

Internship report

On

**The dominating factors in deciding Audit Fees
in Bangladesh**



Inspiring Excellence

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in Bangladesh**

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Letter of Transmittal

Date: 8th May 2019

Mr. Riyashad Ahmed
Assistant Professor
BRAC Business School
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Subject: **Submission of internship report**

Dear Sir,

I am delighted to submit my internship report on “The dominating factors in deciding Audit Fees in Bangladesh” which is the last requirement for completing my Bachelors of Business Administration degree. For internship purpose, I worked as an audit assistant at Rahman Rahman Huq Chartered Accountants (KPMG Bangladesh).

During the three months, I worked under supervision of senior colleagues and auditors. I gained experience and learned how this industry works. I, along with a team of few auditors were allocated to audit SML Packaging Solutions and SML Trims Bangladesh Limited. I got to observe my seniors performing audit tasks and making reports on their observations. I worked with real documents including sales invoices, purchase orders, delivery challans etc.

My paper focuses on the audit fee structure and practices in Bangladesh and I have tried to bring down some factors that may affect the determination of audit fees. I have carried out regression analysis and analysis with graphs and charts to determine them. It took tremendous effort to conduct the research which is why I hope it satisfies you.

Sincerely,

Kaniz Sakina
ID: 15104093
BRAC Business School
BRAC University

Acknowledgement

I would like to express my gratitude towards the people without who this report would not be in its finest form. Firstly, thanks to Mr. Riyashad Ahmed, Assistant Professor and my internship supervisor of BRAC University who constantly supported me along the internship journey. He inspired me to choose a research worthy topic for my report and taught me approaches to work on it. I want to thank my manager Mr. Aatur Rahman, ACA in my organization who allocated me to a client company named SML Packaging Solutions Ltd from second week of internship so I can gain practical experience. Special thanks to Mr. Amir Hossain who has been my direct supervisor in that client company. He along with the team taught me how to work, familiarized me with documents and has been constant guide.

Executive Summary

For the service of statutory audit, all accountancy firms charge a fee that will cover all necessary costs and leave a profit for the firm. This report intends to narrow down the most dominating factors that are kept in mind while deciding the audit fees for an audit. A thorough research was done to determine the factors since these factors are never openly disclosed by firms. A literature review was done to understand some of the factors that were previously thought to be determining factors. Following those factors, data were collected and tested for their dependency. With the help of secondary data, these factors were tested with regression and other quantitative measures. This paper has worked with six factors, among which three proved to have an impact on the audit fees whereas the other three didn't. The paper is concluded with the findings and references to researched articles.

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Organizational overview

Rahman Rahman Huq (RRH) is a partnership firm of Chartered Accountants that was established in 1962 by Mr. Rezaur Rahman, Mr. M. Saifur Rahman and Mr. T. I. Huq. RRH is the Member Firm of KPMG International and has a professional association with nearly all major multinationals in Bangladesh, and several large local businesses. It is also known as KPMG Bangladesh and has been operating in Bangladesh over 50 years. It is a firm which trains and educates chartered accountancy students and prepares them for working in a professional manner. KPMG Bangladesh professionals achieve the very high professional standards and quality control required by global KPMG offices including USA, UK and Qatar. As a result, KPMG Bangladesh professionals are getting jobs in those overseas KPMG offices.

Rahman Rahman Huq is now currently under three partners:

- 1) Adeeb H. Khan – Senior Partner
- 2) Ali Ashfaq – Partner
- 3) Mehedi Hasan – Partner

RRH provides three services to its clients, and it is aligned with KPMG International, they are:

- 1) Audit – This refers to the statutory audit of financial statements of clients both annually or interim period. The main concern in this service is the independence of decisions. Before starting any audit, the employees of RRH, the partner and managers engaged in the audit of that client are entitled to sign papers ensuring independence of appearance and decisions. During this service, RRH uses a particular software named E-audit. E-audit is a software that works like a storage of information and reports that the employees have worked upon. After completion of audit, all the reports are uploaded in E-audit, to which the senior managers and partners have access to. The reports are cross checked and evaluated for accuracy and then annual reports of the client are published on behalf of the firm.
- 2) Tax & Corporate services - KPMG International maintains a comprehensive and solid [Global Code of Conduct](#) that is publicly available which sets the ethical standards for everyone in KPMG member firm network. For ethical tax practice and behavior, Tax professionals are also bounded by principles. As both tax authorities and the public

examines the tax strategies of multinationals and domestic companies, KPMG works with their clients to develop tax strategies that are fit for purpose in the tax system.

- 3) Advisory – In middle of the complexity of today’s ever changing market practices KPMG Advisory professionals guide the clients through it. To deal with the world better, smarter, grow faster and compete stronger, KPMG international leverages the skill and knowledge adopted by the whole network and develops recommendations for its’ clients. KPMG has become trusted advisors for the corporate. Corporate managers and decision makers always turn to professionals like RRH for advices because they seek technical expertise, experience wisdom, knowledge from talented employees and industry insights. Advisory services include - Due Diligence, Valuations, Corporate Restructuring and IT services like ERP implementation.

Rationale of study

All products and services are provided in exchange of a value, mostly in money. Prices of these products and services are either fixed or varies within a range. Chartered accountancy is a service that is treated as a high end service for B2B transactions and only availed by registered companies. In exchange of this service, chartered accountancy firms charge a fee that varies according to client. How they charge the fee is highly confidential information which is not available to anyone except the partners and managers. This paper intends to justify the audit fees that is charged against some factors that might affect the fees. The intention of this study is to bring down some qualitative factors that actually affects the audit fee by treating them quantitatively.

Statement of problem

The determining factors for audit fees in Bangladesh are not disclosed therefore this paper provides some factors dominating the decision.

Limitations of the study

- I. Audit fee data is highly confidential and kept privately among partners and managers. A major portion of the employees do not know how the audit fee is fixed, nor do they know how much is charged to the client they are working for. Therefore, all data collected for

his study is secondary and not raw. They are collected from annual reports, the only source they are published in.

- II. The sample size of 40 clients could not be randomly selected. Random selection of audit fee data would also bring various audit firms which would disturb the study since different firms have different tactics of charging fees. Therefore, some manipulation had to be done while selecting the sample, that is, only **top four** audit firms were kept in consideration while choosing the data.
- III. Each factor had to be treated differently because of their own nature. All the factors could not be treated with regression because some factors were just qualitative in nature. Those factors were judged with charts and graphs which also draws a conclusion.
- IV. The top four audit firms utilized for the study usually audits large organizations that are not necessarily a listed company in Bangladesh. An example of such is- Save the Children is audited by Rahman Rahman Huq, but it is not a listed company in Bangladesh making it unavailable for sample. Therefore, this resulted in such small sample size of 40.

Objectives of the report

The main objective of the study is to understand what factors affect the determination of audit fees in Bangladesh. Other than the standards or rules set by Institute of Chartered Accountants of Bangladesh (ICAB), there are some dominating and significant influencing factors that help decide the audit fees to be charged on the client. This paper's objective is to also study the behavior of four different firms in terms of pricing strategy. Furthermore, it aims to be helpful to startup firms in Bangladesh when it decides audit fees to be charged for their service.

Research questions

- What are the dominating factors while deciding the audit fees in Bangladesh?
- Does the factors previously thought to be crucial also affecting the fees in context of Bangladesh?

Literature Review

Many studies have been conducted regarding the determinants of audit fees, as to how the fee that an auditor firm receives is calculated. Researchers carried out a study that learns the trend of audit fees for 14 years and found out that even though nominal fee has been increasing, the real

fee (deducting the effect of inflation) is actually reducing. They also find positive relation of client size and multinationalism with audit fees that is charged by audit firms. They further found that clients in the financial industry and with diverse ownership structure in Bangladesh pays higher audit fees comparatively [1]. A similar study in Hong Kong proves similar result as other studies. The risk associated with client, timing of the audit being carried out, bureaucracy of the audit are also factors in affecting the audit fees found in Hong Kong. They also find the fact of Big Six firms also being a significant factor [2]. Another study in France also lists the factors similar to those mentioned above. However, they bring in new dimension of industry of the client firm being a factor that determines audit fee. Industry is a huge factor as it differentiates each client from one another. A client that is in financial sector will definitely be charged higher than a client in textile industry [3].

An interesting factor in determining external or statutory audit fees is the contribution of internal audit fees, as proven by another study. Internal audit contributions refer to the audit tasks carried inside a client company by internal employees. Internal auditor makes sure their organizational control is strict and creates a bridge between the accounts department and external auditors. The availability or existence of internal auditor and their quality and expertise are huge influencers in determining the contribution of internal auditors [4]. One factor that also might affect the audit fee was the competition and industrial rivalry among audit firms. This was brought into the light by another study in 1991. Since audit firms are themselves organizations hoping to make profit at the end of their service, their own tactics in pricing and their strategies are also an important dominating factor. Popular and affiliated firms (with BIG 4) are more likely to charge higher fees than local ones [5]. The difficulty level of carrying out an audit is a major factor in determining the audit fee, a study in UK says. The complication or difficulty may be in either form- in terms of auditing operations or compiling financial statements. Audit client's location has been considered also as a significant factor. For example, if audit firm needs to send their resource far away from city, then they need to provide accommodations to their resources for conducting such audit and thus audit fee is charged higher [6]. In Bangladesh, ICAB (Institute of Chartered Accountants of Bangladesh) has published a rulebook/ schedule to be followed while determining audit fees. Minimum Audit fees are fixed for manufacturing companies, banks, non-banking financial institutions, insurance, telecom, service sector and different fees for state-

owned companies as well. Therefore, another factor to be considered while determining audit fees is the schedule that is issued by ICAB [7].

Methodology

This paper works only with secondary data, that is, annual reports available of DSE listed companies. Such approach is chosen since audit fee information is highly confidential and sensitive, they are not made available by audit firms, however they are published in annual reports. A sample of 40 companies were chosen for this research and 6 variables were identified as appropriate measures that might determine audit fees in context of Bangladesh. Even though the audit fees published in annual reports are ought to be accurate and true, it might not be completely exact due to many internal reasons (as hinted by my supervisor). The 6 variables had to be treated differently depending on its nature. For some, multiple regression was able to run and for some, explanatory graphs had to be used. Depending on those, the analysis and conclusion were drawn.

Analysis and interpretation

The 6 variables (obtained from literature review) that might affect audit fees in Bangladesh are:

- Client's Size (measured by total assets)
- Client's Profitability (measured by profit after tax)
- Client's Inventory size
- Sector/Industry the client belongs to
- Client's Multinationality
- International link of Audit firm

For the first three variables, regression analysis was able to be conducted, since they have similar data set and nature of variables. The dependent variable (Y) is audit fees whereas, the independent variables are Total asset (X1), Profit after tax (X2) and Average inventory (X3). The regression analysis says whether the independent variables have any effect on the audit fees. The hypotheses are-

H0: The Audit fees have **positive relation** with the variables

H1: The Audit fees have **no or negative relation** with the variables

The results have been-

SUMMARY OUTPUT

<i>Regression Statistics</i>	
Multiple R	0.614222249
R Square	0.377268971
Adjusted R Square	0.322322115
Standard Error	719699.4396
Observations	38

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	3	1.06692E+13	3.5564E+12	6.86607027	0.000971043
Residual	34	1.76109E+13	5.17967E+11		
Total	37	2.82801E+13			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>Lower 95.0%</i>	<i>Upper 95.0%</i>
Intercept	806004.8983	169889.6817	4.744283997	3.67653E-05	460747.5254	1151262.271	460747.5254	1151262.271
Total Assets (x1)	0.000001819	5.7791E-07	3.147881812	0.00341425	6.44738E-07	2.99364E-06	6.44738E-07	2.99364E-06
Profitability (x2)	0.000057438	2.71214E-05	2.117807748	0.041582533	2.32059E-06	0.000112555	2.32059E-06	0.000112555
Avg. Inventory (x3)	-0.000026182	4.00357E-05	-0.653963374	0.517534505	-0.000107544	5.51804E-05	-0.000107544	5.51804E-05

Analysis: R square is 0.377268971 which means 37% of the data variability of audit fees can be explained by the independent variables Total asset (X1), Profit after tax (X2) and Average inventory (X3).

Client's Size

The coefficient for client size was 0.000001819 which means for every 1 unit of change in total asset, the audit fees will change by 0.000001819 units. It is also positive which means they have a **positive relation**, therefore the null hypotheses for variable 1 is correct. If total asset increases/ decreases, the audit fees will increase/decrease accordingly. Another way of reading these results is considering 10%. Any p-value less than 10% means independent variables have significant effect on dependent variable. P-value for variable 1 is 0.00341425 which is less than 10% and therefore it means the total assets has **significant effect** on the audit fees.

Client's Profitability

The coefficient for client profitability was 0.000057438 which means for every 1 unit of change in profit after tax, the audit fees will change by 0.000057438 units. It is also positive which means they have a **positive relation**, therefore the null hypotheses for variable 2 is correct. If profit after tax increases/ decreases, the audit fees will increase/decrease accordingly. Another way of reading these results is considering 10%. Any p-value less than 10% means independent

variables have significant effect on dependent variable. P-value for variable 2 is 0.041582533 which is less than 10% and therefore it means the profit after tax has **significant effect** on the audit fees.

Client's Inventory size

The coefficient for client's inventory size was -0.000026182 which means for every 1 unit of change in average inventory, the audit fees will change by -0.000026182 units, but in the different direction. It is also negative which means they have a **negative relation**, therefore the null hypotheses for variable 3 is wrong and the alternate hypotheses is right. If average inventory increases/ decreases, the audit fees will increase/decrease in the opposite way. Another way of reading these results is considering 10%. Any p-value less than 10% means independent variables have significant effect on dependent variable. P-value for variable 3 is 0.517534505 which is more than 10% and therefore it means the average inventory has **no significant effect** on the audit fees.

Sector/industry the client belongs to

The sample of data can be sorted into 4 different sectors- Financial, Power, Consumer products and Construction. The figure illustrates how the audit fees differ considering the industry the client firm belongs to. The first 3 industries are quite similar since it deals with higher value transactions or valuable products, the last one (construction) is quite different. It is heavy weight product and simpler in kind, and the audit fees reflects such difference. As the graph shows, the first 3 industries pays more or less high and similar audit fees and construction industry pays comparatively low audit fees. The average audit fees paid by companies in construction is only **TK 4,48,485** whereas, other industries average are **TK 1,449,978**, **TK 1,038,000**, **TK 1,069,200** respectively. It clearly proves that which sector the client firm belongs to affect the audit fees and acts as a standard while deciding so.

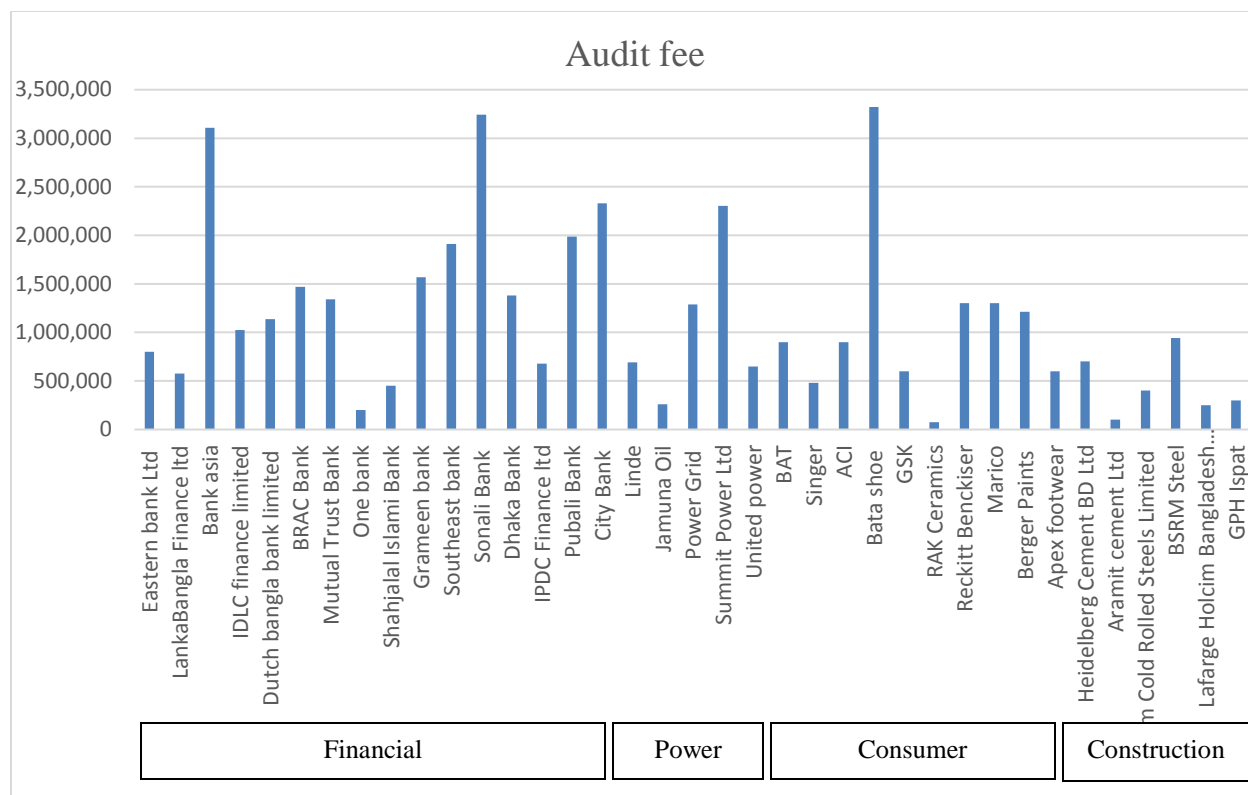


Figure: Audit fees of different companies belonging to different sectors.

Client's Multinationality

This is also an important factor because the audit firm that is auditing the client has to maintain international standards in their work. They have to understand any foreign standards that the client is following as well as the local standards. One example from my experience in my internship was that our client SML Packaging Bangladesh Ltd. was keeping provision for certain losses as per their parent company situated in Hong Kong, which highly violates Bangladesh standards. In such case, the auditors have to work excess in coming into negotiation with management to solve such matter. Furthermore, any multinational client means the auditors has to present their observations to the parent company's auditor at the end of audit session, causing further work and stress. Because of all these reasons, technically a multinational client must pay higher audit fees than any local company.

However, as per my sample, in Bangladesh this factor was found **not very impactful**. There was not many difference between audit fees paid by multinational company and audit fees paid by local firms. Infact, local firms paid higher audit fees than multinational ones. The average audit fees paid by each criteria are:

Multinational clients	TK 1,158,937
Local clients	TK 1,167,896

International link of Audit firm

This paper collected data for top four audit firms in Bangladesh. And as per their own website, their international affiliation is such:

1. Rahman Rahman Huq	KPMG
2. ACNABIN	Baker Tilly
3. A Quasem & Co.	Ernst & Young
4. Hoda Vasi & Co.	No International link

The quality of audit firms is usually judged by the affiliation it has with any international firms, and more preferably, with the BIG 4. The BIG 4 are international audit firms that are considered top most worldwide and any local audit firms having connection with such firms are considered the best in the country. The BIG 4 are- **Deloitte, Ernst & Young, KPMG, Pricewaterhouse Coopers (PwC)**. From my sample, Rahman Rahman Huq and A Quasem has international links with BIG 4 so far.

However, my results suggest that such affiliations **do not affect** the audit fees very much and it is a very insignificant factor to consider. The figure below shows that all the audit fees charged by Rahman Rahman Huq and A Quasem having international links with BIG 4 are not very different or high than those with no links with the BIG 4.

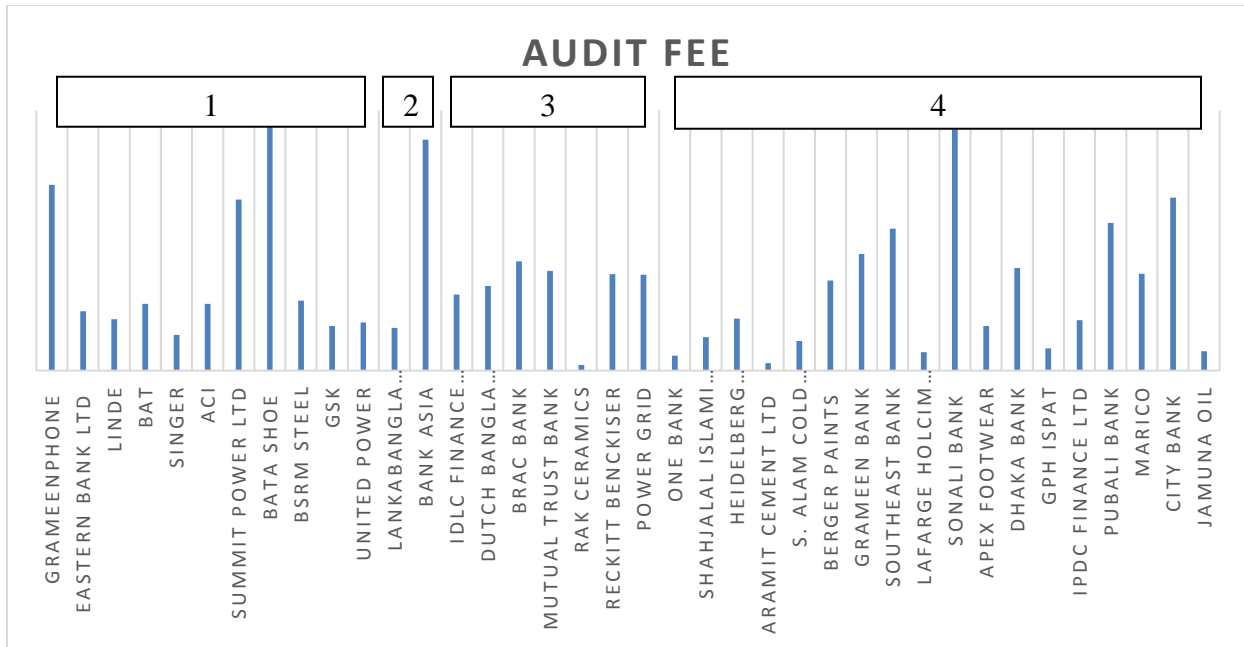


Figure: Audit fees of different companies charged by audit firms with international links.

Findings

- a. Client Size has a **positive** impact in deciding the audit fees.
- b. Client's Profitability has a **positive** impact in deciding the audit fees.
- c. Client's Inventory size has a **negative** impact in deciding the audit fees.
- d. Client's Industry has a **positive** impact in deciding the audit fees.
- e. Client's Multinationality has a **negative** impact in deciding the audit fees.
- f. Audit firm's International link has a **negative** impact in deciding the audit fees.
- g. Audit fee deciding factors are confidential and inaccessible to general public.

Conclusion

After conducting this research, it is clear that what factors are previously thought as to be deciding criteria for audit fees are not all true. Since this is an industry where everything is dealt with high confidentiality, the pricing strategy of this service is also not available. Infact, it is also doubted that the audit fees discharged in annual reports may not be entirely accurate as well. However, even so, some common factors are seen to be influential and therefore they are tested in context of Bangladesh. This research may be further conducted with a larger sample size for more accurate results.

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