

## Research article

# The Impact of Abnormal Audit Fees on Audit Quality: A Study of ASEAN Countries

**M Ridzky and F Fitriany**

Department of Accounting, Faculty of Economics and Business, Universitas Indonesia, Depok, West Java, 16424, Indonesia

### ORCID

F Fitriany: <https://orcid.org/0000-0003-1389-6910>

### Abstract.

This study investigates the impact of abnormal audit fees on audit quality. An abnormal audit fee is the difference between the actual fee paid by the auditee to the external auditor and the normal fee. If the actual audit fee is above the normal audit fee, it is called a positive abnormal audit fee (premium) and if the actual audit fee is below the normal audit fee, it is called a negative abnormal audit fee (discount). The samples for this study were 3,694 selected companies from Indonesia, Malaysia, Singapore, the Philippines, and Thailand. Data were analyzed using regression analysis and it was found that positive abnormal audit fees could decrease the audit quality. This is because of the economic arrangement between the auditors and the clients as the auditor will be more tolerant towards the earnings management carried out by the client. On the other hand, negative abnormal audit fees have an insignificant relationship with the audit quality, which means if auditors are paid below the normal fees, they have no incentive to compromise the audit quality. Because audit fees can affect audit quality, regulators need to make policies so that audit fees paid to the external auditors should not be more than the normal fees.

**Keywords:** audit quality, audit fees, negative abnormal audit fees, positive abnormal audit fees, abnormal working capital accruals

## 1. Introduction

One of the factors affecting the quality of external auditor is fees paid by clients to the auditors (audit firm). The audit fees are determined based on negotiations between the accounting firm and its clients. This allows the determination of audit fees to be lower or higher than normal (abnormal fee). This study investigates impact of abnormal audit fees on audit quality.

Abnormal audit fee can be regarded as the client's attempt to bribe the auditor by paying additional fee to obtain economic rent [1]. Abnormal audit fees (ABN\_FEE) are the difference between the actual fees paid by auditee to auditors with normal fees (based on the condition of the individual company calculated by various factors, such

Corresponding Author: F

Fitriany; email:

[fitrianyamarullah@gmail.com](mailto:fitrianyamarullah@gmail.com)

**Published:** 01 August 2022

Publishing services provided by  
**Knowledge E**

© M Ridzky and F Fitriany. This article is distributed under the terms of the [Creative Commons Attribution License](#), which permits unrestricted use and redistribution provided that the original author and source are credited.

Selection and Peer-review under the responsibility of the VCOSPILED 2021 Conference Committee.

 **OPEN ACCESS**

as size, complexity, and specific risk). ABN\_FEE can be divided into positive ABN\_FEE and negative ABN\_FEE.

The research results on the effects of audit fees on audit quality are still mixed. Audit fees (both normal and abnormal) could had positive effects on audit quality. However, abnormal audit fee could also negatively affected audit quality [2]. POS\_ABN\_FEE (premium fee) found negatively affect audit quality, but NEG\_ABN\_FEE (discounted fees) do not have a significant impact on audit quality [3]. According to [3] the decline in audit quality is likely due to the economic ties between auditors and management that undermines the independence of auditors. Of the several studies that deal with abnormal audit fees, three studies found that abnormal audit fees positively affect audit quality [9][10][11]. Two studies found that abnormal audit fees negatively affect audit quality [2][12]. Some studies divide abnormal audit fees into positive and negative abnormal audit fees. There are four studies that found negative relationships between positive abnormal audit fees and the quality of the audit [3][5][13][4]. A different study conducted by [14] had different results, showing that positive ABN\_FEE have a positive effect on the quality of audit.

Because the results are mixed, this study attempts to re-examine the effects of ABN\_FEE on quality of audit, not only in Indonesia but also in ASEAN. ASEAN countries were selected because ASEAN has both developed countries, such as Singapore, and developing countries, like Indonesia and the Philippines. In developed countries, which are characterized by high levels of competition in the audit services market, high levels of litigation risk, and tight oversight, negative ABN\_FEE may not reduce the quality of audit. This is because in developed countries, reputation is an important thing that must always be maintained by auditors because of the high level of low reinforcement. While in developing countries, where government oversight remains loose and the risk of litigation is low, these results may be different.

Research relating to abnormal audit fees is still rare, especially in ASEAN countries. Research on abnormal audit fees for ASEAN countries have been done by [4] but with a sample size of only 1,292 firms from 2010-2014 and found that there is a negative relationship between audit quality and audit fees regardless of whether the abnormal audit fees are positive or negative. This study uses a much larger sample of 3,694 firms from 2011-2015. The difference between this study and those of [3] and [4] is the use of the AWCA (Abnormal Working Capital Accruals) model as a proxy for quality of audit. Ano[3] and [4] used DAC (discretionary accrual). Only few studies have used AWCA as a proxy for audit quality. AWCA was used by [6][7]and [8].

According to [15], the Public Accounting Firm that receives positive ABN\_FEE let their clients to perform income smoothing. This is because the benefits obtained by auditors (higher audit fees) are greater than the associated cost (such as litigation risk and reputational lost). Abnormal audit fees could be seen as "client-specific quasi-rent" [16]. The positive existence of this "client-specific quasi-rent" make incentives for auditors to negotiate their independence for a particular client. [16][17] and [18] show that audit quality is disrupted when auditors are paid higher than normal. Based on the previous studies, hypothesis one is as follows:

**H1: Positive ANB\_FEE have a negative impact on audit quality**

There are three possibilities that arise if the auditor is paid below normal (abnormal negative audit fees) [3]. First, If auditor is paid below normal, they have no incentive to compromise their independence, due to increased oversight of auditors with reforms like SOX. Second, if the auditor is willing to accept a lower audit fee with the expectation of a higher audit fee in an agreement in the future, the client may put more pressure on the auditor so that they will tolerate earnings adjustments made by the client. It is predicted that there is a negative relationship between ABN\_FEE and audit quality. Third, if the auditor is paid below the normal fee, the auditor is not motivated to compromise the quality of the audit because the benefits (audit fees) are less than the costs to the auditor due to poor audit quality (lawsuits). It is estimated that the relationship between abnormal audit fees and discretionary accruals (audit quality) is weak or non-existent. Based on the three possibilities above, the effect of negative abnormal audit fees on audit quality could be positive, negative, or not significant. Therefore, the second hypothesis is as follows:

**H2: Negative ANB\_FEE affect audit quality**

**2. Methods**

The unit of analysis for this research is company. Data were collected from Eikon, Financial Report, and the Securities Exchange site for each country and the World Bank website (GDP data). The sample is listed companies in ASEAN. The data is then regressed with panel data. Financial companies are not included in this research because they have different financial reporting formats. This is the model:

$$AWCA = \beta_{it} + \beta_1 ABN\_FEE_{it} + \beta_2 ROT + \beta_2 SIZE_{it} + \beta_3 SIZE\_CLIENT + \beta_4 CFO_{it} + \beta_5 RISK_{it} + \beta_6 GROWTH_{it} + \beta_7 ROA_{it} + \hat{\alpha}_8 LOSS_{it} + \beta_9 GDP_{it} \dots \dots \dots Model 1$$

AWCA: Absolute Abnormal Working Capital Accruals. ABN\_FEE: Abnormal audit fee, using Choi model; ROT: Rotation of audit firm; SIZE\_AUDIT: Big4, SIZE\_CLIENT: Ln on total sales. CFO: cash flow from operations; lev: leverage. GROWTH: Change of total sales. ROA: Return on asset in year t. LOSS: 1 if company get loss, and 0 for others. GDP: Ln of total gross domestic product.

Audit quality is proxied by AWCA, which was used by [6][7][8]. The AWCA measurements used by [6] are somewhat more complex. AWCA in this paper more simple, following [8]. The AWCA figure is difference between the predicted working capital level and the actual working capital for the current year. AWCA is inversely related to future earnings, so it can shift earnings between reporting periods. The greater the AWCA value, the greater the earnings management, and the lower the audit quality. AWCA is directly proportional to earnings management and inversely proportional to audit quality because the auditor cannot prevent earnings adjustments made by the company. Similar to the use of discretionary accrual as the audit quality proxy, the value used is the absolute value of the AWCA. This is because the value taken is the accrual magnitude, not how much the value is the decreasing or increasing.

### 3. Results and Discussions

Data in this study is from ASEAN countries from 2011 to 2015. Purposive judgment sampling is used with sample criteria shown in Table 1 where 3,694 samples were obtained, consisting of 1,767 companies that have positive ABN\_FEE and 1,927 companies have negative ABN\_FEE.

#### 3.1. Impact of Positive ABN\_FEE to Quality Audit

Table 3.a indicates that the model is significant and that R-sq is 28.32%. The ABNFEE variable has a significant positive effect on AWCA. Because AWCA has an inverse relationship with audit quality, it means that ABNFEE has a significant negative impact on audit quality. This means that the higher the positive abnormal audit fees, the lower the audit quality. This result is in accordance with hypothesis one, which states that when the auditor is paid above normal, it will create an economic bond between the client and the auditor and therefore auditor will permit the client to made earnings adjustments. This result is consistent with Dye's findings that audit quality is impaired when auditors are paid more [18]. These results are also supported by previous studies by [13][3][5]and [4].

TABLE 1: Sample Selection.

	INDO	MALY	PHLP	SINGP	THAI	TOTAL
Data available on Eikon from 2011 - 2015	2.715	4.650	1.315	3.790	3.660	
Companies in the financial industry	-710	-685	-415	-600	-845	
Companies did not disclose the audit fees	-1588	-901	-735	-961	-2537	
Company with incomplete data	-33	-251	-88	-281	-49	
Companies with negative CFO	-79	-631	-21	-645	-60	
Sample before outlier deleted	305	2182	56	1303	169	
Outlier	-12	-182	-10	-94	-23	
Sample final for 5 years (2011 – 2015)	293	2.000	46	1.209	146	3.694

TABLE 2: Statistic Descriptive - Positive ABN\_FEE.

Variable	Mean	Std.Dev.	Min	Max
AWCA	0.1284	0.1188	0.0003	0.5142
AFEE	490229.1	2127730	10416.67	7.17E+07
ABN_FEE	0.6567	0.4623	0.0015	1.6203
ROT	0.1561	0.3631	0	1
SIZE_AUDIT	0.5619	0.4962	0	1
SIZE_CLIENT	18.6074	1.5777	15.0300	21.8259
CFO	16.4641	1.8620	12.4123	20.1996
RISK	0.1917	0.3273	0.0019	0.9756
GROWTH	0.0127	0.2453	-0.5607	0.6074
ROA	0.0524	0.0657	-0.0913	0.1959
LOSS	0.4346	0.4958	0	1
GDP	26.4395	0.0810	26.2628	26.6284

Note: n = 1.767

### 3.2. Impact of Negative ABN\_FEE on Quality Audit

Table 3.b shows that the model is significant and that R-sq is 26.16%. From Table 5, it appears that in companies that pay below average fees (ABNFEE negative), the ABNFEE variable has no significant effect on the amount of earnings adjustments or audit quality. This result is in accordance with Choi's prediction that the relationship between the abnormal audit fee and audit quality can be positive, negative or unrelated [3]. The results of this study indicate an insignificant relationship. This means that if auditors

TABLE 3: *Statistic Descriptive - Negative ABN\_FEE.*

Variable	Mean	Std.Dev.	Min	Max
AWCA	0.1294	0.1109	0.0012	0.4755
AFEE	68063.35	67998.71	961.24	698412.7
ABN_FEE	0.6168	0.4285	0.0006	1.4966
ROT	0.1603	0.3670	0	1
SIZE_AUDIT	0.5640	0.4960	0	1
SIZE_CLIENT	18.5082	1.3448	15.4975	21.2546
CFO	16.0696	1.6611	12.4217	19.4611
RISK	0.6738	0.5292	0.0019	1.8076
GROWTH	0.0065	0.2040	-0.4736	0.5057
ROA	0.0557	0.0704	-0.0974	0.2062
LOSS	0.4250	0.4944	0	1
GDP	26.5237	0.1913	26.1670	27.1084

Note: n = 1.927

TABLE 4: *Regression Result Positive ABN\_FEE.*

Variable	Pred to AWCA	Coef	Prob	Sign
ABN_FEE	+	0.009	0.076	*
ROT	-	(0.000)	0.478	
SIZE_AUDIT	-	0.004	0.258	
SIZE_CLIENT	-	0.035	0.000	***
CFO	+	0.001	0.347	
RISK	+	0.041	0.000	***
GROWTH	-	0.029	0.002	***
ROA	+	0.116	0.004	***
LOSS	+	0.005	0.171	
GDP	-	0.098	0.004	***
Cons		0.111	0.007	
No of Obs	1767		R-sq	0.2832
			Prob > F	0.000

are paid below normal, auditors have little incentive to compromise their audit quality, because the benefits obtained by the auditor (fees) are lower than the costs that must be borne by the auditors such as lawsuits or damage to reputation.

Based on the above results, it can be concluded that hypothesis one is proven and hypothesis two is not proven. These results are in accordance with the research of [3] which was conducted in the United States. It can be concluded that, in both developing countries, such as ASEAN countries, and developed countries, like in the United States, an above-normal audit fee can lead to strong bonding between auditee and auditors, thereby decreasing audit quality since it creates incentives for auditors to compromise

their independence for a particular client, the auditor will tolerance to the earnings management made by the client.

Reffering to the agency theory, the auditor should act as an independent institution that provides assurance regarding the fairness of the financial statements that made by the agent which will be used by the principle in decision making. However, the findings of this study indicate that auditors have not performed this role properly.

TABLE 5: *Regression Result* Negative ABN\_FEE.

Variable	Pred to	Coef	Prob	Sign
ABN_FEE	+/-	(0.020)	0.162	
ROT	-	(0.004)	0.276	
SIZE_AUDIT	-	0.010	0.232	
SIZE_CLIENT	-	(0.035)	0.010	***
CFO	+	(0.003)	0.154	
RISK	+	(0.012)	0.087	*
GROWTH	-	(0.047)	0.005	***
ROA	-	0.373	0.000	***
LOSS	+	0.013	0.018	***
GDP	+	0.010	0.334	
Cons		0.118	0.000	
No of Obs		1927	R-sq	0.2616
			Prob > F	0.000

## 4. Conclusion

This study found that positive abnormal audit fees (auditor pays above normal) will decrease audit quality. An audit fee that is above normal creates an economic bonding between the auditor and the client. This bonding causes the auditor will be more tolerant towards earnings management carried out by the client. On the other hand, audit fee that is below normal are not proven have significant impact to audit quality, which means that if the auditor pays below normal, the auditor has little incentive to compromise the quality of the audit. Third, if the auditor is paid below the normal fee, the auditor is not motivated to compromise the quality of the audit because the benefits (audit fees) are less than the costs to the auditor due to poor quality audits (lawsuits).

Due to data limitations, this paper didn't account for different business environments among ASEAN countries, and only used a macroeconomics indicator (GDP). Further research may include other country levels, such as corporate governance, rule of law, and others. Many samples cannot be used due to the availability of audit fees information

on the Eikon database. Future research may directly find audit fee data directly from the relevant financial statements.

The study found that audit fees affect the independence of auditors. Therefore, the auditor should improve its independence and objectivity in conducting audits and avoid prohibited practices to improve the audit quality. Not all firms disclose information about their audit fees, whereas information on audit fees is important for readers of financial statements. Therefore, regulators should encourage companies to disclose information about audit fees in financial reports or annual reports.

## Acknowledgements

We gratefully acknowledge financial support from Research Grant from RISTEK DIKTI, contract No 8/E1/KP.PTNBH/2021 dated at 08 Maret 2021 & NKB-046/UN2.RST/HKP.05.00/2021

## References

- [1] Kinney WR, Libby R. The relation between auditors' fees for nonaudit services and earnings management: Discussion. *The Accounting Review*. 2002;77:107-114
- [2] Hribar P, Kraver T, Wilson R. A new measure of accounting quality. Working paper. University of Iowa; IOWA; 2010.
- [3] CHOI, Jong-Hag; KIM, Jeong-Bon; and ZANG, Yoonseok. Do Abnormally High Audit Fees Impair Audit Quality?. (2010). *Auditing: A Journal of Practice and Theory*. 29, (2), 115-140. Research Collection School Of Accountancy.
- [4] Nugroho B, Fitriany F. Impact of abnormal audit fees on audit opinion and quality in ASEAN countries. *Pertanika Journal of Social Sciences & Humanities*. 2019;27(2); 1959-1977.
- [5] Fitriany F, Veronica S, Anggraita V. Impact of abnormal audit fee to audit quality: Indonesian case study. *American Journal of Economics*. 2016;6(1);72-78.
- [6] Francis JR, Wang D. The joint effect of investor protection and big 4 audits on earnings quality around the world. *Contemporary Accounting Research*. 2008;25(1):157–191.
- [7] DeFond ML, Park CW. The reversal of abnormal accruals and the market valuation of earnings surprises. *The Accounting Review*. 2001;76(3):375-404.



- [8] Corbella S, Florio C, Gotti G, Mastrolia SA. Audit firm rotation, audit fees and audit quality: The experience of Italian public companies. *Journal of International Accounting, Auditing and Taxation*. 2015;25:46-66.
- [9] Eshleman JD, Guo P. Abnormal audit fees and audit quality: The importance of considering managerial incentives in tests of earnings management. *Auditing: A Journal of Practice & Theory*. 2014;33(1):117-138.
- [10] Higgs JL, Skantz TR. Audit and nonaudit fees and the market's reaction to earnings announcements. *Audit Journal of Practicing Theory*. 2006;25(1):1–26.
- [11] Mitra S, Deis DR, Hossain M. The association between audit fees and reported earnings quality in pre- and post-Sarbanes-Oxley regimes. *Review of Accounting and Finance*. 2009;8(3):232–252.
- [12] Hoitash R, Markelevich A, Barragato CA. Auditor fees and audit quality. *Managerial Audit Journal*. 2007;22(8):761–786.
- [13] Patrick K, Pronobis P, Zülch H. Abnormal audit fees and audit quality: Initial evidence from the German audit market. *Journal of Business Economics*. 2015;85(1):45-84.
- [14] Blankley AI, Hurtt DN, MacGregor JE. Abnormal audit fees and restatements. *Auditing: A Journal of Practice & Theory*. 2012;31(1):79-96.
- [15] Kinney, W. and Libby, R. Discussion of: The Relation between Auditors' Fees for Non-Audit Services and Earnings Management. *The Accounting Review*, 2002, 77, 107-114..
- [16] DeAngelo LE. Auditor independence, low balling, and disclosure regulation. *Journal of Accounting and Economics*. 1981;3:113-127.
- [17] DeFond M, Raghunandan K, Subramanyam K. Do non-audit services fees impair auditor independence? Evidence from going concern audit opinions. *Journal of Accounting and Economics*. 2002;40(4):1247–1274.
- [18] Dye RA. Informationally motivated auditor replacement. *Journal of Accounting and Economics*. 1991;14(4):347–374.