

Effect of Internal Audit Function on Audit Fees

Laras Auditria Putri¹, Muhammad Iqbal Ramadhan²

^{1,2} Universitas Airlangga, Indonesia

laras.auditria.putri-2020@feb.unair.ac.id, muhammad.iqbal.ramadhan-2020@feb.unair.ac.id

Abstract

This study aims to obtain effect of internal audit function on audit fees. The research approach uses a quantitative approach. The implementation of this research was carried out on All Companies except the Financial Sector listed on the Indonesia Stock Exchange in the period 2016 and 2017. The population of this study is All Companies except the Financial Sector listed on the Indonesia Stock Exchange in the period 2016 and 2017. The sampling is carry out purposive sampling. The data used in this study is secondary data. The analysis technique used is multiple linear regression with STATA software. The results of the study show that internal audit function, namely company size has a positive and significant effect on audit fees. Expertise of internal auditor has a positive and significant effect on audit fees. Internal certification has a positive and significant effect on audit fees.

Keywords

Internal audit
function; company
size; expertise;
internal certification;
audit fees



I. Introduction

The economy in Indonesia is becoming increasingly developing, this encourages companies to disclose reliable, reliable, and relevant information in their published financial reports. In order for the financial statements to be relied upon by all stakeholders, the financial statements need to be audited. Auditing is the cornerstone of governance (Cadbury, 1992). Companies that have good governance tend to produce quality audit reports (Lin and Liu, 2009). Good corporate governance can assist auditors in understanding the company's internal control system so that audit services will be maximized and efficient.

The issue of governance in Indonesia becomes interesting because in practice, there are still many companies that have not implemented good governance. The ASEAN Capital Markets Forum in Manila revealed that of the many, only two companies from Indonesia were included in the list of the 50 Best Issuers in Corporate Governance Practices in ASEAN in the 2015 ASEAN Corporate Governance Awards awarding event. This revealed that there are still few companies that implement good governance. Whereas the better the governance, the better the internal control. If internal control is weak, it results in a high risk of fraud.

The low quality of corporate governance also has an impact on the quality of the audits produced. External auditors provide a significant monitoring role in testing the credibility of financial reports provided by management (Lin and Liu, 2009). This means that the poorer quality of financial reports produced by management will make it difficult for the auditor to carry out audit procedures and obtain reliable audit findings so that it can affect the quality of the audit produced. However, poor audit quality is not only influenced by internal corporate governance, auditors as auditors of corporate finance can also take part in fraudulent practices. In this case, there is a need for good synergy between auditors and company management so that they can realize reliable corporate governance (Prawitt

et al., 2009). According to Prawitt et al. (2009) One of the 4 tools that support effective corporate governance is the existence of an internal audit in addition to the existence of executive management, the board of directors, and external auditors. In Al-Shetwi et al. (2011) stated that the internal audit function is a significant form of internal control on the effectiveness of corporate governance.

The traditional internal audit function is to examine and evaluate internal processes, procedures, and controls. On the other hand, external audit focuses more on providing assurance on financial statements. Given the different roles of external audit and internal audit, the two functions can work together by coordinating their activities to achieve synergistic results such as higher quality audits and economic benefits.

There are various factors that can affect the size of the audit fee, according to Simunic (1980), the factors that influence the amount of the audit fee are how big the company is being audited, audit risk, and audit complexity. Internal audit is one of the factors that can affect the audit fee. Internal and external auditors have different goals and responsibilities when carrying out their duties, but both have common interests so they need to coordinate in the interests of the company. This coordination is important so that there is no overlap in carrying out activities that can affect the audit fee.

The relationship between internal audit and audit fees has been discussed in the literature in the context of two different interpretations of the way internal audit and external auditors interact, which predict opposite results. On the one hand, previous studies have shown that the two functions interact on the basis of a substitution relationship (Felix et al., 2001), while other literature states that these functions interact on a complementary basis. With the increasing complexity in the scope and process of the audit, Public Accounting Firms are constantly being challenged to be more cost-effective as well as being challenged to improve audit quality. Likewise, clients are under pressure to reduce external audit costs as much as possible and at the same time are expected to improve the quality of financial reporting. A decrease in audit fees occurs when internal audit's contribution to external audit tends to reduce the work done by external auditors. This substitution effect assumes that the implementation of effective governance mechanisms will limit the control efforts of external auditors and reduce audit costs. Complementary effects have been considered by the literature. Companies express their desire to develop complementary governance mechanisms to reduce agency costs between managers and shareholders. Therefore, they tend to invest in larger levels of the internal audit function to discipline managers, and they are prepared to pay more for external audits.

Research examining the relationship between the contribution of internal audit and external audit fees shows different results. There are several studies which state that the internal audit function has a positive effect on audit fees, but there are also studies which state that the internal audit function has a negative effect on audit fees.

Companies that have good internal audits will have less work from external auditors so that the audit costs incurred will be smaller.

Based on the inconsistency of the results, this study aims to get a further picture of the relationship between the internal audit function and audit fees. A possible relationship between the internal audit function and audit fees makes it possible to obtain indirect evidence about the way in which the internal audit function and external auditors interact within the control structure and corporate governance, which could potentially affect the effectiveness and quality of controls within the company, as a total cost of control (Prawitt et al., 2011). This research provides several contributions. First, it contributes to the existing literature related to the internal audit function and audit fees, and provides a better understanding of how the internal audit function can affect audit fees in various ways.

Second, for relevant regulators, the results of this research can be used as a recommendation in considering the policies and laws of limited liability companies and corporate governance in Indonesia.

This study aims to obtain effect of internal audit function on audit fees.

II. Review of Literature

2.1 Agency Theory

Agency theory is a concept that forms the basis of corporate governance. Jensen and Meckling (1976) explain the agency relationship in agency theory that the company is a set of contracts between the resource owner (principal) and the manager (agent) who manages the use and control of these resources. Given these differences in interests, the contractual relationship between the owner and agent will lead to issues of interest because the two parties will work for their own profit. Adam Smith in his book *The Wealth of Nation* reveals that "If an organization is managed by a person or group of people who are not the actual owners, then there is a possibility that they are not working for the benefit of the owners".

To overcome this agency problem, agency costs will eventually be borne by both the principal and the agent. Jensen and Meckling (1976) describe agency costs, including: monitoring costs, bonding costs and residual loss. Monitoring costs are costs that arise as a result of supervisory actions against company processing agents and overcome non-transparent information so that shareholders can monitor the use of company assets in accordance with the company's operational needs, for example the emergence of Monitoring costs, fees for hiring independent auditors. Bonding costs are costs incurred to ensure managers work in accordance with the interests of the company and increase the transparency of corporate governance, these costs are usually incurred to pay the audit committee and internal audit division employees. Finally, residual loss is the number of sacrifices made by the principal due to fraud or manipulation, and decision-making errors made by agents that harm the principal, for example profit manipulation.

2.2 Internal Auditor

The Institute of internal auditors defines internal audit as an objective assurance and independent consulting activity. The internal audit division is also responsible for overseeing the company's operations designed to add value and improve a company's operations by evaluating and improving the effectiveness of risk management, control and corporate governance processes.

Based on the Financial Services Authority Regulation Number 56/POJK/4/2015 concerning the Establishment and Guidelines for the Preparation of an Internal Audit Charter, it is emphasized that in realizing good operational control and supervision, a publicly listed company must establish a unit, namely an internal audit unit. The regulation also confirms that the internal audit unit is a work unit within an issuer or public company that carries out the work function of internal audit, but the use of the name of the Internal Audit Unit can be determined by the company itself.

2.3 Audit Fees

Audit fees are the amount of honorarium billed to client companies that receive audit services for services provided by the auditor. Simunic (1980) defines audit fees as the unit product of the number of audit services requested by the audited client company. Audit fees are rewards in the form of money or goods received from clients to obtain

engagement from clients. In negotiating regarding the professional services rendered, the auditor may propose the amount of professional fees deemed appropriate. This depends on the condition of the client company faced by the auditor. The amount of audit fees is influenced by 4 variables, namely company size, company internal control, business risk, and audit complexity.

Decree No. KEEP. 024/IAPI/VII/2008 concerning the Policy for Determining Audit Fees, provides a guide in determining the amount of audit fees for public accounting firms that carry out the practice of providing audit services. Considerations in determining the amount of the audit fee must be based on the following:

1. Client Needs.
2. Duties and responsibilities according to law.
3. Independence.
4. The level of expertise and responsibility attached to the work performed, as well as the complexity of the work.
5. The amount of time needed and effectively required by members and staff to complete the work.
6. The basis for determining the agreed fee.

III. Research Method

The research approach uses a quantitative approach. Quantitative approach is an approach that in research proposals, processes, hypotheses, goes to the field, analyzes data and concludes data until the writing uses aspects of measurement, calculation, formula and certainty of numerical data (Asyraini et al., 2022; Octiva, 2018; Pandiangan, 2015).

Implementation of research is a series of activities in data collection techniques, processing, analyzing, and interpreting data developed in research results (Octiva et al., 2018; Pandiangan, 2018). The implementation of this research was carried out on All Companies except the Financial Sector listed on the Indonesia Stock Exchange in the period 2016 and 2017. The population of this study is All Companies except the Financial Sector listed on the Indonesia Stock Exchange in the period 2016 and 2017. The sampling is carry out purposive sampling. Purposive sampling is a sampling technique with certain considerations (Jibril et al., 2022; Pandiangan et al., 2018; Pandiangan, 2022).

The data used in this study is secondary data. Secondary data is data taken through intermediaries or parties who have collected the data previously, in other words the researcher does not directly take the data himself into the field (Pandiangan et al., 2022; Tobing et al., 2018). Secondary data in the form of financial and annual reports listed on the Indonesia Stock Exchange in the period 2016 and 2017.

The analysis technique used is multiple linear regression with STATA software. Multiple linear regression is a linear regression model involving more than one independent variable or predictor (Octiva et al., 2021; Pandiangan et al., 2021; Pandia et al., 2018).

IV. Results and Discussion

4.1 Descriptive Statistics Results

Table 1. Descriptive Statistics Results

	Mean	Median	Minimum	Maximum
AUDFEE	20.525	20.436	17.910	23.817
IASIZE	7.479	4.000	0.000	63.000
ROA	0.046	0.043	-0.319	0.404
FSIZE	28.683	28.689	25.439	32.233
FIRMAGE	31.259	29.000	3.000	112.000

In this study AUDFEE is the dependent variable which is measured using the natural logarithm of audit fees. The lowest score was 17,910 owned by PT Leyand International Tbk in 2017, and the highest score was 23,817 by PT Indosat Tbk in 2017. The average value of audit fees is 20.525. From the lowest and highest values that are not too far away, this indicates that the amount of audit fees in public companies is not too varied.

In this study, IASIZE is the dependent variable which is measured using the natural logarithm of audit fees. The lowest score of 0.000 was owned by PT Mineral Sumberdaya Mandiri Tbk in 2017, and the highest score was 63,000 by PT Telkom Indonesia Tbk in 2017. The average value of the internal auditor size is 7.479. Judging from the lowest value of 0, it means that there are public companies that still do not have internal auditors.

In this study ROA is the dependent variable which is measured using the natural logarithm of audit fees. The lowest value is -0.319, and the highest value is 0.404. The average value of ROA is 0.046. Judging from the lowest value of 0, it means that there are public companies that still do not have internal auditors.

In this study, firm size (SIZE) is a control variable measured using log n of total assets. The lowest value is 25,439, and the highest value is 32.233. The average value of company size (SIZE) is categorized as quite high, which is 28,683. This indicates that the average total assets owned by companies in Indonesia tend to be large. With the high total assets of the company, the company has a fairly large size.

In this research, company age (FIRMAGE) is a control variable which is measured using log n of total assets. The lowest value is 3, and the highest value is 112. The average value of company size (SIZE) is categorized as quite high, which is 31,259. This indicates that the average company in Indonesia is quite old with an average age of 31 years.

4.2 Multiple Linear Regression Results

Table 2. Multiple Linear Regression Results

	AUDFEE
IASIZE	0.024** (2.77)
IAEXPERT	0.430** (2.24)
IACERTIF	-0.146 (-0.94)
BIG4	0.855*** (3.29)
ROA	-0.625 (-0.86)

FSIZE	0.290*** (3.06)
FIRMAGE	0.004 (1.33)
_cons	11.433*** (4.39)
Industry Fixed Effect	Yes
Year Fixed Effect	Yes
r2	0.613
r2_a	0.557
N	121
t statistics in parentheses	
*p< 0.1, **p< 0.05, ***p< 0.01	

The results of the study show that internal audit function, namely company size has a positive and significant effect on audit fees. Expertise of internal auditor has a positive and significant effect on audit fees. Internal certification has a positive and significant effect on audit fees.

V. Conclusion

The results of the study show that internal audit function, namely company size has a positive and significant effect on audit fees. Expertise of internal auditor has a positive and significant effect on audit fees. Internal certification has a positive and significant effect on audit fees.

Based on the results of the research that has been done, suggestions that can be given for further research are that further researchers can expand the research period, and further researchers may be able to interact between internal auditors and the audit committee. To see if there is a role for the audit committee in determining audit fees.

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