



The relationship of Audit quality & Agency cost associated with Audit fees

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ABSTRACT

Objective: Agency problems caused as a result conflict of interest between managers and shareholders. In the meantime, the audit the efficient strategy to limit the powers of the managers in contractual relations is considered. The aim of this paper is the investigation the relationship between agency costs and audit quality associated with audit fees. The study population consisted of 492 years - company during the period 2010 to 2014. **Methodology:** In this study, the independent variables agency costs (the ratio of sales to total assets), agency cost (the operating expenses ratio on sales) and audit quality (the rank of audit company) and the dependent variable (audit fees) that using multivariate regression techniques with combined data and to Eviews8 software, hypothesis analysis were made. **Results:** The results revealed there is a significant relationship between agency costs (the ratio of sales to total assets), agency cost (the operating expenses ratio on sales) and audit fees and the lack of a significant relationship between audit quality and auditing fees. **Conclusion:** The other research results showed that there is significant relationship between company sizes with audit fees.

1. Introduction

Assess Pricing of audit services, is one of the favorite subjects for many audit researchers audit and so far, many studies in this regard have been done that some of them are mentioned in the background (Palmrose, 1989). Although the methodology used in this study is somewhat different together, but most of them follow one major goal and that is to identify the factors affecting audit fees. Knowledge of these factors is useful both for the client and the auditor. For many clients, the audit cost is significant digits (Collier and Gregory, 1999). Although it is possible in enterprises with high sales volume and liquidity or some public companies, the ability to pay these costs are easily possible, but the most small businesses or those which do not benefit from the strong financial situation, the cost can be very meaningful and important ; the costs that they have to pay for it (DeAngelo, 1981). As a result, from the view of client, to identify factors influencing audit fees, both negotiating and bargaining with them and by controlling the factors within the organization, it is possible to reduce such cost and its bear easier. The auditors also with knowing these factors can their services are properly is priced. The importance of this issue, especially in recent years, and after formation of the *Iranian Association of Certified Public Accountants - IACPA* can be seen in our country, because after the formation of *IACPA* a monopoly of audit labor market is broken down and intense competition among auditors conducted, an event that long time ago in the most developed countries have happened. From the early 70s to the early 2000s, the most audit institutions focus were on their growth than the professional values (Deis Jr and Giroux, 1992).

The audit institutions partners to find new customers keep current customers and counseling services, are under very stress and the failure to achieve such developmental goals in audit institutions, serious consequences, including dismissal from work for them terminated. In other words, it can be said in the recent 20 years, auditing profession had rapid changes and remarkable. Reducing regulation on audit labor market, to audit institutions be allowed more pursue economic goals and are looking to grow their revenue and reducing costs are in any audit work (Francis and Wilson, 1988). A number of financial experts, accounting is regarded as a notification system and some of them, the main purpose of accounting is providing useful information for decision-making. It is the duty of researchers that provide information to decision-makers to take correct decisions based on them. In this study, with relationship

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between audit quality and agency cost associated with audit fees and test hypotheses we provide useful information to users of accounting and auditing data (Becker et al., 1998). In fact, by doing this research is attempted to above target (the main purpose of accounting provides useful information for decision-making) has been followed.

1.1 A review of the research background

1.1.1 Internal researches

Alavi tabari et al. (2011) the study, entitled ‘the relationship between governance system and an independent the firms audit fees’ have done. In this study, of 201 companies listed in the Tehran Stock Exchange in 2008 was investigated. In this study, they concluded that there is direct and significant relationship between the percentage of institutional ownership governmental and quasi-governmental and the type of auditor with independent audit fees. It also showed that there is no significant relationship between board independence and audit fees.

Darougheh Hazrati and Pahlavan (2012) examine the relationship between earnings management, conditional clauses in the audit report, the type of auditor and the board composition with audit fees. The results show that among the four factors mentioned there is direct and significant relationship with audit fees.

Malekian et al. (2012) findings concerning the relationship between some of the mechanisms of corporate governance and audit fees, suggest a negative relationship between audit fees and percentage of non-duty board members and positive relationship between CEO duality with audit fees of companies listed was in Tehran stock exchange. Also, the relationship between CEO duality and audit fees when dispersed ownership is strengthened.

Azizkhani and Agha Beigi (2013) in their article titled "the Investigation audit fees in the initial audit and in future years the tenure of the audit duration in the companies listed on the Stock Exchange" The issue of pricing of the initial audit and how the relationship between future years tenure audit duration with fees and their impact on auditor independence upon audit quality, ever considered by observer organizations on the auditing profession ,capital markets and professional associations have been examined. The results indicate that an initial audit fee is higher than the future years audit fees. The results also indicate there is no significant relationship between future year's tenure duration and audit fees. The results did not show the existing initial audit breaking rate.

Vakilifard et al. (2014) in his article entitled "the investigation of adhesion audit fees" to investigate adhesion and short-term and long-term changes in audit fees is paid. For this purpose, the data relating to companies listed on Tehran Stock Exchange for the period 2008 to 2012 were extracted. Finally, the results indicate that the auditor change, lead to closer audit fees to the standard model.

Vaez et al. (2014) in the study, to investigate the relationship between audit quality and audit fees in company stock is paid. Their results showed that the relationship between audit quality criteria (size, expertise and continuity audit institute choice) with audit fees is a significant relationship.

They also in their research showed that by increasing continuity auditor choice, audit fees increased as well.

1.1.2 external researches

Lin and Hwang (2010) in his article entitled "Characteristics of corporate governance and independent audit fees" concluded that the independence of the Board of Directors (the ratio independent directors to the board) and the audit committee diligence (the number of sessions) there is positive and significant relationship with audit fees.

Rahman Khan et al (2011) in his article the ownership company concentration on audit fee in emerging economies studied. Bangladesh is used as an example. Previous research showed that significantly an audit fee in Bangladesh is lower. As well as, in Bangladesh the private sector by high ownership concentration is controlled. The agency theory predicts that in an efficient market, the managers in situation with high ownership concentration, have sufficient motivation for big auditing, but managers in emerging economies, that have no strong market may not have above motivation. The results of audit fees with the ownership company concentration have a negative significant relationship. This shows that in Bangladesh, the companies when by sponsors and institutional shareholders are control, audit fees have little pay.

Ittonen and Peni (2012) concluded auditor change lead to reduce audit fees. Audit institutions to adopt new business, reduce audit fees to obtain new business, as well as reduced fees, is due to the market structure of audit fees.

Table 1. Summary of results research accomplished

Name of Author	Year of research	Research results
Ittonen and Peni	2012	auditor change lead to reduce audit fees
Rahman Khan et al.	2011	audit fees with the ownership company concentration have a negative significant relationship
Lin and Hwang	2010	Independence of the Board of Directors (the ratio independent directors to the board) and the audit committee diligence (the number of sessions) there is positive and significant relationship with audit fees.
Vaez et al.	2014	The relationship between audit quality criteria (size, expertise and continuity audit institute choice) with audit fees is a significant relationship.
Vakilifard et al.	2014	The results indicate that the auditor change, lead to closer audit fees to the standard model.
Azizkhani and Aghabeigi	2013	The results also indicate there is no significant relationship between future year's tenure duration and audit fees
Alavi Tabari, Rajabi and Shahbazi	2011	there is direct and significant relationship between the percentage of institutional ownership governmental and quasi-governmental and the type of auditor with independent audit fees

Darougheh Hazrati and Pahlavan	2012	There is a significant relationship between earnings management, conditional clauses in the audit report, the type of auditor and the board composition with audit fees
Malekian et al.	2012	There is a negative relationship between audit fees and percentage of non-duty board members and positive relationship between CEO duality with audit fees of companies listed was in Tehran stock exchange

2. Materials and methods

In this study, the comparative method to understand the study theoretical principal and from the inductive method to data collection and test hypotheses was used. In this study, data both library research and databases methods were used. In library method the articles used in this research through the Internet have been received. The data that are required to calculate variables, through the *Tadbirpardaz, Rahavard Novin* databases, financial reports provided by Tehran stock exchange and other data obtained through the site www.rdis.ir (site of the Stock Exchange organization) is collected.

In data analysis model, the information after collection and then processed by statistical methods as follows using EvIEWS software version 8 are analyzed. The test hypotheses model is as follows:

(H₁): There is a significant relationship between agency costs and audit fees.

(H₂): There is a significant relationship between audit quality and audit fees.

The Models related to the first hypothesis:

$$FA_{i,t} = \alpha_i + \beta_1 AC1_{i,t} + \beta_2 SIZE_{i,t} + \varepsilon_{i,t} \quad (1)$$

$$FA_{i,t} = \alpha_i + \beta_1 AC2_{i,t} + \beta_2 SIZE_{i,t} + \varepsilon_{i,t}$$

The Model related to the second hypothesis:

$$FA_{i,t} = \alpha_i + \beta_1 QA_{i,t} + \beta_2 SIZE_{i,t} + \varepsilon_{i,t} \quad (2)$$

FA= Audit fees (the dependent variable)

AC₁= Agency cost (independent 1 variable) that is calculated in two ways.

AC₂= Agency cost (independent variable)

QA= Quality Audit (independent variable)

SIZE= Company size (control variable)

As mentioned in the model tests the hypothesis, in this study, the variables divide into three categories: independent variable, dependent and control. Agency costs and audit quality, it is considered as the independent variable. Audit fees, considered as the dependent variable. The effect of variable company size in this study is in the regression model controlled. Table 2 shows operational definition research variables and how to computing them.

Table 2. operational definition research variables and how to computing them.

Variable name	Variable type	how to computing	Source of data mining
Agency cost	independent variable	the operating expenses ratio on sales	Income statement (profit-and-loss statement)
Agency cost	independent variable	the ratio of sales to total assets	Balance Sheet and Profit & Loss
Audit quality	independent variable	To measure the audit quality from audit firms ranking is used.	Reports and notes accompanying the financial statements and independent auditors' reports
Audit fees	dependent variable	Cost of audit fees	The notes accompanying Financial Statements
Company size	Control variable	Logarithm of total assets	Balance sheet

According to the purposes of research and study population, in this study, a census method is used, which means that sample of all members community are considered and their required indicators examined during the 2010 to 2014. So, due to research territory where the Tehran Stock Exchange, considered and given the research nature and also some inconsistencies among companies listed on the Tehran Stock Exchange, the member firms which have the following conditions, as the research community chosen: in the period under consideration do not have change financial period, and are not Investment companies, financial Intermediaries, banks& leasing, the financial information required especially, the notes accompanying the financial statements are available. due to mentioned limitations, a number of 492 years - The company has been selected as the study population that given to availability all information relevant to companies in this study, from all the companies of study population (492 years), as a sample to test research hypotheses have been used.

3. Discussion and results

These Since data analysis is usually with summarized statistics computing such as Mean and Standard deviation takes place, so, in order to review and initial data analysis, the first the data related to descriptive statistics of the studied dependent and explanatory variables are presented in Table 3. When overview of the data analyzed in this study were obtained.

Table 3. Descriptive statistics of variables used in the study

Variable property	Agency cost (the operating expenses ratio on sales)	Agency cost (the ratio of sales to total assets)	Size (Logarithm of total sales)	Audit fees(figures)
Average	0.83	1.59	5.70	8.80
Middle	0.81	0.78	5.75	8.78
Max	8.88	129.04	7.18	10.13
Min	0.004	0/003	4.01	5.90
SD	0.46	6.70	0.51	0.41
variation range	0.88	129.04	3.16	4.23
Variation Coefficient	0.55	4.22	0.09	0.05

In this study to test hypotheses used combined data. In the combined data method to choose between panel and pulling method from F Limer test is used. If we select panel method, Haussmann test methods to choose from between the fixed effects and random effects methods is done and then, according to tests done and also, then. Check heteroscedastic to determine the research model and estimation method to estimate the model and test research hypotheses have been explored. The results of model estimation the first hypothesis to **ols** method include the following:

Table 4. Results of the first part of the first research hypothesis

$FA_{i,t} = \alpha_i + \beta_1 AC1_{i,t} + \beta_2 SIZE_{i,t} + \epsilon_{i,t}$			
variable	Variable coefficient	T statistic	P-value
Agency cost	0.04	4.17	0.000
Company size	0.36	2.85	0.004
Intercept	6.69	9.37	0.00
R2	0.149		
R2 justified	0.146		
F	40.82		
Prob	0.00		
Durbin–Watson statistic	1.64		

Table 5. Results of the second part of the first research hypothesis

$FA_{i,t} = \alpha_i + \beta_1 AC2_{i,t} + \beta_2 SIZE_{i,t} + \epsilon_{i,t}$			
variable	Variable coefficient	T statistic	P-value
Agency cost	0.003	3.45	0.000
Company size	0.36	2.72	0.006
Intercept	6.71	8.99	0.000
R2	0.152		
R2 justified	0.149		
F	41.81		
Prob	0.00		
Durbin–Watson statistic	1.65		

The results of model estimation the second hypothesis to **ols** method include the following:

Table 6. Results of the second research hypothesis

$FA_{i,t} = \alpha_i + \beta_1 QA_{i,t} + \beta_2 SIZE_{i,t} + \epsilon_{i,t}$			
variable	Variable coefficient	T statistic	P-value
Auditor rank	0.006	0.28	0.77
Company size	0.33	4.46	0.000
intercept	6.89	16.16	0.000
R2	0.67		
R2 justified	0.57		
F	7.02		
Prob	0.00		
Durbin–Watson statistic	2.06		

Post- test hypotheses considered, the results in Table 7 can be found.

Table 7. Results

hypothesis	Interval(Y)	P-Value	Test results
There is a significant relationship between agency costs (the operating expenses ratio on sales) and audit fees.	5	0.00	Hypothesis verification
There is a significant relationship between agency costs (the ratio of sales to total assets) and audit fees	5	0.00	Hypothesis verification
There is a significant relationship between audit quality (auditor rank) and audit fees.	5	0.77	Hypothesis refusal

4. Conclusion

This study examines the relationship between audit quality and audit fees on agency fee. Therefore, in this study, eventually using of the information inserted in the text and the notes accompanying Tehran Stock Exchange and Rahavarde Novin software (492 years-company) for the test hypotheses during the 2010-2014 is used. According to test hypotheses the following results have been obtained,

Table 8. Summary results

hypothesis	Test result	Related research
There is a significant relationship between agency costs (the operating expenses ratio on sales) and audit fees	Hypothesis verification	Zerni (2012)- Rajabi and Mohammadi Khashouei (2008)
There is a significant relationship between agency costs (the ratio of sales to total assets) and audit fees	Hypothesis verification	Zerni (2012)- Rajabi and Mohammadi Khashouei (2008)
There is a significant relationship between audit quality (auditor rank) and audit fees	Hypothesis refusal	Vaez et al. (2014)

The probability value independent variable of Agency costs (the ratio of sales to total assets), agency costs (the operating expenses ratio on sales in both is less than error coefficient considered (0.05). As a result, the first hypothesis states that the agency cost has a significant impact on audit fees. The results of the research with findings Rajabi and Mohammadi Khashouei (2008) are compatible, so that, they also obtained a significant relationship between agency costs and pricing auditing services. The results of the research with findings Zerni (2012) which states there is significant relationship between agency theory indicators and audit fees have corresponded. Independent variable coefficient audit quality (auditor rank) -0.006 and p-value 0.77 indicates a lack of a significant relationship between audit quality (auditor rank) and the audit fees. Therefore, there is no significant impact on the dependent variable of audit fees. The results of the research with findings Vaez et al. (2014) is not compatible, because of their results show significant positive relationship between audit quality and audit fees.

4.1 Research limitations:

Of course, any study due to 100% environmental conditions is not certainly and is faced with limitations. The first limitation that can be said is the most important limitation of this study, the characteristic of quasi-experimental research in social sciences is common. In other words, the effect of other variables that their control is out of available researcher and the possibility of an impact on results are not ruled out. The results of current study can be generalized to the stock companies.

Therefore, generalization of results to out of stock companies should be done cautiously.

4.2 Suggestions for future researches

in order to test the integrity of the results of research, using other statistical methods (factor analysis, regression, etc.) and research plan different from what was used in this study, the effectiveness of the independent variables used in conjunction with variables, such as profitability, financial leverage, The combination of company ownership, audit quality the number accounting documents and comprehensive manner be reviewed. During the study, other justified independent variables that can be affect the financial audit fees, could be identified. The variables, such as profitability, type of company ownership, the effectiveness of the internal control system, and so on and suggest these variables are tested in the future research.

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