
The Impact of IFRS Adoption on Audit Fees and Audit Quality

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Abstract

This study highlights the impact of adopting the International Financial Reporting Standards (IFRS) on audit fees for all the companies that trade European shares on the Bucharest Stock Exchange (ATS INT – Alternative international trading systems). The total sample that is the basis of this study is made up of 15 companies that trade European shares through the International Alternative Trading Systems. The data was collected manually, from the Thomson Reuters BDI, for the period 2000-2018, so we could easily observe the real size of the audit fees after the adoption of IFRS became mandatory, which is the share of companies audited by Big 4 and their audit opinion. In this paper a CrossTabulation was used in SPSS, to test our hypothesis, according to which the adoption of IFRS led to the growth of the audit fees, which registered considerable increases after 2012. At the same time, it was observed that most of the companies are audited by Big 4 and an unqualified opinion is given above all by them.

Keywords: audit fees; audit opinion; discretionary accrual; IFRS adoption

JEL Classification: M42

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1. Introduction

In 2002, the International Accounting Standards Board (IASB) together with the International Accounting Standards Board (FASB) formulated a unifying instrument for the entire world. The main arguments that increase the number of IFRS users are: increasing the credibility, the high level of the disclosure of the financial information, the high accuracy of the financial accounting information existing in the financial reports and the increased comparability (Wedari and Oktorina, 2017). Moreover, in 2015, Scott pointed out that the adoption of IFRS only led an increase of the disclosure of financial information and an accelerated decrease of the number of options to the commonly used accounting methods. Limiting the number of quotable methods required by the adoption of IFRS represents a huge advantage because it can control the managerial discretionary power leading an increase in earnings. In the same context an year earlier, Byun & Luttecke stated that companies have a positive reaction, lacking evidence of informational asymmetry and a mistaken calculation in Agency costs. The tendency observed by Ibanichuka (2018), in this sense, is that these companies that adopt IFRS tend to record small managerial gains, increasing the information transparency.

In 2014, Kao confirmed the relationship between the audit fees and the expenses related to the adoption of IFRS, considering the fact that there is a real need for resources, specialized trainings but also the training of the competent authorities in order to apply international standards. The globalization of the accounting standards has led, without preparation, to the information transparency, to the increase of the degree of complexity of the operational business, impact felt by all the users of the financial information, having qualitative and conclusive financial statements (Wulandari, Lastanti, 2015).

On the other hand, the growth of audit risk has led to the growth of audit costs, because that companies which are not experienced with these standards can make big mistakes. At the same time for the auditors, the complexity brought by the transition but also the failure of the client entity can increase the risk in their evaluation. By following the complexity of the audit and the risk that may exist from the client entity are associated with high audit costs. In order to be able to

understand the exaggerated increase in audit fees after the transition to international standards, we must analyze the costs underlying the adoption of IFRS, namely:

1. The Theory of Economic Bonding – it emphasizes that the auditor's independence can be indeterminate if there is an economic commitment that can have a considerable impact on the quality of the audit services. This economic commitment occurs when the client entity pays a larger amount of money to the auditor so that he can follow in detail the managerial discretionary power in the financial statements or in the reports of the companies. In some cases, companies give up the quality of the audit services and place more emphasis on the economic commitment, at the request of the client entity.
2. The Theory of Audit Effort – it emphasizes that an extremely high level of the expenses related to the audit services is given by the auditor's effort in increasing the quality of the audit services. Finally, the audit risk assessed by the audit firm leads to increase audit fees (Esheman, Guo, 2014).

On the other hand, Jung (2016) pointed out that when the audit risk is low, the level of the expenses related to the audit services should not be at all associated with the quality of the audit services. This relationship between the quality of the audit services and the level of the audit expenses was analyzed by many researchers in the field, using the discretionary accrual as the calculation figure of the quality of the audit services. Moreover, depending on the time period analyzed (pre / post IFRS), it was found that there is no relation between the high level of the expenses related to the audit services and its quality until 2012, but we have a positive relation between the abnormal expenses of audit and the quality of the audit services during the post IFRS period.

For the period 2000-2018, we analyzed the level of audit fees using the type of auditor and audit opinion to emphasize if the quality of the audit services is changeable, and also to see if these expenses increased after the IFRS adoption became mandatory. Therefore, the transition year 2012 was taken as a benchmark to observe easily how the financial reporting standards have influenced over time.

2. Literature review

At global level, financial reporting according to IFRS has led to an informational transparency and a very high disclosure of financial statements. These benefits of IFRS were also observed in the quality of the audit, because more transparent information is reported, the risk of the audit is lower.

All audit services play a critical role in applying the new reporting standards, especially regarding implementation costs (Loukil, 2016). When reporting according to International Financial Reporting Standards became mandatory, the costs of audit services have undergone considerable changes. These expenses have increased because the new financial reporting model required a rather large effort, which automatically led to these costs rising. Ultimately, the audit represents the control mechanism of the company, and the main purpose is to reduce the agency's costs.

In order to be able to analyze audit fees, we need to look at what are the underlying costs of transactions within an entity. Agency Theory (Agency Theory) highlights the immanent chain of contracts between associates / shareholders and agents (managers who are required to control all resources within an entity) (Jensen and Meckling, 1976; Adams, 1994). This theory postulates the general idea that the associates / shareholders do not have access to all the information when the managers have to make certain decisions. The informational asymmetry represents the difference between the figures reported and the disclosures which are in the financial statements reported by the management. Therefore, the auditors have the obligation to minimize the information asymmetry, discovering all the irregularities existing in the audited documents. The informational asymmetry that emerges from this theory can be a moral hazard, when managers act only for the purpose of maximizing their own wealth and not for the purpose of the company they work for (Mohammad A., 2011).

There is the possibility of an endogenous decrease in establishing the exact monitoring processes from the point of view of the managers, which can affect the general working conditions of the audit companies (Hudson, 2014). In this context, the Theory of the Agency postulates that the managers tend to favor the interests of the shareholders to the detriment of the creditors, which may include restrictions in the contracts

carried out (Watson et al., 2002), which lead to the distorted increase of the agency's costs. This is where the specialized auditors intervene, who must constantly defend the interests of all shareholders / creditors, while also verifying internal controls, risk and financial reporting of management. For the first time, this criterion was observed by Jensen and Meckling as follows: "the existence and size of agency costs depend on the nature of the costs monitored by the agent (manager)". The audit companies that have the obligation to control the financial statements and the management behavior attest the decreasing of the expenses related to the audit services. In 2011, in a well-known journal, Leventis stated the following: "Audit expenses are the most measurable and direct costs of the agency and reducing audit costs reveals reducing agency costs." It is quite immanent to conclude that audit firms make larger checks when there are problems, which increases the number of hours worked, leading to an increased level of costs.

Another advantage of large firms compared to small firms is that they have a rather sophisticated accounting system, thus having an advantage given by internal audit, which imminently reduces the total level of expenses related to audit services. Even if the convergence with IFRS has brought numerous benefits to internal and external users, this financial reporting has increased the expenses related to the audit services, especially for those who first adopted these standards (DeGeorge et al., 2013; Schadewitz and Vieru, 2010).

In the audit market where the competition is quite tight, the term audit costs is associated with the audit risk and audit effort, factors that are determined by the auditing company (Big 4 / Non Big 4).

Therefore, the audit costs are divided as follows:

- the normal audit expenses (determined according to the complexity, size and risk of the client entity);
- abnormal audit expenses (expenses that are generated from the relationship with the client entity);

Choi (2010) pointed out that these exaggerated audit fees can hide a compromise between the client entity and the auditor, in which case the auditor does not take into account the independence and the quality of the audit services is altered. This compromise may take the form of a bribe or may only be the result of high operational costs signed by the mission auditor (KAP). Another less bias point of view is Blankley (2012), who

pointed out that these high costs related to audit services can be considered as additional audit costs, in order to maintain the reputation of the accounting profession, which leads to an increase in audit quality.

Also, in this context, the same point of view was emphasized in the same year by Boone and Asthana, which certified that a low level of audit expenses does not show a low level of auditor's effort or a negative relationship with the audit mission partner (KAP). To the level of Romania, for the analyzed period after IFRS adoption, a positive relationship can be observed between the quality of the audit services and the high level of the audit expenses. On the other hand, an increase of the same audit fees exists to the companies audited by Big 4.

3. The relationship between financial reporting according to IFRS and financial audit

The first researcher in the field that analyzed the audit fees was Simunic (1980), who built a regression model in order to calculate the level of the expenses related to the audit services.

The audit services consist of the audit offer and demand, regulated on a free market. The audit request depends on certain characteristics, namely: various company-specific elements, name, size and other risk factors of the client entity (Dye, 1993). Moreover, the factors existing at the company level systematically specify the audit procedures, the complexity of the audit mission and, ultimately, the effort of the auditor who can have a direct correspondent in the share of the audit expenses.

A study by Narktabtee and Patpanichot, in 2011, shows that all the features of the client entity can affect the improvement of the information system after adopting IFRS. Also, it was observed that, where the client entities allow a high discretionary power of the manager, no results were seen regarding the quality improvement during the post IFRS period. This discretionary power has raised many problems over time, not always being calculated within the legal limits. When calculating the discretionary power of management, the following must be taken into account: the size of the client entity, the cash flow affected by the operational volatility, the

volatility of sales, and the probability of negative earnings.

On the other hand, another study attests that the growth of the quality gains (earning quality) increases at the same time as the growth of the expenses related to the audit services. Taking into consideration the Sarbanes-Oxford (Sarbox / SOX) law of 2002 (Pub. L. 107-204, 116 Stat. 745, adopted July 30, 2002), also known as the Public Companies Accounting Act for reform and investor protection and by the corporate and audit act of responsibilities and responsibilities, the result seems to remain the same and provisions increase corporate governance and financial reporting gradually (Ittonen et al., 2019). In addition, The Institute of Chartered Accountants in England announced in 2007 that listed companies in the European Union have recorded an increase in audit costs following the adoption of IFRS.

One of the first countries that adopted IFRS was New Zealand, and a study of small and medium-sized Finnish companies, conducted by Griffin (2009), vehemently attests that IFRS adjustments arising from a disparity between local and IFRS standards, implicitly incorporate increased audit fees. Regarding the transition year, the expenses related to the audit services were even higher, as the audit effort increased considerably, the effort measured in ensuring the mission and the work of the auditor.

Regarding the audit offer, most studies in the field have pronouncedly Big 4 / Non Big 4 and the level of audit fees was given by this difference. Imperatively, the change of the auditor appeared, as the first influence of the adoption of IFRS, because the legal context constrained this tendency over time.

4. Research methodology

The present analysis is based on official data published by Bucharest Stock Exchange, Thomson Reuters and official site of Big 4 (Deloitte, E&Y, KPMG & PWC). The database is for the entire period 2000-2018, which also contains the transition year, registered for 15 companies which trade ATS INT audited by Big 4 firms.

Looking at audit fees, for the period 2000-2018, we can observe that for all companies that trade ATS Int, these costs register a continuous growth.

Table no.1. The evolution of the audit fees, for the period 2000-2018 (in Euro)

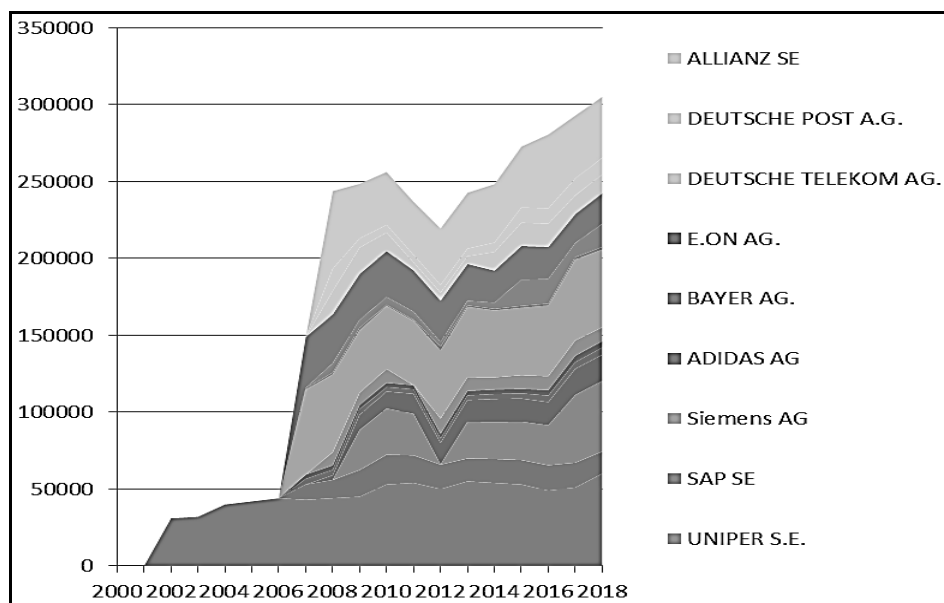
Company	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
DEUTSCHE BANK AG			31.000	32.000	40.000	42.000	44.000	43.000	44.000	45.000	53.000	54.000	50.000	55.000	54.000	53.000	49.000	51.000	60.000
COMMERZBANK AG								10.000	11.905	17.358	19.344	17.876	15.945	14.852	15.540	15.850	16.532	16.136	14.324
DAIMLER A.G.										26.000	30.000	27.000	--	24.000	24.000	25.000	26.000	44.000	46.000
BAYERISCHE MOTOREN WERKE AG								0	3.000	10.000	11.000	13.000	14.000	14.000	15.000	15.000	15.000	17.000	17.000
CONTINENTAL A.G.								3.500	3.500	3.500	2.900	2.900	2.900	3.000	3.200	3.300	4.200	4.400	4.600
DEUTSCHE LUFTHANSA A.G.								2.900	3.000	2.800	2.800	2.700	3.000	2.900	2.900	2.900	3.600	4.100	4.200
UNIPER S.E.																			
SAP SE									8.400	8.000	9.000	--	10.000	9.000	8.000	9.000	9.000	10.000	9.000
SIEMENS AG								55.300	50.700	40.500	40.900	42.000	44.200	45.600	43.500	43.700	45.900	52.600	50.600
ADIDAS AG								1.200	1.200	1.800	800	800	2.600	1.000	1.000	1.300	1.300	1.600	1.700
BAYER AG.								--	6.000	5.000	5.000	5.000	3.000	3.000	4.000	17.000	16.000	9.000	15.000
E.ON AG.								33.000	32.000	30.000	30.000	27.000	27.000	24.000	21.000	22.000	21.000	19.000	20.000
DEUTSCHE TELEKOM AG.								-	15.000	17.000	12.000	5.000	5.000	5.000	12.000	15.000	15.000	12.000	12.000
DEUTSCHE POST A.G.								--	14.500	6.000	5.000	5.000	5.000	5.000	6.000	10.000	10.000	11.000	11.000
ALLIANZ SE								--	50.500	35.500	34.400	34.600	36.800	36.300	38.100	39.600	48.000	41.000	39.600

Source: Own projection, using Excel-Microsoft Office

The entire sample (Table no. 1) shows a growth of audit fees, for the period 2008- 2018. For the company,

UNIPER S.E., we didn't find any data. About the period 2000-2007, Thomson Reuters didn't count any figures.

Figure no. 1. The increasing of audit fees, for all European shares trade on Bucharest Stock Exchange (in Euro)



Source: Own projection, using Excel-Microsoft Office

As we can observe, the adoption of International Financial Reporting Standards has grown steadily, between the years 2007- 2018 (*Figure no. 1*). The transition year 2012 emphasized a continuous increasing of audit fees.

Also, for the period 2008-2018, we verified the growth of audit fees using descriptive statistics because we wanted to see exactly the standard deviation. In this context, we observed that audit fees counted a growth in time.

Table no. 2. Audit fees, for the period 2008-2018 (in Euro)

Company	Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
DEUTSCHE BANK AG		44000	45000	53000	54000	50000	55000	54000	53000	49000	51000	60000
Commerzbank AG		11905	17358	19344	17876	15945	14852	15540	15850	16532	16136	14324
DAIMLER A.G.			26000	30000	27000		24000	24000	25000	26000	44000	46000
BAYERISCHE MOTOREN WERKE AG		3000	10000	11000	13000	14000	14000	15000	15000	15000	17000	17000
CONTINENTAL A.G.		3500	3500	2900	2900	2900	3000	3200	3300	4200	4400	4600
DEUTSCHE LUFTHANSA A.G.		3000	2800	2800	2700	3000	2900	2900	2900	3600	4100	4200
SAP SE		8400	8000	9000		10000	9000	8000	9000	9000	10000	9000
Siemens AG		50700	40500	40900	42000	44200	45600	43500	43700	45900	52600	50600
ADIDAS AG		1200	1800	800	800	2600	1000	1000	1300	1300	1600	1700
BAYER AG.		6000	5000	5000	5000	3000	3000	4000	17000	16000	9000	15000
E.ON AG.		32000	30000	30000	27000	27000	24000	21000	22000	21000	19000	20000
DEUTSCHE TELEKOM AG.		15000	17000	12000	5000	5000	5000	12000	15000	15000	12000	12000
DEUTSCHE POST A.G.		14500	6000	5000	5000	5000	5000	6000	10000	10000	11000	11000
ALLIANZ SE		50500	35500	34400	34600	36800	36300	38100	39600	48000	41000	39600

Source: Own projection, using SPSS

We extracted manually the data from Thomson Reuters, for the entire period 2000-2018 (*Table no. 2*). Till the year 2008 we didn't find any data for our sample. The main reason is that it

wasn't mandatory for all the entities to apply IFRS. So, we can conclude that the adoption of IFRS brought some changes for all the types of users.

Table no. 3. A descriptive statistics of audit fees using the average of audit fees

Descriptive Statistics			
	Num.	Mean	Std. Deviation
ADIDAS AG	11	1372,73	531,208
DEUTSCHE LUFTHANSA A.G.	11	3172,73	536,826
CONTINENTAL A.G.	11	3490,91	630,007
BAYERISCHE MOTOREN WERKE AG	11	13090,91	3986,340
Commerzbank AG	11	15969,27	1948,590
E.ON AG.	11	24818,18	4578,606
Siemens AG	11	45472,73	4134,753
DEUTSCHE BANK AG	11	51636,36	4566,678

Source: Own projection, using SPSS

For the period 2008-2018 we verified this continuous increase of the expenses related to the audit services using descriptive statistics, thus wishing to see exactly what is the standard deviation (*Table no. 3*). In this context, there has been an increase in audit costs over time.

The entire sample was formed by 15 companies but we tested only 14 (*Table no. 4*). because for the entity UNIPER S.E. we didn't find any data to Thomson Reuters. We demonstrate, in the same time that, the trend continues with unqualified opinion for the companies audited by Big 4

(13 entities from the entire sample). Also, Big 4 remains unchanged for the analyzed period

2000-2019. We found one exception, the entity SAP S.E. which was audited by Non Big 4.

Year		2005		2006		2007		2008		2009	
Type of variable		Auditor opinion		Auditor opinion		Auditor opinion		Auditor opinion		Auditor opinion	
		Qualified	Unqualified	Qualified	Unqualified	Qualified	Unqualified	Qualified	Unqualified	Qualified	Unqualified
Big 4	No	0	0	0	0	0	0	0	0	0	0
	Yes	0	14	0	14	0	14	0	14	0	14
Total		0	14	0	14	0	14	0	14	0	14

Year		2010		2011		2012		2013		2014	
Type of variable		Auditor opinion		Auditor opinion		Auditor opinion		Auditor opinion		Auditor opinion	
		Qualified	Unqualified	Qualified	Unqualified	Qualified	Unqualified	Qualified	Unqualified	Qualified	Unqualified
Big 4	No	0	0	0	0	0	0	0	0	0	0
	Yes	0	14	0	14	0	14	0	14	0	14
Total		0	14	0	14	0	14	0	14	0	14

Year		2015		2016		2017		2018	
Typ of variable		Auditor opinion		Auditor opinion		Auditor opinion		Auditor opinion	
		Qualified	Unqualified	Qualified	Unqualified	Qualified	Unqualified	Qualified	Unqualified
Big 4	No	0	0	0	0	0	0	0	0
	Yes	0	14	0	14	0	14	0	14
Total		0	14	0	14	0	14	0	14

Source: Own projection, using SPSS

Between the period 2000-2018, our results show that more than 99% of companies are audited by Big 4, while only one company is audited by Non Big 4. A study by Mohrmann et al., (2019) shows that for the countries from the European Union, the percentage is lower, because the Romanian market is not as concentrated as the other markets in the European Union. In the actual study, it is related that the adoption of International Financial Reporting Standards has implied a major change of audit firms from Non Big 4 to Big 4. The total number of clients audited by Big 4 increased by 89.96%.

Also, it could be seen that out of a total sample of 15 companies, a single company is audited by Non-Big 4. The quality of the audit is represented by the ability of the audit firm to find and report errors at the customer's level, to make decisions by providing expertise on the client's information system and finally to provide an opinion conveyed in the audit report (Singh et al., 2019).

Conclusions

The main objective of the actual study is to emphasize the structure of the financial audit market for the companies listed on the Bucharest Stock Exchange

(BSE), focusing on ATS Intl shares. The main results of the actual CrossTabulation analysis are very consistent with the global predictions on the direct effects of IFRS adoption on audit fees. Using the full sample of 15 firms, for the period 2000-2018, the evidence was found to achieve our hypothesis that the adoption of IFRS always has a positive effect on audit fees. In the same time, for the entire period, the companies were audited by Big 4 which gave an unqualified opinion, for the majority of firms. The inherent limitations of this study cannot be circumvented because our sample size is relatively more than small even if we counted all the ATS Intl shares traded on Bucharest Stock Exchange. The result of the empirical test of the relationship between the adoption of IFRS and audit fees carried out on the Bucharest Stock Exchange, Alternative International Trading Systems (ATS Intl) based on data of companies listed on BSE, for the period 2000-2018. The entire sample shows a growth of audit fees, for the period 2008- 2018. For the company, UNIPER S.E., we didn't find any data and for the years 2000-2007, Thomson Reuters didn't count any figures.

While this small sample may reduce involuntary the generalizability of our findings on a global scale, our

results are still generalizable and the effects of IFRS adoption on audit fees remains positive. Additionally, our findings hand over new evidence on audit costs from a specific type of shares, ATS Intl, avoiding more potential issues that can appear with cross section research.

We can conclude that the adoption of International Financial Reporting Standards has increased the

number of societies audited by Big 4, even though the audit fees have recorded high values. Moreover, the effect of IFRS adoption is positive for the entire simple of different sizes. In addition, depending on the possibilities of accessing the specific data series, the study can also be applied for another types of shares.

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