

## Does Auditor Fees contributed to high quality of Audit Services? Further Evidence from Malaysia

Masdiah Abdul Hamid<sup>1</sup>, Wan Mohammad Taufik Wan Abdullah<sup>2</sup>

### Abstract

The purposes of this study are to examine the relationship between fees paid to auditors and audit quality. The study hypothesized that the higher audit fees paid therefore big audit firm will deliver a high audit quality to their audit clients. Using a sample of 125 Malaysian listed companies, this study employed multivariate regressions analysis to answer the proposed research question on discretionary accruals. The findings reveal that the audit fees are not related to audit quality. Evidence from this study might be a signal for legislative to the need for improving the competitiveness of the audit market and delivering a high quality of audit.

**Keywords:** Auditor Fees, Audit Quality, Malaysia.

### 1. Introduction

The audit process is intended to ensure the quality of reported earnings that reflect with economic entity. The auditor less likely to enforce GAAP if they are received large amount of audit fees from their audit clients (Hotaish, 2007). The amount of auditor's fees widely debated among auditing scholars where the higher fees may jeopardised the auditor independence and therefore would affect the quality of services. Perhaps, incumbent auditor would depends on their audit client if the higher fees contributed by higher portion of non-audit services. Auditing scholars have highlighted on the auditor's ability to conduct a high audit quality especially when the auditor has received large fees from the audit client. Audit fees may affect the audit quality through the higher payment of statutory audit and also come from provision of non-statutory services (Hoitash, 2007; Abdul Hamid and Abdullah, 2012). Those services may impact the quality of audit if the auditor's judgement is affected or auditor produce long engagement with audit clients. A greater emphasis on auditor's rotation and independence by national regulations could reduce the bias in auditing judgement. Lack of study on auditor behavior motivated this study to investigate whether a sum of payment to auditors will contributed to the delivery of higher audit quality. Additionally, the quality of audit is not heavily rely on the size of audit firms, instead there are other factors that contributed to the audit quality such as lengthy engagement between auditor-client (Jackson et al., 2008), client age (Al-Thuneibat et al., 2011), audit fees (Hoitash, 2007). The quality of audit where the auditor should provide reasonable assurance of reported earnings. Audit quality is something that is abstract, difficult to measure and only be perceived by the users of audit services (Yuniarti, 2011). DeAngelo (1981) defined the audit quality as the market-assessed joint probability of detection and revelation of any irregularity and report those misstatement. Auditor should has an ability in detecting fraud to enable them issuing appropriate opinion on the reported earnings. It is therefore attempts to examine the association between auditor fees and whether it is related to the delivery of high quality of audit services. Accordingly, this study demonstrated the research question on

---

<sup>1</sup>Universiti Tenaga Nasional, Accounting Department, Sultan Hj Ahmad Shah Campus, 26700 Muadzam Shah, Pahang, Malaysia

<sup>2</sup>Universiti Tenaga Nasional, Accounting Department, Sultan Hj Ahmad Shah Campus, 26700 Muadzam Shah, Pahang, Malaysia

do the big audit firm has charge higher audit fees, and whether the higher fee received are related to the delivery of superior audit services to Malaysia listed companies.

The reminder of the paper is organised as follow: the second section reviews previous literature and hypotheses development. The third section explains the methodology employed in the study. The next section discusses the main findings of the research while the last section considers the conclusions drawn and suggestion to the interested parties.

## 2. Literature Review and Hypotheses Development

Previous studies have documented that size of audit firm will influence the auditor in delivery a better quality of audit services. Hamdan et al., (2012) posited that the majority of largest companies have demanded for the big auditing firm instead of small audit firm once they believe on the expertise and monitoring ability of such auditors to provide higher audit quality. Big audit firms also can deliver better services since their employees engage in greater degree of specialization, audit term's background are more extensive and they offer a higher level of continuing professional education (Ebrahim, 2001; Campa, 2013) and importantly, a big audit firm able to put more pressure on management. Studies suggested that big auditing firm tendency to improve the quality of financial reporting and less likely to allow earnings management in the company (Becker et al., 1998; Ebrahim, 2001; Duh et al., 2007).

Several studies have examined the relationship between bigger audit firms and audit quality. There is direct relationship between earning quality and the conduct of audit by a biggest audit firm(Becker et al.,1998; Duh, et al., 2007; Chih-Ying et al., 2008). Studies found that big auditing firms are related to the lower of discretionary accruals (Becker et al., 1998; Chih-Ying et al., 2008). This indicates that those non-big 4 clients exhibit higher discretionary accruals than big 4 client. The study on transition economies, Iran, Gerayli, et al., (2011) posited that big 4 auditors favor to engage in less earnings management as compare to their counterpart, which indicates that the biggest audit firms are related with reducing management discretion over earnings. Dehkordi and Makarem (2011) found that auditor size does not affect on the level of audit quality and therefore does not lead any changes in the level of discretionary accruals, in Iran context. Similarly, Abdul Hamid et al. (2013) revealed that the size of audit firm does not influence the level of audit quality in Malaysia, as measured by discretionary accruals.

Big audit firms also will enhance their independence and improve the quality of audit services, thus it is considered as obstacles for applying earning management in client firms. Kabir et al., (2011) measured the audit quality by both absolute discretionary accruals and signed discretionary accruals found that Big 4 affiliates do not have a positive impact on accruals quality of their client, in Bangladesh context. Consistent with Francis and Wang (2008), they found that the Big 4 has a direct impact with accruals quality in strong investor protection regimes, and vice versa in weaker regimes. In Korea, there is no difference level in audit quality between big audit firm and non-big audit firms (Jeong and Rho, 2004), when the auditor has low incentive to provide higher level of audit quality. This is true for firms that switch from non-big auditors to big auditors. Big audit firms have charged higher audit fees because they need to spend more time on audit work. Bearing all these in mind, the first hypothesis can be stated as follows:

**H1:** The auditor fee is significantly related to the delivery of higher audit quality.

## 3. Methodology

### Measurement of the Audit Fee

This study constructs a regression model to several controls variables as below:

$$LNFE_{it} = \beta_0 + \beta_1 BIG4_{it} + \beta_2 MBV_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 ROA_{it} + \varepsilon_{it} \quad (1)$$

Where:

- LNFEED = Natural logarithm of audit fees
- BIG4 = 1 for Big4 audit firm, 0 otherwise
- MBV = Market to book ratio
- SIZE = Natural logarithm of total assets
- LEV = Leverage measured as total liabilities over total equity
- ROA = Return on assets calculate as operating profit over total assets

This study uses BIG4 to test the presence of an audit “fee premium” among the group of the Big4. Furthermore, this study also includes control variables as additional factors that may affect the amount of the audit fees. This study includes MBV and SIZE and to examine the effect of growth and size on the audit fees. We expect that SIZE will affect the amount of audit fees paid as the number of hours consumed to complete the audit is increase. This study also includes LEV to measure the client-related litigation risks and ROA to control for operating performance.

### Measures of Audit Quality

The determinant of discretionary accruals is used to measure the audit quality. Discretionary accruals refer to accruals that do not relate to normal operating activities or management has changed their accounting decision on terms its favorable. Following the criticised of Jones model due to measurement errors and biases in its parameter (Campa, 2013), this study uses Modified Jones model to reduce the measurement error of discretionary accruals when discretion is applied over sales. Moreover, this model is effective and had the highest statistical power in detecting earning management (Dechow et al., 1995; Jackson et al., 2008). The model used in this study is described in equation 2 as follow:

$$\frac{TA_{it}}{A_{it-1}} = \beta_0 + \beta_1 \left[ \frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}} \right] + \beta_2 \left[ \frac{PPE_{it}}{A_{it-1}} \right] + \varepsilon_{it} \quad (2)$$

Where:

- TA = is the total accruals, is measured by difference between accounting earnings and CFO
- A = is the total assets
- REV = is net sales revenue
- REC = is account receivables
- PPE = is the gross property, plant and equipment
- $\Delta$  = is change operator

In order to get discretionary accruals, non-discretionary accruals will be subtracted from the total accruals for each observation as described in equation 3:

$$DA_{it} = \frac{TA_{it}}{A_{it-1}} - \left[ \beta_0 + \beta_1 \left[ \frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}} \right] + \beta_2 \left[ \frac{PPE_{it}}{A_{it-1}} \right] \right] \quad (3)$$

This study also incorporates the element of control variables to reduce the factors that may affect discretionary accruals. The estimate model is designed as shown in equation 3:

$$DA_{it} = \beta_0 + \beta_1 BIG4_{it} + \beta_2 CFO_{it} + \beta_3 MBV_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 ROA_{it} + \varepsilon_{it} \quad (4)$$

Where:

- DA = The level of discretionary accruals

BIG4	=	1 for Big4 audit firm, 0 otherwise
CFO	=	Cash flow from operations divided by total assets
MBV	=	Market to book ratio
SIZE	=	Natural logarithm of total assets
LEV	=	Leverage measured as total liabilities over total equity
ROA	=	Return on assets calculate as operating profit over total assets

### Sample and Data Collection

This study examines listed Malaysian government linked companies for the period 2006-2010. The list of government linked companies (GLCs) was obtained from Ministry of Finance (MOF) and list of listed companies was obtained from Bursa Malaysia. From the MOF source, there are 97 companies and those non-listed are excluded from this study leaving a balance 33 companies. For the purpose of this study, those companies which their annual report and required information are not available under the period of study are also excluded. Therefore, the final sample produced of 125 firm-year observations during the period of study. All data used in this study are secondary data gathered from annual report and Thomson Reuters Eikon Database. This study includes listed government linked companies sectors such as Infrastructure, Transportation, Logistics, Automobiles, Telecommunications, Utilities, IT, Health Care Providers & Services, Diversified Trading & Distributing, Construction, Food Processing, Agricultural, Pharmaceuticals, Industrial Conglomerates and Oil & Gas.

## 4. Result and Discussion

### Descriptive Statistics

Table 1 presents the descriptive statistics for audit fees (LNFEED) and discretionary accruals for all the other variables used in the regression models. The result shows that the average LNFEED is 5.649 with maximum value is 7.35. For the size of audit clients, the average value is 6.52 with minimum and maximum value is 4.82 and 7.88 respectively which corresponds to an average total assets approximately RM94 million. As for LEV, the mean value is fairly low, 0.55 indicating that the firm's assets were financed through equity rather than debt. An average value for ROA and OCF are 0.06 and 710 respectively. Table 2 presents the information of audit firms size and reveals that 96 percent indicating that most Malaysian listed companies are likely choose big 4 audit firms to audit their companies while for small audit firms present only 4 percent. Lawrence (2011) also highlighted that Big 4 audit clients are significantly different from those audited by non-big 4 audit firms. As all these features described might potentially affect the level of fees and discretionary accruals thus more reliable conclusion can be made after a multivariate analysis employed.

**Table 1: Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation
LNFEED	125	0	7.35	5.6485	0.79477
DA	125	-0.284	24.4252	0.904491	2.2063805
BIG4	125	0	1	0.96	0.197
BMV	124	63104	21668600	1608714.8	3210715.2
SIZE	125	4.823	7.88	6.52474	0.699934
LEV	125	0	9.7943	0.550834	1.35946
ROA	125	-0.4118	0.7596	0.058705	0.1023119
OCF	125	-13944000	16182258	710666.6	3233001.1

**Table 2: Information on Audit Firm Size of Sample**

Status		N	Percent
GLCs	NON-BIG4	5	4.0
	BIG4	120	96.0

Table 3 reports the correlations between the variables used in the regressions. The results mainly support the descriptive statistics. The level of fees is positively related with the variable Big4. The result shows that the variable of audit fees has significant correlations with other factors. Indeed, the level of audit fees is positively correlated with book to market ratio, company’s size, ROA and operating cash flow. However, the level of audit fees is negatively associated with leverage. The correlation analysis was carried out using the Pearson index does not show particular differences in the magnitude and significance of the association between variables. The result also shows that the majority correlations between each pair of independent variables of the sample companies are weak which is below than 0.6 and the correlation among them has statistically significant association at the 1 percent and 5 percent confidence level, indicating that the study model is effective in explaining and determining the effect on the dependent variables. Based on the result, the Pearson’s correlation matrix does not give rise to multicollinearity problems.

**Table 3: Pearson Correlations Matrix**

	LNFEED	DA	BIG4	BMV	SIZE	LEV	ROA	OCF
LNFEED	1							
DA	.117 (.193)	1						
BIG4	.198* (.027)	-.009 (.920)	1					
BMV	.413** (.000)	.095 (.292)	.098 (.281)	1				
SIZE	.539** (.000)	.158 (.079)	.365** (.000)	.410** (.000)	1			
LEV	-.217* (.015)	.014 (.875)	-.497** (.000)	-.117 (.196)	-.519** (.000)	1		
ROA	.018 (.842)	.056 (.532)	.225* (.011)	.018 (.845)	-.186* (.038)	.201* (.025)	1	
OCF	.376** (.000)	.144 (.110)	.488** (.000)	.273** (.002)	.436** (.000)	-.093 (.300)	.085 (.344)	1

\*. Correlation is significant at the 0.05 level (2-tailed);

\*\* . Correlation is significant at the 0.01 level (2-tailed).

**Multivariate Analyses**

**Probability of Selecting a Big 4 Audit Firm**

The result in Table 4 shows that the model is highly statistically significant ( $p < 0.01$ ) and the value of  $R^2$  is 38.4 percent. In line with extant literature indicates that most of the large companies more likely to choose a Big 4 audit firm as their favour (Lawrence et al., 2011; Campa, 2013), therefore this study employed this analysis to test the probability of Malaysian listed companies selecting a Big 4 audit firm. Aligned with previous studies, the result exhibits that the choice of a big 4 audit firm is associated with client size and growth (Campa, 2013).

**Table 4: Probability of Selecting A Big 4 Audit Firm**

Dependent variable	BIG4
INTERCEPT	0.574**(0.001)
MBV	-0.050(0.536)
SIZE	0.211*(0.025)
LEV	-0.465**(0.000)
ROA	0.359**(0.000)
R Square	0.384
Adjusted R Square	0.364
F-statistic	18.569**(0.000)

\*. Correlation is significant at the 0.05 level (2-tailed); \*\*. Correlation is significant at the 0.01 level (2-tailed).

Regression models:

$$BIG4_{it} = \beta_0 + \beta_1 MBV_{it} + \beta_2 SIZE_{it} + \beta_3 LEV_{it} + \beta_4 ROA_{it} + \varepsilon_{it}$$

### Audit Firms and Auditor Fees

Table 5 presents the results of model (1) which investigates the relationship between big 4 audit firm and auditor fees by standard OLS. Based on the result, the model (1) is statistically significant ( $p < 0.01$ ) with an  $R^2$  is 34.5 percent. The results exhibit that the amount of fees is not associated with the variable BIG4 ( $p > 0.05$ ). The other control variables present that only variable of MBV ( $p < 0.05$ ) and SIZE ( $p < 0.01$ ) of the companies positively and significantly associated with the level of audit fees. The results are consistent with the extant literature indicates that size of the companies and growth could influence the amount of fees paid to the audit firms (Campa, 2013; Abdul Hamid et al., 2013). Other control variables such as leverage and return on assets do not present any significant relationship with audit fees ( $p > 0.05$ ). Therefore, this study suggests that the BIG4 audit firms have not charge excessive fees to audit clients than their smaller competitors since the result exhibits no relationship between BIG 4 ( $p > 0.05$ ) and the level of audit fees charged. This result provides evidence that the audit market in emerging country like Malaysia is different with those from developed country which exhibits an existence of “fee premium” among big audit clients (Campa, 2013).

**Table 5: The Investigation of the “Audit Fee Premium”**

Independent variable	LNFEET
INTERCEPT	1.887*(0.014)
BIG4	-0.005(0.957)
MBV	0.215*(0.011)
SIZE	0.491**(0.000)
LEV	0.042(0.673)
ROA	0.100(0.236)
R Square	0.345
Adjusted R Square	0.317
F-statistic	12.421**(0.000)

\*. Correlation is significant at the 0.05 level (2-tailed); \*\*. Correlation is significant at the 0.01 level (2-tailed).

Regression models:

$$LNFEET_{it} = \beta_0 + \beta_1 BIG4_{it} + \beta_2 MBV_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 ROA_{it} + \varepsilon_{it}$$

**Big 4 Audit Firms and Audit Quality**

The next analysis is to investigate whether fees paid to the auditor is accompanied by an improvement in audit quality. The result (Table 6) shows that the adjusted  $R^2$  is 8 percent which indicates that the model only explains 8 percent of the variability in audit quality as measured by discretionary accruals. For the variable of BIG 4, the result does not reveal any significant relationship with the discretionary accruals indicating that the type of audit firms is not a signal that the auditor will deliver a higher level of audit quality. Therefore, our hypothesis was rejected. Additionally, the conduct of audit by the Big 4 audit firms is not associated with better audit quality. Therefore, this study suggests that the type of audit firms does not influence the companies to manage earnings. Furthermore, the results also do not reveal any significant relationship with the other variables. The results is consistent with previous study (Abdul Hamid et al., 2013) indicates that size of companies and clients total debts are not influence to the level of audit quality in Malaysia. The results also do not support Lawrence et al. (2011) as they highlighted that client’s earning management is affected by several others factors. The results show that size of the companies, profitability and growth exhibit the main characteristics of Big 4 clients.

**Table 6: Big 4 Audit Firms And Audit Quality: Discretionary Accruals**

Independent variable	DA
INTERCEPT	-1.679(0.579)
BIG4	-0.152(0.248)
OCF	0.127(0.286)
MBV	-0.002(0.980)
SIZE	0.194(0.130)
LEV	0.029(0.822)
ROA	0.111(0.277)
R Square	0.057
Adjusted R Square	0.008
F-statistic	1.172**(0.000)

\*. Correlation is significant at the 0.05 level (2-tailed); \*\*. Correlation is significant at the 0.01 level (2-tailed).

*Regression models:*

$$DA_{it} = \beta_0 + \beta_1 BIG4_{it} + \beta_2 CFO_{it} + \beta_3 MBV_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 ROA_{it} + \varepsilon_{it}$$

**5. Conclusion**

The objectives of this study are the empirical investigation of the existence relationship of a Big 4 audit firm and audit fee and therefore examine whether it is related to the delivery of a better audit quality. This study also includes several variables as controlling effect. The results reveal that Big 4 audit firms do not charge their client an excessive audit fees to Malaysia listed company. The result was not consistent with Campa (2013), which indicated that big 4 audit firm doesn’t concentrate on the audit market in order to charge excessive fee to big audit client. The further analyses examine whether the amount of fees paid is related to the superior audit services as measured by client’s earning quality. The second analyses focus on amount of fees paid to audit firms and the result shows that the amount of fees is not significant which indicates that the level of fees does not influence the Big 4 audit firm in delivering better audit services, as measured by discretionary accruals. This study concludes that the big 4 audit firms have providing an audit services to their client without concentrate on audit market. The other factors such as size of companies, profitability and growth also do not find any significant relationship with discretionary accruals. Therefore,

this study concludes that higher audit fees are not accompanied by an enhancement of the quality of the service provided to ensure the quality of earnings produced.

The evidence from this study might be significant to Big 4 audit clients in the case of a renegotiation of the audit fees as it may improve their bargaining power. Therefore, audit clients would not be ready to pay a high fees or “fee premium” if there is no incremental benefits in terms of audit quality. Furthermore, this result might also be significant to legislative body in improving the competitiveness of the audit market in delivering higher audit quality. This research is not free from limitations. This paper explores the audit quality using a single method only, as an appropriate dimension of earning quality. Therefore, there are many other proxies have been developed in the extant literature to analyse the client earnings quality. The different proxies used may produce a different result. Next, this study only focuses in Malaysia and therefore, it may affect the generalization of the reported results.

## **References**

- Abdul Hamid, M. and Abdullah, A. (2012). Influence of corporate governance on audit and non-audit fees: Malaysian evidence. *Journal of Business and Policy Research*, 7(3, Special Issue), 140-158.
- Abdul Hamid, M., Wan Abdullah, W.T., and San, S. (2013). The effect of audit tenure and firm size on audit quality: Empirical evidence from GLCs in Malaysia. *Proceedings of 6th International Economics & Business Management Conference*, 1-19.
- Al-Thuneibat, A.A, Al Isaa, R.T.I and Ata Baker, R.A. (2011). Do audit tenure and firm size contribute to audit quality?: Empirical evidence from Jordan. *Managerial Auditing Journal*, 26(4), 317-334.
- Becker, C.L, Defond M.L, Jiambalvo, J., and Subramanyam, K.R. (1998). The effect of audit quality on earnings management. *Contemporary Accounting Research*, 15(1), 1-24.
- Campa, D. (2013). "Big 4 fee premium" and audit quality: latest evidence from UK listed companies. *Managerial Auditing Journal*, 28(8), 680-707.
- Chih-Ying, C., Chan-Jan, L., and Yu-Chen, L. (2008). Audit partner tenure, audit firm tenure, and discretionary accruals: does long auditor tenure impair earnings quality? *Contemporary Accounting Research*, 25(2), 415-445.
- Craswell, A., Francis, J., and Taylor, S. (1995). Auditor brand name reputations and industry specializations. *Journal of Accounting and Economics*, 20(3), 297-322.
- DeAngelo, L. (1981). Auditor size and audit quality. *Journal of Accounting and Economics*, 3(3), 183-199.
- Duh, R.-R., Lee, W.-C., and Hua, C.-Y. (2007). Non-audit service and auditor independence: An examination of the Procomp effect. *Review of Quantitative Finance and Accounting*, 32(1), 33-59.
- Ebrahim, A. (2001). Auditing quality, auditor tenure, client importance and earning management: Additional evidence. Rutgers University, [www.aaahq.org/audit/midyear](http://www.aaahq.org/audit/midyear). Retrieved from [www.aaahq.org/audit/midyear](http://www.aaahq.org/audit/midyear)
- Francis, J.R, and Wang, D. (2008). the joint effect of investor protection and big 4 audits on earnings quality around the world. *Contemporary Accounting Research*, 25(1), 157-191.
- Gerayli, M.S., Yanesari, A.M., and Ma'atoofi, A.R. (2011). Impact of audit quality on earnings management: Evidence from Iran. *International Research Journal of Finance and Economics*, 66(1), 77-84.
- Gonthier-Besacier, N. and Schatt, A. (2007). Determinants of audit fees for French quoted firms. *Managerial Auditing Journal*, 22(2), 139-160.
- Hamdan, A.M.M., Kukreja, G., Awwad, B.S.A., and Dergham, M.M. (2012). The auditing quality and accounting conservatism. *International Management Review*, 8(2), 33-50.

Hoitash, R. (2007). Auditor fees and audit quality. *Managerial Auditing Journal*, 22(8), 761-786.

Jackson, A., Moldrich, M., and Roebuck, P. (2008). Mandatory audit firm rotation and audit quality. *Managerial Auditing Journal*, 23(5), 420-437.

Jeong, S.W., and Rho, J. (2004). Big six auditors and audit quality: the Korean evidence. *The International Journal of Accounting*, 39(1), 175-196.

Kabir, M.H., Sharma, D., Islam, M.D., and Salat, A. (2011). Big 4 auditor affiliation and accruals quality in Bangladesh. *Managerial Auditing Journal*, 26(2), 161-181.

Lawrence, A., Minutti-Meza., and Zhang, P. (2011). Can big 4 versus non-big 4 differences in audit quality proxies be attributed to client characteristics? *The Accountign Review*, 86(1), 259-286.

Yuniarti, R. (2011). Audit firm size, audit fee and audit quality. *Journal of Global Management*, 2(1), 84-96.