

# **Audit Fees and Audit Delays in Politically Connected Firms: Evidence from Bangladesh**

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***Abstract:** The objective of this paper is to investigate the relationship between audit fees, audit delay, and political connections in the context of an emerging economy, namely, Bangladesh. For the purpose of this study, the author uses 576 firm-year observations (2010 to 2015 inclusive) of companies listed in Dhaka Stock Exchange. A number of OLS regression models are used to capture the relationship between audit fees, audit delay and political connections. The results indicate that political connection is significant as an explanatory variable for audit fees for all companies as well as for export oriented companies, but however, there is no evidence of political connections being an explanatory variable for audit delay. Some corporate governance variables and ownership structures are also found to be significant variables for audit fees and audit delay. The analysis appears to suggest that politically connected firms tend to manage the interests of the political power at the expense of other shareholders by managing the earnings in the annual reports, which is likely to affect the firm's risk and require the auditor's extra risk and extra effort and thus more audit fees. The demand for quality audit in export-oriented industries, however, allows auditors to perform a more rigorous audit, and thus charge higher audit fees.*

***Keywords:** Political connections; audit fees; audit delay; emerging market: Bangladesh*

## **1. Introduction**

Political influence on corporations and the existence of political patronage have been well documented in prior literature (Mathuri and Gilbert, 2011; Chapple and Moon, 2007; Prachel and Morris, 2010; Walker and Rea, 2014, Lux et al., 2011; Uddin et al., 2018). Previous research, primarily in the area of management studies and political science, have documented the relationship between political connections and the quality of accounting information, performance of firms, and corporate bailouts of politically connected firms (Ball et al., 2003, Chaney et al., 2011, Bliss et al., 2011, Faccio et al., 2006). It is argued that management in politically connected firms may attempt to manage their earnings in an effort to serve the interests of their political allies, exposing such firms to higher risks. This may affect auditor's assessments of business risk in politically connected firms, resulting in higher audit fees (Gul, 2006). Following this argument, it is also possible that

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auditors in politically connected firms may perform a more rigorous audit in an attempt to allay concerns of the stakeholder groups. This may result in audit delays.

There have been very few studies investigating audit pricing and audit delays in politically connected firms. In a Malaysian context, Gul (2006) provides empirical evidence to support the proposition that auditors perceive greater risk inherent in politically connected firms leading to their performing greater audit effort. This in turn, leads to these firms being charged higher fees. In a more recent study, Aswadi et al. (2011) find that audit fees are significantly higher in politically connected firms in Malaysia, confirming Gul's (2006) prior findings. Matten and Moon (2008) point out that the influence of political affiliation of firms varies in different shapes and forms depending on the institutional, cultural and social settings of the country. Given that both papers examine the relationship between political connections and audit fees in the same institutional context, i.e. that of Malaysia, there is the need for conducting studies in locations where the relationship between politicians and businesses may be different. We aim to explore this research gap in the auditing literature by investigating the relationship between political connections, audit fees and audit delays in a developing economy, namely, Bangladesh.

Bangladesh has made substantial economic progress in the recent past<sup>1</sup>. However, like many other developing economies, the Bangladesh corporate sector is characterised by relatively unsophisticated and inefficient legal and regulatory framework (Farooque et al, 2007), high ownership concentration, weak capital markets, lack of shareholder activism, and poor enforcement and monitoring of regulations (Siddiqui, 2010). Even the public listed companies are primarily family owned or owned by a group of families. On average, the top five shareholders, usually belonging to the same family, hold more than 50 percent of shares in listed public limited companies (Imam and Malik, 2007). As of December 31, 2011, more than 70 percent of the top performing companies on the Dhaka Stock Exchange (DSE) were family-owned firms, making this the dominant form of listed companies in Bangladesh<sup>2</sup>.

In addition, the audit market in Bangladesh is characterised by poor demand for audited financial statements (Ahmed & Goyal, 2005) and poor perceptions regarding audit quality (Sobhan & Werner, 2003). The nature of politics and democracy in Bangladesh also provides a unique opportunity to shed light on the relationship between company management and political regimes (Uddin and Hopper, 2001). The country has a fragile democratic system, and is subject to frequent violent confrontations between two family-led political parties (Uddin and Choudhury 2008).

Recent research (Uddin et al, 2018; Siddiqui and Uddin, 2016) report the existence of a connection between the politicians and the government in Bangladesh, leading to potential abuse of business resources. It is claimed that political identity plays a crucial

role in the process of granting licenses to businesses (Uddin and Hopper, 2003; Kochanek, 2000). In addition, the majority of listed companies are family dominated, exposing minority shareholders to higher risks of appropriation (Khan et al., 2015). Also, conditions such as under-developed democratic institutions, poverty, family ownership, lack of institutional investors, and weak capital markets in Bangladesh are well noted in the literature (Uddin and Choudhury, 2008).

The presence of such attributes makes developing economies such as Bangladesh an interesting research site. The lack of institutional arrangements to protect the interest of shareholders make developing countries like Bangladesh, more susceptible to the expropriation effect, where the company management only works for the interest of the majority shareholders (Young et al., 2008). Also, whereas the market for corporate control deemed to be the governance mechanism of last resort in developed economies, it tends to be typically inactive in emerging economies (Peng, 2006), creating more scope for expropriation. We argue that the unique institutional context in Bangladesh, characterized by the presence of a buyer's audit market, political patronage of businesses, and poor legal protection for the investors make it an interesting site for studying the relationship between political connections, audit fees and audit delay.

Using data of 576 firm year observations from 2010 to 2015 inclusive of listed companies in Dhaka Stock Exchange, this paper investigates the association of political connections of firms with audit fees and audit report lag/audit delay. Results indicate that political connection is a positively significant variable for audit fees, but it is not found to be an explanatory variable for audit delay. The corporate governance variables and ownership structure variables are controlled in the study. Corporate governance mechanism is presumed to minimize/ mitigate the negative concerns of being politically connected. The ownership structure variables are controlled to understand the impact of other stakeholders with audit fees and audit delay. However, for export oriented companies, political connections is positively significant to audit fees, perhaps to allay the concerns of the foreign buyers, who are deemed to the most important stakeholder groups. (Islam and Deegan, 2008). At the same time, there is no evidence of political connections being an explanatory variable for audit delay in export-oriented industries. This indicates that political influences are not significant in the companies involved in export-oriented industries. This also supports the previous studies (Islam and Deegan, 2008; Khan et al., 2013, Khan et al., 2015), which identify the most important stakeholders (i.e. the foreign buyers) in export-oriented companies and their role in financial reporting quality.

The rest of the paper is organized as follows: section 2 reviews the literature on audit fees, audit delay and political connections, followed by a discussion on the institutional context, leading to development of four hypotheses. Section 3 describes the methodology, specifies the model, and variables to test the hypotheses. Section 4 reports and discusses

the results. Section 5 concludes by summarizing the findings and discussing the implications.

## **2. Literature Review, Institutional Context and Hypothesis Development**

### **1. *Audit fees and audit delay in emerging economies***

A number of studies focus on identifying the determinants of audit fees in emerging economies (for example, Simon et al., 1986) which investigate the determinants of audit fees in India; Simon et al., (1992) performed a comparative study of audit markets in Hong Kong, Malaysia and Singapore; Simon and Taylor (1998) studied determinants of audit fees in Pakistan. Karim and Moizer (1996) investigated the determinants of audit fees in Bangladesh. The study indicated that auditee size had the greatest influence on audit fees in Bangladesh. Significant relationships were also found for Big<sup>4</sup> audit firms, companies operating in the banking sector and auditee profitability. Ahmed and Hussain (2000) studied the effect of growth opportunities on audit fees. Their results show that the experimental variables, growth opportunities and managerial ownership have incremental power in explaining variation in audit fees. Ahmed and Goyal (2005) compared the determinants of audit fees in three emerging audit markets: Bangladesh, India and Pakistan. For Bangladesh, auditee size, multinational affiliation and auditor size was found to be significantly related to audit fees. A very recent study on audit fees, auditor choice and stakeholder influence by Khan et al., (2015) explores the audit fees and auditor choice in a family dominated economy like Bangladesh. Their results indicate that the family owned listed companies in Bangladesh pay significantly lower audit fees than non family owned firms and are less interested in hiring higher quality auditors.

Audit delay is generally defined as the lag between the end of the accounting period and the date of audit report (see for example, Newton and Ashton, 1989; Carslaw and Caplan, 1991, and Davies and Whittred, 1980). This length is considered to be important due to the timeliness attribute of financial reporting. Givoy and Palmon (1982) regard the length of audit as the single most important factor for earnings announcements. Bamber, et al., (1993) found that audit report lag was an increasing function of factors affecting the audit work, which related to auditor business risk (proxied by concentration of client ownership and client's financial condition), audit complexity (proxied by client industry), and other work-related factors (proxied by extraordinary items, net losses, and qualified audit opinions). Wallace (1993) acknowledged that in emerging economies, provision for timely information in the annual reports is even more important, due to the non-availability of other sources of information such as media releases, news conferences and reports of financial analysts, and also because of poor monitoring by regulatory bodies, compared to their counterparts in the developed economies. However, like audit fee research, studies investigating audit delays were mainly conducted in the context of developed economies with a few exceptions.

Ahmed (2003) conducted a comparative study on the timeliness of corporate financial reporting in South Asia, namely Bangladesh, Pakistan and India. Using a multivariate regression analysis, he reported that the financial year to date is a significant determinant in each country. The size of the audit firm, as measured by the factor loading of audit fees, number of reporting entity audited by an audit firm and international linkage, indicating large audit firms take significantly less time in India and Pakistan. Profitability and corporate size are significant determinants only in Pakistan (Ahmed, 2003).

## 2. Prior research using Political Connection as a context

Corporate political connections play an important role in many of the world's largest and most important economies (Fisman, 2001). Prior literature primarily in the area of management studies and political science, has examined the relationship between political connections and quality of accounting information (Ball et al., 2003, Chaney et al., 2011), corporate bailouts for politically-connected firms (Faccio et al., 2006), examination on performance of politically connected firms (Johnson and Mitton, 2003, Leuz and Oberholzer-Gee, 2006, Bliss et al., 2011) and political favoritism in relation to access to finance (Faccio 2006) and value of such connection (Fisman, 2001).

Faccio (2006: 369) defined politically connected companies ...

*“...whereby a company is identified as being connected with a politician if at least one of its large shareholders (anyone controlling at least 10% of voting shares) or one of its top officers (CEO, president, vice-president, chairman, or secretary) is a member of parliament, a minister, or is closely related to a top politician or party.”*

However, for this study, the definition has been broadened by following Goldman et al. (2013), which includes an examination of all members of the board of directors, and classifies a firm as connected if any one member of the board is politically connected explicitly or implicitly.

Some studies find political connections positively related to firm performance/ value (Nee, 1992; Peng and Luo, 2000; Fisman, 2001) while others come to a different conclusion (Fan et al., 2007). The study by Johnson and Mitton (2003) suggests that the political connections of Malaysian firms may affect transparency in that information concerning expropriation or bribes may be hidden to disguise the poor performance of such politically connected firms. The study conducted by Bliss et. al. (2011) examines whether political connection to firms affects the association between audit committee independence and demand for higher quality audits. They reported a weaker relationship for politically connected firms suggesting that the independence of audit committees in Malaysian politically connected firms may be compromised.

Further, politically connected firms, besides having the traditional agency costs, also have to bear the costs of catering to the interests of the political party/entity to which they are affiliated (Micco et al., 2007). The risk is that to preserve and serve this political relationship, members of the management who produce financial reports may manage

earnings to serve the interests of their political allies at the expense of other stakeholders, such as the shareholders and creditors. This consideration is likely to affect an auditor's perception of a politically connected firm's business risk. Gul (2006) also suggested that political connections affect audit fees. Politically connected firms seemed to be associated with higher audit risks and consequently were charged higher audit fees. It might also be argued that because politically connected firms are associated with higher risk, the audit report lag or audit delay will also be higher.

More recently, Chaney et al., (2009, p. 58) in a cross-country study provide evidence that politically connected firms have a significantly lower quality of earnings. It may well be that politically connected firms disclose lower quality information due to their having a "lesser need to respond to market pressures to increase the quality of (such) information". In that case, it might be possible that politically connected firms will be less likely to high demand for quality audit and thus pay less audit fees. Similarly, lower demand for quality audit might result in less extra effort and eventually less audit delay.

### **3. Institutional context and hypothesis development**

In many ways, Bangladesh provides an ideal research site to understand the impact of political connections to audit fees and audit delay. Like many emerging economies, the Bangladeshi corporate environment is characterized by the dominant presence of a business-politician nexus- an overwhelming majority of MPs sitting in the current parliament also own large businesses. This is also consistent with previous literature, which argues that countries with weak democracy, family led politics, and prevalence of corruption and poverty create the necessary conditions for strong political ties with the business elites (Berglof and Classens, 2006; Dieleman and Boddewyn, 2012). The presence of such a state-business nexus in Bangladesh allows these businessmen to receive favors from the government in terms of obtaining lucrative business licenses (Mahmud et al., 2008). Naturally, it is possible that the businessmen would reciprocate such favors by catering to the needs of the politicians at the expense of other stakeholders, primarily minority shareholders. The presence of such collusion between the political power and businessmen, coupled with poor market mechanisms, may make it possible for firms to manipulate financial reporting. Previous studies on politics and disclosure practices (Uddin et al., 2018) in Bangladesh reported that organizations in Bangladesh are, in some cases, politically motivated to disclose CSR activities.

Another interesting aspect of Bangladeshi business is that family structure and kinship are deeply rooted in Bangladeshi society, and outspread to the social, political, and cultural lives of Bangladeshi people (Uddin 2009, BEI, 2004) Bangladesh is controlled by two family led political parties since independence. The presence of familial power in both politics and organizations provides the very fabric of the Bangladeshi society, and is reflected in the way the business corporations operate in Bangladesh and their connections with the politicians. Khan et al., (2015) recently studied audit fees in a family dominated economy. They reported that the audit fees in family firms are less compared to the audit fees in non-family firms.

As mentioned in Khan et al., (2015), the audit market in Bangladesh is characterized by poor demand for audited financial statements (Ahmed and Goyal, 2005), and poor perceptions regarding audit quality. (Sobhan and Warner, 2003). Uddin and Chowdhury (2008) reported that integrity and competence of the professional audit firms is questionable and, consequently, the financial reporting practices in Bangladesh lack quality (meaning the adequacy of disclosure) as well as transparency of information disclosed.

Based on agency theory and previous literature on emerging economies, politically connected firms seemed to be associated with higher audit risks and consequently charge higher audit fees. It might also be argued that because politically connected firms are associated with higher risk, the audit report lag or audit delay will also be higher (Gul, 2006).

However given the dynamics among political connections of firms, family dominated economy and the absence of demand for high quality audited financial statements in Bangladesh, it is also likely that the political connections of firms will have a negative influence on the quality of audit and hence the audit fees. Since the corporate governance in Bangladesh is weak, shareholders' rights are not exercised, it might be possible that political members present in the board can expropriate minority shareholders (type II agency problem) and thus does not feel the necessity of providing the audited financial statements to the stakeholders on time. Given this scenario, the proposed hypothesis for the study is:

***Hypothesis 1:*** Political connections of firms are likely to have a positive association with audit fees

***Hypothesis 2:*** Political connections of firms are likely to have a positive association with audit delay

Another important aspect in Bangladesh is the influence of different pressure group such as foreign buyers, donor agencies, international organizations, World Bank etc. Bangladesh, being one of the largest exporters of readymade garments is highly influenced by foreign buyers, Islam and Deegan (2008) studied the importance of pressure groups /important stakeholder groups in driving the strategies and social policies and related disclosure practices. Many of the export-oriented companies in Bangladesh are family dominated (Khan et al., 2015) and explicitly or implicitly politically connected. Family and kinship ties are deeply rooted in Bangladesh's political and economic history. The power of family and friends often shapes the political power within the Bangladeshi state. (Uddin and Choudhury, 2008). Under such circumstances, it might be reasonable to assume that the political connections of firms in the export-oriented industries might have an impact on the demand for quality audit and hence audit fees and audit report lag. The proposed hypotheses are:

**Hypothesis 3:** Political Connections in export- oriented industries have a positive association with audit fees

**Hypothesis 4:** Political Connections in export-oriented industries have a positive association with audit delay.

#### 4. Methodology

##### 1. Data and Sample

The sample consists of 100 non-financial companies listed with Dhaka Stock Exchange (DSE) in Bangladesh from 2010 to 2015 inclusive. The author excludes 18 companies due to missing or incomplete information. The final sample comprises the remaining 82 companies with a total of 576 firm-year observations. The sample consists of various sectors such as: engineering, food and allied, jute, cement, ceramics, miscellaneous, pharmaceuticals, tannery, and textile. *Table 1* represents the industry wise distribution of the firms. The data for the analysis comes from multiple sources. The financial, ownership and corporate governance data are collected from the annual reports of the sample companies listed on the Dhaka stock exchange. Political Connections of firms are collected from the biographies of the board of directors in the annual reports, websites. OLS pooled regression is run for both audit fees and audit delay.

**Table 1: Industry wise classification**

Industry	Freq.	Percent
Engineering	96	16.67
Food and allied	54	9.38
Fuel and power	72	12.5
Jute	12	2.08
Textile	90	15.62
Cement	30	5.21
Ceramic	24	4.17
Miscellaneous	24	4.17
Pharmaceuticals	108	18.75
Real estate and hospitals	18	3.12
Tannery	24	4.17
Telecom	24	4.17
Total	576	100

## 2. Model Specification

There are two models used in the study to identify if political connection is associated with audit fees and audit delay. The definitions of all the dependent and independent variables are included in the appendix.

### 3. Audit Fees Model:

$$L\_AF = \alpha + \beta_1(PCON) + \beta_2(CG \text{ CONTROLS}) + \beta_3(FIRM \text{ SPECIFIC CONTROLS}) + \beta_4(OWNERSHIP \text{ STRUCTURE CONTROLS}) + \beta_5(INDUSTRY \text{ CONTROLS}) + \beta_6(YEAR \text{ CONTROLS}) + \varepsilon_i \quad (1)$$

The dependent variable in the study, Audit Fees (AF), is measured by the natural logarithms of audit fees (L\_AF). The key variable, Political Connections (PCON) is an indicator /dummy variable that equals “1” if the company is politically connected and “0” if otherwise. The corporate governance (CG) mechanism of firms is assumed to minimize or mitigate the negative impacts of political connections. Thus, the CG variables are considered in the study to identify their influence on audit fees. The CG controls include the size of the board (BOARD\_SIZE), the presence of independent directors on the board (IND\_DIR), Qualification of the Chairman of the Audit Committee (AUDCHAIR\_QUALI), presence of family members in the audit committee (FAM\_AUDCOM). In Bangladesh, even if the CEO and Chairman are different persons, they are usually from the same family (Uddin and Choudhury, 2008). Thus, in this study, the author replaces role duality with another variable, the relationship of Chairman and (CEOCHAIR\_REL)<sup>3</sup>.

Auditor quality is likely to have a positive impact on audit fees. For example, it is expected that higher quality auditors such as Big 4 audit firms will charge a premium for their quality (Beattie, et al., 2001; Firth, 1997). In the study, the top 6 audit companies, who are/were either one of the Big 4 or an affiliates of Big4<sup>4</sup> during the time period considered for the study.

The ownership structure variables used in the study include family ownership (FAMOWN) represented by the percentage of shares owned by the family members, Institutional Ownership (INSOWN), Government Ownership (GOWN), Managerial ownership (MOWN) measured as the percentage of shares owned by the directors and sponsors, foreign ownership (FOWN) and Public ownership (POWN). The ownership variables are controlled to address the impact of ownership of different groups of stakeholders on audit fees. Institutional and Government ownership are usually perceived as monitoring agents (Khan et al., 2015) and believed to mitigate the risks associated with political connections. Therefore, auditors might assess a lower level of risk and charge less audit fees. Independent directors are likely to be effective monitors and therefore,

firms with independent directors will charge less audit fees. It is also possible that independent directors might require more rigorous audits to protect the interest of general shareholders and hence firms incur higher audit fees. Audit complexities and the number of subsidiaries involve greater loss exposure in terms of audit risk, which results in higher audit fees (Simon & Taylor, 1997). Previous studies suggest that size is an important determinant of audit fees (Ahmed & Goyal, 2005; Karim & Moizer, 1996; Simunic, 1980). Low profitability could be associated with financial pressure, which would require more audit efforts to confirm that a company is not a going concern (Khan et al., 2015).

#### 4. Audit Delay Model:

$$l\_AD = \alpha + \beta_1(PCON) + \beta_2(CG\_CONTROLS) + \beta_3(FIRM\_SPECIFIC\_CONTROLS) + \beta_4(OWNERSHIP\_STRUCTURE\_CONTROLS) + \beta_5(INDUSTRY\_CONTROLS) + \beta_6(YEAR\_CONTROLS) + \epsilon_i \quad (2)$$

The dependent variable in this model is audit delay, (AD) and defined as the lag between the end of the accounting period and the date auditor signed the annual report and is measured in the study as the logarithms of Audit delay (l\_AD). (For example, Newton and Ashton, 1989; Carslaw and Kaplan, 1991; and Davies and Whittred, 1980, Karim, Ahmed & Islam, 2006). The independent variables are similar to the variables used in *equation 1*. The CG variables used in the study are independent directors (IND\_DIR), Size of the board (BOARD\_SIZE), Type of Auditors (TYPE\_AUDITORS), the Qualification of the Chairman of Audit Committee (AUDCOMCHAIR\_QUALI), Family Members present in the board. (FAM\_BOARD).

Consistent with prior research (such as Iman, Ahmed & Khan, 2001; Ng & Tai, 1994), it is argued that larger audit firms in emerging countries (henceforth, international audit firms/associates) would complete audits more quickly because they have greater staff resources and better experience in auditing listed companies. International audit firms may enjoy economies of scale in the provision of audit services and are more efficient in verifying accounts compared with smaller domestic audit firms. On the other hand, larger firms are concerned with reputation loss due to poor audit service, therefore would spend more time to ensure accounts are in order before an opinion is expressed. In Bangladesh, where we do not have presence of International Big<sup>5</sup>, it would be interesting to see if the quality or size of auditors makes any difference to the audit delay.

The different ownership structures considered in the study are Family ownership (FAMOWN), Institutional Ownership (INSOWN), Managerial ownership (MOWN), Foreign Ownership (FOWN) and Government Ownership (GOWN). The ownership structures are controlled to identify the impact of various stakeholders on audit delay.

The firms specific control variables are: size of the auditee measured as the logarithms of total assets of the firm ( $L\_TA$ ). Carslaw and Kaplan (1991) stated that larger companies might have stronger internal controls, which in turn should reduce the propensity for financial statement errors to occur and enable auditors to rely on controls more extensively and to perform interim work, and eventually reduce audit delay. However, Leventis et al., (2005) provide a counter argument stating the fact that larger companies have the power to ensure prompt audits also means that they have the power to delay the audit reports as well.

In order to see if the financial condition of the companies have any impact on audit delay, profitability (PROFROE) and Leverage (LEV) have been controlled. Previous studies have found mixed results on the financial condition. Ahmed (2003) reports no significance of profitability and leverage with audit delay.

The operationalization of all variables are described in the table below:

<b>Dependent Variables</b>	<b>Operationalization of the Variables</b>	<b>Sources of Information</b>
L_AF	Logarithm of audit fees measured as the natural log of fees paid by a firm to the auditor for audit services	Notes to the financial statements in the annual report
L_AD	Logarithm of Audit Delay measured as the number of days elapsed between the balance sheet date and the date auditor(s) sign(s) the financial statements.	Auditor's reports in the Annual reports
<b>Independent Variables</b>	<b>Operationalization of the variables</b>	<b>Sources of Information</b>
Political Connections (PCON)	If one or more members of the board is a current or former MP/minister former MP/minister. Directors or Chairman appointed have political background and had served or is currently serving as government officer in state owned enterprises.  If one or more members is politically linked (e.g. advisor or close connection known to the public) to a major political party.  If one or more members, including the Chairman is a sibling of the current or former minister/MP	Annual Reports, Websites, Company profiles, newspaper etc.
<b>Corporate Governance</b>		
Presence of Independent Director (IND_DIR)	Ratio of independent directors to total number of directors on the board	Annual Report
CEO and Chairman Related (CEO_CHAIRREL)	Whether the CEO and Chairman of the board are related to each other	Annual Report

Family members in the board (FAM_BOARD)	Ratio of family members to total no. of directors	Annual Report and Company Profiles, Company web sites etc.
Size of the Board (BOARD SIZE)	Number of Directors in the board	Annual report
Quality of Auditors (TYPE OF AUDITORS)	Associate of Big Four vs. Local (Top 7 audit companies in Bangladesh)	Annual Report
Qualifications of the Chairman of Audit Committee (AUDCOMCHAIR_QUALI)	Qualification of the Chairman of the Audit Committee measured by the no. of professional experience, educational background, important positions held etc. Dichotomous variable (YES/NO)	Annual report, Company profiles and biographies
Family Members in the Audit Committee (FAM_AUDCOM)	Dichotomous (yes/no), whether there is a family member present in the audit committee	Annual Report
Ownership Structure		
Family Ownership (FAMOWN)	Percentage of shares owned by the family members	Annual report
Government Ownership (GOWN)	Percentage of shares owned by the government	Annual report
Public Ownership (POWN)	Percentage of shares owned by public	Annual report
Foreign Ownership (FOWN)	Percentage of shares owned by foreign nationals/foreign board members	Annual report
Managerial Ownership (MOWN)	Percentage of shares owned by the sponsor directors	Annual report
Institutional Ownership (InsOwn)	Percentage of shares owned by institutions	Annual report
<b>Firm Specific Characteristics</b>		
Size of the firm (L_TA)	Logarithm of Total Assets	Annual Report
Industry Type (IND)	SIC Code	Annual Report
Age of the firm (AGE)	Actual Listing age / Natural logarithm of age	Annual Report
Complexity of the business (COMPX)	No. of subsidiaries the company has	Annual Report
Gearing (LEV)	Debt/Total Assets	Annual Report
Profitability of the firm (PROF)	ROE(NI /Total Owner's Equity) /Net Income /Total Assets	Annual Report

## 5. Empirical Results

Table 2 reports the summary statistics of the full sample. The mean audit fees for our sample companies are: Tk. 285,466 (\$ 3,358). The mean audit delay is 122 days. Khan et al., (2015) reports an average audit fees of Tk. 116,726, (\$ 1,496) using data from 2005 to 2013; whereas; Khan et al., (2011) in their study reports an average audit fees of Tk.

67,480 (\$865) using data from 2003 to 2005. The average audit delay reported in previous studies (Ahmed, 2003) found an average audit delay of 162 days in Bangladesh.

51% of the companies in the sample of our study are politically connected. The family ownership is 23.0%, government ownership is 8%, and public ownership is 37%. 36% of the companies in the sample has CEO and Chairman related to each other. Mazumder (2006) in Uddin and Chowdhury (2008) mentioned that in Bangladesh, most of the listed companies, except the multinationals, are dominated by family members, the head of the family becomes the Chairman and the other family members, the CEO or Managing Director.

**Table 2: Descriptive Statistics**

Variable	Mean	Std. Deviation	Min	Max
AUDIT FEES	285,466	561,535	5000	5450000
AUDIT DELAY	122.01	69.60	22	791
AGE	17.9	10.0	-1	39
PCON	0.51	0.5	0	1
IND_DIR	0.173	0.12	0	1
BOARD_SIZE	7.52	2.35	3	20
TYPE OF AUDITORS	0.25	0.43	0	1
AUDITCOM_CHAIR_QUALI	0.43	0.50	0	1
FAM_AUDCOM	0.57	0.50	0	1
CEOCHAIR_REL	0.36	0.48	0	1
FAM_BOARD	0.36	0.31	0	1
DIV_BOARD	0.17	0.17	0	2
FAMOWN	0.23	0.231	0	0.79
GOWN	0.08	0.203	0	0.84
POWN	0.37	0.20	0	0.96
FOWN	0.098	0.240	0	0.96
INSOWN	0.13	0.12	0	0.54
MOWN	0.380	0.243	0	0.9
LEVERAGE	0.075	0.143	0	1.55
PROFITABILITY	0.097	0.54	-4.35	4.59
FIRM SIZE ( L_TA)	21.28	1.87	14.21	25.5

Table 3 present the Pearson Correlation Matrix of the full sample. The Pearson correlations coefficient in table 5 suggests that the multicollinearity is not serious for the independent variables. As suggested by Gujarati (1988), simple correlations between independent variables are considered “harmful” when it exceeds 0.80 or 0.90. The Pearson correlations between independent variables in this study have a range “between” 0.001 to 0.70, except FOWN and DIV\_BOARD ( $\beta = 0.826$ )

**Table 3: Pearson correlation of the variables used in the full sample**

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22
I_AF (1)	1																					
I_AD (2)	-0.151*	1																				
AGE (3)	-0.077	0.022	1																			
PCON (4)	0.114*	0.089	-0.030	1																		
IND_DIR (5)	0.026	0.022	0.022	0.253***	1																	
BOARD_SIZE (6)	0.264***	-0.080	-0.077	0.226***	0.290***	1																
TYPE_AUDIT-S (7)	0.465***	0.157***	0.027	-0.008	-0.029*	0.290***	1															
AUDCOMCHAI-I (8)	0.473***	-0.115	0.046	0.015	0.039	0.245***	0.469***	1														
FAM_AUDCOM (9)	-0.233***	0.061	0.073	-0.096	0.054	0.211***	0.264***	-0.074	1													
CEOCHAIR_REL (10)	-0.239***	0.025	0.049	-0.068	0.034	-0.085	0.203***	-0.136	0.528***	1												
FAM_BOARD (11)	-0.198***	0.037	-0.007	0.001	-0.031	0.204***	0.214***	-0.122	0.800***	0.551***	1											
DIV_BOARD (12)	-0.244***	0.046	-0.016	-0.081	-0.035	0.156***	0.164***	-0.084	0.454***	0.350***	0.537	1										
FAMOWN (13)	-0.083	0.041	-0.032	-0.009	0.049	-0.061	-0.080	-0.038	0.642***	0.385***	0.699***	0.339***	0.314***	1								
GOWN (14)	0.029	0.194	-0.042	0.337***	0.205***	0.193*	0.061	-0.101	-0.410	0.265***	0.439***	0.310***	-0.127	0.371***	1							
POWN (15)	-0.299	0.117	-0.105	-0.102	0.122	0.289***	0.461***	0.322***	0.110	0.064	0.105	0.097	0.365***	-0.066	0.244*	1						
FOWN (16)	0.459***	0.314***	0.108	-0.114	0.069	0.165***	0.499***	0.422***	0.426***	0.278***	0.431***	0.218***	0.826***	0.360***	-0.127	-0.431***	1					
INSOWN (17)	-0.164***	-0.008	0.173***	0.002	-0.015	-0.052	0.024	-0.018	0.086	0.089	0.027	-0.015	-0.049	-0.068	0.012	-0.324***	0.125***	1				
MOWN (18)	0.180***	-0.072	0.210***	-0.072	0.009	0.139	0.152***	0.140	0.244***	0.143***	0.289***	0.163***	0.080	0.443***	0.144*	-0.416***	0.036	-0.072	1			
LEV (19)	-0.009	0.006	-0.101	0.122	-0.030	0.086	-0.155	-0.108	0.063	0.051	0.062	-0.002	0.149***	0.054	0.158	0.108	0.154***	-0.100	0.074	1		
PROFROE (20)	0.150***	-0.053	-0.024	-0.119	0.014	-0.043	0.204***	0.147	0.045	0.031	0.067	0.037	0.134	0.082	-0.209	-0.146**	0.164**	0.081	0.199*	-0.047	1	
I_TA (21)	0.498***	0.023	0.249***	0.175**	-0.118	0.240***	0.308	0.270	-0.181	-0.133	-0.109	-0.178	0.051	-0.128	0.304*	-0.203***	0.114	0.126*	0.100	0.068	0.076	1

\* p&lt;0.1, \*\*p&lt;0.05, \*\*\*p&lt;0.001.

(1) I\_AF= Log of Audit Fees; (2) I\_AD= Log of Audit Delay (3) AGE= as the no. of yrs. of the company from listing year ; (4) PCON = firms if they are politically connected ; (5)IND\_DIR= the proportion of independent directors in the board; (6) BOARD\_SIZE = the total number of board members ; (7)TYPE\_AUDITORS= Associates of Big 4 / Top 7 audit firms of Bangladesh during this time period; (8) AUDCOMCHAIR\_QUALI= Qualification of the Chair of the audit committee; (9) FAM\_AUDCOM= Presence of family members in the audit committee; (10) CEOCHAIR\_REL= Relationship between CEO and Chairman; (11) FAM\_BOARD= Presence of family members in the board; (12) DIV\_BOARD= Presence of female in the board; (13) FAMOWN= % of shares owned by family members; (14) GOWN = % of shares owned by the government; (15) POWN= % of shares owned by the public; (16)FOWN= the % of shares owned by foreigners/ foreign parent company; InsOwn= the % of shares owned by institutions ; (18)MOWN= percentage of shares owned by the directors; (19) LEV= Total Assets/ Total Liabilities; (20) PROFROE= Profitability measured as the Return on Equity; (21) I\_TA= size of the company measures as the natural logarithms of the total assets of the company .

Table 4 represents the OLS regression results of the sample. Model 1 reports the results of the regression of audit fees with political connections. The adjusted R<sup>2</sup> is 0.5709. This is similar to those studies conducted in the context of developing nations (see Khan et. al. 2015; Khan et.al. 2011; Ahmed and Goyal, 2005). Model 2 reports the regression of audit delay with political connections of firms. The R<sup>2</sup> is 0.2098. The assumptions underlying the regression models were tested for multicollinearity based on the correlation matrix as well as the variance inflation factor (VIF)<sup>5</sup>. Both the regressions have been run using robust standard error.

**Table 4: Regression Models**

	AF and PCON		AD and PCON		AF and PCON		AD and PCON	
	FULL SAMPLE		FULL SAMPLE		EXP ORIENTED COMP		EXP ORIENTED COMP	
	R <sup>2</sup> = 0.5709		R <sup>2</sup> = 0.2098		R <sup>2</sup> = 0.5293		R <sup>2</sup> = 0.5293	
	Model 1		Model 2		Model 3		Model 4	
	Coef.	P value						
AGE	0.001	0.890	0.002	0.309	-0.008	0.309	-0.001	0.658
PCON	0.180	0.022	0.049	0.247	0.252	0.007	0.007	0.878
IND_DIR	0.189	0.576	0.206	0.104	-0.522	0.602	-0.098	0.744
BOARD_SIZE	-0.009	0.610	-0.011	0.246	0.091	0.024	0.009	0.567
TYPE_AUDITORS	0.384	0.001	0.002	0.975	0.398	0.071	-0.168	0.010
AUDCOMCHAIR_QUA	0.411	0.000	0.019	0.627	0.406	0.000	0.021	0.701
FAM_AUDCOM	-0.100	0.414	-0.029	0.540	-0.542	0.001	0.104	0.103
CEOCHAIR_REL	-0.171	0.074	-0.020	0.633	-0.001	0.995	0.033	0.527
FAM_BOARD	-0.073	0.729	-0.187	0.073	-0.198	0.556	-0.220	0.176
DIV_BOARD	-0.589	0.021	0.199	0.050	-0.635	0.089	0.319	0.025
FAMOWN	0.332	0.216	0.074	0.583	0.970	0.011	-0.156	0.444
GOWN	-0.339	0.238	0.447	0.009	-18.022	0.114	12.128	0.001
POWN	0.075	0.849	-0.007	0.974	-0.373	0.492	-0.206	0.228
FOWN	1.145	0.012	-0.652	0.001	1.729	0.007	-0.987	0.000
INSOWN	-0.767	0.089	-0.285	0.108	-0.123	0.885	-0.224	0.299
MOWN	0.478	0.053	-0.084	0.523	-0.784	0.070	-0.021	0.916
LEV	0.370	0.117	-0.175	0.106	0.542	0.048	-0.041	0.792
PROFROE	0.061	0.299	0.034	0.162	-0.127	0.677	-0.172	0.278
l_TA	0.227	0.000	0.012	0.304	0.136	0.002	0.023	0.144
_cons	6.818	0.000	4.828	0.000	8.855	0.000	3.858	0.000
Industry Dummies	Included		Included		Included		Included	
Year Dummies	Included		Included		Included		Included	

\* p<0.1, \*\*p<0.05, \*\*\*p<0.001

Model 1 reports a positive and significant relationship between audit fees ( $I\_AF$ ) and political connections (PCON) of firms at the 95% confidence level ( $\beta = 0.180$ ,  $p$  value = 0.022), suggesting if firms are politically connected, the audit fees charged are more. Therefore, H1 is supported. In addition to the traditional agency problem, politically connected firms tend to manage the interests of the political power at the expense of other shareholders by managing the earnings in the annual reports. According to Gul (2006), this is likely to affect the firm's risk and require the auditor's extra risk and extra effort and thus more audit fees. However, Model 2 does not find any evidence of PCON to be an explanatory variable of the audit delay of the firms.

The statistical significance of the some of the CG variables, ownership structure variables and firm specific control variables in Model 1 and 2 of Table 4 suggest that audit fees and audit delay are affected by other factors as well.

The positive and significant coefficient ( $\beta = 0.384$ ,  $p$  value = 0.001) of type of auditors (TYPE OF AUDITORS) suggests high audit fees for high quality auditors<sup>6</sup> (Beattie et. al., 2001; Firth, 1997, Khan et. al., 2015). The study also finds the qualification of the Chairman of the audit committee (AUDCOMCHAIR\_QUALI) to have a positive significant influence on the audit fees ( $\beta = 0.441$ ,  $p$  value = 0.000).

Interestingly, Model 1 and 2 does not find board independence (INDIR) to be a significant explanatory variable with audit fees, suggesting that independent directors are not a factor in determining audit fees, rather independent directors are appointed by name only (Uddin and Choudhury, 2008) and are primarily acquaintances of family members.

Family Ownership (FAMOWN) reports no significant association with audit fees or audit delay. This contradicts the results of Khan et.al. (2015), who report a negative and significant coefficient. They mentioned in their study that the presence of strong incentives to engage in fraudulent activities might increase audit risk and eventually require more extensive audit and thus incur higher fees. Presence of family members in the board is not found to be an explanatory variable for audit fees. This is inconsistent with the findings of Khan et.al. (2015).

However, Foreign Ownership (FOWN) is found to be positively significant with Audit Fees ( $I\_AF$ ). This might indicate rational behavior of the foreign owners in the sense that the foreign owners would want to employ high quality auditors and thus pay higher audit fees. This is also reflected in model 2 where it reports that the higher foreign ownership is significantly negatively associated with audit delay.

When the CEO is related to the Chairman (CEO-CHAIR-REL), it reports a negatively significant relationship ( $\beta = -0.171$ ,  $p$  value = 0.074), indicating that when the CEO and the Chairman is related, the audit fees is low. This is consistent with Khan et. Al. (2015).

This could be due to the fact that they do not want to hire high quality auditors or pay higher audit fees. This could be possible that the CEOs represent the interest of the families as they do not want to spend higher audit fees to ensure better monitoring through extensive audit.

Model 2 of Table 4 also reports a negative association of family members in the board (FAM\_BOARD) with audit delay ( $\beta = -0.187$ , p value= 0.073). When family members are present in the board, they are less likely to demand extensive audit and hence less audit delay.

In terms of audit delay, GOWN is found to be positively significantly associated with audit delay ( $\beta = 0.4470$ , p value= .009), indicating the high risks of auditing government owned companies and thus, requiring more audit effort and eventually fees.

The negative and significant ( $\beta = -0.035$ , p value = 0.008) association of the size of the firm measured as log of Total Assets (L\_TA) with audit delay indicates that larger firm may have more strong control system and tend to use auditors on a more regular basis carrying out interim compliances rather than year end balances (Ng & Tai, 1994). This is consistent with the previous studies conducted on auditee size (Ashton et.al 1989; Carslaw and Caplan, 1991). The positive and significant coefficient ( $\beta = 0.4$ , p value= 0.000) of firm size with audit fees in model 1 also suggests that larger firms incur higher audit fees than smaller firms.

Leverage has a positive and significant relationship with audit fees. Previous studies have reported positive association of leverage and audit fees (Gist, 1994). In Model 2, profitability or leverage are not found to be explanatory variables on audit report lag. This is consistent with study conducted by Ahmed (2003), which might suggest that the firms in Bangladesh are primarily financed by commercial banks and banks have their own examination of the company accounts before the funds are released. Besides, audited final accounts are, in most instances, submitted in order to fulfill statutory requirements rather than to be used for lending decisions.

### ***PCON AND Audit Fees in Export Oriented Industries***

The same regression models are run for export-oriented companies in the sample data. Model 3 and Model 4 of Table 4 reports the regression results of audit fees and audit delay with political connections in export oriented companies.

Interestingly, PCON is positively significant with audit fees in the export-oriented industries perhaps to allay the concerns of foreign international buyers. Foreign buyers are deemed to be one of the most important stakeholder groups (Islam and Deegan, 2008). It might be possible that due to political connections of firms, the export oriented companies are perceived to be risky to the auditors and thus pay higher audit fees.

However, in the audit delay model (l\_AD), our sample does not provide evidence of PCON being an explanatory variable to audit report lag/audit delay. This again is perhaps due to the fact that the foreign buyers are concerned about the timeliness of quality audited financial statements and so, the political connections do not have any impact on audit delay.

Type of Auditors (TYPE\_AUDITORS) and Qualifications of Audit Committee Chairman (QUALI\_AUDCOM\_CHAIR) are found to be positively associated with audit fees. This is consistent with previous studies (Ahmed and Goyal, 2005; Khan et. al. 2015) that high quality auditors receive an audit fee premium for higher quality audit .

However, when family members are present in the Audit Committee (FAM\_AUDCOM), it reports a negative significant association indicating that family members might indicate family interests and thus do not want to ensure better monitoring through extensive audit.

Foreign Ownership (FOWN) measured as the percentage of shares owned by foreigners reports a negative and significant relationship with audit delay, indicating that the more dispersed the owners, the demand for timely information is more. (Bushee and Noe (2000), Bushee, Matsumoto, & Miller (2003); Abdelsalam and Street (2007).

### **Conclusion**

The objective of this paper was to investigate the relationship between audit fees, audit delay and political affiliation in an emerging economy, namely Bangladesh. The social and political environment of Bangladesh provides an interesting setting for the study of audit fees, audit delay and political connections. Recent research (Uddin et al, 2016; Siddiqui and Uddin, 2016) report that existence of a nexus between the politicians and the state in Bangladesh, leading to potential abuse of business resources. In addition, the majority of listed companies are family dominated, exposing minority shareholders to higher risks of appropriation (Khan et al, 2015). The presence of such conditions would increase audit risk, and may result in significant increase in audit fees and audit delay. This presents the context for this study.

Using data of 576 firm year observations from 2010 to 2015 of listed companies in Dhaka Stock Exchange, we investigate the association of political connections of firms with audit fees and audit report lag/audit delay. This paper finds evidence that political affiliation of firms tend to increase the risks of the firms and thus audit fees. However, this paper does not find any evidence of political affiliation of firms having any impact on the time lag of audit. This is the same for export oriented companies that tend to pay higher audit fees when they are politically connected. This is consistent with the agency theory arguments and suggests that the managers of export-oriented industries would pay higher audit fees to appoint higher quality auditors in order to address the concerns of the international buyers. However, timeliness of financial reporting is not related to political

connections in listed firms in Bangladesh. In addition, we identify few more important determinants in terms of Corporate Governance and Ownership structure of audit fees and audit delay in a developing country like Bangladesh.

Given the socio-political context of Bangladesh, it would be natural to expect that auditors in politically connected firms perform more rigorous audits and end up charging higher audit fees. The presence of longer audit delays in politically connected firms may not be due to the performance of more rigorous audits in these firms, as there is no corresponding increase in audit fees. Prior research, such as Sobhan and Werner (2003) identify political influence as one of the major reasons for many companies not holding their annual general meetings in a timely manner. The demand for quality audit in export-oriented industries, however, allows auditors to perform a more rigorous audit, and charge higher audit fees. This is consistent with prior research (Khan et al, 2015; Khan et al, 2013), who identify pressure exerted by buyers as an important determinant of corporate disclosure and audit fees in Bangladesh.

This paper contributes to the existing literature in a number of ways. This paper is one of the first studies to have studied audit delay in politically connected firms. There are a number of studies, which identify the determinants of audit delay, (Bamber et. al. 1993; Ng and Tai, 1994). However, none of the previous studies captured political affiliation of firms with the delay of audit. We also extend prior research on audit fees (for example, Gul, 2006; Aswadi et al., 2011) by providing evidence of the relationship between audit fees and political connections in different contexts, and using a different proxy for political connections. Future research can look into different methodologies such as interviews with the board of directors, auditors, and regulatory bodies to understand the actual dynamics among the political power, regulatory and state bodies and companies.

## Notes

<sup>1</sup> Bangladesh has maintained more than 6 percent GDP growth over the last ten years, mainly fuelled by a booming textile sector (World Bank, 2012). The country is now regarded as one of the 'next eleven' emerging economies (Goldman Sachs, 2011). Bangladesh is expected to grow at the rate of 7.2% ( World Bank, 2019)

<sup>2</sup> For this paper, the author used company data from 2010-2013. As of December 31, 2011, more than 70 percent of the top performing companies in the Dhaka Stock Exchange were family-owned firms ([www.dsebd.org](http://www.dsebd.org)).

<sup>3</sup> According to the CG regulation 2012 by Securities and Exchange Commission (SEC), it is mandatory to have an audit committee (AUDCOM) in the firm and the CEO and Chairman have to be different persons, Therefore, Role duality of Chairman and CEO and presence of AUDCOM as variables is not considered in the study.

<sup>4</sup> Only KPMG (local Rahman Rahman Haque) has a presence in Bangladesh. The other 5 companies are Hoda Vasi Chowdhury (affiliate of Deloitte), Howlader and Younus (affiliate of Ernst and Young), A

Quasem and Co. (affiliate of PWC), S.F. Ahmed and Co (affiliate of Ernst ad Young), M J Abedin (affiliate of Moore Stephenson)

<sup>5</sup>. None of the variables have a VIF value in excess of 10 (Neter et. al. 1983), which suggest that multicollinearity is not a problem in interpreting the regression results.

<sup>6</sup>. The top 7 auditors, who are either an associate or linked with the international BIG4 auditors, are taken into account in this study. The variable is an indicator variable, if the auditor is one of the top five auditors in Bangladesh, it is given as '1', otherwise '0'.

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