Accounting and Auditing with Application

www.aaa.reapress.com

Acc. Aud. Appl. Vol. 1, No. 4 (2024) 187–195.

Paper Type: Original Article

Business Risk and Audit Fees as Moderators of Operational Complexity: Further Evidence from an Emerging Market

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Citation:

Received: 27 October 2023 *Revised: 23 January 2024* *Accepted: 12 April 2024*	Imeni, M., & Alqahtani, H. (2024). Business risk and audit fees as moderators of operational complexity: Further evidence from an emerging market. *Accounting and auditing with application, 1*(4), 187-195.

Abstract

This study examines the impact the Business Risk (BR) on the auditing fees in companies listed on the Tehran stock exchange. The statistical sample of this research includes the financial information of 113 companies in the period 2012-2019. This research is based on the analysis of panel data. The results show a positive and significant relationship between BR (financial leverage) and audit fees. There is no significant relationship between BR (Z-Altman's) and audit fees. OC does not significantly affect the relationship between BR (financial leverage) and audit fees. OC does not significantly affect the relationship between BR (Z-Altman's) and audit fees.

Keywords: Business risk, Audit fees, Operational complexity.

1 | Introduction

The environment of the unit under consideration determines the limits of the auditor's activity; therefore, it can be considered that a significant part of the audit service fee is affected by the conditions and characteristics of the unit under consideration, including the risk, size, and complexity of the unit's operations [1]. Auditors use various factors to price audit services. The auditor determines this amount according to its assessment of the scope and risk of the audit work [2]. Hamada's studies [3] believe that BR has a positive relationship with a company's financial leverage, operational leverage, and BR and that auditors should assess the risks in each of their audit engagements and reflect these risks in audit pricing [4]. Other factors that affect the audit should be considered, such as the size of the company, the risk to the entrepreneur, the complexity of the audit process, etc [5]. Nikkinen and Sahlström [6] investigated the effect of risk on the pricing of audit services in

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10.22105/aaa.v1i4.49

the UK. This research shows that the fee for audit services is directly related to the dimensions of risk (financial risk, operational risk, and BR).

According to the results of this research, agency costs, the size of the company, and the complexity of the audit can describe the fees for audit services. As the audit fee is a positive function of risk, it should have a positive relationship with the risk dimensions. As a result, it can be assumed that there is a positive relationship between the audit fee and the company's BR (operating leverage, etc.). The importance of assessing BR is reflected in recent auditing standards. These standards require the auditor to understand the client's BR to identify areas of financial reporting stress. Another factor that affects the audit fee is the complexity of the business and, in fact, the complexity of the auditor's work process because it increases the auditor's effort and, therefore, the audit fee [7].

A proper understanding of these factors will help auditors assess the risk arising from their work properly and work harder to mitigate it. As a result, the more effort they put in, the higher the audit fee. On the other hand, the more complex the business owner's activities, the more effort the auditor has to put in, which in turn affects the auditor's fee. It is expected that as the activity's complexity increases, the BR will also increase, which may have an interactive effect on the audit fee. This study analyzes the relationship between Operational Complexity (OC), BR, and audit fees in the emerging market of Iran and provides several scientific and practical:

First, this research analyzes the Iranian market due to the need for studies in the auditing field in emerging markets. It provides new insights on how OC and BR affect audit fees. This research fills the scientific gap in emerging market research literature and helps develop new concepts in this field.

Second, considering that OC (such as complex organizational structures, product diversity, and financial status) directly affects auditors' time and effort, this study shows that companies with greater OC usually require more detailed and comprehensive audits, which lead to the fee increase being audited. Third, this study provides practical implications for companies and audit institutions in Iran.

Companies can expect higher audit fees based on their OC and BR level, and auditors can adjust their audit programs based on companies' complexity and risk level. Iran's emerging market has created a challenging and risky environment for businesses and auditors due to changing economic conditions and international sanctions. This research helps clarify the relationship between OC and BR with audit fees. It shows auditors how to optimize their activities in the face of these complexities and risks. Also, for researchers and students in the auditing field, this research is a valuable source for studying emerging markets and Iran's special economic conditions.

2 | Theoretical Literature and Hypotheses

2.1 | Operational Complexity

OC refers to activities that cause the normal routine of the reporting unit's operations to be subject to obstacles that require a total effort to resolve. In other words, OC is a set of additional activities that all parties involved in the matter must undertake to be able to carry out the normal routine of their activities without interruption or problems. Factors leading to complexity of operations may be internal (within the organization) or external.

Among the internal factors (within the organization) that affect the complexity of the operations of the reporting unit are geographical diversity (dispersion of the reporting unit in the field of distribution, production, etc.), the number of exports, diversity in the production of products, the number of employees, the volume of activity, etc. Regarding external factors, we can also refer to national and global laws and regulations or global trade, competition, competitive markets, the expectations and needs of stakeholders, and so on. The level of complexity, therefore, depends on the factors considered. The level of complexity in a small bakery, whose members are the shareholders (owners) themselves, could be improved. Because its

management is much simpler, and monitoring and control are more effective. As a business grows, so does the amount of communication and complicating factors; a multinational reporting unit with a geographically dispersed workforce, each unit subject to the laws and regulations of a geographical area, is usually more complicated than a bakery. Large companies are, therefore, inherently more complex. This is because managers' decisions are subject to more complicating factors. Managers and employees of complex units should be equipped with technologies and processes to obtain more information, depending on the environment and the needs of the environment. The complexity of management, therefore, increases with the complexity of the business.

2.2 | Complexity of Audit Profession

Users of financial information know that complex financial matters can always contain accidental or deliberate errors. Therefore, to obtain the desired satisfaction from the quality of information, experts and experienced people should credit the said information. To pay more attention to audit quality in the context of increasing accounting complexity, auditors seek more help from experts in tax, information technology, valuation, and forensic accounting [8]. A task is considered complex when the decision-maker is unfamiliar with the task or has to process a large amount of information to make a decision [9].

The complexity of the financial statements is distinct from the OC of the audited entity, as specialist auditors invest more resources in complex financial statements than in the OC of their client, and both are positively related to complexity. Audit fees are associated. Industry specialist auditors differ from non-specialist auditors in their ability to serve complex clients. Specialist auditors are more likely than non-specialist auditors to invest more in technology and human resources to audit complex operations effectively [10]. Auditors have more confidence in the accuracy of their judgments for tasks described as easy but need more confidence in their decisions for difficult or complex tasks. There is a reason for this. This is because auditors expect to make accurate judgments in a simple task (as opposed to a complex task).

Audit value comprises three components, the relative importance of which changes over time according to the changing economics of the business. These three components are Fraud detection, auditing as an element of corporate governance, and contributing to the transparent functioning of the capital market. Fraud detection is important in the initial audit, but its role has diminished with the advent of risk-based auditing and the increasing complexity of business. As a company grows, it becomes more complex and increasingly difficult and costly to trust its financial statements [11]. Therefore, paying attention to the complexity of the audit work and acquiring the necessary knowledge of the audited institutions and enterprises can play a significant role in improving the quality of the audit and, consequently, the effectiveness of the audit, regardless of whether the audit is of four types, all the more desirable.

With the organization being audited, it can have significant effects on the audit results, in such a way that some kinds of audits, such as performance audits, cannot achieve adequate results without knowledge, and the basis of the audit is based on better and more understanding. It is stated that in this regard, the classification of the entities under audit should be made in a specialized manner so that the auditors, while being thoroughly familiar with the laws and regulations of the entities under audit, also have a complete and accurate knowledge of the objectives, duties, and powers of the entities under audit. By providing more detailed and in-depth reports while increasing the effectiveness of the audit, they can be more effective in the corrective movement of the entities to fulfill the assigned tasks.

As stated in the definition of the task, a task is considered complex when the decision-maker is unfamiliar with the task or has to process a large amount of information to make a decision. In this regard, the Iranian auditing standard in No. 315, entitled Knowing the unit under review and its environment and estimating the risks of material misstatement, deals with the importance of the auditor's knowledge of the unit under review and states; to identify and assess the risks of material misstatement of the financial statements due to fraud or error, and to design and perform the necessary audit procedures, the auditor needs to obtain sufficient knowledge of the audited entity and its environment, including internal control. The audit standard addresses

the use of knowledge of the audited entity in planning the audit. It states that Acquiring knowledge of the audited entity and its environment is a crucial aspect of performing an audit according to the auditing standards. In particular, this knowledge provides a framework within which the auditor plans the audit and applies professional judgment in assessing the risks of material misstatement of the financial statements and how to respond to those risks during the audit.

2.3 | Business Risks

BR is the probability of loss resulting from essential operations, such as product completion, and is recognized in the firm's earnings. Three criteria for measuring BR are earnings volatility, operating leverage, and dividend payout ratio [12]. BR can be defined as the inability of the company to be stable in the competitive environment or to maintain the growth rate or stability of profitability in the short or long term, which is affected by economic and operational risk. In such a case, the company's dividend will decrease, which will negatively impact the yield and volatility of the annual yield.

According to Russell, BR is industry-specific. Therefore, an organization may need help understanding the management of developing and implementing strategies related to achieving business goals and existing values. This risk involves evaluating internal and external risk factors in terms of their negative or positive impact on business and strategic opportunities in the company using mathematical methods [13].

The stock market plays a constructive role in equipping the capital market and financing productive economic activities, but this market is very vulnerable. Political factors, financial decisions, and sometimes crises and social unrest can tense the stock market and cause investors to suffer huge losses. What is certain is that in developing countries such as Iran, where the capital market still needs more mobility, dynamism, and efficiency, any convulsions in this market can obscure the investment process. The influence of large investors on management's financial decisions, such as the composition of ownership structure and stock market value, is significant and can significantly affect market reactions. Changes and developments in other parallel financial markets (banking, foreign exchange, housing, etc.) change the liquidity of the markets according to the degree of substitution of the markets.

2.4 | Audit Fees

The audit fee is one of the most critical issues for the company and the auditor and should be negotiated. An effective audit plans and performs appropriate and high-quality audit work. Low audit quality reduces the confidence of financial statement users, leading to the failure to achieve audit objectives and reducing the credibility of the audit process on a large scale [14]. According to the Code of Professional Conduct, the audit fee should be determined based on logical criteria such as the duration of the audit process, the costs associated with providing audit services, and the expected profit [14]. The audit fee depends on various factors, the importance of which varies from country to country. The audit fee should be determined based on the time required to perform the audit. In a competitive market for audit services, the additional fee received by the auditor is due to the optimal use of time to perform the audit service. Audit fees reflect the economic costs of efficient auditors. From the auditor's perspective, the auditor seeks to minimize total costs by balancing its resource costs (costs of performing more audit work) and future losses from legal liability.

2.5 | Research Hypotheses

H1: a significant relationship exists between BR (financial leverage) and audit fees.

H2: a significant relationship exists between BR (Z-Altman's) and audit fees.

H3: OC significantly affects the relationship between BR (financial leverage) and audit fees.

H4: OC significantly affects the relationship between BR (Z-Altman's) and audit fees.

3 | Methodology

3.1 | Statistical Population

The statistical population of this research is all companies listed on the Tehran Stock Exchange during the period 2012-2019. To make the study's statistical population, the following limitations were considered.

I. Audited financial information should be available for each company studied.

II. The companies have kept their financial year the same during the research period.

III. Companies that are active on the stock market from 2012 to 2019.

IV. Not belonging to investment and financial intermediation companies (banks, insurance companies, etc.).

Finally, the final sample size is shown in *Table 1*, according to the systematic elimination method and based on the above criteria. After applying the above conditions, 113 firms were studied.

Research model

The following multivariate regression model is used to analyze the research hypotheses:

$$\mathrm{LNFEE_{it}} = \alpha_0 + \beta_1 \mathrm{BR_{it}} + \beta_2 \mathrm{B/M_{it}} + \beta_3 \mathrm{QUICK_{it}} + \beta_4 \mathrm{CURRENT\ RATIO_{it}} + \beta_5 \mathrm{ICW_{it}} + \beta_6 \mathrm{BIG4_{it}} + \beta_7 \mathrm{AUDIT(OP)_{it-1}} + \beta_8 \mathrm{SPEL_{it}} + \varepsilon_{it} \quad (1)$$

$$\mathrm{LNFEE_{it}} = \alpha_0 + \beta_1 \mathrm{BR_{it}} + \beta_2 \mathrm{CO_{it}} + \beta_3 \mathrm{CO} * \mathrm{BRi_{it}} + \beta_4 \mathrm{BM_{it}} + \beta_5 \mathrm{QUICK_{it}} + \beta_6 \mathrm{CURRENT\ RATIO_{it}} + \beta_7 \mathrm{ICW_{it}} + \beta_8 \mathrm{BIG4_{it}} + \beta_9 \mathrm{AUDIT(OP_{it-1})} + \beta_{10} \mathrm{SPEL_{it}} + \varepsilon_{it} \quad (2)$$

Dependent variable

The dependent variable in this research is the audit fee (Ln fee), which is taken from the natural logarithm of the auditor's fee.

Independent variable

The independent variable in this research is BR. According to the study by Chen et al. [15], BR is based on (1) financial leverage and (2) Z-Altman's.

I. Financial leverage is obtained by dividing total liabilities by total assets.

Z-Altman's index is used, and it is obtained as follows:

II. Z-Altman=1/2(working capital/total assets)+1/4(retained earnings/total assets)+3.3(profit before tax/total assets)+0.6(market value of equity/total liabilities)+0.999(sales)/total assets).

Modifier variable

CO: there are various variables to measure the complexity of the audit. According to Chen et al. [15], total accounts receivable and inventory were used in this research. It is obtained from the total ratio of inventories and receivables to total assets, which is one if the figure obtained is higher than the industry average and 0 otherwise [15], [16].

Control variables

Current ratio (QUICK): it is obtained by dividing current assets by current liabilities.

Current ratio: it is obtained by dividing current assets, less inventories, and prepayments by current liabilities.

Internal Control Weakness (ICW): 1 if the audit reports the virtual variable and 0 otherwise.

Size of the audit firm (BIG): 1 if it is an Iranian audit organization; otherwise, 0.

The Auditor's Opinion (AUDIT(OP)): if the auditor's opinion is unqualified, it takes the value 1. Otherwise, it takes the value 0.

Auditor's Expertise (SPEL): it is obtained by dividing the wealth of an audit firm's owners by the total wealth of the owners in that sector. If the numbers obtained is higher than the average, it is equal to 1; otherwise, it is equal to 0.

4 | Research Findings

4.1 | Descriptive Statistics

This section discusses descriptive statistics indices, which include central indices (maximum, minimum, mean) and dispersion indices, standard deviation. The results are indicated in *Table 1*.

Table 1. Statistic of variables.

Variable		Symbol	Average	Median	Max	Min	Sd.
Fees		LNFEE	6.96	6.93	9.50	4.79	0.80
Z-Altman	BR	Z	2.92	2.84	8.11	-4.48	1.79
Financial leverage		LEV	0.63	0.59	3.97	0.04	0.39
Book value to market value		BM	0.51	0.41	1.58	0.0007	0.25
Institutional ownership		Owner	0.64	0.74	0.98	0.006	0.26
Current ratio		QUICK	1.48	1.29	7.61	0.07	0.93
Current ratio		CURRENT	0.93	0.78	5.61	0.03	0.67
Weak internal control		ICW	0.27	0.00	1	0.00	0.34
Auditor's opinion		OP	0.49	0.00	1	0.00	0.44
BIG		BIG	0.20	0.00	1	0.00	0.40
Auditor expertise		SPEL	0.49	0.0000	1	0.0000	0.50
OC		CO	0.50	1	1	0.00	0.50

The mean is the most important and most used central indicator. The average value lies precisely at the data's equilibrium point and centre of gravity. Variables of suitable quality do not differ significantly between their mean and median.

4.2 | Results

The first hypotheses to be tested with this *Model (1)* are as follows:

The results of the hypotheses test (1 and 2) based on the above model are shown in *Table 2*.

Table 2. Test results for the first model.

Variable	BR (Financial Leverage)			BR (Z-Altman)		
Symbol	Coeff.	t stat.	Sig.	Coeff.	t stat.	Sig.
C	7.03	62.64	0.0000	6.93	58.98	0.000
BR	-0.11	-2.46	0.0142*	-0.005	-0.23	0.8136
OWNER	-0.03	-0.14	0.8843	-0.03	-0.15	0.8749
BM	0.07	0.666	0.5053	0.09	0.84	0.4002
QUICK	-0.13	-1.279	0.2013	-0.106	-1.02	0.3036
CURRET	0.15	1.160	0.2462	0.148	-1.09	0.2734
ICW	-0.07	-0.564	0.5729	-0.072	-0.56	0.5712
BIG	-0.25	-2.95	0.0032	-0.250	-3.07	0.0022
OP	0.02	0.561	0.5746	0.026	0.59	0.5544
SPEL	0.32	3.159	0.0017	0.339	3.15	0.0017
R-squared		0.68		0.68		
Adj. R-squared		0.62		0.62		
F-stat.		11.11		11.08		
Durbin-Watson stat.		1.83		1.82		

According to *Table 2*, the significance level between the two variables is equal to 0.813, which is higher than the significance level considered in this study (5%), as well as the absolute value of the t-statistic, which is

equal to 0.23 of 1.96, which corresponds to the distribution. The normal standard is 0.95, it is less; therefore, at the 95% confidence level, the null hypothesis that there is no significant relationship between BR (Z-Altman's) and audit fees is confirmed, and the main hypothesis is not confirmed. Meanwhile, the results showed that financial leverage as BR has a significant relationship with audit fees.

The second model

The third and fourth hypotheses were tested using the following *Model (2)*. The results are shown in *Table 3*.

Table 3. The result of the second model test.

	BR (Financial Leverage)			BR (Z-Altman)		
Variable Symbol	**Coeff.**	**t stat.**	**Sig.**	**Coeff.**	**t stat.**	**Sig.**
C	7.03	78.81	0.0000	6.97	66.24	0.000
BR	-0.09	-1.06	0.2860	-0.006	-0.23	0.7882
CO	-0.017	-0.120	0.9042	-0.06	-0.384	0.7010
BR*CO	-0.02	-0.183	0.8548	0.005	0.173	0.8626
OWNER	-0.04	-0.185	0.8527	-0.04	-0.20	0.8376
BM	0.07	0.595	0.5520	0.08	0.72	0.4698
QUICK	-0.13	-1.17	0.2386	-0.105	-0.96	0.3336
CURRET	0.15	1.08	0.2790	0.144	1.02	0.3036
ICW	-0.07	-0.565	0.5721	-0.073	-0.56	0.5716
BIG	-0.26	-2.85	0.0045	-0.255	-2.80	0.0052
OP	0.02	0.571	0.5676	0.027	0.615	0.5382
SPEL	0.32	3.106	0.0020	0.339	3.16	0.0016
R-squared		0.68		0.68		
Adj. R-squared		0.62		0.62		
F-statistic		10.90		10.87		
Durbin-Watson stat.		1.83		1.83		

According to *Table 3*, the level of significance between two variables is equal to 0.86, which is higher than the level of significance considered in this study (5%), as well as the absolute value of the statistic, which is equal to 0.173 of 1.96, which corresponds to the distribution The normal standard is 0.95, it is less; therefore, at the 95% confidence level, the null hypothesis that OC does not have a significant effect on the relationship between BR (Z-Altman's and leverage) and audit fees is confirmed, and the main hypothesis is not confirmed.

5 | Conclusion

The evidence on the relationship between graduates of current auditors on the audit committee and low audit fees suggests that cognitive proximity may improve communication and understanding between audit committees and auditors. In this respect, experts and experienced people from the audit firm have the right expertise to serve on the audit committee and effectively evaluate the costs and benefits of the auditor's services. However, a close relationship with the current auditors can enhance or detract from the quality of the audit committee's decisions. In particular, experts and people with audit experience who have a higher cognitive level can communicate with auditors and understand the audit process and audit risk. This may influence the auditors' assessment of audit risk [17], [18].

Auditing and accounting are part of the supervisory dimension of any system. They are widely used from the highest level of the country's administration to the smallest business unit because every system needs monitoring and feedback to be sustainable, but despite the scope of audit work, due to its necessity, determining the fee for this service in our country is not based on a scientific model, but on a logical and defensible basis. It is impossible to say at what cost this work can be done according to the unit's characteristics under consideration [14].

Therefore, the change in the audit approach from a systematic activity to a risk-based activity has meant that from now on, more attention will be paid to the quality and methods of work because the lower the quality of work methods, the higher the professional risk will be [7]. The importance of BR assessment is evident in recent auditing standards. These standards require the auditor to understand the client's BR to identify areas

that pressure financial reporting. Another factor that affects the audit fee is the complexity of the business and, in fact, the complexity of the auditor's work process; as it increases the auditor's effort, the audit fee increases.

The limitations of the present research can be mentioned as follows:

I. The present research was carried out using the data of companies listed in the Tehran Stock Exchange, and the investment, leasing, and insurance companies were excluded from the statistical population due to the special nature of their activities, so the results obtained cannot be generalized to all companies.

II. Unavailability of information on all companies for data analysis.

III. The main limitation of the research is the small number of companies studied, which we had to reduce to have common characteristics. Although the number of companies studied is more significant, the statistical results will be better.

IV. Impossibility of easy and sufficient access to the right amount and type of information needed.

This section proposes two categories of suggestions based on the research results and findings: practical suggestions expected to help users of accounting and financial information, especially investors and managers, in their decision-making and recommendations for future research that can guide future research on the research topic.

Practical research suggestions

I. Based on the findings of the present research, investors and capital market activists are suggested to pay attention to the company's risk components in addition to the financial variables when making investment decisions and consider them an influential factor in determining the audit fees of companies in considering their decision models.

II. It is also suggested that the regulators of the audit market, including the accountancy profession and the audit organization, develop a suitable model for pricing audit services based on the company's risk components.

III. It is suggested that company managers use the audit report as a reassuring factor to reduce BRs.

Author Contributions

Mohsen Imeni conceptualized the research and contributed to the design and methodology, data collection, and analysis. Haifa Alqahtani assisted with data interpretation, provided critical revisions, and helped with drafting and editing the manuscript.

Funding

This study received no specific financial support from public, commercial, or non-profit funding agencies.

Data Availability

The data used in this study are derived from publicly available financial reports of companies listed on the Tehran Stock Exchange. Further information about data sources and access can be obtained from the authors upon reasonable request.

Conflicts of Interest

The authors declare that there are no conflicts of interest regarding the publication of this article.

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