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**EVALUATING THE RELATIONSHIP BETWEEN POLITICAL CONNECTIONS OF
THE BOARD'S MEMBERS AND AUDITOR ELECTION AT COMPANIES LISTED IN
TEHRAN STOCK EXCHANGE**

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ABSTRACT

The study aimed to evaluate the relationship between political connection of the board's members and auditor election at the companies listed in the Tehran Stock Exchange. This covers companies that listed over a 5-year period from 2008 to 2012 in Tehran Stock Exchange. It is put political connections of the board's members as an independent variable, the auditor election as a dependent variable and the ownership structure as an adjustment variable. The population is selected among 37 industries divided into the exchange, more than 328 companies, and according to a formula Cochran, 71 companies were selected as the research sample. Using simple linear regression, it examined the relationships between variables in the first hypothesis, and then using the single-sample t-test the, second hypothesis was approved or rejected. The results showed there is a significant relationship between the political connections of the board and auditor election of the companies listed in Tehran Stock Exchange. The ownership structure has a significant impact on the relationship between the political connection of the board's members and the auditor election of the companies listed in Tehran Stock Exchange.

**Keywords: Political Connections of The Board, The Auditor Election, The Ownership
Structure**

INTRODUCTION

Recommended Advisory Committee on the audit profession represents a step towards increasing the participation of shareholders in the auditor election. Saul (1996) argues that the auditor election with the approval of shareholders is more than a symbolic move in strengthening auditor's independence. By increasing stakeholders' participation in the auditor selection and making changes in governance practices and the dynamics of accountability between auditors, it can be known shareholders voting on the auditor election to be a factor to elevate the audit fees and audit quality. The competition level in the market for public companies' audit services (and therefore its impact on the fees) remains a significant ongoing issue among legislators and regulators of standards to consider. Such concerns led to the formation of the Advisory Committee on the audit profession. The committee, with the participation of stakeholders in the auditor election, states that shareholders' participation in the auditor election through the annual meeting, can lead to increased monitoring of audit committee and also to ensure proper auditor election based on size and in relation to the client's needs to the financial reporting. This procedure may increase competition in the audit industry and the committee also called

for the implementation of these practices by certain companies (Rashidi Baghi, 2012). In fact, impenetrable borders of realm on the political connections as one of its strengths is that many theories of other fields are entering this field, due to that. Now, on the one hand, the conditions and practices of political connections would be facing dramatic changes, and on the other hand, as the underlying sub-context, they involve layers of various and numerous theories, including political science, the theory of the public sphere and new culturalism factors, and not merely political philosophy. This heterogeneity, however problematic, is potentially useful (Abdollahinezhad, and Afkhamimi, 2012). So it seems that political connections of the board of the companies can play a significant role, in this study, we sought to examine the relationship between political connections of the board's members and the auditor election of the companies listed in the Tehran Stock Exchange.

Literature

Lee (2010), in his research, examined the impact of ownership structure on the financial performance of Korean companies. The results showed that the company's performance can be improved by increasing the concentration of company's ownership,

but the effect of institutional ownership and foreign ownership is negligible.

Lee and Lyon (2012), in their study, examined the effect of corporate governance system on the auditor has to change. The results show that there is an inverse significant relationship between the percentage of ownership of the major shareholder and changing the auditor due to the low quality of audit's work and a direct significant between the number of non-bound members of the board and the separation of chairman and CEO with changing auditor.

Marguerite and Sylaki (2012) examined the relationship between ownership structure, capital and the performance of French companies using tested nonparametric data analysis approach to compare the company's performance with optimal border considered. The results show that concentrated ownership brings about further debt in the capital structure, but it was not a significant relationship between the selection of type of ownership and type of leverage.

Owen Gyor (2013), over his study on companies in African countries of Kenya entitled "The relationship between ownership structure and performance of the company" came to the conclusion that there is a negative significant relationship between the ownership structure, concentration and state

ownership and the performance of the company, and on the other hand there is a positive significant between dispersed ownership structure and corporate ownership and company performance.

Hook et al (2013) examined the relationship between the quality of corporate governance system and electing independent auditors by the company. The results showed a significant relationship between high quality corporate governance system and the possibility of choosing the four largest audit firms. In addition, countries that have adopted IFRS and have stronger governance these relationship and probability are likely to increase.

Godahamy et al (2013) examined the relationship between the political connections and the election of the auditor in US companies. Their results show that there is positive and strong relationship between political connections and the auditor election. They also concluded that state-owned companies than in other companies would be more willing to choose the big auditing firms to conduct their audit affairs.

METHODOLOGY

Hypotheses

- There is a significant relationship between political connections of the board's members

and auditor election of the companies listed in Tehran Stock Exchange.

- The ownership structure has a significant impact on the relationship between political connections of the board's members and the auditor election of the companies listed in Tehran Stock Exchange.

3-2 Statistical sample and population

The study sample includes companies listed in Tehran Stock Exchange during 2008 to 2012 and statistical sample is selected by systematic removal method, by putting the following restrictions:

1. Their fiscal period ends on March 19.
2. Listed in Tehran Stock Exchange before 2008.
3. Not intermediation, investing, leasing and insurance companies.
4. Their financial information available.

According to primary studies, in turn, the companies from the statistical population were determined more than 328 ones among 37 industries divided into the exchange; and based on Cochran formula, 71 companies were selected as a sample.

3-3- Regression Model

$$\text{Auditor}_{it} = \gamma_0 + \gamma_1 \text{politically connected}_{it} + \gamma_2 \text{Size}_{it} + \gamma_3 \text{Industry}_{it} + \varepsilon_{it}$$

$$\text{Auditor}_{it} = \gamma_0 + \gamma_1 \text{politically connected}_{it} + \gamma_2 \text{Ownership structure}_{it} + \gamma_1 (\text{Ownership}$$

$$\text{structure}_{it} \times \text{politically connected}_{it}) + \gamma_2 \text{Size}_{it} + \gamma_3 \text{Industry}_{it} + \varepsilon_{it}$$

Auditor_{it} : If the sample companies based on the National Audit Office Ranking to audit employ large audit firms, the number one is given and otherwise zero (Sajadi, et al, 2012).

$\text{Politically connected}_{it}$: If at least one of the members of the board belongs to the representative of Islamic Parliament, members of the Cabinet, the Assembly of Experts and expediency discretion council of the regime's and judiciary's heads (according to the Board of Directors' reports and financial statements notes), number 1 is given and zero otherwise (Abdolahinejad and Afkhami, 2011, Kamal Akbari 2011).

$\text{Ownership structure}_{it}$: If a company has a number of public shareholders, number one is given, and otherwise, zero (Hasas Yeganeh, et al 2005).

Size_{it} : The natural logarithm of the total book value of the assets of the company (Ghalibaf asl et al, 2009).

Industry_{it} : Based on classification of Tehran Stock Exchange (Ghalibaf asl et al, 2009).

3.4 Data analysis method

To analyze the statistical data within the companies, first the descriptive statistics for each of the variables will be examined and in the second part, the test of variance heterogeneity, F Lymer-test and Hausman

test, as a pretest, will be performed. Finally, in order to check each of research hypotheses, ordinary least squares regression test will be used. Software EVIEWS 7 is used in this study.

RESULTS

Variance heterogeneity evaluation

To evaluate variance heterogeneity presence, Arch-LM-test disturbing statements were conducted in the study; the results are as follows in the table 1-1:

According to **Table 1-1**, the statistic is not significant less than 5% level, so the hypothesis on variance homogeneity is confirmed and disturbing statements of variance heterogeneity rejected.

2-4- Testing fixed-effect method to be significant

4-2-1- F-statistics test

According to Table 2-1, two tests results the probability obtained in both tests (F, Huassman) is less than %5 and so it should be used fixed effects methods in the relevant regression model.

According to Table 4.1 influence-coefficient variable of political connections of the board's members on the auditor election is equal to 4.299, suggesting a positive and direct impact on political connection of the board's members on auditor election. According to the t-statistic significant level to

the political connections of the board's members on the auditor election (0.000), because of error level less than 5% the null hypothesis can be rejected at 95% confidence level and can be expressed there is a significant relationship between political connections of the board's members and the auditor election of the companies listed in Tehran Stock Exchange. It can be an experimental model wrote as follows:

$$\text{Auditor}_{it} = 2.258 + 4.299 \text{ politically connection}_{it} + 1.215 \text{ Size}_{it} + 0.469 \text{ Industry}_{it} + \varepsilon_{it}$$

According to Table 1-5 influence-coefficient variable of political connection of the board's members on the auditor election is equal to 0.845, suggesting a positive and direct impact of political connections of the board's members on auditor election. Also, the impact of ownership structure on the relationship between political connections of the board's members on the auditor election is equal to 1.665, indicating the ownership structure impact on the relationship between political connections of the board's members and the auditor election is positive and direct. Due to significance level of t-statistics to the variable of ownership structure on the relationship between political connections of the board's members and the auditor election (0.012), because of error level less than 5%, the null

hypothesis can be rejected at 95% confidence level and can be expressed the ownership structure has a significant impact on the relationship between the of political connections of the board's members and auditor election of the companies listed in

Tehran Stock Exchange. It can be an experimental model wrote as follows:

$$\text{Auditor}_{it} = 1.326 + 0.845 \text{ politically connected}_{it} + 0.174 \text{ Ownership structure}_{it} + 1.665 (\text{Ownership structure}_{it} \times \text{politically connected}_{it}) + 2.718 \text{ Size}_{it} + 0.341 \text{ Industry}_{it} + \varepsilon_{it}$$

Table 1-1: result of Arch-LM-test disturbing statements

Description	Statistic value	Probability
F-statistic	0.995214	0.1741
Obs* R-squared	1.209612	0.1741

Table 2-1- Results of F-statistics tests

Description	Statistic value	Freedom degree	Probability
Cross-section F	1.814521	70	0.000*
Cross-section Chi-square	175.620362	70	0.005*
Huassman test			
Description	Statistic value	Freedom degree	Probability
Cross-section F	8.615441	14	0.000*

* 5% significance level

4-3- First hypothesis test

Table 4-1- Regression test for first hypothesis

Variable name	Estimated coefficient	Deviation on estimation	t-statistic	Significance level
Fix	2.528	0.555	4.552	0.032*
Political connections of the board's members	4.299	0.269	15.981	0.000*
Firm size	1.215	0.159	7.641	0.019*
Type of industry	0.469	0.036	13.027	0.000*

* 5% error level

R ²		Watson-Durbin	ANOVA	
Determination coefficient	Adjusted determination coefficient		F-statistics	Significance level
0.557	0.536	1.586	55.269	0.000**

* 1% error level

4-4- Second hypothesis test

Table 5-1- Regression test to the second hypothesis

Variable	Estimation coefficient	Estimation deviation	t-statistic	Significance level
Fix	1.326	0.185	7.158	0.018*
Political connections of the	0.845	0.935	9.036	0.009*

board's members				
Ownership structure	0.174	0.012	14.251	0.000*
Political connections of the board * ownership structure	1.665	0.218	7.612	0.012*
Firm size	2.718	0.428	6.339	0.028*
Type of industry	0.341	0.041	8.145	0.011*

* 5% error level

Table 1-6- explanatory and significance of the total model

R ²		Watson-Durbin	ANOVA	
Determination coefficient	Adjusted determination coefficient		F-statistics	Significance level
0.669	0.648	1.824	43.118	0.000**

* 1% error level

CONCLUSIONS

RECOMMENDATIONS

Results of the first hypothesis indicated that there is a significant relationship between political connections of the board's members and auditor election of the companies listed in Tehran Stock Exchange. This result is consistent with the result of research by Godhamy, since they showed a strong positive relationship between political connections and auditor election. The result of the second hypothesis showed that the ownership structure has a significant impact on the relationship between the political connection of the board's members and the auditor election of companies listed in Tehran Stock Exchange. According to the results, can be expressed in the following suggestions:

1. All relevant organizations and institutions should take into action to formulate regulations and standards needed in order to

AND

reduce or eliminate factor of political connections of board's members when selecting large and small audit firms which may lead to ignoring and failing to conduct an audit affairs of these and increasing the risk of investors, shareholders and other stakeholder groups in while decision-making.

2. Investors, shareholders and other stakeholder groups themselves should consider this factor in their decisions that the election of auditor varies in state-owned and private companies and state-owned companies tend to choose large audit firms more than other institutions.

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