

AUDITING QUALITY CHARACTERISTICS AND ACCOUNTING CONSERVATISM: AN EMPIRICAL STUDY OF THE LISTED COMPANIES IN EGYPT

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Abstract

The growing issues on the quality of audit and accounting conservatisms have long been regarded and seemed as a hot debated since both could impact on the capital market efficiency. This study aims to investigate the impact of the audit quality which is characterized by audit firm size, auditor specialization, and auditor tenure on accounting conservatisms in the financial reports of the more active 50 non-financial companies listed at Egyptian stock exchange across four years of period from 2007 to 2010. After controlling for company size, leverage and profitability, the results show that auditing quality characteristics (audit firm size, auditor specialization, and auditor tenure) have significant positive relation with accounting conservatism. On the other hand, no significant relationship is found between company size and accounting conservatism. Based on these results, the study provided recommendations to the interested parties.

Keywords: Audit Quality, Accounting Conservatism, Egyptian Companies

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1. Introduction

Accounting conservatism is one of the most important accounting principles that accountants still insist on it. Previous studies find persuasive evidence that accounting conservatism has increased over time (Basu, 1997; Givoly and Hayn, 2000; Sivakumar and Waymire, 2003; and Srivastava and Tse, 2009). Conservatism is traditionally defined as accounting practices that “anticipate no profit but anticipate all losses” (Bliss, 1924). Basu (1997) depicts conservatism as the asymmetric timeliness of earnings which require higher verification to recognize good news as gain than to recognize bad news as losses. Givoly and Hayn (2000) define conservatism as ‘a selection criterion between accounting principles that leads to the minimization of cumulative reported earnings by slower revenue recognition, faster expense recognition, lower asset valuation and higher liability valuation’. All of these definitions acknowledge that earnings reported under conservative accounting are understated rather than overstated. It limits over payment of incentive to managers (Chen *et al.*, 2007), allows for early detection of negative net present value projects as it immediately recognizes expected losses (Ball *et al.*, 2003), limits managers’ opportunistic behaviour (Watts, 2003; and Chen *et al.*, 2007) and reduces information asymmetry between managers and outside shareholders (LaFond and Watts, 2008). Further, it improves the usefulness of financial

statements (Ball and Shivakumar, 2006) and increase firm value (Watts, 2003).

The quality of audit service is very important since it reflect with the auditor’s activities in gathering the sufficient evidence, detecting fraud activities, reducing the manipulation of financial information and finally issuing the appropriate opinion on the financial reporting with all material respects (Soliman and Ragab, 2014). Simultaneously, the auditing quality also will enhances the public confidence in the credibility of the audit process and financial reporting, especially on the auditor’s independence and believes that the auditor ethically behave towards their client (Hamid and suzana, 2013).

This study sought to analyze the set of audit quality characteristics such as auditor’ size; specialization of the auditor; and tenure of auditor engagement. These characteristics have been studied in other environments and even in the Egyptian context, but very little interest has been paid to the relationship between the quality characteristics of auditing and accounting conservatism, one of the main attributes of accounting information quality.

Therefore, the problem discussed in this study is exemplified through answering the following question: Is what are the impacts of auditing quality characteristics on enhancement of the level of accounting conservatism in the more active 50 non-financial companies listed at Egyptian stock exchange?

This study provides new insights and integrated analysis of the relationship between the quality of external auditing and accounting conservatism in the most active 50 non-financial companies listed at Egyptian exchange and thus achieve the quality of accounting information which will be reflected on the decisions of investors and the movement of the stock market in Egypt.

The remainder of the paper is organized as follows. Section 2 discusses findings from previous studies on earnings conservatism and ownership concentration. Section 3 covers research methods, which explains the sample used in the study and measurements of the variables. Section 4 presents the descriptive analysis, empirical results and discussions. Lastly, section 5 concludes the paper with limitations of the study and suggestions for future research.

2. Literature Review

The need for accounting conservatism is related to the increase of credibility in accounting information, as conservatism of declaring good results of the company increases accounting credibility and the ability to predict the future (Hellman, 2008; and Sameh and Reyad, 2012).

Lafond and Watts (2008) suggest that information asymmetry among equity investors is the key reason for accounting conservatism; that is, conservatism is caused by the non-verification of information, which results in asymmetric loss functions among related parties. When debt is greater, creditors require a higher level of conservatism in accounting reports to avoid potential losses (Ahmed *et al.*, 2002; Watts, 2003; and Xia and Zhu, 2009). Conservative accounting can also be beneficial for firms; hence, companies may have incentives to adopt conservative financial reporting policies (Francis *et al.*, 2004; and Zhang, 2008). Separation between ownership (cash flow rights) and control (voting rights) brings about agency problems (Jensen and Meckling, 1976), which result from information asymmetry, and accounting conservatism is one of the mechanisms addressing agency problems that protects investor interests (LaFond and Roychowdury, 2006).

Also, conservatism reduced managers' incentive to manage earnings because timeliness in incorporating losses into earnings reduces the impact of bad news on the share price (Chen *et al.*, 2007); and creditors reward firms that employ higher conservatism with lower interest because conservatism provides an early signal to the lender of any possible debt violation (Zhang, 2008).

The significance of the conservatism principle was re-emphasized through issuing a group of standards which contains conservatism among which are the following: Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No.5 (SFAS No. 5) "Accounting for Contingencies" in 1975, Statement of

Financial Accounting Standard No. 87 (SFAS No. 87) "Employer's Accounting For Pensions" in 1985, Statement of Financial Accounting Standard No. 121 (SFAS No. 121) "Accounting for the Impairment of Long-Lived Assets" in 1995, and the two International Accounting Standards (IAS No.36) "Impairment of Assets", and (IAS No.37) "Contingent Liabilities and Contingent Assets" (Al-Sahli, 2009 and Sameh and Reyad, 2012).

Reyad (2011) investigated the relationship between the degree of accounting conservatism and the level of earnings quality at the corporations listed at Bahrain stock Exchange. The study found that the Bahraini corporations had an acceptable level of accounting conservatism and high quality of earnings in, the existence of a direct relation between the degree of accounting conservatism and the level of earnings quality. The study concluded that the high level of accounting conservatism contributes to enhance the credibility of financial statements, thus contributing to the rationalization of investment decisions.

Wu (2010) examines the extent to which conservative accounting affecting shareholder value. He finds that there is a positive association between conservatism and cumulative stock returns during the current financial crisis. The results provide supportive evidence to the positive accounting theory that conservatism is an efficient governance mechanism to mitigate information risk and control for agency problems, and shareholders benefit from it.

2.1 Auditing Quality and Accounting Conservatism

Recent years have seen many cases of collapse of many of the major companies in various countries around the world, this lead to loss of confidence in the information contained in the financial statements, accompanied by many of the cases against audit firms which were involved in auditing the financial statements of these companies and there was no indication about lack of continuity in their reports (Sameh and Reyad, 2012). In his attempt to coin a definition to the term audit quality, Issa (2008) mentioned that Audit quality means the ability of audit process to detect and report on the material misstatement of the financial statements, and the reduction of information asymmetry between management and shareholders. The level of audit quality is linked to quality level of the information contained in financial statements, the reason for this is that the financial statement that have been audited by high quality auditors rarely contained substantial misstatements, which is reflected in minimization agency costs between shareholders and management. Thus, according to the literature, audit quality positively affects the quality of accounting information. With respect to conservatism, it is expected that accounting conservatism is greater in

the financial statements of companies that use the best auditing services. Therefore, the main goal of this study is to investigate the impact of the audit quality which is characterized by audit firm size, auditor specialization, and auditor tenure on accounting conservatism in the financial reports of the more active 50 non-financial companies listed at Egyptian stock exchange

Audit Firm Size and Accounting Conservatism

According to the literature, conservatism is affected by size of the independent auditing firm, suggesting that larger audit firms provide better audit quality, which positively affects the quality of the accounting information reported (DeAngelo, 1981; and Karmar *et al.*, 2011). The study of DeAngelo, (1981) was the first study about the auditing quality and the factors affecting it. This study found a positive relationship between auditing quality and the size of the audit firm. Recently, Hamdan *et al.*, (2012) have document positive relationship between audit firm size and accounting conservatism, which indicates the big auditing firms are able to improve the level of accounting conservatism in financial statements issued by Jordanian Industrial Corporation. In contrast, Yaganeh *et al.* (2012) examine the impact of audit quality on conservative earning reveals no significant result of audit firm size on accounting conservatism, in Tehran context. Based on the discussion above, this study first hypothesis is:

Hypothesis 1: *There is an impact with statistical significant of the audit firm size on accounting conservatism*

Specialization of the Auditor and Accounting Conservatism

The more specialized an auditing firm is in a particular economic sector, the greater should be its knowledge about the activities of the client and the better the services. Thus, the more specialized the audit firm is in a particular sector, the higher should be the quality audit services and the better the quality of the accounting information reported (Sun and Liu, 2011).

The previous studies indicated that “auditors’ specialization in the industry of the client” helps on enhancing the quality of financial statements, because it confirmed that the auditor's specialization in the client's industry will lead to a better auditing quality which consequently, leads to increase the quality of financial reports, thus improving the level of accounting conservatism in the related companies (Albring *et al.*, 2007). Based on the discussion above, this study second hypothesis is:

Hypothesis 2: *There is an impact with statistical significant of the specialization of the auditor on accounting conservatism*

Tenure of auditor engagement and Accounting Conservatism

Audit tenure refers to the number of consecutive years that the auditor has audited the client (Johnson *et al.*, 2002). Auditors who have long served a client may establish close relationship with management lead to impairment of auditor independence (Carcello and Neal, 2000; and Hamid and Suzana, 2013). Raghunandan (2002) claims that auditor tenure is not associated with the reporting failure and claims that the mandatory auditor rotation not perceived as a good solution to improve the audit quality. From the auditor perspective, long duration enhances the auditor competency which make them become more knowledgeable about client business environment, valuable in management plan and mitigate in contingency arise. In contrast, Albring *et al.*, (2007) claims that the mandatory rotation could be a vital solution in improving the auditor independence and audit quality since the longer tenure will contribute to the client willingness to purchase other services from their auditor.

Yeganeh, *et al.*, (2012) found that accounting conservatism increase as auditor–client relationship lengthens. Also, Jenkins and Velury, (2008) find the significant result between auditor tenure and conservative in reported earnings. However, Kramer *et al.*, (2011) reveal that the level of conservatism in reported earnings are higher for short audit firm tenure than long audit firm tenure. On the other hand, some studies in the literature also indicate that a longer relationship between auditor and client can be beneficial because the auditors over time acquire more knowledge about the client and its industry (Jenkins and Velury, 2008; Li, 2010; and Hamdan *et al.*, 2012). Based on the previous discussion, this study Third hypothesis is:

Hypothesis 3: *There is an impact with statistical significant of the tenure of auditor engagement on accounting conservatism.*

2.2 Accounting Conservatism and Auditing Profession in Egypt

Egypt has many significant differences from other developed markets since it is classified within the emerging Middle East accounting regime, where many social and cultural aspects affecting accounting policies and choices (Ismail and Elbolok, 2011).

Being more specific, Egyptian accounting systems and standards adopt the historic accounting principle for the valuation of fixed assets, liabilities, revenues and expenses with the application of fair value accounting for evaluation of financial

instruments and biological assets. The main consequence of the historical cost principle is that the financial statements and the balance sheet especially, do not present the fair value of the firm's assets.

Almost all studies examining disclosure practices in the Egyptian context find a low disclosure level (Abdelsalam and Weetman, 2007; and Hassan *et al.*, 2009). They concluded that the reasons that lead to the low disclosure level in Egypt are (i) presence of uniform, secretive, and conservative accounting practices, (ii) absence of a unified law governing Egyptian firms' activities and transactions, (iii) and lack of strict enforcements imposed by the Egyptian Capital Market Authority on non-complying firms to comply with the mandatory requirements of the Egyptian accounting standards.

To conclude, accounting conservatism in Egyptian practice is justified on the ground that some features as (i) high uncertainty avoidance, (ii) large power distance, (iii) preference for individualism, and (iv) a masculine attitude, are characteristics that drive accounting values to be uniform, secretive, and conservative. The Egyptian accounting system can be characterized as conservative and tax oriented. This means that losses and expenses are realized immediately in the financial statements, even if they are not accrued but the relative provision has been made, while profits are incorporated into the financial statements when they occur (Ismail and Elbolok, 2011). Thus, accounting conservatism is one of the major features of the Egyptian accounting practice.

Regarding auditing profession, Egypt has a combined structure of the auditing firms. All the major international auditing firms have a presence in Egypt in addition to well-established local auditing firms. It might be expected that international auditing firms working in Egypt would be more familiar with IAS including parts of the IAS which are not publicly available in Arabic. As a result, it is expected that Egyptian companies audited by one of the international auditing firms will comply more closely with the IAS. KPMG, Ernst and Young, Deloitte Touche Tohmatsu, and Price Waterhouse Coopers are the major international accountancy and legal firms with local partnership.

Almost all ISA are applicable in Egypt. Auditors are required to follow the six Egyptian auditing standards that relate to an auditor's report, and any ISA that relates to other aspects of the auditing process. Knowledge deficiencies of most practitioners by ISA in practice restrict ensuring sound auditing practice. Although large auditing firms have greater competence to provide high auditing quality, compliance with the applicable auditing standards is

not always ensured: in this respect the large firms differ from the small firms. Abd-Elsalam and Weetman (2003) noticed in Egypt that international auditing firms, in most cases, stated that the financial statements were prepared according to the IAS. In many cases, international auditing firms referred to compliance with IAS, but not the ISA. In contrast, local auditing firms, in most cases, stated that the financial statements were prepared according to Generally Accepted Accounting Principles (GAAP) without giving any further explanation of what the phrase meant.

3. Research Methodology

3.1 Sample

The sample in the current study consists of the Egyptian companies from amongst the top 50 most active-traded companies listed in the Egyptian Stock Exchange over the period 2007-2010. financial companies; e.g. banks, insurance companies, and leasing companies; were excluded from the sample due to the different requirements of disclosure and corporate governance. Hence their annual reports may be not comparable to those of other companies. This gave us a sample of 38 firms. Sources of data collection are annual reports, web sites and direct contacts as well, covering the four year period 2007-2010, to extract the information on the variables needed to test each of the research hypotheses.

3.2 Variables of the study

Dependent Variables

According to Givoly and Hayn (2000), conservatism leads to persistently negative accruals. More conservative accounting is reflected by more negative average accruals. Averaging over a number of years will mitigate the effects of any temporary large accruals, since accruals will likely reverse within one to two years (Richardson *et al.*, 2005; and Ahmed and Duellman, 2007). This study uses the accrual-based measure of conservatism proposed by Givoly and Hayn (2000), Ahmed and Duellman (2007); and Xia and Zhu (2009). This measure is computed as income before extraordinary item and discontinued operations plus depreciation expenses minus operating cash flows (operational accruals) and divided by total asset at beginning of period. The accrual value is then averaged over 3 years centered in year *t*, and is multiplied by -1 and refers as ACCON. Higher values of ACCON indicate more conservatism.

Independent Variables

Audit Firm Size

Research on auditing (DeFond and Subramanyam, 1998; Fargher *et al.*, 2008; and Lennox *et al.*, 2012)

$$ACCON = \frac{OACC}{TA_{t-1}} \times (-1) \quad (1)$$

Where:

ACCON: Accounting conservatism

OACC: Operational accruals

TA t-1: Sum of assets at beginning of period

consider audit firm size (ASIZ) as a proxy, usually related to reputation, based on whether or not it is one of the Big Four firms. In this case, if the company's audit was performed by one of the big firms, the (ASIZ) variable assumes value 1, otherwise 0. Here the study considered the Big Four to be PricewaterhouseCoopers, Deloitte Touche Tohmatsu, KPMG and Ernst & Young.

Specialization of the Auditor

To indicate the specialization, or expertise, of the independent auditor, this study created a proxy (ASP) that takes value 1 if the audit firm has a portfolio of clients from the same economic sector representing more than 15% of its net revenue from clients in the same economic activity, and 0 otherwise. This is consistent with the metric used by O'Keefe *et al.*, (1994) and Li (2010).

Tenure of auditor engagement

Consistent with the work of Jenkins and Velury (2008), Li (2010) and Chin *et al.* (2012), this study used as a proxy for the time of service to the client (ATEN) the number of consecutive years in which the audit is performed by the same firm.

Control Variables

Company size (CSIZ)

Based on theory, it is expected that there will be a negative association between company size and earnings conservatism (Arabahmadi *et al.*, 2013). As for the relationship between the size of company and accounting conservatism. Hamdan *et al.*, (2012) found that big companies adopt conservative accounting policies to avoid political costs, but Al-Sahli (2009) did not find any relationship between the size of the company and the degree of accounting conservatism. In contrary to what was expected. In this study, company size considered as a control variable. The

company size (CSIZ) is proxy by natural log of total assets.

Leverage (LEV)

Financial leverage represents other creditors' claims on the assets of the company; according to these contracts and the power that the groups bring could be applied force to conservatism; so the financial leverage considered as a control variable (Kim and Jung, 2007; and Scott, 2012). The influence of creditors is proxies by the debt ratio (LEV), which is equal to total liability divided by total assets at year end.

Profitability (ROA)

Profitability also is potentially associated with companies' demands for and cost of conservatism (Ahmed *et al.*, 2002). Companies with higher profitability are expected to use more conservative accounting because the cost of making a conservative accounting choice is lower than for low-profitability companies. Hence, this study includes return on assets as a proxy for profitability to control for the potential cost of conservatism (Ahmed *et al.*, 2002). In addition, including a control for profitability also reduces the likelihood of an omitted-variables bias. Profitability (ROA) is the average of company *i* return on assets. The explanations of dependents; independents; and control variables are presented in Table 1.

There are a number of companies that were in the top 50 most active-traded companies listed in the Egyptian Stock Exchange in 2007 that are not in 2010 raising concerns regarding the effect that non-surviving firms have on the results. To control the effect of non-survivorship firms on the results, a dummy variable (SU) is created which is equal to 1 if the firm is continuously present in all the years of the sampling period from 2007 to 2010, otherwise it is equal to 0.

Table 1. Dependent; Independents and Control Variables

Variables	Indicators	Expected Signs	Measurement
Dependent Variables (Accounting conservatism)			
Accounting Conservatism	ACCON		Income before extraordinary item and discontinued operations plus depreciation expenses minus operating cash flows and divided by total asset
Independent Variables (Audit Quality)			
Audit Firm Size	ASIZ	+	Dummy value (1 = if the audit firm among the Big five auditing firms; 0 = otherwise).
Auditors' Specialization	ASP	+	Dummy value : This was measured by scale (1,0) ,1 = If the audit firm specialization in the client's industry; 0 = otherwise
Auditor Tenure	ATEN	+	Continuous variable: length of years the auditor audit their client
Control Variables			
Company Size	CSIZ	+	Natural log of total assets.
Leverage	LEV	+	Total liability divided by total assets at year end.
Profitability	ROA	+	The average of company <i>i</i> return on assets.

3.3 Models specification

The following regression model tests the influence of ownership structure and the control variables on accrual measure of conservatism.

$$\text{ACCON} = \beta_0 + \beta_1 \text{ASIZ} + \beta_2 \text{ASP} + \beta_3 \text{ATEN} + \beta_4 \text{CSIZ} + \beta_5 \text{LEV} + \beta_6 \text{ROA} + \beta_7 \text{FSU} + \varepsilon \quad (2)$$

Where:

ACCON: Accounting conservatism index, ASIZ is the audit firm size; ASP is auditor specialization in the client's industry; ATEN is auditor tenure; CSIZ is company size; LEV is firm's financial leverage; ROA is firm's profitability; FSU is firm survival; and ε , the error term, normally distributed about a mean of 0.

4. Results and Analysis

This section includes three major parts: the first is concerned with the validity of the data for statistical analysis. The second deals with descriptive statistics

for variables of the study from the perspective of many descriptive statistical standards, and the third tests the study hypotheses.

4.1 Testing the Validity of Data

Model of this study belong to the General Linear Model (GLM) that requires many conditions before being practiced. Therefore, data of this study must be tested to make sure that they meet the conditions of the GLM. What follows is testing data credibility for statistical analysis. Table 2 shows the necessary tests needed to test data validity of statistical analysis. The Variance Inflation Factor (VIF) is the standard that measures the effect of independent variables. Gujarati (2003) stated that getting a VIF higher than 10 indicates that there is a multicollinearity problem for the independent variable of concern. From Table 2, one can notice that the VIF value for all independent variables is less than 10, which means that we do not have any Collinearity problem in the model of the study.

Table 2. Testing the Validity of Data

Variables	Multicollinearity Test		Time Series Stationarity (Unit Root Test)	
	Tolerance	VIF	ADF	PP
ASIZ	0.768	3.863	-0.561	-0.658
ASP	0.586	1.267	-0.368	-0.487
ATEN	0.692	2.983	-0.694	-0.624
CSIZ	0.749	3.983	-0.396	-0.645
LEV	0.859	2.734	-0.672	-0.742
ROA	0.744	1.223	-0.536	-0.635

Where: ASIZ is the audit firm size; ASP is auditor specialization in the client's industry; ATEN is auditor tenure; CSIZ is company size; LEV is firm's financial leverage; ROA is firm's profitability; and FSU is firm survival.

Also, empirical research that uses time series, like the case of this study, presupposes stability of these series. Autocorrelation might occur in the model because the time series on which this study is based in non-stationary (Gujarati, 2003). To check the Stationarity of the time series, a Unit Root test, which includes the parametric Augmented Dicky-Fuller test (ADF) and the non-parametric Phillips-Peron (PP) test, were used. From Table 2, one could notice that the absolute value for one of the two tests: the parametric (ADF) and the non-parametric (PP) were bigger than the critical value of the levels 5%, which meant acceptance of the null hypothesis that the data of time series (2007-2010) was stationary.

4.2 Descriptive Statistics

Table 3 provides a summary of the descriptive statistics of the firms examined. The mean ACCON is -0.084. The negative value indicates that Egyptian

firms practice lower conservatism as compared to those found by Ahmed and Duellman (2007) and Krishnan and Visvanathan (2007) for US firms which was 0.010 based on the abnormal accruals approach. Also, the results reveal that (31%) of companies sampled are audited by the big 4 audit firms, which contributes to earning a lot of experience and skills in auditing. Table 3 shows that (62%) of the auditing firms of companies sampled has experience in the client's industry. This finding is in line with Hamdan *et al.*, (2012) those found that more than two-thirds of the auditing firms of Jordan have experience in the client's industry.

Also, Table 3 shows that the mean of ATEN is 5.25 which mean that the auditing firms of companies sampled have been working with the same clients on average 5 years with a minimum of 2 years and maximum of 8 years.

Table 3. Descriptive Statistics

	ACCON	ASIZ	ASP	ATEN	CSIZ	LEV	ROA
Mean	-0.084	0.31	0.621	5.25	13.92	0.35	16.65
Maximum	0.323	1	1	8	17.82	.98	78.20
Minimum	-0.545	0	0	2	9.96	-0.12	21.88
St. Dev.	5.12	.46790	2.793	1.767	2.6087	.31554	10.6343

Where: ACCON: Accounting conservatism index, ASIZ is the audit firm size; ASP is auditor specialization in the client's industry; ATEN is auditor tenure; CSIZ is company size; LEV is firm's financial leverage; and ROA is firm's profitability.

4.3 Regression Results

The analysis of logistic regression was done to test the hypotheses proposed for this study. Table 4 represents a correlation matrix for the selected variables; The

Pearson's correlation matrix shows that the degree of correlation between the independent variables is either low or moderate, which suggests the absence of multicollinearity between independent variables.

Table 4. Correlation Coefficients Matrix of the Variables Used in the Study

Variable	ACCON	ASIZ	ASP	ATEN	CSIZ	LEV	ROA	FSU
ACCON	1							
ASIZ	0.521	1						
ASP	0.475	0.137	1					
ATEN	0.040	0.342	0.224	1				
CSIZ	0.724	0.136	0.655	-0.640	1			
LEV	0.452	-0.249	0.067	0.468	0.471	1		
ROA	0.045	0.224	0.0743	0.034	0.373	-0.323	1	
FSU	0.368	-0.424	0.632	0.173	0.374	0.093	-0.047	1

Where: ASIZ is the audit firm size; ASP is auditor specialization in the client's industry; ATEN is auditor tenure; CSIZ is company size; LEV is firm's financial leverage; ROA is firm's profitability; and FSU is firm survival.

As suggested by Bryman and Cramer (1997), the Pearson's R between each pair of independent variables should not exceed 0.80; otherwise, independent variables with a coefficient in excess of 0.80 may be suspected of exhibiting multicollinearity. The highest correlation as disclosed in the table is between accounting conservatism (ACCON) and company size (CSIZ) with the amount of 0.724. This confirms that there is no multicollinearity among the variables.

This study developed a model based on previous study and aim to identify the impact of auditing quality characteristics on improving the level of accounting conservatism in the financial statements issued by Egyptian listed companies. Based on table 5, the result shows the association between audit quality characteristics as independent variables and accounting conservatism. The model is significant at 0.05% confidence level ($p < 0.05$) with adjusted R square is 0.362 indicating that the model explains more than 30% of the variability in accounting conservatism.

Table 4 and 5 show that the relationship between the audit firm size (ASIZ) and accounting conservatism is positive because the coefficient was 0.521, as well as the p-value was 0.041, which is less than 5%. Thus, the results support the first research

hypothesis, which posits that the level of conservatism contained in the financial statements is greater in companies audited by large independent audit firms than by smaller audit firms. This is consistent with prior studies, such as those of Ebrahim (2001); and Hamdan *et al.*, (2012) that empirically find a positive relationship between audit firm size and accounting conservatism, which indicates the big auditing firms are able to improve the level of accounting conservatism in financial statements. This study inquires if the auditors' specialization in the industry of the client helps them to exert a high level of accounting conservatism.

Table 4 and 5 show that the relationship between the "ASP" and the accounting conservatism is positive and statistically significant at 95% coefficient = 0.475; as well as the P- value = 0.037. Thus, the results support the second study hypothesis, which posits that the auditor specialization in the industry of the client helps improve the level of accounting conservatism. This finding is in line with prior studies, such as Albring *et al.* (2007); and Hamdan *et al.*, (2012) that empirically find a positive relationship between auditor specialization in the industry of the client and accounting conservatism.

Table 5. Regression results

ACCON= $\beta_0 + \beta_1 ASIZ + \beta_2 ASP + \beta_3 ATEN + \beta_4 CSIZ + \beta_5 LEV + \beta_6 ROA + \beta_7 FSU + \epsilon$			
Variable	β	t-value	Sig.
Constant	5.83	1.87	0.021
ASIZ	0.52	1.77	0.041
ASP	0.44	1.78	0.037
ATEN	0.04	1.72	0.034
CSIZ	-0.214	-5.364	0.000
LEV	-1.962	-5.154	0.068
ROA	0.385	0.892	0.000
FSUR	-1.962	-5.154	0.127
Model Summary			
R			0.633
R square			0.401
Adjusted R square			0.362
F-value			12.84
Sig.			0.00

Dependent variable: ACCON

Significant at .05%

Where: ACCON, accounting conservatism index; ASIZ is the auditor's size; ASP is auditor specialization in the client's industry; ATEN is auditor tenure; CSIZ is firm size; LEV is firm's financial leverage; ROA is firm's profitability; and FSU is firm survival.

Table 4 and 5 also, show that the relationship between the auditor tenure (ATEN) and accounting conservatism is positive because the coefficient was 0.040, as well as the p-value was 0.034, which is less than 5%. Thus, the results support the third study hypothesis, which posits that the level of conservatism contained in the financial statements is greater when audit firm retained the client. This could be justified that the more the audit firm retained the client the higher the audit quality, as a result of better knowing the nature of the client's activities and operations which leads to increase the quality of financial reports, thus improving the level of accounting conservatism. This finding is not in line with previous studies such as Issa (2008); and Reyad (2012) there indicated that auditor tenure not helps on enhancing the quality of financial statements, because it confirmed that the auditing firms which maintain customers for a substantial period may make the auditor non-creative and depend on procedures and justification of the company without verification, thus not improving the level of accounting conservatism in the related companies

4.5 Testing of the Control Variables

The company size: The study of Hamdan *et al.*, (2012) found that the large companies are most conservative. But Al-Sahli, (2009) did not find that there is an impact of the company size on the level of accounting conservatism. This study used a different approach to measure accounting conservatism and found that there is a positive relationship between companies' size and accounting conservatism exists, which indicates that large companies are the most conservative.

Financial leverage: Table 4 and 5 show that there is a positive relationship between financial leverage and accounting conservatism. Therefore the companies which are more dependent on debt are most conservative. However, this relationship is not statistically significant, where p -value > 0.05 in the model. The previous results are different from the results of Hamdan *et al.*, (2012), who indicated that there is a negative relationship between the value of debt and the level of conservatism.

Profitability: Table 4 and 5 show that there is a positive relationship between ROA and accounting conservatism as well as the p-value was 0.00. This finding is in line with prior studies, such as Ahmed *et al.*, (2002) that empirically find that companies with higher profitability are expected to use more conservative accounting because the cost of making a conservative accounting choice is lower than for low-profitability companies. Hence, this study includes return on assets as a proxy for profitability to control for the potential cost of conservatism.

5. Conclusion

This study aims to investigate the impact of the audit quality which is characterized by audit firm size, auditor specialization, and auditor tenure on accounting conservatisms in the financial reports of the more active 50 non-financial companies listed at Egyptian stock exchange across four years of period from 2007 to 2010. This study uses the accrual-based measure of conservatism proposed by Givoly and Hayn (2000); Ahmed and Duellman (2007); and Xia and Zhu (2009). The results show that auditing quality characteristics have significant positive relation with accounting conservatism. Based on these results, the

study recommends that the professional associations in Egypt and the government work to improve the auditing quality in Egypt, as the characteristics of auditing quality have impact on the enhancement the level of conservatism.

As is the case with all studies, this one has limitations. Firstly, survey results restrict generalization, as the sampling design cannot be claimed to represent all Egyptian listed firms. Secondly, the model used to measure the conservatism may not be appropriate because of some limitations of the measure. For example, characteristics of the firm's information environment that are unrelated to conservatism may unduly affect the measure. However, there is a need for further research to consider more factors that might affect conservatism as environmental and cultural factors and industry type. Such investigation can be carried out using data of a large sample of listed firms to test the relationship between auditing quality and accounting conservatism on wide spectrum of variables as earning's quality, stock prices, firm valuation, cost of capital, and corporate governance mechanisms.

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