Determinants of Audit Fees in Malaysia’s Top 100 Listed Companies: An Empirical Study

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ABSTRACT

This paper examines the determinants of audit fees in a sample of top 100 companies listed in Bursa Stock Exchange in Malaysia; market capitalization of these companies is about 85% of the total market capitalization at the end of 2012. The authors collected data from the annual reports of the companies for the year 2012, and analyzed it using a multiple regression model. The authors report that firm size, profitability, and ownership structure are the main determinants of audit fees in Malaysia. Additionally, profitability shows a negative and significant relationship, which is also in line with findings of the most recent studies. The results also indicate that there is no Big 4 premium in audit fees in Malaysia; interestingly, the relationship though insignificant is negative. The adjusted R square is approximately 47% and there were no multicollinearity issues among the variables. The study makes an incremental contribution to the literature on audit fees in the Malaysian context.

Keywords: Audit Fees, Auditor Size, Determinants, Malaysia, Ownership, Profitability, Size

INTRODUCTION

The purpose of this paper is to investigate the determinants of audit fees in Malaysia. Internationally, audit fees have been a perennial topic of research for a variety of reasons. This research has identified different factors that affect audit fees and audit quality in different countries (Causholli et al., 2010). External audit significantly contributes to good corporate governance. Moreover, the external auditors assure users of corporate financial statements...
that the statements reflect a true and fair view of the affairs of the entity. Audit fees charged to the client affect audit quality and may influence the external auditor’s role in corporate governance (Hassan and Naser, 2013).

Auditors charge audit fees to perform audit services. In setting the audit fees, the Malaysian Institute of Accountants (MIA) in its Recommended Practice Guide (RPG) 7 requires auditors to consider the degree of responsibilities, risks and skills involved, and the amount of time required. Malek and Saidin (2007) argue that audit services fee has become an issue in auditing due to the possible contradictory effects on audit quality, that is, high audit fees may increase auditor’s capability to detect misstatements or may impair auditor’s independence. The Malaysian government’s concern has led to the compulsory requirement for the disclosure of audit fees and non-audit service fees in the companies’ annual reports as required by the Companies Act, 1965.

**MOTIVATION FOR UNDERTAKING THE STUDY**

Hay et al., (2006) argue that audit fees determinants, the significance of certain variables, change according to the characteristics of each country. They suggest that these models be periodically revisited and revised. In recent years, there have been significant changes in the economic variables, especially in the context of accounting and auditing scenario in Malaysia, therefore, research into audit fees determinants warrants further investigation. Audit services serve as a monitoring mechanism because of the potential conflicts of interests between owners, managers, and other different classes of security holders (DeAngelo, 1981). Auditors play key role in enhancing the credibility of financial statements and increasing the quality of audit, therefore, the determinants of audit fees remains an important issue. Niemi (2005) argues that the extant research on audit fees determinants has focused primarily on markets where buyers are assumed to have a sufficiently homogeneous ownership structure, resulting in the lack of research on client ownership as a determinant of audit effort and fees. Apart from other determinants of audit fees, research in divergence in ownership structure and audit fees may be of interest in developing countries such as Malaysia due to the limited number of studies focusing on audit markets.

This study extends a few studies conducted on the audit fees in Malaysia such as Yatim et al., (2006), Bliss et al., (2007), Wahab et al., (2009), and Aswadi et al., (2011). Most of these studies focused on the impact of audit fees in the early implementation of Malaysian Code on Corporate Governance (MCCG) in 2001, except for Yaacob and Che-Ahmad (2012) who report that IFRS adoption resulted in a significant increase in audit fees in Malaysia. The present study focuses on the impact of audit fees after the revised MCCG 2007. Therefore, the study of the determinants of audit fees in Malaysia is motivated by two factors. First, corporate governance practices as practiced by Malaysian listed firms are considered different from those practiced in developed markets and Malaysian corporate governance mechanisms are still evolving. Second, Malaysian Accounting Standards Board (MASB) requires full convergence with the International Financial Reporting Standards (IFRS) on January 1, 2012, which significantly affects auditors’ responsibilities and audit work. Thus, the present study contributes to the existing base of knowledge by investigating determinants of the audit fees after the revision of MCCG 2007.

The findings from this study may be useful to regulators, academics, as well as practitioners and investors in various ways. For example, regulators need to pay more attention to factors that affect audit fees and audit markets. Academics need to understand the role played by audit fees in improving the financial transparency of the firm and audit quality, this study may help on some of these dimensions.

This study contains five sections. Section 2 contains accounting and auditing practices in Malaysia and prior literature and presents research hypotheses. The Section 3 explains
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