

SESSION 1: AUDIT  
DATE: THURSDAY, FEBRUARY 22  
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## **Post-SOX Era Client Power and Auditor Specialization Effects on Audit Pricing and Auditor Objectivity in City Markets\***

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**ABSTRACT:** The considerable realignment of audit services market is one by-product of the Sarbanes-Oxley Act of 2002. Faced with increased regulatory scrutiny and heightened auditing requirements (e.g., Section 404 of the Act), Big 4 audit firms began to shed smaller issuing firms who then looked to non-Big 4 auditors for their audit services. While these clients were small in a Big 4 firm's client portfolio, it is likely that they are large in the non-Big 4 firm's client portfolio. For all auditors, the realignment enhances the position of the remaining clients in the firm's portfolio. In general, these are conditions in which client power can increase. Strategically, the realignment also creates an opportunity for audit firms to focus on particular segments of the audit service market; that is, to specialize in particular industries. I examine the effects of client power and auditor specialization on 3,278 audit fees for fiscal year 2004 engagements. Following recent studies (c.f., Francis et al. 2005), I define auditor industry specialization at the city office level using two definitions: (1) the percent of client audit fees to the sum of client industry audit fees for that office and (2) an indicator variable to identify whether the audit firm is the industry leader at the city level. I define client power by percent of client sales to the sum of sales for all firms audited by the audit firm. These variables of interest are regressed in a simultaneous equations framework on 2004 audit fees and discretionary accruals (as a proxy for auditor objectivity). I find that audit fees are negatively associated with client power and non-Big 4 auditors. Non-big 4 audit specialists, however, are associated with higher audit fees. No effects are detected for client power and auditor specialization on discretionary accruals.

\* The full text of this paper is available online by going to [http://aaahq.org/meetings/2007SW\\_program.htm](http://aaahq.org/meetings/2007SW_program.htm) and clicking on the link.