

# THE EFFECT OF DIRECTORS' EXPERTISE ON THE EXTERNAL AUDIT QUALITY

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## ABSTRACT

*Study aims to examine whether directors' expertise in the ACs and BDs have a significant impact on the external AQ of Jordanian environment, using secondary data of non-financial companies in Amman stock exchange, (ASE) for the period (2016-2020). Results revealed that directors' expertise in ACs and BDs have a significant positive effect on external AQ by imposing high auditing costs. The study makes a contribution to literature by providing information on the correlation between ACs and BDs directors' expertise, as well as helping policy-makers in Jordan and other countries to conduct upcoming regulatory alterations within similar conditions. The current study also contributes to literature by finding alternative channels that help external auditors to obtain information about the industry to boost performance.*

**Keywords:** Directors' Expertise, Auditing Committee, Board of Director, Audit Quality

## INTRODUCTION

The continuous scandals of organizations surrounding the business represented in the large four firms and create great concern for the world today (Saidu & Aifuwa, 2020), where the audit concept has received the attention of many sectors for various reasons. One reason for the increased interest in studies related to audit is lack of users' dependability in the financial statements of organizations, therefore auditing staff have an obligation to prepare and produce an accurate and error-free financial statements (Sharhan & Bora, 2020). Furthermore, the phenomenon of financial statement fraud committed by organizations' management occurs repeatedly, and it will be intensified through the support of external auditors to such a fraud (Widani & Bernawati, 2020).

(Lisic, et al., 2019) argued that AC's directors' expertise will support the enhancement of external audit's quality level through the need of additional audits and assessments over the internal control, because as they argued the expertise of AC's directors protects the external auditor from dismissal decisions whenever they issue adverse opinions to the internal control, but financial expertise of ACs might be a double edged sword (Alderman & Jollineau, 2020). The CG system consists of several mechanisms, where BDs and ACs considered as the most significant mechanisms of such system (Amer, 2016), therefore the current study investigates whether if there is a relationship between AC members' experience and AQ, and provides a valuable addition to literature; in regard to the correlation between ACs and BDs directors' expertise. Study results also provide inference to policy-makers in Jordan and other countries to consider for upcoming regulatory reform; at similar institutional surroundings.

## Motivation

High quality of the external audit is considered as focal part of operating wellcapital markets (Khudhair, et al., 2019), where the composition of BDs and ACs considers the most important mechanism of corporate governance, and because Most of the decisions are taken at the highest level of management in the organization, it is valuable and appropriate Interesting in setting of AC (Alkebsee, et al., 2021). (DeFond & Zhang, 2014) discussed the required environment changes of ACs presented by SOX in the USA, as an attempt to increase AQ by enhancing client power and thereby increasing client demand for AQ. The basic element of recent governance recommendations in several countries calls for ACs to have no less than one member with current and related financial expertise (Alhababsah & Yekini, 2021).

The external auditors' trust in auditing committees' directors lead to the enhancement of their communications with others, in term of information sharing, dedicating time and efforts to external audit, and providing valuable information about directors (Cheung, 2019). There are diverse and unreliable results in regard to the role directors' expertise of ACs and BDs play on the external AQ; particularly in the Jordanian environment which create motives to investigate the influence of ACs and BDs directors' expertise on AQ.

Recently, governance regulators put great emphasis on guaranteeing the existence of financial expertise on BDs (Mustafa, et al., 2018) and on ACs (Sarbanes-Oxley, 2002; UK Corporate Governance Code, 2010–2016), where there is a faith that larger expertise will increase the efficiency of ACs and positively enhance the external AQ (Ghafran & O'Sullivan, 2017). Therefore, the importance of external AQ to upsurge investors' confidence and develop the financial markets motivate researchers to investigate the roles played by BDs and ACs expertise in the Jordanian market to ensure a high degree of AQ.

## LITERATURE REVIEW

### Board Expertise & Audit Quality

BDs have several incentives and characteristics and an ability to request a high degree of external AQ in order to control management activities (Mustafa et al., 2018), where one of these characteristics is the accounting and financial expertise. The current study follows the definition of board expertise by (Bédard, et al., 2004) which refers to members who possesses qualifications in finance or accounting issues, or the membership in any accounting and financial professional body. To be exact, expertise is an important feature of the board members which influences the effectiveness of board of directors. Considering effective CG mechanisms, the board needs expertise and knowledge besides other characteristics to make the best decisions regarding the company's performance as well as monitor the functions on the management. Thus, the experience of directors may be decisive whenever they must rely on their own decision-making addition to the control function (Zarza, et al, 2020).

In addition, well-experienced managers have more incentives to monitor the work, which creates pressure on management to comply with high-quality accounting policies (Jiang, Ferris, & Coffman, 2009). In this side, the directors' experience is decisive to enhance the efficiency of boards in decision-making (DeFond, Hann & Hu, 2005). Accordingly, it is possible to conclude that boards with various qualifications and experiences lead to a high audit quality (Lisic, et al., 2019). Khudhair, et al, 2019) study indicates the importance of board members, especially executives to have the financial expertise needed to change the courses of deviation in the auditing process and to ensure maximum audit efficiency. Therefore, researchers formulated the following hypothesis:

*H<sub>1</sub>: Board Expertise is significantly and positively affects AQ*

## Audit Committee & Audit Quality

ACs is in charge of controlling the process of financial reporting, and the process of hiring and paying external auditors (Rani, 2018), as well as preserving the auditors' independence, and guaranteeing the efficiency of mechanisms and risk-management processes. ACs must have special features to guarantee its effectiveness, As empirical research has shown, characteristics such as independence, diligence, financial expertise and work experience will affect the effectiveness of corporate governance (Abbott, et al., 2003; Collier & Zaman, 2005; Thiruvadi, 2012). Mostly, ACs believed to be as one of the many mechanisms for corporate governance and is the connection between both internal and external audit (Sharhan & Bora, 2020), therefore ACs makes large contributions to accounting and financial reporting, rule commitment, risk management, and organizations' internal control (Lekka, 2019). Results revealed that behaviors of ACs; in correlation with AQ take part in the evaluation of reports' contents performed by external auditors of ACs, where the control of AQ by ACs includes an in-depth evaluation of external auditors' observation thru the interface and communication between two parties, which demonstrates the role of experts in ACs as an effective controlling mechanism of AQ (Sulaiman, 2017).

ACs now plays a significant role in internal fraud prevention and is being recognized as a solution of fraud (Suryanto, et al., 2017), where some diverse and erratic implications have been stated in the previous studies. (Choi, et al., 2020) found that existence of regulatory experts on ACs has a negative effect on the cash assets value, which indicates that regulatory experts of ACs would worsen the control of supervisory activities. Study found that negative outcome of directorial experts on cash assets value would be lessened with the existence of other ACs accounting expertise. (Ghafran & O'Sullivan, 2017) showed that ACs which possess high degree of financial expertise usually require large auditing fees while (Sukma & Bernawati, 2019) revealed that size and experience affect AQ significantly, while audit meetings and education don't significantly affect AQ. (Alderman & Jollineau, 2020; Cheung, 2019) discovered that ACs with high financial expertise entail more work from external auditors and lead to greater auditing fees.

(Lisic, et al., 2019) revealed that whenever ACs has more members with accounting and financial expertise, there will be a greater possibility that external auditors will issue adverse opinion of the internal control, and lower possibility that external auditor will face the dismissal decisions after the adverse opinions. These results indicate that expertise of AC's members actually protect auditors from the dismissal decisions by the management, and then enhance quality level of the audit. (Sultana, et al., 2019) found that directors' expertise of ACs have significantly positive relationship with the auditing fees. (Suryanto, et al., 2017) revealed a positive correlation between financial expertise' directors of ACs and AQ while (Zarza, et al., 2020) showed that ACs with more expertise meet often, need fewer directors with round-the-clock commitment, and pay lesser auditing fees where there is no correlation between external auditing firms attributable to compulsory auditors' replacement.

(Khudhair, et al., 2019; Asiriwa, et al., 2018; Goodwin-Stewart & Kent, 2006) found insignificant correlation between the financial expertise of directors in the ACs and the external AQ. In addition, (Alhababsah & Yekini, 2021) found insignificant influence of AC's directors expertise on the AQ. The agency theory indicates that superiority and expertise of ACs positively affect controlling and leads to the development of AQ and the controlling of EM, while the social interdependence theory specifies that each time two parties rely on one another; such as external auditors and ACs members who will seek to develop their communications and accomplish their goals of high AQ (Cheung, 2019). Therefore, current study developed the hypothesis that stated:

*H<sub>2</sub>: Audit Committee's expertise is significantly and positively affects AQ*

## RESEARCH DESIGN

### Data & Methodology

Researchers collected data from the financial reports of (94) non-financial shareholding firms registered on ASE; for the period (2016-2020) by using the descriptive approach to analyze data and test hypothesis, as well as using the statistical e-views program. Researchers used the Linear Regression Analysis method to find the relationship between independent variables represented in experiences of audit committees' members and board of directors' members and auditing quality.

### Variables Measurement

This study consists of the following:

1. Independent Variables: represented in the experience of ACs and BDs members, which measured by the availability of financial and accounting experience, accounting certificates, or financial and administrative sciences through the percentage of member experience (the number of experienced members divided by the total number of members).
2. Dependent Variable: represented in the external AQ, which measured by the normal logarithm of auditing fees, due to a logical correlation between AQ and auditing fees (Bshayreh, et al., 2021; Ghafran, et al., 2017). In addition, some controlled variables have been employed to reduce the interpretive errors of independent variable on the dependent, as described below:

*BIG4: Audit Firm Size*

*BDIND: Board Independence*

*LOSS: LOSS*

*BDSIZ: BOARD SIZE*

*FSIZ: FIRMSIZE*

Table (1) shows the variables, its symbols, and its measurement methods, as well as the regression equation formula of the study model as follows: (Axén, 2018)

$$AQ = \beta_0 + \beta_1 BDEXP + \beta_2 ACEXP + \beta_3 BIG4 + \beta_4 BDIND + \beta_5 BDSIZ + \beta_6 LOSS + \beta_7 FSIZ + \varepsilon$$

Where:

*AQ: Audit Quality*

*BDEXP: Board Experts*

*ACEXP: Audit Committee Experts*

*BIG4: Audit Firm Size*

*BDIND: Board Independence*

*LOSS: LOSS*

*BDSIZ: BOARD SIZE*

*$\beta_0$ : constant*

*$\beta_1 - \beta_4$ : coefficients*

*$\varepsilon$ : Error term*

<b>Table 1</b>			
<b>MEANING OF VARIABLES</b>			
<b>Type</b>	<b>Variables</b>	<b>Symbols</b>	<b>Measurements</b>
Dependent Variable	Audit QUALITY	AQ	log of the Audit fees
Independent	Board Experts	BDEXP	Percentage of experts' directors in the board

Variable	Audit Committee Experts	ACEXP	Percentage of experts' directors in the AC
Controlled Variable	Audit Firm Size	BIG4	1 = Big 4; 0 = Non-Big 4
	Board Independence	BDIND	Percentage of Board members who are non-executive independent directors
	Board SIZE	BDSIZ	NUMBER OF BOARD SIZE.
	LOSS	LOSS	Dummy Variables = 1 for business loss, 0 if not
	FIRMSIZE	FSIZ	LN of total assets

## RESULTS

### Descriptive Statistics

It shows from table (2) that natural logarithm of external auditing fees represents an AQ level of (9.2) with highest score of (11.5) which agrees with the study results of (Qawqzeh et al., 2019) who conducted their study on the Jordanian economic environment. The arithmetic mean of BDEXP amounted to (68%) with a highest mean of (100%), which indicate the availability of EXP with a high mean among the BD members, and also the mean of ACEXP amounted to (82%) with a highest mean of (100%) which indicates a high level of EXP among the internal AC at the study sample companies. The number of companies that audit BIG4 amounted to about (50%), which indicates that half of researched companies prefer the major audit companies to audit its accounts and supports the AQ in it. The mean of BDIND reached (59%) and the mean of BDSIZ amounted to (7.82) members with a mean LOSS of (33%) and a FSIZ of (10.37). Table (2) gives descriptive statistics' details of all study variables.

	AQ	BDEXP	ACEXP	BG-4	BDIND	BDSIZ	LOSS	F-SIZ
Mean	9.2	0.68	0.82	0.48	0.59	7.82	0.33	10.377
Max	11.5	1	1	1	0.86	14	1	14.4
Min	6.6	0	0	0	0	4	0	5.98
Obs	564	564	564	564	564	564	564	564

### Correlation Matrix

Table (3) shows the statistical analysis of relationships between independent, dependent, and controlled study variables by illustrating the correlation between each two variable, and this test measures whether if the correlation results are between ( $\pm 0.80$ ), and if so the correlations will be strong, significant, and explain the relationships between variables reliably and realistically. The biggest variable correlation degree with the dependent AQ variable was the BDEXP members with (0.738) and the EXP of AC members with a degree of (0.621), as well as the FSIZ which had a significant correlation with the AQ fees of (0.68) and explains that FSIZ considers one of the determinants of AQ fees (Sultana, et al., 2019). P-VALUE amounted to (0.000), which is a significant value while it was a negative correlation between LOSS and AQ and indicated that AQ (audit fees) had an inverse relationship with the company's business result. The rest of correlations between variables were within the test range as shown in table (3) below:

	AQ	BDEXP	ACEXP	BG-4	BDIND	BDSIZ	LOSS	F-SIZ
AQ	1							
BDEXP	0.738	1						
	0	---						

ACEXP	0.621	0.518	1					
	0.021	0	---					
BIG4	0.638	0.542	0.407	1				
	0.01	0	0	---				
BDIND	0.223	0.067	0.189	0.146	1			
	0	0.035	0	0	---			
BDSIZ	0.134	0.159	0.083	0.086	0.03	1		
	0	0	0.01	0.007	0.342	---		
LOSS	-0.072	-0.063	-0.015	0.022	0.028	-0.579	1	
	0.025	0.051	0.641	0.486	0.374	0	---	
FSIZ	0.687	0.439	0.442	0.345	0.182	0.2	-0.172	1
	0	0	0	0	0	0	0	---

### Relaxing of the General Assumptions:

#### Multicollinearity

It is a type of linear interference or overlap test called Multicollinearity and interference indicates that two variables or more are strongly and specifically related to each other, which leads to weakness in the interpretation of relationship between variables. The VIF value considers an indication on the nonexistence of linear interference Multicollinearity problem between study variables, where if its value greater than 1 it will indicates no Multicollinearity problem between variables. Table (4) below shows that VIF test results for all study variables were greater than 1.

Variables	(VIF)
BDEXP	1.664
ACEXP	2.498
BG-4	1.655
BDIND	2.055
BDSIZ	2.087
LOSS	2.433
F-SIZ	2.561

#### Heteroskedasticity & Serial Correlation:

This test examine the existence level of Heteroskedasticity and Serial Correlation Heteroskedasticity, and it showed through table (5) below the nonexistence of correlational flexibility and serial correlation problems verified by the test result which came very small for variables, therefore the study of dependent variable effect on the independent variable would be free of any Heteroskedasticity and Serial Correlation, where the test results came (0.115-0.233) respectively, according to the Breusch-Pagan-Godfrey test. The nonexistence of correlations problems between the independent, dependent, and controlled variables give greater validity and reliability to the test results of study hypotheses, where there's no linear interference or Heteroskedasticity problem in the statistical analysis of variables which means that effect of each independent variable will have individual effect on the dependent variable.

(HTST) Heteroskedasticity	(SCO) Serial Correlation
.233	.115

## Outcomes

Table (6) shows linear Regression Analysis to detect impact of independent variables relationship(BDEXP&ACEXP) and controlled variables (BIG4, BDIND, BDSIZ, LOSS, FSIZ) on the dependent variable AQ, where the value of R-squared amounted to (0.664)with a significant p-value (0.000),and based on this resultthe independent variables explain (0.664)of the changes in internal AQ and means that any changes in BDEXP and ACEXP will improve AQ by (66%).

Variable	Coefficient	Std. Error	T-Statistic	Prob.
BDEXP	0.435	0.043	9.544	0.010
ACEXP	0.442	0.049	8.864	0.000
BG-4	0.209	0.047	8.112	0.020
BDIND	0.324	0.059	4.364	0.000
BrdSiz	-0.101	0.011	-2.132	0.654
LOSS	0.005	0.014	0.076	0.854
F-SIZ	0.314	0.022	18.235	0.011
(C)	5.335	0.202	59.225	0.000
(R)-Squared	.664	Mean Dep Variable		8.208
Adjusted R-Squared	.440	Durbin-Watson.		1.445
Prob(F-Statistic)	.001	(D.V)		AQ

Outcomes of statistical analysis showed a clear and positive impact between BDEXP&ACEXP and the improvement of external AQ, which confirmed by the testresults of relationship in table (3) and shows that financial and administrative BDEXP & ACEXP motivate external auditors to give the required professional care while practicing the auditing profession and to be very careful of these experiences for fear of failing to do the work that might lead to legal accountability. Corporate governance rules oblige companies to hire experienced and competent people, where these instructions are in the interest of management and owners and support the positivity of agency theory. Study results agree with the study results of (Yekini, 2021; Sharhan & Bora, 2020; Choi, et al., 2020; Khudhair, et al., 2019; Ghafran, et al., 2017), therefore researchers accept the correct hypothesis that calls for the existence of statistical significant relationship and impact between the BDEXP level and AQ, as well as the existence of positive and statistical significant relationship between the internal ACEXP and external AQ at the non-financial companies registered on ASE.

Study results showed a positive relationship and a clear impact of BIG4 role on the external AQ, and this indicates the validity of previous studies' results which confirm that audit services provided by large companies are of high quality, and statistically confirmed by the P-VALUE significance level of (0.000). At the same level, researchers found a significant positive correlation between BDIND and external AQ confirmed by P-VALUE of (0.000), which indicates the existence of independent external control over the performance of external audit and that this control is effective in making a quality control process. We also noticed from table (6) the existence of statistical significance positive relationship of the FSIZ variable on the internal AQ, where the larger FSIZ the greater the tasks placed on the external auditor and therefore leads to an increase in the external AQ, and these results agreed with the study results of (Alderman & Jollineau, 2020); (Sukma & Bernawati, 2019) & (Cheung, 2019).

In regard to the variable BdSiz, it had an inverse relationship with the external AQ where any increase in the BdSiz will lead to a decrease in the internal AQ, and any decrease in the BdSiz will lead to an increase in the external AQ, therefore the P-VALUE reached (0.278)

which is not statistically significant value, and this result agreed with the study results of (Alhababsah & Yekini, 2021); (Januarti, et al., 2020). Finally, there is no significant correlation between the LOSS variable and the external AQ, where the P-VALUE amounted to (0.922) which is not statistically significant, and this result agrees with the study results of (Bshayreh, et al., 2021).

## CONCLUSION & RECOMMENDATION

There is a need to develop the management theories that support the principles of accounting and auditing profession, where the external audit profession has greater privacy and independence than the profession of internal audit, and external auditors need to be provided by data from the management in order for them to express their neutral opinion about the financial statements validity and accuracy, which all done by the authentication of internal audit. Therefore, the internal ACEXP is very important in improving the external AQ, and the presence of independent internal auditors or the presence of ACEXP independent members will enhance both of the internal and external AQ. The administrative expertise represented by expertise in the fields of finance, accounting, and management create a pressure factor on the external auditor to work accurately and to adhere to the international audit criteria that control the quality of their performance and development.

The financial and management expertise, especially accounting are very essential for the BD members, where the marginal decisions issued by BD to be implemented with extreme accuracy, and the hypothesis says that one of the most important objectives of BD is to strengthen the financial position and results of company's business, therefore any defect or deviation that external auditors can't or weren't able to detect, the BDEXP members can do so. In our study on the Jordanian non-financial companies, we found that (68%) of board members have expertise in the management and finance, and that (82%) of the internal audit committees' members also have financial and management expertise, and both of them have an effective impact on the internal AQ of non-financial companies registered on ASE.

Study results may be explained at different ways while researchers interpret companies' results included in the study and make an attempt to adapt the theoretical framework of study variables to the study statistical results, and with the conviction that some results may be unpersuasive but researchers explain what is really happening. The corporate management try to abide to the rules and mechanisms of corporate governance in order to justify any criticisms that may be directed to them, where the detection of errors, fraud, and manipulation by external auditors consider important in improving the external AQ but something like that won't happen under inexperienced management and won't go in line with the reality of accounting and professional legislation. Therefore, the existence of BDEXP or ACEXP members shortens many distances between the work of external auditors and external AQ.

There is no doubt that economic environments in the countries of West Asia and North Africa are very similar, therefore it's possible to generalize the results of this study on all developing countries where its economies together form one large economy. The secondary data analysis has been used in this study, therefore researchers recommend conducting similar studies using questionnaires that will be distributed on targeted samples in these companies, and the study recommends the need to re-examine study variables in a better economic environment in terms of GNP. Study also recommends examining the modification of corporate governance mechanisms impact on the external AQ, and as an example the appointment of independent internal auditors and the appointment of corporate governance and mechanisms controller, and its impact on the external AQ. It is also possible to change the quality measurement of external AQ from auditing fees to the capability level of auditors to detect errors, fraud, or manipulation.

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