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Factors related to the pricing of audit services in New Zealand

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A thesis submitted in partial fulfilment of the requirements for the degree of

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Abstract

Listed companies in New Zealand appoint an auditor, first, in compliance with statute (mandatory appointment) and, second, to monitor agent (management) performance compared to principal (shareholder) preferences. The monitoring requirements of the audit contract should be reflected in the audit fee. In this thesis, I use Simunic's (1980) fee model to investigate three questions regarding the determinants of audit pricing.

First, auditors have the incentive to earn fee premiums (quasi-rents) by developing specialised monitoring skills that address the needs of industries with a differentiated demand for monitoring. Three classifications of differentiated monitoring are developed to investigate whether fee premiums are earned on those audits. Fee premiums are shown to be earned by Big Seven auditors over non-Big Seven auditors, but the null hypothesis that industry specialist auditors do not earn fee premiums over non-specialists is not rejected.

The incentive to earn quasi-rents in future fees provides a rationale for auditors to bid a reduced audit fee in order to gain incumbency (DeAngelo, 1981a). The second research question uses a sample of audit fees from the first financial statements after listing to test for reduced fees on initial audits. Results indicate that audit fees for the first financial statements after listing are lower than the level of audit fee for existing companies.

Negotiation of audit fees may be affected by professional regulation. The third research question investigates whether abandonment of a fee scale by the professional accounting body in New Zealand influenced the general level of audit fees. The results fail to reject the null hypothesis that there is no difference in fees before and after abandonment of the fee scale.

The incentive to develop industry-specialised monitoring skills may be replaced, in a small country, by alternate audit practice development strategies; for example, diversification of an audit portfolio in order to spread risk. Auditor brand name, reflecting technical skills, may thus earn a fee premium in preference to industry specialist skills. A final limitation of this work arises from the time period of interest (1985-87), a time of change in New Zealand's business environment, in which audit fee determinants may be subject to effects not captured in this thesis.
Table of Contents

Chapter | Page
--- | ---
Title page | i
Acknowledgements | ii
Abstract | iii
Table of contents | iv
List of tables | vii
List of figures | viii

1. The determinants of audit fees in New Zealand | 1
1.1 Introduction | 3
1.2 The research framework | 6
1.3 Fee premiums | 10
1.4 Low-balling | 11
1.5 Fee deregulation | 12
1.6 Structure of the thesis | 12

2. A monitoring framework for audit fees | 13
2.1 Introduction | 15
2.2 The demand for monitoring | 17
2.2.1 Agency theory and the auditor's role as monitor | 21
2.2.2 Demand for differing levels of monitoring | 22
2.2.3 Supply of differentiated monitoring | 24
2.2.3.1 Differentiation on audit industry structure | 27
2.2.3.2 Differentiation on auditor quality | 29
2.2.3.3 Differentiation on auditor knowledge | 29
2.2.4 Summary | 31
2.3 The rationale for low-balling | 32
2.4 Fees for services in regulated and unregulated markets | 37
2.5 Summary | 37

3. Development of hypotheses | 39
3.1 Introduction | 40
3.2 The components of monitoring and the components of the audit fee model | 53
3.3 Fee premiums | 64
3.4 Low-balling | 69
3.5 Fee deregulation | 71
3.6 Data and research design | 71
3.6.1 Data availability and verification | 74
3.6.2 Research design and audit fee model | 75
3.6.3 Measurement of variables | 83
3.7 Summary | 85

Appendix | 85
3.8 Measurement of variables | 85
### 4. Fee premiums

4.1 Introduction
4.2 Restatement of hypotheses
4.3 Descriptive statistics
4.4 A fee premium to Big Seven auditors
4.5 Diagnostic checking of model and data
4.6 Industry specialisation in auditing
  4.6.1 Inference-based determination of industry specialisation
  4.6.2 Demand-based determination of industry specialisation
4.7 A fee premium to brand name controlling for industry specialisation
4.8 A fee premium for industry specialisation
4.9 A fee premium to an auditor dominant in the audit industry
4.10 Discussion
4.11 Summary

**Appendix I**

4.12 New Zealand Stock Exchange industry codes

**Appendix II**

4.13 Identification of additional observations in order to test a reduced model
4.14 Tests of hypotheses one to five using a reduced model and an expanded sample
4.15 Discussion and summary

### 5. Low-balling

5.1 Introduction
5.2 Restatement of hypothesis
5.3 Descriptive statistics
5.4 Multivariate tests
5.5 Discussion
5.6 Summary

**Appendix**

5.7 Identification of additional observations in order to test a reduced model
5.8 Descriptive statistics
5.9 Multivariate tests using a reduced model and an expanded sample
5.10 Discussion and summary

### 6. Fee deregulation

6.1 Introduction
6.2 Restatement of hypothesis
6.3 Descriptive statistics
6.4 Multivariate tests
6.5 Discussion
6.6 Summary
7. Conclusions and directions for future research

7.1 Audit fees and the monitoring framework 212
7.2 Fee premiums 212
7.3 Low-balling 214
7.4 Deregulation 215
7.5 Limitations of the thesis 216
7.6 Directions for future research 217

Bibliography 220
## List of Tables

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Significance of independent variables in selected audit fee determinants</td>
<td>46</td>
</tr>
<tr>
<td></td>
<td>studies proxying for exposure to potential loss</td>
<td></td>
</tr>
<tr>
<td>3.2</td>
<td>Significance of independent variables in selected audit fee determinants</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>studies proxying for loss sharing ability</td>
<td></td>
</tr>
<tr>
<td>3.3</td>
<td>Significance of independent variables in selected audit fee determinants</td>
<td>49</td>
</tr>
<tr>
<td></td>
<td>studies proxying for auditor production function</td>
<td></td>
</tr>
<tr>
<td>3.4</td>
<td>Significance of independent variables for type of auditor in selected audit</td>
<td>51</td>
</tr>
<tr>
<td></td>
<td>fee determinants studies</td>
<td></td>
</tr>
<tr>
<td></td>
<td>and Palmrose (1986a)</td>
<td></td>
</tr>
<tr>
<td>3.6</td>
<td>Listed company observations by year</td>
<td>72</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1</td>
<td>Descriptive statistics for the dependent and independent variables of the</td>
<td>91</td>
</tr>
<tr>
<td></td>
<td>audit fee model in section 3.6.2</td>
<td></td>
</tr>
<tr>
<td>4.2</td>
<td>Descriptive statistics for the dependent and independent variables of the</td>
<td>93</td>
</tr>
<tr>
<td></td>
<td>audit fee model in section 3.6.2, analysed between Big Seven and non-Big</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Seven auditors</td>
<td></td>
</tr>
<tr>
<td>4.3</td>
<td>Test of hypothesis 1: Big Seven auditors have higher audit fees than non-Big</td>
<td>97</td>
</tr>
<tr>
<td></td>
<td>Seven auditors</td>
<td></td>
</tr>
<tr>
<td>4.4</td>
<td>Correlation matrix of the variables used in the fee model for hypothesis</td>
<td>106</td>
</tr>
<tr>
<td></td>
<td>one, using 1985-7 data</td>
<td></td>
</tr>
<tr>
<td>4.5</td>
<td>Identification of auditor industry specialisation by inference</td>
<td>109</td>
</tr>
<tr>
<td></td>
<td>New Zealand Stock Exchange (NZSE) sector codes equivalent to the industries</td>
<td></td>
</tr>
<tr>
<td></td>
<td>identified in Craswell et al. (1995)</td>
<td></td>
</tr>
<tr>
<td>4.6</td>
<td>Identification of auditor industry specialisation by inference</td>
<td>111</td>
</tr>
<tr>
<td></td>
<td>NZSE sector codes and auditors specialising in those industries, based on</td>
<td></td>
</tr>
<tr>
<td></td>
<td>pre-specified criteria for 1983-87 years</td>
<td></td>
</tr>
<tr>
<td>4.7</td>
<td>Identification of industries demanding high levels of monitoring</td>
<td>115</td>
</tr>
<tr>
<td>4.8</td>
<td>A summary of industry specialisation alternative classifications</td>
<td>118</td>
</tr>
<tr>
<td>4.9</td>
<td>Test of hypothesis 2: Big Seven auditors earn a fee premium over non-Big</td>
<td>121</td>
</tr>
<tr>
<td></td>
<td>Seven auditors in industries where there is no industry specialisation</td>
<td></td>
</tr>
<tr>
<td>4.10</td>
<td>Test of hypothesis 3: non-specialist Big Seven auditors earn a fee premium</td>
<td>125</td>
</tr>
<tr>
<td></td>
<td>over non-specialist non-Big Seven auditors in industries where industry</td>
<td></td>
</tr>
<tr>
<td></td>
<td>specialisation exists</td>
<td></td>
</tr>
<tr>
<td>4.11</td>
<td>Test of hypothesis 4: specialist Big Seven auditors earn a fee premium over</td>
<td>129</td>
</tr>
<tr>
<td></td>
<td>non-specialist Big Seven auditors in industries where industry specialisation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>exists</td>
<td></td>
</tr>
<tr>
<td>4.12</td>
<td>Market share percentages, based on audit fees (not adjusted for inflation)</td>
<td>133</td>
</tr>
<tr>
<td></td>
<td>of listed companies</td>
<td></td>
</tr>
</tbody>
</table>
4.13 Test of hypothesis 5: a dominant auditor will have higher audit fees than non-dominant auditors

4.14 Test of hypothesis 1: Big Seven auditors have higher audit fees than non-Big Seven auditors

4.15 Test of hypothesis 2: Big Seven auditors earn a fee premium over non-Big Seven auditors in industries where there is no industry specialisation

4.16 Test of hypothesis 3: non-specialist Big Seven auditors earn a fee premium over non-specialist non-Big Seven auditors in industries where industry specialisation exists

4.17 Test of hypothesis 4: specialist Big Seven auditors earn a fee premium over non-specialist Big Seven auditors in industries where industry specialisation exists

4.18 Test of hypothesis 5: a dominant auditor will have higher audit fees than non-dominant auditors

5.1 Descriptive statistics for 1985-87 observations

5.2 Number of first financial statements after listing for listed companies, by type of auditor and by industry sector

5.3 Test of hypothesis 6: audit fees reported in the first financial statements after listing will be lower than audit fees for existing companies

5.4 Test of hypothesis 6: audit fees reported in the first financial statements after listing will be lower than audit fees for existing companies

5.5 Test of hypothesis 6: audit fees reported in the first financial statements after listing will be lower than audit fees for existing companies

5.6 Descriptive statistics for 1985-87, including extra observations

5.7 Test of hypothesis 6: audit fees reported in the first financial statements after listing will be lower than audit fees for existing companies

6.1 Listed company continuing audit engagements observations by year

6.2 Descriptive statistics for 1985, 1986 and 1987 years for continuing engagements

6.3 Trends of median audit fees and median auditee total assets over five years for continuing engagements

6.4 Trends in median audit fees and median auditee total assets over time, for matched pairs (1985-6) and matched triples (1985-7) of continuing engagements

6.5 Test of hypothesis 7: for continuing audit engagements, there is a reduction in the level of audit fees after abandonment of a fee scale in December 1984

List of Figures

4.1 Restatement of hypotheses regarding fee premiums to brand name and industry specialisation 88