:

Financials leverage: it is the proportion of the company's debts to its assets (Hoitash et al. [15]).
Company's size: It has been defined as the natural logarithm of the market value of equity.

Research Model:

This study attempts to investigate the factors affecting on the qualified audit report. So, the below pattern has been used to investigate the hypotheses:

$$MAO_{it} = \alpha_0 + \alpha_1 SPC1_{it} + \alpha_2 SPC2_{it} + \alpha_3 TENURE_{it} + \alpha_4 BIG_{it} + \alpha_5 Ln Fee_{it} + \alpha_6 SIZE_{it} + \alpha_7 LEV_{it} + \varepsilon$$

In the mentioned model, MAO represents the audit adjusted report; BIG represents the audit firm size; SPEC1 and SPEC2 represent the auditor's specialization in the partner's and audit firm levels, respectively; TENURE represents the auditor's selection tenure; Ln Fee represents the audit fees; LEV represents the financial leverage and SIZE represents the firm, size, i and t are the signs of the company and year in question respectively.

4.4 Statistical Population

The statistical population of this study are all the companies accepted in Tehran stock exchange during 2009-2014. It consists of 85 companies which were selected through sampling.

5 Main Results

5.1 Descriptive Statistics

To provide an overview of important characteristics of the calculated variables, some concepts descriptive statistics of these variables which involve mean, median, standard deviation, minimum and maximum observations have been presented in the following table.

Table 1: Descriptive statistics of the variables

Variables	Mean	Median	Standard Deviation	Maximum	Minimum
Qualified report	0.653	1.000	0.476	1.000	0.000
Audit firm size	0.310	0.000	0.4636	1.000	0.000
Auditor's specialization in the partner's level	0.310	0.000	0.466	1.000	0.000
Specialization in the audit firm level	0.440	0.000	0.4976	1.000	0.000
Auditor's selection tenure	6.1433	5.000	4.040	7.000	1.000
Audit fees	19.609	19.515	0.7003	21.820	16.811
Financial leverage	0.631100	0.6300	0.1907	1.470	0.090
Company size variables	12.274	12.094	1.450	16.800	9.300

The results obtained from the descriptive statistics of this study's variables indicate that the mean of the auditor's selection tenure is almost 6 years and this shows the long-term cooperation of companies accepted in Tehran stock exchange and audit firms. The number of this study's observations is 360 year-company.

5.2 Inferential Statistics

This study has applied the multi-variate regression by using the combined data. In the present study, Camera-Watson test has been used to diagnosis the autocorrelation of the model. If the statistics amount of Camera-Watson is close to the number 2, the independence of the model's error can be accepted. In addition, fisher test has been used to investigate the significance of the model. Table 2 shows the results of estimating this study's model.

According to the results of estimating the model, it can be concluded that this model is significant, because the possible error level related to F statistics is zero and less than 5 percent. So, the significance of the model is also accepted even at the confidence level of 99 percent. Moreover, according to the amount of Durbin-Watson statistics of the model mentioned in the Table 2, it can be concluded that this study's model doesn't have the problem of autocorrelation.

The amount of the adjusted coefficient of determination of the model is 0.53. This statistic shows that about 53 percent of the dependent variable changes is described by the independent ones. According to the approved statistics of the model, the hypotheses are examined.

5.3 Results of Testing the Hypotheses

Testing the hypothesis 1:

The first hypothesis is formulated as follows: There is a significant relationship between the audit firm size and qualified opinion. According to the results presented in Table 2, the probability of the null hypothesis about the effect of audit firm size on the qualified audit opinion is 0.984 which is larger than 0.05 and t statistics is -0.019; therefore, the null hypothesis is rejected at the 5 percent error level.

Table 2: Results of estimating this study's model

Variable	Method	Combined data method = Fixed effect model		
		Coefficient	t statistics	Error level
	Intercept	0.643423	52.17725	0.0000
	Audit firm size	-1.840005	-0.019407	0.9845
	Auditor's specification in the partner level	0.104747	3.688067	0.0003
	Specification in the audit firm level	-0.016244	-2.795811	0.0056
	Auditor's selection tenure	0.180005	0.233298	0.8157
	Audit fees	-0.000977	-2.179195	0.0303
	Financial leverage	0.003747	2.175883	0.0306
	Company size	0.000107	0.313707	0.7540
	Coefficient of the determination		0.622	
	Adjusted coefficient of the determination		0.531	
	Durbin-Watson statistics		1.807	
	F statistics		9.143	
	Possibility of F statistics		0.0000	

Testing the hypothesis 2:

The second hypothesis is formulated as follows: There is significant relationship between the auditor's specialization in the partner's level and qualified opinion.

The second hypothesis, the probability of the independent variable of the auditor's specialization in the partner level, is 0.000 and t-statistics is also 3.688 and this shows that this variable has a significant and direct effect on the qualified audit opinion at 5 percent of the error level. The results indicate that the qualified audit report also increase by increasing the auditor's specialization in the partner level. The results of testing the second hypothesis are presented in Table 2.

Testing the hypothesis 3:

The third hypothesis is formulated as follows: There is a significant relationship between the auditor's specialization in the audit firm level and qualified opinion.

The effect of the auditor's specialization in the audit firm level on the qualified audit report was examined to test this hypothesis. The significance of coefficients was examined through t-statistics mentioned in Table 2 and according to t-statistics which is -2.795 and the probability of 0.000, this hypothesis is confirmed and there is a negative significant relationship between the auditor's specialization in the audit firm level and the qualified audit opinion.

Testing the hypothesis 4:

There is a significant relationship between the auditor's selection tenure and the qualified audit opinion.

The effect of the auditor's selection tenure on the qualified audit opinion was examined to test the fourth hypothesis. The significance of coefficients was examined through t-statistics which is provided in Table 2 and according to t-statistics which is -2.179 and the probability of 0.030, this hypothesis is confirmed.

6 Conclusion

In this study, the effects of the independent variables of auditor's specialization, audit firm size, auditor's selection tenure and audit fees on the dependent variable of the qualified audit opinion were investigated. The first hypothesis of this study that there is a significant relationship between the audit firm size and the qualified audit opinion has been rejected. In Iran, the audit organization is responsible for biggest industries and in other words, the larger clients run higher quality control with respect to their financial capabilities which this issue cause not to receive the adjusted reports. The

results of this hypothesis are not consistent with Richlet and Wang's study [22]. The findings of this study indicated that the auditor's specialization in the partner level and the audit firm has a significant effect on the qualified audit opinion because the proficient auditors do the audit operations with more confidence and on the other hand, the audit quality of these firms is more than the other ones. The proficient auditors are more interested in stating the adjusted opinions in several ways. First, due to their better knowledge about their customers' industries, the proficient auditors can evaluate the capability of the activity tenure likelihood of a customer of special industry better. Second, the industry specialists spend a considerable resource to achieve popularity and reputation by presenting more quality of the audit, and they preserve this quality through expressing an adjusted audit opinion. The findings of this study are consistent with the findings of Richlet and Wang's study. According to the findings of testing the fourth hypothesis, there is no significant relationship between the auditor's selection tenure and the qualified audit opinion because the companies in Iran are in the growth stage and have not still reached the full maturity. Therefore, the operation amount of these companies are also increasing and it requires the more attempt of the auditors and the special changes in the reports. In other words, the lack of uniformity in the activities as well as the change of economic conditions cause new problems which it allows the probability of adjustment or non-adjustment to increase and it is not possible to create a special relationship between the tenure and the qualified opinion. The findings of this hypothesis also are not consistent with the previous studies including Meyers et al. [19] The fifth hypothesis of his study, the effect of the audit fees on the qualified audit opinion, has been confirmed. According to being dependent of the auditor to the client, because he receives fees from him, it can be expected that an increase of the auditor's fees may also cause a problem for his independence, so the probability of issuing the adjusted report decreases. The results of this hypothesis are consistent with the studies of De Angelo [11].

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