

The Effects of Auditee and Auditor Characteristics on the Relationship between Non-audit Services and Audit Quality: Australian Evidence

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Abstract: This study analyzes the effects of auditee and auditor characteristics on the relationship between non-audit services (NAS) and audit quality in Australia. It examines data of Australian Securities Exchange (ASX) 500 companies from 2006 until 2016. Findings show that the propensity to receive a going-concern qualified opinion is lower in Adelaide compared to Brisbane, Hobart, Melbourne, and Perth. In contrast, when clients in Adelaide receive NAS from their auditors, their propensity to receive a going-concern qualified opinion increases. However, receiving NAS in Brisbane, Hobart, Melbourne, and Perth do not increase the likelihood to receive a qualified opinion. Further, this study suggests that providing NAS to clients can compromise the audit quality of some auditors (such as Deloitte or Bentleys), but not for all. Specifically, it does not impair the audit quality of PWC or PKF. Overall, findings suggest that a gain in audit efficiency and a decline in audit quality are both at play when auditors provide NAS to their clients. Thus, whether audit quality improves or declines due to the provision of NAS depends on market characteristics and auditor characteristics. These results potentially explain why there is mixed evidence in the literature when it comes to NAS and audit quality.

Keywords: audit quality, auditor, Australia, location, non-audit

1. Introduction

This study aims to analyze the effects of auditee and auditor characteristics on the relationship between non-audit services (NAS) and audit quality in Australia. Prior studies do not provide a conclusive result regarding the effects of NAS on audit quality. For example, some suggest that economic bonding (Church, Jenkins, McCracken, Roush, & Stanley, 2014) and social bonding (Hohenfels & Quick, 2018) of NAS impair auditor independence. However, others support the knowledge spillover argument, suggesting that the benefits of knowledge spillover are greater than the costs associated with impaired auditor independence (Koh, Rajgopal, & Srinivasan, 2013; Walker & Hay, 2013). Hence, this study is

motivated to find why there is mixed evidence in the literature when it comes to NAS and audit quality.

Around the time that major corporate collapses such as Enron and WorldCom hit the U.S. market, Australia suffered from some major corporate scandals such as HIH Insurance and One.Tel. Australia passed the Corporate Law Economic Reform Program (CLERP) 9 to enhance corporate governance through enhancements in transparency, accountability, and the rights of shareholders (Salman & Carson, 2009). The Australian government's justification for enacting CLERP 9 was that a stronger regulatory environment serves the public interest and assures audit and financial reporting quality. The government's intervention regarding CLERP 9 allowed better enforcement of auditing standards (Hecimovic, 2008).

CLERP 9 requires the disclosure of non-audit fees as follow: "Details of the amount paid or payable to the auditor for non-audit services provided by, or on behalf of, the auditor during the year (including the names of the auditor and the dollar amount that the listed company paid, or must pay, for each of the non-audit services)" (Waldron, 2002, p. 19). Moreover, audit committees should declare that the purchased NAS do not impair auditor independence (Carey, Monroe, & Shailer, 2014). There are no regulatory changes after CLERP 9 that affect the relationship between NAS and audit quality. Therefore, this study is motivated to investigate the reasons behind prior mixed evidence in the literature in the current Australian setting.

An auditee's location is likely to influence its audit quality because different environments have diverse requirements (Nicolaescu, 2013). For example, regions with high disclosure requirements have more audit tasks and audit hours (Nicolaescu, 2013), hence higher audit quality. This study is motivated because an auditee's location is a part of its audit market dynamics. Thus, an auditee's location (Hay, 2013) can influence its audit quality. Moreover, empirical evidence suggests that large auditors provide higher quality audit services (Dehkordi & Makarem, 2011). This is because large auditors have more resources, enabling them to resist the management's pressure (DeAngelo, 1981). However, prior Australian studies failed to examine the moderating effects of auditees' location and auditors' size on the relationship between NAS and audit quality. Thus, this study is motivated to examine the effects of auditee and auditor characteristics on the relationship between NAS and audit quality in Australia.

This study finds that a gain in audit efficiency and a decline in audit quality are both at play when auditors provide NAS to their clients. Hence, whether audit quality improves or declines due to the provision of NAS

depends on market characteristics and auditor characteristics. This study contributes to the current debate regarding the relationship between NAS and audit quality. Its results potentially explain why there is mixed evidence in the literature when it comes to NAS and audit quality. Further, its findings can be generalized to other Anglo-American countries (e.g., the UK) because of the similarities of their regulatory settings with Australia.

2. Literature Review

Audit quality is the cornerstone of the audit profession (Lindberg & Beck, 2004). Different accounting bodies emphasize the importance of independence (Bazerman, Morgan, & Loewenstein, 1997). For example, the American Institute of Certified Public Accountants Code of Professional Ethics mentions that: "A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services" (AICPA, 2014, p. 6). However, auditors are likely to impair their independence. For example, Bazerman *et al.* (1997, p. 93) mention that:

In sum, auditors' judgments are likely to be biased in favour of their own and their client's interests. This bias occurs indirectly as a result of selective sifting and integrating audit information. As a result, the bias is likely to be unintentional and impervious to moral suasion or the threat of delayed and probabilistic sanctions, which are likely to seem quite remote.

NAS cause auditors to not report violations of accounting standards (Kinney, Palmrose, & Scholz, 2004). Moreover, NAS reduce an audit effectiveness (Frankel, Johnson, & Nelson, 2002; Huang, Mishra, & Raghunandan, 2007). The high amount of non-audit fees increases discretionary accruals (Ferguson, Seow, & Young, 2004). Sharma and Sidhu (2001), through an analysis of a sample of distressed firms, suggest that NAS encourage auditors to issue fewer qualified opinions. A meta-analysis of 48 studies shows a positive relationship between NAS and earnings management (Lin & Hwang, 2010) because NAS increase the economic bonding between auditors and their clients (Lin & Hwang, 2010).

Beattie and Fearnley (2002) suggest that the provision of NAS affects perceived audit quality. This is because investors place less reliance on financial statements if they believe auditors do not fulfill their duties to obtain NAS (Krishnan, Sami, & Zhang, 2005). Auditors are rational decision-makers, aiming to maximize their wealth through impairment of audit quality (Habib, 2012). Auditors are more likely to permit earnings management whenever their NAS create economic rents (Frankel *et al.*, 2002). NAS lead to short audit report lags, wherein quickness of audit shows

less audit effort, compromising audit quality (Knechel & Payne, 2001). Frankel *et al.* (2002) show a positive association between the ratio of non-audit service fees to total auditors' fees as a proxy for auditor independence impairment and earnings management.

Enron, World Com, and similar cases are examples of auditors' leniency when they obtain NAS from their audit fee clients (Knechel & Sharma, 2012). Poor corporate governance is the reason behind the mentioned collapses. The critics mention that auditing and financial reporting were off the track at that time (Rouse & Weirich, 2006). As it is a common practice for regulators to enact laws to respond to corporate scandals (Cooper & Deo, 2005), different governments introduced new legislation such as SOX to heighten audit quality and preserve corporate governance (Salman & Carson, 2009). The introduction of new rules shows auditors' vital role in financial reporting and reliance of financial statements' users on financial reports (Commission, 2003).

The Australian government's approach before CLERP 9 was based on a principle-based approach with minimal government interventions (Hecimovic, 2008). However, CLERP 9 changed the approach from a co-regulatory framework to a government-controlled approach (Jubs & Houghton, 2007). Before CLERP 9, major professional accounting bodies were responsible for establishing the auditing standards and enforcing them through their peer-reviewed programs and disciplinary actions (Jubs & Houghton, 2007). Under CLERP 9, the Auditing and Assurance Standards Board (AUASB) becomes a statutory body, being in charge of the revision of existing auditing standards (Houghton, Kend, & Jubb, 2013). This movement was similar to what happened in the U.S. with the movement from the American Institute of Certified Public Accountants to the Public Company Accounting Oversight Board. The revised standards become legally enforceable. The legal enforceability was one of the most important changes in CLERP 9 (Houghton *et al.*, 2013). The AUASB revised and reissued the auditing standards based on the IAASB's clarity project (Houghton *et al.*, 2013).

CLERP 9 permitted the Australian Securities and Investments Commission to have more authority to regulate auditing practices. The Australian Securities Exchange (ASX) welcomed CLERP 9, mentioning that changes progressed rules that govern listed companies and market participants (Dwyer & Laura, 2002). CLERP 9 has changed auditors' incentives as it introduced heavy fines and possible jail terms for breaches of the law (DeFond, 2010). Auditors should rewrite their procedure manuals. They should incur training costs for their staff, and their professional indemnity insurance increases because of a rise in the risk of breach of

standards (Jubs & Houghton, 2007). Moreover, auditors should conduct a sophisticated audit and provide more documentation (McCollum, 2006). Due to these changes, the time needed to conduct an audit increased, and the expected audit quality improved (McCollum, 2006). Australian companies incur higher audit fees after CLERP 9, mainly due to the higher audit effort associated with CLERP 9 (Salman & Carson, 2008). However, the increased confidence in the capital market serves the public interest, justifying the higher fees that auditees have to pay (Jubs & Houghton, 2007).

CLERP 9 enhanced auditor independence through (1) increased restrictions about employment and financial relationships between auditors and their clients (2) mandatory audit partner rotation after every five years (3) audit committees' mandatory statement to confirm their satisfaction regarding the alignment of NAS with auditor independence requirements, and (4) mandatory disclosure of fees paid for NAS (Carey *et al.*, 2014). CLERP 9 requires public disclosure of audit and non-audit fees (Commonwealth of Australia, 2004, p. 44). There are no other regulatory changes after CLERP 9 which can directly affect audit and non-audit fees in Australia (Salman & Carson, 2009).

Prior research supports the view that these new requirements safeguard auditor independence and audit quality. For example, Kilgore, Radich, and Harrison (2011) analysis of the effects of different factors on audit quality impairment after CLERP 9 show that NAS have the lowest effect on quality impairment. Gul, Tsui, and Dhaliwal (2006) show that a lower amount of NAS increases the value relevance of earnings. Ruddock, Taylor, and Taylor (2006) find that restrictions regarding non-audit services can at least improve the perceived auditor independence. Ye, Carson, and Simnett (2011) show a positive association between long audit partner tenure and high non-audit fees and issuance of an inappropriate audit opinion. Ye *et al.* (2011) support the Australian government's decision to restrict long partner tenure and place a cooling-off period before a former partner can become a director. Hossain (2013) shows that auditors are more likely to issue a going-concern opinion for their financially distressed firms after the provision of NAS. Moreover, auditors tolerated a larger magnitude of absolute values of discretionary accruals while providing NAS before CLERP 9. However, their tolerance level decreased after the implementation of CLERP 9 (Hossain, 2013). Overall, Hossain (2013) suggests that CLERP 9 requirements improved auditor independence.

The geographical distance between a client and its auditor increases its audit costs (Hay & Davis, 2004) and delays the provision of its audit reports (Cohen & Leventis, 2013). A location's costliness increases its service fees (Firth, 1997). Moreover, audit staff costs are higher in some locations than

in others. Audit personnel requires higher pays in expensive markets (Che-Ahmad & Houghton, 1996). Furthermore, location reflects local market characteristics (Sirois, Marmousez, & Simunic, 2012). For example, Australian audit firms face longer audit partner tenure outside of Sydney, Melbourne, and Brisbane (Ryken, Radich, & Fargher, 2007). Further, a location's characteristics influence auditors' national and international outsourcing relationships (Handley & Benton Jr, 2013).

An auditee's location affects its audit engagement coordination (Palmrose, 1986) because it is a reflection of the auditee's complexity and the required audit effort (Chan, Ezzamel, & Gwilliam, 1993). Specific locations require a higher coordination level and are more complex. The existence of multiple work locations makes it difficult for employees to share their knowledge and coordinate with each other (O'Leary & Cummings, 2007). Audit firms should use more resources to enable effective coordination among their personnel, increasing their coordination costs (Handley & Benton Jr, 2013). This audit task complexity creates higher costs (Handley & Benton Jr, 2013). Audit firms transfer this extra cost to their clients as higher fees (Che-Ahmad & Houghton, 1996).

Large auditors have more negotiation power which helps them to limit earnings management and consequently provide a better report (Jeong & Rho, 2004). For example, Nelson, Elliott, and Tarpley (2002) show that large auditors detect earnings manipulations and demand their auditees to correct them. Carcello and Nagy (2004) find that discretionary accruals are lower for companies that are audited by large auditors. Large auditors are likely to enjoy a higher independence and competence level. This occurs as they have less financial affiliation with their auditees and are less likely to endanger their reputation because of their auditees, safeguarding their independence. Further, they have a better technology and enjoy from expert employees, increasing their competence (Dehkordi & Makarem, 2011).

Large auditors provide better work. They spend more time on their tasks, reducing the likelihood of legal action against them (Colbert & Murray, 1999). This view is supported by prior research. For example, Francis (2004) suggests that an audit failure can be concluded from a lawsuit against an auditor. Moreover, Palmrose (1988) finds that there are fewer legal actions by auditees and sanctions by regulatory bodies against big auditors. Large auditors are more cautious regarding their clients' earnings manipulation (Rusmin, 2010). Hence, their auditees suffer from fewer abnormal accruals (Becker, DeFond, Jiambalvo, & Subramanyam, 1998). Large auditors' industry expertise is a factor that contributes to their ability to reduce earnings management (Francis, 2004). Large auditors are capable of hiring industry expert employees, enabling them to provide better audit

judgments (Solomon, Shields, & Whittington, 1999). Further, they have a lower threshold to issue a qualified audit opinion (Francis & Krishnan, 1999).

Large auditors have a better capacity to invest in audit technology (Sirois, Marmousez, & Simunic, 2016). They can improve their audit quality through investment in different technological tools such as information technology, software, and databases (Bedard, Deis, Curtis, & Jenkins, 2008). Moreover, large auditors can invest in computer-assisted audit technologies (Stimpson, 2008). The technology used by large audit firms provides them with a competitive advantage, wherein small auditors cannot replicate an audit conducted by large auditors through more audit hours (Sirois *et al.*, 2016). Large auditors through their investments in real audit quality-enhancing technologies such as modern information technology and hardware provide efficient audits. For example, Menon and Williams (2001) show that large auditors spend less time to verify inventories and confirm account receivables by using computerized systems and analytical procedures.

Technology helps auditors to enhance their process innovation and production efficiency, enabling them to deliver their services at a lower effort cost compared to their competitors (Sirois *et al.*, 2016). This means through technological enhancements they can provide the same quality, using less audit or labor hours. Chang, Chen, Duh, and Li (2011) show that technical enhancements such as information technology capital accumulation increase large auditors' productivity, reducing their costs. The creation of in-house central research and accounting consultation units helps audit engagement employees to tackle complex auditing issues (Bedard *et al.*, 2008). However, these support units are costly and are usually used among large auditors (Bedard *et al.*, 2008).

Large auditors can better advertise their services. They engage in quality-based advertising, responding to market requirements (Hay & Knechel, 2010). This helps auditees to select the most appropriate auditor for their needs, reducing their transaction costs (Hay & Knechel, 2010). Large auditors can develop their universal network and brand-image (Sirois *et al.*, 2016). This ensures auditees regarding the quality of large local auditors, reducing the transaction costs involved in dealing with auditors (Sirois *et al.*, 2016). Hence, the fee premium of large auditors is at least partially a reflection of their audit quality which is derived from their higher audit effort (Choi, Kim, Liu, & Simunic, 2008; Pae & Yoo, 2001), independence (DeAngelo, 1981), technology (Sirois *et al.*, 2016), and support groups (Bedard *et al.*, 2008). Overall, there are theoretical reasons to believe that an auditee's location and auditor size affect the relationship between NAS and audit quality. Therefore, this study hypothesizes that:

H1: whether NAS improve or decline audit quality depends on auditee and auditor characteristics.

3. Data and methodology

Prior research considers fee as a measure of audit quality (Choi, Kim, Liu, & Simunic, 2009; Fung, Gul, & Krishnan, 2012; Gul & Goodwin, 2010; Numan & Willekens, 2012). Therefore, cities with low fees are expected to have low audit quality. This study runs the following going-concern model to examine this expectation:

$$\begin{aligned}
 GC = & a_0 + a_1 Ch \text{ Audit Firm} + a_2 ACexist + a_3 LnTotalAsset + a_4 GCPY + \\
 & a_5 PBANK + a_6 LnAge + a_7 CCFO + a_8 Big Four + a_9 Current Ratio + a_{10} Debt Ratio + \\
 & a_{11} LnNon - auditFees + a_{12} Adelaide + a_{13} LnNon - auditFees * Adelaide + \\
 & a_{14} Brisbane + a_{15} LnNon - auditFees * Brisbane + a_{16} Hobart + a_{17} LnNon - \\
 & auditFees * Hobart + a_{18} Melbourne + a_{19} LnNon - auditFees * Melbourne + \\
 & a_{20} Perth + a_{21} LnNon - auditFees * Perth + a_{22} PWC + a_{23} LnNon - auditFees * \\
 & PWC + a_{24} EY + a_{25} LnNon - auditFees * EY + a_{26} Deloitte + KPMG + \\
 & a_{30} Pitcher Partners + a_{31} LnNon - auditFees * Pitcher Partners + a_{32} PKF + \\
 & a_{33} LnNon - auditFees * PKF + a_{34} Benthleys + a_{35} LnNon - auditFees * Benthleys + \\
 & a_{36} BDO + a_{37} LnNon - auditFees * BDO + a_{38} HLB Mann Judd + a_{39} LnNon + \\
 & auditFees * HLB Mann Judd + year dummy + \varepsilon
 \end{aligned}
 \tag{1}$$

Table 1 summarizes the variables of this study and their definitions.

Table 1: Variables of this study and their definitions

<i>Variable</i>	<i>Definition</i>
GC	Issuance of a going-concern audit opinion – Yes = 1 and No = 0
Big Four	1 if a Big Four auditor audits an auditee, else 0
LnAge	Natural logarithm of an auditee's age in years
LnTotalAssets	Natural log of an auditee's total asset in dollar value
LnNon-auditFees	Natural log of an auditee's non-audit fee in dollar value
GCPY	Existence of a prior-year going-concern audit opinion – Yes = 1 and No = 0
ACexist	Existence of an audit committee in an auditee – Yes = 1 and No = 0
PBANK	Probability of bankruptcy as measured by adjusted Zmijewski score
CCFO	Change in cash flow from operation from year $t-1$ to year t , scaled by total assets as of the end of year $t-1$

contd. table 1

<i>Variable</i>	<i>Definition</i>
Ch Audit Firm	1 if the audit firm of an auditee is changed during a year, else 0
Debt Ratio	Debt ratio – An auditee’s total liabilities divided by its total assets
Current Ratio	Current ratio – An auditee’s current assets divided by its current liabilities
Adelaide	Adelaide as the location of an auditee
Brisbane	Brisbane as the location of an auditee
Canberra	Canberra as the location of an auditee
Hobart	Hobart as the location of an auditee
Melbourne	Melbourne as the location of an auditee
Perth	Perth as the location of an auditee
Sydney	Sydney as the location of an auditee
PWC	PWC as the auditor
EY	EY as the auditor
Deloitte	Deloitte as the auditor
KPMG	KPMG as the auditor
Pitcher Partners	Pitcher Partners as the auditor
PKF	PKF as the auditor
Bentleys	Bentleys as the auditor
BDO	BDO as the auditor
HLB Mann Judd	HLB Mann Judd as the auditor

Australian Corporations Act requires public listed companies to audit their financial reports (Carey *et al.*, 2014). The AUASB’s auditing standards under the Legislative Instruments Act 2003 took effect in July 2006 (Carey *et al.*, 2014). Therefore, this study examines data of ASX 500 companies from 2006, and it considers a 10-year period to obtain sufficient data (2006 – 2016), based on their market capitalization on 30 June 2016. To gather other relevant data (if unavailable at ASX), this study has recourse to other databases such as Connect 4, Morningstar, and the companies’ annual reports. These data are hand-collected. Table 2 shows the sample selection procedure of this study.

Table 2: Sample selection procedure of this study (ASX500: 2006 – 2016)

	<i>Number of observations</i>
Initial sample	5,511
Less:	
Missing observations	(3,779)
Final sample	1,732

Note: The data are obtained from ASX, Connect 4, and companies’ annual reports.

4. Findings

4.1. Descriptive Statistics

Panel A in Table 3 shows descriptive statistics of audit fees for sample companies in different cities from 2006 until 2016. Sydney and Canberra have the highest and lowest means, suggesting that they have the highest and lowest audit fees. However, Hobart and Perth have the highest and lowest medians. The difference between mean and median values is due to a small number of ASX 500 companies that are operating in Canberra and Hobart, leading to few audit fees. Sydney and Hobart have the highest and lowest standard deviations, showing their audit fee dispersion.

Panel B in Table 3 shows descriptive statistics of non-audit fees for sample companies in different cities from 2006 until 2016. Non-audit fees are considerably lower than audit fees in major cities, whereas the difference in non-major cities is small. Similar to audit fees' data, Sydney and Canberra have the highest and lowest non-audit fees. Moreover, Hobart and Perth have the highest and lowest medians. However, Sydney and Canberra have the highest and lowest fee variation. Panel C in Table 3 shows descriptive statistics of total fees for sample companies in different cities from 2006 until 2016. Like audit and non-audit fees, Sydney and Canberra have the highest and lowest fees. Further, Hobart and Perth have the highest and lowest medians. However, similar to non-audit fees, Sydney and Canberra have the highest and lowest fee variation.

4.2. Multicollinearity

Multicollinearity can be a concern because of significant correlations among some variables. Therefore, this study examines the variation inflation factors (VIF) values of its going-concern model to determine a potential multicollinearity problem. A VIF value greater than 10 signals a multicollinearity problem (Adeyemi & Fagbemi, 2010; Rahmina & Agoes, 2014). In un-tabulated results, Canberra and Sydney obtain a VIF value greater than 10. Hence, this study excludes them from further analysis. The remaining variables obtain a VIF value below 4, suggesting that multicollinearity is not a concern.

4.3. Main Results

This study uses a log transformation of non-audit fees to capture the economic importance of an auditee to its auditor (Ashbaugh, LaFond, & Mayhew, 2003). Results show that Adelaide (z -statistic = -3.93, p -value = 0.000) obtain a significant negative association with GC, suggesting a lower propensity to receive a going-concern opinion in Adelaide. However,

Table 3: Descriptive statistics of audit fees, non-audit fees, and total fees for sample companies in different cities (ASX 500: 2006 – 2016)

<i>Panel A: Descriptive statistics of audit fees for Australian cities</i>						
	<i>Mean</i> (<i>\$</i>)	<i>Std.</i> <i>Devia-</i> <i>tion(\$)</i>	<i>First</i> <i>Quartile</i> (<i>\$</i>)	<i>Median</i> (<i>\$</i>)	<i>Third</i> <i>Quartile</i> (<i>\$</i>)	<i>95th</i> <i>Percentile</i> (<i>\$</i>)
Adelaide	190 716	134 847	102 000	152 598	250 000	372 800
Brisbane	232 489	222 191	87 500	145 000	305 000	762 000
Canberra	122 948	70 257	61 500	102 500	193 754	213 073
Hobart	207 500	45 962	175 000	207 500	240 000	240 000
Melbourne	321 389	612 603	62 000	125 500	258 918	1 600 000
Perth	143 535	224 545	35 450	87 500	172 900	441 265
Sydney	513 726	1 741 591	51 000	143 600	311 500	2 274 000
Non-capital Cities	197 744	206 553	74 250	118 000	250 033	781 079
<i>Panel B: Descriptive statistics of non-audit fees for Australian cities</i>						
	<i>Mean</i> (<i>\$</i>)	<i>Std.</i> <i>Devia-</i> <i>tion(\$)</i>	<i>First</i> <i>Quartile</i> (<i>\$</i>)	<i>Median</i> (<i>\$</i>)	<i>Third</i> <i>Quartile</i> (<i>\$</i>)	<i>95th</i> <i>Percentile</i> (<i>\$</i>)
Adelaide	68 781	119 878	0	14 900	52 000	423 200
Brisbane	72 837	144 194	4 060	24 680	79 000	279 412
Canberra	8 265	13 954	0	19 065	19 530	489 755
Hobart	191 871	256 862	10 242	191 871	282 686	355 337
Melbourne	170 432	679 865	2 200	25 678	104 122	554 448
Perth	77 887	238 418	0	10 457	53 092	434 527
Sydney	267 181	993 295	1 071	31 000	139 232	1 104 389
Non-capital Cities	196 059	361 823	6 000	37 450	179 834	1 037 289
<i>Panel C: Descriptive statistics of total fees for Australian cities</i>						
	<i>Mean</i> (<i>\$</i>)	<i>Std.</i> <i>Devia-</i> <i>tion(\$)</i>	<i>First</i> <i>Quartile</i> (<i>\$</i>)	<i>Median</i> (<i>\$</i>)	<i>Third</i> <i>Quartile</i> (<i>\$</i>)	<i>95th</i> <i>Percentile</i> (<i>\$</i>)
Adelaide	259 497	223 696	105 208	170 334	304 000	741 269
Brisbane	305 326	315 463	99 890	198 478	409 126	969 459
Canberra	131 213	71 148	59 750	132 500	204 055	987 557
Hobart	399 371	210 900	250 242	399 371	473 936	533 587
Melbourne	491 132	1 170 523	75 254	159 050	378 000	1 885 250
Perth	221 422	408 559	40 738	103 580	241 343	823 289
Sydney	780 906	2 642 606	65 093	203 352	436 701	3 070 100
Non-capital Cities	393 803	485 844	86 000	179 813	433 000	1 513 835

Brisbane (z -statistic = 0.41, p -value = 0.683), Hobart (z -statistic = -0.66, p -value = 0.507), Melbourne (z -statistic = 0.03, p -value = 0.977), and Perth (z -statistic = 0.48, p -value = 0.632) obtain insignificant results, suggesting that there is no association between these cities and going-concern reports. Therefore, the propensity to receive a going-concern qualified opinion is lower in Adelaide compared to Brisbane, Hobart, Melbourne, and Perth. Conversely, when clients in Adelaide (z -statistic = 4.01, p -value = 0.000) receive NAS from their auditors, their propensity to receive a going-concern qualified opinion increase. However, receiving NAS in Brisbane (z -statistic = -0.31, p -value = 0.760), Hobart (z -statistic = 1.17, p -value = 0.243), Melbourne (z -statistic = -0.28, p -value = 0.779), and Perth (z -statistic = 0.12, p -value = 0.901) does not increase the likelihood to receive a qualified opinion. This finding suggests that auditors can achieve audit efficiency when they also provide NAS in some city-level markets.

Audit quality may vary at individual auditor level. Hence, this study further investigates the influence of NAS on audit quality at audit firm level among the highest-paid auditors. All else being equal, some auditors are more likely to issue going-concern audit opinions than others. For example, results show that Deloitte (z -statistic = 1.99, p -value = 0.047), KPMG (z -statistic = 2.99, p -value = 0.003), Bentleys (z -statistic = 6.75, p -value = 0.000), and HLB Mann Judd (z -statistic = 2.83, p -value = 0.005) are more likely to issue going-concern opinions than others. However, when they provide NAS to their clients the propensity to issue a going-concern opinion declines, as LnNon-auditFees*Deloitte (z -statistic = -1.99, p -value = 0.046), LnNon-auditFees*KPMG (z -statistic = -3.15, p -value = 0.002), LnNon-auditFees*Bentleys (z -statistic = -7.41, p -value = 0.000), and LnNon-auditFees*HLB Mann Judd (z -statistic = -2.99, p -value = 0.003). This result suggests that providing NAS to clients can compromise audit quality of some auditors.

However, results do not show any association between other auditors and issuance of going-concern opinions. For example, PWC (z -statistic = -0.64, p -value = 0.525), EY (z -statistic = 1.13, p -value = 0.260), Pitcher Partners (z -statistic = 0.80, p -value = 0.421), PKF (z -statistic = 1.18, p -value = 0.238), and BDO (z -statistic = 1.08, p -value = 0.281). Moreover, NAS create an insignificant interaction with GC, suggesting that NAS do not influence audit quality among them. LnNon-auditFees*PWC (z -statistic = 0.22, p -value = 0.823), LnNon-auditFees*EY (z -statistic = -1.27, p -value = 0.202), LnNon-auditFees*Pitcher Partners (z -statistic = -1.06, p -value = 0.288), LnNon-audit Fees*PKF (z -statistic = -1.11, p -value = 0.267), and LnNon-audit Fees*BDO (z -statistic = -1.21, p -value = 0.226). Table 4 provides the results.

Table 4: Logistic regression results of the going-concern model of different auditors in different cities during the sample period using robust standard errors (ASX 500: 2006 – 2016)

GC	Coef.	z	P>z
Ch Audit Firm	-0.853	-1.39	0.165
ACexist	0.255	0.48	0.630
LnTotalAsset	-0.018	-0.18	0.858
GCPY	3.699	12.45	0.000
PBANK	0.001	0.16	0.870
LnAge	-0.261	-1.50	0.133
CCFO	0.597	0.67	0.502
Big Four	0.274	0.76	0.450
Current Ratio	-0.004	-0.49	0.621
Debt Ratio	0.099	0.17	0.868
LnNon-auditFees	0.193	1.12	0.265
Adelaide	-23.457	-3.93	0.000
LnNon-auditFees*Adelaide	1.924	4.01	0.000
Brisbane	1.281	0.41	0.683
LnNon-auditFees*Brisbane	-0.086	-0.31	0.760
Hobart	-3.857	-0.66	0.507
LnNon-auditFees*Hobart	0.587	1.17	0.243
Melbourne	0.084	0.03	0.977
LnNon-auditFees*Melbourne	-0.074	-0.28	0.779
Perth	0.803	0.48	0.632
LnNon-auditFees*Perth	0.020	0.12	0.901
PWC	-1.703	-0.64	0.525
LnNon-auditFees*PWC	0.050	0.22	0.823
EY	3.545	1.13	0.260
LnNon-auditFees*EY	-0.357	-1.27	0.202
Deloitte	4.753	1.99	0.047
LnNon-auditFees*Deloitte	-0.422	-1.99	0.046
KPMG	9.508	2.99	0.003
LnNon-auditFees*KPMG	-1.022	-3.15	0.002
Pitcher Partners	3.842	0.80	0.421
LnNon-auditFees*Pitcher Partners	-0.512	-1.06	0.288
PKF	10.340	1.18	0.238
LnNon-auditFees*PKF	-0.856	-1.11	0.267
Bentleys	96.008	6.75	0.000
LnNon-auditFees*Bentleys	-10.578	-7.41	0.000
BDO	4.090	1.08	0.281
LnNon-auditFees*BDO	-0.412	-1.21	0.226
HLB Mann Judd	22.416	2.83	0.005
LnNon-auditFees*HLB Mann Judd	-2.598	-2.99	0.003
Year	Yes	Yes	Yes
_cons	-5.208	-2.17	0.030

Prob > chi2 = 0.000, and Pseudo R² = 0.443

Number of observations = 1,732, LnNon-auditFees*Adelaide = Interaction between LnNon-auditFees and Adelaide, LnNon-auditFees*Brisbane = Interaction between LnNon-auditFees and Brisbane, LnNon-auditFees*Hobart = Interaction between LnNon-auditFees and Hobart, LnNon-auditFees*Melbourne = Interaction between LnNon-auditFees and Melbourne, LnNon-auditFees*Perth = Interaction between LnNon-auditFees and Perth, LnNon-auditFees*PWC = Interaction between LnNon-auditFees and PWC, LnNon-auditFees*EY = Interaction between LnNon-auditFees and EY, LnNon-auditFees*Deloitte = Interaction between LnNon-auditFees and Deloitte, LnNon-auditFees*KPMG = Interaction between LnNon-auditFees and KPMG, LnNon-auditFees*Pitcher Partners = Interaction between LnNon-auditFees and Pitcher Partners, LnNon-auditFees*PKF = Interaction between LnNon-auditFees and PKF, LnNon-auditFees*Bentleys = Interaction between LnNon-auditFees and Bentleys, LnNon-auditFees*BDO = Interaction between LnNon-auditFees and BDO, and LnNon-auditFees*HLB Mann Judd = Interaction between LnNon-auditFees and HLB Mann Judd.

This study suggests that providing NAS to clients can compromise the audit quality of some auditors (such as Deloitte or Bentleys), but not for all. Specifically, it does not impair audit quality of PWC or PKF, consistent with prior studies that conclude NAS do not impair audit quality (Church *et al.*, 2014; Knechel & Sharma, 2012; Mitra, 2007; Reynolds, Deis Jr, & Francis, 2004). Overall, analysis suggests that a gain in audit efficiency and a decline in audit quality are both at play when auditors provide NAS to their clients. Thus, whether audit quality improves or declines due to the provision of NAS depends on market characteristics and auditor characteristics. These results potentially explain why there is mixed evidence in the literature when it comes to NAS and audit quality.

5. Conclusions

This study analyzes the effects of auditee and auditor characteristics on the relationship between NAS and audit quality in Australia. Prior studies do not provide a conclusive result regarding the effects of NAS on audit quality. For example, some suggest that economic bonding (Church *et al.*, 2014) and social bonding (Hohenfels & Quick, 2018) of NAS impair auditor independence. However, others support the knowledge spillover argument, suggesting that the benefits of knowledge spillover are greater than the costs associated with impaired auditor independence (Koh *et al.*, 2013; Walker & Hay, 2013). Therefore, this study is motivated to find why there is mixed evidence in the literature when it comes to NAS and audit quality.

Australia passed CLERP 9 to enhance corporate governance through enhancements in transparency, accountability, and rights of shareholders (Salman & Carson, 2009). There are no regulatory changes after CLERP 9 that affect the relationship between NAS and audit quality. Therefore, this study is motivated to investigate the reasons behind prior mixed evidence in the literature in the current Australian setting. An auditee's location is

likely to influence its audit quality because different environments have diverse requirements (Nicolaescu, 2013). Further, empirical evidence suggests that large auditors provide higher quality audit services (Dehkordi & Makarem, 2011). However, prior Australian studies failed to examine the moderating effects of auditees' location and auditors' size on the relationship between NAS and audit quality. Thus, this study is motivated to examine the effects of auditee and auditor characteristics on the relationship between NAS and audit quality in Australia.

This study examines data of ASX 500 companies from 2006, and it considers a 10-year period to obtain sufficient data (2006 – 2016), based on their market capitalization on 30 June 2016. Findings show that the propensity to receive a going-concern qualified opinion is lower in Adelaide compared to Brisbane, Hobart, Melbourne, and Perth. In contrast, when clients in Adelaide receive NAS from their auditors, their propensity to receive a going-concern qualified opinion increases. However, receiving NAS in Brisbane, Hobart, Melbourne, and Perth do not increase the likelihood to receive a qualified opinion. Further, this study suggests that providing NAS to clients can compromise the audit quality of some auditors (such as Deloitte or Bentleys), but not for all. Specifically, it does not impair audit quality of PWC or PKF, consistent with prior studies that conclude NAS do not impair audit quality (Church *et al.*, 2014; Knechel & Sharma, 2012; Mitra, 2007; Reynolds *et al.*, 2004).

Overall, findings suggest that a gain in audit efficiency and a decline in audit quality are both at play when auditors provide NAS to their clients. Thus, whether audit quality improves or declines due to the provision of NAS depends on market characteristics and auditor characteristics. These results potentially explain why there is mixed evidence in the literature when it comes to NAS and audit quality. However, this study suffers from some limitations. First, it only examines the ASX 500 firms; therefore, its findings are not generalizable to the whole Australian market. Future research can investigate any association between NAS and audit quality in a broader randomized sample. Second, this study examines the 2006 – 2016 period. Future research can assess more recent data.

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