Research on the Impact of TMT Heterogeneity on Auditing Quality

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Abstract: Agriculture is the basis of living and the prerequisite of production which is also the mainstay industry in China and plays a very important role in all ages. Nevertheless, The frequent occurrence of irregularities in the agricultural industry makes people lose trust in the financial reports issued by agricultural companies which also lose the confidence of investors in recent years. Consequently, improving the reputation of agricultural companies and the audit quality of listed-agricultural companies is very important. We find out that there are few research on the relationship between executive heterogeneity and audit quality after the analysis of current research condition. Thus the listed agricultural company in China is selected as a sample from 2013 to 2017 to study the impact of the heterogeneity of the age, term of service and education of TMT on the audit quality in this article and making suggestions for companies to choose more reasonable top management team and improve audit quality.

1. Introduction

Agriculture is the basis of social security and important power for economic and social development. development of agricultural industry attracts a lot of attention for its special position. With the support of national policies and local governments, agricultural enterprises in China have made great progress of which proportion in listed companies and planned listed companies is gradually increasing recently. In order to guarantee civil interests, the management and inspection of the Economic Business of Listed Companies under government is stricter as the stock market is playing a more and more important role in our life. A few number of agricultural listed companies still take any chances after the frequent occurrence of irregularities of listed agricultural companies such as Kanghua and Yinguangxia. Agricultural enterprises accounted for half of the latest company irregularity investigation.

Agricultural enterprise management is particular. The rate of return of agricultural industry is more obviously influenced by the season compared with other industries which leads to obviously volatility of profit rate of agricultural enterprises and agricultural enterprises are difficult to keep enough profit result in delisting. Therefore, agricultural enterprises have more motivation for irregularity compared with other industries. Meanwhile, the interests of investors is affected by enterprise financial fraud seriously and the public loses confidence in the independence of auditors for the fake audit reports issued by accounting firms.

As a result, in order to make sure investors to invest in the agricultural market, we must ensure the quality of audit reports of agricultural enterprises. As auditors keep improving their professional and audit quality, there will be differences in the values, world view, behavioral style and psychological characteristics of top management teams, resulting in different cognitive models according to the factors affecting audit quality. In the process of team decision-making, these characteristics will interact and affect the behavior of management. As the insider of company's internal financial situation and operating performance, the management may change the financial statements and provide fake information to auditors, thereby affecting the audit quality directly.

We have to pay more attention to the development situation of audit quality of agricultural enterprises in such circumstances. It is quite complicated that the research on the affecting factors of audit quality in the world theoretically.

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Previous research focused on the ownership structure or the proportion of shareholdings through auditees which is we need to focus on the characteristic of the company's control rights, the board of supervisors and the board of directors. Nevertheless, as the real managers of the company, the top management has the right to control the company's financial reports directly and there is more motivation to conspire with accounting firms which causes the fake audit reports directly. In addition, few theoretical research combine TMT heterogeneity with audit quality to study the relationship between them around the world.

Practically, on the one hand, with the development of economic society, the ownership of the company is separated from the actual operation right and the top managers become the core force of the company, holding the company's economic business. The top managers control the company as well as the financial reports and even bribe auditors to cover up their irregularity. At the same time, the owner of the company also intends to supervise the actual situation of the company at all times and protect their economic interests from being infringed by the management, thus the owner of the company focuses on the quality of audit reports.

On the other hand, bad examples are set to the economic society thanks to the continuous occurrence of financial irregularities in agricultural enterprises which also did great damage to the order of market-oriented economy. As a result, investors want have confidence in and indirectly discredit the agricultural industry and eventually affect the whole capital market in China.

According to the current audit situation of agricultural companies in China, we ought to pay more attention to the audit quality of the agricultural industry. We will try to make up for the shortcomings of previous studies in this article.

The agricultural industry as an example, we start from the real managers of the enterprise, study the impact of TMT heterogeneity on audit quality innovatively and the potential relationship between them. last but not least, we will give countermeasures and suggestions correspond on the basis of the research which may provide reference for the enterprises to arrange the top management reasonably and improve audit quality.

2. Literature Review

2.1 Reasons Affecting Audit Quality

2.1.1 Internal reasons

The research shows that governance and audit quality of listed companies are significantly positively correlated based on macrosystem level. Zuoping Xiao (2006) .Since then, Yuying Yu and Qiliang Liu (2007) have the same view with Zuoping Xiao which are also based on macrosystem level research. They believe that the enterprise governance system is positively correlated to audit quality. The better the governance structure, the smaller the earnings management space of the enterprise, the less management's manipulation of profits will be.

Jia Wang (2014) found that there is a significant relationship between audit quality and the share proportion of shareholders. Panpan Yuan (2015) held that the share proportion of the majority shareholder, state-owned shares and audit quality are significantly negatively correlated .However, Runxuan Liu (2015) has different opinions. He believes that the relationship between audit quality and shareholding proportion of listed companies is not significant, but audit quality is positively correlated with the proportion of independent directors, the scale of board of directors and ownership concentration.

In addition, Xinyi Xu (2016) holds that enterprise governance is one of the main characteristics of modern companies resulting from the separation of ownership and management and enterprise governance situation will affect the independence of auditors.

Qi Pan and Quan Wen (2017) mentioned again that enterprise governance structure does have an impact on audit governance after a period of theoretical research. They have the same conclusion as the formers that all of them hold that a good enterprise governance structure will have a positive effect on audit quality.

Based on the former research results, we can basically ensure that enterprise governance

structure has a significant impact on audit quality. Correct enterprise governance structure can effectively reduce the possibility of management irregularity, in that way the audit reports issued by auditors in this situation will be of better quality, too.

2.1.2 External reasons

On the one hand, audit quality is related to audit cost. First, Franke, Johnson and Nelson (2002) believe that the cost of audit is significantly positively correlated with audit quality. Whereas the cost charged is too expensive to be affordable for the auditees, so the auditees will find small-scale accounting firms which will reduce the audit cost while the audit quality of small-scale accounting firms will be worse than that of large and medium-sized ones so that the audit quality will be in bad condition. In addition, Pittman and Fortin (2004) realized that the more the firm charges, the work harder the auditors will be and they will be more patient and rigorous, thereupon then improving the audit quality. However, if the cost is too high, auditors will lose their professional ethics and firms will ignore the results for the sake of economic interests, resulting in the audit results unpersuasively and bad audit quality. Hoitash, Rani and Markevich (2007) held that the more the audit cost, the higher the earnings management level of the company. Like that audit cost is negatively correlated with audit quality.

On the other hand, the characteristics of accounting firms also affect the audit quality. Jiasheng Chen (2014) found out that accounting firms behavior style affects audit quality significantly: If accounting firms regard high profits as their business objectives but neglect the quality of audit results, their employees will also neglect the quality of audit in this working situation.

However, the auditing business of a company will lose its impartiality and the quality of auditing will also be affected. Chen Ma, Maoyong Cheng and Junrui Zhang (2014) have similar views on the impact of accounting firms behavior choice on audit quality. They believe that auditors may be threatened by customers to give a fake audit report in the process of auditing, but in order to keep the business, it is possible to indulge the true situation of the auditees, thus issuing fake audit reports which will also lead to the reduction of audit quality.

Next, Carcello and Nagy (2014) studied the relationship between audit term and audit reports and found out that companies with shorter audit term were possible to give fake audit reports which means the longer the audit term of accounting firms is, the more correct the financial report is. Audit term is positively correlated with audit quality according to it. However, Carey and Simnett (2016) have different opinions. They found out that companies without auditor rotation, the longer the audit term is, there's less chance of being given uncertain opinions about continuing operations. In other words, the longer the auditor term is, the worse the audit quality may be.

2.2 Relationship between top management team and audit quality

The relationship between the top management team and audit quality started earlier in foreign countries, so their research range is more than that in China.

Auditors have a lot of opportunities to have contact with the auditees in the process of auditing so that they have a full understanding of the listed companies. Lennox (2005) believes that it creates opportunities for them to work from firms to listed companies as executives. Moreover, as the owner of the company employs a employee from an auditing firms, whether the employee conforms to the company's culture and whether they can cooperate will be checked in advance. Fan and Wong (2005) combined the optimal contract theory to study the relationship between salary incentive mechanism and audit mechanism and found out that the more difficult it is for executives to supervise, the more they want the more salary incentive mechanism to adjust, reflecting the obvious correlation between executive salary and external audit quality .At the same time, Sullivan (2000) studied and found that audit quality has a negative correlation with the share proportion of top management: the more the proportion of top management hold, the less the restriction they have. They have more opportunities to manipulate audit results which leads to the bad audit quality.

In addition, other authors have also studied the top management team heterogeneity in China. Liqun Wei and Zhi Wang (2003) firstly selected three characteristics of top management team: age, education and professional background to analyze the heterogeneity of top management team .Ping

Zhang (2006) chose the age, term of service, education background and professional experience to study the heterogeneity of senior management team .In addition, Yuanqiong He and Wen Yang (2013) found out that the heterogeneity of top managers' age, term of service and education background has a linear relationship with diversification strategy .Zhaoguo Zhang and Yongli Liu and Duojiao Tan (2014) also tested and verified the impact of top managers background characteristics on accounting conservatism. They found out that the less the heterogeneity of the age, education and term of the top management team is, the higher the decision-making level of the enterprise will be and the top management team will choose a sTable accounting policy to make sure the long-term development of the enterprise .Xiaoguang Zhang (2014) held that the heterogeneity of top management team refers to the difference of the characteristics, values and perceptions of the members of the top management team. The heterogeneity of top management team will affect the communication of the team directly and then affect the efficiency and quality of decision-making of the whole team members.

Based on the previous research conclusions, Fang Wang (2016) studied the relationship between the characteristics of top management team and audit quality innovatively. She found out that the internal composition of top management team affects audit quality more, that is, the term, member number and education level of top management team affect audit quality.

2.3 Literature review

After studying the existing literature around the world, we can find out that the research on audit quality is generally comprehensive. However, according the internal perspective of audited units, most of the current literature are based on the macrosystem level of the company and the ownership structure or share-holding proportion, that is, starting from the control rights of the company. Few documents are studied from the management rights of enterprise governance which means the top managers. Therefore, literature on the research methods of top managers heterogeneity which is referenced in this article to study and analyze the relationship between the heterogeneity of top managers and audit quality and study the relationship between them. We try to make up for the shortcomings of previous studies in this article. Starting from the internal management of the company, analyze the impact of the management in the governance structure on the audit quality and on the basis of the research, give countermeasures and suggestions to improve the audit quality.

3. Research design

3.1 Research hypothesis

The age of top management team affects the attitude in dealing with problems of team members. The age difference of top managers means the difference of growth environment, education environment and social experience which are reflected in the difference management style to the company. The top managers with similar ages have similar experiences and values and their strategic behaviors are almost the same. Different ages in a top management team is accompanied by different values of team members. It's obviously that the more the age heterogeneity, the more difficult it is to form ingroup preference, the more useful it is for enterprises to break its own culture and group thinking to make sure the effectiveness of internal control thereupon then improve the quality of audit. Based on this, hypothesis 1 is proposed.

H1: Age heterogeneity of top management team is positively correlated with audit quality.

The education background of top management team affects its mastery of management methods and techniques, innovation consciousness and decision analysis. Education shows one's ability. With the improvement of education, the things that members learn and the way of thinking is better.

The more the difference in educational of top management team, information and their respective conceptual skills are different and there are also different ways of dealing with and thinking about information. As it's time to make final decisions, not only based on interests, but also long-term considerations. Therefore, the audit quality will be also better. Based on this, hypothesis 2 is proposed.

H2: There is a positive correlation between the education heterogeneity of top management team and audit quality.

The term of managers is highly related to their requirements for internal control and management quality in modern corporate governance theory. As the term heterogeneity of top managers is different, it shows that the management changes frequently, the cooperation time of top managers team members is short and the teamwork among team members is not good.According to different management perspectives, it is difficult for managers to make the same decision on the requirements of internal control which reduces the effectiveness of internal control and reduces the quality of audit.Based on this, hypothesis 3 is proposed.

H3: Term heterogeneity of top management team is negatively correlated with audit quality.

3.2 Sample Selection and Data Source

We choose the financial data of listed companies of agriculture, forestry, animal husbandry and fishery in China from 2013 to 2017 in this article which is from Guotai'an database. In addition, the data of the JuChao information network are used to adding, testing and sampling individual abnormal values of individual companies. The results of the four major accounting firms came from Baidu Encyclopedia. It excludes: enterprises that incomplete annual report information or incomplete data of top management team; ST with poor performance and delisting. After selection, the total number of listed agricultural companies is 215 with 181 eligible in the database from 2013 to 2017.

3.3 Selection Variable

3.3.1 Interpreted variables

The audit quality is selected as the explanatory variable but cannot be effectively checked. Therefore, we can only choose the alternative variable - Audit cost. In order to check it more accurately, we should ignore the impact of asset scale. So the audit cost rate is an explanatory variable.

3.3.2 Explanatory variables

For top management team heterogeneity, we choose age, term and education level heterogeneity as the check indicators. Age and term are continuous variables. We use standard deviation coefficient (coefficient of variation) to check heterogeneity. The formula is standard error/average. In addition, education background is categorized variables, so managers education background is divided into five categories: middle and secondary schools, junior colleges, undergraduate, master's degree and double degree, doctor's degree and above, which are checked by Herfindahl-Hirschman index. The measurement formula is as follows:

$H=1-\sum_{i=1}^{N} p_i^2$ (Pi represents the percentage of the total membership of class i).

3.3.3 Control Variables

We should control other factors that affect audit quality and then understand the relationship between variables. The audit cost rate is selected as the explanatory variable so we should control the indicators that affect the audit cost in this article. We select the proportion of inventory and receivables in assets, asset scale, net assets income rate, accounting firms scale as control variables referring to the literature.

Table 1 variable definition

variable name	variable symbol	variable type	variable definition
audit cost rate	ROF	Interpreted variables	Audit cost for annual reports of listed companies/Total assets at the end of the year
Age heterogeneity	AGE	Explanatory variables	Age Standard error/Age Average
Term heterogeneity	TIME	Explanatory variables	term Standard error/term Average
Education heterogeneity	EDU	Explanatory variables	$H=1-\sum_{i=1}^{N} p_i^2$ (2)
proportion of inventory and receivables in assets	RLINTA	Control Variables	(Net year-end receivables + net year-end inventory)/total year-end assets
asset scale	SIZE	Control Variables	Logarithm of total assets of a company
net assets income rate	ROE	Control Variables	Net profit/year-end net assets
accounting firms scale	BIG4	Control Variables	Accounting Firms belong to the “BIG4”, then it’s 1, or 0.

3.3.4 Model specification

$$ROF=\beta_0+\beta_1 AGE+\beta_2 TIME+\beta_3 EDU+\beta_4 RLINTA+\beta_5 SIZE+\beta_6 ROE+\beta_7 BIG4+\varepsilon$$

4. Empirical analysis

4.1 Descriptive statistics

Table2 Descriptive analysis results

	N	minimum	maximum	average	Standard err
ROF	181	0.000062	0.000823	0.000296	0.000156
AGE	181	0.017444	0.248931	0.153286	0.033334
TIME	181	0.000000	1.336441	0.607343	0.221923
EDU	181	0.405000	0.790400	0.639892	0.087015
ROE	181	-1.800068	0.410125	-0.072600	0.251514
RLINTA	181	0.024262	0.731343	0.269848	0.154124
SIZE	181	16.527687	23.521523	20.780114	1.236089
BIG4	181	0	1	0.010000	0.105000

According to the descriptive analysis results in Table 2, we can see that the average audit cost rate is 0.03%, the minimum value is 0.0062%, the maximum value is 0.0823% and the maximum audit cost rate is 13.27 times of the minimum value. The maximum value of age heterogeneity is 14.27 times of the minimum value which indicates that there is a large difference in age heterogeneity in the sample. The maximum value of tenure heterogeneity is 1.3364, the minimum value is 0, the average value is 0.6073, the maximum value of education heterogeneity is 0.6399, the minimum value is 0.4050, the average value is 0.6399, the maximum and minimum of net assets income rate are 41.01% and - 180%, the average value is - 0.72% and the maximum and minimum value of the proportion of inventory and receivable in assets are 73.13% and 2. 4%, average value is 26.98%, maximum and minimum asset scale are 23.5215 and 16.5277, average value is 20.7801.We can find out that there are large difference among the selected agricultural listed companies which is convenient for us to make a comparative analysis according to the data.

In addition, whether audit firms are the “Big4” is a virtual variable. Descriptive analysis is of

little significance. Therefore, we make the frequency analysis refer to others research as shown in Table 3.

Table3 education frequency analysis results

	frequency	percentage	Effective percentage	cumulative percentage
0	179	98.9	98.9	98.9
1	2	1.1	1.1	100
total	181	100	100	

The results show that 179 companies are not audited by the “Big4” accounting firms which accounting for 98.9% of the sample, while only 2 companies are audited by the “Big4” accounting firms which accounting for 1.1% of the sample and it shows that most of the samples we selected are not audited by the “Big4” accounting firms.

4.2 Correlation analysis

Before regression analysis, we use correlation analysis to study whether there is correlation among variables and check whether there is a linear relationship between variables with QQ chart by SPSS 17.0.According to the results of QQ chart, the Pearson coefficient Tables among variables are shown by further correlation analysis.

Table 4 correlation analysis results

		1	2	3	4	5	6	7	8
1	ROF	1							
2	TIME	0.018	1						
3	AGE	0.463**	0.006	1					
4	EDU	-0.124	-0.142	0.032	1				
5	BIG4	0.105	-0.021	0.073	-0.044	1			
6	SIZE	-0.759**	-0.142	-0.430**	0.037	0.040	1		
7	ROE	-0.046	0.044	-0.073	0.035	0.039	-0.056	1	
8	RLINTA	0.139	-0.022	0.258**	-0.028	-0.139	-0.036	-0.002	1

Note: **Represents a significant level of 1%

As shown in Table 4, age heterogeneity is positively correlated with audit cost rate, while term heterogeneity and education heterogeneity are not significantly correlated with audit cost rate. Therefore, the relationship between them needs another regression analysis.

Among the control variables, the relationship between asset scale and audit cost rate is more significant. On the whole, the relationship between the control variables and the explanatory variables is not significant ($p < 0.5$), which make sure the validity of the study and available of regression analysis.

In addition, in order to verify the existence of multiple collinearity among variables, we made a collinearity diagnosis.

Table5 Collinearity diagnosis

		tolerance	VIF
	AGE	0.725	1.380
	TIME	0.956	1.046
	EDU	0.969	1.032
	SIZE	0.774	1.293
	BIG4	0.952	1.051
	RLINTA	0.895	1.117
	ROE	0.978	1.023

If there is a variable with tolerance less than 0.1 or VIF more than 10, it shows that the multiple collinearity is strong. As can be seen in Table 5, the variance inflation factor (VIF) of each variable

is less than 10 and the tolerance is more than 0.1. The results show that there is no multiple collinearity.

4.3 Multiple linear regression analysis

Table 6 multiple linear regression analysis results

variable		standard coefficient	tvalue
	(constant)		13.598
	AGE	0.115**	2.161
	TIME	-0.092**	-1.995
	EDU	0.103**	2.246
	SIZE	-0.725***	-14.104
	BIG4	0.135***	2.917
	RLINTA	0.097**	2.020
	ROE	-0.076*	-1.650
	R^2	0.632	
	P	0.000	

Note:***,**,*Represents a significant level of 1%,5%,10%

(1) The p value of the model in this article is 0.000 which means that the model is available. R2 is 0.632 which indicates that the goodness of fit is high.

(2) Age heterogeneity is positively correlated with audit cost rate, indicating that the higher the age heterogeneity of top management team is, the higher the audit quality will be. Verify hypothesis 1.

(3) Education heterogeneity is positively correlated with audit cost, indicating that the higher the educational heterogeneity of top management team is, the lower the audit quality will be. Verify hypothesis 2.

(4) Term heterogeneity is negatively correlated with audit cost rate, indicating that the greater the term heterogeneity of top management team is, the lower the audit quality will be.Verify hypothesis 3.

4.4 Robustness test

Last but not least, in order to test the correctness of the regression results, we choose another variable to check the audit quality of the company which is the audit opinion instead of the audit cost rate in the original model. After the robustness test of the model, the regression results are the same as former. The robustness test shows that the original hypothesis is available.

5. Conclusions and recommendations

5.1 Conclusions

We study the impact of the heterogeneity of top management team on audit quality in agricultural listed companies in this article and use audit cost rate as an alternative variable to audit quality then make an empirical study on the heterogeneity of the term of top management team, age and education background. The results showed that:

(1) Age heterogeneity of top management team is positively correlated with audit quality. This shows that in enterprises with large heterogeneity of top management team, the members of top management team have great differences in psychological cognition and behavior style, which makes it difficult to form ingroup preference and it is useful for enterprises to break its own culture and group thinking.

Also the members' thinking method will be more independent and scientific which is not easily influenced by others, thereupon then improve the effectiveness of internal control and audit quality.

(2) The education heterogeneity of top management team is positively correlated with audit quality. This shows that when making strategic decisions, the members of the top management team often take into account the opinions of members with different educational backgrounds in

enterprises of different educational levels so that the decision-making is more scientific and reasonable which plays an important role in promoting the quality of internal control and improves the quality of audit.

(3) The term heterogeneity of top management team is negatively correlated with audit quality. This shows that enterprises with more term heterogeneity, internal staff changes is frequent as well as unfamiliar with each other of the senior management team. The time of term determines that how much the top managers know the company which directly affects the construction of internal control. In this way, it's hard to make sure the effectiveness of internal control, accordingly the quality of audit is worse.

5.2 Recommendations

According to the analysis results, we know that in order to get a better audit quality and know the situation of the company for the real owners, it is necessary to optimize the top management team. The following suggestions are for the top management team optimization:

(1) Select employee of different ages and education background to join the management team with the experience and knowledge of different members, so as to improve the knowledge of the top management team and the decision-making and analysis ability of the whole team to reduce the possibility of irregularities.

(2) Strictly control the term of the top management team and make the term of the top managers as consistent as possible. Select senior managers for re-election and strictly limit the re-election of senior managers, so as to effectively make the construction of internal control and improve the quality of audit.

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