LITERATURE REVIEW

The effect of mandatory fee disclosure on subsequent audit pricing and audit quality

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SUMMARY

This literature review synthesizes the current body of academic research on mandatory fee disclosure, with a focus on its effect on audit pricing and audit quality. While extant studies demonstrate that public fee disclosure has an impact on subsequent audit pricing, evidence on its impact on audit quality is inconclusive. Most research cited relies on archival data from listed firms in Asia and the US which leaves gaps in our understanding of the impact of mandatory fee disclosure in audit markets dominated by privately held firms. Private companies, however, constitute world-wide the majority of companies. Specifically, in continental European countries, such as the Dutch audit market, private companies make up over 99 percent of audited companies. Because private firms differ from listed firms on a number of important dimensions (e.g., exposure to market forces, nature of agency conflicts, information environment, it is *ex ante* unclear whether results from listed firms are generalizable to private firms. As part of the FAR Replication Program, our project aims to address this research gap: by replicating existing studies that investigate the impact of mandatory fee disclosure in the context of listed companies (i.e., Francis and Wang (2005) and Chen et al. (2019)), our FAR replication project explores the actual consequences of the mandatory disclosure of fees on audit pricing and audit quality in the Dutch audit market, which is predominantly composed of private firms. To do so, we formulate several research questions that will be studied throughout our FAR replication project. Further, we elaborate on the methodology that we will employ and our anticipated contribution. Our review offers valuable insights for academics, regulators, and practitioners interested in the consequences of mandatory fee disclosure on audit pricing and quality. Specifically, our study contributes to the academic literature examining the real effects of disclosures. Regulators should be interested in our findings in case there are consequences—whether intended or unintended—to audit pricing and audit quality. With respect to practical implications, our study provides an analysis on the potential increased bargaining power after the regulatory implementation of mandatory fee disclosure.

1. Introduction

The *raison d'être* of the audit market is public trust in the quality of audits (Maijoor and Vanstraelen 2012). A vital factor in preserving the public's trust is maintaining auditor independence. Since it is likely that economic bonding between the auditor and its client can threaten auditor independence and, hence, audit quality (DeAngelo 1981), the level of audit fees and the proportion of non-audit fees relative to audit fees are regularly considered as potential risks to independence. After all, if total fees from a single audit client constitute a significant portion of the audit firm's total fees, this could lead to economic dependence on the client thereby creating a self-interest threat, as auditors may be concerned about losing the client.

Throughout the 1980s and 1990s, a period in which auditors increasingly provided non-audit services to their audit clients, but especially in the aftermath of accounting scandals at the turn of the century, regulators attempted to reinforce (the perception) of auditor's independence. With the aim of restoring public trust in the quality of audits (Elifsen and Willekens 2008), one of the requirements set out by regulators around the globe was for companies to disclose the audit and non-audit fees charged by their auditor in the financial statements. Promoting transparency in the auditor-client relationship by requiring companies to report on their auditors' fees was seen as a crucial tool to address concerns about auditor's independence (European Commission 2006; SEC 2000). By having more information about the level of fees and scope of work performed, stakeholders (can) have a better understanding of the company-auditor relationship and, hence, are better able to assess whether auditor's independence is impaired (European Commission 2006).

While the objective of mandatory fee disclosure was to increase transparency of the relationship of the auditor and its client, practitioners and professional bodies have voiced their concerns about other, perhaps inadvertent, effects of mandatory fee disclosure. They believe that disclosing fees may intensify price competition in the audit market, as increased client bargaining power could exert excessive downward pressure on fees. Eventually this could result in auditors reducing the quality of their service. (IBR 2016; Dopuch, King and Schwartz 2003).

Up to now, academic research has shown that public fee disclosure influences subsequent audit pricing (Francis and Wang 2005; Mayhew 2005; Chen, Duh and Li 2019; Su and Wu 2017; Averhals, Van Caneghem and Willekens 2020). Consistent with increased price competition and clients gaining more bargaining power than auditors, evidence shows that audit fees of overcharged clients have been adjusted downward more than audit fees of undercharged clients have been adjusted upward (Averhals et al. 2020; Su and Wu 2017). Overall, fee disclosure seems to enhance pricing precision and to reduce variances in audit fees (Francis and Wang 2005). Evidence about the impact of fee disclosure on audit quality remains mixed, with some studies finding that overall audit quality improves following fee disclosure (Chen 2016; Lai 2009) and others finding that downward fee adjustments are associated with decreased audit quality (Chen et al. 2019).

The limited number of studies considering the consequences of fee disclosure focuses on listed firms in Asia and the US. The effect of fee disclosure in markets dominated by private firms, such as the Dutch audit market, remains, however, largely unknown, a study in Belgium by Averhals et al. (2020) notwithstanding. However, it is important to note that private companies constitute world-wide the majority of companies (Vanstraelen & Schelleman, 2017). Specifically, in continental-European countries, private companies make up over 99 percent of audited companies (Willekens and Gaeremynck 2005). Because private firms differ from listed firms on a number of important dimensions (e.g., exposure to market forces, nature of agency conflicts, information environment) (Langli and Svanström 2014; Vanstraelen and Schelleman 2017), it is *ex ante* unclear whether results from listed firms are generalizable to private firms. In particular, the impact of fee disclosure could be greater in private firms as the private client segment of the audit market is characterized by lower concentration, leading to a higher level of price competition (Simunic 1980). Moreover, as compared to listed firms, price seems to be a major determining factor in private firms' auditor selection (Almer, Philbrick and Rupley 2014; Willekens and Achmadi 2003; Collins and Killough 1992).

The literature review is structured as follows. First, we provide an overview of the regulatory framework regarding fee disclosure by especially focusing on the Dutch audit market. Then, we analyze the existing empirical research, and present our research questions that our FAR project seeks to address. Following that, we discuss the ongoing FAR project. Finally, we conclude the review.

2. The regulatory framework of fee disclosure

2.1. Rationale for the regulatory implementation of fee disclosure

Disclosure of audit fees has been mandatory for several decades in many British Commonwealth countries. Australia and the United Kingdom, for example, have required the disclosure of audit fees since 1962 (via the Uniform Companies Act of 1961-1962) and 1967 (under the Companies Act 1967), respectively (Carson, Redmayne and Liao 2014; Köhler and Ratzinger-Sakel 2012; Firth 1997a). The separate disclosure of non-audit fees paid to the auditor has been required in both countries since the 1990s (Firth 1997a). Also Norway has mandated the disclosure of audit and non-audit fees as from then (Firth 1997b). At the turn of the century, regulatory bodies in many other countries worldwide have implemented the public disclosure of fees in response to major accounting scandals such as Enron, Lernout & Hauspie, and WorldCom. Regulators were concerned that economic bonding due to the level of fees received from an audited company or the increased provision of non-audit services could impair auditor's independence. By requiring companies to publicly disclose audit and non-audit fees, regulators aimed to enhance transparency and, hence, to provide more information to market participants about the auditor's relationship with the company being audited. As such, stakeholders were able to evaluate whether the magnitude of audit and non-audit fees might impair the auditor's independence (SEC 2000). Since 2000, the Securities and Exchange Commission (SEC) in the United States has mandated companies to disclose both audit fees and non-audit fees paid to auditors (SEC 2000). Similarly, this requirement has been implemented in China, Taiwan, and member states of the European Union. Specifically, the European Parliament and Council approved the Eighth Company Law Directive (2006/43/EC), which is better known as the Statutory Audit Directive, on 17 May 2006. This Directive mandates audited companies across the EU member states to disclose the audit fee and other fees for non-audit services charged by the audit firm in the financial statements.

2.2. Dutch regulatory framework for mandatory fee disclosure

In line with the EU Statutory Audit Directive (2006/43/EC), the Dutch legislation has required large[1] companies to disclose audit and non-audit fees in their financial statements since 2008 (art. 382a, 1°, Title 9 Book 2 *Burgelijk Wetboek* [BW]). The fees must be broken down into the following categories: audit of the financial statements, other audit engagements, tax advisory services and other non-audit services. Also, audit and non-audit fees paid by the subsidiaries of the company should be included (art. 382a, 2°, Title 9 Book 2 BW). Interestingly, however, although at first sight it seems that every large company should disclose information about the audit and non-audit fees in the financial statements, a closer look at the Dutch regulation reveals that a vast majority of large Dutch companies still not have to publish this information in their *statutory* financial statements. Indeed, according to art. 382a, 3° Title 9 Book 2 BW, the audit fee disclosure is not mandatory in the statutory financial statements if the financial data of the company are integrated in the *consolidated* financial statements of the group, and the audit fee is included in these consolidated financial statements. Note that small groups are exempted from preparing consolidated financial statements (art. 407, 2°, Title 9 Book 2 BW).[2]

3. Empirical research on mandatory fees disclosure

Our review of the existing empirical research is organized as follows. First, we present an overview of studies investigating the impact of mandatory fee disclosure on audit pricing. We initially discuss the immediate short-term effects of the regulatory implementation, followed by a focus on the long-term effects. Second, we delve into research exploring the relationship between mandatory fee disclosure and audit quality. As the findings regarding the impact of fee disclosure on audit quality are limited, we also provide a summary of research on the association between audit and non-audit fees and audit quality. Furthermore, we discuss the scarce research examining the effects of fee disclosure on both actual and perceived audit quality.

3.1. Effect of mandatory fee disclosure on audit pricing

3.1.1. Short-term effects

While regulators mandated fees disclosure with the intent to enhance stakeholders' understanding of the auditor-client relationship, practitioners and professionals feared its unintended impact on subsequent audit pricing and price competition. Accordingly, some studies have examined the short-term effect of mandatory disclosure of audit fees on subsequent audit pricing (i.e., the effect that occurs immediately following the implementation). The first study to tackle this issue was conducted by Francis and Wang (2005). They analyzed data from listed US firms after the requirement for public fee disclosure was put in place in 2001 and found that clients who were

[1] *Small companies* are not legally required to appoint an auditor (art. 396, 7° Title 9, Book 2 BW) and *middle-sized companies* are exempted from disclosing information about audit and non-audit fees billed by the auditor in the financial statements (Article 397, 4°, Title 9 Book 2 BW). *Large companies* currently exceed two of the following three criteria on two consecutive balance sheet dates: (i) maximum 250 employees (ii) maximum sales of 40 million euros, and (iii) maximum total assets of 20 million euros (Article 397, 1°, Title 9 Book 2 BW).

[2] Currently, a group is classified as small if it meets at least two of the following three criteria on two consecutive balance sheet dates: (i) maximum 50 employees, (ii) maximum sales of 12 million euros, and (iii) maximum total assets of 6 million euros (art. 396, 1° Title 9 Book 2 BW).

overcharged could negotiate lower fees, while those who were undercharged faced higher fees in the aftermath of the initial public disclosure.[3] Interestingly, they found evidence of greater downward than upward fee adjustment indicating that clients have more bargaining power than auditors (Francis and Wang 2005). Complementary evidence was found using both proprietary and public audit fee data from listed Chinese firms before and after public fee disclosure was mandated in 2001 (Su and Wu 2016). While Francis and Wang (2005) concluded that public disclosure of fees increases precision of audit pricing and reduces the variance in fees over time, Mayhew (2005) suggests that the found evidence might also be the result of a simple mean reversion in fees over time[4] irrespectively of public disclosure.

Recently, Averhals et al. (2020) expanded this stream of research by investigating the effect of mandatory audit fee disclosure on audit pricing using both proprietary and public audit fee data from private Belgian firms before and after public fee disclosure was mandated in 2007. Based on descriptive statistics of a balanced sample, Averhals et al. (2020) show that average audit fees (adjusted for inflation) increased in the period 2004-2010. This finding contradicts the expectations of practitioners who had anticipated downward fee pressure following mandatory fee disclosure. The authors attribute the rise in fees to heightened audit risk stemming from the financial crises. Results from Breesch et al. (2013), however, studying the evolution of pricing on the (full) Belgian audit market in the period 2008 and 2010, show a sharp decrease in average 'absolute' pricing between 2008 and 2009, and between 2009 and 2010. Taking into account 'relative' pricing (by comparing audit fees against the size of the audited firm and, hence, controlling for changes in the audit market structure) no more significant price-level changes were noted. Interestingly, Averhals et al. (2020) explicitly test the moderating effect of client importance in the auditor's portfolio and competition faced by the auditor on audit pricing following the mandatory disclosure of audit fees. Results show that overcharged clients were able to secure downward fee adjustments, while undercharged clients faced upward fee adjustments (Averhals et al. 2020). Upward fee adjustments were, however, dependent on the importance of the client in the auditor's portfolio and the competition that the auditor faced (measured by the auditor's market share). Specifically, undercharged clients were better able to mitigate upward fee adjustments if they were more important in the auditor's portfolio or if the auditor faced more intense competition.

Finally, evidence shows that fee adjustments after mandatory fee disclosure vary depending on the disclosure form (i.e., fee amount disclosure or fee range disclosure) that client companies use. Using a Taiwanese dataset, Chen et al. (2019) show that a more precise disclosure form (i.e., fee amount disclosure) is associated with larger downward fee adjustment in the period subsequent to the fee disclosure.

Overall, this body of research indicates that mandatory audit fee disclosure influences subsequent audit pricing. Fee transparency seems to provide clients with bargaining power over auditors and to intensify price competition.

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[3] Over(under)charged clients refer to those companies that are being charged more (less) by their audit firm than is appropriate for the level of service supplied (Causholli and Knechel 2012). Over(under)charged clients are identified as those whose audit fee exceeds (falls below) the estimate predicted by the fee model (Francis and Wang 2005).
[4] Deviations from average fees are likely to reflect special circumstances facing the client, resulting in unusually high or low fees in a given year. In future years, however, the fees would revert back to a more 'normal' level of fees (Mayhew 2005).

3.1.2. Long-term trends

Only a limited amount of research has explored how audit fees behave over time (e.g., de Villiers, Hay and Zhang 2013; Menon and Williams 2001). For instance, Menon and Williams (2001) examine long-term trends in audit fees of listed US Big 6 clients who voluntarily disclosed audit fees in the period 1980-1997. Their study found that changes in auditing standards led to an increase in audit fees and provided evidence of changes in the audit fee model over the sample period. Similarly, de Villiers et al. (2014) studied audit fees of listed US companies between 2000 and 2008, after the implementation of mandatory fee disclosure. Their research found evidence of audit fee stickiness, which refers to the fact that audit fees do not immediately or fully adjust to changes in their determinants. However, no evidence has been found on long-term trends of fees in the private client segment of the audit market. Although such a study requires substantial time series of post disclosure data and would be susceptible to confounding effects from other changes, it would be interesting to test how audit fees of private firms behave over time after they became publicly available.

3.2. Effect of mandatory fee disclosure on audit quality

3.2.1. Effect of fees on audit quality

Although studies specifically addressing the effect of fee *disclosure* on audit quality are limited, a significant body of research exists on the relationship between audit and non-audit fees and audit quality. Findings from prior research examining the effect of audit fees on audit quality provide mixed evidence by showing positive effects (e.g., Geiger and Rama 2003; Willekens 2008), no effects (e.g., Hope and Langli 2010), and negative effects (e.g., Vanstraelen 2002). As explained by Breesch et al. (2013) these mixed results may be due to the fact that most empirical studies ignore the endogeneity between the two aspects. Audit fees may influence audit quality but the demand for audit quality may also influence audit fees.

Some studies use 'abnormal' audit fees[5] to test the effect on audit quality. These studies equally do not provide unequivocal evidence. Choi, Kim and Zang (2010) conclude for the American audit market, that abnormally high audit fees are associated with higher earnings management, and, hence, lower audit quality. They observe, however, no significant effect for abnormally low audit fees. According to the authors, these results indicate that in case of abnormal high audit fees litigation and reputation risk do not outweigh commercial incentives and auditor's independence is impaired. Asthana and Boone (2012) on the other hand, also show that abnormally low audit fees, suggesting strong client bargaining power, compromise audit quality. In the European private firms dominated market, also known as a low litigious environment, Hope and Langli (*Norway*, 2010) do not find any significant association between abnormal audit fees and audit quality. Breesch et al. (*Belgium*, 2013) show that both very low (1st quartile) and very high (4th quartile) audit fees are potential threats to audit quality. While companies that pay very low audit fees are more likely to be engaged in earnings management, the likelihood that an auditor will issue an

[5] 'Abnormal' audit fees relate to differences between actual and estimated fees; the latter are calculated via an audit fee model that takes into account both client and auditor characteristics determining audit fees (e.g., size, risk and financial situation of the audited client and specialization, experience and type [Big 4/Non-Big 4] of the auditor). Positive abnormal audit fees suggest overpricing, while negative abnormal audit fees suggest underpricing.

unqualified going concern opinion (GCO) while the company will go bankrupt within 12 months (i.e., type II misclassification) is significant higher for companies paying very high audit fees.

Also, the association between non-audit services fees and audit quality is unambiguous. Indeed, the provision of non-audit services can have both a positive or negative impact on audit quality. On the one hand, non-audit services lead to a transfer of knowledge that allows the auditor to increase his/her expertise and efficiency with regard to the audited company, which can enhance audit quality (e.g., Knechel and Sharma 2012; Svanström 2013). On the other hand, fees for non-audit services also create a (financial) dependency between the auditor and the audited company, which may compromise the auditor's independence (e.g., Basioudis, Papakonstantinou and Geiger 2008). In their study for the Belgian audit market, Breesch and Hardies (2014) conclude that there is little empirical support for the assumption that non-audit services have an impact (neither negative nor positive) on audit quality.

3.2.2. Fee disclosure and audit quality

Three archival studies have exploited specific institutional settings to examine the effect of mandatory fee disclosure on *actual* (as opposed to perceived) audit quality. Consistent with Dye's (1991) argument that fee disclosure can enhance auditor independence by increasing clients' bargaining power and reducing auditors' expectation of quasi-rents[6], two pre-post studies have found that overall audit quality increased after the implementation of the fee disclosure requirement. Lai (2009) was the first researcher to empirically investigate this topic using data from listed US firms. Lai (2009) found a positive association between mandatory fee disclosure and auditor independence. Specifically, audit firms were more inclined to issue going concern opinions to their clients when fees were disclosed, indicating that fee disclosure improved the quality of their audits. An archival study by Chen (2016) provides corroborating evidence that more information transparency on auditor fees is associated with enhanced auditor independence. Specifically, using Taiwanese listed firms, Chen’s (2016) results show that mandatory fee disclosure is associated with reduced earnings management and that the type of disclosure (i.e. fee amount vs. fee range) has a significant effect on audit quality, with fee amount disclosure being associated with higher quality.

Conversely, Chen et al. (2019) demonstrated with Taiwanese data that downward fee adjustments subsequent to the regulatory implementation of mandatory fee disclosure impairs audit quality, particularly for companies opting for fee amount disclosure. This suggests that increased price competition undermines audit quality which would be an unintended consequence of the regulation. Upward fee adjustments are, however, neither associated with increased audit quality. In conclusion, the evidence on the effect of mandatory fee disclosure on audit quality coming from audit markets dominated by listed firms is inconclusive.

[6] DeAngelo (1981) contends that switching auditors incurs significant transaction costs for both clients and new auditors, giving incumbent auditors an opportunity to charge future fees above their avoidable costs. This creates the potential for quasi-rents or future pay-offs, which could impair the independence of incumbent auditors if they respond competitively to this expectation. However, Dye (1991) challenges DeAngelo's assumption that auditors possess all the bargaining power in setting future-period fees. If fees were made transparent and clients had greater bargaining power, there would be no future quasi-rents, since clients would insist on auditors charging no more than the avoidable cost of the audit.

Since auditor independence is difficult to observe, part of the mandatory fee disclosure requirement relies on the *perception* of auditor independence. A consequence of mandatory fee disclosure could be the potential strategic behavior of auditors in curbing non-audit services. Early studies in the UK and the US show that the hypothesized negative effect of non-audit fee disclosure on the provision of non-audit services was either temporary (Iyer, Iyer and Mishra 2003) or non-existent (Scheiner 1984).[7]

More recent research has focused on the impact of mandatory audit fee disclosure on the market's perception of audit quality and find mixed results. While some studies suggest that high levels of non-audit fees are associated with lower perceived audit quality (Francis and Ke 2006), others show no market reaction to disclosure of non-audit service fees (Ashbaugh, LaFond and Mayhew 2003; Koh, Rajgopal and Srinivasan 2013). A concern exists however, that mandated fee disclosure may lead investors to develop inaccurate beliefs about auditor independence (Dopuch et al. 2003; Gaynor, McDaniel and Neal 2006).

4. Research Questions

This literature review shows that only a handful of studies have actually examined the effect of mandatory fee disclosure. After more than a decade of having regulations on fee disclosure in place, evidence on this topic is still limited. Questions remain regarding the impact of fee disclosure on subsequent audit pricing and particularly audit quality, especially in markets dominated by private firms such as the Dutch audit market. Indeed, prior research on the impact of mandatory fee disclosure has merely focused on listed firms in Asia and the US. A recent study by Averhals et al. (2020) is the only one to date that has empirically examined the effect of mandatory fee disclosure on audit pricing in the private segment of the audit market. Private firms differ, nevertheless, from listed firms on a number of important dimensions. Therefore, it is *ex ante* not apparent that results from listed firms will generalize to private firms. Price competition in the private client segment of the audit market is assumed to prevail because of lower concentration (Simunic 1980) and more cost considerations among smaller firms (Collis 2012). Accordingly, the consequences of fee disclosure could be more important in the private client segment. Hence, in order to increase our understanding of the effect of mandatory fees disclosure, it is necessary to investigate whether research findings from markets dominated by listed firms generalize to markets dominated by private firms.

The evidence on mandatory fee disclosure presented above raises the following interesting research questions about subsequent audit pricing and audit quality in the private client segment of the Dutch audit market:

1) How does the regulatory implementation of mandatory fee disclosure affect audit pricing?

[7] To examine the impact of mandatory fee disclosure on audit and non-audit services, Iyer et al. (2003) studied the UK setting where disclosure of (non-)audit fees has been required since 1989 (1992), while Scheiner (1984) analyzed the effects of SEC's Accounting Series Release (ASR) No. 250, which mandated disclosure of non-audit services as a percentage of the total audit fee between 1978 and 1982.

a. What is the dispersion in audit fees subsequent to the regulatory implementation of mandatory fee disclosure?
b. Does fee disclosure is associated with subsequent period fee adjustment?
c. How do fees change over time in the periods subsequent to the initial implementation of mandatory fee disclosure?

2) How do audit fee adjustments subsequent to the regulatory implementation of mandatory fee disclosure affect audit quality?

It is important to note that the objective of this project is to examine the connection between fee *disclosure* and audit pricing and audit quality rather than the effect of fees as such on audit quality. Nonetheless, it would be valuable to conduct a partial replication of the studies by Hope and Langli's (2010) and Breesch et al. (2013) to provide updated evidence on the relationship between the level of fees and audit quality in the private market. This replication could also investigate the impact of abnormal audit fees on audit quality.

5. Ongoing FAR project on mandatory fee disclosure

5.1. Aim of our FAR replication project

In continental-Europe and more specifically the Netherlands, there has been limited research on the impact of regulatory interventions on audit quality. However, there are studies in the literature that have examined similar interventions in other countries. To address this gap, the FAR initiated a Replication Program in 2020, inviting researchers to replicate the best existing research on regulatory interventions from the literature. As part of the FAR Replication Program, the overall purpose of our FAR project is to obtain a better understanding of the actual consequences of mandatory fee disclosure in the Netherlands. Specifically, the aim of our study is twofold. The first purpose of our FAR replication project is to investigate which effect mandatory fee disclosure has on subsequent period audit pricing. The second objective of this project is to also focus on the effect of mandatory fee disclosure on audit quality.

We aim to provide complementary evidence to the study by Averhals et al. (2020) by investigating mandatory fee disclosure in the Dutch audit market, which is -like the Belgian setting- dominated by private firms. Nevertheless, our study differs in three important ways. First, a peculiarity of the Belgian audit market is that an auditor is appointed for a three-year period during which the audit fee is fixed (Averhals et al. 2020). In the Netherlands, like in most other countries, companies are allowed to switch auditors every year. Moreover, the auditor agrees the basis for calculating the fee yearly (art. 29, Besluit toezicht accountantsorganisaties van 16 augustus 2006). Second, we aim to examine a larger time span subsequent to mandatory disclosure of fees (12 years versus 4 years). Finally, we will also consider non-audit fees, while Averhals et al. (2020) were not able to do so, and we will examine the effect of potential fee adjustments on audit quality.

5.2. Method

First, by replicating the study by Francis and Wang (2005) we aim to examine (a) the dispersion in fees subsequent to the regulatory implementation of mandatory fee disclosure and (b) whether audit fee disclosure leads to subsequent period fee adjustment. Additionally, we will analyze (c) the changes in audit fees over time, particularly within the 10-year period after regulatory implementation. This will allow us to examine how fees evolve and adjust over time in response to mandatory fee disclosure.

Second, by partially replicating the study by Chen et al. (2019) to examine whether fee adjustments in periods subsequent to the regulatory implementation of mandatory fee disclosure affect audit quality. We infer audit quality by three widely used proxies: (i) discretionary accruals, (ii) the propensity to issue going-concern opinions, and (iii) the incidence of small profits.

To achieve these research goals, we gratefully make use of the possibility offered by the FAR to conduct replication research in the Dutch audit market and to provide us with archival data from consolidated financial statements from Dutch non-financial companies for the period 2006-2019.[8] The time-series perspective allows us to analyze several subsequent years after the implementation of the fee requirement and to focus on trends. We will investigate our research questions through univariate tests of the variance of audit fees and several regression analyses.

5.3. Project status

Regarding the project's present status, we were able to obtain financial data from the annual accounts of consolidated Dutch companies, which were compiled by Bureau van Dijck. Starting from this dataset, we collected a sample of 14,300 observations (13,818 observations from private firms and 482 observations from listed firms) covering the period from 2006 to 2019, for which sufficient data is available to calculate variables from our models. At present, FAR research assistants are collecting audit and non-audit fees, the audit opinion, the audit firm and the individual auditor.

6. Expected contribution

Our project aims to contribute to the literature studying the relationship between mandatory fee disclosure, audit pricing and audit quality. Our results will allow to provide suggestions and recommendations relevant to regulators, audit firms and client companies, not only active in the Dutch audit market, but also in similar settings such as continental EU countries.

Regulators should be interested in our finding in case there are consequences—whether intended or unintended—to audit pricing and audit quality. Regulators should weigh our findings carefully as they evaluate the efficacy of the regulation. Should it turn out that our study brings to light potential unintended consequences of mandatory fee disclosure, our results cast doubts on the effectiveness of this regulatory intervention. In that case, our results could trigger discussions

[8] Although audit fee disclosure became mandatory as from 2008, we aim to collect financial statement data as from 2006 for the calculation of accruals and control variables.

regarding potential modifications to auditing regulations and identify factors that could potentially mitigate any unfavorable outcomes.

Our study also contributes to the **academic** literature examining the real effects of disclosures (e.g., Dunn, Lundstrom and Wilkins 2021).

With respect to **practical implications**, our study is relevant to **practitioners and audited companies** as well. An analysis on the potential increased bargaining power after the regulatory implementation of mandatory fee disclosure, could be interesting in benchmarking audit fees during fee negotiations. Should our study confirm the worry of practitioners and professional bodies that fee disclosure creates downward pressure on the audit level of fees and compromises quality, we would recommend audit firms to act as a profession and never save on audit quality when setting fees. Specifically, we advise audit firms to set fees and audited companies to accept fees at a level that can guarantee an ISA-compliant audit, particularly in situations in which they experience fierce competition for clients. Delivering high-quality audits is, after all, essential to serve the public interest.

7. Conclusion

Although the purpose of mandatory fee disclosure is to promote transparency in the auditor-client relationship, practitioners and professional bodies have expressed concern about its unintended consequences on audit pricing and the potential negative impact on audit quality.

A limited number of studies have revealed that the initial public disclosure of fees can impact subsequent audit pricing. Clients who were overcharged previously are able to negotiate a reduction in fees, while those who were undercharged face an increase in fees. These studies also suggest that price competition has intensified as a result of fee disclosure, with audit fees being adjusted downward more often than upward. This indicates that clients now have greater bargaining power compared to auditors. Empirical evidence on the impact of mandatory fee disclosure on audit quality is equally scarce and rather mixed.

Since most existing research on the consequences of fee disclosure has been conducted in listed firms, the effect of fee disclosure in the private segment of the audit market remains understudied. Only one recent study by Averhals et al. (2020) has investigated the topic in the context of private firm audits. It is, however, crucial to specifically study the effects of fee disclosure in the private segment of the audit market, because the effect of fee disclosure can be more important is this segment due to lower concentration, less quality-seeking clients and thus more fierce price competition (Simunic 1980).

With the aim to contribute to the regulatory debate, we answer the call from the FAR for academic replication research on the impact of mandatory fee disclosure in the Netherlands. Our objective is to provide key insights into how fee disclosure affects audit pricing and audit quality. It is crucial for the audit practice and regulators to gain a deep understanding of the impact of mandatory fee disclosure on both price competition and audit quality. This knowledge can help uncover and address any potential unintended consequences of the regulation.

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