RISK MANAGEMENT COMMITTEE AND AUDIT PRICING : EVIDENCE IN MALAYSIA

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Abstract

The aim of this study is to examine the relationship between audit fees and the formation of risk management committee (RMC). Based on the agency theory, it states that agency problem occur due to information asymmetry between the agent and principal. Thus, the formation of RMC may act as an agent to principal in assessing and disclosing more information regarding the risks that occur in the company. Hence, this will increase the transparency of the company as well as reduce agency problems thus, leading towards higher quality of financial reporting. This study predicts that by forming separate RMC and having members of RMC whom are more independent, expert and female are more likely to demand for higher audit engagement thus, lead towards higher audit fees. Analyses were conducted by using 208 data listed companies in the Bursa Malaysia in 2014. Ordinary Least Square (OLS) regression method was employed to estimate the relationship between RMC and audit fees. The results show that RMC members with independent non-executive and with financial expertise are significantly, positively associated with audit fees since they demand higher level of assurance in auditing. Meanwhile, separate RMC and female members show that they are positively associated with audit fees but are not significant. Therefore, the results provide initial evidence on the relationship between audit fees and RMC in the Malaysian business environment.

Keywords: risk management committee (RMC), audit fees, agency theory and Malaysia.

Abstrak

Tujuan kajian ini adalah untuk mengkaji hubungan yuran audit ke atas pembentukan jawatankuasa pengurusan risiko (RMC). Berdasarkan teori agensi, masalah agensi berlaku disebabkan oleh ketidakseimbangan maklumat antara ejen dan pemilik. Justeru itu, pembentukan RMC boleh bertindak sebagai ejen kepada pemilik dalam menilai dan mendedahkan lebih maklumat mengenai risiko yang wujud dalam syarikat itu. Oleh itu, dengan penubuhan RMC ia dapat membantu meningkatkan ketelusan syarikat dan kualiti pelaporan kewangan. Kajian ini menjangkakan bahawa dengan membentuk RMC berasingan dan mempunyai anggota RMC yang lebih bebas, pakar dan disandang oleh wanita akan meningkatkan permintaan yang lebih tinggi terhadap tugasan audit, maka menyebabkan yuran audit yang lebih tinggi. Analisis-analisis telah dijalankan ke atas 208 buah syarikat tersenarai di Bursa Malaysia pada tahun 2014. Kaedah regresi *Ordinary Least Square (OLS)* telah digunakan untuk menganggarkan hubungan di antara RMC dan yuran audit. Dapatan kajian menunjukkan bahawa ahli-ahli RMC yang bebas dan memiliki kepakaran kewangan mempunyai hubungan positif dan signifikan dengan yuran audit disebabkan kerana permintaan pengauditan yang lebih tinggi. Manakala, pengasingan RMC dan ahli-ahli wanita sebagai RMC mempunyai hubungan yang positif tetapi tidak signifikan dengan yuran audit. Justeru, dapatan-dapatan ini menunjukkan bukti awal mengenai hubungan di antara yuran audit dan RMC dalam persekitaran perniagaan di Malaysia.

Kata kunci: jawatankuasa pengurusan risiko (RMC), yuran audit, teori agensi dan Malaysia.

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List of Abbreviations

OLS	Ordinary Least Square
Obs	Observation
POB	Public Oversight Board
RMC	Risk Management Committee
SPSS	Statistical Package for Social Science
UUM	Universiti Utara Malaysia
VIF	Value Inflation Factor

CHAPTER 1 : INTRODUCTION

1.1 Research Interest

Recent corporate scandal and financial crisis have affected most of the big firms in the west such as Parmalat, Citigroup, Bear Stearns, Enron WorldCom, Lehman brothers and Dexia (Becht, Bolton and Roell, 2011) whereas in Malaysia, such as Oilcorp, Megan Media and Transmile (Zulkifli and Abdul Samad, 2007). This recurrence of business downfall has substantially cast doubt on the effectiveness of the audit committee in overseeing and executing risk management system (Bates and Leclerc, 2009). Therefore, many initiatives have been imposed by the government in order to overcome and reduce these problems. Among the initiatives proposed are by enhancing corporate governance with significant emphasis placed on the role of the risk management. This is consistent with the risk-based approach, where it ensures that the board must place a systems of risk management by increasing the firm's awareness in regards to risk management (Committee of Sponsoring Organizations of Treadway Commission, 2004). Thus, it allows the board to be more focus in making decisions in order to reduce the risk that occur in the firms.

However, the number of public listed companies in Malaysia which form stand alone risk management committee are still limited. This is because most of the companies still combine risk management committee together with the audit committee (Safitri and Meiranto, 2013). In 2014, the Institute of Internal Auditors (IIA) has emphasize that the internal audit process should be separated from process of risk management. This is because the responsibilities of the audit committee is more proactive and involves in a

continuous process. According to Bugalla, Kallman, Lindo and Narvaez (2012), an audit comitee can maintain its integrity and protect fiduciary malfeasance if the the company can separate the function of audit committee from risk management committee. These have been supported by Brown, Steen and Foreman (2009), which stated that the risk management committee should be established independently due to weaknesses of audit committee which may not be capable of overseeing the risks that occur in financial as well as non-financial burden of risk oversight.

In addition, Zaman (2001) added that due to lack of time and expertise, it is unfair to expect the audit committee to carry out all the given tasks. Thus, separating risk management committee and audit committee may allow audit committee to focus more on their duties which has been stated in the charter of auditor. Moreover, ISO 31000 which is standards relating to risk management codified by the International Organization for Standardization has also come out with a standard relating to the implementation of risk management. From the argument above, it has supported that the formation of separate risk management committee should be applied in a company in order to manage risks effectively as well as enhance the internal control of a company (Organization for Economies Cooperation and Development, 2014).

1.2 Background of the Study

In order to manage a business effectively and smoothly, forming several committees maybe helpful in order to assist the execution of board responsibilities. This is aligned with the requirement of Malaysia Code on Corporate Governance 2012 (MCCG 2012)

which states that all public listed companies should clarify the role of the board in providing leadership skills as well as to enhance board effectiveness (refer to MCCG 2012, principle 1). Therefore, the board may delegate certain responsibilities to the committees of the board to operate within the define terms of references. Aside from the audit committee which has been mandated since 1993, MCCG 2012 also recommends the formation of remuneration and nomination committee where their roles are to assist the boards (refer to MCCG 2012, principle 2).

However, with different companies and different industries it may establish other board committees to fit the nature of business in order to manage specific areas of the operations. For example, for high risk companies, they usually form a separate risk management committee in order to overview the risk of companies and indirectly focus more on ways to reduce and manage the risk effectively compared to non-risk companies (Olamide, Uwalomwa and Ranti, 2015).

Amongst the other committees that are set up are the Employees' Share Option Scheme (ESOS), The Executive and Management Committee, Share Buy-Back Committee, Corporate Governance Committee and the Risk Management Committees. All these board committees will review matters pertaining their scope and make recommendations to the board for approval.

1.2.1 Risk Management Committee (RMC)

In the year 2000, there is guidance issued by Bursa Malaysia which is "A Guidance on Internal Control" where it explains the information which needs to be disclosed in "A Statement of Internal Control". Under this guideline, it explains that directors should

emphasize more on the need for proper risk management, where this kind of area is considered as a critical element towards better internal control system. Due to this standard, it seems that forming risk management committee is the best measure for companies in order to for them to efficiently manage and detect the risks that occur in their companies.

1.2.2 Role of Risk Management Committee

Generally, the board as a whole has the overall responsibility in organizing the risk oversight and also overseeing the strategy of the organization. In deciding how the board organized their roles in overseeing the risk as well as managing the risks, lead towards the question whether the board should establish a risk committee or not.

Thus, the main aim of the risk management committee is to assist the board in terms of identifying the principal risks and also implementing the appropriate system for the risk assessment process, in line with the MCCG 2012 issued by the Securities Commission and Bursa Malaysia Listing Requirements.

There are several main roles of the risk management committee that have been outlined in the various standing committee's charter for companies (see for example Beaumier and DeLoach, 2012) which are:

a) To determine whether all activies regarding risk are in placed and constantly improved when there is changes in the business environment.
b) To supply timely input on critical risk issues for executive management.
c) To keep management aligned with the risk appetite and flexible towards new opportunities arise.

d) To supervise risk assessment system through identification and reporting of risks.

e) To assist in coordinating activites regarding risks.

f) To monitor any dysfunctional behavior in the company's that may weaken the effectiveness of the risk management process.

Therefore, it is important for risk committee charter to clearly clarify the activities in which to support the boards' risk oversight objectives and avoid the degree of overlapping between roles of risk management committee and audit committee. Table 1.1 shows the main distinction between the responsibilities of risk management committee and audit committee.

Table 1.1 Distinction between Responsibilities of Risk Management Committee (RMC) and Audit Committee

	RMC	Audit Committee
Focus	• For future performance. • Wider scope of risks. • Financial and non-financial risks.	• For historical performance. • Financial reporting and compliance with applicable laws and regulations.

Table 1.1 (Continued)

Terms Of Reference	**Risk Assessment** • To make sure that risk-management system is in the right track. • To make sure that any decision making is aligned with the risk appetite by the board.	**Audit** • To guarantee that the company's external and internal audits are sufficient to address business risks.
	Risk Management • To ensure the effective functioning and currency of such a system.	**Internal Control** • To ensure that the internal controls are suitable to address business risks.
	Risk Reporting • To assess information and reports to the board on the company's major risks and exposures.	**Financial Reporting** • To review the company's financial reports
Core Attributes of Committee Members	• Logical and creative • Qualitative • Wider knowledge	• Analytical • Quantitative • Financial expertise

Source : *A Global Corporate Governance Forum Publication (2015)*

1.3 Problem Statement

The importance of risk management in a company has become more significant to the committee of board not only for those in developing countries but also in developed countries. For example, a study in Saudi Arabia carried by Alzharani and Aljaaidi (2015), found that the Saudi Code on Corporate Governance 2006 has not focused on the risk management activities as part of the function of the audit committee but it has been admitted in the primary role of the boards of directorss. Similarly, a survey that has been conducted by Deloitte (2014) in eight countries (Australia, Brazil, China, Mexico, Netherland, Singapore, United Kingdom and United States) representing the whole world as their sample was used to assess the prevalence of the risk management committee especially in a large public listed companies.

In Australia, the Australian Securities Exchange (ASX) had also released their third edition of the Corporate Governance Principle and Recommendations where it recommends that all listed entities to establish a risk management committee which has been enforced on the 1st of July in 2014. The listed entity should establish a risk committee whether it is on a stand-alone basis or a combine with audit committee. While in Brazil, the Brazilian National Monetary Council's (CMN) Resolution number 2.554 had issued principles relating to control risk and thus recommended the risk committees to be established in 1988 (OECD, 2014). Similarly in the United States, the risk committee was said to be set up separately or integrated with other committees and has been stated under the Securities and Exchange Commission (SEC) which went into effect in 2010 (OECD, 2014). All public listed companies in these eight countries are categorized into five industries which are Financial Services Industry (FSI), Consumer

and Industrial Product (C&IP), Energy and Resources (E&R), Life science and Health care (Ls&Hc) and lastly Technology, Media and Telecommunication (TMT). Findings from Deloitte's (2014) analysis shows that amongst the five industries, companies under FSI are more likely to have the risk management committee rather than the non-FSI companies in all of the countries. This is aligned with studies conducted by Beasley, Clune and Hermanson (2005) and Wallace and Kreutsfeldt (1991) which found that industries related with banking and insurance are having more regulatory and other risk compared to other industries.

In addition to that, Nigerian Code on Corporate Governance (2011) also came out with a recommendation by stating that the board of any organization may form a risk management committee to refocus on the risk function profile, risk management framework and the risk-reward system (see for example Kamardin and Edogbanya, 2015).

Meanwhile in Malaysia, after the roles and responsibilities of audit committee are redefined, the risk management committee was being introduced. Currently, many companies task their audit committee with the responsibility of monitoring risks that exist in the companies (Subramaniam, McManus and Zhang, 2009 and Yatim, 2010). Due to the importance of assessing risk in the companies the board should consider to delegate this task by forming separate risk management committee which is another committee that is not only focuses on compliance of accounting standards. According to Yatim (2009), to avoid corporate disaster and unexpected business failure, the business society should take preventive action and increase the risk management's awareness. Due to this issue, the society started to notice the importance of forming the risk management

committee. However, the formation of the risk management committee in all public listed companies are still voluntarily. But in 2010, the Central Bank of Malaysia Act 2009 has set a regulatory reform that it is compulsory for all Malaysian insurance company to have stand alone risk management committee (Ng, Chong and Ismail, 2013).

Moreover, it has been argued that the committee of risk management could strengthen the performance of the company, as well as improve the audit quality (Beasly et al., 2005). A study carried out by Md Yusof & Ishak (2013), found that by having separate risk management committee it has reduce the issuance of the modified audit report. This indicates that the risk management committee has improved the assessment of risk and risk managing of the company effectively leading towards lower probability for the company to receive modified audit report. Thus, it is proved that committee of risk management enhance the performance of the company as well as improve quality of audit leading towards higher audit fees charged due to more auditor's risk assessments and audit efforts required. Whilst there are studies have been carried out regarding risk management committee but to my knowledge, there is no published article that has specifically examined the relationship between risk management committee and audit fees especially those conducted in Malaysia. Therefore, this study is expected to provide further insight on the association of audit services fee from the perspective of risk management committee as well as the characteristics of the committee members.

1.4 Research Questions

Based on the research problem, four research questions are formulated. Thus, the research questions are as follow :

1. What is the relationship between the formation of a separate risk management committee and audit fees?
2. What is the relationship between independence of risk management committee members and audit fees?
3. What is the relationship between expertise of risk management committee members and audit fees?
4. What is the relationship between gender diversity among the risk management committee members and audit fees charged to the company?

1.5 Research Objectives

The primary purpose of this study is to examine whether the existence of the risk management committee gives any effect on the audit fee charged towards the company. Therefore, the study specifically examines :

1. The relationship between the formation of a separate risk management committee and audit fees,
2. The relationship between independence of risk management committee members and audit fees,
3. The relationship between expertise of risk management committee members and audit fees, and
4. The relationship between gender diversity among the risk management committee members and audit fees charged to the company.

The empirical findings in this respect still remained few and limited. Yatim (2010), has reviewed the formation of risk management committee towards the board structure while Bugalla et al. (2012) had conducted research on the model of governance and risk management. Md Yusof and Ishak (2013) also had conducted similar research in the Malaysian context regarding the effect of formation separate risk management committee towards modified audit report. However, for this study it examines another aspect of audit quality which is the effect of the formation of risk management committee on audit pricing whether it is in a separate or combined form.

1.6 Significance of the Study

To my knowledge, this study can be considered as the first study to examine the association between the formation of risk management committee with audit fees. There are several prior studies that have been conducted on risk management committee with different perspectives such as firm structure, audit committee characteristics and modified audit report (see for example Yatim, 2010; Yatim, 2009; Md Yusof and Ishak, 2013). Therefore, it is expected that the findings of this study can contribute to the knowledge and literature that the formation of risk management committee has an implication on the audit fee charged especially in the developing country like Malaysia whereby the adoption of formation risk management committee is still voluntarily.

This study is also expected to present more justification regarding the relationship between the characteristics of risk management committee in terms of independence, expertise and gender diversity towards audit fees. Whereas, previous study only

considered the relationship between independence of risk management committee and risk taking in insurance companies (see for example Ng. et al., 2012).

In addition, the findings of this study are also expected to give more evidence for regulators and policy makers to consider forming a separate risk management committee as a mandatory requirement in the future. While in terms of risk oversight function, it directly contributes towards the risk management committee and corporate governance literature.

1.7 Scope and Limitation of the Study

The scope of this study is to examine the relationship of audit fees and the formation of risk management committee. Furthermore, this study also investigates the association between risk management committee characteristics (independence, expertise, and gender diversity) and audit fees. Thus, the independent variables of this study are the existence of a separate risk management committee, independence, expertise and gender diversity in risk management committee while the audit fees is the dependent variable. Alike any previous studies, there is a methodological limitation to the design used in this study as this study only employ a one year basis of companies listed on the Bursa Malaysia which is year 2014. 2014 is chosen in order to get the latest total number of companies that formed risk management committee after the announcement regarding formation of risk management committee being released.

1.8 Conclusion

This chapter outlines the background of this study, where the formation of risk management committee are being supported by many countries not only in Malaysia but also in Australia, United States and China. Initiative of forming risk management committee has been introduced since the board hesitate regarding the effectiveness of the audit committee in managing the risk that occur in a company. The chapter further explains the problem statement whereby there are many developed countries that has already implemented the formation of risk management in their company while in Malaysia the formation of risk management committee is still voluntarily. Similarly, the objectives and research questions of this study are discussed with respect to the formation of risk management committee and audit fees. The significant and scope of this study are also been discussed in this chapter.

1.9 Organizing of Remaining Chapters

The remainder of the study proceeds as follows. The next chapter review the past research related to risk management committee and audit fees. Meanwhile Chapter 3 underline the hypotheses developed and theoretical framework together with the research design, the variables, data and sample selection used in the research. Chapter 4 discusses the results of the tests and followed by the conclusion of the study in Chapter 5. Limitations of the study and recommendations for future research are also included in this chapter.

CHAPTER 2 : LITERATURE REVIEW

This chapter discusses the relevant literature on risk management committee and audit fees. The first section discusses the formation of risk management committee and then followed by audit fees which focus on the determinants of audit pricing.

2.1 Risk Management Committee (RMC)

The empirical findings regarding risk management committee have remained few and limited especially in Malaysia. Previous research deal with formation of risk management committee in the company for example, a study conducted by Yatim (2009) found that a company with audit committee members who are more independent, expert and diligent may lead towards the formation of separate risk management committee. Similarly a study conducted in Saudi Arabia by Alzharani and Aljaaidi (2015) also found that the size of audit committee also act as proxy in forming risk management committee with the bigger size of audit committee will lead towards the formation of separate risk management committee.

Meanwhile, a research carried out by Subramaniam et al. (2009) shows the association between risk management committee establishment and board factors. He argued that firms with an independent board chairman and larger board probably established a risk management committee. Similarly, Tazilah and Abdul Rahman (2014) found that larger size of board members might established a risk management committee compared to combining it with audit committee in the context of Malaysian Islamic financial institution. This is due to the nature of the financial institutions that have greater leverage

as well as higher debt covenants and higher going concern of risks. Added to this, Yatim (2010) also found that firm structures like complexity of firm's operation, the use of Big Four audit firms and firm size are foreseeable to form risk management committee.

Added to this, Brown et al. (2009) found that most of biotech companies and high technology firms in Australia usually constitute a committee of risk management in order to have full understanding of the risk profile and Bugalla et al. (2012) has came out with a model of governance and risk management for financial intermediaries. It is found that, the banking sector is usually form risk management committee due to various risks such as market risk, credit risk, country risk, technology and operational risk, interest risk and foreign exchange risk.

While for current research, it is deal more towards the effect of formation risk management committee. For example, study done by Md Yusof & Ishak (2013) found that company with separate risk management committee has lower probability to receive modified audit report from the external auditor. Therefore, this study has the intention which exist by examining the effectiveness of risk management committee and not only just looking at the formation but also the characteristics of risk management committee and its effect on audit quality proxy by audit fees. Thus, filling the gap which exist.

2.2 Audit Fees

According to Generally Accepted Accounting Principle (GAAP), audit fees is defined as the cost of conducting audit to express an opinion regarding the conformity of financial statements (Solatni, 2007). In line with the study carried out by Simunic (1984) where he

defined audit fees as a cost associated with the audit service which have been demanded by a client. The issue regarding audit fees has received a considerable amount of attention since it affects the audit quality. It is also an issue in determining the amount of the audit fees charged towards the company. According to Low, Tan and Koh (1990), to measure the audit fees, it should be directly measured through the audit effort expanded in terms of risk involve in the audit engagements. It can be concluded that the higher the audit engagement involve, the higher audit fees is being charged.

2.2.1 Determinants of Audit Pricing

In a company, there exists to be various determinants of audit fees. Previous practitioners such as the number of field work required to conduct the audit, the background or qualification of auditor, the quality of the client, the type of items requiring auditing and also the number of years the auditing firm has been associated with the client are considered in determining the fees to be charged to the company. In addition Hay, Knechel & Wong (2006) found that audit fees are being charged due to customer size, the overall audit risk, complexity of the client, customer profitability and the degree of competition of market share. In general it can be summarize that the higher specification needed to audit the company the higher the audit fees is charged. However, very few studies show that audit fees are being derived by using working hours taken by the auditor to finish auditing the firm except a study done by Davis, Ricchiute and Trompeter (1993). In the study, it demonstrates that audit fees are primarily driven by the number of direct, billing rate adjusted labor hours dedicated to the audit.

Meanwhile, there are several factors which are regularly used to examine the determinants of audit pricing which are non-audit services, complexity, brand-name auditor, business risk and ethnicity.

Non-Audit Services (NAS)

Non-audit services such as preparing accounts, taxation and consultation also influence the amount of the fee charged towards the company. According to Simunic (1984), there is a negative association between NAS fee and audit fee due to "knowledge spillover theory". Thus, it means that by providing audit and non-audit services it shall lower the fee of an audit in which the auditors utilize the knowledge obtained from the non-audit works into the audit works. In contrast, Firth (2002) found that there is a positive relationship between NAS and audit fees since it considers that NAS as one of the additional services demanded by the client thus leading towards higher audit efforts. Thus, indirectly stating that higher audit effort will lead towards a high audit fee. Similarly Peel and Clatworthy (2001) also found a positive relationship to audit fees increase since the expenses for non-audit services are also being included under the audit fees.

Complexity

Business complexities are related to the inherent complexities arising from the nature of a company's business. Complexity of the business can be measured based on size, diversification and divisionalization of the organization. Number of subsidiaries and foreign subsidiaries are also used to measured the complexity of the business (Sandra and Patrik, 1996; Joshi and Al- Bastaki, 2000 and Anderson and Zeghal, 1994). The more

complex the society or firm which has been audited the higher the audit fees are charged towards the audit due to more time consumed and manpower required to finish the audit engagement (Chan, Ezzamel and Gwilliam, 1993; Md Yusof & Che Ahmad, 2000). The same result was found by Joshi and Al-Baski (2000) which argued that audit work will be more complex when the business operation of the auditee are more diversified or when having foreign operations.

Brand Name Auditor

Most of the arguments stated that the brand name auditors which are also known as Big Four audit firms namely Ernst & Young, PricewaterhouseCoopers, KPMG and Deloitte charge higher audit fee as compared to non-Big Four auditors. This is because the Big Four audit firms charge high audit fee due to the reputation and brands name in providing higher quality of audit since they consist of higher quality staff and use higher audit procedures thus more probable to detect omission and errors. However, these 'brand effect' not only occurs in Malaysia but also in other countries such as United States (Palmrose, 1986 ; Francis and Simon, 1987) and United Kingdom (Chan et al ,1993 ; Peel and Clatworthy, 2001) where fee premiums are being paid to brand name auditors. Similarly in China, a study that has been carried by Ji-hong (2007), found that the 'brand effect' may suggest Big Four as providers of differential quality thus giving them opportunity to charge premium or higher audit fee.

Business Risk

A business with high exposure of risk will demand higher audit engagement since the auditor requires more test in order to assess the risk that occurs in the business. Therefore

the auditor may need to enhance their audit work which act as a form of compensation or insurance for accepting the risk (Firth, 1997). Thus, high audit fees are being charged to the business with high risk. A prior study conducted by O'Keefe, Simunic and Stein (1994) found that greater risk may influence the auditor to provide more 'defensible' audit by involving better documentation and tests which act as their legal defense. In addition, Bell, Landsman and Shackelford (2001) also stated that high fees have been charged towards the presence of high business risk due to the increase the number of working hours and not because of the form compensation or insurance as suggested by Firth (1997).

Ethnicity

In Malaysia, Yatim et al. (2006) and Gul (2006) found that the effects of ethnicity on audit fees through the ethnicity of the Chief Executive Officer (CEO) is a significant issue in determining the audit fees. It is argued that, Bumiputera CEO usually lacks monitoring thus leading towards greater scrutiny that may requires more time consuming in carrying out the audit works compared to firms with non-Bumiputra CEO. Similarly, Gomez and Jomo (1997) and Johnson and Mitton (2003) also argued that company controlled by Bumiputra are politically connected company thus perceiving to have poor corporate governance and high agency problems influencing the auditor's risk assessments leading towards high audit fees charged.

In addition, a prior study conducted by Che Ahmad and Houghton (2001) argued that Chinese business practices may influence difference levels of agency problems and risks. Che Ahmad (2001) also added that ethnicity of shareholders has also influence the audit

pricing where the business structures and practices are different within Chinese, Bumiputra and foreign-controlled companies. He added that Chinese controlled companies pay lower audit fee due to lower agency conflict hence lowering the operational risk and lessen the extensive audit. Meanwhile, he also found that for foreign-controlled companies they pay the highest audit fee since it requires high audit quality in order to reduce the problem of parent-companies being located far away and also demanding high level of monitoring.

2.3 Audit Fees and Corporate Governance

Several studies have been conducted to test the relationship between the audit fees and corporate governance and the result are mixed. These have been supported by Griffin, Lont and Sun (2008), where the findings show that corporate governance has both positive and negative impact towards the audit fees. The study documented that audit services fee tend to be higher regarding to the requirement of high audit quality due to external factor changes in expected liability and other mechanism to attain better governance thus requiring greater auditing. On the other hand, fee charged will be lower due to the auditors reducing the price of risk to reflect the benefit for better governance. This means that by having good corporate governance the impact on the fees charged towards the companies show how efficient the company is being managed.

A good corporate governance consist of efficient and effective committees formed by the boards to assist them. MCCG 2012 has suggested that a new committee should be form in order to improve the performance of the company based on their nature of business.

According to Bell et al. (2001) audit fees charged to the riskier companies are far greater compared to companies which has less risk. This is because the external auditor need more time to audit the companies which have higher risk due to lots of procedure that needs to be done. Directly the fees charged towards the companies also increased. Therefore, a company with effective committees may charged with lower audit fees.

In contrast, an effective committee in a good corporate governance has high level of assurance and monitoring system in the company. This argument is aligned with a research conducted by Hay, Knechel and Ling (2008) which shows that measures of concentration ownership, corporate governance and internal auditing are positively related to audit fees when complementary controls view is applied. In a similar view, Zaman, Hudaib and Haniffa (2011) found that effective committees leads toward higher audit fees charged due to more monitoring which needs wider audit scope to be done. While having effective committees such as the risk management committee, may improve strategies of managing risk and enhance corporate governance. Audit fees charged to the company may be higher since the auditor may require longer time or/and more audit work for the audit engagement.

2.4 Conclusion

The preceding sections have provided a summary of the relevant studies conducted by previous researchers on audit fees and risk management committee. It is noted that the studies on audit fee have been conducted extensively by earlier researchers but there is no (until to date) published study regarding the effect of characteristics of risk management

committee on audit fees. The next chapter provides a discussion on the research framework which lead towards the hypotheses development and the method use in this study.

CHAPTER 3 : HYPOTHESES DEVELOPMENT AND METHODOLOGY

Chapter 2 discusses the relevant literatures on risk management committee, audit fees and determinants of audit pricing in the company while for Chapter 3, it focuses on these issues in more detail and develop the hypotheses that are eventually tested. The first section discusses the agency theory and the theoretical framework was developed based on this theory. Method used in the study is also discuss togather with the conclusion at the end of the chapter.

3.1 Agency Theory

According to Jensen and Meckling (1976), agency theory is the contractual relationships which the principal engages the agent to provide services on their behalf. Within this agency relationship, agency problems between shareholders (principal) and management (agent) usually arise from a combination of asymmetric information and differences in sensitivity to firm-specific hazard. In other words, the problem of risk sharing emerges due to the principal and agent having different actions toward the risk preference. Islam and Huq (2010), found that the agent is generally assumed to a risk-averter and the principal to be a risk-seeker.

Therefore, in order to reduce the agency problem that occurs in companies, good corporate governance and effective board sub-committee plays an important role in this situations (Harrison, 1987). Generally from an agency theory perspective, the risk management committee is consider as the authority whereby it act on behalf of the shareholders in assisting firms to understand and manage risks. Thus, the main role of the

risk management committee is to monitor the management involvement in riskier activities that may affect the firm's objectives as well as alerting management when such activities achieve towards unacceptable risk level. In addition, instituting separate risk management committee in a company enhance the effectiveness of the board to perform the role of monitoring and oversight role especially in aligning the two interest between agent and principal (Jiraporn, Singh and Lee, 2009; John and Senbet, 1998 and Klein, 1998). This is because, forming risk management committee may increase the transparency of the company by disclosing more information regarding the risk and provide better insight regarding risks towards shareholder. Reliability of information disclosed will lead towards high quality of financial reporting as well as reduce the agency cost of the company. Aligned with a study conducted by Patel, Balic and Bwakira (2002), it is found that timely and adequate disclosure of financial information can reduce the agency problem in corporate governance. Meanwhile, in Malaysia, Hassan (2008) supported that the formation of committee of risk management is related with higher disclosure quality of financial instruments.

Therefore, by having an effective committee in a company, it not only responsible in assisting the board but also reduce the agency problems that occur in the company. This has been supported by a study done by Dey (2008) stating that the level and intense of agency problem is less in those firms where board committee is more effective in terms of composition and functioning. Effective committees here refer to high level of independence which is aligned with Jensen and Meckling (1976) who stated that independent board are more effective than insiders in terms of managerial monitoring.

Similarly, agency theory suggests that independent of committee members is one of the factor that influence the committee effectiveness (Carson, 2002).

In addition, diverse boards in terms of gender, ethnicity or cultural also leads toward high level of effectiveness in the sense that they may ask questions or provide solutions that are not seen or justify by inside directors with similar backgrounds or experiences (Arfken, Bellar and Helms, 2004). Furthermore, there is a significant influence towards board effectiveness through monitoring policy due to women's presence in the board. Thus, in general this study is expected that by forming risk management committee may help the company to reduce the agency problems and at the same time reduce the agency cost incurring in the company. Therefore, due to high level of monitoring, risk management committee may request for higher level assurance of audit engagement from auditor and this will lead towards higher audit fees charged.

3.2 Theoretical Framework

Risk management committee plays an important role in assessing risks especially in finance companies yet, several prior studies have been carried out on risk management committee (Beasley et al.,2005; Subramaniam et al., 2009) especially in Malaysia (Yatim, 2009; Yatim, 2010; Ng et al., 2013; Md Yusof & Ishak, 2013). Company with risk management committee as one of the board committees shows that, it focus more on consciousness of risk management and control whereby it is aligned with the risk-based approach (COSO, 2004).

A study done by Yatim, Kent and Clarkson (2006) found that governance structure, especially establishment of risk management committee lead towards high quality of financial reporting. In addition, characteristics of the subcommittees are also likely associated with the effective monitoring of the function of the committees (Kallamu, 2015). Specifically, this study predicts that forming risk management committee especially separate risk management committee has a positive relationship with audit fees. Liew, Mat Zain and Jaffar (2012) had also found that formation of separate risk management committee improve the performance of the company in managing the internal and external risks. As separate risk management committee relies on more audit engagement from the auditor to detect and manage the risks effectively, audit fees to be charged by the auditor to the company will be higher.

In addition, higher proportion of independence, expertise and presence of women in risk management committee also may cause higher audit fees charged. This is due to the characteristics of effective committees whereby the more independence, expert and with the presence of women director in the committee the more higher the level of monitoring is required (Carcello and Neal, 2000; Yatim, 2009; Ittonen and Peni, 2011). Wider audit scope due to more high monitoring carried out by the committee of risk management will lead to higher audit fees to be charged.

Dependent variable in this study is the audit fees and may be explained independent variables that might affect the audit services fee charged to the company which are the existence of separation of risk management committee, independence, expertise and gender diversity in risk management committee. The link between these variables are shown in Figure 3.1.

3.3 Hypotheses Development

3.3.1 Separation of Risk Management Committee

Risk management committee plays a vital role in an organization with high risk in nature. Therefore, it has specific responsibilities, but not limited to the supervision and approval of the enterprise risk management framework of the company. The components of risk management in an organization usually comprises of oversight risk, common risk infrastructure accessed together with the people process using the technology, risk management activities and identification of the risk classes (Deloitte, 2014). Based on the agency theory, this study argues that the establishment of RMC will be able to safeguard the investors'/shareholders' interests through its supervising responsibilities on the management's actions regarding detecting and assessing risks.

Subramaniam et al. (2009) argued that a separate risk management committee lead towards higher quality of risk reporting and thus lower organizational complexity. By having a separate risk management committee, the committee focuses more on detecting the risks as well as managed the risk in order to enhance the quality of financial report. Separate risk management committee required auditor to perform more audit engagement as well as demand for high level of monitoring in their audit scope. Thus, external auditor required more attention towards the financial report and longer time are consumed. Hence, higher audit fees be charged towards the company.

Md Yusof & Ishak (2013) added that the formation of a separate risk management committee reduce the probability of the company to receive modified audit report due to high quality of financial reporting. Therefore, the study supported that the company with

superior internal control from the aspect of risk management are probably increase the monitoring from external auditors thereby lead towards higher audit fees. Hence, the following hypothesis is developed:

H1 : There is a positive significant relationship between audit fees and existence of separate risk management committee.

3.3.2 Independence of Risk Management Committee

A company can achieve its business objectives, enhance its financial reporting as well as safeguard its reputation through having an effective risk management system. A study conducted by Fama and Jensen (1983) found that board's oversight committee members which come from outside company or independent seem to be more effective and efficient due to a good reputation and expert people. In the Malaysian context, it is aligned with Malaysia's Central Bank requirement where it requires the risk management committee for insurance firms to be entirely composed by non-executive directors or at least one independent director which is the chairperson in risk management committee (Ng.et al., 2013).

It is said that, quality of oversight in risk management activities in a company are due to high proportion of outside directors sitting on the board. Carcello & Neal (2000) argue that the independence of the members in the committee will increase the reporting quality since this type of member usually tend to be more cling towards the laws, standard and requirements. This is aligned with MCCG 2012 which requires not only for audit committee but also other committee to have independence member sitting on the board.

This is also the same as the requirement of the Corporate Governance Council in Australia which explain that the majority of the board should be independent directors.

Hay and Knechel (2004) further added that an independent board more concerned about its monitoring role and, consequently, will put pressure on management to enhance the external audit role. Hence, this study is expected that greater independence members of risk management committee will seek more comprehensive audit in order to detect greater amount of uncertainty risks. Meanwhile, independence member of committee may also request for frequently meeting and as a consequence higher audit fees be charged towards the company. Thus, the following hypothesis is developed:

H2 : There is a positive significant relationship between audit fees and independence of risk management committee members.

3.3.3 Expertise of Risk Management Committee

Public Oversight Board (1993) states that, expertise of the members in terms of accounting and financial reporting, internal controls and auditing lead towards high performance of the committee. The argument shows that, the expertise of the members in the committee, especially in the area of accounting and finance lead towards high audit quality and detecting risk. This is because expertise such as knowledge and skill owned by the board (Lorsch, 1995) is important in governing the company. Therefore, the board is well trained in order to explain the risk management activities and are more active in risk management process. In line with a study conducted by Robert, McNulty & Stiles (2005) found that members with qualification and academic background from

accounting, finance or profession as well as specific knowledge in particular industry allows them to have better understanding on the company issues and problems. Thus, there is a significant relationship between the directors's ability in managing a firm's risk and the level of director's financial knowledge (Dionne and Triki, 2005).

Meanwhile, by having expertise members in risk management committee it can improve the effectiveness in detecting and managing the risks due towards their qualification, educational background and knowledge. Zaman et al. (2011) also added that, expertise member of committee demand more monitoring activities resulting in extensive audit work and higher audit fees. Therefore, it is predictable that there is a positive relationship between expertise of risk management committee with audit fees. Hence, leads to the following hypothesis :

H3 : There is a positive significant relationship between audit fees and expertise of risk management committee members.

3.3.4 Gender Diversity in Risk Management Committee

Another characteristic of risk management committee that may affect the audit fee charged towards the company is gender diversity. Gender diversity here refers to male or female committee members. According to Fondas and Sassalos (2000), the functioning and efficiency of corporate boards and committees are affected by gender diversity. This indirectly shows that, there is a significant influence on the effectiveness of board due to the presence of women especially in monitoring activities. A prior study conducted by Adam and Ferreira (2009) using sample of United States firms indicates that, the

presence of women in boards are likely to have better attendance record and are more likely to join monitoring committee. This is supported by a survey conducted on women boards in Turkey in 2014 whereby it found that women directors are increasingly to serve as chairs on Corporate Governance Committees, Audit Committee and Risk Committee (Ararat and Alkan, 2014).

Burke and Mattis (2000) added that, women in board also usually comes from various background such as marketing, technology, human resources and finance which brings more diversified work and career experiences to the boardroom. Since men and women behave differently in terms of planning, group decision-making and risk tolerance it may affect the audit fees charged to the company.

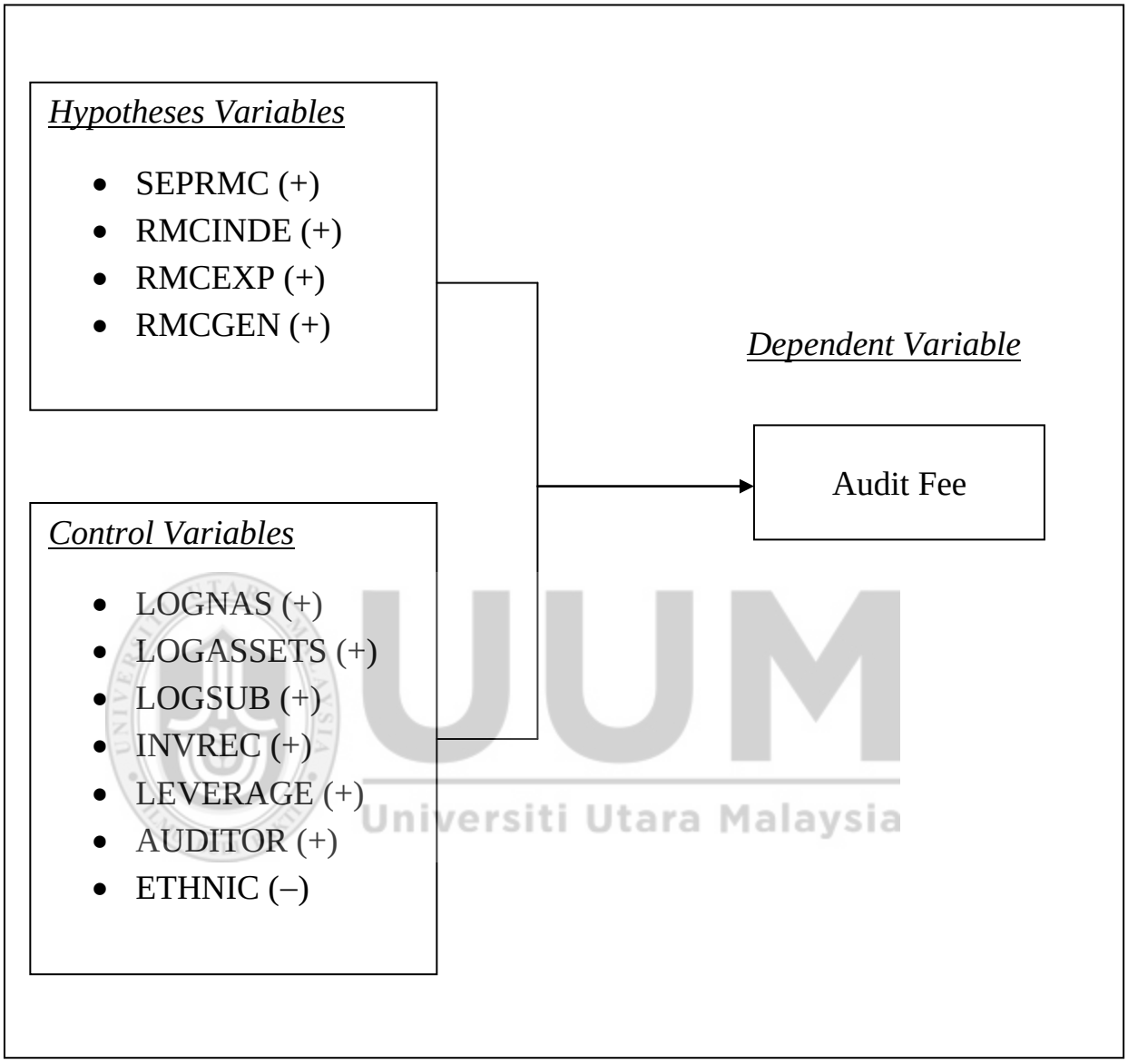
According to Jenilek and Adler (1988), greater communication of information happens in an environment where there are occurrence of women in boards. Thus, it is assume that women directors are likely to engage auditors to the auditing process creating an atmosphere that lead towards greater effort from auditors. Indirectly the implication from the situation is that the auditor is required to have higher level of assurance and more work which comprises of planning, risk assessment, conducting the audit and evaluating the result including issuing the report. Therefore, this may increase audit fees charged to the company.

In addition, another study found that women are more risk-averse and seek greater clarity especially in decision making (Brooks and Zank, 2005), thus they demand higher audit effort and scope of auditing in order to protect the company from legal liability especially for risky companies. Therefore, it is expected that by having female members in the risk

management committee it increase the quality of risk reporting. This is due to the extensive audit work required thus leads towards higher audit fees charged. Hence, the subsequent hypothesis is developed:

H4 : There is a positive significant relationship between audit fees and gender diversity in risk management committee.

Figure 3.1 Theoretical Framework



3.4 Methodology

This section discuss on the sample selection and data collection process. Then followed by a discussion of the model and the measurement of the variable used in the model. Lastly, summary of the research design is provided at the end of this section.

3.4.1 Sample and Data

The association between risk management committee and the audit fees was examined using the population of all companies listed on Bursa Malaysia in the year 2014. Table 3.1 below present the sample selection of the companies.

The study utilized all public listed companies on Bursa Malaysia, totaling to 810 companies. Companies listed under banking and financial institution (39 companies) are excluded due to the regulations and nature of these companies which significantly diverse from the non-financial companies and is consistent with the previous studies (see for example Firth, 2002; Md Yusof and Ishak, 2013). In addition, 9 companies with incomplete information and 554 companies which not stated whether it has form a separate or a combined risk management committee, was dropped from the sample list. The total amount of 208 companies which forms the risk management committee are the final sample of this study. Out of the 208 companies, 141 companies were found to form a separate risk management committee while a balance of 67 companies form a combined risk management committee together with the audit committee.

Table 3.1
Sample Selection of Companies for the year 2014

	TOTAL
Total companies listed on Bursa Malaysia 2014	810
(–) Finance companies	(39)
(–) Companies with incomplete financial data and unavailable annual reports (current or prior-year)	(9)
(–) Companies which not stated whether it form separate or combined RMC	(554)
TOTAL SAMPLE	**208**
Companies with separate RMC	161
Companies with combined RMC	67
TOTAL SAMPLE	**208**

Majority of these 208 companies are from trades and services (72 companies), industrial products (54 companies) and consumer products (26 companies). The remaining are in the sectors property (25 companies), construction (12 companies), plantation (10 companies), technology (8 companies) and a company from the hotel sector. Table 3.2 shows the distribution of the companies listed in Bursa Malaysia which form risk management committee across industry groups for the year 2014.

From the perspective of an industrial sector (as shown in Table 3.2), during 2014, the highest percentage of company which form risk management committee is in the Trading and Services sector with a percentage of 34.6, followed by the Industrial Product sector by 26 percent. However, no risk management committee was found within the Mining and Infrastructure sectors. This study assumes that there was no risk management committee found in this two sectors due to the nature of the business of these sectors that less riskier compared to the other sectors. Thus, forming the risk management committee does not give any impact to the company. This is aligned with a study conducted by Wallace and Kreutsfeldt (1991) which found that different industries have different level

of business risk, however, industries related to banking, education and insurance are the ones having riskier compared to the other industries.

Table 3.2
Industry Classifications of Risk Management Committee in Companies for the year 2014

	2014	
Industry	Frequency	%
Consumer Products	26	12.5
Industrial Products	54	26
Construction	12	5.8
Trading / Services	72	34.6
Hotel	1	0.5
Plantation	10	4.8
Mining	0	0
Technology	8	3.8
Infrastructure	0	0
Property	25	12
TOTAL	208	100

The process of data collection involved are by sorting information needed from annual reports of the 208 companies which form the risk management committee. The one-year period 2014 was chosen based upon the most recent annual reports available within the Bursa Malaysia during the study and together with the introduction of the Malaysian Code on Corporate Governance regarding the announcement of formation risk management committee in 2012.

The following information was extracted from the annual reports of each of the companies: name of individual directors that sit in the risk management committee, qualification of risk management committee members, gender of risk management committee members and names of auditors employed by these companies. On the basis of this information, it was possible to identify companies which form risk management committee for the year 2014. The collection of data regarding the characteristics of risk

management committee was done by examining the details of the directors' profile in the annual reports regarding the independence, expertise and the gender of the directors.

3.4.2 Data Analysis and Model Specification

The final sample comprises of 208 public listed companies where 141 companies formed a separate risk management committee while the other 67 companies has a combined risk management committee together with the audit committee over the one year period in 2014. Hypotheses H1, H2, H3 and H4 examines the existence of committee of risk management and the characteristics of the committee through independence, expertise and gender diversity of the observed companies for the specified period which is year 2014. Based on the hypotheses, a regression model was used in order to test the relationship between characteristics of risk management and audit fee.

In testing the hypotheses, this study extended and replicated the well-established audit-pricing model from Simunic (1980) and other models in Malaysia. The OLS model was used in order to analyse the data since it has been employed broadly in the audit pricing literature (see, e.g. Simunic, 1984; Palmrose, 1986; Francis & Stokes, 1986; Francis & Simon, 1987; Che Ahmad, Shafie and Mohamad Yusof, 2006). In this study, four additional variables are introduced which are SEPRMC, RMCINDE, RMCEXP and RMCGEN.

The research model is as follows:

$$LOGFEE = \beta_0 + \beta_1 SEPRMC + \beta_2 RMCINDE + \beta_3 RMCEXP + \beta_4 RMCGEN + \beta_5 LOGNAS + \beta_6 LOGASSETS + \beta_7 LOGSUBS + \beta_8 INVREC + \beta_9 LEVERAGE + \beta_{10} AUDITOR + \beta_{11} ETHNIC + e$$

Where (the definition of the variables is set out below, the specification of the measures follows later in this chapter)

Dependent Variable

LOGFEE = Natural log of total audit services fee of group level

Hypotheses Variables

SEPRMC = A dummy variable coded 1 if the company has separate RMC, 0 otherwise.

RMCINDE = number of RMC independence members

RMCEXP = RMC expertise 1, with financial background and 0 otherwise

RMCGEN = RMC gender diversity 1, if female otherwise 0

Control Variables

LOGNAS = Natural log of the NAS fees

LOGASSETS = Natural log of total assets

LOGSUBS = Natural log of the number of consolidated subsidiaries

INVREC	=	Total inventories and account receivables to total assets
LEVERAGE	=	Total debt to total assets
AUDITOR	=	Indicator variable having a value of 1 if the auditor is the Big Four firm and 0 if otherwise
ETHNIC	=	Total ethnic Chinese directors on the board
e	=	Error term
βi	=	constant (i = 0), regression coefficients (i = 1, 2, 3, …, 11)

3.4.3 Explanation and Measurement of Variables

3.4.3.1 Dependent Variable for the Audit Fees Model

Consistent with prior study by Yatim et al. (2006) the OLS audit fees model was used to test all the hypotheses. Audit fees are measured by the logarithmic transformation of Ringgit Malaysia value of the audit fees paid to its auditor.

It is expected that audit fees charged towards the company may be vary due to different auditor characteristics. The variable of audit fees has also been discussed under explanatory variables in the non-audit services. This is because audit fees may also be affected by the NAS due to occurrence of knowledge spillovers. This is supported by prior studies done by Palmrose (1986) and Simunic (1980) which found that there is a positive significant relationship between NAS and audit fees.

3.4.3.2 Hypothesis Variables

Existence of Separate Risk Management Committee (SEPRMC)

A separate risk management committee can be identified when the committee has a single committee with a title of 'Risk Management Committee' without any combination with any other committee including the audit committee. The other hand, any combination of chores and responsibility of the risk management with other committees' tasks is considered as a combination of the risk management committee. In the study, if the company has a Separate Risk Management Committee, '1' is coded and if a company has a Combined Risk Management Committee, it is coded as '0'. This criterion has been used by previous studies such as Subramaniam et al. (2009), Yatim (2009), Md Yusof and Ishak (2013) and Sekome and Lemma (2014).

Independence of Risk Management Committee members (RMCINDE)

The number of independent non-executive members sitting in the risk management committee is reflecting the independence of RMC. The information can be accessed through the directors' profiles and the composing of the risk management committee in the company's annual report. The number of independent non-executive members is divided by the total number of risk management committee members and then the proportion number is generated for further analysis (see Fama & Jensen, 1983; Farinha & Viana, 2009; Pucheta-Martinez & Fuentes, 2007).

Expertise of Risk Management Committee members (RMCEXP)

For the risk management committee expertise, this kind of information can be found in the directors' profile by analysing the qualification of the risk management committee members. In this study, expertise was measured through the financial educational background of the risk management committee members and their academic level with at least a bachelor's degree and above. It is coded as '1' if the member of the risk management committee has a financial background and 0 if otherwise (Yatim, 2009).

Gender Diversity in Risk Management Committee (RMCGEN)

Gender diversity of risk management committee which is used in this study can be measured by looking at the number of two gender categories which are men and women and the balance of distribution of board members among them (Vera & Martin, 2011) in the risk management committee. However in this study it is focussed more on the existence of women in the risk management committee members. In this study, if women are presence in risk management committee, it is coded as '1' and if there is no presence of women in the committee '0' is coded.

3.4.3.3 Control Variables

The purpose of this study is to examine the effect of risk management committee characteristic on audit fee charged to the company. However, other variables related to audit fee will need to be controlled in the model since they have been argued and found to have significant effect on the models from previous studies (refer to Che Ahmad et

al.,2006; Yatim et al.,2006). The control variables are discussed on the non-audit services fee, auditee size/total asset, inventory and receivable, number of companies in the auditee's group, leverage, auditor and ethnicity.

Non-Audit Services Fee (LOGNAS)

In line with study done by Parkash and Venable (1993), that used OLS and logarithmic transformation is applied to non-audit services fee. Non-audit services fee is fees paid by the firm to its auditor for services other than audit service. In the audit fee model, NAS is said to has a probable significant relationship with the audit fees and it is valued by the Ringgit Malaysia. The US Securities And Exchange Commission's purpose in requiring the fee disclosures is to provide investors with information to evaluate "whether the proportion of fees for audit and non-audit services causes them to question the auditor's independence" (Securities and Exchange Commission 2000, Section III.c.5). Simunic (1984) models and DeAngelo (1981) found that joint demand for non-audit and audit services can impair the independence of the auditor due to the economic bond between the auditor and the client.

Auditee Size / Total Asset (LOGASSET)

Client size is measured by the total assets of a company in the current year. According to Courtney and Jubb (2001), an increase in auditee size will increase the likehood for the auditee to choose brand name auditors. This is because when the firm size increase it will lead towards high risk and face higher difficulty in monitoring the management thus requires independent auditor to rely upon. Therefore, it is expected that the size of auditee has a significant positive relationship with audit fee since larger auditee require more

audit effort and work (Ji-Hong, 2007). Logarithmic transformation of total asset was used to control the non-linear relationship between audit fee and client size.

Inventory and Receivable (INVREC)

Auditee were found to more likely to choose an auditor most capable of dealing with a certain complexity (Courtney and Jubb, 2001). Auditee's complexity can be measured as the ratio of inventory and receivables to total assets. According to Hay et al. (2006), INVREC is predicited to have a significant positive association with the audit fees model. This is because, a large amount of inventory and receivables requires a company to demand additional services from its auditors (Antle, Gordon, Narayanamorthy and Zhou, 2006).

Number of Companies in the Auditee's Group (LOGSUB)

Complexity of the auditee is measured by using a logarithmic transformation of the number of companies in the auditee's group (LOGSUB). This is consistent with the finding by Woo and Koh (2001) who suggest that complexity of the firms can be determined by examing the numbers of subsidiaries as well as the number of industrial sectors that it operates in. LOGSUB is predicited to have a significant positive association with the audit fees model. Previous studies in Malaysia by Che Ahmad et al. (2006) and Yatim et.al (2006) also found a significant positive relationship between the number of subsidiaries and audit fees. Companies with a large number of subsidiaries and are more complex business operated requires additional costs to the auditor due to larger scope of auditing work thus leading towards high audit fees charged (Craswell and Francis, 1999).

Leverage (LEVERAGE)

Leverage is measured by the proportion of total debt to total assets. Leverage act as a proxy of agency cost and business risk since the higher the leverage the higher agency cost and business risk. In audit fee service model, leverage is expected to have a significant positive relationship (Francis and Stokes,1986; Yatim et al., 2006; Low et al.,1990). Highly leverage company which is more risky in term of business risk leads towards high demand of audit quality service thus increasing the amount of audit fee charged. Hence, leverage can be considered as the proxy of the company risk. Therefore, it is said to have a positive and significantly linked to audit fees.

Auditor (AUDITOR)

According to Simon and Francis (1988), audit firms can be classed into two categories which are the Big Four (brand name) and the non-Big Four (non-brand name auditor). A dummy variable 1 is coded, if the auditor is Big Four and 0, if the auditor is non-Big Four is used. The Big Four audit firms (and affiliates) comprises of PwC (Jaafar Hussein), Ernst and Young (Hanafiah Raslan Mohamad or HRM, Lim Ali and Co.), KPMG Peat Marwick (KPMG Desa Megat), and Deloitte and Touché (Kassim Chan and Co.).

In the audit fee model, Big Four audit firms is expected to be positively significant due to their high audit quality as well as audit engagement which allows them to charge higher cost or premium audit fee (Firth, 2002; Ji-Hong, 2007). Past studies conducted in the US (e.g. Palmrose, 1986; Francis & Simon, 1987) and additionally in the Malaysian business

sectors (Che Ahmad, 2001) show a positive relationship between the Big Four firms and audit pricing. This is due to Big Four's reputation effect.

Ethnicity (ETHNIC)

The ethnic factor is used to control the effect of ethnicity due to difference in business structure and practices between Chinese, Bumiputra and foreign-controlled companies. In this study, ethinicity is measured by examining the number of Chinese Board of Director sitting in the board. According to Che Ahmad (2001), ethnic business practice affects audit pricing in the client business. It is reported that the most minimal audit fees were paid by the local Chinese companies compared to foreign and Bumiputera owned companies. The reasons are due to the difference level of agency conflict and risks connected that are closely linked with the audit quality demanded.

3.4.4 Summary of the Variable Description

Table 3.3 provides a summary description of the variables as well as the data source and the measures used in this study. All explanatory variables for audit fee were used in the audit fee model.

Table 3.3 Summary Variables, measures and data sources

No	*Variables*	*Type*	*Expected Sign*	*Measures*	*Data Sources*	*Data Needed*
1	Audit Fee	Dependent	d.v	Logarithmic transformation of Ringgit value paid to auditor for audit service	– Annual reports of sample firms, downloadable from the website of the Bursa Malaysia	– Income statement – Notes to the Financial Statement
2	Separate RMC	Independent	Positive (+)	Dummy variable where if the company has a separate RMC, it is coded as '1' and if a company does not have a separate RMC, the value of '0' is coded	Annual reports of sample firms, downloadable from the website of the Bursa Malaysia – Statement of Corporate Governance – Statement on Risk Management and Internal Control	– Corporate information
3	Independence RMC	Independent	Positive (+)	Number of independence directors of RMC members	Annual reports of sample firms, in the section of: – Biography and background of Board Members	– Total number of independence board in RMC members

Table 3.3 (Continued)

4	Expertise RMC	Independent	Positive (+)	Dummy variable where if the members of RMC has accounting and financial background, it is coded as '1' and 0, if otherwise.	Annual reports of sample firms, in the section of: – Biography and background of Board Members	– Total number of RMC member who has financial and accounting background
5	Gender Diversity RMC	Independent	Positive (+)	Dummy variable where if the members of RMC is women it is coded as '1' and 0, if otherwise.	Annual reports of sample firms, in the section of: – Biography and background of Board Members – Notes to Financial Statement	– Total number of women board members in RMC – Total number of board members in RMC
6	NAS	Control	Positive (+)	Logarithmic transformation of Ringgit value paid to auditor for non-audit service	Annual reports of sample firms, downloadable from the website of the Bursa Malaysia – Audit Committee Report	– Notes to the Financial Statements

Table 3.3 (Continued)

7	Auditee Size	Control	Positive (+)	The natural logarithm of total assets	– Annual reports of sample firms, downloadable from the website of the Bursa Malaysia	– Balance sheet
8	Auditee Complexity	Control	Positive (+)	– The numbers of subsidiaries measured by logarithmic transformation of total subsidiaries and holding company – Proportion of total account receivables and inventories over total assets	– Annual reports of sample firms, downloadable from the website of the Bursa Malaysia	– Balance sheet

Table 3.3 (Continued)

9	Leverage	Control	Positive (+)	The proportion of total debt to total assets.	–	Annual reports of sample firms, downloadable from the website of the Bursa Malaysia	– Balance sheet
10	Auditor	Control	Positive (+)	Dummy variable 1 is coded, if the auditor is Big Four and 0, if the auditor is non Big Four.	–	Annual reports of sample firms, downloadable from the website of the Bursa Malaysia.	– Corporate information
11	Ethnicity	Control	Negative (–)	Number of Chinese Board of Director sitting on the board.	–	Annual reports of sample firms, downloadable from the website of the Bursa Malaysia.	– Total number of Chinese Board sitting on board.

3.5 Conclusion

The preceding sections have discussed the research framework which leads towards the hypotheses development. The presence of a separate risk management committee, characteristics (independence, expertise and gender diversity) of risk management committee members are expected to have an influence on the audit fees charged to the company. All the hypotheses variables are expected to have positive relationship with the audit fees since it is argued that by having a separate risk management committee, independence, expertise and gender diversity in risk management committee it improve the risk management of the company. The risk management committee is expected to demand more audit engagement and monitoring from auditors due to risks that occur in the company. Therefore, it will increase the audit fees.

This chapter also justifies the methodology used for the purpose of achieving the research objectives and answering the research questions. The next chapter discusses the results from the regression model.

CHAPTER 4: RESULTS AND DISCUSSION

4.1 Introduction

This chapter discusses the results from the analyses conducted based on the model identified earlier in the previous chapter. The results are divided into two subsections which are the main analysis and the further analyses. The chapter begins with the descriptive analysis. The next section provides analyses of multicollinearity, normality test, heteroskedasticity, autocorrelation and followed by the OLS analysis. Results for further analyses are presented later in this chapter. The final section is the conclusion on the discussion of the results of the model.

4.2 Descriptive Analysis

As discussed earlier in the previous chapter, the sample of this study consists of all companies listed in the Bursa Malaysia for the year 2014, excluding the banking and financial sectors, which comprises of 762 companies. Out of the 762 companies, a total amount of 208 companies are found to have formed risk management committee in their organization.

Table 4.1 presents the descriptive statistics for the continuous variables, which explains the minimum, maximum, mean and standard deviation of the variables in the model and Table 4.2 presents descriptive statistics for the dummy variables for the entire sample. The mean for independence of risk management committee members is 2.01 with a minimum of 0 and maximum of 5 with the overall standard deviation of 1.095 for the

year 2014. Minimum amount of leverage is comes from Hibiscus Petroleum Berhad and maximum amount is from Perwaja Holdings Berhad. The amount of audit fees ranging from RM19,500 to RM6,600,000 comes from Pansar Berhad and the latter from Sime Darby Berhad with an average of RM479,287. This is found to be much higher than the amount reported by Yatim et al. (2006) with an average fee of RM191,975. In addition to this, 174 companies (84 percent) purchased non-audit services while only 34 companies (16 percent) did not purchase any non-audit services. The average non-audit services fee amounted to RM212,125 with the highest non-audit services fee recorded comes from Telekom Malaysia Berhad which is RM5,000,000.

Table 4.1
Descriptive Statistics on Continuous Data, N= 208

Variable	Minimum	Maximum	Mean	Std. Deviation
LOGFEE	4.290	6.820	5.401	0.437
RMCINDE	0.000	5.000	2.010	1.095
LOGNAS	0.000	6.699	3.904	1.866
LOGTA	7.291	11.044	8.889	0.698
LEVERAGE	0.024	0.998	0.410	0.229
INVREC	0.001	0.958	0.290	0.196
LOGSUB	0.000	2.017	0.870	0.408
ETHNIC	0.000	12.000	4.000	2.592
Audit Fees (RM)	19,500	6,600,000	479,286.93	861,999.70
Non-audit Fees (RM)	0	5,000,000	212,125.66	641,729.54
Total Assets (RM'000)	19,530	110,665,400	3,377,078	101,321,185
Subsidiary (number)	1	104	11.75	14.474

[a] The last four (4) variables are not variables of interest (i.e. they are not in the models) but are included to provide further insight into the behavior of Malaysian business practices.

LOGFEE	= Natural logarithm of audit fees
RMCINDE	= Number of independece member in RMC
LOGNAS	= Natural logarithm non-audit services fee
LOGTA	= Natural logarithm of total assets
LEVERAGE	= Total debt to total assets
INVREC	= Total inventories and account receivables to total assets
LOGSUB	= Log10 of the number of subsidiaries
ETHNIC	= Total ethnic Chinese directors on the board

The amount of total assets from the total sample range from RM19,530,000 to RM110,665,400,000. The mean asset size is RM3,377,078,000, with a standard deviation of RM101,321,185,000. The descriptive statistic of the sample companies also showed that the mean value for the number of subsidiaries is 11.75, with the maximum number of 104 subsidiaries and a standard deviation of 14.474.

Meanwhile Table 4.2 shows that from the total sample of 208, 67.8 percent of the sample has formed a separate risk management committee, which is found to be much higher than those documented by Md. Yusof and Ishak (2013) of 48.8 percent for the year 2004 until 2009. While the balance of 32.2 percent formed a combined risk management committee. 74 percent of members of the risk management committee have financial background while another 26 percent did not have any financial background. In addition, from the analysis conducted only 19.7 percent of the sample companies have female members in their risk management committee, while another 80.3 percent is dominated by male. Larger percentage of companies have employed brand name auditors (129 companies) as compared to companies which employed non-brand name auditors with a percentage of 38 percent (79 companies).

Table 4.2
Descriptive Statistics on Dummy Data, N= 208

Variable		Frequency	Percentage
SEPARATE	Separate RMC	141	67.8
	Non-separate RMC	67	32.2
EXPERTISE	With financial background	154	74
	Non-financial background	54	26
GENDER	Female	41	19.7
	Male	167	80.3
AUDITOR	Big4	129	62
	Non-Big4	79	38

4.3 Multicollinearity Test

Multicollinearity test explains the level by which one variable's effect could be managed by other variables (Hair, Anderson, Tatham and Black, 1995). Pearson correlation and Variance Inflation Factor (VIF) are conducted under this multicollinearity test.

4.3.1 Pearson Correlations Analysis

According to Asteriou and Hall (2007), correlation analysis has been used to explain the level of relationship between one variable to another variable. Pearson correlation indicates that for those variables which do not have any relationship with other variables the correlation estimation between the variables is 0, while for a correlation equals +1 indicates a perfect positive relationship. In contrast, correlation equals to -1 means it has a perfectly negative relationship (Pallant, 2010).

Table 4.3 below presents the correlation matrix between the variables for the audit services fee model. The correlation matrix reveals that few variables are significantly correlated with each other. Among the independent variables, correlations are found to be

less than 0.5 except for correlation between SEPRMC and RMCINDE (0.559). Overall, as shown in the table, all the correlations are found to be less than 0.80, which indicates that there are no serious multicollinearity problem in the regression. This is aligned with Zainal Abidin, Mustafa Kamal and Jusoff (2009) and Firth (1997) which have used 0.8 as a threshold for possible multicollinearity.

Table 4.3 : Correlation Matrix for Dependent and Independent Variables

Pearson Correlation Coefficients of Variables (Sample= 208)

	SEPRMC	RMCINDE	RMCEXP	RMCGEN	AUDITOR	LOGNAS	LOGTA	LEVERAGE	INVREC	LOGSUB	ETHNIC
SEPRMC	1.000	-0.559*	-0.150*	0.135	-0.094	0.040	0.030	0.082	-0.012	0.177*	0.041
RMCINDE		1.000	0.276**	-0.026	0.061	0.018	0.111	0.046	-0.057	-0.005	-0.117
RMCEXP			1.000	-0.175*	0.101	-0.040	-0.034	-0.044	0.001	-0.060	-0.016
RMCGEN				1.000	-0.060	0.125	0.021	-0.075	-0.142*	-0.004	-0.094
AUDITOR					1.000	0.197**	0.330**	-0.009	-0.156*	-0.007	-0.136*
LOGNAS						1.000	0.338**	0.083	-0.161*	0.223**	-0.017
LOGTA							1.000	0.341**	-0.322**	0.330**	-0.072
LEVERAGE								1.000	0.050	0.046	0.004
INVREC									1.000	-0.069	0.124
LOGSUB										1.000	0.113
ETHNIC											1.000

**Correlation is significant at the 0.01 level (2-tailed)

*Correlation is significant at the 0.05 level (2 tailed)

4.3.2 Variance Inflation Factor (VIF)

In order to ensure whether high collinearity exists among the independent variables or not, a test of Variance Inflation Factor (VIF) was conducted. It states that when the tolerance value is below 0.10 and VIF is greater than 10, high collinearity exists and therefore, needs to be addressed (Healy, 2002).

As shown in the Collinearity table, the tolerance level for all variables is greater than 0.10 and the VIF values are less than 10 (see Table 4.4) which indicates that there are no serious multicollinearity problems exist.

Table 4.4
Collinearity Statistics

Variables	Tolerance	VIF
SEPRMC	0.623	1.605
RMCINDE	0.605	1.652
RMCEXP	0.875	1.143
RMCGEN	0.894	1.118
AUDITORS	0.815	1.227
LOGNAS	0.842	1.188
LOGTA	0.571	1.750
LEVERAGE	0.813	1.230
INVREC	0.841	1.189
LOGSUB	0.801	1.249
ETHNIC	0.934	1.071

[a] See Table 3.3 for the definition of the variables.

4.5 Normality Test

In order to determine whether the data is normal enough for further statistical test, normality test is conducted. Under this normality test, the main concern is the distribution of score on variables and this is conducted by looking at the value of skewness (symmetry of the distribution) and kurtosis (peakedness of the distribution). According to Klein (1998), the data is normally distributed if the value of skewness is less ±3 and the kurtosis does not exceed ±10.

Table 4.5
Normality Test for Audit Service Fees

Variables	Obs	Skewness	Kurtosis
LOGFEE	208	0.775	0.770
SEPRMC	208	-0.767	-1.426
RMCINDE	208	0.115	-0.360
RMCEXP	208	-1.105	-0.788
RMCGEN	208	1.534	0.356
AUDITORS	208	-0.499	-1.768
LOGNAS	208	-1.255	0.476
LOGTA	208	0.410	0.058
LEVERAGE	208	0.978	1.426
INVREC	208	0.857	0.464
LOGSUB	208	0.169	-0.019
ETHNIC	208	0.242	-0.565

[a] See Table 3.3 for the definition of the variables.

Table 4.5 presents the Statistical Package for the Social Science (SPSS) normality output of skewness and kurtosis for the audit fees model. Based on the results of the skewness

and kurtosis test, it shows that all the values of skewness are less than ±3 and the kurtosis does not exceed ±10 which indicate that the data is accurate and normal for further analysis.

4.6 Heteroskedasticity

This analysis uses the Breusch-Pagan test to confirm whether heteroskedasticity exists or not in the model. According to the Breusch-Pagan test, it states that if the Chi Square value is significant with the p-value below an appropriate threshold then null hypothesis of homoskedasticity is rejected and heteroskedasticity is assumed (Breusch & Pagan, 1979; Hayes & Cai, 2007). The result of the Breusch-Pagan test shows the presence of heteroskedasticity with a probability value of (0.0095) which is significant at a one percent level. Therefore, the results have been corrected using OLS-robust regression due to the problem of heteroskedasticity together with other results for further analyses.

4.7 Autocorrelation

The Durbin-Watson test is used to test for serial correlation between errors which is to ensure that autocorrelation does not exist in the analysis. According to Field (2009), it states that value closer to 2 is acceptable and indicates that autocorrelation problem does not exist. The Durbin-Watson test value for this study is 2.007 which is close to 2, thus it indicates that there is no severe autocorrelation among error terms.

4.8 Multivariate Analysis

The regression analysis was carried out in order to test the hypotheses on the relationship between the variables of the study. After cross checking the mulitcollinearity, normality, heteroskedasticity and autocorrelation of the data, the regression analysis was conducted. Table 4.6 presents the OLS regression results in testing the hypotheses. The model consists of the independent variables (SEPRMC, RMCINDE, RMCEXP and RMCGEN) and the control variables (AUDITOR, LOGNAS, LOGTA, LEVERAGE, INVREC, LOGSUB and ETHNIC) with audit fees as the dependent variable. The result shows that the model is significant at one percent significance level. The adjusted R-squared of the model is 0.7249 which is slightly higher than the previous studies by Che Ahmad et al. (2006) of 0.720 and Yatim et al.(2006) of 0.699 percent. As predicted, the results show the coefficients for variables RMCINDE and RMCEXP are positively significant (at a five percent and ten percent significance level). However, the coefficients for variables SEPRMC and RMCGEN are not significant.

Table 4.6

Multiple Regression Analysis for Audit Services Fee Model (N=208)

Variables	Expected Sign	Standardized Coefficients Beta	t	Sig.
SEPRMC	+	0.042	0.93	0.177
RMCINDE	+	0.039	1.93	0.028**
RMCEXP	+	0.056	1.42	0.079*
RMCGEN	+	0.013	0.34	0.368
AUDITORS	+	0.042	1.15	0.126
LOGNAS	+	0.023	2.41	0.008***
LOGTA	+	0.437	12.45	0.000***
LEVERAGE	+	0.144	1.44	0.075*
INVREC	+	0.132	1.46	0.072*
LOGSUB	+	0.173	3.76	0.000***
ETHNIC	–	-0.011	-1.78	0.038**
Constant		1.059	3.64	0.000
Adjusted R-square			0.7249	

* Significant at 0.10 (one-tailed)

** Significant at 0.05 (one-tailed)

***Significant at 0.01 (one-tailed)

[a] SEPRMC = A dummy variable coded 1 if separate RMC, 0 otherwise.
RMCINDE = Number of independence member in RMC.
RMCEXP = A dummy variable coded 1 if has expertise, 0 otherwise.
RMCGEN = A dummy variable coded 1 if female, 0 otherwise
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
LOGNAS = Natural logarithm non-audit services fee.
LOGTA = Natural logarithm of total assets.
LEVERAGE = Total debt to total assets.
INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

For the hypothesis variable of RMCINDE which represents the number of independent members sitting in risk management committee, the result is found to be statistically significant at a five percent level in a positive direction as predicted. The coefficient of 0.039 implies that the higher the number of independent non-executive members sitting in the risk management committee, resulting to an increase of the audit fees by 3.9 percent. Thus, this result is consistent with the previous study done by Hay and Knechel (2004) which argued that independent board will be concerned more in terms of monitoring, thus enhancing the external audit function. This can likewise be enforced in the risk management committee whereby, the more independent the members are, the more concerned these members will be towards the risks that may occur in the company since they are expected to prefer comprehensive risk management structure in order to complement their monitoring duties. Hence, independent risk management committee will be more interested in an extensive audit testing in order to minimize the risk of managerial thus, manipulation leading towards higher audit fees charged.

The RMCEXP is positively significant at a ten percent level with a beta coefficient of 0.056. This implies that, an increased in the number of expert members in risk management committee, there will be an increased in the audit service fees charged by 5.6 percent, on average. This suggests that risk management committee members with financial expertise background can provide more information and knowledge for external auditors as well as assist auditors to better understand the risk that occur in the company. Thus, this may lead to more audit procedures required that may increase audit fees charged. The result is consistent with the argument by DeZoort and Salterio (2001) which

states that board members with finance and accounting background have better understanding of auditing issues including risk awareness and risk detection.

For the control variables, in general, the results are consistent with the previous studies conducted in Malaysia and elsewhere (see eg. Che Ahmad, 2001; Che Ahmad et al., 2006; Yatim et al., 2006). Six (6) variables are found to have significant relationships with audit fees across the regression. As expected, variables such as LOGNAS, LOGTA, LOGSUB, LEVERAGE and INVREC are all positively significantly related to audit fees, whilst ETHIC is significantly negatively related to audit fees.

The significant and positive coefficient of LOGNAS implies that the higher the non-audit services fee, the higher the audit fees, which rejects the argument of knowledge spill-over effects and this is consistent with the argument of Davis et al. (1993), and Peel and Clatworthy (2001). In addition, the significant and positive coefficient of LOGTA, LOGSUB, LEVERAGE and INVREC indicate that the higher the asset size, number of subsidiaries and more complex the company lead towards more audit work is required thus, higher audit fees may be charged and this is aligned with a prior study done in Malaysia by Che Ahmad et al. (2006).

Meanwhile, the significant negative coefficient of ETHNIC is consistent with agency theory, whereby the higher the agency problem, the higher demand for audit work. This implies that the higher number of Chinese directors on the boards, the lower the audit fees, which supports the contention of low agency problem within Chinese-controlled companies as proposed by Che Ahmad (2001).

However, for control variable AUDITOR, it is found to be positive but not significant. This result is found to be contrary to other studies done on brand name auditors such as Firth (2002), Ji-hong (2007) and Che Ahmad et al. (2006). This may be due to the small sample size used for the purpose of this study.

4.8.1 Partition Analysis

In this partition analysis, from the total sample of 208 companies this study conducts a regression model separately on companies with the separate risk management committee (N=141) and companies with the combined risk management committee (N=67). As shown in the previous Table 4.3 out of 208 companies, 141 companies (67.8 percent) have formed a separate risk management committee, while the other 67 companies (32.2 percent) have non-separate or combined risk management committee. Thus, the regression analysis was carried out on these two data separately. Table 4.7 presents the regression results from the partition analysis.

From the result, it shows that for the 141 sample of companies which form the separate risk management it is found to be significant at a one percent significance level with an adjusted R-squared of 0.7924. Consistent with the main regression result, for separate risk management committee the hypotheses variables, RMCINDE and RMCEXP are found to be significant and positively related to the audit fees at a five percent and ten percent level respectively, while RMCGEN is insignificant. On the other hand, none of these hypotheses variables (RMCINDE, RMCEXP and RMCGEN) are positively significant with the audit fees for the combined risk management committee.

These provide evidence on the roles of independence and financial expertise of risk management committee on audit quality (proxy by audit fees) with regards to the separate the risk management committee compared to the combined risk management committee.

Table 4.7
Multiple Regression Analysis for Partition

		Separate Risk Management Committee (*N = 141*)		**Combine Risk Management Committee** (*N = 67*)	
Variables	**Expected Sign**	**Coefficient (t-value)**	**Sig.**	**Coefficient (t-value)**	**Sig.**
(Constant)		1.062 (3.04)	0.000	0.909 (1.61)	0.000
RMCINDE	+	0.043 (1.94)	0.027**	0.014 (0.31)	0.38
RMCEXP	+	0.617 (1.45)	0.075*	0.051 (0.60)	0.274
RMCGEN	+	0.427 (0.89)	0.187	-0.061 (-0.75)	0.227
AUDITORS	+	0.048 (1.14)	0.127	-0.021 (-0.27)	0.392
LOGNAS	+	0.019 (1.73)	0.043**	0.027 (1.35)	0.090*
LOGTA	+	0.442 (10.21)	0.000***	0.463 (7.55)	0.000***
LEVERAGE	+	0.118 (1.03)	0.152	0.176 (0.85)	0.199
INVREC	+	-0.006 (-0.06)	0.477	0.498 (2.45)	0.008***
LOGSUB	+	0.194 (3.54)	0.001***	0.133 (1.51)	0.068*
ETHNIC	–	-0.003 (-0.58)	0.282	-0.0209 (-1.25)	0.1085
Adjusted R-square		0.7924		0.5751	

* Significant at 0.10 (one-tailed)
** Significant at 0.05 (one-tailed)
*** Significant at 0.01 (one-tailed)

[a] RMCINDE = Number of independence member in RMC.
RMCEXP = A dummy variable coded 1 if has expertise, 0 otherwise.
RMCGEN = A dummy variable coded 1 if female, 0 otherwise
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
LOGNAS = Natural logarithm non-audit services fee.
LOGTA = Natural logarithm of total assets.
LEVERAGE = Total debt to total assets.
INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

4.9 Further Analysis

In order to examine the sensitivity of the result, further tests were carried out by using different measurements for the hypotheses variables and non-audit services fee. Their results are provided in Table 4.8, Table 4.10 and Table 4.12 for the total samples of 208 companies. In addition, further test for partition analysis was conducted and the results are provided in Table 4.9, Table 4.11 and Table 4.13.

Earlier in the study, it has been stated that the hypotheses variables used in the model are using dummy variables coded 1 and 0, while for non-audit fee it has been measured by using logarithm. Instead of using dummy variables, further analysis was conducted by using other types of measurement for the hypotheses variables as well as the measurement of non-audit services fee.

4.9.1 Proportion of RMCINDE, RMCEXP and RMCGEN

In order to get the proportion, the number of independence, expertise, and female members of risk management committee were divided by the total number of members in risk management committee. This measurement is consistent with a previous study conducted by Md Yusof and Ishak (2013) which also uses similar measurement in their model. For the total sample of 208 companies, the OLS regression result shows that the model is significant at a one percent level with an adjusted R-squared of 0.7227. From the result shown in Table 4.8, it revealed that only hypothesis variable of RMCEXP shows positive significant relationship with audit fees at a five percent significance level while the other hypotheses variables (SEPRMC, RMCINDE and RMCGEN) are

insignificant. Control variables such as LOGNAS, LOGTA and LOGSUB are all found significantly positive at a one percent level and for INVREC is found to be positively significant at a ten percent. While for ETHNIC, it is found to be negatively significant at five percent level.

In addition, further test was also conducted towards the partition analysis and the result is provided in Table 4.9 below. Regression result for the separate risk management committee shows that the model is significant at a one percent level with an adjusted R-square of 0.7849. Similar with the result of the total sample, only RMCEXP is found to be positively significant at a five percent significance level for the case of the separate risk management committee. However, none of the hypotheses variables are found to be significant for the combined risk management committee.

Table 4.8

Results of Further Analysis on the Audit Fees Model (Hypotheses Variables are Measured by Proportion, N= 208).

Variables	Expected Sign	Coefficient	t	Sig.
SEPRMC	+	0.0202	0.42	0.338
RMCINDE	+	0.013	0.16	0.435
RMCEXP	+	0.205	2.13	0.017**
RMCGEN	+	0.138	1.05	0.146
AUDITORS	+	0.044	1.22	0.112
LOGNAS	+	0.024	2.38	0.009***
LOGTA	+	0.435	12.55	0.000***
LEVERAGE	+	0.182	1.84	0.033**
INVREC	+	0.123	1.30	0.097*
LOGSUB	+	0.170	3.55	0.000***
ETHNIC	–	-0.012	-1.98	0.024**
Constant		1.138	3.96	0.000
Adjusted R square			0.7227	

* Significant at 0.10 (one-tailed)

** Significant at 0.05(one-tailed)

*** Significant at 0.01 (one-tailed)

[a] SEPRMC = A dummy variable coded 1 if separate RMC, 0 otherwise.
RMCINDE = Proportion of independence members in RMC.
RMCEXP = Proportion of expertise members in RMC
RMCGEN = Proportion of female members in RMC
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
LOGNAS = Natural logarithm non-audit services fee.
LOGTA = Natural logarithm of total assets.
LEVERAGE = Total debt to total assets.
INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

Table 4.9

Results of Further Analysis on the Audit Fees Model for the Partition (Hypotheses Variables are Measured by Proportion).

		Separate Risk Management Committee (*N = 141*)		**Combine Risk Management Committee** (*N = 67*)	
Variables	**Expected Sign**	**Coefficient (t-value)**	**Sig.**	**Coefficient (t-value)**	**Sig.**
RMCINDE	+	-0.021 (-0.24)	0.406	0.006 (0.03)	0.489
RMCEXP	+	0.228 (1.92)	0.028**	0.181 (1.12)	0.133
RMCGEN	+	0.107 (0.72)	0.235	0.228 (0.83)	0.205
AUDITORS	+	0.430 (1.02)	0.155	-0.014 (-0.22)	0.414
LOGNAS	+	0.201 (1.71)	0.044**	0.029 (1.29)	0.102
LOGTA	+	0.435 (10.07)	0.000***	0.453 (7.34)	0.000***
LEVERAGE	+	0.156 (1.36)	0.088*	0.238 (1.23)	0.112
INVREC	+	-0.037 (-0.35)	0.362	0.531 (2.65)	0.005***
LOGSUB	+	0.197 (3.32)	0.001***	0.141 (1.61)	0.056*
ETHNIC	–	-0.007 (-1.12)	0.132	-0.014 (-1.17)	0.124
Constant		1.192 (3.43)	0.000	0.926 (1.64)	0.000
Adjusted R-square		0.7849		0.5852	

* Significant at 0.10 (one-tailed)
** Significant at 0.05 (one-tailed)
*** Significant at 0.01 (one-tailed)

[a] RMCINDE = Proportion of independence members in RMC.
RMCEXP = Proportion of expertise members in RMC
RMCGEN = Proportion of female members in RMC
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
LOGNAS = Natural logarithm non-audit services fee.
LOGTA = Natural logarithm of total assets.
LEVERAGE = Total debt to total assets.

INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

4.9.2 Proportion of Non-audit Services Fee to Total Fees

Table 4.10 below provides the regression result for the sample of 208 companies by using proportion of non-audit services fee to total fees. For the hypotheses variables, it is measured by proportion while the others variables remain unchanged. Total fees refer to the sum of total audit fees and non-audit fees of the company. This measurement is consistent with a previous study done by Bloomfield and Shackman (2008) which also uses similar measurement for non-audit services fee. As shown in the table below, the model is significant at a one percent level with an adjusted R-squared of 0.6995. As predicted, only variable RMCEXP is positively significant (at a five percent significance level) while the others remain the same.

The regression result for the partition analysis using this measurement are also presented below in Table 4.11. However, the result shows that there is no significant difference compared to the previous result whereby for the separate risk management committee only hypothesis variable RMCEXP is positively significant at a five percent level while all the hypotheses variables are insignificant for the combined risk management committee.

Table 4.10

Results of Further Analysis on the Audit Fees Model (Non-Audit Fees are Measured by Proportion of Non-audit Fees to Total Fees, N= 208).

Variables	Expected Sign	Coefficient	t	Sig.
SEPRMC	+	0.017	0.36	0.359
RMCINDE	+	0.008	0.10	0.459
RMCEXP	+	0.209	2.11	0.018*
RMCGEN	+	0.149	1.10	0.137
AUDITORS	+	0.484	1.32	0.094*
NAS	+	0.101	1.12	0.131
LOGTA	+	0.448	12.76	0.000***
LEVERAGE	+	0.186	1.85	0.032**
INVREC	+	0.123	1.26	0.105
LOGSUB	+	0.185	3.84	0.000***
ETHNIC	–	-0.011	-1.86	0.032**
Constant		1.083	4.063	0.000
Adjusted R square			0.7155	

* Significant at 0.10 (one-tailed)
** Significant at 0.05 (one-tailed)
*** Significant at 0.01 (one-tailed)

[a] SEPRMC = A dummy variable coded 1 if separate RMC, 0 otherwise.
RMCINDE = Proportion of independence members in RMC.
RMCEXP = Proportion of expertise members in RMC
RMCGEN = Proportion of female members in RMC
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
NAS = Ratio of non-audit fees to total fees
LOGTA = Natural logarithm of total assets.
LEVERAGE = Total debt to total assets.
INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

Table 4.11

Results of Further Analysis on the Audit Fees Model for the Partition (Non-audit Fees Measured by Proportion of Non-audit Fees to Total Fees).

		Separate Risk Management Committee (*N = 141*)		**Combine Risk Management Committee** (*N = 67*)	
Variables	**Expected Sign**	**Coefficient (t-value)**	**Sig.**	**Coefficient (t-value)**	**Sig.**
(Constant)		1.115 (3.18)	0.000	0.842 (1.46)	0.000
RMCINDE	+	-0.027 (-0.30)	0.383	0.044 (0.21)	0.418
RMCEXP	+	0.225 (1.85)	0.033**	0.192 (1.61)	0.124
RMCGEN	+	0.125 (0.81)	0.209	0.207 (0.74)	0.231
AUDITORS	+	0.045 (1.03)	0.151	-0.007 (-0.11)	0.454
NAS	+	0.069 (0.55)	0.291	0.152 (1.05)	0.148
LOGTA	+	0.449 (10.33)	0.000***	0.468 (7.19)	0.000***
LEVERAGE	+	0.186 (1.63)	0.053*	0.162 (0.81)	0.210
INVREC	+	-0.047 (-0.41)	0.339	0.549 (2.73)	0.004***
LOGSUB	+	0.209 (3.50)	0.000***	0.168 (1.88)	0.032**
ETHNIC	–	-0.006 (-1.00)	0.158	-0.021 (-1.25)	0.108
Adjusted R-square		0.7802		0.5733	

* Significant at 0.10 (one-tailed)
** Significant at 0.05 (one-tailed)
*** Significant at 0.01 (one-tailed)

[a] RMCINDE = Proportion of independence members in RMC.
RMCEXP = Proportion of expertise members in RMC
RMCGEN = Proportion of female members in RMC
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
NAS = Ratio of non-audit fees to total fees
LOGTA = Natural logarithm of total assets.

LEVERAGE = Total debt to total assets.
INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

4.9.3 Proportion of Non-audit Services Fee to Total Audit Fees

Another measurement used to assess non-audit fees is the proportion of non-audit fees to a total audit fees, which has likewise been done by Abbott, Parker, Peters and Raghunandan (2003) in their study. The results are shown in Table 4.12 and Table 4.13 below for the total sample of 208 companies and also for the partition analysis of the separate and combined risk management committee.

As predicted, the result present in Table 4.12 shows that RMCEXP has a positive significant relationship with the audit fees at a five percent level similar with the result for the separate risk management committee in Table 4.13. In contrast, for the combined risk management committee all the hypotheses variables are insignificant towards the audit fees.

Table 4.12

Results of Further Analysis on the Audit Fees Model (Non-Audit Fees are Measured by Non-audit Fees over Total Audit Fees, N=208).

Variables	Expected Sign	Coefficient	t	Sig.
SEPRMC	+	0.016	0.34	0.367
RMCINDE	+	0.001	0.02	0.492
RMCEXP	+	0.199	2.02	0.022**
RMCGEN	+	0.151	1.09	0.137
AUDITORS	+	0.544	1.50	0.067*
NAS	+	0.001	0.14	0.442
LOGTA	+	0.450	12.79	0.000***
LEVERAGE	+	0.183	1.79	0.037**
INVREC	+	0.111	1.12	0.132
LOGSUB	+	0.187	3.75	0.000***
ETHNIC	–	-0.012	-1.92	0.028**
Constant		1.088	4.060	0000
Adjusted R square			0.7138	

* Significant at 0.10 (one-tailed)

** Significant at 0.05 (one-tailed)

*** Significant at 0.01 (one-tailed)

[a] SEPRMC = A dummy variable coded 1 if separate RMC, 0 otherwise.
RMCINDE = Proportion of independence members in RMC.
RMCEXP = Proportion of expertise members in RMC
RMCGEN = Proportion of female members in RMC
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
NAS = Ratio of non-audit fees to audit fees
LOGTA = Natural logarithm of total assets.
LEVERAGE = Total debt to total assets.
INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

Table 4.13

Results of Further Analysis on the Audit Fees Model for the Partition (Non- audit Fees Measured by Non-audit Fees over Total Audit Fees).

		Separate Risk Management Committee (*N = 141*)		**Combine Risk Management Committee** (*N = 67*)	
Variables	**Expected Sign**	**Coefficient (t-value)**	**Sig.**	**Coefficient (t-value)**	**Sig.**
(Constant)		1.101 (3.12)	0.000	0.972 (1.69)	0.000
RMCINDE	+	-0.031 (-0.34)	0.368	0.052 (0.23)	0.408
RMCEXP	+	0.212 (1.76)	0.04**	0.188 (1.14)	0.128
RMCGEN	+	0.133 (0.88)	0.19	0.180 (0.63)	0.265
AUDITORS	+	0.051 (1.20)	0.116	-0.005 (-0.08)	0.470
NAS	+	-0.003 (-0.10)	0.458	-0.001 (-0.05)	0.480
LOGTA	+	0.453 (10.41)	0.000***	0.459 (7.05)	0.000***
LEVERAGE	+	0.188 (1.62)	0.053*	0.145 (0.69)	0.248
INVREC	+	-0.045 (-0.48)	0.316	0.501 (2.42)	0.009***
LOGSUB	+	0.210 (3.44)	0.000***	0.159 (1.69)	0.048**
ETHNIC	–	-0.007 (-1.03)	0.151	-0.024 (-1.31)	0.098*
Adjusted R-square		0.7796		0.5679	

* Significant at 0.10 (one-tailed)
** Significant at 0.05 (one-tailed)
*** Significant at 0.01 (one-tailed)

[a] RMCINDE = Proportion of independence members in RMC.
RMCEXP = Proportion of expertise members in RMC
RMCGEN = Proportion of female members in RMC
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
NAS = Ratio of non-audit fees to audit fees
LOGTA = Natural logarithm of total assets.

LEVERAGE = Total debt to total assets.
INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

4.10 Conclusion

Further analyses were conducted on the data by using different measurement for hypotheses variables (RMCINDE, RMCEXP and RMCGEN) and non-audit services fee. The study also uses partition for the separate and combined risk management committee to test the sensitivity of the results. The results reveal that only hypothesis variable RMCEXP is positively significant with audit fees for the total sample of 208 companies and also for partition of the separate risk management committee for all types of measurement used. However, for the combined risk management committee, the result shows that none of the hypotheses variables have any significant relationship with audit fees throughout all the different measurement applied.

CHAPTER 5 : CONCLUSION AND RECOMMENDATION

5.1 Introduction

The aim of this study is to examine the relationship between formation committee of risk management and audit fees in the context of Malaysia business environment. As a conclusion, this study has achieved the four objectives which specifically examine the relationship between separate risk management committee, independence of risk management committee, expertise of risk management committee, gender diversity of risk management committee and audit pricing. Results shows that, hypotheses variables of separate risk management committee, independence, expertise and gender diversity of are positively related with audit fees. Yet, only independence and expertise are significantly associated with audit fees. In partition analysis the result for separate risk management committee shows that, hypotheses variable of independence and expertise are significantly associated with the audit fees while for combined risk management committee none of the hypotheses variables have a significant relationship with the audit fees. Overall, the result indicate that independence and expert of the risk management committee members have an influence on the audit quality proxy by audit fees. Table 5.1 presents the summarization of the key findings.

Table 5.1 Summarization of the key findings

		Main Analysis	Partition Analysis	
			Separate RMC	Combine RMC
Variables	**Expected Sign**	**Coefficient (t-value)**	**Coefficient (t-value)**	**Coefficient (t-value)**
(Constant)		1.059 (3.64)	1.062 (3.04)	0.909 (1.61)
SEPRMC	+	0.042 (0.93)	-	-
RMCINDE	+	0.039** (1.93)	0.043** (1.94)	0.014 (0.31)
RMCEXP	+	0.056* (1.42)	0.617* (1.45)	0.051 (0.60)
RMCGEN	+	0.013 (0.34)	0.427 (0.89)	-0.061 (-0.75)
AUDITORS	+	0.042 (1.15)	0.048 (1.14)	-0.021 (-0.27)
NAS	+	0.023*** (2.41)	0.019** (1.73)	0.027* (1.35)
LOGTA	+	0.437*** (12.45)	0.442*** (10.21)	0.463*** (7.55)
LEVERAGE	+	0.144* (1.44)	0.118 (1.03)	0.176 (0.85)
INVREC	+	0.132* (1.46)	-0.006 (-0.06)	0.498*** (2.45)
LOGSUB	+	0.173*** (3.76)	0.194*** (3.54)	0.133* (1.51)
ETHNIC	–	-0.011** (-1.78)	-0.003 (-0.58)	-0.0209 (-1.25)
Adjusted R-square		0.7249	0.7924	0.5751

* Significant at 0.10 (one-tailed)

** Significant at 0.05 (one-tailed)

***Significant at 0.01 (one-tailed)

[a] SEPRMC = A dummy variable coded 1 if separate RMC, 0 otherwise.
RMCINDE = Number of independence member in RMC.
RMCEXP = A dummy variable coded 1 if has expertise, 0 otherwise.
RMCGEN = A dummy variable coded 1 if female, 0 otherwise
AUDITORS = A dummy variable coded 1 if Big Four firm, 0 otherwise.
LOGNAS = Natural logarithm non-audit services fee.
LOGTA = Natural logarithm of total assets.
LEVERAGE = Total debt to total assets.

INVREC = Total inventories and account receivables to total assets.
LOGSUB = Log10 of the number of subsidiaries.
ETHNIC = Total ethnic Chinese directors on the board.

The remaining of the chapter presents recapitulation of Chapter 1 to Chapter 4 followed by discussion on the limitations of the study. This chapter continues with discussions on the implication of the findings and recommendations for future studies. The final section concludes this study.

5.2 Recapitulation of the Study

Chapter 1 discusses the formation of risk management committee in public listed companies in Malaysia. It is noted that, like many other countries, risk management committee has already been introduced in their organizations. However, in Malaysia, formation of risk management committee is still voluntary and it is not a mandatory requirement for all listed companies to form risk management committee. Therefore, this study examines the effect of forming risk management committee on audit pricing in the company. This contributes to the objectives of this study, which are to study the relationship between the fromation of a separate risk management committee, independence, expertise, gender of committee members and the audit fees.

The relevant literatures on risk management committee, audit services fee and factors that affect the audit services fee are reviewed in Chapter 2. It is noted that extensive previous studies have been conducted on audit services fee, but to my knowledge, there is no

published article which specifically examines the relationship between risk management committee and audit fees especially those conducted in Malaysia.

Chapter 3 discusses the theory related and develops the hypotheses to be tested. Hypotheses are developed from independent variables of separate risk management committee, independence, expertise and gender of members in risk management committee. All hypotheses developed are expected to have a significant positive relationship with audit service fees. Methods as well as the model used in the study are also explained under this chapter. Audit service fee model is regressed by using the OLS regression. The total sample of this study are also stated in this chapter comprising of 208 public listed companies for the year 2014.

Chapter 4 discusses the results of the analyses conducted for the main test as well as the further test. For the main test, data used is a total sample of 208 listed companies in Bursa Malaysia for the year 2014. The results provide evidence that RMCINDE and RMCEXP are significantly positive at significant five percent level and ten percent level respectively. While other hypotheses variables shows insignificant towards audit service fees. Partition analyses are also conducted under further analyses whereby the total sample of 208 companies are divided into category of separate and combine risk management committee. Thus, only the sample of separate risk management committee (N=141) shows the same result as the main test which hypothesis variable for RMCEXP has significant value while for combined risk management committee (N=68) none of the hypotheses variables show significant values towards audit fees.

5.3 Limitations

This study used cross-sectional data of the financial year 2014. It is probable that the constitution committee of a risk management by Malaysian listed firms has increased due to regulation imposed by goverment. Other limitation of this study is due to incomplete or insufficient information regarding the members of risk management committee such as education background which is not clearly and specifically disclosed in the annual reports.

5.4 Theoretical and Policy Implication of the Study

Subjected to the above limitations, the outcomes of this study may contribute to the theoretical and practical (policy) implications. In particular, this study adds to the growing literature on the risk management committees, characteristics of risk management committees and audit fees. It also provides evidence on the formation of risk management committees by explaining the variation in the audit fees charged to the companies. In addition, the findings from this study may also be beneficial to the regulatory bodies in developing and evaluating relevant policies. This is because the formation of a risk management committee is still voluntarily for public listed companies in Malaysian context. The findings have shown that the more independent and expert the members of the risk management committee, the higher audit fees will be since it will demand for higher audit quality of financial reporting. Indirectly, this will increase the value of financial reporting of the corporation. The findings of this study can also be beneficial to the accounting profession in Malaysia by providing empirical evidence on the structure of audit services fee from the external perspective.

5.5 Future Research

Certain areas may be considered for future studies. For example, future research may replicate this study in a different business environment (in a different country) or by match pairing companies with risk management committee and companies with none risk management committees in their company. In addition, this study was conducted based on archival method (theory-driven approach), future studies may adapt the perception approach in examining the effects of formation of risk management committee on audit fees. Since this study only uses secondary data as its main source, in the future, primary data can also be used in order to get a more implicit information that could be raised by the auditors or other respondents. Meanwhile, similar study should also be carried out in a longer period in order to get more justification effects when using the regression model in identifying the relationship between variables. Empirical evidence on risk management committee is limited and scarce, thus more studies should be conducted in order to provide more evidence and guidelines for companies due to the importance of risk management committee in a company, besides the audit committee, remuneration committee and nomination committee. Lastly, future studies should also consider other factors to be included into the model.

5.6 Conclusion

The primary purpose of this study is to investigate the effect of formation of risk management committee in the listed firms in Malaysia towards the audit fees. The study was conducted on 208 sample listed companies in Malaysia for a period of 2014 financial year. The main results show that, two out of four hypotheses variables tested in the study

are statistically significant with respect to audit fees. Thus, it indicates a strong basis to conclude that independence and expertise of risk management committee members are associated with audit fees charged towards the companies. Another interesting finding from this study is that the order of significance level found from the result of the analyses indicates that the hypothesis variable of RMCEXP is found to be robust and more significant, even though different measurements were used. Thus, the findings provide some evidence on the effect of formation of the risk management committee on audit pricing.

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