

**Pricing and Competition:
Fee Premia in the Market for Audit Services**

-by-

Larry R. Davis
University of Wisconsin-OshKosh

Daniel T. Simon
University of Notre Dame

Greg Trompeter
Boston College

This paper examines the association between competition in the audit services market and the ability of large international firms (hereafter, Tier I firms) to charge a premium for their audit services. Specifically, we examine the fees charged by Tier I firms in the U.K. during the 1980's when their code of professional conduct was modified to ease the competitive restrictions against advertising and competitive bidding for audit engagements. Our results provide evidence of a reduction in the Tier I fee premium in the mid-1980's, coinciding with the relaxation of the restrictive regulations in the code of professional conduct. This finding is consistent with regulators' arguments that professional regulation effectively constrained price competition. These results also suggest that Tier I clients were paying, on average, higher audit fees than would have been paid in a more competitive market. Although the results suggest that a change in the code of conduct may have led to lower Tier I fees, we do not make general claims regarding net benefit to society, for a reduction in the Tier I fee premium may also reduce the incentives to provide quality-differentiated audit services. Without data pertaining to audit quality, we cannot conduct such analysis, and therefore limit ourselves to addressing the costs associated with professional regulation. Consequently, while the changes in the code of conduct may benefit Tier I audit clients in the form of reduced audit fees, it is not clear whether society is better off if those changes also reduce the incentives to provide quality-differentiated audits and lead to a reduction in the quality of audit services.