International Journal of Engineering & Technology, 7 (3.21) (2018) 73-81

International Journal of Engineering & Technology

Website: www.sciencepubco.com/index.php/IJET

Research paper

Relationship Analysis of Corporate Governance Mechanisms, Audit Fees, and Financial Report Quality in Indonesia

Dody Hapsoro[1]

[1]STIE YKPN Yogyakarta, Indonesia,
**Corresponding author E-mail: dodyhapsoro@gmail.com*

Abstract

The aim of this study is to examine the effect of corporate governance mechanisms on the financial reporting quality and examine the effect of corporate governance mechanisms on audit fees. In addition, this study also aimed to examine the effect of audit fees on the financial report quality. The sample in this study is manufacturing companies listed on the Indonesia Stock Exchange (BEI) in the period 2014 and 2015. The total sample is 144 companies. Data analysis was performed using Partial Least Squares (PLS). The results of this study show that the proportion of independent commissioners and audit committee from the board of commissioners and audit committee negatively affect audit fees; the proportion of independent commissioners and audit committee from the board of commissioners, audit committee, and board of directors negatively affect audit fees; the proportion of independent commissioners and audit committee from the board of commissioners and audit committee do not positively affect the financial report quality; the proportion of independent commissioners and audit committee from the board of commissioners, audit committee, and board of directors do not positively affect the financial report quality; and audit fees negatively affects the financial report quality.

***Keywords**: Corporate Governance Mechanisms; Audit fees; Financial Reporting Quality*

1. Introduction

Issues about the factors that influence the financial reporting quality is an issue that has always attracted the attention of regulators, practitioners, and academics. The application of accounting rules freely provides an opportunity for managers to use its authority on what should be reported. In this view, the managers occasionally opportunistically implemented accounting standards for personal gain. The main role of the audit is to increase the value or the financial reporting quality by reducing the information asymmetry. Auditors should be able to eliminate the management's effort to creatively manage earnings by enforcing appropriate accounting policy (1, 2). A decrease in auditor independence can withstand the auditor's ability to enforce accounting policies appropriately. One major factor that led to a decrease in auditor independence is the economic ties between the auditors and the clients (3, 4). In an auditor-client tie, the auditor is subject to the clients and does not have other choice but to agree with the client's choice reporting, even when such reporting does not represent the reality(2). As noted in several studies, high audit fees can be a reflection of the efforts of auditors, and the auditor's efforts will affect the quality of audited financial reports.
In recent times, regulators and academics have shown of concern about the high level of concentration of the Big 4 accounting firm and the excessive audit fees in the audit market(5). The high level of concentration on the Big 4 accounting firms is related to high competition in the audit market. This circumstance has an impact on the state of dissatisfaction of the quality of accounting information. In the eyes of most people, KAP Big 4 has been widely recognized as being able to provide high quality audit services (2, 6). Cases of financial report manipulation in Indonesia is thought to occur because of the existence of the accounting firms that operate in a market segment with a high level of concentration but without carrying out the task with high quality as expected.
In Indonesia, factors such as weak market, bribery, corruption, and inadequate infrastructure make agency problems worse. These factors help to facilitate the exploitation of minority shareholders by controlling (majority) shareholders (7). In addition, the above factors also give empirical support to the statement from (7) regarding the inability of the majority shareholders to act effectively in monitoring corruption. The aim of this study is to answer the question of whether the audit fees paid to the auditor reflects the effort of the auditor in carrying out professional work or whether the auditor was forced to be tied economically with their clients, resulting in a loss of their independence.
Scott (8) stated that the choice of accounting policies by managers for a particular purpose is called earnings management. The manager's behavior in doing earning management can be minimized by applying the mechanism of corporate governance. Corporate governance is the set of mechanisms used to limit the problem of information asymmetry that can lead to earnings management(9).
Corporate governance mechanisms, among others, are characterized by the presence of independent commissioners and audit committees. The existence of independent commissioners and audit committees of a company are proven to be effective in preventing the practices of earnings management, due to the existence of the independent commissioners' and audit committees' aim to supervise the activities of the company in achieving the company's goals(10).
The board of commissioners has the task of overseeing the company's strategy, guaranteeing the accountability implementation, and supervising management in running the compan y (11). In the study of (12), which examined the impact of the board of commissioners characteristics in the company on the fee paid to the exter-

nal auditors, showed that the intensity of board commissioners' meetings positively and significantly impacted the audit fees. The existence of the various control mechanisms and the audit committee that are often associated with high audit fees and good audit quality should improve the financial report quality and reduce the auditor's risk in the provision of audit opinion. Francis and Wang (2) found that a high audit fees represents a good audit quality. Further, Abbott, et al., (13) stated that the demand of the audit committee of the level of assurance provided by the auditor will increase the audit fees because of the vast scope of the investigation that should be done by the auditor.

Financial report quality that is proxied by earnings management is management's interference in the financial reporting process with the purpose of benefitting himself (manager). One way to measure earnings management is using a discretionary accrual proxy. Discretionary accrual is an accrual component that is in the policy manager's duties, meaning the manager intervenes in the process of accounting reporting. Earnings management is different from income smoothing because income smoothing is flattening profit reported in financial reports for external reporting purposes, particularly for investors, since most investors prefer relatively stable earnings. Therefore, income smoothing is part of earnings management (14).

Based on the background described previously, the aim of this study is to examine the effect of corporate governance mechanisms on the financial report quality, examine the effect of corporate governance mechanisms on the audit fees, and examine the effect of audit fees on the financial report quality.

2. Literature Review

Agency theory describes that the company's management is the agent and the shareholders are the principal in a separation between management and ownership of the company. The separation between the agent and the principal may cause a conflict of interest(15).

Conflicts of interest that often occur in the company include conflicts between the management company and the owner of the company, the company's management and subordinates, and the owner of the company and the creditor. To mediate the conflict of interest, it is necessary to retain an independent party that is expected to reduce the agency's problem. Audit services are required as monitoring tools between agents and principals because of the potential conflict of interest between the management company and the employer. The external auditor as an independent party is useful in providing audit services that are expected to reduce agency problems.

A company's management is obliged to disclose financial reports to owners as a monitoring tool. With the financial reports, management of the company is forced to act in accordance with the interests of the owners. The theory of agency states that conflicts of interest and information asymmetries that emerge can be reduced by proper monitoring mechanisms to align the interests of various parties in the company. The monitoring mechanism that is referred to in agency theory can be implemented by using a corporate governance mechanism. Application of a corporate governance mechanism can improve the performance of management in managing the wealth of the owners (shareholders) to minimize agency fees and conflicts of interest.

Jensen & Meckling (15) split the agency fee into:

a) Monitoring Costs

Monitoring costs are costs occurred to monitor the behavior of agents, i.e., the costs incurred for measuring, observing, and controlling the behavior of agents. Examples of monitoring costs include: costs incurred to conduct the audit, costs to set a management compensation plan, restrictions of budget, and rules of operation. The better the reputation of the agent, then the greater the compensation is to be received by the agent, as monitoring costs incurred by the principal become smaller. Conversely, if the agent's reputation is not good, then the compensation to be received by the agent becomes smaller because the monitoring costs incurred by the principal increase.

b) Bonding Costs

Bonding costs are those costs occurred to insure that the agent would not act in a way that may be detrimental to the principal or to ensure that the principal will provide compensation if the agent is really doing the right thing.

c) Residual Loss

Residual loss represents the value of money that is equal to a reduction in the prosperity experienced by the principal as a result of discrepancy in interests.

2.1. The Financial Report Quality

The financial report quality in this study is proxied by earnings management. Earnings management is any management action that may affect the reported earnings figures. Earnings management is the process of taking deliberate steps within the limits of the general accounting principles both inside and outside the borders of Generally Accepted Accounting Principles (GAAP). Sulistyanto (16) explained that the earnings management is a manager's attempt to influence the information in the financial reports with the intention to deceive stakeholders who want to know the performance and condition of the company.

Healy & Wahlen (17) suggested that earnings management happens when managers use their judgment in financial reporting and manipulating transactions to change financial reports, thereby misleading the stakeholders about the economic performance of companies or affecting the results relating to the contract depending on the reported accounting figures. Earnings management can be achieved by using creative accounting methods and procedures through the creation of policies that can accelerate or delay the costs and revenue so that the company's profit will be smaller or larger than expected (8).

2.2. Audit Fees

Audit fees are fees paid to the auditor by the auditee to compensate or replace the service the auditor has done (18). The total audit fees is the sum of all the audit fees paid by the auditee to the auditor (19). Total audit fees consists of audit fees paid to the auditor for auditing services and non-audit fees paid by the auditee for services outside audit services. According to the Decree of the Chairman of the Indonesian Institute of Accountants KEP.024/IAPI/VII/2008 on Audit Fees Determination Policy, in determining the audit fees paid by the auditee, the auditor should consider a variety of things such as the needs of the auditee, duties and responsibilities under the law, independence, the level of expertise and responsibility, job complexity, and amount of time required to determine the agreed-upon fee.

The higher the audit fees, the higher the audit effort undertaken by the auditor will be, which will ultimately be reflected in high quality audits (6). This is reinforced by the assumption that when the audit fees are low due to low-balling, then the quality of the audit will be reduced because the auditor will reduce the audit effort(20). Low-balling is the determination of the audit fees under current total cost at the initial audit agreement with the expectations that the accounting firm can recoup the loss of audit revenue in subsequent years (6). Low-balling is usually done to get the initial audit agreement from the auditee at competitive prices due to the high degree of competition. However, on the other hand, there is an argument assuming that when the auditor receives the excess of the audit fees, it would threaten the auditor's independence, which results in the increase or decrease in the audit quality.

2.3. Corporate Governance

According to Cadbury (21), corporate governance is a bunch of rules governing the relationship between shareholders, management of the company, the creditors, government, employees, and other internal and external stakeholders relating to their rights and obligations. In other words, this is a system that regulates and controls the company. The purpose of corporate governance is to create added value for all interested parties (stakeholders).
According to the Forum for Corporate Governance in Indonesia/(22), in corporate governance there are five essential elements that need to be addressed:

a) Fairness

Guaranteeing the protection of the claims of the shareholders, including the rights of foreign shareholders and minority shareholders, as well as guaranteeing the implementation of the investor's commitment.

b) Transparency

Requiring that the information is open, timely, and clear. Can be compared concerning the financial condition, corporate management, and ownership of the corporation.

c) Accountability

Clarify the roles and responsibilities and support the efforts to ensure a balance between the interests of management and shareholders, as overseen by the board of commissioners.

d) Responsibility

Ensure compliance of the rules and regulations that serve as a reflection of adherence to social values.

e) Independency

A condition where a company is professionally managed with no conflicts of interest and influence or pressure from any party that does not comply with the legislation in force and the principles of sound business.
FCGi (22) stated that the benefits of the application of corporate governance are as follows:
a) Improve the performance of companies through the creation of a better decision making process, increase its operational efficiency, and further improve the service to its stakeholders.
b) Facilitate obtaining cheaper financing funds because of the trust factor that will ultimately increase corporate value.
c) Companies will be able to improve reception of the state budget mainly from privatization.
d) Reduce management's ability to perform actions that are detrimental to shareholders and other stakeholders.
e) Reduce the high cost economy, especially in corporate targets.
f) Returns the confidence of foreign investors to invest in Indonesia.

2.4. Management/Control Structure

a) Audit Committee

The audit committee has a separate task helping the board of directors fulfill their responsibility to provide overall supervision. For example, the audit committee has the competency to implement and validate the investigation of problems within the scope of its responsibilities. The Institute of Internal Auditors (IIA) recommends that every public company have an audit committee that is set up as a permanent committee. IIA also advocated the formation of audit committees in other organizations, including of non-profit institutions and government.
The audit committee comprises independent commissioners and, in spite of the daily management activities, has the primary responsibility to assist the board of commissioners in carrying out their responsibilities, especially with the problems associated with the internal controls, company's accounting policies, and financial reporting systems.

b) Independent Commissioner

The existence of an independent commissioner could be used to reduce the agency conflict because independent commissioners can communicate the goals and desires of shareholders to managers. Klein (23) stated that the external board membership could encourage the creation of a clear management system and limit managers' opportunistic behavior. The board of commissioners has the task to oversee the company's strategy, oversee management in running the company, and guarantee the implementation of accountability(11). The Indonesia Stock Exchange, through the regulation of BEI, on July 1, 2000 set the existence of an independent commissioner. In the regulation they stated that the companies listed on the stock exchange must have an independent commissioner that is proportional to the number of shares held by the minority shareholders. The requirements regarding the minimum number of independent commissioners is 30% of all commissioners.

c) Research Model

The following shows the model used in this research:

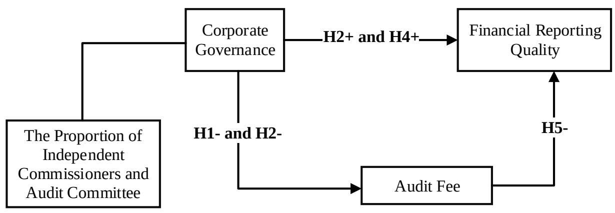

Fig. 1: Research Model

2.5. Hypothesis Formulation

a. The Effect of Proportion of Independent Commissioner and Audit Committee on Audit Fees

The board of commissioners has the task of overseeing management in running the company, overseeing the company's strategy, and guaranteeing the implementation of accountability (11). In their study, (12) examined the impact of the characteristics of the company's board of commissioners on the fee paid to the external auditors and showed that the intensity of board commissioner meetings positively and significantly affected the audit fees.
The relationship between external audits and the audit committee is complex, and is derived from the request for audit services by the client and the provision of audit services by the external auditor(24). On the demand side, the presence of the audit committee have a positive relationship with audit costs by ensuring that audit hours are not reduced to levels that could endanger the audit quality, because the task of the audit committee is to monitor the company's performance as a whole and report its findings regularly to the council of commissioners, review the work of external auditors, assess the objectivity, independence, and the adequacy of the external audit. Members of the audit committee must have an incentive to ensure the high quality of audit in order to reduce the loss of reputation and the risk of litigation in the case of fraudulent

financial reporting (21). From the supply side, the involvement of the audit committee in fulfilling oversight responsibilities, which include a review of the audited annual report and financial statements, the review of the financial reporting process and internal control systems, as well as oversight of the audit process causes the external auditor's role in auditing the level of control risk to be reduced. As a result, reliance of auditors on internal controls should produce less substantive testing and therefore lower the cost of the audit(24).

(25) recommended that audit committees that are independent, diligent, expert, and numerous are good in evaluating the management in financial reporting practices. This is a step towards supporting the improvement of the governance environment and reducing external audit fees. Additionally, the positive relationship between the audit committee and the audit fees is when an effective audit committee reduces the threat of dismissal of auditors and therefore strengthens the bargaining position of the auditor during fee negotiation (13).

Based on the above arguments, the following hypotheses can be stated:

H_1: The proportion of independent commissioners and the audit committee from audit committee and the board of commissioners negatively affect audit fees.

H_2: The proportion of independent commissioners and the audit committee from the board of directors, board of commissioners, and audit committee negatively impact audit fees.

b. The Effect of Proportion of Independent Commissioners and Audit Committee on the Financial Reports Quality

An independent commissioner is a commissioner who is not associated with the management, board of commissioner members, and other controlling shareholders, and is free of any other relationship that could affect its ability to act independently or act solely in the interest of the company(26). The existence of independent commissioners within the company serves as a counterweight in the decision making process in order to provide protection to minority shareholders and other parties related to the company(27).

The audit committee set up by a company serves to support the board of commissioners in overseeing the management in preparing the financial reports(28). The purpose of the existence of the audit committee in the company, as stated by (10) is to serve assurance that the financial reports issued by the company management are in conformation with generally accepted accounting principles, providing assurance that the company's internal controls are adequate, monitoring and following up the possible material deviations of financial and legal implications, and providing recommendations for the selection of an external auditor who will audit the company.

Based on the above arguments, the following hypotheses can be formulated:

H_3: The proportion of independent commissioners and audit committee from the board of commissioners and audit committee positively affect the financial report quality.

H_4: The proportion of independent commissioners and audit committee from the board of commissioners, audit committee, and board of directors positively affect the financial report quality.

c. The Effect of Audit Fees on the Financial Report Quality

One major factor that led to a decrease in the independence of an auditor is the economic ties between the auditors and their clients(3, 4). When there is an auditor–client tie, the auditor is subject to the client and has no other choice but to agree with the choice of client reporting, even when such reporting does not represent the reality (2). As noted in several studies, the high audit fees can be a reflection of the auditor's efforts, and the auditor's efforts will affect the quality of the audited financial reports.

Several studies have examined the views of the economic ties between the auditors with the client. (29) presented evidence showing that the magnitude of the absolute discretionary accruals is negative when linked with audit fees rankings. This means that the higher the earnings management conducted by the company, the lower the audit fees received by the auditors. However, (30) found no significant relationship between the two. Some recent literature tends to consider the signs of abnormal audit fees. They noted that these signs have implications for auditor reporting incentives. Choi et al., (31) documented the existence of a significant relationship between abnormal audit fees with audit quality. However, their findings are sensitive to abnormal audit fees signs. When positive (audit fees is higher than the expected), it is possible that the auditor will lose independence. Conversely, when negative (audit fees is lower than the expected), the relationship is not significant. They concluded that the audit fees and the audit quality are asymmetrical and non-linear. In other words, the relationship between abnormal audit fees and audit quality depend on what is determined by the sign of abnormal audit fees, which is positive or negative.

When auditors perform an audit, they will receive a fee. The amount of the fee depends on the extent of the given task. Companies with a high level of earnings management are more likely to pay a greater audit fees than companies that have a low level of earnings management(32). When the auditor receives high fees because the company is performing high earning management, it can degrade the financial report quality.

Based on the above arguments, can be formulated that:

H_5: Audit fees negatively affects the financial report quality.

3. Research Methodology

3.1. Research Variables and Operational Definitions

a. Financial Report Quality

The quality of financial report variables is proxied by earnings management. Earnings management is measured by discretionary accruals. The amount of discretionary accruals are calculated using the Modified Jones Model. This model is widely used in accounting studies because it is considered to be the best model in detecting earnings management and provides the most powerful results (16). This model uses the total accruals (TAC) that were classified as a component of discretionary accruals (DAC) and non-discretionary accruals. The model can be written as follows:

1) Calculate the value of total accruals by the equation:

Total accruals (TAC) = Net profit after tax (net income) - Cash flows from operating activities (operating cash flow).

2) Calculate the regression coefficient values α1, α2, and α3 with the regression equation ordinary least square (OLS):

$$\left(\frac{TAC}{A_{t-1}}\right) = \propto_1 \left(\frac{1}{A_{t-1}}\right) + \propto_2 \left(\frac{\Delta REV_t}{A_{t-1}}\right) + \propto_3 \left(\frac{PPE_t}{A_{t-1}}\right) + \varepsilon$$

Description:

TAC_t = Total accrual of the company in period t

A_{t-1} = Total assets of the company at the end of the year t-1 (previously)

ΔREV_t = Revenue in year t minus revenue in the year t-1 (previously)

PPEt = Fixed assets of companies at the end of year t

3) The value of the regression coefficients α1, α2, and α3 obtained are then used to find the value of non-discretionary accruals in the following ways:

$$NDA_t = \propto_1 \left(\frac{1}{A_{t-1}}\right) + \propto_2 \left(\frac{\Delta REV_t - \Delta REC_t}{A_{t-1}}\right) + \propto_3 \left(\frac{PPE_t}{A_{t-1}}\right)$$

Description:

NDA_t = Non-discretionary accruals in year t

ΔREC_t = The receivables of the company in year t minus the receivables of the company in year t-1

α = Fitted coefficient obtained from the regression results in the calculation of total accruals

4) Calculating the value of discretionary accruals:

$$DAC_t = \left(\frac{TAC_t}{A_{t-1}}\right) - NDA_t$$

Description:

DAC_t= Discretionary accruals of the company in year t

b. Audit Fees

The dependent variable used in this study is the audit fees. Data on the audit fees will be represented by a professional fees account contained in the financial reports of manufacturing companies listed on the Indonesian Stock Exchange (BEI). These variables will then be measured using the natural logarithm of professional fees. The usage of professional fees data as a proxy of audit fees variable is due to the unavailability of data on the audit fees. Disclosure of data on the audit fees in Indonesia is still voluntary, so not many companies include such data in the annual report.

c. Proportion of Independent Commissioner and Audit Committee from the Board of Commissioner and the Audit Committee (PKKA)

The role of the board commissioner is to monitor the board of directors' policies that are expected to minimize agency problems that occur between the board of directors and shareholders. The number of independent commissioners shall represent at least 30% of the number of commissioners on the board of commissioners (Bapepam-LK No. IX.I.5).

The audit committee referred to in this study is the number of audit committees within the company. The audit committee is responsible for overseeing the financial reporting and internal controls and acts as a mediator between the internal and external auditors (33). Bapepam Regulation No. IX.I.5 explains that the existence of an audit committee is composed of at least three people and an independent commissioner serves as the chairman of the audit committee, while the other is an independent external party. At a minimum, one of them has to have skills in the fields of accounting and finance.

The proportion of independent commissioners and audit committees from the board of commissioners and audit committee (PKKA) is formulated as follows:

$$PKKA = \frac{\text{The number of independent commissioners + The number of audit committees}}{\text{The number of board commissioners + The number of audit committees}} \times 100\%$$

The proportion of independent commissioners and audit committees from the board of commissioners, board of directors, and audit committee (PKDK) is formulated as follows:

$$PKDK = \frac{\text{The number of independent commissioners + The number of audit committees}}{\text{The number of board commissioners + The number of audit committees + The number of board of directors}} \times 100\%$$

3.2. Population and Sample

The population in this research is manufacturing companies listed on the Indonesia Stock Exchange (BEI). The observation period used is 2014–2015. Determination of the sample companies was performed using the purposive sampling method. The use of this method has the purpose to obtain a representative sample in accordance with the specified criteria. The criteria that must be met for a sample of this research are:

1. The manufacturing company was listed on the Indonesia Stock Exchange during the period of 2014-2015.
2. The company did not experience any delisting during the observation period.
3. The company has financial reports in rupiah currency.
4. The company includes annual reports and financial reports that were audited by an independent auditor during the period of 2014-2015.
5. The company includes audit fees or professional service fees accounts.

3.3. Types and Sources of Data

The data used in this research is secondary data from company financial reports that were audited in 2014–2015. The data was derived from www.idx.co.id, audited financial reports, and annual reports.

3.4. Data Collection Methods

The data collection method was collecting secondary data, namely the method of literature study and documentation. Studies were conducted by processing literature, articles, journals, and other written media related to the topic of discussion of the study. The method of documentation was collecting documentary data sources such as company financial reports that were audited from a sample of companies in the study.

3.5. Data Analysis Methods

The analysis model used in this study was Partial Least Square (PLS). The basic idea of PLS is to predict the variable Y (dependent) from the variable X (independent). PLS will search for the best X component to predict Y. PLS will seek one component called latent vector and a simultaneous decomposition of X and Y with the restriction that these components can explain the covariance between X and Y(34). Ghozali, (34) also explained that the PLS is a soft modeling analytical method because it does not assume the data must be within a certain scale measurement.

According to Hussein (35), there are two types of SEM: the variance-based SEM called PLS and covariance-based SEM using AMOS and LISREL. Although both are categorized as SEM, the PLS and covariance-based SEM (CBSEM) have a clear distinction. The main thing that distinguishes between the PLS and CBSEM is the purpose of using the method. The purpose of using PLS is to make predictions. Prediction in this case is the prediction of the relationships between the constructs. In contrast to PLS, which aims to make predictions, CBSEM use is intended as a method to confirm a theory, so it can be said that the PLS is more oriented to the prediction, while CBSEM is oriented to the theory (36).

Based on statistical assumptions, PLS is classified as a type of non-parametric, while CBSEM is classified as a multivariate normal distribution and independent observation (parametric). Therefore, PLS modeling not necessary as the data has a normal distribution.

In terms of construct, CBSEM can only accommodate a reflective shaped construct, while PLS can accommodate both formative and reflective shaped constructs. Total constructs and indicators used in the PLS and CBSEM are different. PLS can accommodate up to 100 constructs and 1,000 indicators, whereas CBSEM only accommodates a maximum of 100 indicators.

Other differences between PLS and CBSEM is the number of samples. Because PLS is based on the variance, the number of samples used is not great. The sample used can range from 30-100, while CBSEM, because it essentially is the covariance, the sample used ranged from 200-800 samples.

Analysis of the structure models of PLS is done through three stages, namely:

1. Outer Analysis Model. Outer analysis model was made to ensure that the measurement used is a decent measurement (valid and reliable). Outer analysis model can be seen from several indicators, namely convergent validity, discriminant validity, and unidimensionality. Convergent validity is the loading factor value on the latent variables with indicators (expected value > 0.7). Discriminant validity is the cross loading factor value useful in knowing whether the construct has adequate discriminant validity by comparing the value of the loading on the target construct, which must be greater than the value of the loading with the another construct and unidimensionality, i.e., specific concepts (not to be general) containing just one type of symptom.
2. Inner Analysis Model/Structural Analysis Model ensures that the built structural model is robust and accurate. Inner evaluation model can be seen from several indicators, namely the coefficient of determination (R2), predictive relevance (Q2), and Goodness of Fit Index (GoF).
3. Hypothesis Testing. Hypothesis testing is done by looking at the probability value and t-statistics. For a probability value, p-value with an alpha of 5% is less than 0.05. The t-table value for alpha 5% is 1.96, so the criteria for acceptance of the hypothesis is t-statistic > t-table.

Data analysis techniques used in this research hypothesis testing are as follows:

1. Designing a Structural Model (Inner Model)

Structural models describe the relationship between latent variables based on substantive theory. The design of the structural model shows the relationships between the latent variables based on the formulation of the problem or the research hypothesis, assuming that latent variables and indicators or manifest variables are on a scale of zero means and a unit variance equal to one, so that the constant parameter can be removed from the model.

2. Measurement Model (Outer Model)

The measurement model defines how each indicator block is associated with the latent variables. The design of the measurement model determines the indicator nature of each latent variable, whether reflexive or formative, based on operational definitions of variables. Measurement model (outer model) is used to test the construct validity and reliability of the instrument. A validity test is done to determine the ability of research instruments measure what should be measured (37), while the reliability test is used to test the consistency of the measuring instrument in measuring a concept.

3. Constructing the Path Diagram

After steps one and two, the subsequently shaped path diagram was constructed. The path diagram is shown in Fig. 2 below:

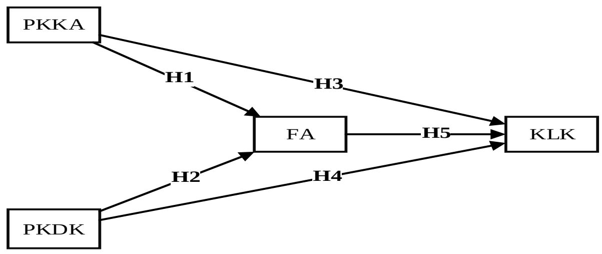

Fig. 2: Path Diagram

4. Description:

PKKA = Proportion of independent commissioners and the audit committee from the board of commissioners and audit committee
PKDK = Proportion of independent commissioners and the audit committee from the board of commissioners, board of directors and audit committee
FA = Audit fees
KLK = Financial report quality

4. Make Estimation

The parameter estimation method (estimation) in PLS is the least squares method. The calculation process is done by iteration, where the iteration will stop if it has reached a convergent condition. The estimation of the parameters in the PLS consists of two things, namely:

a. Relationship between the latent variables and the estimation of loading between the latent variables with the indicator.
b. Estimating the path that relates the latent variables and the estimation of loading between the latent variables with the indicator.

5. Evaluating Structural Model Constructs

WarpPLS can be used to evaluate the best model by providing the calculation results of Average R-Square (ARS), which is used to assess the effect of exogenous, endogenous, and moderating variables, can be said to be good if the ARS value < 0.05. Average Path Coefficient (APC), which is used to see the relationship between variables, can be said to be good if the APC value < 0.05. Average Variance Inflation Factor (AVIF) is used to see the magnitude of the correlation between the endogenous variables/multicollinearity, which can be good if the value of AVIF < 5.

6. Testing the Hypothesis

Testing the hypothesis in this study was conducted by examining the relationships between variables. Statistical tests were performed when the obtained p-value < 0.05 (5% alpha), and it was concluded to be significant, and vice versa. If the test results in the inner models is significant, it means that there is a significant effect. Application of this method allows the enactment of the free distributed data, does not require the assumption of a normal distribution, and does not require a large sample.

The significance level of the path coefficients in the WarpPls model used in this study is a p-value < 0.05. Thus, the decision could be made as follows: If the path coefficient that connects the two variables has a p-value < 0.05, it can be concluded that there is a significant influence between these variables. Conversely, if the path coefficient has a value > 0.05, it can be concluded there is a non-significant influence between these variables.

5. Results and Findings

a. Descriptive Analysis

Data analysis in this study was performed using the results of descriptive statistics and analysis of PLS. The results of the data analysis by descriptive statistics are shown in Table 1.

Table 1: Results of Data Analysis with Descriptive Statistics

	PKKA	PKDK	Audit Fees	Financial Report Quality
Mean	0.667	0.401	9.293	-0.000
Min	0.462	0.250	7.942	-2.033
Max	0.857	0.571	12.449	0

Source: Output (Data Processed)

Table 1 shows that the average value for the proportion of independent commissioners and the audit committee from the board of commissioners and audit committee variable is 0.667 or 66.7%, a minimum value of 0.462 or 46.2%, and the highest proportion of 0.857 or 85.7%. The average value of proportion of independent commissioners and the audit committee from the board of commissioners, board of directors, and audit committee variable is 0.401 or 40.1%, the minimum value is 0.250 or 25%, and the highest proportion is 0.571 or 57.1%. The average value of the audit fees variable amounted to 9.293, the minimum value is 7.942, and the maximum value is 12.449. The average value of the quality of the financial report variable is -0.000, the minimum value is -2.033, and the maximum value is 0.344.

b. Inductive Analysis

Inductive analysis by PLS in this study consisted of outer models assessment, the value of goodness of fit (inner model) calculation, and hypothesis testing.

1. Outer Research Model

This study did not conduct outer models research. Outer models determines the relationship specification between constructs and its indicators. The construct is divided into two, namely exogenous constructs and endogenous constructs. The exogenous construct is a cause construct, which are constructs that are not influenced by other constructs. Endogenous constructs are the effects of exogenous constructs. Outer models research includes the validity test and reliability test because the power used in this study was the measured data.

2. Calculation of Value Goodness of Fit (Inner Model)

Structural models or inner models on the conceptual framework constructed based on the concepts and theories is called fit if supported by empirical data. Calculation of the value of goodness of fit inner model is based on the analysis results of the SEM Warp-PLS in Table 2 below:

Table 2: Results of Inner Model (R-square Value)

Variable	R-square
PKKAa	-
PKDK	-
Audit fees	0.11
Quality Financial Report	0.05

Source: PLS Output (Data Processed)

Goodness of fit inner models in the PLS analysis using the Stone-Geisser Q-Square test size in the form of Q-square predictive relevance value were calculated based on the value of R2 for each endogenous variable. The audit fees variable obtained an R_{FA}^2 value of 0.11, and the financial report quality variable obtained a R_{KLK}^2 value of 0.05. Thus, the value of the Q-square predictive relevance is:

$$
\begin{aligned}
Q2 &= 1 - (1 - R_{FA}^2)(1 - R_{KLK}^2) \\
&= 1 - (1 - 0.11)(1 - 0.05) \\
&= 1 - (0.89)(0.95) \\
&= 1 - 0.85 \\
&= 0.15
\end{aligned}
$$

Based on the calculations, the value of the Q-square predictive relevance is 0.15 or 15%. Therefore, the model is said to have a weak predictive value because the variable in the model that includes PKKA, PKDK, and audit fees variables is only able to explain the financial report quality variable by 15%, while the remaining 85% is another variation on the outside of the model.

3. Hypothesis Testing

Hypothesis testing is done to determine the effect of exogenous variables on endogenous variables. Exogenous variables in this study were PKKA and PKDK. The endogenous variable is the financial report quality. The audit fees variable is as an intervening endogenous variable. For more details, hypothesis testing results can be seen in Fig. 3 below:

In Fig. 3, the arrows show the influence between variables (hypothesis), whereas the beta (β) symbol shows the coefficients and the probability level marked with the symbol P. Explanation and interpretation of each hypothesis testing result is reviewed as follows:

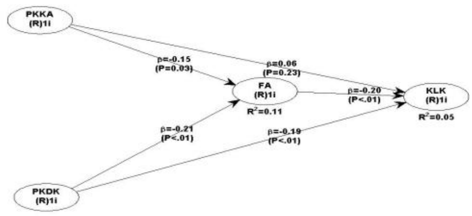

Fig. 3: Hypothesis Testing Results

1. The proportion of independent commissioners and the audit committee from the board of commissioners and audit committee negatively affect the audit fees. The analysis showed that the proportion of independent commissioners and the audit committee from the board of commissioners and audit committee (PKKA) negatively affect the audit fees ($\beta = -0.15$; $p < 0.05$).
2. The proportion of independent commissioners and the audit committee from the board of commissioners, audit committee, and board of directors negatively affect the audit fees. The analysis showed that the proportion of independent commissioners and the audit committee from the board of commissioners, audit committee, and board of directors negatively affect the audit fees ($\beta = -0.21$; $p < 0.05$).
3. The proportion of independent commissioners and the audit committee from the board of commissioners and audit committee positively affect the financial report quality. The analysis showed that the proportion of independent commissioners and the audit committee from the board of commissioners and audit committee does not positively affect the financial report quality ($\beta = 0.06$; $p > 0.05$).
4. The proportion of independent commissioners and the audit committee from the board of commissioners, board of directors and audit committee positively affect the financial report quality. The analysis showed that the proportion of independent commissioners and the audit committee from the board of commissioners, audit committee, and board of directors does not positively affect the financial report quality ($\beta = -0.19$; $p < 0.05$).
5. Audit fees negatively affects the financial report quality. The analysis showed that the audit fees negatively affects the financial report quality ($\beta = -0.20$; $p < 0.05$).

c. Discussion

1) The Proportion of Independent Commissioners and the Audit Committee from the Board of Commissioners and Audit Committee Negatively Affect the Audit Fees.

PKKA negatively affects the audit fees, as shown by the β value of -0.15 and a P value of 0.03 that is less than the value α (0.05). Therefore, the first hypothesis stating that the proportion of independent commissioners and the audit committee from the board of commissioners and audit committee (PKKA) negatively affect the audit fees is supported. The board of commissioners has the task of overseeing the company's strategy, overseeing management in running the company, and guaranteeing the implementation of accountability (11). The involvement of the audit committee in strengthening internal controls may cause the external auditor to reduce the level of control risk. As a result, the reliance of auditors on internal control should produce less substantive testing and therefore the audit should have a lower cost (24).

2) The Proportion of Independent Commissioners and the Audit Committee from the Board of Commissioners, Audit Committee, and Board of Directors Negatively Affect the Audit Fees.

PKDK negatively affects the audit fees, as is shown by the β value of -0.21 and a P value of 0.01 that is smaller than 0.05. Therefore, the second hypothesis, which states that the proportion of independent commissioners and the audit committee from the board of commissioners, board of directors, and audit committee negatively affect audit fees, is supported. Duties and authority of the board of commissioners is based on Article 19 of the Articles of Association, which says they are to oversee the management of the company undertaken by the board of directors and to advise the board of directors. The board of commissioners also make recommendations for improvements or suggestions on the review submitted by the audit committee and submit those recommendations to the chief executive or director concerned. The strong control and recommendations for improvement will reduce the duty of the external auditor, ultimately reducing the audit fees.

3) The Proportion of Independent Commissioners and the Audit Committee from the Board of Commissioners and Audit Committee Positively Affect the Financial Report Quality

PKKA does not positively affect the financial report quality. This is shown by the β value of 0.06 and a P value of 0.23 that is greater than α (0.05). Therefore, the third hypothesis, which states that the proportion of independent commissioners and the audit committee from the board of commissioners and audit committee positively affect the financial report quality, is not supported. This happens because of the existence of the audit committee, and independent commissioners in a company cannot carry out their duties in monitoring financial reporting. Therefore, the presence of the audit committee and independent commissioners failed to detect earnings management, which in turn lowers the quality of the company's financial reports.

4) The Proportion of Independent Commissioners and the Audit Committee from the Board of Commissioners, Board of Directors and Audit Committee Positively Affect the Financial Report Quality

PKDK does not positively affect the financial report quality. This is shown by the β value of -0.19 and a P value of 0.01 is smaller than α (0.05). Therefore, the fourth hypothesis, which states that the proportion of independent commissioners and the audit committee from the board of commissioners, board of directors, and audit committee positively affect the financial report quality, is not supported. As discussed earlier, the duties and authority of the board of commissioners is to oversee the management of the company undertaken by the board of directors and advises the board of directors. The board of commissioners also make recommendations for improvements or suggestions on the review submitted by the audit committee, and they submit those recommendations to the chief executive or director concerned. However, if the task is not done well, then the existence of the independent commissioner and audit committee within the company fails to become one of the mechanisms of corporate governance in detecting earnings management.

5) Audit Fees Negatively Affect the Financial Report Quality

Audit fees negatively affects the financial reporting quality. This is shown by the β value of -0.20 and a P value of 0.01 is smaller than α (0.05). Therefore, the fifth hypothesis, which states that the audit fees negatively affects the financial report quality is supported. The decline of the independence of an auditor can occur if there are economic ties between the auditors and their clients (3, 4). When there are economic ties between the auditor and their client, the auditor will be subject to the clients and will have no other choice but to agree with the choice of client reporting. When companies conduct earnings management, the manager will try to cover it up at the time of the company audit. Therefore, managers will provide a high audit fees for the results of the audit in accordance with what managers wanted, which in turn will lower the financial reporting quality.

6. Conclusion

6.1. Conclusions

The conclusions of this study are as follows: The proportion of independent commissioners and the audit committee from the board of commissioners and audit committee (PKKA) negatively affects the audit fees; The proportion of independent commissioners and the audit committee from the board of commissioners, the audit committee, and board of directors (PKDK) negatively affects the audit fees; The proportion of independent commissioners and the audit committee from the board of commissioners and audit committee (PKKA) does not positively affect the financial report quality; The proportion of independent commissioners and the audit committee from the board of commissioners, board of directors, and audit committee (PKDK) does not positively affect the financial report quality; and Audit fees negatively affects the financial report quality.

6.2. Implications

The implications of this study are as follows:

1. The results of the study prove that the proportion of independent commissioners and audit committees from the board of commissioners and audit committees, as well as the proportion of independent commissioners and audit committees from the board of commissioners, the audit committee, and board of directors, negatively affect audit fees. This is in line with(11) statement that the board of commissioners has the duty to oversee corporate strategy, oversee the management in running the company, and ensure proper accountability. The involvement of independent commissioners and audit committees in strengthening internal controls can reduce the risk level of external auditor control. In addition, the results of the study are also in line with the statement of (24) that external auditors' dependence on internal controls should result in less substantive testing and ultimately lead to lower (efficient) audit costs. Therefore, the existence and the number of independent commissioners and audit committees in the corporate governance structure should always be a concern of the capital market regulator in Indonesia in order to create efficient and effective corporate governance mechanisms in reducing the audit fees.
2. The results of the study prove that the proportion of independent commissioners and audit committees from the board of commissioners and audit committees as well as the proportion of independent commissioners and audit committees

from the board of commissioners, the audit committee, and board of directors have no positive effect on the quality of the company's financial report. This shows that the existence of the audit committee and the independent commissioner within the company has not been able to perform its intended function in monitoring and detecting the occurrence of earnings management, which ultimately degrades the quality of the company's financial report. In other words, the existence of independent commissioners and audit committees within the company fails to be an effective corporate governance mechanism in detecting earnings management. Therefore, the existence and the number of independent commissioners and audit committees in the corporate governance structure need to be strengthened and increased in number to be more capable in carrying out the duties and functions of detecting the possibility of earnings management conducted by the company, in order to create quality financial reports.

3. The results prove that audit fees negatively affect the financial report quality. This is in line with the statement of (3) and (4), that reducing the independence of an auditor can occur when there is an economic tie between the auditor and the client. When an economic tie exists between the auditor and the client, the auditor becomes subject to the client's interests and has no choice but to agree with the client's reporting option. In other words, when a client company does earnings management, the manager will attempt to cover up the action when the client's company is audited. Managers provide high audit fees in the hopes that the audit results are in accordance with the desired results and will ultimately reduce the financial reporting quality. Therefore, in Indonesia it is necessary to make a rule (limitation) about the amount of audit fees that will be paid by the client company to the auditor in order to create a quality audit process that does not depend on the amount of the audit fees that will be received by the external auditor. Through the quality audit process, it is expected that quality financial reports will be produced and that quality audit reports will result from factors of competence and independence. As stated by (38), audit quality is determined by two things: competence and independence, and both directly affect audit quality.

References

[1] Gibbins M. Evidence from Auditors about Managers' and Auditors' Earnings Management Decisions: Discussion. 2002;77(2002):203-11.

[2] Francis JR, Wang D. The Joint Effect of Investor Protection and Big 4 Audits on Earnings Quality around the World. Contemporary Accounting Research. 2008;25(1):157-91.

[3] Defond ML, Wong TJ, Li S. The impact of improved auditor independence on audit market concentration in China. Journal of Accounting and Economics. 1999;28(3):269-305.

[4] Chung H, Kallapur S. Client Importance, Nonaudit Services, and Abnormal Accruals. Accounting Review. 2003;78(4):931-55.

[5] Okike E. Management of crisis: The response of the auditing profession in Nigeria to the challenge to its legitimacy. Accounting, Auditing & Accountability Journal. 2004;17:705-30.

[6] DeAngelo LE. Auditor size and audit quality. Journal of Accounting and Economics. 1981;3(3):183-99.

[7] Ahunwan B, editor Corporate governance in Nigeria2002 2002.

[8] Scott WR. Financial Accounting Theory2006. 546- p.

[9] Darmawati D. Corporate Governance dan Manajemen Laba: Suatu Studi Empiris. Jurnal Bisnis dan Akuntansi. 2003;5(1):47-68.

[10] Herawaty N. Pengaruh Pengendalian Intern dan Lamanya Waktu Audit terhadap Fee Audit (Studi Kasus pada KAP Kota Jambi dan Palembang). Jurnal Penelitian Universitas Jambi Seri Humaniora. 2011;13(1):07-12.

[11] Neville M. The role of boards in small and medium sized firms. CORPORATE GOVERNANCE. 2011;11(5):527-40.

[12] Carcello JV, Hermanson DR, Neal TL, Riley Jr Ra. Board Characteristics and Audit Fees. Contemporary Accounting Research. 2002;19(3):365-84.

[13] Abbott LJ, Parker S, Peters GF, Rama DV. Corporate Governance, Audit Quality, and the Sarbanes-Oxley Act: Evidence from Internal Audit Outsourcing. The Accounting Review. 2007;82(4):803-35.

[14] Akuntansi JE, Ekonomi-Universitas F, Petra K, Ary T, Dosen G, Ekonomi F, et al. Earnings Management: Suatu Telaah Pustaka. Jurnal Akuntansi & Keuangan. 2000;2(2):104-15.

[15] Jensen MC, Meckling WH. Theory of the Firm : Managerial Behavior , Agency Costs and Ownership Structure Theory of the Firm : Managerial Behavior , Agency Costs and Ownership Structure. Journal of Financial Economics. 1976;3(4):305-60.

[16] Sulistyanto SH. Manajemen Laba: Teori dan Model Empiris. Jakarta: Grasindo; 2008.

[17] Healy PM, Wahlen JM. A review of the earnings management literature and its implications for standard setting. 1999. p. 365-83.

[18] Srinidhi BN, Gul FA. The Differential Effects of Auditors' Nonaudit and Audit Fees on Accrual Quality. Contemporary Accounting Research. 2007;24(2):595-629.

[19] Hoitash R, Markelevich A, Barragato Ca. Auditor fees and audit quality. Managerial Auditing Journal. 2007;22(8):761-86.

[20] Gupta N. Partial privatization and firm performance. Journal of Finance. 2005;60(2):987-1015.

[21] Cadbury A. Cadbury Report: The Financial Aspects of Corporate Governance. 1992 0 85258 913 1.

[22] FCGI. Corporate Governance: Tata Kelola Perusahaan. 3 ed. Jakarta2001. 100- p.

[23] Klein A. Audit committee, board of director characteristics, and earnings management. Journal of Accounting and Economics. 2002;33(3):375-400.

[24] Collier P, Gregory A. Audit committee effectiveness and the audit fee. European Accounting Review. 1996;5(2):177-98.

[25] Committee BR. Report of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committee. 1 ed. New York: NYSE and NASD; 1999. 100- p.

[26] Ojk IFC. The indonesia corporate governance manual. Jakarta: OJK dan IFC; 2014. 100- p.

[27] Antonia E. Analisis Pengaruh Reputasi Auditor, Proporsi Dewan Komisaris Independen, Leverage, Kepemilikan Manajerial dan Proporsi Komite Audit Independen terhadap Manajemen Laba (Studi pada Perusahaan Manufaktur di Bursa Efek Indonesia Periode 2004 – 2006). Semarang: Universitas Diponegoro; 2008.

[28] Mayangsari S. Analisis Pengaruh Independensi, Kualitas Audit, Serta Mekanisme Corporate Governance Terhadap Integritas Laporan Keuangan. Simposium Nasional Akuntansi VI, Surabaya. 2003:1255-69.

[29] Frankel RM, Johnson MF, Nelson KK, editors. The relation between auditors' fees for nonaudit services and earnings management2002 2002.

[30] Ashbaugh H, LaFond R, Mayhew BW. Do nonaudit services compromise auditor independence? Further evidence. Accounting Review. 2003;78(3):611-39.

[31] Choi JH, Kim JB, Zang Y. Do abnormally high audit fees impair audit quality? Auditing. 2010;29(2):115-40.

[32] Caneghem TV. Audit pricing and the Big4 fee premium: evidence from Belgium. Managerial Auditing Journal. 2010;25(2):122-39.

[33] Hay D, Knechel WR, Ling H. Evidence on the Impact of Internal Control and Corporate Governance on Audit Fees. International Journal of Auditing. 2008;12:9-24.

[34] Ghozali I. Multivariate dengan Program SPSS. 1 ed. Semarang: Badan Penelitian Universitas Diponegoro; 2005.

[35] Hussein AS. Metode Kuantitatif Untuk Riset Manajemen. 1 ed. Surabaya: Sekolah Tinggi Ilmu Ekonomi Indonesia Surabaya; 2015.

[36] Jogiyanto. Analisis dan Desain. Yogyakarta: Andi. 2009;53:160-.

[37] Cooper D, Schindler P. Business Research Methods. Social Research. 2014(12th Edition):792-.

[38] AAA. Commentary: SEC Auditor Independence Requirements. Accounting Horizons. 2001;15(4):373-86.