

**THE EFFECT OF CHIEF EXECUTIVE OFFICER  
CHARACTERISTICS AND OWNERSHIP  
STRUCTURES ON AUDIT FEES**



Undergraduate Thesis By  
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**THE EFFECT OF CHIEF EXECUTIVE OFFICER  
CHARACTERISTICS AND OWNERSHIP  
STRUCTURES ON AUDIT FEES**

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Is indeed the result of my own work. There are no citations from the works of others that I have not appropriately referenced in this undergraduate thesis.

I make this statement in good faith, and should it be proven false in the future, I am willing to forfeit my graduation status and academic degree.

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## **MOTTO AND DEDICATION**

“It is not for the sun to overtake the moon, nor does the night outrun the day.  
Each is travelling in an orbit of their own.”

Quran 36:40

*Ad meliora et ad maiora semper.*

**This Thesis is Tributed to :**

Alm. Ayah

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Families and Good Friends

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## PREFACE

Praises and gratitude are extended to Allah SWT for the blessings and grace that enabled the completion of this undergraduate thesis entitled "The Effect of Chief Executive Officer Characteristics and Ownership Structures on Audit Fees". This thesis is submitted as one of the requirements to obtain the Bachelor of Economics degree in the undergraduate program (S-1) of the Department of Accounting, Faculty of Economics, Universitas Sriwijaya.

This undergraduate thesis examined the effect of Chief Executive Officer Characteristics and Ownership Structure on audit fees for all non-financial companies listed on the Indonesia Stock Exchange. CEO characteristics encompass gender and tenure, while ownership structure includes foreign and institutional factors.

In presenting this work, the author aspires to contribute to the body of knowledge in the field of accounting. However, it is important to acknowledge that every research endeavour has its limitations and shortcomings. The author sincerely apologizes for any constraints that may have affected the comprehensiveness of this study. Hopefully, this research will provide valuable insights and serve as a foundation for future studies.

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## ABSTRACT

### THE EFFECT OF CHIEF EXECUTIVE OFFICER CHARACTERISTICS AND OWNERSHIP STRUCTURES ON AUDIT FEES

By:  
**Mega Aulia Putri**

This study aims to empirically examine the effect of chief executive officer (CEO) characteristics and ownership structures on audit fees. The observed factors of CEO characteristics include gender and tenure, while the ownership structures are foreign and institutional. The population in this study consists of non-financial companies listed on the Indonesia Stock Exchange (IDX) during the period of 2018 to 2022. A total of 930 company-year samples were obtained using the purposive sampling technique, but 45 data points were eliminated through outlier testing, resulting in 885 overall samples. The data analysis technique used is panel data regression using the STATA MP 17 program. The results of the Fixed Effect Model (FEM) with the additional cluster approach show that the gender and tenure of the CEO have no effect on audit fees, while foreign and institutional ownership positively affect audit fees.

**Keywords :** Audit Fees, CEO Gender, CEO Tenure, Foreign Ownership, Insitutional Ownership

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## ABSTRAK

### THE EFFECT OF CHIEF EXECUTIVE OFFICER CHARACTERISTICS AND OWNERSHIP STRUCTURES ON AUDIT FEES

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Penelitian ini bertujuan untuk menguji secara empiris pengaruh karakteristik direktur utama dan struktur kepemilikan terhadap biaya audit. Faktor karakteristik direktur utama yang diamati mencakup gender dan masa jabatan, sedangkan faktor struktur kepemilikan yaitu asing dan institusional. Populasi pada penelitian ini adalah perusahaan non-keuangan yang terdaftar di Bursa Efek Indonesia (BEI) selama periode 2018-2022. Terdapat 930 sampel perusahaan-tahun yang diperoleh dengan menggunakan teknik *purposive sampling*, namun terdapat 45 data yang dieliminasi melalui uji outlier, sehingga jumlah sampel keseluruhan adalah 885. Teknik analisis data yang digunakan adalah regresi data panel dengan menggunakan program STATA MP 17. Hasil uji *Fixed Effect Model* (FEM) dengan metode tambahan *cluster* menunjukkan bahwa gender dan masa jabatan direktur utama tidak memiliki pengaruh terhadap biaya audit, sedangkan kepemilikan asing dan institusional berpengaruh positif terhadap biaya audit.

**Kata Kunci :** Biaya Audit, Gender Direktur Utama, Masa Jabatan Direktur Utama, Kepemilikan Asing, Kepemilikan Institusional

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# CHAPTER I INTRODUCTION

## 1.1. Background

Over the past few decades, a number of major accounting scandals have adversely affected the global financial system and highlighted severe flaws in corporate governance, financial reporting, and auditing practice, such as the collapse of Enron in 2001 and WorldCom in 2002 (Lin et al., 2014). These scandals have significantly impacted investor confidence in the reliability of financial information. In order to restore investor confidence, it is essential to prioritize the quality of audits as a way to ensure the reliability of financial statements. Jensen & Meckling (1976) asserted that an external audit carried out by the independent auditor is one of the important instrument in mitigating problems between owners and agents. An audit will provide assurance to investors regarding the conformity of financial statements with the accounting standards (Hay et al., 2006).

The auditor provides audit services for a company in exchange for an audit fee. An audit fee refers to the monetary consideration paid by a client to an auditor for services rendered in connection with the audit of financial statements (Simunic, 1980). It is essential for both the auditor and client to determine the appropriate amount of audit fees to give clients added confidence regarding whether the fee is charged clearly, fairly, and reasonably under the value of their money (Shakhatreh & Alsmadi, 2021). The Institute of Public Accountants (IAPI) in Indonesia issues regulations governing the mandatory audit fees that corporations must incur. These

standards are outlined in Regulation Number 2 of 2016, which specifically addresses the determination of fees for financial statement audit services.

According to Appendix I of the IAPI regulation, the audit fee is determined using various methods that are agreed upon between the client company and Public Accounting Firm. Whereas in Appendix II of the IAPI regulation, it is stated that regardless of the level of classification, the value of the audit fee can be adjusted according to certain characteristics and conditions (IAPI, 2016). The Table 1.1 below shows the minimum hourly charge-out rates classified by IAPI as an indicator of audit service billing rates.

**Table 1.1 Hourly Charge-out Rates of Audit Fees in Indonesia (in IDR)**

<b>Region</b>	<b>Junior Auditor</b>	<b>Senior Audit</b>	<b>Supervisor</b>	<b>Manager</b>	<b>Partner</b>
Jabodetabek	100.000	150.000	300.000	700.000	1.500.000
Outside of Jabodetabek	70.000	125.000	200.000	500.000	1.200.000

Source: IAPI, 2016

Regardless of the regulation governing the determination of audit fee amounts, due to its voluntary disclosures and no obligation to input its indicators inside the company report, it makes audit fee determinants still an interesting topic to question. In less developed countries, audit fees are typically determined based on the level of activity involved by the auditor and specific requirements of the audit process. The main factors affecting audit fees in these countries are the firm's size, the complexity and scale of its operations, and the choice of audit firms (Salehi et al., 2017).

Saleh & Ragab (2023) mentioned that there are three dimensions related to determining factors of audit fees, namely auditee attributes, auditor attributes, and

engagement attributes. This research will further elaborate on auditee attributes, including the characteristics of the Chief Executive Officer and ownership structures. The auditee side is essential to discuss because it relates to the risks that can occur in the company as a result of the internal control system by the management (DeFond et al., 2002). Agency theory highlights the tendency of managers to make self-interested decisions and not always make value-maximizing choices and decisions for shareholders (Naseem et al., 2020). This conflict creates agency costs and ultimately leads to poor firm performance. Lack of quality firm performance can potentially increase audit costs because auditors must invest more resources and effort to guarantee the accuracy and reliability of financial information. It is important for the auditee, who are the clients of auditors, to understand the factors that determine audit fees so it can be aligned with the standards and services provided by the auditor.

Chief Executive Officer (CEO) is a crucial figure in developing and implementing strategic plans, managing resources, and overseeing the company's day-to-day operations (Warren et al., 2009). One of the cases involving the CEO and top management of the company was the Toshiba Corporation scandal which inflated the company's operating profits by \$1.2 billion or IDR15.85 trillion for 6 years since 2008. In this case, three Toshiba directors, including the CEO, had actively and systematically falsified accounting records for the sake of achieving the profit target even though the company's business unit had stated that the target was unrealistic. As a result of the exposure of this fraud, the CEO, Hisao Tanaka, along with the Vice CEO and Chief Executive of Toshiba, resigned from their

positions (The Wall Street Journal, 2015). This example demonstrates how important it is for the CEO and top management to guarantee that financial reports accurately and transparently reflect the company's performance and financial state while complying with applicable accounting standards and regulations.

The determination of audit fees is closely associated to the role of a Chief Executive Officer (CEO) as part of top management in a company. The CEO has a certain persona that influences the company's governance performance, which is called the CEO Characteristic (Lin et al., 2014). CEOs' characters, prior experiences, and values will affect their strategic decision-making process and sequentially will affect the organization's performance outcome (Hambrick & Mason, 1984). CEO characteristics may also provide information and sign to external parties, such as investors, regarding the company's value. Several studies suggested that CEO characteristics possess an essential role in determining audit fees because CEO's role is closely related to the quality of corporate governance (Huang et al., 2014; Shen, 2021). Corporate governance practices can either enhance or diminish the quality of financial reporting and either increase or decrease the risk of material misstatements, which in turn can lead to lower or higher audit fees. Several CEO characteristics, including gender and tenure aspects, are both essential determinants of audit fees (Lin et al., 2014; Shen, 2021).

In other scientific fields, including psychology and sociology, the concept of gender determines differences in perceptions of men and women in terms of status and roles as a result of socio-cultural construction in society (Eagly & Karau, 2002) . The business field is also viewed to be gendered (Khlif & Achek, 2017).

The last decade of the 20th century was marked by the entry of women into the board as their experience and competence within companies were used to be neglected (Ho et al., 2015). Despite these advances, women are still significantly underrepresented in top management roles, specifically in CEO positions. This statement is supported by data from the Badan Pusat Statistik (2022), which shows that the proportion of women in managerial positions in Indonesia is still below 50%. Whereas many previous studies indicate that companies led by women showed an increase in efficiency and effectiveness in processing information in complex tasks compared to those led by men (Naseem et al., 2020; Shen, 2021).

Woman CEO reflects more conservatism and cautiousness in the decision-making process, risk preferences, and ethical considerations of a company (Harjoto et al., 2015). Due to those characteristics of women, there is a tendency for them to demand higher quality audits in order to minimize the potential negative consequences of poor audit quality, such as financial losses or reputational damage. Research from Lin et al. (2014) indicates that female CEOs are more sensitive to pressure in maintaining the quality of financial reports so that they will ensure adequate internal control to maintain and reduce the acceptable level of inherent risks. Therefore there will be a bigger likelihood of CEOs demanding better assurance, such as by requesting more experienced auditors or additional tests, which can influence the audit fees determination.

Huang et al. (2014) examined the relationship between CEO gender and audit fees with a sample of 8.402 United States companies for the period of 2003 - 2010. The result of this research showed that CEO gender with female CEO is



positively associated with higher audit fees. This result is aligned with the research conducted Harjoto et al. (2015) on 1.642 companies in the United States for the period 2000 - 2010, which showed a positive association between these two variables. On the contrary, research by Wea (2019) on 247 Indonesian companies in 2015 - 2017 and Riswandi et al. (2021) on 257 Indonesian companies in 2015 - 2018 showed no effect of CEO gender on audit fees.

The second factor in this study is the Chief Executive Officer's tenure. CEO tenure refers to the CEO's serving time length in their position within an organization or company (Mitra et al., 2020). Hambrick & Mason (1984) said that CEO's leadership duration plays an essential role in corporate decision-making, where the longer someone holds an executive position, the more familiarity with the company's internal business process and team cohesion will be. An extended period of time in occupying a position will widen the experience and knowledge of a CEO on the company's operational system.

However, a series of corporate governance literature (Baatwah et al., 2015; Shen, 2021) suggest that longer CEO tenure will lead to entrenched management because CEOs have the potential to show opportunistic behaviour and pursue self-interest. Tee (2019) further asserted that the leadership period of a CEO directly correlates with the accumulation of influence and power in corporate decision-making, often at the expense of shareholders' value. Due to these conditions, external auditors may perceive long-tenured CEOs with enhanced reporting risk so that additional audit effort and resources are needed to mitigate any future loss.

The association between the CEO tenure and audit fees has not been extensively studied, especially in the context of Indonesia. However, Mitra et al. (2020) conducted a research that investigated the correlation between the length of time a CEO serves in their position and the fees charged for auditing services. The study utilized a sample of 15.925 companies in the United States within the period from 2000 to 2013. The findings of this research suggest that CEOs with long tenure are more likely to take actions that increase reporting risk, which shows its association with the audit fees determination.

The third factor that can affect audit fees is the ownership structure. Ownership structure refers to the company's equity ownership distribution among various types of shareholders, including individuals, families, institutions, governments, and foreign (La Porta et al., 2000). The type of ownership is related to the risks owned by the company. Demsetz & Lehn (1985) argued that the ownership concentration of a company is closely related to monitoring activities carried out by majority capital owners. However, this can also have an inverse effect, the majority owners of controlling shareholders will have the potential to seek opportunities to divert company resources as a result of information asymmetry. According to Hay et al. (2006), the presence of a dominant shareholder can have two possible implications: it may lead to increased agency costs or result in stronger control, which can have contradictory impacts toward the audit fees. Therefore, the type of ownership might have impact on determining audit fees. This study examines the ownership structure with a specific emphasis on foreign and institutional ownership. Foreign and institutional ownership holds the majority

shareholder position with the largest percentage, making it a major influence on corporate governance and decision-making processes (Han et al., 2013).

In developing countries, legal protection for investors is often weaker than in developed countries (Shleifer & Vishny, 1997). Ownership concentration can effectively serve as a corporate governance mechanism agent that protects the wealth of shareholders. This weak protection system is often detrimental for foreign investors who are constrained by geographical distance to monitor company management directly and must face an information gathering disadvantage (Pronobis & Schaeuble, 2022). In addition to this information asymmetry, foreign investors tend to demand for quality audits to bridge the differences they encounter as assurance for detecting possible fraud in financial reports.

Pronobis & Schaeuble (2022) investigated the relationship between foreign ownership and audit fees by analyzing a dataset of 1.744 European companies from 12 countries during the period of 2005 to 2016. The findings of this study demonstrated a positive relationship between foreign ownership and audit fees. The result of this study is consistent with the result by Nelson & Mohamed-Rusdi (2015), who investigated the same factors in 345 Malaysian companies during the year 2010. Their research revealed a positive association between foreign ownership and increased audit fees. In contrast, a study conducted by Shakhathreh & Alsmadi (2021) on 109 manufacturing and services firms in Jordan throughout the period of 2012-2019 revealed a negative correlation between foreign ownership and audit fees.

Institutional ownership denotes the amount of a firm's shares that are owned by various types of entity or organization with a significant amount of invested capital (Demsetz & Lehn, 1985). Investors in the form of institutional tend to have a significant level of share ownership, making them actively monitor company management performance. Moreover, with significant voting power, majority shareholders are facilitated with incentives to be able to ensure companies take steps that will maximize their worth and take corrective actions when needed. Highly concentrated institutional ownership will improve the quality of corporate governance by encouraging the companies they invest in to produce high-quality audits (Han et al., 2013). The audit function is a valuable monitoring form that can reduce the potential for financial information misreporting (Jensen & Meckling, 1976). Hence, institutional shareholders would be interested in seeking a more secure company monitoring system to reduce the potential of agency costs. The demand for an extensive and reliable audit will correspond to the determination of audit fees charged by auditors, which will increase as the level of effort required to audit the client rises due to factors such as corporate complexity, risk, regulations, and other related aspects.

In their study, Vivandari & Fitriany (2019) investigated the correlation between institutional ownership and audit fees by analyzing a dataset of Indonesian companies from 2012 to 2016. The study's findings indicated a positive association between institutional ownership and increased audit fees. This findings align with the study carried out by Tee et al. (2017) on Malaysian companies from 2003 to 2011, which demonstrated a positive relationship between

these two factors. In contrast, a study conducted by Routledge (2021) on 220 Japanese companies in 2017 revealed a negative association between institutional ownership and audit fees.

This study integrates several determinants of audit fees that have been studied in prior studies into one research model. This study combines the CEO gender variable from research by Harjoto et al. (2015), the CEO tenure variable from Mitra et al. (2020), the foreign ownership variable from research by Pronobis & Schaeuble (2022), and the institutional ownership variable from research by Vivandari & Fitriany (2019). These four variables are integrated into one research model to empirically test their effect on audit fees. This research brings several differences from previous studies. Firstly, the existing prior studies primarily examine the factors that influence audit fees from the aspects of general board and committee characteristics or firm-level characteristics and do not pay much attention to the individual personas (characters, values, experiences) of top executives. This research aims to investigate how CEO characteristics influence audit fees in a more comprehensive manner.

The second difference between this study and the preceding study lies in the research object, which encompasses data from all non-financial Indonesian firms obtained from the Indonesian Stock Exchange. Most of the previous research related to the topic of CEO characteristics and ownership structures with their relationship to audit fees is still limited to developed countries, such as the European Union and United States. These countries already have adequate corporate governance systems and a more established regulatory environment, which differs

from Indonesia, a developing country with emerging economies and unique behavioural characteristics. In Indonesia, regulatory conditions in business circumstances still show relatively weak legal protection, especially for foreign shareholders. Aspects regarding the composition and role of women in corporate leadership positions and the length of a CEO tenure do not yet have clear guidelines or regulations. This creates a unique and under-researched situation, particularly in the context of its relationship to audit fees. This regulatory environment opens up opportunities to further understand how CEO characteristics and ownership structures affect audit fees in business environments that are different from developed countries.

This study also incorporates multiple control variables that are consistent with other prior research on audit fees. According to the previous research by Harjoto et al. (2015); Mitra et al. (2020); Pronobis & Schaeuble (2022); Vivandari & Fitriany (2019), there are three major factors that become the main drivers of the effect on audit fees, including audit engagement, client size, and client complexity risk from the client and auditor sides. Thus, this study incorporates control variables, including company size (SIZE), leverage (LEV), company loss (LOSS), and audit firm size (BIG4), which have the capacity to influence the dependent variable. The use of control variables aims to suppress or eliminate other influences besides the independent variables so that the possibility of biased calculations can be prevented. Hence, the inconclusive and conflicting research results of the variables above are the foundation that this research is still intriguing to be further studied and explored.

## **1.2. Problem Formulation**

Audit fees are an important aspect that can provide further understanding regarding the financial reporting's quality, the cost-effectiveness of an audit engagement, and the accountability and transparency of an organization. Such insights are essential materials for company stakeholders to assess the value of a company and economic considerations in making decisions. Previous studies have shown that audit fees can be influenced by various determinants from both a supply and demand perspective, including CEO characteristics and ownership structures. Therefore, the questions from the problem in this research are:

1. Does the CEO Gender affect the Audit Fees?
2. Does the CEO Tenure affect the Audit Fees?
3. Does the Foreign Ownership affect the Audit Fees?
4. Does the Institutional Ownership affect the Audit Fees?

## **1.3. Research Objectives**

Based on the research problems that have been formulated above, the purposes of this study are:

1. This study empirically examines the phenomenon about the effect of CEO Gender on Audit Fees.
2. This study empirically examines the phenomenon about the effect of CEO Tenure on Audit Fees.
3. This study empirically examines the phenomenon about the effect of Foreign Ownership on Audit Fees.

4. This study empirically examines the phenomenon about the effect of Institutional Ownership on Audit Fees.

#### **1.4. Research Contribution**

##### **1.4.1 Theoretical Implications**

The expected outcome of this study is to provide theoretical implications in expanding the literature review on the audit fee phenomenon, which is influenced by CEO characteristics and ownership structures. This study incorporated two theories underlying the effect on each variable. First, agency theory that emphasizes the agent-principal relationship and how monitoring mechanisms can mitigate agency costs. Second, the use of upper echelon theory is still not commonly utilized, especially for research based in Indonesia. This theory emphasizes how values, experiences, and the persona of top executives can influence the decision-making process and organizational outcomes. By integrating these two theories, this study offers a more comprehensive insight into how CEO characteristics and ownership structures influence corporate governance practices and outcomes, including audit fees.

##### **1.4.2 Practical Implications**

This research is expected to carry practical implications for organizations and policymakers. Firstly, by highlighting the effect of CEO gender on audit fees, this study provides empirical evidence that can contribute to the ongoing debates surrounding the importance of promoting gender diversity in executive positions.



Secondly, the study on CEO tenure can provide practical insights for organizations on succession planning and executive leadership, as evidence linking longer CEO tenure is associated with potential risks such as entrenched management and the need for evaluation and continuous monitoring of top leadership positions. From these two factors, organizations or policymakers can utilize this information to develop guidelines or regulations that encourage a more inclusive gender balance in corporate boards and introduce periodic leadership transitions. Especially in Indonesia, there are still no regulations that govern the composition of females on the company's board and the maximum tenure length of CEO, in which this research is expected to help bringing good reforms to corporate governance practices in Indonesia.

In the third and fourth parts, companies can utilize the information in this study for foreign and institutional ownership factors by understanding the importance of establishing corporate governance regulations that promote a strong internal control system, reduce information asymmetry with transparent reporting, and protect shareholder interests. By understanding the different types of investors, companies can formulate a more strategic decision based on each shareholder's needs, including the determination of audit fees. This allows for increased investment opportunities from foreign and institutional shareholders.

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