Audit Committee and Audit Fees in High Regulated Firms: Moderating Role of Regulatory Oversight

I.K. Norziaton

Faculty of Accountancy, UiTM Puncak Alam Campus, Selangor Malaysia.
Email: norzi153@salam.uitm.edu.my

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ABSTRACT

This research is conducted under the Malaysian corporate setting that is unique due to its stringent regulatory oversight by the Bank Negara Malaysia on financial institutions. The Bursa Malaysia revamped its Listing Requirements to enhance the internal governance mechanisms, specifically on the roles and responsibilities of audit committees. Hence, it provides an opportunity to examine the association between audit committee characteristics namely independence, diligence and expertise, and audit fees from the demand side perspective for high regulated firms. The study uses multiple regression model to investigate the moderating effect of regulatory oversight and the association between audit committee and audit fees for a sample of 1045 firms-year observation during the period of 2013 to 2017. Four hypotheses are developed and tested. The results reveal that high regulated firms pay higher audit fees than less regulated firms due to its additional industry-specific regulator, which requires more audit effort thus increasing audit fees. The findings reveals shows that regulatory oversight strengthens the association between audit committee diligence and expertise, and higher audit fees for high regulated firms. However, audit committee independence is insignificant and thus rejected. Higher audit fees paid by high regulated firms act as a complementary role of the regulatory oversight function, not a substitute, for external audit monitoring. Hence, results supported the notion that regulatory oversight complements the external audit as monitoring mechanisms. This study is important to policy makers, practitioners and academic literature as it provides additional knowledge about the impact of audit committee characteristics, both high regulated firms and less regulated firms. It draws from two theories, namely, the agency theory and institutional theory, to form the framework and develop the hypotheses to be examined. The results reported in this research is based on limited sample for high regulated firms in Malaysia.

Keywords: *Corporate Governance, Institutional Theory, Audit Committee, Regulatory Oversight, Audit Fees*

INTRODUCTION

Good corporate governance is essential to economic stability and growth in developed and developing economies. Malaysia is committed to advancing the improvement of sound corporate governance systems and practices (Abdul Rahman, 2006). Indeed, it can be said that considerable progress has already been achieved. Even in the most progressive economies, there are signs that a few improvements in the capital market have outpaced the advancement of corporate administration frameworks and practice (Abdul Rahman, 2006). This is nothing new as financial policy-makers, supervisors, and regulators are always trying to catch up with the evolution of capital markets in an ever-changing world.

Expanding competition and the ongoing spate of corporate collapses have renewed attention to the effectiveness of audit pricing. The auditing profession has received much criticism for the increase in audit fees (Ciesielski and Weirich, 2006). Since the demise of Arthur Andersen, the costs associated with the much-reviled section 404 of Sarbanes Oxley (SOX) Act have made the criticism sharper (Lee and Azham, 2008). The reason for the SOX Act is to diminish the potential outcomes of corporate fraud by expanding the stringency of procedures and requirements for financial reporting. Section 404 of the Act mandates all listed firms in the United States to set up internal controls and procedures for financial reporting as to ensure their effectiveness.

Prior studies on audit fees are generally drawn from the governance of firms in the less regulated or non-financial industry (Carcello et al., 2002; Abbott et al., 2003; Goodwin and Kent, 2006). This is because firms in the financial industry are different from firms in other industries, for they are more complex and difficult to monitor and thus, stringent monitoring and greater regulatory oversight are applied to these firms. There are two strands of prior research on the relationship between regulatory oversight and corporate governance practices by firms. The first strand finds that greater regulatory oversight complements the critical role of corporate governance. The justification is that an independent and effective board and audit committee of high regulated firms (HRFs) have more prominent impetuses to secure their reputational capital than those in less regulated firms (LRFs). They demand extra affirmation from the external auditor in order to reduce their personal risks (Abbott et al., 2003) and consequently increase in audit fees (Stoll, 1998; Adams and Mehran, 2003). Whereas, the second strand finds that regulatory oversight partially substitutes the external audit as a monitoring mechanism. According to Bryan and Klein (2005), direct monitoring by regulators decreases information asymmetries in high regulated firms as compared to less regulated firms. This is because regulatory oversight demands a greater level of responsibility and increases the risk of lawsuits if the directors failed to discharge their governance duties (Boo and Sharma, 2006). They also attribute lower audit fees to high regulated firms as compared to less regulated firms. This and other differences between high regulated and less regulated firms have led some to view regulatory oversight acts as a substitute or complement for the internal governance of high regulated firms (Stoll, 1998; Adams and Mehran, 2003).

Additionally, past studies were conducted in developed countries from different perspectives, on the impact of regulatory oversight on audit fees (i.e. Boo and Sharma, 2006 and 2008; Adams and Mehran, 2003) and studies which provide convincing evidence of audit fees in Malaysia (i.e. Abdul Wahab et al., 2009, 2011; Yatim et al., 2006, Gul, 2006) exclude financial institutions and firms in other regulated industries (Shen and Chih, 2005), such as insurance firms. As indicated by Jizi and Nehme, (2018), the impact of corporate governance on audit fees literature is lacking in the banking sector, which is subject to different regulations and reporting requirements compared to other sectors. Thus, this study extends this line of research and examines the relation between external audit fees and the enhanced listing requirements on audit committee characteristics. Therefore, it is timely to examine this audit fee-regulatory oversight nexus in Malaysia where the banking institutions and insurance firms are subject to stringent regulatory by the Bank Negara Malaysia (BNM).

Several institutions are involved in institutionalizing good corporate governance practices in Malaysia such as the Securities Commission (SC), Bursa Malaysia (BM), and Bank Negara Malaysia (BNM). This is consistent with the underlying assumption of the institutional theory on the role of regulators in promoting good corporate governance practices. Thus, it is the responsibility of the regulatory agencies having oversight authority over accounting matters (Baker et al., 2006) to restore public confidence by enforcing good corporate governance practices. The institutional theory theorized an important role for regulatory agencies to ensure that formal mechanisms are in place to ensure compliance of rules and regulations. The role of regulatory oversight is more pertinent in high regulated firms which are tightly regulated by the Bank Negara Malaysia. Using the argument that the role of governance mechanisms is to

communicate with the various actors of the corporate governance mosaic (Cohen et al., 2004), this study hypothesized that regulatory oversight strengthens the association between audit committee characteristics and audit fees in Malaysia. Hence, questions arise as to the efficacy of the corporate governance reforms at enhancing further the governance of high regulated industries, particularly the banking institutions and insurance firms in Malaysia.

We recognize our investigation from earlier research by evidencing the relationship between the important corporate governance mechanisms, in particular, the audit committee, external auditors and regulatory oversight in three ways. First, we extend the audit fees research and examine whether HRFs pay higher audit fees in comparison with LRFs in Malaysia. Second, we evidence that the relationship between audit committee characteristics and audit fees is significant for HRFs. We anticipate that this relationship to be positive on the grounds that good governance is more likely to demand higher audit quality, resulting in higher audit fees. Third, from the practical perspective, this research will provide feedback to the regulators (i.e. Bursa Malaysia, Bank Negara Malaysia, and Securities Commission) on ensuring policies that support and enhance the link between the internal governance mechanisms and external auditing.

The remainder of this paper is structured as follows. The next section explains the literature review and hypotheses development. The third section describes the research design. The results of our study are reported in the fourth section while in the final section conclusions are drawn and the implications of the study are discussed.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Regulatory Oversight

Regulatory oversight influences corporate governance practices in organizations in the following ways. Regulatory oversight partially substitutes for corporate governance and reduces the need for extensive external audit testing in high regulated firms which results in lower audit fees (Dunn and Mayhew, 2004; Bryan and Klein, 2005; Boo and Sharma, 2008). Further, close monitoring by an industry-specific regulator diminishes information asymmetries and the dimension of oversight required from the corporate governance mechanisms such as the boards of directors, audit committees, and external auditors (Demsetz and Lehn, 1985; Smith and Watts, 1992; Bryan and Klein, 2005). According to Zgarni et al., (2018), financial security law adoption and governance regulation is a substitute for strong governance mechanisms. Hence, lower audit fee was evidenced for high regulated firms as compared to less regulated firms (Boo and Sharma, 2008). Bedard et al., (2004) posit that from a governance risk perspective, the external auditors perceive lower client risks if the firm is subject to a strong regulatory oversight function coupled with having an effective audit committee and internal audit functions. The external auditors will have greater assurance that the internal governance mechanisms are operating effectively, thus the audit effort and fees are reduced.

However, according to Abbott et al., (2003), given the complementary effect of regulatory oversight for internal governance, independent directors serving on the boards of high regulated firms have more noteworthy motivating forces to protect their reputational capital and avoid litigation cost than those in less regulated firms. Further, stringent regulatory oversights enhance the critical role of internal governance mechanisms (Stoll, 1998; Adams and Mehran, 2003) and consequently increase in audit fees. With reference to Norziaton et al., (2016) regulatory oversight strengthens the relationship between internal audit function attributes and higher audit fee for high regulated firms. In other words, as stringent prerequisites are imposed on high regulated firms due to its industry-specific regulator, the boards of directors and audit committees may demand additional affirmation from the firms' external auditors. This is because regulatory oversight demands the directors to discharge their governance duties and increases the risk of

lawsuits if the directors fail to perform (Boo and Sharma, 2008). As a result, a wider scope of audit engagement by external auditors is required causing an increase in the audit fees.

Questions emerge with respect to whether governance reforms can also be effective at enhancing the governance of high regulated industries, particularly the banking and insurance firms in Malaysia which is strictly regulated by the Bank Negara Malaysia. This and other differences between high regulated and less regulated firms have led to the conflicting views on the role of regulatory oversight as a substitute or complement for the internal governance of high regulated firms (Stoll, 1998; Adams and Mehran, 2003). Hence, the existence of the regulatory oversight and audit fees gaps arguably needs to be addressed and investigated so as to offer a better and clearer understanding of corporate governance issues. In addition, as will be discussed below, it is still unclear whether regulatory oversight moderates the relationship between the audit committee characteristics and audit fees. Therefore, this study examines the moderating effect of regulatory oversight on the association between the said audit committee characteristics and audit fees for high regulated firms.

High Regulated Firms and Audit Fees

Past literature suggests that effective regulatory oversight has an influence on the firm's corporate governance. Bryan and Klein (2005) recommend that immediate direct monitoring by regulators diminishes information asymmetries in regulated industries as compared to less regulated industries. They likewise contend that regulatory oversight gives close monitoring that eventually will reduce the role of external auditing as a control mechanism. By depending on the effective external and internal monitoring processes, auditors could decrease the extent of exorbitant testing procedures in high regulated firms. Similarly, Boo and Sharma (2008) investigate the regulatory oversight impact on internal corporate governance and audit fees for a sample of 469 large United States high regulated and less regulated firms. They find that regulatory oversight impacts audit fees and the relationship between internal governance and audit fees. They ascribe lower audit fees to high regulated firms as compared to less regulated firms. Consequently, regulatory oversight can possibly to diminish the important role of corporate governance key players such as the board of directors and audit committee. Greater vigilance and stronger internal control in response to close regulatory monitoring reduce the level of audit risk, which deter the need for closer review of audit examination. Corporate governance mechanisms such as the board of directors and audit committee do not require an extensive audit when there is regulatory oversight. Therefore, there will be lower audit effort and eventually lower audit fees for high regulated firms than less regulated firms (Boo and Sharma, 2008).

However, Fields et al. (2004) find that high levels of litigation risk in high regulated industries also affect the relationship between industry-specific regulated firms and auditors. When auditors are subject to extensive regulatory scrutiny, they are likely to charge higher audit fees due to the increased regulatory risks. Villiers et al., (2014) highlighted that audit fees also respond to changes in audit requirements more quickly, leading to an increase in audit fees as compared to respond toward reductions in audit requirements. As per Bedard et al. (2004), auditors deliberately react to client risks through proper audit procedures. Auditors who observe higher client risks will increase their audit effort, resulting in higher audit fees. Consequently, effective regulation and oversight of regulators give better impetuses in a circumstance where directors with reputation capital at stake demand for an extensive audit, resulting in higher audit fees.

Although Malaysia has a well-developed set of regulations and rules related to corporate governance performance areas, it was rated among the lowest in the region in terms of enforcement (Miles, 2009). The reality is that enforcement has been discerning previously and is seen to be politically determined (Gul, 2006). This has incited awareness about issues concerning the role of regulators and the need for enhanced disclosure and corporate governance. Because of the ineffectual enforcement by regulators, it has uncovered a few

examples of corporate maltreatment which are attributable to ineffective corporate governance structures. Thus, the foregoing argument leads to the following hypothesis stated in an alternate form:

Hypothesis 1: High regulated firms pay higher audit fees than less regulated firms.

Audit Committee Characteristics and Audit Fees

Agency theory highlighted that an effective board of directors enhance the credibility of the financial reporting process and facilitate communication between managers, external auditors and internal auditors (DeZoort, 1997). An effective audit committee characteristic will improve the corporate governance practices and higher audit fees due to the demand for additional assurance from the external auditors in order to safeguard their reputational capital (Abbott *et al.,* 2003). It is also suggested by Sulaiman (2017) that the effectiveness of the oversight role is also influenced by the quality of the audit committee chairman and the relationship between the audit committee members and the external auditors.

Regulators emphasize the need for audit committee members to be independent and at least one member of the committee should be financially literate. Since the accounting and auditing literature draws intensely upon the agency theory, an essential focus has been comprehension of the effect of the independence of the board or audit committee or both on a number of financial reporting and auditing issues (Cohen *et al.*, 2008). For instance, Rosenstein and Wyatt (1990) find that the appointment of outside directors was related with positive abnormal returns in the stock market. Likewise, audit committee independence and competence is significantly identified with a lower occurrence and severity of financial restatements (Larry and Taylor, 2012). Where else, firms that committed financial statement fraud were less inclined to have a strong and independent audit committee (Abbott *et al.,* 2003; Beasley, 1996; Beasley *et al.,* 2000). Consistent with the risk-based approach, an independent audit committee leads to an effective audit committee oversight of the financial reporting process which diminishes the occurrence of financial reporting issues (Abbott *et al.,* 2004; BRC, 1999; Dechow *et al.,* 1996; McMullen, 1996). Thus, it is not surprising that Abbott *et al*. (2003) and Vafeas and Waegelein (2007) find that audit committee independence has a significant positive impact on audit fees when the audit committee is made up of either solely or a majority of independent members. It also lends support that an independent audit committee is connected with higher audit fees due to greater demand for audit quality in order to protect its members' reputation (Abbott and Parker, 2000; Carcello and Neal, 2000). On the contrary, a study by Kee (2015) suggested that audit committee attributes are not significantly related to audit fees, which suggests that audit committee attributes have no influence on the audit fees.

Past studies and governance best practices called for audit committees to be diligent in carrying out their duties (Abbot *et al.,* 2004: BRC, 1999; NYSE, 2002; BMLR, 2008). Further, as indicated by Yatim *et al*. (2006), frequent audit committee meetings can diminish the inclination for financial reporting problems as they provide a platform for the audit committee and internal auditor to exchange relevant information and to notify the external auditor of issues that require greater attention (Raghunandan *et al.,* 1998). As found by Kalbers and Fogarty (1998) and Goodwin and Kent (2006), audit committees that meet frequently are bound to be better educated and progressively tenacious in releasing their duties. As such, it is sensible to expect that audit committees who meet frequently will exhibit more noteworthy ingenuity in carrying out their obligations. Consequently, as supported by Yatim *et al.* (2006) external audit fees are positively and significantly related to the frequency of audit committee meetings. Studies by Carcello *et al.* (2002) and Abbott *et al.* (2003) which are consistent with the demand approach, argue that more diligent audit committee is likely to seek higher quality audits from external auditors, resulting in higher audit fees.

Having a financial expert on the board helps when reviewing the internal audit proposals (Read and Raghunandan, 2001) and investigating accounting irregularities. Besides, past experience and knowledge in accounting and auditing improves the accuracy of the audit examination and produces better quality of financial reporting. DeZoort and Salterio (2001) find that audit committee's professional judgments on auditor-management issues pertaining to accounting policy differed between those with and without accounting and auditing knowledge. As such, Sharma *et al.,* (2009) reveal that audit committee accounting experts and independent directors play an important role in monitoring by demanding frequent audit committee meetings when management adopts aggressive accounting practices. Further, Gendron and Bedard (2006) reveal that an audit committee who is financially literate is more effective in adhering to best practices, and to secure a high quality of reported earnings. Thus, the more number of experts there are in the audit committee, the better will be the monitoring and adherence to best practices. According to Abbott *et al.* (2003), audit committee financial expertise has a significant positive impact on audit fees. Yatim *et al.* (2006) find a significant and positive association between audit committee expertise (proportion of audit committee members with accounting and finance qualifications) and audit fees. This is because financially literate and knowledgeable audit committee will demand for audit quality as the members are knowledgeable on technical auditing issues, and hence the increase in audit fees (Abbott *et al.* 2003).

The literature suggests that these characteristics impact the effectiveness of the audit committee (Beasley *et al.,* 2000; Carcello and Neal, 2000; Abbott *et al.,* 2004) because they play an important role in monitoring the financial reporting process. The board of directors and its sub-committees are identified as important components of internal control mechanisms for monitoring management's activities (Vafeas, 2007; Carcello, 2009; Goh, 2009). The audit committee assists the board in fulfilling its obligation to give oversight with regards to financial statements and reports, and other disclosures provided to stockholders. Further, if the external auditor perceived the client risk is higher, then more audit effort is required, resulting in higher audit fees.

Prior studies (Carcello *et al.,* 2002; Abbott *et al.,* 2003; Knechel and Willekens, 2006; Goodwin and Kent, 2006) suggest that audit committee members who are independent, diligent and financially literate demand expanded audit scope in order to avoid being associated with financial misstatement and to preserve reputation capital. This is because investors, depositors and regulators have direct interest and are concerned with the performance of the firm. For that reason, audit committee in an industry-specific regulated firms demand for higher external audit monitoring and auditing services. Hence, this study extends the literature by examining the impact of regulatory oversight on audit committee characteristics has on audit fees for HRFs. The study predicts that with the presence of efficient regulatory oversight coupled with audit committee independence, diligence and expertise contribute to a better internal and external monitoring and result in higher audit testing by external auditors, and hence higher audit fees. Consequently, the study predicts the following hypotheses:

The investigation predicts that the nearness of effective administrative oversight with the freedom, ingenuity and ability of a review board add to a superior inside and outside observing and result in higher review testing by outer inspectors, and thus higher review charges.

H2a: There is an association between AC independence and audit fees moderated by regulatory oversight, for HRFs

H2b: There is an association between AC diligence and audit fees moderated by regulatory oversight, for HRFs

H2c: There is an association between AC expertise and audit fees moderated by regulatory oversight, for HRFs

RESEARCH DESIGN

Data Collection

The sample data set consists 209 firms which comprised of 20 high regulated firms and 189 less regulated firms, which is equivalent to 1045 firms-year observation during the period of 2013 to 2017. The firms in the sample are listed on the main board and the data used for this study is primarily collected from *DataStream* and hand collected from the firms' annual report. Drawing from prior literature (i.e. Craswell and Francis, 1999; Tsui *et al*., 2001; Carcello *et al*., 2002), we posit the following audit fee model:

$$AF = \beta_0 + \beta_1 TA + \beta_2 NAF + \beta_3 SUB + \beta_4 ROA + \beta_5 LEV + ß_6 LOSS + ß_7 AQ + \beta_8 PRD + \beta_9 REG + \beta_{10} IND + \beta_{11} DIL + \beta_{12} EXP + \beta_{13} IND\_REG + \beta_{14} DIL\_REG + \beta_{15} EXP\_REG + \varepsilon,$$

Where:

AF	=	Audit fee paid by the audited firm (Natural logarithm of audit fees).
TA	=	Total assets (Natural logarithm of total assets).
NAF	=	Total non-audit fee paid by the audited firm (Natural logarithm of non-audit fees).
SUB	=	Number of firm's local subsidiaries.
ROA	=	Profit before tax over total assets.
LEV	=	Proportion of total liability over total assets.
LOSS	=	An indicator variable equals to '1' if the firm has made loss in any of the years and '0' if otherwise.
AQ	=	An indicator variable equal to "1" if Big4 auditor and "0" otherwise.
REG	=	An indicator variable equals to '1' for HRFs and '0' if otherwise.
IND	=	Proportions of independent non-executive directors to audit committee.
DIL	=	Number of audit committee meetings.
EXP	=	Number of audit committee with accounting or finance qualification.
IND_REG	=	Interaction between IND and REG.
DIL_REG	=	Interaction between DIL and REG.
EXP_REG	=	Interaction between EXP and REG.
ε	=	Error term.

Audit Fee Model

Audit fee is regarded as a dependent variable for this study. It is measured by the value of paid fee in Ringgit Malaysia by the firm to its auditors. Where else, audit committee independence (IND), diligence (DIL) and expertise (EXP) are the main experimental variables for this study. Several standard variables to control for cross-sectional differences associated with client size, complexity and client risk (Simunic, 1980; Craswell 1992; Gul and Tsui, 1998) are used. The set of control variables selected is consistent with the variables identified in the audit fees literature (Hay *et al.* 2006; Hay, 2012). The effect of firm size is controlled by using total assets (TA). Audit complexity is based on the number of directly owned local subsidiaries (SUB), (Simunic, 1980; Hackenbrack and Knechel, 1997). Client profitability (ROA) is measured by dividing the profit before tax over total assets. Loss-making (LOSS) is considered another measure of risk because it reflects the extent to which the auditor may be exposed to loss in a situation where the client is not financially strong (Simunic, 1980). To control for leverage (LEV), the ratio of total liability to total assets is used. Non-audit fees (NAF) are also included as a control variable because it is significantly associated with audit fees (Whisenant *et al.,* 2003; Hay *et al.,* 2006). A dummy variable for Big4 audit firm's controls for differences in audit quality (AQ), '1' if audit firms hire Big4 and '0' if otherwise (Craswell and Francis, 1999; Tsui *et al.,* 2001). A dummy variable for regulated (REG) is incorporated to control for high regulated firms by setting '1' for HRFs and '0' if otherwise.

Descriptive statistics

Table 1 provides descriptive statistics for the continuous and indicator variables. The analysis includes the t-tests and Pearson's correlation tests between the dependent variable (audit fees) and independent variables which consisted of audit committee characteristics. Table 1 shows the means and medians between the variables during the testing periods. The descriptive analysis shows that the average audit committee IND is 90 percent. It indicates a high proportion of independent non-executive directors to the audit committee for the sample firms. Additionally, the sample firms have audit committee members that are predominantly diligent (DIL) with an average of conducting 5 meetings per annum and having financial or accounting expertise (EXP) of at least 1 in the board. Audit fees show an amount of RM356, 491 during the period. This is due to significant total assets (TA) and a larger number of local subsidiaries (SUB). These firms also have a significant average amount of non-audit fees (NAF)(RM9768026) and hiring Big4 to conduct audit work (AQ).

Table 1: Descriptive data for periods 2013 – 2017 (n = 1045)

Variable	Mean	Std. Dev	Median
LAF	12.09	1.05	11.94
AF	356491.00	640995.40	155500.00
LTA	13.57	1.70	13.34
TA	5283143.50	18372.32	627154.00
LNAF^{o}	4.79	9.27	9.69
NAF	9768026.00	605188.75	16302.50
SUB	21.80	22.30	21.70
ROA	0.05	0.06	0.05
LEV	0.27	0.18	0.24
LOSS	0.18	0.38	0.00
AQ	0.65	0.45	1.00
IND	0.90	0.12	0.88
DIL	5.30	2.05	5.00
EXP	1.40	0.62	1.00

p < 0.05

^{o}Observations having a zero for LNAF are re-corded to a small positive value (0.00001) to enable a logarithmic transformation.

Notes: AF is audit fees while LAF is natural logarithm of audit fees; TA is total assets (in RM) while LTA is natural logarithm of total assets; NAF is non audit fees (in RM) while LNAF is natural logarithm of non-audit fees; SUB is number of subsidiaries; ROA is net profit before tax over total assets; LEV is the proportion of total liability over total assets; LOSS is an indicator variable equals to '1' if the company has made loss in any of the years, '0' if otherwise; AQ an indicator variable equals to '1' if the company hire Big4 auditor and '0' if otherwise; IND is the proportion of independent non-executive directors to audit committee; DIL is the number of meetings; EXP is the number of AC with accounting or finance qualification.

Correlation

Table 2 shows the correlation matrix between audit fees, control variables and experimental variables. Audit committee IND, DIL and EXP have a positive and significant association with audit fees. Consistent with our expectations, the correlation matrix also shows that the correlation coefficient between regulatory oversight (REG) and audit fees is positive and significant. Except for ROA, all other variables are significantly correlated with audit fees. The signs for the control variables are all in the predicted direction in the testing periods except for the coefficient for LEV, ROA and LOSS. Since none of the explanatory variables are highly correlated (r > 0.09), their correlations do not indicate that Multicollinearity is a serious problem (Pallant, 2001).

Table 2: Pearson Correlation Matrix for sample firms (2013 – 2017, n = 1045)

	LAF	AF	LTA	TA	LNAF	NAF	SUB	ROA	LEV	LOSS	AQ	REG	IND	DIL	EXP
LAF	1	0.77**	0.79**	0.48**	0.36**	0.48**	0.69**	0.07	0.10**	-0.12**	0.30**	0.28**	0.18**	0.37**	0.15**
AF		1	0.67**	0.68**	0.27**	0.68**	0.65**	0.07	-0.06	-0.11**	0.18**	0.29**	0.17**	0.33**	0.09**
LTA			1	0.68**	0.34**	0.46**	0.52**	0.04	0.16**	-0.15**	0.33**	0.44**	0.17**	0.33**	0.09**
TA				1	0.18**	0.37**	0.29**	-0.09*	-0.07	-0.09**	0.16**	0.49**	0.15**	0.47**	0.13**
LNAF					1	0.29**	0.23**	0.08*	0.06	-0.05	0.27**	0.14**	0.15**	0.17**	0.08**
NAF						1	0.49**	0.08	-0.01	-0.04	0.17**	0.13**	0.08**	0.29**	0.11**
SUB							1	0.09**	0.01	-0.08*	0.12**	0.00	0.09**	0.09**	0.17**
ROA								1	-0.09**	-0.58**	0.03	-0.16**	-0.07	-0.08**	0.03
LEV									1	0.12**	0.02	0.12**	-0.03	0.07	-0.07*
LOSS										1	-0.08*	-0.05	0.07	-0.02	-0.01
AQ											1	0.13**	0.03	0.11**	0.06
REG												1	0.15**	0.28**	0.02
IND													1	0.14**	0.03
DIL														1	0.11**
EXP															1

Significant at *10, **5 and ***1 per cent levels. **p < 0.05;* © chi-square tests

ºObservations having a zero for LNAF are re-corded to a small positive value (0.00001) to enable a logarithmic transformation.

Notes: AF is audit fees while LAF is natural logarithm of audit fees; TA is total assets (in RM) while LTA is natural logarithm of total assets; NAF is non audit fees (in RM) while LNAF is natural logarithm of non-audit fees; SUB is number of subsidiaries; ROA is net profit before tax over total assets; LEV is the proportion of total liability over total assets; LOSS is an indicator variable equals to '1' if the company has made loss in any of the years, '0' if otherwise; AQ an indicator variable equals to '1' if the company hire Big4 auditor and '0' if otherwise; REG is an indicator variable equals to '1' for HRFs and '0' if otherwise; IND is the proportion of independent non-executive directors to audit committee; DIL is the number of meetings; EXP is the number of AC with accounting or finance qualification.

RESULTS AND DISCUSSION

T-tests and Chi-Square Tests for High Regulated Firms

Table 3 shows the results for the differences between HRFs and LRFs. The results highlight significant differences between the two groups except for SUB, LOSS, AQ and audit committee EXP. The analytical procedure is applied to answer the hypothesis as to whether HRFs pay higher audit fees than LRFs. In comparison of the two groups, the AF is statistically different for both sub-sample firms at five (5) percent significance level (t=-8.53, p<0.05). HRFs experience higher audit fees than LRFs (μ=RM1,084,256.40, μ=RM347169), thus fully support H1. This is due to HRFs are larger in terms of size (TA) and at the same time hire the Big4 auditors to audit their financial statements (AQ).

Given the t value of -9.13 with a significant level of p<0.05, the audit committee independence (IND) is statistically significant for both groups. From this data, it shows that HRFs have higher level of audit committee independence. Additionally, the audit committee diligence (DIL) is also significantly different at p<0.05 with HRFs audit committee members meeting more frequently at an average of 7 to 8 times in a year as compared to LRFs whose average is 6 times per annum.

Table 3: T-test results for High Regulated Firms and Less Regulated Firms for sample firms (2013 – 2017, n = 1045)

	Highly Regulated Firms (n=100)		***Less Regulated Firms (n=945)***		***T-test***
Variable	*Mean*	*SD*	*Mean*	*SD*	*t-value*
LAF	13.89	1.35	12.79	1.29	-8.53*
AF	1084256.40	1558515.60	347169.38	579473.90	-5.48*
LTA	16.39	2.02	14.53	2.15	-13.42*
TA	42279873.00	61110876.02	3108390.00	9422653.80	-6.89*
LNAFº	9.34	8.09	5.13	10.63	-5.58*

NAF	494036.36	1093045.20	175601.18	651935.94	-3.08*
SUB	23.49	22.27	22.25	33.81	0.05
ROA	0.07	0.05	0.08	0.07	8.45*
LEV	0.54	0.47	0.36	0.28	-3.37*
LOSS	0.18	0.42	0.29	0.58	0.31
AQ	0.98	0.40	0.75	0.54	0.00
IND	0.99	0.19	0.98	0.26	-9.13*
DIL	7.58	4.79	6.08	1.82	-5.28*
EXP	2.45	1.26	1.93	0.81	-0.99

p < 0.05; © chi-square tests

ºObservations having a zero for LNAF are re-corded to a small positive value (0.00001) to enable a logarithmic transformation.

Notes: AF is audit fees while LAF is natural logarithm of audit fees; TA is total assets (in RM) while LTA is natural logarithm of total assets; NAF is non audit fees (in RM) while LNAF is natural logarithm of non-audit fees; SUB is number of subsidiaries; ROA is net profit before tax over total assets; LEV is the proportion of total liability over total assets; LOSS is an indicator variable equals to 1 if the company has made loss in any of the years, 0 if otherwise; AQ an indicator variable equals to 1 if the company hire Big4 auditor and 0 if otherwise; IND is the proportion of independent non-executive directors to audit committee; DIL is the number of meetings; EXP is the number of AC with accounting or finance qualification.

Multivariate Analysis

The multiple regression results for testing the hypotheses are presented in Table 4. Models A and B are significant at one percent significance level (p=0.000) with an adjusted R^2 of at least 75 percent. The coefficients on the control variables across the two models are in the predicted directions. Overall, the models are structurally stable. The results in Model A show the association between external audit fees on seven (7) control variables derived from Gul, (2006); Boo and Sharma, (2008); Yatim *et al.,* (2006); and Abdul Wahab *et al.,* (2009). According to Simunic, (1980); Francis and Simon, (1987); Craswell *et al.,* (1995), it is expected that the audit fees are positively associated with total assets (TA), non-audit fees (NAF), number of local subsidiaries (SUB) audit quality (AQ) and loss (LOSS). All other variables remain significant with the exception of LOSS and audit committee EXP. TA is positive and significant at one (1) percent level of significance (0.44, t=18.33), indicating that the bigger the size of audit client firms' the higher the audit fees charged by the external auditors. The coefficient of NAF (0.07, t=3.88) is also significant and positive at p=0.001. Besides that, audit complexity measured by SUB coefficient is found to be positive and significant at one (1) percent significant level. Past studies confirm that the more complex an audit client, the harder it is to audit and is more time-consuming (Simunic, 1980; Hackenbrack and Knechel, 1997). AQ is positively associated with audit fees which strongly support the observation that the Big4 is associated with higher audit fees.

Similarly, ROA is negatively significant at one (1) percent level (p<0.01), indicating the extent to which the auditor may be exposed to higher risk in the event that the audit client is not financially viable (Simunic, 1980). LEV is also negatively significant at one (1) percent level (p<0.01). It is another measure of risk of a client failing, which potentially exposes the auditor to loss (Simunic, 1980). Positive and significant (p<0.01) coefficient on REG is also observed. This is to confirm that HRFs pay comparatively higher audit fees than LRFs. This is consistent with the argument that regulatory oversight complements the external audit monitoring, hence higher audit fees. This is because the audit committee members demand for extensive audit test even though HRFs have stronger internal controls and internal monitoring. Audit committee IND and DIL coefficient is positive and significant (0.07, 0.13, t=3.74, t=6.82, p<0.01).

Table 4: ***Audit fee regression models (n =1045) (dependent variable is log audit fees)***

	Model A		**Model B**					
			Model I		*Model II*		*Model III*	
Variable	*Coefficient*	*t-value*	*Coefficient*	*t-value*	*Coefficient*	*t-value*	*Coefficient*	*t-value*
Constant		33.93		33.12		33.54		33.82
LTA	0.48	19.13**	0.49	18.26**	0.46	18.63***	0.45	18.43***

TA	0.08	2.58**	0.06	2.28**	0.07	3.30***	0.06	2.76***
LNAF	0.07	3.89***	0.07	3.62***	0.05	3.67***	0.05	3.53***
NAF	0.08	3.98***	0.09	3.80***	0.08	4.01***	0.08	4.02***
SUB	0.65	18.57***	0.61	18.11***	0.55	18.31***	0.55	18.24***
ROA	-0.09	-3.85***	-0.09	-3.75***	-0.07	-3.73***	-0.07	-3.65***
LEV	-0.19	-4.51***	-0.13	-4.13***	-0.10	-4.14***	-0.09	-4.03***
LOSS	0.08	0.79	0.06	0.72	0.01	0.75	0.01	0.65
AQ	0.09	4.19***	0.07	3.92***	0.06	3.86***	0.06	3.92***
REG	0.10	4.67**	0.15	0.68	0.04	1.17	0.02	0.57
IND	0.07	3.74***	0.08	3.64***	0.09	3.40***	0.05	3.47***
DIL	0.13	6.82***	0.16	6.83***	0.10	3.41***	0.11	6.39***
EXP	0.05	0.91	0.07	0.95	0.00	0.59	0.02	1.44
IND_REG			0.15	2.42**				
DIL_REG					0.17	2.99***		
EXP_REG							0.12	2.37**
F- statistic		198.81		187.22		187.23		187.50
p-value		0.00		0.00		0.00		0.00
Adj. R^2		0.75		0.77		0.77		0.78

ºObservations having a zero for LNAF are re-coded to a small positive value (0.00001) to enable a logarithmic transformation.
Notes: AF is audit fees while LAF is natural logarithm of audit fees; TA is total assets (in RM) while LTA is natural logarithm of total assets; NAF is non audit fees (in RM) while LNAF is natural logarithm of non-audit fees; SUB is number of subsidiaries; ROA is net profit before tax over total assets; LEV is the proportion of total liability over total assets; LOSS is an indicator variable equals to '1' if the company has made loss in any of the years, '0' if otherwise; AQ an indicator variable equals to '1' if the company hire Big4 auditor and '0' if otherwise; REG is an indicator variable equals to '1' for HRFs and '0' if otherwise; IND is the proportion of independent non-executive directors to audit committee; DIL is the number of meetings; EXP is the number of AC with accounting or finance qualification. IND_REG is an interaction term; DIL_REG is an interaction term; EXP_REG is an interaction term.

Model B brings in the interaction variable (REG) to test the hypotheses. It comprises of three (3) individual Models I, II and III on audit committee characteristics and their interactions with regulatory oversight. The interaction term DIL_REG (audit committee diligence by regulatory oversight) is positive and significant (0.17, t=2.99, p<0.01). The positive coefficient for the interaction variable reveals a stronger positive association between audit committee DIL and audit fees for HRFs. It is consistent with the demand-based perspective that diligent audit committees demand for additional assurance from external auditors to ensure effective oversight over financial statement audit and to protect their reputational capital (Carcello *et al.,* 2002, Abbott *et al*., 2003). This result is in line with our expectation in Hypothesis 2b, which posits positive association between audit committee DIL and audit fees implementation for HRFs, thus fully support Hypothesis 2b.

Similarly, the coefficient on the interaction term EXP_REG (audit committee expertise by regulatory oversight) is positive and significant (0.12, t=2.37, p<0.05). This result is consistent with our expectation in Hypothesis 2c, which posits that the association between audit committee EXP and audit fees for HRFs, thus fully support Hypothesis 2c. It is important to note that the interaction variables on audit committee characteristics and higher audit fees observed in this study is consistent with the demand side perspective of the audit fee phenomenon. It proposes that improved monitoring by the audit committee members seek higher audit quality.

Such greater assurance provided by the external auditors requires an additional audit work which is reflected in higher audit fees. Since one of the primary responsibilities of the audit committee is to review and monitor the audit process, active and independent audit committees can influence the extent of the audit (DeZoort, 1997). Hence, we find that industry-specific regulatory oversight influences audit fees and the association between audit committee characteristics and audit fees. We attribute the higher audit fees paid by HRFs to the complementary role of the regulatory oversight function as complement, not a substitute, for external audit monitoring. The remaining of the interaction variable term IND_REG is insignificant and thus, do not support H2a.

Hence, it can be said that the analysis above complies with the Guidelines on Corporate Governance for Licensed Institutions by Bank Negara Malaysia (2008) which emphasised on the

direct authority and supervision of the audit committee. Besides that, these findings are also consistent with the comprehensive disclosure requirements for better understanding of the financial and management position of the HRFs, particularly in relation to its internal governance practices. As supported by Adams and Mehran (2003) that the boards of directors of HRFs are placed in a crucial role in the governance structure. Although the boards of HRFs are assigned the same legal responsibilities as the boards of LRFs, regulators have placed additional expectations on HRFs, resulting in the boards delineating their responsibilities even further. Consequently, the internal governance mechanisms quality will impact the quality of corporate governance (Gramling *et al.,* 2004). Therefore, it can be concluded that firms that are committed to strong corporate governance are willing to pay for a higher quality external audit (Goodwin and Kent 2006).

CONCLUSION

The Bursa Malaysia Listing Requirements provides a greater obligation for both high regulated and less regulated firms to enhance Malaysia's corporate governance regime. The panel analysis of 1045 firms-year observation for a period from 2013 to 2017 shows that HRFs pay higher audit fees due to an additional industry-specific regulator i.e. Bank Negara Malaysia, which requires more audit effort, thus an increase in audit fees. Similarly, regulatory oversight strengthens the association between audit committee DIL and EXP, with higher audit fees for HRFs. The results indicate that external auditors perceived HRFs which are being monitored by BNM, require more audit effort, thus increase in audit fees. This is consistent with the notion that regulatory oversight complements the external audit as monitoring mechanisms. The application of institutional theory in this research supports the argument that an institution plays an important role in monitoring the operation of the firms. In addition, the establishment of regulatory agencies helps to promote corporate governance best practices, formulating and enforcing the accounting standards applicable to listed firms. Thus, it can be said that the additional-specific regulator i.e. BNM has put high expectations on HRFs, which requires audit committee members to take a more pro-active and independent role in the monitoring process. In sum, it can be concluded that audit fees have significantly increased due to compliance with the regulatory requirements. The corporate governance reforms do matter as firms that are committed to strong corporate governance are likely to engage in greater levels of external auditing and are willing to pay for a higher quality external audit fee.

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