Fair Value of Non-Current Assets and The Second Largest Ownership on Audit Fee

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Abstract. The use of fair value method has positive and negative impact. The positive impact of applying the fair value method is more relevant for the decision maker and shows the economic value according to the circumstances at that time. While its negative impact, can lead to manipulation and uncertainty. It takes greater effort for the auditor to assess fairness of fair non-current asset quality, resulting in increased audit fees. This study aims to determine the effect of fair value of non-current asset on the determination of audit fees and to know the multiple large shareholder moderation in the relationship between fair value of non-current asset and audit fee. Using the OLS regression, this study uses companies listed on the IDX from 2013 to 2015 with the exception of the financial sector. The result of this research indicates that fair value of non-current asset influences audit fee and this research shows that the second largest ownership can weaken the effect of fair value of non-current asset toward audit fees.

Keyword. fair value non current asset; multiple large shareholder; audit fee

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INTRODUCTION

In a company, there is often a conflict of interest and asymmetry information between agents and principals. Such conflict of interest and asymmetry information may facilitate the agency to commit fraud within the company. The process of auditing the financial statements is considered to reduce the asymmetry information within the company. Meutia (2004) in (Wiryadi et. al., 2013) stated that auditing is a process of reducing the misalignment of information that exists between managers and shareholders by using external parties to authorize financial statements.

After the audit of the financial statements is performed, the company is obliged to repay the services of a public accountant by providing audit fees. The absence of standard of audit fees causes the frequent abnormal audit fees that may affect audit quality. The threat of abnormal audit fees faced by Indonesian auditors is illustrated by the regulation of audit fees stipulated in the Decree No. KEP. 024/IAPI.VII/2008 which contains guidance for members of the Indonesian Institute of Certified Public Accountants (IAPI) in determining the reasonable amount of audit fees according to their professional services.

Non-current asset is one of the accounts that often shows the amount of material in the financial statements of most entities, so it has its own complexity in the audit process, especially if non-current assets are assessed using fair value. Apandi (2014) stated that an auditor should evaluate the use of estimates, assumptions and judgments made by management in a rational manner and determine the consistency of measurement in the fair value concept. It is indicated to increase audit fees that may be received by the auditor.

Several differences in results are still encountered in the study of the effect of fair value of non-current assets on the determination of audit fees. Researches by Ettredge et. al. (2014), Yao et. al. (2015), and Apandi (2015) resulted in the hypothesis that fair value has a positive impact on audit fees, but a research from Goncharov et. al. (2012) stated otherwise, that fair value has a negative impact to audit fees. Differences in the results of previous studies may allow for other aspects affecting the influence of fair value of non-current assets on the determination of audit fees, for which the current researcher is motivated to conduct a research in order to see the effect of fair value of non-current assets on audit fees that are weakened by the second largest ownership.

The present study is a replication of Apandi's research (2015). The researcher uses a variable of fair value of non-current asset as an influencing factor to audit fee. This study adds the second largest ownership as a moderating variable that influences fair value of non-current asset on the determination of audit fee. This study uses a sample of companies listed in the Indonesia Stock Exchange in 2013 to 2015 excluding the financial sector and banking.

This study has a general purpose to add literature review which provides empirical evidence of previous research differences on the effect of fair value on audit fees, and provides an overview of the benefits and costs associated with fair value implementation in a company. In addition, this study also aims to increase the study of the second largest ownership in Indonesia. The specific purpose of this research is to prove that fair value of non-current asset has an effect on audit fee and that the effect of fair value of non-current asset on audit fee is moderated by the second largest ownership.

This research is expected to add a comprehension, increase knowledge, and can be a reference for related discussion, and can become reference for next researchers who have interest to study the effect of fair value of non-current asset on audit fee with second largest ownership as a moderating variable. In addition, this research can be useful as a guidance, a reference, and a consideration for auditor in determining a rational audit fee, can become an input and a reference for the determination of policy and become consideration in decision making in a company and is expected to be a consideration for policy maker relating to audit fees.

Agency Theory

The agency theory was first coined by Jensen and Meckling in 1976. Jensen et. al. (1976) described the agency relationship in agency theory that a company is a collection of contracts between the owner of the economic resource (principal) and the manager (agent) who takes care of the use and control of the resource. This contract stipulates the obligation of agents to perform various services based on the delegation of authority from principal to the agent, among them is the decision-making for the interests of the principal.

Fair Value of Non-Current Asset

Since 1994, Indonesia has started to harmonize to implement International Financial Reporting Standard (IFRS). IFRS establishes a fair value as the basis for measurement of assets and liabilities. Fair value is the amount of rupiah agreed upon for an object in a transaction between parties of free will without pressure or compulsion (Suwardjono, 2008, p.475). Herrmann et. al. (2006) argued that the measurement of property, plant, and equipment using fair value is superior to historical cost based on characteristics of prediction value, feedback value, timeliness, neutrality, representational loyalty, comparability, and consistency.

Corporate Governance

Until now, the definition of a Good Corporate Governance is still diverse. Turnbull (1997) defined corporate governance by describing all the influences affecting institutional processes including to designate controllers and/or regulators, involved in organizing the production and sale of goods and services.

It can be concluded that corporate governance is a system that regulates, manages and supervises the process of business control on an ongoing basis, aims to increase the value of a company as well as a form of attention to corporate stakeholders.

Second Largest Ownership

Kim et. al., (2007) stated that when the ownership of public companies is concentrated in the hands of several large shareholders, these large shareholders have the incentive and the power to monitor the operations and management of the company effectively. While Attig et. al. (2008) argued that the presence of multiple controlling shareholders with comparable voting rights offsets the costs of corporate agencies and lowers the cost of equity firms' capital; this makes sense because the high risk of contest control ability (from the largest controlling shareholder) makes it possible to improve the quality of corporate information and the cost is thus lower than the capital.

Based on the description, it can be concluded that the existence of the second largest ownership in the company can positively affect the quality of corporate governance. This is because the second largest owner can control the controlling shareholder in making the company's decision to avoid expropriation and deviation. In this study, a company is said to have the second largest shareholder if the largest shareholder holds a stake of more than 20% while the second largest shareholder owns at least 10% of the shares (La Porta et. al. 1999).

Audit Fee

Simunic (1980) is the first researcher to conduct research on audit fee. The audit fee is another term for the audit fee required by an independent party in carrying out the action (Sukaniasih et. al., 2016). Tuanakotta (2011, p. 230) described a meta-analysis showing three characteristics or attributes related to the determination of the amount of audit fee, i.e. client attributes, auditor attributes and engagement attributes.

Effect of Fair Value of Non-Current Assets on Audit Fee Stipulation

A research conducted by Apandi (2015) also produced an evidence that the application of fair value affects audit fees positively. A research by Yao et. al. (2015) revealed some significant increases in audit fees when non-current assets (PPE, property investment and intangible assets) were measured using fair value due to reduced audit efficiency and increased audit risk caused by agency problems. While Ettredge et. al. (2014) found evidence that auditors receive premium audit fees when auditing bank assets that have unverified fair value, which is consistent with the idea that audit efforts will increase in the difficulty of verification. In contrast to the results of the study, a study by Goncharov et. al. (2012) found that audit fees decreased in the company's exposure to fair value.

Second Largest Ownership as a Moderating Variable in the Effect of Fair Value of Non-Current Asset and Audit Fee

Gutiérrez et. al. (2004) stated that having two or more large shareholders can supervise the results of managers. While Amdouni et. al. (2015) argued that the presence of multiple large-shareholders has an important monitoring role because it can decrease managerial opportunism and prevent managerial owners from transferring corporate resources for their own benefits.

Thus, it can be said that the second largest ownership is one form of Good Corporate Governance. In the study of Yao et. al. (2015), the amount of change in audit fees in relation to the revaluation of assets depends on the strength of corporate governance mechanisms.

The second largest ownership is thought to have an influence as a moderating variable (weakening) the effect of fair value of non-current asset on the determination of audit fee. Fair value of non-current assets will have a positive effect on audit fees but the positive influence will be weakened if there is the second largest ownership in the company. This is due to the second largest ownership that can improve the internal control of the company so that financial statements produced by management are more reliable and relevant. Furtheremore, the effort given by the auditor can be reduced and impact on the decrease of audit fee is obtained.

RESEARCH METHOD

Research design used in this study is a quantitative approach with descriptive and causal studies. Setyosari (2010, p.33) argued that a descriptive research is a study aimed at explaining or describing a state, event, object whether a person or anything related to variables that can be explained either by numbers or words. The population in this study consists of 444 non-financial companies listed in the Stock Exchange in 2013-2015. Sampling technique used in this study is purposive sampling and there are 39 companies that can meet the criteria. Data were were processed using tools in the form of multiple linear regression analysis and moderating regression analysis as follows:

Multiple Linear Regression Analysis

$$FEE_{it} = a + b_1\, FAIR_{it} + b_2\, \text{KEPEMILIKAN}_{it} + b_3\, SIZE + b_4\, LOSS_{it} + b_5\, \text{KAP}_{it} + e$$

Moderating Regression Analysis

$$FEE_{it} = a + b_1\, FAIR_{it} + b_2\, \text{KEPEMILIKAN}_{it} + b_3\, \text{KEPEMILIKAN}_{it} * FAIR_{it} + b_4\, SIZE + b_5\, LOSS_{it} + b_6\, \text{KAP}_{it} + e$$

Note:

FEE = Natural Logarithm The amount of audit fee on Company i in year t

FAIR = Natural Logarithm The amount of Fair value of non-current asset in Company i in year t

OWNERSHIP = 1 if company i has the second largest Ownership in year t and 0 if it does not have

SIZE = Natural logarithm Total company asset i in year t
LOSS = 1 If company i in year t loses and 0 if not
KAP = 1 If company i uses auditors Big 4 and 0 if not
a = constant
b = regression coefficient of independent variables
e = *error*

RESULTS AND DISCUSSION

Regression Analysis

Results of Regression Test

Variables	I Without Control Variable, Without Moderating Variable		II With Control Variable, With Moderating Variable	
	Coefficient	**Sig.**	**Coefficient**	**Sig**
Independent Variable:				
FAIR	0.2449	0.0000	0.1279	0.0014
Moderating Variable:				
OWNERSHIP			2.8347	0.0473
FAIR*OWNERSHIP			-0.1439	0.0476
Control Variable:				
SIZE			0.3955	0.0000
LOSS			-0.4129	0.0037
BIG4			0.8142	0.0000
Adjusted R-Squared	0.2079		0.6858	
Prob (F Stat)	0.0000		0.0000	

Source: Results of Data Processing

Based on the above table, the coefficient of determination can be observed from the value of Adj. R^2 from model I with 0.2079, meaning that the variable of fair value of non-current asset (FAIR) is able to explain audit fee (FEE) equal to 20.79%. And the value of Adj. R^2 of model II is 0.6858. This means that all independent variables, i.e. fair value of non-current asset (FAIR), the second largest ownership (OWNERSHIP), total assets (SIZE), profitability (LOSS), and the use of Big 4 PAF (BIG4) services are able to explain the audit fee (FEE) of 68.58%. The rest is explained by other factors that are not included in the model.

Simultaneous testing in both in model I and model II yields a comparison of sig values 0.000 <0.05 thus H_a is accepted. This means that simultaneously fair value of non-current assets (FAIR), total assets (SIZE), profitability (LOSS), use of Big 4 PAF (BIG4) services, and the second largest ownership (OWNERSHIP) can affect the audit fee (FEE).

The regression test for model I yields p-value 0.0000 <0.05, showing that fair value of non-current asset (FAIR) has significant effect to the determination of audit fee (FEE) without moderating variable and without control variable. Coefficient value 0.2449 shows the influence of FAIR to FEE is positive. That is, if the fair value of non-current assets increased 1 unit then the audit fee will increase by 0, 2449 (24.49%).

Regression test for model II shows p-value of 0.0014 <0.05. This means that the fair value of non-current assets (FAIR) significantly influence the determination of audit fees (FEE) with the moderating variables and control variables. In other words, the auditor gets a higher audit fee when the client company uses the fair value method that contains estimates, assumptions and judgments. Coefficient value 0.1279 shows the influence between FAIR to FEE is positive. That is, if the fair value of non-current assets increased 1 unit then the audit fee will increase by 0.1279 (12.79%).

Based on the analysis of Moderated Regression Analysis (MRA), the moderating variable is an interaction between the fair value method in assessing non-current assets (FAIR) with the second largest ownership (OWNERSHIP), (FAIR * OWNERSHIP) has p-value 0.0476 <0, 05. This means the moderating variable (FAIR * OWNERSHIP) is significant at the 5% level. Coefficient value of -0.1439 shows the effect of OWNING on the influence of FAIR on FEE is negative.

Effect of Fair Value of Non-Current Asset on Audit fee Determination

Results of the analysis shows that the variable of fair value of non-current asset have a significant positive effect to the audit fee. It is proved based on the results of analysis showing that the value of fair value coefficient non-current assets is 0.1279 with significance of 0.0014 (<0.05).

The results of this study indicate that higher the fair value of non-current assets will lead to an increase in the determination of audit fees. This is in line with other researches by Ettredge et. al. (2014), Yao et. al. (2015), and Apandi (2015) which resulted in a hypothesis that fair value has a positive impact on audit fees caused by difficulties to verify, reduced audit efficiency and increased audit risks caused by agency issues, as well as more time and energy resources in assessing the fairness of assumptions, estimates and judgments made by management. Yet, the results of this study are not in accordance with the results of another research by Goncharov et. al. (2012) which stated otherwise, that fair value negatively impact audit fees.

Lee et. al. (2013) stated that auditors require a component for broader audit work because high levels of subjective assumptions, valuations and estimates can lead to an increased risk of material misstatement, resulting in increased audit risk. Increased risks and efforts that auditors must be faced in conducting audits of fair value of non-current assets containing assumptions, estimates and judgments are entitled to rewards of higher audit fees. Regardless of the possibility of fair value of non-current asset has been assessed by other independent parties, the auditor must keep ensuring the value of its value because fair value of non-current asset is one component of financial report which becomes the responsibility of the auditor in conducting the audit process.

Based on the results of this study, it is certain that companies are already consider fair value of non-current asset as a factor affecting the determination of audit fees. It can be concluded thus far that auditors in Indonesia do not get abnormal fee associated with fair value of non-current asset, although there is no definite policy value of audit fee.

Second Largest Ownership as Moderating Variable in the Influence of Fair Value of Non-Current Asset and Audit fee

Test results and data processing shows that the second largest regression value as moderating variable between fair value of non-current asset and audit fee is 0.0476 (<0.05) with coefficient equals to -0.1439, meaning that the influence of second largest ownership to fair value of non-current asset with audit fee is negative (weakening). The results of this regression show that the effect of fair use of non-current asset value will lead to high audit fees, but the effect will be weakened/decreased when there is a second largest ownership in the company.

The results are indicated to be related to the control that can be granted by the second largest ownership in the company. As Amdouni et. al. (2015) pointed out, the presence of multiple large-shareholders has an important monitoring role because it can decrease managerial opportunism and prevent managerial owners from transferring corporate resources for their own benefit.

The second largest ownership can supervise management so as not to deviate or manipulate the components of financial statements, such as non-current assets assessed by fair value method. Besides, the second largest ownership can also be a counterweight to the power of majority shareholders so as not to take arbitrary decisions that can harm the company or other parties. The second largest ownership can improve the internal control of the company, so that the financial statements produced by the management are more reliable and relevant. Then, the effort put forth by the auditor can be reduced and the impact is on the decreased audit fee.

CONCLUSION

Based on the result and analysis of the present study about the influence of fair value of non-current asset to the determination of audit fee on non-financial companies listed in Indonesia Stock Exchange year 2013-2015, the following conclusion can be drawn (1) Fair value of non-current assets have a positive effect on audit fee, meaning that the higher fair value of non-current asset of a company will cause an increase in the audit fee that must be issued. This is due to an increase in the effort taken by the auditor based on the assumptions, estimates and judgments contained in the application of the fair value method. (3) The second largest ownership as a moderating variable weakens the influence of fair value of non-current asset on the determination of audit fee. This is because the second largest ownership can be one form of internal control within the company. In a company that has the second largest ownership, the management can be more supervised so as not to deviate or manipulate the components of financial statements. The second largest shareholder can also be a counterweight to the power of the majority shareholder so as not to take decisions that could harm the company or other parties. It affects the more reliable financial statements.

Based on the results and analysis of the the study on the influence of fair value of non-current asset to audit fees and obtain conclusions, the authors propose some suggestions that can be put forward as follows. (1) Auditors are expected to consider that the time and energy resources required to examine the fairness of the fair value method will increase with the assumptions, estimates and judgments contained in the fair value of non-current asset. Such time and energy resource increases also relate to the obligation to verify the fair value and continuous communication with the management or independent parties regarding the method used in the calculation of fair value and the result of the fair value calculation. (2) The present study has a relatively small amount of data because not many companies have disclosed the amount of audit fee while applying fair value of non-current asset in Indonesia. Therefore, this research is expected to encourage the regulator in increasing the transparency of audit fee information in annual report. To overcome the limitations of this study then the researchers can further develop by using cross-country analysis so as to provide a more comprehensive picture of fair value linkage with audit fee. (3) This research is not a research on the quality of fair value of non-current asset valued by the management and independent party, therefore the researcher can further develop related to the study on the difference of risk level contained in the fair value of non-current asset valuation which is evaluated by the party management and independent parties.

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