

Financial Crisis Impacts on Audit Fees

Public Companies Audit Fee Five Year Trend from 2006-2009
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Introduction

This research is designed to understand the impact the financial crisis has had on audit fees (the amount payable to auditors for an audit). We sought to determine whether increased financial risk drove increased audit risk and an increase in audit fees. Previous fee research has not been updated since 2005.

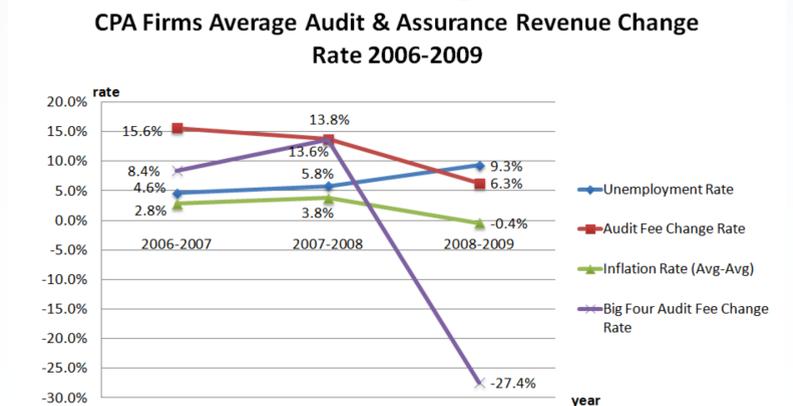
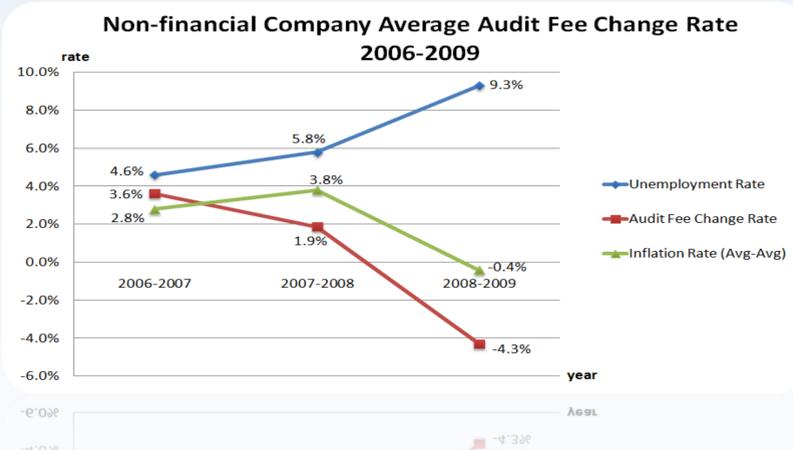
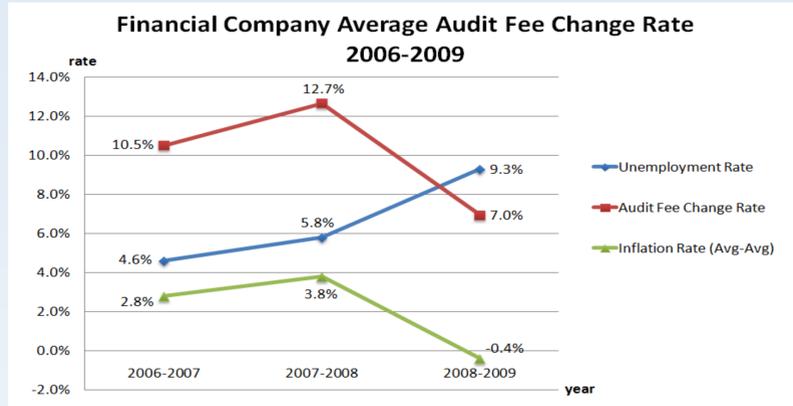
Our hypotheses for the result are:

1. The audit fees for financial service companies have increased since 2006 due to portfolio valuation and going concern issues.
2. The audit fees for non-financial service companies have decreased resulting from economic pressures experienced by firms' audit clients that translate to audit fee reductions.
3. Audit fees at the largest CPA firms have been flat or declined since 2007.

Methods

1. Select 375 sample companies from the 2009 Fortune 1000 list and public accounting reports, including 25 largest financial companies; 100 each for large, medium and small non-financial companies (according to ranking); and 50 largest CPA firms.
2. Obtain audit fee data of each company from their proxy statements filed between 2006 and 2009. Only "pure" audit fees are included, excluding other fees paid to the audit firms (e.g. tax fees, audit related fees and other) in the final analysis.
3. Separate the companies with extreme high/low audit fee change rate that distort the summary by a large extent from the others, and find out the reason for the unusual change from their annual report (e.g. audit increase/decrease due to companies' special activities such as change of auditors, major acquisition, and others.)
4. Analyze data by calculating the amount audit fee changed from previous year and the change rate, specifying the histogram of the audit fee change rate distribution year to year, graphing the four year trend, and relating that trend to inflation (as measured by CPI) and unemployment rate.

Graphs



Results

1. The annual average audit fee increase percentage for financial service companies was 10.5%, 12.7%, and 7% for 2007, 2008, and 2009, respectively. The increased percentage of audit fees far exceeds the inflation rates over the same periods. There is also a positive correlation with unemployment rate trends.
2. The annual average audit fee increase percentage for non-financial service companies was 3.6%, 1.9%, and -4.3% for 2007, 2008, and 2009, respectively. However, the percentage change in audit fees did not keep up with inflation over the same periods. The four year trend also has a negative correlation with the unemployment rate.
3. The annual average audit & assurance revenues at the 50 largest CPA firms was 15.6%, 13.8%, and 6.3% for 2007, 2008, and 2009, respectively. The increased percentage change in audit fees exceeds the inflation rates over the same periods, and correlates positively with the unemployment rate. However, the audit revenues for big four (PwC, Deloitte, E&Y, KPMG) represented an average of -27.4% reduction in 2009.

Conclusion

1. The financial crisis since late 2007 has increased financial risk, thus directly impacted audit risk. The average increase in audit fees for financial companies proves this point.
2. With the negative impact that economic recession brought, unemployment rate sky-rocked, and the inflation rate turned negative because of the reduced customer purchasing power especially in 2009. This caused a 4.3% drop of average audit fees for non-financial companies.
3. The increased average audit & assurance revenue in CPA firms evidenced the increased presence of various audit risk, and the need for more thorough analysis of financial statements, the importance of considering liquidity, and other complexities connected with the auditing of companies that are impacted directly and indirectly by the market crash.
4. Big four's audit fee deduction of -27.4% in 2009 reflected the drop of audit fee at non-financial companies, since they dominated 71.4% of all the SEC clients.

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