

# Do Western Hegemony Exist in the Selection of Independent Auditors?

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**Abstract**—Most business people perceive that big four affiliated public accounting firms have better quality than others. We use the mixing method to uncover the phenomena of internationalization among the auditor selections. This study only explores the empirical aspects of western hegemony in auditor selection but also present. Those Charged with Governance's subjective perceptions of the Westernization in auditing practice. This study uses a sample of companies in the non-financial sector listed on the Indonesia Stock Exchange during 2016-2018. Preliminary analysis results show that institutional and individual ownership are more inclined to choose affiliated big-four auditors than the local ones. Whereas when compared to the non-big four affiliated accounting firms, institutional ownership is consistently more interested in the big four affiliated. In further analysis, local institutional ownership seems to prefer international affiliated accounting firms. Foreign institutional ownership always shows a preference for the big four affiliated accounting firms. Regarding individual ownership, researchers divide ownership into an independent, board of the director and management. The analysis proves that only management ownership has a role in choosing auditors. The ownership management tends to choose international affiliated accounting firms. Based on the subjective perception, one of the audit committees revealed that there were crucial differences in audit quality between the local and the international affiliated public accounting firms. Affiliated auditors are indeed far more thorough than local. Using Giddens's global modernity theory, we conclude that globally affiliated auditors can create new expertise needed by their users that is different from the past.

**Keywords**—*institutional ownership, government, management, affiliated accounting firm, Giddens*

## I. INTRODUCTION

Giddens described that the era of digitalization will always follow the flow of turbulent and continuous globalization [1]. Globalization could potentially change the thinking patterns, behaviour, and needs of the global society around the world. Globalization will tend to win international versus national brands [2]. Winning international brands is a manifestation of the wave of westernization in the business world [3]. When westernization is considered the most modern trend, business decision-makers can push the management to follow this trend.

Therefore, this study aims to observe the phenomenon of internationalization in the selection of independent auditors empirically. Besides, this study also confirms the allegation of globalization trends in auditor selection using qualitative methods.

## II. LITERATURE REVIEW

A possible moral hazard occurs when the principal does not have the opportunity to monitor various activities carried out by the agent [4,5]. Auditors are one mechanism to reduce moral hazard between them by narrowing the information asymmetry, especially in the digital age [6]. The direct stakeholder of the auditor is the owner of the company or shareholder. In this study, we classify shareholders based on their similarity, namely: institutional ownership [local and foreign], government, individuals [independent, the board of commissioners, management].

Institutional shareholders are one of the components of good corporate governance [7]. Generally, they have the expertise to monitor and control company's management [8], so that their active roles potentially reduce agency costs [9]. Although having a small number of ownerships, the government is fully capable of selecting auditors [10]. However, the government usually does not play an active role in monitoring their investment [11]. Auditor selection is one of the strategic decisions for the company. Major shareholders (including the ownership of individuals) actively participate in corporate strategic decisions [12]. The hypothesis used is:

H1: Local institutions, foreign institutions, governments, independent individuals, boards of commissioners and management ownerships influence the selection of auditors

## III. METHODS

This research uses two types of data sources analysed by the researchers. First, we use empirical data from annual reports from companies registered in the Indonesian capital market. The sample includes all non-financial companies listed on the Indonesia Stock Exchange during the 2016-2018 periods so that 1,009 final samples were selected. After empirical data

collected, researchers use multinomial logistic regression to analyse empirical results.

$$\text{Audit} = \alpha + \beta_1 \text{LINST} + \beta_2 \text{FINST} + \beta_3 \text{GOV} + \beta_4 \text{INDEP} + \beta_5 \text{MAN} + \beta_6 \text{BOD} + \beta_7 \text{SIZE} + \beta_8 \text{COMPLX} + \beta_9 \text{GROWTH} + \beta_{10} \text{LEV} + \beta_{11} \text{ROA} + \epsilon$$

Note:

- **AUDIT:** Code (2) if the company is audited by the Big 4 affiliated accounting firms, (1) if the company is audited by a non-Big 4 affiliated KAP, (0) if the company is audited by accounting firms without affiliation.
- **LIST:** Percentage of ordinary shares held by institutions and domiciled in the same country as the country where the company is located at least 5% of the total outstanding shares [13].
- **FINST:** Percentage of ordinary shares held by an institution and domiciled in a country that is different from the country where the company is located in at least 5% of the total ordinary shares outstanding [13].
- **GOV:** Percentage of ordinary shares held by the government of at least 5% of the total outstanding shares [14].
- **IND:** Percentage of shares A and B that can be traded and held by individuals divided by the total number of ordinary shares outstanding.
- **INDEP:** Percentage of company ordinary shares held by individuals (other than management and BOD) of the total outstanding common shares.
- **MAN:** Percentage of company ordinary shares held by corporate insiders of the total outstanding common shares.
- **BOD:** Percentage of common shares of companies owned by executive directors of the total outstanding shares.

Secondly, the researcher gets the data from an audit committee of a listed company in the Indonesian capital market. Before becoming an audit committee, the informant had sufficient experience in one of the big four affiliated public accounting firms. Data obtained from informants is qualitative data that is used by researchers to answer internalization trends

in the selection of independent auditors. By having an in-depth interview, the researcher will have a thick understanding of those phenomena from the other side. In this stage, researchers used Giddens as a methodological theory. Methodological theory is actually a tool for qualitative researchers to analyse and explain the social behaviour of such phenomena in different ways according to the paradigmatic assumptions adopted [15]. Social theory is a methodological theory that is often used by qualitative researchers to connect findings into a coherent interpretation [16]. There are several leading social theories produced by social theorists, including Anthony Giddens, Michel Foucault, Pierre Bourdieu, Harold Garfinkel, Jean-Paul Sartre, Erving Goffman. This study uses the theory of globalization proposed by Giddens as a qualitative data analysis tool.

#### IV. RESULTS AND DISCUSSION

##### A. Results

The results section should explain the findings of the research. It can include the tables of final data analysis or anything that indicates the results of the study. Empirical data shows that listed companies choose local-non-affiliated firms (6.6%), non-Big four affiliated firms (62.6%), and Big 4 affiliated firms (30.7%). The data shows that the majority of companies in Indonesia choose non-Big four affiliated firms. Table 1 shows the addition of independent variables correctly classified cases at 70.7%. Table 2 shows the results of testing all parameters. The table consists of two parts. The top compares the selection between local and big-4 affiliated audit firms. While the bottom compares the choices between non-big four and big-4 affiliated.

TABLE I. CLASSIFICATION TABLE

Observed	Predicted			Percent Correct
	0	1	2	
0	7	58	2	10,4%
1	10	538	84	85,1%
2	0	142	168	54,2%
Overall Percentage	1,7%	73,1%	25,2%	70,7%

TABLE II. SUMMARY OF PARAMETER ESTIMATION

AUDIT <sup>a</sup>	B	Std. Error	Wald	df	Sig.	Exp(B)
0						
Intercept	42,179	3,716	128,844	1	0	
LIST	-3,757	0,831	20,441	1	0,000**	0,023
FINST	-7,321	1,126	42,258	1	0,000**	0,001
GOV	-1,791	1,38	1,685	1	0,194	0,167
INDEP	-0,89	1,731	0,265	1	0,607	0,41
MAN	-10,232	4,411	5,381	1	0,020*	3,60E-05
BOD	-1,876	1,76	1,136	1	0,287	0,153
SIZE	-1,456	0,127	130,789	1	0,000**	0,233
COMPLX	0,013	0,008	2,622	1	0,105	1,013
GROWTH	0,66	0,236	7,803	1	0,005**	1,935
LEV	0,894	0,313	8,174	1	0,004**	2,444
ROA	-4,564	0,703	42,192	1	0,000**	0,01

Table 2. Cont.

AUDIT <sup>a</sup>		B	Std. Error	Wald	df	Sig.	Exp(B)
1	Intercept	27,565	2,381	134,06	1	0	
	LINST	-0,618	0,519	1,416	1	0,234	0,539
	FINST	-2,708	0,544	24,768	1	0,000**	0,067
	GOV	0,148	0,724	0,042	1	0,838	1,16
	INDEP	0,353	1,456	0,059	1	0,808	1,424
	MAN	0,676	1,685	0,161	1	0,688	1,965
	BOD	-0,898	1,17	0,59	1	0,443	0,407
	SIZE	-0,908	0,079	130,788	1	0,000**	0,403
	COMPLX	0,012	0,004	10,639	1	0,001**	1,012
	GROWTH	0,345	0,191	3,26	1	0,071	1,412
	LEV	0,212	0,268	0,626	1	0,429	1,236
	ROA	-4,042	0,655	38,104	1	0,000**	0,018

\*\* significant in level 1%; \* significant in level 5%

(coefficient value -10,231,  $p < 0.05$ ) rather than Big-4 affiliated ones.

### B. Discussion

1) *Trend of internationalization:* Foreign institutional investors are more demanding than local institutional investors. Basically, Foreign institutional investors do want top-performing companies. Foreign ownership drives companies to go with the flow of globalization by following global convergence in financial reporting [17]. Institutional ownership holds a monitoring function within the company through the selection of high-quality auditors [18]. Local institutional investors only ask companies to be audited by affiliated audit firms, while foreign institutional investors ease higher audit quality by choosing big-4 auditors. Assert that foreign institutional investors are in unfavorable conditions [related to information] compared to local institutional investors [13]. Foreign institutional investors potentially have sharper information asymmetry when investing outside their countries because they must speculate in the limitations of accounting information that is difficult to understand. As a consequence, foreign institutional investors will ask the superior quality auditors to monitor their investments outside their countries, thus narrowing the information asymmetry [19].

Individual ownership also influences the selection of independent auditors, though not all of them. The majority of independent individual ownerships does not have a large proportion of shares in companies selected as observational samples compared to others. The small portion of independent individual shareholding makes the voice scattered and incomplete [20], so it does not have the opportunity to contribute directly to various strategic decisions [21], including the selection of independent auditors. The information asymmetry of independent individual investors tends to be higher than institutional investors due to limited information [22]. The collective action theory shows how institutional investors are able to control management with their strength

Local institutional ownership (LINST) prefers international affiliated auditors, both Big 4 and non-Big four affiliated. Based on table 2, increasing local institutional ownership significantly reduces the possibility of choosing the local without affiliation by 43.48 times (coefficient value -3.756,  $p < 0.01$ ) compared to selecting the Big-four affiliated. When comparing the effect of choosing non-Big four and Big-four affiliated, the results were not significant (coefficient values -0.618 and sig = 0.234). Meanwhile, foreign institutional ownership (FINST) shows a tendency to choose big-four affiliated accounting firms. An increase in foreign institutional ownership significantly reduces the possibility of selecting the local [non-affiliated] by 1000 times (coefficient value -7.321,  $p < 0.01$ ) compared to choosing the Big 4 affiliated. Increasing foreign institutional ownership is also significantly reducing the possibility of selecting the local [non-affiliated] by 14.93 times (coefficient value -2.708,  $p < 0.01$ ) compared to choosing the Big 4 affiliated firms.

On the other side, government ownership [GOV] proves that there is a considerable influence on the selection of auditing firms. Table 2 shows that an increase in government ownership does not significantly influence the probability of firms choosing local non-affiliated accounting firms (coefficient values -1.791 and sig = 0.194) compared to Big 4 affiliated firms. Increasing government ownership also does not significantly influence the probability of firms in choosing non-Big four affiliated firms (coefficient value = 0.148 and sig = 0.838) compared to selecting a national KAP affiliated with Big 4.

Managerial ownership influences the selection of the international affiliated auditors, both Big 4 and non-Big 4. Hereafter, BOD appears not affecting the choice when comparing local-non-affiliated and affiliated-big 4 with coefficient values -1,876 and sig = 0,287, but also the comparison between non-big affiliated four and big four affiliated with coefficient values of -0,889 and sig = 0,194. Instead, managerial ownership significantly reduces the possibility of choosing non-affiliated auditing firms

and legitimacy to management [23]. Associated with securing the investment of independent minority individual investors, they are also unable to sue for losses due to misinformation, because there is no governance to protect them, so the cost for individual monitoring costs are relatively high [24]. Moreover, most independent individual investors tend to buy shares for short-term speculation to earn their profit [25]. Accordingly, they are reluctant to spend money on monitoring and control costs for management activities [20], and tend to sell ownership when the company's performance is not satisfactory [21]. Managerial ownership shows a significant influence in the selection of auditing firms. An increase in managerial ownership increases the likelihood of choosing an international affiliated auditing office. There are several arguments why management accepts international-affiliated auditors because the use of lower quality auditors can charge agency costs to management in the form of lower compensation and restrictions on access to funding from external parties [26]. Furthermore, the selection of high-quality auditors will help management to convey positive signals related to the quality of the information in the financial statements (partners). This strategy brings economic benefits that have the potential to increase the value of the company in the form of improving credit ratings, reducing the cost of capital and supervision intensity by creditors.

2) *The expertise of the past, present and tomorrow:* The empirical evidence above provides evidence that the owners of listed companies look like they are following the internationalization trend in auditor selection. This section seeks to answer whether the use of foreign affiliates is a globalization trend from the side of the audit committee members. Mr. Margono is one of the audit committees at Gajah Co. [one of the companies listed on the Indonesia stock exchange] since 2017. Gajah Co. using the services of a local-unaffiliated international auditor. Because Mr. Margono is an alumni auditor of the big-4 affiliated accounting firm, Mr. Margono was able to monitor the work of non-affiliated auditors in his company, as stated in the following statement:

*"As an auditor, I make an evaluation. I make a report that shows my assessment to the auditor."*

As the audit committee, Mr. Margono wants the auditors to work with full attention, especially Gajah co. is engaged in the industrial estate.

Mr. Margono asserts that industrial estate industry has different characteristics from the general industry because it involves a variety of agreements that have legal consequences. It is what he said:

*"The accuracy is lacking for local. Thoroughness, neatness..o..carefulness in reading material sheets or notarial deeds..notary deeds related to third party agreements, bank agreements. I pay more attention to things more related to..disclosure, from the disclosure, I pay more attention to the disclosure of the agreement."*

The inability to read a legal agreement will deteriorate the independence related to capabilities in carrying out their work. The ability to understand the essence and impact of implementing legal contracts is a new expertise for auditors in the present and future. As Giddens said, that The global world will force global citizens to bring up unique expertise [1], including auditors. The ability to read a legal agreement is not a mandatory skill of the auditor in the past. However, globalization, with its modernization, will redefine the expertise of auditors. Businesses, including auditors, must conduct reskilling that combines new skill and knowledge, to create a new differentiated identity [27]. For this reason, global quality auditors must always develop new experts to survive and win in the global world.

What abilities does the audit committee of the Gajah Co. want? Mr. Margono asked the auditor to understand how the implementation of a legal agreement, so that the auditor could estimate the economic impact of compliance or violation of the legal agreement on the financial statements, as he revealed:

*"About the numbers are the same .. the figures are relatively the same..coincidentally, I am more..so far, because many people look at the numbers include the accounting manager, the company.. All pay attention to the accuracy of the numbers, so I pay more attention to matters more related to ... disclosure "*

The statement above implies that technical ability related to numbers is the expertise required by the auditor. Still, Mr. Margono asked for more than that, namely the ability to understand the impact of a disclosure on the financial statements carefully. The auditor profession has entered the grip of the global world. Giddens illustrates that abstract systems will work in globalization [27]. He claims that abstract systems will reduce overall risk in certain areas, but will create other risks in new areas. The dangers faced by the auditor will also change. Risks arising from clerical work begin to be reduced by modernization. Because of the help of modernization, Mr. Margono did not scrutinize the accuracy of the numbers in the financial statements. Mr. Margono believes that the auditor has adequate clerical capabilities.

Is internationalization a form of western hegemony? Giddens assert that globalization has created new economic and cultural zones throughout the world [1,28]. Thus, not only do western countries feel it but also all corners of the world receive their impact. On the contrary, globalization potentially creates reverse colonization from developing countries to developed countries [27]. The trend of selecting international affiliated auditors is not a manifestation of westernizing, rather than finding for new unique expertise.

## V. CONCLUSION

This study answers about the existence of westernization in auditor selection. This study empirically analysed the behaviour of company owners based on five major groups, namely ownership of local and foreign institutions, government, independent individual, BOD, and managerial.

Empirical facts prove that foreign institutional investors tend to choose a big-four affiliated accounting firm. Meanwhile, local institutional ownership and managerial individuals only require international affiliation.

On the other hand, the role of government, independent individuals, and BOD ownership does not appear in the selection of auditors. Based on an analysis using global modernity theory, there is a new expertise that must be provided by the auditor. New expertise requires both knowledge and skills. Thus, this study answers that internalization does not mean Westernization. This study does not examine how the behaviour of other interested parties other than the owner. The use of BOD, the audit committee, and management characteristics will provide new knowledge in terms of auditor selection.

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