

**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**

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**Thesis Submitted to  
Othman Yeop Abdullah Graduate School of Business  
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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 finds that 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

Tesis ini mengandungi dua kajian yang berbeza—penentu keputusan pertukaran juruaudit dan pemilihan juruaudit di kalangan syarikat awam tersenarai di negara *Gulf Cooperation Council (GCC)*. Model kajian telah dibangunkan dengan menggunakan kerangka kerja teori agensi, teori gerid pengurusan, kerangka kerja tarikan-pemilihan-pergeseran dan hipotesis kawalan maklumat. Kategori penentu yang pertama ialah mekanisma pentadbiran korporat. Ini termasuk skor keberkesanan lembaga pengarah (kebebasan lembaga pengarah, saiz, kepakaran kewangan, bilangan mesyuarat, kewarganegaraan, pengalaman antarabangsa dan dwi-CEO), pemilikan kerajaan, pemilikan keluarga dan pemilikan korporat domestik. Kategori penentu kedua adalah ciri khusus audit; iaitu yuran audit. Kategori ketiga pembolehubah adalah ciri khusus syarikat; saiz syarikat, keberhutangan, prestasi syarikat dan pertukaran pengurusan. Bagi model pertukaran juruaudit, skor keberkesanan lembaga pengarah, pemilikan keluarga, saiz firma audit dan keberhutangan boleh dikaitkan secara signifikan dan konsisten dengan pertukaran juruaudit. Untuk model pemilihan juruaudit, pemilikan keluarga, pemilikan korporat domestik, yuran audit, prestasi syarikat dan pertukaran pengurusan berkait secara signifikan dengan kualiti audit. Kajian ini mendapati penentu ekonomi dan tingkahlaku berhubungkait dengan permintaan audit di *GCC*. Kajian ini juga mengutarakan bahawa pihak perundangan terutamanya bursa saham di *GCC* perlu menetapkan syarikat mengisytiharkan semua maklumat yang relevan, yang berkaitan dengan pertukaran juruaudit secara telus dan pada masa yang tepat, serta mempertingkatkan lagi perlaksanaan undang-undang bagi memperbaiki lagi amalan pentadbiran korporat. Untuk pihak syarikat, kajian ini mencadangkan bahawa mereka perlu memberi lebih penekanan kepada tindakan meningkatkan peranan dan kualiti mutu lembaga pengarah dan ahli jawatankuasa audit disebabkan oleh penglibatan mereka dalam keputusan menukarkan dan memilih juruaudit.

**Kata Kunci:** pentadbiran korporat, pilihan juruaudit, *GCC*

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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].

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# TABLE OF CONTENTS

<b>CONTENTS</b>	<b>PAGE</b>
<b>TITLE PAGE</b>	<b>i</b>
<b>CERTIFICATION OF THESIS WORK</b>	<b>ii</b>
<b>PERMISSION TO USE</b>	<b>iv</b>
<b>ABSTRACT</b>	<b>v</b>
<b>ABSTRAK</b>	<b>vi</b>
<b>ACKNOWLEDGEMENTS</b>	<b>vii</b>
<b>TABLE OF CONTENTS</b>	<b>ix</b>
<b>LIST OF TABLES</b>	<b>xiii</b>
<b>LIST OF FIGURES</b>	<b>xiv</b>
<b>LIST OF ABBREVIATIONS</b>	<b>xv</b>

## CHAPTER ONE: INTRODUCTION

1.1	Background of the Study	1
1.1.1	What Would Happen if Auditors were not There?	1
1.1.2	Issues Associated with the International Audit Market	3
1.1.3	Issues Associated with the Underlying Theories and Studies	4
1.1.4	Issues Associated with the Measurement of Audit Quality	7
1.1.5	Why Does Demand for Audit Quality in the GCC Matter?	9
1.1.6	Concerns Associated with the Demand for Audit Quality in the GCC	12
1.1.7	How is This Study Different?	13
1.1.7.1	Audit Quality Score	14
1.1.7.2	Contextually-Cultural Determinants in the GCC—Nationality and International Experience—Managerial Grid Theory, and Attraction-Selection-Attrition Framework	15
1.1.7.3	Combined Scores of Board of Directors and Audit Committee Effectiveness Using a Combined-Theoretic Perspective of Economic and Behavioral Theories	21
1.1.7.4	Dominant Groups of Shareholders in the GCC	24
1.2	Problem Statement	26
1.3	Research Objectives and Questions	28
1.4	Research Motivation and Significance	30
1.4.1	Research Motivation	30
1.4.2	Research Significance	32
1.5	Scope of the Study	36
1.6	Organization of the Study	37

## CHAPTER TWO: GGC BACKGROUND, GCC AUDIT MARKETS, AND INSTITUTIONAL FACTORS ASSOCIATED WITH THE DEMAND FOR AUDIT QUALITY

2.1 Introduction	39
2.2 GCC Country—Background	41
2.3 Audit Markets and Auditing Regulations in the GCC	43



2.4 Corporate Governance in the GCC	56
2.5 Auditor Choice within GCC Codes of Corporate Governance	60
2.6 Auditor Role within GCC Codes of Corporate Governance	64
2.7 Financial Scandals and Status of Qualified Audit Reports in the GCC	66
2.8 Summary and Conclusion	69

### **CHAPTER THREE: DEMAND FOR AUDIT QUALITY AND ITS RELATED THEORIES**

3.1 Introduction	71
3.2 Demand for Audit Quality	72
3.3 Theories Associated with the Demand for Audit Quality	73
3.3.1 Agency Theory	75
3.3.2 Managerial Grid Theory and Attraction-Selection-Attrition Framework: A Complementary Fashion	85
3.3.3 Information Suppression Hypothesis	92
3.4 Summary and Conclusion	93

### **CHAPTER FOUR: AUDITOR CHANGE AND SELECTION: A REVIEW AND SYNTHESIS OF THE LITERATURE**

4.1 Introduction	94
4.2 Auditor Change	94
4.3 Audit Quality Score	96
4.3.1 Auditor Size	98
4.3.2 Brand-Name Auditor	98
4.3.3 Industry-Specialist Auditor	100
4.3.4 Auditor Independence	103
4.4 Corporate Governance Mechanisms	110
4.4.1 Board of Directors' Effectiveness Score	113
4.4.2 Audit committee's effectiveness score	138
4.4.3 Ownership Structure	152
4.5 Audit-Specific Characteristic	165
4.5.1 Audit Fee	165
4.6 Firm-Specific Characteristics	169
4.6.1 Firm Size	169
4.6.2 Firm Performance	172
4.6.3 Leverage	174
4.6.4 Management Change	177
4.7 Summary and Conclusion	178

### **CHAPTER FIVE: RESEARCH DESIGN AND METHODOLOGY**

5.1 Introduction	179
5.2 Theoretical Frameworks	180
5.2.1 Theoretical Framework of the Auditor Change (Model 1)	181
5.2.2 Theoretical Framework of the Auditor Selection (Model 2)	184
5.3 Hypotheses Development	191
5.3.1 Corporate Governance Mechanisms	192
5.3.1.1 Board of Directors Effectiveness	192

5.3.1.2 Audit Committee Effectiveness	198
5.3.1.3 Ownership Structure	202
5.3.2 Audit-Specific Characteristic	207
5.3.2.1 Audit Fees	207
5.3.3 Firm-Specific Characteristics	208
5.3.3.1 Firm Size	208
5.3.3.2 Firm Performance	210
5.3.3.3 Leverage	211
5.3.3.4 Management Change	213
5.4 Measurements of Variables	214
5.4.1 Auditor Change	214
5.4.2 Audit Quality Score	215
5.4.3 Board of Directors and Audit committee's effectiveness scores	219
5.4.4 Ownership Structure	231
5.4.5 Audit-Specific Characteristic	233
5.4.6 Firm-Specific Characteristics	233
5.5 Specification of the Models	237
5.5.1 Auditor Change Framework (Model 1)	237
5.5.2 Auditor Selection Framework (Model 2)	239
5.6 Data Collection	241
5.6.1 Sample Selection	241
5.6.2 Procedures	242
5.7 Summary and Conclusion	243
 <b>CHAPTER SIX: EMPIRICAL RESULTS AND DISCUSSIONS OF AUDITOR CHANGE FRAMEWORK (MODEL 1)</b>	
6.1 Introduction	245
6.2 Sample Description, Sample Statistics and Data Collection	246
6.3 Descriptive Statistics and Univariate Analyses	251
6.4 Diagnostic Tests	260
6.4.1 Sample Size Assumption	261
6.4.2 Tests to Detect Outliers	261
6.4.3 Tests of Multicollinearity	262
6.4.4 Model Specification Tests	264
6.5 Multivariate Results	266
6.5.1 Corporate Governance Mechanisms	272
6.5.2 Audit-Specific Characteristic	280
6.5.3 Firm-Specific Characteristics	281
6.6 Summary and Conclusion	285
 <b>CHAPTER SEVEN: EMPIRICAL RESULTS AND DISCUSSIONS OF AUDITOR SELECTION FRAMEWORK (MODEL 2)</b>	
7.1 Introduction	288
7.2 Sample Description, Sample Statistics and Data Collection	289
7.3 Descriptive Statistics	291
7.4 Diagnostic Tests	302

7.4.1 Tests of Outliers	303
7.4.2 Tests of Multicollinearity	303
7.4.3 Tests of Normality	305
7.4.4 Tests of Linearity	306
7.4.5 Tests of Homoscedasticity	306
7.4.6 Tests of Autocorrelations	307
7.4.7 Model Specification Tests	308
7.5 Multivariate Results	309
7.5.1 Corporate Governance Mechanisms	312
7.5.2 Audit-Specific Characteristic	319
7.5.3 Firm-Specific Characteristics	319
7.6 Summary and Conclusion	323
 <b>CHAPTER EIGHT: SENSITIVITY ANALYSIS AND ADDITIONAL EMPIRICAL TESTS</b>	
8.1 Introduction	326
8.2 Auditor Change and Selection Models in Year ( $t_0$ )	326
8.3 Individual Effects of Board and Audit Committee Characteristics	328
8.4 Country-Specific Characteristics	340
8.5 Summary and Conclusion	346
 <b>CHAPTER NINE: SUMMARY AND CONCLUSION</b>	
9.1 Introduction	348
9.2 Summary of Results	348
9.2.1 The Results of the Auditor Change Framework (Model 1)	349
9.2.2 The Results of the Auditor Selection Framework (Model 2)	354
9.3 Implications of the Study	360
9.3.1 Implications for Theory	360
9.3.2 Implications for Policymakers	363
9.3.3 Implications for Management and Stakeholders	364
9.3.4 Implications to Academia	365
9.4 Limitations of the Study	366
9.5 Suggestions for Future Research	368
9.6 Conclusion	371
REFERENCES	377

## LIST OF TABLES

TABLE	DESCRIPTION	PAGE
2.1	External Auditor Legal Requirements	54
4.1	Dependent Variables for Auditor Change and Audit Quality Surrogates	106
4.2	Issues of Board of Directors in GCC Codes: Largely Similar	137
4.3	Issues of Audit Committee in GCC Codes: Largely Similar	152
5.1	Constructing Board of Directors' Effectiveness Score	225
5.2	Constructing Audit committee's effectiveness score	230
5.3	Summary of the Operationalization and the Expected Sign of the Research Variables for the Auditor Change (Model 1) and the Auditor Selection (Model 2)	235
6.1	Sample Selection Process	247
6.2	Descriptive Statistics and Univariate Test Results of Continuous Variables Classified by Auditor-Change Companies/non-Auditor-Change Companies	252
6.3	Descriptive Statistics (Percentage) and Univariate Test Results for dummy Variables for Auditor-Change/non-Auditor-Change Companies	259
6.4	GCC Ownership Structure of the Sample Companies	259
6.5	Correlation Matrix of Independent Variables for the Two-year Period ( $t_{-1}$ & $t_1$ )	263
6.6	Multicollinearity Statistics of Assessing VIF and Tolerance Values	264
6.7	Logit Analysis Results–Auditor Change (Model 1)	273
7.1	Summary of Auditor Change Types (Big 4/Second Tier/Local–Classifications)	290
7.2	Descriptive Statistics of Continuous Variables	292
7.3	Descriptive Statistics (Percentage) for Dummy Variables	296
7.4	GCC Ownership Structure of the Sample Companies	296
7.5	Principal Component and Reliability Analyses on Audit Quality	302
7.6	Correlation Matrix of Independent Variables for the Two-Year Period ( $t_{-1}$ & $t_1$ )	304
7.7	Multicollinearity Statistics of Assessing VIF and Tolerance Values	305
7.8	OLS Analysis Results–Auditor Selection (Model 2)	310
8.1	Logit Analysis Results–Auditor Change Model ( $t_0$ )	327
8.2	OLS Analysis Results–Auditor Selection Model ( $t_0$ )	328
8.3	Logit Analysis Results–Auditor Change (Model 1)	330
8.4	OLS Analysis Results–Auditor Selection (Model 2)	331
8.5	Principal Component Analysis on Institutional Environment Score	342
8.6	Logit Analysis Results–Auditor Change (Model 1)	343
8.7	OLS Analysis Results–Auditor Selection (Model 2)	345

## LIST OF FIGURES

FIGURE	DESCRIPTION	PAGE
1.1	Board and Audit Committee Scores Using a Combined-Theoretic Perspective of Economic and Behavioral Theories	23
1.2	Outline of the Thesis	38
3.1	Managerial Grid Theory	86
3.2	The Complementary Fashion of Managerial Grid Theory and Attraction-Selection-Attrition Framework	91
5.1	Theoretical Framework of the Auditor Change (Model 1)	182
5.2	Theoretical Framework of the Auditor Selection (Model 2)	188
5.3	Cross-Temporal Differences in the Auditor Change Framework	190
5.4	Cross-Temporal Differences in the Auditor Selection Framework	190

## LIST OF ABBREVIATIONS

<b>Abb.</b>	<b>Full List</b>
AAA	- American Accounting Association
AC	- Audit Committee
ADSM	- Abu Dhabi Securities Market
AML	- Anti-Money Laundering
BMA	- Bahrain Monetary Agency
BSAA	- Bahrain Society of Accountants and Auditors
CCG	- Code of Corporate Governance
CTF	- Counter-Terrorist Financing
DFM	- Dubai Financial Market
E&Y	- Ernst & Young
ESCA	- Emirates Securities and Commodities Authority
FTAs	- Free Trade Agreements
GCC	- Gulf Co-operation Council
GCCAAO	- Cooperation Council Accounting and Auditing Organization
GDP	- Gross Domestic Product
GLC	- Government-Linked Companies
IASs	- International Accounting Standards
IFC	- International Financial Corporations
INSEAD	- Institut Européen d'Administration des Affaires (The Business School of the World)
MENA	- Middle East and the North-African
MNCs	- Multinational Corporations
MSM	- Muscat Security Market
OECD	- Organization for Economic Co-operation and Development
OLS	- Ordinary Least Square
PTC	- Permanent Technical Committee
PwC	- PricewaterhouseCoopers
QCB	- Qatar Central Bank
QFMA	- Qatar Financial Markets Authority
ROA	- Return on Assets
RTAs	- Regional Trade Agreements
SAAs	- Saudi Accounting Standards
SAGIA	- General Investment Authority
SOCPA	- Saudi Organization for Certified Public Accountants
SOEs	- State-Owned Enterprises
TNI	- The National Investor
UAEAAA	- UAE Accountants and Auditors Association
UAECB	- UAE Central Bank
WTO	- World Trade Organization

## **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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internal user  
only



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