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THE ECONOMICS OF AUDITING

Advanced Cases in Assurance Services (ACCTG 521)

Class 2 | MPAcc class of 2025

Agenda

Welcome and administration

Information and uncertainty

- Economics of disclosure (information)
- Qualitative analysis: Analysis of Private Company Disclosure

Review

Information Verification

- Economics of auditing (information verification)
- Quantitative audit fee analysis

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Review

Why do we expect firms to disclose or not disclose information?

What kinds of financial information do private firms disclose voluntarily?

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Information Verification

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Information Verification:
Demand for auditing and assurance

CONSEQUENCE

COMPLEXITY

CONFLICTS OF INTEREST

REMOTENESS

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Explain with examples

CONSEQUENCE **COMPLEXITY** **CONFLICTS OF INTEREST** **REMOTENESS**

Consequence: Groups 1, 2 & 3

Complexity: Groups 4, 5 & 6

Conflicts of interest: Groups 7 & 8

Remoteness: Groups 9 & 10

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Economics of Audit Fees

If we think of auditing as an economic good, in a competitive market, then **audit fees** are a result of supply and demand factors

- Demand ↑ when information verification is more valuable
- Supply ↓ when audit requires more effort

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Economics of audit fees discussion

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Microsoft

Fees Billed by Deloitte & Touche

This table presents fees for professional audit and other services rendered by Deloitte & Touche for the fiscal years 2024 and 2023.

Year ended June 30,	2024	2023
Audit Fees	$56,280,000	$45,630,000
Audit-Related Fees	18,643,000	10,713,000
Tax Fees	6,334,000	5,049,000
All Other Fees	10,000	10,000
Total	$81,267,000	$61,402,000

Ernst & Young	2024 ($)	2023 ($)
Audit Fees[1]	22,380,946	19,684,602
Audit-Related Fees[2]	2,417,439	487,120
Tax Fees[3]	3,435,193	3,864,411
All Other Fees[4]	2,037,244	1,367,196
Total	30,270,822	25,403,329

Reason why firms pay higher audit fee	How to measure it
• Size of the company	• A company’s total assets

Lab

Quantitative audit fee analysis
(lab and presentation)

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Team activity

1. Labs demonstration and extension to test hypotheses:
   1. Larger firms pay more audit fees
   2. An incremental reason a firm would pay more
2. 1 min presentations at end of class (approx. 3:05pm).
3. Be prepared to have one team member share their screen (front of room).

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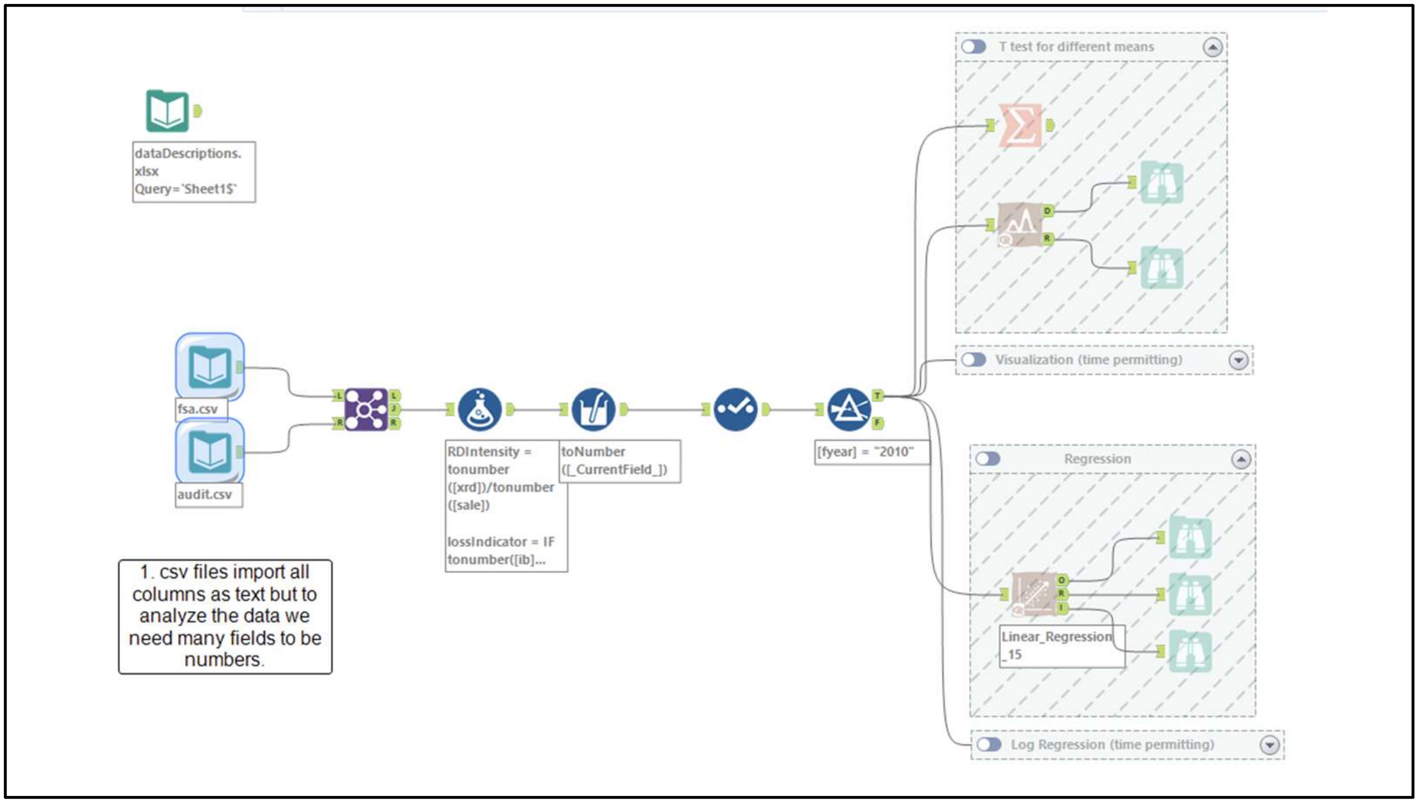
dataDescriptions.
xlsx
Query=`Sheet1$`
fsa.csv
audit.csv
RDIntensity =
tonumber
([xrd])/tonumber
([sale])
lossIndicator = IF
tonumber([ib]...
toNumber
([_CurrentField_])
[fyear] = "2010"
T test for different means
Visualization (time permitting)
Regression
Linear_Regression
_15
Log Regression (time permitting)
1. csv files import all columns as text but to analyze the data we need many fields to be numbers.

Takeaways

- Conflicting incentives for firms to disclose and withhold information
- Conflicting incentives for firms to undertake audits (or information verification)
- Factors that influence demand for audit and therefore audit fee include:
  - Agency conflicts
  - Information asymmetry
  - Risk of intentional manipulation
  - Risk of unintentional errors

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THANK YOU

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