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## INVESTIGATING THE EFFECT OF AUDIT TIME PRESSURE ON THE EARNINGS QUALITY OF THE ACCEPTED COMPANIES IN TEHRAN STOCK EXCHANGE

Ghasem RAMAZANI

Faculty of Law and Administrative Sciences, Islamic Azad University, Birjand Branch, Birjand, Iran.

### ABSTRACT

*The present study examines the effect of audit time pressure on earnings quality in the accepted companies of the Tehran Stock Exchange. Auditors often face tight time budget pressure. Due to the importance of audit firms to achieve time budgets as a measure of effectiveness, their problems in measuring the effectiveness of auditing, the potential contradiction between doing the right things and controlling the costs of high quality audits are intensified. The population in this study is audit firms of the certified public accountants in Tehran and they were selected from these firms randomly and the required data was collected. In addition, in order to test the research hypothesis, the Durbin-Watson model and correlation using E-Views software are applied. The results showed that the audit time pressure has a significant relationship with earnings quality.*

**Keywords:** Time Pressure, Audit, Earnings Quality.

### INTRODUCTION

It seems that time budget pressure has turned into a general phenomenon in auditing, and therefore, professional judgment is really important. The auditor may, based on his own judgment, considers some of the steps as an insignificant work for the time pressure and did not do them, but in his worksheet, it would be contrary to them. Under the increasing time pressure and the auditor's incentive to continue his working with the audit firm, it is important to know whether accountability for the audit work has led to an understanding of the reputation cost and the observance of manipulation in the process of collecting audit evidence, whether time pressure is present or not, will be in danger. The quality of auditing decreases when auditors are subjected to the increased imposed time pressure. This negative effect will be even among auditors who have more resources. The auditors complete the procedures near to the required term (extended) of filing, which may threaten the audit quality to meet the required report. Time budget pressure can have positive or negative effects. This pressure can make auditors work harder and thus try to increase efficiency. However, if the time budget pressure is unconventional, its negative effect will appear. This pressure may cause stress in auditors and may lead to different actions. These actions can appear in different ways. They may pay attention to the operation time of last year and try to keep up the operation time of the current year as the past. This action takes place through working at a specific time. This stress may force them to act in a way to reduce the audit quality to keep up the time budget. It is also possible that with a positive approach they request an increase in the time budget. This stress

becomes more intense when the time budget is considered as an important factor in the performance evaluation (Karami et al., 2016, 9-10).

The earning quality is the important aspect of the financial health of companies that is of interest to all users of financial statements. The earning quality refers to the ability of reported earnings in the reflection of real earnings, usefulness in predicting future earnings, and also refers to the stability, permanence and non-changeability of the reported earnings.

Therefore, the criticism of users for such earnings is logical and serious, and in economic societies like Iran, which are in the work of privatization process, measuring the actual profitability and proper valuation, which is fundamentally related to the reported earnings, is vital (Dastgir et al., 2015, 22). The earnings quality is the degree of stability of earnings function in the future period. The earnings quality is the probability of stability of the current earnings in the future. The earnings quality is defined as the ability of reported earnings (income) to predict future earnings. The earnings quality is related to the desired earnings, that is, in their view, the earnings quality is a measure of honesty that shows the reported earnings in the desired earnings profit. The earnings quality is the degree of difference in the reported net profit from real earnings. The high quality earning is an earning which is closer to the value of the company in the long-term and contains more information content. Earnings quality is defined as a relationship between accruals and cash flows. The possible reasons for the variety in the definitions of earnings quality can be due to the different scholars' views on the various aspects of this concept. Therefore, the subject of the earnings quality is a complex subject and so far no scholar has been able to provide a comprehensive definition of this concept or complete the indicator (Jalili and Gheisari, 2014, 150).

Time pressure is defined as a common limitation in allocating resources to carry out auditing. In this research, two aspects have been considered: the pressure of doing the job in the deadline and budget pressure. These two concepts are distinct, but not necessarily independent of each other (Barzideh and Kheirallah, 2011, 12).

In this study, we first describe how increasing the time pressure from outside can fundamentally affect the audit approach and limit the year-end audit of account balance and transactions. We use the audit delay to design a continuous scale of audit time pressure and to the group companies based on the extent, they are most affected by the change in deadlines. The audit delay is defined as the length of time from the financial year-end of a company to the date of the audit report. Therefore, the main question of this research is: what is the effect of audit time pressure on the earnings quality of the accepted companies in the Tehran Stock Exchange?

## **THEORETICAL FRAMEWORK AND RESEARCH MODEL**

Earnings quality measurement: corporate executives for earnings manipulating use earnings management based on the accruals and earnings management based on the manipulating real activities. In this research, for measuring earnings management, two criteria of discretionary accruals and manipulating real activities have been used: several studies have used discretionary accruals as indicators of earnings management and earnings quality. A) In this model, first, the total accruals (TAC) for each period are calculated by the model (1). To



calculate the accruals for each year, the Net Cash Flows from operating activities (CFO) are deducted from Net Income (NI):

$$1) \text{ TAC}_{i,t} = \text{NI}_{i,t} - \text{CFO}_{i,t}$$

Then, using the modified Jones model (2), the non-discretionary accruals of that period are estimated ( $\text{NDAC}_{i,t}$ ).

$$2) \text{ NDAC}_{i,t} / \text{TA}_{i,t} = a (1 / \text{TA}_{i,t-1}) + b (\text{NREVI}_{i,t} / \text{TA}_{i,t-1}) + c (\text{PPE}_{i,t} / \text{TA}_{i,t-1}) + \varepsilon_t$$

In the above model:  $\text{TA}_{i,t-1}$  is the total assets to the first period,  $\text{NREVI}_{i,t}$  is the income changes minus (excepted) revenue account changes,  $\text{PPE}_{i,t}$  is the gross property of plant and equipment.  $a$ ,  $b$ ,  $c$  are the coefficients of the model according to formula (3) and  $\varepsilon_t$  is the model error in  $t$  year. To estimate the coefficients of the modified Jones model, we use the primary Jones model (model number 3).

$$3) \text{ TAC}_{i,t} / \text{TA}_{i,t-1} = a (1 / \text{TA}_{i,t-1}) + b (\text{SREVI}_{i,t} / \text{TA}_{i,t-1}) + c (\text{PPE}_{i,t} / \text{TA}_{i,t-1}) + \varepsilon_t$$

In the end, the number of discretionary accruals ( $\text{DAC}_{i,t}$ ) is calculated from the difference in aggregate accruals of each year with the estimated non-discretionary accruals based on the modified Jones model. B) The second criterion for measuring the real earnings quality is the abnormal discretionary costs. Badrassper (2011) has used the following model to estimate the level of discretionary costs, which is used in this research:

$$\text{DISEXP}_{i,t} / \text{A}_{i,t-1} = a_0 + a_1 (1 / \text{A}_{i,t-1}) + \beta (\Delta \text{S}_{i,t-1} / \text{A}_{i,t-1}) + \varepsilon$$

A: Total assets

S: Equals to net sales

$\varepsilon$ : The remaining amount as an indicator of earnings quality which is derived from the Badrassper model (2011).

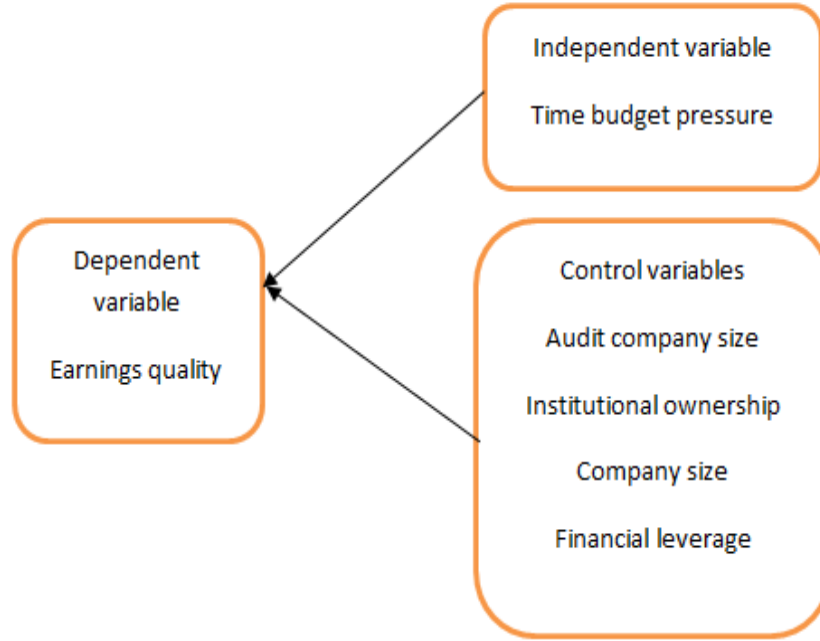
$\Delta$ : Change of the total revenue account

DISEXP: It is the discretionary cost which is equal to the sum of the research and development costs and advertising costs.

Time pressure: Time pressure is defined as a common limitation in allocating resources to carry out audit work. Time pressure has been taken in to account in two aspects: the pressure of doing job at a specific deadline and budget pressure. These two concepts are distinct, but not necessarily independent of each other.

For example, if an auditor had an audit in the last year before the first deadline change and the date of registration was 85 days after the end of the year, then the pressure would be the same. This auditor should reduce the audit.





**Figure 1: Conceptual Model of Research**

(Reference: Malekan and Tavakolneya, 2014; Tamara et al., 2017)

#### **Keyword definitions**

**Time pressure:** Time pressure is defined as a common limitation in allocating resources to carry out audit work. In this study, time pressure has been taken in to account in two concepts of the pressure of doing job in a specific deadline (collective persona) and budget pressure (principals). These two concepts are distinct, but not necessarily independent of each other (Barzideh and Kheirallahi, 2011, 12).

**Budget pressure:** If the budget represents a definite and tangible goal, it has a very strong capacity to provoke. The two main tasks of the budget are planning and control. Two words of planning and control contain a single concept, and it is representing a systematic and specific method for carrying out responsibilities. From this point of view, the management should provide the plans and control them continuously (Mehrani and Naimi, 2003, 44-46).

**Time budget:** Time budget is also a comprehensive and important management tool in many contemporary audit programs, since they provide the basis for cost estimation and control, promote the timely completion of work, performance evaluation and present the evidence in compliance with the standard of audit and planning and proper audit monitoring for the first time (Karami et al., 2016, 7).

**Earnings quality:** Scholer (2004) defines the earnings quality as the relationship between accruals and cash flows. Different definitions of earnings quality can be due to the different scholars' views on the various aspects of this concept. Thus, the subject of earnings quality is a complex subject and so far no scholar has been able to provide a comprehensive definition of this concept or to find a complete indicator (Jalili and Gheysari, 2014, 148).

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## BACKGROUND OF RESEARCH

Robertson (2007) has conducted a study entitled "The simultaneous effect of work pressure on deadlines and budget pressure on the concealment of audit evidence". The results showed that with regard to the auditors' view, in the circumstances in which the pressure of carrying out the job on deadlines is increasingly important in the environment of daily audit, failure to comply with the deadline date and budget will undermine the reputation of auditors as an effective person. Gandry et al. (2007) conducted research entitled "Time budget pressure, type of auditors' personality and promotion of audit quality reductions". The results showed that they examine the relationship between time budget pressure and type of auditors' personality and promotion of two types of audit quality reductions, doing an audit step before the deadline and acceptance of weak explanations of the auditor client. The findings of the research indicate that there is a significant relationship between time budget pressure and premature completion of an audit step. There is also a significant relationship between the type of auditors' personality and the occurrence of two types of audit quality reducing measures. These results indicate that the audit environment is complex and time budget pressure is only one of the reducing factors of the audit quality.

Hyatt and Taylor (2013) conducted a study entitled "The impact of pressure and targeted time budget on the accountability and response of auditory supervisors to the wrong task completion of audit staff". In this research, the time budget pressure on the audit and orientation of members of the audit team has been manipulated. The results indicate that audit supervisors often report a mistake in the completed work when the audit members are working under the low time budget pressure against high time pressure and audit staff who deliberately complete their work inaccurately, as well as employees who work wrong unintentionally.

Glover et al. (2015) conducted a study entitled the "Duration of imposed time pressure on the audit quality". The results showed that the audit quality will be reduced when the auditors are subjected to increased time pressure. This negative impact will be even among auditors who have more resources. The findings of this study indicate that auditors complete the procedures near the deadline for the file completion, which may threaten the quality of the audit to meet the required report. In addition, in recent surveys of public company auditors, the timeliness of completing the audit work is related to the audit quality.

Pechiva (2008) examined the impact of situational and job pressures in auditing on auditors' opportunistic behavior. He concluded that the existence of mentioned pressures in auditing has increased the focus on the individual reputation costs and led to make motivation in auditors to do activities that can put the audit process at risk.

Jones (2008) in investigating the identity of auditors, the responsibility burden of the client and auditors' satisfactory behavior concluded that in addition to economic incentives and cognitive bias desires, the social and individual factors play an important role in the auditors' preferred behavior.

## METHODOLOGY

The present study is an applied research in terms of the classification based on the purpose. The purpose of an applied research is the development of applied knowledge in a particular



context. In addition, the present research is correlated in terms of method and nature of the research. Since the purpose of this study is to investigate the effect of audit time pressure on the earnings quality of the accepted companies in the Tehran Stock Exchange, correlation research includes all the research in which it is tried to find and determine the relationship between different variables using the correlation coefficient. The number of admitted companies to the Tehran Stock Exchange at the end of 2017 was 520 companies. Therefore, according to the paragraphs of 1 to 7, 1000 companies were selected as systematic research samples and 390 data-year numbers for each variable were calculated to test the statistical hypotheses. The sampling method is a systematic elimination type. Data collection was done using the initial information of the companies. The required information and data for the research were gathered using the library method, Rahavard Novin software and referring to the Tehran Stock Exchange and the study of the fundamental financial statements of the admitted companies in the Tehran Stock Exchange during 2012-2017.

## RESEARCH FINDINGS

In this part of the research, using the data of 2012-2017 for the studied companies, we will investigate the research model.

**Table 1: Estimation of Research Model**

Variable	Coefficient	t-statistic	Significance level
Time pressure	-0.022601	-2.049576	0.0408
Audit company size	-0.008657	-0.782019	0.4345
Institutional ownership	-0.107711	-2.007554	0.0451
Company size	-0.008072	-3.203603	0.0014
Financial leverage	-0.022318	-1.450443	0.1475
Assets return	0.009128	28.46568	0.0000
Fixed value	0.173727	3.027139	0.0026
Prob (F)=0.000	D.W=1.95	$R^2=0.73$	$R^2=0.73$

Reference: Research Findings

The coefficient of determination indicates that what percentage of the dependent variable changes depends on the independent variable.  $R^2$  is a number that if it is close to 1, it will show the suitability of number and type of the selective variables to justify the dependent variable in the regression. As can be seen, the determination coefficient of this estimation is 0.73 and this shows that the number and type of the selected variables are suitable to justify the dependent variable in the regression and the mentioned independent variables could justify the dependent variable.

**Hypothesis 1:** Time pressure has a significant effect on the earnings quality of admitted companies in the Tehran Stock Exchange.

**Hypothesis  $H_0$ :** Time pressure has no significant effect on the earnings quality of admitted companies in the Tehran Stock Exchange.

**Hypothesis $H_1$ :** Time pressure has a significant effect on the earnings quality of admitted companies in the Tehran Stock Exchange.

In the studied companies, the study of time pressure variable shows that the probable statistic value of this variable is 0.0408, which indicates that time pressure has a significant effect on the earnings quality. As a result, the first hypothesis states that time pressure has a significant effect on the earnings quality of the admitted companies in the Tehran Stock Exchange.

Therefore, considering the statistical results, the effect of controlling variables on the earnings quality has been investigated, which we will discuss below:

The size of audit firm has a significant effect on the quality earnings of admitted companies in the Tehran Stock Exchange.

In the studied companies, investigating the size of audit firm indicates that the probable statistic value of this variable is 0.4345, which indicated that the size of audit firm does not have a significant effect on the earnings quality. As a result, the hypothesis of this study which states that "the size of audit firm has a significant effect on the earnings quality of the admitted companies in the Tehran Stock Exchange" is rejected.

## CONCLUSION BASED ON THE HYPOTHESES

**Hypothesis 1: Time pressure has a significant effect on the earnings quality of the admitted companies in the Tehran Stock Exchange.**

In the studied companies, studying the time pressure variable shows that the probable statistic value of this variable is 0.0408, which indicated that time pressure has a significant effect on the earnings quality. As a result, the first hypothesis which states that "Time pressure has a significant effect on the earnings quality of admitted companies in the Tehran Stock Exchange" is accepted. This research examines the effect of common pressures of audit environment on the earnings quality. It is assumed that the pressures in the audit profession increase the perceived costs of individual reputation by auditors and motivate them to engage in the activities that may jeopardize the effectiveness of the process of collecting and evaluating impartial audit evidence. The studied pressures in this research, taking into account the responsibility for accountability background- a common phenomenon in the audit environment- shows that the responsibility for the accountability was carried out for the audit work and time pressure led to stimulating the auditors to understand the costs of individual reputation when they face the subsequent contradictory evidence in auditing. This means that the accountability responsibility for the audit work can be considered as an incentive for the occurrence of threatening behavior of earnings quality by the auditors in such circumstances.

### *Suggestions*

1. As seen, time pressure can increase the possibility of concealing the contradictory evidence, therefore, it is suggested that an interim audit be conducted to reduce the volume of audit work for the final audit during the financial period. Another strategy is that the end of the fiscal year of companies differs from each other, taking into account the specific characteristics of each company and industry in which they are operating
2. The results indicate that accountability responsibility for the carried out audit work can lead to the personalized reputational concerns in auditors when confronted with conflicting evidence. Possible strategies for the profession are as follow:



- a) Division of work related to the selection and testing of sample evidence among different auditors.
  - b) Perform of statistical sampling and use of the specialized systems in sampling methods.
3. The results show that the accountability responsibility of auditors for the carried out audit work creates an impression of conflicts of interest between auditors when confronted with contradictory evidence as a result of concealing the evidence in a sequential decision making state. Therefore, adherence of auditors to the ethical values and fulfillment of their duties within the framework of those values can lead to the reduction of pursuing individual interests. In addition, increasing the awareness of evaluators of the possible occurrence of threatening quality behavior and emphasis on peer review can be effective.

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