

Do Managers Reappoint Auditor for Related Party Transactions? Evidence from Selected East Asian Countries

(Adakah Pengurus Melantik Semula Juruaudit untuk Urusniaga Pihak Berkaitan? Bukti dari Negara-negara yang Dipilih dalam Asia Timur)

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ABSTRACT

We study the association between auditor reappointment (initial relationship stage), including recurring auditor appointment over several consecutive years (close relationship stage) and company engagement in related-party transactions (RPTs) for selected listed companies from Hong Kong, Malaysia, Singapore and Thailand. The results show that auditor reappointment has significant and negative associations with company engagement in RPTs. By contrast, the close ACR relationship increases company engagement in RPTs. The evidence also suggests that Big 4 audit firms can reduce company engagement in RPTs, even when they have a close relationship. However, the findings derived from a sub-sample of RPT companies suggest that the close relationship between Big 4 audit firms and their clients substantially encourages companies to engage in RPTs. Overall, these findings are consistent with theories in which higher audit quality is effective at monitoring RPTs, but the established relationship looks likely to create conflicting opinions that impair auditors' independent judgment. Nevertheless, the likelihood of conflict disappears when clients operate in countries that more effectively implement and enforce regulations and protect minority shareholders.

Keywords: Auditor-client relationship; auditor tenure; auditor reappointment; related party transactions; audit independence

ABSTRAK

Kami mengkaji hubungan antara pelantikan semula juruaudit (peringkat awal hubungan), termasuk pelantikan semula secara berulang untuk beberapa tahun yang berturutan (peringkat hubungan yang rapat) dan penglibatan syarikat dalam urus niaga pihak berkaitan (UPB) bagi syarikat tersenarai terpilih dari Hong Kong, Malaysia, Singapura dan Thailand. Keputusan menunjukkan bahawa pelantikan semula juruaudit (peringkat awal hubungan) mempunyai hubungan yang negatif dan signifikan dengan penglibatan syarikat dalam UPB. Sebaliknya, pelantikan semula juruaudit di peringkat hubungan yang akrab meningkatkan penglibatan syarikat dalam UPB. Bukti juga mengesyorkan bahawa firma audit "Big 4" boleh mengurangkan penglibatan syarikat dalam UPB, walaupun mempunyai hubungan yang rapat dengan pengurus. Namun, penemuan yang diperoleh daripada sub-sampel syarikat UPB sahaja mencadangkan bahawa firma audit "Big 4" yang mempunyai hubungan rapat dengan pihak pengurusan meningkatkan penglibatan syarikat dalam UPB dengan signifikan. Secara keseluruhan, penemuan kajian ini adalah konsisten dengan teori, kualiti audit yang tinggi efektif dalam memantau UPB. Tetapi, hubungan yang rapat antara juruaudit dan pengurus menyebabkan konflik yang boleh menjejaskan pertimbangan yang bebas. Namun demikian, kemungkinan berlakunya konflik akan lenyap apabila syarikat beroperasi dalam negara yang melaksanakan peraturan dan perlindungan yang efektif kepada pemegang saham minoriti.

Keywords: Hubungan juruaudit-klien; tenur juruaudit; pelantikan semula juruaudit; urusniaga pihak berkaitan; kebebasan audit

INTRODUCTION

The reappointment of the same audit firm over a long-tenure auditor-client relationship (ACR) has been subject to considerable debate and criticism for many years, over more than a decade (Goodwin 2002; Kleinman & Palmon 2001) in which the close ACR (established network) could impair auditor's independent judgment (Beattie & Fearnley 1998; Beattie, Fearnley & Brandt 2004; Schmidt & Cross 2014), particularly after a revelation

of Enron accounting scandals. However, audit firms and auditor's rotation policy in majority jurisdictions over the world has never changed much, including in East Asia countries. Prior studies found mixed evidence to show a prevailing negative impact of close ACR. Instead of auditor's monitoring role in agency conflict as covered in most prior studies (Gallery, Gallery & Supranowicz 2008; Myers, Myers & Omer 2003), this study integrates the close ACR from the networking perspective. Close ACR's literatures e.g. (Beattie et al. 2004; Schmidt & Cross 2014)

suggest that clients (hereafter managers) gain a larger scale of advantages than auditors. Thus, this study argues that managers' decision to reappoint the same auditors for subsequent audit engagements are influenced by many factors (e.g., they may believe in the trustworthiness, service quality and reputation of a service provider in sharing advantages and others) in order to achieve certain goals, including a sustainable competitiveness or opportunity advantages (Chowdhury 2012).

Managers typically focus on degrees of chemistry in their personal relationships prior to selecting a suitable auditor for a company (Beattie & Fearnley 1998) in which managers prefer to appoint auditors from their personal contacts or networks (Beattie et al. 2004). This study employs managers' engagement in related-party transactions (RPTs) as a potential incentive that derive them to reappoint the same auditors over many consecutive years in order to gain benefits from the established close network. The study was motivated by Gordon, Henry, Louwers, and Reed (2007) who highlight that companies engaging in RPTs prefer to appoint auditors with whom they have a sense of chemistry, established through networking or past experiences. Nevertheless, Gordon et al.'s (2007) argument is not empirically proven to date, thus crucially motivating the present study to explore the predicted relationship.

ACRs are formal business relationships, and established networks can benefit one another (de-Ruyter & Wetzels 1999). A recurring appointment of the same auditor over several consecutive years can promote a stronger sense of mutual understanding and can ultimately establish close networks between managers and their auditors (Chowdhury 2012). While managers can use their close networks to increase their companies' operational efficiency levels, opportunistic managers may utilize close networks for personal gains (Hawkins, Knipper & Strutton 2009). Therefore, managers may reappoint the same auditors over several consecutive years to benefit opportunistic advantages from close relationships, including to engage in RPTs. We predict that close ACRs increases number and magnitude of RPTs. Although close relationships can enhance an auditor's efficiency, the auditor can be trapped into conflict of interest scenario (Dao & Pham 2014; Meyer, Rigsby & Boone 2007). If the auditors (who are supposed to play the role of independent external control mechanism) are appointed among managers' close networks, managers engagement in RPTs may cause harm to minority shareholders' wealth.

The auditor is responsible for monitoring and ensuring that RPTs are conducted honestly and disclosed properly. Nevertheless, as several of the accounting scandals that have occurred over the recent decade have involved RPTs, market participants have criticized auditors' capacities to maintain independence in auditor-manager conflict situations. This main concern is aligned with Shockley (1982), who stated that longstanding ACRs promote complacency, lacking innovation, less rigorous audit procedures and learned confidence. Schmidt and

Cross (2014) also emphasized that manager demands and negotiation strategies would be changed throughout the relationship, which are more pronounced than those of auditors in long tenure ACR. Thus, managers may manipulate close ACR advantages to engage in abusive RPTs, as they have access to auditors' preferences.

Therefore, the main objective of our study is to examine the association between auditor reappointment and a company's engagement in RPTs during two different stages: initial or close stages of relationship. We define the initial relationship stage as a reappointment of the same audit firm for a subsequent to the first-year audit engagement. At this stage, the ACR is considered new and fragile, and any disagreement or conflict between both parties can end the relationship easily. By contrast, we define the close relationship stage as an actual tenure of repeated auditor appointment over several consecutive years for the audit engagement. At the close stage, commitment between both is strong (Beattie et al. 2004) and negotiation strategies can also change from the initial stage (Schmidt & Cross 2014).

Another objective of this study is to investigate the association between recurring auditor appointment among Big 4 audit firms and company engagement in RPTs. We extend cross-sectional studies conducted by Gallery et al. (2008) and by Gul, Kim, and Qiu (2010), which suggest that Big 4 audit firms can minimize company engagement in RPTs, can reduce numbers of RPTs and transform RPTs with potential for conflict in facilitating efficient transactions. However, we argue that the use of audit firm size (either by Big 4 or non-Big 4 firms) may not sufficiently reflect close relationships found by Gordon et al. (2007). Can the same Big 4 audit firms withstand independence when firms are reappointed repeatedly over several consecutive years?

RPTs are prominent among companies in many East Asian countries due to company concentrated ownership structures and business landscapes that encourage companies to conduct business with related parties (Claessens, Djankov & Lang 2000; Munir, Mohd-Saleh, Jaffar & Yatim 2013). While corporate governance and regulatory reforms have been extensively implemented in these four countries since the Asian financial crisis in 1997, auditor rotation policies have remained unchanged. We use a sample that consists of 1,269 observations derived from 421 listed companies from Hong Kong, Malaysia, Singapore, and Thailand within three years. The results suggest that initial ACR stage significantly reduce company dealings with related parties. Managers may behave less aggressively as they require ample time to become more familiar with auditors and prefer to cooperate with auditors (Schmidt & Cross 2014). However, the results show the relationship change drastically, the magnitude of RPTs increases along with the number of years auditors are consecutively reappointed. These findings confirm that managers may reappoint the same auditors over several consecutive years in order to conduct RPTs by manipulating the advantages of close relationships. The

evidence is robust when the test is conducted strictly by excluding companies that do not disclose RPTs. Generally, the Big 4 audit firms play an efficient role to reduce the magnitude of RPTs, although they are reappointed over several consecutive years. However, the ability of the Big 4 audit firms to withstand independence on long ACR is impaired when the test is repeated on a sample of RPTs companies.

This cross-country analysis contributes to the existing literature at a broader international perspective involving four selected East Asian countries. We pioneer in contributing evidence of the association between auditor reappointment and company engagement in RPTs. The auditor reappointment is categorized into two stages, an initial ACR stage and a close ACR stage to differentiate an ability of auditor to withstand independence when a tenure of auditor reappointment increases consecutively. At the initial ACR stage, auditor reappointment represents a new relationship, and both manager and auditor are considered to begin understanding and familiarizing themselves with one another. The evidence shows that both parties behave well during the initial relationship stage by limiting high-risk decisions. The finding is consistent with our expectation that auditors exhibit scepticism and professionalism at the initial ACR stage while managers are willing to cooperate with the auditors (Schmidt & Cross 2014).

We also contribute empirical evidence on the above-described relationship at the close ACR stage. Auditors who have been reappointed for several consecutive years may denote a close ACR. While managers are typically more demanding, auditors are expected to be more willing to compromise ethical principles (Schmidt & Cross 2014). The finding supports Gordon et al. (2007) in which we show that managers may opportunistically utilize established close ACRs as incentives to set arrangements with related parties. The magnitude of RPT increases as consecutive tenure relationships continue, suggesting that the managers may intentionally reappoint the same auditors for RPTs. Our study also integrates a function of Big 4 audit firms as independence with high quality monitoring entities for RPTs to a network relationship that raises potential conflicts of interest. Overall, the evidence recommends that Big 4 audit firms can withstand independence to substantially reduce company engagement in RPTs, even when they have close ACR. However, only evidence derived from RPT companies (excluding non-RPT companies) suggests that there is likelihood of Big 4 audit firms to encourage company's engagement in RPTs at the close ACR stage.

Policy makers and regulators are recommended to revisit a mandatory auditor rotation policy, specifically for companies that are engaged in high risk contract involving related parties. Recurring auditor reappointments over several consecutive years are predicted to build up networks and form close relationships and generate future commitments (de-Ruyter & Wetzels 1999). The auditors' capacities to withstand independence and remain sceptical in negotiating specific issues may be compromised as a

result of close relationships (Beattie et al. 2004; Schmidt & Cross 2014).

The remainder of this article is organized as follows: Section 2 presents background information on East Asia, ACR and RPTs, and Section 3 discusses the literature review, theory and the hypotheses. Section 4 describes the research design and Section 5 reports the empirical results. The last section discusses and concludes the findings.

THE LANDSCAPE OF EAST ASIA, ACR AND RPTs

East Asian countries, specifically Hong Kong, Malaysia, Singapore and Thailand, are very important economically and use similar equity capital structures. Most of the listed companies are typically dominated by controlling shareholders through block or concentrated ownership (Claessens et al. 2000), particularly by a family (Villalonga & Amit 2006). Controlling shareholders also typically occupy key managerial positions, and founders and/or their family members often assume upper management positions in these controlled companies (Munir et al. 2013; Wiwattanakantang 2001). This ownership structure encourages controlling shareholders or managers to enter contract arrangements with related parties, specifically among families. In addition, controlling shareholders may enjoy substantial controlling ownership over other entities or affiliates in groups. The dominant control structure creates opportunities for firms to address related members through controlled entities or affiliates, especially when some entities complement or exist to support the operations of others (Thomas, Herrmann & Inoue 2004). Thus, RPTs are prevalent among group companies in inefficient markets of East Asia (Bae, Baek, Kang & Liu 2012). RPTs serve as an alternative market where controlling shareholders can effectively use inter-groups transactions to maximize capital resources, to secure business opportunities, and to secure financial support from the group when outsource funding is difficult to obtain (Khanna & Palepu 1997). RPTs can be used to improve business and communication efficiency levels, to establish business networks, to reduce uncertainties and to save transactional costs for all group companies due to external market inefficiencies (Khanna & Palepu 2000).

However, these affiliations formed under the umbrella of common ownership can be exploited, as the structure allows controlling shareholders or managers to engage in RPTs to expropriate the wealth of minority shareholders (OECD 2009). They also can employ the prospect of incomplete information in external markets due to information asymmetries that help with ways of disclosing, hiding or manipulating RPTs through financial reporting. For example, opportunist controlling shareholders reap private gains from using RPTs by making improper cash or debt transfers, by purchasing assets at inflated prices, and by securing outright bailouts for failing subsidiaries (Jensen & Meckling 1976). The expropriation problem is likely to be more severe in companies where controlling shareholders also occupy management teams (Bebchuk,

Kraakman & Triantis 2000). Thus, the internal markets of group companies may increase the number of abusive RPTs (Jian & Wong 2010). Additionally, since the 1997/1998 Asian Financial crisis, the emerging economies of East Asia have been notorious for exhibiting poor corporate governance, regulatory frameworks and weak level of minority shareholders' right enforcement (Mitton 2002) which created a conducive business landscape that renders RPTs inevitable (Villalonga & Amit 2006).

Minority shareholder protection mechanisms in East Asian countries may improve following amendments or the issuance of acts or regulations. Each East Asian country has strengthened corporate governance practices by establishing institutions and by introducing and promoting the best practice code on corporate governance. A broad range of laws and regulations have been enacted; financial reporting standards have been developed, and the enforcement perspective has been strengthened (Abdul-Wahab, Haron, Lok & Yahya 2011). The Stock Exchanges in East Asia also stress that every RPT is required to grant a general mandate of approval from shareholders as well as thresholds to be disclosed. While soliciting shareholder approval, the interested party and any associate of the interested party cannot vote on the RPT resolution. Central minority shareholder groups such as The Minorities Shareholders Watchdog Group in Malaysia and Singapore's Securities Investors Association are established to provide advisory to investors.

Mandatory rotations are proposed as a means of improving auditor independence and audit quality levels by limiting frequent interactions between managers and auditors. There are two forms of auditor rotation: partner rotation and audit firm rotation. Although the mandatory rotation is recommended, many East Asian countries prefer longer periods between rotations. Hong Kong, Malaysia and Singapore do not require audit firm rotations and instead require audit partners to be rotated for every five years. In Japan, no rotation requirements are placed on audit firms or audit partners, while in China, both audit firms and audit partners must be rotated every five years. Only in Taiwan mandatory rotation rule requires audit partners to rotate every year. Most listed companies in these four countries studied have retained the audit firms in practice for more than six years (Abu Thahir, Wahid, Nazri & Hudaib 2006).

LITERATURE REVIEW, THEORY AND DEVELOPMENT OF HYPOTHESES

ACR AND RECURRING AUDITOR REAPPOINTMENT

The concept of ACRs extends beyond the scope of buyer-seller relationships documented in the marketing literature, as auditors are required to withstand independence from their clients (Kleinman & Palmon 2001). ACRs are not only restricted by guidelines and laws, and rationality and emotions cannot be separated as they are part of the

human being's experience, often complementing one another during decision-making (Monin, Pizarro & Beer 2007). ACRs involve an exchange of interdependence where managers need audit services provided by auditors while auditors require audit fees from clients for business survival (Goldman & Barlev 1974; Nichols & Price 1976). ACRs also require cooperation and interaction, as auditors depend on clients for information while conducting audit work (de-Ruyter & Wetzels 1999).

Past studies debated consequences of long tenure ACR from two opposite views. Proponents argue that long tenure ACRs can develop auditors' client-specific knowledge, reduce a recurring client's business understanding of costs and limit conflicts between managers and auditors (Levinthal & Fichman 1988). Auditors also benefit from learning curve effects through the detection of a material misstatement (DeAngelo 1981), while a new auditor can make more mistakes due to a lacking understanding of a client's business (Vanstraelen 2000). On the other hand, opponents are more concerned that long tenure ACR impairs auditor independence and reduce audit quality levels. Close ACRs increase auditor loyalty to their clients (de-Ruyter & Wetzels 1999) and create economic dependence between auditors (Nichols & Price 1976). Thus, the close ACR affects incumbent auditors' complacency, limits innovativeness, and results in fewer rigorous audit procedures (Shockley 1982) and may be less sceptical and able to preserve a decline in independence over time (Whittington, Grout & Jewitt 1995). Some prior studies have evidence that long-tenure ACRs are associated with lower levels of conflict, disagreement between managers and auditors, and decrease a likelihood of auditors in issuing a qualified opinion (Levinthal & Fichman 1988). Beasley, Carcello, Hermanson and Lapides (2000) also criticized that the auditor may choose to cooperate with a client's decision to conceal an abusive RPT. Opportunistic managers can misuse the established network with repeatedly reappointed auditors and put pressure on auditors to meet their needs (Schmidt & Cross 2014).

RPTS AND EXPROPRIATION IN EAST ASIA

RPTs have received considerable attention since they were used as expropriation tools in many global corporate collapses (Munir et al. 2013). RPTs are a normal course of business in which they are frequently maintained through subsidiaries, joint ventures, associates or affiliates (Thomas et al. 2004). Two views on RPTs due to nature and complexities of RPTs can be utilized either efficiently or opportunistically. The efficient views suggest that RPTs can reduce costs, improve efficiency levels (Jian & Wong 2010), and help companies meet their economic and financial goals (Gordon et al. 2007). For example, managers can ensure an efficiency of the company's daily business operation by buying raw materials from subsidiaries at a lower cost than the market price. Managers also can utilize RPT to allocate resources for

helping subsidiaries that experienced financial difficulty (Khanna & Palepu 1997). RPTs are also legal agreements and not necessarily indicate that a company engages in greater earnings management or fraudulent reporting to deceive investors (Gordon et al. 2007).

By contrast, the conflict of interest view argues that RPTs increase the probability of aggressive accounting in which affect earnings quality (Sherman & Young 2001). Managers and controlling shareholders can manipulate a term of a transaction and disclosure for personal gains due to an information asymmetry. The conflict of interests are hidden behind RPTs among affiliates or subsidiaries that they hold duality ownership in both entities. RPT may be seen efficient to the company but with a duality ownership the managers or controlling shareholders may increase own wealth. Many prior studies support that RPTs are used as tunneling tools to transfer assets and profits away from companies to the benefit of those who control them (Cheung, Jing, Lu, Rau & Stouraitis 2009; Gordon, Henry & Palia 2004).

Nevertheless, an underlying reason of RPT's commitment is difficult to be identified (Louwers, Henry, Reed & Gordon 2008) either to represent efficient or conflict of interest, particularly at international level due to different requirements and standards for RPT's disclosure. RPTs have caused many audit failures (Beasley et al. 2000). Considering the nature of RPTs as a normal business transaction, legal and soundly efficient for company's daily operation, complex and gives privilege to violate arm's length assumption (agreed at a lower or higher than the market price), RPTs are opportunistic contracts.

INITIAL AND CLOSE STAGES OF ACRS AND RPTS IN EAST ASIA

The ACR does not simply emerge. Rather, it evolves through a process over time. Such process involves establishing, developing and maintaining successful relationships (Morgan & Hunt 1994). Scanzoni (1979) described the process as involving five phases, i.e., awareness, exploration, expansion, commitment and dissolution. During the awareness phase, both parties strive to secure a position in the best possible way in order to increase levels of attraction between one another. After the awareness phase is the exploration phase, where both parties become acquainted with one another by considering ACR requirements, benefits and burdens and start-up costs, which are relatively high in the audit services market. The relationship remains fragile, can be easily terminated as no major investment has been made and interdependence is not yet achieved (de-Ruyter & Wetzels 1999). These two phases are referred to as reappointment phases after the first year of relations (Dwyer, Schurr & Oh 1987). At this initial stage, the auditor will minimize audit risks, avoid unethical conduct and complete work according to audit guidelines and requirements. By contrast, the manager respects the auditor and is willing to cooperate by being less demanding. The expansion phase refers to

the continual increase in benefits to be obtained; both parties begin to trust one another more and become satisfied with the relationship. During the commitment phase, both parties have achieved a level of satisfaction from the relationship, which is the most desirable one in the development of an ongoing ACR (Dwyer et al. 1987). The final phase is dissolution, whereby one party begins to evaluate his or her dissatisfaction with the other party of dissolution (de-Ruyter & Wetzels 1999) due to disagreements or regulatory reasons.

The ACR involves a continuation process, and such a relationship develops considerably (close) during the commitment phase in which is developed concurrently with increase in a tenure of engagement. Reappointment is done by managers once they are satisfied with the auditors' working behaviours and services rendered (Öhman, Häckner & Sörbom 2012), thus increase the audit engagement tenure (Beattie & Fearnley 1998). As the reappointment tenure becomes longer, the interpersonal relationship becomes stronger between managers and audit firms (Meyer et al. 2007) and managers and audit partners (Ball, Tyler & Wells 2015). Thus, the close ACR can develop trust resulting in hassle-free and efficient audit engagements and increased efficiency. Within this context, managers' intention to reappoint the same auditors for a subsequent audit can be considered as an initiative to form the close ACR.

By contrast, managers may also reappoint the auditors in consecutive long tenure to get their objectives realized in later years since the decision to terminate and continue relationship is in their hands (Bennouri, Nekhili & Touron 2015). Managers can easily convince the auditor to accept managers' preferred treatment (Kerler & Brandon 2010) when they have gained trust from the auditors. The close ACR, which is acquired through a long tenure reappointment (Reheul, Caneghem & Verbruggen 2013) may cause auditors to become less sceptical 44 (Baker & Al-Thuneibat 2011). The opportunistic managers may use the close relationship to maximize personal gains by engaging in contracts through RPTs. Managers can also use a personal relationship through past experiences and informal ties (Waresul, van_Zijl & Mollah 2013) as well as degrees of chemistry in their personal relationships (Beattie & Fearnley 1998) as a basis for reappointing the same auditors. Thus, it is crucial to understand managers incentives to retain the same audit firms over several consecutive years. Do such processes occur coincidentally or are they intentionally planned?

The quality of the ACR is vital when determining an auditor's ability to monitor manager engagement in RPT activities (Meyer et al. 2007). Auditors are required to be more sensitive to any indicators that may result in RPT activities. However, RPT auditing is not an easy task, as when ascertaining undisclosed RPTs, opportunistic managers may intentionally prevent RPTs from being audited (Gordon et al. 2007). Therefore, auditors must be equipped with sufficient knowledge and experience to allow them to be more sceptical of RPT indicators.

Consistent with theory, ACRs involve a continuation process, the relationship is fragile at the initial stage and strong relationships are considered to exist during the commitment stage. At the initial stage, relationships are considered delicate and both parties are working to understand one another. The auditors will conduct audit work purely consistent with auditing requirements. By contrast, managers cooperate with the auditors' requests to comply with financial reporting standards and place few pressures on the auditors (Schmidt & Cross 2014). Auditors are required to review RPTs every year when auditing company's financial statements. At this initial ACR stage, the auditors are expected to have familiarity with the clients and prefer to withstand independence and avoid violating auditing requirement standard. The auditors can play monitoring role in preventing abusive contract during initial ACR stage, including RPTs from manifesting. As a result, RPTs and any indicator of undisclosed RPTs will be audited thoroughly, which will reduce magnitude of RPTs, particularly the abusive. We develop the following hypothesis (H_1) to confirm that at the initial stage ACR magnitude of RPTs would be minimized.

H_1 During the initial ACR stage, auditor reappointment is negatively related to RPTs

Recurring auditor appointments in many consecutive years allow auditors to acquire specific client knowledge and to thus produce high quality audits (Myers et al. 2003). By contrast, retaining the same auditors in long tenure ACR will cause auditors to become empathetic towards client's companies and poor judgment (Dao & Pham 2014; Meyer et al. 2007). When the ACR reaches the commitment (close) stage, levels of negotiation power may be influenced by interdependencies between both parties that typically favour managers (Nichols & Price 1976). Major concerns centre on the argument that close ACRs cause auditors to prioritize client demands over stakeholders' interests. Managers also can influence auditors' judgment by offering recurring appointments over several consecutive years and/or by offering non-audit service portfolios (Beattie et al. 2004; Meyer et al. 2007).

Schmidt and Cross (2014) depict that auditor negotiation strategies change when the ACR is extended. Managers are more demanding and employ stronger strategies during negotiations that can influence and dominate auditors. Auditors may not be able to efficiently prevent the occurrence of abusive RPTs. This conclusion is consistent with theories and prior studies, including Schmidt and Cross (2014) who state that managers use contentious approaches to get their views accepted. While predicting magnitude of RPTs increases in long tenure ACR, hypothesis H_2 is developed to confirm a direct relationship between close ACRs and RPTs.

H_2 During the close ACR stage, auditor reappointments occurring over several consecutive years are positively related to RPTs

RECURRING REAPPOINTMENTS OF BIG 4 AUDIT FIRMS AND RPTS IN EAST ASIA

Several prior studies show that Big 4 audit firms are likely more capable of monitoring RPTs activities. Gallery et al. (2008) and Gul et al. (2010) show that Big 4 audit firms play a significant governance role in reducing the number of RPTs and converted RPTs with potentials to become abusive in facilitating efficient transactions. However, these prior findings disregard the existence of close ACR, which may impair auditor independence. This argument is aligned with Almutairi, Dunn and Skantz (2009) in that information asymmetries and audit tenure involve a U-shaped process where information asymmetries are more pronounced during the first year of engagement, decrease during initial years and increase over longer periods of tenure.

Existing evidence supports the fact that ACRs become stronger when managers reappoint the same auditors over several consecutive years. Close relationships involving higher levels of trust and commitment between auditors and managers may exacerbate information asymmetries. When the trust element evolves, auditors may apply less scepticism while conducting audit work (Luippold, Kida, Piercey & Smith 2015). We stress that the efficiency role of Big 4 audit firms in the context of close relationships stage resulting from recurring reappointments over several consecutive years has remained unexplored. Close ACR due to long tenure are likely to compromise auditor's scepticism attitudes despite the efficiency of Big 4, specifically to negotiate specific issues such as RPTs (Beattie et al. 2004; Schmidt & Cross 2014). Thus, we present the following hypothesis:

H_3 During the close ACR stage, recurring auditor reappointments over several consecutive years from Big 4 audit firms are positively related to RPTs

RESEARCH DESIGN

The sample consists of companies listed in Hong Kong, Malaysia, Singapore and Thailand from 2008 to 2010. Hong Kong and Singapore represent superior minority shareholder protection and higher governance quality while Malaysia and Thailand represent relatively poor regulatory regimes (World Bank 2012). However, we acknowledge that these four countries have been advanced in terms of implementing and reforming corporate governance practices and various company related statutes over the last decade relative to other East Asian countries. Thus, a quality of reporting standards should be higher and more reliable. Crucially, the majority of companies listed in these four countries publish annual reports in English because we have to collect data manually from annual company reports. Additionally, audit firms and auditors' rotation policy in these selected countries has never been changed since it was implemented until nowadays. Also, there is no major regulation on RPTs implemented since

2007. Thus, we argue that the data is relevant to show the current predicted relationships. Some non-financial data on archive corporate governance structures, ownership structures and audit quality levels were also collected manually from the annual reports. We collected additional annual company reports for 2002 to 2007 to assess the number (tenure) of recurring and consecutive years during which auditors had been reappointed.

A database was screened to exclude companies without a complete set of required annual reports and financial institutions due to different regulatory requirements. From the available database, the companies were ranked by average company size for the prior three years and roughly one-third of the data for each country were selected via stratified random sampling. This procedure rendered the sample representative, including a balanced number of large and small companies. We identified 423 listed companies over the three-year period and collected a total of 1,269 observations, involving four major industries, i.e., manufacturing, retail, service, and property companies. We omitted a few observations due to the presence of incomplete information, producing a final sample of 1220 observations. We created another sub-sample of companies that disclosed RPTs in annual reports during the period, generating a total of 783 observations. The sub-sample was aligned with our objective to investigate whether RPTs whereby companies that reappointed the same auditors over several consecutive years were associated with the intention to engage in RPTs. In turn, we avoided potential confounding effects of non-RPTs companies.

We used a pooled regression to examine the hypotheses. The regression models are as follows:

$$\begin{aligned} RPTS_{i,t} = & \beta_0 + \beta_1 ReApp_{i,t} + \beta_2 RecReApp_{i,t} + \beta_3 AudQ_{i,t} \\ & + \beta_4 AOPIN_{i,t} + \beta_5 GROWTH_{i,t} + \beta_6 SIZE_{i,t} \\ & + \beta_7 LEV_{i,t} + \beta_8 BDSIZE_{i,t} + \beta_9 BDIND_{i,t} \\ & + \beta_{10} ACIND_{i,t} + \beta_{11} CS_{i,t} + \beta_{12} CSF_{i,t} + \beta_{13} RISK_{i,t} \\ & + \beta_{14} EQ_{i,t} + \beta_{15} \sum_{ij}^3 Year_{i,t} + \beta_{16} \sum_{ij}^4 Ind_{i,t} + \\ & \beta_{17} \sum_{ij}^4 Country_{i,t} + \varepsilon_{i,t} \end{aligned} \quad (1)$$

$$\begin{aligned} RPTS_{i,t} = & \beta_0 + \beta_1 ReApp_{i,t} + \beta_2 RecReApp_{i,t} + \\ & \beta_3 RecReApp_{i,t} * Big4_{i,t} + \beta_4 AOPIN_{i,t} + \\ & \beta_5 GROWTH_{i,t} + \beta_6 SIZE_{i,t} + \beta_7 LEV_{i,t} + \\ & \beta_8 BDSIZE_{i,t} + \beta_9 BDIND_{i,t} + \beta_{10} ACIND_{i,t} + \\ & \beta_{11} CS_{i,t} + \beta_{12} CSF_{i,t} + \beta_{13} RISK_{i,t} + \beta_{14} EQ_{i,t} + \\ & \beta_{15} \sum_{ij}^3 Year_{i,t} + \beta_{16} \sum_{ij}^4 Ind_{i,t} + \beta_{17} \sum_{ij}^4 Country_{i,t} \\ & + \varepsilon_{i,t} \end{aligned} \quad (2)$$

In the models, $RPTS_{i,t}$ is a vector describing an abnormal magnitude of total RPTs. $ReApp_{i,t}$ denotes a binary variable representing auditor reappointment, value equals to “1” if a company reappoints the same auditor or “0” if a company switches the auditor. $RecReApp_{i,t}$ is the actual number of consecutive years during which audit firms were reappointed after the first year of engagement. $RecReApp_{i,t} * Big4_{i,t}$ is the actual number of consecutive years during which Big 4 audit firms were reappointed after the first year of engagement. $AudQ_{i,t}$ is a binary variable representing an audit quality, value equals to “1” if a firm is audited by the Big 4 or “0” if otherwise. $AOPIN_{i,t}$ is an

indicator variable, equals to one if an auditor issued a clean audit opinion and zero otherwise. $GROWTH_{i,t}$ is a company’s market value at the end of a year t divided by book value of total assets. $SIZE_{i,t}$ is a natural logarithm of a company’s total assets. $LEV_{i,t}$ is the ratio of total debt over total assets. $BDSIZE_{i,t}$ is the board size based on the actual number of directors. $BDIND_{i,t}$ is the proportion of independent non-executive directors to total board members. $ACIND_{i,t}$ is the proportion of independent non-executive members to total members on an audit committee. $CS_{i,t}$ is a percentage of ownership belonging to a controlling shareholder. $CSF_{i,t}$ is a binary variable equals to “1” if a controlling shareholder is an individual or family group and “0” if otherwise. $RISK_{i,t}$ is an operating risk measured based on a three-year earning standard deviation. $EQ_{i,t}$ is earnings quality measured based on discretionary accruals (modified Jones’s model). $Year_{i,t}$ is a vector of year indicator variables for 2008, 2009, and 2010. $Ind_{i,t}$ is a vector of industry indicator variables based on the GICS industry classification. $Country_{i,t}$ is a vector of country indicator variables. $\varepsilon_{i,t}$ is the error term.

Equation 2 is developed to exclude $AudQ$ as this variable is highly correlated with $RecReApp * Big4$ at roughly 0.80. We measure RPTs based on an abnormal magnitude of transactions in which the magnitude of RPTs minus the mean RPT value, which is determined by controlling the year, industry and country. Then, the abnormal magnitude is scaled by the starting total assets for each year. This centric measurement approach has been extended from prior studies, including Cheung, Rau, and Stouraitis (2006) and Jian and Wong (2010). The independent variable, which is the auditor reappointment ($ReApp$), refers to the reappointment of an auditor after the first year of engagement. Every observation at year t (2008, 2009 and 2010) is assumed as a second year after the first-year engagement. The previous year, $t-1$ is assumed as the first time the audit firms were appointed by the company. The measurement excludes the actual number of consecutive years during which auditor was reappointed. This assumption is vital to represent $ReApp$ as the initial ACR stage. It is scaled by a dummy variable that is equal to one when a company reappoints an auditor and which is equal to zero when a company appoints a new auditor. Another independent testing variable, which is the auditor recurring reappointment ($RecReApp$), considers the tenure of an auditor who had been reappointed; this is measured based on the actual number of years during which an audit firm is employed by a firm in year t minus the first engagement year.

We included control variables to represent company-specific characteristics, corporate governance patterns, audit quality levels, ownership structures and earnings quality levels that may have an effect on a company’s involvement in RPTs. Cross-sectional differentials of company characteristics include the following: control through company growth ($GROWTH$), size ($SIZE$), leverage (LEV), operating risk ($RISK$) (Ahmed, Hossain & Adams, 2006) and earnings quality (EQ) (Gaio & Raposo 2011). We controlled for audit quality ($AudQ$) (Gallery et al.

2008; Gul et al. 2010) and the types of audit opinions (*AOPIN*) expressed by auditors during a given period. We also controlled for cross-sectional differentials in corporate governance characteristics that may influence company RPT involvement, including board size (*BFSIZE*) (Mohd-Saleh, Iskandar & Rahmat 2005), board independence (*BDIND*) (Gordon et al. 2004), audit committee independence (*ACIND*), controlling shareholders (*CS*) (Gordon et al. 2004), and types of controlling shareholders (*CSF*) (Munir et al. 2013; Wiwattanakantang 2001). Consistent with cross-country sectional pooled data, we included *Year*, *Industry* and *Country* indicators to control their differential effects (Mitton 2002). The detail measurements of these control variables are shown in Appendix A.

RESULTS

DESCRIPTIVE ANALYSIS

Panel A of Table 1 shows descriptive statistics based on all observations and only companies that disclosed RPTs, while Panel B of Table 1 presents frequency statistics for binary variables. Panel A of Table 1 shows that RPTs have a mean (median) value of -0.45 (-0.05) with a standard deviation of 1.19. The mean (median) value of RPTs reaches -0.56 (-0.08) with a standard deviation of 1.38 for RPT companies only. Excluding non-RPT companies from the sample removes 11% percent [-0.56(-0.45)] of

the RPT mean value, which is considered significant in interpreting the findings. The standard deviation for all of the variables is considered to be small, suggesting that the data are not widely dispersed.

Panel B of Table 1 presents a frequency of auditor reappointment (*ReApp*) with 1,200 observations, which represents 94.8% of companies that reappointed the same auditors for audit engagements in subsequent years. The table also shows 763 (94.2%) observations of reappoint of the same auditors for the subsequent engagement among RPT companies. In addition, Panel A of Table 1 shows that the companies reappoint the same audit firms for several consecutive years and for more than five years on average. The mean and median values for *RecReApp* are 5.56 (6.00) and 5.43 (6.00), respectively. These statistics indicate in average that the companies retained the same audit firms for more than five years, which may be associated with intentions to establish close relationships. These statistics are consistent with a study by Abu Tahir et al. (2006) that found majority companies in Malaysia retained the same auditors for more than five years.

Table 1 also shows that the mean, median and standard deviations for the control variables do not indicate that the data are widely dispersed. The Pearson's correlation matrix for companies that disclose RPTs (not tabulated) suggests that there is no indication that unreasonably high correlations are present among the independent variables. These values suggest that there is no a harmful level of multicollinearity (Neter, Wasserman & Kutner 1983).

TABLE 1. Descriptive analysis

Panel A:	All Samples					RPT Companies Only				
	Mean	Median	Max	Min	Std. Dev.	Mean	Median	Max	Min	Std. Dev.
RPTs	-0.45	-0.05	1.33	-7.84	1.19	-0.56	-0.08	1.33	-7.84	1.38
RecReApp	5.56	6.00	8.00	0.00	2.35	5.43	6.00	8.00	0.00	2.43
GROWTH	0.73	0.48	6.09	0.05	0.86	0.75	0.49	6.09	0.05	0.90
LEV	0.15	0.12	0.60	0.00	0.14	0.15	0.12	0.60	0.00	0.14
BFSIZE	9.04	9.00	18.00	4.00	3.03	9.39	9.00	18.00	4.00	2.93
BDIND	0.43	0.40	0.82	0.17	0.13	0.42	0.40	0.82	0.17	0.13
ACIND	0.90	1.00	1.00	0.50	0.15	0.92	1.00	1.00	0.50	0.14
CS	0.36	0.33	0.85	0.04	0.18	0.34	0.30	0.85	0.04	0.18
RISK	9.34	9.21	13.84	5.82	1.75	9.29	9.16	13.84	5.82	1.76
EQ	0.08	0.05	0.87	0.00	0.10	0.07	0.05	0.65	0.00	0.08
Panel B:	Frequency					Frequency				
ReApp	1,200 (94.8%)					763 (94.2%)				
AudQ	929 (73.2%)					584 (71.8%)				
AOPIN	1,217 (95.9%)					781 (96.1%)				
CSF	548 (43.3%)					343 (42.4%)				

Notes: Variables are defined in Appendix A. Year, Industry and Country variables are not reported for brevity.

MULTIPLE REGRESSION RESULTS

Table 2 shows our results on the association between auditor reappointment (*ReApp*) and recurring auditor reappointment (*RecReApp*) with the abnormal RPTs. Panel A of Table 2 shows the results derived for the whole sample, while Panel B depicts the results for the RPT companies. Model 1 in Panel A of Table 2 shows that *ReApp* has a significant negative relationship with abnormal RPTs (the coefficient is -0.27 ($t = -3.3$; $p < 0.01$)¹), supporting the hypothesis. The adjusted R^2 of the model is 33.2%. This result indicates that during the initial ACR stage, when audit firms are first reappointed for another annual contract, auditors are highly efficient at limiting company involvement in RPTs.

We found that *RecReApp* has a significant and positive association with abnormal RPTs as predicted. The coefficient is 0.03 ($t = 2.6$), significant at the $p < 0.01$ level. This result indicates that the magnitude of RPTs increases with ACR length. This suggests that recurring auditor appointments over several consecutive years may be related to managers' intentions to engage in RPTs. The coefficients of other control variables (*AudQ*, *GROWTH*, *SIZE*, *LEV*, *CSF*, and *RISK*) are positive while *AOPIN*, *BDIND*, *BFSIZE*, *BDIND*, *CS* and *EQ* are negative, justifying the

need to control their effects on company involvement in RPTs prior to examining the effects of recurring auditor appointment.

Model 2 in Panel A of Table 2 shows the *RecReApp***Big4* results, or interactions between *RecReApp* and Big 4 audit firms. In this regression model, we excluded a control variable, *AudQ*, as this variable is highly correlated with *RecReApp***Big4* at roughly 0.80. The adjusted R^2 is 33.1% accurate at explaining the predicted relationship. The results show that the associations between *ReApp* and *RecReApp* and abnormal RPTs are consistent with the results obtained from Model 1. The coefficients are almost the same -0.28 ($t = -3.4$) and 0.04 ($t = 3.1$), respectively, at a significance level of $p < 0.01$. The most crucial is the findings pertaining to the fact the *RecReApp***Big4* coefficient is negative (-0.01; $t = -2.6$) and also significant at $p < 0.01$. The directions and significance level of all of the control variables are consistent with Model 1. These results indicate that recurring auditor reappointments from Big 4 audit firms effectively limit company's RPT engagement. This evidence suggests that Big 4 audit firms can maintain independence while keeping the close relationships healthy, thus playing a vital role in discouraging RPTs (and mainly abusive ones).

TABLE 2. The results of the association between auditor reappointment and RPTs

Variables	Panel A		Panel B	
	Whole Samples (n = 1,231)		RPT Companies (n = 783)	
	Model 1	Model 2	Model 1	Model 2
Constant	-4.45 (-20.2)***	-4.50 (-20.7)***	-6.03 (-21.7)***	-6.11 (-21.7)***
ReApp	-0.27 (-3.3)***	-0.28 (-3.4)***	-0.43 (-5.1)***	-0.47 (-7.0)***
RecReApp	0.03 (2.6)***	0.04 (3.1)***	0.03 (2.4)**	0.05 (3.0)***
RecReApp* <i>B4</i>		-0.01 (-2.6)***		0.01 (2.2)**
AudQ	0.07 (6.5)***		0.15 (5.3)***	
AOPIN	-0.07 (-2.9)***	-0.07 (-2.0)**	-0.06 (-0.9)	-0.03 (-0.4)
GROWTH	0.04 (4.4)***	0.04 (4.4)***	-0.01 (-0.9)	-0.02 (-2.6)***
SIZE	0.36 (15.0)***	0.36 (15.2)***	0.47 (21.6)***	0.48 (22.1)***
LEV	0.38 (2.6)***	0.37 (2.5)***	0.38 (2.7)***	0.35 (2.2)**
BFSIZE	-0.04 (-5.0)***	-0.04 (-5.1)***	-0.01 (-2.9)***	-0.02 (-4.7)***
BDIND	-0.74 (-25.6)***	-0.75 (-21.9)***	-0.66 (-5.6)***	-0.81 (-4.8)***
ACIND	-0.07 (-0.6)	-0.07 (-0.5)	-0.20 (-0.9)	-0.16 (-0.6)
CS	-0.49 (-7.9)***	-0.48 (-7.9)***	-0.36 (-5.0)***	-0.12 (-1.5)
CSF	0.10 (2.3)**	0.10 (2.2)**	0.08 (1.5)	0.06 (1.2)
RISK	0.01 (4.7)***	0.01 (4.4)***	0.00 (0.1)	-0.01 (-0.8)
EQ	-0.50 (-4.0)***	-0.50 (-4.0)***	-0.94 (-3.4)***	-0.57 (-1.2)
Year	Included	Included	Included	Included
Industry	Included	Included	Included	Included
Country	Included	Included	Included	Included
Adj. R^2	33.2%	33.1%	39.2%	34.7%

Notes: ***, **, * represent statistical significance at the 1 percent, 5 percent, and 10 percent levels, respectively. Variables are defined in Appendix A. Year, Industry, and Country variables are not reported for brevity.

We exclude non-RPT companies to further investigate whether the above findings are affected by the inclusion of companies that did not disclose RPTs. The descriptive analysis shows that the non-RPT companies reduced the mean value of abnormal RPTs by roughly 11%, which is considered substantial. The results are shown in Panel B of Table 2 and the adjusted R^2 values of Models 1 and 2 are higher than those of the models on the whole samples (39.2% and 34.7%, respectively). The results of Model 1 are consistent with the results for the whole samples. The *RecReApp* coefficient is also similar: 0.03 ($t = 2.4$) at a significance level of $p < 0.05$. By contrast, the coefficient for *ReApp* (-0.43 [$t = -5.1$]) significant at $p < 0.01$ is substantially larger than that for the whole samples. This finding strongly suggests that recurring auditor appointments over several consecutive years are effective at limiting RPTs. The *ReApp* and *RecReApp* results shown in Model 2 are also consistent, but the coefficients are larger compared to those of the whole sample. The coefficient for *ReApp* is -0.47 ($t = -7.0$), and the coefficient for *RecReApp* is 0.05 ($t = 3.0$), and both are significant at $p < 0.01$.

By contrast, the *RecReApp*Big4* coefficient is positive at 0.01 ($t = 2.2$) and is significant at $p < 0.05$. This contradictory result confirms that the negative relationship found for the whole samples is influenced by the presence of non-RPT companies. These results are considered accurate, as one-third of the sampled companies that had been audited by Big 4 audit firms were not engaged in or disclosed RPTs. Overall, Big 4 audit firms can maintain independence over long-term ACRs. However, Big 4 audit firms that had been reappointed over several consecutive years by RPT companies encouraged RPTs. This result confirms that close ACRs may limit auditor scepticism in evaluating RPTs. The contradictory results found for the whole samples substantially support our argument that managers intentionally reappoint auditors (including Big 4 audit firms) to establish close relationships.

ADDITIONAL ANALYSIS: REGULATORY REGIMES WITH GREATER MINORITY SHAREHOLDER PROTECTION

The tests were repeated by controlling for regulatory regime differentiation within the sampled countries. We created two groups based on the World Governance Indicator Index (World Bank 2012). Hong Kong and Singapore are represented by a dummy variable indicator (*HProtect*) equals to 1, as these countries exhibited superior minority shareholder protection measures and higher governance quality levels than Malaysia and Thailand, which were assigned a value of 0 for exhibiting poor regulatory regimes. The results were not tabulated but showed that *RecReApp*HProtect* and *RecReApp*B4*HProtect* have negative and significant associations for all of the company models and those for RPT company models. These results show that relationships between auditor reappointment in over many consecutive years, including by the Big 4 audit firms and RPTs were attenuated in countries where

minority shareholder protection is more effective and where more effective governance mechanisms are in place. These findings may confirm that the ability of managers to establish close networks of ACR for opportunistic purposes is prominent in countries presenting lower levels of shareholder protection, less effective corporate governance practices and lacking enforcement of implemented regulations.

DISCUSSION AND CONCLUSION

This study examines company behaviors in reappointing auditors over several consecutive years and RPTs, for four East Asian countries due to the dominance of family and concentrated ownership structures. Although the OECD and ASEAN countries have worked together by implementing several measures to improve governance mechanisms and have updated relevant regulatory provisions to reduce the opportunistic nature of RPTs, there is no specific provision discussing this issue from the perspective of tenure ACRs. While research on this issue referring to the East Asian region has been limited, this study fills the knowledge gap on this important research issue by investigating company auditor reappointment associations at two different stages (initial and close stages of ACRs) and RPTs for East Asian companies. The evidence shows that *ReApp* limits manager engagement in RPTs. This is consistent with the argument that during initial ACR stages, relationships are considered fragile and managers are more cooperative, as the auditor's negotiation power is greater than that of the client (Schmidt & Cross 2014). It supports that audits conducted by Big 4 audit firms effectively minimize the number of RPTs, can maintain independence and remain healthy relationships.

The findings are robust for both models and samples, suggesting that close ACR stages (*RecReApp*) increase manager dealings with related parties. The evidence is in support of Gordon et al. (2007) that companies involved in RPTs - especially the abusive- maintain close relationships and networks with the auditors. Managers may intentionally establish close ACRs by reappointing auditors on a continual basis in order to reduce auditor scepticism and the questioning of company incentives while carrying out RPTs (Schmidt & Cross 2014). Managers can select favoured auditors from their established close networks in which provide managers with choices, however auditors can be influenced by. While close ACR may impair an auditor's ethical judgment, the implementation of RPTs and reporting requirements may be easily agreed upon by auditors. This supports the contention that recurring auditor appointments over several consecutive years are opportunistically used to support RPT implementation.

The findings also show that close ACRs from Big 4 audit firms can play a significant role in limiting RPTs. This suggests that close ACRs do not necessarily generate conflicts of interest. Some auditors from Big 4 audit firms

conduct professional works objectively and independently to uphold their reputations. These individuals resist being influenced by pressures from managers despite being reappointed over several consecutive years. However, for those companies that were engaged in RPTs, the findings empirically show that the close ACR from Big 4 audit firms encourages companies to engage in RPTs. This is concerning, as such auditors may become complacent and may lack scepticism in querying RPTs, specifically given that such transactions are likely to be abused. The above findings contribute substantially to the literature as the first study to date that provides empirical evidences on the relationship between ACR (at initial and close ACR stages) and RPTs. However, implications of recurring auditor appointments over several consecutive years among Big 4 audit firms can be generalized to two perspectives. Under certain circumstances, when Big 4 audit firms have the incentive and capacity to maintain independence, close relationships are considered healthy. In contrast, such relationships may be considered unhealthy when an auditor enters a conflict of interest due to his failure to respond to a client's influence. Nevertheless, ACR involves human being relationship which is difficult to judge the healthier level of the relationship, creating a big challenge for future researches.

Our samples present some limitations that may affect our findings. The abnormal RPTs were determined based on information disclosed in annual company reports but there is possibility that companies engaged in RPTs may not have disclosed such transactions. RPT companies also did not disclose market prices on the reported RPTs, and thus abusive RPTs are related to potential effects and not to actual tunneling processes. We limited our conclusions on initial ACRs, as our measurements were assessed by excluding the actual number of years during which auditors were reappointed. We were also unable to simply interpret close ACR as Big 4 firms and RPTs present negative impressions due to the difficulty to judge when RPTs are abused. Auditors from Big 4 audit firms can also evade firm policy and reputation incentives and maintain independence while being reappointed through long-tenure ACRs.

Our findings imply that managers, particularly the opportunistic managers gain more advantages from close ACR in which they can manipulate the relationship for fulfilling their personal interests. This circumstance urges policy makers to revisit existing auditor rotation policies. Close ACR should be carefully considered, specifically with regards to companies that engage with any high risk contract such as RPTs. It seems likely that close ACRs can be used opportunistically by companies as tools to engage in RPTs, which can harm shareholder interests. Close ACRs with strong networks provide managers with choices that allow them to place pressures on auditors. Interdependence auditors can in turn be influenced, potentially limiting their degree of scepticism and independence. As a result, managers can easily engage in any desired contract. Thus, the mandatory rotation policy should not focus only on

auditors but should also focus on the design of the rotation policy to minimize managers' opportunity in threatening the auditors.

ENDNOTE

We report t-Statistics based on White's (1980) consistent estimator.

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APPENDIX

APPENDIX A. Variable definitions & measurements

Variables	Explanation
<i>RPTs</i>	An abnormal magnitude of RPTs; the magnitude of RPTs minus the mean RPT value, which is determined by controlling the year, industry and country. The abnormal magnitude is scaled by the beginning total assets for each year.
<i>ReApp</i>	Auditor reappointment; the auditor is reappointed for a subsequent audit engagement after the first year of engagement. Dummy variable, coded 1 if the auditor is reappointed, and 0 if the company switches the auditor.
<i>RecReApp</i>	Auditor recurring reappointment; an actual number of consecutive years during which auditors are reappointed after the first year of engagement.
<i>RecReApp*B4</i>	Auditor recurring reappointment in which define as an actual number of consecutive years during which Big 4 audit firms are reappointed after the first year of engagement.
<i>HProtect</i>	A binary variable representing a high protection country, value equal to "1" if a company is operated in Singapore or Hong Kong, or "0" otherwise.
<i>AudQ</i>	A binary variable representing an audit quality, value equal to "1" if a firm is audited by the Big 4 or "0" otherwise.
<i>AOPIN</i>	An indicator variable equal to one if an auditor issued a clean audit opinion and zero otherwise.
<i>GROWTH</i>	Company's growth calculated as a market value of a company at the end of a year <i>t</i> , which is divided by book value of total assets (Collins & Kothari 1989).
<i>SIZE</i>	Natural log of a company's total assets.
<i>LEV</i>	Leverage measured as a ratio of total debt over total assets.
<i>BDSIZE</i>	Board size based on the actual number of directors.
<i>BDIND</i>	Board independence measured as a proportion of independent non-executive directors to total board members.
<i>ACIND</i>	Audit committee independence calculated by a proportion of independent non-executive members to total members on the audit committee.
<i>CS</i>	A percentage of ownership belonging to a controlling shareholder.
<i>CSF</i>	A binary variable equal to "1" if a controlling shareholder is an individual or family group and "0" otherwise.
<i>RISK</i>	An operating risk measured based on a three-year earning standard deviation.
<i>EQ</i>	Earnings quality measured based on discretionary accruals. The discretionary accruals are estimated using modified Jones's model (Dechow, Sloan, & Sweeney 1995). The procedures of partitioning component for firm <i>i</i> can be summarized as shown below: $TACC_{it} = NDAC_{it} + DAC_{it}$, where $TACC$ denotes total accruals, $NDAC$ denotes non-discretionary accruals, and DAC denotes discretionary accruals. Total accruals for a firm also can be computed as: $TACC_{it} = EARN_{it} - OCF_{it}$, where $EARN$ is income before extraordinary items and OCF is operating cash flows. The DAC_{it} for firm <i>i</i> and time <i>t</i> is determined using the following equation: $DAC_{it}(\epsilon_{it}) = (TACC_{it}/TA_{it-1}) - \{\beta_1(1/TA_{it-1}) + \beta_2(\Delta REV_{it} - \Delta REC_{it})/TA_{it-1} + \beta_3(\Delta PPE_{it}/TA_{it-1})\}$ where: TA_{it-1} denotes opening total assets, ΔREV_{it} is the change in net for firm <i>i</i> in year <i>t</i> , PPE_{it} denotes property plants and equipment for firm <i>i</i> in year <i>t</i> , ΔREC_{it} denotes net receivables for firm <i>i</i> in year <i>t</i> minus net receivables in year <i>t-1</i> , and ϵ denotes prediction errors.
<i>Year</i>	A vector of year indicator variables for 2008, 2009, and 2010.
<i>Ind</i>	A vector of industry indicator variables based on the GICS industry classification.
<i>Country</i>	A vector of country indicator variables i.e., Hong Kong, Malaysia, Singapore, and Thailand.
□	An error term.