An Empirical Investigation on Ownership Characteristics, Activities of the Audit Committee, and Audit Fees

in Companies Listed on Indonesia Stock Exchange

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Abstract

This study examines the effect of ownership characteristics and activities of the audit committee to audit fee. This study also uses control variables which include free cash flow, liquidity ratios, profitability ratios, solvency ratios, firm size, market -to-book value of equity, and audits quality of manufacture companies in Indonesia Stock Exchange in the year 2010 - 2012 are used as the population in this study. Data collection method used was purposive sampling. The statistical methods used to analyze the data are the multiple linear regression and results obtained indicate that managerial ownership, audit committee activity, firm size, liquidity ratios, profitability ratios affect audit fees. Meanwhile, institutional ownership, free cash flow, solvency ratio, and market -to-book value of equity do not affect the audit fees significantly.

Keywords: audit fees, ownership characteristics, the activity of the audit committee.

1. Introduction

Attention to the issue of corporate governance has increased significantly since several cases of failure of companies listed on the JSE were revealed. Corporate Governance emerged as a reaction to various corporate failures caused by poor corporate governance. Corporate governance issues have received significant attention since the financial crisis in the middle 1997. Weak implementation of corporate governance was believed as the main reason of economic vulnerability that led to worsening economic condition in several Asian countries including Indonesia. Banking crisis in Indonesia started in the end of 1997 was not solely caused by economic crisis, but also due to yet implementation of Good Corporate Governance and its underlying ethics. Therefore, efforts to restore confidence to Indonesian banking sector through reconstruction and reconciliation can have long term and significant effects if they are accompanied by the implementation of Good Corporate Governance (Guidance of Indonesian Banking GCG, 2004). The audit committee and stock ownership are considered as an alternative chosen to address the issue of corporate governance. There has been a variety of studies on the effect of various corporate governance factors over financial reporting and audit quality and level of audit fees (Gul and Tsui, 2001, Carcello et al, 2002; Abbott et al, 2003; Tsui et al, 2001). Those researches are based on argument that when managers are separated from the owners, managers would act on their personal interests and provide false financial reports with 'opportunistic' reason, even if it means harming the interests of the shareholders (Jensen and Meckling, 1976). The role of high quality audit is very important to limit opportunistic managerial behavior (Becker et al, 1998).

Seeing from the viewpoint of demand-side, governance mechanisms require high-quality audits to reduce agency costs and possibility of fraudulent financial reporting which results high audit fee. High audit fee is the result of high quality audit conducted to enlarge audit scope and to add numbers of investigated audit evidences in which it will reduce detection risk and audit risk. (Carcello et al, 2002; Abbott et al, 2003). Meanwhile, from the point of view of supply-side, other studies found that governance factors intended to lower agency problems in financial reporting process and reduce the risk of misstatement of accounting or accounting errors, so that management will be more careful in preparing financial statement and will produce a qualified financial statement. This led to the decrease of scope of audit work, in which it would lead to the lower cost of audit (Gul and Tsui, 1998; Tsui et al., 2001).

The high level of ownership by management encourages managers to produce more relevant information than to compile accounting figures opportunistically for personal gain. This resulted in decrease of the inherent risks of material misstatement, thereby reducing audit risk and audit fees. The demand for audit services and audit quality is an efficient effort to solve contracting problems (Watts and Zimmerman, 1986).

This study will conduct an analysis based on monitoring argument of shareholders and propose an idea that large shareholders will actively monitor and influence the choice of accounting methods and strategies to produce financial information. In developing argument, researchers take into account the influence of both supply and demand factors as they both allow creating a contradiction relation between ownership characteristics with audit fee.

Institutional investor has better information than individual investor because its information is valuable and timely analized. To fulfill fiduciary responsibilities, institution develops an investment policy and keep monitoring its portfolio. Researchers argue that according to point of view from demand side, if institutional shareholders have less than 20% (called diffused) of outstanding ordinary shares individually, then the level of supervision of listed companies will be lower than institutional shareholders that have more than 20% (called Blockholder). Institutional shareholders blockholder, will be more influential and be able to push companies to conduct an audit of high quality to avoid fraud in financial reporting. Active surveillance will reduce the risk of congenital and planed audit process so that the cost of audit will be lower. Seeing from the point of view of supply side, blockholder shareholders actively monitor companies include financial reporting process to reduce the inherent risk of material misstatement, so that the management will also use the service of high quality audit to attract big investor which in turn will increase audit fee. However, institutional shareholders diffused will not be interested in monitoring companies and its managers' strategic decisions, and will sell their shares if they are not satisfied with the performance of the companies.

The managers with high ownership are less likely to commit opportunistic management for short-term gain and will be more willing to yield valuable financial statement. Gul et al (2003) stated that managerial with high stock ownership is less motivated to perform earning management. This opportunistic action will disappear due to an increase in managerial ownership, thus reducing the risk of congenital material misstatement and the audit fee.

The audit committee is not mandatory and not always present in a small company, but for public companies it is mandated by the regulation of Indonesian Capital Market and Financial Institution Supervisory Agency. This obligation indicates that the Indonesia Stock Exchange (IDX) wants to increase control to the management of the public companies in order to reduce the possibility of material misstatement and decrease the inherent risk and audit risk in which it will finally lower the audit fees.

In this study, researchers use audit committees variable as an independent variable which is measured by number of audit committee meetings held by sampling company, as an indicator to the level of supervision and the effectiveness of the audit committee as one element of Good Corporate Governance (GCG)'s implementation.

Based on the said background, the problems formulated in this study are as follow: first, do the characteristics of ownership affect the cost of the audit? And second, do the audit committee activities affect the cost of the audit?

2. Hypotheses Development

2.1 Institutional Ownership and Audit Fees

Kane and Velury (2004) argue that institutional investors influence the management in two ways. First, as a provider of large capital, they affect the trading of securities by certain percentage so it will impact market price of the stock. Hand (1990) finds that sophisticated investors more accurately interpret information in earnings announcements. Bartov et al.(2000) find that the pattern of post earnings announcement drift documented in the prior literature (e.g., Bernard and Thomas 1990) is reduced as the level of institutional investment increases. They also have influence on the cost of capital which is very important for the company's capital structure and component in the assessment of the company. Secondly, because of large holding, institutional investors have voting rights that can be used to influence strategic managerial decisions.

Institutional investors typically have better information than individual investors as they obtain specific information which is valuable and timely for analysis. To fulfill fiduciary responsibilities, institutions have developed an investment policy and monitored their portfolio continuously. Researchers argue that when institutional shareholders individually have less than 20% of common shares outstanding, called spread (diffused), the level of supervision of listed companies will be lower than that level on institutional shareholders who have 20% or more of common shares outstanding (blockholder). When the level of ownership on institutional investors diffuses, shareholders tend to lack desire and ability to monitor the activities of the company (mitra et al. 2007). However, if institutional ownership increases, institutional block holder will become more influential, forcing companies to perform high-quality audits to prevent fraud in financial reporting. In order to reduce uncertainty about the reported financial numbers, institutional shareholders as a group may demand high-quality audit service (Kane and Velury, 2004)

From demand-side perspective, level of investment by blockholder will affect audit fees positively. From supply-side, blockholders will actively monitor common activities in the company, including financial reporting process, and reduction of inherent risks of material misstatement. These whole activities of blockholders ultimately will cause a growth in audit fees. On the other side, small shareholders or diffused shareholders are remain not interested in monitoring the company and making managerial strategic decisions, and they even will sell their shares if they are less satisfied with the performance of the company. Thus, our H1 hypothesis is:

H1 = There is significant relationship between institutional ownership and audit fees.

2.2 There is Significant Relationship between Institutional Ownership and Audit Fees

2.2.1 Managerial Stock Ownership and Audit Fees

Managerial ownership is an important factor in resolving agency conflicts (Jensen and Meckling, 1976). Managers with high ownership are less likely to perform opportunistic management for short-term gain and will be more willing to produce reliable financial statements. Gul et al (2003) stated that the high shareholders ownership by managerial was less motivated to perform earnings management. These opportunistic actions will be lost due to an increase in managerial ownership that will reduce inherent risks of material misstatement and reduce audit fees. It can be said, that from supply-side perspective, there is a negative effect between managerial ownership and audit fees.

From demand-side, it is stated that managerial ownership has positive effect on audit fees. In companies with high managerial ownership, managers request a high quality and wide scope audit to give positive signal about the quality of published financial statements. This will provide economic benefits for companies such as: increasing the credit ratings of the companies, lowering the cost of capital, reducing control of the creditors, and providing more flexibility for managers, which in turn will improve status of the companies in the capital market. Our H2 hypothesis is:

H2: There is A Relationship between Managerial Ownership and Audit Fees.

2.3 Audit Committee Activity

The Audit Committee is a sub-committee of the main board company, usually formed from a non-executive director and is responsible for matters relating to financial reporting and auditing (LF Spira, 1999). The main responsibility of the audit committee is ensuring the quality of auditing and reporting within the company, therefore, the audit committee must primarily consist of independent directors. It is assumed that active audit committee will lower the audit fees charged by external auditor because of improvement on control performed by it. Regular meetings between audit committee and external auditor are likely to make audit committee remains to update information on auditing and accounting. There are some recommendations from NACD (national association of corporate directors) (Abbott et al, 2003) that: (1) the frequency of meetings is an important component of the effectiveness of the audit committee, (2) the frequency of meetings is often used as a proxy craft of the audit committee. Beasley et al (2000) states that fraudulent audit committee of company usually has fewer meeting than the audit committee of a non-fraud company (no cheating). Abbott et al (2000) found that companies with audit committee that meet at least 4 times a year tend not to restate the audited financial statements. Base on the decree of the Chairman of Bapepam No. Kep-643 / BL / 2012, the Audit Committee should hold a regular meeting at least once every three (3) months.   However   there   is   another contradictive opinion mention that there is a positive influence on the activity of the audit committee towards audit fees (Carcello et al, 2002). This happens because the audit committee has interests to give the signal of efficiency, to maintain reputation, and to avoid the risk of litigation, with consequences that it will increase the scope of the audit and also will increase the cost of the audit. Of these conflicting results, the researchers set the following hypothesis.

H3: There Is a Relationship between Activities of the Audit Committee and Audit Fees

3. Methods

3.1 Sample and Data Collection

The population of this study included all manufacture companies whose shares are listed on the Indonesia Stock Exchange (IDX) in 2010-2012. Meanwhile, the samples used in this study were selected based on certain criteria (purposive random sampling):

    a.   Companies that publish financial statements in IDR (Indonesia currency);

    b.   Companies that publish financial statements with periods ending December 31;

    c.   Companies that have complete data i.e. data of managerial ownership, institutional ownership, number of audit committee meeting in a year, and the amount of audit fees in the year concerned or professional fee.

3.2 Operational Definition of Variables

The following is the definition of each variable.

This study uses audit fees as the dependent variable earned from the cost of professional fees of the company, which in

natural logarithmic.

The independent variable used in this study include:

1. Institutional Ownership. Institutions could mean insurance companies, investment banks, and other institutions. Institutional ownership in this study using a dummy with 0 is the institutional ownership diffused (spread) which is less than 20% ownership, while 1 is institutional blockholders ownership of $\geq 20\%$.
2. Managerial Ownership. Managerial ownership in this study using the percentage of managers who become owners.
3. Activity of the audit committee. Audit committee activity in this study was measured using the number of audit committee meetings in one year.

Control variables. Control variables used in this study include:

a. Free cash flow = operating cash flow - capital expenditures - cash dividend
b. Liquidity ratio: measured using the current ratio or the current ratio (CR)
   Current Ratio = current assets / current liabilities
c. Profitability ratio: measured using the rate of return on total assets or return on assets (ROA)
   Return on Assets = net income / total assets
d. Solvency ratio: measured using the ratio of debt or leverage (LEV)
   Leverage = long-term debt / total assets
e. Market-to-book value of equity (MB)
   Market to Book Value of Equity = market value of equity / total shareholders' equity
   Market value of equity = stock price x number of shares outstanding
f. Size of company: measured using the natural logarithm of total assets
g. Audit quality is measured using a dummy =, which the number 0 indicates the company is audited by a non-big four public accounting firm and dummy 1 shows the companies are audited by a big four public accounting companies. The big four public accounting firm are :
   a) PricewaterhouseCoopers affiliated with Haryanto Sahari
   b) Ernst & Young affiliated with Purwantono, Sarwoko, Sandjaja
   c) Deloitte Touche Tohmatsu affiliated with Osman Bing Satria
   d) KPMG affiliated with Sidhartha, Sidhartha, Widjaja.

3.3 Regression Model

We use the following multiple linear regressions to examine the association between audit committee and audit fees. Following prior literature (e.g., Carcello et al., 2002;Tsuietal.,2001; Abbott et al., 2003; Mitra et al., 2007), the model includes several firm-specific control variables that proxy for the effect of client size, complexity, and audit risk in the analyses. This research used some control variables namely: Free Cash Flow (FCF), liquidity ratio, profitability ratio, solvability ratio, market to book ratio, firm size, and audit quality with consideration that there were several factors might have relations on audit fees. Therefore, this research needed to examine the effect of ownership characteristics and activity of audit committees by including control variables which was proxy for the effect of client size, audit risk, and complexity.

$$LAFEE = \beta_0 + \beta_1 DINST + \beta_2 PMGR + \beta_3 AC\_MEET + \beta_4 LTA + \beta_5 CR + \beta_6 MB + \beta_7 LEV + \beta_8 ROA + \beta_9 FCF +$$

$$\beta_{10} AUDIT\_QUALITY + \varepsilon$$

Dependent Variable:

LAFEE : natural logarithm of audit fees

Independent variable

DINST : dummy institutional shareholders, the number 0 indicates diffused and dummy 1 shows the blockholder.

PMGR : the percentage of managerial shareholders

AC_MEET: number of audit committee meetings that have been done in one year

Variable Control

LTA   : natural logarithm of total assets

CR   : the current ratio

MB   : the market value of equity divided by total shareholders' equity

LEV   : leverage ratio

ROA   : Return on assets

FCF   : free cash flow

Audit_quality: dummy 0 indicates the company is audited by a non-big four public accounting firm while dummy 1 shows the companies are audited by a big four public accounting companies.

In order to make sure the data is Best Linear Unbiased Estimator (BLUE), through classical linear regression assumption, the result showed that the data was free from normality, heteroskedasticity, autocorellation, and multicollinearity, then the use of model to test the hypothesis can be performed, and the results will be described. Test of normality used One-Sample Kolmogorov-Smirnov Test with rule if Asymp. Sig. value ≥ 0.05 then data were normally distributed. Test of multicollinearity applied Variance Inflation Variance (VIF) with condition if VIF value < 10 then it was free from multicollinearity. Test of autocorrelation utilized Durbin-Watson test with condition if Durbin-Watson value between du and 4-du, it meant there were no autocorrelation. Test of heteroscedasticity used Glejser test with provision of dependent variable was absolute residual, p-value ≥ 0.05 which meant there were no heteroscedasticity.

4. Results and Discussion

4.1 Descriptive Statistics Analysis

This study uses data pooling and has total observation in period of observation during the years 2010-2012 as many as 281 observations. Tables 1a and 1b below presents the test results of descriptive statistics for all variables used in this study.

Table 1a. Descriptive Statistics

		AC_Meet	K_MGR	FCF	CR	ROA	LEV	MB	LN_TA	LN_FEE
N	Valid	281	281	281	281	281	281	281	281	281
	Missing	0	0	0	0	0	0	0	0	0
Mean		7.93	1.7303	144897396319.36	7.4832	.0694	.1855	228.8140	28.4631	22.1459
Median		5.00	.0000	7256550544.00	1.5895	.0631	.1251	1.6951	28.4124	22.0137
Std. Deviation		8.021	6.52680	1546538593792.077	62.09250	.13032	.31088	2847.13559	1.80231	1.94968
Minimum		1	.00	-10176000000000	.02	-1.07	.00	-.87	20.37	15.16
Maximum		57	51.98	8307912000000	1005.18	.58	4.39	47351.29	32.84	26.71

All data are in IDR.

Table 1b. Descriptive Statistics of Audit Quality and Institutional Ownership

		AUDIT _QUALITY	D_INST
N	Valid	281	281
	Missing	0	0
Mode		0	1
Std. Deviation		.501	.145

Dummy audit quality: 0 = non PAF big -4, 1 = PAF big-4. Institutional ownership dummy: 0 = diffused $\leq 20\%$, 1 = blockholders> 20%

Based on Table 1a, it is shown that mean and median of Ln_ audit fee is 22.1459 and 22.0137 with standard deviation of 1.94968 and maximum value (minimum) is 26.71 (15.16). The result describes that the majority of the sampled companies, possess a quite high value of audit fee on the average. It is   possible to occur due to the level of audit committee activity that is seen on Table 1b showing the low frequency of number of meeting, so that, its role as an observer in composing financial report become less effective and lead to the higher audit fee that has to be paid.

The frequency of meetings (number of meetings) of the audit committee has mean and median of 7.93 and 5.00 with standard deviation of 8,021 and maximum value (minimum) is 57 (1). Based on the rules of the Securities and Exchange Commission (BAPEPAM), minimum limit of number of audit committee meeting should be equal to the number of meeting for the board of commissioners, which is once in a month.   Since the analysis result delivers low number of audit committee meetings with average of 7.93 $\approx$ 8, the audit committee activity shows its lack of ability in performing the role of observer in the process of financial reporting. As a consequence, it has to pay costly audit fees in order to get a qualified audit.

Since the majority sampled companies have greater proportion of institutional ownership that is more than 20% or blockholder (shown by dummy 1), they demand a qualified audit to gain their trust in the reliability of the financial statement earns.

Managerial ownership has mean and median of 1.7303 and 0.0000 with standard deviation of 6.52680 and maximum value (minimum) was 51.98 (0.00). It shows that the proportion of managerial ownership of sampled companies is considerably low, thus managerial ownership has minor influence on decision-making and corporate issuers have no incentive (desire) to participate in the improvement of the quality of the financial reporting process that will affect the audit fees charged.

Free cash flow has mean and median of 144897396319.36 and 7256550544.00 with standard deviation of 1546538593792.07 and maximum value (minimum) 8.307912 trillion (-10,176,000,000,000). It shows most of sampled companies have positive free cash flow level that still can be utilized for investment activities.

Current ratio (CR), which describes the sampled companies' liquidity has mean and median amounted to 7.4832 and 1.5895 with standard deviation of 62.09250 and maximum value (minimum) of1005.18 (0.02). These results illustrated that the sampled companies have a positive current ratio level, which means they are in the condition of being able to pay the debt that will be immediately due (current debt).

Profitability ratio (ROA) has mean and median amounted to .0694 and .0631 with standard deviation .13032 and maximum value (minimum).58 (-1.07). These results indicate that the sampled companies have a positive return ratio over company's assets, so that company's investment on their asset will be beneficial for the company.

The ratio of debt or leverage (LEV), which represents the ratio of solvency, has mean and median.1855 and .1251 with standard deviation .31088 and maximum value (minimum) 4.39 (.00). These results indicate that the ratio leverage is less than 0.5, so most likely the company issuers have the ability to pay off its long-term debts.

Market-to-book value of equity ratio (MB) has mean and median 228.8140 and 1.6951 with standard deviation 2847.13559 and the maximum value (minimum) is 47351.29 (-.87). A positive value greater than 1 indicates that the sample companies are managed to increase the value for its shareholders. Ln_total asset value (Ln TA) has mean and median 28.4631 and 28.4124 with standard deviation 1.80231 and maximum value (minimum) 32.84 (20.37).

As for the quality of the audit, the majority of the sampled companies show dummy value worth 0.It shows that the majority of sampled company hiring a public accounting firm (PAF) non-big four.

4.2 Results of Multiple Linear Regressions

After classical linear regression assumption test, the result showed that the data was normal, free from heteroskedasticity, autocorellation, and multicollinearity, then the use of model to test the hypothesis can be performed, and the results will be described.

Table 2. F Test Results

Model		Sum of Squares	Df	Mean Square	Adj R square	F	Sig.
	Regression	738.817	10	73.882	.683	61.277	.000[b]
1	Residual	325.538	270	1.206			
	Total	1064.356	280				

a. Dependent Variable: LN_FEE

b. Predictors: (Constant), QUALITY_AUDIT, LEV, K_MGR, MB, FCF, D_INST, CR, AC_MEET, LN_TA, ROA

Table 2 shows that all regression models can be used to predict the dependent variable (audit fees). Statistically, it can be seen from the F values which is significant at $\alpha = 0.05$ (0.00 <0.05). It means that the regression model was fit to test. The value of adjusted R square which is 0.683 means that the variation of the independent variables has the ability to explain variation in the 68.3% dependent variable. While the remaining 31.7% is explained by other variables outside of this research.

4.2.1 The Effect of Institutional Ownership to Audit Fee

The result in table 3 shows that concentrated Institutional ownership (D_INST) has a p-value ≥ 0.10, so that theH1 hypothesis which states that institutional ownership effect towards audit fee is not supported. This is not in accordance with theory predicted that blockholder actively monitors the company including financial reporting process to reduce the inherent risk of material misstatement which will increase the audit fees. Meanwhile, for the minor shareholders (diffused) remain not interested in monitoring the company including manager strategic decisions. Instead, they prefer to sell their shares if they are less satisfied with the company's performance.

In addition, the t-test results of different influence between diffused and blockholder institutional ownership indicate that there is no distinctive effect of them both towards the audit fees. This can be seen in Table 4.

Table 3. Results of t Test

Coefficients [a]						
Model	Unstandardized	Coefficients	Standardized Coefficients		T	Sig.
	B	Std. Error	Beta			
(Constant)	-1.725	1.312			-1.315	.190
AC_MEET	.025	.009	.101		2.684	.008
D_INST	-.083	.467	-.006		-.179	.858
K_MGR	.019	.010	.062		1.803	.073
FCF	1.710E-013	.000	.056		1.642	.102
CR	-.004	.001	-.130		-3.255	.001
ROA	-1.452	.620	-.097		-2.340	.020
LEV	-.002	.226	.000		-.008	.993
MB	-2.991E-006	.000	-.004		-.114	.909
LN_TA	.832	.043	.769		19.506	.000
AUDIT _ QUALITY	.353	.151	.091		2.343	.020

a. Dependent Variable: LN_FEE

Table 4. T-Test Results: Differences between Institutional Ownership Diffused and Block Holder towards Audit Fee

		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	90% Confidence Interval of the Difference	
		Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower
LN_FEE	Equal variances assumed	1.976	.161	.747	279	.455	.60188	.80523	-.72701	1.93077
	Equal variances not assumed			1.079	5.481	.326	.60188	.55801	-.50112	1.70488

The result obtained is similar to Mitra (2007) which states that there is no difference in the relationship between institutional ownership and non-institutional blockholder with the audit fees. This can occur because both the diffused shareholder and blockholder demand to buy a high quality audit services to increase their confidence in the reliability of financial statements, which as the consequence, the company need to pay higher audit fees.

4.2.2 Effect of Managerial Ownership towards Audit Fee

Managerial ownership variable (K_MGR) has a p-value <0.10. This shows that the second hypothesis which says that there is an influence of managerial ownership on audit fees cannot be rejected. According the result of t test, managerial ownership variable has a positive coefficient. Thus, the higher managerial ownership percentage in a company, the higher audit cost becomes. This is not in accordance with the theory that states opportunistic actions by the manager can be reduced by an increase in managerial ownership, which will reduce the inherent risk of material misstatement and audit fee reduction.

The relationship of managerial ownership to audit fee in this research showed positive direction. This means that the higher the managerial ownership in a company the more expensive its audit fee and vice versa. Along with the increase of managerial ownership, the management will be more motivated to produce a more qualified financial reporting. The management will also give positive signal to investors by asking high scope of work that led to a high cost audit. This is done so that the investors have confidence in the financial statement prepared by the Management.

The results of this study are not in accordance with the research partners Mitra Sentanu et al (2007) which prove that managerial ownership affects the cost of the audit negatively and significantly. Mitra states that managers with a high level of stock ownership does not want to take opportunistic activities. This act will reduce the risk of congenital (inherent risk) of material misstatements in the financial reporting process.

4.2.3 The Effect of Audit Committee Activities towards Audit Fees

Based on the results of the t test, the variable activity of the audit committee (AC_Meeting) has a p-value <0.10, so that the third hypothesis which states that there is a significant impact of audit committee activities towards audit fees, cannot be rejected. The coefficient direction, which has a positive value, shows that the more audit committee meetings held, the higher cost of the audit becomes.

This result is match with what has been predicted by the theory but in the opposite direction, which states that number of audit committee meeting is one component that determines the audit committee effectiveness. The external auditor see it as a better environment control which will lower the level of risk control by the auditor and reduce the amount of work performed by external auditors (Tsui et al, 2001). This can happen due to all shareholders, both institutional shareholders and managerial shareholder, request the company to purchase and use a qualified audit service, which as consequence, the audit fees increase.

The relationship of audit committee meetings is positive. It means that the more active internal audit committee (more meetings) then the higher impact of internal audit monitoring to a better corporate governance. There is high demand to the quality of external audit in the company that has high commitment to implement corporate governance. Therefore, the scope of audit became wider that led to a high audit fee. This research supported the research of Goodwin-Stewart and Kent (2006) stated that internal or external audit will increase supervision as whole in the company.

The results of this study are not in accordance with Carcello et al. (2002) which found that there was no relationship between the audit committee and audit fees. This result is consistent with the research result of Lawrence et al. (2003) which found that the result of audit committee characteristics which are measured with the independency, expertise and frequent meetings, affected the audit fees significantly.

4.2.4 The Influence of Free Cash Flow towards Audit Fee

The free cash flow (FCF) as one of the control variable shows p-value ≥ 0.10 which means it does not impact audit fees significantly. This result is not in accordance with theory which has been stated that the positive level of free cash flow will influence the audit fee since the auditor will need more time to carefully inspect the performance and the usage of cash flow owned by Issuer Company. In that way, FCF can not be use as control variable. This result also does not match with the research of Gul & Tsui (1998 and 2001) which found a positive relation between the high level of FCF and the audit fee.

4.2.5 The Effect of Liquidity Ratio towards Audit Fee

The other control variable in this study is ratio of liquidity which is measured by the current ratio (CR). T-test result indicates that CR has p-value < 0.10 with coefficient -0.004 which means the higher liquidity ration of a company, the lower audit fee becomes. It is consistent with the stated theory that if the issuer company has better level of liquidity, the audit fee will become lower because the external auditors find a low risk on its company, so they do not need to extend the scope of examination.

4.2.6 The Effect of Profitability Ratio towards Audit Fee

Ratio of profitability as a control variable measured by return on asset (ROA) has p-value < 0.10 with coefficient -1.452. It reflects a negative and significant ratio of profitability towards audit fee. This circumstance is in accordance with a theory which stated the higher profitability of a company could reduce the audit fee. It is because the auditor know since the company does a good performance, it will be able to press down its audit risk which will reduce the audit fee charged.

4.2.7 The Effect of Solvency Ratio towards Audit Fee

Solvency ratio measured by variable of leverage ratio (LEV) has p-value ≥ 0.10 which means leverage ratio as control variable does not have significant influence towards the audit fee. It is not match with theory stated a company with higher leverage level will hire auditor from the big four to raise the reliability of its financial report and to gain interest and trust from auditor, which as a consequence of this act, the audit fee needed will be higher.

In addition, the auditor will charge a higher audit fee to the issuer company which has high level of solvency because it has a high risk of business and audit. Therefore, the audit need to be more careful in auditing and extending the scope of examination.

This result is different from that of research done by Rusmin el al (2009) which found that a company with high leverage ratio will have increased the risk of controlling environment and be ended by the enhancement of audit fee. This dissimilarity gained because the research data shows that the majority of sampled company possesses a good level of leverage and uses auditor from non-big four.

4.2.8 The Effect of Firm Size towards Audit Fee

Firm size variable measured by natural logarithm from total asset (LN TA) has p-value < 0.10 with coefficient 0.832. It indicates a significant influence of firm size towards audit fee i.e. the higher firm size, the higher audit fee becomes.

This particular situation is in line with theory stated that big companies has had higher inherent risk and got more and complex transaction compared to small companies. Therefore, it will cost higher audit fee since the auditor need more time and resources to do inspection. This result also matches with that published by Abbottt et al (2003b) and Hav, Knechel & Ling (2008) which found a connection between firm size and audit fee.

4.2.9 Market -to-Book Value of Equity (MB) to Fee Audit

Market -to-book value of equity (MB) has p-value ≥ 0.10 which means there is no significant effect of market-to-book value of equity towards audit fee. It does not meet the theory stated that a big company which is measured by high market -to-book value of equity has a high inherent risk which will cause an increase of audit fee. This different result occurs because the investors have trust on a company with big market -to-book value of equity, so they will not require a qualified audit.

4.2.10 The Effect of Audit Quality towards Audit Fee

The t-test result reflects that the variable of quality control audit has p-value < 0.10 with coefficient 0.353 which means it provides a significant influence towards audit fee i.e. when a company uses audit assistance from the public accountant company, known as big four, the audit fee will become more expensive. It is in line with theory stated that high quality audit will cost more audit fee. It is also consistent with the previous research from Abbott et al. (2003b); Hay, Knechel & Ling (2008) and Rusmin et al. (2009).

5. Conclusion, Limitation of the Study, And Recommendation

5.1 Conclusion

The result indicates that the first hypothesis which states there is an effect of institutional ownership towards audit fee, is rejected. This is proved because we do not find dissimilarities effect of institutional ownership of diffused and block holder towards audit fee. Different result reflected by the second and the third hypothesis which mention that institutional ownership and audit committee activities make significant influence towards audit fee. The bigger number of managerial ownership and audit committee activities, shown by the high number of meetings of audit committee, the higher audit fee becomes. It proves that the more often audit committee hold meeting, the auditor will notice an indication which shows a business complexity of its client, so they will charge a high audit fee because of a wide scope of audit.

5.2 Limitation of the Study and Recommendation

Limitation of this study is on extending of the small number of samples used for research. It is because the number of companies which have complete data as required for this research is limited. Moreover, variable of audit committee activity only consists of one characteristic i.e. number of meeting of audit committee in a year, without involving other characteristics such as competency or expertise of audit committee members, experiences, etc. The data obtained form BEI is not consistent in year to year. The numbers written on annual financial report of BEI is sometimes different form one year to another. There is also no company that put number of their audit fee, which has been paid, on the BEI's report. Therefore, the researchers use number of professional fee as the data of audit fee. It results a less reliability of this study.

Because of the limitation of the study, the researchers recommend next of future research to input variable of characteristics audit committee such as competency of audit committee members, educational background, and experience. In addition, ownership characteristic can be extend to ownership of institutional and non-institutional.

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