

## THE PRICING OF AUDIT SERVICES: EVIDENCE FROM CHINA

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### Abstract

This paper explores the determinants of audit fees and examines if government ownership, auditor choice, and legal environment affect the pricing of audit services in China. The pricing of audit services literature builds on Simunic's (1980) model that tests audit market competition after controlling factors that affect audit fees (i.e. difference in loss exposure, assessed loss-sharing ratio and production economies) as a function of audit quantity and price. The Chinese audit market provides a setting where the audit market is dispersed between three classes of audit firms (i.e. International Big-4, Domestic Big-10 and other Non-Big-10). Moreover, it gives the opportunity to test how government ownership might affect audit pricing, as well as the effects of the split-share reform (2005-2009). Finally, it allows the studying of how different regions with different macro-economic characteristics, as introduced by Taylor and Simon (1999), (i.e. litigation, disclosure and regulatory environments), may affect audit pricing in China. Using a sample of 1,845 Chinese listed firms during the period from 2003 to 2014, the main results show that: 1) audit firms charge government-owned firms less compares to other NSOE firms, 2) this audit fee discount for SOEs is only observed when an International Big-4 audit firm is assigned, 3) after the completion of the split-share reform this discount becomes marginal and slightly significant, and finally 4) macro-economic factors (i.e. legal environment) increases audit fees. This paper contributes to the literature on ownership structure and audit fees by including evidence from the split-share reform in China which helps practitioners understand how audit services pricing works in China and the role of auditor choice in moderating the government influence over audit pricing.

**Keywords:** Audit Fees, Auditor Choice, Government Ownership, Market Development.

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