SESSION 2: CORPORATE GOVERNANCE: FINANCIAL MARKETS AND RELATED ISSUES

AUDITOR CHOICE AND CORPORATE GOVERNANCE MECHANISMS: A STUDY OF LISTED COMPANIES ON THE ATHENS STOCK EXCHANGE

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Abstract

Auditing is a key factor of financial reporting quality that reduces information asymmetry, improves regulatory compliance, and enhances internal control effectiveness. The decision to select an audit firm is one of the most complex decisions. There are several factors that drive auditor selection including ownership structure, corporate governance attributes, the risk of information asymmetry and country-level determinants (Habib, Wu, Bhuiyan, & Sun, 2019). Although several studies have been conducted in this field, findings on the association between auditor choice and corporate governance from European countries are limited (Quick, Schenk, Schmidt, & Towara, 2018), and since accounting standards are issued at the national level, cultural

differences affect the auditing environment (Knechel, Niemi, & Sundgren, 2008). The purpose of this study is to extend the literature by examining corporate governance factors which affect auditor choice in Greece, focusing on the impact of board characteristics, gender diversity and ownership structure.

For this purpose, a logit regression model was developed to assess the association of board size, board independence, audit committee size, presence of women on the board of directors and the audit committee, family and institutional ownership with the selection of a Big4 or non-Big4 auditor; controlling for firm size, profitability, leverage, and liquidity. The sample of the study comprised all non-financial companies of the *FTSE/Large Cap* and *FTSE/Mid Cap Indexes* of the Athens Stock Exchange (ASE) for the five-year period from 2014 to 2018[1]. The final sample -after excluding the financial sector companies (i.e., banks, insurance firms, etc.) — amounted to 37 companies with 185 firm-year observations. The estimated logit regression model is depicted in the following equation:

$$Audc_{it} = \beta_0 + \beta_1 bsize_{it} + \beta_2 bindep_{it} + \beta_3 acsize_{it} + \beta_4 wboard_{it} + \beta_5 waudcom_{it} + \beta_6 famown_{it} + \beta_7 instown_{it} + \beta_8 fsize_{it} + \beta_9 prof_{it} + \beta_{10} lever_{it} + \beta_{11} liq_{it} + u_{it} \quad (1)$$

where,

- *audc*: auditor choice, a dummy variable that takes the value 1 if the firm that conducted the annual audit of the financial statements is one on the Big4 audit firms (Ernst and Young, PwC, KPMG, Deloitte) and 0 otherwise;
- *bsize*: board size, measured by the total number of the members of the board;
- *bindep*: board independence, measured by the percentage of independent members to the total members of the board of directors;
- *acsize*: audit committee size, measured by the total number of the members of the audit committee;
- *wboard*: presence of women on the board, a dummy variable that takes the value 1 if there are women on the board of directors and 0 otherwise;
- *waudcom*: presence of women on the audit committee, a dummy variable that takes the value 1 if there are women on the audit committee and 0 otherwise;
- *famown*: family ownership, the percentage of the shares owned by the founding family of the firm;

[1] FTSE/Large Cap is the large capitalization index capturing on real time the performance of the 25 largest blue-chip companies within the Athens stock market. FTSE/Mid Cap is the middle capitalization index and captures on real time the performance of the next 20 companies of the ASE.

- *instown*: institutional ownership, the percentage of shares owned by institutional investors;
- *fsize*: firm size, measured by the natural logarithm of total assets;
- *prof*: profitability, measured by return on assets (ROA) ratio;
- *lever*: leverage, measured by debt-to-equity ratio;
- *liq*: liquidity, measured by current assets to current liabilities ratio;
- *u*: error term.

The results of logit regression are illustrated at the table that follows:

Table 1. Logit regression results

Variables	*Coef.*	*Std. err.*	*Z*	*P>|z|*	*[95% conf. interval]*	
bsize	1.389527	0.5783011	2.40	0.016**	0.2560773	2.522976
bindep	16.39327	7.231495	2.27	0.023**	2.219804	30.56674
acsize	3.364698	2.248446	1.50	0.135	-1.042175	7.77157
wboard	7.184807	1.795277	4.00	0.000***	3.66613	10.70348
waudcom	-1.631129	1.775354	-0.92	0.358	-5.110758	1.848501
famown	-6.216029	2.798185	-2.22	0.026**	-11.70037	-0.731688
instown	8.663355	3.872012	2.24	0.025**	1.074351	16.25236
fsize	1.012142	0.6584904	1.54	0.124	-0.2784752	2.30276
prof	8.702298	2.544757	3.42	0.001***	3.714666	13.68993
lever	-1.625142	4.530134	-0.36	0.720	-10.50404	7.253759
liq	0.8206399	0.2878319	2.85	0.004***	0.2564998	1.38478
Constant	-60.84035	12.36366	-4.92	0.000	-85.07267	-36.60803
sigma_u	6.177468	0.9281936			4.601649	8.292921
Rho	0.920632	0.0219578			0.865527	0.954347
LR test of rho = 0; chibar2 (01) = 69.91				Prob >= chibar2 = 0.000		
Number of obs. = 185 Number of groups = 37				Wald chi2 (11) = 75.09 Prob > chi2 = 0.0000		

*Notes: *** = significant at 0.01, ** = significant at 0.05, * = significant at 0.10.*

Panel logit regression analysis suggests that corporate governance affects auditor choice in Greece. More specifically the selection of a Big4 audit firm was found to be significantly positively associated with the presence of women on the board at the 1% level of significance and with board size, board independence and institutional ownership at the 5% level of significance. A negative association was found with family ownership also at the 5% level of significance. The above results indicate that firms with larger boards, with more independent members and women in their boards' composition, as well as firms with higher institutional ownership are more likely to appoint a Big4 audit firm. On the other hand, family-owned firms are less likely to engage a Big4 audit firm. As far as the control variables are concerned the decision to appoint a Big4 audit firm was found to be significantly positively associated with profitability and liquidity at the 1% level of significance.

The findings of the study meet our expectations that stem from agency theory and highlight the role which corporate governance plays in auditor selection. The negative relationship of auditor choice with family ownership supports the argument that family firms in the absence of a strong external shareholder may be unwilling to appoint high-quality auditors (Khan, Muttakin, & Siddiqui, 2015; Habib et al., 2019). Board independence on the other hand is positively associated with auditor choice suggesting that greater board independence mitigates family influence in family-controlled firms (Matondi, Tucker, & Tommasetti, 2016). Institutional ownership is also positively associated with auditor choice confirming the results of prior studies (Kim, Pevzner, & Xin, 2019) and indicating that institutional owners appoint Big4 auditors to reduce agency costs and information asymmetry. Finally, the positive association of the presence of women on the board of directors with auditor choice supports the argument that firms with female directors are more likely to demand higher audit quality and engage industry specialist auditors (Lai, Srinidhi, Gul, & Tsui, 2017).

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