Do Board and Audit Committee Characteristics Improve External Auditor Choice?

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Abstract. The conflict of interest between management and owners can be resolved by an independent auditor, a crucial entity that verifies and assures the accuracy of financial statements issued by a company's management to both internal and external stakeholders. Research on auditor selection has primarily focused on the characteristics of the board of commissioners and audit committee. This study aimed to investigate how these factors influence the choice of external auditors by companies. It involved 112 manufacturing firms listed on the Indonesia Stock Exchange from 2016 to 2019, analyzing the data using logistic regression. The findings indicate that the size and expertise of the board of commissioners, the independence and expertise of the audit committee, and profitability significantly impact the selection of external auditors. On the other hand, factors such as the independence of the board of commissioners, the frequency of meetings, the size and number of audit committee meetings, and company size do not influence auditor choice. Future research could expand on this topic by extending the study period, exploring additional indicators like the roles of the board of commissioners and the audit committee, and incorporating variables related to risk management.

Keywords: Auditor Choice, Commissioners Board's Characteristics, Audit Committee's Characteristics.

1 Introduction

Good corporate governance helps increase the company's external transparency [1] and is influenced by the presence of an external auditor. The management is responsible for auditing financial statements by external auditors [2] and proxies such as big 4 or non-big 4 (3,4). Furthermore, the big 4 has better quality, more experience, and a wider scope than the big 4 [5].

Accounting scandals in Indonesia have harmed the confidence of financial statement users. As a result, the auditors' job and quality are heavily criticized, requiring hiring a high-quality auditor. For instance, Toshiba was found guilty of accounting fraud totaling 1.22 billion dollars in 2015. British Telecom was also struck by a fraud scandal in 2017, which saw the corporation increase its earnings through false contract extensions,

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invoices, and vendor transactions (liputan, 6). The board of commissioners and the audit committee monitor financial policies and select public accounting firms (6,7). Similarly, agents must improve internal control because they have potential agency problems.

External auditor selection has been developed and implemented in previous studies. For instance, (8, 9, 10), (11,12) examined family control, the board of commissioners' independence and size, Good Corporate Governance (GCG), ownership structure, profitability, leverage, and the size of the audit committee are key factors studied. However, the findings contradicted previous research on the board of commissioners' meeting frequency and experience, as well as the independence, meeting frequency, and expertise of the audit committee. These elements—board of commissioners, audit committee, and the frequency and expertise of their meetings—are crucial criteria in the corporate sector, particularly within the capital market. The accuracy of financial statements is significantly influenced by the roles of the board of commissioners and the audit committee. Specifically, the audit committee plays a pivotal role in ensuring the credibility of financial statement preparation. Both the board of commissioners and the audit committee are tasked with providing guidance and overseeing the selection of external auditors. Ultimately, auditors are reviewed and approved during the General Meeting of Shareholders [13]. In line with this, [8] and [14] investigated the impact of various criteria on the selection of corporate auditors.

Research concerning the board of commissioners and audit committees has primarily concentrated on financial statements (15, 16, 17). The study aimed to investigate how the characteristics of the board of commissioners and audit committee influence the selection of external auditors. To fill the literature gap (9,18) this study sought to analyze how the characteristics of the board of commissioners and audit committee influence the selection of external auditors. The characteristics under examination include the size, independence, frequency of meetings, and expertise of both the board of commissioners and the audit committee.

This research does analyze the correlation between the board of commissioners and audit committee characteristics in external auditor choice, and moving from the consideration above, we address **research questions**:

RQ1: Does the board of commissioner's characteristics (the size, independence, frequency of meetings, and expertise) on external auditor choice?

RQ2: Does the audit committee characteristics (the size, independence, frequency of meetings, and expertise) on external auditor choice?

The findings could be used to assess the board of commissioners and audit committee in overseeing and reviewing the transparency and accountability in selecting corporate auditors. Furthermore, the results have policy and practical implications for audit service requests not previously investigated. This gives verifiable explanations to boards of commissioners, public business audit committees, policymakers, and stakeholders regarding audit choice decisions. Additionally, the study contributes to management decision-making in selecting auditors in Indonesia as a developing country.

2 Research Method

The study utilized secondary data obtained from www.IDX.co.id and focused on a population consisting of manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2019. Purposive sampling was employed to select 112 manufacturing firms meeting specific criteria: (1) Listed on the Indonesia Stock Exchange during 2016-2019; (2) Regular publication of financial reports; (3) Compliance with all variable criteria.

Out of the 168 companies listed on the IDX, 110 did not report financial statements between 2016 and 2019, and 30 did not meet the specified criteria. This resulted in a final sample of 112 companies over four periods. The data were meticulously analyzed to ensure reliability and validity, and hypothesis testing was conducted using SPSS version 25 with a logistic regression model [19] (Fig. 1).

2.1 Research Model

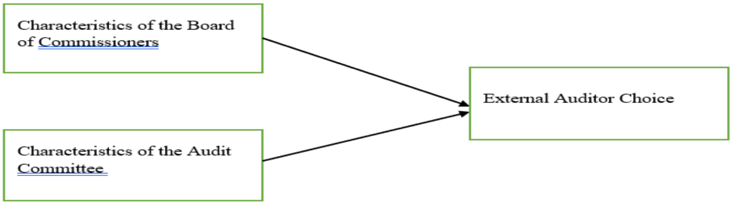

Fig. 1. Model Framework

2.2 Variable Measurement

Table 1 outlines the assessment of the dependent, independent, and control variables. The dependent variable pertains to the selection of external auditors, while the independent variables encompass the size, independence, meeting frequency, and expertise of both the board of commissioners and the audit committee. Control variables include company size and profitability.

Table 1. Variable Measurement

Variable	Definition and Measurement	Variable Scale
Dependent		
EAC	external auditors' choice, dummy variable where the number 1 is given if the auditor from PAF is big 4, and 0 if otherwise	*Dummy*
Independent		
SBC	The size of the board of commissioners: the number of commissioners in company i at time t	Nominal

IBC	Independence of the board of commissioners: the number of independent commissioners divided by the number of commissioners in company i at time t	Nominal
BCM	Board of commissioners meetings: the number of board of commissioners meetings in one financial year	Nominal
EBC	Expertise of the board of commissioners: using a dummy, value of 1 if the board of commissioners has accounting and finance expertise and 0 otherwise	*Dummy*
SAC	The size of the audit committee: the number of audit committees in company i at time t	Nominal
IAC	Independence of the audit committee: the number of The Independent audit committee divided by the number of audit committees.	Nominal
ACM	Audit committee meetings: number of audit committee meetings in company i at time t.	
ACE	Audit committee expertise: using a dummy, score 1 if the audit committee has accounting or finance expertise and 0 otherwise	*Dummy*
Control		
FS	Firm size: natural logarithm of total assets	Nominal
PROF	Profitability: net profit ratio divided by total assets	Ratio

Source: Data processed 2020

The logistic regression model used is:

$$\text{Ln}\left(\frac{AE}{1-AE}\right) = \alpha + \beta_1 SBC + \beta_2 IBC + \beta_3 BCM + \beta_4 EBC + \beta_5 SAC + \beta_6 IAC + \beta_7 ACM + \beta_8 ACE + e \quad (1)$$

3 Results And Discussion

3.1 Descriptive statistics

Table 2 displays the choice of external auditors across all sampled companies. Specifically, 39% of the samples engaged Big 4 Public Accounting Firms (PAFs), while 61% opted for non-Big 4 PAFs.

Table 1. Descriptive statistics

Auditor selection	**Observation**	**Percentage**
SAEF *big 4*	44	39%
SAEF *non big 4*	68	61%
Total	112	100%

Source: Secondary Data Processed, 2020

Table 2. Descriptive statistics

Variable	**Mean**	**Std Deviation**	**Minimum**	**Maximum**

SBC	4.875	198.658	2.00	9.00
IBC	0.4213	0.11470	0.20	0.83
BCM	66.250	401.153	1.00	24.00
EBC	0.25	0.43496	0.00	1.00
SAC	31.339	0.51106	2.00	6.00
IAC	0.4444	0.31428	0.00	1.00
ACM	69.732	599.618	2.00	33.00
ACE	0.25	0.43496	0.00	1.00
FS	52.519	26.858.365	9.75	2869.00
PROF	0.0903	0.09112	0.00	0.47

Source: Secondary Data Processed, 2020

Table 3 presents descriptive statistics. The average board of commissioners size is 4.87, indicating sufficiency. The independent variable for the board of commissioners averages 0.42, suggesting a balanced mix of independent and non-independent commissioners. Additionally, the board holds an average of 6.6 meetings, indicating infrequency. Board expertise averages 0.25, indicating a lack of accounting expertise among most commissioners.

The audit committee averages 3 members, meeting Financial Services Authorization requirements. Audit committee independence averages 0.4, indicating a majority are non-independent. The committee holds an average of 6.7 meetings, also infrequent. Audit committee expertise averages 0.3, indicating a lack of accounting expertise among most members.

Company size, based on average total assets of IDR52.5 million, indicates that most sample companies have small assets. Profitability, measured by Return on Assets, averages 0.09, indicating that most sample companies have low ROA.

3.2 Multivariate Analysis Results

The analysis results from the logistic regression model indicate that Hosmer and Lemeshow's test yielded a probability of 0.080, which is greater than 0.05, supporting H0. This suggests that the model is accepted, indicating no significant difference between the model and the observed values.

Furthermore, examining the overall model fit through the -2 Log-Likelihood values, before entering all predictors (Step 0), the test yielded a value of 150,082. After entering all predictors (Step 1), the test result decreased to 103,955. This decrease in -2 Log-Likelihood (46,127) indicates that the logistic regression model used is effective.

3.3 Testing Nagelkerke R Square

The analysis results from Nagelkerke's R Square in Table 7 indicate an R Square value of 0.457. This suggests that 45.7% of the variation in the external auditor selection variable is explained by the variables included in the model. The remaining 54.3% of the variation is attributed to factors outside the scope of this model.

3.4 Testing logistic regression coefficients/Multivariate analysis

Table 4 displays the results of logistic regression, indicating which hypotheses are accepted or rejected based on a significance level (p-value) of 0.05.

Table 3. Logistics Regression Results

AE	B	Std Error	Wald	Sig.	Odds Ratio	AE
Constant	-3.393	2.218	3.155	0.076	0.019	*Constant*
SBC	0.676	0.169	16.038	0.000	1.965	SBC
IBC	2,459	3.079	0.638	0.424	11.698	IBC
MBC	0.101	0.079	1.602	0.206	1.106	MBC
EBC	-1.443	0.791	3.331	0.068	0.236	EBC
SAC	-0.038	0.598	0.421	0.516	0.678	SAC
IAC	-1.909	1.035	3.401	0.065	0.148	IAC
ACM	-0.078	0.069	1.285	0.257	0.925	ACM
ACE	1.587	0.801	3.925	0.048	4.890	ACE
control variable						control variable
FS	0.002	0.013	0.035	0.852	1.002	FS
Prof	10.385	4.024	6.660	0.010	32386.048	Prof

Source: Secondary Data Processed, 2020

Table 4 presents the results of logistic regression analysis. The significance (sig wald) value for the size of the board of commissioners is 0.00, indicating it is less than 0.05, thus accepting H1. This suggests that the size of the board of commissioners positively influences the choice of external auditors. However, the independence of the board of commissioners has a sig wald value of 0.42, which is greater than 0.05, leading to the rejection of H2. Similarly, the board of commissioners' meeting frequency, with a sig wald value of 0.206, also leads to the rejection of H3. Regarding the expertise of the board of commissioners, the sig wald value is 0.068, which is less than 0.01, thereby accepting H4.

For the audit committee, the size has a sig wald value of 0.516, indicating it is greater than 0.05 and leading to the rejection of H5. The independence of the audit committee has a sig wald value of 0.065, which is less than 0.1, resulting in the acceptance of H6. The frequency of audit committee meetings, with a sig wald value of 0.257, leads to the rejection of H7. Finally, the expertise of the audit committee has a sig wald value of 0.048, which is less than 0.05, thus accepting H8. The firm size factor, with a sig wald value of 0.852, is greater than 0.05, resulting in the rejection of H9. On the other hand, profitability (ROA) has a sig wald value of 0.01, which is less than 0.05, leading to the acceptance of H10.

4 Discussion

4.1 Board size and the external auditor choice

Table 4 indicates that the board of commissioners' size has a notable impact on the selection of external auditors. Companies benefit from having a larger board of commissioners, as it provides enhanced deliberation and direction in auditor selection. Commissioners play a crucial role in supervising the company's activities, including the implementation of financial policies and the appointment of external auditors, which aligns with the agency theory (6, 20,21). The audit committee also plays an important role in company policies, including regulatory compliance (22, 23), and external auditor selection [24]. The existence of audit committee can affect the auditor choice and this is one of the internal governance mechanisms, (25,26). It reduces information asymmetry (27,28) to cut agency costs [29]. The committee's composition, size, qualifications, and activities affect the monitoring of company policies (30,31).

Corporate governance could be implemented by establishing a board of commissioners, which monitors financial policies and external auditor choice (6,21). The number of commissioners also influences the supervisory function. In this case, a small number of commissioners reduces the supervisory function and weakens the company's governance processes, resulting in ineffectual monitoring. This indicates poor corporate governance as corporations select non-Big 4 auditors. For this reason, many commissioners make monitoring effective by providing feedback or advice in selecting a good auditor [2]. Companies with more boards of commissioners are more likely to hire high-quality external auditors to help solve organizational problems and publish more accurate financial reports [32]. The number of commissioners positively affects the choice of external auditors (33,34,32); [35]. This result supports (24,37,39) that the size of the board of commissioners positively impacts external auditor choice.

4.2 Independence of the board of commissioners and the external auditor choice

Table 4 shows that an independent board of commissioners does not affect the external auditor choice. This explains that auditor choice is not influenced by the board of commissioners' role in supervising management. According to agency theory, management has more information and personal interest. Therefore, it needs to be monitored by the company's internal parties [25]. The descriptive statistics results indicated that most boards of commissioners are non-independent. Auditors are still selected by management regardless of the board's independence. Although most commissioners are non-independent, the company still chooses an external auditor. This implies that the independence of the board of commissioners does not impact the corporate governance mechanism. This finding goes against the expected role of independent commissioners in enhancing corporate governance effectiveness. Management typically relies on the board to provide impartial and trustworthy information to investors while overseeing company operations. These results present a contradiction to these expectations (35,32, 2), that the board of commissioners' independence does not affect the selection of external auditors. However, this study supports [24,39,40] that the board of commissioners' independence does not influence the selection of external auditors.

4.3 Frequency of board of commissioner's meetings and the external auditor choice

Table 4 Table 4 indicates that the frequency of board of commissioners' meetings does not impact the selection of external auditors. The board of commissioners, while integral to corporate governance, does not directly influence auditor selection. It is not solely responsible for overseeing the appointment of external auditors within the corporate governance framework. External audits serve as a mechanism to oversee the quality of directors' financial reporting. The effectiveness of how the board of directors manages the company is influenced by both the company's internal control system and its corporate governance structure [41] and [37].

Improving corporate governance quality influences the selection of corporate auditors. Enhanced corporate governance can lessen the necessity for top-tier auditors. When the corporate governance system is robust, the quality of information in financial statements improves, thereby reducing information asymmetry and opportunistic behavior. Consequently, there is a potential decrease in both internal and external demand for high-quality audits [42].

The results of the descriptive statistical test show that the board of commissioners rarely conducts meetings. The board of commissioners is stated to have failed to carry out the company's duties and responsibilities adequately. Even though the board of commissioners rarely attends meetings, the external auditor choice is nonetheless done as a foundation for compliance with OJK requirements, which require businesses registered on the IDX to disclose audited financial statements. This study is inconsistent with [37,43] that the frequency of board meetings has a negative effect on the external auditor choice.

4.4 Board of commissioners' expertise and selection of external auditors.

Table 4 shows that the board of commissioners' expertise does not influence the external auditor choice. It is indicated by the results of the descriptive statistics that most of the companies sampled have non-accounting skills. As a result, the board of commissioners lacks understanding of their responsibilities as supervisors of management, particularly in selecting external auditors. Their inability to fulfill these roles effectively stems from insufficient expertise in accounting. These findings are not in line with (35,36) that the board of commissioners' expertise positively affects the external auditor choice. In a well-functioning company, the core of a robust corporate governance framework lies in having an effective board of directors, which significantly contributes to a well-operating capital market. The committee's oversight role and its collective experience enable the company to seize opportunities, operate efficiently, and deliver timely and dependable financial information to investors [44] and [35].

4.5 Size of the audit committee and the external auditor choice

The results in Table 4 show that the audit committee size does not influence external auditor choice. Based on descriptive statistics, most companies sampled are small and have few assets, forcing them to use external non-big 4 auditors. The audit committee remains in charge of external auditor choice, though the number is small. The results contradict [35] that a high audit committee size contributes to selecting a reputable auditor. Also, a sub-committee of the board of directors is essential in auditor choice.

The audit committee oversee the implementation of financial policies and the external auditor choice based on the agency concept (6,20,7). The audit committee also plays an important role in company policies, including regulatory compliance (22, 23), financial disclosure and reporting (42,9), and external auditor selection [24]. The existence of audit committee can affect the auditor choice and this is one of the internal governance mechanisms, (25,26). It reduces information asymmetry (27,28) to cut agency costs [29]. The committee's composition, size, qualifications, and activities affect the monitoring of company policies (43, 31).

4.6 Audit committee independence and the external auditor choice

The results in Table 4 show that the audit committee's independence affects the external auditor choice. The higher the independence of the audit committee, the higher the choice of an external big 4 auditor. An independent committee monitors the company's performance by selecting qualified auditors. Based on the descriptive statistics, the sample companies have three independent audit committees that meet the requirements of corporate governance and the Financial Services Authority. Independent audit committees provide more effective oversight than non-independent committees [47,48]. These findings are in line with (46,48) but contradict with (40,49).

4.7 Frequency of audit committee meetings and the external auditor choice

The findings indicate that the frequency of audit committee meetings significantly affects whether the company accepts or rejects auditor choices. However, the number of meetings held by the audit committee does not influence external auditor selection. Descriptive statistics reveal that the committees in the sample companies convene meetings infrequently, suggesting they may not effectively fulfill their duties and responsibilities. Effective committee meetings typically occur four to six times annually and last approximately four hours on average [53]. The results do not support [37] that the frequency of audit committee meetings positively impacts the external auditor choice.

The frequency of meetings signifies an active audit committee where members are highly motivated to collaborate with management, internal, and external auditors. However, holding too many supervisory meetings could potentially lead to coordination issues, thereby diminishing the effectiveness of board decisions. Moreover, a high frequency of supervisory board meetings might simply indicate underlying issues within the company rather than enhanced operational activities.

4.8 Audit committee expertise and the external auditor choice

The results showed that the expertise of the audit committee significantly affects the external auditor choice. Audit committees with expertise in accounting or finance understand the audit process and resolve disputes between management and external auditors [20,54]. Furthermore, an audit committee with accounting expertise understands the company's risk [55], especially in external auditors choice. Audit committee members with expertise in accounting or finance communicate well in their auditor choice roles. The accounting expertise of the audit committee will make financial reporting more efficient, [56]. The supervisory role of management is reduced due to a lack of accounting expertise [57,58]. According to agency theory, special accounting and finance skills are needed to eliminate information asymmetry and align the interests of the agent and the principal. Expertise in accounting or finance ensures that the audit committee performs its role effectively (56,58). Additionally, an audit committee with good expertise is more efficient in discussing, understanding, and adequately evaluating accounting policies with external auditor choice [56].The result are not inconsistent with [62] the association among expertise of chairman of audit committee and auditor choice is positive but insignificant ($\beta = 0.194105$, $p > 0.10$). This result demonstrates that the audit committee chairman expertise has no influence on the auditor choice.

4.9 Firm size and profitability and the external auditor choice

The size of the firm does not influence the selection of external auditors, as it does not determine the relationship between the board of commissioners and the audit committee. Regardless of whether a company is large or small and listed on the Indonesia Stock Exchange, it is obligated to disclose financial statements. The findings align with [10] that firm size does not affect the external auditor choice. However, this study contradicts (10, 60) that firm size affects external auditor choice.

Profitability, as measured by ROA, affects external auditor choice. Companies with high profitability will choose good quality auditors. The higher the profitability, the greater the company chooses a quality auditor, namely big 4. The greater the company's ability to generate profits, the more selective it is in selecting a good quality external auditor. This result supports [10] that profitability with the Return On Assets (ROA) indicator significantly and positively affects external auditor choice.

5 CONCLUSION

The board of commissioners and the audit committee oversee and provide guidance to the company regarding the selection of Big 4 auditors. In Indonesian manufacturing companies, decisions to choose a Big 4 auditor are influenced by factors such as the size, expertise, and independence of these boards and committees. The study also identified that organizational profitability plays a role in determining the choice of external auditors. However, several hypotheses were not supported, including those related to the independence and meeting frequency of the board of commissioners, as well as the size and expertise of the audit committee. Future research could extend the study period to further investigate auditor selection criteria. They could additionally include risk management variables and incorporate other indicators, such as examining the roles of the board of commissioners and the audit committee.

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