

## CHAPTER I

### A. Background

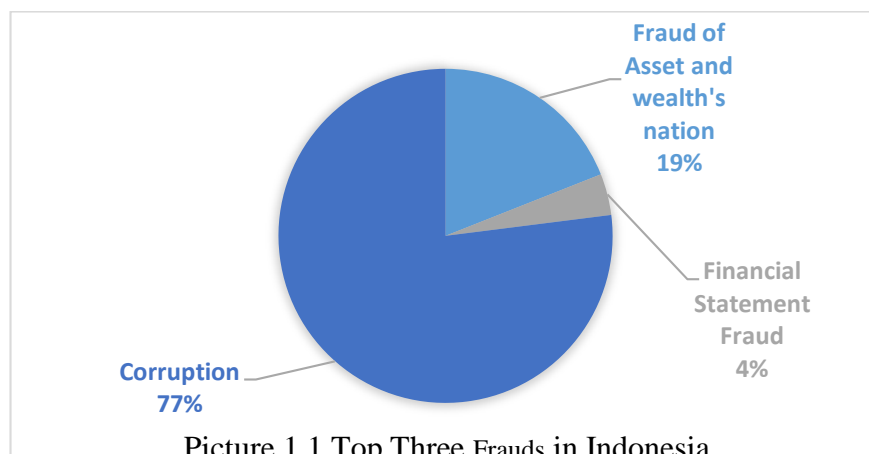
Every company can not be separated with financial statement. Financial statement is expected to give information to investor and creditor in making decision that is related to their investment. Thus, company is expected to make financial statement that fulfills 4 characteristics of good financial statement. Those are relevant, reliable, understandable, and comparable. Financial statement should have good quality and audited by independent auditor. Financial statement's user rely on independent auditor to make sure that financial statement in accordance with general accepted accounting principle.

Based on Law Number 5 Year 2011, public accountant is a profession that has assurance service as a main service (audit service of historical financial information, review service of historical financial information) and the result will be used by public broadly as an important consideration in decision making. With this, public accountant has significant role in supporting transparency and information quality in financial aspect. This regulation also explained rights of auditor, in article 24 defined that auditor has a right to gain fee from do audit to client. In 2016, Indonesian Institute of Certified Public Accountant published the new regulation about determining of audit fee.

Although there is guideline in determining audit fee, the fact is audit fee that given by company is varied. The amount of audit fee is based on one party's enforcement or based on negotiating between auditor and auditee. This negotiating fee explained that there is difference audit fee in every company and every public accounting firm, thus it will influence high or low audit fee. The amount of audit fee that is determined by public accounting firm is interesting to be researched.

Problem might arise when auditor paid by company to do audit, however auditor should be independent to make an opinion. Because there are many cases about financial statement fraud. Started with Enron's case which shaking auditing's world and recently in 2017, British Telecom reported increasing their net profit GBP530 millions. It was revealed that their manager and director manipulate the invoice and cover up their payables. PWC was their public auditing firm in that time. British Telecom get a loss for paying income tax and their stock aggressively went down.

The same thing also happened in Indonesia. Based on Association of Certified Fraud Examiner, in 2016 the top three fraud in Indonesia is financial statement fraud:



Picture 1.1 Top Three Frauds in Indonesia

In 2017, Public Company Accounting Oversight Board (PCAOB) in USA punishes Ernst and Young Indonesia to pay \$1 million because makes unqualified opinion to Telecommunication Company that is lack of audit evidences. PCAOB Indonesia found that E&Y Indonesia still giving unqualified opinion to leasing of more than 4 thousands tower. In addition, PT Kereta Api Indonesia ever did fraud in financial statement which they disclose 6.9 billions in profit, but actually they get loss 63 billions. Before 2015, PT KAI is audited by Badan Pemeriksa Keuangan and in 2015 (which did fraud) PT KAI is audited by S. Manan public accounting firm.

Based on Siskawati et al (2017), company requires effective management to avoid such frauds, one of them by applying good corporate governance. The National Committee on Governance Policy has issued the General Guidelines of Good Corporate Governance in Indonesia in 2006. In the guideline, the organs of a company are consists of the General Meeting of Shareholders (GMS), the Board of Commissioners and Directors, have an important role in the implementation of good corporate governance. Researches about corporate governance structure explained about independent commissioners, commissioners, audit committee, and proportion of meeting of commissioners. (Chandra, 2016; Goodwin and Kent, 2006; Yatim et al., 2006; Carcello et al., 2000; Hazmi and Sudarno, 2013).

Board of commissioners is an organ of the company responsible for supervising publicly and / or specifically in accordance with the articles of association and giving advice to the directors (Law Number 40, 2007). The composition of the board of commissioners is one of the characteristics of the council relating to the information content of earnings. Through its role in carrying out the supervisory function, the composition of the board can influence the management in preparing financial statements so that a quality earnings report can be obtained (Nugrahani, N. R., & Sabeni, A., 2013).

Based on Siskawati et al (2017), board of commissioners is not significantly effect on audit fee. However, Hazmi and Sudarno, (2013) shows that board of commissioners positively effect on audit fee. this research defined that the higher number of board commissioners the higher of audit fee should be paid by client.

There are three important elements that will influence the board of commissioner's effectiveness, namely independence, competence and commitment. Independence is expected to arise in the presence of independent commissioners. The existence of

independent commissioners is intended to create a more objective and independent climate, and also to maintain "fairness" and be able to provide a balance between the interests of the majority shareholders and protection of the interests of minority shareholders, even the interests of other stakeholders (Boediono,2005).

Independent Commissioners are members of the board of commissioners who are not affiliated with the directors, other members of the board of commissioners and controlling shareholders, and are free from any business relationship or other relationship that may affect their ability to act independently or act solely for the benefit of the enterprise (Law Number 40, 2007). Based on Hazmi & Sudarno (2013), there is negative influence between independent commissioners and audit fee. Higher number of independent commissioners the lower of audit fee. Independent commissioner has a duty to control the business operation of company, thus external auditor lesser of audit workload. Conversely, Yatim et al (2006) resulted positive relation between independent commissioner and audit fee.

Independent board of commissioners who are separate from the management have a duty to oversee management performance, including overseeing financial reporting. With the high intensity of board of commissioners meeting, the corporate governance function in the company has been running well so that this will reduce the risk assessment by external auditors that will also impact the reduction of audit fees. Chandra (2016) ; Hazmi and Sudarno (2013) researches shows that number of commissioners meeting has negative influence on audit fee. Higher number of commissioners meeting, the lower of audit fee.

There are three important elements that will influence the board of commissioner's effectiveness, namely independence, competence and commitment. Competence is created

by the committees established by the board of 3 commissioners, especially the audit committee (Boediono, 2005). The audit committee is a group of persons selected by a larger group to do certain work or to perform specific tasks or a number of members of the Board of Commissioners of the client company responsible for assisting the auditor in maintaining his or her independence from management (Tugiman, 1995). Hazmi and Sudarno (2013) reported that number of audit committee has negative influence on audit fee. However, Goodwin et al (2006) defined that audit committee has positive influence on audit fee.

Based on Boediono (2005), competency on audit committee has a relation with the efficiency of commissioners effectivity. Committee who has background in accounting has wider knowledge of accounting and it will lead to good controlling of financial statement. With this, external auditor has lesser audit workload and went to decreasing of audit fee (Hazmi and Sudarno, 2013).

Audit of financial statement is done to monitor the accountability of management in business operation. This activity needs expenditure as audit fee. Based on Institut Akuntan Publik Indonesia's letter Number 2 year 2016 about enforcement of determining audit fee, where this letter is used as base for all member of public accountant institute shareholder and company's management.

However, basis of determining audit fee in IICPA Number 2 year 2016 only using estimation hours of auditor when doing audit. This estimation is calculating in engagement phase. Thus, based on this regulation, audit fee determined by how long audit can be done. It is related to complexity of client business to be audited. Subsidiaries represent the complexity of the audit services provided which are the size of the complexity of transactions owned by clients of the Public Accounting Firm for auditing (Widiasari,

2009). Based on Suharli (2008), number of subsidiaries has no relevance on audit fee. However, Chandra (2016); Xu (2011) defined that higher number of subsidiaries the higher of audit fee.

The new regulation of determining audit fee, the basis is on work hours. In fact, the new International Standard on Auditing introducing risk based auditing. Risk based auditing (ISA 315) that defines auditor not only focus on giving unqualified opinion on financial statement but also give going concern a year later. Based on Suryanto (2013), risk based auditing approach is done by some steps, these are engagement, gathering information, giving opinion, and making audit report. This approach produces good audit quality and reliable information as the result of audit process.

Audit opinion of a company can become a signal for investor and creditor for financial decision in this tight of market. In this tight market competition forces every company to give good performance. In providing good performance of company, sometimes it leads management to do manipulation of financial statement. Hence, auditor has a significant role to give assurance of financial statement. Siskawati et al (2017) use credit rating of company as a tool to define the risk of company. This research also defined that the higher risk of credit rating company, the higher of audit fee. Conversely, Jubb et al (1996) shows that business risk has no significant influence on audit fee. It is because that research used Altman Z Score as a proxy.

This research is compilation research of Xu (2011); Hazmi and Sudarno (2013); Siskawati et al (2017). This research gave a new model of research and wider scope of sample which is all companies and larger range of years. Thus, researcher wants to research with title **“The Effect of Corporate Governance Structure, Business Complexity, and Business Risk on Audit Fee”** (Empirical Study on Companies listed in Indonesia Stock Exchange Year 2013-2017).

## **B. Scope of Research**

Scope of this research is on corporate governance structure using independent commissioners, size of board commissioners, size of board of commissioner's meeting, size of audit committee and audit committee expertise variable. Besides, business complexity is using number of subsidiaries. Business risk variable is using credit rating.

## **C. Research Question**

Based on that background, so that there are research questions in this research:

1. Does the existence of independent commissioners negatively influence audit fee?
2. Does size of board of commissioners positively influence audit fee?
3. Does size of board of commissioner's meeting negatively influence audit fee?
4. Does size of audit committee negatively influence audit fee?
5. Does audit expertise negatively influence audit fee?
6. Does business complexity positively influence audit fee?
7. Does business risk positively influence audit fee?

## **D. Research Objective**

Based on those research questions, this research has objectives to gain empirical evidence:

1. To examine empirically the effect of independent commissioners on audit fee.
2. To examine empirically the effect of size of board of commissioners on audit fee.
3. To examine empirically the effect of size of board of commissioner's meeting on audit fee.
4. To examine empirically the effect of size of audit committee on audit fee.
5. To examine empirically the effect of audit expertise on audit fee.

6. To examine empirically the effect of business complexity on audit fee.
7. To examine empirically the effect of business risk on audit fee.

## **E. Significance of Research**

### **1. Theoretical Significance**

This research is expected to give understanding and knowledge as reference to future research about factors that effect audit fee.

### **2. Practical Significance**

#### **a. For Government**

This research is expected become additional reference for government as one of regulator that has authority in determining audit fee enforcement.

#### **b. For Investor**

This research is expected become additional reference for investor to making decision.

#### **c. For Researcher**

This research is expected to give reference material to other researchers for future research and deeply explain about audit fee.