The Determinants of Firms' Characteristics on the Audit and Non-Audit Premium : An Analysis of Firms Listed in the Malaysia Stock Exchange

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Abstract

A number of studies have concentrated in exploring the audit service provided by audit firms, and the related fee charged. Factors such as an audit firm's brand and its reputation and the skills and experience of auditors' are some of the important variables influencing the audit service fee. There is a lack of evidence of a relationship between an audit premium and audit quality or the monopoly of an audit firm. In addition, a significant increase in the non-audit service fee has posed a dilemma to auditors' ethical principles. It appears that the auditors have compromised their independence, objectiveness, and professionalism to provide the financial statement assurance in order to maximize their revenues. This impression has triggered the focus of this research to revisit the determinants that control the audit and non-audit fee and empirically explore whether the above claim is valid in the context of Malaysia's business environment. This research is crucial due to increasing corporate scandals recently reported in Malaysia. The analysis was undertaken on the Annual Reports of 2012 using the partial least square (PLS) for a sample study of 100 firms listed in Malaysia's stock exchange. The analysis revealed that only the firm characteristics of foreign shareholding, market capitalization, and foreign operations have a significant relationship with both the audit and non-audit fee.

Key words : **audit fee, non audit fee, agency theory and corporate governance of client characteristics**

JEL Classification : M410, M420, M490

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Much research has been undertaken to examine the determinants of audit and non- audit fees in the context of the business environment. After the notorious financial scandals, auditors are in the lime light, questioning their accountability in providing the assurance to stakeholders of a financial statement free from error and material misstatements. The auditors are entrusted to uphold the integrity and professionalism regarding the accuracy of financial statements. The seriousness of corporate scandals not being detected by the substantial audit tests by external auditors poses an important question regarding the substantial expenditures incurred by companies on audit fees and non-audit fees. Researchers argue the auditors' motive is to maintain the contractual relations with companies disposed to fraud risk in return for financial benefits earned

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through the audit fee and non-audit fee, where the latter provides significant contributions to the revenue of audit firms (Mironiuc & Robu, 2012).

The audit fee and non-audit fee is one of the most debated issues in the context of financial audits. This has resulted in serious repercussions to the audit independence and the quality of the audit work (Wines, 2011). The audit fee is related to services provided by auditors undertaking the audit tests on financial instruments, which are supposed to be the auditors' greatest concern. In most circumstances, the auditors' expertise is also channeled to a wide range of services, which result in a significant proportion of non-audit service fees and the common non audit services including bookkeeping , management functions, internal audit service, financial information systems design and implementation to name a few (Ahadiat, 2010).

This issue of the higher fees charged by the big audit firms has resulted in calls for evidence in the U.K., whether the oligopolistic structure of the audit or the delivery of a superior service are related to an audit premium (Campa, 2013). Although on the one hand, there is a lack of evidence of any relationship between an audit premium and audit quality or the monopoly of an audit firm, a stringent requirement to monitor auditors has become the primary objective due to the corporate scandals happening in bigger corporations like Enron-Anderson, Worldcom, Adelphia, etc. According to Campa (2013), the introduction of the Sarbanes-Oxley Act (SOX), regulations, and a code of corporate governance are in place to emphasize independent, good governance practices, and at the same time, to improve the audit quality internally and externally. The introduction of the Sarbanes-Oxley Act (SOX), Section 4 requires the managements and the external auditors to report the adequacy of internal controls within an organization (Franklin & College, 2016). This act even further puts pressure on managements and auditors on assurance of the audit services and non audit services and minimizes the unethical activities. However, the practitioners and the corporate leaders have reiterated that the accounting firms overlook the unethical activities, including misstatements of earnings, in an effort to increase firms' overall revenue (Ahadiat, 2010).

The audit firms are making significant revenue through non-accounting consulting services. A significant increase in non-audit service fees has posed a threat to auditors' ethical principles, where the auditors compromise their independence, objectiveness, and professionalism as they move away from their intended mission to provide the financial statement assurance to instead, maximizing profits.

This has caught the attention of academicians and practitioners, and subsequent detailed discussions have been done in the context of Western businesses. The focus of research has mainly dwelt on issues determining the audit fee and non-audit fee, though a positive contrary view has been presented that the auditors' involvement in non-accounting related services helps them to provide more efficient services related to financial assurance. This view, supported by Kinney, Palmorse, and Scholz (2004) and Flaming (2005), shows that the knowledge gained through engagement in non-audit services increases the audit firm's intellectual capital, leading to a more efficient audit performance.

Literature and Hypotheses Development

(1) Board Size : According to Abdullah (2004) , the board of directors is viewed as a team of individuals with fiduciary responsibilities to lead and direct a firm, with the primary objective to protect the shareholders' interests. The purpose of the board of directors is to monitor the performance of the firm so that the interests of the shareholders are protected (American Law Institute, 1982 ; Kosnik, 1987). Furthermore, Larcker and Richardson (2004) showed that for a small subset of firms with poor corporate governance, the relative level of non-audit fees (NAS) is positively associated with the level of abnormal accrual adjustments. Rahman (2009) claimed that the larger the board, the more effective they are in their responsibilities and also result in more strategies in decision making between them, compared to smaller boards. Similarly, Zahra and Pearce (1989) suggested that larger

boards are often more capable of monitoring the actions of their top management. Hence, a larger board intentionally requires less audit assessment and thus leading to lower audit fees. Hassan, Hassan, Iqbal, and Khan (2014) found that corporate governance, which proxies by board size, has a significant positive relationship with audit fee.

Providing a different view, Beasley (1996) and Jensen (1986) argued that board size significantly influences financial statement fraud and suggested that board size is likely to affect the financial reporting process, and hence, will influence the audit process. The larger board is perceived as less effective in monitoring financial reporting, leading to more audit assessments compared to smaller boards. This means that the larger number of members in the board will have difficulties in coordinating and face problems in organizing them. Regarding the number of board members, the research hypothesis is as follows:

↳ **H_1 :** The larger size board of directors is positively associated with audit and non-audit fees.

(2) Leverage : Simunic (1980) affirmed that debt, which is a measure of the risk of bankruptcy of the client, exposes the auditor to financial risk and reputation. Under these conditions, auditors may provide non-audit services to help companies manage their reputation risk. According to Watts and Zimmerman (1986), for companies which face a high level of debt, their board of directors encourage the auditors to preserve their accounting image. As a result, this leads to an increase in non-audit fees.

Arruñada (1997) argued that the higher is a company's probability of facing future financial difficulties, the more independent the auditor will be. His argument is consistent with the arguments of Zaman, Hudaib, and Haniffa (2011), who stated that leverage is positively related to audit and consulting fees because leveraged companies require more careful monitoring to protect themselves from financial and market risks. This implies that the auditing and consulting effort will be greater for companies with financial difficulties. Furthermore, Lu and Sapra (2009) also stated that companies with higher business risks are associated with auditor conservatism and that increased customer pressure improves auditing quality in this situation.

Given that more highly leveraged companies are more likely to have insolvency issues and have a higher financial risk, the relationship between company leverage and audit and non-audit fees should be positive; that is, audit and non-audit fees should be higher for more highly leveraged companies.

↳ **H_2 :** Leverage is positively associated with audit fees and non-audit fees.

(3) Return on Sales (ROS) : Profitability is related to the operations of the firm and the efficient use of its assets and other resources. A ratio is widely used to evaluate a company's operational efficiency. Highly profitable firms usually pay more fees in view of the fact that higher profits may require rigorous auditing testing of the validity for the recognition of revenue and expenses, which requires more audit time. Empirical evidence is inconclusive in this regard. While studies carried out by Wallace (1984) and Joshi and Al - Bastaki (2000) found that profitability had a significant effect on the level of audit fees, subsequent studies by Francis and Simon (1987) and Chan, Ezzamel, and William (1993) did not find it significant. Return on sales (ROS) is taken as an indicator of profitability in this study. Therefore, the following hypothesis is developed:

↳ **H_3 :** Return on sales (profitability) is positively associated with audit and non-audit fees.

(4) Directors' Shareholdings : Jensen (1986) concluded that a manager that has a large share of his/her wealth in the company is likely to be more risk-averse in making investment decisions than a manager who has a more diversified portfolio. Furthermore, Abdel-Khalik (1993) argued that the higher the managerial ownership, the lower the demand for assurance because owners are more actively engaged in day-to-day operations. In line with

these arguments, Chow (1982) and Niemi (2005) found that audit fees are lower for companies which are owner-managed. Gotti, Han, Higgs, and Kang (2012) found that managerial ownership has a significant negative relationship with audit fees, which suggests that managerial equity ownership aligns management and shareholder interests, which results in reducing the agency problem that arises from separation of ownership and control.

↳ **H_4 :** Directors' shareholdings are negatively associated with audit and non-audit fees.

(5) Foreign Shareholding : Bladacchino, Attard, and Cassar (2014) revealed that foreign-owned companies tend to pay higher fees than their Maltese-owned counterparts. A number of audit partners confirmed that the recovery rates related to audit services provided to foreign companies are higher than those achieved on similar Maltese companies. One possible reason for such an outcome is that foreign-owned companies tend to regard the auditing service more highly than their Maltese equivalents, who view an audit as something compulsory. On the other hand, the higher rates could be due to the believed "deeper pockets" of foreigners, tying up with the explanations emanating from the results on auditee profitability. The following is the hypothesis developed :

↳ **H_5 :** Foreign shareholdings are positively associated with audit and non-audit fees.

(6) Institutional Shareholding : Bladacchino et al. (2014) stated that government-controlled entities have lower audit fees than other companies. They argued that auditing such firms was of a prestigious nature and in a bid to win the audits of such companies, lower fees are charged. In fact, although recently, the majority of companies have shifted to private ownership, the culture of lower fees for government entities is still entrenched in the Maltese market. Ali and Lesage (2014) also reported a negative association between government shareholdings and audit fees in French listed firms. Therefore, the hypothesis developed is:

↳ **H_6 :** Institutional shareholdings are negatively associated with audit and non-audit fees.

(7) Internal Audit Department : Bladacchino et al. (2014) stated that internal audits and the effectiveness of internal controls strengthens the internal controls and accountability within organizations. The strength and extent of internal audit could be said to be directly correlated with the value of the external audit function. For instance, work carried out by the internal audit department may be used as evidence by the external auditors, thereby reducing the duplication and the extent of audit work. Although it is possible to determine which companies have such a capability, it is very difficult to determine its effectiveness, which is crucial if the aforementioned theory is to apply. Linked to internal audits is the notion of internal controls, which are also expected to affect audit fees because the audit process should be sensitive to differences in the control environment of an organization. Audit partners highlighted that an audit engagement, *ceteris paribus*, based on compliance testing, is cheaper than if a fully substantive approach is adopted. Owing to the sensitivity of the type of strategy executed by audit firms, such information was unavailable. Therefore, the following hypothesis is developed:

↳ **H_7 :** The presence of an internal audit department is negatively associated with audit and non-audit fees.

(8) Market Capitalization : Simunic (1980) stated that company size appears to be the central explanatory feature when studying audit fees. This conclusion is rather intuitive, since auditors' fees are paid according to the amount of time spent in completing a given job. This implies that the bigger companies are involved in a greater number of transactions that necessarily require longer hours for an auditor to inspect. Consequently, the positive correlation between the size of the audited company and the fees paid to the auditors can be explained by the higher number of

hours billed. Gonthier-Besacier and Schatt (2007) also provided the same conclusion that the audit fees are higher in larger firms where conditions for risk are higher, namely in terms of inventory and receivables. Therefore, the hypothesis developed is:

↳ **H_8 :** Market capitalization is positively associated with audit and non-audit fees.

(9) Foreign Operations : Bladacchino et al. (2014) stated that complexity in terms of the scope of operations has an effect on the audit fee, especially when the company's activities widen, particularly if they span across international borders. It has been corroborated that as active subsidiaries increase, consolidated financial statements require additional effort to audit as subsidiaries become more complex to be audited. Audit fees escalate further when the majority of subsidiaries are incorporated in foreign countries, as audit partners held that this requires additional correspondence with the foreign subsidiary's auditors. As the number of subsidiaries in a company increases, the amount of time required to perform the audit increases (Menon & Williams, 2001) which would indicate that as the geographical spread increases, the complexity also increases. More subsidiaries or operations require more audit work; therefore, audit firms charge higher audit fees. Additionally, Joshi and Al-Bastaki (2000) also argued that complex, diversified businesses with foreign operations lead to complex audit process. If organizations have more subsidiaries, then it requires more complex audit work leading to firms charging higher audit fees. They further stated that subsidiaries in different countries often have to comply with a variety of statutory and professional requirements for disclosure, and thus this entails additional audit testing. This implies that the companies have to bear additional charges for audit work. Important studies which support the complexity variable as a determinant of audit fees are Langendijk (1997), Collier and Gregory (1996), Sandra and Patrick (1996), and Taylor and Baker (1981). Amba and Al-Hajeri (2013) discovered that the number of subsidiaries has a significant influence in determining audit fees in Bahrain.

This study concentrates on complexity in terms of the scope of foreign operations of the sample companies. Therefore, the following hypothesis is developed :

↳ **H_9 :** Foreign operations are positively associated with audit and non-audit fees.

(10) Company Growth : Growth is an additional factor to be taken into account in order to understand the determinants of audit fees. Gonthier-Besacier and Schatt (2007) stated that it is expected that high-growth firms would generate a greater degree of complexity and greater risks for the auditing firms. In fact, the auditing procedures must be significantly adjusted to reflect the amount of company transactions, which in turn increases the risk of not detecting potential anomalies in company accounts.

The audited company's growth is also assessed to explain audit fees. Previous audit studies by Maher, Tiessen, Colson, and Broman (1992) ; Chan, Ezzamel, and William (1996) ; Carcello, Hermanson, Neal, and Riley (2002) indicated that audit complexity significantly influences the audit fees. Hypothetically, we would expect that as the audit client becomes more complex, more time and effort are needed to perform the external work. The increased audit effort will result in increased external audit fees (Pop & Iosivan, 2008). As the revenues increase, the transactions also increase, thereby increasing the items to be audited and sampled, giving rise to more audit hours (Swanson, 2008). Titshabona (2014) found that the relationship between revenue and audit fees is significantly positive. In this study, the variable revenues have been used to indicate audit client complexity. Therefore, the following hypothesis is developed:

↳ **H_{10} :** Company growth is positively associated with audit and non-audit fees.

Research Methodology

Although research studies are continuously produced on this aspect, the findings still lack in developing countries such as Malaysia and the focus of this research is to revisit the determinants that control the audit fee and non-audit fee and empirically explore the same in a developing country context like Malaysia. This research in the context of Malaysia is timely due to a number of corporate scandals and that the firms are facing financial obstacles justifies revisiting the clients' characteristics influencing the audit and non-audit fees. In view of this research need, the following research questions were formulated to address this empirical analysis.

RQ1 : What are the client characteristics that influence the audit fee in Malaysia?
RQ2 : What are the client characteristics that influence the non-audit fee in Malaysia?

The data obtained from annual reports were analyzed using the PLS which improves the accuracy in determining the factors that influence the audit and non-audit fee. The regression models to test the association between the level of audit premium (audit and non-audit fees) and client characteristics using the PLS research methodology are provided below :

$$\eta_1 = \beta_0 + \beta_1\, BODZISE + \beta_2\, DEQ + \beta_3\, FRGNOPT + \beta_4\, FRGSHDG + \beta_5\, IA + \beta_6\, GROWTH + \beta_7\, MKTCAP + \beta_8 INSTHOLD + \beta_9 DIRHOLD + \beta_{10} ROS + \varepsilon$$

…… Model 1

$$\eta_2 = \beta_0 + \beta_1\, BODZISE + \beta_2\, DEQ + \beta_3\, FRGNOPT + \beta_4\, FRGSHDG + \beta_5\, IA + \beta_6\, GROWTH + \beta_7\, MKTCAP + \beta_8 INSTHOLD + \beta_9 DIRHOLD + \beta_{10} ROS + \varepsilon$$

…… Model 2

The dependent variables in this study are audit and non-audit fees. Model 1 describes the audit fee (η_1) and Model 2 describes the non-audit fee (η_2).

The details of the independent variables are as follows:

where,

β_1 *BODZISE* = board size
β_2 *DEQ* = debt equity ratio
β_3 *FRGNOPT* = foreign operations
β_4 *FRGSHDG* = foreign shareholding
β_5 *IA* = internal audit
β_6 *GROWTH* = company growth
β_7 *MKTCAP* = market capitalization
β_8 *INSTHOLD* = institutional shareholding
β_9 *DIRHOLD* = director shareholding
β_{10} *ROS* = return on sale

The literature highlighted that the partial least square (PLS) is not limited to survey-based data but is applicable to the evaluation of latent construct based on archival sources, and experimental results, and is highly recommended (Lee, Petter, Fayrard, & Robinson, 2011). Ittner, Larker, and Rajan (1997) asserted that the structural equation modeling (SEM) and partial least square (PLS) can be used to further extend accounting research and also applies, in particular, to data from archival accounting research. Thus, using the PLS to analyze the factors influencing the audit and non-audit fees in Malaysia of listed firms provides the empirical

methodological knowledge where in the past, the empirical analysis was concentrated using the first generation statistical analysis, such as ordinary least square (OLS).

Analysis and Results

The data for this research is taken from the Bursa Stock Exchange, Malaysia which had 819 companies listed by the end of 2012. The purpose of selection of 2012 is mainly due the introduction of revised Malaysia code of corporate governance. Using the data from 2012 provides justification to study the influence of firm characteristics on audit and non - audit fee. The sample firms selected are the top 100 companies based on their market capitalization. As of December 31, 2012, market capitalization of these 100 companies constituted more than 80% of the total listed companies' market capitalization. As such, the selected companies can be considered

Table 1. Industry Category

Industry	Frequency	%
Trading	37	37.0
Plantation	13	13.0
Consumer	16	16.0
IPC	4	4.0
Industry Product	13	13.0
Properties	8	8.0
Constructions	5	5.0
Technology	1	1.0
Transportation	1	1.0
Manufacturing	1	1.0
Hotel	1	1.0
Total	100	100.0

Table 2. Collinearity Statistics

	Audit Fee		Non-Audit Fee	
Variables	Tolerance	VIF	Tolerance	VIF
BODSIZE	0.875	1.1422	0.875	1.1422
DEQ	0.928	1.0781	0.928	1.0781
FRGNOPT	0.861	1.1616	0.861	1.1616
FRGSHDG	0.832	1.2025	0.832	1.2025
IA	0.917	1.0905	0.917	1.0905
Growth	0.886	1.1283	0.886	1.1283
MKTCAP	0.852	1.1741	0.852	1.1741
Insthold	0.960	1.0416	0.960	1.0416
Dirhold	0.949	1.0532	0.949	1.0532
ROS	0.915	1.0933	0.915	1.0933

BODSIZE - Board Size, *DEQ* - Debt Equity Ratio, *FRGNOPT* - Foreign Operations, *FRGSHDG* - Foreign Shareholder, *IA*- Internal Audit Department, *Growth* - Company Growth, *MKTCAP* - Market Capitalization, *Insthold* - Institutional Share Holding , *Dirhold* - DirectorShareholding, and *ROS* - Return on Sale.

as a representative sample for this study. All data for the above variables tested in this study were extracted from the annual reports of the 100 companies for the year 2012.

As shown in the Table 1, the majority of the companies represented are in the trading sector (37%) followed by the consumer sector (16%). The plantation and industry product sectors represent equal proportions (13%). The rest of the industry representation is only 1%, nevertheless, these companies are retained as the data collected from these companies provide valuable information to support the research objective, which is to investigate the factors influencing audit and non- audit fees. Industries such as technology, transportation, manufacturing, and hotel receive professional financial and non financial consultation from auditors. Thus, the inclusion of these firms has some impact on the analysis. The analysis of firms listed on the Malaysian stock exchange revealed the majority of the firms , that is, 91% received services from the Big 4 audit firms and a small portion of the above sample received audit and non-audit assurance services from non-Big 4 audit firms which represent only 9% of the sample companies .

The model is tested for construct validity and reliability using the variance inflation factors (VIF) and Pearson

Table 3. Correlation Matrix

Panel A: Pearson Correlations of Non-Audit Fee

	Log NAFEE	*BODSIZE*	*DEQ*	*FRGNOPT*	*FRGSHDG*	*IA*	*Loggrowth*	*MKTCAP*	*PercInsthold*	*Percdirhold*	*ROS*
Log NAFEE											
BODSIZE	-0.0958										
DEQ	0.1209	-0.0788									
FRGNOPT	0.0720	0.0594	-0.1733**								
FRGSHDG	0.2118**	0.2051**	-0.0080	0.1128							
IA	0.2073**	-0.0144	0.0551	0.1668**	0.1261						
Loggrowth	0.0001	0.0673	-0.0069	-0.2102***	0.1989**	-0.1025					
MKTCAP	0.2772***	0.1573**	0.1327*	-0.0983	0.1966**	0.1507**	0.0388				
PercInsthold	0.0352	0.1551*	-0.0102	0.0687	-0.0112	0.0248	0.0226	-0.0380			
Percdirhold	-0.0878	0.0085	-0.0510	0.0032	0.0802	-0.0173	0.0330	-0.1757**	-0.0438		
ROS	-0.0320	-0.1895**	-0.0851	-0.0653	-0.1493*	0.0453	0.0478	0.0414	-0.0679	-0.0539	

Panel B: Pearson Correlations of Audit Fee

	LogAFEE	*BODSIZE*	*DEQ*	*FRGNOPT*	*FRGSHDG*	*IA*	*Loggrowth*	*MKTCAP*	*PercInsthold*	*Percdirhold*	*ROS*
LogAFEE											
BODSIZE	0.2211***										
DEQ	0.0927	-0.0788									
FRGNOPT	0.2066***	0.0594	-0.1733**								
FRGSHDG	0.4576***	0.2051**	-0.0080	0.1128							
IA	0.1948**	-0.0144	0.0551	0.1668**	0.1261						
Loggrowth	0.0362	0.0673	-0.0069	-0.2102***	0.1989**	-0.1025					
MKTCAP	0.2973***	0.1573**	0.1327*	-0.0983	0.1966**	0.1507**	0.0388				
PercInsthold	-0.0769	0.1551*	-0.0102	0.0687	-0.0112	0.0248	0.0226	-0.0380			
Percdirhold	0.1316*	0.0085	-0.0510	0.0032	0.0802	-0.0173	0.0330	-0.1757**	-0.0438		
ROS	-0.2009**	-0.1895**	-0.0851	-0.0653	-0.1493*	0.0453	0.0478	0.0414	-0.0679	-0.0539	

Notes : Coefficient is statistically significant at : *10, **5, ***1 % and at one-tailed.

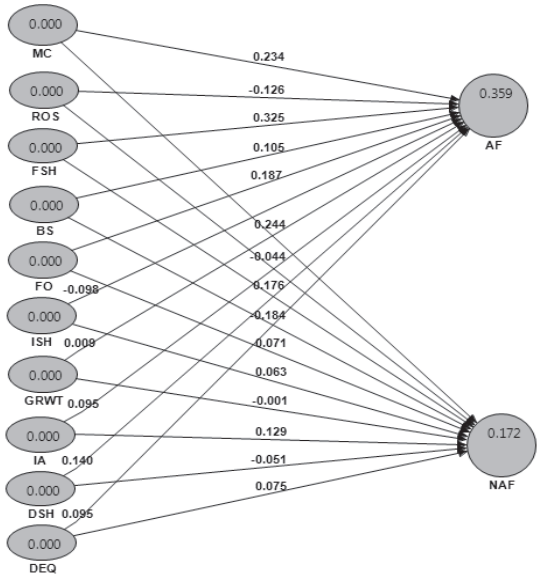
correlation matrix. Both of these reliability tests are shown in the Table 2 and Table 3, respectively. The analysis of VIF less than 10 and greater than 0.1 for tolerance is recommended by Hair, Anderson, Tatham, and Black (2010). As shown in the Table 2, the VIF value of audit fees and non-audit fees ranges from 1.042 to 1.202. The tolerance values range from 0.832 to 0.960 for both the audit fee and non-audit fee. On the whole, both the analysis of Pearson correlation and diagnostic analysis conclude that there is a non-existence of multicollinearity issue between the research variables. The VIF value less than 10 is not a serious concern of multicollinearity as argued by Neter, Wasserman, and Kutner (1989) and has no significant effects on the stability of the parameter estimates (Dielman, 1991). Therefore, based on the validity analysis presented in the Table 2, the data has no issues related to multicollinearity.

As shown in the Table 3, the correlation results reveal that the entire correlation value is less than 0.80. The value of correlation should not be more than 0.80 to ensure the absence of a multicollinearity issue (Gujarati & Porter, 2009). The results reveal that the highest correlation is below the threshold of 0.80. As presented in the Table 3, among all other client characteristics, only foreign shareholding *(FRGSHDG)* has some correlation with an audit premium. As the results reveal, the value is 0.4575 (significant at the 0.1 level) with audit fee and a value of 0.2118 (significant at the 0.05 level) for non-audit fees. Although significant, the value is less than the recommended threshold value claimed by Gujarati and Porter (2009) of 0.8. This provides clear evidence that the multicollinearity between the client characteristics (independent variables) and the audit premium (audit fee and non-audit fee- as dependent variables) and between the independent variables is absent.

On the whole, the test analysis of VIF and correlation indicates that the data collected is free from error, and the data is analyzed further using the PLS statistical methodology to test Model 1 Audit Fee (η_1) and Model 2 Non-Audit Fee (η_2) with all client characteristics. The results of path analysis on both the dependent variable of audit (η_1) and non-audit fee (η_2) with all the independent variables (β_1 till β_{10}) are shown in the Figure 1.

The path analysis, as presented in the Table 4, reveals the R^2 for audit and non-audit fee is less than the threshold value of a strong association of 80% and above. The value for the former is 0.36 and the latter is 0.17, indicating that the association between the client characteristics classified as independent variables and the dependent research variables is weak. These results suggest that overall, the client characteristics selected in this

Figure 1. Structural Model of Audit and Non Audit



Variable Definition

MC	- Market Capitalization
ROS	- Return on Sales
FSH	- Foreign Shareholding
BS	- Board Size
FO	- Foreign Operations
ISH	- Institutional Share holding
GRWT	- Company Growth
IA	- Internal Audit Department
DSH	- Director Share Holdings
DEQ	- Debt Equity Ratio
AF	- Audit Fee
NAF	- Non Audit Fee

Table 4. Path Coefficients and Analysis Results

	Sample Mean *(M)*	Standard Deviation *(STDEV)*	Standard Error *(STERR)*	Coefficients	*t* Value
Board Size -> Audit Fee	0.091	0.086	0.086	0.105	1.227
Board Size -> Non-Audit Fee	-0.184	0.122	0.122	-0.184	1.517
Company Growth -> Audit Fee	0.006	0.095	0.095	0.009	0.093
Company Growth -> Non-Audit Fee	-0.003	0.094	0.094	-0.001	0.010
Debt Equity Ratio -> Audit Fee	0.077	0.101	0.101	0.095	0.947
Debt Equity Ratio -> Non-Audit Fee	0.067	0.063	0.063	0.075	1.191
Directors Share Holdings -> Audit Fee	0.122	0.125	0.125	0.140	1.127
Directors Share Holdings -> Non-Audit Fee	-0.051	0.151	0.151	-0.051	0.339
Foreign Operations -> Audit Fee	0.178	0.094	0.094	0.187	*1.999
Foreign Operations -> Non-Audit Fee	0.069	0.110	0.110	0.071	0.650
Foreign Shareholding -> Audit Fee	0.322	0.092	0.092	0.325	**3.537
Foreign Shareholding -> Non-Audit Fee	0.181	0.057	0.057	0.176	**3.079
Institutional Share Holding -> Audit Fee	-0.019	0.166	0.166	-0.098	0.587
Institutional Share Holding -> Non-Audit Fee	0.084	0.053	0.053	0.063	1.173
Internal Audit Department -> Audit Fee	0.104	0.095	0.095	0.095	1.004
Internal Audit Department -> Non-Audit Fee	0.138	0.124	0.124	0.129	1.037
Market Capitalization -> Audit Fee	0.224	0.093	0.093	0.234	**2.510
Market Capitalization -> Non-Audit Fee	0.240	0.084	0.084	0.245	**2.927
ROS -> Audit Fee	-0.114	0.083	0.083	-0.126	1.513
ROS -> Non-Audit Fee	-0.034	0.075	0.075	-0.044	0.589
R Square	Audit Fee				0.36
	Non-Audit Fee				0.17

Note : Coefficient is statistically significant at the **0.01 level (2-Tailed) and * 0.05 level (2-Tailed)

Table 5. Results of Hypotheses Testing

Hypothesis	Relationship	Supported
H_1	The larger size of board members is positively associated with audit and non-audit fees.	No
H_2	Leverage is positively associated with audit fee and non-audit fees.	No
H_3	Return on sales (profitability) is positively associated with audit and non-audit fees.	No
H_4	Directors' shareholdings is negatively associated with audit and non-audit fees.	No
H_5	Foreign shareholdings are positively associated with audit and non-audit fees.	Yes
H_6	Institutional shareholdings are negatively associated with audit and non-audit fees.	No
H_7	The presence of internal audit department is negatively associated with audit and non-audit fees.	No
H_8	Market capitalization is positively associated with audit and non-audit fees.	Yes
H_9	Foreign operation is positively associated with audit and non-audit fees.	No for Audit Fee Yes for Non-Audit Fee
H_{10}	Company growth is positively associated with audit and non-audit fees.	No

study are only influencing the audit fee by 36% ; whereas, the non-audit fee is influenced by only 17%, and both indicate very poor associations.

The client characteristic variables, such as board size, company growth, debt to equity ratio, directors' shareholding, institutional shareholding, internal audit department, and return on sales are not significant with both the audit or non-audit fee. Foreign operations is significant with the audit fee (t - value = 1.999 and $p \leq 0.05$), however, it is not significant with the non-audit fee. The foreign shareholding is significant with both audit (t- value = 3.537 and $p \leq 0.01$) and non-audit fee (t - value = 3.079 and $p \leq 0.01$). Similarly, the market capitalization is also significant with both the audit (t - value = 2.510 and $p \leq 0.01$) and the non-audit fee (t - value = 2.927 and $p \leq 0.01$).

Thus, the above analysis confirms the research hypothesis relationships as shown in the Table 5. The following section discusses the above findings on the influence of client characteristics classified as independent variables on audit and non-audit fees.

Discussion and Conclusion

This empirical study explores the influence of client characteristics on audit fees and non-audit fees in the context of the Malaysian business environment. Some of the findings provide a contrary view from other past empirical studies. This research reveals that only two client characteristics, namely foreign shareholding and market capitalization have a significant positive association with audit and non-audit fees. The analysis also indicates that foreign operations have a significant positive association with audit fees but not with non-audit fees.

The past research studies use market capitalization as an important yardstick to measure the firm size and the results revealed that this variable has a strong positive association with both dependent variables. This finding is consistent with prior studies, which suggests that firm size is one of the main factors that determine the audit service premium charges (Ezzamel, Gwilliam, & Holland, 1996 ; Joshi & Al-Bastaki, 2000). When firms grow bigger, the assets size also proportionately increases through the diversification of business and this ultimately determines the market capitalization. A higher value of market capitalization indicates growth in the size of the business assets, but this also exposes the firm to an increase in corporate risk. Thus, seeking the external auditors' assistance in receiving business advice is crucial to sustain the business's survival and minimize the agency cost related to business risks. The finding of this study is consistent with the empirical research results obtained by Gonthier-Besacier and Schatt (2007), where the audit fee is higher for a large firm, considering that the business risk is higher due to bigger market capitalization.

The impact of market capitalization on audit premium clearly demonstrates that the corporate sector companies in Malaysia seek professional advice from external auditors on financial and non financial matters such as tax service, discretionary accruals, and on earnings management, which has an impact on financial statements. This kind of non audit service is justified when a business grows bigger, adding to the complexity of business and demand for these services increases when a business operates in a foreign country. These then drive both audit and non-audit fees, which varies according to the size of the company measured via market capitalization. In most cases, both of these services are provided by the same accountant who has been appointed to audit the financial statement. This type of business requires the knowledge and support from external auditors to provide assurance for the sustainability of a business, and also to instill confidence among investors and stakeholders. This brings benefits to a company, but also danger, where a similar accountant, who has been providing both the audit and non - auditing services, could pose some negative impact to the firm, whereby the auditors tend to favor the client decision for retaining the customer. This view is supported by the results of Venkatesh and Aghajan (2008) that the joint provision of providing multidisciplinary services by auditors is mainly due to economic incentives and receiving lucrative NAS fee will create a tendency in the auditor to agree with clients.

The other corporate governance variable that has a positive and significant association with both audit and non-audit charges is foreign shareholding (audit fee ; t = 3.5367 ; p - value < 0.01 and non-audit fee ; t = 3.0791, p - value < 0.01). Most of the foreign shareholders operate in a highly regulated corporate governance environment, such as within the framework of the Sarbanes-Oxley Act of 2002. As a result, these foreign shareholders expect similar corporate governance policies that are practised in their country to be followed or practised in their foreign subsidiary. The prime reason behind this motive is to ensure that their investment is protected, and business is administered fairly. The foreign shareholder entrusts the audit firms, and the fee is paid for their services in return to mitigate any capital losses of their investment and also to reduce the agency cost. The evidence of emphasis on good corporate governance practices and policies is acknowledged in a number of empirical studies; for instance, Wu (2012) indicated that auditors have now begun to attach greater importance to evaluation of internal corporate governance. Firms treating auditors as management consultants, in particular, those from the Big 4 audit firms, is mainly because of their knowledge and experience. On the other hand, it may also be argued that Malaysian firms' appointment of Big 4 audit firms for both audit and non-audit services is one of the strategies to attract foreign shareholders as mentioned earlier. This view is highlighted in the signaling theory where managers signal high-level corporate governance to external stakeholders by inviting a more rigorous external audit, which inevitably leads to higher audit fees and, therefore, companies with strong corporate governance pay higher audit fees to accounting firms (Wu, 2012), and the rigorous external audit is better performed by the Big 4 audit firms due to the experience and knowledge the auditors gain from auditing firms at a global level, which brings the advantage of spill over knowledge to the other audit clients and they provide better assurance of audit services. As noted by Pouraghajan (2009), the large audit firms try to supply a higher quality of audit service to primarily protect the brand and reputation that comes within the Big 4 category.

The third variable, namely foreign operations, has also shown some significant relationship with the dependent variables. However, this client characteristic has a positive but moderate association (t-value 1.9991, p - value < 0.05) with audit fees and no significant association with non-audit fees. A foreign operation means a Malaysian firm is operating a subsidiary in a different nation. The findings of this study reveal that the significance on audit service than non-audit service has some logical reason. This could be argued from the point of view that the priority of the audit is to ensure corporate financial assurance. The non-audit service is less of a priority due to legislation on corporate governance already in place in their respective countries, whereby the Malaysian subsidiaries operating in a foreign country are required to follow the rules and regulations on corporate governance with no exception to it to legally operate. This contributes less cost to be incurred on non-audit services in Malaysia, where the focus of local auditors is to look into maintaining the accuracy of corporate financial reports as per the accounting standards and practices of a particular country. The view, claimed by Hassan and Naser (2013), is that the audit fee has a strong association with a company's complexity and is measured by the number of subsidiaries; this high cost is justified on the grounds that more audit work is required to examine both, individual company financial statements and consolidated financial statements. They further stated that complicated audit procedures are necessary for a company which has foreign subsidiaries in order to make sure that the company complies with accounting standards imposed in the home country. The above discussion provides valid justification for the significant association between the foreign operations and a higher audit fee, mainly due to the complexity of accounts.

The other corporate governance independent variables such as board size, company growth, leverage measured using the debt to equity ratio, directors' shareholding, institutional shareholding, internal audit department, and return on sales have no significant association with either audit or non-audit fees. Although these clients' characteristics are not significant, the analysis of association reveals that board size, company growth, directors' shareholding, and return on sales have a negative association with non-audit fees ; whereas, institutional shareholding and return on sales have a negative association with audit fees. Interestingly, the other corporate components, in particular, board size, leverage, and company growth, in the past empirical studies, showed some

association with audit premiums ; whereas, this study provides a contrary view which calls for future research to explore the area further using the qualitative research approach.

Implications, Limitations of the Study, and Scope for Future Research

This study offers a number of limitations. First, the audit fee and non-audit fee may be calculated in different forms ; whereby, the fee should include other associated expenses in relation to audit services and non-audit services. This includes costs like travel fees and whether the audit cost is inclusive of interim reports. Besides, the study also highlighted that the mean difference between the Big 4 and non Big 4 for audit premium is significant in comparison to non audit premium. The study revealed that the audit premium of the Big 4 is lower compared to non Big 4 - this is mainly to attract the business by reducing the lower audit fee and increase the charges on non audit fee. However, the justification is insufficient, and it is recommended that the future studies undertake a more robust analysis using time-series analysis incorporating at least 3 years data to evaluate the impact of audit fee and non audit fee to provide a more concrete justification of explaining the similarities and differences of payments of audit and non audit fees. The findings from the analysis can further clarify the absence of oligopoly manipulation in Malaysia. The income of non audit service fee remains the main lucrative source of income for audit firms in Malaysia and extending the analysis further, as recommended earlier, will enrich the literature knowledge in this area. Future studies in this area can further be classified into large companies audited by Big 4 and non Big 4.

The other limitation is that almost all studies in accounting research include a research focus on agency theory. Few studies in Malaysia concentrate on anything other than the agency theory. Accounting theories such as substitution theory and signaling theory provide two distinct explanations on association between corporate governance and audit fees, and empirical studies should be undertaken on the basis of this theory, and studies can be undertaken using other board characteristics such as board independence and audit committee.

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