

DETERMINANTS OF AUDIT FEES: EMPIRICAL EVIDENCES FROM ROMANIAN PUBLIC-INTEREST ENTITIES

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Abstract: *In the field of audit pricing, there are a lot of previous research studies, but a significant part of them has focused on the US, New Zealand and Australia markets and too less have been focused on the emerging markets. This study aims to elaborate an empirical analysis of various determinant factors on audit fees for an emerging market such as Romania. The purpose of this paper is to contribute at identifying some of the most relevant determinants of audit pricing, in the case of Romanian 55 public-interest entities (PIEs) listed at Bucharest Stock Exchange, for 2009-2011 period. In order to test the working hypotheses we have employed panel data methods. Two models were finally used in the analysis that proved to be the most consistent. The difference between the two models consists in the fact that shareholders equity is used once in its natural form (as scale variable) and once as a dummy variable, assessing only if the company has positive or negative shareholders equity. The use of both forms in the same models would have caused serious multicollinearity problems. The outcomes of panel data analysis highlights that, regardless of the model specified, the same three variables are highly significant in both cases. The findings revealed that audit pricing for Romanian public-interest entities are significantly influenced by the annual turnover of the company, the number of employees and the importance of the auditor (whether it is a Big4 auditor or not).*

Keywords: *audit fee, Big 4 auditor, auditees' size, public-interest entities, panel data analysis.*

1. INTRODUCTION

Every financial crisis that have shuddered the financial markets in the last century has strongly affected the public confidence in the auditors' professionalism and independence, therefore the audit pricing and audit quality has received much attention, especially in the light of the recent global economic crisis [1] - [2]. Prior theoretical and empirical research in audit pricing has paid a considerable attention to the developed economies while too fewer studies were focused on examining the audit quality [3] - [4], auditor independence and audit pricing determinants for emerging countries [5] - [7]. In 2006, a meta-study presented the possible determinants for the audit fee in the previous 25 years (1997-2002). Out of 88 research paper, just 6 papers presented auditing activity in emerging countries, and 45 studied the United States of America's market [8].

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Since October 2010, the European Commission stated in the green paper entitled “Audit policy: Lessons from the crises”, with regard to statutory audits in the European Union that needs to be improved. It has touched many subjects, but one of the most important for strengthening the auditor independence, is a proposition for a regulatory change to the European audit market where the assignment, remuneration, should be determined by a third involved party like a governmental institution or a professional body [9]. Immediately the accounting profession started to pay more attention to the determinants of the audit fees, trying to identify which are more important, more influent and subsequently the one to be regarded as mandatory to consider when negotiating a fee. According to recent data for the US Market [10], shows that “2015 audit fee increases”, taking into consideration the size and type of company being audited, for US Market a median of 3,2% in 2015 over the previous year for SEC filers.

The purpose of this paper is to contribute at the developing of audit pricing research in the emerging economies such as Romania. The analysis involves using of panel data analysis to explain the contribution of various determinant factors for audit fees in a sample of 55 public-interest entities operating on Bucharest Stock Exchange. Audit and financial information was gathered for 2009-2011 period from annual and financial reports available on companies' websites.

The Romanian profession of financial audit is coordinated by Chamber of Financial Auditors (CAFR), a professional organization. According to the information published on CAFR's website, the main objective of this professional organization is to *“build on a solid ground, the identity and the public recognition of the financial audit profession in Romania, having as a main objective the sustainable development of the profession and its strengthening, in accordance with the Auditing Standards and with the Code of Ethics and professional conduct, by fully assimilating the International Standards on Auditing and the Code of Ethics issued by the International federation of Accountants (IFAC), that will allow the Romanian financial auditors to provide high quality services, for the public interest, in general, and for the business community, in special”*.

The Romania audit profession started its development after 1990 and more strongly from the beginning of the 21st century, due to the criteria and conditions required on Romania's accession by the EU, continuous developing of businesses and the diversification of trade and business relations.

There are too few studies focused on researching the impact of various variables on audit fees in emerging countries such as Romania. No doubt, more research efforts are needed in East European countries in the field of audit pricing, but undertaking this type of studies demands an adequate transparency in disclosure of audit fees. In the context of Romania, companies listed on Bucharest Stock Exchange were not required to disclose the audit fees paid to audit firms until 2009 financial year, and this requirement was available particularly for public-interest entities. Therefore, the choice of public-interest companies in our sample was argued by the fact that all these entities should disclose the audit fees in their financial statements. Hence, identifying variables that might influence audit pricing paid by public-interest companies listed on Bucharest Stock Exchange will be a pioneering study since the listed companies on BSE never disclosed audit pricing before.

The remainder of the paper is organized as follows. The next section provides a brief synthesis of the main previous research findings in the field of audit pricing and quality, together with

hypotheses development. Section 3 discusses our research methodology and sample. The empirical findings are reported in Section 4, while Section 5 concludes the paper.

2. BACKGROUND LITERATURE AND HYPOTHESES DEVELOPMENT

There is a large amount of academic international literature that has exploring the linkages between audit fees and various corporate characteristics. There were many independent variables tested in relation with audit fees in previous research such as corporate size, profitability, capital's structure, type of auditor (BIG 4 or not), industry type of audit opinion or audit report lag. No doubt, the choice of variables from one study to another was mainly decided by the data availability. There are also behavioral studies realized [11] in what the audit fee is concerned that bring indication, that audit fee's stickiness is present and it does not immediately or fully adjust to changes in their determinants. Next, the main variables considered relevant to this study and the rationale behind their choice in prior studies are presented.

- *Auditee size*

It is supposed that larger size companies realizes more complex activities and need to be attractive to the investors. Therefore, these companies need to disclose more information and the audit of their financial statements definitely supposes bigger costs, while they have financial resources to select big well-known audit firms. The influence of corporate size on audit pricing was largely investigated in the international academic literature [12] - [22]. Many previous studies have used a regression analysis in order to test the influence of auditee size on audit pricing. As [23] admit a significant proportion of previous studies have used total assets or the logarithm of total assets as a proxy for company size, while other researchers [16] used the logarithm of total sales as a proxy for corporate size. Some authors [23] in their investigation on the role played by various size effects on audit pricing using data from the German market, proposed the using of the logarithm of the number of employees as a better proxy for corporate size than is the more common variable used logarithm of total assets. They also [23] argued that using logarithm of the number of employees is much better justified because it is more constant over time, it is not based on financial statement data and therefore collinear relations to other variables are not expected. So that, the same authors [23] used the logarithm of employees as the corporate size variable, while the robustness of the results were tested by using the logarithm of total assets as well as that of total sales for auditee size.

Therefore, our decision was to use as proxies for company size the total assets, the annual turnover (total sales) of the company and the number of employees, transformed using the natural logarithm. We expect a significant association between auditor size and audit fee in the Romanian market and our first hypothesis predicts:

Hypothesis 1: *Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by auditee size (the auditee size measured by using the proxies of total assets, turnover and the number of employees transformed using the natural logarithm).*

- *Profitability*

Considering the prior research [24] in what the expertise of the Chief Executive Officers in finance, is regarded as direct factor that induces the increase in profitability and reduces the probabilities for firm bankruptcy, other authors [25]:325 find in their recent research that

“auditors' engagement risk decreases when incumbent CEOs possess financial expertise, raising the likelihood that auditors will charge these firms lower fees”, one direct link between audit fee and corporate profitability.

Previous research studies realized on this topic revealed more frequently a positive linkage between audit fees and corporate profitability [21], [26]. Other specialists [26] found that companies with a high level of profit will manifest a tendency to disclose more information, which will be used by management to strengthen their position on market. On the other hand, these companies most frequently will be the subject of rigorous audit services testing their revenues and expenses [26]. Rigorous audit services suppose more significant audit fees. Various proxies were used by previous researchers in order to measure the profitability such as: net profit or result, return on assets, return on equity, net profit to sales. Consistent with the findings of the most of prior studies, our second hypothesis is formulated as follows:

Hypothesis 2: Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by profitability (net result).

- ***Capital's structure and shareholders' equity***

Considering prior research studies on this topic, we anticipate a positive impact of audited company's risk on the audit fees. There are recent studies realized by [27] that show that the social capital where the firm is headquartered affects audit fees, namely the social environment where the firm is headquartered is affecting the trusted-relation with auditors and, ultimately, the audit fees. The study implies that *„auditors judge the trustworthiness of their clients based on where the firm is headquartered and charge a premium when they trust the firm less”* [27]:611, the premium is consistently consider among the researchers the difference between a Big N audit fee and what a client could pay for a non-Big N auditor.

In a recent study, conducted in 42 countries [28]:744, it is argued that public firms that *“improve accounting transparency by appointing a Big Four auditor benefit through having a larger fraction of long-term debt in their capital structures, especially in countries that impose better legal institutions”*.

If other authors [29] used exogenous characteristics such as activity sector or endogenous ones such as “risks linked to the audited firm itself” (financial conditions, company growth, financial situation, etc), our decision was to use as proxies for measuring the risks associated with the audited company – capital's structure and shareholders' equity [30]-[31]. Therefore, our third hypothesis predicts:

Hypothesis 3: Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by capital's structure and shareholders' equity.

- ***Type of auditor***

In the previous academic literature there are some prior studies that have investigated the impact of characteristics of Big 4 (former known as Big 8, Big 5) auditors on audit fees for several international markets [23]. Other author [32] found that international well known auditors earn higher audit fees because their audit services are expected to deliver a higher quality. One author [13] concluded that a Big 8 audit fee is superior when using an Australian sample, while his findings were also supported by other results [33] when investigated a Hong Kong sample.

Analyzing the German audit market, while testing a sample of 2005 data on the German prime standard and GEX (German Entrepreneurial Index), some authors [34] have found that Big 4 auditors have an oligopoly, obtaining 87% of all audit fees, showing in the same time the significance of non-audit fees, which count to 41,9% of total audit fees. Other specialists [35] investigating the audit market in China, by using data from annual reports prepared by publicly traded companies, found evidence of Big 4 premiums for brand name for both statutory and supplementary market. Even more, they argued that Big 4 auditors can earn additional premiums in the statutory market as compared to non-Big 4 audit firms. They also found that non Big 4 audit firms increased their market share particularly for mid- and small-sized entities.

Other authors [23] study the existence of a Big 4 audit fee premium in German market, while prior audit pricing research in Germany has reported Big 4 audit fee premium without analyzing the factors influencing this premium more closely [34]. The findings of [23] confirm the existence of a Big 4 audit fee premium in Germany, but it is strongly affected by the premium of the overall market leader and the audit fee premium is not homogenous among Big 4 auditors. Furthermore, other author [36] find evidence for the Australian market that Big N Premium has augmented “*significantly*” in the two decades (Big 6 to Big 5 and Big 4 periods). Considering prior studies mentioned above our forth hypothesis is formulated as follows:

Hypothesis 4: *Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by type of auditor (Big 4 or not).*

- ***Type of audit opinion***

The literature review in this area consists, in early years, in examining the association between client’s independence using as indicative the audit opinion (in all its forms: unqualified opinion; qualified opinion; adverse opinion; disclaimer of opinion). The first to study this area were some specialists [37] which have found that auditors are “*less likely to issue a qualified audit opinion to larger clients when warranted*”.

More recently, other authors [38] conducted a research in Norway, a unique environment due to its significantly lower litigation risk (compared to the UK or US Market), for a large sample of private Norwegian firms, they studied whether auditors who receive higher fees are less likely to issue modified opinions, they find no evidence that auditors compromise their independence through fee dependence.

For the US market, other authors [39] find strong support for the debate on whether that higher levels of Non Audit Services fees paid to auditors reduces the frequency of modified audit opinion. Their findings suggest that concerns over the relation between auditor fees and the possible impairment of auditor independence, as reflected in modified audit opinions are supported in the more recent years (2010 and on) for highly distressed clients.

Regarding the influence in forming of the type of audit opinion, it was found that there is no evidence economic dependence cause Big Five auditors to report more favorably for larger clients [40], but that Big Five auditors report more conservatively for larger clients, suggesting that reputation protection dominates audit behavior. Later, other specialists [41] find that a BIG-N audit firm is more likely to issue modified audit opinions and clients in larger offices evidence less aggressive earnings management behavior, they argue that audit quality is higher on average in Big N offices, but makes no claims that audit quality is unacceptably low the other firms. Another opinion relevant in this matter is the one of [42] find that Big N partners do not compromise their independence for large clients, whereas non-Big N partners do.

While the impact of the type of audit opinion on audit fees was less analyzed in previous research studies [43] - [44], for an emerging economy we have not identified any prior study that investigates the influence of audit opinion on audit pricing, therefore, the proposed research hypothesis is:

Hypothesis 5: *Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by type of audit opinion.*

3. RESEARCH METHODOLOGY AND DATA CHARACTERISTICS

The goal of the present research is to test the following working hypotheses and evaluate if their significance has changed in time for the most important Romanian companies classified as public-interest entities, listed on Romania Stock Exchange.

3.1. Data

For the purpose of our analysis we have employed data for the most important 55 companies listed at the Romanian Stock Exchange. Audit and financial information was gathered for the 2009 – 2011 period. The last year of analysis is 2011 because starting 2012 Romanian companies are not obliged anymore to publish specific information regarding the annual audit process. Consequently, 2011 was the last year for which data could be publicly found for all 55 public-interest companies. Data was collected from the financial statements of the companies for the period selected.

According to the audit Directive 2014/56/EU on statutory audit amending Directive 2006/43/EC and the Regulation (EU) No 537/2014 on specific requirements regarding statutory audits of public interest entities, disclosed in the Official Journal of the EU on 27 May 2014 and entered into force on 16 June 2014, the definition of public-interest entities (PIEs) in the European Union is given by:

- a. *„Entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;*
- b. *Credit institutions as defined in point 1 of Article 43(1) of Directive 2013/36/EU of the European Parliament and of the Council, other than those referred to in Article 2 of that Directive;*
- c. *Insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC or;*
- d. *Designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.” (Article 2 point 13) [45].*

It was mentioned that this Directive 2014/56/EU on statutory audit has to be transposed into national law of each Member States within 2 years.

Public-interest companies were selected for realizing this present study, because of their significance for Romanian economic environment development, but also due to their transparency (even if required by the legal requirements) about the audit fees paid during the selected period. The relevance of public interest companies is also emphasized by the DIRECTIVE 2006/43/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending

Council Directives 78/ 660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC saying that: „*Since public-interest entities have a higher visibility and are economically more important, stricter requirements should apply in the case of a statutory audit of their annual or consolidated accounts*” (art.23) [46].

Quantitative variables were transformed using the natural logarithm. The variables are disclosed in Table 1.

Table 1: Variables used in the analysis

	Symbol	Variable	Type
<i>Endogenous</i>	Audit pricing	Audit pricing (audit fees)	Scale
<i>Exogenous</i>	T	Turnover	Scale
	Sh_E	Shareholders' equity	Scale
	Sh_E _DUMMY	Shareholders' equity (codified: 0 - if negative; 1- if positive)	Dummy
	TA	Total assets	Scale
	EMPL	Number of employees	Scale
	NET_RES	Net results (codified: 0 - if loss; 1- if profit)	Dummy
	BIG4	If the auditor is a Big4 company (codified 0 – if the auditor is not Big4 company; 1- if the auditor is Big4 company)	Dummy
	OPINION	The type of opinion expressed by the auditor (1 – unqualified opinion; 2 – qualified opinion; 3 – adverse opinion) 4 – disclaimer of opinion.	Ordinal
	CAP_STRUCT	Capital structure of the auditee (codified 1 – local capital; 2- foreign capital)	Ordinal

3.2. Methodology

In order to test our hypothesis, we have conducted an empirical study and we have covered most important 55 public-interest companies listed at the Romanian Stock Exchange between 2009 and 2011. We have employed panel data methods. Two models were finally used in the analysis that proved to be the most consistent. The difference between the two models consists in the fact that shareholder's equity is used once in its natural form (as scale variable) and once as a dummy variable, assessing only if the shareholder's equity are positive or negative. The use of both forms in the same models would have caused serious multicollinearity problems. We have applied a series of tests to evaluate the type effects present in our panel regression – the Hausman test, the Breusch-Pagan test, the Lagrange Multiplier test and so on. The final models proved to be in the cross-section random effects form, without time effects.

4. RESULTS

After applying all the required steps of the methodology, the most consistent models proved to be the one presented in Table 2. There are two models finally specified, due to the fact that shareholder's equity was once used per se (as values), and once as a dummy variable stating only if the shareholder's equity are positive or negative.

Table 2: Factors affecting audit pricing in Romania – cross-section random effects.

VARIABLE	MODEL 1		MODEL 2	
	Coefficient	P-value	Coefficient	P-value
T	0.203	0.009***	0.204	0.009***
Sh_E	-0.038	0.621	-	-
Sh_E_DUMMY	-	-	0.032	0.874
TA	0.038	0.700	-0.012	0.863
EMPL	0.161	0.011**	0.148	0.020**
NET_RES	-0.075	0.397	-0.069	0.436
BIG4	0.676	0.000***	0.761	0.000***
OPINION	-0.099	0.354	-0.159	0.128
CAP_STRUCT	0.052	0.487	0.077	0.296
Cons.	0.123	0.863	0.269	0.719
R-sq. – within	0.2817		0.2751	
R-sq. – between	0.4863		0.4914	
R-sq. – overall	0.4640		0.4763	
Wald Chi ²	76.70		77.94	
Prob. > chi ²	0.000		0.0000	
Sigma_u	0.640		.640927	
Sigma_e	0.269		.277670	
Rho	0.850		.84197	

Significance: *** - 1%, ** - 5%, * - 10%.

Source: authors' calculations in STATA 9.

Regardless of the model specified, the same three variables are highly significant in both cases. Thusly, we can state that for the analyzed sample of the most important Romanian companies, audit pricing is significantly influenced by the annual turnover of the company, the number of employees and the importance of the auditor (whether it is a Big4 auditor or not). As disclosed in Table 3, one can note that two of the four working hypotheses tested are accepted. Auditee size influences audit pricing in a positive way; larger auditee implies higher audit pricing. This hypothesis is accepted using as proxies for the auditee size both the annual turnover and the number of employees. But we should emphasize the fact that total assets do not influence the size of the audit price.

The second part of H1 goes together with H2 – audit pricing is higher is the auditor is a Big 4 company. The other two working hypotheses are rejected. The net result is not significantly influencing audit pricing, nor does the capital structure of the auditee.

The pre and post-estimation analyses (The Hausman, Breusch – Pagan and Lagrange Multiplier tests for fixed and random effects) all show the presence of cross-section (company) random effects and the lack of time effects. The existence of cross-section random effects is accepted

with a probability of $0.214 \gg 0.05$ by the Hausman test, for example, while the lack of time effects is accepted with a probability of $0.409 \gg 0.05$.

These results show that audit pricing is strongly influenced by the differences existing between the companies in the analyzed sample, while no significant difference appeared in the level of audit pricing in time. Consequently, no significant changes occurred in the level of audit pricing in Romania from 2009 to 2011 due to the international crisis or other factors influencing economic stability.

Table 3: Acceptation/rejection of working hypotheses

Hypothesis	Accepted/rejected
<i>Hypothesis 1: Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by auditee size (measured by total assets, turnover and the number of employees transformed using the natural logarithm)</i>	Partially accepted
<i>Hypothesis 2: Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by profitability (net result).</i>	Rejected
<i>Hypothesis 3: Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by capital's structure and shareholders equity.</i>	Rejected
<i>Hypothesis 4: Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by type of auditor (Big4).</i>	Accepted
<i>Hypothesis 5: Audit fees paid by Romanian public-interest entities listed on Bucharest Stock Exchange are influenced by type of audit opinion.</i>	Rejected

5. SUMMARY AND CONCLUSIONS

This paper developed a panel data analysis and estimated two models of audit fee determinants from Romanian market capital, in the case of Romanian 55 public-interest entities listed on Romania Stock Exchange, for 2009-2011 period. The difference between the two models consists in the fact that shareholders equity is used once in its natural form (as scale variable) and once as a dummy variable, assessing only if the company has positive or negative shareholders equity. The use of both forms in the same models would have caused serious multicollinearity problems. Our findings highlight that, regardless of the model specified, the same three variables are highly significant in both cases. The findings revealed that audit pricing for Romanian public-interest entities are significantly influenced by the annual turnover of the company, the number of employees and the importance of the auditor (whether it is a Big4 auditor or not).

This study is not without limitations. For instance, some of the standard variables which control the auditee characteristics used in previous studies, such as audit committee independence, corporate complexity, industry type or audit report lag are not included here. Then, the sample used was not such a large one, but this limit was because at the moment of data collection the disclosure of audit fees was not mandatory for all publicly entities, only for public interest companies the disclosure of audit fees was required. Finally, because our sample of entities was not very large, it is possible, despite the significance levels showed by our findings that the sample may be driving to the result. Therefore, an empirical objective for further research will

be to expand the sample to a much larger number of entities included, of course in the context of a much more transparency about audit fees in their financial annual reports.

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