

---

# Interdependencies between corporate governance and financial audit: evidence from the Romanian Stock Exchange

---

Univ. lect. Florin DOBRE, PhD.,  
Bucharest University of Economic Studies,  
e-mail: flndobre@gmail.com

## Abstract

*The purpose of this research is to provide evidence about the relationship between the financial audit and corporate governance indicators. The study uses data from entities listed on the Bucharest Stock Exchange in Romania, which have both a one-tier system and a two-tier system management. The study aims to detect the interdependencies between financial audit (measured through the audit fees) and specific corporate governance indicators, such as the CEO/chair duality, the existence of the audit committee, the number of executive members from the board of directors or other characteristics of the board that are part of the corporate governance process. As there is a correlation between audit and corporate governance indicators, the research is conducted using a simultaneous equation model for the listed entities that have an obligation to report their individual financial statements using the IFRS approach. The data is manually collected from both the entity's individual financial statements and corporate governance statement. The results showed mixt evidence. While there is a negative relationship between the audit fees and the number of executive board members, ambiguous results are found for the other board characteristics. The explanation can be attributed to the fact that there is an important problem regarding data availability on the Romanian market and to a lack of transparency in the reporting process.*

**Keywords:** audit fees, corporate governance, tier management system, Romania, Board characteristics, IFRS approach

**JEL Classification:** M42, G34

## 1. Introduction

Since the beginning of the financial crisis, there is a stronger need to certify that the financial information is correct and reliable, especially as this is audited by a financial auditor. His credibility has been mitigated as there is doubt about his ability to detect huge financial problems (Sikka, 2009). In a period of crisis, the entities seek to change their financial auditor to a BIG 4 company rather than to another company, as it is thought that BIG 4 financial auditors confer a higher credibility to the way in which the financial statements are prepared (Hubens, 2012).

There also has to be considered that the financial auditor is not the main party responsible for the financial crisis. Companies that have a weak corporate governance system are more inclined to report fraud than companies that have a strong corporate governance system (Farber, 2005). Moreover, the entities with a weak corporate governance system have more agency problems and provide a lower protection of the minor shareholders (Core, Holthausen and Larcker, 1999).

The interdependencies between the audit process, the corporate governance elements and the company's profitability or the financial performance cannot be neglected. For these reasons, the present research aims to provide evidence about these interdependencies in the context of the Romanian market.

The rest of the paper is structured as follows: section one presents a short literature review about the interdependencies between financial audit, corporate governance elements and financial performance; section two focuses on the database and the methodology of the research; section three reports the results and the discussions, while section four concludes and provides further research directions.

## 2. Literature review

The correlation between the financial audit, corporate governance indicators and financial performance has been extensively studied in the literature. On the one hand, the audit remuneration seems to depend on the characteristics of the board and the entity's financial performance. According to Carcello et al. (2002) and Cohen and Hanno (2000), the higher the independence of the board of directors, the higher is the amount paid

for auditing process. On the other hand, Dittmann, Maug and Schneider (2008) provide evidence that there is not a correlation between the auditing remuneration and the independence of the board of directors. The results are also mixt when the characteristics of the board of directors are analyzed. Chan, Ezzamel and Gwilliam (1993) and Mitra, Hossain and Deis (2007) consider that the companies are more inclined to pay high audit fees when they have a diverse ownership structure. It could be concluded that the entity has higher agency problems when the major shareholder is having the control of the company (Hay, Knechel and Wong, 2006; Core, Holthausen and Larcker, 1999).

There is also mixt evidence when the literature analyzes the correlation between the financial audit, proxy by audit fees and the existence of the audit committee. Some studies such as those conducted by Voller, Bremert and Zein, (2013), Steward and Kent (2006) and Abbott et al. (2003) report a positive correlation between the existence of the audit committee and the audit fees, while other research papers such as Cohen and Hanno (2000) state that a negative influence is more appropriate since the risk associated with the auditing process is mitigated.

Another element that is part of the corporate governance system is the CEO/chair variable. According to Farber (2005), when the CEO is the same person as the chairman of the company, the company has a low corporate governance system and it is more inclined to manipulate the financial information. The results are in accordance with the assumption of Idowu (2014, p.292).

The type of financial auditor that the entity has could also influence the value of audit fees. It is perceived that BIG 4 companies require higher audit fees for the auditing process due to their reputation (Campa, 2013; Reichelt and Wang, 2010). On the other hand, the change of the financial auditor can occur due to different levels of audit fees (Craswell, Stokes and Laughton, 2002) or due to lower financial information (Williams, 1988).

The problems discussed above are related with the fact that several entities, both financial and non-financial ones, encountered problems as their remuneration system was not reliable for the entity and due to the weaknesses found in the corporate governance system – the evaluations of the risks of the entity.

Regarding the Romanian market, there have been conducted a small number of studies in the field. Brad et

al. (2014) found a negative correlation between the existence of the audit committee, the type of auditor, the CEO/chair variable and the value of audit fees, the results being similar with those found by Dobre (2014).

### 3. Methodology of research

The idea of the present research is to identify the correlation between the financial audit and the corporate governance variables. In order to achieve this, data regarding the companies that had to report their individual financial statements under IFRS was collected from the Bucharest Stock Exchange and from the companies' individual websites. It is considered that once the financial reporting is completed by using the international accounting referential for individual statements, there is going to be an increase in the quality of financial information (Daske, 2006). In order to establish the dimension of the sample, we took into consideration the regulation of the Romanian Financial Supervision Authority. According to it, 71 companies have to report their individual financial statements using the IFRS approach. From this initial sample, we subtracted 9 companies that have a negative value of their own capital (COFI, OLT, CGC, COS, EPT, MJM, RRC, UCM, ARM). We have also excluded 4 companies that were not listed in 2013 or that had to report their individual financial statements under IFRS starting with 2013 (COTE, SNN, SNG, CNTE). Two companies that were in insolvency before the adoption of international regulation were also excluded (SRT, UZT). There is also a company that has another way of reporting (MPN) which was not taken into consideration.

As the idea of research is to reveal the correlation between financial audit, proxy by audit fees and coded as *FEES*, and the corporate governance variables, we have also excluded 13 companies, from the remaining sample, as they had not provided information about the value of their audit fees. Consequently, the dimension of the sample on which the analysis is conducted is of 41 companies.

It has to be mentioned that the analysis is conducted considering financial information from 2011, as there is a lack of information about the amount paid for the auditing process afterwards. For each entity that is part of our analysis, we have collected both financial and non-financial information. While the level of indebtedness computed in two ways as the ratio of debt

divided to the value of own capital (coded as *LEV<sub>1</sub>*) or as the ratio of total debt divided by total funds (coded as *LEV<sub>2</sub>*), the return on asset (coded as *ROA*) and the change found in the value of sales (coded as *SALES CHG*) could be classified as financial information, the other variables could be included into the non-financial information category. This is due to the fact that they are either binary variables or they are variables that characterize the corporate governance system, such as the number of executive members from the board of directors (which was coded as *EXMB*). For the number of executive members of the board of directors we took the average value of it.

The other variables that were taken into consideration are all of a binary form. The first dummy variable that we have included into the analysis is the variable related with the type of management system that the entity has. As a fact, if the entity is having a one tier management system, than the variable took value 1, otherwise its value was 0. The variable was coded as *DSYST*. A variable that could be correlated with the management system is the variable that characterizes that the CEO and the chairman of the entity are being individually separate. This means that the person who is the CEO of the company is not the same person who is the president of the entity. The variable was coded by *DCEO* and took value 1 in case the functions were hold by two different persons.

There are also other corporate governance variables that we used into the analysis. One of them is being the type of financial auditor. The variable was coded by *DAUD* and took value one if the financial auditor is a company that is part of BIG 4. When the financial auditor is not a high quality one, the variable was 0.

The change of financial auditor is another element that we considered it could be correlated with the value of audit fees, which is in fact both a measure of corporate governance and of financial audit. The variable was coded *DCHG* and took value 1 in case a change of financial auditor occurred at company level. For this the financial auditor's name from 2010 was compared with the financial auditor's name from 2011.

Another variable that we used is the existence of the audit committee. In order to compute it, we analyzed the corporate governance document. The variable was coded as *DCOMT* and took value 1 in case the entity reported the existence of audit committee.

The fact that the major shareholder has or not the majority of shares can also influence the level of audit fees. As a fact, we collected the percentage that the major shareholder has. In case it was up to 50%, that the variable took value 1. The variable was coded as *DMAJS*.

We have also considered other dummy variables that are related with the entity's activity. One of them reflects if the company is acting on manufacturing area. As a fact, we classified the entities according to the CAEN code. The variable was coded as *DMANF* and in which

took value 1 in case the area in which the company acts is the manufacturing one.

Another variable is represented by the type of the major investor. As a fact, if the major investor is a Romanian one, then the variable took value 1. Otherwise, the variable took value 0. The variable was coded as *RINV*.

As there is a correlation between financial audit, corporate governance variables and financial performance we have conducted a model of simultaneous equation. Its structure form is presented in system I.

### System I

$$\left\{ \begin{array}{l} FEES_i = \alpha_0 + \alpha_1 \times DSYST_i + \alpha_2 \times DCEO_i + \alpha_3 \times DAUD_i + \alpha_4 \times DCHG_i + \alpha_5 \times DCOMT_i + \alpha_6 \times DMAJS_i + \\ \quad + \alpha_7 \times EXMB_i + \alpha_8 \times LEV_i + \alpha_9 \times ROA_i + \varepsilon_i \\ ROA_i = \beta_0 + \beta_1 \times DSYST_i + \beta_2 \times DCEO_i + \beta_3 \times LEV_i + \beta_4 \times DMANF_i + \beta_5 \times RINV_i + \beta_6 \times SALES\ CHG_i + \\ \quad + \beta_7 \times DCOMT_i + \beta_8 \times FEES_i + \theta_i \end{array} \right.$$

Where  $\varepsilon_i$  and  $\theta_i$  are the error terms and  $i$  refers to each company that is included into the sample.

In order to solve the model of simultaneous equations, several steps have to be conducted. First of all, the type of each equation has to be identified. A comparison between the number of endogenous variables (in our case – two: the audit fees and the return on assets) minus one is compared with the number of missing variables from each equation. In

case the number of missing variable exceeds the number of endogenous variables minus one, then the equation is over-identified and it can be estimated either by using the 2SLS, either by computing the reduced form of the equation, calculating the adjusted values and replacing them into the initial form of equations.

The reduced form of the equations is presented in system II.

### System II

$$\left\{ \begin{array}{l} FEES_i = \alpha_0 + \alpha_1 \times DSYST_i + \alpha_2 \times DCEO_i + \alpha_3 \times DAUD_i + \alpha_4 \times DCHG_i + \alpha_5 \times DCOMT_i + \alpha_6 \times DMAJS_i + \\ \quad + \alpha_7 \times EXMB_i + \alpha_8 \times LEV_i + \alpha_9 \times \beta_0 + \alpha_9 \times \beta_1 \times DSYST_i + \alpha_9 \times \beta_2 \times DCEO_i + \alpha_9 \times \beta_3 \times LEV_i + \\ \quad + \alpha_9 \times \beta_4 \times DMANF_i + \alpha_9 \times \beta_5 \times DRINV_i + \alpha_9 \times \beta_6 \times SALES\ CHG_i + \alpha_9 \times \beta_7 \times DCOMT_i + \\ \quad + \alpha_9 \times \beta_8 \times FEES_i + \alpha_9 \times \theta_i + \varepsilon_i \\ ROA_i = \beta_0 + \beta_1 \times DSYST_i + \beta_2 \times DCEO_i + \beta_3 \times LEV_i + \beta_4 \times DMANF_i + \beta_5 \times DRINV_i + \beta_6 \times SALES\ CHG_i + \\ \quad + \beta_7 \times DCOMT_i + \beta_8 \times \alpha_0 + \beta_8 \times \alpha_1 \times DSYST_i + \beta_8 \times \alpha_2 \times DCEO_i + \beta_8 \times \alpha_3 \times DAUD_i + \\ \quad + \beta_8 \times \alpha_4 \times DCHG_i + \beta_8 \times \alpha_5 \times DCOMT_i + \beta_8 \times \alpha_6 \times DMAJS_i + \beta_8 \times \alpha_7 \times EXMB_i + \\ \quad + \beta_8 \times \alpha_8 \times LEV_i + \beta_8 \times \alpha_9 \times ROA_i + \beta_8 \times \varepsilon_i + \theta_i \end{array} \right.$$

The next step is to transform the form of reduced equations by grouping the

common terms. It is presented in System III

### System III

$$\left\{ \begin{aligned} (1 - \alpha_9 \times \beta_8) \times FEES_i &= \alpha_0 + \alpha_9 \times \beta_0 + (\alpha_1 + \alpha_9 \times \beta_1) \times DSYST_i + (\alpha_2 + \alpha_9 \times \beta_2) \times DCEO_i + \alpha_3 \times DAUD_i \\ &+ \alpha_4 \times DCHG_i + (\alpha_5 + \alpha_9 \times \beta_7) \times DCOMT_i + \alpha_6 \times DMAJS_i + \alpha_7 \times EXMB_i + \\ &+ (\alpha_8 + \alpha_9 \times \beta_3) \times LEV_i + \alpha_9 \times \beta_4 \times DMANF_i + \alpha_9 \times \beta_5 \times DRINV_i + \\ &+ \alpha_9 \times \beta_6 \times SALES\ CHG_i + \alpha_9 \times \theta_i + \varepsilon_i \\ (1 - \beta_8 \times \alpha_9) \times ROA_i &= \beta_0 + \beta_8 \times \alpha_0 + (\beta_1 + \beta_8 \times \alpha_1) \times DSYST_i + (\beta_2 + \beta_8 \times \alpha_2) \times DCEO_i + (\beta_3 + \beta_8 \times \alpha_3) \times LEV_i + \\ &+ \beta_4 \times DMANF_i + \beta_5 \times DRINV_i + \beta_6 \times SALES\ CHG_i + (\beta_7 + \beta_8 \times \alpha_5) \times DCOMT_i + \\ &+ \beta_8 \times \alpha_3 \times DAUD_i + \beta_8 \times \alpha_4 \times DCHG_i + \beta_8 \times \alpha_6 \times DMAJS + \beta_8 \times \alpha_7 \times EXMB_i \\ &+ \beta_8 \times \varepsilon_i + \theta_i \end{aligned} \right.$$

Each term of the equation is divided by the coefficient of

endogenous variable. This could be seen in system IV.

### System IV

$$\left\{ \begin{aligned} FEES_i &= \frac{\alpha_0 + \alpha_9 \times \beta_0}{1 - \alpha_9 \times \beta_8} + \frac{(\alpha_1 + \alpha_9 \times \beta_1)}{1 - \alpha_9 \times \beta_8} \times DSYST_i + \frac{(\alpha_2 + \alpha_9 \times \beta_2)}{1 - \alpha_9 \times \beta_8} \times DCEO_i + \frac{\alpha_3}{1 - \alpha_9 \times \beta_8} \times DAUD_i + \frac{\alpha_4}{1 - \alpha_9 \times \beta_8} \times DCHG_i + \\ &+ \frac{(\alpha_5 + \alpha_9 \times \beta_7)}{1 - \alpha_9 \times \beta_8} \times DCOMT_i + \frac{\alpha_6}{1 - \alpha_9 \times \beta_8} \times DMAJS_i + \frac{\alpha_7}{1 - \alpha_9 \times \beta_8} \times EXMB_i + \frac{(\alpha_8 + \alpha_9 \times \beta_3)}{1 - \alpha_9 \times \beta_8} \times LEV_i \\ &+ \frac{\alpha_9 \times \beta_4}{1 - \alpha_9 \times \beta_8} \times DMANF_i + \frac{\alpha_9 \times \beta_5}{1 - \alpha_9 \times \beta_8} \times DRINV_i + \frac{\alpha_9 \times \beta_6}{1 - \alpha_9 \times \beta_8} \times SALES\ CHG_i + \frac{\alpha_9 \times \theta_i + \varepsilon_i}{1 - \alpha_9 \times \beta_8} \\ ROA_i &= \frac{\beta_0 + \beta_8 \times \alpha_0}{1 - \beta_8 \times \alpha_9} + \frac{(\beta_1 + \beta_8 \times \alpha_1)}{1 - \beta_8 \times \alpha_9} \times DSYST_i + \frac{(\beta_2 + \beta_8 \times \alpha_2)}{1 - \beta_8 \times \alpha_9} \times DCEO_i + \frac{(\beta_3 + \beta_8 \times \alpha_3)}{1 - \beta_8 \times \alpha_9} \times LEV_i + \frac{\beta_4}{1 - \beta_8 \times \alpha_9} \times DMANF_i + \\ &+ \frac{\beta_5}{1 - \beta_8 \times \alpha_9} \times DRINV_i + \frac{\beta_6}{1 - \beta_8 \times \alpha_9} \times SALES\ CHG_i + \frac{(\beta_7 + \beta_8 \times \alpha_5)}{1 - \beta_8 \times \alpha_9} \times DCOMT_i + \frac{\beta_8 \times \alpha_3}{1 - \beta_8 \times \alpha_9} \times DAUD_i \\ &+ \frac{\beta_8 \times \alpha_4}{1 - \beta_8 \times \alpha_9} \times DCHG_i + \frac{\beta_8 \times \alpha_6}{1 - \beta_8 \times \alpha_9} \times DMAJS + \frac{\beta_8 \times \alpha_7}{1 - \beta_8 \times \alpha_9} \times EXMB_i + \frac{\beta_8 \times \varepsilon_i + \theta_i}{1 - \beta_8 \times \alpha_9} \end{aligned} \right.$$

The last part of establishing the reduced form of the equations is to replace each

coefficient with another variable. The results are presented in system V.

### System V

$$\left\{ \begin{aligned} FEES_i &= \gamma_0 + \gamma_1 \times DSYST_i + \gamma_2 \times DCEO_i + \gamma_3 \times DAUD_i + \gamma_4 \times DCHG_i + \gamma_5 \times DCOMT_i + \gamma_6 \times DMAJS_i + \gamma_7 \times EXMB_i + \\ &+ \gamma_8 \times LEV_i + \gamma_9 \times DMANF_i + \gamma_{10} \times DRINV_i + \gamma_{11} \times SALES\ CHG_i + \mu_i \\ ROA_i &= \lambda_0 + \lambda_1 \times DSYST_i + \lambda_2 \times DCEO_i + \lambda_3 \times LEV_i + \lambda_4 \times DMANF_i + \gamma_5 \times DRINV_i + \lambda_6 \times SALES\ CHG_i + \lambda_7 \times DCOMT_i + \\ &+ \lambda_8 \times DAUD_i + \lambda_9 \times DCHG_i + \lambda_{10} \times DMAJS + \lambda_{11} \times EXMB_i + \varpi_i \end{aligned} \right.$$

After establishing the reduced form, each equation is regressed on individual factors and the fitted values are computed by subtracting the value of residuals from the value of endogenous variable.

The final form of the simultaneous equation model is established by replacing the fitted values in the structural form of the equation (initial equations).

The hypotheses on which the analysis was conducted are:

- H1. A one tier management system influences in a negative way the audit fees.
- H2. The lack of CEO/chair duality influences in a positive way the audit fees.
- H3. The BIG 4 auditors perceive higher audit fees for the auditing process.
- H4. The existence of the audit committee will mitigate the risks associated with the auditing process and thus, the value of audit fees will decrease.
- H5. If the major shareholder has the control of the entity, then the value of audit fees is lower.

H6. The number of executive members of the board of directors should be positively correlated with the audit fees, as they could be a proxy for company's size.

H7. Higher the level of indebtedness is, higher the audit fees are.

## 4. Results and discussions

The purpose of this analysis is to reveal the correlation between audit fees, proxy as a measure of financial audit and corporate governance, with the corporate governance variables and the financial auditor's characteristics.

In order to conduct the simultaneous equation model, we have first presented the correlation matrix. Lower correlations are expected to be found in order to obtain better fitted values. The correlation matrix is presented in **Table 1**.

**Table 1. The correlation matrix**

Elem.	FEES	ROA	DSYST	DCEO	DAUD	DCHG	DCOMT	DMAJS	EXMB	LEV1	LEV2	DMANF	DRINV	SALES CHG
FEES	1													
ROA	0.221	1												
DSYST	-0.346**	-0.043	1											
DCEO	-0.065	-0.191	-0.250	1										
DAUD	0.158	0.177	-0.196	0.078	1									
DCHG	0.121	0.017	-0.28***	0.210	0.044	1								
DCOMT	-0.047	0.080	-0.336**	0.133	0.014	0.076	1							
DMAJS	-0.103	0.152	0.172	0.111	0.088	-0.164	-0.070	1						
EXMB	0.071	0.239	-0.128	0.195	0.425*	-0.026	0.187	0.045	1					
LEV <sub>1</sub>	-0.190	-0.29***	0.125	0.298***	0.194	0.095	-0.105	0.073	0.059	1				
LEV <sub>2</sub>	0.110	-0.028	0.159	-0.219	0.026	-0.016	0.016	-0.142	-0.27***	-0.088	1			
DMANF	-0.321**	-0.102	0.283***	-0.120	-0.190	-0.35**	-0.120	0.028	-0.229	0.016	-0.099	1		
DRINV	-0.040	-0.027	0.156	0.133	0.127	0.206	-0.171	0.040	-0.005	0.058	-0.082	-0.018	1	
SALES CHG	-0.097	-0.234	-0.209	0.034	-0.096	-0.185	0.001	0.103	-0.119	-0.224	-0.037	0.146	0.035	1

Where \*, \*\*, \*\*\* denotes the level of significance at 1%, 5% and 10%

From **Table 1**, it can be observed that the highest correlation is between the number of executive members from the board and the type of financial

auditor. As the correlation is around 0.425, we considered that both variables can be included into the analysis.

In order to reveal the interdependencies between financial audit, corporate governance variables and financial

performance, we provide a summary statistics of the variables included into the analysis. It is presented in **Table 2**.

Elem.	Mean	Median	Max	Min	Std. Dev.	Skewness	Kurtosis	Jarque-Bera	Probability
FEES	4.755	4.748	5.521	4.079	0.383	0.154	2.153	1.386	0.500
ROA	0.019	0.022	0.158	-0.328	0.079	-2.077	10.668	129.923	0
DSYST	0.902	1	1	0	0.300	-2.713	8.358	99.326	0
DCEO	0.634	1	1	0	0.488	-0.557	1.310	6.998	0.030
DAUD	0.244	0	1	0	0.435	1.193	2.423	10.291	0.006
DCHG	0.171	0	1	0	0.381	1.750	4.063	22.861	0.000
DCOMT	0.488	0	1	0	0.506	0.049	1.002	6.833	0.033
DMAJS	0.732	1	1	0	0.449	-1.046	2.094	8.878	0.012
EXMB	4.659	5	9	3	1.543	1.042	4.067	9.360	0.009
LEV <sub>1</sub>	0.671	0.294	3.882	0.033	0.913	2.182	7.051	60.570	0
LEV <sub>2</sub>	0.301	0.213	0.791	0.031	0.230	0.829	2.489	5.141	0.076
DMANF	0.659	1	1	0	0.480	-0.669	1.447	7.175	0.028
DRINV	0.488	0	1	0	0.506	0.049	1.002	6.833	0.033
SALES CHG	0.084	0.092	0.518	-0.427	0.190	-0.054	3.331	0.207	0.902

From **Table 2**, it can be concluded that approximately 90% of the entities included into the sample have a one tier management system. About 63.4% of the entities report that the positions of CEO and of the chairman of the company are held by different persons. Approximately a quarter (24.4%) of the entities from the analysis has as financial auditor a company from BIG 4. About 17% of them changed their financial auditor. Almost a half of them report the existence of the audit committee (48.8%). In almost 75% (73.2%) the major shareholder is having more than 50% of the entities shares, while in almost a half of the companies included into the analysis the major shareholder is a Romanian one (48.8%). Regarding other characteristics, it can be concluded that almost 66% of the entities are manufacturing players.

The return of assets is around 2% per year (1.9%), having a minimum of -32.8% and a maximum of 15.8%. The leverage ratio provides evidence that the companies are one part financed from debts and two parts finance from own capital. In medium, the sales have increased with 8.4% per year.

Regarding the distribution of the variables, it can be concluded that they do not have a normal distribution. This is due to the fact that the probability of rejecting the null hypothesis that the variable is having a normal distribution is small, thus, with a minor risk we can say that the variables are not normally distributed.

After we have analyzed the correlation matrix and the characteristics of the variables included into the analysis, we conducted the analysis based on a simultaneous equations model. The results of the structural form of it are presented in **Table 3**.

**Table 3. The interdependencies between financial audit, corporate governance and financial performance**

Model 0031			Model 2		
Element	Coefficient	P Value	Element	Coefficient	P Value
Constant	5.3966	0.0000*	Constant	5.2818	0.0000*
DSYST	-0.4806	0.0000*	DSYST	-0.5112	0.0000*
DCEO	0.0140	0.7424	DCEO	0.0642	0.1692
DAUD	0.0213	0.6296	DAUD	-0.0152	0.6668
DCHG	-0.0165	0.7210	DCHG	-0.0268	0.4917
DCOMT	-0.1631	0.0000*	DCOMT	-0.1897	0.0000*
DMAJS	-0.0131	0.0043*	DMAJS	-0.1251	0.0034*
EXMB	-0.0236	0.0966***	EXMB	-0.0152	0.2689
$LEV_1$	0.0114	0.6568	$LEV_2$	0.2964	0.0000*
ROA_FIT	3.0394	0.0001*	ROA_FIT	3.5486	0.0000*
R squared	83.05%		R squared	87.51%	
DW	2.03		DW	1.96	
F with probability	16.8882*		F with probability	24.1395*	

Where \* and \*\* states for the level of significance at 1% and 10%.

Considering the results presented on **Table 3**, several conclusions could be drawn out. There is a strong negative correlation between the value of audit fees and the one tier management system. It seems that companies that have a two tier management system are more inclined to pay higher fees for the auditing process. This is quite a surprising result as we expected the value of audit fees to be lower in a two tier management system as it is considered that it could provide more transparent data. The results could be correlated with the results found for the CEO/chair variable. It seems that entities where the position of CEO is not held by the chairman are more inclined to pay higher fees for the auditing process. The coefficient could be considered statistically different from zero if we assume a risk of 16.92% of rejecting the null hypothesis that the coefficient is not statistically different from zero. This could be accepted as we have only 41 companies included into the analysis. The rejection of the null hypothesis is done considering that the indebtedness ratio is computed by dividing the value of total debts to the value of total funds (total debts plus own capital). Considering both results, it could be revealed that companies that have a one tier management system, but where the CEO is the same as the chairman, pay

lower taxes for the auditing process. The results are contrary with the results found by Tsui, Jaggi and Gull (2001) as they found that once the CEO is different from the chairman of the company, there should be a more effective internal control, and thus the risks associated with the audit process are mitigated, the consequence being lower audit fees.

The characteristics of financial auditor seem not to influence the value of audit fees at least for this sample included into the analysis. As a fact, both the coefficients associated with auditor's type and auditor's change is not statistically significant from zero. In fact, for the auditor's type mixt results are obtained when comparing model 1 with model 2. This could be associated with the small number of companies that have as financial auditor a company from BIG 4. On the other hand, the results could provide evidence that high quality audit could be done also by non-BIG 4 companies and they could perceive also high audit fees.

The existence of the audit committee seems to mitigate the value of audit fees. The results are in accordance with the results found by Cohen and Hanno (2000) as they consider that the existence of audit committee mitigates the risk associated with the auditing process.



The fact that the major shareholder has the control of the company reflects that lower audit fees are paid to the auditor. According to Chan, Ezzamel and Gwilliam (1993) the entities that have a diverse ownership structure will pay more for higher quality audit as they aim to fulfil the minimum requirements. The results could be correlated with the results of Hay, Knechel and Wong (2006) who consider that when a company is having a major shareholder, higher agency problems could be detected.

The executive members of the board of directors seem to influence in a negative way the amount paid to financial auditors. As a fact, an increase of the executive members of the board of directors mitigates the value of audit fees with a value between 0.0152% or 0.0236%. The fluctuation is due to the fact that there is a possibility to accept that both models are reliable. This means that we accept a risk of about 26% to reject the null hypothesis according to which the value of the coefficient is not statistically equally to zero.

Regarding the level of indebtedness, there are studies such as those conducted by Hay, Knechel and Wong (2006) or by Simunic (1980) which they provide evidence that higher the level of indebtedness is (computed as the value of total debt to total funds), higher the audit fees are. This result can be also observed when analyzing the second model as an increase with 1% of the level of indebtedness generates an increase with 0.29% for the audit fees.

The last element that we have to analyze is the value of return on assets. In fact, it is expected to be negatively correlated with the audit fees. The idea behind this assumption is that low profitability encounters higher risk for the auditing team and thus there should be higher audit fees. Our results seem to be contrary to this assumption. It looks that higher the profitability of the entity is, higher the value of audit fees is. This could be due to the fact that there is a need to assess that the financial information is reliable and trustworthy, especially after the financial crisis when the credibility of financial auditor has been mitigated.

The models have a R-squared higher than 80%, present no autocorrelation and provide evidence that not all the coefficients are statistically significant from zero.

## 5. Conclusions

The idea of research was to detect if there is any correlation between financial performance, audit

elements and corporate governance indicators. In order to provide evidence about the interdependencies between them, a model of simultaneous equation was conducted. The model encounters 41 companies that are listed on the Bucharest Stock Exchange. The model took into account both financial and non-financial information such as the type of the financial auditor, the CEO/chair variable, the type of the management system that the entity has, the existence of the audit committee, the fact that the major shareholder has or not the control of the company, the number of executive members from the board of directors, the value of return on assets, the level of indebtedness that the entity has.

For estimating the fitted values of the endogenous variables, we used other control variables such as the fact that the major shareholder is a Romanian investor or not, the fact that the entity is acting on manufacturing area and the change in sales that the company had obtained.

A part of the results is in accordance with the results found in the literature, while the others are contradictory to them. For example, when the entity has a CEO different from the chairman of the company higher audit fees are expected. Moreover, the entities with a two tier management system also behave in a similar way. It seems that the entities with a one tier management system, where the CEO is the same as the president of the company, pay lower fees for the auditing activity.

For the sample on which the analysis was conducted, the characteristics of the financial auditor seem not to affect the value of the audit fees. As a fact, either the type of financial audit or the change of it influence in a statistically significant way the amount paid to the financial auditor.

A positive relationship between the level of indebtedness and the audit remuneration is found. The result is similar with the one of Hay, Knechel and Wong (2006), but is contrary with it in term of profitability. The authors consider that a more negative relationship between audit fees and the profitability of the entity should be observed rather than a positive relationship as is the result in our case.

The existence of the audit committee influences in a negative way the value of audit remuneration. This is due to the fact that the audit risk is mitigated with the existence of the audit committee, thus lower financial audit fees are requested for the auditing process. The

results are in accordance with the results found by Cohen and Hanno (2000).

On the other hand, we could observe that in case the major shareholder has the control of the company, higher agency problems could be encountered. The explanation resides on the fact that the audit fees decrease when the major shareholder has the control of the company. This could be similar with the fact that lower protection is encountered for minor shareholder when the major shareholder has the control of the company. The result could be correlated with the negative influence of the executive members from the board of directors. It seems that the larger the company is, or the larger the number of executive members of the board of director is, the lower the value of auditor' remuneration is.

The limits of the research are considered to be due to the small dimension of the sample included into the analysis, due to the fact that no data could be found

regarding the auditor's remuneration after 2011. There is a lack of transparency on the Romanian market, which makes the data collection more difficult.

Further research aims to detect the interdependencies between financial audit, corporate governance and financial performance by using a larger sample, by including elements that are found in the corporate governance document and by conducting a comparison analyzing with a market that has similar characteristics with Romania.

### Acknowledgement

This work was cofinanced from the European Social Fund through Sectoral Operational Programme Human Resources Development 2007-2013, project number POSDRU/159/1.5/S/142115 „Performance and excellence in doctoral and postdoctoral research in Romanian economics science domain”

### REFERENCES

1. Abbott, L. J., Parker, S., Peters, G. F. and Raghunandan, K. (2003), The association between audit committee characteristics and audit fees, *Auditing: A Journal of Practice & Theory*, vol. 22, no. 2, pp. 17–32.
2. Brad, L., Dobre, F., Ciobanu, R. and Braşoveanu, I. V. (2014), “Interdependența între guvernanța corporativă și auditul financiar: evidență de pe piața de capital din România”, articol prezentat la *Emerging Market Queries in Finance and Banking*, 24-25 Octombrie 2014, București, România.
3. Campa, D. (2013), Big Four fee premium and audit quality: latest evidence from UK listed companies, *Managerial Auditing Journal*, vol. 28, no. 8, pp. 680-707.
4. Carcello, J.V., Hermanson, D.R., Neal, T.L. and Riley, R.A. (2002), Board characteristics and audit fees, *Contemporary Accounting Research*, vol. 19, no. 3, pp. 365-384.
5. Chan, P., Ezzamel, M. and Gwilliam, D. (1993), Determinants of audit fees for quoted UK companies, *Journal of Business Finance and Accounting*, vol. 20, no. 6, pp.765-786.
6. Cohen, J.R. and Hanno, D.M. (2002), Auditor's Consideration of Corporate Governance and Management Control Philosophy in Preplanning and Planning Judgments, *Auditing: A Journal of Practice & Theory*, vol. 19, no. 2, pp. 133-146.
7. Core, J.E., Holthausen, R.W. and Larcker, D.F. (1999), Corporate governance, chief executive officer compensation, and firm performance, *Journal of Financial Economics*, vol. 51, pp. 371-406.
8. Craswell, A., Stokes, D.J., and Laughton, J. (2002), Auditor independence and fee dependence, *Journal of Accounting and Economics*, vol. 33, no. 2, pp. 253-275.
9. Daske, H. (2006), Economic benefits of adopting IFRS or US-GAAP: Have the expected cost of equity capital really decreased?, *Journal of Business Finance & Accounting*, vol. 33, no. 3&4, pp. 329-373.
10. Dittmann, I., Maug, E.G. and Schneider, C. (2008), Bankers on the board of German firms: What do they do, what they are worth, and why they are (still) there, *Review of Finance*, vol. 14, no. 1, pp. 35-71.
11. Dobre, F. (2014), “Are financial audit elements and corporate governance policies solutions for the economic crisis?”, presented at *International*

- Conference Post-Crisis Developments in Economics*, 21-22 noiembrie 2014, București, România.
12. Farber, D.B. (2005), Restoring Trust after Fraud: Does Corporate Governance Matter?, *The Accounting Review*, vol. 80, no. 2, pp. 539-561.
  13. Hay, D.C., Knechel, W.R. and Wong, N. (2006), Audit fees: A meta-analysis of the effect of supply and demand attributes, *Contemporary Accounting Research*, vol. 23, no. 1, pp. 141-191.
  14. Hubens, R. (2012), "The Influence of the Financial Crisis on Auditor Changes and Earnings Management", Tilburg University, Available at: <http://arno.uvt.nl/show.cgi?fid=123020> [Accessed January 9th, 2016].
  15. Idowu, S.O.(2014), *Corporate governance: an international perspective*, Springer Publishing, Berlin.
  16. Mitra, S., Hossain, M. and Deis, D.R. (2007), The empirical relationship between ownership characteristics and audit fees, *Review of Quantitative Finance and Accounting*, vol. 28, pp.257-285.
  17. Reichelt, K.J. and Wang, D. (2010), National and Office-Specific Measures of Auditor Industry Expertise and Effects on Audit Quality, *Journal of Accounting Research*, vol. 48, no. 3, pp. 647-686.
  18. Sikka, P. (2009), Financial crisis and the silence of the auditors, *Accounting, Organizations and Society*, vol. 34, no. 6-7, pp. 868-873.
  19. Simunic, D.A. (1980), The pricing of audit services: Theory and evidence, *Journal of Accounting Research*, vol. 18, no. 1, pp. 161-190.
  20. Steward, J.G. and Kent, P. (2006), "The relation between external audit fees, audit committee characteristics and internal audit", 9-1-2006 *Working Paper Faculty of Business Publications*, Available at [http://epublications.bond.edu.au/business\\_pubs/14/](http://epublications.bond.edu.au/business_pubs/14/) [Accessed January 9th, 2016].
  21. Tsui, J.S.L., Jaggi, B. and Gul, F.A. (2001), CEO Domination, Growth Opportunities, and their Impact on Audit Fees, *Journal of Accounting, Auditing & Finance*, vol. 16, no. 3, pp. 189-208.
  22. Voller, D., Bremert, M. and Zein, N. (2013), Interdependencies between auditing and corporate governance –evidence from Germany, *Auditing and Corporate Governance*, vol. 65, pp. 198-226.
  23. Williams, D.D. (1988), The potential determinants of auditor change, *Journal of Business, Finance & Accounting*, vol. 15, no. 2, pp. 243-261.