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

Doctor of Philosophy

in the
Department of Accounting and Finance
The University of Auckland

1999

Acknowledgements

My sincere gratitude for assistance and support goes first to my supervisors, Professor Jilnaught Wong, Department of Accounting and Finance, and Professor Alastair Scott, Department of Statistics; to Jilnaught for his encouragement to undertake doctoral study and for numerous suggestions as well as personal and editorial advice; to Alastair for his understanding, experience and willingness to provide help. Both of them gave of their time and knowledge. I am grateful for their commitment and stamina in seeing my thesis through to completion.

This thesis would not have been completed without the support of friends and colleagues. In particular, I would like to thank Leigh Houghton for her encouragement and personal support, and David Emanuel for his scholarship and active interest over many months. Others who provided cheerful words or advice, reviewed early drafts or were in the right place at the right time are Jan Bebbington, Mike Bradbury, Jeff Casterella, Cheryl Cliffe, Alister Hunt, Farshid Navissi, Sonja Newby, Martin Putterill, Alan Teixeira and Norman Wong.

The financial support of the Institute of Chartered Accountants of New Zealand through the award of a PhD Scholarship is greatly appreciated.

Lastly, to Andrew, who has endured my doctoral study for several years, my love and gratitude.

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.

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