

# Examining the Impact of Labor Market Flexibility on the Relationship between the Workplace and Audit Fees

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**Abstract:** Examining the variables that impact the costs of conducting audits is a captivating subject within the realm of accounting and auditing research. Prior studies have examined the variables that influence audit fees. This research specifically explores the moderating impact of labor market flexibility on the relationship between the workplace and audit fees. The research focused on the companies that were listed on the Tehran Stock Exchange from 2014 to 2018. The sample size for the study was 106 companies. The data has been analyzed and the research hypotheses have been tested using the ordinary least squares regression with fixed effects data technique. The findings indicate a significant relationship between the workplace and the labor market's flexibility with respect to the audit fee. Specifically, the auditor's workplace is inversely related to the audit fee, as is the flexibility of the labor market. Additionally, it was discovered that the level of flexibility in the labor market plays a moderating influence in the relationship between the workplace and audit fees.

**Keywords:** Labor Market Flexibility, Audit Fee, Auditor's Workplace

## Introduction

The auditor is a significant shareholder in a firm, and the impact of client characteristics on auditors' behavior is a crucial and widely studied topic in accounting literature research (Ormazábal, 2018).

When determining pricing strategies, auditors assess the expenses associated with conducting an audit, the likelihood of legal action involved, and the probability of non-legal issues stemming from the client's probable failure. The audit processes and efforts are modified to minimize potential expenses associated with risks specific to the customer. Auditors provide compensation for risks that are expensive to mitigate and cannot be addressed by increasing the audit effort (Houston et al., 2005; Pratt and Stice, 1994; Simunic, 1980). Hence, any variable associated with the client's particular hazards can impact the auditors' determinations. Given that employees can serve as a means of achieving a lasting competitive advantage and contribute to a company's success in the market, auditors who are focused on customer performance and risk may find information on employees or the workforce to be of interest. Auditors have previously demonstrated their keenness towards the workplace. Rebecca Debs, a partner at Ernst & Young, asserts that organizations may enhance workplace productivity by effectively overseeing the environment, health, and safety (Fulmer et al., 2003).

Recent research indicates that a workplace that is conducive to family needs can have a dual benefit for

organizations. Firstly, it can assist in the recruitment and retention of highly skilled individuals. Secondly, it can serve as a catalyst for increased cooperation and productivity among employees (Hom et al., 2017; Turban and Cable, 2003). Furthermore, empirical research indicates that companies operating in a favorable workplace demonstrate superior performance and evaluation, higher levels of innovation, reduced internal control inefficiencies, and lower costs of debt capital compared to those operating in less favorable environments (Bloom et al., 2000; Chen et al., 2016; Guo et al., 2016).

According to a study conducted by Guo et al. in 2016, individuals who work in a setting that is supportive of their well-being are less likely to encounter significant internal control problems. Moreover, Ji et al. (2018) discovered that auditors impose elevated costs on companies that reveal noteworthy non-financial internal control deficiencies.

Thus, a positive labor environment, which is the key factor in non-financial data, may be seen as a sign of minimal risk in client internal control and highly reliable client financial statements. Thus, these favorable indicators decrease the expenses associated with conducting audits. Furthermore, a conducive work atmosphere has the potential to decrease the occurrence of labor disputes. Employees are more inclined to withhold reporting instances of managerial wrongdoing when they are employed in a gratifying workplace (Gong et al., 2018; Redmayne et al., 2010).

Reduced media coverage of labor-related controversies is expected to decrease audit costs from the standpoint of audit risk. This is because when there is less public attention on the client, the risk of auditor lawsuit is also reduced (Gong, 2003).

Based on these research, we propose that companies with a positive workplace are comparatively less risky. Consequently, auditors charge lower rates to these companies since they require less audit effort and have fewer insurance needs for audit risk. Moreover, the impact of work-related information may differ among jurisdictions with distinct labor market characteristics. The impact of labor market flexibility on the relationship between workplace and audit costs remains unresolved, as it is influenced by factors like as firing and hiring expenses, employee mobility, and worker behavior. In labor markets that are more flexible, companies that offer better working conditions can more readily replace less efficient employees with less efficient ones due to their greater ability to make cost adjustments compared to companies in less flexible labor markets. Simultaneously, in labor markets that are more adaptable, employees who do not meet expectations face the possibility of job termination if they neglect their duties, so compelling them to enhance their performance. Consequently, organizations that function within a flexible labor market and maintain a good workplace may experience consistent or enhanced staff productivity. This, in turn, can lead to higher corporate performance, thereby decreasing audit risk to a greater extent. (Dyck et al., 2010).

Hence, nations with a high degree of labor market flexibility offer larger advantages for investing in the labor environment. In such countries, enterprises have the ability to swiftly and effortlessly adapt their personnel as needed. Consequently, we believe that auditors are more inclined to decrease audit fees for organizations that possess a positive working environment and are situated in nations with more adaptable labor markets. The primary focus of this research is to determine whether the flexibility of the labor market plays a moderating influence in the link between the workplace and the audit fee.

### Method

This study is applied and correlational in terms of purpose and nature, respectively. The sample for this study consisted of 522 companies that were listed on the Tehran Stock Exchange between 2014 and 2018. The sampling process employed the systematic method. A sample size of 106 companies was chosen for statistical analysis. The criteria for selecting the samples are as follows: the financial year must end in March and remain consistent throughout the research period, the organizations must have been active during the financial period, and the necessary information pertaining to the research variables must be accessible. And are not affiliated with insurance companies, financial intermediaries, or banks.

### Data Collection

The required data for this study were collected by consulting the financial statements, explanatory notes, and activity report of the selected companies. Additionally, data were obtained from the image and statistical archive compact discs of the Tehran Stock Exchange Organization, the stock exchange website, and other relevant databases. Tadbir Pardaz and Rahvard software were also used as sources of data. The data were processed for analysis following collection and transfer to an Excel spreadsheet, and subsequent application of the required calculations. Econometric software, Eviews, was utilized for the ultimate analysis of the data.

### Data Analysis

Initially, the unprocessed data was inputted into Excel software in order to derive the final data and do necessary computations. Subsequently, the conclusive data from the research was imported into Eviews 10th

edition software for analysis utilizing the statistical method of panel data. The analyses were conducted in two distinct stages: descriptive and inferential. The descriptive statistics of study variables encompass central measures of tendency such as the mean and median, measures of dispersion including the maximum, minimum, and standard deviation, and measures of distribution such as skewness and kurtosis. Prior to fitting the research models, an assessment was conducted to verify the normality and collinearity of the research variables. The normality of the distribution of the research variables was assessed using the Jarque-Bera test. The absence of collinearity between the variables was evaluated using the Variance Inflation Factor. The significance of the variables was determined using the Levin, Lin, and Chu test. Given the characteristics of the data, regression models were employed to examine the study hypotheses.

### Findings

The statistical analysis revealed a negative estimated coefficient of approximately 20% for the workplace variable. The t-test yielded an absolute value greater than two, indicating a significance level of less than 5% (0.0000). Consequently, it can be asserted that there exists a significant relationship between the workplace conditions and the fees charged for audits (as seen in [table 1](#)). Furthermore, the variable coefficient type signifies the existence of a negative and inverse relationship with audit fees.

The analysis of the relationship between labor market flexibility and audit fees reveals that the estimated coefficient for the labor market flexibility variable in [table 1](#) is approximately -5 percent. Additionally, the absolute value of the t-test exceeds two, indicating a significance level of less than 5 percent (0.0000). Hence, it can be concluded that there is a notable relationship between labor market flexibility and audit fees. The coefficient of the variable type suggests the presence of a negative and inverse association with audit fees.

The statistical analysis revealed that the coefficient of the interaction variable between labor market flexibility and workplace in [table 1](#) is approximately 16 percent positive. The t test yielded an absolute value greater than two, indicating that the obtained significance level is less than 5% (/0000). Hence, it can be asserted that the labor market's flexibility plays a moderating function in the relationship between the workplace and the audit fee. Furthermore, the presence of a variable coefficient suggests a positive and direct relationship with the audit fee.

**Table 1.** Overview of the Statistical Findings from the Research Model Examination

	Factor	Std.	T test	Sig.	Variance Inflation Factor
intercept	1/223	1/076	1/131	./0000	-
Labor market flexibility	-./051	./017	-2/881	./0000	2/497
Audit workplace	-./201	./045	-4/468	./0000	1/129
Flexibility of the labor market * workplace	./161	./036	4/427	./000	2/481
Company size	./316	./058	5/447	./0000	1/312
Debt ratio	./706	./221	3/195	./0015	2/172
Inventory ratio	./599	./211	2/832	./0047	1/100
Rate of return on assets	1/109	./344	3/221	./0013	2/282
Function type	2/310	./180	12/792	./0000	1/504
Type of audit firm	-./418	./076	-5/475	./0000	1/076
Market to book ratio	./592	./299	1/977	./0482	1/106
Board size	./258	./104	2/473	./0135	1/052
board Independence	./202	./216	./934	./3506	1/132
earning management	./210	./173	1/213	./2255	1/268
current ratio	-./007	./034	-./227	./8198	1/913
audit committee	./144	./193	./744	./4570	1/948
Independence of the audit committee	./032	./180	./182	./8556	1/542
Financial skill of the committee	-./108	./136	-./798	./4248	1/600
CEO duality	-./141	./069	-2/032	./0427	1/147
gross domestic product	-./233	./372	-./627	./5310	1/174
Fisher's F	15/968		durbin watson test		1/991
Fisher's F significance	./0000		Adjusted R <sup>2</sup>		./7782

### Discussion and Conclusion

The initial finding of this research indicates that there is a significant relationship between the audit workplace and the audit fee, with a statistical significance level of 5%. The statistical research revealed a negative relationship between the audit workplace and the audit fee. Confirming this hypothesis and based on theoretical foundations, academic research indicates that the costs associated with conducting an audit consist of two factors: resource cost and expectation loss (Pratt and Stice, 1994; Simunic, 1980). The resource cost factor quantifies the audit effort, while the expectation loss factor represents the present value of future losses for which the auditor will be held accountable, and is linked to the client's specific risks. Furthermore, auditors do their audit activities with the aim of minimizing anticipated future losses, hence keeping the overall cost of the audit to a minimum (Simunic and Stein, 1996). Furthermore, Houston et al. (2005) propose the inclusion of the non-litigation premium in the audit cost model, encompassing audit effort, litigation risk, and non-litigation premium as a whole. According to Hay et al. (2006), various factors influencing audit fees can be categorized into client characteristics, auditor characteristics, and interaction characteristics. The clients' workforce information is regarded as a client attribute that impacts the pricing behavior of the auditor. The significance of employees in contemporary corporations has been a subject of ongoing discussion for numerous years. Contrary to the traditional view of employees as a mere component of the production process, contemporary management theory emphasizes that employees are a vital asset for the company's achievement. According to the resource-based perspective, organizations' resources can be divided into three categories: physical capital resources, human capital resources, and organizational capital resources (Barney, 1991). Human capital resources encompass the collective knowledge, skills, expertise, discernment, cognitive abilities, interpersonal connections, and unique perspectives possessed by managers and workers inside an organization. Human capital resources possess the attributes of sustainable competitive advantage by virtue of their valued, uncommon, inimitable, and non-substitutable features. These qualities differentiate human capital resources from other types and enable organizations to attain competitive success (Wright et al., 1994).

Hence, it is imperative for organizations to enhance and sustain the productivity and proficiency of their employees in order to stay competitive. Employers can inspire employees not just through traditional monetary incentives, but also by providing non-monetary rewards and welfare-related perks. The non-monetary benefits encompass the chance to engage in the company's decision-making process, flexible work schedules, a more secure workplace, and further training and career advancement prospects. Research has shown that employees demonstrate increased effort and improved task performance when they are provided with a favorable workplace. This, in turn, results in higher levels of productivity and overall performance (Akerlof, 1982; Bloom et al., 2011; Dalal et al., 2012; Levine, 1992).

Furthermore, when employees are treated well, they exhibit increased cooperation and are less inclined to partake in detrimental behaviors. Various research, conducted in both individual nations and global contexts, have presented data indicating that organizations with contented employees are more inclined to surpass their competitors with discontented staff (Chen et al., 2016). Edmans (2011, 2012), Faleye and Trahan (2011), Filbeck and Preece (2003), and Lee and Kim (2016).

Companies that receive high rankings for being friendly towards their employees typically have low levels of debt (Bae et al., 2011), and shareholders want lower rates of return. It is important to understand that these advantages may only apply to treating employees fairly within an acceptable scope. Additionally, providing excessive welfare benefits to employees can negatively impact the value of the company for shareholders. They demonstrate that employees have the option to go from a company or experience detrimental performance if they fail to address an unsuitable workplace. Consequently, inadequate employee treatment rules greatly enhance the likelihood of deficient internal control measures concerning personnel and the potential for misstatement caused by accidental errors (Guo et al., 2016). Companies that possess an unfavorable workplace are prone to experiencing employee conflicts, such as strikes and disputes, which can result in significant financial and reputational damages. Therefore, auditors enhance their professional skepticism regarding hazards that are peculiar to a client when the customer has a weak labor force. This concept has been empirically validated in US contexts by Huang et al. These studies indicate that the workplace of the customer might impact audit expenses in several manners. Creating a more favorable workplace can decrease the probability of financial statement falsification, resulting in reduced audit efforts. Consequently, personnel working in a friendly workplace are more inclined to fulfill their internal responsibilities accurately, and thereby decrease the inclination to experience significant deficiencies in internal control. Furthermore, auditors may benefit from reduced insurance costs for litigation if they operate in a positive workplace for clients, as the likelihood of auditors filing complaints against fundamental abuses is diminished. Moreover, these companies effectively mitigate labor conflicts and controversies that are often highlighted in the media, resulting in less public scrutiny towards both the companies and their auditors. Additionally, this proactive approach significantly minimizes the potential for legal disputes for the auditors. Typically, organizations with a favorable workplace tend to have a comparatively low audit risk. As a result, auditors allocate less resources to these clients and bill them reduced fees.

The second finding revealed that the statistical analysis demonstrated a significant relationship between the labor market's flexibility and the audit fee, with a significance level of 5%. The findings revealed a negative relationship between the labor market's flexibility and the audit fees. In relation to the statistical analysis of the third conclusion, it was discovered that the labor market's flexibility influences the relationship between the audit workplace and audit fees. Based on the theoretical foundations and supporting research by [Choi et al. \(2008\)](#), [Kuo and Lee \(2016\)](#), and [Taylor and Simon \(1999\)](#), the first hypothesis examines the characteristics inside a company's workforce that influence audit costs. Nevertheless, prior research demonstrates that institutional factors, such as the wider legal environment, also have a significant impact on the determination of audit fees. Our second finding examines the level of flexibility in the labor market, specifically how quickly the workforce can adapt to changes in market conditions. We consider this flexibility as a potential factor that influences the relationship between the working environment of the client workforce and audit costs. Our analysis reveals that there is a negative relationship between labor market flexibility and the extent of employment protection regulations ([Gangl, 2003](#)). Job protection legislation impact the expenses incurred by companies in relation to their employees, encompassing both the expenses associated with recruiting each worker and the expenses associated with adapting to changes in job requirements. The first chart illustrates the expenses related to recruitment and the provision of employee benefits, while the second chart depicts the costs connected with significant changes, particularly those arising from employee terminations. The costs will be greater in nations or markets with stringent employment restrictions, resulting in reduced labor market flexibility ([Edmans, 2017](#)).

In countries of this nature, companies engage in less frequent hiring and firing of personnel, resulting in decreased mobility of the labor force and limited outside prospects. In nations with labor markets that are more adaptable, the abundance of employment opportunities in foreign countries enables workers to transition between firms with more ease. In addition, when enterprises have access to a greater number of external alternatives, they must offer increased remuneration in order to retain their highly trained employees. [Shapiro and Stiglitz \(1984\)](#) theorized that if all firms raise their wages, it will lead to a decline in the overall demand for labor. Consequently, employees who neglect their duties face the possibility of being terminated, which motivates them to pursue personal investments. Utilizing data from a prominent Italian bank, the researchers establish that the average number of days of employee absence per week experiences a notable and statistically significant increase following the implementation of employment restrictions. Biogen employs a natural experimental approach in Sweden to investigate the relationship between labor market flexibility and labor productivity. Following the implementation of the Swedish labor law reform, it was observed that the productivity of the work force in small enterprises that were subject to the reforms improved by 2% to 3% in comparison to large companies that were unaffected by the reforms. The author posits that the heightened risk of job termination can serve as a catalyst for employees to exert greater diligence in their work. [Adams et al. \(2017\)](#) and [Gupta and Krishnamurti \(2018\)](#) present more proof about the advantages of implementing employee-friendly policies in nations with a significant degree of labor market flexibility. Based on this debate, it was anticipated that in labor markets that allow for flexibility, companies that provide attractive work conditions are more inclined to keep highly productive employees and dismiss those with low productivity, hence diminishing the risk of termination. It is designed specifically for the existing personnel, compelling them to perform with great diligence. Hence, organizations with a favorable workplace can effortlessly sustain or enhance employee performance owing to the little expenses associated with hiring and firing in adaptable labor markets. Consequently, countries with more transparent labor markets get amplified advantages from having a favorable workplace. Consequently, the auditors' apprehension regarding the particular risk associated with these organizations is diminished even more due to the enhanced adaptability in the labor market.

Based on the research findings, it is recommended that future studies consider using other factors of audit quality, such as audit fee independence and the type of audit firm, as dependent variables.

Furthermore, it is important to consider that the present investigation is conducted independently by several sectors, and the findings are subsequently compared on an industry-specific basis.

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