CORPORATE GOVERNANCE AND AUDITOR CHOICE AMONG COMPANIES IN GCC COUNTRIES

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CORPORATE GOVERNANCE AND AUDITOR CHOICE AMONG COMPANIES IN GCC COUNTRIES

By

KHALED SALMEN YASLAM ALJAAIDI

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ABSTRACT

This thesis examines two separate studies—auditor change and auditor selection determinants among public listed companies in the Gulf Cooperation Council (GCC) for the period of 2005-2010. The models were developed using the frameworks of the agency theory, the managerial grid theory, the attraction-selection-attrition framework and the information suppression hypothesis to examine the associations of three categories of determinants with the decisions of auditor change and selection. The first category of determinants is the corporate governance mechanisms: board of directors’ effectiveness score (board of directors independence, size, financial expertise, meetings, nationality, international experience and CEO duality), audit committee’s effectiveness score (audit committee independence, size, financial expertise, meetings, nationality and international experience), government ownership, family ownership, and domestic corporate ownership. The second category of determinant is the audit-specific characteristic: audit fee. The third category of determinants is the firm-specific characteristics: firm size, leverage, firm performance, and management change. For the auditor change model, the results show that the board of directors’ effectiveness score, family ownership, firm size, and leverage are significantly associated with the incidence of auditor change. As for the auditor selection model, the results indicate that the family ownership, domestic corporate ownership, audit fees, firm performance, and management change are significantly related to audit quality. This study findsthat the economic and the behavioral issues are related to audit demand in GCC. Additionally, the study suggests that regulators, especially the GCC stock exchanges, should mandate companies to disclose all relevant information related to auditor change in a transparent and timely manner, and increase law enforcement to enhance good corporate governance practices. For companies, this study proposes that they should emphasize more on enhancing the role and the quality of the board of directors and the audit committee members, as they are involved in the both decisions of auditor change and selection.

Keywords: corporate governance, auditor choice, GCC
ABSTRAK


Kata Kunci: pentadbiran korporat, pilihan juruaudit, GCC
ACKNOWLEDGEMENTS

In the name of Allah, the Most Gracious and Most Merciful

Praise to Allah, Lord of the universe for his bounties and bestowed upon us. Peace be upon Prophet Mohammed S.A.W. the sole human inspiration worthy of imitation.

Allah has called Himself Aleem (All-Knowing) and He also called some of His slaves Aleem. So, One Aleem is not like the other. He said, ‘We raise to degrees whom We please, but over all those endowed with knowledge is the All-Knowing (Allah)’ [Soorah Yusuf (12): 76].

After praising Allah for the strength and endurance provided to me to complete this thesis, my excessive gratefulness is to my parents who bless me all the time and work for my best since I was born.

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<td>AAA</td>
<td>American Accounting Association</td>
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<td>AC</td>
<td>Audit Committee</td>
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<td>ADSM</td>
<td>Abu Dhabi Securities Market</td>
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<td>AML</td>
<td>Anti-Money Laundering</td>
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<td>BMA</td>
<td>Bahrain Monetary Agency</td>
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<td>BSAA</td>
<td>Bahrain Society of Accountants and Auditors</td>
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<td>CCG</td>
<td>Code of Corporate Governance</td>
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<td>CTF</td>
<td>Counter-Terrorist Financing</td>
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<td>DFM</td>
<td>Dubai Financial Market</td>
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<td>E&amp;Y</td>
<td>Ernst &amp; Young</td>
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<td>ESCA</td>
<td>Emirates Securities and Commodities Authority</td>
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<td>FTAs</td>
<td>Free Trade Agreements</td>
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<td>GCC</td>
<td>Gulf Co-operation Council</td>
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<td>GCCAAO</td>
<td>Cooperation Council Accounting and Auditing Organization</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>International Financial Corporations</td>
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<td>INSEAD</td>
<td>Institut Européen d'Administration des Affaires (The Business School of</td>
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<td></td>
<td>the World)</td>
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<td>MENA</td>
<td>Middle East and the North-African</td>
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<td>MSM</td>
<td>Muscat Security Market</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>OLS</td>
<td>Ordinary Least Square</td>
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<td>PTC</td>
<td>Permanent Technical Committee</td>
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<td>QCB</td>
<td>Qatar Central Bank</td>
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<td>Qatar Financial Markets Authority</td>
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<td>ROA</td>
<td>Return on Assets</td>
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<td>The National Investor</td>
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<td>UAE Accountants and Auditors Association</td>
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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

This thesis examines similar determinants influencing two related decisions: auditor change (Model 1) and auditor selection (Model 2) in a unique country setting—the GCC—in two periods, preceding and subsequent to both decisions. Both models are developed using individual and combined economic and behavioral theoretic perspectives. These include the frameworks of agency theory and its related hypotheses; managerial grid theory; attraction-selection-attrition; and information suppression. All of these have been used to explain the association of corporate governance mechanisms (board of directors effectiveness, audit committee effectiveness, government ownership, family ownership, and domestic corporate ownership), an audit-specific characteristic (audit fee), and firm-specific characteristics (firm size, leverage, firm performance, and management change) with the decision of auditor change and selection.

1.1.1 What Would Happen if Auditors were not There?

In modern companies, ownership is separated from control. In this case, potential conflicts of interest and information asymmetry arise between owners and managers, as well as among different classes of security holders. For that reason, auditors work as
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