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Auditor's specialization and audit fee in military-connected firms

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A R T I C L E   I N F O

A B S T R A C T

The aim of this research is to analyze the association among auditor industry specialization, military connection, and audit fee. This study used 790 observations from 227 different firms that were listed in Indonesian Stock Exchange for the period 2010 to 2017. The analysis technique used in this research was Ordinary Least Square Regression analysis model processed with STATA 14.0 software. This study has found that auditor industry specialization is positively and significantly related to audit fee. The results indicated that the auditors perceived their specializations as a product differentiation which increased audit quality conducted, hence audit fee.

Introduction

This paper studies about how auditor industry specialization alters firms' audit fees. The concern of discussing industry specialist auditor comes from the fact that 80 percent of the companies view industry expertise or specialization as an important factor in choosing an auditor (Cahan et al., 2015). According to Signalling Theory, signalling the market is important to strive a good impression. Generally, a firm chooses to hire an industry specialist auditor based on the urge to signal the investors the improvement of its financial reporting quality. Palmrose (1986) uses industry specialization as a control variable in examining the determinants of audit fees. On the other side, Cahan et al. (2011) found that industry specialists who gained market share by auditing a small proportion of clients in an industry not only pursued a product differentiation strategy and offered higher quality, but also charged higher audit fee.

A number of studies found that many Indonesian firms are politically connected. The connection between a firm and a political or military party has an essential effect on the company's outcome (Gul, 2006). The main reason why the connection is built is the need for one party to take advantage from another party. The same goes for the company and political party. The special benefits enjoyed by both parties will be more optimum in a developing country with less stable political environment (Harymawan & Nowland, 2016). From different point of view, Benmelech and Frydman (2015) see a military board could bring advantages. The judgement arose based on the well-trained characters that were built from the military service. The personnel who joined armed forces may acquire hands-on leadership experience through military service that is not easy to learn, and they may be better at making decisions under pressure or in a crisis. Based on the arguments, this study assumes that having military connection will genuinely improve firm's performance, and auditor perceives this issue as one of the factors to lower the firm's risk which consequently also reduces the audit efforts needed as well as the fee charged.

Recently, Indonesian Institute of Certified Public Accountants issued the guidelines that regulate the indicators of PAF's audit quality (IAPI, 2018). One of the backgrounds to this regulation is to address the requirements for Indonesian listed firms' financial reports to be audited by PAF. In other words, PAF must have several indicators that reflect its competency to be able to provide assurance services. In addition to the maintenance of its internal qualifications, the maintenance of PAF's audit quality is also supported by external bodies' indirect monitoring function. For instance, Indonesian Financial Service Authority (IFSA) requires all Indonesian PAF to register into IFSA database to legally provide assurance service for Indonesian firms (OJK, 2017). Additionally, Indonesian Financial Professional Development Center requires Indonesian PAF to submit their annual reports to monitor their activities. Therefore, audit quality which is commonly represented by audit fees is crucial topic to examine in Indonesia.

This study aims to see how specialist auditors value firms in order to determine the audit fee charged to clients. Balsam et al. (2003) said that many researchers including himself had some difficulties in measuring industry specialization. Although many papers studying this problem considered market share as the most tolerable

measurement, Gramling and Stone (2001) argued that market share was actually subject to several limitations as a measure of specialization. In line with this thought, Cahan et al. (2011) elaborates more details describing that it is problematic because market share depends jointly on the proportion of clients audited and the average size of those clients. Market share can be obtained both with small and large number of clients.

Habib et al. (2017) found that military connection did not significantly affect firms' earning management. The argumentation of the result was based on the fact that in 2004 there was a regulation enforcing a five-year due date for Indonesian government to resume control over all business that were possessed and run by the military since these business practices might cause a progressive disintegration of military power and thus the value of military associations. This research proposes a discussion more specifically about how military connection plays a role in business, particularly in relation with audit fees paid by the firms. This study posits an argument that the existence of military connection will diminish the audit risk which is then reflected into lower audit fees. This is due to assumption that military-connected firms tend to be more conservative (Guo et al., 2020). The military-connected firms usually avoid fraud (Koch-Bayram & Wernicke, 2018), comply with taxation regulations (Law & Mills, 2017), and disclose more information (Nasih et al., 2019), where all of these traits represent good corporate governance mechanism of a firm.

This study aims to prove that the association between auditor industry specialization and military connection influences audit fees through the 790 main samples of firm-year observation. The data were obtained from OSIRIS and collected from the firms' annual reports during the period 2010-2017 which were listed at Indonesian Stock Exchange. This study used regression analysis to find the relationships between SPECIALIST, MCONNECT, and AFEE controlled by some variables. The results would show the positive (negative) association between SPECIALIST (MCON) and audit fee.

Mounting studies related to audit firm industry specialist has been conducted, and up to this time, this topic is continuously being investigated. For instance, the recent study by Griffith (2020) investigates whether or not a specialist can enhance the fair value of audit process. Among all, Juliana and Widodo (2019) imply that the research on audit quality conducted by audit firm specialists must be improved by using alternate measures other than discretionary accruals. Based on the previous study, this study employed audit fees as another measurement of audit quality (DeFond and Zhang, 2014) and examined the robustness of positive relationships which was previously documented. Specifically, this study investigated the moderating effects of military connection on the association between auditor industry specialization and audit fee. Based on the backgrounds and brief explanation on the prior studies above, this study expects that auditor industry specialization will tend to charge fee premium. Also, this study showed that the existence of military connection will weaken the positive relations between short audit specialist and audit fee.

This study contributes several crucial lessons, both for academicians and practitioners. First, this study extends the current literature examining the relations between audit firm industry specialization and audit quality by investigating alternate versions of audit quality. Specifically, this study addresses the limitation of Juliana and Widodo's (2019) study which only focused on single measurement of audit quality. Second, this study also found consistent results with the prior studies. This uniformity implies that this study indirectly supports the research results of DeFond and Zhang (2014). Furthermore, this study is also important for the managers who are interested in employing an audit firm specialist. The managers should be aware of this study results which showed that the specialist did not only lead to higher audit quality, but also would charge them more.

The further discussions in this study are organized as follows. Part 2 addresses the research hypothesis, and Part 3 describes the sample and variables. Moreover, Part 4 presents the main results of the study, while Part 5 gives a brief explanation from all sections of this paper and concludes the findings.

Literature Review

Institutional Setting

This research idea lies on Audit Pricing Theory which explains the determinants of audit fees (Simunic, 1980). This theory provides a conceptual framework that is commonly used by auditors to determine audit charges as their professional auditing services provided to the firm. Audit fees represent estimated cost of all audit process required to provide audit opinion regarding the firm's financial reporting quality. For instance, the resources needed during audit engagement, auditor remuneration, and potential loss due to legal issue, and reputational damage. Furthermore, this theory also underlines that audit fees are determined from both the supply side (the quality of auditor) and the demand side (the quality of auditee). This study tries to examine audit pricing theory by using industry specialist auditor as representation of supply side of audit fees and the demand side is represented by the presence of military connected boards, as their leadership style, more or less, influences the firm's governance mechanism. Specifically, in Indonesia, there is a particular regulation that regulates audit fees. Indonesian Institute of Certified Public Accountants issued a regulation regarding the determination of audit fee, that is KEP 024 IAPI

VII 2008. It oversees the involvement of all audit processes; a.) planning; b.) field study and reporting; c.) client needs; d.) independence; e.) skill level and responsibility during the audit, in determining audit fee.

Many empirical studies suggest that an industry specialist auditor potentially affect many aspects, such as audit quality and earnings quality (Balsam et al., 2003; Rusmin & Evans, 2017). Audit specialist is also frequently discussed together with audit tenure. Indonesia is one of the countries which have a regulation regarding audit tenure. It is stated in the Government Rule No. 20 of 2015 that the limitation of audit tenure could be applied only for auditor at the longest 5 years, while audit firms tenure is not limited. Auditor's specialization might be assessed from their experiences. This study could determine an auditor is industry specialist if one had deep knowledge about specific industry. The advance knowledge can be obtained from the length of auditing in the same industry. Audit firms which are specialist tend to charge premium fee because they enact their special knowledge as product specialist (Cahan et al., 2011).

Balsam et al. (2003) define auditor specialization using continuous market share based upon the client sales. Other studies suggest that using market share is apprehended to be problematic as to its dependence on the proportion of the clients audited and the average size of those clients (Cahan et al., 2015). According to the existence of audit rotation regulation in Indonesia, this study suggests that specialist audit firms in Indonesia do not have the likelihood to have large numbers (of what?) in one industry. Based on the argument, this study adopted market share based upon total asset as the measurement for auditor industry specialization.

A number of studies report that many Indonesian firms are politically connected (Gul, 2006). Based on the empirical studies, the existence of military connection in firms shows additional benefits created from the connection by allowing the businesses to be less painful than it should be. The privilege can be seen from the firms' outcomes. Benmelech and Frydman (2015) found that the CEOs that served in military tended to have better ethical decisions than those who did not. Thus, the firms who have their CEOs having ever served in military in the past are perceived to be more potential and have better performance. Some of past findings agree with this study, one of which is a study from sociology and organizational behaviour which posited that someone who served in military would get a tremendous leadership experience and brought them to be a very prudent decision maker even in a crisis (Duffy, 2006).

Auditor Industry Specialization and Audit Fees

The direct association between auditor's industry specialization and audit fee is merely discussed in research papers. The views regarding their relations also vary. Two points of view are found in the prior studies by Palmrose (1986) who stated that resulting production of economic scale enables specialist auditors to charge relatively lower fees to their clients. Oppositely, agreeing with the supply-side story of audit fees, audit firms perceive the fee charged to clients is closely related to the quality of the audit they provide. Higher quality audit indeed requires more efforts which increase the audit fee. Auditor specialist is an auditor who has deep knowledge and many experiences in certain industry, thus is perceived to produce high quality audit with high assurance. Beasley and Petroni (2001) argued that a industry specialist auditor offered a higher level of assurance than does a non-specialist auditor. Based on the arguments above, this study develops the first hypothesis as follows.
H1: There is a positive association between auditor industry specialization and fee premium.

Military Connection and Audit Fees

Another sentiment comes from the fact that Indonesia is a country where its politics has dominant role in business. This statement is corresponding to the study of Harymawan et al. (2020) who find that firm value in Indonesia is highly influenced by political connection. There are two arguments regarding this issue. First, appointing military personnel to be members of the boards of organizations provides an important avenue for the firms to gain access to (Habib et al., 2017). Therefore, it is presumed that the likelihood for military connected firms to overuse power in running their business is relatively high and susceptible to be involved in fraud. Second, if it is seen through the experience gained from the military service, it is clearly proven that someone who served in military will be more well-trained in many aspects than those who are not. This is shown through the ability of a military CEO in taking decision ethically and highly dedicated to be loyal to the company, not only pursuing his own interest (Franke, 2001). Agreeing with the idea, it is perceived that the less risky a firm is, the lower audit fee will be charged. On the other side, Habib et al. (2017) give another supporting argument which assumes that since 2004 the military role in Indonesia has been lessened. On top of that, since the end of the Suharto era, the army has lost formal political influence considerably and does not serve as a backbone for the incumbent regime anymore resulting in a progressive disintegration of military power and, thus, the value of military associations. Based on the arguments above, This study develops the second hypothesis as follows.
H2: There is a negative association between military connection and audit fees.

Auditor Industry Specialization, Military Connection, and Audit Fees

Following the first hypothesis, this study expects that auditor who is specialist in the industry will charge audit fee premium to the company. This statement is supported by some earlier studies which posit an industry-specialist auditor is likely to provide more advance services with more assured audit quality (Eshleman & Guo, 2020; Owhoso et al., 2002; Rama et al., 2018). In addition, this study also builds the second hypothesis that assumes auditor to charge lower fees to a militarily connected firm, considering that the value obtained in military training will bring advantageous impacts on the personnel capacity such as the ability to take a good decision under pressure and tendency to put individual interest aside for the sake of the organization as a form of loyalty (Duffy, 2006). Prior studies also documented that military connected firms tended to behave ethically (Koch-Bayram & Wernicke, 2018), comply with tax provisions (Law & Mills, 2017), and have better disclosure quality (Harymawan et al., 2020). Responding to both assumptions that eventually have contradictory outcomes, this study proposes the third hypothesis with two sub-discussions as follows.

H3a: Military connection will weaken the association between auditor industry specialization and audit fee.
H3b: Non-specialist auditor will charge lower audit fee to militarily connected firms.

Research Method

Research Design

To test the hypotheses stated before, this study used regression equations. The first equation was particularly to test the first and second hypotheses, and the second equation was to test the third hypothesis of this study.
Audit Fee and Auditor Industry Specialist equation is as follows.

$$FEEi,t = \beta0SPECIALISTi,t + \beta1MCONi,t + \beta2RPTi,t + \beta3FSIZEi,t + \beta4ROAi,t + \beta5MKBVi,t + \beta6LEVi,t + \beta7BIG4i,t + \beta8ARINVi,t + \beta9CRi,t + \beta10INDCOMi,t + \beta11INDDIRECi,t + \beta12FIRM\_AGEi,t + \beta13ACMEETi,t + \beta14YEARi,t + \beta15INDUSTRYi,t + \varepsilon \dots\dots\dots\dots\dots\dots(1)$$

Audit fee, Auditor Industry Specialist, and Military Connection equation is as follows.

$$FEEi,t = \beta0SPECIALISTMCONi,t + \beta1SPECIALISTi,t + \beta2MCONi,t + \beta3RPTi,t + \beta4FSIZEi,t + \beta5ROAi,t + \beta6MKBVi,t + \beta7LEVi,t + \beta8BIG4i,t + \beta9ARINVi,t + \beta10CRi,t + \beta11INDCOMi,t + \beta12INDDIRECi,t + \beta13FIRM\_AGEi,t + \beta14ACMEETi,t + \beta15YEARi,t + \beta16INDUSTRYi,t + \varepsilon \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots(2)$$

Data and Sample

The data were obtained from annual reports of all non-financial listed companies from 2010-2017 and collected from Indonesian Stock Exchange. For the regression analysis purposes, this study used only the data that provided all of the variables and left out the ones which were incomplete. The number of final samples was 790 based on firm-year observation.

Variable Operationalization

In total, this study employed 14 variables which composed one dependent variable, two independent variables, and 11 control variables. In this section, all variable measurements used will be discussed.
The first is the dependent variable, that is audit fees. Audit fee was measured by taking the natural log of audit fees, paid by the entity to the audit firm for performing audit services during the period. This information was disclosed by the firm in the annual report. This measurement was adopted from Larasati et al. (2019).
As for the first independent variable, audit industry specialist actually could not be measured directly. Therefore, this study adopted one of the measurements used in the prior study. Rusmin and Evans (2017) used market share as the proxy for audit specialist, based on the client's total assets or audit fees paid by the client. Some other earlier studies suggest that the measurement of auditor industry specialization also uses market share based on client's total assets.
This study included military connection to identify how the connection would alter the association between audit specialist and audit fees. This study used the measurement as one used by Harymawan (2018) to define the existence of military connection. He asserts that military connection is closely related to the boards' military experiences. This study categorized a firm-year observation as militarily connected firm if at least one of the board's member ever did military service or is a military retired. The other control variables will be described in Table 1.

Analysis Technique

This study used a linear-regression model to determine the relationshipd between auditor industry specialist and audit fees. Following the nature of the companies in Indonesia which are most likely politically connected, this

study assumed that audit firms would tend to charge higher audit fees to a company with military connection. To strengthen the argument, this study also tried to see how military connection affected the association between auditor industry specialist and audit fees which was expected to reinforce the positive relations between auditor industry specialization and audit fee.

This study conducted an additional test by dividing the samples into two sub-samples to find out the relations between military connected firms to audit fees. The sub-samples were audit specialist and non-audit specialist. The result was expected to be positive (negative) for the firms with industry specialist (non-specialist) auditor.

Table 1. Variable Operationalization

Variable	Definitions
Audit fee (FEE)	Natural logarithm of audit fees
Auditor Specialization (SPECIALIST)	Valued by 1 if the audit fees or client's total assets of the respective public accounting firm in single industry is more than 90% of all audit fees or client's total assets within single industry or 0 if otherwise.
Military connection (MCON)	Valued by 1 if at least one member of the firm's boards has military experience prior to his current position or 0 if otherwise
Related party transaction (RPT)	Valued by 1 if the firm has disclosed transactions with the related party in its financial report or 0 if otherwise
Independent Commissioner (INCOM)	Total number of persons seated as the firm's independent commissioners
Independent Director (INDDIREC)	Total number of persons seated as the firm's independent directors
Audit committee meeting (ACMEET)	Number of audit committee meetings during the current year
Firm size (FSIZE)	Natural logarithm of total assets
Profitability (ROA)	Total revenue divided by total assets
Market to book ratio (MKBV)	Total market value divided by sum of total equities and liabilities of the firm
Leverage (LEV)	Total liabilities divided by total assets
PAF size (BIG4)	Valued by 1 if the public accounting firm (PAF) is one of PwC, Deloitte, KPMG, and EY or 0 if otherwise
Receivable and Inventory (ARINV)	Sum of the total inventories and total receivables
Current ratio (CR)	Total current asset divided by current liabilities
Firm age (FIRM_AGE)	Total years between the current year and the year of the firm establishment

Results and Discussion

This section discusses the empirical results of this research in relation with auditor industry specialization, military connection, and audit fees. Firstly, this study would like to present the descriptive statistics which describe all variables used in this study. Before the regression process, this study winsorized all the variables in order to weaken the effects of outliers. The descriptive statistics is presented in Table 2. Each table has two sections which depict the two proxies used to measure auditor industry specialization, those are audit fee and total assets.

As seen in Table 2, audit fees paid by the firms listed in Indonesian Stock Exchange in the first section had the average cost of 2,019 million rupiahs with the highest fee of IDR 43,700 million and quite high variance. In section 2, the mean of audit fee was 1,977 million rupiahs with the same maximum fee as stated in the first section. From the two sections, it can be seen that the lowest fee was 46 million rupiahs. It was reported that a quarter of the total samples, using audit fee as the proxy, were audited by industry specialist auditor.

Based on the audit specialist (total asset), there is not much difference from the previous, amounting 24% of the total samples which were audited by the specialists. Viewing the statistics of the firms with military connection, both proxies show similar percentages from the total samples, those are 9.6% and 9.2% for audit fee and total assets respectively. The number of transactions the firms had with the related party indicate the overall percentage of 45% for both proxies. Similarly, regarding board independence, both sections demonstrate similar average of having two members (one member) as independent commissioner (independent director). The firm size measured based on total assets had the highest value of 261,000 billion rupiahs and the lowest was approximately 46 billion rupiahs. Return on asset for both measurements is 6.6 that means that the firms was capable to generate 6.6 rupiahs for every 1 rupiah of asset. Both sections state an identical number of market-to-book value that is 2.4. The leverage values are 1.381 and 1.383 for audit specialist measured by audit fee and total assets respectively. 54% of the samples were audited by the big four accounting firms according to the audit fee proxy and 52.8% according to the total assets. The ratio of total account receivables and inventories to total asset is approximately 27%, as stated in both sections. The last two variables have the similar scores for both proxies, namely current ratio and firm's age, amounting 2 points and 37 years respectively.

Table 2. Descriptive Statistics

Section 1 - SPECIALIST (AUDIT FEE) N=748			
	Mean	Median	Minimum	Maximum
FEE	2,019,000,000	844,600,000	46,750,000	43,700,000,000
SPECIALIST	0.245	0.000	0.000	1.000
MCONNECT	0.096	0.000	0.000	1.000
RPT	0.445	0.000	0.000	1.000
INDCOM	1.729	2.000	0.000	4.000
INDDIREC	0.607	1.000	0.000	2.000
ACMEET	0.464	0.000	0.000	1.000
TOTALASSET	12,410,000,000,000	3,910,000,000,000	46,760,927,000	261,900,000,000,000
ROA	6.577	5.440	-24.560	51.190
MKBV	2.388	1.313	-0.998	23.789
LEV	1.381	0.879	0.046	8.786
BIG4	0.543	1.000	0.000	1.000
ARINV	0.269	0.235	0.010	0.781
CR	2.042	1.466	0.184	10.880
FIRM_AGE	36.860	35.000	9.000	117.000
Section 2 - SPECIALIST (TOTAL ASSETS) N=790			
	Mean	Median	Minimum	Maximum
FEE	1,977,000,000	841,900,000	46,750,000	43,700,000,000
SPECIALIST	0.241	0.000	0.000	1.000
MCONNECT	0.092	0.000	0.000	1.000
RPT	0.446	0.000	0.000	1.000
INDCOM	1.722	2.000	0.000	4.000
INDDIREC	0.604	1.000	0.000	2.000
ACMEET	0.468	0.000	0.000	1.000
TOTALASSET	12,200,000,000,000	3,829,000,000,000	46,760,927,000	261,900,000,000,000
ROA	6.625	5.460	-24.560	51.190
MKBV	2.398	1.322	-0.998	23.789
LEV	1.383	0.886	0.046	8.786
BIG4	0.528	1.000	0.000	1.000
ARINV	0.270	0.237	0.010	0.781
CR	2.027	1.466	0.184	10.880
FIRM_AGE	37.156	35.000	9.000	117.000

Table 3. Auditor Industry Specialization based on Market Share

Auditor Industry Specialization (Audit Fee)			
SIC	Industry	Public Accounting Firm	Market Share
0	Agriculture, Forestry, Fishing	Purwantono, Sungkoro & Surja (EY)	70%
1	Mining and Construction	Purwantono, Sungkoro & Surja (EY)	28%
2	Manufacturing (1)	Purwantono, Sungkoro & Surja (EY)	30%
3	Manufacturing (2)	Tanudiredja, Wibisana, Rintis & Rekan (PwC)	50%
4	Transportation and Public Utilities	Purwantono, Sungkoro & Surja (EY)	54%
5	Wholesale and Retail Trade	Tanudiredja, Wibisana, Rintis & Rekan (PwC)	37%
7	Service (1)	Purwantono, Sungkoro&Surja (EY)	48%
8	Service (2)	Amir Abadi Jusuf, Aryanto, Mawar & Rekan (RSM)	46%
Auditor Industry Specialization (Total Assets)			
SIC	Industry	Public Accounting Firm	Market Share
0	Agriculture, Forestry, Fishing	Purwantono, Sungkoro & Surja (EY)	40%
1	Mining and Construction	Tanudiredja, Wibisana, Rintis & Rekan (PwC)	27%
2	Manufacturing (1)	Purwantono, Sungkoro & Surja (EY)	28%
3	Manufacturing (2)	Tanudiredja, Wibisana, Rintis & Rekan (PwC)	42%
4	Transportation and Public Utilities	Purwantono, Sungkoro & Surja (EY)	38%
5	Wholesale and Retail Trade	Tanudiredja, Wibisana, Rintis & Rekan (PwC)	38%
7	Service (1)	Purwantono, Sungkoro & Surja (EY)	63%
8	Service (2)	TanubrataSutanto Fahmi & Rekan (BDO)	46%

For additional information, this study also provides the data of public accounting firms with the biggest market shares in each industry. It is listed in Table 3 which also has two sections for the two proxies used to measure auditor industry specialization; audit fee and total assets. As seen in Table 3, public accounting firms Purwantono, Sungkoro & Surja (EY) and Tanudiredja, Wibisana, Rintis & Rekan (PwC) had the most prominent positions in both

measurements using audit fee and total asset as the proxies of AIS. Based on audit fees paid by the firms, EY led 5 out of 8 industries with SIC codes 0 (Agriculture, Forestry, Fishing), 1 (Mining and Construction), 2 (Manufacturing 1), 4 (transportation and public utilities), and 7 (service). The highest market share was held by Ernst & Young in the agriculture, forestry, fishing sector.

PT Sawit Sumbermas Sarana Tbk was one of their clients from the corresponding sectors, moreover it was inclusive in LQ45. On the other side, PwC led the manufacturing (2) and wholesale and retail trade sectors. Not only the big four accounting firms which were in top rank, this research also found Amir Abadi Jusuf, Aryanto, Mawar & Rekan (RSM) which was the second-tier accounting firm leading the service (2) sector. Having assessed from the total assets, it is clearly seen in the table that EY was the majority market share holder in industries with SIC codes 0, 2, 4, and 7. Subsequently, PwC followed by leading the 1, 3, 5, industry codes. The second-tier accounting firm, Tanubrata Sutanto Fahmi & Rekan (BDO), reached the 46% market share for service industry with a quite massive percentage.

Table 4 and Table 5 provide the details of the firms which disclosed audit fee, were audited by specialist auditors, and the firms with military connection. Table 4 shows that compared to the firms which did not disclose the audit fees paid to auditors, auditor specialists tended to audit firms which stated the audit fees in their annual reports. The second section shows that the firms which presented audit fees charged by the auditors in annual reports were more likely to have high level of monitoring, as stated in the independent commissioner, independent director, and audit committee meetings compared to the firms without audit fees reported in their reports (1.722; 0.604; 0.468 are more than 1.497; 0.419; 0.335 respectively).

Table 4. Firm's Characteristics based on Auditor Industry Specialization

	Specialist (N=183)	Non-Specialist (N=565)	t-value	z-value
	Specialist (Audit Fee)			
AFEE	21.335	20.361	10.546***	9.560***
MCON	0.104	0.094	0.399	0.399
RPT	0.361	0.473	-2.656***	-2.646***
INDCOM	1.885	1.678	2.915***	3.161***
INDDIREC	0.525	0.634	-2.325**	-2.511**
ACMEET	0.557	0.434	2.930***	2.916***
BIG4	0.945	0.412	14.146***	12.57***
FIRM AGE	33.514	37.943	-2.771***	2.017**
FSIZE	22.664	22.034	5.232***	4.820***
ROA	9.735	5.554	4.286***	4.913***
MKBV	2.846	2.240	2.059**	3.521***
LEV	1.189	1.443	-2.023**	-2.251**
ARINV	0.274	0.267	0.379	-0.321
CR	1.963	2.068	-0.695	1.058

	Specialist (N=190)	Non-Specialist (N=600)	t-value	z-value
	Specialist (Total Asset)			
AFEE	21.268	20.363	9.889***	9.358***
MCON	0.089	0.093	-0.160	-0.160
RPT	0.368	0.470	-2.461**	-2.454**
INDCOM	1.842	1.683	2.268**	2.450**
INDDIREC	0.537	0.625	-1.904*	-2.100**
ACMEET	0.579	0.433	3.529***	3.503***
BIG4	0.942	0.397	14.823***	13.116***
FIRM AGE	33.021	38.465	-3.441***	-2.855***
FSIZE	22.768	21.971	6.809***	6.252***
ROA	9.492	5.717	3.993***	4.592***
MKBV	2.790	2.274	1.816*	3.253***
LEV	1.270	1.418	-1.213	-1.276
ARINV	0.278	0.268	0.621	-0.106
CR	1.995	2.037	-0.286	1.257

Table 4 indicates that the auditors who were specialized in certain industry would more likely to charge higher audit fees. This is applied for both market share measurements in determining audit specialization. On top of that, it is revealed that most audit specialists came from the BIG 4 audit firms (0.945; 0.942 are higher than 0.412; 0,397). Besides, in terms of firm size, both tables prove that bigger firm size tended to be audited by auditor specialists.

Table 5. Firm's Characteristics based on Military Connection

	MCON (N=72)	NON-MCON (N=676)	t-value	z-value
	Specialist (Audit Fee)			
AFEE	20.624	20.597	0.186	0.387
SPEC	0.264	0.243	0.399	0.399
RPT	0.500	0.439	0.984	0.984
INDCOM	1.806	1.720	0.817	0.701
INDDIREC	0.681	0.599	1.188	1.200
ACMEET	0.472	0.463	0.149	0.149
BIG4	0.639	0.533	1.723[*]	1.721[*]
FIRM AGE	43.292	36.175	3.058[***]	3.053[***]
FSIZE	22.169	22.190	-0.120	0.150
ROA	6.533	6.582	-0.034	-0.283
MKBV	2.448	2.382	0.153	0.991
LEV	1.184	1.402	-1.188	2.429
ARINV	0.275	0.268	0.293	0.528
CR	2.199	2.026	0.788	0.481

	MCON (N=73)	NON-MCON (N=717)	t-value	z-value
	Specialist (Total Asset)			
AFEE	20.624	20.576	0.336	0.520
SPEC	0.233	0.241	-0.160	-0.160
RPT	0.493	0.441	0.858	0.858
INDCOM	1.795	1.714	0.776	0.636
INDDIREC	0.685	0.596	1.306	1.346
ACMEET	0.479	0.467	0.199	0.199
BIG4	0.630	0.517	1.839[*]	1.836[*]
FIRM AGE	44.027	36.456	3.240[***]	3.113[***]
FSIZE	22.164	22.163	0.010	-0.264
ROA	6.568	6.631	-0.044	-0.255
MKBV	2.528	2.385	0.341	-0.871
LEV	1.186	1.403	-1.199	-2.415
ARINV	0.272	0.270	0.074	0.235
CR	2.176	2.012	0.769	0.293

Table 5 demonstrates the firms' characteristics based on whether or not the firms are militarily connected. As seen in Table 5, most of the firms with military connection are the firms that were longer established. Military connection triggers the firms to conduct the transactions with the related party (0.500 > 0.439), and this is also valid for section 2 which uses total assets as the proxy in measuring industry specialization (0.493 > 0.441). Using the first regression model, this study tested the effects of auditor industry specialization and military connection on audit fee with controlling variables including RPT, FSIZE, ROA, MKBV, BIG4, ARINV, CR, INDCOM, INDDIREC, FIRM_AGE, and ACMEET.

As presented in Table 6, based on the ordinary least squares and robustness test, applied to the two audit specialist measurements, SPECIALIST had coefficients of 0.373 and 0.191 with 1% and 5% level of significance respectively. This fact proves that specialist auditors significantly have positive association with audit fee. For the second hypothesis, this study assumes that military connection will affect the audit fee paid by the firms. However, the ordinary least squares result showed insignificant relations, which means whether or not a firm has military connection, it does not really matter to the auditor in determining audit fee charged to the client. This result due to the fact that in Indonesian setting, military connection is perceived similarly with political connection as political regime in Indonesia is heavily influenced by military fraction (Harymawan, 2018). This result is in line with the research results of Al-Hadi, Taylor, and Al-Yahyaee (2016) which find that politically connected firms possess higher inherent risks that are possible to be captured by the auditor as an additional risk that increases audit fee. Therefore, high quality of military connected firm's governance mechanism will be netted off with its high inherent risks which will result in no significant changes in audit fee.

This study explores more things related to how military connection affects auditor industry specialization and audit fee. As proven in Table 6, the presence of military connection weakens the association between SPECIALIST and AFEE, by changing the significance level from 1% into 5% for both proxies of audit specialist measurement, audit fee and total assets. It is also shown that non-specialist auditors will charge a militarily connected firms lower fee, amounting -0.228** for auditor specialist determined by audit fee and -0.190* for

auditor specialist determined by total assets. Both values show the negative and significant relations between non-specialist auditor auditing militarily connected firms and audit fee charged.

Table 6. Effects of Auditor Industry Specialization and Military Connection on Audit Fee

	SPECIALIST*MCONNECT TO AFEE		SPECIALIST TO AFEE	
	Audit Specialist (Audit Fee)	Audit Specialist (Total Assets)	Audit Specialist (Audit Fee)	Audit Specialist (Total Assets)
SPECIALISTMCON	0.435**	0.390*		
	(2.23)	(1.76)		
MCON	-0.164*	-0.125	-0.050	-0.033
	(-1.67)	(-1.28)	(-0.56)	(-0.36)
SPECIALIST 1	0.322***		0.373***	
	(3.56)		(4.46)	
SPECIALIST 2		0.153*		0.191**
		(1.80)		(2.29)
RPT	0.048	0.030	0.051	0.033
	(0.82)	(0.51)	(0.88)	(0.57)
INDCOM	0.050	0.039	0.053	0.042
	(1.35)	(1.04)	(1.42)	(1.13)
INDDIREC	0.006	0.033	0.015	0.041
	(0.09)	(0.50)	(0.24)	(0.63)
ACMEET	0.053	0.064	0.048	0.059
	(0.94)	(1.11)	(0.85)	(1.02)
BIG4	0.570***	0.618***	0.559***	0.612***
	(7.73)	(8.75)	(7.71)	(8.71)
FIRM AGE	0.005***	0.005***	0.005***	0.005***
	(3.38)	(3.13)	(3.39)	(3.03)
FSIZE	0.448***	0.451***	0.453***	0.456***
	(16.21)	(16.43)	(16.68)	(16.83)
ROA	-0.001	-0.001	-0.001	-0.001
	(-0.43)	(-0.43)	(-0.47)	(-0.40)
MKBV	0.023**	0.027***	0.024***	0.027***
	(2.56)	(2.97)	(2.73)	(2.99)
LEV	-0.031*	-0.039**	-0.031*	-0.039**
	(-1.65)	(-2.11)	(-1.67)	(-2.11)
ARINV	-0.080	-0.066	-0.063	-0.040
	(-0.50)	(-0.41)	(-0.39)	(-0.26)
CR	-0.043***	-0.045***	-0.044***	-0.044***
	(-2.88)	(-2.89)	(-2.89)	(-2.86)
Constant	10.319***	10.414***	10.160***	10.298***
	(15.80)	(16.94)	(15.92)	(17.05)
Industry Dummies	Included	Included	Included	Included
Year Dummies	Included	Included	Included	Included
r2	0.623	0.611	0.621	0.609
Adjusted r2	0.608	0.596	0.606	0.595
N	748	790	748	790

To enrich the findings, this study also conducted an additional test by dividing the samples into two sub-samples, specialist auditors and non-specialist auditors. Table 7 shows an insignificant result for the association between military connection and audit fees, for the firms which were audited by the specialists. It means that specialist auditors did not pay much attention whether or not a firm has military connection in determining the audit fee. On the other side, non-specialist auditors considered the otherwise. It is depicted in Table 7, the values were -0.167* and -0.130 for audit fee and total assets respectively based on market shares. Recalling the second hypothesis that assumes that audit fees will be lower for the firms with military connection, this results showed that it was only applied to the firms that were not audited by specialist auditors. This result was caused by the tendency that the specialist auditors used to have better risk assessment capability which therefore made them not easily ensured that a firm would have better governance mechanism solely based on its military connected boards. On the other hand, non-specialist might perceive military connected firm would have better governance mechanism, thus resulting in lower audit fees. Table 7 indicates that practically non-specialist auditors who audited militarily connected firms charged lower audit fees because non-specialist auditors perceived military connection as one of the essential factors to decide fee charged to the firms.

Table 7. Effects of Military Connection on Audit Fees, with sub-samples audit specialist and non-audit specialist

	SPECIALIST		NON-SPECIALIST	
	Audit Specialist (Audit Fee)	Audit Specialist (Total Assets)	Audit Specialist (Audit Fee)	Audit Specialist (Total Assets)
	Robust	*Robust*	*Robust*	*Robust*
MCON	0.168	0.144	-0.167*	-0.130
	(0.97)	(1.10)	(-1.66)	(-1.26)
RPT	0.225	0.335**	0.035	-0.026
	(1.36)	(2.41)	(0.53)	(-0.39)
INDCOM	0.089	0.102	0.026	-0.031
	(1.20)	(1.36)	(0.60)	(-0.70)
INDDIREC	-0.017	-0.019	0.010	0.099
	(-0.12)	(-0.16)	(0.14)	(1.26)
ACMEET	0.215*	0.241**	0.010	0.010
	(1.71)	(2.20)	(0.16)	(0.15)
BIG4	-0.451	0.165	0.697***	0.743***
	(-0.79)	(0.43)	(10.36)	(10.73)
FIRM AGE	0.005	0.006*	0.005***	0.005***
	(1.20)	(1.78)	(3.01)	(3.08)
FSIZE	0.570***	0.470***	0.403***	0.432***
	(10.39)	(8.12)	(13.47)	(14.35)
ROA	-0.002	-0.021***	-0.002	0.001
	(-0.28)	(-3.68)	(-0.55)	(0.31)
MKBV	0.021	0.068***	0.019**	0.014
	(0.82)	(2.78)	(2.01)	(1.56)
LEV	0.053	-0.112**	-0.039*	-0.034*
	(0.89)	(-2.14)	(-1.85)	(-1.68)
ARINV	0.237	0.547*	0.024	0.002
	(0.57)	(1.67)	(0.12)	(0.01)
CR	-0.050	-0.074	-0.042***	-0.033**
	(-0.78)	(-1.47)	(-2.73)	(-2.04)
Constant	8.305***	11.151***	11.446***	10.872***
	(6.32)	(7.64)	(15.98)	(16.14)
Industry Dummies	Included	Included	Included	Included
Year Dummies	Included	Included	Included	Included
r2	0.603	0.662	0.591	0.594
r2_a	0.534	0.608	0.570	0.575
N	183	190	565	600

Conclusion

This study tests Audit Pricing Theory which argues that audit fees are determined by both supply and demand side. The supply side is represented by auditor specialization while the demand side is represented by military connection. This study posits that industry specialist auditor will charge higher audit fees as their compensation for their capability. On the other side, military connected firms tend to behave ethically, which result in lower audit fees.

Using Indonesian non-financial listed firms from 2010-2017, this study finds that auditor specialization induces higher audit fees as it was hypothesized. On the other hand, this study fails to document negative relationships between military connection and audit fees. This result is due to high inherent risks of military connected firms which are compensated with the tendencies to behave ethically. Furthermore, this study also has documented the facts that specialist auditor will charge higher audit fees when their client is a military connected firm. An additional analysis documented that by non-specialist auditor sample, a military connected firm was charged lower audit fees. This study provides several crucial implications, both for academic purposes and business practices.

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