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The Effect of the Changes in Board of Directors on the Relation Between Audit Fee and Financial Restatements

[1]Ebrahim Mehrabani, [1]Mohamad Reza Shoorvarzy and [2]Mohammad Karimi
[1]Department of Accounting, Faculty of Humanities, Neyshabur Branch,
Islamic Azad University, Neyshabur, Iran
[2]Department of Economics, Faculty of Humanities, Neyshabur Branch,
Islamic Azad University, Neyshabur, Iran

Abstract: According to the standard 6 of Iranian accounting standards when accounting procedure changes (if necessary), former comparative annual figures must be restated based on the new procedure. Also sometimes it is possible that published financial statements for one or several former periods include important errors in a way that a wrong image to be represented, then the reliability of such financial statements may be decreased. For correcting such errors it is necessary that financial statements for former year or years to be restated. The purpose of this study is examine the effect of the change in board of directors on the relation between audit fee and the restatement of financial reports for listed companies of Tehran stock exchange. The present study is a descriptive-applied one which is based on the periodical data of 136 companies listed in the TSE from 2009-2014. The multivariate regression is used for examination of the relation of each effective factor to audit fee and financial restatement. The findings state that there is a significant relation between the change in the board of directors' members and the restatement level of total asset at the 95% confidence level. Also it is appeared from the findings that change in board of board can't affect audit fee. The determination coefficient obtained for the above relation shows that independent variables can only explain a part of financial restatements and investors must consider other factors when are examining this matter.

Key words: Restatement of financial statements, change in board of directors, audit fee, independent variables, findings

INTRODUCTION

It is necessary for auditors, employers and also people who pursue policymaking and regulation in the audit profession to be familiar with the effective factors on audit fees (Nikbakht and Tanani, 2010). Auditors can offer a proper price for their services if they know such factors (Gist, 1992). The importance of this matter was recognized especially in recent years and after foundation of the Iranian Association of Certified Public Accountants (IACPA) because after IACPA there is an intense competition among auditors and the exclusive control of the audit market is broken up. The successful auditor in such conditions is that one who can offer the best estimation for audit fee according to the characteristics of under-audit company so that while audit quality is preserved its fee to be the least one (Nikbakht and Tnanani, 2010). Knowing such factors auditors can reach to reliable and uniform standards and through commitment of all auditors to them a definite order and coherence will dominate the fees. So audit profession will be protected more against commercial view-originated damages (Moosavi and Daroogheh, 2011). Audit offices found that it is necessary to introduce better services at lower costs because of intense competition in the audit market. Audit offices intend to optimize their fees and to give best offers aiming to compete with others based on advantages other than quality and different services. Therefore they can increase their income and preserve their customers in a competitive market. For this purpose it is worthy to be aware of factors which can affect audit fee. Identification of factors which have effect on audit fee also can help employers to understand benefits of such services better and to know why they are undergoing this fee. It is obvious that knowing this matter can lead to faster and easier audit and because employer takes part in the process the audit process may perform with higher quality (Gist, 1992). The modern professional market has undergone many developments. Globalization not only affected commerce but also other professionals. This

Corresponding Author: Ebrahim Mehrabani, Department of Accounting, Faculty of Humanities, Neyshabur Branch, Islamic Azad University, Neyshabur, Iran

means that demand for more precise results and lower cost is increased and we can't rely on traditional systems and methods anymore. During past years after increasing in the competition among audit offices this profession has undergone many developments. The increasing professional completion and economic pressures are factors that made employers more sensitive to the relation between audit services and audit fee (Hassas and Alavi, 2003). The cost of goods and services is a price which consumer is ready to pay for using them but this formula isn't practically effective in the countries without competitive market and in such countries the price is determined according to monopolies and minimum livelihood price (Khodadadi and Hajizadeh, 2011). At the present time determination of the minimum audit fee and price-decreasing by some audit offices are the controversial subjects among the related professionals. Identifying factors which have effect on audit fee we can develop proper policies for some problems in this professional field. It seems that the final goal is developing a model like Simunic (1980) Model by which audit fee to be determined in a proper way in Iran so that the fee to be a function of audit cost, working hours multiplied by service price rate and a risk which is considered by auditor for legal actions and the prospective possible losses of employer (Nikbakht and Tanani, 2010). The main justification by managers for using the annual adjustments is better representation of changes in operational environment and company's investor. This justification is in agreement with accounting standards, because such adjustment is allowed by them. According to the standard 6 of Iranian accounting standards when accounting procedure changes (if necessary) former comparative annual figures must be restated based on the new procedure. Also sometimes it is possible that published financial statements for one or several former periods include important errors in a way that a wrong image to be represented then the reliability of such financial statements may be decreased. For correcting such errors it is necessary that financial statements for former year or years to be restated. There aren't many studies about the effect of changes in board of directors on the relation between audit fee and restatement of financial statements but their findings show that restatement of financial reports is related with auditor's fee. Therefore the main question here is that whether the changes in board of directors are related with audit fee and restatement of financial statements or not?

The restatement of financial statements and audit fee are two matters which can absorb investors' attentions and the changes in board of directors can produce uncertainty among investors about lack of ability to provide reliable statements and doing proper audit by auditors. Therefore the present study seeks to find the effects of the changes in board of directors on the relation between audit fee and the restatement of financial statements.

Theoretical foundations

The restatement of financial statements: It is emphasized in a part of accounting standards that "the financial statements must include the comparative items of former period except in the cases that another practice to be allowed or necessitated by an accounting standard." And since it is necessitated that comparative figures to be stated and the procedure to be preserved from one period to another it is expected always that stated figure for any element of financial statements in financial reports of current period is equal with restated figure for same element in next year financial report but in some cases because of below causes such equality isn't existed. The disagreement between primary figures for items of financial statements and restated figures mainly is the result of one or several factors which can change accounting procedure, errors, revision of estimations by management and change in classification of items (Mohammad *et al*., 2013).

Accounting changes: Since, economic and social conditions and eventually the needs of financial report users are changing constantly it is necessary that the principles and methods of accounting to be changed for better conformity of under-audit business with new conditions. The accounting changes are about three matters) the change in accounting principles and methods (the change in accounting procedure) the change in accounting estimations the change in accounting personality of reporter department (Shabahang, 2013).

Accounting fee: The source of auditor's economic benefit is audit fee from employers. This fee is determined according to auditor's working time and is paid in proportion to work progress (Moosavi and Daroogheh, 2011).

Error correction: It is possible that some errors in past statements to be found in the current period. The source of these errors may be: Mathematical errors, wrong usage of accounting procedures, wrong interpretation of existing facts in the time of statement preparation or ignoring the facts, change from one accounting procedure to another one and fraud.

Literature review: Moutinho examined the relation between audit fee and company's performance. Their studied sample includes non-financial American companies between 2000 and 2008. They used the fixed effects model to study the relation between variables. The studied control variables in this study were size, leverage, sale growth and the expenses of research and development. Also they used the variables of corporate governance as control variable. Their findings state that the company's operational profit has a significant relation to audit expenses. In a research, Gopal *et al.* (2013) investigated about the hierarchical effect of profit management on increasing in the audit risk especially after Sarbanse-Oxley act. The researchers also in this paper investigated the effect of profit management on auditors turn implicitly. Their findings show that fee and turn of auditor have a positive and significant relation to the company's profit management. Aiming to answer the question that whether corporate governance does affect the restatement of financial reports or not, Zhizhong *et al.* (2011) performed a study on a sample includes 1147 companies in China in the period of 2005-2012. They used logistic regression to examine the relation between the synthetic variable of financial restatement with the structure of shareholders' and board of directors' rights and also the independence quality of auditors. According to the findings because of accounting errors the restatement of financial statements is related with the performance and this may be controlled by a strong internal governance for example by a board of directors which is consisted of high proportion of non-executive directors, an independent and effective auditing committee, external governance for example by main shareholders and a strong and independent auditing. Also according to the findings the effect of audit committee on the control of financial restatements is dependent on the effects of other corporate governance's factors. Khodamipoor studied the effects of financial restatements on corporate growth. This investigation studied the effect of financial restatements on the growth of the companies in the studied sample. For this purpose the data for 10 years (2003-2012) about listed companies in the Tehran stock exchange were studied annually by systematic omitting sampling method. The hypothesis test of the research was performed by multivariate regression model within combinative data. The findings shows that the companies which have restated their financial statements have a lower growth in compare with those companies that didn't so. And this lower growth led to lower potential beneficial investment by these companies and even investors may lose their confidence to the companies and then the companies' reputation may be ruined. Definitely in the time of correcting the errors of past periods or the change of accounting procedure, the comparative financial statements must be restated. The restatement of financial reports has a negative effect on the relevancy and reliability of date in such statements. However, restatement was common very much among stock exchange's listed companies during recent years. Abdoli examined the effect of auditor's characteristics on the financial restatement. The effect of auditor's characteristics including size of audit office, turn and the kind of auditor's declaration on the financial restatement for the listed companies are examined in this research. For this purpose 130 companies were selected and the hypotheses of research were tested by least squares regression analysis. The findings show that there is a negative and significant relation between the turn of auditor and size of audit office and mean of restated figures. Therefore turn and change of auditor can reduce the items which are restated in financial statements and increasing in employees and partners of audit office lead to decrease in restated items of financial statements. Although the declarations of auditor and the mean of restated figures have no significant relation.

The realm of the research: The realm of the research is the effect of changes in board of directors on the relation between audit fee and the restatement of financial statements. The time period of the research is a 6 years period from 2009-2014. The place realm is Tehran Stock Exchange.

The statistic society and sample: The studied statistic society was all listed companies in the Tehran Stock Exchange (TSE). And time limit of the research is 6 consecutive years from 2009-2014:

- These companies were selected from TSE because of below reasons
- Access to financial information of the listed companies in the TSE is easier
- More importantly some data are accessible as databases on CDs
- Since, financial data of the listed companies are under supervision, it seems that such data have more accuracy
- Since, accounting regulations and standards must be observed in the listed companies' financial statements, it seems that the data in such statements are more uniform and comparable

- In determination of the statistic society in the present study an omitting method is used for estimation of sample size and sampling, not a specific equation. In other words, those companies of the statistic society which had following conditions were selected and the rest were omitted
- They must be listed in the TSE from 2009-2014
- Their financial year must be ended on 19 March to be comparable about the items of their statements
- They must not be among investment, financial broking and monetary institutions
- The companies must have complete data for all financial statements including balance sheet, profit and loss statement

Therefore, the number of companies in the selected sample is 136 (it is possible that the companies with incomplete data to be omitted).

MATERIALS AND METHODS

The research's hypotheses and the model for hypothesis test: According to the research's questions, following hypotheses are developed:

First hypothesis: There is a significant relation between the change in board of directors' members and the level of total asset restatement.

Second hypothesis: There is a significant relation between the change in board of directors' members and audit fees. The following models are used to test the hypotheses: The first hypothesis is tested by following model:

$$\Delta \text{In Asset}_{it} = \alpha_0 + \alpha_1 \text{turnover}_{it} + \alpha_2 \text{groh}_{it} + \alpha_3 \text{size}_{it} + e_{it}$$

The second hypothesis is tested by following model:

$$\Delta \text{In Fee}_{it} = \alpha_0 + \alpha_1 \text{turnover}_{it} + \alpha_2 \text{growh}_{it} + a_3 \text{size}_{it} + e_{it}$$

The research method: The present study is an experimental and applied one. Using library method the theoretical foundations are collected in this research and then the needed data for the analysis of hypotheses and decision making about them for a 6 years period are collected about the TSE-listed companies' financial statements by examination method.

RESULTS AND DISCUSSION

The descriptive statistics of samples: Before examination of the research's hypotheses, the research's data must be examined quantitatively and by descriptive statistics. The descriptive statistics is used for data summarization and better understanding of the studied society. The central statistics for the research's variables are shown in the Table 1. These statistics include the central indices such as mean, standard deviation and other indices including minimum and maximum which we will discuss about them. According to the findings of Table 1 we can say that: the mean as the most important central parameter and the standard deviation as the most important dispersion parameter along with minimum and maximum indices were introduced in this Table. The mean indicates the balance point and the gravity center of data.

The standard deviation in statistics and probability is a kind of dispersion measurement for a distribution of probability or a random variable. The minimum and maximum of audit fee are 16.52356 and 22.71400 and the minimum and maximum of asset change in restatements are -364.097 and 86.91204 respectively.

The test of residual normality in the model: The hypothesis of the normality of error distribution is one of hypotheses in linear regression method. It is obvious that if this presumption isn't right then we can't use classical regression. Jarque Bera test is used to test the normality of error term. If the probability of statistics is >5%, then H_0 hypothesis about normality of errors distribution will be accepted. The findings of this examination are provided in Fig. 1. As can be seen the Jarque Bera Fig. 1 and its probability is 0.138 and, at 5% error level the distribution of terms is normal. H_0: Data distribution is normal H_1: Data distribution isn't normal.

Heteroscedasticity : According to another presumption of linear classical regression model the regression error terms of society must have equal variances. There are different tests including graphical and non-graphical ones to say whether variances of the model are constant or not. White test is used here for this purpose. The statistics of F and Lagrange Multiplier (LM) test are two statistics which are provided in this test. The amount of LM is computed through multiplying the determination coefficient R^2 by the number of observations. In both statistics if computed p-value is <5%, the H_0 about variance constancy of error term will be rejected and variance variability is happened. According to the findings related to F in Table 2, since computed p-value for both statistics are >5%, it must be said that the variance of error terms is constant and this means that the constancy hypothesis of variances isn't rejected (Table 3). H_0 = Variance constancy H_1 = Variance Inconstancy.

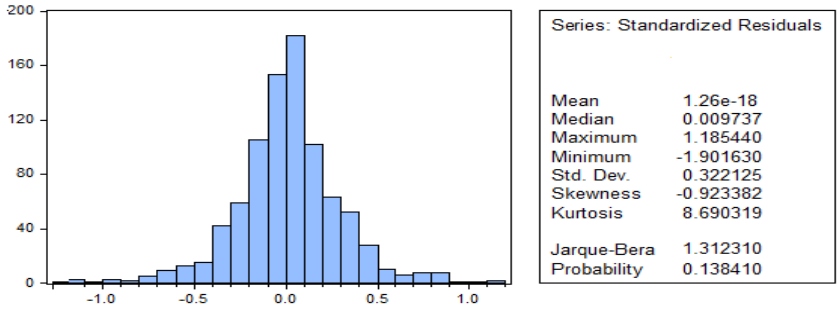

Fig. 1: Normality test for residual terms

Table 1: The Descriptive statistics of variables. For homogenization of variables their logarithms are computed

Variables	Mean	Median	Maximum	Minimum	SD	Skewness	Kurtosis	Observations No.
Audit fee	19.760410	19.703740	22.71400	16.52356	0.661789	0.224822	6.059483	816
Changes in restated assets	-0.292550	0.091124	86.91204	-364.09700	14.035170	-22.000900	565.5977	816
Company growth	1.768258	0.160064	1275.38100	-0.99887	44.671720	28.487590	812.6945	816
Company size	13.671220	13.520560	18.81726	10.50455	1.339703	0.995284	4.619696	816

Table 2: White test for determination of variance constancy in error terms

Statistic	Statistic	p-value	Result
F-value	6.874	0.899	Variance constancy for errors is observed

Table 3: Breusch bagan test for determination of variance constancy in error terms

Statistic	Statistic	p-value	Result
LM	48.542	0.584	Variance constancy for errors is observed

Table 4: Haderi test for determination of autocorrelation between error terms

Statistic	Statistic	p-value	Result
F-value	1.298	0.154	Lack of autocorrelation between error terms

Lack of autocorrelation: Lack of autocorrelation between error terms is one of classical regression model's basic assumptions. If autocorrelation to be ignored then the estimation of coefficients will be without constancy but ineffective and this can lead to wrong conclusions. There are different methods and tests to identify autocorrelation and here we used Haderi method. Hypothesis 0 in this test indicates the lack of autocorrelation. As it can be seen from the findings in the Table 4 and affirmation of H_0 we can conclude that this means lack of autocorrelation between error terms in the model.

Hypothesis testing: To test hypotheses at first we must see which method is better, Ordinary Least Squares (OLS) regression or the panel method of Fixed Effect Method (FEM) and Chowe test is used for making this decision. If OLS to be chosen the model fitting will be done by this method and if fixed effects method to be preferred then we must test it against random effects by Hausman test to define the proper panel model from these two models. To complete our choice for proper model when we preferred fixed or random effects model, we can use Fischer test to examine whether time or company have poolability in both models or not.

Table 5: F-test to choose between panel data or OLS methods

Variables	Values
F figure	186.851353
Freedom degree	135
p-value	0.0000

Table 6: Hausman test to choose between fixed and random effects panel model for first model

Statistic	Freedom degree	p-value
7.918008	3	0.5424

First hypothesis test: Chowe test for first model: this test defines that whether fixed effects model's determination coefficient is significantly more than regression model's determination coefficient or not. The related hypotheses and statistics are as follows:

- H_0: pooled model
- H_1: fixed effect model

All y-intercepts are equal (Mixed data). At least one y-intercept is different from others (panel data). The null hypothesis indicates that there is no difference between estimated coefficients for any single cross section and estimated collective coefficient. This means that there is no necessity to estimate the model by panel data.

The null hypothesis is rejected because p-value (Table 5) is <the 5% significance level and the null hypothesis is rejected. Therefore the fixed effects model is preferred to the least squares regression for fitting to data. After ensuring that the model must be fitted by panel data method, it is necessary that fixed panel model

Table 7: Coefficients of random effects model for the relation between the change in board of directors and the level of total assets restatements

Variables	Coefficient	SD	Statistic t	Significance level
Change in board of directors	0.2246	0.0449	5.0033	0.0000
Company growth	0.3231	0.4849	0.6663	0.5089
Company size	0.0732	0.0579	1.2653	0.2127
Fixed coefficient	-0.3648	0.1473	-2.4775	0.0173

F statistic = 13.57270; DWS = 2.322069; Determination coefficient = 23.80%; Significance level = 0.0000

Table 8: F-test to choose between panel data model and ordinary least squares

Items	Variables	Values
1	F statistic	330.852025
2	Freedom degree	135
3	p-value	0.0010

with random effects to be fitted to data and both models (fixed effects and random effects panel model) must be compared using Hausman test. Hausman tesr for first model: researcher use of this test for The Choose random data models in against fixed data. Hausman test's distribution is an asymptotic Chi-square and its freedom degrees are equal with the number of explanatory variables. The related hypotheses and statistic are as follows: H_0: Random effect. H_1: Fixed effect. As it is appered in Table 6, p-value for Hausman test is >5%, therefore it is concluded that random effects panel model is more proper than fixed effects panel model.

First hypothsis: There is a significant relation between the change in board of directors and the level of total assets restatements. H_0: No linear relation between two variables. H_0: $\alpha_1 = 0$ H_1: Linear relation between two variables. H_1: $\alpha_1 \neq 0$ First hypothesis is introduced to examine the relation between the change in board of directors and the level of total assets restatements. The first hypothesis test for regression is as follows.

The results of first hypothesis test are appeared in Table 7. The statistic of Durbin-Watson 2.32 is in the favorable range (1.5-2.5). Therefore autocorrelation between model's error terms is rejected. And Fischer statistic confirms that model fitting at 95% significance level is proper. Therefore the model fitting is performed accurately according to the results of F and Durbin-Watson tests. Also the determination coefficient as R^2 shows that model's variables can explain 23.8% of dependent variable's variations. And the probability of its significance level is 0.00 which is <0.05, then H_0 is rejected and at 95% significance level there is a relation between the changes in board of directors and the level of total asset restatement. And the study's first hypothesis is confirmed at 95% significance level.

Table 9: Hausman test to choose between fixed and random panel model for second model

Statistic	Freedom degree	p-value
7.887902	3	0.5405

Table 10: Coefficients of panel model with random effects for the relation between the changes in board of directors and audit fees

Variables	Coefficient	SD	t-statistic	Significance level
Change in board of directors	0.0252	0.0595	0.4237	0.6739
Company growth	-0.7087	0.2134	-3.3219	0.0019
Company size	0.6499	0.1003	6.4806	0.0000
Fixed coefficient	-0.1612	0.0351	-4.5939	0.0000

Durbin-Watson = 2.132252; F-statistic = 37.91775; Determination coefficient = 14.5%; Significance level = 0.00000

Second hypothesis test: Chowe test for second model: this test defines that whether fixed effects model's determination coefficient is significantly more than regression model's determination coefficient or not. The related hypotheses and statistic are as follows: H_0: pooled model. H_1: Fixed effect model. All y-intercepts are equal (Mixed data). At least a y-intercept is different from the rest (panel data). The null hypothesis indicates that there is no difference between the estimated coefficients for all cross sections and estimated collective coefficient. This means that there is no necessity to estimate the model by panel data.

Table 8 shows that p-value is <5% significance level and the null hypothesis is rejected. Therefore fixed effects panel model is preferred to the least square regression for fitting to data. After ensuring that the model must be fitted by panel data, it is necessary that fixed panel model with random effects to be fitted to data and these two models (random and fixed effects panel models) to be compared using Hausman test. Hausman test for second model: we use of this test for The choose random data models in against fixed data. Hausman test's distribution is asymptotic chi-square and its freedom degrees is equal with the number of explanatory variables. The related hypotheses and statistic are as follows: H_0: Random effect. H_1: Fixed effect. As it is appeared in Table 9, the p-value for Hausman test is >5%. Therefore random effects panel model is more proper than fixed effects model.

Second hypothesis: There is a significant relation between the change in board of directors' members and audit fees. H_0: No llinear relation between two variables H_0: $\propto_1=0$ H_1 There is a linear relation between two variables H_1: $\propto_1 \neq 0$ The second hypothesis is defined to examine the relation between the changes in board of directors and audit fees. The regression model to test second hypothesis is as follows:

$$\Delta \text{In Fee}_{it} = \alpha_0 + \alpha_1 \text{turnover}_{it} + \alpha_2 \text{growh}_{it} + a_3 \text{size}_{it} + e_{it}$$

The results from second hypothesis test are appeared in Table 10. The Durbin-Watson statistic 2.13 is within the favorable range (1.5-2.5). Therefore autocorrelation between the model's error terms is rejected. And the Fischer parameter confirms at 95% significance level that model fitting is proper, therefore according to the results from F and Durbin-Watson tests the model is fitted accurately. Also determination coefficient R^2 shows that the model's variables can explain 14.5% of the changes in dependent variable. And the probability of its significance level is equal with 0.6739 which is >0.05, therefore H_0 is not rejected at 95% significance level and there is not a significant relation between the change sin board of directors and audit fees. Accordingly the study's second hypothesis is not confirmed at 95% significance level (Yeganeh, 2005).

CONCLUSION

The studied statistic society in the present study includes the listed companies in Tehran stock exchange which have continuous activity from the beginning of 2009 to the end of 2014. The reasons for choosing this statistic society are data transparency, financial statement supervision and strong informative environment for the listed companies in TSE in comparison with other companies. The number of selected companies was 136 for this study and after collection and extraction of data from existing financial software at the next stage, the data of selected companies were entered in Excel and processed. And then the data were entered in Eviews to be tested by the study's tests. The data combination method is used to test the study's hypotheses. In this method the companies' data in different industries, for different years, were used simultaneously for estimation of models. The first hypothesis states that there is a significant relation between the changes in board of directors and the level of total assets restatement. The results from regression test show that the probability for its significance level is equal with 0.0000 which is <0.05, therefore H_0 is rejected and there is a significant relation between the changes in board of directors and the level of total assets restatement at 95% significance level. And first hypothesis is confirmed at 95% significance level. These results are similar to that of Jabari who studied about corporate governance and financial restatement in their study and their findings shown that there is only a significant positive relation between audit quality and financial restatement at 95% significance level. According to the second hypothesis, there is significant relation between the change in board of directors' members and audit fees. The results from regression show that the probability of its significance level is equal with 0.6739 which is >0.05, therefore H0 is not rejected and at 95% significance level there is not a significant relation between the changes in board of directors and the level of profit-loss restatement. Consequently the study's second hypothesis is not confirmed at 95% significance level. Also The study results against Gopal *et al.* (2013) showed that between audit fees and rotate them, there is a significant positive relationship. Since, there is no significant relation between the change sin board of directors and audit fee, for future studies, according to the present study it is recommended to audit organization and audit offices before making a contract that they must pay more attention to the level of changes in board of directors and the sum of audit fee. Also because the relation between the changes in board of directors and total assets restatement is significant, it is recommended that for a better audit and optimized use of financial reports by users such factors and their usage way to be considered more carefully.

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