Does political environment and gender diversity affect audit fee?

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Executive summary

In this study, the relation between gender diversity, political environment and audit fee is investigated. Female, male, Republican, and Democratic audit partners could have different qualities or characteristics that are affecting the audit fee. Audit fee is not a preceding amount, based on the law. Audit fee is created by negotiation between the involved parties. Female audit partners are expected to earn a higher audit fee compared to male audit partners. Woman are more risk averse, are less overconfident and have more communication skills. Republican audit partners are expected to earn a lower fee, compared to Democratic audit partners. In the Republican environment is more Government support. Republican states are also less urbanized, so there is less busyness for auditors. At last the interaction effect between gender diversity and political environment is investigated. The expectations are that audit fee is affected by the interaction effect between gender diversity and political environment. In contradiction to the expectations, there is no evidence that female audit partners have a positive and significant effect on audit fee. The influence of political environment is the opposite of the expectations of this study. The outcome is not significant, so there is no clear evidence and no clear conclusion. At last there is no significant outcome for the interaction effect, which is also in contradiction with the expectations of this study. Together, these findings suggest that gender diversity, political environment and the interaction effect have no significant effect on the audit fee. These results should be relevant to auditors, companies and researchers.

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1. Introduction

1.1 Background information and motivation

These days there is a lot of discussion about the differences between black and white, religions or woman and man. Every person on this world should be equal, but do we treat every person equally? The organization AAUW investigated the salary difference between man and woman in the USA. AAUW concluded that a woman earns 20% less than a man when doing the same job (AAUW, 2017). This difference was found when Treiman and Terrel (1975) investigated the relation between women and their husbands of corresponding ages. The level of education and occupational attainment is virtually the same and identical for both, but women earned far less, compared to man. The result keeps standing if hours of work and experience are taken into account (Treiman & Terrell, 1975). Tolbert (1986) found that there is a difference in salary, when higher educated women and men are compared to lower educated women and men. When man and women with the same job are lower educated, there is a bigger difference in salary between women and men, than with higher educated women and men The average salary of a women is 75 percent of the men salary. In comprehensive institutions it is 86 percent of the men salary (Tolbert, 1986).

This study focuses on the audit world. More than half of all the accountants and auditors in the USA is female, to be precise 61.3%. Just 24% of the partners and principals are women. So, more than half of the accountants and auditors is woman, but 76% of the lead is man (Bureau of Labor Statistics, 2018). Ittonen and Peni (2012) investigated the differences between female and male partners. They concluded that female partners earn a higher fee but, found no clear explanation to support this (Ittonen & Peni, 2012). Maupin and Lehman (1994) investigated masculine or feminine behavior as a historical and culturally determined activity, because audit specialists have stereotypical sex role characteristics. They found that there are high stereotypic masculine characteristics for the partnership levels in accounting (Maupin & Lehman, 1994). A more recent study researched which companies were more likely to have a female partner leading the audit. They found that a more gender-diverse board of directors or top management, is more likely to have female partners (Lee, Nagy, & Zimmerman, 2018). Hardies, Breesch, and Branson (2011) provides no evidence for a gender difference in overconfidence within a population of auditors.

Sarbanes-Oxley Act of 2002, section 301, requires audit committees to be directly responsible for the compensation, appointment, and oversight of the work of the external auditor (Representatives, 2002). Audit committees should carry out responsibilities for auditor selection during the post-SOX period, but there is evidence that rejects this statement (Dhaliwal, Lamoreaux, & Lennox, 2014). Research suggests that SOX positively impacted the role of audit committees, but they do not reject the influence of the management fully (Cohen, Hayes, Krishnamoorthy, Monroe, & Wright, 2013). The mandatory auditor rotation is used many times as experiment. Owens (2015) concluded that strong audit committees oversight does not stop executives from chosing more rigorous audit partners. The management influences the decision for a new partner. Maupon (1993)concluded scarcity of women partners

Economic conditions can influence voters in their choice between a Republican or a Democratic presidential candidate in the USA. Prior research found no clear evidence for association between Republicans or Democrats in economic perspective (Stigler, 1973). Bartels (2004) concluded that Democratic presidents realized more income growth for poor families and Republican presidents realized more income growth for rich families.

Democrats are associated with the blue color, Republicans with the red color. Schreiber, et al. (2013) concluded that Democrats are seen as more politically liberal and Republicans are seen as more politically conservative. Democrats are more risk-taking compared to the conservative behavior of the Republicans. Audit fee and business risk are positively associated with each other. Most of the Democratic states are more urbanized and have better economic welfare. The and location of auditors in these states can also have a positively relation with audit fee (Chan, Ezzamel, & Gwilliam, 1993). More recently are the elections of 2016 in the US. The Democrats were in the lead from 2008 till 2016 with Barack Obama. From 2016 the Republican party is in the lead with Donald Trump (Walton, et al., 2016). The government could support or protect public related companies. In this case, the probability of earnings management increases in a Republican environment (Johnson & Mitton, 2003). Earnings management and audit fee are positively related (Abbot, Parker, & Peters, 2006). This study wants to researchthe relation between the audit fee, and the political environment.

1.2 Research question

To my best knowledge, there is no other recent study investigating the direct relation between partner gender, partner political environment and audit fee in the United States of America. Earlier research was just about partner gender in combination with audit fee. This study is adding a new variable to the existing literature. Earlier research already suggest that women earn a higher audit fee. (Ittonen and Peni, 2012) Political environment could influence the behavior of taking risk (Bell, Landsman, & Shackelford, 2000). The audit fee is also based on the risk of the company. So there might be a relation between the political environment and the audit fee. Based on these findings, this study is investigating the following research question:

Does political environment and gender diversity influence audit fee?

1.3 Relevance

Finding an answer on the research question could be an improvement in the reliability and objectivity of the accounting world. The world of auditors is a fast growing and developing world. Reliability is one of the four dimensions of trustworthiness (Mintz & Morris, 2016). Objectivity is one of the principles of professional conduct and fundamental principles. It is important for an auditor to be objective and reliable to customers. The answer on this research question could make the audit fee more reliable.

Audit fee is based on an agreement between the partner and his client. Audit fee is not a preceding amount based on law. It forms during the negotiation between partner and client. The negotiation can be influenced by a lot of factors. Determinants exist for the client and partner. If the partner is positive about the future, the audit fee is lower the first year, to attract new clients. This is called low balling effect (DeAngelo, 1981). If the client is riskier, than the audit fee is higher (Abbot, Parker, & Peters, 2006). Characteristics of the partner, such as experience or level of education, also influence the audit fee (Ettredge & Greenberg, 1990). Audit fee for companies could be more reliable and standard for companies if the input is known.

This study contributes to the existing literature in different ways. Firstly, to my best knowledge this study is the first study researching the effect of partner gender diversity and partner political environment in the United States of America on the audit fee. Research is done to the construction of audit fee. Hardies, Breesch, and Branson (2015) did earlier investigation to the

audit fee premium of female partners. Hardies, Breesch, and Branson (2014) investigated also the differences of gender overconfidence. Gregory and Coller (1996) investigated the effect of auditor change on audit fee. There are many different variables that could influence the audit fee. Prior literature investigated a lot of those variables, but never political environment of the partners.

1.4 Methodology

This study is an archival study. The archival study is conducted to answer the research question. Investigation of the relation between partner gender diversity, partner political environment, and audit fee is done by an ordinary least square (hereafter: OLS) regression. In this study the methodology created by Hay, Knechel, and Wong (2010) is followed.

1.5 Conclusion

The effect of gender diversity and political environment is tested by multivariate regressions. The regression contains control variables for factors that could affect the audit fee. The first hypothesis is rejected. Women have a positive effect on audit fee, but the effect is not significant. There is not enough evidence to conclude that gender influences audit fee. The second hypothesis is not in line with the expectations. Republicans are negatively related with audit fee. Political environment shows a negative relation if the dummy variable of partner gender diversity and the dummy variable of partner political environment are not included in the regression. The relation is positive if the variables are included. The second hypothesis is also be rejected, because the outcome is not significant. Political environment has no significant effect on audit fee. The third hypothesis is about the interaction effect between gender and political environment. The last hypothesis is also be rejected. There is an interaction effect between those variables on audit fee, but it is not significant.

Finally, gender, political environment and the interaction effect between those variables, do not have a significant effect on audit fee. The effect is too small and there is not enough evidence to accept the hypothesis.

1.6 Structure

This study is organized as follows. In the next section, literature, prior research and corresponding theory are discussed. After that, the hypotheses were developed based on the existing literature. In the fourth part of the study, the methodology is explained. Finally, the results of the study are discussed and a conclusion is made.

2. Theoretical Environment

In this section, the theory is discussed. First, the theory about audit fee is examined. Audit fee is separated in three subjects; client attributes, auditor attributes, and engagement attributes. Further, gender is generally explained and linked to the audit fee. Finally, the last section is about the political environment of the partners. This is generally explained and linked to audit fee and gender. Political environment is separated in two subjects; Democrats and Republicans.

2.1 AUDIT FEE

Audit fee can be defined as the price for the quantity of the product 'audit services' that is provided by audit companies. Quantity of audit hours or quality differences can influence the price charged by audit firms (Simunic, 1980). Auditors could be forced to perform more audit procedures during an audit. In this case the auditor increases the quality of an engagement, so the quantity of hours also increases. More audit hours and higher audit quality increase the audit fee of a company. The auditor is responsible for detecting material misstatements in the financial statements of their clients. There is a positive relation between litigation and abnormal accruals (Heninger, 2001). So, if the auditor does not detect the material misstatements, while there are material misstatements, the litigation risk increases.

There are more drivers behind audit fee. Simunic (1980) is one of the first researchers who created a model of the drivers of audit fee variation. Firm size is one of the factors in the model of Simunic (1980). Audits are provided on sampling base, so if the total assets increase, the amount of audit procedures increase simultaneously. The auditor must assure a certain level of assurance. The second driver mentioned by Simunic (1980) is the complexity of audited firms. Firms can be decentralized or have diverse operations, which is more complex for the auditors. The balance sheet can also have a few complex numbers that require specific audit procedures, Simunic (1980) mentioned 'Receivables' and 'Inventories'. At last, Simunic (1980) added the differences of the industry, however he has no theoretical explanation for this factor.

Simunic (1980) was not the only paper about the determinants of audit fee. Chan, Ezzamel, and Gwilliam (1993) also mentioned auditee size and audit complexity as the most used determinants of the audit fee. They included more variables as auditee risk, profitability of the company and timing variables (Chan, Ezzamel, & Gwilliam, 1993). Audit risk is a significant factor in determining the audit work. A higher audit risk results in a higher audit fee, as a kind of an 'insurance' premium. Audit risk includes the 'nature of the entity', but also the control environment. Audit profitability is about the client profitability. Chan, Ezzamel, and Gwilliam (1993) mentioned a link between the level of client profitability and the level of audit fee. If a company is facing financial pressure, the auditor must extend the audit scope. In this case the auditor must face problems as going concern or concentrate more on the cash flow forecasting. At last they mentioned about timing variables as an important variable. The busiest season for an auditor is between yearend (31 December) and 31 March. The demand of auditors is higher in this period, so the audit fee will also be higher in this period.

Simon and Francis (1988) defined another determinant in their paper. They investigated the effect of auditor changes on the audit fee. There is an association between auditor changes and audit fee. They used a sample base of 214 firms that had changed auditor and 226 firms that had not changed auditos for the same period (1979-1984) (Simon & Francis, 1988). The fee of ongoing audit engagements increased with an average of 24 percent. The fee of the companies that switched auditor firm, decreased the first two years to 15 percent on average. After four years the audit fee increased to the normal level of continuing engagements. In this paper they talked about price cutting's effects on auditor independence.

There are many more studies researching the determinants of audit fee. Hay, Knechel, and Wong (2006) combined papers from more than 20 countries over a timeframe of 27 years (1977-2003) that used audit fee as a dependent variable. The purpose of this study was creating a meta-analysis that assessed the overall effect of the independent variables of prior literature (Hay, Knechel, & Wong, 2006). Hay, Knechel, and Wong (2006) divide the determinants in three categories: (1) client attributes, (2) auditor attributes and (3) engagement attributes. In this paper the same categories are discussed.

2.1.1 Client attributes

The meta-analysis made by Hay, Knechel, and Wong (2006) provided client size as a determinant of audit fees across all the studies. The second determinant of client attributes is the complexity of the clients. In prior research, complexity is measured with proxies as number of subsidiaries, the number of business segments and the number of audit locations. Researchers mentioned in prior research something about a relation between inherent risk and the audit fee (Hay, Knechel, & Wong, 2006). Inherent risk is the risk that an auditor could not find a material misstatement in the financial statements of a company (Bettman, 1973). Some parts of the audit need more attention and require specific audit procedures. Chan, Ezzamel, and Gwilliam (1993) mentioned the profitability of the company that is audited by the auditor. If the company is not financially profitable, the audit fee reflects this. Another risk in a company is the leverage. A higher leverage ratio means that there is an increase in debt compared to equity which increases the risks. The risk of agency costs or general risks in the organization, can be affected by the form of ownership. Audit fees can be influenced by the form of ownership of a company. Managers (agents) are working for the shareholders (principals) of a company. The agents and shareholders do not always have the same goals, which is called agency theory (Ross, 1973). Managers are willing to act to increase their own reputation and situation, instead of working to benefit the reputation and situation of the company. If there is one major shareholder, that shareholder can indicate stronger controls. If there are a lot of shareholders, so the managers control the company, agency costs can emerge and the audit fee increases. Further, a determinant for the audit fee is the industry of the client. Some industries are more difficult to audit than other industries. The last two determinants of clients are internal control and corporate governance. The control environment of every company can be different, which influences the audit fee. An auditor needs less hours for a firm with a strong control environment. Corporate governance is the last determinant in this section. This could also affect the control environment of the client, and so the audit process. As mentioned before, a stronger control environment lowers the audit fee. An audit committee, separation of duties and a number of outside directors, can be proxies for a strong control environment. Limited studies used the corporate governance of the company as proxy. The Sarbanes-Oxley Act, that influences the internal control, was implemented in 2002. Establishing, maintaining, and regularly evaluating effectiveness of internal control over financial reporting, are requirements that SOX demands for top management (Ge & McVay, 2005).

2.1.2 Auditor attributes

The first determinant of audit fee is the audit quality. The most commonly used proxy for audit quality is a dummy variable for the big four audit companies. In prior research there are mixed results about the audit quality. A bigger office has a higher audit quality, because of the greater in-house experience (Francis & Yu, 2009). Hay, Knechel, and Wong (2006) confirm, in contradiction to Lawrence, Minutti-Meza, and Zhang (2011), in the meta-analysis that auditor quality is strongly associated with higher audit fees. Companies must pay a higher audit fee if they hire a big four firm. Audit firms offer a lower audit fee to attract new clients, which is called low-balling effect (DeAngelo, 1981). Another explanation is that a company can deliver better service, with less effort, so the audit fee can be lower (Hay, Knechel, & Wong, 2006). The proxy for this determinant can be a dummy for a specific period. In most of the situations it is a dummy variable that the auditor is staying one audit versus more audits. Further, the location of the auditor is an interesting determinant of audit fees. Prior studies are in line with Hay, Knechel, and Wong (2006), audit offices located in metropolitan center areas are providing a higher audit fee. At last, the determinant gender and political environment may influence the audit fee. The theory of gender is discussed in part 2.2 of this paper. The theory of political environment is discussed in part 2.3 of this paper.

2.1.3 Engagement attributes

Audit report lag is the time between the end of the fiscal year and the end of the audit field work (Knechel & Payne, 2001). Knechel and Payne (2001) mentioned that the audit report lag increases, because of audit hours increasing through use of specific audit engagements. If the audit engagement team includes more partners and managers, the audit report lag is smaller. The second determinant is based on engagement attributes is ‘busy season’. For most of the audit companies the ‘busy season’ is from 31 December till 31 March. In this season, most of the companies have their fiscal year-end, so there is increasing demand of auditors. The busy season can increase the audit fee based on supply and demand of the clients for auditors. The effect on the audit fee differs across countries and time samples. There are different opinions an auditor can provide about an annual report. If the auditor gives a different opinion than an unqualified opinion, the audit fee is expected to be higher. Another opinion is an indication of audit problems, so it affects the audit fee. Hay, Knechel, and Wong (2006) concluded that this determinant and audit fee were positively correlated before 1990. After 1990 the results were positive as well, but not significant anymore. The explanation of the paper concerning this issue in the reporting of going-concern issues. Auditors are forced to evaluate a going-concern

opinion about their client by SAS No.59 created in 1988 (Holder-Webb & Wilkins, 2000). The issuance of a going-concern opinion must be disclosed if the auditor has any doubts about the continuous existence of the client. Non-audit services are an important subject and focus of many prior studies. It can reduce costs, because of the synergy effects between audit and non-audit services. It also requires additional effects from audit firms and increases the audit fees. The last determinant is the complexity in reporting. Reporting requirements can be more complex for auditors, which increases the risk of detecting material misstatements in the financial statements. The number of audit reports to be issued is used as a proxy for this determinant.

2.2 Partner gender

Ittonen and Peni (2012) investigated the difference in audit fee between male and female partners. Prior research mostly focused on client characteristics, audit firm characteristics, and the engagement attributes. There might be a difference between individual auditors, based on experience, skills, audit team, and risk preferences (Defond & Francis, 2005). The study of Ittonen and Peni (2012) is based on earlier research and mentioned that women tend to be less overconfident than men and women are more risk averse. Nelson (1996) concludes that female partners are more neutral in moral judgement. Female partner impact reliability in another way as male partners (Nelson, 1996). Male partners can be associated with being public, active and rational. Female partners can be defined as being private, passive and emotional (Nelson, 1996).

The partner has regulated comprehensively responsibilities. The overall quality of each engagement, what the audit partner is assigned to, is the full responsibility of the partner, stated in the International Standards of Auditing (ISAAB, 2009). An audit partner is responsible for the nature, timing, and extent of guidance and supervision of team members, and reviews their work. The engagement team must be a good combination of capabilities, competence and time to perform the audit. The professional standards and regulatory requirements must be met during the audit. The audit must include specialized experts and needs to use appropriate consultation in case of complicated or contentious matters, according to ISA requirements (ISAAB, 2009).

The Code of Ethics for Professional Accountants is also interesting for partners. An engagement partner is responsible for a reliable audit fee, which reflects a sufficient amount of resources

that can be invested in the engagement (IESBA, 2009). The audit fee should not be a reason behind the lack of resources or time to properly perform the audit. The estimation is done personally by the partner, so it can influence the required amount of work. Gender differences in risk aversion, may lead to a higher fee for female auditors. Female partners require a higher level of assurance, which results in more work and more audit hours (Ittonen & Peni, 2012).

The process of an engagement consists out of four major phases: planning, risk assessment, conducting the audit, and evaluating the results and issuing the report. The height of the audit fee is determined in the planning and risk assessment phase. The partner is responsible for the whole audit process (Ittonen & Peni, 2012).

As mentioned above, Ittonen and Peni (2012) documented behavioral differences between male and female partners. Planning, group decision-making, risk tolerance, and overconfidence may affect the audit fee, and can be different between male and female partners (Ittonen & Peni, 2012). Hardies, Breesch, and Branson (2011) investigated the effect of partner overconfidence. Male partners are more overconfident of domains related to mathematics, science, and technology. The picture in financial matters is less clear. Female partners are less confident in investment decisions and trade decisions on the financial market. All the auditors' got the same training in forming objective and unbiased judgements. If partners get the same training, similar audit judgements are expected (Hardies, Breesch, & Branson, 2011). Hardies, Breesch and Branson (2011) investigated with help of a survey. They concluded that the audit fee differences cannot be caused by overconfidence of gender. There is a little difference in the results of their research, but it is not significant.

According to the literature of gender diversity, there may be features that affect the planning of the audit engagement. As first, female partners in high positions better prepare their work than male partners in the same position (Huse & Solberg, 2006). Female partners also must prove their skill and competence more to reach top positions, and they have higher expectations about their responsibilities (Eagly & Carli, 2003). Other prior studies concluded that female partners have better communicative skills and have an advantage when working in different teams. Female audit partners have advantages in working with different audit teams (Schubert, 2006). As partner, you must sell your work to a client. Female partners have the advantage to sell the audit for a higher level of assurance.

Prior studies show that female partners are more conservative and risk averse compared to male partners (Byrnes, Miller, & Schafer, 1999). Female partners try to avoid losses take less risks or avoid extreme risks, compared to male partners (Schubert, 2006). The partner responsible of an engagement must assess the inherent risk, control risk, and setting the detection risk of each engagement. This is done in the planning phase of the audit cycle. Female partners could have higher audit fee, because the fee could be influenced by audit investment and/or risk premium.

Collin et al (2007) confirms that it would be more difficult for women to achieve high positions, such as partnership. The world of business remains a world of men, even with the developments in the last decades (Collin, Jonnergard, Qvick, Silfverberg, & Zabit, 2007). Women have less possibilities to charge higher fees, so there could be a negative relation between female partners and audit fees. Wage differences between male and female partners can make a difference in the audit fee. The gender wage gap can have influence on the audit fee, but it had no significant effect in prior research.

Hardies, Breesch, and Branson (2015) investigated the audit fee premium differences of female partners. They analyzed 57,723 firm-year observations during the period of 2008-2011. They concluded that clients must pay 7 percent more audit fee to female auditors. A reason could be that female auditors may demand more audit effort in the engagements, as skills, knowledge, abilities, preferences, and behavior. Hardies, Breesch, and Branson (2014) concluded that female partners deliver a higher audit quality. Clients are willing to pay a higher audit fee, if they recognize or are positive about the higher quality of the engagement. The audit quality could also be a reason for the 7 percent higher audit fee. Furthermore, Hardies, Breesch, and Branson (2015) give the emotional influence of female partners as a second determinant. Above was already mentioned that female partners are more communicative. Average characteristics of women; more agreeable, tenderminded, warm, and open feeling, can satisfy the client more. At last they explain the diversity policy of the company. There are companies that want more diversity and are willing to pay more for a female auditor.

Audit partners can be influenced by the political environment and may strengthen the association between gender and audit fee. Partners with the same political ideology can have the same thoughts and same characteristics. This may be in line with the gender characteristics and strengthen the effect on audit fee. The political environment theory is discussed in next chapter.

2.3 Political Environment

A monopoly influences the welfare of consumers negatively and market competition influence the welfare of consumers positively. Competition between political parties has the similar effect, but there is less prior research about this subject (Besley, Persson, & Sturm, 2010). The sample base of this paper is the US. Two large political camps exist in the US, Democrats and Republicans. The president cabinet (the executive), the US Congress (the legislature) and the courts (the judiciary) are the three parts of the US Government. They separate the system, to prevent for an absolutism country. Last election Hilary Clinton (Democrats) and Donald Trump (Republicans) were the most potential president candidates. The electoral college decides who will become the next US president (Smith, 2016). The electoral college consist of hundred senators (two for each state) and 435 representatives, with an additional three electors for the District of Columbia. To be the president of the United States of America, you need most of the votes (more than 269) (Smith, 2016). The citizen of the state can vote for the representative of their state. It is possible that most of the nationwide votes are for Democrats, but Republicans have more votes in the electoral college, so the president of United States will be Republican. Every state have their own number of representatives in the electoral college. So, if most of the voters, for example in California, are voting for Democrats. The Democrats will get the full representatives of California on their name, that are 55 representatives. All the states have different representatives in the electoral college.

Park and Pantzalis (2014) investigated the effect of political power centers and abnormal returns. They concluded that the position of firm headquarters could be positive or negative related with higher abnormal returns. When a headquarter moves to another state, with another political power, it can have a positive effect on the abnormal accruals (Pantzalis & Park, 2014). Political strategies can influence growth opportunities of companies. They can give companies competitive advantages in uncertain environments (Kim, Pantzalis, Park, & Kim, 2017). Last decades, firms become more politically active to build a better business landscape. Firms with political connection differs in the financial reporting characteristics from firms without connection. (Gross, Königsgruber, Pantzalis, & Perotti, 2016). Prior literature identifies advantages of connectedness, better access to bank financing, a lower effective tax rate, and obtaining government procurement contract have a higher change. In developing countries, they found connections about positive and negative effects on capital market performance and firms' operating. Connected companies depend on a level of secrecy and are not very interested in

much scrutiny. Less strict enforcement of disclosure rules lead to higher information uncertainty (Gross, Königsgruber, Pantzalis, & Perotti, 2016). Firms that are connected have more troubling to forecast earnings or the precision of estimate values are costlier for knowledgeable investors. Political connections are also positively associated with earnings management (Chaney, Faccio, & Pasley, 2011). Bad news of connected firms is suppressed in the release before important political events. Prior research found that bribes may be hidden or there exists misleading of poor performance (Johnson & Mitton, 2003).

Bliss, Gul, and Majid (2011) are using 500 public listed companies of the years 2001 and 2002. In their research the relation between the amount of independent directors in the audit committee and the audit fee is investigated. A higher number of independent directors is positively associated with a higher audit fee for political connected firms (Bliss, Gul, & Majid, 2011). Whab, Zain, and James (2011) have 1022 observations over 2001 till 2003. They have the same conclusion as Bliss, Gul, and Majid (2011), politically connected audit firms must pay more audit fee (Wahab, Zain, & James, 2011). More risks require more audit effort, which should be the reason for the higher audit fees.

The research of this paper is based on audit partners linked to a specific state. If most of the voters in California voted for Democrats, all the audit offices in this state are marked as Democrats. Prior research concluded that political connection of companies has a positive association with the audit fee. In the next part Democrats and Republicans is highlighted.

2.3.1 Democrats

Democrats are recognizable by the blue color. Democrats are seen as more politically liberal (Schreiber, et al., 2013). Democrats are more risk-taking compared with conservatism behavior (risk aversion) of the Republicans. In this case, companies that have a political connection with the Democrats take more risk. Business risk is associated positively with audit fee, if a company takes more risk, the audit fee is higher. The proxies of business risk are audit effort or audit hours. If a company take more risk, not the fee per hour, but the effort of audit hours increases (Bell, Landsman, & Shackelford, 2000). Audit partners can be Democratic, so more risk accepting. If an auditor is more risk accepting, the auditor can take more risk in the audit process. In the first phase of the audit process, planning of the audit, the partners must assess the risk of the audit (Ittonen & Peni, 2012). When the audit has more risk, this means less audit

hours, this will lower the audit fee. Auditors with a Democratic environment expect to decrease the audit fee in this case.

Last years, voting for a Democratic party becomes more popular in the US (Breweer, Mariani, & Stone Cash, 2002). Most of the increased voting scores has been attributed to big changes in the south of the US. The north of the US constitutes a larger part of the House now. In the past, Democrats held approximately 35 percent of seats in the north. In the 1970s, the Democrats were increasing to 60 percent of the seats. States in the north have urbanization, racial composition, and considerably economic situations. This could be a reason for creating a base for the new direction of liberal voting in the region. Most of the Democratic states are more urbanized compared with the republican states. The three biggest and most busy cities (based on citizen) are located in Democratic states. The busyness and location of the audit offices in these states can influence the audit fee. Prior research mentioned that audit offices located in big cities can increase the audit fee (Chan, Ezzamel, & Gwilliam, 1993)

A strong federal government with power to regulate businesses and industries is strong supported by the Democratic party. They also support to fight the unemployment and benefit the poor. Further they want federally financed social services and protection of the civil rights (The Editors of encyclopaedia Britannica, 2018). Democratic people prefer internationalism and multilateralism over isolationism and unilateralism. In this case democratic companies should prefer big four companies over small located audit firms. Audit partners should favor companies that are working international over national. Audit partners that are Democratic can raise the audit fee for national companies to stimulate internationalism. Democratic states are also fighting for regulation of businesses and industries. Government support of companies could mislead the knowledgeable investors (Gross, Königsgruber, Pantzalis, & Perotti, 2016). The Republicans are in the lead now, so federal government regulation is lower. Expectation about the association between Democratic and audit fee in this case is difficult and interesting.

Nearly a half of the states voted for the Democrats last elections[1] (Walton, et al., 2016). Democrats were more popular by women compared with men, 54 percent of the women voted for Hilary, 4 percent was neutral, and 42 percent voted Republican. Hilary was also in the favor

[1] California, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New Mexico, New York, Oregon, Rhode Island, Vermont, Washington, and Virginia

by people younger than 44 years. Popularity by the women is in contradiction with the audit fee premium theory. Democrats are riskier, but female partners are more risk averse (Hardies, Breesch, & Branson, 2015). The interaction effect of women, political environment and audit fee should be interesting in this case.

2.3.2 Republican

Republicans are recognizable by the red color. Republicans are seen as more politically conservative (Schreiber, et al., 2013). The main definition of conservatism about the last few decades is "anticipate no profit but anticipate all losses" (Watts, 2003). Profit does not be realized before it is verifiable, losses work in the asymmetrical way. This will increase the information asymmetry and increase the information costs of investors. The increase of information asymmetry increases the audit fee.

The Republican party is strongly against power of the federal government. It fights against the government about the regulation of traditionally state and local matters, such as policing and education (The Editors of Encyclopaedia Britannica, 2018). This has the opposite effect of the Democratic side. Government intervention could has positive and negative effects. The government does not protect companies, so earnings management is less. If there is less chance of earnings management, the audit fee is lower. Republic related companies can get support and protection by the government, in this case earnings management increase (Johnson & Mitton, 2003). Increasing of earnings management is associated positively with audit fee (Abbot, Parker, & Peters, 2006).

Republicans and Democrats are both highly decentralized but encompasses a variety of opinion. People of this party would like to see a reduce in taxes to stimulate the economy and would like economic freedom (The Editors of Encyclopaedia Britannica, 2018). Most of the Republicans prefer increased government regulation in private situation that are not economic, such as abortion. The Republican party prefers national defense and nationality. Republican states are fighting for nationality. In this case a Republican partner can lower the audit fee for national companies and vice versa.

More than a half of the states voted for the Republicans in the last election[2] (Walton, et al., 2016). Republicans were more popular by the male voters. More than 53 percent of the males voted for Trump, 6 percent was neutral, and 41 percent voted for Hilary. Trump was in the favor by people older than 44 years. At last, the Republicans were in favor by the male citizens. Males take more risk, so the audit fee and risk are negatively related (Hardies, Breesch, & Branson, 2015). Male partners can take more risk, which results in less audit hours, so less audit effort. In this case, the audit fee should be lower.

3. Hypothesis Development

Giving an answer to the research question requires the formulation of three hypotheses. The first one discusses the relation between the gender of an audit partner and audit fee. In the second part, a hypothesis is developed based on the relation between partner political environment and audit fee. Lastly, the interaction effect between audit partner gender and partner political environment is examined.

3.1 Hypothesis 1

Audit fee could be influenced by the demand and supply side of the market. A company demands audit services, that is supplied by an audit firm. The focus point in this study is the supply side of the market. All audit partners are different, in this study the difference between audit partner gender (men or women) is discussed. Auditors got all the same training to form an objective opinion and unbiased judgement. There should be no difference between the audit opinion of male and female auditors (Hardies, Breesch, & Branson, 2011). However, differences between male and female auditors exist according to other studies. Hardies, Breesch, and Branson (2014) analyzed 57,723 firms during the period 2008-2011. This study finds that the audit opinion of men and women are different. Moreover, women deliver higher quality audit services, and they receive a higher audit fee than men.

Ittonen and Peni (2012) conclude that women are less overconfident and are more risk averse than men. Women are more likely to avoid the audit of a high-risk company or they increase the audit fee of these companies. Furthermore, women are more conservative than men

[2] Alabama, Alaska, Arizona, Arkansas, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, Nebraska, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, West Virginia, Wisconsin, and Wyoming

(Schubert, 2006). According to the research of Itonnen and Peni (2012), engaging in less risky behavior and overconfidence are related positively to audit fee. Female audit partners require a higher level of assurance. They are putting more effort in their engagements, and so, women spend more hours on an audit engagement than men (Ittonen & Peni, 2012). Consistent with Ittonen and Peni (2012), Hardies, Breesch, and Branson (2011) find that risky behavior is related positively to audit fee, but they do no find a significant effect for overconfidence. The differences in the extent of overconfidence between women and men have no significant effect on audit fee.

Women in high positions are better with preparing their work compared with men in the same position (Huse & Solberg, 2006). A better preparation of the work is likely to benefit the audit quality, which affect the audit fee positively. Women also must prove their skills more and have higher expectations of their responsibilities (Eagly & Carli, 2003). This often results in a better quality of the audit and indirectly a higher audit fee.

Lastly, women have better communication skills (Eagly & Carli, 2003). The communication with the audit team and the client are better than men. The partner and client must negotiate about the audit fee. As female partner, you must sell your service to the client and they are willing to pay for it. Because of the advanced communication skills, they have the advantage to sell the audit for a higher level of assurance. A higher level of assurance and audit fee have a positive association, so in this case the audit fee is higher if the audit partner is a female.

Based on prior studies and the theory, female audit partners are expected to have a positive association with audit fee. Women are more conservative, risk averse, take more responsibilities, have better communication skills and are less overconfident than men. Taking this into account, a a positive direction for the hypothesis is expected:

H1: Audit fee is higher, if the audit partner is a female.

3.2 Hypothesis 2

Besides the gender diversity, other characteristics of the audit partner could also influence the audit fee. Political environment of the audit partner could influence the audit fee. In the United States, there are two dominant political parties: Democrats and Republicans. At this moment,

the Republicans won the election and Donald Trump is President of the United States of America, who represents the Republican party.

Political environment gives companies growth opportunities. Last decades, companies are building a better business landscape based on politics. Firms with political connections show other financial reporting characteristics as companies without connection (Gross, Königsgruber, Pantzalis, & Perotti, 2016). Companies with political connections depend on a level of secrecy and are not very interested in much scrutiny. Connected firms have more forecasting errors and are more expensive to valuate for knowledgeable investors (Chaney, Faccio, & Pasley, 2011).

Democrats are more risk-taking compared to Republicans (Schreiber, et al., 2013). A Democratic partner take more risk in the first phase of the audit. Partners must assess the risk of a client in the planning phase (Bell, Landsman, & Shackelford, 2000). If the auditors take more risk, less additional testing or specific testing is needed, which results in less audit hours for the engagement. In this case, the audit fee is lower if the partner is Democratic.

Democrats prefer internationalism and multilateralism over isolationism and unilateralism of the Republican party (Gross, Königsgruber, Pantzalis, & Perotti, 2016). The big four firms are international audit firms that are spread across the world. Democratic partners are expected to have a negative association with audit fee if the company is international. Democratic partners are supporting international companies, so this could result in a financial advantage. Democratic companies are willing to pay more audit fee for auditors from international offices as the big four.

The Republican party won the election of 2016. This means that Republican companies could benefit from relations with politicians. If Republican companies have political connections, the possibility of earnings management could arise. The assessment of the value of a company is costlier for knowledgeable investors (Johnson & Mitton, 2003). If companies are related to the politics or stated in related states, the audit fee may be higher. Republican firms would get more government support, so the partners could lower the audit fee. If the company is Republican and the partner is Democratic, it could increase the audit fee.

Based on the different determinants. Based on the last elections, Republicans are in political advantage compared with the Democrats. The follow hypothesis is created:

H2: The audit fee is lower, if the audit partner works in a Republican environment.

3.3 Hypothesis 3

Audit fee could be influenced by individual determinants. It might be possible that determinants strengthen or weaken the effect of other determinants. If Democrats influence the audit fee, and gender also influences the audit fee, the effect of a combination can be significant different.

Democrats are more risk-taking compared with the conservatism thoughts of the Republican (Bell, Landsman, & Shackelford, 2000). Ittonen and Peni (2012) mentioned that women tend to be less overconfident than men, and men are more risk taking. Men take more risk, so the audit fee and risk are related negatively (Hardies, Breesch, & Branson, 2015). Democrats are also more risk taking, so the audit fee and risk are also negatively related. In this case, men that are Democrat, charges a higher fee. Furthermore, Republicans are more conservative, which also applies to women (Byrnes, Miller, & Schafer, 1999). In this case, a Republican could enhance the effect of a women. At last there is a contradiction, because most of the women voted for the Democrats, while Republicans are more in line with their behavior.

Based on the theory, the last hypothesis is created:

H3: There is an interaction effect between audit partner gender and political environment.

4. Methodology

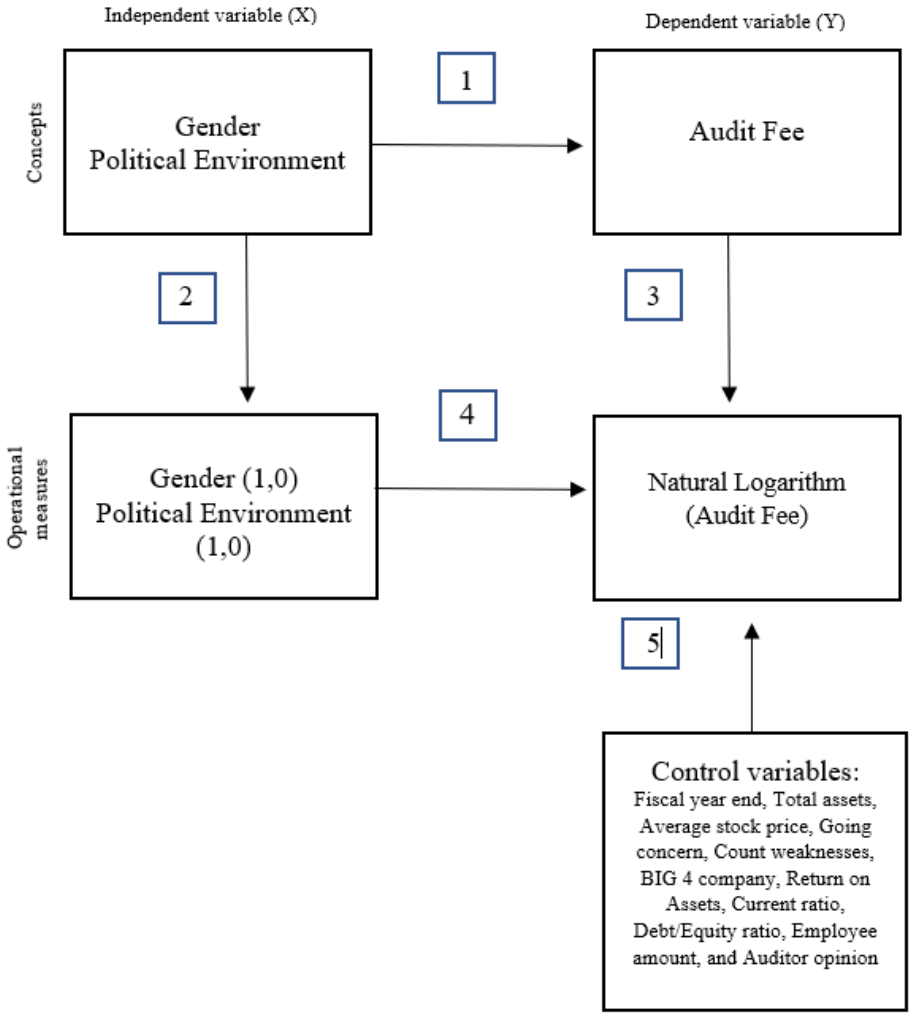
This section explains the methodology of this paper. Firstly, the research design is explained with a 'Libby box' and research model. Secondly, the dependent, independent, and control variables are discussed. Lastly, the sample selection of this research is discussed.

4.1 Research Design

4.1.1 Operationalization of theoretical constructs

Firstly, a 'Libby boxes' is created. The Libby box explains the theoretical relations that are tested. These relations are described by the Libby box. The Libby box is created based on the empirical model that is used during this study.

Figure 1: Libby Boxes



In this study three possible relations are tested. The mean theoretical construct that is tested in this study is the relation between gender diversity, political environment and audit fee. To be more specifically, this study is focusing on the amount of audit fee. As already mentioned in section 2, determinants could influence audit fee. Some determinants that are affecting audit fee are already shown in existing literature. Since it is nearly impossible to determine all the determinants and links with audit fee. This study is focusing on gender diversity and political environment.

The concepts of the Libby box are clarified. A dummy variable is used for the gender diversity. This dummy variable takes the amount 0 for men and 1 for women. As already discussed in section 2 and 3 of this study, gender has a significant effect on audit fee in existing literature. Women are more conservative compared with men. The second independent variable is political environment. The model uses a dummy variable for this, where 0 is assigned to Democrats and 1 to Republicans. Prior literature examined only the relation between political background and audit fee in Malaysia (Wahab, Zain, & James, 2011). Democrats and Republicans have different thoughts and act different. Therefore, it is important to investigate the relation between political environment and audit fee in the United States. At last, the interaction effect is measured by operational measures. Women are conservative, and Republicans are also conservative, so this may strengthen the relation with audit fee. The interaction effect is measured by a dummy variable which takes value of 1 for a Republican female partner and 0 otherwise.

The following manner is used to operationalize the theoretical relations, as illustrated by Libby boxes (figure 1). Firstly, the dependent variable, natural logarithm of audit fee is used for the audit fee. Furthermore, the independent variables, gender diversity of the partner is divided in female and male. At last, political environment of the partner is divided in Republican or Democratic. The partner is linked to the home office. This home office is linked to the state. The state is marked as Republican or Democratic.

4.1.2 Research Models

The following research model is created for this study:

$$Audit\ Fee = \beta_0 + \beta_1\ DUMFYR + \beta_2\ AT\_N + \beta_3\ AVG\_PR + \beta_4\ GOING\_CONCERN + \beta_5\ COUNT\_WEAK + \beta_6\ BIG4 + \beta_7\ ROA + \beta_8\ CUR\_RATIO + \beta_9\ DEBT\_EQUITY + \beta_{10}\ EMP\_N + \beta_{11}\ AUOPIC + \beta_{12}\ DUMGENV + \beta_{13}\ DUMPOLR + \beta_{14}\ DUMGENPOLVR + Industry\ Effects + \varepsilon$$

In the first hypothesis, the model is used excluding the variable DUMPPOLR and DUMGENPOLVR. The second hypothesis the variable DUMGENV and DUMGENPOLVR are excluded. The third hypothesis, all the variables are included. In their model, Lee, Nagy, and Zimmerman (2018) use partner gender also as main variable. They used their own regression to measure this variable. A prohibit function is used for the variable audit partner gender in this study. In line with this study BIG4 is used to control the office size of the auditor. Current ratio and debt/equity ratio is added to control for the leverage, also in line of the study. ROA, GOING_CONCERN, DUMFYR, COUNT_WEAK are added in line with the study of Lee, Nagy, and Zimmerman (2018). Return on assets is added to control for the profitability of the company. Fiscal year end is added to control the business of the auditors. Going concern is added to control for the complexity of the audit, even as the variable COUNT_WEAK. AT_N and EMP_N are added as proxy variable for the size of the company that is audited. Simunic (1980) concludes that employee amount could also affect the complexity of an audit. At last AVG_PR and AUOPIC are included contrary to the study of Lee, Nagy, and Zimmerman (2018). The reason behind AVG_PR variable is that stock price could reflect the market value of the company (Chambers & Penman, 1984). The auditor opinion could influence the effort and additional testing during an audit. If the auditor gives the company an adverse opinion, the auditor need additional testing, so more effort and audit hours.

Table 1. Variable Description

Variable name	Description
AUDIT_FEES	The natural logarithm of audit fee
DUMFYR	Dummy variable of fiscal year end (1 for October, November, and December 0 for the other months)
AT_N	The natural logarithm of total assets on balance sheet
AVG_PR	The natural logarithm of average stock price
GOING_CONCERN	Dummy variable going concern (1 if company had a going concern opinion, 0 if company had no going concern opinion)
COUNT_WEAK	Weaknesses of internal control scaled from 0 to 6 (0 if internal control is effective increasing to 6 if internal control is very weak)
BIG4	Dummy variable big4 companies (1 for big 4 companies (EY, KMPG, PwC and Deloitte), 0 for the other accounting companies)
ROA	Return on assets (Retained earnings divided by total assets)
CUR_RATIO	Current ratio (Current assets divided by current liabilities)
DEBT_EQUITY	Debt equity ratio (Debt divided by equity)
EMP_N	The natural logarithm of employees working in the company or consolidated subsidiaries
AUOPIC	Auditor's opinion (0 for no auditor's report, 1 for effective (no material weaknesses) and 2 for adverse (material weakness exists))
DUMGENV	Dummy variable gender (1 for Women, 0 for men)
DUMPOLR	Dummy variable politics (1 for Republican, 0 for Democrats)
DUMGENPOLVR	Dummy variable gender * politics (1 for women and Republican, 0 for other options)

4.2 Variable description

This section explains the main variables and control variables. The variables in this section are all part of the model that is used for this research.

4.2.1 Variables of Interest

The methodology of Lee, Nagy, and Zimmerman (2018) is followed in this study to some extent. They used gender and number of years since the partner's bachelor's degree as main variables. This study uses gender, political environment and the interaction effect as the variable of interest.

Gender diversity of the audit partners could have two solutions: men or women. In the model, a dummy variable DUMGENV is used. If the dummy variable has the value 0, the partner is a male. The dummy variable could have the value 1, in this case the partner is a female. The first hypothesis predicts a positive relation between female audit partners and audit fee. In this case, the coefficient of gender should be positive. If the partner is a women, the audit fee should be higher with a positive coefficient. The information of the gender of an audit partner is obtained from LinkedIn.

The second independent variable of interest is political environment. Political environment is used as dummy variable DUMPOLR. The dummy variable has a value of 0, if the audit partner's office is located in a Democratic state, and vice versa. The coefficient of political environment is expected to be negative. Republicans and audit fee are expected to have a negative relation. If the auditor is from a Republican state, the audit fee is expected to be lower.

The third independent variable of interest is DUMGENPOLVR. This variable is the interaction effect between political environment and gender diversity. The expectations are an interaction effect between political environment and gender on audit fee. The interaction effect is measured by multiplying the variable of political environment and gender. The expectations are a greater or lower number as zero in the correlation table. In this case, there is an interaction effect between the political environment and gender on audit fee.

4.2.2 Control Variables

Prior research shows that there are some firm characteristics or auditor characteristics related to the audit fee. To limit omitted variables bias, the regression is controlled by control variables. If the independent variable is influenced by a variable that is not included in the model, there is an omitted variables bias. In this case, there is a change of false results.

Total assets

The balance sheet of the company is an important variable in determining the audit fee. Companies with a bigger size must pay more audit fee compared with smaller companies (Simunic, 1980). It should be rational, because firms with a bigger size take more time and effort. This variable is included to control for firm size. Total assets are representing the whole balance sheet of a company. This variable is expected to be positively related to audit fee. If the total assets of a company are higher, the audit fee is higher.

Employee Amount

Total assets representing the financial firm size of the company. Employee amount also represents the firm size, but the physical firm size of the company. More employees in the company can influence the audit fee. This is also due to the complexity of the company that could be defined by the number of employees (Simunic, 1980). Internal control must be more effective, if the number of employees is higher. Employee amount is expected to be related positively to audit fee.

Segment

Segment is used to define the difference between different segments. Segments can be more complex or less complex compared to other segments (Chan, Ezzamel, & Gwilliam, 1993). Service segments have other important complexities compared with manufacturing or mining firms. Firms with excessive inventory or receivables are more difficult to audit than financial institutions. Differences between audit fees arise from the complexity of particular segments (Hay, Knechel, & Wong, 2006). The amount of audit hours, effort and different testing is influencing the audit fee. This control variable controls for the differences between the segments.

Internal Control Weaknesses

The control environment of every company can be different and influences the audit fee (Hay, Knechel, & Wong, 2006). An auditor spends less hours for a firm with a strong control environment. In this case, auditors can rely more on the internal control data of the company. This variable judges the internal control weaknesses. The variable takes a value between 0 and 6. The variable is 0 for firms without internal control weaknesses, and 6 for firms with a very high extent of internal control weaknesses. Internal control weaknesses influences the audit fee. An auditor must perform more additional tests for a company with a weak internal control that will take time and effort. In conclusion, a firm with a weak internal control, results in a higher audit fee.

Going Concern

Auditors are forced to evaluate a going-concern opinion about their client by SAS No.59 created in 1988 (Holder-Webb & Wilkins, 2000). The issuance of a going-concern opinion must be disclosed if the auditor has any doubts about the continuous existence of the client. In this case, the auditor can give the client a qualified opinion. There are different kind of opinions about an annual report an auditor could provide. The most important opinions are qualified opinions and unqualified opinions (Chow & Rice, 1982). If the auditor gives another opinion than an unqualified opinion, the audit fee is expected to be higher. Another opinion is an indication of audit problems, so it will affect the audit fee. Going-concern opinions can lead to a qualified opinion. Going-concern issues are expected to increase the audit fee.

Return on Assets

Chan, Ezzamel, and Gwilliam (1993) mentioned the profitability of the company that is audited. A proxy for the profitability of a company is return on assets (further: ROA). The ROA reflects the performance of the company. If the company is not financially profitable, so there is a loss, the audit fee is expected to be higher. Less profitable companies are more stressed (Lee, Nagy, & Zimmerman, 2018). Firms with a negative profitability are expected to pay a higher audit fee.

Debt/Equity

Another risk in a company is the leverage. A higher leverage ratio means that there is an increase in debt compared with equity. This increases the risk of a company. Prior literature expect that there is an increase in the audit fee if the leverage is higher (Gist, 1994). The

leverage is measured by debt/equity ratio. The expectations are in line with Gist (1994), higher leverage ratio raises the audit fee.

Current ratio

Current ratio is used to measure the short-term leverage of a company (Hay, Knechel, & Wong, 2006). If the current ratio of the company is more than 1, the company can pay the current debt within one year. A low current ratio suggests that a company could have trouble with paying the current debt within a year. This could be a factor measuring the audit fee and leverage. The expectation is that a higher current ratio results in a lower audit fee. In this case, the company is more liquid.

Fiscal Year-end

The timing of the audit influence the audit fee of the companies (Hay, Knechel, & Wong, 2006). There are more companies requesting for auditors, so the price is higher. For most of the audit companies, the 'busy season' is from 31 December till 31 March. In this season, most of the companies have their fiscal year-end, so there is an increasing demand of auditors. The busy season can increase the audit fee based on supply and demand of the clients of auditors. The audit fee is lower if the fiscal year-end is in October, because it is less busy for auditors in this period. Fiscal year-end is used as a dummy variable. The variable takes 1 for firms with a fiscal year-end during the busy season, and vice versa. The audit fee is expected to be higher during the busy season.

Big4

Higher audit quality increases the audit fee. The most commonly used proxy for audit quality is a dummy variable of the big four audit companies. In prior research there are mixed results about the audit quality. A bigger office has a higher audit quality, because of the greater in-house experience in the office (Francis & Yu, 2009). Lawrence, Minutti-Meza, and Zhang (2011) did also research to the difference between big four and non-big four audit companies. They used discretionary accruals, cost-of-equity capital, and analyst forecast accuracy as proxies for the quality. There is no significant difference between the big four and non-big four companies. The big four companies do not provide a better audit quality in this case (Lawrence, Minutti-Meza, & Zhang, 2011). PriceWaterhouseCoopers (PWC), KPMG, Deloitte, and Ernst & Young (EY) are the current big four audit companies. Hay, Knechel, and Wong (2006) confirm, in contradiction with Lawrence, Minutti-Meza, and Zhang (2011), with the meta-

analysis that auditor quality is strongly associated with higher audit fees. As company you must pay a higher audit fee for big four firms. Expectations are in line with Hay, Knechel, and Wong (2006) big four companies increase the audit fee.

Average Stock Price

Stock price is one of the most important numbers of a company and shareholders. The stock price evaluates the market value of the company (Chambers & Penman, 1984). If investors expect a profitable period, the stocks are popular, and the stock price increases. If the stock price reflects a bad period in the future, the stock price decreases. Companies with higher stock prices are more profitable by good financial transparency. It is more valuable to show the investors the future perspective of the company. So, the expectation of stock price is, when the stock price is higher, the audit fee is also higher.

Auditor Opinion

The opinion of the auditor could be important for a partner to negotiate about the audit fee. The auditor could rate the company from 0 to 2. If the value of the variable is 0, there is no auditor report available. If the value of the variable is 1, the auditor reported that there are no material weaknesses in the annual report. At last, the value 2 is an adverse opinion of the auditor. In this case there exist material weaknesses in the annual report. If there are material weaknesses in the report the auditor must do more additional testing. In this case they must put more effort in the audit and the audit fee is expected to be higher.

4.3 Sample Selection

Table 1 shows the selection as well as the description of the sample used in this study. This study is focused on 2017, because of the information availability. Auditor information is available since 2017. Because of the missing information, there is a total drop of 22,409 observations.

The sample consist of 446 firms in the United States in 2017. Most of the data is lost by merging the databases. Using the PCAOB database, all the information about the partners and auditors is found. Company information is found in the Compustat, AuditorSearch and AuditAnalytics database.

Panel A of table 1 shows the sample selection process. AuditorSearch PCAOB database consists of the most observations, the sample selections started from this database. After merging all the databases together, the final number of observations is 446. All the data of the test were from 2017, so a time panel is not created. Furthermore, panel B is created to show the distribution of the firms over the industries. The table is classified by the 2-digit SIC code. Financial institutions could lead to biased result, so they are left out of the tables and observations. Most of the observations are in the manufacturing industries, were the mining industries have the smallest observation percentage.

TABLE 2 – Sample description

Panel A. Sample Selection

Number of observations with complete Auditor name data available from Auditor Search PCAOB database	22,855
Number of observations lost due to merging with Compustat dataset	(3,270)
Number of observations lost due to merging with AuditAnalytics dataset	(9,170)
Number of observations lost due to merging with AuditAnalytics dataset	(6,562)
Number of observations lost due to merging with AuditAnalytics dataset	(2,219)
Number of observations lost due to merging with AuditAnalytics dataset	(824)
Number of observations left after merging all datasets	810
Number of observations dropped due to missing data	(344)
Number of observations dropped due to being financial institutions (SIC >5999 & <6800)	(5)
Number of observations dropped after winsorizing because of missing data	(15)
Total number of observations dropped	(22,409)
Final number of observations	446

Panel B. Industrial Distribution

Two-digit SIC	Industry Title	N	% of Total
10-15	Mining	5	1,12%
15-18	Construction	7	1,57%
20-39	Manufacturing	223	50,00%
40-49	Transportation & Public utilities	10	2,24%
50-51	Wholesale Trade	25	5,61%
52-59	Retail Trade	111	24,89%
70-89	Services	65	14,57%
Total		446	100,00%

5. Results

In this section of the study, the findings of empirical research are described. Descriptive statistics and correlation statistics are explained at first. The hypotheses that are developed in chapter 3 are answered and discussed by the results. At last the answers and results are compared to comparable prior research.

5.1 Descriptive statistics

Table 2, panel A shows the descriptive statistics of the variables that are used in this study. The first variable is audit fee. The mean of the natural logarithm of audit fee is between 13,875 and the median is 13,989. The first variable of interest is a dummy variable about the gender diversity. The mean of this variable is 0,202, this means that an average of 20 percent of the partners is a women. The second variable of interest is a dummy variable of political environment. The mean of this variable is 0,41, so less than a half of the partners has a Republican environment. At last the third variable of interest is the dummy variable of the interaction between gender and political environment. This variable has a mean of 0,087, so there is a chance of 8,7% that a partner is female and Republican.

Secondly, the control variables are explained in more detail. The first control variable is the dummy variable of the fiscal year end. If the fiscal year end is 1, it is a busy auditor season (January, February, and March). The mean is 0,491, so nearly 220 companies out of the 446 have their fiscal year end in the busy season. The second variable is about the total assets of the company. This variable shows a large variation in the logarithm, with a mean of 20,434 and standard deviation of 2,277. This can be explained by the wide range. The third control variable is the going concern dummy with a mean of 0,034, so 3,4% of the observations have a going

concern opinion. The fourth control variable is about the internal control weaknesses. The companies are rated by 0-6 (0 if internal control is effective till 6 if internal control is very weak), with a mean of 0,161 for this variable. So, most of the internal control systems are reliable in this study. The next variable is the variable about the big 4 offices. In this study 71,5% of the auditors is from a big 4 office. Furthermore, the next variable is about the return on assets (ROA) of a company. The mean of this variable is -0,021, so the mean is negative. In average more companies have a loss instead of a profit. The next variable is the current ratio. The mean is 2,554, so the average of the companies has 2,5 times more current assets compared to current liabilities. Debt/Equity is the next variable in the descriptive statistics. The mean of this variable is 0,955, so the average of the companies has more equity compared to debt. Further the control variable about employees' amount is explained in the table. The mean of the natural logarithm of this variable is 7,994. At last the opinion of the auditor is a variable in this study. The mean of this variable is 0,832, so most of the companies have no auditor opinion or no material weaknesses.

Table 3. Descriptive statistics

Panel A. Statistics

Variable	Mean	Standard Deviation	Min	p25	p50	p75	Max
AUDIT_FEES	13,875	1,309	9,350	13,063	13,989	14,724	17,397
DUMFYR	0,491	0,500	0	0	0	1	1
AT_N	20,434	2,277	12,825	19,083	20,546	21,870	26,651
AVG_PR	3,055	1,266	-1,446	2,197	3,271	4,013	6,471
GOING_CONCERN	0,034	0,180	0	0	0	0	1
COUNT_WEAK	0,161	0,640	0	0	0	0	6
DUMGENV	0,202	0,402	0	0	0	0	1
DUMPOLR	0,408	0,492	0	0	0	1	1
DUMGENPOLVR	0,087	0,283	0	0	0	0	1
BIG4	0,715	0,452	0	0	1	1	1
ROA	-0,021	0,284	-1,942	-0	0,032	0,082	0,311
CUR_RATIO	2,554	2,380	0,001	1,205	1,857	2,989	12,952
DEBT_EQUITY	0,955	5,981	-45,251	0,472	0,889	1,800	19,028
EMP_N	7,994	2,364	1,386	6,565	8,267	9,488	13,015
AUOPIC	0,832	0,465	0	1	1	1	2

This table consist of 466 firm year observations. AUDIT_FEES is the fee that companies must pay for the audit services. DUMFYR is the dummy variable for the fiscal yearend of companies. AT_N shows the total assets of the companies. The stock prices are shown with AVG_PR in this table. GOING_CONCERN is a dummy variable for the going concern report of a company. COUNT_WEAK is measuring the internal control of the company. DUMGENV is a dummy variable for gender and DUMPOLR is a dummy variable for political background. ROA is return on assets of the company measured by dividing net income by

total assets. CUR_RATIO is a percentage of dividing current assets by current liabilities. DEBT_EQUITY is the percentage of dividing debt by equity. EMP_N reflects al the working employees in the company. At last AUOPIC is the auditor opinion about the company.

Panel B. Correlation matrix

	AUDIT_FEES	DUMFYR	AT_N	AVG_PR	GOING_CONCERN	COUNT_WEAK	DUMGENV
DUMFYR	0,091						
AT_N	0,868***	0,098*					
AVG_PR	0,573***	0,033	0,680***				
GOING_CONCERN	-0,251***	-0,010	-0,320***	-0,279***			
COUNT_WEAK	-0,127**	0,012	-0,189***	-0,113*	0,147**		
DUMGENV	0,063	0,030	0,042	-0,021	-0,063	0,004	
DUMPOLR	0,003	0,045	0,042	0,041	-0,079	-0,002	0,027
DUMGENPOLVR	0,064	0,092	0,070	0,012	-0,058	-0,053	0,616***
BIG4	0,635***	0,100*	0,630***	0,473***	-0,187***	-0,161***	0,081
ROA	0,292***	0,008	0,423***	0,418***	-0,668***	-0,174***	-0,017
CUR_RATIO	-0,249***	0,022	-0,222***	-0,089	-0,005	0,048	-0,090
DEBT_EQUITY	0,081	0,050	0,098*	-0,006	-0,172***	-0,008	0,030
EMP_N	0,744***	0,128**	0,858***	0,589***	-0,352***	-0,181***	-0,107*
AUOPIC	0,540***	0,105*	0,554***	0,470***	-0,307***	0,069	0,014

Continues...

	DUMPOLR	DUMGENPOLVR	BIG4	ROA	CUR_RATIO	DEBT_EQUITY	EMP_N
DUMPOLR							
DUMGENPOLVR	0,374***						
BIG4	0,074	0,090					
ROA	0,117*	0,077	0,238***				
CUR_RATIO	-0,048	-0,091	-0,167***	0,033			
DEBT_EQUITY	0,018	0,026	0,048	0,023	-0,050		
EMP_N	0,095	0,129**	0,590***	0,450***	-0,340***	0,094*	
AUOPIC	0,044	0,027	0,458***	0,333***	-0,056	0,034	0,520***

The Pearson coefficients among the variables are shown by panel B of table 2. The dummy variable gender is positively correlated with audit fee, as expected. Dummy variable politics is also positively correlated, which was not expected. Both variables are not significant, so they have no significant effect on audit fee. At last the variable about the interaction effect between gender and political environment is measured. The hypothesis stated that there is an interaction effect between those two variables. In the correlation table there is an effect of 0,064, so the effect is small, but there is an interaction effect between the two variables on audit fee.

The second part is checking on multicollinearity. Other variables could be strongly correlated with each other. Variables that have a -1 or 1 in the correlation table are strongly correlated and could influence the results. The correlation table, panel B of table 2, shows that there is no correlation above 0,7. In conclusion, there are no multicollinearity problems in this study.

To minimize the chance of a biased result in this study, some of the data is winsorized at the 1% and 99% level to deal with outliers. The top and bottom 1% of the data set gets the value of the 99% and 1% respectively. The variable AUDIT_FEES, AT_N, AVG_PR, ROA, CUR_RATIO, DEBT_EQUITY, and EMP_N are winsorized.

5.2 Main results

The first hypothesis is about partner gender diversity affecting audit fee. The audit fee increases if the partner is a female. The correlation found in Panel B of Table 2 is in line with our expectations. Table 4, column 2 shows a regression model that is used to test the relation between audit fee and partner gender diversity. If the partner of the engagement is a female, the audit fee is higher. The results in the regression are not significant in column 2. This means that the effect of gender diversity has no significant effect on audit fee. The results are in line with prior research. A possible explanation could be that the characteristic differences between female and male partners have no significant effect on audit fee. Column 4 shows a different result as column 2. The variable DUMGENV increase from 0,030 to 0,109. The relation between audit fee and dummy variable of partner gender diversity is still positive. The variable is in column 4 not significant. The correlation table shows a correlation of 0,26 between DUMGENV and DUMPOLR and a correlation of 0,616 between DUMGENV and DUMGENPOLVR. The variable influences each other, but gender diversity has no significant effect if everything is included. A possible explanation could be that political background filters

the characteristics of women and men. The different characteristics between female and male partners still have no significant effect on audit fee. The results of column 2 and 4 do not support the first hypothesis. There are no significant results to support the conclusion that female partners are more conservative and take more time for testing. A possible explanation could be that female partners are working slower and take less risk during the audit. This could be compensated by male managers or senior managers during the same engagement. Another explanation could be that the profit of an engagement is lower with female partners. The audit fee is significantly the same, but female partners put more effort in it. The costs are higher, so the profit is lower.

The second hypothesis is about the political environment of the partner. If the partner has a Republican environment, the audit fee is expected to be lower. The regression shows us in table 4, column 3, a negative relation between political environment and audit fee. Engagements with Republican partners have a 0,010 lower audit fee compared to Democratic audit partners. Political environment has no significant effect on audit fee. Column 4 shows a different result as column 3. The variable DUMPOLR increases from -0,010 to 0,027. There can be several reasons why both have no significant effect on audit fee. In the second column, the value is in line with the expectations. Republicans are stated in less urbanized states. The busyness of the auditors could be less, so the audit fee is lower. The fourth column is not in line with the expectations. A possible reason could be that Democratic people are more risk-taking compared to Republican people. This could have a higher valuation for the partners and auditors, so in most of the cases democratic partners take more risk. Another explanation could be that Government support has a negative effect on audit fee. Auditors are independent and need more time and extra testing to give reasonable assurance about financial statements in Republican areas.

In the fourth column of table 4 the interaction effect between gender diversity and political environment is added. The variable of interest is DUMGENPOLVR in this regression. The results of the regression are interesting. The variable of DUMGENV and DUMGENPOLR are increasing in this regression, but the variable DUMGENPOLVR is a negative amount. So, if the partner is female or has a Republican environment, the audit fee is higher. If the auditor is female and has a Republican environment, the interaction effect will lower the audit fee. Republican environment and female gender together weaken the effect on audit fee. DUMGENV separately has a positive effect on audit fee, but as interaction variable a negative

effect. An explanation for this could be that female partners are risk averse and Republicans are also risk averse. In this case, both are taking less risk in the audit. If the variable strengthen each other, the audit fee could increase too much. The audit fee must be realistic for the companies. A combination of Republicans and female partners must take more risk during the audit. If there is more risk, the audit fee decreases. So, there is a small interaction effect between gender diversity and political environment on audit fee, seen earlier in the correlation table. The effect is not significant and negative on audit fee in table 4, column 4.

Secondly, the control variables are discussed. First, the control variable total assets shows a positively and significant effect on audit fee. In table 4, column 1, 2, 3 and 4 the variable has a 1% significance level. Corresponding theory suggests that companies with a bigger size have a higher audit fee. Companies with a bigger size need more effort and testing, so the audit fee increases. The variable BIG4 also shows a positive and significant effect on audit fee. The variable has a 1% significance level in all the columns of table 4. BIG4 companies have more resources and more in-house experience. BIG4 is used as proxy variable for the audit quality of an audit. If the engagement increases in quality, the audit fee increases in amount also. Current ratio shows a significantly negative effect. The variable has a 1% significance level in all the columns. In this case, a higher current ratio is a lower leverage on the short term. Audit fee decreases, because the audit needs less effort and no additional testing. Return on Assets has a negative relation with audit fee and has a 1% significance level in all the columns. In this case, if the company is more profitable, the audit fee is lower. At last, the value of auditor opinion is positive and significant. The variable has a 5% significance level in the first and second columns of table 4 and a 10% significance level in the third and fourth column. If the audit report shows material mistakes, the audit fee is higher, and the audit needs more effort and additional testing.

Finally, some other, although insignificant, interesting results are discussed. Going concern has a negative relation with audit fee. This is interesting, because if a company has a going concern report, an increase in audit fee is expected. An audit needs more additional testing if the company shows a going concern report. The variable COUNT_WEAK shows interesting variable also. A positive relation with audit fee is expected, but it shows a negative relation in all the columns of table 4. If the internal control of the company is weaker, the audit fee is lower. Also, the outcome of the variable DEBT_EQUITY is interesting. If the long-term leverage of the company is higher, the audit fee decreases.

Table 4. Regression results

Sample consist of 446 firm year observations. DUMFYR is the dummy variable for the fiscal yearend of companies. AT_N shows the total assets of the companies. The stock prices are shown with AVG_PR in this table. GOING_CONCERN is a dummy variable for the going concern report of a company. COUNT_WEAK is measuring the internal control of the company. DUMGENV is a dummy variable for gender and DUMPOLR is a dummy variable for political background. ROA is return on assets of the company measured by dividing net income by total assets. CUR_RATIO is a percentage of dividing current assets by current liabilities. DEBT_EQUITY is the percentage of dividing debt by equity. EMP_N reflects al the working employees in the company. At last AUOPIC is the auditor opinion about the company.

$$Audit\ Fee = \beta 0 + \beta 1\ DUMFYR + \beta 2\ AT\_N + \beta 3\ AVG\_PR + \beta 4\ GOING\_CONCERN + \beta 5\ COUNT\_WEAK + \beta 6\ BIG4 + \beta 7\ ROA + \beta 8\ CUR\_RATIO + \beta 9\ DEBT\_EQUITY + \beta 10\ EMP\_N + \beta 11\ AUOPIC + \beta 12\ DUMGENV + \beta 13\ DUMPOLR + \beta 14\ DUMGENPOLVR + Industry\ Effects + \varepsilon$$

VARIABLES	Column (1) Audit Fee	Column (2) Audit Fee	Column (3) Audit Fee	Column (4) Audit Fee
DUMFYR	0,058	0,059	0,057	0,068
	(0,772)	(0,812)	(0,771)	(0,956)
AT_N	0,489***	0,489***	0,488***	0,488***
	(10,43)	(10,41)	(10,26)	(10,33)
AVG_PR	-0,071	-0,070	-0,070	-0,072
	(-1,632)	(-1,618)	(-1,631)	(-1,650)
GOING_CONCERN	-0,092	-0,083	-0,093	-0,060
	(-0,632)	(-0,553)	(-0,634)	(-0,389)
COUNT_WEAK	-0,010	-0,010	-0,010	-0,012
	(-0,153)	(-0,159)	(-0,151)	(-0,186)
BIG4	0,398***	0,397***	0,400***	0,399***
	(4,043)	(4,045)	(4,027)	(3,963)
ROA	-0,466***	-0,461***	-0,463***	-0,439***
	(-3,118)	(-3,062)	(-3,125)	(-2,957)
CUR_RATIO	-0,036***	-0,036***	-0,036***	-0,037***
	(-4,314)	(-4,144)	(-4,300)	(-4,255)
DEBT_EQUITY	-0,001	-0,001	-0,001	-0.001
	(-0,163)	(-0,169)	(-0,167)	(-0,169)
EMP_N	0,002	0,001	0,003	0,003
	(0,050)	(0,030)	(0,053)	(0,065)
AUOPIC	0,170**	0,173**	0,170*	0,174*
	(2,027)	(2,020)	(2,016)	(1,979)
DUMGENV		0,030		0,109
		(0,373)		(1,087)
DUMPOLR			-0,010	0,027
			(-0,157)	(0,343)
DUMGENPOLVR				-0,182
				(-1,44)
Constant	3,716***	3,709***	3,728***	3,710***

	(7,373)	(7,313)	(7,112)	(6,977)
Industry FE	Yes	Yes	Yes	Yes
Obs	446	446	446	446
R-squared	0,793	0,794	0,794	0,794

Robust t-statistics in parentheses
*, **, *** indicate significance of the coefficients at 10%, 5% and 1% confidence level, respectively.

6. Conclusion

The purpose of this study is to investigate the relation between gender diversity, political environment and audit fee. Audit fee is not a fixed amount, so the partner and company must negotiate over the audit fee. Audit fee depends on the partner, audit firm, but also the company. Prior research taught us about the composition of the audit fee. In the United States of America, prior research never considered political environment as a variable. It also never considered political environment with interaction effect of gender as variable. This study could be an interesting for partners, companies and researchers.

Audit fee influences almost all business branches. Existing literature investigated different determinants which could influences audit fee. Political environment is in prior research never considered as a variable in the United States of America. Gender diversity is already investigated in different studies. Prior research shows that if the audit partner is female, the audit fee increases. This research also investigates the interaction effect of audit partner diversity and political environment. Therefore, this study adds value to the existing literature.

The sample used in this study consists of all the available data in the AuditorSearch, AuditAnalytics and Compustat databases. The study is limited to one year, because of a new regulation. Since 2017 auditors are forced to sign the annual report with their own name and signature. The partner's name is needed to find the gender of the auditor. To measure the political environment, the partner's home office is used.

In line with hypothesis 1, female partners effect the audit fee positively. The audit fee increases as the partner is female. Gender effects audit fee positively, but the effect is not significant. This means that gender has no significant effect on audit fee. The outcome is in line with the

expectations of this study, so the explanation of this outcome could be in line with the predictions. If political environment and the interaction between political environment and gender diversity is added as a variable, the effect is different. The variable DUMGENV still shows a positive effect on audit fee, but the value increased. A possible explanation could be that political environment splits some characteristic qualities of the partners. So, the qualities that effect audit fee, are stronger if DUMPOLR is added to the regression. There is no evidence that female partners increase the audit fee. The first hypothesis of this study is rejected. The second hypothesis is rejected. The effect of a Republican environment on the audit fee is in line with the expectations, but the effect is not significant. The outcome is in line with the expectations, so also in line with the predictions. If the variable DUMGENV and DUMGENPOLVR are added to the regression, DUMPOLR is positive. A possible explanation for this conflicting result could be the risk attitude of Democratic audit partners. Democratic audit partners take more risk, so the audit fee is lower. Another explanation could be that the change of earnings management is higher in the Republican states. The Republican states have more support of the Government. Engagements in these states could cost more effort and more additional testing, so the audit fee is higher. At last the outcome of hypothesis three is not in line with the expectations. The interaction between gender diversity and political environment weaken the separate effects of gender diversity and political environment. The interaction effect between gender and political environment on audit fee is not significant. A possible explanation could be that both variables are risk averse. If both take more time for an audit, the audit fee could be too high for companies. The third hypothesis is also rejected. To the best of my knowledge, there is no prior research available to compare the results of hypotheses two and three.

The purpose of this study is to investigate to the relation between gender diversity, political background and audit fee. The conclusion is that female partners do not increase the audit fee significantly. This conclusion stays true if political environment is added to the regression. Political environment and the interaction effect between political environment and gender diversity have no significant effect on audit fee. A company can choose a Democratic or Republican, female or male partner, without significant differences in the audit fee.

The first limitation is the time frame of this study. The partner data is available for public since 2017. In the future it could be interesting to do the same research over a larger time frame. Also because of the time limitations, it is impossible to look to the effect if a majority in the state

voted Democratic prior election and Republican in last election. It would be interesting if there is a political turn in states or in the whole US. there is a lot of information missing in the databases. Out of the 22.000 entries in the dataset, only 446 remain for the specific use of this study. In the future it would be interesting to use more companies or use better databases. The results could be affected by a larger dataset. Lastly, this study investigates to the political environment of the audit partner. In a further study it would be interesting to investigate the political background of the partner. A state where the majority voted for the Republican does not guarantee that a partner is also Republican.

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