**DETERMINANTS OF AUDIT FEES IN THE BANKING INDUSTRY**

Abstract

This research examines determinants of audit fees in the banking sector.The main objective is to find out if there is any relationship between audit firm size and audit fee and also to verify if profitability has significant impact on audit fee. Using Ordinary Least Square (OLS) regression technique with the aid of a computer software, the empirical findings revealed among other things that, there is no significant relationship between audit firm size, firm profitability, firm tangibility, net income and audit fee. It furthermore reveals that there is a significant relationship between firm size, firm turnover and audit fee. The study concludes that the nature of audit fee has attracted attention in recent times because of its effect on auditor independence and by implication the audit quality. The study recommends that corporate organizations in Nigeria should pay proper attention to their firm size and firm turnover as they are the major determinants of audit fee in the Nigeria banking sector as observed in this study.

**CHAPTER ONE**

**INTRODUCTION**

**1.1 Background to the Study**

According to Swanson (2008), it is as important for corporations to know that their corporate structure and strategic decisions affect audit fees as it is for the auditor to adequately understand and evaluate the liability risk associated with that audit engagement. Auditors accept engagements to perform services and issue an opinion on the representations of the financial statements. There is, however, a great deal of risk associated with the process. An auditor is liable to the corporation, its shareholders, and other foreseeable third parties, such as banks or regulators, for its performance of the audit.

According to Chersan, Robu, Carp and Mironiuc (2012), studies regarding the audit market and its actors (auditors and auditees) have been performed for more than 30 years. Many of them point the audit fees and their determinants. Consequently, more and more determinants of audit fees have been identified during this time, and it has been settled that the impact of these factors on the fees level is mostly contradictory. Among the determinants of the audit fees, they mentioned are: the auditee’s size and the geographical dispersion, the size of the audit company, the level of consulting services, the quality of the auditee’s internal control system, the type of contract regarding fees (fixed fees against variable fees). Moreover, they remark that the Big companies the existence a fee raise request, called fee premium. Although most of the studies have pointed out an unidirectional connection between determinants and audit fees, there are studies which prove the existence of a circular causality, meaning that, although they are influenced by some determinants, the audit fees are determinants in their turn for different elements characterizing the auditees and the auditors (for example, the stake holders’ perception of the Communications of the transparency of the audited companies and their performances, as well as the hierarchy of the audit companies).

Since the early work on the pricing of audit services by Simunic (1980) substantial progress has been made in understanding the factors which determine audit fees. In the light of past financial scandals, regulators around the world have passed stricter laws to ensure appropriate financial reporting and audit quality. The newly created and widely debated Public Company Accounting Oversight Board (PCAOB) has implemented a system of periodic independent inspections of audit firms in the U.S. The purpose of these inspections is to improve audit quality.

Accordingly, effort adjustments are expected to be largest in those settings of high fee pressure. Audit firms have certain flexibility in adjusting effort due to excess capacity, shifts from non-public clients, hiring of new employees, and more work done by existing team members. Given the assumption that the market for audit services is competitive, adjustments in audit effort are reflected in audit fees.

To what extent deficiencies mentioned in the inspection report present a sufficient incentive for the auditor to adjust effort is uncertain for several reasons. First of all, there has been extensive criticism of the inspectors’ technical and in- depth expertise (Glover, 2009). It takes an extended period of time before the inspection results get published (Offermanns & Peek, 2010), the identity of the inspected clients remain unknown, and the high quality Big4 audit firms have repeatedly received deficient inspection reports in the US. Thus, the inspection result is unlikely to be perceived as signal of an audit firm’s overall audit quality. Also, it is uncertain to what extent the PCAOB will use its discretion in imposing sanctions on audit firms. If the pressure of the PCAOB is sufficiently large, audit effort and fees are expected to rise for clients of deficient firms, and particularly under conditions of high pre-inspection fee pressure.

**1.2 Statement of Problem**

The services rendered by auditors are obviously not for free the remuneration for these services is popularly known as audit fee. Determining the actual amount of total remuneration given to these auditors is a very difficult task, hence, this research seeks to know the significant relationship between audit firm size and audit fee, and relationship between firm profitability and audit fee, also to what extent does firm size significant determine audit fee.

**1.3 Research Questions**

The following are the research questions of the study;

1. Is there significant relationship between audit firm size and audit fee?

2. What is the relationship between firm profitability and audit fee?

3. To what extent does firm size significant determine audit fee?

4. What is the relationship between firm tangibility and audit fee?

5. To what extent does firm turnover determine audit fee?

6. Is there significant relationship between net income and audit fee?

1.4 Objective of the Study

The primary aim of this study is to examine the determinant of audit fee in the Nigerian banking sector. The following are the objectives of this study:

1. To determine whether audit firm size have significant relationship with audit fee.

2. To verify if firm profitability have significant impact on audit fee.

3. To ascertain whether firm size have significant impact on audit fee.

4. To determine the relationship between firm tangibility and audit fee

5. To find out the extent to which firm turnover determine audit fee.

6. To verify if there is significant relationship between net income and audit fee.

1.5 Statement of Hypotheses

The following hypotheses are formulated for the purpose of this study

Hypothesis One

HO: Audit firm size does not have significant relationship on audit fee.

HI: Audit firm size has significant relationship on audit fee.

Hypothesis Two

HO: Firm profitability does not have significant impact on audit fee.

HI: Firm profitability has significant impact on audit fee.

Hypothesis Three

HO: Firm size does not significantly determine on audit fee.

HI: Firm size significantly determine on audit fee.

Hypothesis Four

HO: There is nosignificant relationship between firm tangibility and audit fee.

HI: There is a significant relationship between firm tangibility and audit fee.

Hypothesis Five

HO: Firm turnover does not determine audit fee.

HI: Firm turnover determines audit fee.

Hypothesis Six

HI: There is no significant relationship between net income and audit fee.

HI: There is a significant relationship between net income and audit fee.

1.6 Significance of the Study

It is true that a number of researchers have advanced research findings on the determinant of audit fee.

Researchers: this research will in no small measure contribute to the body of knowledge on current situation of non – audit fees and audit fees in auditing literature across various sectors, it will also promote understanding of basic variables contributing to the enlightenment of audit fees among firms and Nigeria at large.

Auditor: It is also expected that it will be a useful tool in evaluating the adequacy of auditor by shareholders and help auditors in fixing audit fees. The outcome of the study can also be used by audit firms to determine audit fees. Companies management can also use the results of the study to predict the amount of audit fees that they will pay.

1.7 Scope of the Study

This research is focus on the determinants of audit fee in the Nigerian banking sector. The population of the study is the entire quoted banks in the Nigerian Stock Exchange.

The sample size will be restricted to ten (10) quoted on the Nigeria Stock Exchange for the periods of six (6) years i.e. 2008 to 2014, Geographically, the study will be conducted in Benin City, Edo State.

1.8 Limitations of the Study

It is worthy to mention here that the information collected for this research such as library references of various financial journal, textbooks, media, printing and e-books on workshop and various seminars employed have their interest, disadvantages or are very non-committed and subjective.

In order to generalize the outcome of the study, the same study needs to be conducted over a longer period of time. Other variables such as litigation, regulation of government, the market share of audit firm and economic conditions of the country need to be included in the regression model in future research.

Nevertheless, we hope that this study will serve as a guide material for other researchers who wish to carryout similar studies to work with.

1.9 Definition of Terms

i. Auditor: An auditor is an independent person appointed to investigate the organization, its records, and the financial statement prepared by them, thus form an opinion on the accuracy and correctness of the financial statements.

ii. Audit fee: Are fee paid by company to an external auditor in exchange for performing an audit.

iii. Audit market: Analysis and evaluation of a firm’s marketing approach, activities, aims and results achieved.

iv. Audit client: An audit client is any person or organization that requests an audit.

v. Equilibrium price: The equilibrium price is where the supply of goods matches demand or the price at which the quantity of a product offered is equal to the quantity of the product in demand.

vi. Financial statement: Financial statements is a collection of a report about an organization’s financial results, conditions and cashflows.

vii. Accounting error: An accounting error is an error in the process of systematically recording, measuring and communicating information about financial transactions.

viii. Earnings management: Is defined as reasonable and legal management decided

**CHAPTER TWO**

**LITERATURE REVIEW**

**DETERMINANTS OF AUDIT FEE**

Researchers in different countries have gone into intensive research to find out the determinant of audit fee for example; Simon et al (1986) in India , in Malaysia and Singapore( Simon et al,1993),Fith (1985) in New Zealand, in Canada (Chung and Lindsay,1988) Anderson & Zeaghal (1994) perform it in Pakistan, Karim & Moizer, (1996) in Bangladesh , in UK (Haskins & Williams, 1988; Chan, Ezzamel & Gwilliam, 1993; Ezzamel, Gwilliam & Holland, 1996; Iyer, 1996; in Holland, 2002; Neimi, 2002; Simon & Taylor, 2002); in Australia( Francis, 1984; Francis & Stokes, 1986; Craswell, Francis & Taylor, 1995; Craswell & Francis, 1999;in Ireland: Haskins & Williams, 1988; Japan: in Taylor, 1997) ;in Norway: Firth( 1997). In Jordon: Naser & Nuseibeh, (2007) and in Bahrain: Joshi & Al-Bastaki, 2000; Qatar: Kutob & Al-Khater, 2004; by

Joshi & Al-Bastaki (2000), Naser & Nuseibeh 2007 and Kutob & Al-Khater (2004).All these studies are aimed at examining the factors that determines audit fee(firm characteristics like;size,profitability,firm complexity and firm risk). Determinants of audit fees can be categorized into two : client attributes (Auditee attributes) and auditor attributes. Auditee characteristics include ; of size, complexity, risk, and profitability of the firm being audited .Some Arthurs argued that , audit fee tends to increase with an increase in the client’s size (Simunic 1980), risk (Stice 1991), complexity ( Hackenbrack & Knechel, 1997), and profitability ( Hay, Knechel & Wong, 2006). Audit company attributes include; Size, reputation, experience, competition, industry specialization and firm status .Extant literature opine that audit fee increases with the Audit firm’s Size (Francis, 1984; Palmrose, 1986), reputation (Larcker & Richardson, 2004, Gonthier & Schatt, 2007), experience, industry specialization (Pearson & Trompeter, 1994; Craswell et al., 1995; Cullinan, 1998) and status (Palmrose, 1986; Francis & Simon, 1987; Butterworth & Houghton, 1995).

However, Hay et al.( 2006) suggests that audit fee decreases with the increase in competition, the greater the number of competitors the lower the audit fees are charged .y the predicted effect of audit fees based on prior studies’ findings and then based on this theoretical foundation, hypotheses of the present study will be

A lot of extant literature on the determinant of audit fee dating from the seminar article by Simunic (1980). . Siminic (1980) develops a pricing model in which the audit fee is determined by difference in loss exposure, differences in the accessed loss-sharing ratio, differences in auditor production functions, and auditor identity. He notes that the observation of a big premium, while in line with the existence of produce differentiated accruing to high reputation. Moreover, the potential existence of scale would off set both of these factors . Beginning with Siminic (1980), a number of studies have observed the market for auditing services in different nations of the world . Majority of these studies were performed in developed nations e , for example, palmrose (1986) Francis and Simon(1987), Simon and Francis, (1988) Turpen (1990). The United kingdom for example, Brinn et al (1994). Australia e.g Francis (1984), Francis and Stokes (1986), Crosswell et al (1995).

Another series of researches reveal that there a positive relationship between audit and non-fees .these studies include; Siminic (1984) , Palmrose (1986), Parkash (1986),Parkash & Venable (1993) and Divis, Recchiute & Trampeter (1993) in the US, Ezzamel, gwilliam and Holland (1997) in the UK, Barkess & Simnet (1994) in Australia, and Firth, (1997) in Norway. David (1993) on the other hand did not find a significant relationship, between non-audit and audit fees.

In Nigeria Statement No.7 of Institute of Charted Accountants of Nigeria(ICAN) professional codes of conduct for members make extensive provision for fee to be charged by chartered accountants. The conduct mandates auditors to charge specific and calculated fees agreed with the client on a fair and reasonable fee based on seniority and professional expertise, the degree of risk and responsibility, priority and importance of the work to be client, and expense properly incurred as well as the time necessarily spent on the work. Audit price estimates must sent to potential to client in writing before to commencement of the engagement. The auditor should take care to ensure that the client have a full and complete understanding of the services to be covered by the fee and the basis on which the fee is determined both for current and future years. This guide line binds ICAN members only . Section 361 of CAMA stipulates that the remuneration of auditors may be fixed by the directors. However, in other cases, the auditors remuneration shall be fixed by the company at the annual general meeting or in such a manner as the company in its general meeting may decide. Remuneration in this context consist of auditors fees and expenses. It also provides that under no circumstance must the audit fee from an audit client constitute 25% or more of the gross practice income of an audit firm or gross earned income of a member.

2.4.1 Client Size

Extant academic studies argued that auditors in large sized companies have to spend a lot of time and effort in reviewing their clients operations hence client size should be one of the determinants of audit fee. Client is measured total assets of client .Joshi (1999) reveals that firm size (total asset) is the most important variable in determining audit fees.The findings Abdulhammed & Nuseriber (2009) also reveal that there is a positive relationship between audit fees and client size.

On the contrary, Hay (2009) found a negative relationship between client size and audit fees which he explained was due to the chances of large firms ability to negotiate for lower prices. .

2.4.2 Client Risk

Audit risk is also considered an important element in determining the level of audit fees. This is because of the increasing number of law suit against auditors world over. Auditors risk relates to the probability of an auditor issuing an unqualified opinion on materially misstated financial statements (AICPA 1983, part 2), Sandra & Patrick (1996) used gearing and liquidity ratio to measure client’s risk. They also included a measure of operating risk based on the level of profits in the study. It was found that the measures of financial risk, gearing and liquidity had an important bearing on audit fees. In this study, debt ratio is taken as the indicator of risk and debt ratio is defined as the percentage of long term debt to total assets.

Hay (2009) and Craswell, Francis and Taylor (2006) found a significant and positive relationship between inherent risk and audit fees.

2.4.3 Client Complexity

If the client’s business operations are more complex that is, more diversified or having foreign operations, the audit work will also be complex. More subsidiaries or operations will require more audit work, therefore, audit firms charge higher audit fees. Sandra and Patrick (1996) argued that auditors of group companies with a higher number of subsidiaries often incur high cost in examining the individual financial statement and the accuracy of the consolidated financial statements. They also stated that subsidiaries or branches in different countries will have to comply with a variety of statutory and professional requirement for disclosure and thus, this requires additional audit testing and implies additional charges for audit work. May studies conclude that complexity in terms of scope of operations or in respect of balance sheet composition has a significant impact on the level of audit fees.

2.4.4 Client Profitability

Profitability refers to the operations of the firm and the efficient use of its asset and other resources. An efficient use of resources often results in a high return on assets. Highly profitable firms usually pay more fees in view of the fact that higher profits may require rigorous audit testing of the validity for the recognition of revenue and expenses which requires more audit time, Joshi (1999). Return on asset is taken as an indicator of profitability

2.5 Theoretical Review

Audit fee is the amount paid to the client firm auditor for the annual audit service of financial statements. Audit pricing is a complex issue that takes in to account various clients and auditor attributes. At the heart of pricing the audit service auditors should consider the quality of their service for the fact that various stakeholders rely on the audited financial statements for various decision and failure to account for such issues may lead to severe litigation in the advent of audit failure. The probability to discover error depends on the auditor ability, experience and auditor audit technology while the probability to report lies on the auditor independence.

The extant literature identified various auditor client relationships which potentially impacted the audit quality and auditor independence. Especially, the following accounting scandals in the west auditing profession are highly analyzed by researchers. Among others NAS, abnormal high audit fees, audit tenure and auditor size is found to impact audit quality and independence. The first section present the theories related to audit pricing, audit fees, audit quality and independence issues. In the second section, literatures related to factors that regulate audit fees are reviewed in a considerable detail.

2.5.1 Theory of Audit Pricing

Before the theoretical discussion of factors affecting audit fees, it is necessary to take in to account demand and supply side of the audit service itself. The demand for audit service arises from company owners, outside investors, company managers, governments and general public

for their various decisions. But there exist agency conflict and information asymmetry issues which paradoxically complicate the audit service. For example, manager‟s manipulating short- term earnings at the expense of long-term performance in order to receive a bonus. Outside investors also need information which truly represents the company performance to make investment decisions. However, external auditors are hired by company managers not by owners or outside investors. As a business it is obvious that both the audit firm and the client company have the same goal, i.e. maximizing profit Klein, A., (2002).

To maximize a profit, it is clear that audit firms have to gain more customers and minimize audit procedures. It means in certain cases they may compromise with client‟s managers. As a result, audit independence may be impaired. However, it simultaneously means auditors face the risk of litigation and being revoked their audit practice (like Andersen‟s case in Enron scandal). This fact involves that auditing firms have to consider watchfully loss and profit to decide their audit fees.

According to Diamant, (2000) there are four types of audit contract regulated in legal documents and presented in practice: fixed price, contingent fee, benefit in kind and hourly billing rate. The nature of audit services points out that auditors should satisfy not only managers but also investors. Meanwhile, the interests of managers and investors are so different, even antagonistic. Admitting the fact that contingent fees impair auditor‟s independence, many regulatory bodies prohibit receiving contingent fees by accounting firms (SEC, 2004, OFAG, 2009).

2.4 Audit Fees

Audit fee defined as cost of conducting audit to express an opinion there on about the conformity of financial statements with generally accepted accounting principles (GAAP). In the similar context, Audit fees mean all charges that the companies pay to the external auditors against the audit services and non-audit services, e.g. management advisory and consultants. Auditing fees consist mainly of the wages and benefits of office and field personnel, travel costs, and other costs necessary to the audit and related support activities. The fees equal the estimated cost of staff time and the actual cost of travel for those activities, plus margin of profit. In their discussion of Kinney and Libby, (2002) suggested that the threat to auditor independence could be as strong when the audit fee is large.

Moreover, as a response of agency contract (DeAngelo, 1981 and Watts & Zimmerman, 1990) stated the audit of financial statement as a cost-effective contract between the management and shareholders.Meanwhile, according to the rules of ethics of public accountant‟s compartment, the fee amount may vary depending on the risk assignment, the complexity of services provided, level of expertise required to perform such services, the related cost structure CPA firm and other professional considerations.

In this regard, Code of Ethics for Professional Accountants (IFAC, 2010) provides that “when entering into negotiations regarding professional services, a professional accountant in public practice may quote whatever fee is deemed appropriate” (Section 240). In the same manner, the Ethiopian Code of Ethics for Professional Accountants (OFAG, 2009, p 47) stated that “It is in the best interests of both the client and the professional accountant that the bases on which fees are computed”.

However, the code requires billing arrangements to be clearly defined in writing, before the commencement of the engagement to help in avoiding misunderstandings with respect to fees. Nevertheless all the three code of ethics for professional ethics for accountants i.e. (OFAG 2009), (AICPA, 2009) and (IFAC, 2010) remind the threats that may arise with regard to the fundamental ethical standards i.e. independence, objectivity and professionalism, when different level of fee levels are billed. It should be noted that if an auditor charges a lower fee than another auditor, this is not unethical, if the audit is carried out at an analogous quality level.

External auditor plays a significant role in providing assurance to all the shareholders that the financial statements are free from misstatements and voluntarily mistakes. This assurance may be affected if the auditors are not performing independently. The dependency of auditors on its client financially may lead to violation of auditor‟s independence (Larcker and Richardson, 2004). Regarding the independence of auditor, (DeAngelo, 1981 and Watts & Zimmerman, 1983) provided that auditor must not only detect errors and frauds, but must be independent (report appropriate). This may cause the unwillingness of auditor to detect errors and frauds in financial statements even though he/she knows about it.

As the research conducted by Jensen and Meckling, (1976) considered non-audit service (or consulting) services by audit firm as a key issue towards the auditor‟s independence. In contrast, study of (Antle et al., 2006) provided that the availability of prior knowledge about the client company‟s system make it easy about provision of services.

Moreover, study of Hay et al. (2006) highlighted that the factors affecting audit fees. In this study, characteristics of various companies as mentioned by Francis (1984) are taken to propose that audit fee depends on company size, governance practices and audit firm size.

2.6 Empirical Review

Several empirical studies address those factors affecting audit fees in both industrial and financial companies though recently evolving for the later one. Recent studies also extended audit fees studies to investigated audit quality and independence issues. This section presents the review of empirical studies in two sections. The first section deals with audit fees studies in industrial while the second section review studies for financial companies.

2.6.1 Audit Fee Studies in Non-financial Companies

A plenty of empirical studies has been conducted to identify the factors that may influence audit fees especially in the developed countries. These factors have been investigated in literature from both the client (Auditee) perspective as well as the auditor perspective. The major factors that influence audit fee from the client perspective include client size, client business risk, profitability, business complexities and client industry. On the other hand Auditor size/ reputation and computation also influence audit fee from the auditor perspective.

Research conducted by Bell et al., (2001) studied the relation between auditors' perceived business risk and audit fees to determine whether audit firms or their clients bear the expected legal costs of business risk. Using data from the audit working papers of a sample of 422 U.S audit performed in 1989 they find evidence that audit fees are increasing in the engagement partners' assessments of business risk.

Pratt and James (1994) examined whether auditor judgments of litigation risk and their recommendations for the preliminary audit plan and client fees are influenced by certain client characteristics. They used a sample of 243 audit partners and managers of four "Big 6" firms in US. With an experimental design the researchers suggest that auditors rely heavily on their assessments of a client's financial condition to assess litigation risk. Poorer financial condition was associated with higher levels of litigation risk, more audit evidence, and higher audit fees. Their result also weakly support high levels of receivables and inventory, equity market value, and sales growth were associated with high levels of litigation risk. The authors finally suggested

that audit fees reflect both the amount of audit evidence collected and an additional premium to cover litigation risks.

Researchers Lyon and Maher (2005) investigated the relation between audit fees and business risk for audit clients doing business in developing countries where bribery of top government officials has been an accepted business practice. Using a sample of 82 companies registered with the SEC a cross-sectional audit fee regression model based on prior audit fee research after controlling for cross-sectional differences in client size, audit complexity, and auditor-client risk sharing. They also expand their model to include control for variables that might be correlated with the payment of bribes. Their results indicated that clients who engage in behavior that is viewed by some as misconduct incur higher audit fees than those who do not.

Davis et al., (2009) studied weather providing audit clients with non-audit services result in knowledge spillovers and audit production efficiencies that could produce economic rents for the auditor. Using a sample 98 clients 3 years data, their result suggest that, although purchasers of non-audit services pay higher audit fees than non-purchasers, the higher fees are associated with a proportional increase in audit effort, measured in this study as unweighted and weighted audit hours. These findings are inconsistent with one interpretation of prior research: that performing non-audit service for audit clients may provide the auditor with incentives to compromise objectivity.

Palmrose (1986) studied to test whether there is a systematic relationship between audit firm size (in both absolute size and relative market share) and audit fees using 1200 companies(both public and non-public) in 39 industries. She used a mail questionnaire with a response rate of 30%. Her result indicates that, there is a statistically significant relationship between auditor size and audit fees based on being a Big-Eight/ non- Big-Eight classification.

Francis and Simon (1987) studied the presence of audit premium to provide further evidence on audit pricing in the small-client segment of the U.S. audit market for publicly-traded companies. They used a final sample of 220 small companies having sales less than $ 125 million with a response rate of 23%. Audit fees are regressed on a set of explanatory variables that includes the experimental variable audit firm size. Their result strongly supports the existence of a Big Eight price premium with respect to both second-tier national auditors and local/ regional auditors.

They also suggest given the assumption of competition in the small auditee market segment, higher Big Eight prices imply Big Eight product differentiation.

The research conducted by Caneghem, (2010) to test whether a well-documented Big fee premium also applies to the Belgian audit market. He used a sample of 4,403 (of which 99% were privately held) observations for the year 2007. The researcher used OLS (the traditional audit fee model) In addition to the traditional audit fee model, based on the studies of (Ireland and Lennox, 2002), the author used a two-stage procedure in order to control for potential endogeneity biases (auditor self-selection). His result based on the traditional audit fee model is consistent with Big4 auditors charging a fee premium compared to non-Big4 auditors. However, after controlling for the self-selection problem the results did not support the Big4 fee premium.

It also estimated the premium charged by large audit firms after controlling for the effects of auditor selection on the estimated fee premium using a two-stage model in UK companies. They find the effects of auditor selection on audit fees are statistically and economically significant. In addition their result shows the premium earned by large audit firms is more than twice as large when selectivity bias is taken into account (53.4% compared to 19.2%). Further their result indicate large auditors attract clients that are of higher than average quality and require less than away audit effort.

Gonthier-Besacier and Schatt (2007) based on audit fees paid in 2002 by 127 non-financial public French firms studied whether specific “traditional” determinants of audit fees, as previously identified in other countries, prove to be relevant in France. In addition, they analyzed whether the joint audit process (which is specific to the French setting), and especially the presence of one or two Big Four firms, has an influence on the amount and the division of audit fees.

In their methodology, in count to the traditional determinants of audit fees, they also take in to account factors arising from French joint audit practice like distribution of fees between auditors and the number of Big Four firms involved. Their result shows that size of the audited firm and risk to be significant factors in determining the audit fees in France. It shows that also audit fees become higher when a firm decides to employ the services of only one Big Four firm. They recommended that there exists an advantage for French companies, employing two of the Big Four firms for their joint audit in terms of audit fees.

Al-Harshani (2008) examined factors influencing the amount of external audit fees using a sample which consists of 49 audit engagements with 2005 fiscal-year ends that were performed by both “Big” and “non-Big” audit firms in Kuwait. He used a cross-sectional audit fee regression model consisting of explanatory variables commonly believed to be key determinants of external audit fees. His results showed that the amount of audit fees in Kuwait is positively related to the audit client size and profitability of the audit client. His results also indicated that external audit fees are inversely related to the client‟s liquidity ratio, as a measure of client risk. The results, however, do not provide significant evidence of the expected relation between external audit fees and the number of audit locations visited, the client‟ debt-to-equity ratio and the audit firm size.

Garsombke et al., studied whether clients who obtain competitive audit engagement bids have lower audit fees. Using 507 samples, the researchers found that choosing the lowest of the bids may not result in lower fees, on average, than firms that choose other than the lowest bid.

Beattie and Fearnley (1998) studied factors influencing auditor changes within external auditing environment, which is characterized by increased competition using questionnaire survey of 508 listed UK companies. Their results suggest the expectation of a reduced audit fee was not a top priority when selecting firms to tender.

2.6.2 Empirical Studies on Bank Audit Fees

As the research conducted by Fields et al., (2004) investigated audit pricing for financial institutions using standard audit fee model for industrial companies by incorporating measures of risk and complexity that are unique and used by bank regulatory agencies. Using a sample of 277 financial institutions in fiscal 2000 they find that audit fees are higher for banks having more transactions accounts, fewer securities as a percentage of total assets, lower levels of efficiency, and higher degrees of credit risk.

They also find that audit fees are higher for savings institutions that are more involved in acquisition activity, and for institutions that are required by regulatory agencies to maintain

higher levels of risk-adjusted capital. Their model speaks directly that complexities and risks considered important by regulatory agencies are also the drivers of audit fees and hence tend to be priced by audit firms.

Anandarajan et al., (2005) studied how LLPs are used in earnings management and capital management in Australia using OLS regression model. They used 441 number of bank-year observations comprised of 79 for listed and 362 for unlisted commercial banks. Their result revealed evidence of earnings management behavior using LLPs by Australian banks, and by listed commercial banks in particular relative to other types of banks. They also find evidence of accentuated earnings management behavior using LLPs in the post-Basel period. Further, their findings indicate that reported financial numbers may not reflect the underlying economic reality of the financial institution.

**CHAPTER THREE**

**METHODOLOGY**

**3.1 MEHODOLOGY**

The sample selected for the purpose of this study will be 5 quoted banks from among the twenty five (21) banks listed in the Nigerian stock exchange.

Five years financial reports for each of the five banks chosen were used. The sampling method employed in this research work is the convenience sampling because it makes it easy for the researcher to select whatever sampling unit that is easily accessible and are conveniently located.

**MODEL SPEFICATION**

Therefore, the basic regression model applied in this study is as follows.

AUDFE = b0 + b1 ASST + b2ROA + b3 DR + b4 NSUB + e

Where

AUDFE - Audit fee

ASST - Log of total Asset (firm size) ROA - Return on Asset (Profitability) DR - Debt ratio (firm risk)

NSUB \_ Number of subsidiaries (firm complexity)

**Method of analysis**

The ordinary least square and the generalized least square method of regression is used to analyze the data.

**CHAPTER FOUR**

**PRESENTATION INTERPRETATION AND ANALYSIS OF DATA**

**4.1 DESCRIPTIVE STSTISTICS**

The descriptive statistic of the data used in the analysis is presented in the table 4.1.1 below. In the table, it can be seen that the average audit fee paid by the sampled banks for the period of study is N109,077,400. This is a relatively high amount for the banks. The median audit fee amount is a bit far from the mean value suggesting that there might be a level of heterogeneity among the banks with respect to audit fee paid. In other words, the amount of fee paid may be dissimilar among banks. To confirm this statement, we consider the Jarque-Bera (J-B) test. The test statistic is greater than the 5 percent critical chi–square value of 5.99. Thus we cannot reject the result of the probability distribution of audit fee across the sampled banks .Indeed, the audit fee paid, varies from one bank to the other

Table 4.2.1 Descriptive statistics

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| b | Variable | Mean | Median | Std.Dev. | skewness | Kurtosis | J-B |  |
| AUDFE | 109077.4 | 100000.0 | 69000 | 1.088 | 4.040 | 6.055 | 25 |
| NSUB | 7.32 | 7.0 | 2.268 | 1.185 | 1.728 | 1.823 | 25 |
| ASST | 3.260000 | 2310000 | 2.25E+8 | 0.949 | 1.728 | 3.751 | 25 |
| RAO | 0.115 | 0.109 | 0.035 | 1.009 | 5.064 | 8.681 | 25 |
| DR | 8.382 | 2.160 | 12.189 | 2.108 | 6.944 | 34.709 | 25 |

With respect to the independent variable, the descriptive statistics shows that the bank had an average of 7 subsidiaries and the J-B test indicates that the number is quite similar among the firms. Therefore, the level of complexity of each bank seems to be quite high. The average size of the banks in terms of assets is over N326bn. this value seems to be similar to all banks because of the result from the J-B test. The profitability and risk variable have an average of 0.115 and 8.38 respectively. These variables are however not very similar in all the banks judging from the J-B test.

The descriptive statistics therefore shows the extent of individual and group characteristics of each data. It indicates that the firms selected have a level of similarity for some variables and dissimilarity for other variables.

4.3 REGRESSION ANALYSIS

In the regression analysis, the model specified in the previous chapter is estimated and interpreted. Some coefficient of the estimation are obtained and based on their outcomes, empirical judgment is made on the hypothesized relationships in the model. The result of the initial OLS estimate models is reported in table 4.3.1 below.

Table 4.3.1 Result of OLS Estimates

|  |  |  |
| --- | --- | --- |
| Variables | Coefficient | T-ratio |
| Constant (AUDFE) | 12.6395 | 8.836 |
| NSUB | 0.0338 | 1.606 |
| ASST | -0.0504 | -0.717 |
| ROA | -2.9767 | -2.150 |
| DR | 0.0002 | 0.057 |

R2 = 0.314 R-2 = 0.177

F = 2.29 D.W = 1.12

In the result the goodness of FIT statistics are quite low. The R- squared value of 0.314 is very low and it suggests that over 31 percent of the systematic variation in audit fee was explained by the explanatory ability. The T – statistics value of 2.29 is also very low and it is less than the critical 5 percent F-value of 2.76. Thus the model fails the overall significance test which implies that we cannot accept the hypothesis of a significant relationship between the dependent variable and all the independent variable combined. The coefficient of ROA (profitability) has a negative sign instead of the expected positive sign. Also only the coefficient of ROA passes the significance test of 5 percent level.

The D.W statistics value of 1.18 is excessively low and it shows that positive auto correlation is present in the result. Indeed, the estimates provided in the model are not reliable for policy issues. Thus, a better model needs to be estimated.

In order to obtain a better estimate in the model the equation is re-estimated by including a first order autoregressive term, AR (1). This is aimed at providing the model with a weight on which to transform the data to hedge against serially correlated error terms. Thus, the second method used is the generalized least square (GLS) method. The resultant output of the model is reported in table 4.3.2 below.

Table 4.3.2 Generalized least square result.

|  |  |  |
| --- | --- | --- |
| Variable | Coefficient | T-ratio |
| Constant (AUDFE) | 12.4807 | 4.390 |
| NSUB | 0.0542 | 2.464 |
| ASST | 0.0271 | 0.572 |
| ROA | -1.6772 | -2.326 |
| DR | 0.0008 | 2.289 |
| ARI | 0.9514 | 6.361 |
| R2 = 0.777 R2 = 0.759F = 4.91 D.W = 1.82 |

The result shows a very impressive goodness of fit statistic. The F-square value of 0.777 indicates that over 77 percent of systematic various in audit fee is explained by all the explanatory variables. The adjust R- squared value is also high suggesting that model has a good predictive ability.

The F- stability value of 4.91 is greater than the critical F- statistic value 0f 2.76 at the 5 percent level. This mode has a high overall significance level. We therefore accept the hypothesis of a significant linear relationship between audit fee and all the independent variables combined. This implies that the variables hypothesized in the model actually significantly determine the audit fee in one way or the other.

A close look at the individual coefficient of the explanatory variables reveals that only the coefficient of profitability has negative value. All the other coefficients fail the significance test at 5 percent level and this implies that the main determinant of audit fee are client complexity ,firm risk and profitability The result

.reveal that there a positive relationship between audit fee and firm complexity since value of F of 2.4 >F Critical value of 1.89. The more complex the client operation is, the higher the audit fee charged. The result of the study also reveals that firm risk has a positive significant relationship with audit fee since F value of 2.2 is > critical of F of 1.89. This implies that more risky the audit work is the more the audit fee charged. In addition , it also discovered that profit has a significant negative relationship with audit fee. This implies that the higher the profit the lower the audit fee charged. Furthermore we discovered that firm size has no significant relationship with audit fee

The D.W statistics value of 1.82 is sufficiently close to 2 guarantees the absence of serial correlation in the model. The auto regressive term has eliminated the auto correlation noted in the initial OLS result. The result in table 4.3.2 is therefore reliable. And base on the result obtained above, we accept the alternative hypothesis of hypothesis I, II and III and the null hypothesis of hypothesis IV.

**CHAPTER FIVE**

**SUMMARY AND DISCUSSION OF FINDINGS**

**5.1 SUMMARY AND DISCUSSION OF FINDINGS**

The examines the determinant of audit fee in the Audit fee in the Nigerian banking sector. Our findings reveal that is a significant relationship between firm risk and audit fee .This is line with the findings of Abdulhammed & Nuseriber (2000) whose findings reveal a positive relationship between client risk and audit. This implies that the more risk the more the audit fee charged. We also discovered that there is a positive relationship between firm complexity and audit fee , this in line with the result of Abdulhammed & Nuseriber(2009) that reveal a positive relationship firm complexity and audit fee. We also discovered there a negative relationship between profitability and audit fee. This is contrary to the result of Sandra & Partick (1999) whose result reveals that there is a positive relationship between firm profitability and audit fee.

This part of the study makes important contribution to the audit fee literature. We recommend the use of conservatism in reporting since it enhances the reliability of accounting numbers and reduces the risk for auditors, thereby reducing the number of substantive test. To ensure lower audit fees, there is obviously the need for reduced substantive test which in turn reduces the auditors’ efforts and the audit complexity for a given level of overall audit risk. That conservative reporting should be employed viz- a-viz cutting cost to minimize losses incurred do not imply lower quality audits, in which audit firms recognizes a lower market rate.

We further suggest the major accounting bodies should come together formulate a model the will be suitable for the Nigerian environment and the Government should enforce all practitioners to compile to the model . Defaulters should be duly sanctioned ..

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APPENDIX I

Generalized least square results

Dependent variable LAUD\_FEE

Method: Least Square

Date: 11/1/13/ Time: 03:03

Sample (adjusted): 2:25

Included Observation 24 after 9 iterations

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Variable | Coefficient | Std. Error | t-Statistics | Prob |
| C | 12.48067 | 2.83092 | 4.389825 | 0.00004 |
| COMP | 0.054228 | 0.0262268 | 2.464413 | 0.0307 |
| PROF | 0.0271173 | 0.047546 | 0.5715112 | 0.5747 |
| RISK | -1.77151 | 0.971511 | .-2326333 | 0.0414 |
| AR(1) | 0.000760 | 0.002632 | 0.288933 | 0.7759 |
|  | 0.951368 | 0.149572 | 6.360619 | 0.0000 |
| R-square | 0.776840 | Mean dependent var | 11.57626 |
| Adjused R-square | 0.75926 | S.D. dependent var | 0.249448 |
| S.E | 0.183426 | Akaike info criterion | -0.341693 |
| Sum square resid | 0.605612 | Scawarz criterion | -0.047180 |
| Log likelihood | 10.10032 | f-statistic | 4.907422 |
| Durbin – Watson sat | 1.819435 | Prob(F-statistic | 0.005236 |
| Inverted AR Roots 95 |

APPENDIX II

Ordinary Least Square Result

Dependent Variable: LAUD \_ FEE

Method: Least Squares

Date: 11/05/13 Time:03:36

Sample(adjusted): 1 25

Included observations: 25 after adjusting endpoint

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |  |
| C | 12.6395 | 1.430382 | 8.836453 | 0 |  |
| COMP | 0.033815 | 0.021058 | 1.605855 | 0.124 |  |
| LSIZE | -0.050354 | 0.070206 | -0.717233 | 0.482 |  |
| PROF | -2.976713 | 1.384673 | -2.149758 | 0.044 |  |
| RISK | 0.000225 | 0.003984 | 0.056557 | 0.956 |  |
| R-squared | 0.314407 | mean dependent | 11.57 |  |
| Adjusted R-squared | 0.177289 | S.D. dependent var | 0.247 |  |
| Sum squared resid | 0.223593 | Akaike info criterion | 0.019 |  |
| log likelihood | 0.999877 | schwaz criterion | 0.263 |  |
| durbin - Watson stat | 4.764027 | F-statistic | 0.029 |  |
|  | 1.117598 | prob (F-statistic | 0.095 |  |

APPENDIX III

DESCRIPTIVE STATISTIC

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | AUD\_FEE | COM | SIZE | PROF | RISK |
| Mean | 109077.4 | 7.32 | 3.26E+08 | 0.11544 | 8.3816 |
| Median | 100000 | 7 | 2.31E+08 | 0.109 | 2.16 |
| Maximum | 193000 | 11 | 9.11E+08 | 0.222 | 50 |
| Minimum | 69000 | 4 | 1.01E+08 | 0.034858 | 12.18961 |
| Std.Dev. | 28752.11 | 2.267892 | 2.25E+08 | 0.034858 | 12.18996 |
| Skewness | 1.087657 | 0.18476 | 9.49E-01 | 1.009396 | 2.107562 |
| Kurtosis | 4.0395 | 1.727699 | 2.98E+00 | 5.063532 | 6.94379 |
| Jarque - Bera | 6.054752 | 1.828433 | 3.75E+00 | 8.680923 | 34.70912 |
| Probability | 0.048443 | 0.400831 | 1.52E-01 | 0.013031 | 0 |
|  |  |  |  |  |  |
| Observations | 25 | 25 | 2.50E+01 | 25 | 25 |

APPENDIX IV

Dependent and Independent Variables

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Name of Bank** | **Years** | **N SUB** | **Total asset** | **Return on asset** | **Debt ratio** |
| **FCMB** | 2006 | 5 | 106611290 | 0.102 | 1.31 |
| 2007 | 5 | 262841089 | 0.095 | 50 |
| 2008 | 5 | 467337030 | 0.113 | 5.25 |
| 2009 | 4 | 463641243 | 0.141 | 2.16 |
| 2010 | 4 | 538590882 | 0.047 | 4.66 |
| **ECO BANK** | 2006 | 7 | 132092000 | 0.131 | 0.93 |
| 2007 | 7 | 31139000 | 0.131 | 0.93 |
| 2008 | 6 | 432466000 | 0.128 | 0.76 |
| 2009 | 5 | 355662000 | 0.168 | 1.29 |
| 2010 | 5 | 454239000 | 0.128 | 0.83 |
| **WEMA BANK** | 2006 | 7 | 129109000 | 0.126 | 0.09 |
| 2007 | 7 | 182866000 | 0.222 | 1.44 |
| 2008 | 7 | 152500000 | 0.166 | 21.07 |
| 2009 | 7 | 129609000 | 0.128 | 33.4 |
|  | 2010 | 5 | 21694401 | 0.10. | 25.04 |
| **UNION BANK** | 2006 | 10 | 666776600 | 0.075 | 6.97 |
| 2007 | 10 | 70009400 | 0.096 | 8.11 |
| 2008 | 9 | 112889000 | 0.076 | 8.93 |
| 2009 | 8 | 123879700 | 0.084 | 11.6 |
| 2010 | 8 | 100691000 | 0.13 | 15.02 |
| **FIRST BANK** | 2006 | 11 | 616824000 | 0.109 | 1.72 |
|  | 2007 | 11 | 911427000 | 0.1 | 2.43 |
|  | 2008 | 10 | 15283400 | 0.102 | 1.93 |
|  | 2009 | 10 | 200991400 | 0.109 | 1.74 |
|  | 2010 | 10 | 230525800 | 0.104 | 1.85 |