

The Impact of the Number of Auditors and an Auditor's Number of Clients on Audit Fees: From a Perspective of Cost-Based Competition

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Abstract

This paper examines the dynamics of auditor competition within the context of the auditing industry. The study uses a model that factors in the cost of auditing, which depends on the auditor's capabilities, chosen audit approach, and client firm characteristics. Auditor capability is defined as the auditor's potential efficiency in auditing any firm, and the auditor's approach refers to their chosen audit procedures.

The model suggests that there is an optimal audit approach for clients with specific characteristics. If this optimal approach is followed, the auditor achieves the highest client-specific efficiency. This efficiency increases with the auditor's capability. However, the cost of developing and maintaining multiple audit approaches can hinder auditors from adopting the optimal approach for all clients. As a result, less capable auditors may be more efficient for some clients by using different audit approaches. This leads to a market with multiple auditors competing for clients based on their bidding audit fees.

Keywords: auditor, auditee, capabilities, audit approach, efficiency