

Computer Problem 7

Determinants of the likelihood that a firm will dismiss its auditor.

You wish to understand what makes a firm dismiss its auditor.

You hypothesize that the probability of auditor dismissal during any given year depends on the auditor's fee, along with other potential control variables, as follows:

Dismiss	= 1 if auditor was dismissed in the current year, 0 otherwise;
Lnauditfee	= ln(auditor's fee);
Lnrev	= ln(total revenue);
Roa	= return on assets;
Leverage	= the firm's leverage ratio;
Loss	= 1 if the firm experienced a loss this year, 0 otherwise;
Gocern	= 1 if firm is not currently a going concern, 0 otherwise;
Big4	= 1 if auditor is a Big 4 accounting firm, 0 otherwise.

Data on the dependent variable (i.e., whether or not a firm dismissed its auditor) are taken from a proprietary dataset that documents the experience of auditor dismissals for a large sample of U.S. firms during the years, 2000-2005. Data on the remaining variables are taken from Compustat, and by searching the annual reports and other information issued by firms.

Estimate an appropriate model to investigate the relation between the likelihood of audit dismissal and various subsets of the potential dependent variables listed above.

Estimate this relation in 3 ways:

1. Linear Model
2. Probit
3. Logit.

Present and interpret the relevant results.

Compare the results across the three estimation techniques.

Note: Consider carefully the specification in each case, and make sure that you understand the implications of how you specify the model, so that you interpret the results correctly.