

Auditor Characteristics and Financial Reporting Fraud Risk¹

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Research Paper

INTRODUCTION

In recent years, due to the scandals caused by fraudulent financial reporting, the accounting profession has been highly taken into consideration and criticized. These frauds have had a profound effect on the profession and led to the bankruptcy of large companies. The scandals caused investors to no longer trust the services of auditors and financial reports. This caused the profession and the U.S Securities and Exchange Commission (SEC) to work harder to strengthen and increase public trust. Fraud assessment by auditors is very important, therefore, auditors should be able to assess the risk of fraud in the best possible way. Fraud risk assessment by auditors is integrated with the audit process and this assessment is continuously reviewed until the end of the auditing process because auditors are responsible for the type, manner, and amount of procedure that they use in the audit process to deal with the fraud risk. Therefore, the auditors' characteristics can affect the fraud risk assessment process. The purpose of this research is to review auditors'

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characteristics in reducing the fraud risk of financial reporting of companies.

MATERIALS AND METHODS

The research method of this paper is correlational in nature and content which analyses the correlation relationship by using secondary data extracted from financial statements of companies accepted on the Tehran Stock Exchange. On the other hand, the current research is a post-event study by the collection of information. This research is done based on past analyses with the financial statements of the companies through the Reheard Novin software and CODAL website. In terms of the purpose of research and collection of information, it is considered as an applied and archival (post-event) study. The independent and dependent variables of this study are the auditor's characteristics and fraud risk of financial reporting, respectively. Three indicators are used for measuring an auditor's characteristics that are included auditor size, auditor expertise in the industry, and auditor tenure period. Also, to measure the fraud risk in financial statements, the combination of Altman's modified model and the F-Score of Dechow et.al (2011) model has been used. The control variables include size, operating cash flow, and financial leverage of the companies.

RESULTS AND DISCUSSION

The results show that there is no significant relationship between auditor tenure period and fraud risk reduction. This finding is consistent with the hypothesis of auditor independence because, with the increase of the tenure of the auditor, the audit quality decreases. Also, there is no significant relationship between auditor expertise and fraud risk reduction. But there is a negative relationship between the size of an auditing company and fraud risk reduction, this means that large auditing companies, have higher audit quality and are less likely to have a high fraud risk. Based on DeAngelo (1981), large auditors are more motivated to provide high-quality auditing reports, because they value their reputation.

CONCLUSION

Despite the importance of the risk assessment process in audit quality, this issue has been practically ignored in the fraud risk assessment literature. The audit profession has a serious responsibility in this field and can be legally relying on relevant standards, help to discover possible fraud

and reduce it. Due to the importance of this issue, in this research, the impact of auditor's characteristics on reducing the fraud risk among 87 companies accepted on the Tehran Stock Exchange from the years 2011 to 2018 was investigated.

The results showed that in companies where the auditor tenure period is longer, the probability of high fraud risk is not lower. Also, as the auditor has more expertise in the industry, the probability of high fraud risk is not less but in companies that are audited by large auditing companies, the probability of high fraud risk is lower. Based on the results, it is suggested to independent auditing applicants that in choosing an auditor, pay more attention to the size of the auditing company and the auditor's expertise in the industry according to the definitions presented in this research. This finding can be useful for users of financial statements because the financial statements of companies that have been audited by large auditing institutions like Mofid Rahbar and Audit Organization are of high quality and users can rely on the results of audit reports. According to the findings of this research, investors are suggested to pay attention to the auditor's criteria when they analyze to buy shares of companies. Because large auditing companies and expert auditors in the industry reduce the risk of fraud and violations in financial reporting. Also, managers are suggested to use auditors who are experts in the industry as well as large auditing companies to gain the trust of the owners of the company.

For future research, suggestions are given as follows:

- 1) In this research, to measure the fraud risk, the two criteria of Altman's modified and Dechow et.al (2011) models were used. It is suggested that other known models named artificial intelligence such as genetic algorithm, bird algorithm, and ... should be used.
- 2) Relationships between other variables including type and continuity of industry, corporate governance, and board members in terms of obligated and non-obligated fraud risk should be examined.
- 3) The present research should be done in SME companies.

Keyword: Auditor characteristics, Fraud risk of financial reporting.

JEL Classification: M41, M42

Tables and figures

Table 1. Descriptive statistics of variables

Variables	Symbol	Average	Standard Deviation	Kurtosis	Skewness	Min	Max
Auditor size	ADT SIZE	0.355	0.479	1/368	0/607	0	1
Auditor expertise	ADT SPEC	0.295	0.456	1.813	0.901	0	1
Continuity auditors tenure	ADT TENURE	3.141	1.833	2.126	0.527	1	7
DECHOW model (2011)	F-SCORE	0.964	0.186	25.877	-4.988	0	1
ALTMAN adjusted model	Z-SCORE	0.806	0.396	3.396	-1.548	0	1
Fraud Risk	FRAUD RISK	0.792	0.406	3.036	-1.436	0	1
Operational cash flow	CF	0.749	1.598	8.654	-0.408	-6.726	6.548
Leverage Size	LEV SIZE	0.600	0.227	3.155	0.131	0.092	1.566
		27.836	1.573	3.721	0.657	27.308	32.987
			n=696				

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