The Journal of Social Sciences Research
ISSN(e): 2411-9458, ISSN(p): 2413-6670
Special Issue. 6, pp: 402-408, 2018
URL: https://arpgweb.com/journal/journal/7/special_issue
DOI: https://doi.org/10.32861/jssr.spi6.402.408

Academic Research Publishing Group

Original Research Open Access

The Relationship between Audit Committee Attributes and Audit Fees of Listed Companies in Nigeria

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Abstract

This paper examines the influence of audit committee (AC) attributes on audit fees (AUF) of 440 firm-year observations of listed companies in Nigeria for five year period (2012 to 2016). A multiple regression was employed in estimating the model using robust standard errors. We explore and improve prior literature of same relations by using additional variables (AC legal experts, AC stock ownership and AC chair independence). The study found that (AC size, AC financial accounting experts, AC legal experts and AC stock ownership) are positively associated with AUF in their quest for greater audit assurance. The study also established that female AC and AC chair independence act as substitute to audit quality which praises that higher internal control will be accredited to lower audit process. The findings and inferences are also consistent with complementary hypothesis of audit quality (payment of high fees in an exchange for better audit efforts. Our result is conclusive and robust for the inclusion of the foregoing AC attributes that were limitedly explored by prior studies in this relationship. Our study provides an insight on the importance of AC legal experts; AC stock ownership and AC chair independence to the current and potential stakeholders who are the direct users of financial reports. The study informs regulators and policy makers the potential influence of these unique AC attributes on auditors' price which is one of the most crucial drivers of audit quality

Keywords: Audit committee; Audit quality; Audit fees; Audit price.

1. Introduction

Audit quality is a vital governance and monitoring device that increase the reliability of financial information which the stockholders use in making decisions. For that, better audit is prerequisite for reliability of the financial reports since it is believed to protect the interest of the stockholders and other stakeholder (Sulaiman, 2017). It is contended that audit fee plays an important role in enhancing audit quality (Goodwin-Stewait and Kent, 2006). This is because audit fee reflects the extent of audit effort. Audit fee is the remuneration received by auditors for rendering audit services to the corporate entities which is endorsed by the AC and finally approved by shareholders. This amount is contingent upon auditors' reputation, market trends, auditor client relationship, extent of the audit work, nature of companies' operation, entities' financial strength among others. The amount of audit fees has been a subject of debate after the emergence of various financial scandals reflecting inaction by auditors (Kishore and Gupta, 2016). Thus, it is argued that higher audit fee provides greater audit effort and accordingly minimizes audit committees' oversight processes thereby promoting the quality of financial reports (Goodwin-Stewait and Kent, 2006).

Conversely, audit committee (AC) plays a pivotal role in corporate governance practices through overseeing the quality of audit. It is argued that active AC members require a high degree of audit to avoid monitoring and reputational losses ascending from lawsuit. Consequently, an active and independent AC that has pertinent expertise is expected to improve audit's approaches and thus enhances audit quality (DeFond and Zhang, 2014; Goodwin-Stewait and Kent, 2006; Kishore and Gupta, 2016; Sulaiman, 2017). Previous literature suggests that internal governance mechanisms and external audit can substitute for each other, which implies that greater internal control will be attributed to lower audit process.

More so, the Nigerian Securities and Exchange Commission Code of Corporate Governance (2011) stipulates that AC is in charge for appraisal of the qualifications and independence of external auditors, determining auditors' remuneration as well as their performance. From these responsibilities among others, it expected that AC can influence audit fee. Moreover, the fraudulent activities that have become the order of the day in the Nigerian companies need to be investigated. Recently in 2015 the Financial Reporting Council of Nigeria (FRC) issued a regulatory order thus suspending the Stanbic IBTC Holdings Plc. chairman and its chief executive officer for accounting irregularities, concealment, and poor disclosures in the financial information which is contrary to the provision of Section 62 of the FRC. The FRC also questioned the competence of the audit giant, KPMG who are the

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auditors of the company for the periods of 2013 and 2014 when the scandals occurred. The audit firm is now being questioned for the approach its adopted that could not detect the infractions in the two accounting periods. Consequently, the failure of the auditors to uncover these scandals and report it to the expected regulators might signpost auditors' independence impairment. In the light of the above statements, the paper aims at examining the influence of AC attributes on audit fees and seeks to answer the question of how AC attributes influence audit fees of listed companies in Nigeria. Thus, the paper is divided into the following sections; section one introduction, section two, review of previous studies, follows by methodology, results and discussions and finally conclusion.

2. Literature Review and Hypotheses Development

2.1. Audit Committee Size and Audit Fees

Prior studies argue that larger AC members have high chance of promoting its status and power in corporate organizations, thus demand higher audit quality. This is observed by Krishnan and Visvanathan (2009) who show that AC size has significantly intensified audit fee. Similarly, (Kim *et al.*, 2016; Zaman *et al.*, 2011) find that larger AC increases audit quality by paying high audit fees. Thus, a more active AC is likely to demand for extensive audit attention from the external auditors by disbursing higher audit fees. This supports the demand side of audit for additional audit efforts which leads to higher audit fees. Following the above arguments, this study hypothesized that:

H_1: AC size has a positive significant association with Audit fees of listed companies in Nigeria.

2.2 Audit Committee Independence and Audit Fees

It is contended that autonomous AC do not have a secluded or financial dependence on managers. Thus, an autonomous AC possibly will be more ready to disagree with managers on dissimilar issues. Since their presence is expected to promote auditor independence because the external auditor is able to discuss issues ascending from the audit process with independent directors free from managerial influence (Abidin *et al.*, 2016). Prior literature argues that firms with active ACs consisting more independent directors pay high audit fee (Carcello *et al.*, 2002). Consequently, independent directors in AC are more likely to perform better monitoring role since they are autonomous from management. This makes them to demand for high quality audit and be more enthusiastic to decrease the tendency of financial fraud and earnings manipulations (Al-Rassas and Kamardin, 2015). This is confirmed by Zaman *et al.* (2011); Lee and Mande (2005) who argue that independent non-executive directors in AC are keen to pay more audit fees in demand for greater audit efforts. In line with the above arguments, this study hypothesized that:

H_2: AC independence has a positive association with Audit fees of listed companies in Nigeria.

2.3. Audit Committee Meetings and Audit Fees

It is argued that frequency of AC meetings is positively related to audit fees of listed companies in US (Abbott *et al.*, 2003). Furthermore, Abbott *et al.* (2003) argue that higher AC attendance make them more admire to demand more audit quality by paying higher audit fees. Thus, AC that meets frequently can aggressively influence audit coverage throughout the several steps of the audit. In line with the foregoing it is hypothesized that:

H_3: AC meetings have a positive relationship with Audit fees of listed companies in Nigeria.

2.4. Audit Committee Expertise and Audit Fees

Previous literature show that larger percentage of AC financial experts intensifies audit fees of listed firms in US (Lee and Mande, 2005). Equally, Cohen *et al.* (2014); Kim *et al.* (2016)contend that AC accounting experts need more audit assurance by paying high audit fees. They empirically find that AC financial accounting as well as supervisory experts increases audit fees. Hence, AC that is composed of larger proportion financial experts offer higher levels of audit assurance and perhaps deliver stronger support for auditors during scope negotiations with management (Abbott *et al.*, 2003). Consequently, those experts let AC members to better comprehend the auditing matters, risks, and the audit procedures premeditated to address these issues and risks (Abbott *et al.*, 2003). Sequel to the above arguments and reference to complementary hypothesis the study hypothesized that:

H_4: AC financial accounting experts and AC legal experts have positive relationship with Audit fees of listed companies in Nigeria.

2.6. Female AC Member and Audit Fees

It is argued that women are highly ranked in terms of adapting transformational leadership fashion (Amran *et al.*, 2016). In that, from the perspective of demand for audit, female AC chairs reduce the yearning for assurance offered by external auditors and hence they are related to lower audit fees. Inversely, from the supply-side perception, female AC chairs may lessen audit fees by influencing the audit evaluation risk or by improving the effectiveness of internal control system or by largely enhancing the credibility of the financial information (Ittonen *et al.*, 2010). This is observed by Huse and Solberg (2006); Lai *et al.* (2017) who find that AC that is composed of men and women is connected to lower audit fees. As such high percentage of females on the board may augment board's actions and efficacy. This implies that female AC members demand more audit efforts than the male counterparts. In line with the foregoing arguments the study hypothesized that:

H_5: Female AC member has a positive relationship with Audit fees of listed companies in Nigeria.

2.6. Audit Committee Stock Ownership and Audit Fees

Agency theory suggests that the demand for external auditor's independence arises from a desire to decrease the management shirking that comes from asymmetric information between stakeholders and managers. The theory has been confirmed by some prior studies such as DeFond (1992). He aligns the agency theory to audit quality, board of directors and ownership structure. Previous studies on AC equity ownership have contended that larger share of equity possessed by AC reduces discretionary accruals and accordingly decreases the propensity that the auditor offers a going concern report for financially distressed companies and auditor dismissal (Kibiya *et al.*, 2016). In line with the above arguments the study hypothesized that:

H_6 AC stock ownership has a positive relationship with Audit fees of listed companies in Nigeria.

2.7. Audit Committee Tenure and Audit Fees

It is contended that new directors may likely demand for more information leading to better audit quality (Lai *et al.*, 2017). They show that female AC tenure is negatively related to audit fees. Based on the above argument it is expected that longer AC tenure may demand for better audit quality to maintain their reputation by paying high audit fees. In line with the above arguments the study hypothesized that:

H_7: AC tenure has a positive relationship with Audit Quality of listed companies in Nigeria.

2.8. Audit Committee Chair and Audit Fees

Interestingly, AC in Nigeria is distinctively characterized as it comprises representatives from shareholders and directors. To examine this uniqueness; the study is set to determine the independence of the committees' chairmanship. In line with the agency theory, it is expected that when the AC is chaired by an independent shareholder audit assurance increases in an exchange for higher audit fees.

H_8 AC chair independence has a positive relationship with Audit fees of listed companies in Nigeria

3. Methodology and Model Specification

The population consists of 170 firms listed on the floor of Nigerian Stock Exchange as at 31st December 2016. From these, 55 financial services were excluded leaving a total of 115 firms. Further 15 companies were delisted in 2016, leaving 100 companies. From these, 12 companies did not have complete information leaving a final sample of 88 companies. The study covers the period of five years from 2012 to 2016. The data for variables were extracted from Thompson Reuters DataStream and the annual reports of the listed companies. A multiple regression was employed in the analysis using robust standard errors. Table 1 presents the variables measurements and definitions.

3.1. Model Specification and Variable Measurement

To test the hypotheses of the study, the following model was estimated.

$$\mathbf{AUF_{it}= \beta_0 + \beta_1 ACS_{it}+ \beta_2 ACI_{it}+ \beta_3 ACM_{it}+ \beta_4 ACFAE_{it}+ \beta_5 ACLE_{it} +\beta_6 FAC_{it}+ \beta_7 ACSO_{it}+ \beta_8 ACT_{it} + \beta_9 ACCI_{it} +\beta_{10} BF_{it} + \beta_{11} BI_{it} + \beta_{12} FS_{it} + \beta_{13} LEV_{it} +\beta_{14} AGE+\beta_{15} SGROWTH+\varepsilon_{it}}$$

Table-1. Variable Measurement

Variable	Acronyms	Measurement
Audit fees	AUF	Natural logarithms of audit fees
AC Size	ACS	Aggregate number of AC members
AC Independence	ACI	Proportion of independent non-executive directors in audit
AC Meetings	ACM	Frequency of meetings held by AC
AC Financial Accounting Experts	ACFAE	AC members who qualified as professional accountants with certificates Association of National Accountants of Nigeria, Institute of Chartered Accountants of Nigeria or their equivalent
AC legal expert	ACLE	AC members with legal backgrounds; Bachelors of Laws, Masters in Laws, members of Nigerian Bar Association
Female AC member	FAC	Proportion of female directors AC
AC stock ownership	ACSO	Aggregate number of shares held by AC members
AC tenure	ACT	Average tenure of AC members
AC chair	ACCI	Dummy variable computed as one if the AC is chaired by a shareholder and zero otherwise
Board expertise	BF	Proportion of board members with financial knowledge
Board independence	BI	Proportion of independent directors on the board
Firm Size	FS	Natural logarithm of total asset
Leverage	LEV	Long-term debt to total equity
Firm age	AGE	computed as year of observation minus of listing
Sales growth	S.GROWTH	Change in sales divided by previous sales
Better coefficients	β_1- β_{15}	

4. Results and Discussions

4.1. Descriptive Statistics

Table 2 presents the descriptive statistics for the variables used in the study. The AUF has a mean of 27,427.890 Naira (equivalent to USD 77, 262). This indicates that on average listed companies in Nigeria pay USD 77, 262 for auditing service. A minimum and a maximum of AUF are 2000,000 and 156, 178,000 Naira (equivalent to USD 5634 and USD 439, 938) respectively. ACS has an average of 5 members with a minimum and a maximum of 4 and 6 members respectively. ACI has a mean of 43% indicating an average of 43% representation of independent directors in the AC. Some firms have 25% independent directors in the AC, while others have 50% representation of independent directors. Result indicates that AC meets at least 4 times in a year which is in line with international recommendations on ACM. Some firms did not have financial accounting experts in the AC, while others have up to 50% members with financial accounting expertise. On average, there are at least 21% AC members with financial accounting expertise. There is an average of 10% AC legal experts while some firms have 29% directors with legal background in the AC. Interestingly, result reveals that some firms did not have women representation in their AC. ACT has an average tenure of 5 years with a minimum of 2 years and a maximum 9 of years respectively. Also, some companies' that ACs are chaired by director while others are chaired by the shareholders representatives.

Table-2. Descriptive Statistics

Variable	Mean	Min	Max	Std. Dev.	Skewness	Kurtosis
AUF	27427.89	2000.00	156178.00	38879.72	2.52	8.35
ACS	5.473	4.000	6.000	0.861	-1.072	2.212
ACI	0.430	0.250	0.500	0.094	-0.740	1.855
ACM	3.791	3.000	5.000	0.624	0.180	2.420
ACFE	0.209	0.000	0.500	0.135	0.462	2.905
ACLE	0.096	0.000	0.286	0.094	0.182	1.623
FAC	0.543	0.000	1.000	0.499	-0.173	1.030
ACSO	37800000	12768	300000000	79100000	2.436	7.849
ACT	5.107	3.000	8.000	1.437	0.209	2.142
ACCI	0.889	0.000	1.000	0.315	-2.471	7.105
BI	0.715	0.060	0.923	0.112	-0.676	4.608
BE	0.499	0.000	0.875	0.159	-0.171	3.364
FS	16.422	13.755	19.450	1.592	0.248	2.089
LEV	0.011	0.000	0.072	0.019	2.223	6.866
AGE	23.818	4.000	42.000	13.288	-0.184	1.534
S.GROW	0.270	-5.256	7.508	2.636	0.842	5.013
Observations.	440	440	440	440	440	440

Note: AUF = audit fees, ACS = AC size, ACI = AC independence, ACM = AC meetings, ACFE = AC financial expertise, ACLE = AC legal expert, FAC = female AC member, ACSO = AC stock ownership, ACT = AC tenure, ACCI = AC chair independence, BI = board independence, BE = board expertise, FS = firm size LEV = leverage, AGE = firm age, S.SGROWTH = sales growth.

4.2. Correlation

The Pearson correlation matrix in Table 3 shows that ACS, ACI ACM ACFE ACLE FAC ACT and ACSO are positively correlated with AUF of companies in Nigeria, whereas only ACCI and SGrowth have weak negative association with AUF. The control variables BI, BE, LEV and FS are positively correlated with AUF of listed companies in Nigeria. The results of the VIF test though not tabulated revealed that tolerance values were less than 1 and the variance inflation factor were less than 10 confirming that multicolinearity might not pose problem to the estimation model (Gujarati, 2004).

4.3. Regression Results

Table 4 presents the regression results of the AC attributes and AUF. ACS has a positive significant relationship with AUF. The coefficient is 0.392 at 1% significance level. This suggests that for every 1% rise in ACS, AUF will increase by 0.392. Thus, larger AC has high likelihood of increasing AUF thereby enhancing audit quality of companies in Nigeria. Accordingly, the result is in line with the findings of Kim *et al.* (2016) who contend that larger AC members are associated with higher increase in audit fees. The result also supports the demand side of audit for additional audit efforts which leads to higher audit fees. ACI and ACM have positive but insignificant association with AUF. In addition, ACFE has a positive and significant association with AUF at 10% level of significance. This shows that an increase of financial expert to the AC will result to an extra increase in audit fees in their quest to enhance external monitoring.

Table-3. Correlation Matrix

	AUF	ACS	ACI	ACM	ACFE	ACLE	FAC	ACSO	ACT	ACCI	BI	BE	FS	LEV	AGE	S.GRW
AUF	1.000															
ACS	0.506***	1.000														
ACI	0.080	0.063	1.000													
ACM	0.279***	0.481***	0.032	1.000												
ACFE	0.152**	0.035	0.1138*	-0.046	1.000											
ACLE	0.090	0.235***	0.062	0.133**	-0.042	1.000										
FAC	0.011	0.233***	0.037	0.234***	0.067	0.269***	1.000									
ACSO	0.068	0.002	0.001	-0.027	0.108*	-0.084	-0.065	1.000								
ACT	0.094*	0.042	-0.051	0.101*	-0.013	-0.041	-0.002	-0.054	1.000							
ACCI	-0.094*	0.127**	0.124*	0.067	0.005	0.165***	0.125**	-0.005	-0.095*	1.000						
BI	0.018	-0.214***	0.130*	-0.130**	0.121*	0.005	-0.129**	-0.037	0.061	-0.046	1.000					
BE	0.318***	0.0570	-0.001	0.123*	0.204***	-0.173***	-0.018	0.068	0.072	-0.012	0.175***	1.000				
FS	0.682***	0.447***	0.082	0.280*	0.079	0.050	0.051	0.027	0.101*	0.096*	-0.098*	0.265***	1.000			
LEV	0.004	-0.043	0.005	-0.066	-0.012	0.037	-0.032	-0.014	-0.108*	-0.098*	0.050	0.037	-0.040	1.000		
AGE	0.167***	0.033	-0.030	0.045	0.008	-0.028	0.027	0.038	0.039	0.089	0.041	0.135**	0.110***	0.058	1.000	
S.GRW	-0.020	-0.070	-0.057	-0.113*	-0.005	0.010	-0.055	0.005	-0.013	-0.073	0.039	-0.133**	-0.144**	-0.030	-0.094*	1.0000

Note: AC characteristics, audit fees and control variables of the study. AUF = audit fees, ACS = AC size, ACI = AC independence, ACM = AC meetings, ACFE = AC financial expertise, ACLE = AC legal expert, FAC = female AC member, ACSO = AC stock ownership, ACT = AC tenure, ACCI = AC chair independence, BI = board independence, BE = board expertise, FS = firm size LEV = leverage, AGE = firm age, S.SGROWTH = sales growth, * p<0.01, ** p<0.05, *** p<0.001.

The result supports the findings of Lee and Mande (2005); Cohen *et al.* (2014) who find that AC accounting experts demand more audit assurance thus paying high audit fees. The model also shows evidence of a positive significant relationship between ACLE and AUF at 5% level of significance. This implies that larger proportion of legal experts in AC increases audit assurance by paying high audit price. This is not surprising since legal experts in AC are proved to be monitors rather than mere signal to financial reporting (Krishnan *et al.*, 2011). Furthermore, AC members with legal know-how instigate AC members to be more watchful about legal risks that are allied to erroneous or inadequate aggressive financial reports. The result is in line with our expectation that ACLE pay high AUF for greater audit assurance. Table 4 reveals that FAC has a negative significant association with AUF at the 5% significance level with the coefficient of -0.163. The presence of female director in the AC of listed companies in Nigeria will likely decrease audit fees. Surprisingly, the result contradicts our expectation that FAC has a positive association with AUF. This may be due to the fact that female directors in the boards are more conservative during board consultations than their men complements. And thus, make them to reduce the desire for audit assurance expected from external auditors by paying less audit fees. This confirms the findings of Ittonen *et al.* (2010) who document a negative significant relationship between FAC and AUF. Our model also provides evidence of a positive significant association between ACSO and AUF at the 1% significance level. The result is consistent with our expectation that ACSO has a positive association with AUF of listed companies in Nigeria. The result supports the findings of (Kibiya *et al.*, 2016) who show that ACSO is evidenced to be a good stimulus for AC members and thus make them to be more watchful, passionate and active monitors. ACT has a positive insignificant association with AUF.

Table-4. Pool of the Relationship between Audit Committee Attributes and Audit Fees

Variable	Coefficient	Robust Std. Err.	T-Values	P-Value
ACS	0.392	0.053	7.430***	0.000
ACI	0.350	0.392	0.890	0.373
ACM	0.018	0.071	0.260	0.794
ACFE	0.532	0.276	1.930*	0.055
ACLE	0.789	0.389	2.030**	0.043
FAC	-0.163	0.077	-2.120**	0.035
ACSO	0.011	0.034	3.090***	0.000
ACT	0.002	0.024	0.070	0.948
ACCI	-0.651	0.165	-3.940***	0.000
BI	0.760	0.350	2.170**	0.030
BE	1.011	0.266	3.810***	0.000
FS	0.372	0.027	13.610***	0.000
LEV	0.013	0.051	0.260	0.792
AGE	0.005	0.003	1.720*	0.087
S.GROW	0.036	0.015	2.460**	0.014
Cons	0.362	0.489	0.740	0.460
R2	**0.603**			
F-Stats	**17.450**			
P-Value	**0.006**			
Observations	**440**			

Note: AUF = audit fees, ACS = AC size, ACI = AC independence, ACM = AC meetings, ACFE = AC financial expertise, ACLE = AC legal expert, FAC = female AC member, ACSO = AC stock ownership, ACT = AC tenure, ACCI = AC chair independence, BI = board independence, BE = board expertise, FS = firm size LEV = leverage, AGE = firm age, S.GROWTH = sales growth, * p<0.01, ** p<0.05, *** p<0.001.

The model also reveals that ACCI has a negative significant association with AUF at 1% significance level. It implies that when AC is chaired by a shareholder audit fees decreases. The result contradicts our prior expectation that ACCI has positive association with AUF.

4.4. Post-estimation Test

Post-estimation test is usually conducted to enable the study chooses the best method of estimation. The results for OLS, fixed and random effect regressions thus not tabulated were used as procedures for the section of the estimation model. We conducted some tests to improve the reliability of statistical inferences and to ensure that OLS assumptions are fulfilled. A panel data is used in this study which may lead to error that are clustered and presumably correlated overtime. For that reason, there is need to control for that. Consequently, fixed and random effect regressions were run. The Hausman Test suggests that random regression is more suitable for the data as it reveals a p-value of 0.1182. This indicates that no company's specific attributes affect the criterion variable. We further ran for 'Breusch and Pagan Lagrangian Multiplier Test for Random Effect' (LM Test) to see if there is a statistical variance among the unit in the panel. The test result discloses that random model is more suitable for this study. The fact that the result from 'Breusch-Pagan and Cook-Weisberg test for heteroskedasticity' reveals a p-value of 0.0085 which indicates a violation of OLS assumption number five. Thus, this may cause the standard errors to be biased. Consequently a variance clustered estimatorrobust standard error is used and inferences are made based on this approach since it tends to be more trustworthy in the presence of heteroskedasticity.

5. Conclusions

We examined the influence of AC attributes on audit fees of listed companies in Nigeria. We explore and improve prior literature of same relations by using additional variables (AC legal experts, AC stock ownership, AC tenure and AC chair independence). We found that AC attributes (AC size, AC financial accounting experts, AC legal experts, and AC stock ownership) are positively related to AUF in their quest for greater audit assurance. The study also found that FAC and ACCI act as substitute to audit quality which suggests that greater internal control will be accredited to lower audit process. Our findings and inferences are also consistent with complementary hypothesis of audit quality (payment of high fees in an exchange for better audit efforts). Our result is conclusive and robust for the inclusion of the foregoing AC attributes that were limitedly explored by prior studies in this relationship. Our study provides an insight on the importance of AC legal experts, AC stock ownership and AC chair independence to the current and potential stakeholders who are the direct users of financial reports. The inferences will enable the investors better recognize the consequences of each variable in augmenting the credibility of financial disclosure which in turn enhance investors' confidence. This study also informs the regulators by making them better understand the underlying importance of distinct AC attributes in enhancing audit quality which is one of the most pivotal driver of firms' financial reporting quality. Specifically, these findings provide the regulators and policy makers the potential influence of AC legal experts, AC shareholdings, AC tenure and AC chair independence on auditors' price which is one of the most crucial drivers of audit quality.

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