

# **The Impact of the Number of Auditors and an Auditor's Number of Clients on Audit Fees from the Perspective of Cost-Based Competition**

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## **Abstract**

In this paper, we use a cost-based competition framework to study the relationship of audit fees to the number of auditors in a given market and to an auditor's number of clients.

Our framework is constructed upon the following three assumptions: 1) the cost of auditing a client is a decreasing function of the auditor's capability and the degree to which a client's characteristics match the auditor's audit approach; 2) an auditor incurs greater costs in developing and maintaining a new or additional audit approach; 3) auditors compete based on their costs.

This framework suggests three outcomes: 1) more capable auditors make higher profits; 2) audit fees charged by existing auditors in a market increase as the number of auditors increases; 3) the average fees charged by an auditor are a decreasing function of his or her number of clients.

In our paper we document the following four areas of empirical evidence:

1) Larger auditors charge higher fees; consequently, they make higher profits and are perceived as being more capable auditors. 2) Existing auditors charge higher fees as the number of auditors in the market increases. 3) Average audit fees across markets are not associated with the number of auditors in those markets. 4) An auditor's number of clients is associated with lower average fees charged by that auditor.

**Keywords:** Auditors, Audit Fees, Clients, Cost-based Competitions,