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### The Examine the Impact of Auditor Choice on Debt Cost and Capital of the Listed Companies in Tehran Stock Exchange

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#### ABSTRACT

The main purpose of the study is to examine the impact of auditor choice on debt cost and capital of the listed companies in Tehran stock exchange. The study is a kind of practical and semi-empirical research and it is done by post-event approach (via past data). All listed companies in Tehran stock exchange were selected as statistical population during 2008 to 2012. So, there are 74 listed companies in this research. So, two hypotheses are provided and related data are collected. Hence, continuation of audit selection, and capital cost and debt cost are considered as independent and dependent variables, respectively. Control variables include firm size, financial leverage, firm age and sale growth. Ordinary Least Squares (OLS) was selected to examine each hypothesis through EVIEWS 7. The results indicated that there is no significant association between continuation of audit selection and debt cost of the listed companies in Tehran stock exchange, and continuation of audit selection and capital cost of those companies.

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#### INTRODUCTION

Auditor choice is caused to auditors gradually take special knowledge about customers that finally increase professional competence of auditors; on the other hand, auditor choice causing an auditor to be too close to management that may leads to negative impact on an audit independence and audit quality. Requiring periodic change of audit institutions is one of the recommended solutions to potential problems originated from auditor choice. As well, auditor choice may reflect auditing for auditors as boring and repetitive task. This causes the professional competence of an auditor to be decreased. Shakleybelieves that the auditor choice can build too self-confidence, lack of creativity and reduction of applying exact methods among accountants. He also argues that management and staffs getting familiar with auditors' personal characteristics and working properties through long-term interaction with them and by which they can violate. Arel et al, [1] believe that accountants often rely on previous year worksheets for affairs like accounting planning, budgeting and providing required information for current year accounting. Relying too much on last year's records and prediction results in place of attention to small changes but essential may cause to prevent to achieving accounting goals.

In this regard, Sajjadi & Farazmand et al investigated the impact of auditor choice on audit quality. The results indicated that the continuation doesn't significant impact on audit quality. Fortin & Pitman [9] examined the association between auditor choice, debt cost and capital of newly listed companies in the stock exchange. Their findings demonstrated that there is no significant relation between auditor choice, debt cost and capital. Karjalaen [13] examined the relationship between auditor choice, debt cost and capital of the private listed companies in the stock exchange. His results show that there is a negative and insignificant relation between auditor choice, debt cost and capital of the private companies. Siji [15] examined the relationship between auditor choice, debt cost and capital of the listed companies in U.S stock exchange. Their results demonstrated that there is no significant relation between auditor choice, debt cost and capital. Generally, what is want in this research is to examine the impact of auditor choice on debt cost and capital of the listed companies in Tehran stock exchange. It seems that an answer to the question can be effective for executive and non-executive managers, real, potential and institutional investors as well as independent accountants.

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## 2. Research methodology:

### 2.1. Research method:

The research plan is done by post-event approach (via past data). On the other hand, the current study is a kind of descriptive-correlation research. It is quantitative based on the type of the research and it is also practical in terms of purposes. To examine the research hypotheses, Ordinary Least Squares (OLS) test is used.

### 2.2. Research hypotheses:

- There were significant effects of auditor choice on debt costs of the listed companies in Tehran stock exchange.
- There were significant effects of auditor choice on capital costs of the listed companies in Tehran stock exchange.

### 2.3. Field of study:

Field of the study includes all listed companies in Tehran stock exchange. The research covers the companies that have been listed Tehran stock exchange in a five-year period during 2008 to 2012. In this research, we deal with the impact of auditor choice on debt and capital cost of the listed companies in Tehran stock exchange.

### 2.4. Research population and statistical sample:

The statistical population of the research includes all listed companies in Tehran stock exchange during 2008 to 2012 and determined sample were selected based on the following condition (the applied sampling method is systematic omissive method).

- 1- They should be manufacturing firm, they have not been related to banks and financial institutions (investment companies, intermediary companies, holding companies, banks and leasing).
- 2- Their financial year ends in 19/3/...
- 3- The firms' shares have been traded in a stock exchange.
- 4- They should not change their fiscal year during the study.
- 5- Their financial information should be completely available.

According to the limitation, 331 companies were selected among 421 listed companies in Tehran stock exchange through selection systematic omission, and 74 companies were finally selected through Cochran method. Cochran method is defined as:

$$n = \frac{(331)(1.96)^2 \times (0.5)(0.5)}{(331)(0.1)^2 + (1.96)^2(0.5)(0.5)} \cong 74$$

In the above formula, maximum permissible error (d) is 0/1, confidence coefficient is 0/95, t= 1/96, p and q are 0/5 and population volume is N. The amount of P is considered 0/5, because if p=0/5, so m would find his maximum amount and it causes the sample to be big enough.

### 2.5. Operational definition of the research's variables:

**Table 1:** Operational definition of the research's variables.

Variable type	Variable name	Symbol	Way of measuring
Dependent	Debt cost	CDEBT	Sum of annual financing cost (interest cost) to total debts
	Capital cost	CCAPITAL	
Independent	Auditor choice	Tenure	In this research, sequential years of an auditor are responsible for auditing is used for measuring the continuation.
Control	Firm size	SIZE	Natural logarithm of total assets
	Financial leverage	LEV	Total debt divided into total assets
	Firm growth	FG	(current year sale-previous year sale) divided into previous year sale
	Firm age	AGE	Based on number of years which listed in Tehran stock exchange

### 2.6. Research model:

- The first hypothesis model

$$CDEBT_{it} = \alpha_1 + a_2 Tenure_{it} + a_3 SIZE_{it} + \alpha_4 LEV_{it} + \alpha_5 FG_{it} + \alpha_6 AGE_{it} + \varepsilon_{it}$$

- The second hypothesis model

$$CCAPITAL_{it} = \alpha_1 + a_2 Tenure_{it} + a_3 SIZE_{it} + \alpha_4 LEV_{it} + \alpha_5 FG_{it} + \alpha_6 AGE_{it} + \varepsilon_{it}$$

### 2.7. Data analysis method:

This paper uses combined data to test the hypothesis. In this method, time series data (years under investigation) and cross-section (the surveyed companies) are combined to each other. Combined data is further used due to increasing number of observations, enhancing the degree of freedom, reducing variance heterogeneity and studying dynamic changes. In order to efficiently estimate a regression model using combined data, one of the common effects, fixed effects and random-effects models are selected using appropriate tests. Test used to select one of the top model are F Limer test for choosing between models of common effects and fixed effects, if you select the fixed effects model, the Hausman test will be used to choose between fixed effects and random effects models. Autocorrelation will be reviewed except disturbing the model, the heterogeneity of variance and normality of the data. To illustrate the explanatory power of the explanatory variables, coefficient of adjusted determination (adjusted  $R^2$ ) will be used to evaluate significant variables, t-statistics and to assess the overall adequacy of the model, Fisher statistical. The statistical analysis will be performed using EXCEL and EVIEWS 7 software.

### 3. Research's results:

#### 3.1. Descriptive statistics:

**Table 2:** Central and distribution indexes of each research variables.

Variable name	Min.	Max.	Average	SD
Debt cost	0.076	0.236	0.164	0.418
Capital debt	0.042	0.192	0.129	0.376
Auditor choice	1	4	1.963	0.109
Firm size	9.265	32.158	21.421	0.554
Financial leverage	0.096	0.763	0.341	0.527
Firm growth	0.158	1.114	0.675	0.286
Firm age	5	9	7.317	0.536

#### 3.2. Augmented Dicky Fuller method:

**Table 3:** Unit root mass test on variables by Dicky Fuller method.

Variables	Probability	Statistics
Debt cost	0.0015	-4.155748
Capital debt	0.0011	-4.623559
Auditor choice	0.0019	-4.001745
Firm size	0.0006	-5.231412
Financial leverage	0.0002	-5.462522
Firm growth	0.0014	-5.197452
Firm age	0.0001	-6.128456

\* 5% error level

#### 3.3. Examination of heteroskedasticity:

**Table 4:** Results of heteroskedasticity test using modified Wald statistics

Description	Ch-square statistics	Probability
Modified Wald statistics	-8254.62	0.7562

\* 5% error level

Regarding table 4, due to the significance level of chi-square is not significant in 5% error level, heteroskedasticity hypothesis is rejected and its homogeneity is approved.

#### 3.4. Determination of estimation model/test for examining significance of fixed effects method:

##### 3.4.1. F statistics test:

**Table 5:** Results of F statistics test.

Description	Statistics	Freedom degree	Probability
Cross-section F	1.926336	73	*0.004
Cross-section Chi square	141.485225	73	*0.002

\* 5% error level

##### 3.4.2. Hausman test:

**Table 6:** Results of Hausman test

Description	Statistics	Freedom degree	Probability
Cross-section F	7.111475	9	*0.006

\* 5% error level

Regarding the results of both tests (F and Hausman), the obtained probability were less than 5% in each tests, so fixed effects method should be used in the related regression model.

### 3.5. First hypothesis test:

**Table 7:** Regression test of the first hypothesis.

Variable name	Impact factor	SD	T statistics	Significance level
Fixed	0.147	0.364	1.963	*0.012
Auditor choice	-0.092	0.441	-1.385	0.072
Firm size	0.279	0.528	1.926	*0.014
Financial leverage	0.342	0.305	1.752	*0.032
Firm growth	-0.373	0.763	-0.962	0.114
Firm age	-0.146	0.428	-2.415	*0.000

\* 5% error level

**Table 8:** Explanation and significance ability of whole model.

R		DW	ANOVA	
Coefficient of determination	Adjusted coefficient of determination		F	Sig.
0.638	0.624	1.932	18.427	0.000*

\* 1% error level

Regarding the table 7, since Durbin-Watson statistic test value is determined among 1.5 to 2.5, lack of correlation between errors is not rejected and regression can be used. Due to F value test is significant (18.427) in error level less than 0.01, it can be concluded that panel research regression model which composed of independent, control and dependent variables is a suitable model and independent and control changes can describe debt cost changes. The adjusted coefficient of determination is equaled with 0.624 and indicating that 62.4% of dependent variables changes are depended on independent and control variables of this equation. The impact coefficient of auditor choice on debt cost is -0.092 and demonstrating that the continuation has negative and inverse impact on debt cost. Regarding the significant level of t statistics of the continuation variable on debt cost (0.072),  $H_0$  hypothesis is rejected with 95% confidence due to its error level is less than 5%. It can be stated that there is no significant relation between the auditor choice and debt cost of the listed companies of Tehran stock exchange.

### 3.6. Second hypothesis test:

**Table 9:** Regression test of the second hypothesis.

Variable name	Impact factor	SD	T statistics	Significance level
Fixed	0.483	0.602	1.962	*0.015
Auditor choice	-0.296	0.613	-1.336	0.081
Firm size	0.245	0.596	2.162	*0.007
Financial leverage	0.182	0.341	1.973	*0.011
Firm growth	-0.066	0.214	-1.245	0.071
Firm age	-0.219	0.524	-2.085	*0.008

\* 5% error level

**Table 10:** Explanation and significance ability of whole model.

R		DW	ANOVA	
Coefficient of determination	Adjusted coefficient of determination		F	Sig.
0.542	0.529	1.522	21.326	0.000*

\*\* 1% error level

Regarding the table 9, since Durbin-Watson statistic test value is determined among 1.5 to 2.5, lack of correlation between errors is not rejected and regression can be used. Due to F value test is significant (21.326) in error level less than 0.01, it can be concluded that panel research regression model which composed of independent, control and dependent variables is a suitable model and independent and control changes can describe capital cost changes. The adjusted coefficient of determination is equaled with 0.529 and indicating that 52.9% of dependent variables changes are depended on independent and control variables of this equation. The impact coefficient of auditor choice on capital is -0.296 and demonstrating that the continuation has negative and inverse impact on capital cost. Regarding the significant level of t statistics of the continuation variable on capital cost (0.081),  $H_0$  hypothesis is rejected with 95% confidence due to its error level is less than 5%. It can be stated that there is no significant relation between the auditor choice and capital cost of the listed companies of Tehran stock exchange.

### Conclusion and Recommendations:

The main purpose of the study is to examine the impact of the auditor choice and debt and capital cost of the listed companies in Tehran stock exchange. The first hypothesis showed that there is no significant relation between the auditor choice and debt cost of the listed companies of Tehran stock exchange. This finding is consistent with the results of Sajjadi, Farazmand et al, Yang, Loven et al [17], Chol, Godhami et al [4], Fortin & Pitman [9] and Siji [15]. The second hypotheses indicated that there is no significant relation between the auditor choice and capital cost of the listed companies of Tehran stock exchange. The findings is consistent with Siji [15], Sajjadi, Farazmand et al, Fortin & Pitman [9], Karjalaen [13], Bru & Vel [3] and Sajjadi, Farazmand et al. As well, the continuation of an audit selection has no impact on debt and capital costs of companies according to the research's results. Therefore, it is recommended that pay attention to factors other than auditor choice for controlling their debt and capital costs. It is also suggested to potential and actual investors and other stakeholders that note to the obtained results as they make their decisions.

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