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OWNERSHIP STRUCTURED FIRMS IN MALAYSIA: AUDIT COMMITTEE CHARACTERISTICS AND AUDIT FEES

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ABSTRACT

The political economy shaped the ownership structure of corporations in Malaysia. The rapid growth of the economy has not diluted the concentrated ownership structure in the Malaysian firms. Malaysia has its own unique feature of ownership structured firms which can be divided into politically connected (PCON) firms, institutional ownership and managerial ownership (INST&MGRL) firms, and family ownership (FAMILY) firms. The purpose of this paper is to investigate whether PCON, INST&MGR and FAMILY firms are associated with higher audit fees. This study also examines the association between audit committee characteristics IND, DIL and EXP and audit fees based on the revamped Bursa Listing Requirements in 2008, which focus on audit committee characteristics. Using data from 567 firm-year observations from years 2008 to 2010, we find that PCON firms pay higher audit fees than INST&MGRL and FAMILY firms. Further, the association between audit committee IND, DIL and EXP and audit fees is positive and significant for PCON firms, suggesting that the government intervention



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is expected to produce better governance and improve the firm's business performance. This is because the government has given much attention and initiatives to ensure that these firms perform in an effective way and assist the government to improve the economic growth.

Keywords: *audit fees, audit committee, corporate governance, political connections*

INTRODUCTION

Malaysia offers clearly identifiable capital segments which are divided into different types of ownership structures. This division can be observed and categorised into institutional ownership and managerial ownership (INST&MGRL) firms, family ownership (FAMILY) firms and politically connected (PCON) firms. Institutional ownership under the Malaysian corporate sector is one of the ownership structures that is being shared amongst the East Asian economies such as Indonesia, Thailand, Singapore and Korea (Sulong & Mat Nor, 2008). It represents approximately 13 per cent of the total market capitalisation of Bursa Malaysia (Abdul Wahab *et al.*, 2009). In addition, firms with managerial ownership are also common amongst Malaysian listed firms. Claessens *et al.* (2000) estimates that approximately 85 per cent of Malaysian listed firms are owner managed, at the 20% cut-off of control right. Jensen and Meckling (1976) observe that as management ownership increases, their interests are more aligned with that of the owners and thus, the need for intense monitoring by the board decreases. Managerial ownership needs to be restricted because high managerial ownership results in managers having high personal interests, so that managers do not act in the best interest of the company, but for their self-interest (Setiadi *et al.*, 2016). Family controlled firm or family ownership is another common form of business organisation. A stream of literature explains that family ownership is central in most countries (Ibrahim & Samad, 2011). Malaysia has its own unique feature of politically connected firms or favoured firms, given the close link between selected large firms or conglomerates and the government. Market economists have argued that firms in the hands of the government are inferior in performance compared to firms in private hands (Boycko *et al.*, 1996b; Shleifer & Vishny, 1998; Dewenter & Malatesta, 2001). This argument arises due to

their institutional relationship with the government, the market structure in which they operate, or the management systems applied within them (Shleifer & Vishny, 1998). It is supported by the political embeddedness perspective emphasising that such connections provides opportunities to gain access to valuable resources (Okhmatovski, 2010). These favoured firms' political linkages influence the accumulation and concentration of wealth in Malaysian business (Gomez & Jomo, 1999). Thus, high level of government equity ownership was then seen as a challenge in enhancing good corporate governance in Malaysia (World Bank, 2005).

Malaysia has made significant progress in developing an efficient and well-regulated capital and financial market, as well as strengthening the institutional framework for the regulation of the accounting and auditing profession (World Bank, 2012). Good progress has been achieved in improving the quality and consistency of corporate financial reporting and corporate governance for listed firms. For instance, the revised Malaysian Code of Corporate Governance (MCCG) 2007 called for increased interactions between audit committee and internal audit functions. To ensure that audit committee serves as an effective check on the management of a firm, the Bursa Malaysia Listing Requirements (BMLR) was amended in 2008 to provide for the composition of audit committees, the frequency of meetings and the need for audit committee members to attend continuous training to keep abreast with developments in relevant financial and other related developments. With the continuous improvement on corporate governance practices, PCON firms are perceived to have better corporate governance practices and it is envisaged that these firms will reinforce this mind-set of continuous improvement in their day-to-day operations. This is important because Malaysian PCON firms were once perceived to be associated with higher business risk and poor performance. Hence, firms with good corporate governance attributes demand higher audit quality, resulting in higher external audit fees. Due to the above arguments, this study extends the audit fee literature to examine the relation between the enhanced internal governance mechanisms after the revision of BMLR 2008, specifically, audit committee independence, diligence and expertise, and audit fees amongst INST&MGRL firms, FAMILY firms and PCON firms.

Prior studies on PCON firms have generally drawn on the supply based perspective. Additionally, these studies have also examined the relationships

between corporate governance and audit fees for PCON firms before Bursa Malaysia revised listing requirements in 2008 (for example, Abbott, 2003; Gul, 2006; Yatim *et al.*, 2006). To date, no study has examined the audit fee phenomenon subsequent to the enhanced reforms in 2008. It is important to investigate whether the enhanced corporate governance rules impact the PCON and other ownership structured firms differently.

The remainder of this paper is structured as follows. The next section provides a review of literature and hypotheses development. The third section describes the research design while the results and discussions are reported in the fourth section. The final section presents conclusions of the study.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

It is generally accepted that selected large firms or conglomerates in Malaysia have close link with the government. As a result of the government's policy to increase Bumiputra equity ownership (Gomez & Jomo, 1999), selected Malays become politically involved in business and have more personal connections with the politicians (Gul, 2006; Johnson & Mitton, 2003). They have close connection with individuals who exert political power in the government and has given firms political influence (Faccio, 2006; Johnson & Mitton, 2003; Riahi-Belkaoui, 2004). Johnson and Mitton (2003) argue that the relationships between entrepreneurs and politicians in Malaysia are based on 'chance personal histories'. They find the PCON firms to have negative impact on firm performance during the Asian Financial Crisis 1997. They provide insights that stock returns of PCON firms were lower in comparison with other ownership structured firms. They observe that PCON firms also suffered the most during the early stages of the Asian Financial Crisis when the government was unable to implement capital controls. However, once capital controls were imposed, the returns of these favoured firms were higher on average (Johnson & Mitton, 2003). During the pre-2007 period, Gul (2006) find a greater increase in audit fees for PCON firms than for other ownership structured firms, suggesting a supply-side explanation for audit fees. Abdul Wahab *et al.* (2009) find a positive relationship between institutional ownership and audit fees and they too found that the audit fees

are higher for PCON firms during the pre-2007 period. In addition, a study by Sherliza and Nur Farha (2015) show a significant positive relationship between audit fees and firms with larger foreign ownership and government ownership but no significant relationship with firms with higher managerial ownership. Amir (2014) found that family ownership firms pay fewer fees for the audit work. Khan *et al.* (2011) provide further evidence with regards to ownership structure; companies with institutional ownerships have a significant negative relationship with audit fees and will pay lower audit fees. Suggesting that companies which are dominated by institutional ownerships will pay lower audit fees.

However, no studies have been reported to date on the impact of the BMLR 2008 on audit fees for PCON and other ownership structured firms. Based on prior literature for pre-2007 period and the arguments presented above, we propose the following hypothesis:

Hypothesis 1: PCON firms pay higher audit fees than INST&MGRL and FAMILY firms post BMLR2008.

Past literature has put forward the idea that an independent audit committee is an effective monitor as it is not part of the management and has no financial interest in the firm. This is because the board and audit committee are in place to monitor the management who otherwise may act in their best personal interest and not the interest of their principal (Fama & Jensen, 1983; Jensen & Meckling, 1976). Due to the separation of ownership and control, the agency theory also views managers as self-interested actors who could engage in opportunistic behaviour (Jensen & Meckling, 1976). Consistent with the risk-based approach, an independent audit committee leads to an effective audit committee oversight of the financial reporting process which reduces the incidence of financial reporting issues (Abbott *et al.*, 2004; BRC, 1999; Dechow *et al.*, 1996; McMullen, 1996). Thus, it is not surprising that Abbott *et al.* (2003) and Vafeas and Waegelien (2007) find that audit committee independence has a significant positive impact on audit fees when the audit committee is made up of either solely or a majority of independent members. It also lends support that an independent audit committee is connected with higher audit fees due to greater demand for audit quality in order to protect its members' reputation

(Abbott & Parker, 2000; Carcello & Neal, 2000). Thus, this study expects that audit committee independence contributes to higher audit fees. Since PCON firms aim at enhancing corporate governance, it is hypothesized that their audit committee members should be more independent and provides superior oversight over financial reporting process. As the firms require more extensive audit testing, higher external audit fees are expected. Therefore, the foregoing argument leads to the following hypothesis stated in an alternate form:

Hypothesis 2a: The association between audit committee independence and audit fees is stronger for PCON firms than INST&MGRL and FAMILY firms post BMLR2008

Past studies and governance best practices called for audit committees to be diligent in carrying out their duties (Abbot *et al.*, 2004). Further, according to Yatim *et al.* (2006), frequent audit committee meetings can reduce the tendency for financial reporting problems as they provide a forum for the audit committee and internal auditor to exchange relevant and important information and also allow the audit committee to notify the auditor of issues that require greater attention from the auditor (Raghunandan *et al.*, 1998). As found by Kalbers and Fogarty (1998) and Goodwin and Kent (2006), audit committees that meet frequently are more likely to be better informed and more diligent in discharging their responsibilities. As such, it is reasonable to expect that audit committees who meet frequently will demonstrate greater diligence in performing their duties. Consequently, as supported by Yatim *et al.* (2006) external audit fees are positively and significantly related to the frequency of audit committee meetings. Studies by Carcello *et al.* (2002) and Abbott *et al.* (2003) which are consistent with the demand approach, argue that more diligent audit committee is likely to seek higher quality audits from external auditors, resulting in higher audit fees. This supports prior research (Yatim *et al.*, 2006; Carcello *et al.*, 2002; Abbott *et al.*, 2003) which determined that diligent audit committee will seek higher quality audits from external auditor resulting in higher audit fees, and conjectures the next hypothesis.

Hypothesis 2b: The association between audit committee diligence and audit fees is stronger for PCON firms than INST&MGRL and FAMILY firms post BMLR2008.

Having a financial expert on the board helps when reviewing the internal audit proposals (Read & Raghunandan, 2001) and investigating accounting irregularities. Moreover, past experience and knowledge in accounting and auditing enhances the accuracy of the investigation and produces better financial reporting quality. DeZoort and Salterio (2001) find that audit committee's professional judgements on auditor-management issues pertaining to accounting policy differed between those with and without accounting and auditing knowledge.

As such, Sharma *et al.* (2009) reveal that audit committee accounting experts and independent directors play an important role in monitoring by demanding frequent audit committee meetings when management adopts aggressive accounting practices. Further, Gendron and Bedard (2006) reveal that an audit committee who is financially literate is more effective in adhering to best practices, and to secure a high quality of reported earnings. Thus, the more experts there are in the audit committee, the better will be the monitoring and adherence to best practices. According to Abbott *et al.* (2003), audit committee financial expertise has a significant positive impact on audit fees. Yatim *et al.* (2006) find a significant and positive association between audit committee expertise (proportion of audit committee members with accounting and finance qualifications) and audit fees. This is because a financially literate and knowledgeable audit committee will demand audit quality as the members are knowledgeable on technical auditing issues, and hence the increase in audit fees. As PCON firms are expected to adopt stronger governance which includes having an audit committee with financial expertise, it is hypothesized as follows:

Hypothesis 2c: The association between audit committee expertise and audit fees is stronger for PCON firms than INST&MGRL and FAMILY firms post BMLR2008

Based on the above hypotheses, the model is schematically described as follows:

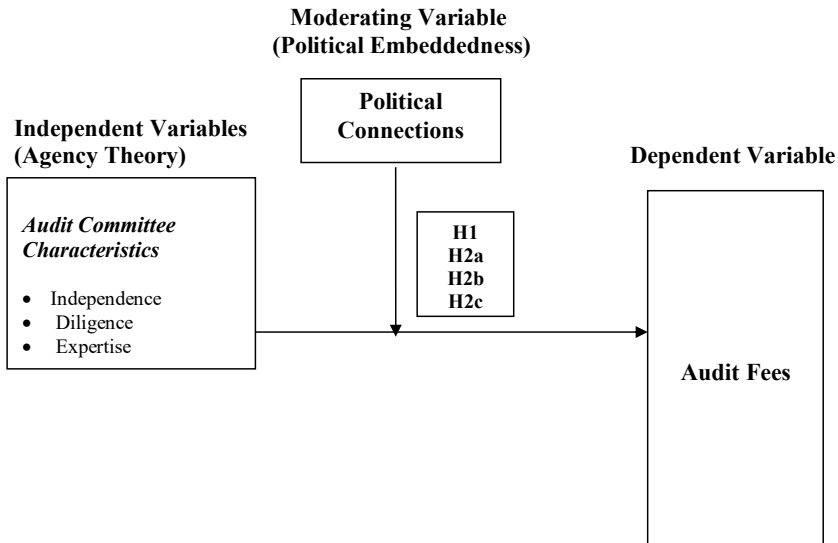


Figure 1: Research Model

RESEARCH METHOD

Data Collection

With regards to quantitative method of data collection, this study uses sample firms' annual reports from years 2008 until 2010. A total of 189 firms with 567 firms' year-observation data were collected. Data that were not available from DataStream were collected from the annual reports of Malaysian firms listed on Bursa Malaysia's main board. Table 1 reports the frequency of ownership structure for the sample firms. 36 per cent of the samples are politically connected (PCON) firms, 34% are family-owned firms (FAMILY), and the balance of 30% are institutional and managerial owned firms (INSTL&MGRL).

Table 1: Frequency of Ownership Structured Firms

	Frequency	Percentage
Politically Connected Firms	68	
Non-Politically Connected Firms:	171	36%
Family Ownership Firms	65	64%
Institutional Ownership Firms & Managerial Ownership Firms	56	34%
		30%
	189	100%

Audit Fee Model

The dependent variable that is the audit fees, is measured by the *Ringgit Malaysia* (RM) value of the audit fee paid by the audit client firm. The main experimental variables are audit committee characteristics namely audit committee independence (IND), diligence (DIL) and expertise (EXP). Audit fees models employed in past research have used a variety of variables to control sectional differences which are primarily influenced by size, complexity and risk of the audit client (Simunic, 1980; Craswell, 1992; Gul & Tsui, 1998; Francis, 1984; Chan *et al.*, 1993). Prior studies have found that the most significant determinant of audit fees is the size of the auditee, which is usually measured by total assets (TA) (Craswell, 1992; Palmrose, 1986; Simunic, 1980; Turpen, 1990). Non-audit fees (NAF) are also included as a control variable because it is significantly associated with audit fees (Whisenant *et al.*, 2003; Hay *et al.*, 2006). Further, the number of business segments (SEG) has been previously used to control for audit complexity (Simunic, 1980; Hackenbrack & Knechel, 1997). Zmijewski score (ZFC) is computed for each firm to control for financial crises. As profitability has also been argued to influence audit fees (Chan *et al.*, 1993), a negative relationship between return on assets (ROA) and audit fees is predicted. A fee premium exists for Big4 audit firms (Francis & Simon, 1987), and it is expected that client firms of Big4 purchase a higher level of audit quality. Finally, an indicator variable equals to '1' if PCON firms and '0' if otherwise is tested.

Descriptive Analysis

The analysis includes the univariate test and One-Way Anova with post-hoc test between the audit fees and audit committee characteristics. Table 2 shows univariate analysis for the continuous and indicator variables. It represents sample for PCON, INST&MGRL and FAMILY firms, with the descriptive statistic of mean, standard deviation and median. The descriptive statistics show that PCON firms are bigger in terms of total assets and have a larger number of business segments (SEG). The PCON firms also have higher non-audit fees and a higher audit quality. In general, PCON firms have higher average audit fees than INST&MGRL and FAMILY firms. As expected, the sample firms' audit committee characteristics IND, DIL and DIL record higher scores for PCON firms. It shows that the PCON firms are complying with the amended BMLR 2008 on audit committee characteristics. This is consistent with past studies (Abdul Wahab *et al.*, 2011; Chan *et al.*, 1993; Collier & Gregory, 1996; O'Sullivan, 1999 and 2000; Carcello *et al.*, 2002) that document higher audit fees for firms with improved governance, which is in line with the demand side explanation.

Table 2: Univariate Analysis for Sample Firms (n = 567)

	PCON	Firms (n=204)	FAMILY	(n=195)	INST&MGRL	(n=168)
Variable	Mean	Std. Dev	Mean	Std. Dev	Mean	Std. Dev
LAF	12.63	1.07	11.72	0.81	11.92	0.83
AF	739045.69	1727857.350	189890.49	371583.93	216048.51	248825.79
LTA	14.31	1.51	12.78	1.06	13.11	1.32
TA	5945714.89	11669897.66	690219.490	1235117.63	1839621.10	5107855.01
LNAF ^o	8.25	8.01	2.13	10.49	2.23	10.65
NAF	461066.97	1324152.27	33455.29	69257.86	64752.97	245056.72
SEG	3.40	1.73	2.73	1.33	3.17	1.65
ZFC	-2.99	0.86	-3.27	0.85	-2.91	0.89
ROA	0.06	0.07	0.06	0.06	0.05	0.07
AQ	0.79	0.41	0.63	0.47	0.62	0.49
IND	0.97	0.09	0.98	0.71	0.96	0.12
DIL	5.63	2.33	4.80	0.88	5.11	1.32
EXP	1.47	0.67	1.35	0.64	1.43	0.55

***p < 0.05**; © *chi-square tests* ^o*Observations having a zero for LNAF are re-coded to a small positive value (0.00001) to enable a logarithmic transformation.*

Notes: AF is audit fees while LAF is natural logarithm of audit fees; TA is total assets (in RM) while LTA is natural logarithm of total assets; NAF is non-audit fees (in RM) while LNAF is natural logarithm of non-audit fees; SEG is the

number of business segments; ZFC is the Zmijewski score for financial crisis; ROA is net profit before tax over total assets; AQ an indicator variable equals to '1' if the firm hires Big4 auditor and '0' if otherwise; IND is the proportion of independent non-executive directors to audit committee; DIL is the number of meetings; EXP is the number of audit committee with accounting or finance qualification.

Model Specification

The study examines the moderating effects of political connections on audit committee (AC) characteristics and audit fees. Drawing from Craswell and Francis, (1999), Tsui *et al.* (2001), and Carcello *et al.* (2002), the following audit fee model is used to test the Hypotheses (refer Table 3).

$$\text{LAF} = \beta_0 + \beta_1\text{TA} + \beta_2\text{NAF} + \beta_3\text{SEG} + \beta_4\text{ZFC} + \beta_5\text{ROA} + \beta_6\text{AQ} + \beta_7\text{INST\&MGRL} + \beta_8\text{FAMILY} + \beta_9\text{IND} + \beta_{10}\text{DIL} + \beta_{11}\text{EXP} + \beta_{12}\text{IND_PCON} + \beta_{13}\text{DIL_PCON} + \beta_{14}\text{EXP_PCON} + \varepsilon,$$

Table 3: Measurement of Independent and Dependent Variables

Hypotheses	Dependent Variable	Exp Sign	Measurement of Variables
	AF		Audit fee paid by the client (Natural logarithm of audit fees used in regression model).
AC Characteristics	Experimental Variables		Measurement of variables
	IND	+	The proportion of independent non-executive directors to AC.
	DIL	+	Number of AC meetings.
	EXP	+	Number of AC with accounting or finance qualification.
	Control Variables		Measurement of variables
	TA	+	Total assets for client at the end of fiscal year (Natural logarithm of TA).
	NAF	+	Total non-audit fee paid by client (Natural logarithm of NAF).
	SEG	+	Number of business segments.

	ZFC	+	Zmijewski scores for financial crisis.
	ROA	-	Profit before tax over TA.
	AQ	+	An indicator variable equals to '1' if the firm hires Big4 auditor and '0' if otherwise.
Hypothesis 1	INST&MGRL	-	An indicator variable, '1' for INST&MGRL, with reference to PCON and '0' if otherwise.
Hypothesis 1	FAMILY	-	As an indicator variable, '1' for FAMILY, with reference to PCON and '0' if otherwise.
Hypothesis 2a	IND_PCON	-	Interaction between IND and PCON
Hypothesis 2b	DIL_PCON	-	Interaction between DIL and PCON
Hypothesis 2c	EXP_PCON	-	Interaction between EXP and PCON

RESULTS AND DISCUSSIONS

One-Way ANOVA with Post-Hoc Tests

Table 4 shows one-way between-groups ANOVA test results for the three groups namely, the PCON firms, INST&MGRL firms and FAMILY firms. A one-way between-groups analysis of variance was conducted to compare the variance (variability in scores) between the three groups, as measured by the ownership structure. The analytical procedure is applied to answer the first hypothesis as to whether PCON firms pay higher audit fees than INST&MGRL and FAMILY firms. The above results generally show significant differences for the three groups except for ROA and audit committee EXP. There was a statistically significant difference at the $p < 0.01$ level in AF scores for the three groups ($F = 87.89$, $p = 0.000$). The actual difference in the mean scores between the groups was large. The post-hoc comparisons using the Tukey test indicates that the mean score for AF for PCON firms ($\mu = RM\ 654,881.40$, $SD = RM\ 1,474,057.76$) is significantly different from FAMILY firms ($\mu = RM\ 165,140.96$, $SD = RM\ 303,254.03$) and INST&MGRL firms ($\mu = RM\ 182,359.10$, $SD = RM\ 193,699.48$), respectively.

From the table, it shows that PCON firms have the highest audit fees in comparison with the other two groups, thus fully support Hypothesis 1. This indicates that PCON firms demand for substantive audit testing and improve audit quality from external auditors and are willing to pay higher audit fees. This is supported by Sherliza and Nurul Farha (2015) that foreign and government ownership will lead to higher audit fees paid to external auditors. According to them, government ownership is very strong in influencing the audit fees. The audit committee IND is significant at one per cent level ($F=16.48$ $p=0.00$) for all groups. The PCON firms have the highest IND mean score of 91 per cent (INST&MGRL = 84%, FAMILY = 87%). It indicates that the PCON firms have higher percentage of audit committee members who are independent non-executive directors. Similarly, audit committee DIL is also significant at one per cent level of significance ($F=20.38$ $p=0.000$) for all groups. The post-hoc comparisons test indicates that the mean score for PCON firms ($\mu=5.53$ $SD=2.21$) is significantly different from INST&MGRL ($\mu= 4.94$ $SD=1.13$) and FAMILY firms ($\mu=4.80$ $SD=1.01$).

It can be further concluded that the audit committee members in PCON firms conduct an average of 5.5 meetings in a year. In comparison, INST&MGRL and FAMILY firms conduct an average of 4.94 and 4.80 meetings in a year, respectively. However, there is no significant difference for audit committee EXP between the groups. Similarly, given the F-statistic value of 38.65 with a significant level of $p=0.000$, the NAF is statistically significant for all groups. The post-hoc comparisons test indicated that the mean score for PCON firms ($\mu=$ RM 403790.66 $SD=$ RM 1056255.03) is significantly different from INST&MGRL ($\mu=$ RM 59406.54 $SD=$ RM 196056.76) and FAMILY ($\mu=$ RM 27392.41 $SD=$ RM 54516.02) firms. The client size measured by total assets (TA) is statistically significant for all groups, with PCON firms having the largest total assets ($F=5817479.97$ $SD=12320223.66$). Additionally, comparable evidence of significance was noted for business segments (SEG) at one per cent level of significance for all groups. The post-hoc comparisons test indicated that the mean score for all groups are significantly different from each other. The financial crisis index (ZFC) is significant and differ significantly from each group, with INST&MGRL firms experiencing higher financial distress during the financial crisis.

Table 4: One-way between Groups ANOVA with Post-Hoc Tests (n = 567)

Variable			Mean	SD	F-stat	Mean Differences	p-value
LAF	PCON	INST&MGRL FAMILY	12.49	1.08	87.89	P>IM P>F	0.000***
	INST&MGRL	PCON FAMILY	11.77	0.79		IM<P	
	FAMILY	PCON INST&MGRL	11.61	0.78		F<P	
AF	PCON	INST&MGRL FAMILY	654881.40	1474057.76	30.89	P>IM P>F	0.000***
	INST&MGRL	PCON FAMILY	182359.10	193699.48		IM<P	
	FAMILY	PCON INST&MGRL	165140.96	303254.03		F<P	
LTA	PCON	INST&MGRL FAMILY	14.28	1.50	137.54	P>IM P>F	0.000***
	INST&MGRL	PCON FAMILY	12.99	1.29		IM<P IM>F	
	FAMILY	PCON INST&MGRL	12.68	1.06		F<P F<IM	
TA	PCON	INST&MGRL FAMILY	5817479.97	12320223.6	43.71	P>IM P>F	0.000***
	INST&MGRL	PCON FAMILY	1431606.96	3978752.80		IM<P IM>F	
	FAMILY	PCON INST&MGRL	634630.40	1091172.92		F<P F<IM	
LNAF	PCON	INST&MGRL FAMILY	7.54	8.81	38.65	P>IM P>F	0.000***
	INST&MGRL	PCON FAMILY	1.23	10.82		IM<P	
	FAMILY	PCON INST&MGRL	1.81	10.48		F<P	
NAF	PCON	INST&MGRL FAMILY	403790.66	1056255.03	34.99	P>IM P>F	0.000**
	INST&MGRL	PCON FAMILY	59406.54	196056.76		IM<P	
	FAMILY	PCON INST&MGRL	27392.41	54516.02		F<P P>IM	
SEG	PCON	INST&MGRL FAMILY	3.40	1.72	16.28	P>IM P>F	0.000**
	INST&MGRL	PCON FAMILY	3.17	1.64		IM>F	
	FAMILY	PCON INST&MGRL	2.72	1.32		F<P F<IM	
ROA	PCON	INST&MGRL FAMILY	0.05	0.06	1.92		0.16
	INST&MGRL	PCON FAMILY	0.05	0.06			
	FAMILY	PCON INST&MGRL	0.06	0.05			

AQ	PCON	INST&MGRL FAMILY	0.79	0.40	13.10	P>IM P>F	0.01***
	INST&MGRL	PCON FAMILY	0.64	0.48		IM<P	
	FAMILY	PCON INST&MGRL	0.62	0.48		F<P F<IM	
ZFC	PCON	INST&MGRL FAMILY	-2.94	0.84	11.39	P<F	0.00***
	INST&MGRL	PCON FAMILY	-2.96	0.88		IM<F	
	FAMILY	PCON INST&MGRL	-3.23	0.84		F>P F>IM	
IND	PCON	INST&MGRL FAMILY	0.91	0.13	16.48	P>IM P>F	0.00***
	INST&MGRL	PCON FAMILY	0.84	0.18		IM>P	
	FAMILY	PCON INST&MGRL	0.87	0.15		F<P	
DIL	PCON	INST&MGRL FAMILY	5.53	2.21	20.38	P>IM P>F	0.00***
	INST&MGRL	PCON FAMILY	4.94	1.13		IM<P	
	FAMILY	PCON INST&MGRL	4.80	1.01		F<P	
EXP	PCON	INST&MGRL FAMILY	1.41	0.64	1.08		0.33
	INST&MGRL	PCON FAMILY	1.41	0.57			
	FAMILY	PCON INST&MGRL	1.35	0.62			

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$.

P: Politically connected firms IM: Institutional ownership and Managerial ownership firms F: Family ownership firms

°Observations having a zero for LNAF are re-coded to a small positive value (0.00001) to enable a logarithmic transformation.

Notes: AF is audit fees while LAF is natural logarithm of audit fees; TA is total assets (in RM) while LTA is natural logarithm of total assets; NAF is non-audit fees (in RM) while LNAF is natural logarithm of non-audit fees; SEG is the number of business segments; ZFC is the Zmijewski score for financial crisis; ROA is net profit before tax over total assets; AQ an indicator variable equals to '1' if the firm hires Big4 auditor and '0' if otherwise; IND is the proportion of independent non-executive directors to audit committee; DIL is the number of meetings; EXP is the number of audit committee with accounting or finance qualification.

Table 5 represents the multiple regression results for testing hypotheses 2a, 2b and 2c. In testing the validity of the models used in the study, the traditional audit fee model introduced by Simunic (1980) is employed whereby the natural log of audit fees is regressed on control (Simunic, 1980; Yatim *et al.*, 2006; Gul, 2006; Ferguson, 2005) and experimental variables.

Results in Models A, B and C are significant at one per cent significant level ($p=0.000$), with an adjusted R^2 of at least 79.9 per cent which is comparable with other Malaysian studies in this area (Yatim *et al.*, 2006; Abdul Wahab *et al.*, 2011). Model A shows the association between external audit fees on 8 control variables derived from the extant literature (Abbott *et al.*, 2003, Goodwin & Kent, 2006; Yatim *et al.*, 2006; Abdul Wahab *et al.*, 2009). The client size (TA) coefficient (0.03, $t=1.51$) is positive and significant at one per cent significant level indicating that the larger the size of firms, the higher the audit fees charged. The coefficient (0.06, $t=2.45$) on NAF is also positive and significant at one per cent significant level. Besides that, SEG, ZFC and ROA indicate a positive and significant relationship at $p=0.05$, $p=0.14$ and $p=-0.03$, respectively. It indicates that as the complexity and risk are higher, the audit fees also increase. AQ is also positive and significant at $p<0.05$. Further, the ownership structure grouping variable coefficient is negative and significant at $p=0.02$ and $p=0.05$ for INST&MGRL and FAMILY firms, respectively. The unstandardised coefficient beta of -0.02 and -0.15 for INST&MGRL and FAMILY firms indicate that the audit fees is lower for these firms compared to the PCON firms, provided that other predictors are constant.

Table 5(a): Audit Fee Regression Models (n =567)

Variable	Model A		Model B	
	Coefficient	t-value	Coefficient	t-value
Constant		35.81		33.12
LTA	0.44	17.70***	0.42	17.79***
TA	0.03	1.51***	0.05	2.65***
LNAF	0.08	4.51**	0.06	3.93***
NAF	0.06	2.45**	0.08	3.65***
SEG	0.05	2.98***	0.05	3.31***
ZFC	0.14	5.59***	0.14	5.90***
ROA	-0.03	-1.53	-0.04	-2.12***
AQ	0.05	3.16**	0.06	4.04***
INST&MGRL	-0.02	-1.23**	-0.02	-1.59**
FAMILY	-0.05	-2.57**	-0.05	-3.13***
IND			0.04	3.21***
DIL			0.07	4.41***

EXP		0.02	1.24*
F-Statistics	231.27		257.26
p-value	0.00		0.00
Adj. R ²	0.79		0.82

$p < 0.10$; ** $p < 0.05$; * $p < 0.01$**

^oObservations having a zero for LNAF are re-coded to a small positive value (0.00001) to enable a logarithmic transformation.

Notes: AF is audit fees while LAF is natural logarithm of audit fees; TA is total assets (in RM) while LTA is natural logarithm of total assets; NAF is non-audit fees (in RM) while LNAF is natural logarithm of non-audit fees; SEG is the number of business segments; ZFC is the Zmijewski score for financial crisis; ROA is net profit before tax over total assets; AQ an indicator variable equals to '1' if the firm hires Big4 auditor and '0' if otherwise; IND is the proportion of independent non-executive directors to audit committee; DIL is the number of meetings; EXP is the number of audit committee with accounting or finance qualification.

Model B introduces the audit committee characteristics IND, DIL and EXP. The results reported shows that external audit fees are positively and significantly associated with the audit committee independence (IND) and diligence (DIL) at $p < 0.01$ and expertise (EXP) at $p < 0.1$. Prior research recommends that stronger audit committee members demand for higher quality audits (Goodwin & Kent, 2006), and firms with strong governance practices engage in greater level of internal auditing and are connected with higher audit fees. Carcello *et al.* (2002) argue that high quality board demands for more external monitoring from external auditors and are willing to pay higher audit fees. The signs for the control variables are all in predicted directions except for ROA. Following prior research (Simunic, 1980; Francis & Simon, 1987; Craswell *et al.*, 1995) it is expected that the AF is positively associated with TA, NAF, SEG, ZFC, AQ, and all other variables remain significant with the exception of INST&MGRL.

Model C brings in the interaction variables, PCON which comprise of three Models I, II and III. Hypotheses 2a, 2b and 2c predict a significant relationship between AC characteristics, IND, DIL and EXP with audit fees for PCON firms as compared to INST&MGRL and FAMILY firms. The results indicate that the interaction term audit committee IND_PCON ($p < 0.1$), DIL_PCON ($p < 0.01$) and EXP_PCON ($p < 0.01$) are significant, thus H2a, H2b and H2c are supported. It reveals that there is a significant positive association between the audit committee IND, DIL and EXP, and

audit fees for PCON as compared to INST&MGRL and FAMILY firms. This is because under the demand side perspective, audit committee members who are independent, diligent and with financial expertise demand for additional audit procedures from the external auditors especially for areas that subsequently reveal greater amounts of contention or risk, consequently higher audit fees.

Table 5(b): Audit Fee Regression Models (n =567)

Variable	Model C					
	I		II		III	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant		32.85		31.99		32.19
LTA	0.41	17.83***	0.42	17.97***	0.41	17.38***
TA	0.05	2.74***	0.07	3.33***	0.05	2.55***
LNAF	0.06	3.87***	0.06	3.98***	0.06	4.03***
NAF	0.08	3.65***	0.09	4.07***	0.07	3.09***
SEG	0.05	3.36***	0.06	3.59***	0.05	3.49***
ZFC	0.14	5.93***	0.14	5.89***	0.14	6.00***
ROA	-0.04	-2.18***	-0.04	-2.12**	0.06	-1.77*
AQ	0.06	3.99***	0.06	3.84***	0.05	4.13***
INST&MGRL	-0.07	-1.25	-0.13	-3.18	-0.12	-3.78***
FAMILY	-0.04	-0.79	-0.11	-2.51**	-0.15	-4.62***
IND	-0.06	-3.34***	-0.05	-2.79*	-0.04	-3.19***
DIL	0.07	4.56***	0.02	0.56	0.08	5.12***
EXP	-0.02	-1.31	-0.03	1.73	-0.00	1.49
IND_PCON	0.11	1.85*				
DIL_PCON			0.24	4.20***		
EXP_PCON					0.16	4.19***
<i>F-statistic</i>	219.05		223.18		223.86	
<i>p-value</i>	0.00		0.00		0.00	
<i>Adj. R²</i>	0.82		0.82		0.83	

p < 0.10; **p < 0.05; *p < 0.01**

°Observations having a zero for LNAF are re-coded to a small positive value (0.00001) to enable a logarithmic transformation.

Notes: AF is audit fees while LAF is natural logarithm of audit fees; TA is total assets (in RM) while LTA is natural logarithm of total assets; NAF is non-audit fees (in RM) while LNAF is natural logarithm of non-audit fees; SEG is the number of business segments; ZFC is the Zmijewski score for financial crisis;

ROA is net profit before tax over total assets; AQ an indicator variable equals to '1' if the firm hires Big4 auditor and '0' if otherwise; IND is the proportion of independent non-executive directors to audit committee; DIL is the number of meetings; EXP is the number of audit committee with accounting or finance qualification.

Firms that are committed to strong corporate governance demand additional assurance from auditors and higher audit quality (Lifschutz *et al.*, 2001), and are likely to engage in greater levels of internal auditing resulting in higher external audit fees (Goodwin & Kent, 2006). Increasing monitoring by audit committees also associated with increase in audit fees (Ismail *et al.*, 2012). According to Norziaton *et al.* (2015), PCON firms have higher audit fees due to improved governance which demands an increase in audit effort. Further, the association between audit committee independence, diligence, and expertise and audit fee is significant, suggesting that PCON firms are committed to strong corporate governance and are prepared to pay a higher quality external audit work. This is because audit committee members who sit on PCON firm's board demand for expanded audit scope in order to avoid being associated with financial misstatement and to preserve their reputational capital. Hence, the PCON firm's audit committee members are committed to strong corporate governance practices. They are in place to monitor the management, who otherwise may act in their own personal best interest and not in the interest of the shareholders. Hence, it can be concluded that there is a marked improvement in corporate governance of PCON firms since it was then generally perceived to exhibit poor corporate governance, greater agency problems (Abdul Wahab *et al.*, 2009) and with high risks (Gul, 2006).

CONCLUSION

This current study draws on the agency theory, where the separation of ownership and control between the owner and manager of a firm would subsequently lead to agency costs, such as audit fees. As managers may not act in the best interests of shareholders, monitoring by independent directors is crucial. The importance of the agency theory in corporate governance is further supported by the findings of this research, which applies an agency theory framework, that the improved internal governance mechanisms through enhanced audit committee characteristics increase the demand

for audit procedure resulting in higher audit fees. In addition, the political embeddedness perspective may also be pertinent to explain the corporate setting in Malaysia which examines the relationship between audit committee characteristics and external audit fees. It is predicted that the mandatory regulations on the audit committee characteristics are positively associated with higher external audit fees for PCON firms than INST&MGRL and FAMILY firms. The panel analysis of 567 firm's year-observation for the years 2008 to 2010 reveals that positive association between audit committee IND, DIL and EXP, and external audit fees was evidenced for PCON firms. Clearly, this study shows that audit committee members have a duty not just to oversee the conduct of business in compliance with laws they should also be effective stewards and guardians of the firm in respect of ethical values, and to ensure an effective governance structure for the appropriate management of risks and level of internal controls. The enhanced corporate governance regime has been effective in that PCON firms still pay higher audit fees even though their internal governance mechanisms are stronger, indicating the dominance of the demand-side explanation. This observation strengthens claims that the corporate governance regulatory has indeed been effective. This study also facilitates to dispel the concerns regarding PCON firms in the corporate governance reform efforts as highlighted in the World Bank Report in 2012.

The present study has a number of limitations that should be noted, hence providing opportunities for further research. First, this study is based on the revamped BMLR in 2008 which emphasised on audit committee characteristics. Future research should examine the new changes in BMLR and their relation to audit fees. Second, this study's sample comprises of 567 firm's year-observation public firms listed on Bursa Malaysia, excluding financial services sector. Hence, generalisation of the results to smaller firms, either public or private, may be inappropriate. It should examine the latest data from the Bursa Malaysia as it will reflect the current situation of ownership structure in Malaysia. A point to note as well, the current study did not distinguish between audit fees and non-audit fees; as it was not the focus of the research to ascertain these differences. It can be highlighted that future research may delve into non-audit services factors that may contribute to the auditor-client relationship.

NOTE

¹The Malaysian government's implementation of capital controls in 1998 was primarily to benefit political-connected firms that were hit by the Asian financial crisis in 1997.

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