



Audit Firm Tenure and Auditor Reporting Quality: Evidence in Malaysia

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Abstract

The main purpose of the study is to examine the relationship between audit firm tenure and auditor reporting quality in Malaysia. This study employs well-established going concern model of logistic regression. Our findings show that audit firm tenure is positively significant relationship with auditor reporting quality. Future research should consider other importance variables that may affect the auditor reporting quality such as non-audit services, and audit partner tenure. However, in sum, this study is in line with the recent decision by the regulators not to regulate a mandatory audit firm rotation in Malaysia. This study provides a very importance implication and as a cornerstone to the regulators and policy makers in a developing country as the issue continues to be strong interest among them in improving the auditor independence.

Keywords: Audit firm tenure, Auditor reporting quality, Malaysia

1. Introduction

In the past few years, auditors had been blamed due to their role in the mega corporate scandals such as Enron, WorldCom, Global Crossing, ImClone Systems and Tyco International. The criticism had raised lots of questions regarding auditors' independence. Besides, such criticism was leveled against auditors because they audit their clients for a long time and subsequently concentrated more on non-audit services rather than audit. For example in the case of Enron, Andersen was the auditor since Enron was set up until collapsed. Therefore, there has been a call for sweeping changes in the auditing profession to ensure independence and therefore improve their audit quality ("Auditing Profession", 2002).

The issue of an audit firm compromise their independence if they audit their client for a long time has been a subject of debate in the United States, which can be traced back at least 50 years ago (Mautz & Sharaf, 1961). Later, the issue

seems to be pertinent international recurring debate among regulators, auditors and academicians (Shockley, 1981; Arrunada & Paz-Ares, 1997; Geiger & Raghunandan, 2002; Johnson, Khurana & Reynolds, 2002). Such long-term relationships could, in reality or be perceived to, make the audit firms too committed or beholden to the companies, thereby undermining its independence, compromising its objectivity, and reducing its effectiveness (“Auditing Profession”, 2002). Therefore, several countries in European Union such as Italy and Spain have required the mandatory audit firm rotation (Geiger & Raghunandan, 2002).

However, even in such a mandatory auditor rotation regime, there is insufficient evidence to suggest that audit quality is improved by this means. For example, the scandal involves a company namely Parmalat in Italy complied with a law that requires companies to change their auditors every nine years. The discovery of losses amounting to RM41.8 billion in Parmalat has provoked outrage across continent of Europe and proves that the law of auditor rotation still does not help to improve audit quality. (“Scandal”, 2003).

Following the corporate scandals in the United States, the regulators in Malaysia such as the Malaysia Securities Commission (SC) and the Bursa Malaysia became more concerned with the mandatory audit firms rotation. In view of the importance of the issue in question, the Malaysian Institute of Accountants (MIA) and the Malaysia Institute of Certified Public Accountants (MICPA), who are the accounting governing bodies in Malaysia, agreed to establish an MIA/MACPA joint Taskforce on Auditor Independence in May 2002. Both institutes agreed that the overall disadvantages of mandatory rotation of audit firms, including exorbitant costs, disruption and loss of accumulative knowledge, and a restriction on the freedom of companies to choose their own auditors, outweigh the benefits that may be derived from such rotation of audit firms. (Malaysian Institute of Accountants, 2002)

However, the MIA suggested a more lenient way to regulate auditor independence. A call of mandatory auditor rotation involve only audit partner rotation but not in the case of the audit firm as a whole. The MIA recommended that there should be a mandatory rotation of the audit partners responsible for the audit of listed companies after a period of not more than five years. Furthermore, the audit partner rotating after such period should not resume the role of audit engagement partner for the audit client until two years have elapsed. Prior to this pronouncement, in 1999, the MIA under its former president, Datuk Hanifah Noordin, called for a mandatory rotation of external auditors in every three or five years. (“MIA”, 1999).

There is very limited empirical evidence regarding the long audit firm tenure impairs auditor independence by compromising auditor reporting quality in developing countries such as Malaysia. Most of the studies were done in developed countries. Furthermore, a strong interest of debate among regulators in the developed countries caused the regulators and policy makers in developing countries to review back their audit legislation. However, it is still not clear whether the issue arise in such developing countries. Besides, recent studies in the developed countries do not support the contention that there should be a mandatory audit firm rotation (Johnson et al., 2002; Geiger & Raghunandan, 2002; Myers, Myers & Omer, 2003; Carcello & Nagy, 2004; Ghosh & Moon, 2005). Therefore, the purpose of the study is to examine the effect of auditor-client relationship, namely audit firm tenure on auditor reporting quality, proxies by going concern opinion in Malaysia environment. Thus, this study tries to support whether the suggestion of auditor rotation can be used in the current situation in Malaysia using Malaysian companies listed on the Bursa Malaysia (Main Board and Second Board).

Our sample is companies listed in the Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange, KLSE). Prior to 1998, the Malaysian Institute of Accountants (MIA) did not adopt the International Auditing Guideline (IAG) 23 on assessment of going concern assumption. Later, in 1998, the MIA adopted ISA 570 Going Concern in which issued by the International Federation of Accountants (IFAC). Then the standard revised in the year of 2000 and became operative from January 2002. Among significant changes between IAG 23 and ISA 570 include provision to assess going concern assumption in every audit engagement and additional prescription to guide practitioners in detecting going concern problem.

In sum, our result shows that a positive relationship between audit firm tenure and auditor reporting quality is in line with the recent decision by Malaysian regulators not to regulate mandatory audit firm rotation in public listed companies. Our results are also consistent with prior studies based in developed countries (Geiger & Raghunandan, 2002) and add to the growing body of literature on mandatory audit firm rotation. The results from this study are useful for the regulators as a feedback to improve the auditor independence in Malaysia. The regulators must emphasize the impact of auditor tenure to the audit quality especially if there is a negative relationship between auditor tenure and audit quality. If this happens, it can be said that long time auditors are deemed to impair their independence when auditing their clients.

The remainder of the paper is organized as follows. In section 2, we present the arguments supporting and opposing long audit firm tenure and develop the hypothesis. Methodology for this research is discussed in section 3 whereas in section 4, we discuss our data and findings and finally our conclusions are presented in final section of the paper.

2. Literature review and hypothesis development

Auditor reporting quality is a basic ingredient to enhance the credibility of financial statements to those interested parties. However, this could not be seen if the auditor is not independent. Without independence, the process of auditing can be argued to the extent that the auditor would give bias opinion to their clients. One of the factors that would adversely influence auditor independence in giving their opinion is a close relationship between auditor and clients, namely long audit tenure. For example, Deis and Giroux (1992) found that the longer the auditors audit their clients the larger that lead to such close relationship between the audit firms and clients and consequently decrease audit quality.

Prior studies have documented two viewpoints of the effect of audit tenure on the credibility of financial statements; regulators view and economic view (Geiger & Raghunandan, 2002). In the point of regulatory view, long association between a client and an audit firm may lead to impair their independence (Geiger & Raghunandan, 2002). For example, in the United States, the Metcalf Committee report argued that long association between a corporation and an accounting firm may lead to such close identification of the accounting firm with the interests of its client's management that truly independent action by the accounting firm becomes difficult. Therefore, the report suggested a mandatory auditor rotation as a way for the accounting profession to bolster their independence from clients (Geiger & Raghunandan, 2002). Furthermore, if we go back to 50 years ago, Mautz and Sharaf (1961) noted that long association with the same client can lead to the auditor independence problems due to the fact that a slow, gradual and honest disinterestedness would be the greatest factors that impaired auditor independence. Therefore, a mandatory auditor rotation regime would improve audit quality by reducing client's ability to adversely influence the auditor judgments (Brody & Moscovice, 1998) and minimize the auditor independence threats. (Geiger & Raghunandan, 2002)

Deis and Giroux (1992); O'Keefe, Simunic and Stein (1994); and Raghunandan, Lewis and Evans (1994) found that the long auditor tenure would decrease audit quality. Similarly, Vanstraelen (2000) found negatively relationship between auditor tenure and opinion and then again provide support for a mandatory audit firm rotation. Also, evidence shows that the shorter auditor tenure the more likely the clients receive a disclaimer going concern opinion (Anandarajan, La Salle & Anandarajan, 2001). In an experimental setting, Dopuch, King, and Schwartz (2001) found the auditors are less likely to impose a biased report if rotation is required, but it also increases the magnitude of investment to improve financial reporting quality. Furthermore, in Malaysia, Teoh and Lim (1996) found that retention of auditors for over five years would influence and impair audit independence. The Malaysian perceived audit firm rotation would improve auditor independence. (Teoh & Lim, 1996)

However, more recently, in the United States, the General Accounting Office (GAO) states, "mandatory audit firm rotation may not be the most efficient way to strengthen auditor independence" (GAO 2003, Highlights). Yet, the GAO leaves a flexibility to revisit the mandatory audit firm rotation if the Sarbanes-Oxley Act's requirements do not lead to improved audit quality (GAO 2003, 5). Moreover, other regulators report in the United States, suggest that a voluntary basis for the clients to change their auditors for a specific of time (New York Stock Exchange, 2003, 11; Commission on Public Trust and Private Enterprise, 2003, 33; and TIAA-CREF, 2004, 9). Under the Sarbanes-Oxley Act, the auditor independence is regulated through audit partner rotation but not for the case of audit firm rotation. The lead audit or coordinating partner and the reviewing partner must be rotated in every 5 years. Similarly, in Malaysia, the MIA only regulated all public listed companies' lead audit partner to be rotated every 5 years.

In the second viewpoint, maintaining the same audit firm for a long period is considered more economic to the clients due to high start up cost when the clients rotate the auditors. According to Geiger and Raghunandan (2002), audit firms tend to reduce their audit fees in the early year of engagement to attract clients. The practice of low-balling requires audit firm to seek for longer audit engagement with their clients so that they could recover back their loss in the early year. Long association between audit firm and its client does not really impair auditor independence. Auditor's independence was impaired only in the early year of audit engagement and not for the whole audit engagement. (Geiger & Raghunandan, 2002)

Similarly, Stice (1991) found the relationship between auditor tenure and a lawsuit against the auditor. In the study, he found that auditor tenure was shorter for those audit engagements that resulted in a lawsuit against the auditor. This happened in the case of control sample that matched only on time period. However, it is not true when compared to an industry pair-matched control sample.

De Angelo (1981) also mentioned that the quality of auditors divided to two parts. First is to detect anything misleading in financial statements of the client and secondly is to report the misleading information. The first quality is regarding the competence and skills of the auditors to detect any fraud while the second one is related to the auditors' independence. In the case of long time auditor, it is argued that the auditor's independence will be reduced because the auditor feels comfortable with the clients whether in term of revenue and also their expertise on the clients' system. Subsequently they will not report any misleading information to ensure there is no any change of auditors. In that case, an unqualified report (clean report) will be issued.

The studies on auditor tenure could not be separated from the auditor switching studies. Many studies found that financially distressed firms were more likely to switch auditors than non distressed companies due to the reason that these types of companies need to hire a new quality of auditor compared to the previous one (Krishnan, 1994; Krishnan & Stephens, 1995). Sinason, Jones, and Shelton (2001) found that auditor tenure is longer for clients who received unqualified or unqualified-modified opinions. Interestingly, in Malaysia, Ismail (1998) found such behavior is less apparent using data from 1975-1995. In one extreme case, the auditor was not even replaced after issuing five consecutive times of a disclaimer opinion to a client. But, the results statistically equivalent, meaning that no evidence exists to indicate that auditor tenure is longer for clients with unqualified opinions.

Similarly, Krishnan (1994); Krishnan & Stephens (1995) found that switching companies were no more likely to have their modified report removed than were similar companies that did not switch auditors. Therefore, it is argued that if the financially distressed firms still maintain the same auditors and by the same time, if an unqualified report is issued, it may be perceived that the auditors' independence is impaired.

It is often argued that mandatory audit firm rotation is one of the solutions to solve auditor's cozy relationship with their clients. Auditor firm rotation supporters argue that its benefits stem from greater audit independence, which in turn improves audit quality. However, the cost of imposing mandatory audit firm rotation would lead to higher start-up cost, impedes learning curve, as well as the failures to attract new-blood to the accounting profession and lower investment from the audit firms to enhance knowledge and expertise in certain industries (Petty & Cuganesan, 1996). In the case of Malaysia where foreign direct investment is still a major economic contributor, the country looks less attractive than its neighboring counterparts especially Singapore since the appointment of auditors is usually for the company affairs and not for regulators as stated under Section 9 (6) of the Malaysian Companies Act 1965. For example, the Monetary Authority of Singapore (MAS) has requisitioned all banks incorporated in Singapore to change their audit firms every five years under a new ruling. The new audit requirement is one of a series of control measures on corporate governance introduced by the Singapore authorities ("Bank", 2002). According to Ravi Menon, executive director of the authority's supervisory policy and banking departments, the mandatory audit firm rotation would help prevent audit firms from having excessive focus on maintaining long-term commercial relationships with the banks they audit. However, in Malaysia there is no regulation binding the banks or the companies to change the audit firms within a certain period.

Since the auditor is an agent to the shareholders in monitoring managers' duties to create wealth for the principals (shareholders), auditor's failure to inform shareholders on the going concern of the principal's business is a serious matter. With the introduction of the US Sarbanes Oxley, auditor's relationship with the client is now being regulated to at least of the engagement audit partner's tenure.

In contrast, Petty and Cuganesan (1996) argued that when mandatory auditor rotation is regulated, clients might be forced to accept a lower quality of service from an auditor who is a generalist, especially if fewer auditors invest in specialized industries such as banking, insurance or natural resources. Moreover, Louwers (1998); Johnson, Khurana, and Reynolds (2002) found no evidence of reduced financial quality for longer audit firm's tenures. Recently, Geiger and Raghunandan (2002) studied a sample of 117 bankrupt companies and suggested that auditors may be more influenced by their newly obtained clients in the earlier years of the engagement. In addition, Chi and Huang (2004) found that audit firm tenure helps to produce higher earnings quality due to familiarity effect, but excessive familiarity results in lower earnings quality. Furthermore, they found that audit firm tenure plays a key role in the transmission of learning experience. Thus, audit independence issue or audit competence issue is crucial and problematic in early years of engagement and not in later years.

Overall, prior researches suggested that there should not be any fast rules on mandatory audit firm rotation. In United States, many auditors have served their clients for more than twenty years (Geiger & Raghunandan, 2002) and some since listed in the stock exchange. In such cases, auditors would be under greater pressure from clients and thus would unlikely issue a going concern opinion. However, auditors may be argued to have in-depth knowledge and thus would be able to defend themselves if such difficult situation arises. In addition, they would be able to advise their clients if going concern assumption is no longer appropriate. Therefore, the derived hypothesis as follows (in alternate form):

H1: *Ceteris paribus*, there is a positive relationship between audit firm tenure and the issuance of going concern opinion.

3. Research method

3.1 Sample and data

The sample comprises all listed non-finance distressed companies identified using a list of financial indicators under ISA 570 (revised) Going Concern. The data is primarily from annual reports of public listed companies in Bursa Malaysia. The year of 2002 is selected since the ISA 570 (revised) came into force from 1 January 2002. We found 187 companies, which fulfilled the distress characteristics.

3.2 Explanations of the Model

This study replicates the model from the previous established studies in going concern audit opinion. (Louwers, 1998; Geiger & Raghunandan, 2002)

The research model (in logistic form) is as follows:

$$GC = \alpha + b_1 \text{TENURE} + b_2 \text{BIGFIVE} + b_3 \text{ACOM} + b_4 \text{ZFC} + b_5 \text{DFT} + b_6 \text{LOGASSETS} + e$$

The measurements of the variables are as follows:

Dependent Variable Measurement

GC = 1 if auditor issued going-concern opinion, else 0

Hypotheses Variables

TENURE = Audit firm tenure in number of years

3.3 Control variables measurement

BIGFIVE = Dummy variable, 1 if the auditor is the Big Five firm, and else 0

ACOM = Dummy variable, 1 if the audit committee is comprised of all non-executive directors, else 0

ZFC = Probability of bankruptcy calculated from Zmijewski Financial Condition (1984)

DFT = Dummy variable having a value of 1 if the company is in default, else 0

LOGASSETS = Natural log of total assets of clients

e = Error term of residual

α_i = constant (i = 0)

b = coefficients (i = 1, 2, 3, 4, 5, 6, 7)

3.4 Variables definition and discussion

3.4.1 Tenure

Tenure is the first hypothesis variable measured by the length of years which audit firms audit their clients (Louwers, 1998; Vanstraelen, 2000). Similarly, we argue that auditors are in greater pressures from clients especially if the auditors have served the clients since the clients listed in the stock exchange for many years. Due to the mixed theories and empirical findings, we do not provide direction for this relationship.

3.4.2 Big Five

DeAngelo (1981) theorized that larger audit firms have superior audit quality since they invest more in audit technology and training. Thus, in term of audit competence, it could be argued that larger audit firm would be more accurately able to detect problems related to going-concern assumption than smaller audit firms. In term of audit independence, larger audit firms have more spreads of clients' base when auditing listed companies than smaller audit firms (Md. Yusof & Che Ahmad, 2000) and thus have less dependence on a particular client. In addition, Palmrose (1988) found that the larger audit firms were less likely to be involved in audit-related litigation than the smaller one. Alternatively, Big Five firms have greater risk of losing reputation, which may motivate them to be more objectivity when making an audit reporting decision. Anandarajan *et al.* (2001) however, found no evidence of auditor size effect on auditor going concern reporting. Such finding warrant a further study, perhaps in Malaysia, since the public perceive differences exist in many aspects of auditing between larger firms and smaller firms including going concern assumption. In addition, this variable is never tested in Malaysia environment. (Md. Yusof, Md. Saleh & Abdul Hamid, 2002).

3.4.3 Audit committees

Audit committee has been made mandatory in Malaysia since 1993. (Note 1) It is more likely that interaction between audit committee with external auditors may influence auditor's choice of issuing going-concern. (Note 2) An independent audit committee could help mitigate such pressure by supporting the auditor in disputes with management (Knapp, 1987). Hence, we expect some characteristics of board of directors, especially non-executive directors, as public watchdog and audit committee will influence auditor's choice in going-concern. Knapp (1987) found that in a major audit disputes, audit committee members tended to support the auditors rather than the management. Similarly, Md. Yusof and Che Ahmad (2000) found evidence that independent audit committee is associated with going concern opinion.

We argue that placing strategic executive directors on the committee may shadow a measurement of independence of audit committee by proportion of outside directors. We believe a higher independence of audit committee, which is measured by non-existence of powerful directors especially the managing director and executive directors (Carcello & Neal, 2000) would lend better support for auditors. Thus, independent audit committees will ensure that the audit opinion really gives a picture the situation of that company.

3.4.4 Probability of bankruptcy

Several studies found that a positively relationship between going concern opinion and probability of bankruptcy of a company. This is due to the fact that, the higher probability of bankruptcy, the higher the need of the auditors to issue going-concern opinion. Regardless of whatever bankruptcy model being employed in prior researches (Hopwood, McKeown & Mutchler, 1989; Vanstraelen, 2000) in going concern opinion, the results suggest that auditors do assess distress condition of their clients. Prior research in Malaysia by Md. Yusof *et al.* (2002) used Zmijewski Financial Condition (ZFC) that suggested by Zmijewski (1984) and they found significant result. Similarly, we employ ZFC to measure financial distress of the companies. Kleinman and Anandarajan (1999) suggested that a score, which exceed 0.28, is considered as financial distress. Therefore, there is a positive association between probability of bankruptcy and going concern opinion.

3.4.5 Default

In this present study, a company is classified a default company if the company is either in payment default or technical default or has breached loan covenants. Therefore, we employ dichotomous variable as suggested by Chen and Church (1992). Going concern is associated with default status. This due to the fact that default status would send strong bad signal which potential and successful negotiation with banks or other creditors would be unlikely. In the absence of such supports, companies under financial distress would hardly stay as going-concern company in the future accounting period. Thus, there is a positive association between default status and of going-concern opinion.

3.4.6 Client Size

Total assets is used in the present study due to the amount of assets, that more consistent before and after the 1997 crisis compared to revenues. However, Md. Yusof *et al.* (2002) found no evidence that size of clients measured by total assets has association with the type of going concern audit report. Other measurements of client size include market capitalization and a mixture of sales and assets. This variable is transformed to logarithmic data to control for non-normality. Consistent with the previous research, a negative relationship between this independent variable and going concern opinion is expected. (Geiger & Raghunandan, 2002)

4. Results and discussions

4.1 Descriptive results

From 187 non-finance companies, Arthur Andersen (AA) and Ernst Young (EY) audited 42.17% of distressed companies. Since the merger between those firms in July 2002, almost half of these troubled companies lie with this new EY. All Big Five accounts 70.28% of the Bursa Malaysia troubled firms. This figure is comparable with their total shares of the Bursa Malaysia companies (Md. Yusof & Che Ahmad, 2000). 77.5% or 145 of these companies received going concern audit opinion. Thus many problems and critics would lie in the case of non-receiving going concern opinion.

Variance Inflation Factor (VIF) figures are closed to unitary and thus conclude that multicollinearity poses minimal threat to further regression analysis. (Note 3) In addition, further inspection using the condition index proves prior VIF test. Besides,

Going concern opinion has strong and significantly correlation with audit tenure ($r = 0.229$), default status ($r = 0.647$), outside audit committee ($r = 0.154$) and probability of bankruptcy ($r = 0.171$). In contrast, correlation analysis does not show any significant relationship between Big Five variable and going concern opinion variable. As mentioned above, univariate results should be read with caution and act as a complement to multivariate analysis of logistic regression.

4.2 Multivariate regression

The result does not support the frequent arguments of negative audit tenure effects made by public and business community. However, our finding reveals that if a client never changes its auditor since listed in stock exchange, then the possibility of receiving clean opinion is higher. These results support Chi and Huang (2004) who suggested that familiarity effect produce higher earnings quality, but excessive familiarity results in lower earnings quality (even the situation are difference between this study and Chi & Huang, 2004, similar proxy of audit firm tenure was used by both studies to examine the role of audit firm whether in going concern opinion or earning aspect).

Moreover, there is evidence that audit firm size as surrogated by Big Five and non-Big Five dichotomous classifications have significant influence over auditor reporting decision. This is consistent with Behn, Kaplan and Krumwiede (2001). Thus, argument of perceived high quality by DeAngelo (1981) is apparent as generally supported in the case of audit fees research.

However, audit committee independence variable is not significantly auditor going concern opinion. This may suggest that non-executive director variable should be replaced with independent director variable as a proxy of outside audit

committees due to the fact that independent director is more likely accurate in term of the whole outside audit committee without any relationships with the company.

77.55% of the sample is companies, which have audit tenure of five years or more. In order to examine the robustness of the model and results, sensitivity analyses have been conducted. The sensitivity analysis is done by first changing the measurement of TENURE to a dichotomous value of TENURE (coded as 1 if the tenure is seven years above and ten years above). Finally, by changing the measurement of TENURE to logarithm. Overall, it can be said that the general results in Table 4 still hold and robust.

The call for mandatory audit rotation may not yield what it hopes for. We would say our results do not support audit firm rotation and thus change of auditor should be made for necessary and reasonable grounds such as in the event of non-performance of auditors or change of substantial and controlling shareholders and others.

Our results are also consistent with Md. Yusof et al. (2002) that related to debt-default status and serious financial distress variable. Both variables are strong determinants of auditor's decision in issuing going concern in Malaysia. These findings also contribute to high pseudo R^2 but it is still comparable with prior researches (Geiger & Raghunandan, 2002 had pseudo R^2 0.33; Louwers, 1998 had pseudo R^2 0.44). In addition, assets of the companies are proved to be insignificant factor whether in the main results or in the sensitivity analyses. There are several explanations. First is the auditor may investigate the quality of the assets and not just "any assets". It is quite possible, if the distressed company has significant portion of assets, which have higher market value and demand such as investment in listed shares or has properties of high value that would make the company more "survive" than others. Thus auditor may not issue a going concern opinion to such companies. Secondly, a better proxy for size in the case of going concern opinion such as revenue or turnover of the companies may yield better results.

Interestingly, it seems that in Malaysia, auditors are skeptical or very conservative on going concern assumption made by directors and thus they made lower type II error compare to type I error. High type I error may lead to self-fulfilling theory which suggest that their clients may face difficulties in obtaining credit or financing facilities from bankers or investors. The auditors do take to the account these factors in their going concern opinion decision. Such events may cause higher cost to the auditors i.e. clients switch their auditors but Ismail (1998) found that going concern opinion alone would not precipitate such effect. Future research on value relevance of going concern audit opinion may unveil this effect.

5. Conclusions

Mandatory audit rotation debates came from the arguments that long audit tenure would create cozy relationship between auditors and clients and thus would lead to audit failure such as in the case of going concern opinion. We found no market wide evidence to support that argument in Malaysia but instead we found that longer audit tenure has positive significant association with auditor's reporting decision. In addition, we found that auditors in Malaysia made less serious error (type II) or audit failure compared to our model. However, we did not test on other type of audit failure such as qualified opinion of non-going concern issues. In this study, we did not discriminate the different types of going concern opinion including modified opinion, qualified opinion or disclaimer opinion as stated in ISA 570 (revised 2000).

Our results also show that if a client never changes its auditor since listed in Bursa Malaysia, there is a tendency to issue a clean opinion though the client suffers apparent financial problems. Therefore, we echo the importance of self-regulation and Laissez-faire practice in Malaysia as a better alternative than a mandatory auditor rotation. Perhaps current national undertakings by regulators such as strengthening audit committee in term of independence and competence and peer audit review process by the MIA would inhibit unethical audit process in Malaysia.

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Notes

Note 1. Beginning 31 August 1993, companies seeking listing on Bursa Malaysia are required to have audit committee under s15A of Bursa Malaysia listing requirement.

Note 2. Among main functions of audit committee are reviewing audit planning and audit procedures and discussing audit findings and report (MIA recommended practice guide on Audit Committee & section 344A Bursa Malaysia listing requirements).

Note 3. VIF ranges from 1.0408 to 1.441.

Note 4. Two assumptions of heteroskedasticity and autocorrelation are considered and corrected in the multivariate regression analysis.

Table 1. Studies of audit tenure on auditor reporting

Studies	Measurement of audit tenure	Country	Sample	Audit tenure to auditor reporting
Geiger and Raghunandan (2002)	Natural log of number of years	U.S.	117 stressed & bankrupt companies	Positive
Anandarajan, La Salle and Anandarajan (2001)	Dichotomous value, 1 for audit tenure of three years or less & 0 otherwise	U.S.	Two partition of 216 for financial service & 307 from non-financial service industry	Negative
Vanstraelen (2000)	Number of years	Belgium	146 match sample of stressed & non-stressed non-bankrupt companies	Negative
Louwers (1998)	Number of years	U.S.	808 stressed non-bankrupt companies	Not significant

Table 1 shows relevant studies on the audit tenure variable in relation to the auditors' reporting. It can be said that, in empirically studies, the audit tenure variable is still new though debates on audit tenure have gone through times and tides for four decades. Results are inconclusive like many other researches in auditing. Thus prompting for a need of a new study in a new environment especially in new emerging markets like Malaysia.

Table 2. T-test of Big Five and Non-Big Five

Variables	Big Five (means)	Non Big Five (means)	t-value	Sig.
TENURE (in years)	10.5	7.26	2.820	0.005
GOING CONCERN	0.82	0.70	1.863	0.064
ACOM	0.33	0.26	0.910	0.364
DFT	0.66	0.61	0.657	0.512
ZFC	15.63	22.99	-0.805	0.422
TOTAL ASSETS (RM)	679,922,418	471,684,583	0.767	0.444

T-test in the Table 2 confirms this preliminary finding that Big Five is different than non Big Five in terms of audit opinion and tenure. Big Five generally have longer audit tenure and issued a slightly more going concern opinion than non-Big Five. However, this is only a univariate test-result, which needs to be interpreted with caution. Therefore, a model that combines multiple variables such as regression procedure would unveil whether such relationship holds true in a multivariate analysis.

Table 3. Pearson’s correlation among independent variables

	TENURE	BIGFIVE	ACOM	ZFC	DFT	LOGASSETS
TENURE	1	.201(**)	.122	-.033	.249(**)	.085
BIGFIVE	.201(**)	1	.039	-.060	.043	.055
ACOM	.122	.039	1	.154(*)	.114	.039
ZFC	-.033	-.060	.154(*)	1	.199(**)	-.101
DFT	.249(**)	.043	.114	.199(**)	1	-.055
LOGASSETS	.085	.055	.039	-.101	-.055	1

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

Table 3 of Pearson’s correlation shows that multicollinearity is minimal. The results in Table 3, suggest that the largest absolute value is only 0.249 between TENURE and DFT with significant level at 0.01.

Table 4. Summary of logistic regression for going concern opinion, n = 187

Variables	Sign	Coefficient (Standard Error)	t-ratio
TENURE	?	.9300516409E-02 (.27108288E-02)	3.431***
BIGFIVE	+	.1102186779 (.59473496E-01)	1.853*
ACOM	+	.8920864604E-01 (.51379021E-01)	1.736*
ZFC	+	.8595481481E-03 (.35859263E-03)	2.397**
DFT	+	.1655871558 (.94579344E-01)	1.751*
LOGASSETS	-	-.1827234697E-01 (.39940892E-01)	-.457
Constant	+/-	.6116888266 (.33447508)	1.829*
<i>p-value</i>		.00000	
<i>Cox & Snell R²</i>		0.464	
<i>Nagelkerke R²</i>		0.714	
<i>Correctly classified</i>		88.8%	
<i>Durbin-Watson</i>		1.95250	

Notes:

a. Dependent Variable: GC

b. Predictors: TENURE, BIGFIVE, ACOM, ZFC, DFT, LOGASSETS, Constant.

*** significant at 0.0001 level (2-tailed)

** significant at 0.05 level (2-tailed)

* significant at 0.1 level (2-tailed)

Table 4 shows that audit firm tenure has statistically positive significant relationship (at-two-tailed) with the issuance of going concern opinion. (Note 4). The results are similar as Geiger and Raghunandan (2002). This means that the longer an audit firm audits a client the higher probability the auditor issuing going concern opinion.

Table 5. Classification table for going concern opinion^a

Auditor's actual opinion	Model's predicted opinion		
	Standard	Going concern	Percentage correct
Standard	32	9	78.0
Going concern	12	134	91.8
Overall percentage	37.5%	6.7%	88.8%

a. The cut value is .500

Table 5 shows minimal improvement in term of accuracy from Md. Yusof et al. (2002). The model has high prediction power of 88.8%. Type II (6.7%) is lower than type I (37.5%) error, which is deemed not a serious problem. Type II error leads to auditors to give a clean opinion whereby they should give a going concern opinion. Thus we can say that most of distressed companies in Malaysia received "warning" from their auditor by issuing a going concern opinion.