

CORPORATE GOVERNANCE AND AUDITOR CHOICE IN KUWAIT

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Although auditor choice has been studied extensively in the audit literature, research examining this issue in developing markets has been scarce thus far. The objective of this study is to investigate the impact of corporate governance (CG) on external auditor choice in the context of the small Kuwaiti emerging market. Specifically, the present study uses both a survey and hand-collected 2012 fiscal-year data pertinent to 53 Kuwaiti listed companies to examine whether firm's auditor choice is influenced by company's board size, board independence, directors' shareholdings, Audit Committee (AC) size, and/or AC independence. Using a logistic regression model, the study's results reveal evidence of a meaningful relation between auditor choice and AC size, company's leverage, and company's belonging to the finance sector. These findings could be useful to market regulators and corporate executives, especially in Kuwait, in improving CG practices within corporations. The research findings should also be of value to international researchers interested in carrying out related research.

Keywords: Corporate governance; audit committee, board, audit independence, auditor choice, developing markets, Kuwait.

I. INTRODUCTION

The dramatic collapse of several gigantic corporations, like Enron and WorldCom, during the first decade of the 21st century has motivated market regulators in numerous countries to launch legislative campaigns to enhance the effectiveness of corporate governance (CG) policies and procedures (Jones, 2011; Aguilera, 2005). As much of these major bankruptcies have been linked to disturbing fraudulent accounting reporting scandals, one of the major objectives legislations aimed at achieving was to enhance the quality of external audit functions responsible for validating the credibility of company's financial reports (e.g., IAASB, 2009; European Commission, 2010; PCAOB, 2011; FRC, 2013). Consequently, company's selection of the external audit firm

due to its potential effects on audit quality has become a crucial decision for companies to make in recent years.

Audit research (e.g., Becker *et al.* 1998; Kim *et al.* 2003; Hsu *et al.* 2015; Ben-Hassoun *et al.* 2018; Jiraporn *et al.* 2018) has long viewed audit firm type (Big 4 vs. non-Big 4) as an influential factor in determining the quality of the financial statements audit. Researchers (e.g., Fan and Wong, 2005; Eshleman and Guo, 2014; Asthana *et al.* 2015; Knechel, 2016) have typically viewed 'Big' audit firms to provide higher quality audit than 'non-Big' firms as a result of their competitive advantages in terms of scale of operations, technical competencies, and market reputation. Accordingly, several audit studies (e.g., Firth and Smith, 1992; Beasley and Petroni, 2001; Lin and Liu, 2009;

Hsu *et al.* 2015; Husnin *et al.* 2016; Lai *et al.* 2017) were carried out to investigate factors related to audit client's choice to hire "Big 4" vs. "non-Big 4" external audit firm. Although audit research has investigated auditor choice for quite some time, a relatively recent stream of this research has focused on the effect of CG factors on this choice (Hay *et al.* 2006). Empirical findings about the relation between CG mechanisms and auditor choice have mainly stemmed from developed countries. Although a few recent studies have examined this relation in some developing countries (e.g., Husnin *et al.* 2016; Alfraih, 2017), empirical findings about this issue in the context of developing countries' markets are still scant. Furthermore, the impact of CG on auditor choice deserves extra attention and further investigation by audit researchers in light of the recent growing role of CG on corporate decision-making (Karaibrahimoglu, 2013).

As indicated, much of the auditor choice research has been concentrated on audit markets of Anglo-Saxon and developed countries' markets (e.g., Beasley and Petroni, 2001; Abbot *et al.* 2003; Ashbaugh and Warfield, 2003; Srinidhi *et al.* 2014; Quick *et al.* 2018), with only very limited research performed in other markets. Moreover, although a few empirical studies were conducted to investigate relation between CG and auditor choice in some developing markets (e.g., Lin and Liu, 2009; Husnin *et al.* 2016), there has been very limited research examining auditor choice in the Middle East region. This is surprising as this topic has been a focus of research by many researchers and for a long period of time. We cannot ignore the possibility that empirical findings reported in prior research about this research issue, which are largely based on data from developed countries, may not be necessarily applicable to the less-developed markets' settings. That is true since developing countries, like Kuwait, are said to have less

developed stock markets and significantly different audit market settings (Woodward, 1997; Fan and Wong, 2005). For example, unlike in developed countries, economic policy-making in developing countries is generally driven by political goals rather than economic yield maximization (DeWenter and Malatesta, 2001). In addition, the responsibilities of and relations between owners, boards of directors, and audit functions of companies in the Middle East are generally unclear and overlapping (Ben-Hassoun *et al.* 2018). Moreover, the Kuwaiti market provides a setting that is quite different from markets where this research issue has been typically explored before. That is true as, unlike in audit markets of developed countries where much of prior research has been conducted, audit guidance by Kuwaiti local professional organizations is very much lacking, and the audit profession is solely regulated and monitored by government-related agencies (Alhajri, 2017). Just like other Gulf Countries Cooperation (GCC) markets, the Kuwaiti market is also characterized by some idiosyncratic cultural traits, where family and tribal social structures as well as informal relationships may interfere with CG policies and procedures (Haniffa and Hudaib, 2007; Hussainey and Al-Nodel, 2008). In addition, unlike developed markets, where much of prior auditor choice research has been conducted, the Kuwaiti market is also featured by high family ownerships (Al-Saidi and Al-Shammari 2013), and highly concentrated corporate ownership structures (Alfraih *et al.* 2012). At the same time, the effectiveness of CG is said to be undermined due to the high ownership concentration (Yasin and Shehab, 2004). As the demand for audit services is closely related to the extent of agency problems (Dye, 1993), it seems that investigating auditor choice in such a market, where agency costs are relatively low (Anderson *et al.* 2003), but CG regimes are relatively weak may provide new insights about this issue. Moreover, it was only in June

2016, when the official CG rules went to effect in the Kuwaiti market as set by the newly formed Capital Markets Authority. At the time of the present study, therefore, no official and unified set of GC rules were in effect in the Kuwaiti market, with the existing trivial rules related to CG being both seriously lacking and scattered over different laws. These rules mainly covered thresholds related to board composition, terms, and meetings. Hence, much of the CG policies and processes adopted by corporations at the time of conducting this study were largely made on a voluntary basis. As this research study was carried out prior to the official date of implementing the CG code, it offers an outstanding opportunity for studying the relation between CG and auditor choice in a market setting where much of the CG processes are adopted voluntarily. The current study, therefore, aims at contributing to the audit literature by empirically examining whether company's auditor choice is impacted by certain CG characteristics, namely, board size, board independence, directors' shareholdings, Audit Committee (AC) size, and/or AC independence in the context of the Kuwaiti emerging market, where this kind of research has been hardly studied. Alfraih (2017) was among the very few studies that examined auditor choice in the GCC region. He examined the relation between some board characteristics and auditor choice using data from the Kuwaiti market. Alfraih (2017) investigation, however, was limited to examining the impact of board characteristics on firm's selection of the external audit firm. He found evidence of a significant relation between auditor choice and board size, independence, and diversity. The current study extends this line of investigation by examining the impact on auditor choice of CG characteristics, including not only board characteristics but also other aspects of CG such as Audit Committee (AC) characteristics. The present study, therefore, aims at extending this line of research audit literature by providing a

more comprehensive evidence about this kind of issues from a voluntary-CG-adoption setting where this kind of research has been rarely investigated before.

The empirical evidence offered by the current study, therefore, is somehow unique in that it offers insights about the relation between CG and audit choice in a setting where CG processes are applied voluntarily by firms. Such an evidence is expected to be of value to the audit literature as research examining the interaction between ownership mechanisms and voluntary CG practices is still rare (Hussainey and Al-Najjar, 2012; Salterio *et al.* 2013).

The study's results show that auditor choice in Kuwaiti is positively related to the size of the company's AC and company's financial leverage, while it is negatively related to company's affiliation to the finance industry. The empirical results reported in the present study about the relation between firm's CG and audit firm selection is expected to be of interest and value not only for accounting researchers but also for regulatory bodies as well. Similar to accounting researchers, market regulators would surely be interested in understanding if and how processes and mechanisms are linked to the level of external audit quality provided about corporate financial reports. Accounting and business educators may also find the results offered by the present study useful for teaching purposes.

II. THEORETICAL BACKGROUND AND LITERATURE REVIEW

Auditor Type and Audit Quality

The major role of external auditors is to minimize the information asymmetries between principles (e.g., shareholders) and agents (e.g., management), and hence limiting agency problems in capital markets (Watts

and Zimmerman, 1983; Ball, 2001; Hope *et al.* 2008). The reliability of corporate financial reports is closely linked to the level of audit quality provided (Husnin *et al.* 2016). DeAngelo (1981) posits that external audit quality can basically be described as the joint probability that the external auditor will detect and report irregularities in financial reports. DeAngelo (1981) further suggests that large external audit firms (e.g., Big 4) have greater incentives to deliver higher quality audit services than smaller ones because they have higher reputational capital to protect. Hence, audit research (e.g., Davidson and Neu, 1993; Lennox, 1999; Knechel, 2016) has typically associated higher levels of audit quality to “Big” audit firms. Empirical research findings documented in audit research (e.g., e.g., Johnson and Lys, 1990; Firth and Smith, 1992; Eshleman and Guo, 2014) are generally supportive of the association between auditor type and the external audit quality. In particular, larger audit firms (i.e., Big 4) are found to provide higher levels of audit and monitoring over corporate financial reports (Lee *et al.* 2003; Farbar, 2005; Lennox, 2005; Gul, *et al.* 2009; Guedhami *et al.* 2014). Large audit firms are also believed to possess higher levels of independence and expertise that enable them to do a better job in discovering and reporting misstatements in firm’s financial statements (DeFond, 1992; Reed *et al.* 2000).

Previous audit research (e.g., Hay and Davis, 2004; Beisland *et al.* 2015) suggests that a firm’s choice of an audit firm reflects its desired level of audit quality. Audit research (e.g., Hsu *et al.* 2015) also suggests that ‘Big 4’ audit firms differ from ‘non-Big 4’ firms in terms of the level of quality, specialty, and expertise they are capable of providing. Company’s selection of external audit firm, however, is expected to be influenced by several considerations, including pressures of the different groups

of firm’s stakeholders (Knechel *et al.* 2008; Beisland *et al.* 2015). Moreover, audit research (e.g., Hay *et al.* 2008) posits that auditor choice reflects also firm’s internal control and governance processes. As audit quality is mostly not observable, prior audit research has typically used certain indicators as proxies for this variable one of which is the size of the audit firm (Palmrose, 1988; Beisland *et al.* 2015). Hay *et al.* (2006) indicate that audit firm type (i.e., Big 4 vs. non-Big 4) is the most frequently used surrogate for audit quality in the audit literature.

Corporate Governance and Auditor Choice

Corporate governance (CG) can basically be defined as the set of procedures and mechanisms used for the direction and control of firm’s activities and operations (OECD, 2004). The aim of CG is to help in improving firm’s performance, and hence, increasing its economic value (Jarbouai *et al.* 2015). According to signaling theory, firms may use the choice of their external auditors to signal to the market participants, including their own shareholders, the status of their CG systems (Husnin *et al.* 2016). In this sense, the hiring of a high-quality external auditor (Big 4) vis-à-vis a low-quality auditor (non-Big 4) entails a mechanism for communicating to the market information about effectiveness of the firm’s CG system, which is anticipated to be eventually reflected in firm’s stock prices (Husnin *et al.* 2016).

Audit research (Parker *et al.* 2005) indicates that auditor choice has significant practical implications on firm’s activities. Research also suggests that when providing their audit services, external auditors play a significant role in externally monitoring management actions on behalf of firm’s stakeholders, and as such, are regarded as an important complement to firm’s CG (Cohen *et al.* 2002; Lin and

Liu, 2009). Previous research (e.g., Cohen *et al.* 2002; Liu and Sun, 2005) has shown that the effectiveness of CG and internal control mechanisms is significantly determined by board and AC characteristics. Prior research (e.g., Coffee, 2002; Ashbaugh and Warfield, 2003) has also suggested that the level of audit quality is a reflection of the quality of firm's GC and internal controls processes.

CG mechanisms can either be decided internally and voluntarily by firm's board of directors and management, or externally mandated by market regulators (Beisland *et al.* 2015). Although CG-related issues have been the focus of a great deal of audit research, much of this research has been focused on issues related to mandatory CG practices, with relatively little empirical research carried out to examine audit issues related to voluntary CG practices, especially in developing markets' settings (Bozec and Bozec, 2007; Salterio *et al.* 2013). Moreover, research examining the relation between external auditing and CG mechanisms is still inconclusive and paradoxical (Hay *et al.* 2006; Karaibrahimoglu, 2013; Beisland *et al.* 2015).

III. HYPOTHESES DEVELOPMENT

Board size

Agency theory advocates (e.g., Jensen, 1993) suggest a positive relation between board size and board's monitoring capabilities. Likewise, the audit fees literature includes several studies (e.g., Karim *et al.* 2015; Jizi and Nehme, 2018) showing a positive association between board size and external audit fees, suggesting that larger boards of directors tend to demand greater assurance levels (i.e., more external audit work) from external auditors. Audit and CG research (e.g., Hay *et al.* 2006; Bhagat and Bolton, 2008; Beisland *et al.* 2015; Ntim *et al.* 2015a) suggests that the effectiveness of CG

and controls within firms is considerably linked to board size. There are diverse views, however, on how governance and control processes are influenced by board size. Some research, for example, posits that smaller boards may not possess the capacity needed to discharge the board's different responsibilities (Guest, 2009), and that larger boards of directors may be more capable in exercising governance and monitoring over firm's activities (Adams and Mehran, 2003; Di Pietra *et al.*, 2008; Shurkeri *et al.* 2012). Other research (Jensen, 1993; Cheng *et al.* 2008; Jensen, 2012; Ntim *et al.* 2015), on the other hand, suggests that large boards of directors may be less effective in monitoring as communication, coordination, and decision making are slower and more difficult among larger number of board members, and that smaller boards are more effective in monitoring management actions. Lin and Liu (2009) suggest that there is a positive relation between board size and the level of CG and controls, and that firms with smaller boards of directors may choose not to hire high-quality external auditor to sustain the vagueness of their reported gains. Using data related to 184 Chinese firms, they performed an examination of this relation, and found evidence of a positive relation between board size and firm recruitment of high-quality audit firms. Beisland *et al.* (2015) performed a similar examination using a sample of 379 microfinance firms. Their results, however, could not report any significant relation between board size and auditor choice. Similarly, Quick *et al.* (2018) examined the same issue in the German market and found evidence of a positive relation between board size and the selection of a Big 4 audit firm. It appears, therefore, that board size may be influential in the selection of the audit firm type. Given the mixed views and empirical results about the relation between board size and the auditor choice, the current study does not predict a direction of this relation, and the

study's first hypothesis is stated as:

H1: there is a significant relation between board size and firm's selection of a 'Big 4' audit firm.

Board's Independence

According to the Signaling theory, firm's board of directors tend to hire high quality auditors (e.g., Big 4) to signal to the market their commitment to high-quality monitoring and controls. Independent directors are more likely to do so due to their trivial stake in the firm, and because of their greater incentive to preserve their professional reputations (Wu, 2012).

The substitution theory, on the other hand, suggests that unlike inside directors who are typically concerned with self-interested interim economic goals, independent board members do not have substantial financial interests in the company, and hence are expected to direct company's operations from a broader and altruistic perspective that does not focus on short-term financial results (Coffey and Wang, 1998; Liao *et al.* 2015). This would enable independent board members to practice more effective control and monitoring over company's activities, including financial reporting, which may substitute for the need for high-quality auditors (i.e., Big 4 auditors). The percentage of non-executive members in the company's board of directors is viewed as an indicator of strong CG (Fama and Jensen, 1983; Hay *et al.* 2006; Liao *et al.* 2015; Beisland *et al.* 2015; Rashied, 2018), and is positively associated with audit quality (O'Sullivan, 2000; Salleh, *et al.* 2006). Moreover, accounting research (e.g. Beasley, 1996; Uzun *et al.* 2004; Peasnell *et al.* 2005; Marra *et al.* 2011) shows that instances of fraudulent financial reporting and earnings management are negatively related to the proportion of independent board members.

The potential impact of board independence on auditor choice has been investigated by a number of studies in the audit literature (e.g. Beasley and Petroni, 2001; Jiraporn *et al.* 2018). While Beasley and Petroni (2001) found evidence of a positive relation between board independence and the selection of a 'Big' audit firm, Jiraporn *et al.* (2018) found no evidence of such a relation. The empirical results, therefore, are mixed and still limited. The current study aims at exploring this issue, and the study's next research hypothesis, therefore, is as follows:

H2: there is a significant relation between board independence and firm's selection of a 'Big 4' audit firm.

Directors' Shareholdings:

Agency theory suggests that agency costs normally arise as a result of the potential conflicts of interests between principals and agents (Watts and Zimmerman, 1978). These agency costs increase (decrease) when information asymmetries between principals and agents are high (low). As high agency costs are detrimental to corporate activities and operations, companies are typically anticipated to aim at reducing them. Audit research (e.g., DeFond, 1992; Anderson *et al.* 2003) suggests that firms' demand for external auditing is primarily meant to reduce the information asymmetries and agency conflicts between owners (principles) and management (agents). Audit research (e.g., Francis and Wilson 1988; DeFond 1992) also suggests that stockholders' need to monitor managerial actions increases when there is a greater separation between ownership and control (e.g., less management ownership). Research (e.g., Yeoh and Jubb, 2002) further suggests that when agency costs are high, company's management tend to demand high-quality audit to signal to the market their openness to high level of monitoring. It is assumed, therefore, that

when board members own less shares in the company, separation between ownership and control will be high, and hence, the demand for high-quality audit (Big 4) would be high. It is surprising that no previous research, the author is aware of, has examined the possible impact of directors' shareholdings on auditor's choice. To explore such an issue, the third hypothesis is stated as follows:

H3: there is a significant and positive relation between directors' shareholdings and firm's selection of a 'Big 4' audit firm.

AC Size

According to DeFond and Francis (2005), the size of AC is an indicator of board's commitment to allocate resource to preserve high quality financial reporting. At present, most stock markets in the world require that firm's AC consist of a sufficient number of members. The main objective for that is to empower AC's with ample human resource to enable them to carry out their duties effectively. It would be intuitive to anticipate that as AC size increases, there will be more resources and talents available, and hence, AC's monitoring and supervision would be more effective. Empirically, previous audit research found a direct association between AC size and effective monitoring (e.g., Leuz and Verrecchia, 2000; Al-Ajmi, 2008) as well as financial reporting quality (e.g., Klein, 2002; Yang and Krishnan, 2005; Johl *et al.* 2012). As larger AC's are associated with an increased capacity for monitoring and control, they would be expected to be set to handle and even demand higher levels of external audit quality. Empirical research examining and documenting the relation between AC size and corporate hiring of 'Big 4' audit firms is very rare and still lacking. Husnin *et al.* (2016) and Karaibrahimoglu (2013) are the only two studies, the author is aware of, that have studied this relation. While Husnin *et al.* (2016)

could not find any significant evidence of this relation, Karaibrahimoglu (2013) showed only a weak evidence of a positive relation between AC size and auditor choice. It seems, therefore, that more research about this relation is still needed. At the time of the current study, there were no official rules requiring firms to form AC in the Kuwaiti market, with much of AC formation by firms made on a voluntary basis. Examining the relation between AC size and auditor choice in such a setting, therefore, would be interesting to explore. The study's fourth hypothesis, therefore, is:

H4: there is a significant and positive relation between AC size and firm's selection of a 'Big 4' audit firm.

AC Independence

Independent AC members are expected to be associated with high-quality financial reports (Xie *et al.* 2003; Abbott *et al.* 2004). Agency theory implies that control and supervision over firm's activities and operations are carried out best when they are carried out by parties independent from management (Andres *et al.* 2005). Individuals who are not engaged in managerial routine decisions and actions are expected to be neutral and more objective when reviewing firm's operations (Husnin *et al.* 2016). Therefore, and for the purpose of promoting independent monitoring and control over management actions, much of the present CG rules and regulations around the world require corporations to include at least one independent non-staff member in their AC's (Yatim, 2009). In addition, research has shown that the inclusion of independent members in firms' board and AC's is associated with enhanced levels of corporate performance (Daily *et al.* 2003; Huang and Chan, 2013), and more effective control (e.g., Abbott *et al.* 2003; Bhagat *et al.* 2008; Upadhyay *et al.* 2013), and an increased demand for audit quality (DeFond

and Zhang, 2014). It is natural, therefore, to expect AC's with more independent members to be more inclined to seek hiring high-quality auditors (e.g., Big 4 firm). It follows that the chance of selecting a 'Big 4' audit firm is positively related to AC independence. Therefore, the study's fifth research hypothesis is:

H5: there is a significant and positive relation between AC independence and firm's selection of a 'Big 4' audit firm.

IV. RESEARCH METHODOLOGY

Data

The data needed to undertake the research hypotheses of interest in this study were gathered via a survey constructed by the author (see Appendix) that was sent to 194 companies listed on KSE by the end of year 2012. At the time of this study, this data was the most recent set of data available with the needed information about the study's variables. Individuals with particular managerial responsibilities within the contacted companies were asked to respond to the survey to provide among other things, information about company's external audit firm, board characteristics, AC characteristics, in addition to other organizational characteristics. The questionnaire survey, therefore, was used to gather data related to the Big 4, BDSIZE, BD_INDP, BD_OWN, AC_SIZE, AC_INDP, and INDUS variables. Moreover, data pertinent to the SIZE, and LEV financial statement variables were manually collected from each company's annual report. Observation pertinent to 122 firms were initially collected. This number was reduced, however, due to some missing data, resulting in a final sample of 53 companies. The final sample represented around 27% of the 199 total number of KSE listed companies at the end of 2012. This sample consisted of data related to 15 financial companies and 38 non-financial companies.

Model

The following logistic regression model that is based on earlier related audit research (e.g., Lin and Liu, 2009; Husnin *et al.* 2016; Beisland *et al.* 2015) is used to examine the research hypotheses of interest in the present study:

$$\begin{aligned} \text{Big 4} = & \beta_0 + \beta_1 \text{BDSIZE} + \beta_2 \text{BD_INDP} \\ & + \beta_3 \text{BD_OWN} + \beta_4 \text{AC_SIZE} \\ & + \beta_5 \text{AC_INDP} + \beta_6 \text{SIZE} + \beta_7 \text{LEV} \\ & + \beta_8 \text{INDUST} + \varepsilon \end{aligned}$$

Where:

BIG 4 = a dummy variable with a value of 1 if the company is audited by EY, Deloitte, PwC, or KPMG, and 0 otherwise.

BD_SIZE = the total number of company's board members.

BD_INDP = the percentage of board members who are independent from the company.

BD_OWN = a dummy variable with a value of 1 if the board's shareholdings equal or exceed 5% of the company's total shares outstanding, and 0 otherwise.

AC_SIZE = the number of company's AC members.

AC_INDP = a dummy variable with a value of 1 if most of the company's AC members are independent from the company, and 0 otherwise.

SIZE = the natural log of the total assets.

LEV = the ratio of the company's long-term liabilities to its total assets.

INDUS = a dummy variable with a value of 1 if the company belongs to the finance sector, and 0 otherwise.

ε = error term.

Variables Measurement

The dependent variable in the research model (Big 4) is a dummy variable that takes the value of one if the company is audited by one of the Big 4 audit firms and zero if not. The Big 4 variable is used as a measure of the type of the external audit firm. An audit firm is classified as a Big 4 firm if it is an affiliate of Ernst and Young, Deloitte, KPMG, or PricewaterhouseCoopers (PwC). The BD_SIZE independent variable is measured as the number of members in the firm's board of directors, and is included in the research model as a measure of firm's board size to test the study's first hypothesis (H1). As specified earlier, board size is expected to be significantly related to the selection of a Big 4 audit firm, but no prediction is made with respect to the sign of the BD_SIZE variable's regression. The BD_INDP independent variable is used as a proxy for board independence, and is included in the model to test the second research hypothesis (H2). This variable was measured as the percentage of independent directors on the board of directors. The regression coefficient of the BD_INDP variable is predicted to have a positive sign. The BD_OWN independent variable is added to the model as a measure of directors' shareholdings, and is employed to examine the third research hypothesis (H3), and is anticipated to have a positive sign. The AC_SIZE variable is used as a measure of AC size and is added to the regression equation to test the fourth research hypothesis (H4). To examine the fifth research hypothesis (H5), the AC_INDP variable is used added to the research model as a measure of AC independence, and is predicted to have a positive regression coefficient. This variable was measured using a self-reported question of whether most of the company's AC members are independent of the company.

Control Variables

Audit research (e.g., Guest, 2009; Hassan *et*

al. 2017) suggests that larger firms have more incentives to strengthen monitoring and controls over their operation as they are expected to be exposed to greater levels of agency costs, and are more likely to raise funds from capital markets. Larger companies are also expected to be financially more capable, and hence, to be more willing to pay the typically higher audit fees charged by Big 4 auditors (Francis and Simon, 1987). Therefore, to control for any potential effect of company size on auditor choice, the SIZE variable is added to the research model, which is measured as the natural log of company's total assets. Likewise, companies with high debts have higher agency costs (Jensen and Meckling, 1976; Sweeney, 1994; Fan and Wong, 2005), and hence, are expected to have greater incentives to stronger and more effective monitoring over corporate financial reports in order to reduce their cost of capital (Reed *et al.* 2000). In addition, previous related studies (e.g., Hope *et al.* 2008; Ben-Hassoun *et al.* 2018) suggest that company's leverage may influence auditor choice as it is considered a proxy for audit risks (e.g., Chan *et al.* 1993; Whisenant *et al.* 2003). Accordingly, and consistent with similar previous research (e.g., Hsu *et al.* 2018; Ben-Hassoun *et al.* 2018; Hsu *et al.* 2015; Lin and Liu, 2009), the LEV variable is added to the regression model as a measure of company's leverage. This variable is measured as the company's long-term liabilities to total assets, and is expected to have a positive regression coefficient. Previous research (e.g., Maletta and Wright, 1996; Hutchinson and Gul, 2004; Hassan *et al.* 2017) suggests that CG processes and procedures may be influenced by the specific industry the company is affiliated to. In Kuwait, companies in the finance industry are exclusively subjected to a dual monitoring and supervision by both the Central Bank and CMA. In addition, the Central Bank typically requires some additional requirements with regards to the

hiring of executives by financial institutions. It also routinely performs additional monitoring over the operations of financial institutions. Accounting research (e.g., Beasley *et al.* 1999) also suggests that misstatements in financial reports are more likely in financial institutions. Hence, the IDUS dummy variable is included to the research model to control for the possible effect of company's affiliation to the finance sector. This value is coded 1 if the company belong to the finance industry and 0 if not. The IDUS variable is predicted to have a positive coefficient.

V. RESULTS

Panels A and B in Table 1 show some descriptive statistics pertinent to the study's continuous and dichotomous variables, respectively. As demonstrated in Panel A, the mean total assets of the sample of companies is about KD 265 million¹. This table also shows that the mean leverage ratio of the sample of companies is around 0.14. These results indicate that the sample of firms included in this study's sample are, on average, smaller in size and less leveraged than the sample used in Alfraih (2017) study. The descriptive statistics also show that the mean board size

Table 1: Descriptive Statistics

Panel A: Continuous variables:					
	N	Minimum	Maximum	Mean	Std. Dev.
BD_SIZE	5	3	10	5.79	1.35
	3				
BD_INDP	5	0.00	1	0.2817	0.34002
	3				
AC_SIZE	5	0	10	3.96	1.901
	3				
Total Assets (KD)	5	4,600,717	5,976,684,000	264,556,377.68	846,573,651.57
	3				
LEV	5	0.001	0.754	0.14158	0.188997
	3				
Panel B: Categorical variables:					
	Value	Frequency	%		
BIG4	0	31	58.5		
	1	22	41.5		
BD_OWN	0	8	15.1		
	1	45	84.9		
AC_INDP	0	25	47.2		
	1	28	52.8		
INDUS	0	38	71.7		
	1	15	28.3		

Table 2: Pearson Correlations

	BD_SIZE	BD_INDP	BD_OWN	AC_SIZE	AC_INDP	SIZE	LEV	INDUS
BD_SIZE	1							
BD_INDP	0.022	1						
BD_OWN	-0.184	0.157	1					
AC_SIZE	0.072	-0.072	0.243	1				
AC_INDP	-0.09	0.184	0.129	0.202	1			
SIZE	.529**	0.014	-0.233	-0.148	0.061	1		
LEV	.408**	-0.025	-0.234	-0.144	-0.151	.535**	1	
INDUS	0.223	-0.008	0.031	.302*	0.006	.311*	0.241	1

** Correlation is significant at the 0.01 level (2-tailed)

** Correlation is significant at the 0.05 level (2-tailed)

of the sampled companies is close to 5.78 members, with a standard deviation of about 1.35. This is comparable to the mean board size of 6.1 reported in Alfraih (2017) study. The mean percentage of independent board members is approximately 0.2817. This mean percentage of board independence is relatively low compared to that reported in other markets with stronger CG regulatory environments. For example, the mean percentage of board independence equaled 58% in US (Klein, 2002), 53% in Australia (O'Sullivan *et al.* 2008), and 47% in UK (Li *et al.* 2008). It is, however, somehow comparable to the reported means of 33% in Spain (Mendez and Garcia, 2007), and 38% in Italy (Allegrini and Greco, 2013). The relatively low mean of board independence reported in the present study is most likely due to the lack of solid official CG rules in the Kuwaiti market during the period of time examined. It is worth noting, however, that Alfraih (2017) study reports a mean percentage of board independence of 78% using a sample from the Kuwaiti market. One possible explanation for this higher percentage reported by Alfraih (2017) is the use of a larger sample (183) and from a different year (2013). The mean AC size of the study sample is approximately 4, ranging from zero for companies that had no AC to 10². Panel

B in the same table shows some frequency descriptive statistics of the study's dummy variables. As Panel B shows, around 42 percent of the sample of companies were audited by a Big-4 audit firm, which is fairly comparable to the 59 percent reported previously in Kuwait by Alfraih (2017), the 48 percent reported in Turkey by Karaibrahimoglu (2013), and the 60 percent reported in Malaysia by Husnin *et al.* (2016). Panel B also shows that directors' shareholdings equaled or exceeded 5% in approximately 85 percent of the sample of companies, and that most of the AC members were independent in about 53 percent of the sampled companies. The descriptive statistics in Panel B also demonstrate that around 28 percent (15 companies) of the sampled companies are financial companies, while the other 72 percent (38 companies) are non-financial companies.

Pearson correlations among the explanatory variables are shown in Table 2. In general, correlations among the variables are relatively low, with the greatest correlation equal 0.535 (p-value = .00) between the SIZE variable and the LEV variable. The correlation results, therefore, do not indicate a sign of a multicollinearity problem.

Results of the logistic regression model are shown in Table 3. Results in this table show that the research model has an overall percentage of correct classification of about 59 percent, with a Chi-square value of 18.703. As shown in the table, the regression coefficient of the BD_SIZE variable has a positive but insignificant regression coefficient (p-value = 0.162). This result, therefore, does not provide support for the study's first hypothesis (H1) of a significant relation between board size and selecting a Big 4 audit firm. The insignificant relation between board size and hiring a 'Big' audit firm reported in the present study, however, is similar to findings reported in several previous related studies (e.g., Beisland *et al.* 2015; Husnin *et al.* 2016). The regression results also show that the coefficient of the BD_INDP variable is positive, as predicted, but is insignificant (0.104), which does not provide support to the study's second hypothesis (H2). The insignificant result reported about the relation between board independence and auditor choice may be due to members' independence in appearance but not in actual substance from corporate executives (Prencipe and Bar-Yosef, 2011). The regression results also do not provide support to the third hypothesis (H3) as the regression coefficients of the BD_OWN variable is not statistically significant (p-value = 0.716). This insignificant relation between directors' shareholdings and external auditor choice, therefore, does not add validity to the notion of owners as good stewards as suggested by some earlier research (e.g., Davis *et al.* 1997; Sundaramurthy and Lewis, 2003). It appears, therefore, that the three board characteristics examined in the present study do not appear to be strongly related to auditor choice in the Kuwaiti market. The regression results also indicate that the regression coefficient of the AC_SIZE has the predicted positive sign and is moderately significant (p-value = 0.064). This result, therefore, provides fair support to the study's

fourth hypothesis (H4) of a positive relation between AC size and the selection of a Big 4 audit firm. This finding is consistent with the complementary perspective of the relation between CG and the external audit function (Carcello *et al.* 2002). That is consistent with findings documented in related audit research from other markets (e.g., Leuz and Verrecchia, 2000; Al-Ajmi, 2008) of a significant relation between the effective monitoring and AC size. The results, however, show that the coefficient of AC_INDP variable is insignificant (p-value = 0.587), and hence do not provide support the fifth hypothesis (H5). This insignificant result between AC independence and auditor choice is similar, however, to that reported in other related studies (e.g., Husnin *et al.* 2016). Finally, the regression results reveal that the regression coefficients of the LEV and IDUS control variables are both statistically significant, with p-values of 0.028 and 0.040, respectively, while the coefficient of the SIZE control variable is not (p-value = 0.875). The positive relation between firm's leverage and the selection of a Big 4 firm is consistent with Reed *et al.* (2000) suggestion that firms that are highly leveraged tend to choose a high-quality audit firms to enhance the credibility of their reports, and hence lower their cost of financing. Contrary to expectation, the results surprisingly show a significantly negative relation between the hiring of a Big 4 auditor and firm's affiliation to the finance industry. One possible explanation is that financial institution are more effective in monitoring practices and therefore may have a lesser need to hire a high-quality auditor (i.e., Big 4 auditor). This result may be also due to the use of a small sample size (53 companies) with a relatively few cases of financial companies (15 companies) in the logistic regression.

These later results, therefore, suggest that auditor choice in the Kuwaiti market is

significantly related to company's financial leverage and affiliation to the finance sector, but not to company's size.

Robustness check:

To check for the robustness of the study's results, alternative measures of both board size and

linear relationship between auditor choice and these two variables. The results of the logistic regression model with the new measures of board size and AC size are shown in Table 4. As shown, the logistic regression results are almost the same, with the new measure of board size insignificantly related to auditor

Table 3: Logistic Regression Results

	B	Wald	Sig.
BD_SIZE	.523	1.951	.162
BD_INDP	1.864	2.641	.104
BD_OWN	-.443	.133	.716
AC_SIZE	.437	3.420	.064*
AC_INDP	-.400	.295	.587
SIZE	.054	.025	.875
LEV	5.541	4.847	.028**
INDUS	-2.074	4.224	.040**
Constant	-6.248	1.055	.304

Regression summary statistics:

Model Chi-square	18.703
-2 log likelihood	53.235
Overall correct classification percentage	58.5%
Cox and Snell R-square	.297
Nagelkerke R-square	.400
Number of observations	53

** , * p-value of statistical significance at the 0.05 level and the 0.10 level, respectively (Endnotes)

AC size used in some earlier studies (Yermack 1996; Ntim *et al.* 2015; Kalelkar, 2016) are employed. Specifically, the natural log of the number of board members (BD_SIZE2) and the natural log of the number of AC members (AC_SIZE2) are used as measures of board size and AC size, respectively. The natural log is used to control for any possible non-

choice, and the new measure of the AC size showing a robustly positive relation to auditor choice evidence. The results of the robustness check suggest that the study's findings related to the study's research hypotheses are robust to the employment of alternative proxies for both board size and AC size.

Additional non-parametric test:

The relatively small number of observations used in the regression analyses has naturally weakened the statistical power of the regression equation. Therefore, additional analyses are performed using the non-parametric Mann-Whitney U-test for the tested variables between firms with Big 4 firms versus non-Big 4 firms, and then between financial firms versus non-financial firms. Table 5 provides the results of the Mann-Whitney test. As the results show, the Mann-Whitney U-test for the *BD_SIZE* variable that compares the board size between the Big 4 group and the non-Big 4 group is 239.5, and appears to be significant (at the .05 level). The results in Table 5 also show that all the other CG variables have insignificant Mann-Whitney tests. The non-parametric results, therefore, provide some support to H1 of a significant relation between board size and company's selection of a Big 4 audit firm, but not for H2, H3, H4, or H5. Additionally, the Mann-Whitney test is also computed to compare the CG variables between the financial firms group and the non-financial firms group. The results show that only the Mann-Whitney test of the *AC_SIZE* appears to be significantly different between financial firms versus non-financial firms. Except for providing support to H1 instead of H4, the additional non-parametric test analyses, appear to provide results that are close to those obtained using the original logistic regression analyses, especially those related to H2, H3, and H5.

VI. CONCLUSION

The primary purpose of the present study is to investigate the relation between corporate governance variables and the decision of Kuwaiti companies to choose a "Big 4" external auditor. By doing so, the present study aims at extending previous auditor choice literature by presenting empirical findings about this

relationship from one of the GCC countries (Kuwait) where this research topic has been rarely investigated. The reported results reveal that the selection of a Big-4 auditor is related to AC size, firm's leverage and the affiliation to a non-financial industry. The results, however, do not offer evidence of a significant relation between auditor choice and board size, board independence, directors' shareholdings, AC independence, or company's size.

As the present study's investigation is pertinent to data from a period of time preceding the effective implementation of CG rules in Kuwait, it provides an exceptional and transient opportunity for examining the impact of CG on audit quality (e.g., auditor choice) in the Kuwaiti market in a setting where CG processes and rules were mainly elected voluntarily by companies. Evidence about the effect of CG on aspects of audit quality from such a setting is anticipated to be of value not only for audit researchers, but also for market regulators. International researchers, for example, could also benefit from the empirical results offered by the present study in linking them to the existing findings about auditor choice and in performing future comparative analyses. Likewise, regulators could use the results provided in the present study for regulatory benchmarking purposes, and to determine areas where CG is more effective with respect to audit quality. The reported results are also anticipated to be useful to market regulators in furthering their understanding about the impacts and antecedences of CG practices on the quality of audits in the Kuwaiti market.

Interpretation of the study's findings should be made with some caveats. First, the size of the study sample is relatively small and pertains to only one year, which has unavoidably led to limiting the statistical power of the reported findings. This small sample size, however, is

typical in similar small markets, where the number of listed firms is relatively small. In addition, although the common rule-of-thumb used by researchers is to have 10 observations per independent variable, some statisticians (e.g., Vittinghoff, and McCulloch, 2006) suggest that this rule may be relaxed in logistic regression with acceptable convergence and bias levels. Moreover, as this study's objective is to examine auditor choice in a voluntary setting, researcher's ability to gather more data was limited by the unavailability of public information about some CG variables for periods prior to 2016 when CG rules were mandated in the Kuwaiti market, and by the resultant shift in the CG context from voluntary adoption of CG procedures to adherence to mandatory CG rules, which could be a subject for future research to compare the impact of CG on auditor choice *before* and *after* the implementation of CG regulations in the Kuwaiti market. Future research is, therefore, needed to carry out similar empirical investigation using larger and multiple-year data sets. Another shortcoming of this study is the risk that the research equation employed may have disregarded some factors relevant to auditor choice. Although the research model employed is based on similar earlier research, the still immature theoretical underpinnings about the determinants of auditor choice in developing countries may have resulted in leaving out some contributory variables. Additional research is, therefore, needed to

further exploring other CG variables related to auditor choice especially in the context of developing countries' markets. For example, future related research could empirically explore the potential impact of AC financial expertise on auditor choice. Such a variable has been regarded as an important determinant of AC effectiveness, and hence, may have an impact on firm's selection of the external audit firm. Another limitation that future research should also strive to avoid is the use of some rusty measures of CG variables. For example, the use of the self-reported measure of AC independence should be replaced by more reliable archival measures. That would surely help enhancing the robustness of the reported empirical findings. Another concern is related to the notable differences in statistics about some of the variables (e.g., board independence, Big 4 audit firms) reported in the current study and those reported in other Kuwait-based studies (e.g., Alfraih, 2017), which raises a concern on whether the relatively small sample used by the current study (53 companies) is representative of all KSE listed firms, and hence may limit the generalizability of the study's results. Another limitation lies in the use of a questionnaire survey to collect the CG data needed. The utilization of such a data gathering instrument may have negatively affected the robustness of the reported results. Future similar research, therefore, should try obtain this type of data from more reliable archival sources.

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Appendix
Data Gathering Form

Name of the company: _____

Please provide the information requested below for your 2012 fiscal year.

1. The industry to which your company belong:

Banking Investment Real Estate Services Insurance Industry
Food Other (specify) _____

2. What is the number of foreign subsidiaries of your company, if any?

3. What is the number of business segments of your company? _____

4. Does your company have an internal audit function (unit)? Yes No

5. What is the number of staff of your company's own internal audit unit?

6. If the internal audit function is outsourced? If yes, please specify: Totally outsourced
partially outsourced; % _____

7. Is there an audit committee in your company? Yes No If yes, what is the number
of audit committee members? _____

8. Are most of the audit committee members independent of the company? Yes No

9. Is any of the audit committee members a member of the company's board of directors?

Yes No

10. Does the audit committee have members with accounting /auditing expertise? Yes No

11. What is the number of audit committee meetings during the 2012 fiscal year?

12. Does the audit committee review the internal audit budget? Yes No

13. Is there a separate risk management committee in your company? Yes No

14. Is there a risk manager in your company? Yes No

15. Is the company's Chairman or CEO a member of the audit committee? Yes No

16. Does the board of directors' shareholdings equal or exceed 5% of the company's total
shares outstanding? Yes No

17. What is the number of board members of your company? _____

18. What is the number of board members who are independent from your company?

19. Is your company currently audited by Ernst and Young, Deloitte Touche, KPMG, or
Pricewaterhouse? Yes No

20. What is the percentage of share ownership of the largest individual shareholder?

% _____

Plus: variables from the company's 2012 fiscal year annual report.

Table 4: Alternative Logistic Regression Results

	B	Wald	Sig.
BD_SIZE2	2.590	1.466	.226
BD_INDP	1.747	2.132	.144
BD_OWN	-.722	.313	.576
AC_SIZE2	2.313	3.588	.058*
AC_INDP	-.439	.342	.558
SIZE	.140	.154	.695
LEV	5.786	4.884	.027**
INDUS	-2.292	4.835	.028**
Constant	-10.222	2.326	.127

Regression summary statistics:

Model Chi-square	19.8
-2 log likelihood	53.235
Overall correct classification percentage	56.9%
Cox and Snell R-square	.297
Nagelkerke R-square	.400
Number of observations	53

** , * p-value of statistical significance at the 0.05 level and the 0.10 level, respectively

Table 5: Results for the Mann-Whitney U-Test

	Big 4 vs. non-Big 4				Financial vs. non-Financial firms			
	Mean Rank		Mann-Whit. U-test	Sig.	Mean Rank		Mann-Whit. U-test	Sig.
	Big 4	Non-Big 4			Financial	Non-Financial		
BD_SIZE	31,61	23,73	239.5	.046*	31,97	24,04	210.5	.109
BD_INDP	30,36	24,61	267.0	.163	27,67	26,74	275.0	.836
BD_OWN	26,18	27,58	323.0	.600	27,47	26,82	278.0	.824
AC_SIZE	30,27	24,68	269.0	.177	33,80	24,32	183.0	.036*
AC_INDP	26,25	27,53	324.5	.731	27,13	26,95	283.0	.964

Endnotes:

Using an exchange rate of KD1 = \$3.3, which was the prevailing rate at the time of performing the analysis.

At the time of this study, AC formation in Kuwait was voluntary as no rules existed mandating such a formation.

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