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THE EMPIRICAL STUDY OF THE EXTERNAL AUDITOR SELECTION

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ABSTRACT
This study aims to examine the influence of good corporate governance and the characteristics of the company on the external auditor selection empirically. The companies need to pay attention to the factors that influence the external auditor selection in order to obtain a high quality auditor. This study was conducted at the companies listed on the Indonesia Stock Exchange (IDX) and follows the Corporate Governance Perception Index (CGPI) in the year 2010-2014. The total sample of 35 was obtained by using the purposive sampling method. The dependent variable used was the external auditor selection, while the independent variable used was good corporate governance, the size of the company, profitability, leverage, and audit fees. The logistic regression analysis method was used to examine the hypothesis of this study. The results of this study showed that variable corporate governance, leverage and audit fees did not have a significant effect on the external auditor selection. While the variable size of the company and the profitability had a significant effect on the external auditor selection.

Keywords: External auditor selection, good corporate governance, size of the company, profitability, leverage, and audit fees.

INTRODUCTION

The statement of the Financial Accounting Standard (FAS) Number 1 (Revised 2009) concerning the presentation of financial statements states that financial statements consist of statements of financial position, comprehensive income statement, equity changes statement, cash flow statement, notes on financial statements, and comparative financial position statements. Among the five financial statements, the income statement is the financial statement that is often used in making decision by the internal and the external parties of the company. Because the financial statements, especially the income statement, are used as a tool for making decision, there is a need for reliability of the information presented in the financial statements (Nafasati and Indudewi, 2015).

The selection of the external auditors is a selection process carried out by the company to choose a public accounting firm as a provider of audit services among the many existing public accounting firms with variations in audit quality. The companies need considerations in selecting the external auditors such as consideration of knowledge, skills, independence and adequate competence. The users of financial information will doubt the information presented if they do not trust the credibility of the external auditor in processing and presenting the financial information (Harini, 2010).

Good corporate governance (GCG) is a form of good corporate management. The companies with good governance are more likely to choose high-quality external auditors. The research on the relationship between GCG and the selection of the external auditors has been widely carried out, but there are still varied research results. The study of Singgih and Drajat (2015) found 2 GCG

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mechanisms, namely foreign ownership and the proportion of the board of commissioners had significant positive effect on the selection of the external auditors. Putra (2014) found the institutional share ownership, managerial share ownership had no effect on the selection of the external auditors, while the size of the board of commissioners and the effectiveness of the audit committee had significant positive effect on the selection of the external auditors. Then Maharani (2012) found the largest share ownership, the size of the board of commissioners, and the effectiveness of the audit committee had significant positive effect on the selection of the external auditors.

The selection of the external auditors is not only influenced by *good corporate governance*. The characteristics of the company are the unique or specific nature of the company and can influence the decision of the external auditors selection. Among several company characteristics, this study focuses on three characteristic components, namely company size, profitability and *leverage*. Company size shows the scale size of the company. Fitriyani and Erawati's research (2016) states that company size does not significantly influence the selection of the external auditors. Whereas Singgih and Drajat (2015) found that company size had significant positive effect on the selection of the external auditors.

Profitability measures how effective the management manages company assets to generate revenue regardless of how the assets are financed. The companies with high profitability will choose good quality auditors. The research conducted by Fitriyani and Erawati (2016) states that profitability measured by *Return On Assets* (ROA) has significant positive effect on the selection of the external auditors. The higher the company's ability to generate profits, the greater the possibility of selecting the external auditors who have high quality.

Regarding *leverage*, agency theory found that the increase in agency costs was an increase in *leverage* (Jensen and Meckling, 1967 in Fitriyani and Erawati, 2016) which led to requests for monitoring such as the external audit mechanism. Fitriyani and Erawati's research (2016) states that *leverage* negatively influences the selection of the external auditors. While Singgih and Drajat (2015) state that *leverage* does not affect the selection of the external auditors. Based on the description of the background of the problem, the formulation of the problem of this study is what is the effect of *good corporate governance*, *size*, profitability, *leverage* and *fee* on the selection of the external auditors?

LITERATURE REVIEW

Logical Relationship Among Variables and the Formulation of Hypothesis

The Effect of *Good Corporate Governance* to the Selection of the External Auditors

The quality of corporate governance has a tendency to influence company decisions in the appointment of public accounting firm as the audit service provider. The declining *corporate governance* mechanism of a company tends to have an impact on the companies refusing to choose high-quality auditors. The better implementation of *corporate governance* mechanism allows the company management to choose qualified auditors, and vice versa (Maharani, 2012).

Fitriyani and Erawati's research (2016) found the mechanism of *good corporate governance* with CGPI rating had positive but not significant effect on the selection of the external auditors. Maharani's research (2012) found 3 GCG mechanisms, namely the largest share ownership, board of commissioner size, and the effectiveness of audit committees had positive and significant effect on the decision of the external auditor selection. The research of Putra (2014) found 4 GCG mechanisms, namely institutional share ownership and managerial share ownership did not affect the selection of the external auditors, while the board of commissioner size, and the effectiveness of the audit committees had positive and significant effect on the selection of the external auditors.

The appointment of qualified external auditors is expected to improve corporate governance. The contribution of this research is important because it can be used as protection for the

users of information about the company to the stakeholders in the form of annual reports so that the level of reliability becomes higher by using audit services that serve as supervision and testing the credibility of the accounting information provided by management.
H1: GCG has significant effect on the selection of the external auditors

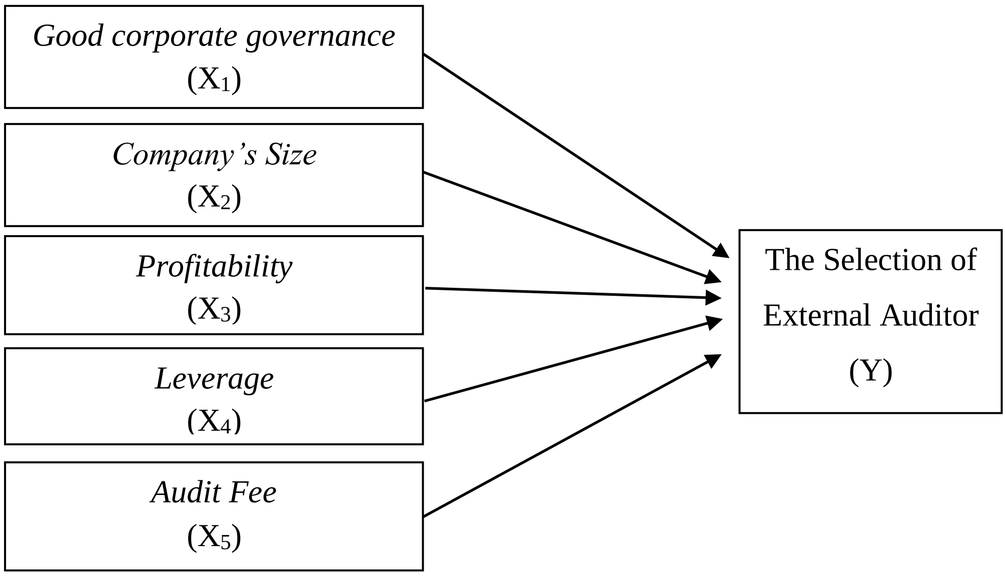
The Effect of Company Size on the Selection of the External Auditors
The size of the company determines the scale size of the company. The larger the company, it usually demands higher audit quality because it has greater volume of audited transactions, has more stakeholders, has greater loss when there is an error, and tends to have greater institutional conflict. Large companies usually get more attention from large audit companies (Fitriyani and Erawati, 2016). The research conducted by Fitriyani and Erawati (2016) states that company size has positive but not significant effect on the selection of the external auditors. Whereas Singgih and Drajat (2015) found that company size had significant positive effect on the selection of the external auditors.
H2: Company size has significant effect on the selection of the external auditors

The Effect of Profitability on the Selection of the External Auditors
Company profitability measures how effective the management manages the company assets to generate revenue regardless of how the assets are financed. The companies with high profitability (usually measured through ROA), will choose good quality auditors. The research conducted by Fitriyani and Erawati (2016) states that profitability measured by *Return On Assets* (ROA) has significant positive effect on the selection of the external auditors. The consistent results is also with Maharani (2012) study which found that profitability had significant positive effect on the selection of the external auditors.
H3: Profitability has significant effect on the selection of the external auditors

The Effect of Leverage on the Slection of the External Auditors
The increasing leverage raises demand for monitoring mechanism such as external audit. The research conducted by Fitriyani and Erawati (2016) states that leverage negatively influences the selection of the external auditors. While the research of Yusef and Singgih (2015), Singgih and Drajat (2015), stated different results that leverage did not affect the selection of the external auditors. The companies with high leverage will prefer qualified external auditors to mitigate the market that the company's performance is good and to reduce costs to obtain capital (Maharani, 2012).
H4: Leverage has significant effect on the selection of the external auditors

The Effect of Audit Fee on the Slection of the External Auditors
The addition of audit fee variables in this study refers to Yuniarti (2011) research in Margi Kurniasih. Abdul Rohman (2014) proved that audit fee significantly influences the quality of the external auditors, because the audit fee obtained in estimating the operational costs needed to carry out the audit process can improve the audit quality. The Indonesian Public Accountant Institute (IPAI) issued Decree No. KEP.024 / IAPI / VII / 2008 on July 2, 2008 concerning the policy of determining the audit fees. Guidelines are issued as a guidance for all IPAI members who practice as public accountants in determining the amount of fair compensation for the professional services they provide (Immanuel, 2014).
H5: Audit fee has significant effect on the selection of the external auditors.

Thinking Framework



Picture 1
Thinking Framework Model

RESEARCH METHOD

The dependent variable in this study is the selection of the external auditor which is a dummy variable. KAP affiliated with the big four is considered to have better reputation and is considered capable of providing qualified audit service. The following are data of public accounting companies affiliated with big four from 2009 (Widyantari, 2011):

a) KAP Purwantono & Partners affiliates with *Ernst & Young.*
b) KAP Siddharta & Widjaja affiliates with KPMG.
c) KAP Tanudireja, Wibisana and Partners affiliates with *Price Waterhouse Coopers* (PWC).
d) KAP Osman Bing Satrio and Partners affiliates with *Deloitte Touche Tohmatsu*.

The sample will be worth 1 if the company chooses a public accounting firm that has a big four affiliation and the sample will be worth 0 if the company chooses a public accounting firm affiliating with *non-big four*. The independent variables used in this study were good corporate governance (GCG), company size, profitability, *leverage*, and audit *fee*. *Good corporate governance* is all systems that become guideline for companies so they can create sustainable *value added* for the long term, but the interests of other stakeholders are still considered (IICG, 2013). The GCG variable in this study was measured using the *Corporate Governance Perception Index* (CGPI) score. The classification of CGPI ranking result is as follows:

a) Score 55 - 69, for quite reliable category.
b) Score 70 - 84, for trusted category.
c) Score 85 - 100, for very reliable category.

The size of the company reflects the scale of the company. The variables in the study are expressed based on total assets. The measurement of variable of the company size is with the natural logarithm of total assets. The use of *ln assets* is intended to reduce the large bias with the variable in the form of ratio.

The company profitability shows the ability of company to earn profits in relation to total assets, sales, and own capital (Sartono, 2001 in Fitriyani and Erawati, 2016). The ROA formula is as follows (Angruningrum, 2013):

$$\boxed{ROA = \frac{\text{Net profit after tax}}{\text{Total Assets}}}$$

Singapurwoko (2011) in Fitriyani and Erawati (2016) explained that *leverage* (debt) was one of the tools used by the companies to increase capital in order to increase company profits. The formula for obtaining this ratio is as follows (Angruningrum, 2013):

$$Leverage = \frac{\text{Total amount of debt}}{\text{Total Assets}}$$

Audit fee is honorarium charged by public accountant to an audit company on the audit merit conducted by the public accountant on the financial statement (Iskak, 1999 in Immanuel, 2014). The lack of companies that disclose audit *fees* and disclosures about audit *fees* is still *voluntary disclosure*, so this study uses professional *fees* data or the estimation cost of operating audit fees is measured using natural logarithm (Ln) from professional *fees* (Rizqiasih, 2010 in Immanuel, 2014).

Research Object, Sample Unit, Population, and Sample

The object of this study is the selection of the external auditors with *good corporate governance*, company size, profitability, *leverage*, and audit *fees* as the factors that influence it. The regions or areas used in this study are the companies listed on the Indonesia Stock Exchange (IDX) from 2010 to 2014 that are included in the *Corporate Governance Perception Index* (CGPI) ranking as the most trusted company.

The population of this study were all companies listed on the Indonesia Stock Exchange (IDX) in 2010-2014. The sample was selected using *purposive sampling* method with the criteria (1) The companies that have consecutive CGPI ranking scores for 5 years from 2010-2014, (2) Publishing complete audited financial statements for 5 years from 2010-2014 and listing the names of auditing auditors and (3) The data needed are available.

Types, Sources and Data Collection

The type of data used in this study was secondary data in the form of the audited company's annual financial statements and CGPI ranking score data for the period 2010-2014. The CGPI score was obtained by accessing the site www.mitrariset.com based on *The Indonesia Institute of Corporate Governance* (IICG) while the data needed for the completeness of data such as total assets, total debt, and profit after tax were obtained through the site www.idx.co.id. Documentation was done by collecting documentary data such as the audited company's annual financial statements and the published CGPI rating score data of the company.

Data analysis

The analytical method used to test the hypothesis in this study is logistic regression, while descriptive statistics is also used to provide an overview of the variables in this study. The logistic regression model in this study is described as follows:

$$\mathbf{Ln\ (p / 1\text{-}p) = \beta0 + \beta1X1 + \beta2X2 + \beta3X3 + \beta4X4 + \beta5X5 + \varepsilon}$$

Notes:
P = opportunity in the selection of the external auditors
β0 = constant of β1, β2, β3, β4 = regression coefficient
X1 = Good corporate governance
X2 = Company size

X3 = Profitability
X4 = *leverage*
X5 = Audit *fee*
ε = error term

RESULT AND DISCUSSION

Based on the criteria in the sample selection, there are 8 companies listed on the IDX that follow the *Corporate Governance Perception Index* (CGPI) ranking score consecutively during the study period. Of the 8 companies, there is 1 company that does not display the complete company data needed consecutively. Therefore the company samples used in this study are 7 companies, so that by using the method of combining data for 5 consecutive years 7 x 5 = 35 observation data are obtained.

Descriptive Statistics

Based on SPSS processed data which includes GCG, company size, profitability, *leverage*, audit *fee*, then the maximum value, minimum value, mean, and deviation standard of each variable will be known.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
The selection of the external auditors	35	.00	1.00	.8571	.35504
GCG	35	70.73	92.88	85.6174	4.52882
Company Size	35	29.40	34.38	32.0977	1.71048
Profitability	35	-.04	.16	.0459	.04520
Leverage	35	.22	.92	.6795	.24383
Audit Fee	35	23.44	28.50	24.9052	1.33715
Valid N (listwise)	35				

Source: SPSS 20 Output

The descriptive statistics table above shows the number of observations in this study are 35 observations. From these 35 observations, the minimum value or the smallest amount for GCG owned by the company is 70.73. While the maximum value or the largest amount owned by the observation company is 92.88. This value indicates that the level of GCG owned by the company is between 70.73 and 92.88. Then the mean value the GCG level of the sample company is 85.6174 with deviation standard of 4.52882.

The minimum value for the company size owned by the company is 29.40, while the maximum value owned by the company is 34.38. These values indicate that the company size obtained by the company is 29.40 to 34.38. The mean value of the company size variable owned by the sample companies is 32.0977 with deviation standard of 1.71048. The minimum value for profitability owned by the company is -0.04, while the maximum value owned by the company is 0.16. These values indicate that the level of profitability owned by the company is between -0.04 and 0.16. Then the mean value of the profitability level of the sample companies is 0.459 with deviation standard of 0.4520.

The minimum value for the *leverage* owned by the company is 0.22. While the maximum value owned by the company is 0.92. These values indicate that the *leverage* obtained by the company is 0.22 to 0.92. The mean value of the *leverage* variable owned by the sample companies is 0.6795 with deviation standard of 0.24383. Furthermore, the minimum value for audit *fee* owned by the company is 23.44, while the maximum value held by the company is

28.50. These values indicate that the audit fee obtained by the company is 23.44 to 28.50. The mean value of the audit *fee* variable owned by the sample companies is 24.9052 with deviation standard of 1.33715.

Coefficient of Determination

The *Nagelkerke R Square* value in this study is 0.562 which means that the variability of the dependent variable which can be explained by the variability of the independent variable is 56.2%, while the remaining 43.8% can be explained by other factors that are not included in this study.

Logistic Regression Model

Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1[a]	GCG	-.872	.701	1.544	1	.214	.418
	SIZE	9.402	6.322	3.212	1	.037	12117.945
	ROA	24.482	23.286	4.105	1	.029	.000
	LEV	-35.462	21.654	2.682	1	.101	.000
	AUFEE	-.370	3.056	.015	1	.904	.691
	Constant	-184.638	162.220	1.295	1	.255	.000

a. Variable(s) entered on step 1: X1, X2, X3, X4, X5.

Source: SPSS 20 Output

The test result on the regression coefficient produces the following model:

$$\mathbf{Ln\ (p/1\text{-}p) = -184{,}638 - 0{,}872X1 + 9{,}402X2 + 24{,}482X3 - 35{,}462X4 - 0{,}370X5 + \varepsilon}$$

Notes:

1. The constant of -184,638 states that if the independent variables (GCG, company size, profitability, *leverage*, and audit *fee*) are considered constant, the company tends to choose KAP that affiliates with the *Big Four* in the selection of the external auditors.
2. The GCG regression coefficient is negative. This means that if GCG increases while other variables are considered constant, then the possibility of selecting external auditors based on KAP that affiliates with the *Big Four* decreases. The significance level of this variable is 0.214 above the alpha value (0.05). This means that GCG doesn’t have significant effect on the selection of the external auditors, so the result of this study **rejects H1**.
3. The company size regression coefficient is positive. This means that if the size of the company increases while other variables are considered constant, then the possibility of choosing the external auditors that affiliates with the *Big Four* increases. The significance level of this variable is 0.037 below the alpha value (0.05). This means that the size of the company has significant effect on the selection of the external auditors, so the result of this study **accepts H2.**
4. The profitability regression coefficient is positive. This means that if profitability increases while other variables are considered constant, then the chances of the companies affiliating with the Big Four increases. The significance level of this variable is 0.029 below the alpha value (0.05). This means that profitability has significant effect on the selection of the external auditors, so the result of this study **accepts H3**.

5. The *leverage* regression coefficient is negative. This means that if *leverage* increases while other variables are considered constant, then the possibility of choosing the external auditors affiliating with the *Big Four* decreases. The significance level of this variable is 0.101 above the alpha value (0.05). This means that *leverage* does not have significant effect on the selection of the external auditors, so the result of this study **rejects H4**.
6. The audit *fee* regression coefficient is negative. This means that if the audit *fee* increases while other variables are considered constant, then the possibility of choosing the external auditors affiliating with the *Big Four* decreases. The significance level of this variable is 0.904 above the alpha value (0.05). This means that audit *fee* doesn't have significant effect on the selection of the external auditors, so the result of this study **rejects H5**.

CONCLUSION

1. *Good corporate governance* (GCG), leverage and audit fee do not have significant effect on the selection of the external auditors.
2. Company size and profitability have significant effect on the selection of the external auditors.

SUGGESTION

1. For the management, the resulta of this study can be used for consideration in selecting the company's external auditor to anticipate the occurrence of audited accounting information that makes the level of reliability and the credibility of the external auditor in auditing doubtful, because the selection of the external auditors is a selection process to choose a qualified public accounting firm (KAP) based on the adequate competence in providing auditor services to the company's accounting information.
2. For the company, the results of this study can be used to provide input so that companies listed on the Indonesia Stock Exchange (IDX) should take part more in the *Corporate Governance Perception Index* (CGPI) ranking survey. so they are able to improve the corporate governance.
3. For the investors, the results of this study are expected to be able to assist in analyzing the implementation of GCG and the characteristics of good corporate governance through the selection of the external auditors, so that it can assist in making investment decisions.

RESEARCH LIMITATION

1. The independent variables used in this study are only able to influence the dependent variable of the external auditors selection by 56.2%, the remaining 43.8% are influenced by other variables outside this study.
2. GCG variables proxied by ranking *corporate governance perception index* (CGPI) score have not had large degree of influence because most of the companies listed on the Indonesia Stock Exchange (IDX) have not taken the CGPI ranking survey. Thus, the sample of companies used in the study is relatively small.
3. Due to the limitations of data on audit *fee*, this study is only proxied only use *professional fee* to provide value to the audit *fee* variable because the disclosure of data on audit *fee* is still in the form of *voluntary disclosure*, so that the selection of samples used is not optimal.

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