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An Analysis of The Effect of Corporate Characteristics and Auditor Characteristics on Audit Fee

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ABSTRACT

The title of this study is an analysis of the effect of corporate characteristics and auditor characteristics on the audit fee. The study aims to prove that the audit fee is influenced by the company characteristics (company size, business complexity, risk, profitability) and the manufacturing companies listed on the Stock Exchange in 2010-2014.

The technique of sampling with purposive sampling obtains 88 companies, which is relevant to the multiple regression analysis tools. The results of this study indicate the significant effect among variables company size, the company profitability, and the auditor size toward the audit fee. However, the company's complexity, the company's risk, and audit tenure have no significant effect on the audit fee.

Keywords:
audit fees, company size, complexity of the company, audit tenure, environmental performance and auditor size

INTRODUCTION

Indonesian Public Accountant Institute (IAPI) has regulated the determination of audit fee in Indonesia by issuing The Decree of Chairman of Indonesian Public Accountant Institute Number: KEP.024/IAPI/VII/2008. The content of this Decree provides guidance that audit fee is determined based on the considerations as follows:

a. Corporate needs
b. Duties and responsibility according to law (statutory duties)
c. Independency
d. Expertise level, Responsibility attached on the job, as well as the job complexity
e. The amount of time needed
f. The base of agreed fee determination.

The decree above can be a reference for public accountant firms in Indonesia to determine the audit fee. It only gives description of what can be the base of audit fee determination, but there is no firm determination from the government to supervise the amount of audit fee that is charged to the client considering the audit fee really affects of the independency of auditor. Therefore, this study is willing to prove what factors becoming the base in determining audit fee. The testing in this study will propose some factors based on the decree above and also outside the decree above. The accounting standard and limiting the practice of discretionary accounting by the agent agen (Ng, 1978). In line with the theory in Watts and Zimmerman (1990), it explained that efficient audit is when the auditor is competent and independent. One of characteristics of independent auditor is the determination of audit fee that is suitable when conducting engagement with his/her client.

Audit Fee Model

Audit Fee Model was firstly introduced by Simunic (1980) and developed by Ramzy (1988) where this model classifies audit fee factor according to corporate characteristics, auditor characteristics, and general factor.

THEORETICAL FRAMEWORK

Agency Theory

Jensen and Meckling firstly proposed the Agency Theory in 1976 stating that agency theory is a contractual relationship between capital owner party (principal), and other parties (agent) to conduct corporate operational activities on behalf of the capital owner. The contractual relationship stated that the principal hands the authority of decision making to the agent. Agency problems appear due to the lack of principal trust as the result of asymmetry information and the different motif of both parties.

Godfrey, et al (2010) explained the different interest of principal and agent that eventually triggers the emergence of agency cost. One example of angency costs is monitoring cost used to measure, observe, and control the behaviour of agent. Audit fee is the example of monitoring cost. There are two main functions of audit which are detecting the disobedience toward the applied accounting standard and limiting the practice of discretionary accounting by the agent agen (Ng, 1978). In line with the theory in Watts and Zimmerman (1990), it explained that efficient audit is when the auditor is competent and independent. One of characteristics of independent auditor is the determination of audit fee that is suitable when conducting engagement with client.

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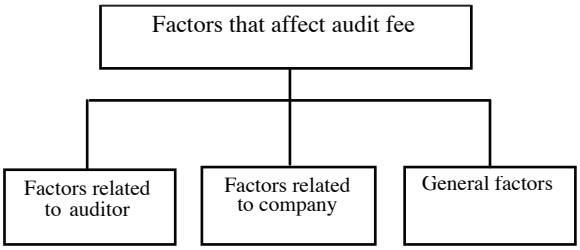

Figure 1. Audit Fee Model

a. Factors Related to Auditor
   The number of staffs who involve in the process of audit, knowledge, experience, and expertise owned by auditor, facilities used from the auditor company and also the reputation of auditor can be the audit fee determinant.
b. Factors Related to Company
   Company size, type of business, quality of corporate internal control system, service value that is asked by company, ability to pay company (solvability), end of the accounting period, and company reputation are the audit fee determinant.
c. General Factors
   Condition of audit service market, inflation, and government regulation can affect audit fee determination in this context.

Based on the Audit Fee Model over the division of determinant factors of audit fee will be done based on the characteristics of audit and the characteristics of company. The factors related to auditor consist of audit tenure and auditor size. Meanwhile, factors related to company consist of size, complexity, risk, and profitability of the company.

Audit Fee

Amba and Alhajeri (2015) and Jubb et al (1996) defined audit fee as the cost that will be paid by company to external auditor related the the job of audit and assurance services. According to Agoes (2011) the amount of audit fee can be varied depending on among others are assignment risk, assignment complexity, service complexity that is given, expertise level that is needed to conduct the service, cost structure of related PAF and other professional considerations.

Company Size

Company size is the most consideration in the determination of audit fee, Kikhia (2015) and Taylor & Simon (1999). The more times needed related to the object that must be examined, the more it would be the main determinant in the determination of audit fee. According to the model of audit fee determinant that is proposed by Ramzy (1988), it is stated that the size of company is the most dominant factor in audit fee determination. The model also stated that the size of company is classified in determinant factor that affects audit fee determination directly.

Complexity of Company

Base on El Gammal (2012) Complexity of company is another factor that affects the duration used during the implementation of audit, because the level of audit rating complexity will affect the audit requirements. Therefore, the company with higher complexity level will be charged higher fee (Simunic, 1980). The model of audit fee determination, Ramzy (1988),

is stated that complexity of company can affect audit fee determination directly. The higher complexity of company, the more effort that must be done by auditor in examining the financial report in order to obtain audit opinion.

Company Risk

The risk level in audit implementation can be considered in audit fee determination because it is related to auditor responsibility. Higher risk in audit implementation means bigger responsibility where it is reasonable to determine higher audit fee. The study from Sun and Liu (2011) in Kikhia (2015) showed the result that higher risk of audit would demand bigger effort in conducting testing, and more effective procedure of application.

Profitability of Company

Company having high profitability level will pay more audit fee to external auditor to see the evidence that higher profit will be required a accuracy test that is done to identify earnings and charge, so the audit implementation needs more time (Baldacchino et al, 2014) and Joshi & Al-Bastaki (2000).

Audit Tenure

Belen et al, (2014) in Kikhia (2015) in their study showed that audit tenure affects audit opinion where if company decides to conduct engagement change with PAF, it is believed to be able to be charged bigger audit fee, because new PAF will try to know the type and characteristics of company that need more working hours if staying in the PAF that has been audited the previous year. Bedard and Johnstone (2010) in Kikhia (2015) examined that there is relationship between audit tenure, audit planning, and audit fee.

Auditor Size

Baldacchino et al, 2014 showed the existence of relationship between auditor size and audit fee that was determined by a study in Lebanon. Generally, its size is from Big Four and Non-Big Four. This study shows that Big Four dominates the needs of audit service on a big company because of its reputation. Therefore, the audit fee of Big Four PAF is higher than the auditor of Non-Big Four.

Hypothesis Development

The Effect of Company Size on Audit Fee

The previous studies such as Simunic (1980), Kikhia (2015), Ramzy (1988), Baldacchino et al (2014) and Urhoghide and Izedonmi (2015) shows that Size of company is the main factor in determining Audit Fee. The bigger size of company, the bigger networking of company both in the country and abroad. The wide networking eventually will demand company to use an advanced technology for the company operational efficiency. The use of advanced technology that will demand auditor to cooperate with the experts in the field of IT in audit. Because the auditor cooperates with the experts of this field, it will add the audit fee charged to the company. Therefore, in this study, there is hypothesis as follows:

H_1= Company size positively affects audit fee

The Effect of Company Complexity on Audit Fee

There is a different result on the effect of company complexity toward the determination of Audit Fee. A positive relationship is shown on the study of Baldacchino et al (2014), Basiodis and fifi (2004), Ramzy (1988) and Shammari et al (2008). The researcher takes variable

of company complexity because the relationship of audit job toward difficulty and complexity level faced by each auditor in examination is inevitable. One of the most common complexity measurements used in the previous studies is based on the size of account receivable and inventories. It is believed that with the size of account receivable and inventories of the company shows more complex and complicated examination faced by auditor. The complexity is viewed from the number of precedures must be done to examine the equity of account receivable and inventories. More examinations that must be done trigger bigger audit fee. Therefore, in this study, the researcher proposes hypothesis as follow:

H_2= Complexity of company positively affects audit fee

The Effect of Company Risk toward Audit Fee

A different result is shown on the risk of company and audit fee. In the study by Francis and Stokes (1986) in Shammari et al (2008), it shows the positive effect of company risk will affect the company. Meanwhile, in the study of Kikhia (2015), the effect of company risk is negative, even in the study of Shammari et al (2008), it shows that there is no significant effect on audit fee.

The variable of risk is believed to have effect on the determination of audit fee. It is because when the auditor is facing the company that has financial risk, he/she will be careful in conducting examination until the final result in audit opinion making. When it is known that the company has high financial risk, the auditor must be very careful or even add examination to produce accurate result. Therefore, the researcher proposes the third hypothesis as follows:

H_3= Company risk positively affects audit fee

The Effect of Profitability on Audit Fee

There is a different result on some studies about this variable. In the studies from Kikhia (2015), Baldacchino et al (2014), Basiodis and fifi (2004) and Urhoghide and Izedonmi (2015), they show the positive effect on audit fee. This examination will need additional time because the complexity of separation in one raw material into many product variants. This additional hour will cause the amount of audit fee charged to the company will increase. This different result makes the researcher wants to take profitability as a variable and make a hypothesis as follows:

H_4= Profitability positively affects audit fee

The Effect of Audit Tenure on Audit Fee

In the study from Urhoghige and Izedonmi (2015), it shows the positive effect of tenure on the determination of audit fee. Meanwhile, other studies such as Simunic (1980) and Kikhia (2015) show that there is no significant effect. The change of auditor can cause the company must pay higher audit fee compared to when not conducting auditor change. The higher cost occurs is due to the auditor who must recognize the characteristics of the previous company that newly handled. It will need additional time to past this stage. The different results in some studies motivate the researcher to examine the effect of this variable. From the background above, the researcher proposes the hypothesis:

H_5= Audit tenure positively affects audit fee

The Effect of Auditor Size on Audit Fee

The previous studies also have different results related to this variable. In the studies from Kikhia (2015), Ulhaq and Leghari (2015), Urhoghide and Izedonmi (2015) and Baldacchino et al (2014), they show the significant effect on audit fee determination. Meanwhile, in the study from Simunic (1980), the relationship of auditor size and audit fee is negative. In the studies from Titshabona (2014) and Shammari et al (2008), their results are not significant. PAFs that are affiliated with Big-four PAF are considered more prestige, thus, big companies will conduct with Big-four PAFs. Audit fee difference will be bigger because each year, PAFs that are affiliated with Big-four will pay royalty to foreign companies that then will make each audit fee charged bigger. Therefore, the researcher wants to propose the hypothesis as follows:

H_6= Auditor size positively affects audit fee

Research samples

This study uses sample of manufacturing companies listed on Indonesia Stock Index from 2010-2014. Based on the sampling by using Purposive Judgement Sampling, there are 41 companies with 88 samples in the years of observations that fulfill the criteria of sampling. The sampling process is based on the criteria presented on Table 1.

METHODS

Population and Sample

Population in this study is large companies listed in Indonesian Stock Exchange (IDX) in 2011 – 2013. Sample selection in this study is done by using purposive sampling method. The total companies listed in Indonesian Stock Exchange (IDX) in 2013 is 517 companies. Based on criteria of purposive sampling used, in this study, there are only 121 companies as the sample of this study from 2011 – 2013.

Data used in this study are secondary data. Study data are taken from company's annual report that is audited and published consencutively during 2011 – 2013. Data are taken from: Indonesian Stock Exchange, www.idx.co.id. Method used in this study is documentary method.

Study Variable and Operational Definition

Variables in this study are classified in 3, which are independent variable, dependent variable, and intervening variable. Independent variable in this study is: ownership structure that is proxied with managerial ownership and institutional ownership, with the reason that both ownership structures are mostly used by companies in Indonesia.

For measuring managerial ownership, dummy variable is used where if in the

Table 1. Sampling Process

No.	Criteria	Total
1.	The number of financial reports that report audit fee during the period of 2010-214	93
2.	Incomplete financial report	(5)
The number of sample in the period of study		88

Table 2. Measurements of Research Variables

No	Code	Name of Variable	Measurement
1	AUFEE	Audit Fee	Ln Audit Fee
2	LnASST	Company Size	Ln Total Assets
3	KOMP	Complexity of Company	Account Receivable + Inventories / Total Assets
4	RISK	Company Risk	Altman Bankruptcy Prediction Model
5	PROFIT	Profitability of Company	Net Profit Before Tax / Total Assets
6	TENURE	Audit Tenure	1 if replacing PAF, 0 if not
7	BIGFOUR	Auditor Size	1 of Big Four PAF, 0 if not

Table 3. Descriptive Statistics

	AUFEE	ASST	KOMP	RISK	PROFIT	TENURE	BIG FOUR
N Valid	88	88	88	88	88	88	88
Missing	0	0	0	0	0	0	0
Mean	20.175	28.516	0.3226	1.5909	0.0771	0.1818	0.5341
Std. Deviation	1.1657	1.4391	0.1673	0.8528	0.08852	0.3879	0.5017
Minimum	17.99	25.88	0.01	1	-0.1	0	0
Maximum	22.85	32.08	0.66	3	0.27	1	1

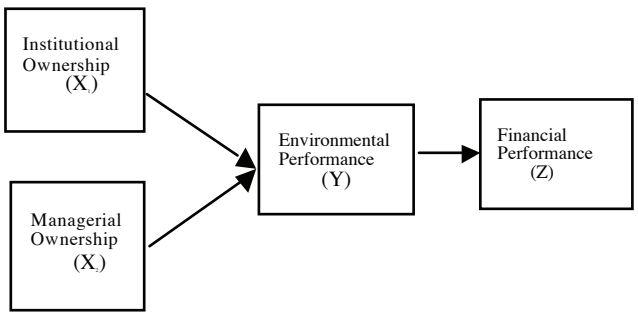

Figure 2. Framework

company there is managerial ownership, it is given score 1 and if there is no managerial ownership, it is given score 0. Dummy variable is used because some companies as the sample do not have managerial ownership, so it does not reduce the number of sample having institutional ownership measured by the percentage of ownership with a formula as the following:

$$\text{Institusional Ownership} = \frac{\text{Total Institutional Share}}{\text{Total Issue Share}} \text{x } 100\%$$

Intervening variable in this study is environmental performance. Environmental performance measured by using PROPER evaluation ratings from ministry of environment consisting of 5 categories which are: gold with score 5, green with score 4, blue with score 3, red with score 2, and black with score 1. For companies that have many branches or have more than 1 repository, PROPER ratings will be scored averagely. Its dependent variable is financial performance that is proxied with Return on Assets (ROA), efficiency level, and asset effectiveness in producing income or how much nett income obtained from total assets owned by the company. ROA is calculated by dividing income after tax with total assets and multiplied by a hundred percent.

$$\text{ROA} = \frac{\text{Net Income}}{\text{TotalAsset}}$$

In this study, control variable of company's size is used. Size of company is a scale used in determining how big or small a company is. According to Brigham and Houston (2006), the size of company that will be used is the total assets.

Analysis Method

Analysis method used in this study is multiple linear regression models. Regression model obtained from Ordinary Least Square – OLS is a regression model that produces Best Linear Unbias Estimate – BLUE. This condition will happen when some classical assumptions are completed. OLS technique used is considered more efficient compared to Generalized Least Squares or Maximum Likelihood. Then, OLS technique requires that the total data used must be larger than the total all variables involved in the model (Gujarati, 2010). In this study the total data used is 121 observations (n = 121), while model 1 with total variables of 3 and model 2 with only 1 mean that OLS requirement is completed.

Statistical Model /Econometric

To illustrate the structural relationship between variables, equation model is used, including:

Model 1: Environmental Performance= f(IO, MO, TA).

Model 2: Financial Performance = f (EP).

Stochastic model used in each model is as the following:

Model 1: $KL = \alpha + \beta_1 KI + \beta_2 KM + \beta_3 TA + \varepsilon$

Model 2: $ROA = \alpha + \beta_1 KL + \varepsilon$

Where:

EP : Environmental Performance
ROA : Return on Assets
IO : Institutional Ownership
MO : Managerial Ownership (dummy)
TA : Total assets (control variable)
β : Regression Coefficient
ε : error term

Hypothesis Testing

Hypothesis testing is done by conducting model test (F statistic test). F statistic test is used to investigate whether all independent variables put in the model have effect togetheron dependent variables at significant level of 0.05. Moreover, t test is also done. T statistic test is used to test hypothesis partially by determining of 0.05..

RESULTS AND DISCUSSION

Result of Multiple Linear Regression Analysis

Multiple regression analysis in this study is to test the effect of managerial ownership, institutional ownership, and size of company on environmental performance and its implication towards financial performance. Test is done by two stages in accordance with model of study.

Discussion

The Effect of Managerial Ownership, Institutional Ownership on Environmental Performance.

In this study, managerial ownership structure is measured by using dummy variable. Hypothesis testing result obtains that H_1 is accepted showing that managerial ownership statistically affects positively and significantly the environmental performance with probability of 0.002 or lower than level of significance 0.05 (0.002 < 0.05) and coefficient of 1.632. Statistically, positive beta coefficient value shows the existence of unidirectional effect meaning that the higher managerial ownership, the higher environmental performance.

This result is in line with Gray e. al (1995), explaining that manager will be encouraged to conduct anything that can increase corporate value, especially when manager is not only company's manager, but also as owner, by increasing environmental performance, it will increase community attention to the company. In the last few years, it also makes companies starting to change their behaviours in operating their business for corporate legitimacy and reputation. To keep corporate reputation, it cannot be separated from the role of stakeholders. Therefore, appropriately, company also pays attention to its stakeholders. It is in line with stakeholder theory.

The result of this study supports the result of study conducted by Murwaningsari (2009) showing that there is effect of managerial ownership on corporate social responsibility, but this result is different from Earnhart, Lubomir (2006) showing that managerial ownership does not affect environmental performance.

Institutional ownership structure is measured with the total percentage of ownership. Hypothesis testing result obtained is that H_2 is accepted showing that institutional ownership statistically affects positively and significantly environmental performance with

Table 4. Regression Analysis of Model 1

Model	Sum of Squares	df	Mean Squares	F	p-value
Regression	124.560	3	41.520	6.987	0.000
Residual	695.225	117	5.942		
Total	819.785	120			

And the partial test for the parameters in model 1 are:

Table 5. The estimation and test of the parameters in Model 1

Source of Variation	Parameter Estimate	T-test	Pvalue
Constrant	2.562	3.664	0.000
KM	1.632	3.188	0.002
KL	0.024	2.463	0.015
TA	0.536	2.358	0.020

Thus, the estimation of the model 1 is given below:

EP = 2.562 + 1.632 IO+ 0.024 MO+ 0.536 TA.

probability of 0.015or lower than level of significance of 0.05 (0.015< 0,05) and coefficient of 0.24. Statistically, positive beta coefficient valueshows that there is unidirectional effect meaning that the higher institutional ownership, the higher environmental performance. The existence of institutional investor is regarded able to monitor effectively each decision done by management because institutional investor is involved in strategic corporate decision-making, including decision in conducting environmental management.

Environmental performance means to show corporate awareness on environment. It is also related to stakeholder outside the owner (manager), such as creditors, employees, customers, suppliers, public interest groups, and governmental bodies. Stakeholder theory of Freeman et al (1984). Defined stakeholder as a group or individual that can give impact or get impact from corporate objective result. The result of this study is in line with the result of the previous study showing that there is positive effect between institutional ownership and CSR disclosure (Chang and Zang 2015; Sofian and Zahan 2013). However, in contrary, the result study of Earnhart and Lubomir (2006), Murwaningsari (2009) shows that the larger institutional ownership in the company, the more pressure on corporate management to increase awareness on environment. Therefore, it can encourage company to do environmental investment.

The Effect of Environmental Performance on Financial Performance

In this study, Environmental Performance is measured by using evaluation rating of PROPER form ministry of environment consisting five categories, which are: gold with score 5, green with score 4, blue with score 3, red with score 2, and black with score 1. Hypothesis testing result obtained is that $H_3$is rejected meaning that environmental performance statistically affects positively, not significantly towards financial performance (ROA) with probability of 0.16 or more than level of significance of 0.05 (0.16 > 0.05) and coefficient of 0.047 (Table 4). Statistically, positive beta coefficient valueshows the existence ofunidirectional effectmeaning that the higher environmental performance, the higher financial performance.

Table 6. Regression Analysis of Model 2

Model	Sum of Squares	df	Mean Squares	F	p-value
Regression	1.779	1	1.779	1.942	0.16
Residual	109.014	119	0.916		
Total	110.973	120			

R^2= 0.016

Table 7. Partial test for the parameters of Model 2.

Source of Variation	Parameter Estimate	T-test	pvalue
Constrant	3.108	31.269	0.000
EP	0.047	1.394	0.166

Thus, the estimation of the Model 2 is given by:

ROA = 3.108 + 0.047 EP

The effect of environmental performance on financial performance is not significant, it might be because variable of environmental performance with PROPER ratings cannot be driving indicator of financial performance that is proxied with ROA, environmental performance is the form of corporate awareness towards environment that must be done, and its effect on financial performance that might occur for long term period.

This result is not in line with the result of study conducted by Choi et. al.(2010), Khlif et. al. (2015), Tuan (2012), demonstrating the result that positive effect of environmental performance on financial performance, it is enabled with the difference of variable and measurement used, but it is in line with the result study of Sarumpaet (2005), Naila (2013) in their study concluding that there is no relationship between environmental performance and financial performance.

F test (joint test) done to see contingency effect of independent variable on dependent variables which are managerial ownership, institutional managerial, and total assets on environmental performance, it obtained F value of 6,987 with significance level of 0.00, and it is considered small compared to significance level of 0.05. Therefore, regression model on contingency effect of independent variable significantly affects dependent variable.

CONCLUSION

Based on the result of study and testing that has been done, conclusion that can be drawn as the following:

1. Ownership structure and managerial ownership that measured by percentage of ownership, both show significantly positive effect on environmental performance measured by PROPER rating, with significance level for each: managerial ownership of 0.002 andinstitutional ownership of 0.015.It means that higher ownership structure (concentrated ownership), both managerial ownership and institutional ownership, so environmental performance will be higher. It is in line with stakeholder theory stating that company is not entity that only operates for its own interest, but has to be able to give benefit for its stakeholder (Freeman (1984), and for its awareness, the company will get legitimacy for community.
2. The result of data analysis shows that environmental performance positively affects financial performance, but not significant, with probability of 0.16 or greater than level of significance of 0.05 (0.16 > 0.05) and coefficient of 0.47, it shows the existence of unidirectional effect meaning that the higher environmental performance, the higher financial performance, but its increase is not significant. Environmental performance is the reflection of corporate awareness towards environment management and allocation of its resources as the form of corporate attention on its environment.

Suggestion

Based on the limitations of the study, the suggestions proposed for the next study are as follows:

1. Using Public Accountant Firm as the object of study so that the result really reflects the base of audit fee determination.
2. Using variable of audit risk, because this factor is the main factor in determining the scope of audit and audit fee.
3. Using the PAF that is foreign affiliated

and PAF that is not foreign affiliated as the proxy for auditor size in accordance with UU no 5 tahun 2011 (Law No.5 year 2011).

4. Not using Altman Bankcruptcy Prediction Model as the proxy of variable company risk because this model is not able to describe the risk in business activity of the company.
5. Able to use proxy of company complexity that has had its standard.
7. Sample used in the next study is expected more as companies recently have been aware of the importance of reporting audit fee voluntarily as well as adding the number of observation years.

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