

An Empirical Investigation into the Pricing of Audit Services in Bahraini Listed Companies

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Abstract

The current study aimed to investigate the factors influencing the pricing of audit services from the viewpoints of financial managers, accountants, and internal auditors who are working in listed companies in Bahrain. To achieve this aim, a questionnaire was used in the study. In addition to descriptive statistics, non-parametric tests such as the Chi-square Test were used. The results of descriptive analysis showed that all of the questions (1-33) in all groups prove to be important factors that affect pricing of audit services in Bahraini listed companies with the average means ranging from 3.43 to 4.5 and standard deviations ranging from 0.47434 to 0.63851. The results of the Chi-square test confirmed the results of descriptive statistics that all questions were significant for the seven groups ($p < 0.05$) indicating that respondents' answers for each question were not equally distributed among the different levels of agreement on determinants of auditor's fees in listed companies in Bahrain in all groups. Thus, the respondents' answers were not equally distributed among the different levels of agreement on the factors affected pricing of audit services in Bahraini listed companies in all groups. Based on the results of the Chi-square Test, all of the hypotheses developed (H1 – H7) are accepted. The study recommended that future research is needed to investigate this issue in other developing countries in general and GCC countries in particular. The study also suggested that other respondent groups such as external auditors, shareholders, regulators and members of the audit committees might be included in future research.

Keywords: Pricing audit services, corporate complexity, audit firm size, developing countries, time lag, seasonability, Bahrain, company size, corporate risk, corporate profitability, Bahrain Bourse.

1. Introduction

The American Accounting Association, AAA (1973 cited in Soyemi and Olowookere, 2014, p. 50) has defined audit as a “systematic process of objectivity and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between the assertion and established criteria and communicating the results to interested users”. Pricing of audit services is defined as “the cost of conducting audit to express an opinion on the conformity of financial statements with generally accepted accounting principles (GAAP)” (Soltani, 2007, cited in Hassan et al., 2014, p. 646). Both companies and auditors are interested in the issue of pricing audit services. “Companies are statutorily required to have their financial statements audited and want the fees they pay to be reasonable, auditors provide such services and want to ensure that the price they charge are sufficient to enable a satisfactory service to be provided” (Gist, 1993, cited in Kikhia, 2014, p. 42). The rest of this paper is organized as follows: Section 2 describes the audit environment in Bahrain. Section 3 details the literature review. Section 4 presents the research methodology. Section 5 illustrates research analysis and results of the study. Section 6 offers a summary, conclusions and recommendations.

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1.1 Statement of the problem

The problem statement of the study is highlighted by providing answers to the following questions:

1. Does corporation's related issues such as corporate size; corporate complexity; corporate profitability; corporate risk; corporate year-end and the time lag of the client between year-end and audit report, and the seasonability, affect pricing of audit services?
2. Does the size of audit firm affect pricing of audit services?

1.2 Motivation for the study:

Bahrain is selected for the current study because it is located in the center of the Gulf countries, enjoys a stable political and economic environment and runs a free market economy. According to the best knowledge of the researchers, very few studies have been conducted in Bahrain regarding pricing of audit services which may result in a lack of information about factors affecting pricing of audit services in the literature review. This may give the motivation to conduct this study. This study is expected to narrow the gap in the literature review between developed and developing countries about the issue of pricing audit services.

1.3 Objectives of the study:

As mentioned earlier, few studies were conducted in Gulf countries in general and in Bahrain in particular to identify the factors that may influence pricing of audit services. The current study aims to investigate the factors that may influence pricing of audit services charged by audit firms against Bahraini companies listed on the Bahraini Bourse. The study also aims to reveal whether pricing of audit services differ according to the factors examined in the study.

2. The Bahrain auditing environment

It is important to highlight some issues related to Bahraini audit environment before undertaking this study. It is important to note that Bahrain Stock Exchange was established in June 1989. Bahrain is a member of the Gulf Cooperation Council, which comprises six Gulf Arab states with several economic and social objectives" (Joshi et al. (2009, p. 268). In 2016, "audit services in Bahrain were provided by 23 accounting firms." Five of these are considered local; four are operating as foreign branches; and the remaining are linked to international forms. The Big 4, i.e., Ernst and Young (E&Y), Deloitte and Touche (D&T), KPMG and Price Waterhouse Coopers (PWC) have a strong presence in Bahrain. D&T and KPMG operate as a joint venture, whereas the other two operate as branches of international firms. "The Big 4 dominate the audit services industry in Bahrain. A total of 82.5% of the listed companies in Bahrain Stock Exchange (BSE) that published their annual reports in 2006 are audited by one of the Big Four, and the other 17.5% are audited by non-Big four" (CBB, Bahrain, 2006, Joshi et al. (2009, p. 268). "Companies in Bahrain are required to comply with International Financial Reporting Standards (IFRS), whereas accounting firms must comply with the International Standards of Auditing. These requirements apply to all companies, including financial intuitions". The results of the study are expected to increase the knowledge about how listed companies and audit firms in Bahrain reflect pricing of audit services through their reporting practices. Because Bahrain is a member of GCC, it shares a number of specific structural economic characteristics. The common characteristics that GCC countries share include a high dependency on oil and gas, young and rapidly growing national labor forces, and heavy reliance upon expatriate labor in the private sector. In addition, listed companies in GCC countries are subject to similar reporting requirements. All legal entities are required by companies' laws to submit their annual report including director's report, auditor's report, and financial statements, and have their accounts prepared according to International Financial Reporting Standards issued by the International Financial Reporting Standards (IFRS). Thus, the institution in GCC countries are expected to benefit a lot from the findings of the current study.

3. Literature review

The most important factors affecting the pricing of audit services that may be highlighted in the literature review include corporate size, audit firm size, corporate complexity, corporate profitability, corporate risk, seasonability and corporate year-end and the time lag between year-end and audit report.

It has been argued in the literature that increasing companies' size resulted in increasing audit fees (Simunic, 1980); risk (Stice, 1991); complexity (Hackenbrack and Knechel, 1997); and profitability (Hay, et al., 2006).

Also, the same conclusion was reached in the literature review- that audit fees increase with audit firm size (Francis, 1984; Palmrose, 1986); reputation (Craswell et al., 1995; Collinan, 1998; Larcker and Richardson, 2004; Gonthier-Besacier and Schatt, 2007); and whether is one of the Big Four (Palmrose, 1986; Francis and Simon 1987; Butterworth and Houghton, 1995).

Friis and Nielsen (2010) investigated the likelihood that applied IFRS standards may result in increased Danish companies' cost of auditing. The study found that using IFRS standards does not increased significantly audit fees. However, they found that combining IFRS with company size and complexity, large and complex companies play a vital role in determining pricing of audit services compared with less complex and small companies that also use IFRS. Ellis and Brooker (2011) examined the determinants of audit fees in the community. The results revealed "that the model is highly significant and explains the majority of the cross sectional variance in audit fees". Also, the study concluded "that the size and complexity variables explain the majority of variance in fees".

Hamid and Ali (2012) investigated the factors that may determine pricing of audit services in Iran. The study concluded that "there was a significant relationship between auditing fees and its predictors". The study contributed some knowledge about understanding auditing fees.

Hallak and Silva (2012) examined the factors affecting auditing and consulting expenditures in Brazilian public companies. The results concluded "that pricing of audit services are positively related to company size, corporate performance quality, and the Big Four status of the auditor, but had no significant relationship with corporate governance".

Muni and Al-Hajeri (2013) conducted a study to examine the factors affecting the pricing of audit services. The study shed light on the importance of the following factors in determining audit fees. The study found that the following factors are significant in pricing audit services: the number of transactions, the sum of accounts receivable and inventory, information technology, number of subsidiaries, and regulations.

Monsuru (2014) investigated the factors affecting the pricing of audit services in the Nigerian commercial banking sector industry. The findings of the study revealed that there is a positive association of complexity, risk, but negative association between operating performance and pricing of audit services.

Liu (2017) conducted a study about determinants of audit fees in China. The paper used the regression model at individual auditor level and concluded that the variables of age, gender, educational background, industry specialization, position and business, all have significant correlation with the audit fees. Sonu (2017) conducted a study about determinants of audit fees and financial crisis in Korea. The study found that audit fees fall down dramatically during the financial crisis period. The study suggests that auditors respond differently to small and risky firms into how auditors behave when they are under pressure to reduce audit fees.

4. Research methodology

The study is an explanatory attempt study to verify the hypotheses about the impact of independent variables upon adependent variable of pricing of audit services. Descriptive statistics and Chi square test were used to test the hypothesis regarding the pricing of audit services on corporate size, the size of audit firm, the corporate complexity, client profitability, client risk, corporate year end and the lag between audit report and end of accounting year and seasonability of the client.

4.1. Sample study selection

The sample of the study consists of all companies listed on the Bahrain Bourse for the year 2015. The total number of listed companies is 42 companies. However, commercial banks and insurance companies were excluded from the study because they have a special nature of their activities, as mentioned earlier, and they have a different fee structure from those of non-financial sector companies that may affect pricing of audit services.

4.2. Data collection:

A questionnaire was developed and distributed to the sample study to collect data necessary to test the hypothesis. Non-financial companies listed on Bahrain Bourse were covered in this study with a number of 30 listed companies.

4.3 Hypothesis development

The current study investigates the distinguishing features in Bahrain where companies try to choose the auditor with the lowest audit price. Therefore, the current study aims to test the relationship between auditors and clients regarding pricing of audit services. These factors can be summarized as follows:

Corporate size:

Company size was employed by many previous studies (Taylor and Baker, 1981; Francis, 1984; Firth, 1985; Barber, et al., 1987; Chan et al., 1993; Anderson and Zeghal, 1994; Pong and Whittington, 1994; Johnson et al., 1995; Gregory and Collier, 1996; Ho and Ng., 1996; Iyer and Iyer, 1996; Simon et al., 1996; WaresulKarim and Moizer, 1996; Zhang and Myrteza, 1996; Firth, 1997; Lengendijk, 1997; Mike et al., 1997; Joshi and Al-Bastaki, 2000; Chung and Narasimhan, 2002; Simon and Taylor, 2002; Ezzamel, et al., 2002). Corporate size is considered an important factor in determining the audit fees, (Hay et al., 2006, cited in Kikhia, 2015, p. 43).

Using corporate size was justified based on the basis that auditors spent more time on auditing transactions of more complex businesses. Joshi (1999), Al-shammari et al., (2008) and Xu (2011) provided exclusive evidence that the size of the client is the most important variable in pricing of audit services. Based on the above discussions, the following hypothesis is developed: H1: There is a positive relationship between corporate size and pricing of audit services.

Corporate complexity

It has been pointed out in the literature a “large companies require vast capital investment that may be raised through the stock exchange or by borrowing. Hence, they tend to embark on many transactions which may result in high-audit fees. Complexity is directly proportional to rigorous audit work hence higher pricing of audit services” (Firth, 1985; Cameran, 2005).

Corporate complexity might be measured by a number of branches and subsidiaries of the firm locally and internationally (subsidiaries in foreign countries). It is important to note that “the more complex the company is, the greater the number and the more diversified the subsidiaries and operations are; which necessitate more audit work; therefore, audit firms charge higher pricing of audit services” (Taylor and Baker, 1981; Gonthier-Besacier and Schatt, 2007; Tringgaard and Kiertzner, 2008)).

Based on the previous studies, the following hypothesis is developed: H2: There is a positive relationship between corporate complexity and pricing of audit services.

Corporate risk

“The degree of the risk involved in the audit work may be a considered when pricing of audit services, as it could affect the auditor’s responsibility. Therefore, the more the risk involved in the audit work, the greater the responsibility which deserve a higher fee to compensate the external auditor for taking such risk” (Kikhia, 2015, p. 44). Firth (1993 cited in Kikhia, 2015, p. 44) “discovered that higher level of client risk will increase the auditor’s effort which results in higher pricing of audit services; therefore, the accounting firm will have to undertake detailed work to resolve or moderate the risk”.

Based on the previous studies, the following hypothesis is developed: H3: There is a positive relationship between corporate risk and pricing of audit services.

Audit size and international link

It has been argued in the literature that there is a positive relationship between auditor size and audit fees (Ibrahim, 2006 cited in Hassan et al., 2014). Companies audited by audit firms affiliated to big international firms tend to publish high quality information. This is justified on the grounds that large international audit firms have audit quality and protect credibility which might entails extra cost. Audit firms with international affiliations are larger and supported by more technical experts than small local firms and hence tend to supply better auditing quality and expect to incur more cost; this in turn would be reflected in their charges to customers.

Waresul Karim and Moizer (1996) justified the existence of a positive relationship between the size of the auditor and the size of the audit fees as the big audit firms have access to higher quality staff, use advanced quality procedures, and so are more likely to detect errors and omissions. In light of the above arguments, the following hypothesis is developed: H4: There is a positive relationship between the size of auditing firms and auditor fees.

Corporate profitability

Corporate profitability is an important variable in pricing of audit services and is regarded as a significant sign of management performance and its effectiveness in allocating variable resources (Kikhia, 2015). Profitable firms are willing to pay more pricing of audit services to their external auditors in view of the fact that higher profits may require accurate audit testing of the authority for the identification of revenue and expenses that require more audit time (Joshi and Al-Bastaki, 2000 cited in Kikhia, 2015). Most of studies in the literature indicate that the size of audit fees is significantly influenced by profitability ratios (Sandra and Patrick, 1996). In the light of the previous arguments, the following hypothesis is developed: H5: There is a positive relationship between corporate profitability and pricing of audit services.

Seasonability:

A busy season was found to be a significant determinant of audit fees (Francise, 1984; Francise and Stockes, 1986; Chan et al., 1993; Craswell et al., 1995; Che Ahmad and Houghton, 1996; Ezzamel et al., 1996). It was also found that there is a difference in audit work performed during the 'busy season' and non-busy season (Chan et al., 1993). This may be justified on the basis that audit firms tend to charge a premium for the busy season (Waresul Karim and Moizer, 1996). Consequently, it is assumed that companies with accounting periods ending during the busy season would be expected to pay a premium for the audit service provided. In the light of the above discussion, the following hypothesis is developed: H6: There is a positive relationship between a "busy season" and pricing of audit services.

Corporate's year end and the time lag between year-end and audit report:

The literature also found the variable "lag between audit report and the end of the accounting year to be a significant determinate of audit fees" (Chan et al., 1993; Ezzamel et al., 1996). In addition, it has been pointed that a short time lag could be associated with either expensive audit fees or with efficient corporate accounting practices and internal control systems that could result in less audit work and hence lower fees. A longer time lag might suggest that a company is facing accounting problems that may require extra audit work and hence additional audit fees" (Naser and Nuseibeh, 2007). Thus, the following hypothesis is developed: H7: There is a positive relationship between corporate year end and the time lag between year-end and audit report and pricing of audit services.

5. Data analysis:

5.1 Data Collection

Two sources were used to collect data (primary and secondary data sources). To achieve the objectives of the current study and in light of the literature review and theoretical background, a survey instrument (questionnaire) was used to solicit respondents' opinions and attitudes towards the factors affecting the pricing of audit services in Bahraini listed companies. Since the main objective of the current study is to investigate perceptions on the factors affecting the pricing of audit services, it would be difficult to conduct the research other than via a survey, as the data sources are persons themselves, rather than any other source. So the survey strategy was chosen to conduct this research. Survey is defined as "a procedure in which information is collected systematically about a set of cases (such as people, organizations, and objects)" (Thomas, 1996, p. 115). Questionnaire surveys are the most frequently used method of collecting data in such a type of research. The details of the questions used in the study are shown in Table 1 below. The questionnaire included a list of 33 factors, which are expected to have an impact upon factors influencing the pricing of audit services. It has been argued that questionnaires are used because they are considered the main source of data collection (Sarantakos, 1997). The questionnaire consisted of two sections. Section One contained some personal data; Section Two included questions about the factors of audit fees. These factors were grouped into the following seven areas including: corporate size, corporate complexity, corporate risk, size of auditing firm and international link, corporate profitability, seasonability and corporate year-end and the time lag between year and audit report.

The questions in the questionnaire were measured using a 5-point Likert scale, where 1 refers to “strongly disagree”, 2 refers to “disagree”, 3 refers to “no opinion”, 4 refers to “agree”, and 5 refers to “strongly agree”. (A copy of the questionnaire is available upon request). 152 questionnaires were distributed to the sample study including financial managers; accountants and internal auditors of Bahraini listed companies and 116 questionnaires were collected. However, 2 questionnaires were excluded from the analysis because they contained numerous unfilled questions. The remaining 114 questionnaires were used in the analysis, with a response rate of 75 %. The distribution of the questionnaires and response rates are shown in Table 1 below:

Table 1: Distribution of the questionnaires and response rates.

Respondents	No. of Questionnaires distributed and collected	% of Used Questionnaires
Financial managers	35	30.7
Accountants	50	43.8
Internal auditors	29	25.5
Total	114	100

5.2 Reliability of Study Tool

To prove the reliability of the study tool, a copy of the questionnaire was sent to many accounting professors in Bahrain University and other private universities in Bahrain. Also, some copies of the questionnaire were given to specific institutions in Bahrain. In addition, the questionnaire was given to some academic professors who are specialists in statistics. All their notes and comments were taken into consideration before finalizing the questionnaire.

5.3 Internal Consistency of the Questionnaire’s Reliability

The internal consistency of the questionnaire’s reliability was measured by using Cronbach’s coefficient alpha statistical test as shown in Table 2 below. The analysis in the table provides an indication of the average correlation among all the items that made up the scale. The results demonstrate that all indices obtained regarding the questions in the questionnaire were considered to be high (above 0.70). A sample scale that shows an alpha value above 0.70 is considered as reliable. Therefore, the indices for the questionnaire’s reliability are generally considered as adequate for this study.

Table 2: Reliability test

Questions	Cronbach’s Alpha
Questions 1-6	0.902
Questions 7-11	0.771
Questions 12-15	0.805
Questions 16-22	0.743
Questions 23-25	0.764
Questions 26-30	0.711
Questions 31-33	0.814

5.4 Chi-square analysis

Table 3 below shows that all values of Chi-square were significant for the seven groups of questions ($p < 0.05$). Therefore, it is possible to say that respondents’ answers were not equally distributed among the different levels of agreement on the factors influencing pricing of audit services in listed companies in Bahrain in all groups. Based on the above results from Chi-square Test, all of the hypotheses formulated earlier (H1 -H7) are accepted.

Table 3: Descriptive statistics and Chi-square results of the seven groups of questions (the overall sample)

Groups of Q	N	Mini.	Maxi.	Std. Deviation	Chi-Square	Asymp Sig.
Group 1 (Q 1-6)	114	1.60	5.00	.52441	234.40	.000
Group 2 (Q 7-11)	114	2.00	4.71	.50443	157.71	.000
Group 3 (Q12-15)	114	1.20	4.92	.52544	329.10	.000
Group 4 (Q16-22)	114	1.71	4.33	.52785	130.60	.000
Group 5 (Q23-25)	114	1.32	4.63	.52212	241.30	.000
Group 6 (Q 26-30)	114	1.40	4.52	.53068	221.50	.000
Group 7 (Q 31-33)	114	1.70	4.38	.55340	131.40	.000

5.5 Descriptive analysis

Table 4 below presents the descriptive analysis regarding the pricing of audit services.

Table 4: Descriptive analysis of the pricing of audit services in Bahraini listed companies.

	N	Mean	Std. Deviation	Std. Error Mean
A. Corporate size.				
Q: 1	114	4.6750	0.47434	0.07500
2	114	4.6000	0.49614	0.07845
3	114	4.4000	0.49614	0.07845
4	114	4.6000	0.49614	0.07845
5	114	4.5500	0.63851	0.10096
6	114	1.900	0.54538	0.08623
Average mean		4.12		
B. Corporate complexity.				
7	114	4.2500	0.54302	0.08586
8	114	4.6000	0.49614	0.07945
9	114	4.6500	0.48305	0.07638
10	114	4.6000	0.49614	0.07845
11	114	1.4500	0.50383	0.07966
Average mean		3.91		
C. Corporate risk.				
12	114	4.6000	0.48990	0.07651
13	114	4.6000	0.48990	0.07651
14	114	4.6000	0.62450	0.09753
15	114	1.4500	0.49749	0.07770
Average mean		3.81		
D. Size of public auditing firm (PAF) and international link.				
16	114	4.6000	0.54538	0.08623
17	114	4.6000	0.49614	0.07845
18	114	4.6000	0.49614	0.07845
19	114	4.5000	0.50637	0.08006
20	114	4.5000	0.50637	0.08006
21	114	4.6000	0.49614	.07845
22	114	2.3000	0.64847	0.10253
Average mean		4.24		
E. Corporate profitability.				
23	114	4.6000	0.49614	0.07845
24	114	4.2000	0.56387	0.08916
25	114	1.5000	0.50637	0.08006
Average mean		3.43		
F. Seasonability				
26	114	4.5000	0.50637	0.08006
27	114	4.5000	0.50637	0.08006
28	114	4.6000	0.54538	0.06823
29	114	1.4000	0.49614	0.07845
30	114	4.5000	0.59914	0.09473
Average mean		3.9		
G. Corporate's year end and the time lag between year-end and audit report				
31	114	4.5000	0.55470	0.08771
32	114	4.5000	0.59914	0.09473
33	114	4.5000	0.50637	0.08006
Average mean		4.5		

The results in the table show that all of the questions in (1-33) in all groups prove are considered as important factors influencing pricing of audit services in Bahraini listed companies with the average means ranging from 3.43 to 4.5 and standard deviations ranging from 0.47434 to 0.63851. Since the standard deviations for all items are less than half of the means, this indicates that there is no dispersion among respondents' views about the questions of the hypothesis. By using the measurement scale, any factor with a mean of 3.50 or more is acceptable, and since all the factors got means above 3.50 except for group 5 where the average mean is 3.43 because of question 25 that is stated in negative way, then the respondents do not agree with it, and thus, the mean for this specific question is very low, and hence all the seven hypotheses are accepted.

The ranking of factors influencing pricing of audit services according to its importance is shown in Table 5 below. The table shows that the factor "corporate year end and the time lag between year-end and audit report" located on the top of the factors with an average mean of 4.50 followed by "size of public auditing firm (PAF) and international link" with an average mean of 4.24 followed by "Corporate size" with an average mean of 4.12 followed by "Corporate complexity" with an average mean of 3.91. The next factor was "Seasonability" with an average mean of 3.90, followed by "Corporate risk" with an average mean of 3.81. The least factor was "Corporate profitability" with an average mean of 3.43.

Table 5: Ranking of factors influencing pricing of audit services.

Rank	Questions	N	Mean	Std. Deviation
Factors influencing pricing of audit services				
1	Corporate year end and the time lag between year-end and audit report	114	4.50	0.5534
2	Size of public auditing firm (PAF) and international link.	114	4.24	0.5279
3	Corporate size.	114	4.12	0.5244
4	Corporate complexity.	114	3.91	0.5044
5	Seasonability.	114	3.90	0.5307
6	Corporate risk.	114	3.81	0.5254
7	Corporate profitability.	114	3.43	0.5221

6. Summary, Conclusions and recommendations

The current study empirically investigated perceptions of three groups working in listed Bahraini firms in Bahrain Bourse namely, internal auditors, accountants and managers on the factors influencing pricing of audit services in Bahraini listed companies. The study concluded that corporate year-end and the time lag between year-end and audit report; Size of public auditing firm (PAF) and international link and corporate size are the important factors affecting pricing of audit services in listed companies in Bahrain with the means of 4.50, 4.24 and 4.12 respectively. Most corporate complexity; seasonability; and corporate risk with the means of 3.91, 3.90 and 3.81 respectively come second in importance. Corporate profitability appeared to have no impact upon pricing of audit services.

The study recommended that future research is needed to investigate this issue in other developing countries in general and the GCC countries in particular. The study also suggested that other respondent groups such as external auditors, shareholders, regulators and members of audit committees might be included in future research. This study is limited to respondents in listed companies working in Bahrain. The question of how the situation would be formed in case of privately held companies is another avenue for research. Also in order to generalize the findings of the study, there is a need to conduct the same study again over a longer period of time.

Other factors can be considered in implementing the study such as market share of the audit firms and the economic conditions of the country. Findings of such research may not be generalized to different countries at different stages of development, or with different business environments and cultures.

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