RECRUITMENT DETERMINANTS FOR CENTRAL AND NON-LOCAL AUDITORS: AN ANALYTICAL ON THE TEHRAN STOCK EXCHANGE


ABSTRACT

Purpose: The object of this analysis is to investigate empirically the determinants of the audit selection by local or Non-local Auditor (NLA) and their effect on companies listed on the Tehran Bourses.

Theoretical framework: The selection of an independent auditor is influenced by numerous factors. The agency theory predicts that when firm size, debt leverage, and staff compensation costs rise, the likelihood of electing a qualified volunteer auditor in the ordinary general assembly will as well (Hassas Yeganeh & Heidari, 2008).

Design/methodology/approach: The study seeks to examine whether local or NLA are chosen in companies mentioned on the Tehran Stock Exchange (TSE). The research sample contains 108 companies listed on the Tehran Bourses between 2013 and 2019.

Findings: The findings show that the probability of contracting with a NLA decline to a considerable degree if there is a rise in the number of local auditor (LA) regardless of auditor rating. Also, the likelihood of choosing a NLA is lower for high-quality financial reporting companies. Besides, if a NLA is selected, audit fees (AF) are likely to be reduced.

Research, Practical & Social implications: Independence is a determinant of employment for central and non-local auditors. The studies focus on auditor independence, which non-local auditors may not have when compared to local auditors in companies in which the government contributes to financing part of its capital.

Originality/value: The research adds to the literature on corporate governance by emphasizing that Board oversight is not a good alternative to auditor monitoring of Financial Statements (FS) credibility and indicates that an auditor may have licensing criteria.

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DETERMINANTES DE RECRUTAMENTO PARA AUDITORES CENTRAIS E NÃO LOCAIS: UMA ANÁLISE DA BOLSA DE VALORES DE TEERÃ

RESUMO

Objetivo: O objetivo desta análise é investigar empiricamente os determinantes da seleção de auditoria por auditores locais ou não locais e seu efeito nas empresas listadas na Bolsa de Teerã

Referencial teórico: Vários fatores influenciam a escolha de um auditor independente. De acordo com a teoria da agência, prevemos que a probabilidade de selecionar um auditor voluntário de alta qualidade também aumentará

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na assembleia geral ordinária, aumentando o tamanho da empresa, a alavancagem da dívida e os custos de pagamento da equipe (Hassas Yeganeh e Heidari, 2008).


Resultados: Os resultados mostram que a probabilidade de contratar um auditor não local diminui consideravelmente se houver um aumento no número de auditores locais independentemente da classificação do auditor. Além disso, a probabilidade de escolher um auditor não local é menor para empresas de relatórios financeiros de alta qualidade. Além disso, se um auditor não local for selecionado, os honorários de auditoria provavelmente serão reduzidos.

Pesquisa, implicações práticas e sociais: A independência é um determinante do emprego para auditores centrais e não locais. Os estudos focam a independência do auditor, que os auditores não locais podem não ter quando comparados aos auditores locais em empresas nas quais o governo contribui para o financiamento de parte de seu capital.

Originalidade/valor: A pesquisa contribui para a literatura sobre governança corporativa ao enfatizar que a supervisão do Conselho não é uma boa alternativa ao monitoramento do auditor da credibilidade das demonstrações financeiras e indica que um auditor pode ter critérios de licenciamento.

Palavras-chave: Auditores Locais, Riscos de Relatórios de Customeres, Honorários de Auditoria.

INTRODUCTION

An assessment of the danger raised by the auditing operation is one of the most important factors. This is always underrated, but its influence can be substantial. There are recommendations and instruments to support the auditor in evaluating the danger and the value of the audit operation (Abass et al., 2022). However, with respect to audit procedure, the determination of importance is a subjective decision of its own, since in assessing and interpreting the levels of meaning the auditor must still exercise his/her professional discretion taking into consideration the reality that consumers are always aware of financial circumstances
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Therefore, it is necessary to know who the customers are, what their knowledge is needed and, last but not least, how they obtain information regarding the organization audited. For example, their area of operation, the basic sense in which they work and any lifecycle information extended, recessive or stable.

In recent years, Audit Quality (AQ) has received much attention from scholars, legislators, governments, and auditors. The International Auditing Standards Board issued a new standard in 2013 to improve AQ. This standard explains the multidimensional nature of AQ, and regulatory authorities and legislators see their role as necessary in enhancing AQ (Al-taee & Flayyih, 2022). Therefore, this research aims to study the factors affecting the selection of LA or NLA. The auditors devote much of their time to the customer's premises since most of the audit work must be carried out in their beliefs. In this case, the local auditor has lower travel and time expenses than the NLA. Financial studies have also developed a path of research in terms of remote lending and investment, for example, a study (Petersen & Rajan, 2002). I discussed that local lenders and investors benefit from local loans and investments due to the advantage of information being the result of a high regulatory system, displaying complete information about companies, obtaining information at reduced costs, and access to confidential information (Al-khoury et al., 2022). Based on the above, the company and auditors should prefer the relationship between The local auditor and the customer based on the relationship between the NLA and the customer. However, a large number of companies hire NLA. From an auditors' point of view, the factors that affect the AQ are either those that limit the ability to detect material errors in the FS or the financial incentives to report the mistakes. Therefore, the research aims to what has been mentioned previously in addition to determining whether the spatial distance between the auditor and the customer can affect the quality of the audit through inconsistency and asymmetry of information. In this context, LA have the advantage of prompt access to data due to their geographical proximity and can improve AQ. In addition to that, the research aims to study customer risks through four indicators: loss, return on assets, financial leverage, and accounts receivable and its relationship with the use of LA.

**LITERATURE REVIEW**

The customer and the auditor jointly agree on the auditor they will use. The firms take into account AF and AQ as their two main considerations when choosing auditors (Hu et al., 2021). In some cases, the corporation benefits from auditors' efforts. The auditors may investigate the internal control lapse or accounting error. Before exposing FS, the corporation
can correct such errors, create internal control procedures, and prevent the occurrence of similar errors in the future (Zakaria et al., 2016).

Previous studies show that competent auditors, like the BIG4 audit companies, can deliver competent financial reports (Flayyih and Khiari 2022). An established auditor can guarantee shareholders that there would be less information asymmetry between shareholders and management.

An AF contains two elements from the perspective of the auditors: the audit work and time involved and the potential harm that could arise from legal costs or the cost of missed opportunities with current and prospective customers, caused by goodwill damages and fines (Ramanna & Watts, 2012).

Provided Audit Standard No. PCAOB,8. The goal of the auditor's inspection of the accounting records is to reduce the ARs as much as possible. The audit likelihood of an incorrect assertion by the auditor is determined by the norm. The financial announcements, on the other hand, contain large distortions, and they also explain that the AR is a feature of the risk of significant distortion, which includes the inherent risk, the risk of control, and the Non-detection risk (NDR). These risks cannot be monitored by auditors; instead, they must be evaluated in order to determine the acceptable level of NDR (Kend et al., 2023).

The NDR level includes some auditor content testing that adds the audit team's effort and time during a job. An incorrect assessment of the significant level of risk of distortion could lead to an increase in AR and potential loss, a decrease in profit, or a loss of customers due to overcharging of AF. Auditors might reject High-risk (HR) customers if they are unable to assess the significant risk of distortion sufficiently, or they might ask for High-AF to account for such risks. The risk analysis methodologies and subsequent audits, such as monitoring and content checks, are categorized under PCAOB Audit Standard No. 5. The audit methods utilized to gather audit records are also clearly described in this standard. These approaches include inspection, observation, survey, confirmation, recalculation, confirmation, investigation, and analysis. However, numerous auditing processes are also required at the client's site. For instance, the observation norm states that it entails "seeking (hunting) for a technique or process performed by others." As a result, the auditors spend a significant amount of time at the locations of their clients (Guénin-Paracini et al., 2014).

Regarding travel costs and time, the customer and LA relationship is lower than the customer and NLA relationship. Firms should bear the travel expenses of NLA. The total fees of auditing should be higher for NLA than the cost of hiring LA. Thus, the firm must prefer the
LA to the non-local ones by assuming that local and NLA have an equivalent degree of AQ. Petersen and Rajan (2002) Viewed that the distance between small companies and their creditors is growing and clarified that technical and communications progress has made it possible for creditors to have reliable and timely borrowers’ information.

Small business loans, according to Flögel & Beckamp (2020), are fully based on bad data, which can only be obtained directly by the developer. These studies often contend that information advantages, such as improved supervisory capacity, observation of dangerous company information, acquisition of lower-cost data, and access to firm sensitive data, help creditors and local investors. However, in some cases, improvements in technology and communications replace the information benefit to creditors and local investors.

The selection of an independent auditor is influenced by numerous factors. The agency's hypothesis predicts that when firm size, debt leverage, and staff compensation costs rise, the likelihood of electing a qualified voluntary auditor in the ordinary general assembly rises as well (Hassas Yeganeh and Heidari, 2008). So, we examine the elements that went into selecting an NLA. According to certain evidence provided by Malloy (2005), local analysts are more accurate than their counterparts, and businesses should choose LA over non-local experts.

Wasinee Thammasiri (2014) In comparison to NLA, they too bemoan the rising tendency of hiring LA. As a result, considering the benefits of using LA, the following first hypothesis and sub-hypotheses are proposed:

\[
H1: \text{If LA are present and sub-hypotheses are suggested to explore this issue further, the possibility of contracting with NLA is lower.}
\]

\[
H1a: \text{If LA of rank A are present, the likelihood of signing the contract with NLA is lower.}
\]

\[
H1b: \text{If LA other than Rank A are present, the likelihood of signing the contract with NLA is lower.}
\]

\[
H1c: \text{In the case of the involvement in the specialized LA' industry, the probability of signing an agreement with NLA is lower.}
\]

LA might not be eager to welcome clients at HR or would demand a significant charge for such an unjustified risk. Bedard and Johnston (2004) An comprehensive audit company's management actions were examined, and it was discovered that some businesses cut their HR clientele and replaced them with less risky ones. The intrinsic risk, control risk, and NDR are all included in the audit risk (AR) model to characterize the AR. The auditors of companies with significant inherent risk and control risk can maintain the AR at a suitable level by making
additional efforts to keep the NDR lower.

LA cannot take or receive very risky financial reporting insurance from companies. There are two theories supporting this prediction. First, there is a link between the danger of corporate financial reporting and the high risk of auditing, and as a result, auditors demand greater fees. Second, LA benefit from the information advantage of risk assessment, whereas NLA is unable to comprehend such a risk or underestimate the risk of potential future harm (Nikkeh et al., 2022).

The second hypothesis of the analysis are suggested as follows, based on the premise that firms prefer high-quality audit to AF:

\[ H2: \text{The probability of a firm hiring a NLA increases with the firm's reporting risk.} \]

In most cases, the auditors' professional judgments will make some conflicting suggestions that have no congruence (Tanani & NikBakht, 2010). At the same level of AQ, NLA can recommend lower AF than LA. In general, the distance between the auditor and the customer should increase the AF. For LA, the travel and time expenses, which are part of the AF, should be lower. Moreover, LA could incur less information asymmetry fees and reduce the auditing process fees. Low asymmetry of information between LA and their customers will minimize litigation risk and anticipated future harm through legal proceedings and reputational damage.

Los Angeles should pay less for the same interest than their non-local competitors. Additionally, the NLA's AF may be higher than the LA's fees due to poor selection. A substantial knowledge gap between NLA and LA leads them to argue that LA has more reliable consumer review data, placing non-local consumers at more risk. Therefore, NLA should get more AF to work for that exact thing. However, an NLA is probably more cost-efficient and effective than a LA. Additionally, by granting customers access to confidential information, auditors can lessen the information imbalance between them and their clients. In addition, NLA might have fewer advantages than LA (Flayyih et al., 2022). As a result, NLA is unable to identify this danger and cannot overestimate the likelihood of possible injury. Generally speaking, businesses can reduce AF by hiring NLA. We anticipate receiving fewer charges from NLA due to a variety of factors. The three assumptions are as follows, provided that corporations choose high-quality audits to audit costs:

\[ H3: \text{The likelihood that a company will hire an NLA is reduced by the AF.} \]
MATERIAL AND METHODOLOGY

The study seeks to examine whether local or NLA are chosen in companies mentioned on the TSE. It uses a descriptive and deductive survey of whether or not the association occurs between variables where logistic regression or what is referred to as Jet regression was used to gather aspect results. Practical, the researcher relied on the FS of the companies, the focus of the research and published within the TSE website, in collecting and extracting the crisis data, organizing it and classifying it within the Excel program, and then using the Eviews9 program for analysis and testing hypotheses. As for the theoretical side, books and scientific articles were relied on external and internal and published in scientific journals Considered.

Samples

The research community includes all Iranian joint-stock companies listed on the TSE for the period from 2013-2019, provided that they fulfill the following conditions:

1. The year of its entry into the stock market must be before 01/01/2013.
2. That its fiscal year ends on December 31, 2019.
3. That it should not have an interruption during the years of research.
4. It should not be included in the banks and financial companies.

Through the above conditions, the number of companies included, which represent the research sample, are (108) companies listed in the market, where information was collected from the official website of the TSE as well as the Securities Commission, which is responsible for publishing the financial reports of the companies listed on the market.

Mathematic Models

The forms used in this research and used to select the LA and NLA are follows (Choi et al., 2012):

\[
\text{NonLocal} = \beta_0 + \beta_1 \text{NumLocal}_{MSA} + \beta_2 \text{NumExp}_{MSA} + \beta_3 \text{ClientRisk} \\
+ \beta_4 \text{Leverage} + \beta_5 \text{Loss} + \beta_6 \text{ROA} + \beta_7 \text{Auditfee} \\
+ \beta_8 \text{Officenatexp} + \beta_9 \text{Big} + \beta_{10} \text{InstOwner} \\
+ \beta_{11} \text{IndepentDT} + \beta_{12} \text{size} + \beta_{13} \text{BookMK} + \varepsilon
\]

\[
\text{NonLocal} = \beta_0 + \beta_1 \text{NumLocal}_{MSA} + \beta_2 \text{NumBig}_{MSA} \\
+ \beta_3 \text{NumnonBig}_{MSA} + \beta_4 \text{NumExp}_{MSA} + \beta_5 \text{ClientRisk} \\
+ \beta_6 \text{Leverage} + \beta_7 \text{Loss} + \beta_8 \text{ROA} + \beta_9 \text{Auditfee} \\
+ \beta_{10} \text{Officenatexp} + \beta_{11} \text{Big} + \beta_{12} \text{InstOwner} \\
+ \beta_{13} \text{IndepentDT} + \beta_{14} \text{size} + \beta_{15} \text{BookMK} + \varepsilon
\]
Study variables

Dependent variable

Non-local: the metaphorical variable for contracting with a NLA and it is (1) if the customer and the auditor are not in one city and the distance between the customer's company and the auditor.

Independent variables

Numlocal MSA: Counting auditors from the perspective of the local accountants association.

NumBign MSA: Counting auditors for Category (A) in the customer's city from the perspective of the Accountants Association.

Counting the auditors in the customer's city who, in the eyes of the Accountants Association, do not qualify for a Category A designation.

NumExp MSA: The number of auditing companies in the customer's city that specialize in the sector.

The ratio of economic force equal to the sum of liabilities to assets is known as leverage.

Loss: Loss is a symbolic variable that would be (1) if the company had experienced a loss in the previous year, and otherwise it would be (zero).

ROA: The ratio of earnings before taxes to total assets is known as the return on assets.

CustomerRisk: The entire customer risk

AF: the natural logarithm of the ratio of total AF to total assets.

Control variables

Control variables were selected in this research according to Jensen et al. (2013) and Choi et al. (2012), and as follows:

Officenatexp: equals (1) if the audit firm is specialized in the manufacture, otherwise it equals (zero).

BigN is equal to (1) if the company's auditor is one of the auditors who have been rated (A) from the viewpoint of the Association of Official Accountants, otherwise it is equal to (zero).

InstOwner: Institutional shareholder percentage ownership, meaning the ratio of the total number of shares owned by institutional investors to the total number of shares. What is meant by institutional ownership are investment companies, banks, insurance companies, and
the retirement authority?

**Independent**: The ratio of the number of non-employee directors to the total number of directors.

**Size**: Company size equals the natural logarithm of sales.

**Bookmark**: The ratio of book value to shareholders’ equity to the company’s market value.

**RESULTS AND DISCUSSION**

To test this hypothesis, we use the research form (1).

**Model Assessment Results (1)**

The evaluation of the research model (1) is based on the study data, as shown in Table 1.

<table>
<thead>
<tr>
<th>Title</th>
<th>Cof.</th>
<th>Standard deviation</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>6.692</td>
<td>3.653</td>
<td>.067</td>
</tr>
<tr>
<td>No. of LA</td>
<td>-.060</td>
<td>.010</td>
<td>.000</td>
</tr>
<tr>
<td>Local industry specialized auditors</td>
<td>-.065</td>
<td>.065</td>
<td>.317</td>
</tr>
<tr>
<td>Customer risk</td>
<td>-.955</td>
<td>1.192</td>
<td>.423</td>
</tr>
<tr>
<td>Loss</td>
<td>-.486</td>
<td>.721</td>
<td>.501</td>
</tr>
<tr>
<td>LEV</td>
<td>.740</td>
<td>1.190</td>
<td>.534</td>
</tr>
<tr>
<td>Return on assets</td>
<td>-.3125</td>
<td>2.088</td>
<td>.135</td>
</tr>
<tr>
<td>Auditor fees</td>
<td>-.871</td>
<td>.348</td>
<td>.012</td>
</tr>
<tr>
<td>Auditor industry specialization</td>
<td>-.341</td>
<td>.602</td>
<td>.572</td>
</tr>
<tr>
<td>Rank A auditor</td>
<td>.599</td>
<td>.669</td>
<td>.371</td>
</tr>
<tr>
<td>Institutional ownership</td>
<td>-.001</td>
<td>.009</td>
<td>.895</td>
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<tr>
<td>Unbounded member ratio</td>
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<td>.589</td>
</tr>
<tr>
<td>Firm size</td>
<td>.111</td>
<td>.263</td>
<td>.673</td>
</tr>
<tr>
<td>Growth opportunity</td>
<td>.384</td>
<td>.311</td>
<td>.216</td>
</tr>
</tbody>
</table>

Source: Prepared by researchers (2022).

The above table results show the (Likelihood ratio) less than .05 and the (Hosmer-Lemeshow statistic) ratio of more than .05, which indicates that the model is excellent and appropriate and its results are considered. R2 also has a rating of 6.48, which is very good for the model. The coefficient of the number of LA was (-.060), and the (Significance) of the number of LA was less than .05. This outcome means a negative relationship with statistical Significance between the number of LA and NLA’ choice. Also, in the case of LA, the probability of contracting with a NLA may decrease significantly. As a result, the first study's hypothesis is accepted.
Test the sub-hypotheses of the first central hypothesis

The research model (2) is based on the study data, as shown in Table 2.

<table>
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<tr>
<th>Title</th>
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<th>Standard deviation</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
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<td>Intercept</td>
<td>5.829</td>
<td>3.313</td>
<td>.079</td>
</tr>
<tr>
<td>No. of rank A LA</td>
<td>-.032</td>
<td>.016</td>
<td>.044</td>
</tr>
<tr>
<td>No. of non-rank A LA</td>
<td>-.206</td>
<td>.078</td>
<td>.008</td>
</tr>
<tr>
<td>No. of local industry specialized auditors</td>
<td>-.077</td>
<td>.061</td>
<td>.208</td>
</tr>
<tr>
<td>Customer risk</td>
<td>-1.260</td>
<td>1.079</td>
<td>.243</td>
</tr>
<tr>
<td>Loss</td>
<td>-.536</td>
<td>.673</td>
<td>.426</td>
</tr>
<tr>
<td>LEV</td>
<td>.458</td>
<td>1.084</td>
<td>.673</td>
</tr>
<tr>
<td>Return on assets</td>
<td>-3.570</td>
<td>2.004</td>
<td>.075</td>
</tr>
<tr>
<td>Auditor fees</td>
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<td>.304</td>
<td>.009</td>
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<td>Auditor industry specialization</td>
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<td>Rank A auditor</td>
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<td>Institutional ownership</td>
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<td>.815</td>
</tr>
<tr>
<td>Unbounded member ratio</td>
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<td>.977</td>
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<tr>
<td>Firm size</td>
<td>.159</td>
<td>.245</td>
<td>.517</td>
</tr>
<tr>
<td>Growth opportunity</td>
<td>.227</td>
<td>.290</td>
<td>.434</td>
</tr>
</tbody>
</table>

Source: Prepared by researchers (2022).

The above table results show the (Likelihood ratio) less than .05 and the (Hosmer-Lemeshow statistic) ratio of more than .05, which indicates that the model is excellent and appropriate and its results are considered. Also, R2 has a magnitude of .504, which is an outstanding ratio for the model. The (Significance) amount for the Auditors Number (AN) obtaining a rating (A) and the AN not receiving (A) rating is less than .05, while the (Significance) amount for the AN specialized in the industry is more than .05. The coefficient of the number of (A) auditors and the number of non-(A) auditors, respectively, were -.318 and -.206. These results indicate a negative relationship with statistical Significance between the number of LA, grade A, and others, and the choice of NLA. It is clear that when the number of LA increases, the auditor is classified under grade A or not, the possibility of contracting with the auditor. NLA may drop dramatically, and the ratio of auditors who received a "a" rating to those who did not may increase, indicating that clients are more likely to hire NLA who have a "a" grade (a). However, there is no statistically significant correlation between the NLA’s preference and the AN who specializes in the industry. As a result, the study's first and second sub-hypotheses are confirmed.

Among the customer risk-related variables (losses, return-on-account, financial leverage, and receivables) only the return-on-account indicator (.075) and coefficient (-3.570) reflect the presence of the business risk (return-on-accounts) in negative terms and the appointment of a NLA. As a result, we can say that the possibility of selecting the NLA for
companies whose customers risk is higher; that is, when the return on assets decreases and the risk of the customer increases, the possibility of using NLA increases. The number (Signification) of the auditor's salary was (.009), and the sum (coefficient) was (.794), suggesting the presence of a negative statistically significant association between auditor's wages and the preference of the NLA. That wages go down.

CONCLUSIONS

As auditing is a powerful instrument for raising consumer confidence in the performance of business activities, the position of the external auditors affects several expectations. There was a noteworthy expectation difference between what consumers think an audit conveys versus what the audit profession expects it to offer. This distance becomes problematic for auditors during a business crisis and the position of the auditor has been placed on special attention. Users have great expectations of the role of the auditor in the detection of fraud and some researchers have revealed AEG as the auditor's duty in the detection of fraud. While, it is evident that both the business manager and the regulatory body are the primary source of concern for the deterrence and identification of misconduct, and the auditor is liable for extracting fair guarantees that the records, as a whole, are free of substantive malapropism, big demands remain. The findings suggest that, more LA will contract with a NLA, whether or not the auditor is categorized as "A." Also, the probability of selecting a NLA for companies whose customers risk the most increases, and if a NLA is appointed, AF are likely to decrease. The results also show no statistically significant relationship between the customer's risk (loss and accounts receivable) and the LA’s choice. Based on the studies completed and the review of previous studies, there is no similar in-house study that examines the factors influencing auditor selection. Among the foreign studies, only the study (Al-Janabi et al., 2023), as the present study results are consistent with the survey results. Therefore, we recommend audit firms to show their marketing focus on local companies. Also, control over auditors' selection is increased because, according to the results, when the customer risks increase, the LA not classified with grade (A) are used more. Therefore, more control is needed over the selection of the auditors. Besides, we recommend that companies provide information regarding NLA' fees before selecting a LA since they may bid for lower wages.
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