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Corporate Governance and Audit Fees: Evidence from a Developing Country

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Abstract

In this paper, we investigate the effect of board and audit committee quality on the audit fees in the context of developing country of Pakistan. We us five years data of KSE-100 index companies listed on Pakistan Stock Exchange. To draw the inference, we use the Partial Least Square based Structural Equation Modeling. We find that effective board quality (measured through board size, board independence, CEO duality, chairperson independence, board equity holding, and board diligence) is positively associated with external auditor fees. This finding suggests that, high quality board demands higher quality audit to have further assurance on the quality of financial reporting. While, we find audit committee effectiveness (measured through audit committee size, audit committee independence, and audit committee diligence) reduces the external audit fee, which supports our notion that, the high quality audit committee will ensure reliable financial reporting which reduces external auditor's efforts that result in lower audit fees.

Keywords: board quality, audit fees, audit committee effectiveness, partial least square.

1. Introduction

Corporate governance and audit fee is a topic of ongoing debate in accounting and auditing literature. Larcker and Tayan (2011) defined Corporate Governance as a control process which is implemented to prevent its management from the actions that are harmful to organizational well-being. This control method has gained the research attention when world's most famous corporations' scandals particularly Adelphia, WorldCom, Enron, and Parmalat loses the trust of their shareholders because of conflict of interest among the managers and shareholders. Now the countries throughout the world are promoting sound business control practices for the guarantee of impartiality, clarity, and liability in the business sector as well as to protect the rights of every shareholder. Furthermore, to confirm the quality of publically available financial data, to help the purpose of liability over the company actions, audit and governing boards have become a general structure of business governance. For the development of effective corporate governance, many countries implemented different laws and procedures officially such as Sarbanes-Oxley Act of 2002 (US), Australian Treasury Act (2002) and Higgs Report (2003) in the UK. Pakistan has also established a Securities and Exchange Commission of Pakistan (SECP), which operates as a governing organization to publish the laws of corporate governance for firms listed on Pakistani stock exchange (PSE). The objective of these governing bodies as well as audit companies is to safeguard the well-being of investors through confirming the quality of financial reports. Because the auditor provides the objective assessment, so, its value in business control cannot be denied.

A number of studies have examined the role of corporate governance in shaping the external auditor fee because of its importance. But, very limited studies have scrutinized the impact of board structure and audit committee on audit fees in the context of developing economies. These studies have tried to find the factors of audit pricing in developing countries, accepting the reality that developing states are different with respect to governance setting, need for audit provisions, phases of economic growth, etc. Inside various developing economies, the family held organizations and concentrated ownership is very common.

This study aims to investigate whether the effective board structure and the audit committee have any impact on the external audit fees in context of the unique business environment of Pakistan. This study has two main contributions. Firstly, most of the prior studies on the subject of audit fee are from developed countries such as USA, UK, and Canada as well as European countries. However, according to Ghosh (2006), it is strongly argued by the economists that the literature has no implication for the developing economies which is based on developed economies because there are elementary structural and institutional differences between these economies. Moreover, in Pakistan ownership concentration is very common and family ownership is usually found in the listed companies of Pakistan (World Bank, 2005). In such companies, the autocratic style of management can be observed. That raises the question that controlling owners may treat the company assets as their own fiefdom, consequently they can make such decision which can be beneficial for them only (Bond, 1996 and Brewer, 1997). In such a situation of self-serving behavior of top managers, it is crucial for the independent directors to play the monitoring role effectively (HKSA, 2001). In addition, Pakistan is also considered as weak investor protection country. For example, the contemptuous role of Pakistan code of corporate governance (PCCG) 2002 draws our attention about the basic question whether code is truly helpful in converging the interest of shareholder and managers in the context of such economy where the ownership concentration and family ownership is very common. The Pakistan first PCCG was issued in 2002 by SECP to promote the sound governance system in public listed companies. However, if we critically examine PCCG, then it can be observed that this code have some deficiencies.

Like, it is not mandatory for the companies to have independent director but it is encouraged. The provisions regarding the classification of independent director are also weak as compared to developed countries such as the UK, the USA, and Australia (World Bank, 2005). Moreover, the code does not provide any mechanism through which the performance of outside directors can be assessed. Furthermore, according to PCCG 2002 the separation of CEO and chairperson is not mandatory, which is inconsistent with sound governance practices. Given these deficiencies it can be expected that the powerful top management can exploit the owners' wealth. This unique institutional context provides us the opportunity to investigate the question whether the board and audit committee affects the external auditor fees. Therefore, we contribute to existing literature by first time investigating the impact of board and audit committee quality on audit fees in the context of developing country of Pakistan.

Secondly, previous studies which have investigated the impact of board characteristics and audit committee characteristics on audit fees have reported inconsistent results. Moreover, the previous studies on this subject have only reported the impact of few board and audit committee characteristics. This study uses the unique methodology (PLS based SEM) which allows us to develop the construct of board structure effectiveness and audit committee effectiveness. Therefore this study contributes towards the international literature by first time investigating the impact of comprehensive measures of board structure effectiveness and audit committee effectiveness on audit fee.

The rest of the paper is organized as; in next section, the hypotheses are developed based on the existing literature. In section 3, we discuss the sample of the study, variables and statistical methodology. In section 4, we report the results and in section 5 we provide the discussion and conclusion.

2. Literature Review

Whether the corporate governance quality affects the auditor's fees or not? This question is an issue of ongoing debate in accounting and auditing literature because of mixed findings (for recent studies please see McNulty and Nordberg, 2016; Ghafran and O'Sullivan, 2017; Jiraporn et al., 2018; Barroso et al., 2018; Jizi and Nehme, 2018 among others). Due to mixed findings the literature holds two different perspectives or views regarding the effect of corporate governance on audit fees i.e., demand based view and risk based view. The demand based view suggest that the good governance agents will demand high quality audits to further ensure reliability and validity of accounting statements and consequently this will lead to increase in cost of external auditors fees. On the flip side, those who speaks from the risk based perspective argue that firms with sound governance practices reduces the risk of external auditor and the external auditor shorten the scope of audit, that leads to reduction in cost of audit fees. In this study we investigate the effect of two main and relevant governance mechanisms (i.e. board quality and audit committee quality) on the external auditor fees. This section includes a comprehensive review of literature and hypotheses of the study.

2.1 Board Quality and Audit Fees

It is the fiduciary duty of the directors to work for the best interest of the shareholders on their behalf. Their utmost responsibility is to monitor and control the opportunistic behavior of managers. They are responsible to make sure that accounting and financial statements show the actual position of the company. Therefore, they should play a key role in decimation of credible and relevant financial information through financial statements.

2.1.1 Board Size

According to Lipton and Lorsch (1992) the size of the board is associated with boards monitoring and controlling ability. However, the literature on the effectiveness of board size on its monitoring efficiency is mixed. Some argue that firms with smaller board are better governed. For example, Ozkan (2007) argue that smaller boards are more effective in monitoring activities because they enjoy better communication and interaction. However Lipton & Lorsch, (1992) and Jensen (1993) argue that larger boards are associated with the board monitoring capability because firms with larger board enjoy more experience and expertise. Similarly, previous studies documented that that larger boards are more effective e.g., the Usman et al., (2018a) documented that board size is negatively associated with CEO power. In addition, previous studies on audit fees also reported that external auditor fees is positively associated with board size because such boards are better monitors and want to have further ensure about the creditability of accounting numbers, as a result they pay higher fees to auditors (e.g., Karim et al., 2015: Bozec and Dia, 2017; Jizi and Nehme, 2018). In alignment with these arguments and findings we expect that the board size adds towards the board quality and such board will demand high quality audit, leading to increase in audit fees.

2.1.2 Board Independence

It is the main duty of the independent directors to monitor the actions and decisions of top managers to safeguard the shareholders interest from the managers' opportunistic behavior. The independent directors are consider as sound governance mechanism due to their monitoring role because they are not under the any hierarchal authority and do not face the issue of retaliation (Daily and Schwenk, 1996). Moreover, the independent directors are considered to be beneficial for the company because they are less conciliatory for top management (Beatty and Zajac, 1994) and have rich experience of controlling and monitoring due to their directors ship in other boards (Fama and Jensen, 1983). In alignment with the above argument, previous studies reported that board independence is positively associated with audit fees because the independent directors demand high quality audit to have further assurance (e.g., Bozec and Dia, 2017; Jizi and Nehme, 2018). These findings support the notion that independent board are more concerned about the quality of external audit because their reputation is at stake and have fear of litigations. So in alignment with above arguments, we expect that the boards with high proportion of independent directors are of more quality and such board will demand high quality of audit.

2.1.3 CEO Role Duality

CEO role duality means that CEO also chairs the board. The sound corporate governance practices around the globe are in alignment with agency theory, which suggest that both position should not be filled by the same person. It is responsibility of the board chairperson to monitor and controls the actions and decisions of the CEO (Weir and Laing, 2001). According to Fama and Jensen (1983) the CEO role duality situation creates the issue of non-separation of decision management and decision control. In addition, the CEO role duality raises the question regarding the independences of board and also signals the CEO dominance. Moreover, the previous studies on the governance perspective of CEO role duality found that CEO role duality is positively with CEO dominance and CEO pay (Usman et al., 20181; 2018b). Similarly, the previous studies audit fees literature also report that that CEO role duality increase the risk of external auditor, which leads to increase in audit fees (e.g., Bliss et al., 2007; Jizi and Nehme, 2018). Therefore, we expect that separating both roles will improve the board independence.

2.1.4 Board Diligence

Board diligence is defined as number of activities performed by the board members during the year and signals the effectiveness of board monitoring. According to Garcia Lara et al. (2009) the number of board monitoring can be a good proxy for board diligences because it represents the board efforts related to monitoring and controlling functions. According to Lipton and Lorsch, (1992) and Byrne, (1996) the board that meet more frequently is more likely to perform their duties diligently, which is important for shareholders interest. In addition Vafeas (1999) argue that board meetings frequency is associated with board monitoring effectiveness. These arguments support the assumption that diligent boards ensure the creditability of financial statements. Similarly, results of Carcello and Neal (2000) support that more diligent board demand a high-quality of the audit to attain the higher level of assurance, which results in higher audit fees. So we can expect that boards which are more diligent will demand closer scrutiny of financial reporting process through high quality audit.

2.1.5 Management Holding

In our study the management holding is defined as percentage of outstanding shares held by the board members. This management holding can be a possible solution to the issue of divorce of interest between the owners’ and agents (Jensen and Meckling, 1976). The main argument regarding the question, why board holding can be a possible solution for non-convergence of interest between agents and owners is that, it encourages the board to work for betterment of the company, because their own wealth is also on stake. Similarly, Tsui et al. (2001) reported that board equity ownership reduces the chances of issuing the misleading information to shareholders. So based on the risk-based perspective we can expect a negative relationship between management holding and audit fees, because of a decrease in auditors risk due to enhanced alignment between agents and owners. Similarly, O’Sullivan (2000) reported an inverse relationship between management equity ownership and audit fees. But based on the demand-based perspective we can expect a positive relationship between the management equity holding and audit fees because when directors have their wealth in the company like other shareholders then to attain higher level of assurance about true representation of financial statements they will demand a high quality of audit and which results in higher audit fees.

2.1.6 Chairperson Independence

Previous literature on the board structure and audit fees used several measures as proxy for board quality (i.e., board size, board independence, board meetings, and board shareholding) except for chairperson independence (Jiraporn et al., 2018; Barroso et al., 2018; Jizi and Nehme, 2018). Following the recommendation or suggestion of code of corporate governance of developed countries (e.g. UK Code of Corporate Governance) we include the chairperson independence as another proxy for board quality. In this study, chairperson independence is defined as whether the board chair is selected from non-executive directors. To this date we only found two studies Habbash et al. (2010) and Usman et al. (2015) which have used board chair independence as a proxy for board quality or independence. The focus of Habbash et al. (2010) is to investigate the impact of board chair independence of earnings management and reported no effect. While Usman et al. (2015) investigated the role of board effectiveness and CEO compensation and used a construct of board effectiveness which includes the chairman independence as a proxy for board effectiveness among other proxies of board effectiveness. They reported a negative relationship between board effectiveness and CEO compensation and concluded that under the effective board structure CEO has fewer chances to manipulate their compensation package and receives lower compensation. So if the chairman is among the non-executive directors then he/she is in a better position to resolve the issue of non-convergence of interest between owners and agents. Correspondingly, Beatty and Zajac (1994) argue that non-executive directors are less conciliatory towards top managers as compared to executive directors. So if the chairman is selected from the non-executive directors monitoring structure of the company will be improved. So we expect that independent chairman will demand a high quality of audit because his reputation will be at stake and has a fear of litigation.

Therefore, we expect a positive relationship between the board quality and external audit fees. So the first hypothesis of the study is;

- **H_1:** Firm with high board quality (Larger, more independent, no role duality, non-executive director as chairman, more diligent and having high ownership) will demand a high quality audit and will pay higher audit fees.

2.2 Audit Committee and Audit Fees

The Blue Ribbon Committee's (BRC) (1999) provides a strong recommendation regarding the existence of an audit committee and its characteristics like audit committee size, independence and financial expertise of the audit committee which results in strong audit committee oversight of financial statements disclosures. According to McMullen (1996), the internal audit committee of an organization facilitates reliable financial reporting and reduces the incidence of errors, irregularities and another such indicator of unreliable reporting. Similarly, Ho and Wong (2001) empirically investigated the relationship between the existence of an audit committee and firms disclosures practices.

Their results support that the presence of an audit committee will lead to high corporate disclosures. Similarly, Pakistan Code of Corporate Governance (2002) also supports the existence of internal audit committee and expects a higher quality of financial reporting as an outcome of an audit committee. Increasing number of studies are investigating the effect of audit committee composition on audit fees (Krishnan and Visvanathan, 2009; Jizi and Nehme, 2018). Therefore, this study also examines the association between audit committee strengthens and audit fees in addition to board structure characteristics.

2.2.1 Audit Committee Size

BRC report 1999 suggests that in order to be effective an audit committee should consist of sufficient members that meet more frequently. According to Braiotta (2000), recommendations regarding audit committee size are to improve its organizational status. Correspondingly, Kallbbers and Fogarty (1993) support that large sized audit committee is legitimized by a meaningful organizational support from the board and considered as an authoritative body not only by internal audit function but also by an external auditor. Thus, aligning with the recommendations of Blue Ribbon Committee's (1999) and many other corporate governance reports we expect that audit committee size is an increasing function of financial reporting quality. Similarly, Yatim et al. (2006) also expected that audit committee size increases the firm's financial reporting quality and reduces external auditor's efforts which result in lower audit fees. But their results do not support their expectation.

2.2.2 Audit Committee Independence

The increased proportion of non-executive directors on audit committee strengthens oversight of financial reporting by the audit committee, which leads toward lower chances of unreliable financial reporting (Abbott et al., 2004). Therefore non-executive directors dominated audit committee facilitate high quality of financial reporting and improves the objectivity of the audit committee as opposed to executive directors dominated audit committee. Therefore, presences of independent directors on the audit committee strengthen internal control system which reduces inherent as well as control risk. Yatim et al. (2006) hypothesized that more independent audit committee improves financial reporting quality which results in lower audit fees, but their results do not support their hypothesis, while, results of Abbott et al. (2003) report a positive relationship between audit committee independence and audit fee.

2.2.3 Audit Committee Diligence

The audit committee which is more diligent in performing their duties enhances the financial reporting disclosures quality. The most commonly used proxy for audit committee diligence in audit fee literature is a number of audit committee meetings held during the year (See Yatim et al., 2006). Previous research supports that audit committee which meets more frequently reduces the problems of financial reporting. So the audit committee which meets more frequently reduces issues relating to financial reporting, which leads to lower external audit efforts and resulting in lower audit fees. But Yatim et al. (2006) and Jizi and Nehme, (2018) reported a positive relationship between the external audit fees and board diligence which supports the demand-based perspective, while Hashim and Abdul Rahman (2011) reported an insignificant association between the audit committee meetings and external audit fees.

Therefore, we expect that strong audit committee ensures the quality of financial reporting and reduces the efforts of external auditor which results in lower audit fee. Therefore our second hypothesis is;

- **H_2:** Firm with strong audit committee (which is large, more independent and meets more frequently) will ensure reliable financial reporting which reduces external auditor's efforts that result in lower audit fees.

3. Methodology

3.1 Sample Selection

To test our developed hypothesis, we use the data of PSE listed companies. The PSE is only stock exchange of Pakistan which provides the different indexes e.g., KMI-30 index, KSE-30 index, and KSE-100. The KSE-100 index represents how PSE is performing and includes one hundred companies. These one hundred companies are selected from each sector (except from open-end mutual fund sector) based on highest free-float capitalization. The 80% of PSE trading is recorded within these 100 companies. We use kse-100 companies data as a sample for two reasons i.e. KSE-100 index consist of 100 companies, which represent each sector of Pakistan, second, the 80% of overall PSE trading is recorded in these companies. These two reasons about our sample not only add towards the usefulness of our study but also towards the generalizability.

3.2 Data Source

In Pakistan there is no any database which provides the firm level data regarding the governance variables. So we first collected the annual reports of KSE-100 index companies from the companies' websites as well as from PSE. There is no validity or reliability issues regarding our data because our data source is companies audited annual reports, because, these annual reports are prepared by professional accountants of the company and cross verified by the profession external auditors. We use five year panel data ranging from 2007 to 2011. Our study period starts from 2007 because the SECP has introduced its first code in 2002 and allowed two years grace period to companies to implement the sound corporate governance. In actual companies have started to implement this code in 2005 but the disclosure was very poor. Therefore, our study period starts from 2007. It ends before 2011 because in 2012 the SECP revised the code. Our final sample reduced from 500 firm-year observation to 406 firm-years observations because some companies do not have reported the information regarding variables used in the study.

3.3 Measurement of Variables

Our dependent variable is an external auditor fee (i.e., the total fees paid to the external auditor as reported in the annual report of the companies). Aligning with previous studies this study also uses log natural of external audit fees to have robustness (see Yatim et al., 2006; Ghafran and O'Sullivan, 2017; Jiraporn et al., 2018; Barroso et al., 2018; Jizi and Nehme, 2018)

In this study we use six proxies of board quality. First is board size, which is defined as number of directors on the board. Second is board independence, which is defined as percentage of outside directors on the board. Third is CEO role duality, which is defined as dummy variables that equal 1 if CEO doesn't chair the board and 0 otherwise. Fourth is chairperson independence, which equals 1 if the chairperson is elected form outside directors and 0 otherwise. Fifth is board diligence, which is defined as number of board meetings held during the financial year Finally, the board holding, which is defined as percentage of firm's outstanding shares owned by the board members and their spouse.

Following the footstep of previous studies, we use three proxies to measure the audit committee quality (Jizi and Nehme, 2018). First is audit committee size, which is measured as number of total directors serving on the audit committee. Second is audit committee independence, which is calculated as proportion of outside directors serving on the board. Finally the audit committee diligence, which is defined as number of audit committee meetings held during the year.

In addition, following the footsteps of previous studies we use firm performance and firm size, as control variables (Yatim et al 2006; Ghafran and O'Sullivan, 2017; Jiraporn et al., 2018; Barroso et al., 2018; Jizi and Nehme, 2018). For firm performance, we use two measures ROA (ROA is defined as net profit divided by total assets) and ROE (ROE is defined as net profit divided by total equity). Regarding the firm size measures the audit fees literature uses various measures. So aligning with majority of previous studies we use log of total assets and log of total sales as proxy for firm size.

3.4 Analytical Methodology

In this study the Partial Least Square (PLS) based Structural Equation Modeling (SEM) is used to test the developed hypothesis. We used the PLS-Graph Version 3.0 software because it is strong statistical technique which is useful for building models and examining the series of associations. Its usefulness in theory generation and in testing the causal relationship cannot be neglected. Especially it is more useful when study model includes multiple exogenous and endogenous variables (please see Wolds, 1985). Another advantage of using this technique is that it calculates the pathe coefficients as well as loadings of indicators towards the latents, which reduces the probability of biased estimates (Cabrita and Bontis, 2008). In addition the PLS based SEM is now commonly used by corporate governnace rsearchers (e.g., Usman et al., 2015). Now the question arises why to use this technique when one can use covariance-based SEM like AMOS, LISREL, and EQS? Because Chin (1998) argues that the covariance-based SEM may encounter the issue of identification or existence of equivalent model. Following the above arguments and previous studies (e.g. Usman et al., 2015), we use PLS based SEM to estimate the effect of board and audit committee quality on audit fees. Our regress model can be depicted as follows.

$$LAF_{it} = \alpha_0 + \beta_1 BQ_{it} + \beta_2 ACQ_{it} + \beta_3 FS_{it} + \beta_4 FP_{it} + \varepsilon_{it} \quad \text{(Eq. 1)}$$

Where LAF_{it} is log natural of external auditor fees for firm *i* for year *t*, BQ_{it} is board quality for firm *i* for year *t*, ACQ_{it} is Audit committee quality for firm *i* for year *t*, FS_{it} is firm size for firm *i* for year *t*, FP_{it} is firm performance for firm *i* for year *t*.

4. Empirical Results

4.1 Evaluating the Measurement Model

To ensure the robustness of results, it is strongly recommended that the measurement model should be evaluated first before estimating the structural model. The measurement model can be evaluated by checking the reliability as well as validity of constructs' indicators. As in our case where we have formative construct it is no necessary to correlate the indicators (Diamantopoulos and Winklhofer, 2001). Due to irrelevance of factorial unity and internal consistency it is not necessary to performa dimensionality and reliability tests, consequently the test of composite reliability is not needed (e.g., Cronbach's Alpha). However, to verify reliability of the indicators it is important to check the multicollinearity between the indicators (Andreev et al., 2009). Following the previous studies and suggestion of Andreev et al., (2009), we check the reliability of indicators by using VIF as a multicollinearity test.

In addition to reliability it is also suggested to check the validity of formative constructs, which is controversial (Diamantopoulos et al., 2008). Basically validity test allows the researcher to know how much an indicator is important and contributing towards formation of the construct. This can be done by using the bootstrapping technique which is used to test the importance of an indicator towards its construct. This method provides the weights of each indicator along with its t-value. The strength and significance of indicator to construct path represents the validity of the formative constructs (MacKenzie et al. 2005). Therefore, the insignificant indicators should be excluded from construct to ensure the validity (MacKenzie et al., 2005). On the flip side, Nunnally and Bernstein (1994) argue that such indicators should not be eliminated because it can harm the theoretical perspective of the any construct.

Table 1 includes the results of reliability and validity tests. Table 1 shows that value of VIF for each indicator remain under the acceptable limit (i.e. less than 10). This indicates that there is no issue of multicollinearity and our indicators are reliable. The weights and the significance of the indicators are calculated through bootstrapping techniques to ensure the validity of the indicators. The results of validity test reveal that among the board effectiveness measures the CNED and BS remains insignificant contributor but all other measures remain significant contributor i.e. BI, DUAL, NM, and BH. While all measures of audit committee effectiveness are a significant contributor toward their latent construct ACE. Similarly, all measures of firm profitability and firm size were significant contributors. To ensure the content validity and in alignments with Bollen and Lennox (1991) we do not omit the insignificant indicators (i.e., BS and CNED). As we have checked the validity and reliability at the measurement model, now we can test our developed hypothesis by analyzing structural model.

Table1: Validity and Reliability

Construct Name	Indicators	Item weights	VIF
BE (Board Effectiveness)	BS (Board Size)	-0.137 (0.814)	1.205
	BI (Board independence)	0.294* (1.720)	1.969
	DUAL (CEO role duality)	0.696** (2.381)	1.418
	CNED (chairman independence)	0.121 (0.635)	1.751
	BH (directors equity holding)	-0.570*** (4.974)	2.453
	NM (number of meetings)	0.678*** (6.304)	2.649
ACE (Audit Committee Effectiveness)	ACS (audit committee size)	0.351* (1.643)	3.159
	ACI (audit committee independence)	0.873*** (3.921)	2.482
	ACM (audit committee meetings)	0.076* (1.744)	3.079
FP (Firm Performance)	ROE (return on equity)	-0.545** (2.012)	1.262
	ROA (return on assets)	-0.545** (2.012)	1.473
FS (Firm Size)	AS (assets size)	0.832*** (12.310)	3.125
	SS (sales size)	0.218*** (2.615)	2.275

Note: * significant at 10%, ** significant at 5%, *** significant at 1%;
t-statistic: reported in parenthesis

4.2 Evaluating the Structural Model

Table 2 represents the results of the structural model. First, we examined the effect of each exogenous variable (board quality and audit committee quality) on the endogenous variable (audit fees) separately (see modes 1 and 2). Finally, we tested the collective influence of all exogenous variables including control variables (see model 3). The coefficient of board effectiveness is negative and highly significant across all models. These results support our first hypothesis which suggest that firms with high quality board (large, more independent, no role duality, non-executive director as chairman, more diligent and having high ownership) will demand a high quality audit and will pay higher audit fees. So, the effective boards demand higher quality audit to have further assurance on the quality of financial reports and that result in higher audit fees. The coefficients of audit committee quality remain negative and significant in both 2nd and 3rd models which also support our second hypothesis. These findings suggest that firms' with strong audit committee (which is large, more independent and meets more frequently) will ensure reliability financial reports, which reduces external auditor's efforts that result in lower audit fees. The coefficient of firm size is positive and highly significant which supports that larger firms are more complex and have a higher risk for the auditor that results in high audit fee. The results also reveal a negative relationship between the firm performance and audit fees which reflect that good performing companies have a less inherited-risk and the auditor will receive lower audit fees. Overall results reveal that in Pakistan the major determinant of external audit fees is firm size

Table 2: Results of Structural Model

Variables/Models	Expected Sign	Model 1 (BQ)	Model 2 (ACQ)	Model 3 (BQ,ACQ,FP,FS)
Board Effectiveness	+	0.303***		0.064**
		(7.95)		(-1.973)
Audit Committee Effectiveness	-		-0.131***	-0.064**
			(2.92)	(1.986)
Firm Performance	-			-0.056**
				(2.520)
Firm Size	+			0.568***
				(5.907)
R^2 (in percentage)		9.20%	1.30%	36.20%

Note: * significant at 10%, ** significant at 5%, *** significant at 1%;
t-statistic: reported in parenthesis

5. Discussion and Conclusion

The aim of this study was to investigate the impact of corporate governance on the audit fees for firms listed on PSE. The five years data was collected from the KSE-100 index companies ranging from 2007-2011. Using the PLS based SEM we found that, the corporate governance agents in the country where family ownership, ownership concentration, and management autocratic behavior is common, will demand a higher quality audit to have further assurance from the external auditors. Our results are similar to Yatim et al. (2006), Bozec and Dia, (2017), Jizi and Nehme (2018), who also have reported a positive relationship between the board independence and audit fees. Likewise, the result of Carcello et al. (2002) and Abbott et al. (2003) also proved a positive association between the board structure and audit fees, while we found a negative impact of audit committee effectiveness and external audit fees. These results also meet our expectation that, the strong audit committee will provide the reliable financial information, which reduces the auditor's inherent risk and results in lower audit efforts that lead to lower audit fees. So these results are similar to the findings of (Yatim et al. 2006 and Boo and Sharma, 2008). This study uses two control variables which are the firm size and firm performance and we found that larger firms are more complex and have a higher risk for auditor and auditor also increase his fee. The results also reveal a negative relationship between the firm performance and audit fees which reflect that good performing companies have a less inherited risk and the auditor will receive lower audit fees. The results also indicate that the firm size is the major determinant of audit fees in Pakistan

Most of the prior literature on corporate governance and audit fees has focused the context of developed economies. However, it is far from apparent that how internal governance mechanism of client affects the external auditor fees in developing countries. In this study, we investigate whether the high quality board requires the high quality audit in the context of developing country, where the ownership concentration and family ownership is common. In alignment with the recent legislations around the globe regarding sound corporate governance practices we find that the high quality board demand high quality audit that leads to increase in external auditor's fees. This finding suggest that the developing countries can provide the protection to shareholders by implementing the sound corporate governance practices. Because we find that the high quality board not only effectively monitors the top management actions and decision but also take such decision such as high quality audit, to ensure the credibility of financial statements.

Our findings that the companies with high quality audit committee enjoy the advantage of lower cost of debt. These findings suggest that those firms the high quality of internal audit committee can mitigate the agency cost (such as external auditors fee). These results support the notion that external auditor consider those firms less risk which have strong internal audit function (i.e. high quality audit committee) and lessen their audit scope and charge less for audit fees. These findings are in line with recent legislations around the globe, which suggest that, every listed firm should have independent board and audit committee. Overall our findings support the SECP initiatives to improve the corporate governance practices in the listed companies of Pakistan.

Despite the fact we make important contributions, we have certain limitations which provides the future research opportunities. In this study, we directly investigate the effect of corporate governance on audit fees. However, it will be more interesting to investigate how within country institutional contingencies (such as ownership concentration, Block holdings, family ownership, and business groups) shape this relationship. In addition, it will be more insightful to investigate the association between corporate governance and audit fees in those firms which have powerful CEOs (i.e., CEO hold the chair person positions or CEO is from the controlling family).

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