

CEO Duality and Audit Fees: Malaysian Evidence

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ABSTRACT

This paper examines the association between CEO duality as a proxy of narcissistic CEO and audit fees using sample of TOP 100 ranked by Market Capitalization on Main Market Bursa Malaysia. There are four indicators used in the study as the proxy of narcissistic CEO, namely CEO photo, CEO compensation ratio, CEO tenure and CEO duality. The findings show that among the indicators, CEO duality has a positive significant with audit fees, indicating that auditor perceived there is higher engagement risk that led to higher audit fees when firm with CEO that also serve as chairman. To the best of our knowledge, this is the first study that examines the relationship between narcissistic CEO and audit fees in emerging countries.

Keywords: narcissistic CEO; audit fees; CEO tenure; CEO duality

Introduction

Numerous research has been done before on the determinants of audit fees. Widmann, Follert, and Wolz (2021) and Hay, Knechel, and Wong (2006) have classified the previous determinants on audit fees into several attributes, such as client attribute, auditor attribute and engagement attribute.

Studies on the CEO's traits and audit fees have gained interest among researchers. One emerging CEO traits that has caught the attention is narcissistic CEOs. A person is identified as having narcissistic personality disorder if they consistently display grandiosity (in behaviour or appearance) and show a striking lack of empathy (American Psychiatric Association, 2013). Prior studies show that narcissistic CEOs engage in earnings management activities (Capalbo et al., 2017; Buchholz, Lopatta & Maas, 2020; Kontesa, Brahmana & Tong, 2020). Kontesa et al. (2020) assert that human psychology is the driving force behind earnings management, whereby a narcissistic CEO who craves superiority and grandiosity is more likely to use his or her capabilities to exaggerate the real performance of their firms through earnings manipulation than non-narcissistic CEOs. Narcissistic CEOs are alleged to distort earnings to raise stated earnings per share (Olsen, Dworkis & Mark Young, 2014). Besides, with the authority that narcissistic CEOs have, they can exert direct influence on financial decisions. This enables them to manage firms' earnings in order to compensate for their substandard performance (Lin, Lin & Fang, 2020).

The issues surrounding narcissistic CEOs and earnings management practices are significant and worth investigating. This is because it has been discovered that narcissistic CEOs' behaviour in manipulating earnings may be a factor in determining audit fees. Up to now, there is a scarcity of study that has explored the association between narcissistic CEOs and audit fees. One exception is Judd, Olsen and Stekelberg (2017) who stated that firms led by a narcissistic CEO are more likely to face increased inherent and control risks. This requires auditors to perform additional work in order to maintain a manageable level of audit engagement risk. Accordingly, Judd et al. (2017) hypothesize a positive association between narcissistic CEOs and audit fees, i.e., auditors expend additional effort, add a risk premium, or both when the firms are led by a CEO with a proclivity for self-promotion and aggressive behavior.

Given the paucity of empirical research to date, with the exception of Judd et al. (2017) in the United States, this has given us a strong motivation to examine the relationship between narcissistic CEO and audit fees. As such, the current study is driven by a desire to enhance the literature and expand the line of research on the association between narcissistic CEO and audit pricing in a developing market, namely Malaysia. Besides, the study aims to increase our understanding of the audit fee variables associated with CEO traits.

Our sample is based on the TOP 200 Malaysian non-financial firms ranked by the market capitalization. To measure narcissistic CEO, the study has used four indicators, namely (i) CEO Photo; (ii) CEO Compensation Ratio; (iii) CEO Tenure; and (iv) CEO Duality. Based on the four indicators used to measure narcissistic CEO, the findings show that CEO Duality has a positive relationship with audit fees.

This study offers several contributions to the auditing literature; Firstly, to the best of our knowledge, this is the first study that examines the relationship between narcissistic CEO and audit fees in emerging countries. Secondly, this study contributes to the auditing literature by investigating the relationship between narcissistic CEO and audit fees by testing several indicators of CEO narcissism. Thirdly, the study findings provide valuable insights to the policymakers, investors, and other stakeholders, on the role of CEO attribute to safeguard the financial reporting quality of an organization.

The rest of this research paper is organized as follows: Section 2 reviews the relevant literature and develops the research hypothesis. Section 3 presents sample selection, data and empirical model. Section 4 presents the results, and Section 5 concludes the paper.

Literature Review and Hypothesis Development

Narcissistic CEO and Audit Fees

According to the upper echelons theory developed by Hambrick and Mason (1984), the characteristics of top managers serve as the main predictors of an organization's performance, particularly in terms of strategic decisions. Hambrick (2007) highlights that an organization's direction and shape are determined by its most powerful individuals, primarily its senior executives.

Narcissism is defined by features such as superiority, self-confidence, a sense of entitlement, grandiosity, and a lack of empathy (O'Reilly et al., 2014). Besides, the term "grandiose individual" refers to someone who suffers from a certain personality condition in which he or she displays grandiosity and craves constant adoration (American Psychiatric Association, 2013). So, it's not an exaggeration to argue that this narcissistic CEO will use any means necessary to realize his goals. One obvious way that can be seen to increase audit assessment risk is that CEO narcissistic is likely to engage in earnings management activities. In this context, past research has established strong empirical evidence that CEOs that exhibiting narcissistic characteristics engage in earnings management activities (Capalbo et al., 2017; Buchholz et al., 2020; Kontesa et al., 2020; Lin et al., 2020).

Kontesa et al. (2020) argue that narcissistic CEOs frequently distort financial statements to gratify their egos and place a premium on their reputation over the firm's wealth, which is consistent with the upper echelons theory. Lin et al. (2020) discovered that a CEO with a high level of narcissism desires to engage in earnings management to offset his or her poor performance. This is because narcissistic CEOs exert direct control over financial decisions. Meanwhile, Olsen et al. (2014) substantiated these findings by asserting that CEOs' narcissistic personality characteristics influence financial performance measures through their decisions. Buchholz et al. (2020) corroborated these findings by demonstrating that accounting decisions by highly narcissistic CEOs are self-interested, instead of being driven by the need to reveal information useful to the market. Furthermore, Capalbo et al. (2017) asserted that a more narcissistic CEO is more likely to over-identify with their company and work toward accomplishing their objectives. This includes using unethical accounting methods, such as aggressive earnings management, to misrepresent earnings information presented to investors.

As a result of the increased risks associated with dealing with narcissistic CEOs, auditors will expend additional audit effort to mitigate that risk and demand a higher price to compensate for being connected with a dangerous client (Judd et al., 2017). Accordingly, Judd et al. (2017) discover that auditors conduct additional audit processes and broaden the scope of their audits when dealing with narcissistic CEOs. Furthermore, they discover that firms led by narcissistic CEOs frequently have insufficient internal controls, which impair the audit process. Therefore, auditor fees are more likely to be increased to cover the risks associated with CEO narcissism. Hence, the following hypothesis (H1) is developed for the association between narcissistic CEOs and audit fees:

H1: There is a positive association between Narcissistic CEO and audit fees.

Methodology

Data Collection and Sample

The sample in this study is based on the Top 200 non-financial companies by market capitalization listed in the Main Market of Bursa Malaysia as at 31 December 2021. The sample consists of both industrial and non-industrial companies. Since financial companies have unique characteristics and operate in a different compliance and regulatory environment, they are excluded from the sample (Yatim, Clarkson & Kent, 2006). After removing the financial firms and non-financial firms with missing data and CEO tenure less than one year, the final sample is reduced to 100 companies for further analysis, as shown in Table 1.

Table 1: Final sample selection

Top 200 firms	200
less Financial firms	(31)
less Non-financial firms due to:	
- missing CEO remuneration data	(39)
- CEO has been appointed for less than one year	(28)
- missing internal audit cost data	(2)
Final Sample	100

In addition, based on market capitalization, the current sample firms represent 43% of all non-financial firms listed on Main Bursa Malaysia. All the data in this study are manually collected from the sample firms' annual report.

3.2 Empirical Model

This study examines the relationship between CEO narcissistic and audit fees. The CEO narcissistic is tested using four indicators, namely (i) CEO Photo; (ii) CEO Compensation Ratio; (iii) CEO Tenure; (iv) CEO Duality. Therefore, the audit fees models which comprise of the dependent variables, experimental variable, and control variables are shown below based on the four different proxies of CEO narcissistic. The variables are defined in the Appendix 2.

$$\text{LnAUDITFEE} = \beta_0 + \beta_1\text{CEOPHOTO} + \beta_2\text{LnIAFCOST} + \beta_3\text{LnNAF} + \beta_4\text{LnTA} + \beta_5\text{LEVERAGE} + \beta_6\text{LOSS} + \beta_7\text{BIG4} + \beta_8\text{SEGMENT} + \beta_9\text{ACCMEETING} + \beta_{10}\text{ACCMEMBERS} + \text{error term} \quad (1)$$

$$\text{LnAUDITFEE} = \beta_0 + \beta_1\text{CEOCOMPRATIO} + \beta_2\text{LnIAFCOST} + \beta_3\text{LnNAF} + \beta_4\text{LnTA} + \beta_5\text{LEVERAGE} + \beta_6\text{LOSS} + \beta_7\text{BIG4} + \beta_8\text{SEGMENT} + \beta_9\text{ACCMEETING} + \beta_{10}\text{ACCMEMBERS} + \text{error term} \quad (2)$$

$$\text{LnAUDITFEE} = \beta_0 + \beta_1\text{CEOTENURE} + \beta_2\text{LnIAFCOST} + \beta_3\text{LnNAF} + \beta_4\text{LnTA} + \beta_5\text{LEVERAGE} + \beta_6\text{LOSS} + \beta_7\text{BIG4} + \beta_8\text{SEGMENT} + \beta_9\text{ACCMEETING} + \beta_{10}\text{ACCMEMBERS} + \text{error term} \quad (3)$$

$$\text{LnAUDITFEE} = \beta_0 + \beta_1\text{CEODUALITY} + \beta_2\text{LnIAFCOST} + \beta_3\text{LnNAF} + \beta_4\text{LnTA} + \beta_5\text{LEVERAGE} + \beta_6\text{LOSS} + \beta_7\text{BIG4} + \beta_8\text{SEGMENT} + \beta_9\text{ACCMEETING} + \beta_{10}\text{ACCMEMBERS} + \text{error term} \quad (4)$$

The CEO photo (CEOPHOTO) and CEO compensation ratio (CEOCOMPRATIO) are expected to be positively associated with audit fees. This is due to the belief that CEO has the tendency to expose more of their image as they become more well-known, prominent, and popular. At the same time, they will ensure that the firm performs well at all times while he is in power. Thus, one of the strategies that might be used as contended by Kontensa et al. (2020) is CEO tends to manage earnings to make the financial statements look good. The CEO will increase his own compensation for this reason as well. Thus, this will signal the auditor to audit thoroughly the financial statements to ensure the statements report true and fair view. This will lead to higher audit fees charged.

CEO tenure (CEOTENURE) is expected to have a positive association with audit fees as argued by Cai and Li (2022), CEO with longer term is motivated to manage earnings and thus increase the audit cost and audit risk. Meanwhile, our fourth indicator of narcissistic CEO namely CEO duality (CEODUALITY) is expected to be

positively associated with audit fees as CEO duality is said to be more dominance towards the company which will result in an increase in the auditor's assessment of the inherent risk (Bliss, Muniandy & Majid, 2007). Firm with an effective internal audit function is said will require additional audit efforts, hence is willing to pay additional audit fees to ensure high level of the external audit quality. Therefore, we expect that our control variable of internal audit function (LnIAFCOST) to have a positive association with audit fees (Bshayreh, Abu Hamour & Eid Haddad, 2021). Following Widmann et al. (2021) and Hay et al. (2006), we control for variables such as non-audit fees (LnNAF), firm size (LnTA), leverage (LEVERAGE), and big four audit firm (BIG4), which we expect that all these variables have a positive association with audit fees. Meanwhile, it is expected that segment (SEGMENT) and loss (LOSS) to have a positive association with audit fees due to the increased number of total business segments and negative income will demand more audit time spent by auditors.

Finally, we include two proxies of corporate governance attributes, namely audit committee number of meetings (ACCMEETING) and number audit committee members (ACCMEMBERS). Our study expected that audit committee meeting frequency to have a positive association with audit fees. It is argued that audit committees that meet frequently are more likely to be informed of current auditing issues and more diligent in the discharge of their duties (Abbott et al., 2003). Besides, the AC meetings are regarded as an effective monitoring mechanism and play a significant protective role for the external auditor against fee reductions that might have a negative impact on the level of audit quality, thus the increase of the monitoring function of the AC by its activity (meetings) will lead to an increase in the audit fees, which will be reflected in the audit quality (Bshayreh, Abu Hamour & Eid Haddad, 2021). Hence, the association between audit committee meeting frequency and audit fees can be viewed from the demand side where the efficient and stronger audit committees are associated with increased audit fees. Furthermore, we expect audit committee members has a positive relationship with audit fees (Vafeas & Waagelein, 2007).

Results

Descriptive Statistics

Table 2 presents the descriptive statistics for all variables which include dependent, experimental and control variables tested in this study. Audit fees vary from RM56,000 to RM18.1 million with an average of RM1.6 million. The mean of CEO photo and CEO compensation ratio are 3.09 and 1.98 respectively. The mean of CEO Tenure of the sample is 12 years and 15% out of the sample represents CEO duality. The average of non-audit fees paid is RM259,000 which is about 16% of the audit fees. Whereas the average IAF cost is RM1.1 million. The mean for business segments 6.26 which showing that the sample firms report between 1 to 18 segments. Almost 62% the sample firms are audited by Big4. Meanwhile, 11% out of sample firms report losses, with an average 0.11. The mean of AC number of meeting and number of AC members are 5.49 and 3.41 respectively.

Table 2: Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Standard Deviation	Skewness	Kurtosis
Audit Fees (RM)	100	56,000	18,100,000	1,628,324	2,424,605	3.99	22.15
LnAUDITFEE	100	10.93	16.71	13.65	1.11	0.38	-0.25
CEOPHOTO	100	1.00	5.00	3.09	1.37	-0.43	-1.02
CEOCOMPRATIO	100	0.26	7.55	1.98	1.36	1.77	3.38
CEOTENURE	100	2.00	46.00	12.00	10.13	1.30	1.42
CEODUALITY	100	0.00	1.00	0.15	0.36	1.99	2.00
IAF Cost (RM)	100	5,000	15,700,000	1,105,207	1,981,907	4.61	29.61
LnIAFCOST	100	8.52	16.57	12.76	1.67	-0.10	-0.81
Non-Audit Fees (RM)	100	0.00	3,000,000	258,894	462,479	3.51	15.57
LnNAF	100	0.00	14.91	10.17	3.82	-1.75	2.51
Total Assets (RM'000)	100	272,151	102,448,100	8,479,102	15,153,844	3.81	17.95
LnTA	100	19.42	25.35	21.90	1.37	0.33	-0.49
LEVERAGE	100	0.07	1.32	0.44	0.22	0.77	1.48
LOSS	100	0.00	1.00	0.11	0.31	2.53	4.50
BIG4	100	0.00	1.00	0.62	0.49	-0.50	-1.78
SEGMENT	100	1.00	18.00	6.26	3.84	0.70	0.10
ACCMEETING	100	2.00	14.00	5.49	1.62	2.17	8.01
ACCMEMBERS	100	3.00	6.00	3.41	0.64	1.54	2.26

Notes: Refer Appendix for variable definitions

Correlation Analysis

The correlation analysis is presented in Table 3. Out of four indicators of CEO narcissistic, only CEO photo has a positive significant correlation with audit fees. The other three indicators i.e., CEO compensation ratio, CEO tenure and CEO duality are insignificant. All the control variables tested in the study, such as the natural log of IAF cost (LnIAFCost), natural log of non-audit fees (LnNAF), natural log total assets (LnTA), leverage, loss, big4, segment, AC number of meeting and AC members have a positive significant correlation with audit fees.

Regression Analysis

We run the regression results based on the audit fees model to achieve the study's objective, i.e., to examine the relationship between Narcissistic CEO and Audit Fees employing four indicators, such as CEO Photo, CEO Compensation Ratio, CEO Tenure, and CEO Duality. As a result, Table 3 shows the findings of the regression using the four indicators, i.e., Model A (CEO Photo), Model B (CEO Compensation Ratio), Model C (CEO Tenure), and Model D (CEO Duality). The adjusted R-Square for all Models are above 84% which indicates that all four models provide confidence in explaining the observed variability.

Model A and B in Table 4 reveal that the coefficient is negative for CEO Photo (-0.027) and CEO Compensation ratio (-0.010) does not show a significant association with Audit Fees. In the Model C, CEO Tenure with a positive coefficient (0.013) likewise does not reveal a significant association between CEO Narcissistic and Audit Fees. But of the four CEO Narcissistic indicators tested in the study, Model D reveals that CEO Duality with a positive coefficient (0.092) has a significant relationship with Audit Fees. This suggests that when the CEO also serves as the board chair, the auditor will spend more time and charge higher audit fees. Most of the control variables tested in the study in all four Models have positive and highly significant coefficient with audit fees.

Conclusion

Recent study provides evidence on the relationship between narcissistic CEO and audit fees. Using four indicators, only one indicator, namely CEO Duality has found positively significant between the audit fees. This finding is supporting by Bliss et al. (2007) and Tsui, Jaggi and Gul (2001) who find that CEO who also serve as chairman of a firm has caused the audit fees increased because the auditor perceived that there is higher engagement risk in such situation. This study subject to several limitations, i.e., the sample used is small which is not generalizable to Malaysia. Despite this, our study offers a valuable conclusion that CEO Duality is a new sign of a narcissistic CEO.

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Conflict of interests

The authors declare no conflict of interests.

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Appendix

Table 3: Correlation Matrix

Variable	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1 LnAUDITFEE	1.000													
2 CEOPHOTO	0.321**	1.000												
3 CEOCOMPRATIO	0.064	-0.067	1.000											
4 CEOTENURE	-0.078	-0.148	0.094	1.000										
5 CEODUALITY	0.184	0.136	0.167	0.100	1.000									
6 LnIAFCOST	0.692**	0.286**	0.069	-0.071	0.073	1.000								
7 LnNAF	0.500**	0.247*	0.126	-0.027	0.068	0.332**	1.000							
8 LnTA	0.856**	0.282**	0.030	-0.059	0.083	0.681**	0.337**	1.000						
9 LEVERAGE	0.495**	0.296**	-0.009	-0.368**	-0.046	0.184	0.220*	0.458**	1.000					
10 LOSS	0.415**	0.094	0.062	-0.178	0.031	0.136	-0.015	0.427**	0.328**	1.000				
11 BIG4	0.331**	0.067	-0.034	-0.082	-0.133	0.329**	0.301**	0.263**	0.153	0.144	1.000			
12 SEGMENT	0.374**	0.178	0.083	0.213*	0.147	0.162	0.068	0.321**	0.108	0.135	-0.087	1.000		
13 ACCMEETING	0.313**	0.317**	0.070	-0.175	0.098	0.185	-0.011	0.293**	0.181	0.270**	-0.018	0.238*	1.000	
14 ACCMEMBERS	0.243*	0.085	-0.016	0.161	0.170	0.232*	0.177	0.157	-0.015	-0.127	0.019	0.026	0.048	1.000

** . Correlation is significant at the 0.01 level (2-tailed)

* . Correlation is significant at the 0.05 level (2-tailed)

Table 4: Regression Analysis

Variable	Model A		Model B		Model C		Model D	
	Coefficient	T - Value	Coefficient	T - Value	Coefficient	T - Value	Coefficient	T - Value
CEOPHOTO	-0.027	-0.589						
CEOCOMPRATIO			-0.010	-0.250				
CEOTENURE					0.013	0.264		
CEODUALITY							0.092	2.245**
LnIAFCOST	0.218	3.607***	0.213	3.561***	0.214	3.552***	0.209	3.596***
LnNAF	0.218	4.719***	0.215	4.660***	0.214	4.682***	0.205	4.608***
LnTA	0.425	6.013***	0.426	6.009***	0.425	5.933***	0.426	6.197***
LEVERAGE	0.144	2.978***	0.137	2.904***	0.143	2.800***	0.146	3.174***
LOSS	0.132	2.737***	0.134	2.767***	0.134	2.769***	0.127	2.698***
BIG4	0.055	1.220	0.055	1.223	0.056	1.244	0.071	1.606
SEGMENT	0.147	3.357***	0.146	3.324***	0.142	3.116***	0.136	3.174***
ACCMEETING	0.059	1.305	0.053	1.202	0.054	1.220	0.047	1.107
ACCMEMBERS	0.101	2.379**	0.100	2.360**	0.099	2.293**	0.087	2.084**
Adjusted R Square	0.841		0.840		0.840		0.849	
F-Value	53.21		53.01		53.02		56.48	
Number of Observations	99		99		99		99	

Notes: Refer Appendix for variable definitions

Variable definitions

Acronym	Measurements	Supporting literature
LnAUDITFEE	Natural log of total audit fees	Hay (2013); DeFond and Zhang (2014); Christensen et al. (2016); Montenegro and Brás (2018).
CEOPHOTO	The average value of the CEO rank photograph	Olsen et al. (2014); Capalbo et al. (2017); Judd et al. (2017); Buchholz et al. (2020); Kontesa, Brahmana and Tong (2020); Lin, Lin and Fang (2020).
CEOCOMPRATIO	The ratio of CEO cash compensation to the highest cash compensation paid to non-CEO executives	Olsen et al. (2014); Capalbo et al. (2017); Judd et al. (2017); Buchholz et al. (2020); Kontesa, Brahmana and Tong (2020); Lin, Lin and Fang (2020).
CEOTENURE	Number of years the CEO has been appointed as a director of the firm	Cai and Li (2022)
CEODUALITY	1 if CEO/MD is Chairman, and 0 otherwise	Bliss (2011), Tsui et al. (2001)
LnIAFCOST	Natural logarithm of total IAF cost	Wan-Hussin & Bamahros (2013), (Bshayreh, Abu Hamour & Eid Haddad, 2021)
LnNAF	Natural log of (1 + non audit fees)	Widmann et al. (2021)
LnTA	Natural log of total asset	Widmann et al. (2021), Hay et al. (2006)
LEVERAGE	Total liabilities divided by total assets	Choi, Kim and Zang (2010); Ebrahim (2010); Nekhili et al. (2018).
LOSS	1 if the firm reports negative earnings for the current year, and 0 otherwise	Tsui et al. (2001), Nekhili et al. (2018)
Big 4	1 if a firm is audited by Big 4 firm and 0 otherwise	Widmann et al. (2021)
SEGMENT	Number of business segments	Widmann et al. (2021)
ACCMEETING	Number of meeting frequency of Audit Committee	Abbott et al. (2003), (Bshayreh, Abu Hamour & Eid Haddad, 2021)
ACCMEMBERS	Number of audit committee members	Vafeas & Waagelein (2007)