

**LAISSEZ-FAIRE OR MANDATORY AUDITOR ROTATION:
THE CASE OF AUDIT FIRM TENURE AND AUDIT FIRM SWITCHING**

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ABSTRACT

The issue of audit tenure has been discussed since four decades ago. Nowadays, due to the recent corporate scandals in the United States, the issue is discussed together with auditor independence that led to companies' demise. Therefore, this study attempts to investigate the situation in Malaysia whereby no empirical study using archival data has been done.

There are two major findings. First, the variable of audit firm tenure is positively significant relationship with going concern opinion. Second, when a client never changes its auditor since became a public listed company; there is a tendency to issue a clean opinion though the client suffers apparent financial problems. This implies that, "auditor change would do well, but forcing an unrealistic auditor rotation might not yield what it hopes for". Therefore, we echo the importance of self-regulation and *Laissez-faire* practice in Malaysia as a better alternative than a mandatory auditor rotation.

Keywords: Audit Firm Tenure, Audit Firm Switching, Laissez-faire, Mandatory Auditor Rotation

INTRODUCTION

The purpose of this study is to examine the effect of audit firm tenure on the issuance of going concern opinion. Our sample is companies listed on the Kuala Lumpur Stock Exchange (KLSE). In addition, we examine the independence of audit committee and Big Five firms on the issuance of going concern opinion. 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.

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. The length of tenure of an audit firm maintains a client has long been an issue in the United States and other countries (Mautz and Sharaf, 1961; Shockley, 1981; Arrunada and Paz-Ares, 1997; and Geiger and Raghunandan, 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 (*The Star*, 2002). Several countries in European Union such as Italy and Spain have required the audit firms to be rotated by a certain time (Geiger and 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 latest 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 (*The News Straits Times*, Dec. 27, 2003).

In the past few years, auditors had been blamed due to the role of themselves in the mega corporate scandals such as Enron Incorporation, WorldCom Incorporation, Global Crossing, ImClone Systems Incorporation and Tyco International. Such criticism had raised lots of questions regarding auditors' independence. Besides, such criticism was levelled 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. For that reason, there has been a call for sweeping changes in the auditing profession to ensure independence and therefore improve their audit quality (*The Star*, Aug, 12, 2002).

It is often argued that mandatory auditor rotation is one of the solutions to solve auditor's cozy relationship with their clients. Auditor rotation supporters argue that its benefits stem from greater audit independence, which in turn improves audit quality. However, the cost of imposing mandatory auditor 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 neighbouring 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.

In ASEAN, 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 (*The Star*, March, 14, 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.

THE MOTIVATION OF THE STUDY

The most important motivation to carry out this study is lack of consensus among the public, regulators and audit firms on the issue of mandatory audit firm rotation. Teoh and Lim (1996) found that in Malaysia, the public perceived audit firm rotation would improve auditor independence. However, recently, the MIA suggested a more lenient way to regulate auditor independence. A call of a mandatory rotation involve only audit partner but not 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 (*New Straits Times*, March 26, 1999).

Following the corporate scandals in the United States, the regulators in Malaysia such as the Malaysia Securities Commission (SC) and the KLSE became more concerned with the mandatory audit firms rotation. In view of the importance of the issue in question, the 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 (the Malaysian Institute of Accountants, 2002). Therefore this study tries to prove that whether these suggestions can be use in the current situation 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.

In addition, no empirical studies have been carried out in Malaysia regarding auditor tenure and audit quality. This study examines the local setting namely Malaysian companies listed on the Kuala Lumpur Stock Exchange (Main Board and Second Board). Hopefully, this study will give new understanding on the auditing profession in Malaysia. The results from this study will be useful for the regulators in improving the independence of the auditor.

Finally, the results can be used by the companies to improve both the effectiveness and efficiency of the audit that they undertake besides their relationship with the auditors in gaining the public trust.

Auditor quality has been concerned in recent times due to several mega corporate scandals in the United States and lately in Europe. For that reason our study contributes to the body of knowledge on current situations of audit quality by examining the financially distressed companies in Malaysia. Besides, we introduce a new variable which is the auditor change variable. This study would then serve as a feedback to the regulators regarding the mandatory rotation and the auditors' independence in Malaysia.

LITERATURE REVIEW & HYPOTHESES DEVELOPMENT

This section highlights several studies that utilized auditor tenure as a variable and its effect to the audit quality. Deis and Giroux (1992) found that the audit quality decreases as auditor tenure increases. The reason they gave was that the auditors become less challenged and therefore less likely to use innovative audit procedures and finally fail to maintain their competency.

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 (1981b) also mentioned that the quality of auditors divided into 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 terms 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.

In the point of view of regulators, long association between a corporation and an accounting firm may lead to impair their independence (Geiger and Raghunandan, 2002). The United States regulators emphasized on this since 1976 under the Metcalf Committee report (the United States Senate, 1976) which suggested that mandatory auditor rotation as a way for the accounting profession to bolster their independence from clients. However, this was only a suggestion. Perhaps the current act, which has been enacted in the United States, the Sarbanes-Oxley Act 2002 (SOX) will remedy this. Under this act, auditor independence is regulated through audit partner rotation but not for the case of audit firm. The lead audit or coordinating partner and the reviewing partner must be rotated in every 5 years. Similarly, in Malaysia, the MIA suggested 5 years to rotate the lead audit partner.

The studies of 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; and Krishnan and 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, Hashanah (1998) found such behaviour 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.

Figure 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.

Insert Figure 1 About Here

Similarly, Krishnan (1994); and Krishnan and 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. In addition, studies by Teoh and Lim (1996) found that retention of auditors for over five years would influence and impair audit independence.

It is argued that the longer the auditors audit their clients the larger that lead to such close relationship between the audit firms and clients. Thus would inhibit auditors' power in audit conflicts i.e. going concern issues. Deis & Giroux (1992), O'Keefe *et al.* (1994) and Raghunandan *et al.* (1994) confirmed that longer auditor tenure would decrease audit quality. Similarly, Vanstraelen (2000) found negatively relationship between auditor tenure and opinion and then again provide support for mandatory audit firm rotation. In addition, Anandarajan, La Salle and Anandarajan (2001) found evidence that the shorter auditor tenure the more likely the clients receive a disclaimer going concern opinion. Longer tenure auditors are likely to only modify the opinion of an audit report when the issue of going concern is at stakes, meaning that, the auditors are less conservative. 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.

In contrast, Petty & 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); and 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 null form):

H₀1a: *Ceteris paribus*, there is no significant relationship between audit firm tenure and the issuance of going concern opinion

H₀1b: *Ceteris paribus*, there is no significant relationship between companies, which never change their auditors since listed in Kuala Lumpur Stock Exchange (KLSE) and the issuance of going concern opinion

RESEARCH DESIGN AND SAMPLE SELECTION

Sample and Data

The sample comprises all 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 KLSE. 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.

Explanations of the Model

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

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

$$GC = a + b_1 \text{TENURE} + b_2 \text{AUDITSWITCH} + b_3 \text{BIGFIVE} + b_4 \text{ACOMOUT} + b_5 \text{ZFC} + b_6 \text{DEFAULT} + b_7 \text{LOGASSETS} + e$$

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

AUDITSWITCH = Dummy variable, 1 if client never change its auditor at least once since listed in the KLSE, 0 otherwise

Control Variables Measurement

¹³ Beginning 31 August 1993, companies seeking listing on KLSE are required to have audit committee under s15A of KLSE listing requirement.

BIGFIVE	=	Dummy variable, 1 if the auditor is the Big Five firm, and else 0
ACOMOUT	=	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)
DEFAULT	=	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
a _i	=	constant (i = 0)
b	=	coefficients (i =1,2,3,4,5,6,7)

Variables Definition and Discussion

Tenure and Audit Switch

Tenure is the first hypothesis variable measured by the length of audit firm tenure in years since the KLSE was established. Audit firm tenure is measured by the length of years which audit firms audit their clients (Louwers, 1998 and Vanstraelen, 2000). In the sensitivity analyses, we use logarithmic transformation to correct for non-normality in the distribution of the data (see Geiger & Raghunandan, 2002). 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.

Big Five

DeAngelo (1981b) 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 (See Atef & Ayoib, 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 (see Atef, Suhaimi, and Zakimi, 2002).

Audit Committees

Audit committee has been made mandatory in Malaysia since 1993³. It is more likely that interaction between audit committee with external auditors may influence auditor's choice of issuing going-concern⁴. 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

⁴ 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 KLSE listing requirements).

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, Atef *et al.* (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 (see also 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.

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 (see among others, Hopwood *et al.*, 1989; Vanstraelen, 2000) in going concern opinion, the results suggest that auditors do assess distress condition of their clients. Prior research in Malaysia by Atef *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 & Anandarajan (2001) 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.

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 & Church (1992). Going concern is associated with default status (refer Atef *et al.*, 2002). 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.

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, Atef *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 and Raghunandan, 2002).

RESULTS AND DISCUSSIONS

Descriptive Results

From 187 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 KLSE troubled firms. This figure is comparable with their total shares of the KLSE companies (See Atef and Ayoib, 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.

T-test in the Table 1 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.

Insert Table 1 About Here

Variance Inflation Factor (VIF) figures are closed to unitary and thus conclude that multicollinearity⁵ poses minimal threat to further regression analysis. In addition, further inspection using the condition index proves prior VIF test. Besides, Table 2 of correlation matrix shows that multicollinearity is minimal. The results in Table 2, suggest that the largest absolute value is only 0.266 between TENURE and AUDITSWITCH, with significant level at 0.01.

Insert Table 2 About Here

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 do 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.

Multivariate Regression

The results are similar as Geiger & Raghunandan (2002). Table 3 shows that audit firm tenure and audit switching variables have statistically significant relationship (at-two-tailed) with the issuance of going concern opinion. Hence, H_01a and H_01b are rejected. This means that the longer an audit firm audits a client the higher probability the auditor issuing going concern opinion. 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 due to familiarity effect, but excessive

⁵ VIF ranges from 1.0408 to 1.441

familiarity results in lower earnings quality (even the situation are difference between this study and Chi and 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).

Insert Table 3 About Here

Moreover, there is no evidence that audit firm size as surrogated by Big Five and non-Big Five dichotomous classifications unlike in Behn *et al.*, (2001) and audit committee independence have significant influence over auditor reporting decision. Thus, argument of perceived high quality by DeAngelo (1981b) is not apparent as generally supported in the case of audit fees research. It is suggested not to use a dichotomous value in audit reporting studies (as a proxy of audit quality) unlike in audit fees studies where the perceived difference of audit quality can be captured by using dichotomous value of Big Five and non Big Five. Furthermore, Raman (2004) found no significant difference of the audit quality between Big Four and non-Big Four in Association of South East Asian Nations (ASEAN) which includes Malaysia even prior to the 1997 financial crisis compared to their counterparts in the United States.⁶ He used earnings conservatism as proxy for audit quality.

77.55% of the sample is companies, which have audit tenure of five years or more. We then conducted sensitivity analyses using a dichotomous value of tenure of more than three years, more than five years and found those results still holds. Thus, 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 also consistent with Atef *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 in going concern issues unlike in many of audit fees studies. 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 fare and survive much better 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.

Insert Table 4 About Here

Table 4 shows minimal improvement in term of accuracy from Atef *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 deem 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.

⁶ Nowadays, there are only four largest audit firms called Big Four (KPMG, PricewaterhouseCoopers, Ernst and Young and Deloitte and Touche. The current study still uses Big Five because Arthur Andersen was still available in the year of 2002.

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 Hashanah (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.

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 KLSE, there is a tendency to issue a clean opinion though the client suffers apparent financial problems. Overall, it can be said, "auditor change would do well, but forcing an unrealistic audit firm rotation might not yield what it hopes for". 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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FIGURE 1
Studies on Audit Tenure to Auditor Reporting

Studies	Measurement of audit tenure	Country	Sample	Audit tenure to auditor reporting
Geiger & Raghunandan (2002)	Natural log of number of years	U.S.	117 stressed & bankrupt companies	Positive
Anandarajan, La Salle & 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
t-test of B5 and Non-B5

Variables	B5 (means)	Non B5 (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*
ACOMOUT	0.33	0.26	0.910	0.364
DEFAULT	0.66	0.61	0.657	0.512
ZFC	15.63	22.99	-0.805	0.422
AUDITSWITCH	0.44	0.41	0.388	0.698
TASSETS (RM)	679,922,418	471,684,583	0.767	0.444

TABLE 2
Correlation Matrix

	GC	TENURE	AUDITSWITCH	BIGFIVE	ACOMOUT	ZFC	DEFAULT	TASSETS
GC	1	.229(**)	-.098	.128	.154(*)	.171(*)	.647(**)	.003
TENURE	.229(**)	1	.266(**)	.201(**)	.122	-.033	.249(**)	.085
AUDITSWITCH	-.098	.266(**)	1	-.033	-.031	.034	-.055	-.210(**)
BIGFIVE	.128	.201(**)	-.033	1	.039	-.060	.043	.055
ACOMOUT	.154(*)	.122	-.031	.039	1	.154(*)	.114	.039
ZFC	.171(*)	-.033	.034	-.060	.154(*)	1	.199(**)	-.101
DEFAULT	.647(**)	.249(**)	-.055	.043	.114	.199(**)	1	-.055
TASSETS	.003	.085	-.210(**)	.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
Logistic Regression, n =187

Variables	Predicted Sign	B	S.E.	Wald	Sig.	Exp(B)
TENURE	?	.169	.097	3.012	.083	1.184
AUDITSWITCH	?	-1.094	.660	2.749	.097	.335
BIGFIVE	+	.629	.653	.928	.335	1.877
ACOMOUT	+	.319	.696	.210	.647	1.375
ZFC	+	.606	.203	8.953	.003	1.833
DEFAULT	+	3.367	.820	16.851	.000	28.991
LOGASSETS	-	-.016	.491	.001	.975	.984
Constant	+/-	-1.287	4.071	.100	.752	.276

a Variable(s) entered on step 1: TENURE, AUDITSWITCH, BIGFIVE, ACOMOUT, ZFC, DEFAULT, LOGASSET.

Cox & Snell $R^2 = 0.464$, Nagelkerke $R^2 = 0.714$, Hosmer & Lemeshow = 0.947

TABLE 4
Classification Table

Classification Table^a

auditor's actual opinion	Model's predicted opinion		Percentage Correct
	standard	going concern	
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