Governance St ... re and External Audit Price: Evidence ... an Emerging Economy

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ABSTRACT

This study provides new evidence on the relationship between external audit price and corporate governance of the largest (based on market capitalization) 100 listed firms on both the main and second board of the Bursa Malaysia (BMB) (previously known as the Kuala Lumpur Stock Exchange). The findings show that for main board companies, external audit price is positively and significantly associated with corporate size, complexity and internal governance variable (i.e. director's remuneration). For the second board firms, complexity, corporate size and internal governance variables (i.e. proportion of non-executive directors to total directors) were important determinants of external audit pricing. External audit price had a significant negative relationship with individual shareholders ownership for both main and second board companies, and companies' age for companies listed on the second board.

Keywords: External Audit Fee, Corporate Governance, Bursa Malaysia, Retail Shareholdings, Corporate Age, Firm Size.

INTRODUCTION

Over the last few decades, a sizeable number of studies have examined the relationship between audit pricing model and corporate governance characteristics in developed

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economies (O'Sullivan and Diacon, 1994; Short *et al*, 1999; Peel and Clatworthy, 2001; Clatworthy and Peel, 2006; Yatim *et al.,* 2006). The Cadbury Report (1992) viewed the auditor's report as "one of the corner stones of corporate governance". Peel and Clatworthy (2001) highlights that audit report contributes significantly towards "effective governance of modern corporations". In Malaysia, a series of reforms has been initiated, for example, shifting from merit based to disclosure based regulatory system since 1996, followed by a number of corporate governance reform activities after the 1997 Asian Financial Crisis to further enhance the level of good governance practices in the market. Among the various governance issues addressed by these reforms, the role of external auditor if facilitating good governance has been highlighted. The high level of Finance Committee on Corporate Governance regards auditor as the external force responsible for good corporate governance. Specifically, the reforms had implications on the link between audit fees and the role of external auditors in ensuring good governance among corporations. This paper ascertains this relationship for the largest 100 firms listed on the main and second board of the Bursa Malaysia. This approach allows us to understand the differences in audit pricing strategies of companies with different size, listing requirements and internal governance variables (i.e. individual ownership, director's ownership, director's remuneration) not documented in the relevant literature from developed markets.

This paper is organised as follows. The following section explains the background to the auditing and audit practice in Malaysia. Section three reviews Malaysian business environment, and relevant prior literature on the relationship between audit fees and corporate governance is presented in section 4. Section 5 briefs on data collection and research design followed by findings and discussion in sections 6 and 7 respectively. Section 8 concludes the paper.

BACKGROUND TO AUDITING AND AUDIT PRACTICE IN MALAYSIA

In the early years of independence, accounting and auditing requirements and practices in Malaysia were similar to those of the British accounting practices[1]. In 1958, the Malaysian Association of Certified Public Accountants (MACPA) was set up by a group of British trained accountants that replicate the UK's ICAEW in all respects of its practices such as the professional education, standards and discipline, except that it has no authority to regulate the profession or register accountants. In addition, the adoption of the Malaysian Companies Act 1965 marked another similarity to the British accounting profession.

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[1] Malaysia gained her independence in 1957.

The Malaysian government in 1967 has initiated to establish the Malaysian Institute of Accountants (the MIA) under the Accountants Act 1967 with the intention to regulate and control the practice. The MIA through the Accountants Act 1967 has required all persons to register with the Malaysian Institute of Accountants (MIA) before they can practice as an accountant or auditor and are bound by a strict ethical code and professional standards.

Malaysian auditing practices adopted the International Standards on Auditing (ISAs) as the basis for approved standards on auditing and related services that issued by the International Auditing Practice Committee (IAPC) of the International Federation of Accountant (IFAC). Previously, the practice adopted the International Auditing Guidelines that had been the authoritative auditing guidelines since 1982[2]. Since 1 July 1998, the codified ISAs become operative for all audits and Malaysian Standards on Auditing (MSAs) are issued to augment ISAs adopted by MIA. MSAs were issued by the MIA as part of its efforts to define standards of auditing and harmonize auditing practices in Malaysia. They cover topics not dealt with in an ISA or topics where particular features of the Malaysian environment warrant a domestic standard written specifically to address those features.

To maintain the level of professional standard of the Malaysian audit practitioners, the MIA has recommended a guideline on audit fees calculation which is called as a 'Recommended Basis for Determining Audit Fees' in its By-Laws (On Professional Conduct). The rationale for this recommendation is to ensure a consistent and harmonize fee levels across the board. The MIA member is expected to counter-check their audit fees derived on time cost basis with the MIA's Benchmark. The audit fees is computed by multiplying the Total Assets or Gross Turnover as shown in the financial statements with the coefficient percentage as outlined in the MIA's by-law.

MALAYSIAN BUSINESS ENVIRONMENT

The securities industry in Malaysia effectively began in the late 19th century with the domination of British companies in both the rubber and tin industries that had their origins in the United Kingdom (UK), or were subsidiaries of the UK companies. The first move towards securities trading in Malaysia was initiated with the establishment of Singapore Stockbrokers' Association in 1930. This was the first formal organisation in the securities business in Malaysia (then Malaya) until the

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[2] The council of the MACPA has approved auditing standard for publication comprised of the International Auditing Guideline (IAG) (approved by the MACPA) and the Malaysian Auditing Guidelines (issued by the MACPA) to cover topics peculiar to the Malaysian environment which warrant domestic standards written specifically to address the peculiar feature.

formation of Malayan Stock Exchange and started their public trading on the 9th May 1960. In 1973, the Kuala Lumpur Stock Exchange (KLSE) was established to provide a central market place for buyers and sellers to transact business in shares, bonds and various other financial securities of Malaysian listed companies[3]. The KLSE is a self-regulatory organisation that governs the conducts of its member (stock broking firms) in securities dealings. Also, it is responsible for the surveillance of the market place and for the enforcement of its Listing Requirements, which spell out the criteria for listing, disclosure requirements and standards to be maintained by listed companies. During the early stage of securities industry in this region, there was a strong link between the KLSE and Stock Exchange of Singapore (SES) where Malaysian incorporated companies were listed and traded through the SES and vice versa. In 1990, both stock exchanges were formally separated and all Singaporean companies were delisted from the KLSE and vice versa.

In 1988 the second board was established on the KLSE. The second board provides opportunity for smaller firms with great potential to grow but do not meet the listing requirements of the main board. The listing requirements for these companies are less stringent than those of the main board. Ow-Yong and Cheah (2000) postulate that prior to the 1980s, the vast majority of Malaysian companies were either family owned domestic firms or subsidiaries of foreign multinationals. These companies were reluctant to participate in the securities industry due to apprehension of losing control. With the introduction of the second tier market for small and high potential firms in 1988, the participation from this group of companies increased tremendously where 294 companies were listed on this board as at 31st December 2002. The development of Malaysian capital market was further enhanced by the government's privatisation programme starting with the national electricity company and national telephone operator. These newly listed companies are still being controlled mainly by particular individuals or are family owned with minority shareholding in the hands of the investing or state-controlled (Claessens *et al.,* 1998, 1999a, 1999b). The KLSE has been renamed as "Bursa Malaysia" since April 2004 and later listed on the Exchange.

Finally, the MESDAQ market was created on March 18, 2002 following the merger between the Malaysian Exchange of Securities Dealing & Automated

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[3] The securities industry is governed by a number of statutes such as Securities Industry Act 1983 (SIA), Securities Industry (Central Depositories Act) 1991 (SICDA), Securities Commission Act 1993 (SCA), Futures Industry Act 1993 (FIA) and Companies Act 1965. In order to make the regulatory structure more efficient, there are five key authorities that involved in regulating the capital market namely the Securities Commission (SC), Central Bank (Bank Negara Malaysia/BNM), Company Commission of Malaysia (Suruhanjaya Syarikat Malaysia/SSM) (formerly known as Registrar of Company), Foreign Investment Committee (FIC) and Ministry of International Trade and Industry (MITI).

Quotation (MESDAQ) Berhad with the Kuala Lumpur Stock Exchange (KLSE). It operates as a unique market with a separate identity from the KLSE's Main and Second Boards, catering specifically for the capital raising needs of technology-based and high-growth potential companies. The MESDAQ Market is focused at bringing together these companies and interested investors.

A REVIEW OF LITERATURE ON CORPORATE GOVERNANCE AND AUDIT FEES

Corporate Governance Dimensions

The need to establish a framework of corporate governance is derived from the agency problem resulting from the separation of ownership and control. A governance structure serves as a mechanism that monitors management performance and ensures its accountability to shareholders. In addition, corporate governance can be used as an instrument to motivate management behaviour towards achieving corporate objectives. In this section, a number of literature based governance dimensions expected to influence external audit price are discussed.

Individual Ownership

The agency theory postulates that the demand for timely audits is directly related to the extent of the separation between ownership and control. In other words, the demand for extensive audit is directly related with widespread ownership. Chan et al. (1993) examined the relationship between the level of corporate ownership concentration and audit fees, after controlling for other variables, in a sample of UK quoted companies and reported negative and significant association between the variables. They concluded that their result gives support to the agency theory in that the more diffused the ownership from control the more extensive is the audit and therefore price or fees charged. However, Peel and Clatworthy (2001) caution that measuring ownership concentration by including both directors and other outside substantial shareholders might result in an interpretation problem. They contend that although there is support to the proposal that directors' concentration is an important factor affecting agency costs, the ability of substantial shareholders to reduce agency costs and hence audit fees is questionable. In this regard, Dedman (2000) investigated the determinants of the non-financial UK firm's board structure and provided no evidence to support the belief that institutional investors played an effective role in promoting best practice in connection with the board structure of their investee companies. Similarly, Faccio and Lasfer (2000) explored the role of occupational funds in monitoring UK companies that hold large stakes and found

no evidence to support that their holdings have any impact on companies' performance, institutional investors or compliance with the Code of Best Practice. They concluded that occupational pension funds are not effective monitors. Consequently, combining directors' ownership and substantial shareholders in one variable might hide part of fact. In this study, the extent of separation between ownership and control is measured by the percentage of shares owned by retail or individual investors. In the Malaysian setting, businesses are generally viewed as family businesses and a significant proportion of shares are owned by a number of investors and government. Hence, the percentage of shares owned by individuals form an accurate reflection of the extent of diffusion between ownership and control. It is, therefore, hypothesized that:

H_1: External audit price is positively associated with the proportion of shares owned by individual shareholders.

Directors' Ownership

The idea that directors' ownership formulates the interest of shareholders and managers is recognised by the agency theory (Jensen and Meckling, 1976). In this respect, Jensen and Meckling (1976) use the convergence interest hypothesis to argue that corporate performance increases as the percentage of shares owned by management increases since management is less willing to tempt resources away from value maximisation. Demsetz (1983), however, challenged this argument in that market forces would force management to observe value maximisation at any ownership levels. Yet, Morck et al. (1988) indicated that high level of management ownership concentration would lead to "*entrenchment*" and outside shareholders will find it difficult to control management's actions. Evidence on the relationship between management levels of ownership and its behaviour is mixed. Studies in the USA found that management adhere to corporate value maximisation principles at low and high level of management ownership (Morck *et al.,* 1988; Kole, 1995; McConnel and Servaes, 1995). Thompson et al. (1992) reported a linear positive relationship exists between performance and the level of management ownership in a sample of UK companies. Short et al. (1999), however, listed a number of factors that form dimensions of corporate governance among them were directors' remuneration and director's ownership. In all cases, it is fairly documented that where management owns high proportion of shares they attempt to maximise wealth. It is therefore hypothesized that:

H_2: External audit price is negatively associated with the proportion of shares owned by the board of directors.

Audit Firm Status

Auditor's report plays an important role in corporate governance mechanism as it minimises information asymmetry between management and provides external funds. Audit firms in Malaysia are typically classified into two main categories: national and national affiliated to the big international audit firms. Zulkarnain et al. (2006a) indicated that the audit firm's reputation influences quality. They reported that the quality of corporate reporting disclosed by companies audited by audit firms affiliated to the big international firms is higher than that disclosed by companies audited by local firms. It is important to mention here that large international audit firms in Malaysia maintain the quality of their audit and usually entails additional cost. In addition, audit firms affiliated to the big international firms incur more overhead costs that are usually borne by the clients. In return, large companies prefer to deal with big international audit firms to assure the public of the audit quality and minimise agency costs. Evidence on the relationship between the status of the audit firm and the price of external audit is not conclusive. Simunic (1980) and Firth (1985) found no difference between fees charged by big and small audit firms and whether the audited company is large or small. On the contrary, Palmrose (1986), Francis and Stokes (1986) and Chan et al. (1993) provide evidence that big audit firm price their services higher than smaller firms. It is therefore hypothesized that:

H_3: Audit firms affiliated to high international audit firms are expected to charge higher audit price than that charged by local audit firms.

Directors Remuneration

The agency theory suggests that suitable remuneration provide directors with incentives to promote corporate objectives and ensures long-term corporate performance (Milgrom and Roberts, 1992). In this respect, Main et al. (1996) reported positive and significant association between corporate performance and directors' remuneration. In practice, shareholders use remuneration to reduce the conflict of interest with the management. Performance related remuneration is becoming a common practice in both the public and private sectors. However, Short et al. (1999) revealed that management controls the process of formulating the remuneration package. Where remuneration is based on performance, the external auditor is expected to undergo intensive testing of corporate accounts to verify performance figures. Taylor and Baker (1981) suggest that a company's ability to pay external audit price is influenced by the level of its profitability. In other words, companies reporting higher profits are expected to pay more in audit fees. However, Simunic (1980) argues that companies reporting high profits decrease auditor's risk and this might subsequently lead to decrease in audit fees. It could further argue that increase in reported profit could be due to efficient use of resources and reduction in overhead

costs. This would lead to less audit work and therefore audit fees. It is therefore hypothesized that:

H_4: External audit price is negatively associated with directors' remuneration.

Control Variables

To ascertain a clearer association between audit fees and governance, the following variables are used as control variables in this study.

Corporate Size
Corporate size has been shown as an important factor associated with external audit price in many previous studies (Taylor and Baker, 1981; Firth, 1985; Simon *et al.,* 1992; Chan *et al.,* 1993; Anderson and Zeghal, 1994; Collier and Gregory, 1996; Firth, 1997; Langendjik, 1997; Clatworthy and Peel, 2006). Auditing a large company requires longer audit time and therefore leads to higher audit fees. Large companies in Malaysia are primarily concentrated in the banking, consumer and manufacturing sectors. Hence, the accounts of these companies are more sophisticated and require more audit time compared to companies in the other sectors. The agency theory, suggests that large sized companies are more likely to be scrutinised by the public and are thus expected to incur higher agency costs. The management of a large company would, however, try to assure the public by minimising agency cost and appointing a prestigious and expensive audit firm. After all, large sized companies can afford to pay higher external audit price than smaller ones and are more likely to use external sources (stock exchange and banks) to raise funds. Using external sources of financing entails comprehensive disclosure and hence auditing work. Therefore large sized companies are expected to employ advanced accounting and internal audit systems that facilitate their audit work at the expense of higher costs. Conversely, it can be also argued that auditor concentration may result in specialisation and economies of scale in the auditor's costs.

Essentially, the literature documents that corporate size as the main factor that explains the price of external audit. Though different measures of size have been used in previous research, the total assets measure was found to be the dominant measure. However, this research uses the market capitalization as a measure of firm size, as asset size is based on historical information and not reflect the true size of the firm. It is therefore hypothesized that:

H_5: Large companies measured by market capitalization are expected to pay more external audit price than smaller companies.

Corporate Risk

Corporate risk has been used in previous studies to explain variations in external audit price. A risky corporation is expected to run the risk of audit failure. This would result in intensive audit testing and hence an increase in audit fees (Simunic, 1980). Due to the difficulty of identifying specific measure of risk, different proxies have been used in the literature such as equity to total assets ratio, long-term liabilities to equity ratio, acid test ratio, current ratio, loss sustained in the previous year, loss sustained in the current year, working capital to total assets ratio and corporate age. Similar to Brinn et al. (1991), this research employs the previous year's performance and corporate age as proxies of risk. As for previous year's performance, a company that sustains loss in the previous year is classified as risky and will be subject to intensive audit testing in the year that follows and this might add to external audit fees. The use of the age variable, however, is based on the notion that companies run the risk of failure in the first ten years of their existence (Hudson, 1987). Hence, young companies are expected to run a higher risk than those associated with much older companies. However, this argument can be challenged on the grounds that older companies are more likely to expand and thus develop different lines of business. This would make the auditing process more sophisticated and costly. It is therefore hypothesized that:

H_6: Companies with high levels of risk measured by previous year's loss and by age are expected to pay higher audit price than that paid by companies reporting profits.

Non-Executive Directors to Total Directors

Shamsher and Zulkarnain (2003) and Zulkarnain et al. (2006a) have indicated that non-executive directors as an effective monitoring agent that act in the best interest of shareholders in particular and stakeholders at large. Borokhovich et al. (1996) find a positive monotonic link between the proportion of outside directors and the possibility that an outside director is employed as CEO that would benefits shareholders. Rosenstein and Wyatt (1990) found a significant share price increase following the appointment of outside directors. Conversely, Weisbach (1988) demonstrate a strong association between managerial turnover and performance within firms with outsider-dominated boards. These studies acknowledge the importance and monitoring effectiveness of outside directors and are consistent with Fama and Jensen (1983) arguments that reputation and the threat of legal action motivate outside directors to act in the best interest of shareholders. Bhagat and Black (1998), contend that previous studies do demonstrate how board composition influence overall firm performance as companies with independent boards could perform better on particular tasks, yet worse on other unstudied tasks, leading to no net advantage in overall performance. Therefore, we hypothesized that:

H_7: Companies with high proportion of non-executive directors are expected to insist more audit work and therefore have a positive impact to the external audit price.

Complexity

Complexity variable has been used extensively in many prior studies on audit pricing model (Cameran, 2005; Chan *et al.,* 1993; Clatworthy and Peel, 2006; Simunic, 1980; O'Keefe *et al.,* 1994; Joshi & Al-Bastaki, 2000). Literature documented that business complexity of the firm being audited as a determinant of audit fees. Firm that is more complex requires deeper and larger audit tests before an auditor could provide an objective opinion. Indeed, auditor needs to put more effort in planning, co-ordinating and executing the audit function, as the complexity increases. Firms with complex business requires more time and this would result to a higher audit fee. Findings in a recent study (Clatworthy and Peel, 2006) showed that complexity was a significant indicator for higher audit fees and the auditor that audit complex auditee would have more exposure to liability than non-complex auditee. Consistent with prior findings in the literature, this paper uses the number of subsidiaries in the auditee's group as the indicator for complexity.

H_8: Companies with high number of subsidiaries (as a proxy measure of level of complexity) are expected to require more audit effort and therefore have an impact to the external audit price.

DATA AND METHODOLOGY

Testable Model

Based on documented literature, an ordinary least square regression (OLS) is used to test the relationship between the dependant variable (external audit price) and the explanatory variables (percentage of shares owned by individual shareholders, percentage of shares owned by the board of directors, corporate size, status of the audit firm, corporate level of risk measured previous year's losses and corporate age, directors remunerations and dividend payout). The relationship between the dependent and independent variables is expressed in the following regression model.

$$EXAP = \alpha_0 + \alpha_1 IOWN + \alpha_2 BOWN + \alpha_3 SAUD + \alpha_4 BREM + \alpha_5 ASSET + \alpha_6 PRLO + \alpha_7 CAGE + \alpha_8 NETD + \alpha_9 CPLX + \varepsilon$$

Where:

	EXAP	=	External Audit price
(+)	INDV	=	Percentage of shares owned by individual investors
(-)	BOWN	=	Percentage of shares owned by individual directors
(+)	SAUD	=	Status of Audit Firm
(±)	BREM	=	Boards remuneration
(+)	ASSET	=	Total Assets
(-)	PRLO	=	Previous year's Loss (1), (0) otherwise
(±)	CAGE	=	Corporate Age
(+)	NETD	=	Ratio of Non-executive Directors to Total Directors
(+)	CPLX	=	Complexity

Data Collection

Profiles of all companies listed on the Main Board and the Second Board of Bursa Malaysia were gathered from the stock market's directory and a list of largest 100 firms (based on market capitalization) were sampled from Datastream database. Financial statements of all sampled firms were sourced from the annual reports posted on the Bursa Malaysia web page.

FINDINGS

Descriptive Statistics

Analysis of the variables showed small positive and negative skewness and kurtosis satisfying the distribution properties of financial figures referred to by Ezzamel and Mar-Molinero (1990) and Zulkarnain et al (2006b) [4].

The normality assumption, which was based on the normal distribution, is important for the interpretation of the tests of significance, and if the data does not satisfy this assumption, the results might be biased. To satisfy the normality assumption, most of the variables have been transformed either into logarithm or square root form (Afifi and Clark, 1990; Zulkarnain *et al.,* 2006b).

Finally, outliers were detected using a threshold at three-standard deviation (Hair et al, 1998).

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[4] Before deriving the final variables for analysis, it is found that most of the variables violated the normality assumption with high value of skewness and kurtosis. The appropriate remedial action has been taken where most of the variables were transformed either to logarithm or square root.

Correlations

Pearson correlation coefficients of variables used are summarised in Table 1. The findings in the table show that those explanatory variables such as *SUBS, BREM* and *ASSET* are positively related, and *IOWN* is negatively associated with external audit price. It is also evident that a number of significant correlations exist between the explanatory variables which imply multicollinearity. Hence different tests have been performed to assess the severity of the multicollinearity problem. However, the variance inflation factor (VIF) procedure was applied to address this problem. The VIFs for all variables reported in Table 2 show a value of less than 2, which is far below 10 when multicollinearity is viewed as a serious problem (Neter *et al.,* 1989). Hence, the explanatory variables used in this study do not pose a serious multicollinearity problem and allows the standard interpretation of the regression coefficients.

Multivariate Analysis

This paper employed nine independent variables to explain the external audit price of Malaysian listed firms. The result of the regression analysis is reported in Table 2 reveals that all explanatory variables are responsible for almost 70% of variations in the price of external audit (p<0.001). For main board companies, size (p<0.001), complexity measured by number of subsidiaries (p<0.001), directors' remuneration (p<0.001), individual ownership (pd<0.001) and companies' age (p<0.1) significantly explain the audit price. For second board companies, variables that reflects complexity measured by number of subsidiaries (p<0.001), corporate size (p<0.001), individual ownership (p<0.1), proportion of non-executive directors to total directors (p<0.1) and companies' age (p<0.1) are significant determinants of audit fees pricing.

This finding is consistent with that documented on similar studies in developed markets (Taylor and Baker, 1981; Firth, 1985; Simon, *et al.,* 1988; Simon *et al.,* 1992; Chan *et al.,* 1993; Anderson and Zeghal, 1994; Collier and Gregory, 1996; Firth, 1997; Langendjik, 1997; Clatworthy and Peel, 2006). For second board companies, complexity measured by number of subsidiaries was the strongest determinant of audit price. This result is consistent with the literature (Taylor and Baker (1981), Francis (1984), Firth (1985), Low et al. (1990), Simon et al. (1992), Iyer and Iyer (1993), Anderson and Zeghal (1994), Pong and Wittington (1994), Johnson et al. (1995), Collier and Gregory (1996), Sandra and Patrick (1996), Firth (1997), Mike (1997), Langendijk (1997) and Joshi and Al-Bastaki (2000)).

Contrary to expectation of the agency theory, individual ownership had a significant and negative association to external audit price for companies listed on the main and second board. The agency theory postulates that as the separation between ownership and management intensifies, audit testing also intensifies resulting in high audit fees. This finding are inconsistent with the notion that

Table 1 Correlation Coefficient Matrix of all Variables

Panel A: Main Board Companies

	EXAP	BREM	BOWN	CAGE	SUBS	ASSET	IOWN	NETD	SAUD	PRLO
EXAP	1.000	0.133	0.090	0.047	0.768**	0.306**	-0.386**	0.031	-0.116	-0.068
BREM	0.133	1.000	0.271*	0.211	0.119	0.403**	0.102	-0.242*	-0.111	-0.016
BOWN	0.090	0.271*	1.000	-0.091	0.158	0.081	0.184	-0.113	-0.267*	0.044
CAGE	0.047	0.211	-0.091	1.000	0.087	-0.016	0.198	-0.153	0.137	0.102
SUBS	0.768**	0.119	0.158	0.087	1.000	0.045	-0.298**	-0.103	-0.187	0.107
ASSET	0.306**	0.403**	0.081	-0.016	0.045	1.000	-0.083	0.214*	-0.174	-0.092
IOWN	-0.386**	0.102	0.184	0.198	-0.298**	-0.083	1.000	-0.162	-0.025	0.163
NETD	0.031	-0.242*	-0.113	-0.153	-0.103	0.214*	-0.162	1.000	0.051	-0.072
SAUD	-0.116	-0.111	-0.267*	0.137	-0.187	-0.174	-0.025	0.051	1.000	-0.087
PRLO	-0.068	-0.016	0.044	0.102	0.107	-0.092	0.163	-0.072	-0.087	1.000

Panel B: Second Board Companies

	EXAP	BREM	BOWN	CAGE	SUBS	ASSET	IOWN	NETD	SAUD	PRLO
EXAP	1.000	0.259*	-0.124	-0.028	0.731**	0.609**	-0.234*	0.120	0.040	-0.182
BREM	0.259*	1.000	-0.185	-0.032	0.314**	0.122	-0.047	-0.062	-0.033	0.023
BOWN	-0.124	-0.185	1.000	-0.307**	-0.149	-0.169	0.194	-0.125	-0.100	-0.080
CAGE	-0.028	-0.032	-0.307**	1.000	0.026	0.225*	-0.105	0.063	-0.012	-0.070
SUBS	0.731**	0.314**	-0.149	0.026	1.000	0.347**	-0.175	0.067	-0.052	-0.110
ASSET	0.609**	0.122	-0.169	0.225*	0.347**	1.000	-0.275**	0.023	0.114	-0.189
IOWN	-0.234*	-0.047	0.194	-0.105	-0.175	-0.275**	1.000	-0.109	-0.079	0.250*
NETD	0.120	-0.062	-0.125	0.063	0.067	0.023	-0.109	1.000	0.125	-0.142
SAUD	0.040	-0.033	-0.100	-0.012	-0.052	0.114	-0.079	0.125	1.000	-0.025
PRLO	-0.182	0.023	-0.080	-0.070	-0.110	-0.189	0.250*	-0.142	-0.025	1.000

** Correlation is significant at the 0.01 level (2-tailed)
* Correlation is significant at the 0.05 level (2-tailed)

Table 2:   **Results of the multivariate regression (audit fees is the dependent variable**

Panel A: Main Board Companies n = 69

	Coefficient	t-Ratio	Standardized Coefficient	Rank	Significant Level	VIF
(Constant)	4.170	3.299			0.002	
BREM	0.000	2.230	0.229	3	0.030	2.127
BOWN	0.051	1.482	0.113	NS	0.144	1.171
CAGE	-0.097	-0.824	-0.063	NS	0.413	1.173
SUBS	0.332	2.840	0.281	2	0.006	1.979
ASST	0.330	6.218	0.509	1	0.000	1.354
IOWN	-1.024	-2.455	-0.194	4	0.017	1.267
SAUD	0.305	1.379	0.103	NS	0.173	1.140
PRLO	0.526	1.112	0.100	NS	0.271	1.630
NETD	-0.433	-0.840	-0.070	NS	0.404	1.410
R			0.842			
R Square			0.708			
Adjusted R Square			0.664			
F			15.921			
Significant F			0.000			

Panel B: Second Board Companies n = 79

	Coefficient	t-Ratio	Standardized Coefficient	Rank	Significant Level	VIF
(Constant)	2.858	1.715			0.091	
BREM	0.000	1.107	0.092	NS	0.272	1.387
BOWN	0.053	1.433	0.119	NS	0.156	1.371
CAGE	-0.100	-1.811	-0.139	5	0.074	1.173
SUBS	0.505	7.761	0.587	1	0.000	1.144
ASST	0.393	4.428	0.347	2	0.000	1.226
IOWN	-0.500	-1.858	-0.151	3	0.067	1.327
SAUD	0.090	0.796	0.059	NS	0.429	1.094
PRLO	-0.011	-0.084	-0.006	NS	0.934	1.179
NETD	0.594	1.823	0.140	4	0.073	1.179
R			0.809			
R Square			0.655			
Adjusted R Square			0.610			
F			14.535			
Significant F			0.000			

external audit price is positively associated with the number of individual shareholders. Similarly, corporate age was found to be a significant and negatively associated with external audit price for companies listed on the second board. This might indicate the auditor's concern of the potential audit risk of new corporate firms that are listed on the second board.

A summary of the direction of the relationship between external audit price and the variables used are reported in Table 3.

Table 3   Summary of the result of the hypotheses testing

Panel A: Main Board Companies

Hypothesis	Hypothesis Direction	Resulted Direction	Hypothesis Accepted (√) Rejected (X)
H_1: Individual Ownership	(+)	-	X
H_2: Board Ownership	(-)	+	
H_3: Audit Firm's Status	(+)	+	
H_4: Directors Remuneration	(+)	-	√
H_5: Assets	(-)	+	√
H_6: Previous Year's Loss	()	-	
H_7: Corporate Age	(±)	+	
H_8: Subsidiaries	(+)	+	√
H_9: Non-Executive to Total Directors	(+)	+	

Panel B: Second Board Companies

Hypothesis	Hypothesis Direction	Resulted Direction	Hypothesis Accepted (√) Rejected (X)
H_1: Individual Ownership	(+)	-	X
H_2: Board Ownership	(-)	+	
H_3: Audit Firm's Status	(+)	+	
H_4: Directors Remuneration	(+)	+	
H_5: Assets	(-)	+	√
H_6: Previous Year's Loss	(±)	-	
H_7: Corporate Age	(±)	-	√
H_8: Subsidiaries	(+)	+	√
H_9: Non-Executive to Total Directors	(+)	+	√

DISCUSSION

This paper provides some preliminary evidence that corporate size explains audit pricing. This is consistent with the notion that auditors for large size companies require more time and effort to examine the client operations, and analyse the data and information (Simunic, 1980; Firth, 1985; Chan *et al.,* 1993; Pong and Whittington, 1994). The auditor needs to perform detail audit procedures to avoid risk of material misstatement (Joshi and Al-Bastaki, 2001).

Another important determinant of audit pricing is the complexity measured by number of subsidiaries. Perhaps, a more complex audit client i.e. client with large number of subsidiaries that have diverse business operations require more complex audit work, requiring higher audit fess. Indeed, auditor needs to apply more audit procedures to examine individual company financial statements and consolidated financial statement. Auditor work would be more complicated when involve foreign subsidiaries that are required to comply with various rules and regulations imposed by home country, therefore, requires more audit procedures and higher audit fees.

It was found that a governance variable namely individual ownership is significantly and negatively associated with the level of audit pricing, contrary to the expectation of the agency theory that explain the demand for extensive audit increases with widespread ownership. The association explains that the more disperse share ownership, the less audit fee would be. Perhaps, the concentration of share ownership to individual, family and state explain the negative association. Indeed, the Asian Financial Crisis in 1997/1998 was partly contributed by concentration of share ownership of the majority of public listed companies in the hands of few families/individuals and the state. This phenomenon is quite different from that documented in most industrialised nations (i.e. the UK and US), where share ownership is concentrated in the hand of relatively few powerful institutional investors such as pension funds, insurance companies and mutual funds. Ownership concentration of Malaysian listed firms before and during the crisis period are documented as follows: (i) single shareholder controls more than two-thirds of firms, (ii) the separation of management from ownership control is rare, (iii) about sixty percent of top management of the firms that are not widely held are associated with the family of the controlling shareholders, (iv) family control is extensive in more than half of East Asian corporations, (v) in some countries, a significant share of corporate assets are controlled by a small number of families; for example, the largest ten families in Malaysia control a quarter of the corporate sector, and Malaysia was also ranked as the second highest concentration of control (after Hong Kong), at 76.2 per cent of GDP (Claessens *et al.,* 2000). Consequently, the corporate policies and practices, reporting practices, level of disclosure and corporate culture may not be compliant with best governance practices as observed in developed markets.

Directors' remuneration variable was found to have a significant and positive relationship with audit pricing for main board companies. The association might

explain the director's incentive to promote corporate objectives consistent with the shareholders interest. Thus, directors would try to show their performance and have an interest to be audited to indicate their activities throughout the year to the shareholders. On the other hand, shareholders would use remuneration to reduce the conflict of interest. Thus, a more audit work is needed when more remuneration is paid to the directors.

The proportion of non-executive directors to total directors and corporate age were significantly associated with audit pricing of second board companies. As indicated in prior studies that non-executive directors have incentive to conduct effective monitoring on business operations. The existence of higher proportion of non-executive directors on the board would increase audit work as these directors would raise their concern and perform their monitoring role, which would increase more audit work. Thus, auditor would charge more audit fees to their clients. However, a negative relationship was also evidenced between corporate age and audit pricing model. In this context, young corporations will have higher risk of failure or incur losses in their early years of operation. Thus, they are subjected to more audit work and as a result auditor would charge more fees to young companies. Therefore, there would be an inverse relationship between corporate age and audit fees.

CONCLUSION

This paper investigates the association between corporate governance and variations in the external audit price. The evidence of this association from the listed firms in Bursa Malaysia provides a unique contribution to the literature on this issue. The association of corporate governance proxies such as percentage of shares owned by individual shareholders, director's remuneration, percentage of shares owned by directors, with audit price was examined. The findings showed that external audit price is positively and significantly associated with corporate size, complexity and internal governance variable (i.e. directors remuneration) for main board companies. The business complexity, corporate size and internal governance variables (i.e. proportion of non-executive directors to total directors) were important determinants of audit pricing for the second board firms. External audit price, however, is negatively and significantly related with the individual ownership of shareholders for companies listed on the main and second board, and companies' age for companies listed on the second board.

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