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THE INFLUENCE OF AUDIT COMMITTEE CHARACTERISTICS, EXECUTIVE COMPENSATION, AND AUDIT COMPLEXITY TOWARDS CORPORATE AUDIT FEE

Dani Angga Nugroho, Fuad[1]

Accounting Department, Faculty of Economics and Business, Diponegoro University
Jl. Prof. Sudharto, SH. Tembalang, Semarang 50275, Phone +622476486851

ABSTRACT

This study aimed to examine the influence of audit committee characteristics, executive compensation, and audit complexity towards corporate audit fee. The audit committee characteristics were examined by the number of its independent member, its size, meetings frequency and members' expertise. This study used the data from company's annual report listed on the Indonesia Stock Exchange (IDX). The populations of this study werethe companies listed on Indonesia Stock Exchange (IDX) in year 2012-2014. The samples were the non-financial companies which were selected by purposive sampling through some requirements for gaining the data in this study. There were 128 companies fulfilled criterias as the research samples. Data analysis was performed by multiple linear regression analysis method. The results of this study showed that the independent audit committee members and its meetings frequency had no significantly influence toward the corporate audit fee. Meanwhile, audit committee member's expertise had negative influence to the corporate audit fee. Otherwise, the audit committee size, executive compensation and audit complexity had positive influences to the corporate audit fee.

Keywords: audit committee, executive compensation, audit complexity, audit fees

INTRODUCTION

Corporate governance is a set of corporate controls and rules that arise due to interaction between parties that manage the company. In other words, corporate governance is a set of actions, policies, and procedures that create the interests alignment of managers, shareholders, and other stakeholders (Rustam et al., 2013). One of the corporate governance actions is auditing. The principles of corporate governance can be explained through agency theory that identifies agency relationship between principal and agent parties. Agency relationship can be interpreted as cooperative contract between investor (principal) and management (agent). However, this relationship may create a conflict of interest between them caused by an information asymmetry. The information gap creates by the separation of company ownership and the requirement of the management control to establish the internal and external control and supervision.

Most of corporate scandals, such as Enron, WorldCom, were caused by the managers who acted for their own interests and made the corporate collapse and loss of shareholder wealth. Since some scandals have been revealed, audits begin to have important value to corporate governance evaluation. As the response of the scandal happened, the policymakers in some countries have made improvements of corporate governance as law or regulation. The 1990s financial crisis, that hit the economy of Asian countries including Indonesia, emerged initiation in strengthening corporate management framework for national and regional levels. In a study conducted by the Asian Development Bank, the financial crisis was affected by the weakness of corporate governance. It can be said that the Asian crisis became the early milestone for the improvement of the corporate governance in Asia.

The corporate governance guidelines that formed immediately after the various corporate scandals put forward the significant role of an audit committee. It seized the public's attention after the report submission by the Blue Ribbon Committee (BRC, 1999). The report provides

[1] *Corresponding author*

recommendations on the composition and activities of audit committees designed to assist external auditors and to improve the quality of internal controls. The existence of the audit committee in Indonesia has been mandated in Financial Services Authority Regulation number 55/POJK.04/2015 on the Establishment and Work Guidelines of the Audit Committee. The characteristics of the audit committee can be reviewed through several indicators namely, independent members, size, frequency of meetings, and member expertise.

The audit committee conducts active monitoring the process of financial reporting and supervises the relationship between company's management and external auditors. As an internal mechanism, it is required to assist the control and supervision functions in the company. As a controlling mechanism, executive compensation is used to align the interests between managers and shareholders. A financial statement is the benchmark of corporate management performance. A company with high complexity requires a firm control and supervision. As a supervising mechanism, it is necessary to have a financial statement audit by an independent auditor from outside the company. For the audit services, an agency cost arises as an audit fee which is based on the contract between the client company and the external auditor.

The audit committee, the executive compensation, and the audit complexity are the determinant for the amount of audit fee as had been done in the developed countries. This is because corporate governance system in the developed countries is steadier and the role of audit committee is firmer than in developing countries. Yatim et al. (2006) found a positive and significant influence of the audit committee independency and its meeting frequency toward the audit fee. Naser and Nuseibeh (2008) stated that the audit fee is determined by the company size, kinds of the public accounting firm, the audit complexity and the corporate risk. Rizqiasih (2010) found that the audit committee independency had a positive and significant impact on the audit fees, while the audit committee size and the audit committee meetings intensity have no effect on audit fee. Rustam et al. (2013) carried out a significant correlation between the activity and the audit committee independence and the audit fee, whereas compensation incentive did not affect the audit fee. In 2013, Hazmi found that the independency, size and intensity of meeting of the audit committee did not influence the audit fee, while in 2015 Gati observed the audit fee was positively influenced by the size and intensity of audit committee meetings and negatively impacted by the committee members' expertise.

This study aimed to examine the influence of audit committee characteristics, executive compensation and audit complexity towards corporate audit fee. Researchs on audit fee are still limited because its disclosure tents to be a voluntary, while the determinants of the audit fee amounts given to the auditor are increasingly diverse.

THEORETICAL FRAMEWORK AND HYPOTHESIS FORMULATION

Agency Theory

This theory explains the relationship between agents and principals. In a company, managers are the agents, while principals are the shareholders. The agents oblige to provide actual information to the principal, while the principals oblige to reward the agents (Hendriksen and van Breda, 1991). The manager as an agent has a duty to run the company and report it to the principal. Meanwhile, the principal is obliged to supervise the manager’s activities and give a reward. Jensen and Meckling (1976) define agency cost as the sum of money of the principal spent for supervising agents.

The information gap arises due to the separation of company ownership. It requires forming internal and external control and supervision. Therefore, it needs an adequate corporate governance mechanism. The consideration of the corporate governance comes out by referring the agency theory in which the control and supervision of corporate management must be carried out to ensure the management performed fulfils the principles of compliance with applicable rules, provisions and standards. The supervision is done through a contract between the principal and the agent. Independent supervision requires agency cost, in the form of audit fee. The supervision cost is the cost of supervising the agent activities whether the agent did regarding the principal interests and accurately reported all activities that have been assigned to the manager.

The Influence of the Independent Audit Committee to the Audit Fee

The agency theory explains that there is separation of ownership and control of the company. An audit committee is required to assist the control and supervision functions in the company. As the implementation of good corporate governance, the audit committee should be independent. It starts with the provision that the chairman of the audit committee is from independent commissioner. As a shareholder representative, an independent commissioner is expected to be able to act independently of the majority shareholder. Besides, the other audit committee members as an external professional party must also be independent. In other words, they have no directly or indirectly business relationship and any familial relationship with the company's boards of commissioners and directors.

As a control mechanism, the audit committee makes the internal control system stronger and improves the quality of the financial statements. The independent audit committee provides the high reliability level of accounting process and the objectivity of the audit committee. According to Yatim et al. (2006), an independent audit committee is more effective in preventing the risk of making errors in the financial reporting process. It makes the internal control stronger and reduces inherent risk level and supervision. Therefore, substantive testing is required to reduce audit fee. Thus, the hypothesis that is to be tested is:

H_1. The independent audit committee negatively affects audit fee.

The Influence of the Audit Committee Size to the Audit Fee

Based on agency theory, the separation of ownership and control of the company leads to a conflict between shareholders and company management. The shareholders have an information access to internal company, while management controls the company's operations. Conflict will arise when corporate governance mechanism is inadequate. The shareholder tries to maximize the profit while the manager seeks to maximize his personal profit. With his capacity, the manager’s tendency to manipulate his own profit becomes greater. Information from management that does not fit with the actual condition is called information asymmetry. In addition, the information asymmetry causes the shareholder can not get, assess, and interpret all of the information about the manager opportunistic behavior.

As a monitoring mechanism, the audit committee assists the shareholders in overseeing the management and reducing the information asymmetry. The Financial Services Authority (2015) determines that an audit committee consist at least three members from independent commissioners and the outsider of the company. Raghunandan and Rama (2007) stated that more number of audit committee members provide more effective supervision so that the company performance becomes better. It can lessen the task of external auditor. It also makes a better quality of the financial statement. Effective and efficient audit process may reduce the audit fee. Thus, the hypothesis that is to be tested is:

H_2. The size of the audit committee negatively affects audit cost.

The Influence of the Audit Committee Meeting Frequency to the Audit Fee

The agency theory shows that the audit committee on behalf of the board of commissioners represents the owners in monitoring the financial reporting process undertaken by managers. The purpose of this supervision is preventing the managers to conduct an opportunistic behavior that will inflict a financial loss of the owner. One of managers’ opportunistic behaviors is manipulating financial report. Therefore, the audit committee that always conducts the meeting will keep monitoring and supervising the reporting process. The more meetings conducted, the managers have no change to manipulate financial reporting because they are constantly being audited by the audit committee (Prasetyo, 2014). The audit committee has duties and be responsible for reviewing financial information, the compliance of laws, the findings of internal auditors and the implementation of risk management. Also, it provides independent advice and opinion to the board of commissioners. Audit committees are authorized to communicate directly with employees, directors and internal audit functions, risk managements and public accountants regarding their duties and responsibilities (Financial Services Authority, 2015). The communication conducted is in the form of meetings or assemblies held periodically attended more than one-half number of the members. Financial Services Authority (2015) recommends the number of meetings is at least four times a year. The audit committee meetings frequency is the number of meetings held by the audit committee within a year to discuss the issues in the company. The more frequent meetings arranged will reduce financial fraud and miscellaneous misstatements and influence the audit fee. Thus, the hypothesis that is to be tested is:

H_3. The audit committee meeting frequency negatively affects audit fee.

The Influence of the Audit Committee Members' Expertise to the Audit Fee

The audit committee is in charge of reviewing the financial information to be released to the public. Besides, the audit committee also reviews the internal audit findings and supervises its follow-up to the board of directors. Based on the Financial Services Authority (2015), the main task of the audit committee is to review financial information issued to the public and its compliance of the laws and regulations. Shareholders are dependent on information provided by management. The company's financial information issued becomes a reference in the decision making by the financial report users. In the implementation of good corporate governance, the audit committee must have sufficient skills and experience in accounting and finance as well as the related regulations. Blue Ribbon Committee (1999) specifies the audit committee must have financial and accounting background. The Financial Services Authority requires to at least one member of the audit committee has educational background and expertise in accounting and/or finance. The performance of audit committee will be more effective if its members have experience in finance and accounting. Xie et al. (in Pamudji, 2009) proved that independent commissioners and skillful audit committees are able to prevent the tendency of earnings management by the managers. With the expertise, audit committee members will perform proper audit procedures and be able to detect risk problems excellently. The lesser audit risk makes the external auditor give a low audit burden. Thus, the hypothesis that is to be tested is:

H_4. The audit committee members' expertise negatively affects audit fee.

The Influence of the Executive Compensation to the Audit Fee

The agency theory considers the relationship between the owner and the company's management. The principal gives a trust to the agent who provides his managerial services. Agency conflict will arise by the motive and interest from the shareholders and managers resulting poor corporate governance that can degrade the company performance. A good relationship between shareholders and managers can be bad because of the problem. Therefore, the relationship between the shareholder and the manager must be controlled in order to improve company performance. The shareholders can establish good corporate governance mechanisms appropriately such as by boards of directors, ownership monitoring, compensation executives, and markets for corporate control, limit the managerial tendencies to manipulate financial numbers and minimize agency costs of managerial wisdom. Compensation is the services value given by the owners to the management for their performance (Jensen and Meckling, 1976). Executive compensation is used to align managers' interests and shareholders. Generally, compensation can be salary, allowance, facilities, bonuses, and long-term benefits. However, executive compensation raises the tendency of managers to cheat. Managers can manipulate financial information because they motivated to get their bonus or compensation at a certain point. Healy's research (1985) and Holthausen et al. (1995) proved that the bonuses affect the financial reporting process by encouraging managers to manipulate the earnings in order to earn bonuses. The tendency of managers' fraudulent actions makes the quality of financial report less reliable. Therefore, the audit effort becomes greater to identify the risk of fraud. This will cause the external auditors to make a burden with higher audit fee. Thus, the hypothesis that is to be tested is:

H_5. Executive compensation has a positive influence on audit fee.

The Influence of the Audit Complexity to the Audit Fee

Financial report serves as a benchmark of a successful management performance in company operational. The level of reliability and fairness is very important in the process of presenting and disclosuring the financial report. To improve the quality of financial report requires an auditing process by professional and independent party. Audit is a service provided by a public accountant to provide an independent auditor's opinion on the financial statements presented by an entity. In conducting the audit, the external auditor considers the business complexity of the client. Audit complexity is a measure of the transaction complexity owned by clients to be audited. The complexity is based on the number of subsidiaries owned by the company. The subsidiary is entirely controlled by the main entity because most of its stock has been acquired. El-Gammal (2012) stated that the number of subsidiaries represents the complexity of the audit. Consolidated financial statement should be made when the company has a domestic subsidiary. Sandra and Patrick (1996) revealed that the more number of subsidiaries, the more time and skill are needed to ensure the accuracy of the consolidated financial report. With some subsidiaries of the client entity, the financial transactions become increasingly complex. This will make an external auditor to charge a higher audit fee. Thus, the hypothesis that is to be tested is:

H_6. Audit complexity has a positive effect on audit cost.

METHODOLOGY

This study was a statistical-correlation study which tried to identify the influence correlation among variables using multiple regression analysis. It was used since it was to predict the value of a variable based on the value of two or more other variables.

Research Variables and Variables Operational Definition

As it was a statistical-correlation study with multiple regression analysis, the variables that were measured as below:

Table 1
Variable Measurement

	Variable	Measurement
1	Audit fee	The amounts of rupiah by natural logarithm that is disclosed in the annual report
2	Independent audit committee	Percentage of independent audit committee members from the total number of audit committee members
3	Audit committee size	Number of the audit committee members stated in the company's annual report
4	Audit committee meetings frequency	Number of meetings held by the audit committee during the reporting year of the minimum meetings obliged to be held by the Financial Services Authority
5	Audit committee member expertise	Number of audit committee members who have accounting and/or financial expertise from the overall number of the audit committee members
6	Executive compensation	The amount of compensation/remuneration by natural logarithm received by the directors during the reporting year
7	Audit complexity	Number of subsidiaries owned by the main entity

Population and Samples

The population in this study was a company listed on the Indonesia Stock Exchange (IDX) in 2012-2014. The year’s period was used because before the year 2012 some data had not been listed in the company's annual report. The determination of the sample companies used purposive sampling method, a sampling method by taking into account of some certain criterias. The criterias that must be met to be the research samples are as follows:

1. Non-financial company listed on IDX during the period year 2012-2014.
2. The company published its financial report and audited annual report for the December, 31^{st} ending period.
3. The data should be fully available for all research variables.

Non-financial corporations were selected as the samples because they were much more than the financial and simply represented the research undertaken. Also, there was a number of unique characteristics of financial company and had some difference regulations between financial and nonfinancial company.

Types and Data Sources

The data used in this study was the secondary data in the form of annual reports and financial statements of companies that have been audited in 2012, 2013, and 2014. Data were obtained or downloaded from the website page of Indonesia Stock Exchange (IDX), the company website pages, and various other types of reference. The dependent variable data is the amount of the audit fee obtained from the public accountant information part of the annual report. The audit committee data, such as the number of independent members, the size, the meeting frequency, and the member expertise can be seen in the Corporate Governance section of the annual report. It was also for the executive compensation data were obtained in the Corporate Governance section of the annual report. The number of subsidiaries data of each sample could be found in the Notes to the Financial Statements.

Analysis Method

The analytical method used in this study was multiple regression analysis. It was used since the purpose of research was to identify the influence of more than one independent variable to one dependent variable. The test was used to recognize the influence of audit committee characteristics, executive compensation and audit complexity towards audit fee.
The regression equation was as follows:

$$LNAuditFee = \alpha + \beta_1 ACInd + \beta_2 ACSize + \beta_3 ACMeet + \beta_4 ACExp + \beta_5 LNExComp + \beta_6 SUBS + \varepsilon$$

Index**:**

LNAuditFee	= natural logarithm of audit fee
ACInd	= independent audit committee
ACSize	= audit committee size
ACMeet	= audit committee meetings frequency
ACExp	= audit committee member expertise
LNExComp	= natural logarithm of executive compensation
SUBS	= audit complexity
β_1 - β_6	= estimated coefficient
ε	= error

FINDINGS AND DISCUSSION

Findings

The study finds a positive influence of audit committee size, executive compensation and audit complexity to the corporate audit fee. Otherwise, there is a negative influence of audit committee members' expertise to the corporate audit fee. Meanwhile, there are no influence of independent audit committee members and audit committee meetings frequency to the corporate audit fee.

The criterias of the sample company used as the research objects could be seen in table 2.

Table 2
Object of the Research

No	Description	2012	2013	2014	Total
1	Nonfinancial companies listed on the IDX	377	405	420	
2	No information on corporate audit fee	(284)	(277)	(256)	
3	No independent variable information				
	Independent audit committee	-	-	-	
	Audit committee size	-	-	-	
	Audit committee meetings frequency	(4)	(3)	(8)	
	Audit committee member expertise	-	(2)	(4)	
	Executive compensation	(8)	(14)	(19)	
	Audit complexity	-	-	-	
		81	**109**	**133**	**323**

Source: The Secondary Data, 2017

Summary of descriptive statistics on audit fee, audit committee characteristics, executive compensation and audit complexity are presented in Table 3.

Table 3
Descriptive Statistical Data Analysis

Variable	N	Minimum	Maximum	Mean	Standard Deviation
LNAuditFee	301	18.035	24.173	20.439	1.199
ACInd	301	0.67	1.00	0.973	0.082
ACSize	301	3.00	6.00	3.236	0.601
ACMeet	301	1.00	14.25	2.086	2.016
ACExp	301	0.25	1.00	0.619	0.229
LNExComp	301	19.494	25.859	23.026	1.185
SUBS	301	1.00	7.55	2.730	1.495

Source: The Secondary Data, 2017

The regression analysis in the model is based on the dependent variable and independent variables. As discussed previously, the audit fee is the dependent variable used in this study. The independent variables in the study are measures of audit committee characteristics, executive compensation and audit complexity. Multiple regression analyses are performed to test all the hypotheses for the models of the study. The results of multiple regression analysis for independent variables with log of audit fee are presented in Table 4.

Table 4
Multiple Regression Analysis Results

Variable	Hypothesis	Coefficient	Significance
ACInd	H1-	-0.358	0.599
ACSize	H2-	0.513	0.000*
ACMeet	H3-	-0.030	0.258
ACExp	H4-	-0.414	0.039**
LNExComp	H5+	0.540	0.000*
SUBS	H6+	0.195	0.000*
R-squared		0.587	
Adjusted R-squared		0.579	
F-statistic		69.695	0.000*

*)Significant 0.01
**)Significant 0.05
Source: The Secondary Data, 2017

Discussions

The study aimed to examine the relationship and influence of the independent variable to the dependent variable. This study was using multiple regression analysis method with a level of significance of 5%. If the significance level more than 0.05, then the independent variables does not have an effect on the dependent variable, and the hypothesis is rejected. In contrast, when the level of significance is less than 0.05, then the independent variables have effect on the dependent variable, and the hypothesis is accepted. The findings of the study were then discussed one by one, as follows:

Hypothesis 1

The first hypothesis stated that the independent audit committee negatively affects the audit fee. Based on the result of multiple linear regression analysis, the coefficient of independent audit committee variable was -0.358 with probability significance value of 0.599. It could be concluded that the first hypothesis was rejected because it was not significant. Therefore, it could be interpreted that the number of independent audit committee members did not affect audit fee. This result was supported by the researchs of Hazmi (2013) which found the independent audit committee has no effect on audit fee. It did not effectively reduce the risk of fraud and fraudulent financial report. Forming the audit committees may only be done to fulfil the Financial Services Authority Regulation Number 55/POJK.04/2015 which requires the audit committee should be from independent commissioners and external parties.

Hypothesis 2

The second hypothesis showed that the size of the audit committee has a negative effect on audit fee. Based on the result of multiple linear regression analysis, the coefficient value of the audit committee size variable was 0.513 with a probability significance value of 0.000. It could be concluded that the second hypothesis was rejected because the coefficient was positive. Therefore, it could be interpreted that the audit committee size had a positive effect on the audit fee. It indicates the greater number of audit committee members made the audit fee higher. This happened because the audit committee on behalf of the board of commissioners represented the owners preferred the high quality external auditors. This result differed from Yatim, et al. (2006), Rizqiasih (2010) and Hazmi (2013) suggested that the audit committee size has no significant effect on audit fee.

Hypothesis 3

The third hypothesis indicated a positive influence of the audit committee meeting frequency to the audit fee. Based on the result of multiple linear regression analysis, the variable coefficient of the audit committee meeting frequency was -0.030 with probability significance value of 0.258. It could be concluded that third hypothesis was rejected because it was not significant. This result supported Rizqiasih’s research (2010) which observed the frequency of audit committee meeting has no effect on the audit fee. This happened because the audit committee had not been maximally carrying out its duties and responsibilities so that its role and functionwas not effective. This might be occurred due to the audit committee meeting findings did not get follow up from the board of commissioners.

Hypothesis 4

The fourth hypothesis denoted the negative effect of the audit committee members’ expertise on audit fee. Based on the result of multiple linear regression analysis, the variable coefficient of the audit committee members’ expertise was -0.414 with the probability significance value of 0.039. It could be concluded that the fourth hypothesis was accepted. Therefore, it could be interpreted that the audit committee members’ expertise negatively affected the audit fee. It indicates that the large number of audit committee members who have financial and accounting expertise made the audit fee lower. With financial and accounting expertise, the audit committee members were able to detect wrong and risk audit procedures better so it reduced the audit fee. This result supported Gati's study (2015) that showed the negative impact of the audit committee members' expertise on audit fee.

Hypothesis 5

The fifth hypothesis stated that the executive compensation had a positive effect on audit fee. Based on the result of multiple linear regression analysis, the variable coefficient value of the executive compensation was 0.540 with a probability significance value of 0.000. It could be concluded that the fifth hypothesis was accepted. Therefore, it could be interpreted the executive compensation had a positive effect to audit fee. It indicates that the compensation was received by the directors made the higher audit fee. The greater compensation was received by the executive made the higher risk of the manager fraud in multiplying the bonus. The results of this study were identical with the research of Vafeas and Waegelein (2007) and Wysocki (2010) who claimed that the executive compensation had a significantly positive effect on the audit fee.

Hypothesis 6

The sixth hypothesis indicated the positive effect of the audit complexity to the audit fee. Based on the result of multiple linear regression analysis, the variable coefficient value of the audit complexity was 0.195 with significance value 0.000. It could be concluded that the sixth hypothesis was accepted. Therefore, it could be interpreted that audit complexity had a positive effect on audit fee. It indicates that audit complexity made the higher audit fee. The more subsidiaries the more complex of the consolidated main entity report made the external auditors charged the higher audit fee. This result encouraged the findings of Naser and Nuseibeh (2008) and Nugrahani (2013) that the audit complexity positively and significantly affected the audit fee.

CONCLUSIONS, LIMITATIONS AND SUGGESTIONS

Conclusions

This study aimed to examine the influence of audit committee characteristics, measured by the independency, size, meeting frequency, and member expertise audit committee, executive compensation and audit complexity towards audit fee. The samples of this research were nonfinancial companies listed on IDX in 2012, 2013, and 2014 selected by using purposive sampling method. Based on the findings and the discussion that have been described previously, it could be summarized as follows:

1. The independent audit committee had no influence on audit fee. Thus, it could be concluded that the first hypothesis was rejected.
2. The size of the audit committee had a positive effect on audit fee. Thus, it could be concluded that the second hypothesis was rejected.
3. The frequency of audit committee meetings did not affect audit fee. Thus, it could be concluded that the third hypothesis was rejected.
4. The expertise of audit committee members negatively affects the audit fee. Thus, it could be concluded that the fourth hypothesis was accepted.
5. Executive compensation has a positive effect on audit fee. Thus, it could be concluded that the fifth hypothesis was accepted.
6. The audit complexity had a positive effect on audit fee. Thus, it could be concluded that the sixth hypothesis was accepted.

Limitations

Some limitations in the study include:

1. This study used the audit fee data that were still voluntary disclosure so it had not reached all sectors of the companies.
2. The executive compensation data in the study was proxied with the total received remuneration. It was not clarified whether the executive compensation was the short-term compensation in the form of salary, allowances, and bonuses or the long-term compensation in the form of stock option, performance achievement plan and other long-term benefits.

Suggestions

The suggestions for further research are as follows:

1. Good corporate governance practices were not assessed merely by an audit committee. The principles of corporate governance should also be considered.
2. The value of coefficient determination (adjusted R square) in the study was 57.9%, which means there are 42.1% other factors that are not examined. The other determinants should be considered towards the audit fee.

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