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# Financial structure signalling to auditors' pricing

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Etumudon Ndidi ASIEN,  
Federal University Otuoke, Nigeria,  
E-mail: ndidi\_66@yahoo.co.uk

## Abstract

*This paper empirically examines capital structure signalling to auditors. Financial structure has adverse selection that can negatively affect auditors' perception of firm value or risk, which can lead the auditor to charge high price. We expect firms' financial structure to positively relate with auditors' pricing. Using panel data analysis methodology to analyse data of 311 firm-year observations of non-finance firms covering the period 2012-2015, pooled OLS regression results suggest that financial structure is positively related to auditors' price. We find that equity, but not debt, is significantly related to auditors' price. These results hold after controlling for auditor type. The positive relations suggest lower perceptions of firm value (hence high risk) by auditors, thereby making firms to pay higher auditors' price. This suggests that auditors penalise equity financed firms more than debt financed firms, probably because auditors interpret equity financing as firms' inability to raise debt. Based on the findings, we recommend that auditors should monitor the capital structure of their clients to guide them in pricing their services. We also recommend that corporate finance managers should rebalance their firms' capital structure cognisant of the fact that it signals to auditors.*

**Keywords:** capital structure, equity, debt, auditors, price, panel data, audit price

**JEL Classification:** G32

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