International Journal of Advances in Engineering and Management (IJAEM)
Volume 2, Issue 8, pp: 230-238 www.ijaem.net ISSN: 2395-5252

Professional specialization of audit offices and companies and its impact on the cost of capital

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Date of Submission: 10-10-2020 Date of Acceptance: 27-10-2020

ABSTRACT-The research aims at measuring the impact of professional specialization of audit offices and companies on the cost of capital, and this aims at achieving this goal by studying the professional specialization of audit offices and companies in all its aspects, and identifying the impact of professional specialization on the cost of capital. Based on the annual financial report data of a sample of 13 Iraqi banks listed on the Iraq Stock Exchange for the period 2008-2017, and for the purpose of measuring the level of professional specialization of offices and companies that have conducted bank audits, the research sample used the researcher to measure the weighted market share. Several examples of capital cost measurement (CAPM peg,MPEG) of the research sample were also relied upon, and for the purpose of testing research hypotheses statistically, the Statistical Program (SPSS) was used to determine the size of the link, the effect, and the level of morale among the research variables. The results found that there is an acceptable level of professional specialization among audit offices and companies that have conducted the audit of bank financial reports sample research, with a low level of capital cost for banks sample research, and a statistically significant impact relationship between professional specialization of audit offices and companies and the cost of capital. The researchers recommended to support and reinforce the professional specialization in the audit offices and companies to practice their activity and encourage the banks and other companies listed in their shares in the Iraqi stock market to contract with professional audit offices and companies. They have the ability and competence to detect and assess the risks of physical distortions in the elements of reported financial reports and to adopt them as a basis for assessing the performance of companies and seeking to diagnose and analyze factors and variables that affect capital cost determination.

Key words: Professional specialization of auditors, cost of capital

I. INTRODUCTION

The financial market reflects an important mechanism for achieving economic development, attracting and optimizing investments toward available investment opportunities. Providing companies with the lowest possible cost of such funds, providing appropriate accounting information for decision-making, seeking to protect investors from opportunistic management behavior, reducing the risk of uncertainty surrounding investment decisions, and enhancing the efficiency of the financial market.

The professional specialization of any profession that supports the practical achievement of professional knowledge and experience to help its members perform their work in a more efficient and effective way, so many of the dominant professions in society have sought to specialize in their work as a tool for improving the efficiency of professional performance. The auditing profession as one of the most important and well-established professions in all societies has also sought to specialize in auditing the activities or sectors of their clients to keep pace with developments and changes in the contemporary business environment and the environment associated with the practice of the profession. Professional specialization has therefore become necessary to manage audit functions, as a result of the evolution in many aspects of various activities, including the breadth, complexity of processes,

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Volume 2, Issue 8, pp: 230-238 www.ijaem.net ISSN: 2395-5252

and the varying knowledge, practices and standards relevant to each activity. In addition to increasing the degree of competition, which requires the auditor to be familiar with all these aspects to contribute to enhancing the quality and credibility of the accounting information contained in the audited financial reports, which are focused on by stakeholders (investors and lenders), thereby enhancing their investment decisions, Because they have the experience and knowledge of the nature of companies' activity and the environment around them, they contribute to reducing or reducing the manipulation, fraud and mispractices associated with that accounting information, so as to support investors' confidence and encourage the attraction and increase of investments in those companies, and this may contribute to reducing the cost of their capital.

II. PROBLEM DESCRIPTION

The main problem is that the divergence of reported accounting information among stakeholders, particularly between management and investors, has led to a weakening of the availability of equal opportunities for those parties to make their decisions properly and the need for a professional specialization of audit offices and companies that can support the quality of financial reporting and protect investors from opportunistic management behavior. The problem has been identified by several questions, including:

1) Is there an acceptable level of professional specialization in audit offices and companies that check the sample research?
2) Is there a reduction in the cost of capital borne by the research sample banks?
3) What is the nature of the impact of professional specialization on the research sample of the offices and companies that scrutinize the cost of capital in banks?

III. LITERATURE REVIEW THE AND DEVELOPING hypotheses

3.1 Auditors' professional specialization

The auditor of a specific activity (industrial, banking, service) needs to have a precise specialization in this activity, as it is one of the important tools to improve the efficiency of the auditor's professional performance, and it can also contribute to supporting the application and keeping up with international auditing standards related to knowledge and understanding of the nature of the customer's activity and the environment. In other words, the auditor's control over the auditing process in a particular activity makes him the most in possession of the knowledge and experience in that activity. So that he directs his important investments to develop audit methods and techniques in that activity (which he works with and help the auditor to plan the audit process, discover fraud and errors (Karami, et al., 2017).

Where we find that professional specialization has an important role in many professions, such as medicine, engineering, finance and other professions, especially in the auditing profession, because of its practical benefit in providing its members with great professional experience and knowledge, which helps them perform their tasks with a high level of efficiency and effectiveness (Wiyantoro& Usman, 2018: 420). With the rapid development of the global economy and the accompanying development in information technology and competition in business activities, it was imperative that auditors possess practical experience and professional knowledge of a particular activity, so that they could provide excellent and high-quality audit services to their clients in that activity (Lowensohn, et al., 2005).

Therefore, the specialized auditor is the one who possesses knowledge and professional content in a particular activity, and his possession of that content was done either directly through auditing that activity or indirectly through obtaining training courses for that activity. As well as having a high ability to assess work conditions and the effect these are conditions on their clients, including economic conditions, government regulations and change in technology, so that they can differentiate themselves from competitors in the auditing market (Chen, et al, 2011). On the other hand, audit offices and companies are considered specialized when they have an integrated information system, effective control systems and professional standards when performing the audit service in a specific activity without others. So that they achieve competitive advantages over audit offices and companies that are not specialized in applying those systems and standards for that activity (Kommunuri, 2013). As professional specialization provides auditors with a competitive advantage over other non-specialists, by providing an audit service to a relatively large group of companies in a

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particular activity, which will push auditors to gain more experience and knowledge and direct their human resources and capabilities to the success of that competitive advantage (Li et al., 2010).

(3.2) cost of capital

The task of providing the necessary capital resources to the units is one of the difficult tasks, especially as these sources are reduced, their cost and the degree of risk associated with each. Knowledge of the cost of these sources is an important and essential element in the success and sustainability of the units in the financial market, assessing the quality of their investment decisions in the light of the many changes in the financial markets and rapid developments in their business environment Of the Unit's assets after all its liabilities have been put forward (IAS,2014) so selecting a specific funding source depends not only on the expected return, but also on the estimated cost of the invested funds or sources of financing. (Brigham& Ehrhardt,2013), In specialized studies on capital cost, it is noted that many researchers and specialists in economic sciences, financial and accounting management have different opinions on defining their concept, although they have been given exceptional importance in making investment decisions, which are considered one of the most important decisions of the unit. The cost of capital can be defined as the return that investors receive from their investments, that is, the minimum return that they need from investments, such as capital budget projects, to ensure that the value of the unit does not fall (Porras, 2011). An (Exley&Smith,2006) study showed that the cost of capital represents the rate at which the value of the funds used by the investor is maintained, or is the lowest rate of return required by investment projects in a way that ensures a capital holder a comparable return with other returns that can be obtained from the market, The study of "Brigham&Ehrhardt,2013" shows that it reflects the likely cost of each source of financing or capital structure, and the cost of capital is calculated for all sources of long-term funding independantly of other sources to reach the likely total cost of those sources. Knowledge of the concept of capital cost has a direct impact on maximizing the value of the unit through the many financial decisions that the administration makes, whether through financing decisions or investment, and the mistake of making these decisions carries the unit with high costs, may reach the liquidation limit (he, et al., 2019).

(3.3) the effect of professional specialization of auditors on the cost of capital

Professional specialization of auditors provides a high degree of confidence in the information contained in the financial reports, thus increasing the efficiency of the stock market and investing in stocks. Increasing investors' confidence in the credibility of financial reporting leads to their reliance on many decisions, such as selling, buying, and holding unit shares and assessing sustainability (Carcello, Nagy, 2004).

According to the researchers, this is due to the fact that professional specialization gives auditors a better understanding of the nature of the unit's work and the risks of its audit, It makes them perform a quality audit compared to other non-professional professionals, which contributes to the value of the reported profit information on which investors depend for their decision, When a study (Mukhlasin,2018) found that the professional specialization of auditors played two roles: Information and surveillance, acting as a watchdog by monitoring management rather than shareholders, and the information role of specialization is to solve a problem that does not match information between management and investors, The risk of asymmetric information from the investor's point of view is therefore reduced because asymmetric information reduces the credibility and reliability of that information, as the possession of a specialized auditor with knowledge and experience of the customer's activity and accounting practices of that activity can reduce the risk that information is not similar to that of investors and management, In order to increase the quality of the information, it enhances the accounting gains contained therein, On the other hand, (Sun&Liu,2013) found that one of the most important factors leading to lower level of revenue management and higher quality is the audit of financial statements by professional auditors experienced in the same activity as those companies, i.e. there is a reverse relationship between auditor specialization and the likelihood that the company's management will apply to revenue management techniques.

3.4 Scientific Research Methods

1. Community and sample research

The research community represents all the Iraqi commercial banks whose stocks are

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listed in the Iraq Stock Exchange within the regular market only and during the period (2008-2017). The reason for choosing this sector is as one of the most active sectors in the circulation of its stocks, and it is considered the essence of the financial system of any country and the clear importance of banks in supplying the national economy with the funds necessary for development. On the other hand, any crisis faced by banks will be reflected in the entire national economy.

2. Method of taking the research sample

The research sample consisted of (13) banks out of (19) of the banks listed on the Iraq Stock Exchange during the period of research (2008-2017), where the selected banks formed (68%) of the research community. Where these banks were chosen because they fulfilled the search conditions, which are as follows:

a. It is listed on the Iraq Stock Exchange (the regular market) for the period mentioned.
b. Availability of the bank's financial reports for the relevant period.
c. Continuing to trade the bank's stocks for the relevant period.
d. It is not an Islamic bank.

After the bank has fulfilled the above conditions, the information related to the bank's variables is obtained.

3. Measuring search variables

a. Measure the professional specialization of auditors

The research uses the weighted market share measure in measuring the level of professional specialization of auditing offices and companies, which was suggested by researchers (Neal & Riley, 2004), It includes both measures (the market share scale and the portfolio share scale), and is reached by multiplying the market share ratio in the ratio of the share of the portfolio and that this measure allows its application in low-competing activities that do not have to be specialized according to the scale of the portfolio, with having a high market share, and vice versa, and in line with (Neal and Riley, 2004), The criterion used in the weighted market share measure is based on to weighted market shares, The two researchers have adopted the weighted market share measure in measuring the percentage of professional specialization of companies listed on the (Iraq Stock Exchange) that has been audited by audit offices and companies and during the specified research period between (2008-2017), It is measured by applying the equations next:

1. Market share of auditors: It is extracted by applying the following equation:
Market share of auditors = market share of auditors in a specific activity / Market share of auditors working in the same activity
2. Portfolio share for auditors: It is extracted by applying the following equation:
Portfolio share for auditors = Portfolio share for auditors in a specific activity / Portfolio share for auditors working in all activities
3. Weighted market share: It is extracted by applying the following equation:
Weighted market share of auditors = market share ratio * portfolio share ratio

Auditors are considered specialists in auditing companies listed on the stock market if they possess a weighted market share percentage equal to or greater than (20%) of the proportion of the auditors working in that market, and this percentage has been adopted by many studies and research as a basis for distinguishing between specialists from other than specialists (Kommunuri, 2013).

b. measuring the cost of capital

1. Capital asset pricing model (CAPM)

The capital asset pricing model is one of the most common models for measuring the cost of capital, relying on the balance of the relationship between yield and risk, by calculating the minimum expected yield on the invested funds to compensate the investor for the regular risk to which the expected return may be exposed. The cost of capital is calculated on this model by the following formula (Moyo& Maché,2018):

$$R_i = R_f + \beta [R_m - RF]$$

Where:
R_i = cost of capital
β = Beta coefficient
R_m = The expected rate of return for the market portfolio
R_i = Market rate of return per share

2) The price-to-abnormal earnings growth model (PEG)

This model was proposed by (Easton,2004), which is a model based on the expected profitability of the stock, since this model assumes that the present value of the shares equals the expected profits in the next period and extracts this ratio by applying the following equation (Hu, et.al,2018):

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$$r_{PEG} = \sqrt{\frac{eps_{t+2} - eps_{t+1}}{P_1}}$$

For:

r_{PEG} = cost of capital

eps_{t+1} = Year's expected Share profitability (1+t)

eps_{t+2} = Expected Share profitability for the year (2+T)

P_t = current stock price

3) A model of price growth to adjusted abnormal profits

A model derived from the price-to-abnormal profits growth model (PEG), proposed by (Easton,2004) and modified by researchers (Ohlson and Juettner-Nauroth,2005), This model is different from the previous model used for the expected growth rate of profits and is based on the idea that abnormal profits are different for two years after that, growing at a constant rate, calculated by the following equation (Persakis&Iatridis,2015):

$$r_{PEG} = \sqrt{\frac{eps_{t+1}}{P_1} \times growth_{t+2}}$$

$$growth_{t+2} = \frac{eps_{t+2} - eps_{t+1}}{eps_{t+1}}$$

Where:

r_{PEG} = Cost of capital

eps_{t+1} = years expected Share profitability (1+t)

eps_{t+2} = Year's expected Share profitability (2+T)

P_t = current stock price

$growth_{t+2}$ = is the rate of growth of the profitability of the stock between two cities.

IV. RESULTS OF THE FIRST HYPOTHESIS TEST AND analysis of the results

For the purpose of testing this hypothesis, the statistical analysis (one sample T-test) will be used. The idea of this test is to discover the extent to which there is a significant difference in the mean of the population from which the sample was withdrawn from a constant value. In addition to the possibility of estimating the confidence interval for the population mean, and since the variable what will be tested here is a result of the quantitative analysis and measurement to calculate the percentage of professional specialization of Iraqi auditing offices and companies, so that the cut-off limit will be used to judge the availability of professional specialization in the banking sector, amounting to (0.00272) as a test value) to conduct a (T-test) analysis, with the help of the program The Statistical Package for Social Sciences (SPSS), the results were as follows:

Table(1)
The first hypothesis test results

One-Sample Statistics					
	N	Mean	Std. Deviation	Std. Error Mean	
Professional specialization	130	.09443	.07578	.006647	
Test Value = 0.00272					
t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
				Lower	Upper
13.797	129	.000	.09170	.07856	.10486

The above table shows that the calculated value of (T) reached (13.797), which is much greater than its tabular value at the degree of freedom of (129) (n-1), which is (1.645), and that the mean standard deviation of the estimation error is (Std. Error Mean) reached (0.006647), which is a very low value, and the smaller this type of error, the better, and the table also shows that the level of significance of the test (Sig. 2-tailed)) was very high and reached (0.000), which is less than the acceptable level of error in social sciences, which is predetermined by (0.05). This means that the sample showed convincing evidence of rejecting the null hypothesis and accepting the alternative hypothesis, that is, there is an acceptable level. From professional specialization in audit offices or companies that audit (the research sample banks).

E. Results of testing the second hypothesis and analyzing results

Having shown the results of the capital cost measurement measured by the researcher in three measures (CAPM,PEG,MPEG), The researcher has standardized the results of these

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measures by means of vehicle and composite measures, a measure derived from a series of observed facts that reflect the position of the phenomenon in question, where a composite measure is formed by combining some separate indicators into a single indicator based on a particular model, A composite metric, therefore, measures multi-dimensional concepts in an ideal way that combines the characteristics and dimensions of individual metrics that cannot be reached by a single metric, By using the primary components analysis, which converts individual key metric values into standard values for the purpose of striding them from their different units into homogeneous and standard values, in which readings range from three to three positive. Depending on the results of the composite metric, the banks divided the search sample into two groups based on the average standard values of 0 degrees as follows:

• Banks with low capital costs (capital costs less than average benchmark values) and given the figure one

• Banks with high capital costs (the cost of capital is higher than the average standard values) and given a zero

Using binary statistical analysis (Bonomial Test) through which we can test the meanings of the low or high cost of capital in the study sample companies and using the Statistical Program (SPSS), the results were as follows:

Table 2 The results of the hypothesis test again

Binomial Test

Details		Category	N	Observed Prop.	Test Prop.	Asymp. Sig. (2-tailed)
cost of capital	Low	1	80	.62	.50	.011a
	High	0	50	.38		
	Total		130	1.00		

a. Based on Z Approximation.

From the above table, the following are noted:

The number of views with a lower cost of capital was 80 (130) views (62%).

When the number of views with a rise in the cost of capital was (50) views (130) or (38%), and the meaning of the test was (0.011), which is (0.05) below the level of acceptable error in the social sciences, so the research hypothesis, which is included, is accepted (There is a decrease in the cost of capital for Iraqi banks, sample research).

F. Results of testing the third hypothesis and analyzing results

To test this hypothesis, the following linear regression model is formulated:

$$COC_{it} = B_0 + B_1 PS_{it} + \varepsilon_{it}$$

Where:

PS_{it} = Autonomous variable (professional specialization of audit offices and companies).

COC_{it} = Slave variable (cost of capital).

ε_{it} = errors in estimate.

B_0 = the regression equation constant that represents the value of the child variable when the value of the autonomous variable is equal to zero.

B_1 = slope of the slope function

Using the Statistical Program (SPSS), the results were as follows:

Table 3 Summary of the sample test of the third hypothesis

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.669[a]	.448	.444	3.167581

a. Predictors: (Constant) professional specialization

b. Dependent VariabThe cost of capital is uniform

The table above shows the sample summary above (Model Summary) that the value of the link ((R) between the variables is (0.669), that the R Square coefficient is (0.448) that represents the "explanatory power" of the model used, i.e. the professional specialization of Iraqi audit offices and companies explains its value (0.3%) of the cost of capital, and that the standard deviation of the calculation error (STD), Error of the estimate) was (3.167581).

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Table 4 The third hypothesis test variance						
ANOVA[b]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1041.790	1	1041.790	103.831	.000[a]
	Residual	1284.297	128	10.034		
	Total	2326.087	129			
a. Predictors: (Constant) professional specialization						
b. Dependent Variable The cost of capital is uniform						

The table above shows the variance (ANOVA) that the calculated value F) was 103.831 and is greater than the calculated value of the Freedom (DF) (128.1) (3.84) at an indication level (5%), and that the significance level is SIG). The amount of 0.00, which is less than the value of the accepted error in social sciences and is specified in advance by 0.05, which indicates the suitability of the statistical model used to test the hypothesis, and that the sample data provided convincing evidence of rejection of the nihilistic hypothesis and acceptance of the alternative hypothesis, which means (Professional specialization of audit offices and firms affects the cost of capital for banks the search sample).

Table 5 The regression function coefficients of the third hypothesis						
Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.460	.310		4.707	.000
	professional specialization	-.973	.096	-.669	-10.190	.000
b. Dependent Variable The cost of capital is uniform						

The coefficients table shows that the regression equation constant (B2) is (1.46), and that the slope value of the regression equation (B1) is (-0.973), which shows the effect of the autonomous variable on the slave variable (by coefficient B), and the negative value of the coefficient () (There is a reverse effect between independent and subordinate variables, or, in other words, an increase in the independent variable (the professional specialization of auditing clerk and companies) by one degree results in a decrease of (97.3%) in the dependency variable (the cost of capital) with all other independent variables fixed.

The regression equation adopted in the test of the hypothesis can be reformulated in the light of the findings that can be used for the purpose of predicting the following:

The following figure shows the histogram, which shows the normal distribution of the regression equation statistical shield, which shows the accuracy of the previous regression equation.

V. CONCLUSION

The results showed how well the audit offices and companies that conducted the bank audit sample research professional specialization according to the likely market share that they possess a professional specialization in this

activity and formed their percentage (73%), as confirmed by the statistical analysis results that found that there is an acceptable level of professional specialization In the audit offices and companies that scrutinize the research sample, which is an important positive indicator for improving the professional competence of auditors and can contribute to reducing risk, increasing the ability and efficiency of auditors to detect or limit the manipulation of accounting information that may be exercised by the bank's management, The results also reflected the results of measuring the cost of capital, according to the three measurement models (CAPM, PEG, MPEG), the sample banks and during the research period, until the peg model recorded a higher cost of capital than the results of the two models (CAPM, MPEG). However, the cost of capital according to the three models and the many banks in sample was low, as was also confirmed by the results of the statistical analysis, which is a positive indicator of a return that satisfies or attracts investors in investment at those banks, and increases investor confidence. The results of the statistical analysis have also shown that there is a reverse effect between the professional specialization of auditors and the cost of capital in the sample banks, which can be explained by the fact that the availability of professional auditors has reduced the cost of capital. The researchers recommended the importance of activating the role of the profession Council for auditing accounts, the Iraqi Accountants Association and the Iraqi Association of Chartered Accountants in following up, supporting and enhancing the professional specialization in audit offices and companies to practice their activities in light of the developments in the auditing profession and the different nature of the companies' accounting and financial systems. Also encouraging banks and other companies listed in the Iraqi Stock Exchange to contract with professional specialized audit offices and companies. For their ability and efficiency to detect and assess the risks of physical distortions and mispractices in accounting information, thereby contributing to the enhancement of confidence and credibility in financial reporting and the improvement of their reputation in the stock market on the one hand, On the other hand, it could support many investors' tendency to buy and retain their shares to contribute to maximizing their market value.

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