



The Relationship between Normal and Abnormal Audit Fees and Financial Restatements

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Abstract

The present study aims to analyze the relationship between normal and abnormal audit fees on financial restatements.

This article benefits from an applied method, and the statistical method used includes a panel regression pattern. Five hypotheses are formulated and tested for this study. The study's statistical sample comprises 116 enlisted companies on the Tehran Stock Exchange from 2012-2016.

The results obtained from hypothesis testing show that the audit fees and audit fees shortage sensitivity significantly affect the Tehran Stock Exchange's financial restatements. Furthermore, these results suggest that abnormal audit fees, high-standard audit fees, compared with low-standard audit fees, and excessive audit fees sensitivity could not influence the financial restatements.

Keywords: financial restatements, normal audit fees, abnormal audit fees.

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1. Introduction

Managers of a business unit are responsible for supplying and disclosing financial statements, and auditors are obliged to credit such statements. One of the problematic issues for the financial statements' reliability is the annual adjustments and the resubmission of comparative figures of financial statements. Annual adjustments may occur for two main reasons, change of accounting policy and the error correction of the present or previous period. Such adjustments may indicate a weakness in the accounting system, financial reporting, internal control of the firm, and management effort to manipulate the income through the inappropriate use of accounting methods, intentional non-recognition of incomes and costs, or recognition of dummy incomes and costs. Moreover, annual adjustments may show the weakness or failure of the auditor in previous audits.

Restatements may warn the investors about the probable deterioration of the economic condition of the restatement firm (Palmrose, Richardson, and Scholz, 2004).

Financial restatements reflect some implicit signs about the non-reliability of the previous periods' financial statements and their low quality in the capital market. Consequently, this would lead to investors' change of expectations about future cash flows and their expected return rate. Financial restatements cause the decline of investors' trust in financial reporting and lower investment efficiency (Vivek and Myungsoo, 2013). In general, the users' response is negative to this issue. On the other hand, when a company restates its financial statements, it acknowledges a significant error or an inappropriate trend in the current or the previous period's financial statements. Accidental or intentional avoidance of restatement, related results, and financial restatements through which the previous periods' reported data would be improved are signs of low-quality accounting information, including reported audit in the previous years.

Some studies suggest that auditors' expulsion rate after financial restatements is more than its regular rate (Hennes et al., 2012).

Presently, the pricing of audit services is one of the auditing scholars' vogue words. Within the competitive markets, the range of audit fees is, to a great extent, indicative of audit attempts and legal risk. Hence, the higher the risk of manipulating data by the management, the higher the audit risk, and the expected audit fees (Latriadis and Kadorinis, 2009). Audit risk is the mutual effect of the inherent risk (derived from the firm's characteristics), control risk (related to internal control quality), and the risk of non-discovery (due to failure of auditing methods to discover significant errors). The range of inherent and control risk goes up due to income and costs manipulation based on the audit risk framework. Such an increase will influence the audit time budget, enhancing the audit fees (Desender et al., 2011).

According to professional standards of auditing, auditors are obliged to carry out the auditing project in order to sensibly make sure that financial statements are free of any significant distortion. For this purpose, auditors organize the nature, time, and the scope of auditing methods and after that, among other factors, determine the degree of significant distortion risk of financial reports by considering the business model of the firm and other related factors, like the inherent risk and lack of internal controls, to prevent, explore, or correct a significant distortion, namely the control risk (the supervisory board of public corporation accounting, 2010).

Auditors cannot control the inherent and internal control risks. The discovery risk is only a part of audit risk under the auditor's control, which is defined as a risk that cannot explore or modify any significant distortion using the auditing methods. Therefore, it is expected from companies with financial restatements to have more risks in their previous years and consequently to spend more time and more fundamental tests in order to alleviate the risk of discovery, increase the possibility of significant distortion discovery

by the auditors, and finally to enhance the audit costs (Messier et al., 2010).

Therefore, the study's main question is whether there is a relationship between auditor's fees and financial restatement.

2. Literature review and hypothesis development

From an investors point of view, financial restatements are not only sung of some performance problems within the previous periods, but it is a kind of future problem prediction for the firm and its management, which could cause the distrust of investors in the credit and qualification of the management and the reported earnings quality. Restatements are a type of public awareness and confirmation that the reported financial statements are not provided following the standard accounting principles and present the most obvious evidence about inappropriate accounting (Palmrose, Richardson, and Scholz, 2004). One of the implicit signs of financial restatement is that the previous periods' financial statements were unreliable and had a low quality in the capital market. Such deeds will change investors' expectations concerning the future cash flow their expected rate of return. Financial restatements can take down investors' trust in financial reporting and lower investment efficiency (Vivek and Myungsoo, 2013).

As mentioned earlier in the prior studies, financial restatements have dramatically decreased companies' average stock price. Hence, the exploration and improvement of any accounting error could lead to a transfer of inappropriate information about the firm to the capital market practitioners. Financial restatement reminds about the increase of the firms' information risk due to a lack of financial statement credit and low accounting quality. Further, a financial restatement may inform the investors of the possible deterioration of the economic status of the firm (Palmrose, Richardson, and Scholz, 2004).

An argument backing the issue is that restatement hurts the contractual relationship between the firm and parties outside, including customers, suppliers, etc., and has an adverse effect on the firm's cash flow. This means that restatement decreases the level of existing internal cash resources for investment. The other argument is that financial restatements could reduce the firm's ability to reach a lower external financial supply (Albring, Huang, and Pereira, 2013).

Independent auditors play a vital role in the credibility of financial statements and advocate investors' rights. Although the management of a business unit is responsible for supplying and presenting financial statements, the audited financial statements are the common byproduct of the employer and the auditor, so as claimed by Czerney et al. (2013), financial restatements could be a kind of auditing failure. According to current theoretical and experimental literature (e.g., Blankly et al., 2014; Files et al., 2014), financial restatements and the reflection of annual adjustments in the financial reports are constantly affected by several factors. Auditing characteristics, including auditor tenure, auditor size, audit industry specialization, and audit report delay, are among the factors that contribute to financial restatements and their recurrence by affecting the audit quality.

When firms restate their financial statements, investors reevaluate their imagination about those companies' financial information quality. The reaction of investors to such statements may be twofold. First, they may observe the report of restatements as modified and qualitative financial reports, in which the previous errors are improved, and second, it is logical to expect from such restatements to increase the financial asymmetry which is derived from the lack of management transparency, distrust in financial reports, and unclarified continuance of firm activity. Therefore, we expect a lower trust of investors in the management credibility and more investors' concerns that management takes opportunistic accounting decisions. Given the above-said factors, investors would be uncertain about the reality of the previous financial statements of the firm as much as they

are of the future ones. Hence, such unpredictability will consequently lead to market information asymmetry and cause a high uncertainty level. As a result of such an event, the proposed price of transactions will be surged by brokers or specialists to compensate for the risk of inappropriate selection. Different reasons proposed in the accounting literature related to financial restatements, among which Scholz (2008) claim that the main factors of restatement are the incomes (e.g., inappropriate or intriguing generation of income), costs (e.g., improper capital spending), and reclassification and disclosure (e.g., the classification of debt reimbursement as an investment) and Hribar and Jenkins (2004) believe that firms carry out financial restatements due to some issues, including income recognition, final price, operational costs, properties, and inventories. Moreover, the auditor may be one of the other factors of the restatement because providing audited financial statements by independent auditors is a useful tool for transferring reliable information. The auditor gives credit to the claims provided by another party in the form of financial statements to increase the reliability applied in the economic decisions. It is worth mentioning that principally the use of annual adjustment is not something disturbing, but being informed of the previous unfair financial statements is the issue that raises many concerns.

Within the past twenty years, the auditing profession has experienced a fast-paced and considerable advancement. The decline of auditing regulations allowed the audit firms to pursue the economic objectives more enthusiastically and seek more earnings and lower costs. In such circumstances, an auditor who can have the best estimation of his/her fees is more fortunate to maintain the project quality and perform that with the minimum cost.

The main objective of auditing is to give credit to financial reporting and make the users confident of the financial statements. At the same time, it is the audit fees that supply the economic interests of an auditor. The classic model of Simonic associates the audit fees with job-related descriptive variables, including the firm size and number of departments, and with risk-related descriptive variables, involving the leverage and financial losses (Khondkar et al., 2015). The firm complication is the other factor of the audit fees increase. When the scope of a firm's operation is wide and complicated, the demand for financial reporting supervision is higher. Firms with complicated operations require various audit services and, consequently, ask for higher audit fees.

Audit fees comprise any payment type for presenting audit services according to the contract or agreement with the auditor or an audit firm. The price of any service or goods is the cost the user will pay for. In reality, such a formula does not work in countries lacking a competitive economy, and the price is set based on the monopolies or minimum livelihood wage.

Abnormal audit fees is the difference between real audit fees (the fees paid for the auditing of financial statements) and the regular expected level of audit fees (Krishnan et al., 2008)

A positive abnormal audit fee reflects the range of reliance between auditor and employer. More dependency between these two by altering the auditor's independence will cause a lower-quality audit (Asthana and Boone, 2012). The abnormal audit fees could be defined based on the auditor and employer (Choi et al., 2010). As Kinney and Libby (2002) mentioned, abnormal audit fees, compared with the regular fees, could be paid more easily in the form of rents or economic briberies relative to audit services or the auditor's economic dependency employer.

The fees paid to the auditor are comprised of two discrete parts: first, costs related to auditors' efforts showing the risk of financial supply, which is called normal audit fees. The normal or expected audit fees are defined based on several factors, including the employer's scale, the employer's operation's complication, and the employer's special risk (Simunic, 1980). The second part, called the abnormal audit fees, could be set based

on the auditor and employer (Choi et al., 2010).

According to Gonzalez et al. (2015), the fees of audit firms is made up of three parts, first the natural costs of auditing (like the required audit policies, providing reports, and the cost of lost opportunities), second the expected costs (including, risk and potential costs derived from running the audit), and third, the profit of the audit firm. The employer hopes to reduce the reporting system's costs while the auditor looks for a plausible profit from the auditing process. Hence, the audit fees result from maximizing both parties' interests (Gonzalez et al., 2015).

Negative abnormal audit fees are the difference in the auditor's fees in proportion to the normal audit fees estimated through the audit fees model (Choi et al., 2010). From a different perspective, lawmakers are concerned about lower initial audit fees than the auditor's actual costs. In fact, in case the auditor is hopeful about the compensation of the initially incurred audit losses in the future, this may be due to his/her fear of losing the job and will cause the non-disclosure of some of the problem in the audit report, so this could lead to a low-quality audit and the weakness of the auditor's independence (Kacer and Wilson, 2016). Salehi et al. (2017) declared that there is a negative relationship between these two variables. The abnormal audit fees are lower during the periods before the occurrence or restatement (namely the upcoming fiscal year). Choy and Gul (2011) concluded that audit fees are increased in companies with more restatements. Mironiuc and Robu (2012) indicated that a lower payment level for audit services and a higher level of payment for non-audit services could enhance the risk of fraud in companies listed on the New York Stock Exchange. Fang et al. (2014) noticed that negative abnormal audit fees have a significant relationship with audit quality. Moreover, there is limited evidence suggesting that the auditor bears the earnings management when the abnormal audit fees are negative. Xinhua (2009) noted that abnormal audit fees could disturb the auditor's independence and consequently believed the firm data are less related to the stock price. The abnormal non-audit fees of the periods before SOX are not this type (Xinhua, 2009). Choi et al. (2010) revealed that negative abnormal audit fees (extra standard to real fees) have no significant relationship with the audit quality, while positive abnormal audit fees (extra real to standard fees) have a negative relationship with the audit quality. They concluded that positive abnormal audit fees could cause a loss of auditors' independence and lower audit quality. Choi et al. (2010) and Hribar et al. (2014) claimed a negative relationship between fee residuals and the audited items' financial reports' quality metrics. The payment-based findings of Choi et al. (2010) could be an organized motive for interrupting the audit market to limit the audit fees. In contrast, the payment-based interpretations of Hribar et al. (2014), based on the fact that the current market puts the auditors under pressure for more efforts relative to the quality of financial reports, is a driver to leave the organization of this area. Having sufficient information about the cost residual is vital to deal with the issue to realize whether the costs should be considered an option for the auditor costs or considered as unpredicted audit costs or none of them.

Within the competitive audit market and from the viewpoint of different individuals' competencies, the probable compilation of cost residuals could be considered a factor for explaining the costs proposed by fresh and experienced auditors (we herein call the approach the stability of cost residuals). Provided that the cost residuals are more than the unpredicted costs and related to both current and future audits, such costs will remain stable (in other words, they account for the upcoming year). For example, about one dollar will be set aside for each dollar of cost for ongoing and new obligations. In contrast, if the cost residuals are more than the fees the current and future auditors are seeking, such costs will remain stable in the ongoing obligations. Still, they will be omitted along with the auditor change process. Such a decline is the competition of new operators that, by gaining future payments, cause the auditors to pay back the excessive payments to the

clients (Kanodia and Mukherji, 1994). Broadly, in case the cost residuals are higher than the amount spent or the payments that are considered as out of the norm by the current auditors, they should be asked by the fresh auditors (in other words, such costs should not be shared with the new auditors or should not be available).

The results of Lifschutz et al. (2010) suggested that the independence of the board members and the competency of the audit committee have a significant relationship with the audit fees. Owusu-Ansah et al. (2010) noticed that the employer's size, the time spent for auditing, the firm size, and the employer's financial condition positively and significantly affect the audit fees. Griffin and Lont (2011) indicated that the audit fees have a significant relationship with some factors, including the type of audit report, auditor change, type of industry, current ratio, number of departments of the business unit, and the employer's size. Charles, Golver, and Sharp (2010) argue that choosing an auditor is a kind of economic decision and the employer purchases the audit services at a level of quality he/she expects at the lowest price from the buyer (auditor) and auditor change is a reaction to the change of amount and type of clients expectations. In addition, the compensation plans for managers contribute significantly to the risk of financial reporting and will increase as the risks of such plans go up (Kannan, Skantz, and Higgs, 2014).

Scherand and Zechman (2012) realized that due to managers' optimistic view and their reliance on the upcoming periods' profit, the risk of their wrong prediction is high. Therefore, if the auditor perceives such a personal characteristic of the managers and overestimates the risk of financial reporting, he/she would be able to ask for a higher payment. By doing so, he/she could complete the auditing operations to lower the risk of non-discovery of significant distortion. Audit fees are directly associated with the working hours of the auditors. In order to decrease the audit cost, the employer negotiates with the auditor about the auditing plans and the scope of the project (Ball, Jayaraman, and Shivakumar, 2012). Within a meta-analysis on the fees of non-audit services and the quality of financial reporting, Habib (2012) showed that the fees of specific non-audit services of the employer are associated with low-quality financial reporting. Such an approach shows the possibility of a positive relationship between audit fees of the year before declaring and the possibility of a future restatement. Moreover, negative audit fees are along with future restatements. Lobo and Zhao (2013) evaluated the relationship between the auditor's characteristics and the range of financial restatements in terms of modified errors. They found out a negative relationship between the auditor's range fees and the amount of error modification. Zhang (2017) showed that the abnormal audit fees reflect the economic tie between the auditor and the firm, which hurts auditor independence and, consequently, the audit quality. Negative audit fees indicate the firms' bargaining power. Such fees could lower the auditing efforts, control the audit costs to achieve a certain profit objective, and decrease the audit quality. Wan Mohammad et al. (2018) analyzed the effect of audit committee characteristics on financial restatements. Such characteristics, including size, independence, experience, and activity, could significantly account for the financial restatements.

Given the theoretical principles and the literature review, the following hypotheses are proposed:

H₁: There is a relationship between audit fees and financial restatements.

H₂: There is a relationship between abnormal audit fees and financial restatements.

H₃: There is a relationship between high-standard audit fees in proportion to low-standard audit fees and financial restatement.

H₄: There is a relationship between excessive audit fees sensitivity and financial restatements.

H₅: There is a relationship between audit fees, shortage sensitivity, and financial restatements.

3. Research Methodology

The study is practical, in terms of objective, and is concerned about the effect of the auditor's characteristics on financial restatements. Data related to research variables are gathered by studying financial statements in CDs provided by the Tehran Stock Exchange, research management websites, and Islamic research and development of Securities and Exchange. They were entered into the Excel Software and finally analyzed using the R Software.

3.1. Statistical population and sample

The present paper's statistical population includes all listed companies on the Tehran Stock Exchange during 2012-2016. The systematic elimination method is used for sample selection, such that among all existed companies, those that lack the following qualifications will be omitted and the remaining with being selected as the sample of the study:

1. Should be accepted in Tehran Stock Exchange till the end of 2011;
 2. Companies should not have changed their financial yearend and experienced no operational lag during 2012-2016.
 3. Their notes should be available in the Stock and Securities.
 4. Should be affiliated with investment companies, banks, and financial intermediaries.
- A total of 116 companies was selected as the sample of the study by considering the above conditions.

3.2. Hypothesis testing model

The following regression model is used for hypothesis testing:

$$\begin{aligned}
 RES_{it} = & \beta_0 + \beta_1 SFee_{it} + \beta_2 ABFREE_{it} + \beta_3 HAFEE_{it} + \beta_4 PAFEE_{it} + \\
 & \beta_5 NAFEE_{it} + \beta_6 AC_{it} + \beta_7 Dsimiss_{it} + \beta_8 MF_{it} + \beta_9 MW_{it} + \beta_{10} OOR_{it} + \\
 & \beta_{11} INDAC_{it} + \beta_{12} Z_{it} + \beta_{13} LEV_{it} + \beta_{14} Size_{it} + \beta_{15} Loss_{it} + \beta_{16} ROOT_SEGS_{it} + \\
 & \beta_{17} FOREIGN_SALES_{it} + \beta_{18} AGE_{it} + \beta_{19} GROWTH_{it} + \beta_{20} ACQUISITION_{it} + \\
 & \beta_{21} BIG1_{it} + \beta_{22} ROA_{it} + \beta_{23} CASH_{it} + \beta_{24} GC_{it} + \beta_{25} INVERC_{it} + \beta_{26} TENURE_{it} + \\
 & \beta_{27} INST_OWNERSHIP_{it} + \beta_{28} MGMT_CHANGE_{it} + \varepsilon_{it}
 \end{aligned}$$

(Equation 1)

3.3. Variables

3.3.1. Dependent variable

Financial restatement (RES_{it}) is the dependent variable of the study, which is a virtual variable. In case financial restatement occurs, we will assign 1; otherwise, it would be 0.

3.3.2. Independent variables

Normal audit fees ($SFee_{it}$): is the natural logarithm of the amount of real audit fees paid to an auditor, which is extracted from financial statement notes in the department of general, office, and sales costs.

Abnormal audit fees ($ABFREE_{it}$): in this paper, the auditor's abnormal audit fees are estimated through the auditor's normal audit fees model's regression residuals.

$$\begin{aligned}
 lnfee = & \beta_0 + \beta_1 lnTA + \beta_2 ROA + \beta_3 LEVE + \beta_4 TEN + \beta_5 AUD SIZE + \\
 & \beta_6 INVERC + \beta_7 ISSUE + \beta_8 LOSS + \beta_9 LIQUID + \beta_{10} CHG SAL + \varepsilon
 \end{aligned}$$

(Equation 2)

LNfees: the natural logarithm of the fees paid to the auditor, LN_{TA}: the natural logarithm of total assets, ROA: return on assets, which is calculated through net profit divided by the total assets, EV: is the financial leverage achieved through total debts

divided by total assets, TEN: the continuity of auditor selection, if the auditors is changed during the years under study, we will assign 0, otherwise, it would be 1, AUD SIZE: the firm size is a virtual variable that in case the firm is monitored by the audit organization, we will assign 1, otherwise, it would be 0, INVREC: inventories, accounts, and documents receivable ratio to total assets, ISSUE: is a dual variable that in case of issuance of stock and bonds in the current year, it would be 1, otherwise it is 0, LOSS: is a virtual variable that in case the firm experienced a loss within the year under study, we will assign 1, otherwise it would be 0, LIQUID: current ratio, which is achieved by dividing current assets into current debts, CHG SALE: change in sales of the current year in proportion to the previous year, ε : the residual of the regression model indicating the abnormal audit fees.

HAFEE it: high-standard audit fees, such that if the abnormal fees are positive, we will assign 1; otherwise, it would be 0.

PAFEE it: excessive audit fees sensitivity, such that if the abnormal audit fees are negative, we will assign 1; otherwise, it would be 0.

NAFEE: audit fees shortage sensitivity, such that if the abnormal fees are positive, we will assign 1; otherwise, it would be 0.

3.3.3 Control variables

Buying the auditor's opinion (OOR it): the significance of internal control is a variable that, if realized as significant by the auditor, would be 1; otherwise, it is 0. If the firm decreases the significance of its internal control weakness, and we have no auditor change, the variable of buying an auditor's opinion would be 1; otherwise, it is 0.

Financial expertise of the audit committee (AC it): knowledgeable audit committee members in finance or accounting ratio to total audit committee members.

Audit committee effort (MF it): the number of sessions held by the audit committee during a year.

Internal control weakness (MW it): significant weaknesses of the internal control achieved from independent auditors' report. Since only significant weaknesses of internal controls of the firm are presented in the audit reports as a condition paragraph and all weaknesses mentioned by the auditor previously in the management letter are ignored, in this study, only those condition paragraphs are proposed that are related to internal control weaknesses as significant weaknesses of the internal control. The number of significant internal control weaknesses in an audit report of listed companies on the Tehran Stock Exchange is extracted during the study. Hence, by significant internal weaknesses in this paper, we mean those weaknesses mentioned by the auditor in the report. Such weaknesses are usually minimized during the year and remain stubborn in some cases. For example, the accounts receivable's weaknesses, inventory, assets, and taxes are among those items related to the board's decisions. They are not available at the level of company accounts or even the company itself.

$$\begin{aligned}
 MV_{it} = & \beta_0 + \beta_1 MV_{it-1} + \beta_2 DISMISS_{it} + \beta_3 LnTA_{it} + \beta_4 Age_{it} + \beta_5 Foreign - \\
 & sales_{it} + \beta_6 RootESEG_{it} + \beta_7 BIG1_{it} + \beta_8 Loss_{it} + \beta_9 INST_OWNERSHIP_{it} + \\
 & \beta_{10} MGMT_Change_{it} + \beta_{11} Z_{it} + \beta_{12} growth_{it} + \beta_{13} DISMISS_{it} * MV_{it-1} + \beta_{14} \\
 & LnTA_{it} * DISMISS_{it} + \beta_{15} AGE_{it} * DISMISS_{it} + \beta_{16} Foreign - sales_{it} * DISMISS_{it} + \beta_{17} \\
 & RootESEG_{it} * DISMISS_{it} + \beta_{18} Big_{it} * DISMISS_{it} + \beta_{19} Loss_{it} * DISMISS_{it} + \beta_{20} \\
 & INST_OWNERSHIP_{it} * DISMISS_{it} + \beta_{21} MGMT_Change_{it} * DISMISS_{it} + \beta_{22} Z_{it} * \\
 & DISMISS_{it} + \beta_{23} growth_{it} * DISMISS_{it} + \varepsilon_{it} \quad \text{(Equation)}
 \end{aligned}$$

3)

MW t: is an artificial variable that in case a significant internal control weakness is reported by the auditor is would be 1, otherwise, it is 0, MW t-1: is an artificial variable that a significant internal control weakness is reported by the auditor for the year t-1, it would be 1, otherwise, it is 0, Auditor change (Ddismiss it): is a virtual variable and in case the change of auditor is occurred it is 1, otherwise, it would be 0, LnTA it: is the natural logarithm of total assets of the firm, age it: is the firm age, Foreign-Sales it: the foreign sales and in case the firm has an export, it is 1, otherwise, it would be 0, Big1 it: is the auditor size that in case the auditor is a company affiliated with the audit organization and grade 1 institutions, it is 1, otherwise it would be 0, loss it: is a virtual variable for the loss that in case the company has some losses, it is 1, otherwise it would be 0, INST-OWNERSHIP: is the institutional ownership of the stock which is achieved by dividing the shares of institutional shareholders (bank, insurance, etc.) into total shares published, MGMT-Change it: is a virtual variable that if a member of the board is change, it would be 1, otherwise, it is 0, Z it: the possibility of bankruptcy which is explained in the following, Growth it: is the sales growth.

Auditor change (Dismiss it): is a virtual variable that is 1 in case of auditor change; otherwise, it would be 0.

Audit committee independence (INDAC it): the number of audit committee members not affiliated with the board of directors.

Chance of bankruptcy (z it): the chance of bankruptcy of the firm is calculated using the Z Altman Score as follows:

$$Z = (\text{total debt/book value of equity}) + 1.05 (\text{total assets/profits before tax and interest}) + 6.72 (\text{total assets/ accumulated profit}) + 3.26 (\text{total assets/working capital}) - 6.5$$

Leverage ratio (LEV it): is calculated by total debts divided by the total assets.

Firm size (SIZE it): the natural logarithm of total sales.

(LOSS it): is a variable indicating that if the net profit is negative, it is 1; otherwise, it would be 0.

(ROOT_SEGS it): the square root of the number of commercial and geographical departments.

(FOREIGN_SALES it): is a variable indicating that if the firm has a foreign sale, it is 1; otherwise, it would be 0.

Firm age (AGE it): the natural logarithm of the number of years, for the first time, the company's name is listed on the Stock Exchange.

(GROWTH it): the rate of net sales growth.

(ACQUISITION it): if the firm is engaged in integration activities, and it is done, it is 1; otherwise, it would be 0.

(BIG 1 it): the auditor's size that if the size of the firm auditor is the audit organization and grade1 institutions, it is 1; otherwise, it would be 0.

(ROA it): return on assets of the shareholders.

(CASH it): total cash and its equivalent ratio (short-term investment) to book value of total assets.

(GC it): if the firm auditor received t-1 for the firm activity's continuity in his/her audit report, it is 1; otherwise, it would be 0.

(INVREC it): inventory plus receivables on a scale of total assets.

(TENURE it): the subsequent number of years of auditor-employer relation is the beginning of the year with the maximum value of 10 years.

(INST_OWNERSHIP it): the percentage of institutional owners.

(MGMT_Change it): is a virtual variable that if one of the board members is changed, it is 1; otherwise, it would be 0.

4. Findings

4.1. Descriptive statistics

Tables 1 and 2 illustrate the descriptive statistics of the research variables.

Table 1: the descriptive statistics of the quantitative variables of the study

Variable	Min.	Max.	Mean	Standard deviation
Tenure	1.0000	7.0000	2.66	1.580
The number of commercial and geographical depts.	0.0000	72.0000	2.04	7087
Audit committee effort	0.0000	12.0000	3.73	5.291
Audit committee independence	0.0000	1.0000	0.1411	0.2144
Audit committee financial expertise	0.0000	1.0000	0.2883	0.3977
The net sales growth rate	-1.7006	0.7321	0.7162	0.3147
Current ratio	0.2226	-0.9564	1.3380	0.6905
Financial leverage	0.1470	1.5673	0.6390	0.2019
Natural logarithm of total assets	22.815	32.7517	27.7294	1.3007
Natural logarithm of total sales	3.865	8.2239	6.0427	0.5649
Firm age	2.079	3.8918	2.8912	0.3424
Cash	0.001	0.4791	0.0564	0.0672
Total inventory and receivables	0.00001	0.9207	0.5033	0.1881
Natural logarithm of the paid audit fees	18.488	22.9388	20.5391	0.7161
Return on assets	-0.7896	0.6216	0.0974	0.1343
Percentage of institutional ownership	0.0000	0.9826	0.4137	0.3336
Chance of bankruptcy	-8.6795	14.2751	2.7294	3.1013
Internal control weakness	-2.6549	5.8301	0.6454	1.3371
Abnormal audit fees	-1.9627	1.7878	0.0000	0.6486
High-standard audit fees	0.0000	1.7878	0.2572	0.3880
Audit fees shortage sensitivity	-1.9623	0.0000	-0.2572	0.3709

4.2. Inferential statistics

In this paper, the variable of abnormal audit fees is achieved via the regression model No. 2, estimated as panel data models.

In the following, we report the type of regression model recognition tests, including F-Limer and Hausman tests, which direct the scholar for selecting the type of regression model. The F-Limer test shows whether the model is a panel or not, and the Hausman test specifies whether the model is random or fixed.

Table 2: The descriptive statistics of qualitative variables of the study

Qualitative variable	Value	Frequency	Frequency percentage
Internal control weakness	0	223	38.4%
	1	327	61.6%
Restatement	0	290	50%
	1	290	50%
Buying the auditing opinion	0	173	29.8%
	1	407	70.2%
Export	0	161	27.8%
	1	419	72.2%
Loss	0	503	86.7%
	1	77	13.3%
Issuance of stocks and bonds	0	418	76.7%
	1	454	23.3%
The board change	0	471	81.2%
	1	109	18.8%

Continuity	0	474	81.7%
	1	106	18.3%
Auditor change	0	403	69.5%
	1	177	30.5%
Auditor size	0	401	69.1%
	1	179	30.9%
Firm achievement	0	584	94.5%
	1	32	5.5%
High-standard audit fees	0	298	51.4%
	1	282	48.6%

Table 3: the results of regression model recognition tests

Test	Statistic value	Degree of freedom	P-value	Result (appropriate mode)
F-Limer	10.745	(115.454)	<0.001	Panel data model
Hausman	40.11	10	<0.001	Fixed effects model

In the F-Limer test, if the P-value is less than 0.05, the selected method would be the panel data model; otherwise, the integrated data method (regular regression) is suitable. Based on the above tables' results, the F statistic's P-value in the model is less than 0.05, so the model should be fitted based on a panel regression model. In the Hausman test, if the P-value is less than 0.05, the fixed-effect model is appropriate; otherwise, the random-effects model should be set. Given the Hausman test results, we can observe that the above model's respective significance is less than 0.05, so the fixed effects model should be fitted.

4.3. Breusch-Pagan test (test of integrability)

In order to test the model of integrated data against the random effects, the test of integrability is used, the H0 of which indicates that the integrability of temporal and spatial effects is possible.

Table 4: The results of the Breusch-Pagan test

Test of integrability	Test statistic	P-value	Test result
Time effects	80.315	<0.001	Time effects cannot be integrated

Given the table results, if the test's P-value is less than 0.05, the H0 is rejected, meaning that the integrability is not possible. As shown in the table, the P-value is less than 0.05, so the integrability of spatial effects is not possible in the model; consequently, the panel with fixed effects is an appropriate model for estimating the coefficients.

4.4. Breusch-Godfrey test (evaluating the autocorrelation of the model errors)

One of the panel models' major principles is to have no serial autocorrelation among the model errors. The Breusch-Godfrey test is used for this purpose, the H0 of which indicates no serial autocorrelation among the model errors.

Table 5: The results serial autocorrelation analysis among the model errors

test	chi-squared statistic	Degree of freedom	P-value	Test result
Breusch-Godfrey	85.354	5	<0.001	Serial autocorrelation is reported

Given the results, there is a serial autocorrelation between the panel model's errors and fixed effects. The adjusted model of the panel model with a fixed effect should be used for this purpose. Thus, the model is used for estimating the coefficients, the results of

which are as follows:

Table 6: The results of the model fitting of abnormal audit fees

Dependent variable: paid audit fees				
Model fitting method: panel regression of adjusted fixed effects				
Variable	Parameter estimation	Standard deviation	T statistic value	P-value
Intercept	10.8178	0.9682	11.173	0.001
Natural logarithm of total assets	0.3417	0.0336	10.165	0.001
Return on assets	-0.5301	0.2336	-2.269	0.0233
Financial leverage	0.0658	0.1871	0.352	0.7252
Tenure	0.0436	0.0369	1.182	0.2372
Auditor size	-0.036	0.0585	-0.615	0.5387
Total inventory and receivables	0.2136	0.1622	1.317	0.188
Stock issuance	-0.0076	0.0404	-0.19	0.8494
Loss	-0.0814	0.0676	-1.204	0.2285
Current ratio	0.0567	0.0409	1.385	0.1662
Net sales growth rate	-0.0834	0.0600	-1.39	0.1644

By replacing the β values in model No. 2, the residuals or the abnormal audit fees are calculated.

By fitting model No. 3, we will achieve the internal control weakness variable. This model is fitted to data using the logistic panel method. Then we compare the models of time effects simple logistic, panel model of integrated data, and random effects panel model using the Akaike criterion. The model with less Akaike criterion is more suited for data fitting and accepted as the final model. The results of the model can be shown in the following table.

Table 7: Akaike values of the four models

Random effects panel	Integrated panel data	Time effects simple logistic	Simple logistic
926.674	672.926	178.668	926.672

As shown in the table, the time effects simple logistic model has less Akaike value, so it is the appropriate data fitting model. The results of the fitting of the time effects simple logistic regression model are presented in Table 8.

Table 8: The results of the fitting of internal control weakness model

Dependent variable: internal control weakness				
Model fitting method: time effects simple logistic				
Variable	Parameter estimation	Standard deviation	Z statistic value	P-value
intercept	-3.9483	2.1327	-1.851	0.0641
Internal control weakness	2.0744	0.2496	8.308	0.001
Auditor change	1.5829	3.6026	0.439	0.6603
Natural logarithm of total assets	0.4523	0.2998	1.508	0.1314
Firm age	0.1644	0.3718	0.442	0.6582
Export	0.5918	0.2836	2.087	0.0369
The number of commercial and geographical depts.	0.0327	0.0388	0.843	0.3990

Auditor size	0.1005	0.2739	0.367	0.7136
Loss	1.2322	0.4855	2.538	0.0111
Percentage of institutional owners	0.1666	0.3890	0.428	0.6684
The board change	-0.2662	0.3117	-0.854	0.3930
Chance of bankruptcy	-0.0199	0.0469	-0.427	0.6693
Net sales growth rate	-0.4121	0.5339	-0.772	0.4402
2012	-0.7141	0.3484	-2.05	0.0404
2013	-0.5597	0.3383	-1.654	0.0981
2014	-0.5775	0.3404	-1.697	0.0897
2015	-1.4258	0.4082	-3.493	0.0005
Mutual effect of internal control weakness and auditor change	-0.4269	0.4476	-0.954	0.3402
Mutual effect of firm size and auditor change	-0.2393	0.5047	-0.474	0.6354
Mutual effect of firm age and auditor change	0.5509	0.6312	0.873	0.3827
Mutual effect of firm export and auditor change	-1.5242	0.5118	-2.978	0.0029
Mutual effect of the number of commercial and geographical depts. And auditor change	0.0635	0.1196	0.531	0.5956
Mutual effect of auditor size and auditor change	0.1367	0.5634	0.243	0.8082
Mutual effect of loss and auditor change	-1.5467	0.8369	-1.848	0.0645
Mutual effect of institutional ownership and auditor change	0.6957	0.6772	1.027	0.3043
Mutual effect of the board change and auditor change	-0.3652	0.5746	-0.636	0.5250
Mutual effect of the chance of bankruptcy and auditor change	-0.0851	0.0856	-0.994	0.3201
Mutual effect of firm growth and auditor change	-0.5474	0.8204	-0.667	0.5046

By replacing the β values in model No. 3, the residuals or the internal control weakness is calculated.

5. Results of the Research Model

After calculating the variables of abnormal audit fees and internal control weaknesses, we now talk about the study's main model. The model is fitted using the logistic panel method then compares the simple logistic models, the simple logistic model with time effect, integrated panel data, and the random effects panel model using the Akaike Criterion. The model with less Akaike Criterion is more appropriate for data fitting and accepted as the final model. Table 9 indicates the results of the model.

Table 9: Akaike values of the four models

Random effects panel	Integrated panel data	Time effects simple logistic	Simple logistic
782.774	793.953	751.518	793.953

As can be seen in the table, the simple logistic model with time effects benefits from the fewer Akaike values, so it is suitable for data fitting. Table 10 illustrates the fitting results of a simple logistic regression model with time effects.

Given the obtained results, we can see that $-p$ is a value related to the variable of audit fees, which is lower than 0.05 error, so the variable has a significant effect on the variable of financial restatements. The first hypothesis is accepted.

Given the obtained results, we can see that $-p$ is a value related to the variable of abnormal audit fees, which is lower than the 0.05 error, so the variable has a significant effect on the variable of financial restatements. The second hypothesis is accepted.

Given the obtained results, we can see that $-p$ is a value related to the variable of high-standard audit fees in proportion to low-standard audit fees, which is more than 0.05 error, so the variable has no significant effect on the variable of financial restatements and the third hypothesis is rejected.

Given the obtained results, we can see that $-p$ is a value related to excessive audit fees sensitivity, which is more than 0.05 error. The variable has no significant effect on financial restatements, and the fourth hypothesis is rejected.

Given the obtained results, we can see that $-p$ is a value related to the variable audit fees shortage sensitivity, which is less than 0.05 error. The variable has a significant effect on the variable of financial restatements, and the fifth hypothesis is rejected.

6. Conclusion

Financial restatements bring some fresh data to the capital market. From the investors' point of view, any news related to financial restatements is not merely indicative of the previous period's problems but also predicts its future problems and management. This will cause investors' distrust in the management's credit and competency and lower the quality of reported profits. The financial statement users count the restatements as a disadvantage, and shareholders are more willing to fire the auditor after such an event.

Table 10: The fitting results of the model using the simple logistic model with time effects

Dependent variable: financial restatements				
Model fitting method: time effect logistic regression				
Variable	Parameter estimation	Standard deviation	Z statistic value	P-value
Intercept	-2.3254	2.102	-1.106	0.2687
Audit fees paid	0.4481	0.1635	2.74	0.0061
Abnormal audit fees	-0.5425	0.2632	-2.061	0.0363
High-standard audit fees	0.2608	0.2992	0.871	0.3835
Excessive audit fees sensitivity	-0.3459	0.3715	-0.931	0.3518
Shortage audit fees sensitivity	-0.6806	0.3028	-2.248	0.0245
Financial expertise of the audit committee	-0.8295	0.5193	-1.597	0.1102
audit committee effort	0.0122	0.0356	0.342	0.7324
Internal control weaknesses	-0.1099	0.1152	-0.954	0.3399
Auditor change	-0.1009	0.3886	-0.26	0.7951
Buying auditor's opinion	0.3253	0.2574	1.263	0.2064
Audit committee independence	2.3276	0.8878	2.622	0.0087

Chance of bankruptcy	0.1236	0.1159	1.066	0.2865
Financial leverage	1.1891	1.2154	0.978	0.3279
Natural logarithm of total sales	-0.1523	0.2948	-0.517	0.6053
Loss	-0.0435	0.4162	-0.104	0.9168
The number of commercial and geographical depts.	0.0096	0.0177	0.544	0.5862
Export	0.1517	0.2287	0.664	0.5069
Firm age	0.5604	0.2953	1.898	0.0577
Net sales growth rate	-0.7813	0.3957	-1.974	0.4836
Achievement	-0.4796	0.4533	-1.058	0.2899
Auditor size	-0.3672	0.2466	-1.489	0.1365
Return of assets	-1.9231	1.8389	-1.046	0.2956
Cash	0.7652	1.7437	0.439	0.6608
Continuity	0.2266	0.3668	0.618	0.5368
Total inventory and receivables	-0.9466	0.7724	-1.225	0.2204
Tenure	-0.0883	0.1106	-0.798	0.4246
Percentage of institutional owners	-0.3286	0.3083	-1.066	0.2866
The board change	0.3112	0.2473	1.259	0.2082
2012	1.0075	0.3250	3.1	0.0019
2013	-0.9481	0.3404	-2.785	0.0054
2014	0.6953	0.3466	2.006	0.0448
2015	0.4834	0.4521	1.069	0.2849

The results suggest that the audit fees and audit fees shortage sensitivity contribute significantly to the Tehran Stock Exchange's financial restatements. In general, the results show that higher/lower audit fees significantly affect the risk of disclosure of the auditor's fraud. Any decline in the audit fees will cause some shortages in the evaluation of the required risks. In such cases, the audit firms will face a decreased number of staff, lack of specialized employees, less workload, which affect the risk of fraud discovery, and the increase of financial restatement is probable. Other results reveal that the abnormal audit fees, high-standard audit fees in proportion to low-standard audit fees, and excessive audit fees sensitivity could not influence the financial restatements. Among the reasons for hypothesis rejection, we could refer to a lack of appropriate concentration on audit committees' roles and ages. The results of the present study confirm with that of Stanley (2011), Habib (2012), Mironiuc and Robu (2012), Lobo and Zhao (2013), Fang et al. (2014), Khondkar et al. (2015), Kacer and Wilson (2016) who show those audit fees contributes to the quality of financial reporting and financial restatements.

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