

## Effect of Internal Control Risk in Determining Audit Fees

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**Abstract.** The existence of low internal control is always associated with the amount of audit fees that will be paid by the company, while good internal control can reduce audit fees. Moreover, the audit fee is an important thing for an auditor in carrying out his duties. Therefore, this study aims to find out how internal control affects the determination of audit fees. The method used in this study is a quantitative method with a descriptive and associative approach. The data for this study uses secondary data available on the Stock Exchanges in Indonesia, Malaysia, and Thailand in 2022. The results in this study indicate that internal control cannot affect audit fees because the determination of existing audit fees is based on an agreement made by the auditor and the company with a look at the various factors that exist in the company.

**Keyword.** Risk; Internal Control; Audit Fee

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### INTRODUCTION

Audit failures related to financial scandals such as financial fraud conspired and hidden by top management require that every company needs internal controls to minimize errors and risks that occur in carrying out business transactions (Wijono, 2012). Another aspect of the financial scandal highlighted the important role of the auditor in having good knowledge of client internal control issues outside of financial reporting (Ji, Lu, & Qu, 2018). Information related to the client's internal control over areas related to financial reporting and areas not related to financial reporting is expected to play a complementary role in helping the auditor form a basis for assessing client audit risk (Ji et al., 2018). When control risk is lower due to higher control quality, the auditor can place more trust in internal control make less effort in the audit, and charge a lower audit fee (Mazza & Azzali, 2018).

Jiang & Son (2015) revealed that The Public Company Accounting Oversight Board (PCAOB) suggests that when internal control risk increases, the auditor can reduce detection risk to achieve the desired overall audit risk level by increasing substantive testing resulting in increased audit fees for clients. Research Munsif, Raghunandan, Rama, & Singhvi (2011) shows that audit fees have a large impact or are closely related to companies that have material weaknesses in internal control over financial reporting. In addition, the cost effect is economically significant as the average company pays an additional 35% in audit fees when there is an internal control deficiency. Hogan & Wilkins (2008) asserts that audit fees increase in the severity of underlying internal control problems because auditors increase their efforts in the face of increased control risk.

According to Jiang & Son (2015) disclosure of internal control weaknesses is often associated with lower accrual quality and a higher restatement frequency. Thus, the determination of the audit fee is very important for the auditor in accepting assignments because it will affect audit quality. Therefore, it is necessary to have an agreement between the client and the auditor regarding the determination of rates so that there is no rates war which can cause the credibility of the public accountant to decrease (Ganda Saputra & Yusuf, 2019). According to IAPI in Management Regulation Number 2 of 2016, matters that must be considered in determining the amount of the audit fee include client needs; legal assignments; level of expertise and

responsibility in the work performed; the complexity of the work; the amount of time needed and effectively used by public accountants to complete their work; agreed costing basis.

Choi in Suseno (2013), concluded that companies that are listed on the capital market and have strong legal force encourage higher audit quality and shareholders are willing to issue higher audit fees to benefit from the value of high quality audits. As mentioned earlier, legally registered companies are required to have their accounts audited by external auditors without compromising on audit quality, hopefully they want the fees they pay to be reasonable (Mohammed, Joshua, & Ahmed, 2018). Fees paid to auditors can affect audit quality in two ways: (1) large fees paid to auditors can increase the effort made by auditors so as to improve audit quality; (2) the large fees paid to auditors especially those related to non-audit services make auditors more economically dependent on their clients (Hoitash, Markelevich, & Barragato, 2007).

Such financial dependence can lead to a relationship in which auditors become reluctant to ask the right questions during the audit for fear of missing out on highly lucrative rewards. Members of public accounting firms are not allowed to get clients by offering fees that can damage the image of the profession (Kuntari, Chariri, & Nurdhiana, 2017). The policy of determining audit fees by public accounting firms is one aspect of quality assessment carried out on public accounting firms (Rahmina & Agoes, 2014).

## METHOD

### Population and sample

The population in this study is 150 non-financial sector companies listed on the Indonesia Stock Exchange, Malaysia, and Thailand. The selection of population in the non-financial sector is because most of the largest sectors related to helping the development of companies are in the non-financial sector and many on the Stock Exchange so that the scope of research will be wider. In selecting samples, this study uses *purposive sampling* techniques with the following criteria: (1) non-financial sector companies listed on the Indonesia Stock Exchange, Malaysia, and Thailand in 2022; (2) companies that consistently report financial statements; and (3) companies that include audit fees in their financial statements. Based on the sample criteria conducted by researchers, 30 non-financial sector companies listed on the Indonesia Stock Exchange, Malaysia, and Thailand in 2022 were obtained.

### Method of data collecting

The method applied in this study is quantitative research with a descriptive and associative approach. Descriptive and associative approaches are used to explain the relationship between variables in the study. The data used in this study is secondary data and the source is obtained from the company's financial statements accessed through the Indonesia Stock Exchange (<https://www.idx.co.id/>), the Malaysia Stock Exchange (<https://www.bursamalaysia.com/>), and the Stock Exchange of Thailand (<https://www.set.or.th>). The analytical methods used in this study are descriptive statistics, classical assumption testing, determination coefficient analysis, and hypothesis testing. The classical assumption test consists of the normality test, the multicollinearity test, and the heteroscedasticity test.

## Variable Operationalization

### Internal Control

Internal control is a process of the company's operational activities and is an integral part of the management process. Good internal control coupled with sound financial management practices will protect company assets preventively, detectively, and correctively (Lestari, 2013). Internal control is a process carried out by the board of commissioners to provide adequate assurance about the achievement of control objectives to operate effectively and efficiently in order to provide reliable financial statements and in accordance with applicable regulations (Dewi Prastuti, 2013). According to COSO (The *Committee Of Sponsoring Organization of The Treadway Commission*), internal control has 5 component elements, namely: (1) control

environment; (2) risk interpretation; (3) accounting information and communication systems; (4) control activities; and (5) monitoring.

**Audit Fee**

According to De Angelo (1981) in Wulandari & Nurmala (2019), explaining that audit fees are incomes whose amount varies depending on several factors in the audit engagement, such as the size of the client company, the complexity of audit services faced by auditors, audit risks faced by clients, and the name of the public accounting firm that performs its audit services. Audit fee is an important control cost for auditors because auditors are responsible for ensuring that the financial statements prepared by management are in accordance with applicable accounting standards and do not harm investors (Tanujaya & Mandela, 2022).

**RESULTS AND DISCUSSION**

The following are presented the results of the descriptive statistical analysis obtained in table 1.

**Table 1. Descriptive Statistical Analysis**  
**Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation
Internal Control Risk	30	11	20	15,90	2,426
Audit Fee	30	9,45	26,48	18,6193	4,72712
Valid N (listwise)	30				

Source: Data processed, 2023

Table 1 produces outputs where the number of samples (N) in this study is 30. The minimum value generated from the independent variable is 11 while the maximum value is 20. For the mean value resulting from the internal control variable (X) of 15.90. While the dependent variable produces a minimum value of 9.45, a maximum value of 26.48, and a mean of 18.6193. The distribution of data on independent and dependent variables has a wide distribution of data because the mean results produced by independent and dependent variables are greater than the standard deviation.

**Table 2. Normality Test**  
**One-Sample Kolmogorov-Smirnov Test**

		Unstandardized Residual
N		30
Normal Parameters <sup>a,b</sup>	Mean	,0000000
	Std. Deviation	4,54367792
	Most Extreme Differences	
	Absolute	,150
	Positive	,101
	Negative	-,150
Test Statistic		,150
Asymp. Sig. (2-tailed)		,083 <sup>c</sup>

a. Test distribution is Normal.

b. Calculated from data.

c. Lilliefors Significance Correction.

Based on the data of table 2 above, it can be seen that the value of Asymp. A sig of 0.083 is greater than 5% or 0.05. Thus, the data of this study is normally distributed because the value is greater than the significance value of 5%.

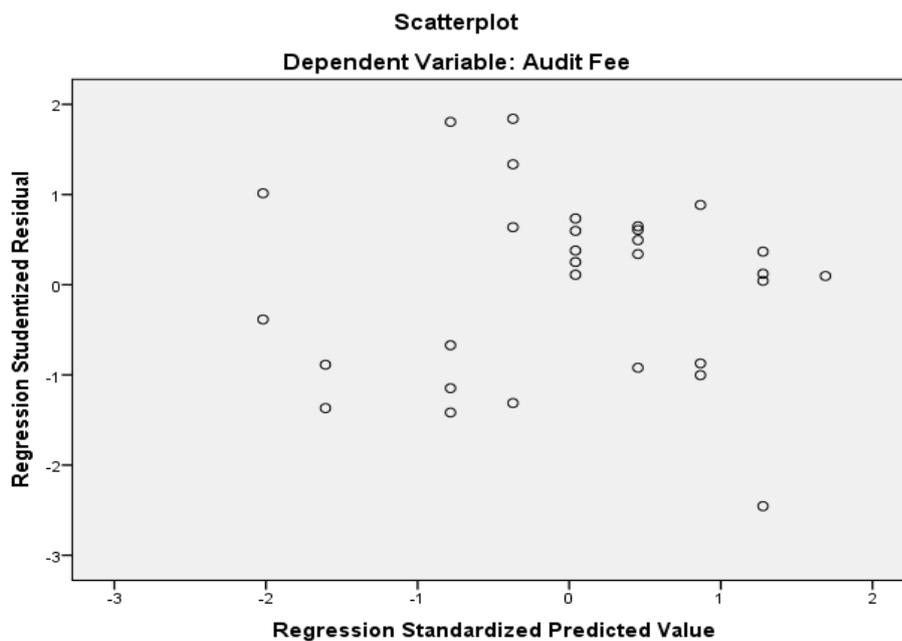
**Table 3. Multicollinearity Test Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	10,073	5,690		1,770	,088		
	Internal Control Risk	,538	,354	,276	1,519	,140	1,000	1,000

a. Dependent Variable: Audit Fee

Based on table 3 above, it can be seen that the tolerance and VIF values produced by this research data do not occur multicollinearity because the tolerance values are  $1,000 > 0.10$  and VIF values are  $1,000 < 10$ .

**Figure 1. Heteroscedasticity Test**



Based on the scatterplot output in figure 1, it can be seen that the study is distributed normally because the data points spread both above and below around the number 0. In addition, the data does not collect at the top or bottom only and is also not patterned. Thus, the data of this study did not occur heteroscedasticity problems.

**Table 4. Coefficient of Determination Analysis Model Summary<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,276 <sup>a</sup>	,076	,043	4,62410

a. Predictors: (Constant), Risiko Pengendalian Internal

b. Dependent Variable: Audit Fee

In the results of the coefficient of determination analysis, it can be seen that the value of R<sup>2</sup> is 0.076 or 7.6%, which indicates the contribution of the independent variable in influencing the dependent variable by 7.6% and the rest is on the variable that was not studied from this study.

**Table 5. Simple Linear Regression Test Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	10,073	5,690		1,770	,088
	Internal Control Risk	,538	,354	,276	1,519	,140

a. Dependent Variable: Audit Fee

Based on the results of testing the hypothesis above, a simple regression equation was obtained in this study, namely:

$$AF = 10,073 + 0,538 RPI$$

The value of the constant obtained is 10.073. This shows if the internal control risk variable = 0 then the audit fee value is 10.073. On the value of sig. indicates that the independent variable gets the SIG value. > 5% so that the risk of internal control has no effect on the audit fee. The results of this study are in line with research conducted by Krisnawan (2018) and Widiyanti & Prabowo (2008) which states that internal control does not affect the determination of audit fees. This is because of the role of the audit committee which is responsible for the effectiveness of internal control in the company so that the company does not need more assurance from auditors. Therefore, in determining the audit fee, the auditor does not consider the company's internal control. In addition, the amount in determining the audit fee is certainly adjusted based on an agreement between the auditor and the company so that there is no relationship with internal control carried out by the company.

In addition, the risks that auditors find in the company, whether high or low, cannot affect the amount of audit fees. This is because the company's risk will not affect the auditor's business and time in carrying out its responsibilities because another factor that strengthens the high audit fee is the complexity of the company which clearly concerns the auditor's working hours which will remain long even though it has been supported by the results of the audit conducted by the internal audit. Based on the precautionary principle, auditors usually do not increase confidence in internal control even though the company or *auditee* has improved the quality of internal control so that a low internal control risk assessment cannot ensure low fees are obtained as well.

**CONCLUSION**

The conclusion that can be obtained is that internal control does not affect audit fees because there are several other factors that can affect audit fees such as the complexity of the tasks carried out by the auditor and the audit risks faced by the auditor. In addition, the determination of audit fees is based on the agreement of both parties, namely the auditor and the company. High or low internal control risk also cannot be used as a reference in determining the amount of audit fees, which of course depends on the independence of auditors who must assess well how the company's condition is by leaving aside the fee matters submitted to the company.

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