

The Effect of Audit Quality Adjustment on the Relationship between Earnings Management and Return on Equity in Listed Companies in Tehran Stock Exchange

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Abstract

In developed economies, the audit process is very important measure of capital and political stability. This is despite the fact that in developing countries likes Iran. The audited financial statements of the most important tools for ensuring the transparency of financial information, which is to increase the predictive power of accounting information, such as financial ratios earnings per share is. Therefore, the quality of accounting information quality increases and future returns of the grounding of the information obtained will be closer to reality. The measures related to earnings management may lead to the disclosure of financial information to be false, because it is not provided in accordance with the actual conditions. Audit process as a moderator variable reduction measures related to earnings management. This paper examines the relationship between audit quality and earnings management among firms listed in Tehran Stock Exchange paid. And towards that goal, all of the companies listed in Tehran Stock Exchange in the financial statements (balance sheet, profit and loss account) and provide the required information for the years 2010 to 2014 were studied. In total, 70 companies were selected from different industries. To test the hypothesis of multivariate regression analysis (stepwise) was used for significance using the t and F statistics were performed, as well as camera-Watson test for autocorrelation test model is used. The results suggest that, between stock returns are positive and significant relationship with audit quality management benefit.

Keywords: audit quality, return on equity, earnings management

1-Introduction

One of the purposes of financial reporting, providing information to investors, creditors and other current and potential users of the investment and credit decisions and other decisions, is of benefit. Firms should prepare up to date and reliable data for investors and creditors to access organized capital markets (Chen and et al, 2005). One of the important criteria for the estimation of the group company's profitability, anticipated future earnings and the related risks and their management, performance evaluation, in last and now year company's profits. Earnings also include cash and commitment items. Interest accruals are largely in the control of management. He can look to improve the performance and increase the predictability of future profits in today's so-called accruals, profit and manage benefits. In other words, managers are trying to authorized method of accounting, the results create predictable and stable. Because most investors and managers believe that companies that have good profitability trend and profit is not the main changes compared to similar companies, worth more and more predictability and compare. On the other hand, according to the agency theory, managers can benefit from the incentive to manipulate in order to maximize their own interests. Thus, earnings management is considered to be one of the important dimensions of financial reports' quality and since the amount of earnings is considered as one of the most important criteria in performance assessment, any type of interference can affect the type of decision makings by the users of financial reports (Zengin and Ozkan, 2010). Also, financial investigators, always variables that can, through them, the stock return for future periods with higher confidence level than previous models predict variables. Investigate how the stock market reaction to accounting information, the detection efficiency of the capital market and to evaluate the usefulness of financial statements, is very important. Experimental studies show that accounting figures predict and may be predictive value as a one of the qualitative characteristics of accounting information to accounting data accepted. (C. Hendrickson and Breda, 1991).

Auditing plays a considerable role in validating the firms' earnings data following the current representation of firms' earnings and the bankruptcy of the big companies (Zhou and Elder, 2004). Thus, auditing quality is considered to be one of the principle foundations regarding the reliable data. Auditing is called

an important element of strong corporate governance and it has been considerably noticed in Iran due to the trend towards privatization in Iran and the necessity of having higher quality financial statements (Namaziand et al, 2010). Thus, regarding the importance of earnings management in users' decision makings about financial data and also the role of auditors in reducing information asymmetry, it is expected that users demand it to increase auditing quality (Yeghaneh Hassasand Pakizeh, 2007).

Janin and Piot (2005) believe that the audit could be one way to prevent and reduce earnings management and the confidence level is more than the stock returns for future periods. It is believed, companies that provide audited financial statements with information content and higher quality earnings. Accruals related to the judgment of managers. Accruals and audit firms that have more, be more difficult. Audit higher quality, more likely to be discovered questionable accounting practices. For quality audit institution has the expertise, resources and more incentives to discover errors and fraud. So given the above, the present study the effect of audit quality as a variable adjusting the relationship between earnings management and efficiency in the capital market deals.

2.Literature Review

2-1. Theories Explaining Earnings Management

According to efficiency theory, correlation between information and stock markets is noticeable. Indeed, it is declared information which is supposed to be reflected in stocks and not accounting value in itself. In this line of thinking, accounting modification which has no impact on cash flow cannot bring about any information to the market and cannot then affect the price as it has no effect on investors' predictions and expectations. Studies focusing on phenomena related to information content of accounting profits, highlighted investors' tendency to focus on variations in earnings (Forester, 2009; Yang and al 2011). These studies matured into the functional fixation hypothesis according to which investors are not warned, hence unable to discover the effects of edifying accounting data on cash flows (also accruals). Often with reference to functional fixation hypothesis, recourse to accounting results is a normal attitude as investors do not adopt any other source of information. Such behavior is at the origin of this tight combination between stock prices on the one hand and accounting changes on the other, independently from cash-flows. Obvious that they upgrade evaluation of firm taking into account magnitude of detected manipulations. What remains are few researchers who show concerns about functional fixation hypothesis, separately considered from other factors. Grossman and Ztigitz (1976) assume that investors' rational behavior affects and guides naïve investors. Then, naïve investors will be taken to follow rational investors' behavior when making arbitrage profits till the disappearance of these profits. This will be taken in what follows. Signal theory came to justify some accounting practices. It assumes that accounting figures need to be confirmed as a genuine tool of signaling market trends, in as much as they allow investors to better appreciate the firm's real value. The hypothesis recently used by researchers of accounting shows that there is information asymmetry between investors and managers. These latter dispose of private information on the situation and perspectives of the firm and also on its capacity to generate future cash flows. In this context, earnings management may be used as a flexible tool allowing for transmitting to investors private information mainly their own opinions on the long-term strategy of the firm and to shape accounting information, within the limits of law. In particular, accounting result is a variable on which managers wish to act. As mentioned by Beaver (1989), « no other figure in the financial statements receives more attention by investors' community other than earnings per share »⁷. Indeed, at the heart of this theory, manipulated accounting figures is an instrument to signal market trends, in as much as they allow investors to better appreciate the firm's value and build up, in an optimal manner, their stocks portfolios. Many studies like those of Kim and Verrecchia (1991), Dotoh and Ronen (1993) and Bamber and Choen (1995) indicate that information asymmetry may guide stock prices reactions during publication of accounting information. Nevertheless, and according to Watts and Zimmerman (1986), competition between firms and motivation to attract the maximum of investors, force managers to present accounting data modified in their favor. As a consequence, firm value is either underestimated or over-estimated on the market. According to information monopoly line of thinking, managers retain information about firm's future at the expense of investors. Managers diffuse even on the market private information that they hold through an appropriate management of accounting results. Accordingly, Beaver (1968) and Morses (1981) underline that published accounting results have an information content in so far as their declarations are likely to provoke an increase in the variance of abnormal returns mean. Ball and Brown (1968) used these abnormal variations of returns to highlight importance of accounting results to investors during their announcement. As we have mentioned and to support the notion of managers' operation efficiency in the market through accounting modifications which lead in their turn to a variation in annual results, Jacobson (1963) notes that 75% of changing accounting methods led to an increase in earnings of the studied firms. (Irani 2001) provided a similar percentage around 76% of the studied firms benefited from a positive impact of an accounting change on the published results. At this level, we may cite as an example of changing accounting methods, the passage from a decreasing amortization of contributions to a linear amortization. Signal theory based on earnings

management is a financial communication tool as underlined by Zhen, Xie et Xu (2005). These researchers contradicted the prejudice according to which earnings management get investors mistaken and defend the thesis that information value of published results is enriched. In contrast to this thesis, other researchers support the idea that earnings management is an attempt to fool stakeholders. Christensen et al (1999) experiment in their turn the possibility of reducing information value of published results through interference of potential motivations of earnings management (Zimmerman 2007). More recent studies in the accounting field provided models in which these earnings management practices reveal a rational behavior. In this line of thinking, Hunt, Moyer and Shevlin (1995), Louis (2003) and Zhou (2003) support the idea of market value as positively related to reducing volatility of results through discretionary management. Likewise, Subramanyam (1996) indicates that information content of net earnings is superior to information content of non-discretionary results and cash-flow (Beyer 2009).

2-2. Audit Quality

DeAngelo (1981) defines audit quality as the market-assessed joint probability that a given auditor will both detect material misstatements in the client's financial statements and report the material misstatements. Therefore, according to DeAngelo's (1981) definition, audit quality is a function of the auditor's ability to detect material misstatements (technical capabilities) and reporting the errors (auditor independence). Palmrose (1988) defines audit quality in terms of level of assurance. Since the purpose of an audit is to provide assurance on financial statements, audit quality is the probability that financial statements contain no material misstatements. In fact, this definition uses the results of the audit, that is, reliability of audited financial statements to reflect audit quality. Palmrose's definition presents actual audit quality. Since actual audit quality is unobservable before and when an audit is performed, a valid proxy is needed when investigating the relationships between actual audit quality and other factors.

Based on the guidelines stated in ISQC 1, compliance with the standard is received as high audit quality. The aim of auditors, the financial statements, thus ensuring quality, accountability means being free from material as misstatement of the audited financial trumpet skills. In fact, this definition emphasizes the results of the audit, it means the audited financial skills forms reliability, and show high quality auditor does. This definition leads to the following question: "How do users rate the reliability of audited financial skills assessment forms?" This is based on the quality of audits performed because of the financial statements cannot be determined before the audit. Consequently, authentic quality audit focuses on defining Palmrose (Schauer, 2000).

Titam and Trueman (1986) has been defined Quality audit after audit the accuracy of the information that is available to investors, Palmrose definition similar to the definition of audit quality. Davidson & Neu (1993) define 'd' audit quality at the auditor's ability to detect and report the discovery of a material misstatement or manipulation done on the net know. However, Lam & Chang (1994) believe that the quality of audit services to be examined rather than to examine all, must be determined for each audit project singly.

Many other studies (Chung and Kallapur, 2003), and (Frankel et al., 2002), reporting bias can be used to infer and deduce the quality audit is used. Like the main parameters affecting the quality of the audit, they are both precautionary measure commitment. To complement these measures, (Chen et al, 2012) were used to guarantee the quality of the other two criteria.

On the other hand, the factors affecting the quality of audit services from the auditor's perspective, the general factors that affect the auditor's ability to detect a material misstatement in the financial or economic incentive to report a material misstatement of the discovery.

Some of this researches are tested the quality of the auditor decision and its impact on the effectiveness and efficiency of audit. Many of these studies did not test the quality of audit services directly, but the factors that have led to improvements in the quality of the auditor and audit service quality is the result. These factors mainly are including the experiences of auditors, audit supervision, specialization and fees. For example, Libby & Frederick (1986) found that the amount is more experienced auditors, and their understanding of existing distortions increases in the financial statements. Hence, the auditor concludes that increasing the quality of auditing experience can be improved.

King & Schwartz (1999) are analyzed the extent of Supervision of the audit as a quality indicator when Auditors under different legal regimes work. Their results demonstrated that the administration predicted the function of punitive legal actions against auditors. Benito Arrunada (2000) found that auditors audit with particular expertise in a specific industry; the two main reasons are the higher audit quality. First, more familiar with the issues and problems in the implementation of continuous auditing, accounting and auditing industries the incentive to earn and maintain a reputation audit specific group of industries.

Willenberg (1999) examined the relationship between audit quality and auditor's preliminary recommendations on remuneration and concludes that the quality of audit services is affected by the auditor's acceptance of the proposed fee. The pricing of audit services and the audit is conducted in Bangladesh. The

results based on firm size, audit risk and audit pricing of audit services are effective. (Karim 2010). The relationship was reviewed between audit fees and non-discretionary accruals for 8187 companies between 2000 and 2006. The results showed that the non-discretionary accruals and audit fees, there is a significant positive relationship. The audit fees are negatively associated with firm profitability. (Alali 2012)

2-3.The Relationship between Audit Quality and Earnings Management Items

Piot and Perra studied the strategic system, audit quality and financing costs in French stock market, examining the effects of corporate governance and audit quality on extra-organizational financing costs between 1999 and 2001. They concluded that corporate governance quality leads to reduced financing costs but the audit quality had no significant effect on financing costs (Piot, Perra 2003).

Lennox examined the relationship between audit quality and managerial ownership in UK stock market. The results indicated a negative association between the managerial ownership and audit quality (Lennox, 2005).

Pittman et al studied the relationship between ownership structure, agency issues and auditor selection among West-European firms. They found no relationship between centralized ownership structure and audit quality (Pittman, Lennox, Guedhami, Ghoul 2007).

Wang et al (2007) performed a study on governmental ownership, institutional environment and auditor selection among the firms enlisted in China stock market. They found that firms with governmental ownership selected smaller and lower-quality independent auditors compared to other firms (Wang, Wong, Xia 2007).

Ahmad and Mansour (2009) explored the relationship between directors' independence, ownership structure, audit quality and earnings smoothing in Malaysia stock market. They concluded that the existing unpaid directors in the board and the audit quality led to reduced earnings smoothing and improved earnings quality (Ahmed, 2001). Lin and Liu (2009) studied the effects of corporate governance structure on independent auditors' selection between 2001 and 2004 in China stock market. They found that firms with weaker corporate governances selected lower-quality auditors and gradually, as the corporate governance improves, they begin selecting higher-quality auditors (Lin, Liu 2009).

Chen et al. (2010) explored the effects of audit quality (AQ) on earnings management and financing costs in the 3310 firms enlisted in China stock market. Their results indicated that audit quality led to improved quality of financial information and limited the directors' use of accruals. They also demonstrated that audit quality led to reduced financing costs. Khoorna and Ramen, too, showed that audit quality leads to reduced financing costs (Chen, Chen, Wang 2010).

Azibi and Hubert (2010) conducted a research titled: "Auditor choice and institutional investor characteristics after the Enron scandal in the French context". Population included 144 firms between 2000 and 2007. They concluded that there was a negative association between institutional investment and audit quality (Azibi, Rajhi 2008).

2-4.The Impact of Earnings Management on Stock Return

Empirical studies on this topic can be classified into two categories detailed below. obvious that they upgrade evaluation of firm taking into account magnitude of detected manipulations. The initial studies focused on correlation studies which rely on the efficiency hypothesis of financial markets. This thesis assumes that stock value is the best estimator of the firm's real unobservable value. In this line of thinking, ability to reflect listed stock value will be considered as the parameter that validates all accounting data. To this end, a number of researchers determine degree of informativeness of an accounting result through its level of correlation with the real observed stock value. Subramanian (1996), by manipulating a sample in the US market, suggests to measure correlation between stock value and a triple measure of the result, i.e. declared net result, the result that could have been declared by the firm in the case of using a simple accounting method instead of a committed accounting procedure and finally the result which should have been declared without manipulation. The second measure relates to global treasury excess fixed as the objective of appreciating interest of a committed accounting method in its systematic type. It is about accounting or some types of products or costs which are affected by the result in the sense that the event which generated them relates to this result, even if these products or costs generated receivables or payments during previous fiscal years or during the coming fiscal years. The third measure of results is hard to track down. Observations that are made of aggregating amounts which are due to accounting manipulation, in a way to obtain a theoretical result equal to the result that could have been published if this latter was not manipulated. Manipulated amounts are determined according to the models which compare amounts object of manipulation with those similar published by firms of the same sector. McNichols (2000) and Randal, al (2003) assume that conceptions of these models and manipulated amounts should be of the same magnitude for all firms of the same sector. Then, any deviation from an average behavior of firms is seen to result in manipulations. Subramanian (1996) confirms this position indicating that net results are strongly

correlated with the firm's market prices more than the simple treasury excess. This argument favors accounting as practiced, since published result reflects better firm value more than result generated by a simple cash accounting. Subramanian's results support similarly the position that theoretical net result, which could have been published, outside manipulation is correlated with firm's market value less than the published result, supposed to be manipulated. Then, recourse to manipulation by managers is done through assimilating to the result the impact of some efficient events during firm evaluation. It provides then an accounting measure of the firm performance which is more consistent with the performance assessed by financial markets as if it is limited to an extremely rigid interpretation of accounting principle and rules. Subramanyam has shown indeed that manipulated amounts are positively correlated to the firm's market prices. The assumption is that manipulation represents an informational contribution compared to firm value. In this line of thinking, Janin (2000) obtained similar results while conducting studies on a sample of French firms, supporting further the thesis of an improvement in the information content of published accounting figures, by accounting manipulation practices. Subramanyam and Janin (2000) join on the basic assumption that a manipulated result reflects better firm potentials more than a non-manipulated result. However, the authors do not specify whether investors use effectively this information superiority or even whether they are aware of these manipulations. The second category of studies based on reaction study's methodology pointed to investors' attitudes towards manipulation. Dumontier (1999), Dumontier and Raffournier (2002) and Burgstahler, Leuz (2004) focused on rates movements affected by information to explain how investors react to publication of new information. Balsam et al. (2002) and Xie (2005) examined a sample of US firms considered to have manipulated their results, to the extent they correspond exactly to those expected by financial analysts. It is clear that reaching such agreements is not a stroke of luck. As for DeGeorge et al. (1999) and Koh (2003), they show in an extremely convincing manner that firms are able to provide results practically identical to those expected by investors, because a majority of them use to that end latitudes that accounting rules offer them. The study of Balsam et al (2002) aim at determining whether manipulations are the very incentives which led firms to publish results consistent with those expected. To this end, they first estimated the amounts manipulated. Then, they examine whether investors' reaction to this publication takes into account these manipulations. It seemed that investors react to this information as if the published results were not manipulated. This is not surprising knowing that at the moment of publication, detailed financial statements through which we can assess all eventual manipulation were not already available. Balsam and al (2002) and Burgstahler and al (2004) focused on the manner with which investors react at the moment of publication of these detailed financial statements. They note that manipulations which increased declared results are systematically associated to negative reactions of prices, whereas those which aimed to diminishing declared results are associated to positive reactions. It seems then that investors are aware of manipulations once they possess elements enabling them to detect such manipulations. It seems then.

The results that we mentioned are interesting in as much as they show that financial market is generally not naïve in terms of earnings management strategies. Nevertheless, they enable us to know whether these accounting manipulations have real information content. The study of Dumontier and Elleuch (2002) is rich with recommendations. It examines the French market with the aim of determining whether investors believe that results superior (or inferior) to those the firms could have published in the absence of any manipulation open up positive (or negative) opportunities. Similar to the study of Balsam et al (2002), the study of Dumontier and Elleuch (2002) shows that investors react to result publication as if this latter was not manipulated. Since they are short of elements allowing for detecting manipulations at that moment, Dumontier and Elleuch (2002) pointed to how investors react at the moment of publishing detailed financial statements. They note a positive correlation between manipulations and stock prices movements. This suggests on the one hand that investors are aware of manipulation, as they react accordingly. On the other hand, this suggests that investors consider manipulation as rather informative, as rates variations and manipulation direction are of the same signal. Indeed, a deeper analysis led them to assert that it is the downward manipulation of earnings which led to these rates movements, while upward manipulations were with no significant effect on rates. It seems then that although aware of accounting manipulations, investors do not change evaluation of the firm, when they perceive an upward manipulation tactic. However, they believe that downward manipulations signal that managers have rather pessimistic anticipations on the future of their firm. This leads them to diminish firm value.

3- Research purposes and hypotheses

The aim of this study is to evaluate the effect of audit quality adjustment on the relationship between earnings management and stock returns in listed companies in Tehran Stock Exchange. Other goals of this study are as follows:

- The study of Audit quality on relationship between earnings management and capital market yields
- The effect of management earning on stock returns for companies that are audited by valid audit firms compared to firms that audit firms are invalid.

Given the purpose of this study, hypothesis as follows:

Earnings management effects on stock returns for companies that audit with valid firms compared with companies that audit with invalid firms are more.

4-Variables of the study and how to measure

In this study, stock returns as dependent variable, earnings management as the independent variable and audit quality are as adjusting variable.

- **Earnings management**

As noted, the independent variables include the earnings management that has been extracted from balance sheet and Income Statement of the companies listed in Tehran Stock Exchange between 2009 to 2014 is calculated as follows:

To calculate the total profit (TAC) we use the following model:

$$TAC_t/TA_{t-1} = \alpha_1(1-TA_{t-1}) + \alpha_2(\Delta sales_t/TA_{t-1}) + \alpha_3(PPE_t/TA_{t-1})$$

TAC_t : obligations of the company in the period t

$TA_{(t-1)}$ total assets for the period t-1

$\Delta sales_t$: change in net sales company in period t

PPE_t : fixed assets of the company in period t

$\alpha_1, \alpha_2, \alpha_3$: characteristics (parameters) of the company in period t

Net profit is calculated by the following equation:

$$NDTAC_t = \alpha_1(1-TA_{t-1}) + \alpha_2(\Delta sales_t - \Delta REC_t) / TA_{t-1} + \alpha_3(PPE_t / TA_{t-1})$$

$NDTAC_t$: non-discretionary obligation firm in period t

$TA_{(t-1)}$: Total assets at period t-1,

$\Delta sales_t$: Change in net sales (sales) participate in period t,

ΔREC_t : Changes in the company's accounts receivable, net at period t

ΔPPE_t : fixed assets of participate in period t

$\alpha_1, \alpha_2, \alpha_3$: characteristics (parameters) of the company in period t

Net profit from the following model:

$$DA_t = TAC_t / TA_{t-1} - NDTAC_t$$

DA_t : unusual obligations or discretionary obligations, $TA_{(t-1)} / TAC_t$: total obligations in the period t,

$NDTAC_t$: non-discretionary obligations firm in period t

The dependent variable is as follows:

- **Abnormal stock returns:** abnormal stock returns originally the difference between actual output and potential output (predicted) that is calculated as follows:

$$AR_t = R_t - E(R_t)$$

AR_t : abnormal stock returns in period t, R_t : real return on stocks for the period t, $E(R_t)$: predicted stock returns in period t

- **The real return on stocks:** return on stocks real return that is actually happening in a particular period and the difference between the current and previous share price is called. The real return on stocks is measured by return on total shares in the total return of an investment.

$$R_t = (P_t - P_{t-1}) / P_{t-1}$$

R_t : the real return on stocks for the period t, P_t : the current share price, $P_{(t-1)}$: The previous share price.

Predicted stocks: predicted stocks market Returns using the model obtained. The model states that the best estimate to estimate the efficiency of a obligation to market index returns at that time. With this model no longer any need to estimate return on an estimate of the commitment, because the obligation is equal to the estimated Returns the market index returns.

$$CAR(t1, t2) = \sum AR_{t1, t2}$$

CAR : The cumulative stocks return, $t1, t2$: Distance observation (review) interruption (during) stock returns or retained earnings during the period t1 to t2, AR_t : Abnormal stocks Returns in period t

An replaced indicator for measuring the quality of the audit, the audit firm's size and is expected to increase audit quality by increasing the size of the audit firm, Because large audit firm should be more careful in their professional reputation (Mojtahedzadeh and Aghaei, 2004).

In this study, the size of the audit firm is a dummy variable If the company is taken by the Audit Organization examined the number one and zero otherwise be available (Yeganeh and Azinfar, 2010).

The control variables are as follows:

- **Debt ratio:** mdebt ratio shows the how much external debt to finance the company's operations and development uses.

$$\text{Debt to Asset ratio} = \text{Total liabilities} / \text{Total Aseet}$$

- **Total Liabilities:** Total liabilities at year t, Total Asset: total assets in year t
- **Company size:** Previous research indicates that company size may affect the ability to decide on the structure and performance of the company (Blvndrn 1993, Ramasvy 2003, Frank 2003). Therefore, in this study, the size of the company as a control variable to confirm the results and does not have any effect on results ; The logarithm of total assets, in order to control the effects of company size on the dependent variable is used rather than assumptions so the company's total assets size of the log is calculated.

5-Techniques and statistical methods used

Since this study sought to examine the effect of audit quality adjustment on the relationship between earnings management and stock returns in the company is listed in the Tehran Stock Exchange data are collected in Excel software and financial ratios of the company is calculated annually and is calculated each company's financial information. Then, using the SPSS statistical analysis software and using income rate response (ERC) and the level of communication between the main variables from the regression is calculated and Pearson correlation test was used to evaluate correlations.

According to the hypothesis of multivariate logistic regression model used in this study is as follows:

- **First model:**

$$AR = \beta_0 + \beta_1 (DA) + \beta_2 (LEV) + \beta_3 (SIZE) + \varepsilon$$

- **The second model:**

$$AR = \beta_0 + \beta_4 (DA) + \beta_5 (AUD) + \beta_6 (DCAUD) + \beta_7 (LEV) + \beta_8 (SIZE) + \varepsilon$$

Table 1 :Variable definition

Row	Symbol	Caption
1	AR	Returns stocks (abnormal stocks Returns accumulated) company I at time t (the dependent variable)
2	DA	Earnings management (discretionary obligations, discretionary accruals) of firm I in period t (independent variable)
3	LEV	Financial leverage (debt) firm i at time t (control variable)
4	SIZE	Size of the company I at time t (control variable)
5	AUD	Quality audit of company I at time t (dummy variable)
6	DCAUD	Interaction between audit quality and earnings management variables

The first model to test the effect of earnings management on stock returns, and the second model to test the effect of audit quality as a variable damper on the relationship between earnings management and stocks return on is used.

6-Data analysis method

The data collected using the proposed theoretical and software EXCEL and SPSS software have been analyzed. Statistical analysis using Pearson correlation coefficient between the Durbin Watson, tests F (Fisher) and T regression was used to examine significant. In this study, the level of significant is $\alpha=5\%$ defined that in this case would be 95%. These tests have been conducted for 45 companies based on the following assumptions.

Table 2: Descriptive tests

	DCAUD	SIZE	LEV	AUD	DA	AR
Mean	0.216	6.01	0.051	0.390	0.562	0.425
Median	0	5.91	0	0	0.588	2.23
Standard deviation	0.308	0.601	0.328	0.489	0.207	7.76
Maximum	0.96	7.80	3.270	0	0.96	32.99
Minimum	0	4.56	-0.63	1	-0.14	-28.72

7-The results of the Pearson correlation coefficient test:

In order to assess the relationship between the variables we use the correlation matrix according to the table the following results were obtained:

- There is a positive and significant relationship between stock returns and earnings management
- There is a positive correlation between stock returns and audit quality

- There is a positive correlation between stock returns and interaction of variable quality audit with earnings management.
- There is a significant negative relationship between stock returns and financial leverage.
- There is a positive correlation between stock returns and firm size.

Table 3: Correlation Matrix

Variables		AR	DA	AUD	DCAUD	LEV	SIZE
AR	Coefficient	1					
	Sig	0.0					
DA	Coefficient	0.375	1				
	Sig	0.0	0.0				
AUD	Coefficient	0.507	-0.339	1			
	Sig	0.0	0.0	0.0			
DCAUD	Coefficient	0.432	-0.209	0.837	1		
	Sig	0.0	0.0	0.0	0.0		
LEV	Coefficient	-0.031	0.094	0.096	0.093	1	
	Sig	0.641	0.166	0.157	0.172	0.0	
SIZE	Coefficient	0.438	-0.417	0.354	0.408	0.007	1
	Sig	0.0	0.0	0.0	0.0	0.912	0.0

According to the above table significant probability (Sig) is smaller than 0.05. So between stock returns and variable size, quality audit, Interaction between audit quality with earnings management variables and earning management are significant. Also because it is a significant level of financial leverage, which is equal to 0.641, is more than 0.05, so there is no significant relationship between stock returns and financial leverage.

8-Explanatory research model and hypothesis testing

According to purpose of this study examine the adjustment effect of audit quality on relationship between earnings management and stock returns; and with regard to the assumptions and variables studied in the same way they came earlier models of research in the following explanation.

- **First model**

$$AR = \beta_0 + \beta_1(DA) + \beta_2(LEV) + \beta_3(SIZE) + \varepsilon$$

- **Second model**

$$AR = \beta_0 + \beta_4(DA) + \beta_5(AUD) + \beta_6(DCAUD) + \beta_7(LEV) + \beta_8(SIZE) + \varepsilon$$

Table 4: Statistical results of first model test

AR Variables	coefficient	T test	significant	VIF
constant	-15.53	-3.66	0.0	-----
DA	-6.544	-3.60	0.0	1.22
LEV	-1.34	-1.34	0.34	1.01
SIZA	3.062	5.12	0.0	1.21
Adjusted R Squared		0.240	R Squared	0.229
Durbin Watson			1.97	
F test	22.25	Significant for F		0.0

According to the model table, a significant level of earnings management variables and company size is less than 0.05, As a result, the null hypothesis is rejected and which are concluded between independent variables and the dependent variable was a significant relationship exists. Also, the results obtained model coefficients and t-statistics if the sign is negative, a negative relationship, and if so, the type is positive. As be seen, a significant negative relationship between stock returns and earnings management and a significant positive correlation between stock returns and size of the company there. In this model the coefficient of determination is 0.240, which indicates how good model of the dependent variable explained by the independent variables. In this model, the Durbin Watson statistic shows the number 1.97, thus rejecting the null hypothesis and the assumption of independence against the remnants of the model will be accepted. If the F test significance level is less than 0.05, the null hypothesis is rejected, and concluded that the regression model is significant. Statistics obtained 22.25 a significance level of less than 0.05 in model 1, which shows the regression model is significant.

Table 5: Statistical test results of the second model

AR Variables	coefficient	T test	significant	VIF
constant	-13.59	-3.28	0.001	-----
DA	-4.12	-2.33	0.02	1.36
AUD	6.43	3.74	0.0	1.73
DCAUD	2.58	5.25	0.0	1.74
LEV	-1.99	-1.50	0.13	1.01
SIZA	2.21	3.42	0.0	1.41
Adjusted R Squared		0.343	R Squared	0.358
Durbin Watson			1.93	
F test	23.37	Significant for F		0.0

The criteria to determine the significance of the relationship between dependent and independent variables, obtained a significant level of the model. Based on the table in the model, the independent variables significant earnings management, size, quality audit and audit quality variable interaction with earnings management is lower than 0.05, then the null hypothesis is rejected and which are concluded between independent variables and there is a significant relationship between the dependent variable. As you see, between stock returns and firm size, quality audit and audit quality variable interaction with earnings management and a significant positive correlation between stock returns and earnings management is a significant negative relationship. Determining factor model for the dependent variable explained by the independent variables. Based on the table in the model to determine the coefficient of 0.358 shows that the model number indicates how well the dependent variable explained by the independent variables. Durbin Watson statistic shows the number 1.93. Statistics indicate that the correlation remains Durbin Watson model. This statistic is calculated as F or t test with significance level is, so empirically proven to be the number is 1.5 to 2.5 that is about 2, a good number. In this model, the camera Watson statistic shows the number 1.93, thus rejecting the null hypothesis and the assumption of independence against the remnants of the model will be accepted. Another test model, the F statistics. The test for a significant regression model is used.

If the F test significance level is less than 0.05, the null hypothesis is rejected, and concluded that the regression model is significant. Statistics obtained 23.37 a significance level of less than 0.05 in model 1, which shows the regression model is significant.

9-Interpret results

According to the results the company size variable has a direct correlation with stock returns. Thus is expected to increase the size of the company's stock returns will increase. While the variable earnings management has an inverse relationship with stock returns; so it is expected that the increase in it decreased in earnings management

In the second part the results showed that the variable company size, quality audit and interaction with earning management and quality audit have a direct correlation with stock returns. Thus is expected to whatever size, quality audit and interaction effect with earning management and quality audit variable is stock returns also increased profits.

10-Conclusion

Since the subject of audit quality and its improvement is one of the most important issues facing, there are many theories and studies in this field. Each of these studies were carried out inside and outside the country, mostly due to a variation in the impact on audit quality have been studied. In the present study together, these theories and studies in the field, the effect of audit quality adjustment on the relationship between earnings management and stock returns of companies listed on the stock exchange of the country was discussed. The results of this study showed the effect of earnings management on stock returns for firms that audit with valid firms compared to firms that audit with invalid firms, are more. The results of this study, economic theory and studies in this area confirm.

Summary the results of this study are as follows:

- There is a positive and significant relationship between stock returns and earnings management
- There is a positive correlation between stock returns and audit quality
- There is a positive correlation between stock returns and interaction of variable quality audit with earnings management.
- There is a significant negative relationship between stock returns and financial leverage.
- There is a positive correlation between stock returns and firm size.

11- Suggestions

11-1 Suggestions from study

Without a doubt, the quality of auditing and disclosure of information, the decisive factor in the economic future of developing countries and businesses will be developed. Thus, according to this strategy and management policies, business managers is necessary and important goals. In this regard, according to studies conducted in this regard, can be very effective in economic and administrative policy. Therefore, based on the findings of this study, the following are recommended:

- Shareholders (investors) for investment in an institution that has been auditing firm to pay attention
- Managers have limited resources to achieve the company's audit institution that they pay attention.

11-2 Suggestions for future studies

Due to the importance and the need for further study on the current study, the following topics are suggested for future studies:

- The effect of audit quality adjustment on the relationship between earnings management and company risk.
- Evaluating the audit quality and stock returns in various industries separately
- The effect of audit quality adjustment on the relationship between earnings management and profit corporation

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