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Analysing Factors Related to Audit Fees in Good Corporate Governance Award Earning Firms

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This study aims to analyse the factors related to the amount of audit fees given by firms to auditors. The sample in this study includes all firms listed on the Indonesia Stock Exchange that received Good Corporate Governance (GCG) Awards during the 2011-2016 period (85 firms). The analysis technique used in this study is OLS regression analysis using SPSS software version 18. The results of this study indicate that the level of corporate governance is positively related to audit fees. This relationship suggests that firms with good governance tend to pay more auditors to obtain good audit quality, intending to preserve the firms' reputations. The study also found that firm performance, public accounting firm (PAF) size, and firm size were positively related to audit fees. However, the level of profitability is not related to audit fees. This research has implications for firms and auditors in determining the exact amount of audit fees.

Keywords: *Audit fee, Corporate governance, Firm performance, Audit firm size, Firm size, Profitability*

Introduction

A financial statement is a structured tool or media that provides financial information for an entity about a certain period. It is generally used to monitor the performance of the entity (Guay, 2016). Financial Accounting Standards (SAK) No. 1, paragraph 7 of the 2009 revision explained that in presenting financial statements, management must include four qualitative characteristics of financial statements that are understandable, relevant, reliable, and comparable. Financial statements play a vital role in entities, since they provide overviews of the capabilities of entities to carry out operational activities for the achievement of their objectives.

The presentation of financial statements can have a negative impact if the financial statements can cause asymmetrical information between management and shareholders. Bouckova (2015) states asymmetric information can arise when one party gets better information than another party. Management may be tempted to shift responsibility because shareholders may not be able to monitor and detect such opportunistic behaviour without additional costs (Jensen & Meckling, 1976). Therefore, this phenomenon raises the need for an assessment or guarantee from a third party of the financial statements made by management. The evaluation of the report disclosed by management will improve its quality and assurance levels so that the report will have value-added for the firm's stakeholders (Harymawan et al., 2020a).

According to Arens (2017), an audit is a systematic process of obtaining and evaluating evidence objectively. It concerns the assertion of economic actions and events to ensure a level of conformity among these assertions. Consequently, they can be accountable to the parties concerned. An auditor is required to have the ability to understand the criteria used and be able to determine the amount of evidence needed to support the conclusions they will make (Amiruddin, 2019; Habbe et al., 2019). An auditor must also have an independent mental attitude, because the information used to make decisions must be unbiased and free from errors or fraud (Harymawan et al., 2020b).

Today, more and more firms are asking for audit services to provide assurance to their shareholders. This creates greater opportunities for professional auditors to increase audit services. De Villiers (2016) states that competition among and rewards for audit services have become essential issues for regulators. Competition among PAFs to create qualified audit results is getting tougher. Audit quality is not only influenced by internal factors, such as experts, but also by external factors from PAFs (Nasih et al., 2020; Harymawan et al., 2019). One external factor that can affect audit quality is audit fees (DeAngelo, 1981). Auditors who have high service quality, many working hours, expert certification, and other values will undoubtedly charge more audit fees as well.

An audit fee is compensation in the form of money or goods given to an auditor in return for audit services that have been provided (Agoes, 2012; Mohammadi et al., 2018). The amount of an audit fee can vary depending on various factors, including the size of the firm being audited, the relevant PAF, or other factors considered necessary. Based on Bapepam-LK Regulation No. X.K.6, attached in the Decree of the Chairperson of the Capital Market and Financial Institution Supervisory Agency Number: KEP-431/BL/2012, explains that each financial statement of firms in Indonesia is required to include the audit fee that they pay to the PAF. The firm must consist of an institution's name and address that provides periodical services to an issuer as well as information about the services offered, fees, and the period of assignment that has been done.

Some previous studies explain that various factors can influence audit fees. Simunic (1980) states that audit fees are determined by the size of a firm, audit risk, and audit complexity. Other things can affect audit fees, namely the level of good corporate governance (Wahab, 2011; Sihombing et al., 2019; Hasibuan et al., 2017). In this case, corporate governance functions in ensuring the implementation of corporate strategy, overseeing management, and requiring accountability are the duties of the board of commissioners (Palestin, 2007). The supervisory responsibilities carried out by the board of commissioners can be assisted by an auditor as an independent party. It is necessary to increase audit fees to obtain audit results with good quality. Wu (2012) analyses the relationship between corporate governance and audit fees. The results show that audit fees are determined by corporate governance, big four PAF, total assets owned by a firm, the outstanding shares of the firm, losses incurred by the firm in the period to be audited, and the number of subsidiaries owned. Rusmanto and Waroruntu (2015) also reveal that the total assets held by a firm and the number of subsidiaries owned by the firm could also affect the amount of audit fees. On the other hand, big four PAF, losses suffered by the firm, the receivable turnover of the firm, inventory turnover of the firm, the industry segment of the firm, and the value of the outstanding shares do not have a significant relationship to the audit fee.

In Indonesia, the implementation of good corporate governance is still truncated compared to other countries. Based on the 2015 ASEAN Corporate Governance Awards research, of the 50 large firms in Southeast Asia, only two firms from Indonesia were included in the GCG category (Muda et al., 2018). From 2000-2010, Indonesia also lagged behind other countries in implementing good corporate governance. Seeing the low implementation of GCG in Indonesia, the government issued SOE Ministerial Regulation PER-01/MBU/2011, Article 2, paragraph 1, which requires SOEs to implement GCG consistently and sustainably. The existence of these regulations is expected to encourage not only SOEs but also all issuers that list their shares on the Indonesia Stock Exchange.

This study specifically aims to analyse the factors that relate to the amount of audit fees, including the level of corporate governance, firm performance, size of PAF, firm size, and profitability. This research was conducted on all firms listed on the IDX and won the Indonesia Most Trusted Firms Awards in 2011-2016. This award was held by the Indonesia Institute of Corporate Governance (IICG) as a form of appreciation and recognition to firms that are committed to implementing good corporate governance.

The results of this study indicate that level of corporate governance is positively and significantly related to audit fees. This result shows as a firm's corporate governance becomes better, the firm will be demanded to obtain higher audit quality for higher audit fees. Good audit quality is expected to enhance a firm's reputation. The study also found that firm performance, PAF size, and firm size were positively and significantly related to audit fees. Conversely, level of profitability is not related to audit fees. This study contributes to the audit fee literature by providing evidence related to factors that can increase the amount of audit fees to be received by auditors. This research can also be a consideration for firms and auditors in determining the exact amount of an audit fee.

The research will be explained using the following structure: Section 2 contains research on developing research hypotheses; Section 3 includes explanations for variables and samples as well as research models; Section 4 contains empirical analysis and the results of hypothesis testing; and Section 5 provides conclusions from the study, including suggestions for further research.

Literature Review

The Relationship Between Corporate Governance and Audit Fees

Corporate governance has main principles, namely transparency, accountability, fairness, responsibility, and responsiveness (Permata et al., 2012). One crucial element of corporate governance is transparency or openness, which is the act of explaining everything done by firm management to the public (Iskander & Chamlou, 2000). The application of GCG is useful to increase the added value of a firm as the firm is required to run with applicable regulations. Corporate governance is a set of rules governing the relationships among shareholders, firm management, creditors, the government, employees, and other internal and external stakeholders relating to their rights and obligations. This can create added value for all stakeholders.

According to the Organisation for Economic Cooperation and Development (OECD), corporate governance is defined as a set of relationships between firm management, boards and shareholders, and other parties who have an interest in a firm. Corporate governance also requires a particular structure to achieve goals and monitor performance. Permata et al. (2012) explain that in implementing GCG, each firm must have an independent audit committee and board of commissioners. A board of commissioners must oversee management and must protect investors. In carrying out its responsibilities, the board of commissioners can be assisted by auditors in producing qualified financial statements.

Several previous studies have shown that corporate governance has a positive and significant relationship with audit fees. Wahab et al. (2011) explain that corporate governance, firm size, political connections, percentage of institutional investor share ownership, number of subsidiaries, and profitability had a positive and significant relationship with audit fees.

Prayugi (2015) found that corporate governance and earnings management had a positive relationship with audit fees. Conversely, corporate governance has a negative and significant relationship with audit fees that have been charged (Wu, 2012; Haniffa et al., 2006). Firms with decent corporate governance tend to be demanded to produce high audit quality by investors. Therefore, to obtain sufficient audit quality, firms are willing to pay higher audit fees. Thus, the hypothesis formulated in this study is

H1: Corporate governance perception has a positive relationship with audit fees.

The Relationship Between Firm Performances and Audit Fees

Jensen and Meckling (1976) explain agency relationship is a concept that describes a contract between a principal and agent to perform several services and provide authority in decision making. Principals are represented by investors or shareholders of a firm, while agents are represented by management. The core of an agency relationship is the separation of functions between share ownership by investors or shareholders and the firm's private parties, namely management. Due to conflicts of interest that occur within the firm, many parties realise that financial statements are very vulnerable to manipulation by management (Sukamulja, 2004).

High firm performance makes firms continue to strive to become larger. Exceptional firm performance must be published to investors and the public, but as mentioned before, this performance is quite questionable, especially if the performance is too high. Therefore, there exists a need for a qualified audit process to investigate the profit figures of firms acutely. This will certainly increase the audit fee charged. Several previous studies have shown that firm performance has a positive relationship with audit fees (Pucheta-Martínez & García-Meca, 2014; Farouk & Hassan, 2014). Rusmanto and Waworuntu (2015) revealed that the total assets owned by a firm and the number of subsidiaries owned by the firm relate to the audit fee. Wu (2012) also found that firm performance was positively related to audit fees. Thus, the hypothesis formulated in this study is

H2: Firm performance has a positive relationship with audit fees.

The Relationship Between PAF Size and Audit Fees

A PAF is a business entity that has obtained a permit from the Minister of Finance as a forum for public accountants in providing their services. The Minister of Finance's Regulation No. 17/PMK.01/2008 describes what services can be provided by PAF. These include audit and non-audit services, such as accounting, finance, management, compilation, taxation, and consultation following the competencies of public accountants and applicable laws and regulations. In Indonesia, large PAFs are commonly known as The Big Four. The Big Four are the group of four of the largest international accounting and professional services firms.

They handle the majority of audit work for public and private firms. The Big Four consists of Ernst & Young, Delloite Touche Tohmatsu, KPMG, and PWC.

Several previous studies have shown that large PAFs tend to receive higher audit fees than smaller firms (Wu, 2012). Kikhia (2015) also explains that PAF size had a significant relationship with audit fees, while a firm's financial risk, profitability, and audit tenure have no significant effect. Simunic (1985) and Rusmanto and Waoruntu (2015) found an insignificant relationship between the size of PAF and audit fees.

Large PAFs that are usually synonymous with the big four PAFs have different audit qualities from small to medium PAFs. The difference can be seen in the auditors' competence, technology used, independence maintained by the PAF, and so forth. Big four PAFs are known as international standard PAFs and PAFs that have the highest income from year to year. Firms that use the services of a big four PAF will be charged an audit fee that is greater than a small to medium PAF. Thus, the hypothesis formulated in this study is

H3: PAFs size has a positive relationship with audit fees.

The Relationship Between Firm Size and Audit Fees

The size of a firm regards the grouping of firms into large, medium, and small firms. This firm scale is a measure used to reflect the size of a firm based on total firm assets (Suwito & Herawaty, 2005). Firm size is an indicator that can show the condition or characteristics of an organisation. Several parameters can be used to determine the size of a firm, such as the number of employees employed in the firm to carry out firm operational activities, the number of assets owned by the firm, the total sales achieved by the firm in a period, and the number of shares outstanding.

Several studies related to firm size and its relationship with audit fees have been carried out. Wu (2012) and Pong et al. (2007) explain that larger firms tend to pay higher audit fees than smaller firms. The size of a firm and the number of subsidiaries have a significant effect on audit fees. Hay (2006) also found that firm size was positively related to the amount of audit fees. However, in Al-Duwaila and Al-Mutairi's (2017) research in Kuwait, there is no significant relationship between firm size and audit fees.

The size of a firm is the main factor that determines the audit fee paid by the firm. The size of the firm, in this case, can be seen from various things, such as total assets owned, total sales, number of transactions, and factors. This study used total assets held as a firm size proxy because assets represent a firm's wealth. Firms that have many assets increase audit complexity so they can increase audit fees. Thus, the hypothesis formulated in this study is

H4: Firm size has a positive relationship with audit fees.

The Relationship Between Profitability and Audit Fees

Profitability ratios, also known as vulnerability ratios, are ratios to assess a firm's ability to make a profit (Kasmir, 2012). These ratios also provide a measure of the level of management effectiveness of a firm. This is shown by the profit generated from sales and investment income. Profitability ratios can be used to determine the level of profits obtained by a firm during one period and profit growth over time.

Profitability experienced by a firm in a certain period can indicate that the firm's performance is sufficient, as it was not incurred losses during that particular period. Firms that have exaggerated profit figures require validation to confirm whether the profits achieved by the firm are actual or just manipulation by management so their performance looks trustworthy. If more effort is required from an auditor, the audit fee paid will be increased.

Previous studies regarding the relationship between profitability and audit fees have been conducted. Fachriyah (2011) shows that corporate profitability is positively related to audit fees. This means that if a firm makes a profit, the audit fee paid to the auditor will be higher. In contrast, research conducted by Hay (2006) shows an insignificant relationship between profitability and audit fees. Thus, the hypothesis formulated in this study is

H5: Profitability has a positive relationship with audit fees.

Research Methodology

Sample and Data Sources

The sample used in this study consisted of all firms listed on the Indonesia Stock Exchange and that won the GCG Award from the Indonesia Institute of Corporate Governance (IICG), which was published by SWA magazine during 2011-2016. This study uses firms that won GCG Awards as GCG implementation in Indonesia is still very low. Indonesia must continue to strive to catch up with other countries. Sources of data in this study were obtained through annual reports and firm financial statements. These can be obtained through the official website of the IDX or the official website of each firm. Firm age data was taken from the IDX's official website by seeing when the firm first conducted an IPO. The sample selection was made using the purposive sampling method. Table 1 explains the sample selection criteria used.

Table 1: Sample Selection Criteria

Criteria	2011	2012	2013	2014	2015	2016	Amount
Firms that obtain GCG Award from IICG.	40	42	31	23	30	30	196
Firms not listed in IDX.	(18)	(17)	(15)	(11)	(15)	(15)	(91)
Firms that do not publish their financial statements or annual reports.	(0)	(2)	(0)	(0)	(1)	(4)	(7)
Firms that do not disclose the audit fees charged.	(6)	(6)	(0)	(1)	(0)	(0)	(13)
Final observation during time period.	16	17	16	11	14	11	85

Variable Operationalisation

The dependent variable used in this study was the audit fee (AUDFEE). Audit fees were measured using the natural logarithm of the total audit fee paid by the firm to the PAF. The independent variables used in this study included the level of corporate governance, firm performance, the size of the PAF, the size of the firm, and the level of profitability. The Corporate Governance Perception Index (CGPI) was measured using the percentage of corporate governance index listed in SWA magazine. The higher the rate of corporate governance index, the better the GCG implementation by the firm. Then, firms' performances (TOBINSQ) were measured by comparing the total market value and book value of equity with total assets. The size of the PAF was measured using a dummy variable. The latter was given a value of 1 if the PAF was included in the Big 4 category and a value of 0 if the PAF was included in the non-Big 4 category. The size of firms (SIZE) was measured using the natural logarithm of total assets. The level of firm profitability (PROFIT) was measured using a return on assets obtained by dividing profit after tax by total assets.

This study also used several control variables that have been proven to relate to the level of audit fees, namely the number of subsidiaries, firm age, and the industrial sector. The number of subsidiaries (SUB) was the total number of subsidiaries owned. Firm age (AGE) was obtained by reducing the year of research by the year a firm conducted an IPO. The industrial sector of a firm (SECTOR) was measured using a dummy variable. The latter was given a value of 1 if the firm was categorised in the service sector and a value of 0 if the firm was categorised in the non-service industry.

Methodology

This study used OLS regression analysis techniques to examine the relationship between the level of corporate governance, firm performance, firm size, PAF size, and profitability and the amount of audit fees paid by firms. The analysis was performed using SPSS 18 software. Regression models in this study are as follows:

$$AUDFEE = a + b_1\ CGPI + b_2\ TOBINSQ + b_3\ PAF + b_4\ SIZE + b_5\ PROFIT + b_6\ SUB + b_7\ AGE + b_8\ SECTOR + e \quad (1)$$

Results and Discussion

Descriptive Statistics

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Audfee	85	19.209	27.526	21.902	1.317
Cgpi	85	66.440	93.290	83.489	6.239
Tobinsq	85	0.553	3.765	1.373	0.599
Paf	85	0	1	0.800	0.402
Size	85	28.332	34.445	31.688	1.616
Profit	85	-0.558	0.289	0.031	0.108
Sub	85	0	93	13.190	16.064
Age	85	0	27	13.410	7.261
Sector	85	0	1	0.750	0.434

Table 2 shows the descriptive statistical results of the variables in this study. The average value of the audit fee variable is 21.902, with a standard deviation of 1.317. Furthermore, the percentage of corporate governance index obtained by the firm is 83.498%. The average value of a firm's performance is 1.373, with a standard deviation of 0.599. An average of 80% of firms use the Big 4 PAF. The firm size variable has an average value of 31.688, and profitability has an average value of 0.031. The average number of subsidiary firms is 13.190. The average firm age is 13.410, and as many as 75% of firms are engaged in services.

OLS Regression Analysis Results

Table 3: OLS Regression Analysis Results

Model	**Coef.**	**t**	**Sig.**
(Constant)	8.586	6.752	0.000
CGPI	0.050	3.922	0.000
TOBINSQ	0.247	2.778	0.007
KAP	0.887	4.575	0.000
SIZE	0.195	3.655	0.000
PROFIT	0.937	1.654	0.102

SUBS	0.020	4.915	0.000
AGE	0.056	6.803	0.000
SECTOR	0.956	5.875	0.000
R square	0.840		
Adjusted R square	0.822		
N	85		

Table 3 shows the results of the OLS regression used to examine the relationship between the level of corporate governance, firm performance, the size of the PAF, the size of the firm, and the level of profitability and audit fees. The R square value or the coefficient of determination is 0.840. This indicates that the regression model can explain the relationship between corporate governance, firm performance, PAF size, firm size, and the level of profitability and an audit fee of 84%, while the remaining 16% is explained by other variables excluded in the research model.

Corporate Governance and Audit Fees

Based on the results in Table 3, the coefficient value of the CGPI variable is 0.050 (t = 3.922) and significant at the 1% level. This shows that corporate governance has a positive and statistically significant relationship with audit fees. Thus, the first research hypothesis (H1) is confirmed. The results of this study indicate that with better corporate governance, firms will pay higher audit fees to obtain better audit quality. One of the provisions in GCG is that firms are required to have an independent board of commissioners. The better the GCG level of a firm, the better the performance of the board of commissioners. In relation to supervising the board of commissioners, it is also mandatory to maintain the quality of financial statements for stakeholders, which maintains a firm's reputation (Aryani, 2011).

For this reason, the board of commissioners needs qualified auditing services to support the board of commissioners' performance. Thus, firms with strong corporate governance also tend to be demanded to produce high audit quality by investors, resulting in increased audit fees. The results of this study are in line with previous research (Wahab et al., 2011; Prayugi, 2015), which shows that corporate governance is positively related to the amount of audit fees paid by firms.

Firm Performance and Audit Fees

The coefficient value of the TOBINSQ variable in Table 3 is 0.247 (t = 2.778) and significant at the 1% level. This shows that firm performance has a positive and statistically significant relationship with audit fees. Thus, the second research hypothesis (H2) is supported. The results of this study indicate that the higher a firm's performance, the higher the audit fee to obtain better audit quality. Exceptional firm performance ensures firms can continue to strive to become larger. Large firms increase the complexity of audits through the number of assets and transactions in the firm's business activities. The complexity of an audit will affect the audit fee to be paid by the firm (Wu, 2012; Rusmanto & Waworuntu, 2015). Firms that obtain high firm performance tend to disclose this to investors and the public. Therefore, to validate their financial statements, firms need to use qualified audit services. This increases the audit fees paid by firms to auditors (Pucheta-Martínez & García-Meca, 2014).

PAF Size and Audit Fees

The results in Table 3 show that the PAF variable coefficient value is 0.887 ($t = 4.575$) and significant at the 1% level. This indicates that the size of the PAF has a positive and statistically significant relationship with audit fees. Thus, the third research hypothesis (H3) is supported. The results of this study indicate that the greater the size of a PAF, the higher the audit fees paid by clients to obtain better audit quality. Big 4 PAFs tend to charge higher rates than non-big 4 PAFs. In the selection of audit services, a Big 4 PAF may have a cooperative relationship with a foreign PAF. This will result in a better assessment in the eyes of stakeholders when compared to an audit by a PAF other than the Big 4. Big 4 PAFs certainly have different audit quality from small to medium PAFs. The difference can be seen in the auditors' competence, technology used, independence of the PAF being maintained, and factors. Hence, the risk of failure in conducting an audit is smaller. Therefore, it is natural that the audit fee they charge is higher. The results of this study are in line with the results of research by Xingze Wu (2012) and Al-Duwaila and Al-Mutairi (2017).

Firm Size and Audit Fees

Based on the results in Table 3, the coefficient value of the SIZE variable is 0.195 ($t = 3.655$) and significant at the 1% level. This shows that corporate governance has a positive and statistically significant relationship with audit fees. Thus, the fourth research hypothesis (H4) is supported. The results of this study indicate that the larger the size of a firm, the more complex the audit process is. Firms pay higher audit fees to obtain better audit quality. The size of a firm is the primary consideration that determines the audit fee paid by the firm to the auditor (Wu, 2012; Pong, 2007). Firm size in this study is seen through the total assets owned. So many assets increase complexity and audit risk. Longer audit time is required, causing the imposition of high audit fees. The results of this study support several previous studies, which found that firm size was positively related to the amount of audit fees paid by firms (Hay, 2006; Rusmanto & Waworuntu, 2015).

Profitability and Audit Fees

The coefficient value of the PROFIT variable is 0.937 ($t = 1.654$) but not significant. This shows that level of profitability is not related to audit fees. Thus, the fifth research hypothesis (H5) is not supported. The results of this study indicate that a firm's profitability is not related to the firm's willingness to pay audit fees. This is because in assessing the profitability of a firm, this study uses return on assets (ROA), which uses net income divided by total assets. In this case, the net profit is not the main factor in seeing how big the firm is. If the firm suffers a loss due to expansion or other activities that make the assets increase, the net income figure will not automatically and significantly affect the audit fee. This relationship exists because the number of assets that the firm has remains large. The results of this research are in line with Hay's (2006) study.

Conclusion

This study aims to analyse the factors that relate to the amount of audit fees given by firms to auditors. The analysis was conducted for all firms that were listed on the Indonesia Stock Exchange and won the GCG Award from the Indonesia Institute of Corporate Governance (IICG), which was published by SWA magazine during 2011-2016. The results showed that the Corporate Governance Perception Index was positively related to audit fees. This indicates that firms with good governance tend to pay more auditors to obtain decent audit quality. This study also found that firm performance, PAF size, and firm size were positively related to audit fee levels, while levels of profitability showed an insignificant relationship with audit fees.

This study has limitations regarding the number of samples because it only uses a sample of GCG Award recipient firms. This study only uses a few control variables to control endogeneity. Future research can expand the sample to all firms listed on the IDX in all industrial sector, to strengthen the generalisability of this study. Future studies can also control other variables that affect audit fees, such as CEO characteristics or the number of corporate audit committees. This research is expected to encourage firms to be able to implement GCG and register their firms in IICG. The results of this study are expected to provide consideration for firms and PAF related to factors that need to be considered in determining audit fees.

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