

The Study of CFO Power on Abnormal Audit Fees

-- An Empirical Study based on A-share Listed Companies

Chenxi Li

School of Management, Shanghai University, Shanghai 201800, China

Abstract

As an important internal governance mechanism, the status of CFO power in listed companies and top management team is quite different. Whether CFO power will affect the auditor's judgment and then adjust the abnormal audit fees is an urgent issue. Taking the data of A-share listed companies from 2007 to 2019 as research samples, this paper explores the impact of CFO power on abnormal audit fees. The study finds that the higher the CFO power, the lower the abnormal audit fees. The negative effect of CFO power on abnormal audit fees is more significant in the sample group of non-state-owned enterprises and small accounting firms.

Keywords

CFO Power; Abnormal Audit Fees; Nature of Ownership; Auditor Size.

1. Introduction

As an internal governance mechanism of listed companies in China, CFO (Chief Financial Officer) has been given higher expectations for its role. Nowadays, CFO is directly employed by the board of directors. It has changed from financial officer who provide digital background for the management's decision-making to senior manager who formulate corporate strategy, participate in investment and financing decisions, and mergers and acquisitions. CFO and CEO have the same important legal status in western developed countries headed by the United States, but even though the status of CFO in the organization has been improved compared with before in our country, it is still not high in the company and the top management team, and the role of CFO in organizational practice varies greatly because of its different power status in the top management. Therefore, it is particularly important to find the role of CFO power in the allocation of corporate resources and organizational output. However, the existing studies mainly focus on the size of CEO power and its economic consequences. Limited by the problem of CFO power measurement and data collection, few literatures discuss the size of CFO power and its economic consequences from the perspective of large sample. Based on this, this paper studies the impact of CFO power on abnormal audit fees.

Taking 2007-2019 A-share listed companies as research samples, this paper analyzes the impact of CFO power on abnormal audit fees. The result shows that there is a significant negative correlation between the power of CFO and abnormal audit fees, that is, CFO power has negative impact on abnormal audit fees; The nature of ownership and the size of the accounting firms have a moderating effect on the negative relationship between CFO power and abnormal audit fees. When the enterprise is a non-state-owned enterprise and audited by a small audit firm, the impact of CFO power on abnormal audit fees is more significant.

The contributions of this paper are as follows: Firstly, based on the high-level management theory and principal-agent theory, this paper discusses the relationship between CFO power and abnormal audit fees and tests the nature of ownership and auditor size as the moderating variables between the two, which enriches the research on the economic consequences of CFO

power and the influencing factors of abnormal audit fees; Secondly, it measures CFO power from four aspects: organizational power, own power, expert power and prestige power, and innovates the way to measure the power of CFO.

2. Theoretical Analysis and Hypothesis Presentation

2.1. CFO Power and Abnormal Audit Fees

The theory of high-level management holds that the power of executives is the decisive factor of company decision-making and strategic formulation. Therefore, the power of executives determines their position, discourse power and participation in decision-making in the company and senior management (Mao Xinshu, 2016). As far as CFO is concerned, the greater the CFO power, the higher the position in the company, the greater the ability to play its own financial expertise, and has a greater impact on the company's decision-making.

On the one hand, CFO has an important influence on the choice and adjustment of accounting policies as the main person in charge of corporate accounting (Mian, 2001). Influenced by education and professional training, CFO is more risk averse and more robust than other executives. Therefore, the greater the power and position of CFO in the top management, the more stable the company's accounting policy will be and the higher the quality of financial report will be. However, the management may collude with the accounting firm to cover up and pay excessive audit fees in exchange for good audit opinions when the quality of financial reports is low (Cai Chun et al., 2010), which can improve the bargaining power of auditors; At the same time, the lower the quality of financial report, the higher the audit risk. Therefore, the greater the CFO power, the lower the bargaining power and audit risk of the company's auditors, and then inhibit the abnormal audit fees.

On the other hand, based on the principal-agent framework, management naturally has self-interest motivation. Studies have shown that CFO may participate in accounting manipulation (Feng et al., 2011) or resign (Qu Xu et al., 2012), which increases the risk of financial audit and the probability of financial restatement (Zhang Chuan et al., 2020). In addition, some studies have shown that CFO can perform the supervision function better as a director, thus reducing earnings manipulation (Bedard et al., 2014). Therefore, it can be inferred that the lower the position of CFO in the company, the lower the quality of financial reporting of the company. Therefore, the CFO's ability to resist the management's bad intervention and whitewash the financial statements is stronger when the CFO has more power in the top management, and the purchase behavior of the management's audit opinion will be relatively reduced, which helps to reduce the audit risk of the company. At the same time, CFO has certain financial expertise. It helps to improve the company's negotiation and game ability in audit pricing, and ultimately helps to curb abnormal audit fees when CFO has more power.

In conclusion, when the CFO has less power in the company's top management, on the one hand, the quality of the company's financial report is relatively low, and the audit risk is relatively high, so the auditor will increase the audit procedures, increase the audit investment, and then increase the audit fees; On the other hand, the game ability of the company in the audit pricing negotiation is relatively low, and the auditor's bargaining power will be relatively improved, which helps to improve the audit pricing.

Based on the above discussion, this paper proposes hypothesis 1:

H1: CFO power is negatively correlated with abnormal audit fees.

2.2. The Moderating Role of the Nature of Ownership

In state-owned enterprises, the mission of enterprises is not only to pursue profits but also to undertake historical and political tasks. The selection of management is mainly directly appointed by the government and the decision-making is supervised by the government. The

freedom and independence of other executives decision-making are relatively reduced, so other executives will also be limited in their behavior even if CFO power is relatively small. However, for non-state-owned enterprises, CFO has weak check and balance ability on executive decision-making such as CEO when CFO power is relatively small. Once other executives have the tendency of financial information fraud, they may purchase audit opinions in order to cover up false information, which makes audit costs higher. With the increasing CFO power, stronger independence and more undertaken risks, it is more willing to maintain sound financial information and restrain other executives' fraud behavior, then the abnormal audit cost will be reduced (Zhang Jinsong et al., 2019).

Based on the above discussion, this paper proposes hypothesis 2:

H2: In non-state-owned enterprises, the negative impact of CFO power on abnormal audit fees is more significant.

2.3. The Moderating Role of Auditor Size

According to the "deep pocket" theory, the threat of litigation loss after the event will force firms to have more motivation to ensure the high quality of audit (Wu Haomin, 2015). With the expansion of the scale of accounting firms, they are faced with stronger reputation constraints and disciplinary risk pressure. Accounting firms are more able to adhere to their professional ethics and will not take risks for short-term economic interests and touch laws and regulations, even if the increase of CFO power can reduce abnormal audit fees to a certain extent. But small accounting firms tend to put more energy into winning more customers, which may give up professional ethics in order to meet the requirements of customers.

Audit pricing will also be affected by the power balance between enterprises and accounting firms, that is, the bargaining power. Due to big accounting firms are in a dominant position in negotiations and have stronger bargaining power, they are not likely to "go along with others" for their own reputation; Small accounting firms are more likely to violate their professional ethics, help enterprises make fraud and strive for customer resources in order to survive (Shen Chengrui et al., 2019).

Based on the above discussion, this paper proposes hypothesis 3:

H3: In small accounting firms, the negative impact of CFO power on abnormal audit fees is more significant.

3. Research Design

3.1. Data Sources and Processing

This paper takes A-share listed companies from 2007 to 2019 as samples. The sample companies are selected according to the following standards: Excluding financial listed companies and ST companies; Winsorizing 1% and 99% for continuous variables to eliminate the impact of individual extreme value; Delete samples with missing data. Finally, this paper obtain the annual observations of 12488 companies. The data comes from the CSMAR databas.

3.2. Variable Design

3.2.1. Measurement of Abnormal Audit Fees

Based on the definition of Chen Songsheng and Cao Yuanyuan (2018), this paper uses the change rate of unit asset audit fee to measure abnormal audit fee. The specific measurement method is shown in the following formula.

$$ABFEE = (\text{Audit fees in year } t / \text{assets in year } t - \text{Audit fees in year } t-1 / \text{assets in year } t-1) / (\text{Audit fees in year } t-1 / \text{assets in year } t-1)$$

3.2.2. Measurement of CFO Power

This paper measures CFO power from four aspects: organizational power, own power, expert power and prestige power, including eight background characteristics. The specific measurement methods are shown in [Table 1](#). SPSS v17.0 software is used to analyze the eight background characteristics of CFO, and the variance contribution rate is used as the weight to calculate the comprehensive index of CFO power.

Table 1. CFO Power characteristics

CFO power	Variable	Definition
Organizational power	Age	Age of cfo as at the end of financial reporting period.
	Concurrent director	If CFO is also a director, the value is 1, otherwise it is 0.
Own power	Whether hold equity	If CFO holds shares of the company, the value is 1, otherwise it is 0.
	Share ratio	Ratio of shares held by CFO in the company.
Expert power	Title	If CFO have obtained the senior accounting title (including CPA), the value is 1, otherwise it is 0.
	Tenure	Tenure of CFO as at the end of financial reporting period.
Prestige power	Education	If CFO master degree or above, the value is 1, otherwise the value is 0.
	Parttime	If CFO works in other company, the value is 1, otherwise it is 0.

3.2.3. Control Variable

The control variables mainly include asset liability ratio, company listing years, enterprise size, operating revenue growth rate, integration of two positions, board size, equity concentration, return on net assets, book to market ratio, see [Table 2](#).

Table 2. Variable description

Variable		Definition
Independent variable	ABFEE	See explanation above.
Dependent variable	CFO power	See explanation above.
Control variable	Lev	Total Liabilities / total assets.
	Age	current year - listed year.
	Size	Size is the natural logarithm of total assets to measure the scale of an enterprise.
	Growth	Growth rate of business income = (main business income of this year - main business income of last year) / main business income of last year.
	Dual	If the chairman and the general manager work together, 1 will be chosen, otherwise 0 will be chosen.
	Boardsize	The number of directors is natural logarithm.
	Top5	Shareholding ratio of top five shareholders.
	Roe	Net profit / net assets.
	Mb	Market value / net worth of assets.

3.3. Model Design

Referring to Gao Yubin et al. (2017) and Chen Songsheng and Cao Yuanyuan (2018), this paper constructs the following model to test the relationship between CFO power and abnormal audit fees:

$$ABFEE = \alpha_0 + \alpha_1 CFO + \alpha_2 Controls + \sum YEAR + \sum IND + \varepsilon_0$$

When α_1 is significantly negative, hypothesis 1 holds.

In order to verify the moderating effect of property rights on the relationship between CFO power and abnormal audit fees, two groups of data are divided into state-owned enterprises and non-state-owned enterprises.

In order to test the moderating effect of firm size on the relationship between CFO power and abnormal audit fees, we divided the data into two groups: the big four accounting firms and the non big four accounting firms.

4. Empirical Results and Analysis

4.1. Descriptive Statistics

Table 3 is the result of descriptive statistics of each variable. According to the data listed in Table 3, the average value of CFO power is 5.636, which indicates that the overall position of CFO among senior executives in China is relatively low; The average value of abnormal audit fees is 0.204, and the maximum value is 28.487, which indicates that there are great differences in audit fees in China. Other variables are within a reasonable range.

Table 3. Descriptive statistics

Variable	Obs	Mean	Std.Dev.	Min	Max
ABFEE	12,488	0.197	0.313	0.000	10.694
CFO power	12,488	5.717	0.935	3.186	9.338
Top5	12,488	0.541	0.151	0.008	0.984
Growth	12,488	0.414	1.139	-0.648	8.483
Mb	12,488	0.526	0.259	0.020	1.485
Size	12,488	22.054	1.284	18.162	28.636
Lev	12,488	0.928	2.103	-0.611	67.344
Dual	12,488	0.275	0.447	0.000	1.000
Boardsize	12,488	2.133	0.195	1.386	2.890
Roe	12,488	0.039	0.717	-48.155	2.191
Age	12,488	8.486	6.482	0.000	2.000

4.2. Empirical Results

Through multiple regression and group regression, this paper will further explore the relationship between CFO power and abnormal audit fees to verify the rationality of the hypothesis. The regression results are as follows:

From the full sample analysis in Table 4, CFO regression coefficient is -0.0121, t value is -4.00, which is also significantly negative at the level of 1%; From the economic point of view, CFO goes from the non "core circle" into the "core circle", which can reduce the company's abnormal audit fees by about 1.21%. This shows that the influence of CFO power on abnormal audit fees is statistically and economically significant, and H1 passes the test.

In the group regression, the CFO coefficient is not significant in the state-owned enterprises, but the CFO coefficient is -0.0135, t value is -3.33 in the non-state-owned enterprises, the CFO power and abnormal audit fees are significant at the level of 1%, which shows with the increase of CFO power, the CFO's ability to check and balance the CEO and other executives' decision-making is enhanced, which can inhibit other executives' fraud behavior to enhance the restraining effect of CFO power on abnormal audit fees that in the non-state-owned enterprises. Therefore, the increase of CFO power is helpful to reduce abnormal audit fees, which is more significant in non-state-owned enterprises, and H2 has passed the test.

Table 4. Regression analysis

Variable	Full sample	State-owned	Non-state-owned	Big four	Not four
	ABFEE	ABFEE	ABFEE	ABFEE	ABFEE
CFO power	-0.0120*** (-3.97)	-0.00649 (-1.48)	-0.0135*** (-3.33)	-0.00501 (-0.20)	-0.0121*** (-4.09)
Top5	0.0172 (0.72)	0.116*** (3.25)	-0.00858 (-0.25)	-0.302 (-1.54)	0.0278 (1.11)
Growth	0.0000333*** (22.26)	0.0000328*** (66.08)	0.000172*** (6.08)	0.000199 (0.88)	0.0000334*** (22.46)
Mb	-0.128*** (-7.05)	-0.0633*** (-2.61)	-0.147*** (-5.57)	0.0867 (1.01)	-0.138*** (-7.17)
Size	0.0134*** (3.46)	0.00979 (1.36)	0.0137*** (2.95)	0.0255 (1.15)	0.0131*** (4.00)
Lev	-0.000280 (-0.23)	0.00253 (0.80)	0.000271 (0.21)	-0.00940 (-0.47)	-0.000394 (-0.32)
Dual	-0.00574 (-1.02)	-0.0187* (-1.80)	-0.00342 (-0.52)	-0.0849* (-1.72)	-0.00306 (-0.54)
Boardsize	-0.0183 (-1.10)	-0.0446 (-1.37)	0.0205 (1.08)	-0.294 (-1.48)	-0.00325 (-0.23)
Roe	-0.0740*** (-3.82)	-0.0784 (-1.41)	-0.0720*** (-3.52)	-0.255 (-1.58)	-0.0742*** (-3.83)
Age	0.000676 (1.18)	0.00100 (1.25)	0.00160 (1.49)	-0.00581** (-2.03)	0.000869 (1.46)
_cons	0.167* (1.81)	0.0399 (0.34)	0.0327 (0.28)	0.545 (1.29)	0.00374 (0.05)
Annual effect	control	control	control	control	control
Industry effect	control	control	control	control	control
N	12488	3915	8046	602	11886
R ²	0.044	0.053	0.051	0.060	0.050
adj. R ²	0.041	0.043	0.046	-0.002	0.047

The CFO coefficient is -0.0121 and the T value is -4.09 in the enterprises not audited by the big four accounting firms. The CFO power and abnormal audit fees are significant at the level of 1%, but they are not significant in the enterprises audited by the big four accounting firms. It shows that small accounting firms with larger bargaining space are more likely to give up professional ethics to meet the needs of customers in order to survive in the fierce competition. Therefore, in the small accounting firms, the increase of CFO power can reduce the abnormal audit fees more obviously, H3 passed the test.

4.3. Robustness Check

In order to further test the robustness of the conclusion of the impact of executive academic experience on audit opinion, this paper uses the instrumental variable method to deal with the problem of missing variables. This paper uses CFO power lag one period (1_ CFO power) as the tool variable. Table 5 reports the results of this test. In the first stage, 1_ CFO power has a significant positive correlation with abnormal audit fees at 1%, which indicates that CFO power with one lag period has an impact on abnormal audit fees, and the instrumental variable is in line with the theoretical expectation. In the second stage, CFO power is still significantly positive, which indicates that CFO power is still significantly positively correlated with abnormal audit fees, so it further verifies the hypothesis of this paper.

Table 5. Regression results of tool variables

Variable	The first stage	Variable	The second stage
	ABFEE		ABFEE
l_CFO power	-0.015*** (0.000)	CFO power	-0.018*** (0.000)
Top5	-0.007 (0.813)	Top5	-0.007 (0.812)
Growth	0.009*** (0.001)	Growth	0.009*** (0.001)
Mb	-0.114*** (0.000)	MB	-0.116*** (0.000)
Size	0.011*** (0.000)	size	0.011*** (0.000)
Lev	-0.003** (0.038)	lev	-0.003** (0.037)
Dual	-0.007 (0.248)	Dual	-0.008 (0.216)
Boardsize	-0.010 (0.540)	Boardsize	-0.009 (0.566)
Roe	-0.080*** (0.000)	ROE	-0.079*** (0.000)
Age	0.001** (0.035)	AGE	0.001** (0.032)
_cons	0.068 (0.373)	_cons	0.102 (0.122)
Annual effect	control	Annual effect	control
Industry effect	control	Industry effect	control
N	9,299	N	9,299
adj. R ²	0.035	adj. R ²	0.034

5. Conclusion

A large number of literatures have examined the role of CEO power in resource allocation and organizational performance, and only a few have studied the role of CFO power in corporate governance, strategy formulation and implementation. Based on this, this paper takes A-share listed companies in Shanghai and Shenzhen stock exchanges from 2007 to 2019 as research samples to explore the relationship between CFO power and abnormal audit fees. The results show that, firstly, there is a significant negative correlation between the power of CFO and abnormal audit fees, that is, the higher the power of CFO, the lower the abnormal audit fees; Secondly, the nature of ownership and the size of accounting firms are important moderators of the relationship between CFO power and abnormal audit fees. When the enterprise is non-state-owned or audited by small accounting firms, the negative impact of CFO power on abnormal audit fees is more significant.

Accordingly, the results show that the power allocation and power size of CFO in senior executives do have an impact on audit pricing, which helps to curb abnormal audit fees. This shows that CFO should play a full role in the audit pricing negotiation between the company and the accounting firm. However, as mentioned above, CFO's position in Chinese companies is not high. Only by effectively enhancing CFO's position and power in the corporate organization can it give full play to its role in corporate governance, strategy formulation and implementation, resource allocation and organizational output.

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