



“The impact of auditor tenure on audit quality; evidence from Pakistan.”

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BY

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Dedication

“I would like to dedicate this thesis to my parents and my teachers

for their endless love, prayers, support and encouragement.”

DECLARATION

I hereby declare that the work entitled “The Impact of Auditor Tenure on Audit Quality; Evidence from Pakistan” is my own work and no part of this thesis has been copied from any other source except where explicit acknowledgement is made in the text.

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Summary:

This study aims to examine the impact of auditor-client-relationship tenure on the quality of audit and whether the mandatory auditor-rotation will result in enhancement of audit quality. Discretionary accruals calculated with the help of Modified Jones Model 1991 are used as the proxy for audit quality. 121 companies related to non-financial sector of Pakistan listed in Pakistan Stock Exchange are selected after taking the data from year 2005 till year 2014. It is observed that the magnitude of discretionary accruals increases during the initial years of auditor-client-relationship tenure, reason being, the auditors are not equipped with required client-specific knowledge. Once the auditors acquire client-specific knowledge, the magnitude of discretionary accruals decreases, resulting in increase in audit quality. Based on the findings of this study, it is derived that the lengthy auditor-client-relationship tenure does not result in decrease in audit quality. Furthermore, the Big 4 audit firms acquire client-specific knowledge far more earlier as compared to other auditors (three years as compared to six years). The results of the study suggest that the regulators and standards setters in Pakistan should reconsider their policy regarding mandatory-auditor-client relationship tenure.

Key words: Auditor Tenure, Audit Quality, Discretionary Accruals, Modified Jones Model 1991, Pakistan Stock Exchange,

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1 Contents

1	Chapter: INTRODUCTION.....	1
1.1	Background.....	2
1.2	Statement of Problem.....	Error! Bookmark not defined.
1.3	Identification of the Research Gap.....	Error! Bookmark not defined.
1.4	Research Questions.....	Error! Bookmark not defined.
1.5	Objective of the Study	Error! Bookmark not defined.
1.6	Contribution	Error! Bookmark not defined.
1.7	Organization of the Study	Error! Bookmark not defined.
2	Chapter: LITERATURE REVIEW.....	Error! Bookmark not defined.
2.1	Audit Quality	Error! Bookmark not defined.
2.2	Mandatory Auditor Rotation.....	Error! Bookmark not defined.
2.2.1	Empirical Evidence Supporting Mandatory Auditor Rotation.	Error! Bookmark not defined.
2.2.2	Empirical Evidence Opposing Mandatory Auditor Rotation...	Error! Bookmark not defined.
2.3	Stakeholder perception of mandatory auditor rotation.....	Error! Bookmark not defined.
2.3.1	Regulators	Error! Bookmark not defined.
2.3.2	Auditors.....	Error! Bookmark not defined.
2.3.3	Clients	Error! Bookmark not defined.
2.3.4	Shareholders.....	Error! Bookmark not defined.
2.4	The concept of Discretionary Accruals.....	Error! Bookmark not defined.
2.5	Impact of auditor tenure on audit quality.....	Error! Bookmark not defined.
2.5.1	“Audit opinion as a proxy” for audit quality.....	Error! Bookmark not defined.
2.5.2	“Going-concern opinion” as a proxy for audit quality.....	Error! Bookmark not defined.
2.5.3	“Audit failures” as a proxy for audit quality.....	Error! Bookmark not defined.
2.5.4	“Discretionary accruals” as a proxy for audit quality	Error! Bookmark not defined.
2.5.5	Control Variables	Error! Bookmark not defined.
3	Chapter: THEORETICAL FRAMEWORK	Error! Bookmark not defined.
3.1	Hypothesis development.....	Error! Bookmark not defined.

3.2	Conceptual Framework.....	Error! Bookmark not defined.
4	Chapter-4: RESEARCH METHODOLOGY.....	Error! Bookmark not defined.
4.1	Research Design.....	Error! Bookmark not defined.
4.2	Sample and Data Collection.....	Error! Bookmark not defined.
4.2.1	Measurement of discretionary accounting accruals (DA).....	Error! Bookmark not defined.
4.2.2	Measurement of auditor-client-relationship tenure (ADTU) ...	Error! Bookmark not defined.
4.2.3	Method of empirical tests.....	Error! Bookmark not defined.
4.2.4	Equation to calculate the turning point	Error! Bookmark not defined.
4.3	Scheme of Methodology	Error! Bookmark not defined.
4.3.1	Calculation of Total Accruals	Error! Bookmark not defined.
4.3.2	Model of Discretionary Accruals	Error! Bookmark not defined.
5	Chapter: RESULTS & DISCUSSION.....	Error! Bookmark not defined.
5.1	Model of Total Accruals	Error! Bookmark not defined.
5.1.1	Multicollinearity	Error! Bookmark not defined.
5.1.2	Stationarity of Data	Error! Bookmark not defined.
5.1.3	Existence of Long run relationship	Error! Bookmark not defined.
5.1.4	Appropriate Model Selection	Error! Bookmark not defined.
5.1.5	Estimation of Total Accruals	Error! Bookmark not defined.
5.1.6	Extraction of Discretionary Accruals.....	Error! Bookmark not defined.
5.2	Model of Discretionary Accruals.....	Error! Bookmark not defined.
5.2.1	Multicollinearity	Error! Bookmark not defined.
5.2.2	The Stationarity of Data.....	Error! Bookmark not defined.
5.2.3	Existence of Long-run Relationship	Error! Bookmark not defined.
5.2.4	Appropriate Model Selection	Error! Bookmark not defined.
5.2.5	Estimation of Main Model (Overall Sample).....	Error! Bookmark not defined.
6	Chapter: CONCLUSION AND IMPLICATION	Error! Bookmark not defined.
6.1	Conclusion	Error! Bookmark not defined.
6.2	Policy Implications of the study.....	Error! Bookmark not defined.

7	Chapter: LIMITATION & FUTURE RESEARCH DIRECTIONS	Error! Bookmark not defined.
7.1.1	Limitations & Delimitations	Error! Bookmark not defined.
7.1.2	Future Research Directions	Error! Bookmark not defined.
	Bibliography:	Error! Bookmark not defined.
	Appendix.....	Error! Bookmark not defined.

List of Tables

Table 1 Table containing Accounts along with the Manager’s Discretion	Error! Bookmark not defined.
Table 2 Summary of prior researches exploring Auditor tenure and audit quality	Error! Bookmark not defined.
Table 3 Sample Selection.....	Error! Bookmark not defined.
Table 4 Correlation Matrix	Error! Bookmark not defined.
Table 5 Calculation of Variance Inflation Factors.....	Error! Bookmark not defined.
Table 6 Panel Unit Root Test.....	Error! Bookmark not defined.
Table 7 Pedroni Residual Co-integration Test.....	Error! Bookmark not defined.
Table 8 Hausman Test	Error! Bookmark not defined.
Table 9 Calculating Total Accruals	Error! Bookmark not defined.
Table 10 Correlation Matrix	Error! Bookmark not defined.
Table 11 Calculation of Variance Inflation Factors.....	Error! Bookmark not defined.
Table 12 Panel Unit Root Test.....	Error! Bookmark not defined.
Table 13 Pedroni Residual Co-integration Test.....	Error! Bookmark not defined.
Table 14 Hausman Test	Error! Bookmark not defined.
Table 15 Main Model of Discretionary Accruals	Error! Bookmark not defined.
Table 16 Main Model of Discretionary Accruals (Only Big 4).....	Error! Bookmark not defined.
Table 17 Unit Root Test-CHAR	Error! Bookmark not defined.
Table 18 Unit Root Test-CHSA.....	Error! Bookmark not defined.
Table 19 Unit Root Test-PPE	Error! Bookmark not defined.
Table 20 Unit Root Test-TOAC	Error! Bookmark not defined.
Table 21 Unit Root Test-ROA.....	Error! Bookmark not defined.
Table 22 Unit Root Test-LEVE	Error! Bookmark not defined.
Table 23 Unit Root Test-GROW	Error! Bookmark not defined.
Table 24 Co-integration Table-Total Accruals Model.....	Error! Bookmark not defined.
Table 25 Hausman Test – Total Accruals Model	Error! Bookmark not defined.
Table 26 Regression Table – Total Accruals Model.....	Error! Bookmark not defined.
Table 27 Co-integration Table – Discretionary Accruals Model.....	Error! Bookmark not defined.

Table 28 Hausman Test – Discretionary Accruals Model	Error! Bookmark not defined.
Table 29 Regression – Main Estimation Model (Overall Sample) ...	Error! Bookmark not defined.
Table 30 Regression – Main Estimation Model (Only Big 4 Firms)	Error! Bookmark not defined.
Table 31 Descriptive Statistics.....	Error! Bookmark not defined.
Table 32 List of Big 4 Audit Firms.....	Error! Bookmark not defined.
Table 33 List of companies.....	Error! Bookmark not defined.

List of Figures

Figure 1 Theoretical Model	Error! Bookmark not defined.
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List of Equations

Equation 1	Error! Bookmark not defined.
Equation 2	Error! Bookmark not defined.
Equation 3	Error! Bookmark not defined.
Equation 4	Error! Bookmark not defined.
Equation 5	Error! Bookmark not defined.

List of Abbreviations

ADTU	Auditor-client-relationship Tenure
ADTU ²	Square of Auditor-client-relationship Tenure
CHAR	Change in Accounts Receivables
CHSA	Change in Sales
DA	Discretionary Accruals
GAAP	Generally Accepted Accounting Principles
GROW	Growth of the firm
IAS	International Accounting Standards
ICAP	Institute of Chartered Accountants of Pakistan
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
LEVE	Leverage of the Firm
MDA	Modulus of Discretionary Accruals
MJ Model	Modified Jones Model 1991
PICG	Pakistan Institute of Corporate Governance
PPE	Property, Plant and Equipments of the firms
ROA	Return on the Assets of the firm
SECP	Securities & Exchange Commission of Pakistan
TOAC	Total Accruals

1 Chapter: INTRODUCTION

The Impact of Auditor Tenure on Audit Quality; Evidence from Pakistan.

1.1 Background

The increase in accounting anomalies, at the start of twenty first century, has raised certain questions like auditor-client-relationship tenure, and audit quality (Bricker, 2002; Ghosh & Moon, 2005). Myers, Myers, and Omer (2003) deduced that lengthy auditor-client-relationship tenure confines management's discretion towards accounting accruals, resultantly, quality of audit enhances. Likewise, companies having shorter auditor-client-relationship tenure have larger and inconsistent accounting accruals comparing with companies with medium or long auditor-client-relationship tenures (Johnson, Khurana, & Reynolds, 2002).

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