

## THE EFFECT OF BUSINESS STRATEGIES AND FINANCIAL REPORTING IRREGULARITIES ON AUDIT

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### ABSTRACT

*This research aims to examine and analyze the effect of business strategy and financial reporting irregularities on audit fees. Business strategy is measured by six comprehensive sizes: research and development ratios, employee ratios, revenue changes, sales load ratios, employee turnover ratios, and capital intensity. Financial reporting irregularities are measured by the indication of deviation from financial statements, and the audit fee is measured by the company's logarithmic number of audit fees. Sample selection using the purposive sampling method and selected 314 companies that meet the criteria for this study. The research was conducted from 2017 to 2019. The results of this study indicate that financial reporting irregularities and business strategy have a significant effect on audit fees. In summary, the results of this study support the view that the company's financial information and the complexity of the business represented in the company's business strategy are essential considerations for auditors in setting audit fees. The research findings prove that a business strategy that represents the complexity of the company's business and indications of financial statement irregularities will affect the cost of external auditors. In general, this research has implications for management policies and actions that will have an impact not only on operational costs but also on agency costs. Minimizing irregularities in financial statements will reduce the costs borne by the company. Therefore, shareholders must monitor the policies and actions taken by the company.*

**Keywords:** *business strategy, financial reporting irregularities, audit fees*

Penelitian ini bertujuan untuk menguji dan menganalisis pengaruh strategi bisnis dan penyimpangan pelaporan keuangan terhadap *fee* audit. Strategi bisnis diukur dengan enam ukuran komprehensif: rasio penelitian dan pengembangan, rasio karyawan, perubahan pendapatan, rasio beban penjualan, rasio perputaran karyawan, dan intensitas modal. Penyimpangan pelaporan keuangan diukur dengan indikasi penyimpangan laporan keuangan, dan *fee* audit diukur dengan jumlah logaritma *fee* audit perusahaan. Pemilihan sampel menggunakan metode *purposive sampling* dan terpilih 314 perusahaan yang memenuhi kriteria penelitian ini. Penelitian ini dilakukan dari tahun 2017 hingga 2019. Hasil dari penelitian ini menunjukkan bahwa penyimpangan pelaporan keuangan dan strategi bisnis berpengaruh signifikan terhadap *fee* audit. Secara ringkas, hasil penelitian ini mendukung pandangan bahwa informasi keuangan perusahaan dan kompleksitas bisnis yang direpresentasikan dalam strategi bisnis perusahaan merupakan pertimbangan penting bagi auditor dalam menetapkan *fee* audit. Temuan penelitian membuktikan bahwa strategi bisnis yang merepresentasikan kompleksitas bisnis perusahaan dan indikasi penyimpangan laporan keuangan akan memengaruhi biaya auditor eksternal. Perusahaan sebaiknya meminimalisir kesalahan atau penyimpangan dalam laporan keuangan, agar tidak berdampak pada peningkatan *fee* audit. Secara umum, penelitian ini berimplikasi bahwa kebijakan dan tindakan manajemen akan berdampak tidak hanya pada biaya operasional, tetapi juga pada biaya keagenan. Meminimalkan penyimpangan laporan keuangan akan mengurangi biaya yang ditanggung perusahaan. Oleh karena itu, pemegang saham harus memantau kebijakan dan tindakan yang diambil oleh perusahaan.

**Kata kunci:** strategi bisnis, penyimpangan pelaporan keuangan, *fee* audit

### INTRODUCTION

According to Statement of Financial Accounting Standards (PSAK) No. 1 concerning Presentation of Financial

Statements, financial reports are a structured presentation of the financial position, financial performance, and cash flow of an entity. Financial reports contain

company financial information that will be useful for stakeholders. Financial reports need to be audited so that the quality of the information in the financial statements follows accounting principles and that stakeholders and interested parties can have confidence in their use for making economic decisions. A public accountant is a professional who provides audit services on financial statements to assure users that the financial statements have been prepared under the applicable financial reporting framework. In giving his opinion on the audited financial statements, the public accountant must be responsible for all audit engagements performed. Public accountants provide professional services; therefore, it is the company's obligation to provide fees to public accountants.

The 2008 Code of Ethics for Public Accountants explains that a public accountant is entitled to receive an honorarium for the knowledge he imparts in carrying out professional work. In setting a reasonable honorarium, an accountant must take into account the responsibilities involved, the nature, limitations, and the importance of the work. However, an accountant is prohibited from receiving benefits other than the honorarium he deserves. Audit fees are an honorarium charged by public accountants to auditee companies for audit services performed by public accountants on financial statements. The fee issue is dilemmatic since, on the one hand, the auditor must be independent in giving his opinion, but on the other hand, the auditor also receives compensation from the client for the work he or she does. In Indonesia, the rules for determining audit fees are contained in the IAPI (Indonesian Public Accountants Association) Management Regulation No. 2 of 2016. This rule is expected to minimize the dilemma of setting fees for audit services and help auditors calculate standard fees that reflect the level of responsibility and risk taken. The regulation has explained several basic principles that must be considered by the auditor in determining the audit fee, such as the level of complexity of the client company, the scope of the audit, and the

time needed to carry out the audit. However, the regulation does not explicitly state that business strategy is the basis for considering audit fees. Likewise, IAPI Management Regulation No. 2 of 2016 explains that in calculating audit fees for financial statements, the auditor must calculate the amount of time needed to carry out the stages of risk assessment, response to risk, and reporting. And financial reporting irregularities are expected to be matters that the auditor considers in assessing audit risk.

Several studies point to the workforce environment (Sun, Habib & Bhuiyan, 2020), market concentration as measured by client size, international operations, use of IFRS (Gunn, Kawada & Michas, 2019), accrual quality (Kwon, Cho & Ki, 2015), and volatility of other comprehensive income (Huang, Lin & Raghunandan, 2015) effect on the audit fee. In addition, Arens (2017) states that in assessing a client's business risk, the auditor uses knowledge obtained from a strategic understanding of the client's business and industry, management control, and corporate governance. Therefore, the influence of the economic environment and client company policies is an interesting factor that can be tested against audit fees. Research on the effect of business strategy and financial reporting deviations on audit fees still needs to be developed. Business strategy and financial reporting irregularities are part of the risk assessment that needs to be tested, whether they are a consideration for auditors in Indonesia in determining audit fees.

Miles & Snow's typology distinguishes strategies based on the organization's adaptation process to changes in its environment, including prospector, defender, and analyzer business strategies (Apriyantopo, Aprianingsih & Kitri, 2022; Rahman & EDT, 2020; Afiff, Fontana & Zubaedah, 2013). The prospector business strategy is a business strategy that tends to expand the market and look for new markets for its products so that it always makes innovations related to the products it produces. Through innovations that the

prospector company continuously carries out, the company becomes the market leader in a market that it focuses on. In contrast to companies that implement a defender business strategy, companies that implement this business strategy tend to have a fixed but strong market. Companies with a defender business strategy try to prevent competitors from entering their market by focusing on low costs. Defender companies tend to be followers of prospector companies because these companies do not innovate on their products. The resulting product does not follow trends but has a strong market, so it does not require a lot of innovation in its products. Analyzer, a strategy that is in the middle between defender and prospector, is a strategy that minimizes risk and maximizes profit opportunities. The analyzer combines the strengths of defenders and prospectors into one system. In addition to focusing on finding new locations and finding products to target new consumers by following or imitating the prospector's success, the analyzer also focuses on maintaining existing products and customers, who are the primary source of analyzer revenue.

Based on the typology of strategies proposed by Miles, Snow, Meyer, Coleman, Miles & Meyer (1978; 2012), companies that implement a prospector business strategy will tend to generate greater business risk because of their risk-oriented focus. The company bears more risk due to rapid product growth and a large market share. The company's rapid development will affect the presentation of its financial statements, which may contain a greater risk of financial reporting irregularities. On the other hand, defenders have fewer risk characteristics because they apply a less risk-oriented focus, meaning that companies take fewer risks that may occur. In addition, defender companies that maintain the market by relying on cost-reduction do not need to innovate their products to have less complexity in their financial statements. Thus, companies with a defender business strategy in presenting financial statements contain less risk of irregularities than prospectors. Meanwhile,

in companies with an analyzer business strategy or a combination of prospector and defender business strategies, the risk level for irregularities in the financial statements is in the middle between the prospector and defender irregularity levels.

Auditors who audit companies with prospector business strategies will require more significant effort in carrying out their duties because the annual reports tend to be unstable on transactions carried out by prospector companies. Due to the large business risk and the fast movement of the company, it has a high risk of irregularities, which will affect the auditor fees for auditing the prospector company. On the other hand, companies with a defender business strategy require lower audit fees than prospector companies because they have fewer risk characteristics. Thus, when compared to defenders, the business risk contained in the prospector is likely to affect the auditor's effort to carry out an audit (audit effort), which is more significant to reduce audit risk so that it affects auditor fees (Bentley, Omer & Sharp, 2013).

This study is empirical, in that the companies that will be studied are all companies listed on the Indonesia Stock Exchange in 2017-2019, except for the financial sector. This study examines whether there is an influence between business strategy and financial reporting deviations on audit fees. This research contributes to the expansion of accounting research because it is multidisciplinary, linking different fields of study, namely auditing, financial accounting, and strategic management. Based on some literature, especially from Indonesia, this research area is not yet sufficiently developed. Furthermore, this study uses business strategy measurement tools that are sourced from secondary data from six proxies, namely research and development to sales (RDS), employee to sales (EMPS), change in total revenue (REVS), marketing to sales (SGAS), employee turnover (EMP), and capital intensity (CAP). Based on the justification of previous research (Bentley et al., 2013; Higgins, Omer & Phillips, 2015; Lim, Chalmers & Hanlon, 2018; Habib &

Hasan, 2020), the business strategy measures used in this study are more comprehensive. In addition, our research adds to the literature on audit pricing. There is evidence of the impact of internal company decisions about audit pricing (DeFond & Zhang, 2014). We contribute to the literature by providing evidence that the direction of corporate business strategy and financial reporting irregularities by companies require auditors to exercise professional skepticism. The rest of our paper is structured as follows: Section 2 discusses related literature and develops hypotheses. Section 3 details our research design, samples, and data. Section 4 presents our main findings. Section 5 concludes.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### Business Strategy

Strategy is not only needed by an organization that focuses on profit-oriented, but also by non-profit organizations such as hospitals, universities, churches, local governments, libraries, and other social institutions. Several research results show that organizations with a clear and well-formulated strategy have superior performance compared to organizations without a formulated strategy.

In the business world, the term strategic denotes a unified, broad, and integrated plan that relates the company's strategic advantages to environmental challenges and is designed to ensure that the company's main objectives can be achieved through proper execution by the organization. Pearce & Robinson (2014) defined strategy as a large-scale and future-oriented plan to interact with the competitive environment to achieve company goals. Every company has a type of strategy for running its business. Strategy categorizes companies based on a general strategic orientation of structure, culture, and processes (Szczepańska-Woszczyna, 2018).

The description of various types of competitor strategies is essential in analyzing the level of competition in an

industry. According to Miles et al. (1978; 2012), competing firms in an industry can be grouped according to their general strategic orientation as one of the four basic types of strategy. Each type has a primary strategy for dealing with the environment and combines structures, cultures, and processes consistent with that main strategy. The differences between the types of strategies explain why companies faced with similar situations act in different ways and maintain that way of working for a long time. The company will develop a systematic and identifiable pattern of behavior based on its ability to adapt to the environment.

Miles et al. (1978; 2012) classified companies according to their adaptive decision patterns into defender, prospector, analyzer, and reactor types. The four types of strategies are explained as follows: 1) Defender, the defender strategy emphasizes market stability by offering and protecting a limited product line for a narrow business segment in a potential market. The defender tries to divide and improve market niches in industries where competitors find it difficult to penetrate. They compete primarily based on price, quality, delivery, and service and concentrate on operating efficiency and stringent cost controls to maintain their competitiveness. The organization or company does this through standard economic measures, such as competing on price or producing a high-quality product. 2) A prospector, is almost the opposite of a defender. Their strength is finding and exploiting new products and market opportunities. Innovation is more important than big profits. The prospector strategy focuses on product innovation and market opportunities. Companies that adopt this strategy emphasize creativity and flexibility over efficiency to respond quickly to changing market conditions and take advantage of new market opportunities. 3) The analyzer, tries to take the best of the two strategies above. The analyzer attempts to minimize risk and maximize profit opportunities. After being proven by prospectors, their strategy will only move to new products or new

markets. The analyzer lives on imitation. They take successful de-ideas from prospectors and then copy them. Analyzers tend to operate in at least two distinct product market areas: stable, which emphasizes efficiency, and variable, which emphasizes innovation. The organizational structure of analyzers is complex, reflecting the vast market they operate in. The analyzer attempts to combine the characteristics of mechanistic and organic organizations. 4) Reactor, the reactor represents a residual strategy. The name is meant to describe the inconsistent and unstable patterns that arise when one of the other strategies is pursued incorrectly. In general, the reactor responds incorrectly. In general, reactors underperformed, and as a result, they were reluctant to commit themselves aggressively to specific strategies for the future. The reactor reacts to a changing environment and strategies, adapting only when stress strikes. They lack a coherent strategy and cannot respond quickly to environmental changes.

#### **Financial Reporting Irregularities**

Financial reporting irregularities are actions that are done knowingly with the goal of misleading or defrauding and that do not comply with the accounting rules. Accounting inconsistencies, which are always linked to negativity in financial statements, are, in essence, at the core of financial statement fraud. These include willful falsifications, the alteration of accounting data, and the deletion of accounting information in order to misrepresent an organization's true financial situation and paint a more favorable picture (Soepriyanto, Kuncoro, Averine & Zudana, 2022; Soepriyanto, Tjokroaminoto & Zudana, A, 2021)

Several accounting risk measures can be used as proxies for measuring financial report irregularities. From academic measures of accounting risk such as M-Score, F-Score, working capital accruals, accrual quality, and unexplained audit fees to commercial ones such as Audit Integrity's Accounting & Governance Risk (AGR), and Accounting Risk (AR) as used by Pearce & Robinson (2014). Researchers can

choose all of these measures when assessing accounting risk to detect financial statement errors and predict future accounting irregularities.

#### **Risk and Audit Fee**

Audit risk is the risk that occurs when the auditor, unknowingly, does not modify his opinion as appropriate on a financial statement that is materially misstated. The more confident the auditor is in expressing his opinion, the lower the audit risk that the auditor is willing to bear, and vice versa. The auditor forms an opinion on the financial statements as a whole based on evidence obtained from verification of assertions relating to individual account balances or classes of transactions. The objective is to limit the risk that the auditor's opinion on the financial statements as a whole will be low. Audit risk affects the implementation of auditing standards, particularly fieldwork standards and reporting standards. Joint audit risk needs to be considered in determining the nature and extent of audit procedures and evaluating those procedures' results. The auditor must plan the audit so that audit risk can be limited to a low level that, in his professional judgment, is adequate to express an opinion on the financial statements (Arens, 2017).

#### **The Effect of Business Strategy on Audit Fee**

In the management literature, several typologies of business strategies describe how companies compete in the market. One of them, proposed by Miles et al. (1978; 2012), classifies strategy types as prospector, defender, and analyzer business strategies. Miles et al. (1978; 2012) divided the types of business strategies into defender, prospector, analyzer, and reactor (not considered a strategy). The defender strategy emphasizes market stability by offering and protecting a limited product line in a narrow business segment from a potential market. The defender tries to divide and refine market niches into industries that competitors find difficult to penetrate. They compete primarily based on price,

quality, delivery, and service and concentrate on operating efficiency and tight cost controls to maintain their competitiveness. The prospector's strategy is almost the opposite of the defender's. The power of prospectors lies in finding and exploiting new products and market opportunities. Innovation is more important than big profits. The prospector strategy focuses on product innovation and market opportunities. Firms that adopt this strategy emphasize creativity and flexibility over efficiency to respond quickly to changing market conditions and take advantage of new market opportunities. Meanwhile, a business strategy analyzer combines prospector and defender strategies. The strategy analyzer combines the strengths of defenders and prospectors into one system. In addition to focusing on finding new locations and finding products to target new consumers by following or imitating the prospector's success, the analyzer also focuses on maintaining existing products and customers, who are the primary source of analyzer revenue.

Based on research by Bentley et al. (2013), which shows a positive and significant relationship between prospector and defender business strategies on audit fees set by auditors, this study suspects that the choice of business strategy in companies in Indonesia also influences audit fees set by auditors because each business strategy has different characteristics and complexities and has different business risks, so the auditor's effort in conducting audits for each type of strategy is also different. Then the first hypothesis developed is:

H1: The company's strategy positively affects the audit fee

The existence of irregularities or irregularities in the financial statements is a form of financial reporting risk that may be intentionally or unintentionally caused by the company's management, causing material errors in the financial statements. Errors and irregularities (Price, Sharp & Wood, 2011) should be watched out for, and the auditor should look for procedures that can find these two types of errors.

These errors can usually be found by observing the weaknesses of the internal control system, assessing the level of honesty of management, seeing unusual transactions, and so on.

One of the conceptual frameworks that can be used to determine and assess audit pricing is the audit risk model as described in professional auditing standards (AICPA, 2007). In that model, the client's increased inherent risk is influenced by lower management quality and competence, poor and non-transparent attitudes toward financial reporting, and weak corporate governance practices. According to the model, when there is an increase in inherent risk, the auditor should accept a lower detection risk. To reduce detection risk, the auditor will increase the level of audit evidence collected, which will result in increased audit fees.

When there are many irregularities in financial reporting found by the auditor, it is suspected that it will affect the fees set by the auditor because the auditor requires greater effort and a longer time to conduct the audit to find indications of the deviation. This assumption is in line with research conducted by Charles et al. (2009), which examined the relationship between financial reporting risk and audit fees and found evidence of a positive relationship between financial reporting risk and audit fees paid to Big 4 auditors. Charles et al. (2009) also found that the relationship between financial reporting risk and audit fees strengthened significantly in 2002 and 2003, consistent with a shift in the way auditors value risk, regarding their response to the Sarbanes-Oxley Act of 2002 after the Enron case was revealed. Charles et al. (2009) stated that they provide evidence of a commercially developed comprehensive risk measure that can effectively capture an element of risk, namely the risk that comes from deliberately distorted financial statements. Based on the description above, the second hypothesis to be developed is:

H2: Financial reporting irregularities positively affect the audit fee

## RESEARCH METHODS

### Research Design

This research is a type of causal study that examines the effect of two independent variables, business strategy and financial reporting irregularities, on the dependent variable, audit fees. The unit of analysis in this research is the company. The time horizon of research data collection is 2017–2019, which does not test trends, so this research is categorized as research at a certain time, which is called a cross-section.

### Population and Sampling

The population in this study is all companies listed on the Indonesia Stock Exchange (IDX) in 2017–2019, except companies in the banking sector and other financial institutions. This research was conducted from 2017–2019 to accommodate data availability, requiring data collection for four to five years (from 2013–2019). Generally, annual report data will only be publicly available on [idx.co.id](http://idx.co.id) for three years. This research began in 2017 because PP IAPI No. 2, which regulates the calculation of audit fees, was only released in 2016. This research does not test data for years after 2019, for example, 2020 and 2021, because in those years there was COVID, in which the company's financial condition changed drastically, so that it is believed to affect changes in the company's business strategy, the company's compliance in submitting financial reports, and even changes to the pattern of audits carried out by auditors of the company. The financial sector is excluded from the research object because it is a regulated sector and the structure of financial statement accounts is different. It cannot be compared with other industries.

The sampling method used in this research is purposive sampling, namely, considering specific criteria with the following criteria: companies listed on the IDX from 2017–2019. Companies that publish annual reports on the IDX website or company websites during the 2017–2019 observation period include audit fees in their annual reports. Companies that

have the complete information needed relating to the calculation indicators used as variables in this study.

### Data and Data Sources

This study uses secondary data in the form of annual report data, which contains financial reports and other narrative information on companies listed on the IDX. Business strategy data is taken from financial statements for four years before the 2017 research year, or from 2013 to 2019. It is because to measure business strategy, the measure used is the 5-year rolling average value of the specified ratio. Consideration of the availability of data is the reason why this research was conducted starting in 2017. This research was carried out until 2019 with the argument that COVID-19 in 2020 could affect the company's financial reporting, so it is likely to form a pattern of irregularities that is different from previous years. This study limits the research period to 2019 to avoid bias due to differences in patterns. Meanwhile, data on audit fees and irregularities is obtained from the narrative information in the company's annual report. The data obtained was taken from the official website of the IDX, namely [www.idx.co.id](http://www.idx.co.id), and through the company's official website.

### Definition and Measurement of Research Variables

The dependent variable is a variable that is the main concern of researchers (Sekaran & Bougie, 2016). The dependent variable in this study is the external audit fee, which is the honorarium charged by the public accountant to the auditee company for the audit services performed by the public accountant. In the company's financial statements, there is usually data about the company's audit fees in the annual reports of companies listed on the IDX. This dependent variable will be measured using audit fee logarithm data, namely the amount of fees paid by the company for the use of external auditor professional services as used in the research of Younas, Velte & Ashfaq (2014). Furthermore, this variable will be symbolized by LnFEEAUD.

Independent variables (independent variables) are variables that affect the dependent variable, either positively or negatively (Sekaran & Bougie, 2016). This study uses the independent variables of the company's business strategy and financial reporting irregularities.

This study uses the typology of business strategies proposed by the company to classify the business strategies adopted by the company. This typology of strategy was chosen for the following reasons: First, many previous studies found that conclusions on a business strategy based on Miles et al. (1978; 2012) tend to align with findings based on other strategic typologies developed by other researchers. Second, and more importantly, Miles & Snow's (1978) typology can be operationalized using archival and secondary data, whereas different business strategy typologies require personal interviews and surveys of company officials. Thus, this typology yields a measure of business strategy that allows this research to be generalized across a broad range of companies and industries.

The determination of the strategy used by the sample company is done using a strategy size composite, consisting of six measures (Bentley, et al., 2013; Higgins et al., 2015; Lim et al., 2018). 1) The ratio of Research and Development to Sales (RDS): the ratio of research and development (R&D) expenditures divided by sales (SALE) measured in a five-year rolling average to measure a company's propensity to develop new products. Prospector increases the intensity of R&D to maintain a reputation as an innovation driver in the market, while defender limits R&D while emphasizing continuous improvement of existing products. Therefore, prospectors will appear with a high ratio of R&D, while defenders will have a low ratio. 2) The ratio of the employee to sales (EMPS): the ratio of the number of employees (EMP) divided by sales (SALE) measured in a five-year rolling average to measure a company's ability to produce and distribute goods efficiently. Highly standardized business operations and clear procedures allow employees at defender companies to

generate higher sales rates relative to prospectors. 3) Change in Total Revenue (REVS): 1-year percentage change in sales, measured five years earlier from the study period. Prospectors tend to experience high growth rates due to market expansion, while defenders stick to a stable market domain and achieve growth through market penetration. Consequently, prospectors tend to have a higher income ratio than defenders. 4) Marketing to sales (SGAS): the ratio of selling, administrative, and general costs (SGA) to total sales (SALE) measured in a five-year rolling average measures a company's focus on exploiting new products and services. To introduce customers to different new products, prospector companies rely heavily on marketing and advertising. In contrast, in defender companies, ordinary customers already know about the company's cost-efficient products; therefore, defenders rely less on marketing and advertising. 5) Turnover employee ( $\sigma$  (EMP): standard deviation of the total number of employees (EMP) as measured in a five-year rolling average to measure the organizational stability of a company. Prospector company employees have shorter tenure when they enter the company based on project availability and also because they generally have common skills that give them mobility between companies. In addition, senior management at prospectors may be hired externally. On the other hand, defender company employees generally lack the skills that would allow them to transfer to another company, and they receive introductory training on the company's business operations, thus making them more attached to the original company. Furthermore, senior management at defender companies is usually promoted between divisions because they have in-depth knowledge (Navissi, Sridharan, Khedmati, Lim & Evdokimov, 2017). 6) Capital intensity (CAP): capital intensity is calculated by net PPE divided by total assets (PPE/TA) measured in a five-year rolling average to measure the company's commitment to technology efficiency. Defender is more automated and capital-



intensive to achieve input minimization and maximize output, ultimately leading to economies of scale. In contrast, prospectors are constantly looking for new market opportunities, are less automated and capital intensive, pay less attention to technological improvements, and are more flexible and regularly change their technology. Therefore, defenders tend to show a higher capital intensity ratio than prospectors.

The six ratio values are calculated on a rolling average over the previous five-year period, then ranked based on quintiles. The highest quintile is assigned a value of 5, the next quintile is assigned a value of 4, and so on (except for CAP, in reverse order). Then the value of each company for the six sizes per year is added up. The maximum value is 30 (prospector strategy type), and the minimum value is 6 (defender strategy type). As per Bentley et al. (2013), a company can be categorized as a defender if the average company rating for the six variable sizes is in the lowest quintile (value 1 or 2) or has a total score in the minimum range of 6 to 12.

On the other hand, the company is categorized as a prospector if the average company's aggregate score for the six variable measures is in the highest quintile (worth 5 or 4). Thus, companies with a total score in the range of 24 to a maximum of 30 are prospector companies. If a company has a total score outside the range mentioned above, it will be categorized as an analyzer, which has a total score in the range of 13-23. In contrast, a company that has a score of 6 to 12 will be categorized as a company with a defender strategy.

This study uses variable dummy financial reporting irregularities measured by two indicators: lawsuits and restatements carried out by companies (Bentley, et al., 2013). This measurement is operationalized by assessing whether the company made a restatement of financial statements in the year of study or whether the company has indications of a lawsuit. For restatement, see the following year's financial statements; as for lawsuits, search on Google. If the company is indicated to be experiencing a lawsuit or carrying out a

restatement, it is given a value of 1, otherwise it is given a value of 0.

### Research Model

The study developed a multiple linear regression model to test the effect of the independent variables, the company's business strategy and financial reporting deviations, on audit fees. The research model formula is as follows. This research does not add control variables to the research model because of several weaknesses in the control variables. Controlling for variables has the drawback that a causal model is required to find significant confounders. Without one, a potential confounder may go unnoticed. Another issue is that if a variable that is not a true confounder is taken into consideration, it may actually cause other variables that were previously not included to become confounders. In other situations, such as when controlling for a mediator or its descendent, the true causal effect of the explanatory factors on an outcome may be underestimated as a result of the non-confounding variable control.

$$\text{LnFEEAUD}_{i,t} = \alpha + \beta_1(\text{STRATEGY})_{i,t} + \beta_2(\text{IRREGULARITIES})_{i,t} + e_{i,t}$$

Where :  $\alpha$ : constant; LnFEEAUD  $it$ : natural logarithm of company  $i$  audit fee, in year  $t$ ; STRATEGY: business strategy used by company; IRREGULARITIES $_{i,t}$ : financial reporting irregularities in the research period of company  $i$  in year  $t$ ;  $e$ : error

### ANALYSIS AND DISCUSSION

#### Description of Research Object

This study examines the effect of the company's business strategy and financial reporting irregularities on external audit fees. The research object is a company listed on the IDX in 2017-2019. The sample selection method used is purposive sampling. Of the total 2,283 companies listed on the IDX for three years from 2017-2019, 314 companies meet the criteria for this study's selection as samples. The sample description is as follows.

From a total sample of 314 companies, if the distribution per industrial sector is displayed, it can be seen that the largest proportion of the research

sample is in the trade, service, and investment sectors, which is 21.22%, with the lowest distribution being in the agricultural sector, which is 7.67%. However, if we compare between sectors, the proportion of sample distribution per sector tends not to show the collection in certain sectors (heterogeneous).

### Descriptive statistics

Descriptive statistics provide data from all samples being studied. It can be seen from the average (mean), standard deviation, minimum, and maximum. Descriptive statistical analysis was conducted on all research variables, both the dependent variable (external audit fees) and the independent variables (business strategy and financial reporting irregularities). The results of the average (mean), standard deviation, minimum, and maximum values of 314 samples processed through SPSS are shown in Table 3.

From Table 3, it can be seen that the dependent variable of external audit fees is

**Table 1.**  
Sample Selection

Criteria	Total
Number of companies listed on the IDX in 2017-2019	2.283
The number of companies that did not completely publish the annual report on the IDX website or company website during the observation period (2013-2019)	(681)
Companies that do not include audit fees in the annual report	(997)
Financial Sector excluded from sample	(291)
Samples that meet the criteria	314

measured by the natural logarithm of audit fees, namely the transformation of audit fee data received by external auditors, with an average value of 20.7950 (Rp1,074,369,698.94). The minimum value is 15.10 (Rp3,612,822.93), and the maximum value is 26.50 (Rp322,703,570,371.16). The standard deviation is 1.28071 (Rp3.599194247). The business strategy variable measured by looking at the total strategy score of each company has obtained an average of 19.6720. This value indicates that, on average, companies in Indonesia adopt a strategy analyzer type, namely a strategy type that combines the competitive advantages of prospector and defender strategies. As described in the previous section, firms that have an average aggregate score of the six strategic measures are 24-30 categorized as prospector firms, 13-23 are analyzers, and 6-12 are defenders. In accordance with the measurement of the business strategy described in the variable measurement section, the minimum value of 11.00 can be interpreted as the research sample being spread across companies in the defender strategy score range. The maximum value of 28.00 illustrates that the sample company is in the prospector strategy score range. The standard deviation is 3.5304. The IRREGULARITIES variable is measured by grouping a value of 1 to companies with an indication of irregularities. In contrast, a value of 0 for companies without an indication of irregularities is obtained by an average of 0.4013. The minimum value is 0, while the

**Table 2.**  
Distribution of Research Samples per Industrial Sector

No.	Sector Type	Number	Total %
1	Goods and Consumption Industry Sector	40	12.85%
2	Basic and Chemical Industry Sector	42	13.56%
3	Other Industrial Sectors	20	6.41%
4	Infrastructure, Utilities and transportation Sectors	37	11.85%
6	Trade, Services and Investment Sectors	67	21,22%
7	Mining Sector	35	11.11%
8	Agriculture Sector	24	7.67%
9	Property, Real Estate and Building Construction Sectors	49	15.61%
	Total	314	100%

maximum value is 1. The standard deviation is 0.50075. These data indicate that almost half of the total sample in this study has irregularities in financial reporting.

#### Classical assumption test

Based on the heteroscedasticity test, the business strategy and financial reporting irregularities variables have significance values greater than 0.05. According to the basis for decision-making in the Glejser test, it can be concluded that there is no heteroscedasticity in the regression model. Based multicollinearity test, the business strategy, and financial reporting irregularities variables have a tolerance value greater than 0.10 and a VIF value below 10. It can be concluded that there are no symptoms of multicollinearity between independent variables. Based on the autocorrelation test, the DW value is 1.988. When compared using the DW table with a 5% confidence level with a total sample of 314 and a dependent variable of 2, a du value of 1.789 is obtained. There is no autocorrelation in this regression model because of the value of du dw 4-du (1.789 1.988 2.012). It can be concluded that there is no autocorrelation or no correlation.

#### Multiple Regression Analysis

The adjusted value ( $R^2$ ) is 0.118. It shows that the ability of the independent variable (business strategy and financial reporting

irregularities) to explain the dependent variable (audit fee) is 11.8%. While other variables outside this research model determine 88.2%. The adjusted  $R^2$  value can be seen in Table 5.

Based on Table 4, it can be seen that the calculated F value is  $22.033 > F$  table 3.06 and the F-Test value is significant at  $0.000 < 0.05$ . It means that the independent variables, namely business strategy and financial reporting irregularities, significantly affect external auditor fees. Table 5 is the result of a partial test on the effect of business strategy and financial reporting irregularities on audit fees.

#### Business strategy and external audit fees

The first objective of this study is to examine the effect of business strategy on external audit fees. Based on Table 5, it can be seen that the significant level of the t-test is  $0.006 < 0.05$ . The result of this study shows that business strategy affects external audit fees. Based on these findings, this study's first hypothesis (H1) was supported.

The assumption developed in this study that the choice of a company's business strategy will affect the audit fee of the external auditor can be proven empirically by testing. In line with the notion that was built, business strategy can reflect the complexity of the company's businesses. Companies with a prospector strategy that tend to develop products and

**Table 3.**  
Descriptive Statistics

Variables	N	Min.	Max.	Mean	Standard Deviation
STRATEGY	314	11.00	28.00	19.6720	3.5304
IRREGULARITIES	314	.00	1.00	.4013	.49094
AUDIT FEE	314	15.10	26.50	20.7950	1.28071

**Table 4.**  
F Test Results

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	63.716	2	31.858	22.033	.000 <sup>a</sup>
Residual	449.682	311	1.446		
Total	251.200	313			

Source: Data processed with SPSS

businesses will have high complexity compared to companies that adopt a defender strategy that manages to survive in small business niches. When the business complexity of the company being audited is high, it will undoubtedly pose a greater risk and effort for the auditor in conducting an examination or audit. The size of the business strategy used in this study illustrates that the greater the business strategy score, the greater the prospector strategy.

On the contrary, the lower the score of the business strategy, the company tends to choose the defense strategy. The results of research testing found that there was a positive effect of business strategy on audit fees, with a coefficient of 0.054. The value of the business strategy coefficient, which is positive, is in line with the assumption. The more companies choose the prospector business strategy, the higher the complexity of the company's business. It requires more audit effort to understand the client's business (company) to charge a high audit fee. This study is in line with Bentley's et al. (2013) research, which suggests that business strategy significantly affects audit fees. Strategy can represent the business complexity and business risk of the company, so the determination of audit fees for prospector companies is also higher than for defender companies. This study is in line with Bentley's et al. (2013) research, which suggests that business strategy significantly affects audit fees. Strategy can represent the business complexity and business risk of the company, so the determination of audit fees for prospector companies is also higher than for defender companies. Several previous studies have

proven that the business strategy is the construction of complexity (Poretti, Jérôme & Heo, 2023; Vatankhah, Bamshad, Altinay & De Vita, 2023). The prospector business strategy is a business strategy that tends to expand the market and seek new markets for its products in order to always innovate regarding the products it produces. Through continuous innovation by prospector companies, the company becomes the market leader in the market that is the focus of the company. Therefore, companies that implement a prospector business strategy will tend to generate greater business risk, thus requiring greater effort for the auditor to gain an understanding of the company's business entity and financial information. Analyzer, a strategy that is in the middle between defender and prospector, is a strategy that minimizes risk and maximizes profit opportunities. The analyzer combines prospector and defender business strategies, so that the risk level of financial statement deviation is in the middle between prospector and defender deviation levels. Finally, companies with a defender business strategy try to prevent competitors from entering their market by focusing on low costs and competing in small niches, so that this strategy requires the auditor's least effort to understand the business entity and its financial information.

In contrast to companies that implement a defender business strategy, companies that implement this business strategy tend to have a fixed but strong market. Companies with a defender business strategy try to prevent competitors from entering their market by focusing on low costs in a small niche, so

Table 5.

Model	Unstandardized Coefficients		T	Sig.
	B	Std. Error		
(Constant)	19.416	.385	50.397	.000
STRATEGY	.054	.019	2.784	.006
IRREGULARITIES	.798	.139	5.736	.000
Adj R <sup>2</sup> = 0.118				

*Source: Data processed with SPSS*

they have the lowest risk characteristics because they apply a less risk-oriented focus, meaning the company takes on as few risks as possible. Thus, a company with a defender business strategy in presenting financial statements has the smallest risk of deviation compared to prospectors and analyzers, so it requires an audit effort that is not large in understanding business entities and their financial statements.

### **Financial reporting irregularities and audit fees**

The second objective of this study is to examine the effect of financial reporting irregularities on the audit fee set by the external auditor. Based on Table 4, it can be seen that the value of the significant level of the t-test is  $0.000 < 0.05$ . It means that financial reporting irregularities affect external audit fees, so the second hypothesis (H2) was supported. The results of testing for financial reporting irregularities on audit fees have a positive regression coefficient of 1.177, which means that if there is an increase in financial reporting irregularities, it will impact an increase in external audit fees of 1.177. Thus, there are more indications of financial reporting irregularities in the financial statements, which will affect the external audit fee. The positive effect of irregularities in financial reporting on external audit fees means that the more indications of irregularities in financial reporting issued by the company, the higher the company's risk compared to companies with a low level of irregularity. The auditors need to put more effort into conducting audits, which will increase the length of audit time and affect the amount of audit fees paid to external auditors.

This research is in line with Cao, Luo & Zhang (2020) in the context of labor employment decisions. Negative abnormal employment changes are associated with a higher likelihood of subsequent financial restatements, accounting irregularities, and lawsuits related to accounting fraud and generally require greater effort from auditors. as manifested by higher audit fees and longer audit report lags. Likewise,

Habib, Jiang Bhuiyan & Islam (2014) concluded that the restatement of earnings has been a major antecedent for class action lawsuits against firms and auditors. Lawsuits against auditors affect audit fees, audit planning decisions, and client portfolio adjustment decisions.

### **CONCLUSION**

The purpose of this study was to examine the effect of business strategy and financial reporting irregularities on audit fees. The findings of this study indicate that: 1) Business strategy has a positive effect on audit fees. A business strategy that represents the complexity of the company's business will affect the cost of external auditors 2). Irregularities in financial reporting have a positive effect on external auditors. Irregularities in financial reporting indicate a higher company risk in the company's internal control. Therefore, the auditor requires more effort in conducting the audit, which will increase the length of time the auditor spends carrying out the audit and affect the amount of the audit fee paid to the external auditor.

The findings of this study have implications for expanding the literature on audit pricing. There is an impact on internal company decisions about audit pricing. This finding for the auditor can be an acknowledgment that the characteristics of the company's management policies and actions should be a factor that the auditor considers when determining fees for audit services. For policymakers and regulators, these findings can form the basis for updating regulations regarding fees for audit services.

### **LIMITATIONS AND SUGGESTIONS.**

This research has several limitations. 1) This research was conducted in 2017–2019, the period before COVID 19. 2) The research model is a direct effect model. 3) This study uses the three types of strategies described by Miles et al. (1978; 2012), namely prospector, analyzer, and defender, to construct a business strategy. 4) The results of this study, which use all industrial sectors except the financial

sector.

Further research 1) may be able to make comparisons with research in 2020 and 2021 to provide a comparison of the impact of COVID-19 on audits. Especially with COVID-19, the possibility of irregularities faced by companies is getting higher. 2) expand the research model by developing an intervening model between business strategy, financial reporting irregularities, and audit fees to prove which model is better. According to Beantly (2013), irregularities can also be related to the company's strategy. Prospectors who demand product innovation and creativity to be able to compete in the market and keep up with rapid market changes raise the possibility of irregularities higher than defenders who persist in the market domain they have mastered. 3) Further research may exclude companies with business strategy analyzers from the sample so that business strategies are only represented by two types of contradictory strategies, namely prospectors and defenders, so that the effect of business strategy on audit fees is more responsive. 4) For more depth, further research is expected to focus on a specific sector because business strategy is closely related to the characteristics of the industrial sector.

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