

The Effect of Corporate Political Risk on Audit Fees

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ABSTRACT

The objective of this study was to examine the effect of political risk on the audit fees of companies listed on the Tehran Stock Exchange. This applied study employed a descriptive-correlational research design. The statistical population consisted of companies listed on the Tehran Stock Exchange during the five fiscal years from 2020/21 to 2024/25. After applying the sampling criteria, 146 companies, representing 730 firm-year observations, were selected. Corporate political risk was measured through a content analysis of the boards of directors' annual reports, and the research hypothesis was tested using a panel regression model. The results indicated that corporate political risk had a positive and statistically significant effect on audit fees. This finding suggests that greater political risk intensifies information uncertainty and audit risk, thereby expanding the scope of audit procedures, increasing the volume of audit testing, and requiring auditors to allocate more time and resources to audit engagements. These factors ultimately increase audit fees. The findings demonstrate that political risk is an important determinant of audit fees. When auditing companies with higher levels of political risk, auditors charge higher fees because of the increased audit risk and the need to perform more extensive audit procedures. By measuring political risk through a content analysis of boards of directors' reports, this study provides new empirical evidence regarding the role of political risk in determining audit fees in the Iranian capital market. The findings may assist financial statement users, audit firms, and policymakers in improving risk assessments and related decision-making.

Keywords: corporate political risk, audit fees, Tehran Stock Exchange

Introduction

Independent auditing is a fundamental component of corporate governance and an essential mechanism for enhancing the credibility of financial reporting. By examining whether financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework, auditors reduce information asymmetry between corporate managers, shareholders, creditors, regulators, and other stakeholders. The assurance provided by an independent audit is particularly important in capital markets in which ownership and control are separated, managers possess superior information about corporate activities, and external users must make decisions based on financial information prepared by those managers. However, the provision of audit assurance requires the allocation of professional expertise, time, technological resources, and organizational capacity. Audit fees therefore reflect not only the direct costs of performing an audit engagement but also the auditor's assessment of engagement complexity, business risk, audit risk, litigation exposure, reputational



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consequences, and the expected level of audit effort. Accordingly, identifying the factors that determine audit fees has become an important research area in accounting, auditing, corporate governance, and financial management (1).

Audit pricing is generally viewed as the outcome of interactions among client characteristics, auditor characteristics, engagement-specific conditions, and the institutional environment. From an economic perspective, an audit firm sets its fee at a level that compensates for the expected cost of conducting the audit, the opportunity cost of professional resources, and the risk premium associated with accepting and completing the engagement. Larger and more complex companies usually require more extensive audit procedures because they possess more subsidiaries, operating segments, geographical markets, transactions, and internal control processes. Similarly, companies with weak financial performance, high leverage, complex accruals, financial distress, or elevated reporting risk may require greater auditor effort and a higher risk premium. Early Iranian evidence has likewise shown that company size, operational complexity, audit scope, auditor characteristics, and financial variables are among the principal determinants of financial statement audit fees (2). Subsequent domestic studies have confirmed that audit fees are influenced by a combination of client size, risk, complexity, and the characteristics of the independent auditor (3).

The audit-fee literature has gradually moved beyond simple measures of company size and engagement complexity toward more comprehensive models that incorporate multiple dimensions of client risk. International evidence indicates that audit fees are affected by profitability, leverage, business complexity, audit firm size, ownership structure, and the quality of corporate governance (4). Evidence from emerging markets similarly demonstrates that the pricing of external audit services reflects the interaction of company size, profitability, risk exposure, auditor reputation, and governance mechanisms (5). More recent findings from the Kosovo audit market indicate that external audit fees continue to be shaped by firm size, financial characteristics, organizational complexity, auditor-related attributes, and engagement risk, although the magnitude of these effects varies across institutional settings (6). These findings suggest that audit pricing cannot be understood solely as a mechanical function of the number of transactions or hours worked; rather, it is a risk-adjusted professional decision influenced by both observable financial indicators and less directly observable sources of uncertainty.

Risk-based auditing provides a useful theoretical foundation for explaining why greater corporate risk is expected to increase audit fees. Under this approach, auditors identify areas in which material misstatements are more likely to occur and allocate additional resources to those areas. When inherent risk or control risk increases, auditors generally respond by modifying the nature, timing, and extent of their audit procedures. These responses may include assigning more experienced personnel, increasing sample sizes, conducting additional substantive tests, expanding analytical procedures, obtaining more external confirmations, consulting valuation or legal specialists, and increasing engagement quality reviews. Research on firm-specific risk dimensions shows that audit pricing incorporates several forms of risk rather than a single aggregate measure, because different risk factors can affect the probability of material misstatement, expected audit effort, and the auditor's exposure to loss (7). Iranian evidence similarly indicates that operational, financial, and reporting-related risk dimensions contribute to the pricing of audit services (8). More recent evidence from companies listed on the Tehran Stock Exchange also supports the existence of a relationship between corporate risk measures and audit fees (9).

Financial reporting risk is particularly relevant to audit pricing because unreliable or unstable accounting information increases the difficulty of obtaining sufficient appropriate audit evidence. Accruals and cash flows

provide auditors with important information regarding earnings quality, liquidity, and the potential for accounting manipulation. Evidence from Iran indicates that accrual-based and cash-flow-related characteristics affect the pricing of audit services, suggesting that auditors incorporate the quality and composition of reported earnings into their engagement assessments (10). Financial statement restatements and financial distress may further indicate deficiencies in prior reporting, internal controls, or managerial judgment. Such conditions increase the likelihood of material misstatement and may require auditors to conduct more extensive procedures. The relationship between audit fees and audit risk therefore becomes stronger when companies experience financial distress or restate previously issued financial statements (11). Moreover, managerial ability can influence both reporting quality and the severity of financial distress, with consequences for the auditor's assessment of engagement risk and the resulting fee (12).

Litigation and regulatory exposure constitute another important component of audit pricing. Auditors may face legal liability, regulatory sanctions, reputational damage, or the loss of clients when an audit failure occurs. Consequently, engagements associated with a greater probability or potential cost of litigation generally command higher fees. Evidence from companies cross-listed in markets with different legal environments demonstrates that increased litigation exposure is reflected in audit pricing, because auditors demand compensation for both additional effort and expected liability costs (13). Litigation risk also increases audit effort by encouraging auditors to perform more procedures and allocate greater professional attention to potentially contentious areas of financial reporting (14). Regulatory noncompliance can produce similar effects. In the Iranian setting, noncompliance with anti-money-laundering legislation has been associated with audit fees, indicating that legal and compliance risk is incorporated into the pricing of audit engagements (15).

Audit fees may also be influenced by conditions in the audit market itself. The degree of competition or concentration within an industry can affect the bargaining power of audit firms and clients, the availability of specialized auditors, and the cost of acquiring industry-specific expertise. Evidence from Iran shows that industry monopoly and competition affect the pricing of independent audit services, suggesting that audit fees are partly determined by market structure rather than only by engagement-level characteristics (16). Market competition may also interact with earnings management and audit hours, as auditors operating in highly competitive environments must balance pricing pressures against the need to maintain audit quality and manage engagement risk (17). Consequently, audit fees reflect both the production economics of audit services and the strategic conditions under which auditors and clients negotiate engagement terms.

Broader economic shocks can alter this pricing process by changing corporate risk, financial stability, and the demand for assurance. During periods of financial crisis, companies may experience declining profitability, liquidity constraints, asset impairment, valuation uncertainty, and heightened going-concern risk. Auditors may consequently increase their effort and revise their risk premiums, although competitive pressures and constraints on client resources can produce complex effects on both audit and non-audit fees (18). Audit fees may also be related to corporate performance because the financial condition of the client affects engagement risk, the ability to pay for assurance services, and the expected consequences of reporting failure (19). These findings indicate that audit pricing is embedded in a broader economic environment and may respond to systemic uncertainty in addition to company-specific accounting variables.

Corporate governance and leadership transitions can further influence the amount of work required from auditors. Changes in senior management may disrupt established reporting processes, alter accounting judgments, affect

internal control systems, and increase uncertainty regarding organizational policies. Evidence from Iran shows that the origin of chief executive officer succession is associated with audit report lag and audit fees, implying that leadership changes affect both the timing and pricing of audit engagements (20). Auditor tenure, auditor change, and auditor size may also influence fees because they affect client-specific knowledge, independence concerns, learning costs, and the capacity to manage complex engagements. A comprehensive audit-fee model must therefore account for the combined influence of financial condition, governance, auditor characteristics, and institutional risk. Research proposing multidimensional models of audit fees confirms that audit pricing is determined by a broad set of interconnected variables rather than any single financial indicator (21).

Despite the extensive literature on audit-fee determinants, political risk has received comparatively limited attention in audit-pricing research. Political risk refers to uncertainty arising from political decisions, government actions, regulatory changes, political conflict, policy instability, geopolitical tensions, sanctions, elections, or shifts in the relationship between businesses and public authorities. Such risk can affect corporate operations through taxation, trade restrictions, financing constraints, changes in industrial policy, licensing requirements, government procurement, exchange-rate volatility, and restrictions on access to domestic or international markets. Firm-level political risk is distinct from general country risk because companies differ in their exposure to political issues, depending on their industry, geographic operations, regulatory dependence, political connections, supply chains, and strategic decisions. A widely used approach to measuring firm-level political risk is the content analysis of corporate communications, which captures the extent to which managers discuss political topics and related uncertainty. Evidence based on this approach shows that political risk varies meaningfully across companies and over time and has significant consequences for investment and corporate decision-making (22).

Political risk can affect audit fees through several interrelated channels. First, political uncertainty may increase information risk by making future cash flows, regulatory obligations, market access, and financing conditions more difficult to predict. Managers operating under political uncertainty may rely more extensively on subjective estimates and forward-looking assumptions when measuring provisions, impairments, fair values, contingent liabilities, deferred taxes, and going-concern uncertainty. Such estimates increase inherent audit risk because they are sensitive to managerial judgment and changes in external conditions. Second, political risk may create incentives for earnings management or selective disclosure when managers attempt to reduce the apparent effects of adverse political developments. Third, political exposure may generate legal, reputational, and compliance risks that are not fully captured by conventional financial ratios. As a result, auditors may broaden the scope of their work and charge a higher fee to compensate for the additional effort and engagement risk.

Political risk also affects firms' strategic and financing decisions. Companies exposed to greater political uncertainty may alter their debt structures, delay investment, maintain additional liquidity, or seek alternative financing sources to preserve operational flexibility. Evidence from the Iranian capital market indicates that political risk plays a role in corporate financing decisions, demonstrating that political exposure has direct implications for financial structure and access to capital (23). Political risk may also affect corporate social responsibility policies, while operational flexibility and management stability can moderate the extent to which companies respond to such risk (24). These strategic adjustments may increase transaction complexity, create unusual financing arrangements, and introduce additional accounting estimates, all of which can affect audit planning and pricing.

At the macroeconomic level, political risk is closely connected to economic uncertainty and financial-market volatility. In Iran, political developments can interact with exchange-rate movements, inflationary pressures,

international restrictions, and uncertainty regarding economic policy. Evidence indicates that macroeconomic uncertainty and political risk contribute to volatility in Iran's foreign exchange market (25). Exchange-rate volatility can complicate the valuation of foreign-currency assets and liabilities, import costs, export revenues, financial instruments, and commitments denominated in foreign currencies. It may also create uncertainty concerning asset impairment, inventory valuation, revenue recognition, and the recoverability of receivables. These conditions increase the amount of evidence auditors must gather and may require specialized procedures, scenario analysis, and greater professional skepticism. Therefore, company-level political risk can translate broader macroeconomic and institutional instability into engagement-specific audit risk.

Political uncertainty may also influence corporate risk-taking and political behavior. Firms may respond to political threats by engaging in lobbying, strengthening relationships with public officials, modifying investment strategies, or accepting greater risks to protect market access and organizational interests. Research demonstrates that firm-level political uncertainty is associated with corporate lobbying and risk-taking behavior (26). Political connections may provide firms with access to resources, contracts, financing, or regulatory advantages, but they can also increase opacity, agency problems, public scrutiny, and the risk of preferential transactions. In Iran, political connections have been shown to influence auditor reporting decisions, particularly when market characteristics are considered (27). Accordingly, auditors may need to evaluate related-party transactions, government contracts, regulatory dependence, and the possibility that political influence affects the credibility of financial reporting.

Political risk can additionally affect corporate disclosure. When exposure to political uncertainty increases, firms may voluntarily provide more information to reduce information asymmetry, reassure investors, or explain the expected implications of political developments. Evidence indicates that political risk increases the demand for voluntary disclosure, although disclosure responses may depend on managerial incentives and the costs of revealing sensitive information (28). From an audit perspective, increased disclosure does not necessarily reduce engagement effort. Political-risk disclosures may contain qualitative assertions, forward-looking estimates, and descriptions of contingent outcomes that require evaluation for consistency with the audited financial statements and other available evidence. Auditors may therefore need to devote additional attention to the consistency, completeness, and neutrality of such disclosures.

The communication of key audit matters offers another mechanism through which firm risk and audit fees may be connected. Key audit matters identify areas that required significant auditor attention and often relate to complex judgments, valuation uncertainty, unusual transactions, or significant risks of material misstatement. Evidence from Iran suggests that the disclosure of key audit matters is associated with audit fees and that firm risk moderates this relationship (29). Politically exposed companies may present more issues requiring significant auditor attention, including regulatory uncertainty, sanctions-related restrictions, government receivables, foreign-exchange exposures, and contingencies arising from policy changes. These circumstances can increase engagement documentation, partner involvement, specialist consultation, and communication with those charged with governance.

Although prior studies have identified many determinants of audit fees, limited empirical evidence directly addresses whether firm-level political risk is incorporated into audit pricing, particularly in emerging capital markets. Existing Iranian studies have examined conventional financial risk, regulatory noncompliance, political connections, industry competition, financial distress, and managerial or governance characteristics, but political risk itself has not been sufficiently investigated as a distinct engagement-level determinant of audit fees. This omission is important

because Iran's economic and institutional environment exposes companies to substantial variation in political, regulatory, exchange-rate, and international uncertainty. Moreover, measuring political risk through a content analysis of boards of directors' annual reports can provide a company-specific indicator that is more informative than broad country-level political indices. Such a measure captures the political issues managers themselves consider relevant to corporate operations and enables researchers to examine cross-sectional and temporal differences in political exposure.

Accordingly, the aim of this study is to examine the effect of corporate political risk on the audit fees of companies listed on the Tehran Stock Exchange.

Methods and Materials

In terms of its objective, the present study was applied research, and in terms of its nature, it employed a descriptive-correlational design. The theoretical foundations and prior research were reviewed using library-based methods, while the research data were collected from financial statements, annual reports, and the Comprehensive Database of All Listed Companies, commonly known as the CODAL system. Corporate political risk was measured using a researcher-developed content-analysis checklist based on the theoretical literature, previous studies, and boards of directors' annual reports. The research hypothesis was ultimately tested using multivariate regression and logistic regression models.

The statistical population of this study consisted of all companies listed on the Tehran Stock Exchange during the five fiscal years from 2020/21 to 2024/25. The research sample was selected using systematic elimination based on the following criteria:

- The company must have been listed on the Tehran Stock Exchange and continuously active throughout the 2020/21–2024/25 period.
- The company must not have been classified as a financial institution, bank, insurance company, investment company, or financial intermediary.
- The company's fiscal year-end must have been March 20, and no change in its fiscal year must have occurred during the study period.
- All information and data required for the study must have been available and extractable for every year under investigation.

After applying the above criteria, 146 companies were selected as the final research sample. Given the five-year study period, a total of 730 firm-year observations were used as the basis for the statistical analyses.

Findings and Results

Descriptive statistics provide an overall representation of the characteristics of the research variables. As shown in Table 1, the mean audit fee variable (LNAUDFEE) was 5.245, indicating the average level of costs incurred by the sample companies to obtain audit services. The mean corporate political risk variable (PRISK) was 24.422, indicating that the companies under investigation were, on average, exposed to a measurable level of political risk. Furthermore, the minimum, maximum, and standard deviation values of these two variables indicate variation among the sample companies in terms of political risk and audit fees. The descriptive statistics for the control variables—including firm size (SIZE), return on assets (ROA), financial leverage (LEV), sales growth (SGROW),

cash holdings (CASH), capital expenditures (CAPEX), earnings-per-share growth (DEPSFI), loss status (LOSS), the book-to-market ratio, bankruptcy risk (BANKRUPTCY), and auditor tenure (TENURE)—also demonstrate diversity in the financial and operating characteristics of the sample companies and indicate an adequate degree of dispersion in the data for statistical analysis.

Table 1. Descriptive Statistics of Continuous Variables

Variable	Mean	Median	Maximum	Minimum	Standard Deviation	Skewness	Kurtosis
LNAUDFEE	5.245	7.715	11.250	0.000	4.206	-0.397	1.264
PRISK	24.422	24.000	78.000	1.000	11.624	0.911	4.515
ROA	0.250	0.230	0.760	-0.380	0.181	0.245	3.071
CR	2.012	1.600	27.100	0.210	1.652	6.835	83.899
DEPSFI	8.150	0.100	4,204.820	-98.350	157.481	26.004	692.796
TENURE	4.488	3.000	24.000	1.000	5.485	2.482	8.139
CASH	0.100	0.060	0.790	0.000	0.119	2.426	9.765
SIZE	31.343	30.890	38.970	27.890	1.574	1.087	4.194
LEV	0.473	0.450	1.810	0.030	0.213	0.879	5.622
SGROW	0.572	0.470	18.170	-0.910	0.792	15.327	335.582
MTB	3.544	2.420	110.270	0.620	5.321	12.617	229.922
INV	0.256	0.230	0.900	0.010	0.149	0.910	3.850
AREC	0.264	0.240	0.800	0.000	0.177	0.675	2.856
CAPEX	0.095	0.040	0.860	-0.330	0.140	2.416	9.681
BANKRUPTCY	-2.127	-3.245	153.190	-4.290	6.780	17.660	385.727

The variance inflation factor (VIF) was used to examine multicollinearity among the research variables. The results presented in Table 2 show that the centered VIF values for all variables were below 10. Therefore, multicollinearity was not considered a concern in the research models. The results of the correlation matrix also confirmed the absence of excessively high correlations among the variables.

Table 2. Results of the Variance Inflation Factor Test for Multicollinearity Among the Explanatory Variables

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
PRISK	0.000001	5.987816	1.104659
ROA	0.012306	6.964655	2.394906
CR	0.000153	6.124890	2.463380
DEPSFI	0.000000	1.027134	1.024387
TENURE	0.000016	4.989487	2.987153
CASH	0.026085	3.738134	2.193895
SIZE	0.000110	639.7594	1.606926
LEV	0.011035	17.60154	2.964920
SGROW	0.000293	1.655571	1.087863
LOSS	0.008480	1.444991	1.403423
MTB	0.000040	9.899823	6.855515
INV	0.013625	7.098617	1.797447
AREC	0.010980	6.574720	2.037602
BIG2	0.002715	2.907711	2.381933
CAPEX	0.012723	2.155260	1.469402
BANKRUPTCY	0.000027	8.128293	7.398879
CHANGE	0.001086	1.560332	1.182005

The Levin–Lin–Chu (LLC) test was used to examine the stationarity of the research variables. The results presented in Table 3 show that the null hypothesis of a unit root was rejected at the 5% significance level. Therefore, all variables used in the research models were stationary and appropriate for estimating the regression models.

Table 3. Results of the Levin–Lin–Chu Panel Unit-Root Test for the Model Variables

Variable	LLC Test Statistic	Probability	Test Result
LNAUDFEE	−56.3900	0.0000	Stationary
PRISK	−30.6196	0.0000	Stationary
ROA	−38.8709	0.0000	Stationary
CR	−30.5129	0.0000	Stationary
DEPSFI	−82.6222	0.0000	Stationary
TENURE	−10.6466	0.0000	Stationary
CASH	−113.6550	0.0000	Stationary
SIZE	−35.6086	0.0000	Stationary
LEV	−14.2343	0.0000	Stationary
SGROW	−29.2032	0.0000	Stationary
LOSS	−11.5478	0.0008	Stationary
MTB	−91.6474	0.0000	Stationary
AREC	−35.7445	0.0000	Stationary
BIG2	−22.9856	0.0000	Stationary
CAPEX	−150.1570	0.0000	Stationary
BANKRUPTCY	−84.9812	0.0000	Stationary
CHANGE	−8.7116	0.0000	Stationary

Bartlett's test was used to examine the homogeneity of the error-term variances in the model. The results presented in Table 4 show that the significance level was greater than .05. Therefore, the null hypothesis of equal error-term variances was not rejected, indicating that heteroscedasticity was not a concern in the model.

Table 4. Results of the Homogeneity of Variance Test

Bartlett's Statistic	Significance Level	Test Result
2.759	.095	Homogeneity of variance

The Jarque–Bera test was used to assess the normality of the residuals of the regression model. Under this test, the null hypothesis indicates that the error terms are normally distributed. As shown in Table 5, the significance level of the test for the linear model was greater than .05. Therefore, the null hypothesis was not rejected, indicating that the model residuals followed a normal distribution and that the regression assumption of normality was satisfied.

Table 5. Results of the Jarque–Bera Test for the Error Terms

Jarque–Bera Statistic	Significance Level
33.30	.075

The Chow test, also known as the redundant fixed-effects or F-Limer test, was used to determine whether the pooled ordinary least squares model or the fixed-effects panel-data model was the appropriate estimation method. The results are presented in Table 6.

Table 6. Results of the Chow Test

Test	Statistic	Significance Level	Test Result
F-Limer test	1.264	.0321	Panel-data model selected

Because the significance level of the Chow test was below .05, the null hypothesis was rejected, confirming the appropriateness of a panel-data model. Accordingly, the Hausman test was subsequently performed to select between fixed-effects and random-effects specifications.

After confirming the appropriateness of the panel-data approach, the Hausman test was conducted to select between the fixed-effects and random-effects models. The results presented in Table 7 show that the significance level was below .05. Therefore, the null hypothesis was rejected, and the fixed-effects model was selected as the appropriate estimation method.

Table 7. Results of the Hausman Test

Test	Statistic	Significance Level	Test Result
Hausman test	26.16	.0214	Fixed-effects model selected

The research hypothesis stated that companies exposed to greater political risk have higher audit fees. This hypothesis was examined using the following model:

$$\text{LNAUDFEE}_{it} = \alpha_0 + \alpha_1 \text{PRISK}_{it} + \sum \alpha_k \text{CONTROL}_{it} + \varepsilon_{it}$$

Table 8. Results of the Research Hypothesis Test: Dependent Variable—Audit Fees (LNAUDFEE)

Variable	Coefficient	t Statistic	Significance Level
Intercept	-1.320	-0.25	.7993
Corporate political risk (PRISK)	0.0109	2.57	.0104
Return on assets (ROA)	0.983	0.64	.5178
Current ratio (CR)	-0.334	-3.48	.0006
Earnings-per-share growth (DEPSFI)	-0.0003	-0.98	.3261
Auditor tenure (TENURE)	-0.046	-0.71	.4781
Cash holdings (CASH)	3.128	2.12	.0348
Firm size (SIZE)	0.343	2.05	.0407
Financial leverage (LEV)	-2.990	-2.54	.0116
Sales growth (SGROW)	-0.429	-3.79	.0002
Loss status (LOSS)	-1.752	-1.41	.1596
Market-to-book ratio (MTB)	-0.618	-4.62	< .001
Inventory (INV)	3.603	2.38	.0177
Accounts receivable (AREC)	2.890	2.46	.0141
Auditor size (BIG2)	-2.900	-2.62	.0093
Capital expenditures (CAPEX)	-1.220	-1.52	.1282
Bankruptcy risk (BANKRUPTCY)	0.529	4.22	< .001
Auditor change (CHANGE)	1.114	4.45	< .001
First-order autoregressive term (AR1)	-0.343	-8.99	< .001
Second-order autoregressive term (AR2)	-0.149	-9.36	< .001
Model Statistic			Value
R ²			.85
Adjusted R ²			.83
F statistic			36.56
Significance of the F statistic			.0104
Durbin-Watson statistic			2.23

Discussion and Conclusion

The present study examined the effect of corporate political risk on the audit fees of companies listed on the Tehran Stock Exchange. The findings showed that corporate political risk had a positive and statistically significant effect on audit fees. Specifically, the coefficient of political risk was positive and significant, indicating that companies exposed to higher levels of political risk paid higher audit fees. This result supports the research hypothesis and suggests that auditors incorporate firm-specific political exposure into their engagement pricing decisions. In other words, political risk is not treated merely as an external macroeconomic condition; rather, it is

reflected in the auditor's assessment of the client's business environment, financial reporting risk, regulatory exposure, and expected audit effort.

The positive association between corporate political risk and audit fees can first be explained through the risk-based audit approach. Under this approach, audit fees are determined partly by the amount of effort required to reduce audit risk to an acceptably low level. When a company faces greater political risk, uncertainty surrounding its future operations, financing conditions, regulatory obligations, market access, and cash flows increases. This uncertainty may affect the recognition, measurement, and disclosure of accounting items, particularly provisions, contingent liabilities, asset impairments, foreign-currency balances, fair-value estimates, and going-concern assessments. Auditors must consequently perform more extensive procedures, gather additional evidence, expand sample sizes, and devote greater professional attention to judgment-sensitive areas. Since these activities require additional working hours and more experienced audit personnel, they increase the cost of the audit engagement and ultimately result in higher audit fees. This interpretation is consistent with the general audit-pricing literature, which considers audit fees a function of client complexity, expected effort, and engagement risk (1, 21).

The result is also aligned with studies showing that different dimensions of corporate risk are incorporated into audit pricing. Firm-specific risk affects not only the likelihood of material misstatement but also the potential economic and reputational losses auditors may incur if an audit failure occurs. Nikkinen and Petri demonstrated that audit pricing reflects multiple firm-specific dimensions of risk rather than a single general measure (7). Similarly, Iranian evidence has shown that operational, financial, and reporting risk dimensions are positively associated with audit fees because auditors demand compensation for the additional effort and exposure associated with riskier clients (8). More recent findings from companies listed on the Tehran Stock Exchange also confirm that corporate risk measures play an important role in determining audit fees (9). The present study extends these findings by demonstrating that political risk represents an additional and economically meaningful dimension of client risk.

The finding can further be interpreted in light of the conceptualization of firm-level political risk. Political risk differs across companies because firms vary in their dependence on government policies, regulated markets, international transactions, political connections, and public-sector contracts. Hassan et al. showed that firm-level political risk can be measured through corporate communications and that such risk has significant effects on firms' investment behavior and strategic decisions (22). Accordingly, a higher frequency or intensity of political-risk discussions in boards of directors' reports may signal that political developments have become materially relevant to the company's operations. Auditors may interpret such disclosures as evidence of elevated uncertainty, potential disruption, and increased financial reporting complexity. As a result, they may revise their risk assessments and incorporate a risk premium into the audit fee.

The positive relationship identified in this study is also consistent with research on the economic consequences of political uncertainty. Political risk may influence corporate financing decisions, alter access to credit, and increase the cost or complexity of funding arrangements. Evidence from the Iranian capital market indicates that political risk affects corporate financing decisions and may lead firms to modify their capital structure or rely on alternative financing sources (23). These changes can create additional audit complexity, particularly when companies enter into unusual debt agreements, renegotiate financial obligations, or face restrictions on external financing. Auditors must examine the classification, valuation, disclosure, and covenant implications of these transactions, increasing engagement effort and fees.

Corporate responses to political risk may also include changes in social responsibility strategies, operational flexibility, and management stability. Research has shown that political risk affects corporate social responsibility and that this relationship may depend on the firm's operational flexibility and the stability of its management (24). From an auditing perspective, such strategic responses may increase the volume and complexity of nonfinancial disclosures, provisions, commitments, and estimates included in annual reports. Auditors must assess whether these disclosures are consistent with the financial statements and whether the underlying assumptions are reasonable. Thus, political risk may increase audit fees not only through direct financial uncertainty but also through changes in corporate strategy and reporting practices.

Another explanation concerns the interaction between political risk and macroeconomic uncertainty. In the Iranian context, political developments are closely related to exchange-rate fluctuations, inflation, international restrictions, changes in economic policy, and instability in financial markets. Alimoradi Afshar et al. found that political risk and macroeconomic uncertainty contribute to volatility in Iran's foreign exchange market (25). Exchange-rate volatility affects the measurement of foreign-currency transactions, imported inventories, export revenues, foreign obligations, and financial instruments. It may also increase impairment risk and uncertainty regarding the recoverability of assets. Auditors facing such conditions may need to conduct additional valuation procedures, examine subsequent events more carefully, and assess the adequacy of related disclosures. These added procedures provide a plausible explanation for the higher audit fees observed among politically exposed firms.

The result may additionally reflect increased litigation, regulatory, and reputational risk. When companies operate in politically sensitive environments, they may face greater scrutiny from regulators, investors, the media, and other stakeholders. Political developments can also create compliance risks, sanctions exposure, contractual disputes, or legal uncertainty. Prior research has shown that litigation risk increases audit fees because auditors demand compensation for both additional effort and potential liability (13). Zhang et al. also reported that greater litigation risk increases audit effort, supporting the view that auditors respond to legal exposure by expanding audit procedures (14). Therefore, political risk may increase audit fees partly because it heightens the probability that financial reporting decisions will be challenged or that auditors will face reputational and legal consequences.

The present finding is similarly compatible with evidence concerning regulatory noncompliance. Ebrahimi Kordlar et al. found that noncompliance with anti-money-laundering regulations influences audit fees, indicating that auditors price legal and compliance risk into their engagements (15). Politically exposed companies may be more vulnerable to changes in laws, government directives, sanctions, tax regulations, or reporting requirements. Evaluating compliance with such rules may require additional consultation, documentation, and substantive testing. Consequently, a higher level of political risk can increase the complexity and cost of the audit.

Political risk may also affect the quality and transparency of corporate disclosure. Grady and Nam showed that political risk increases the demand for voluntary disclosure as firms attempt to reduce information asymmetry and communicate their exposure to investors (28). Although additional disclosure may improve transparency, it can also increase the auditor's responsibilities. Political-risk disclosures frequently contain forward-looking information, qualitative judgments, and descriptions of uncertain outcomes. Auditors must evaluate whether such disclosures are complete, balanced, and consistent with the evidence obtained during the audit. This may require greater partner involvement and more extensive communication with management and those charged with governance, thereby increasing audit fees.

The association between political risk and audit fees may also be understood in relation to political connections. Politically connected firms may benefit from access to resources, government contracts, credit, or regulatory advantages, but such connections may also increase agency problems, opacity, and public scrutiny. Jamei and Lotfijou found that political connections influence auditor opinions in companies listed on the Tehran Stock Exchange, particularly when market characteristics are considered (27). If political connections affect corporate reporting incentives or increase the complexity of related-party relationships, auditors may consider politically exposed firms to be riskier and charge higher fees. The content-analysis measure used in the present study may capture not only exposure to general political uncertainty but also the company's dependence on politically sensitive relationships and decisions.

Firm-level political uncertainty may also encourage risk-taking behavior. Timbate et al. showed that political uncertainty is associated with corporate lobbying and risk-taking (26). Increased risk-taking may lead to aggressive investment decisions, complex transactions, or greater reliance on uncertain projects. These conditions raise inherent risk and may increase the likelihood of estimation errors or managerial bias. Auditors may respond by performing more substantive procedures and assigning more experienced personnel to the engagement, thereby increasing the audit fee.

The results concerning the control variables further support the view that audit fees are determined by a combination of financial condition, operational characteristics, and engagement risk. Firm size had a positive and significant effect on audit fees, indicating that larger companies paid higher fees. This result is consistent with prior research showing that larger firms require more audit hours because of their greater number of transactions, subsidiaries, accounts, and internal control processes (2-4). Larger clients are also likely to have more complex organizational structures and greater public visibility, increasing both audit effort and reputational risk.

Cash holdings had a positive and significant relationship with audit fees. High levels of cash may increase the risk of misuse, unauthorized transactions, and asset misappropriation. Cash balances generally require careful confirmation, reconciliation, and internal control testing. Consequently, companies holding more cash may require additional audit procedures. The positive effect of inventory and accounts receivable on audit fees similarly reflects the audit complexity of these accounts. Inventory often requires physical observation, valuation testing, and examination of obsolescence, while accounts receivable requires confirmation and assessment of collectability. These findings are consistent with audit-pricing models that identify asset composition and operational complexity as major determinants of audit effort (6, 21).

Bankruptcy risk also had a positive and significant effect on audit fees. This finding is theoretically expected because financially distressed companies pose greater going-concern, reporting, and litigation risks. Auditors must assess management forecasts, financing plans, debt agreements, and the adequacy of going-concern disclosures. Gul et al. showed that financial distress is an important determinant of audit fees and that managerial ability influences this relationship (12). Hassani et al. similarly found that financial distress and financial statement restatements strengthen the association between audit risk and audit fees (11). The positive coefficient observed in the present study therefore reinforces the argument that audit fees reflect both expected effort and the risk premium demanded by auditors.

Auditor change was positively associated with audit fees. A newly appointed auditor must acquire knowledge of the client's business, accounting systems, internal controls, and prior reporting practices. This initial learning process can require substantial additional time and resources. Auditor changes may also signal disagreements,

reporting problems, or governance concerns, increasing perceived risk. Evidence concerning chief executive succession similarly shows that organizational transitions may increase audit delays and fees because they create uncertainty and disrupt established reporting processes (20). The result concerning auditor change is therefore consistent with the broader view that organizational discontinuity increases audit effort.

The significant relationship between the current ratio, leverage, sales growth, and audit fees indicates that liquidity, financing structure, and growth conditions also affect audit pricing. These variables may influence risk in different directions depending on company characteristics and the broader economic environment. For example, rapid sales growth can increase audit complexity, but it may also be associated with stronger operating performance. High leverage increases financial risk but may simultaneously strengthen creditor monitoring. The negative coefficients obtained for some variables should therefore be interpreted in the context of the multivariate model, in which each coefficient reflects the effect of a variable after controlling for numerous other characteristics. Prior studies have likewise shown that the direction and significance of financial determinants of audit fees can vary across countries and institutional environments (5, 19).

The significant negative association between the market-to-book ratio and audit fees may indicate that companies with higher market valuations possess stronger growth prospects or better market perceptions, reducing certain dimensions of financial distress risk. However, valuation ratios can capture several competing effects, and their implications may differ across capital markets. Similarly, the negative coefficient for auditor size may reflect competitive pricing, characteristics of the Iranian audit market, or differences in the client portfolios of larger audit firms. Audit-market competition can affect both audit fees and audit hours, especially when auditors balance commercial pressures against the need to maintain quality (17). Iranian evidence also confirms that monopoly and competition within industries influence the pricing of independent audit services (16).

Overall, the findings demonstrate that political risk is a distinct determinant of audit pricing in the Iranian capital market. Previous studies have focused primarily on financial risk, litigation exposure, client size, operational complexity, governance, and auditor characteristics (10, 18). The present study adds to this literature by showing that auditors also respond to political uncertainty at the firm level. The positive coefficient for political risk suggests that auditors translate political exposure into higher assessments of inherent risk, engagement risk, and expected effort. This result has particular importance in emerging markets, where political decisions and institutional changes can rapidly alter firms' financial and operational conditions.

The findings also complement research on key audit matters. Politically exposed companies may have more complex accounting estimates, uncertainties, and significant risks that require greater auditor attention and communication. Khatandlou et al. found that firm risk moderates the relationship between key audit matter disclosure and audit fees (29). This evidence supports the argument that higher political risk may increase both the number and complexity of matters requiring significant audit attention, resulting in higher fees. Thus, political risk should be considered alongside traditional financial and governance variables when evaluating the determinants of audit pricing.

This study is subject to several limitations. First, corporate political risk was measured through content analysis of boards of directors' annual reports. Although this method provides a firm-specific measure, it depends on the extent and quality of management disclosure and may not capture political exposures that managers choose not to report. Second, the sample was limited to nonfinancial companies listed on the Tehran Stock Exchange, and the findings may not be directly generalizable to banks, insurance companies, investment firms, privately held

companies, or firms operating in other institutional environments. Third, the study relied on publicly available accounting and reporting data, which restricted the inclusion of confidential engagement-level factors such as actual audit hours, staff composition, internal audit quality, negotiations between auditors and clients, and detailed assessments of internal control deficiencies. Finally, although the model controlled for a wide range of firm and auditor characteristics, other unobserved factors may influence both political risk and audit fees.

Future studies could employ alternative measures of political risk, including textual analysis of earnings calls, corporate announcements, media coverage, or regulatory disclosures, and compare the results with those obtained from boards of directors' reports. Researchers could also distinguish among different dimensions of political risk, such as sanctions risk, regulatory risk, electoral uncertainty, geopolitical tension, and dependence on government contracts. Comparative studies across industries, countries, or capital markets could clarify whether the relationship between political risk and audit fees depends on institutional quality, investor protection, legal enforcement, or audit-market concentration. Future research could further investigate mediating mechanisms such as financial distress, earnings management, information asymmetry, internal control weakness, or litigation risk. Examining moderating variables such as political connections, auditor specialization, audit committee expertise, ownership concentration, or managerial ability may also provide a more detailed understanding of how auditors respond to political uncertainty.

Audit firms should formally incorporate firm-level political risk into client acceptance, continuance, planning, and pricing procedures. Engagement teams should identify politically sensitive operations, government dependencies, regulatory exposures, foreign-currency risks, and contingent obligations at an early stage and allocate adequate expertise and time to these areas. Corporate managers and audit committees should improve the transparency, consistency, and specificity of political-risk disclosures and strengthen internal controls over transactions affected by policy changes or political uncertainty. Investors, creditors, and regulators should consider audit fees as a potential market signal of engagement complexity and risk, while avoiding the assumption that higher fees necessarily indicate inefficiency. Policymakers and professional bodies may also develop guidance to help auditors assess and document political risk more systematically, particularly in markets where political and economic conditions can change rapidly.

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Authors' Contributions

All authors equally contributed to this study.

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The authors of this article declared no conflict of interest.

Ethical Considerations

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Transparency of Data

In accordance with the principles of transparency and open research, we declare that all data and materials used in this study are available upon request.

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