

## CONNECTIONS BETWEEN AUDIT FEES AND MANAGER'S SALARY ON BSE

Florin DOBRE<sup>1</sup>  
Florentin CALOIAN<sup>2</sup>  
Laura BRAD<sup>3</sup>

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### ABSTRACT

*In a company, managers usually tend to report financial data in such a way that offer them several advantages. It is often discussed if the result obtained during a financial reporting period are realistic by comparing to macroeconomic evolution or they are artificially raised in order to get several advantages. As audit is often seen as a way of monitoring the activity of managers paid by shareholders, we wonder if there is a connection between the quality of audit, the total fees paid and the managers' salary. An analyzed on companies listed on the Bucharest Stock of Exchange was realized. The conclusion of the study is that either Romanian companies offer ambiguous information about their financial data, either there is a connection between managerial activity and audit fees.*

**KEYWORDS:** *manager, Romanian market, financial performance, audit fees, salary.*

**JEL CLASSIFICATION:** *M42, M41, M14, M5.*

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### 1. INTRODUCTION

The problems regarding the transparency of Emergency market are not new, as often there is not a formal way of reporting and as the information provided by the companies are not similar, as no standardize reporting style exist. The idea of our research was to illustrate the way that companies report their financial data and on the other hand, to point out if there is a connection between managers' activity and the audit fees paid to the audit team. Previous studies revealed that there is a connection between the audit quality and the company's performance, as company with higher degree of performance tend to expect higher degree of their audit quality. Nonetheless, the problems are if the performance is truly reliable as it is frequently met that managers can provide fake financial information in order to fulfill their own interests.

### 2. LITERATURE REVIEW

The main literature in the field is focusing on revealing the way that managers obtained abnormal earnings even by financial fraud as Beasley (1996) studied, even by incentives financial earnings as Parker (2000) researched. The problems regarding the unreliable information provided by managers deal with the fact that frequently these are covered intentionally by the audit practices. Klein (2008) point out that earnings management are indirect correlated with the independence of audit committee or of the board of directors, while Bauwhede, Willekens and Gaeremynck (2003) emphasis that managers earnings are link with the benchmark from the previous years. As a consequence, neither the auditor size, neither the public ownership influence the attitude of managers of maximizing their own utility.

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<sup>1</sup> Bucharest University of Economic Studies, Romania, flndobre@yahoo.com

<sup>2</sup> Bucharest University of Economic Studies, Romania, florentin\_caloian@yahoo.com

<sup>3</sup> Bucharest University of Economic Studies, Romania, laura\_brad2004@yahoo.com

Contrary, Xie, Davidson and DaDaltb (2003) stressed that the audit committee and their professional activity are important factors that act like a constraint for managers to engage in earnings management. Moreover, Hsu and Sakaib (2009) revealed that sometimes it is necessary to have a manager audit template in order to surprise a deep analysis of management actions and outcome. The justification finds consolidation not only from the accounting point of view, but also from the literature of evaluation research. The question that rises in the main literature is that if the external of the internal audit should provide generic information about the activity of managers. Buchanan and Gibb (2007) consider that internal audit should reveal all information by evaluating and identifying company's information and company's resources. They also emphasis that improving the audit technique practices can generate more accurate financial reporting, and moreover, a decrease for managers in following only their own interest. Same authors argue in 2008 that the informational audit should include modeling techniques related to the current activity of the company such as business process and managerial behavior. Caramanisa and Lennox (2008) concluded that low audit effort increase the probability for managers to report higher earning that they actually obtain. Regarding the quality of audit Deis Jr. and Giroux (1996) demonstrate that the audit quality and consequence the management salaries are not necessary connected with the audit fees. For example first independent audit perceive a lower fee for their services, even they provide high audit quality. Nonetheless, Niemi (2005) studied that audit fees are lower for by companies owned with majority by their management, but no differences between companies owned by the state or with diversity ownership could be found. As a consequence, the fauds tend to be in companies where the manager has the majority of the company.

Taking these elements into consideration, we wonder if the companies from the Romanian market are transparent regarding the wages that their managers obtain due to their financial performance and moreover if there is a connection between companies fees paid for audit services and the manager's remuneration.

### **3. RESEARCH METHODOLOGY**

The idea of research was to point out if there is a connection between the audit fees percept as agency costs and the salaries that the managers obtained if there activity generates a minimum financial performance or if they reach the minimum benchmark planed through their financial plan. In order to realize this, financial data from the Bucharest Stock of Exchange was extracted for some companies. Firstly, in our sample we included companies that are listed on the first category of BSE, as we consider that these companies should have a high degree of transparency. Surprisingly, not all companies that have the characteristics for the first category provided reliable information. It is important to mention that no the financial institutions were not analyzed, neither the investment societies as the first ones have a different way of reporting, while the second category are frequently undervalue on the market, and moreover they are characterized by a diversity ownership as there is a 1% holding limitation on the Romanian market. As a consequence, some second listed companies were analyzed in order to have a representative sample for the Romanian Market.

Data taken from the financial statements was evaluated for a three year period, and information like the number of board of directors, the number of members in the administrative council, the managers and administrative personal salaries and moreover the audit fees were taken. We considered that a three year period evaluation is more than enough for the Romanian Market as few companies are listed nowadays on the BSE. (About 25 in the first category, including the excluding sample of financial institutions and the investment societies.

Considering these elements, we decided to realize firstly a comparison between the data provided by the companies, as no a proper descriptive statistic of these elements is provided. Moreover, we developed a model, in order to observe if there is a connection between the quantum of audit fees and the management remuneration. As a fact, the model developed has the following format:

$$\log_{10} \text{audit fees}_{2011t} = c + \log_{10} \text{management remuneration}_{2010t} + e_t \quad (1)$$

The analysis of the data proved that there is a higher direct correlation between the audit fees from one year to another and between the manager's salaries from one period to another. As the idea was not to obtain abnormal constant values, we decided to use the logarithmic form. Actually, the interpretation is revealed using the percentage form, while the real relationship between the dependent variable and the independent one is an exponential type.

Nonetheless, the sample was considered relevant for the Romanian Market, but problems regarding the degree of companies' transparency are not yet solved. Even though we emphasis comparison between data collected and provided some percentage information about the relationship between audit and managers remuneration, we consider that a managerial audit report should be established for each financial period.

#### 4. FINDINGS AND DISCUSSIONS

In order to follow a descriptive statistic format, the results were summarized in a table. There has to be mention that from the companies listed on the first category of BSE, 20 % are represented by investment societies, while 8% are associated with financial institution. Our sample was still reduced, as companies such IMP, SRT (about 8 %) do not present this kind of information, while other present ambiguous data like RRC or FP that could not been analyzed as there is no comparison information with the other companies.

The following averages results could have been observed:

**Table nr. 1 The averages results for the audit fess, salaries for managers and members of council administration**

Year	Audit fees (lei)	Number of reported companies	salary for administrative council (lei)	Number of reported companies	salary for managers and directors (lei)	Number of reported companies
2009	147833	22	1355137	12	3128084	12
2010	121374	27	754006	18	1529779	13
2011	123946	25	842831	14	2005801	8

As it can be seen, there is a high discrepancy between the companies that report their fees paid to the audit (both internal and external operation) and the companies that report either their costs with the board of directors. Firstly, we observe that the average level of audit fees has decline from 2009 and 2011, even though the number of reported companies has suffer a slow increase. The explication can be that companies prefer to pay minimum audit fees as their financial situation was affected by the macroeconomic environment.

Regarding the number of companies that provide information about the cost with the members of council of administration, we can say that about 60% from the companies analyzed offer transparent information. The percentage decreases at an average of 44% when the managers 'remuneration is taken into consideration. The tendency was that less transparent information about this field was revealed from 2009 to 2011. It is important to mention that there are companies were the transparency level is not found. The companies reporting emphasis that managers and directors are paid with reference to the internal principal taking count of the Romanian 'legislation.

Other elements that can be provided by the data analyzed are the minimum and the maxim levels. The values obtained are generally transformed from euro and the values are related to the exchange rate that the company used in their financial reporting.

**Table nr. 2. The minimum values of variables analyzed**

Year	Audit fees	salary for administrative council	salary for managers and directors
2009	10000	36000	292836
2010	17856	31212	347700
2011	3000	17628	143145

**Table nr. 3. The maximum level for variables analysed**

Year	Audit fees	salary for administrative council	salary for managers and directors
2009	431900	6656700	1803261
2010	431900	6303105	6015668
2011	431900	6198200	4200564

As it can be seen, the values do not have a constant evolution. The differences between the taxes imposed by audit team are due to the fact that the audit fees are correlated with the size of the company. As a fact, as more as a bigger company is audited, more audit fees are perceived by the audit team. The explication is that there are more elements that have to be evaluated and consequently, more working hours for the audit team and moreover, the audit responsibility in offering a proper and relevant opinion rises as the firm size grows. The justification is that companies that have an important influence upon the market agree to pay more for audit services, as their bankruptcy would affect the evolution of the entire market. As a fact, we considered that the values provided are relevant considering the companies activity and the economic background.

Regarding the numbers of executive members there has been an average of about 4 members in a society and about 5 members that are responsible for the administrative tasks. Moreover, it has been revealed that the main shareholder holds in average about 61,68% of the shares of the company.

Regarding the main shareholder about 20% of the companies are hold by other shareholders (persons), while 16,66% is held by Ministry of Economy and The Ministry of Health.

Not only these information were meant to be analyzed, but also the results obtained by applying the economic model.

The form of equation suggested can be summarized as followed:

$$\log_{10} \text{audit}_{\text{fees}2011t} = 2.53 + 0.630 * \log_{10} \text{managementremuneration}_{2010t} \quad (2)$$

The estimation realized included only 12 observations as there were some adjustment developed and as the financial information was not written in the notes of financial statements. The interpretation can be as follow a rise with 1% in management's salaries generates a 0.63% rise in the audit fees for the next financial reporting period. As a consequence, as manager receive higher benefits from the company; they tend to pay higher amount to the audit team in order to receive a proper audit assurance that their activity is based on reliable information.

## 5. CONCLUSIONS

As the audit activity is one of the most important elements that can provide information about the financial statements of a company and how the elements were registered in the balance sheet, in the loss and profit account and other intangible elements, it is crucial to analyze it with managers' performances. The audit fees can be seen as the monitoring cost paid by other stakeholder in order to supervise the manager's activity. Moreover, the audit teams offer a minimum level of assurance that the elements are properly evaluated by the company itself.

The present research revealed a connection between the remuneration that managers receive for their activity and the audit fees pay in the next financial period. Nonetheless, comparison upon the Romanian fees, managers' salary and remuneration of council of administration was realized. The conclusion is that Romanian Companies listed on the first and second category provide little information about these elements.

The lack of our research is based on the low level of transparency that companies have, on the fact that there is not a standardized way of reporting, on the fact that some companies offer ambiguous information about the real value of these variables. As a fact, there are companies that actually do not offer any kind of information, while there are societies that omit to realize some financial notes to their financial statements.

Other problems can be summarized in the form that companies do not report detailed costs (for internal and external audit), do not offer detailed information if there are part of the group, report these elements in euro without establishing a conversion rate of exchange.

Further research would be focused on collecting similar data not only from the companies from the first and second category from the BSE, but also for the companies listed on Nasdaq. Other research activities would be oriented upon quantifying the relationship between audit activity and managers' remuneration by taking into account the audit quality, the structure of audit team and audit committee, the internal scale upon which the managers are named and are remunerated. Moreover, financial reporting would be considered as a necessary element to be evaluated as the audit fees and manager's activity are connected with them. A panel model and simultaneous equation model would be realized with the purpose of improving the results obtained in this study.

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