

GROWING MEDIAN AUDIT FEES

Is the Growth Real?



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udit fees provide important information to investors, lenders, and other users of financial statements. This is because the audit fee is directly or indirectly related to many critical inputs in the audit process and therefore can be used in

combination with other information to assess the quality of audit service provided by a company's independent auditor. Audit fee information may also be useful for regulators to evaluate the appropriateness of the current market structure of Singapore's public accountancy sector, and informs policy-making debates such as whether there is a need for industry restructuring through consolidation of small accounting firms.

In the US, the Securities and Exchange Commission mandated the disclosure of audit fees for public companies in 2000. Many other developed economies followed suit, including France, Germany, Hong Kong, Japan, and the UK. In Singapore,



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the disclosure of audit fees in annual reports was made mandatory in 2011 via the Singapore Exchange (SGX)'s listing rule 1207(6)(c). This new regulation made it possible to obtain a complete view of the market structure for listed company audits in Singapore.

This study aims to provide a comprehensive analysis of the current status, recent trends, and key determinants of audit fees among listed companies in Singapore.

SAMPLE AND DATA

To construct the sample for analysis, we started with all the companies listed on the SGX Mainboard and Catalist. Some companies, mainly those with only secondary listings on SGX, were audited by auditors located outside Singapore. For example, Jardine Matheson Holdings Ltd, whose audit fees for 2013 amounted to over SGD22 million, was audited by PwC

London. Since the focus of this study is to understand the domestic audit market, we excluded from the sample companies the 56 companies that were audited by foreign auditors.

We collected the audit fee, auditor identity, and other related information from the companies' annual reports. Market capitalisation data and some accounting data, such as total assets, revenue, and net income, were collected from the Compustat database maintained by Standard and Poor's. If a company's reporting currency for its financial statements was not in Singapore dollars, then all relevant amounts were converted to Singapore dollars at the exchange rate at the balance sheet date.

The final sample consisted of 672 companies, with 536 listed on the Mainboard, and 136 on Catalist. These companies accounted for almost 90% of the total listings on SGX as of June 2014.

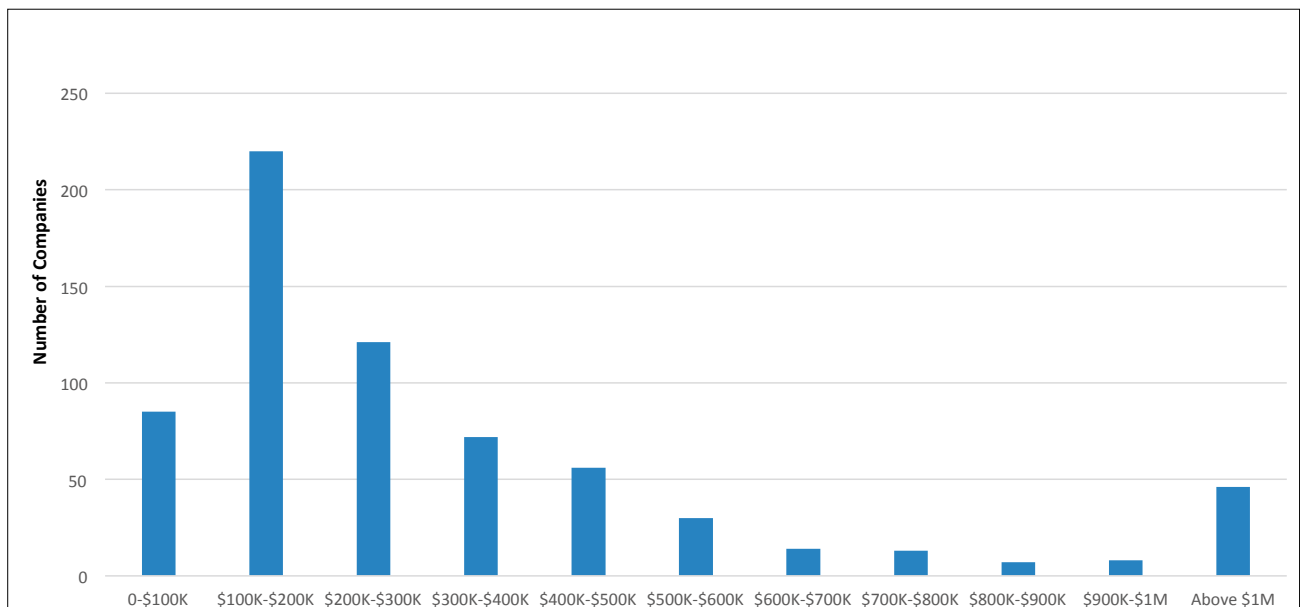
DISCUSSION OF FINDINGS

1 OVERALL STATISTICS

In total, the 672 companies in our sample paid \$291 million in audit fees in 2013. This amount represents about 0.65% of the combined profits of these companies, equivalent to 0.08% of Singapore's GDP in 2013. The audit fees of individual companies exhibited large variations, ranging from as low as \$32,000 to over \$8 million, with a median of \$214,500. As shown in Figure 1, the distribution of audit fees is right skewed, with a long right tail populated by multi-million-dollar fee-payers (46 companies have audit fees above \$1 million). Given our sample size, these companies would have a disproportionately large impact on the sample mean. We therefore used median as the main summary statistics for our analysis.



Figure 1 Distribution of audit fees



2 COMPANY SIZE ANALYSIS

Company size has been shown to be the most important determinant of audit fees in many developed markets. Large companies usually have higher asset balance, more complex operations, cover multiple market segments, and therefore require significantly higher audit efforts. To present a complete view of the relation between company size and audit fees for SGX companies, we measured size from three different dimensions, namely total assets, revenue, and market capitalisation.

We used a portfolio approach to study the correlation between audit fees and each of these dimension measures. The companies in our sample were grouped into five equal-sized portfolios by each company size measure, and the median total assets and audit fees of companies within each size group were plotted. For example, Figure 2 presents the audit fees for companies grouped by total assets.

In Figure 2, Quintile 1 consists of the smallest 20% companies by total assets. A median company in this group has total assets of \$29.64 million, and paid audit fees of \$114,700. In contrast, Quintile 5 includes the largest 20% companies, whose median total assets are \$2.52 billion, with median audit fees of \$558,000. Audit fees increased consistently across the five size groups, suggesting that companies with larger asset balances paid higher fees for auditing services.

As shown in Figures 3 and 4, the same pattern is also found in the five quintiles formed by market capitalisation and revenue.

Put together, our analysis shows that company size is an important determinant of audit fees for listed companies in Singapore. This is consistent with evidence found in other countries.

Figure 2 Audit fees by total assets quintiles

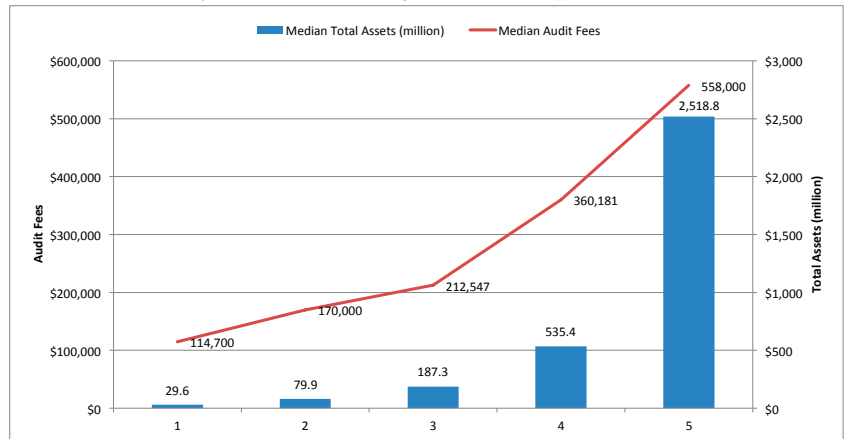


Figure 3 Audit fees by market capitalisation quintiles

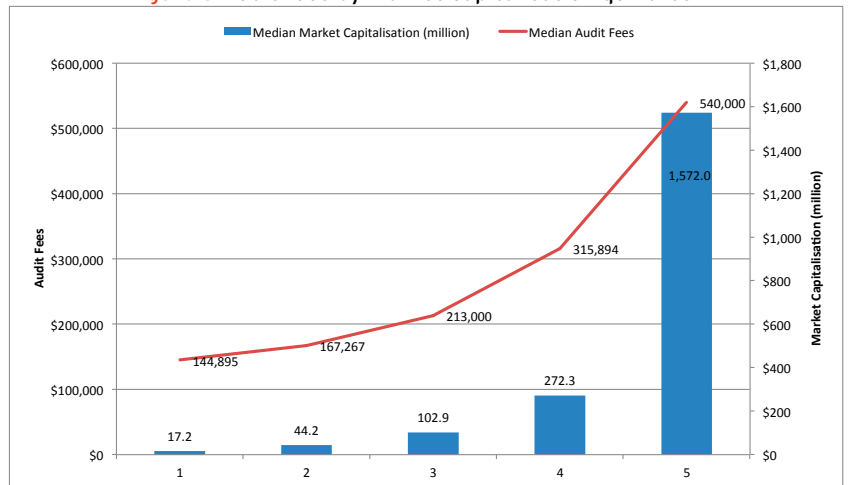
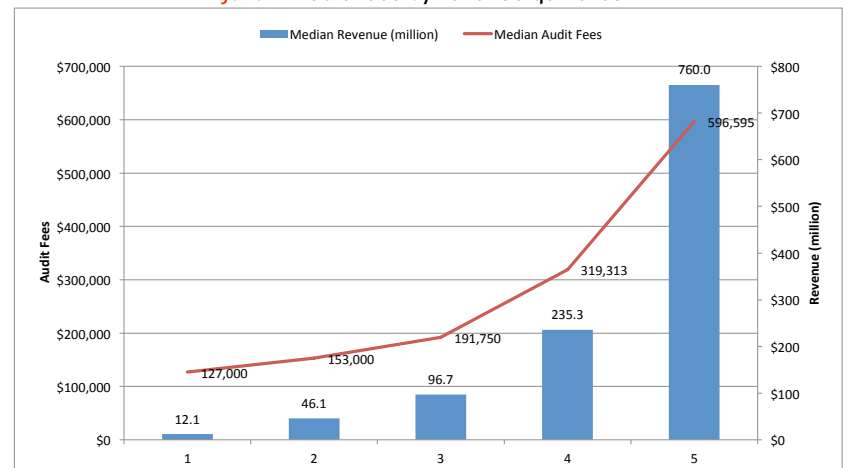


Figure 4 Audit fees by revenue quintiles





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Companies in the Multi-industry sector paid the highest audit fees, followed by the Agriculture sector, Transport/Storage/Communications, and Property sectors. This pattern is not unexpected because companies operating in these industries are usually bigger in size.

3 INDUSTRY ANALYSIS

Our sample covers all 11 industry sectors per SGX's classification.¹ Figure 5 shows the median audit fees and total assets for each industry. Companies in the Multi-industry sector paid the highest audit fees, followed by the Agriculture sector, Transport/Storage/Communications (TSC), and Property sectors. This pattern is not unexpected because companies operating in these

industries are usually bigger in size. The more interesting results are the comparison among the Agriculture, TSC and Property sectors.

In this group, companies in the Property sector have the largest asset base but paid the lowest audit fees. In contrast, companies in the Agriculture sector are smaller, as measured by total assets, but paid substantially higher audit fees than the Property

companies. This could reflect the differential complexity of audit for each specific industry. For example, companies in the Agriculture industry generally require more audit efforts given their significant biological assets.

¹ There is only one company in the Electricity, Gas and Water sector, so it is not included in the industry analysis.

Figure 5 Audit fee/Total assets by industry

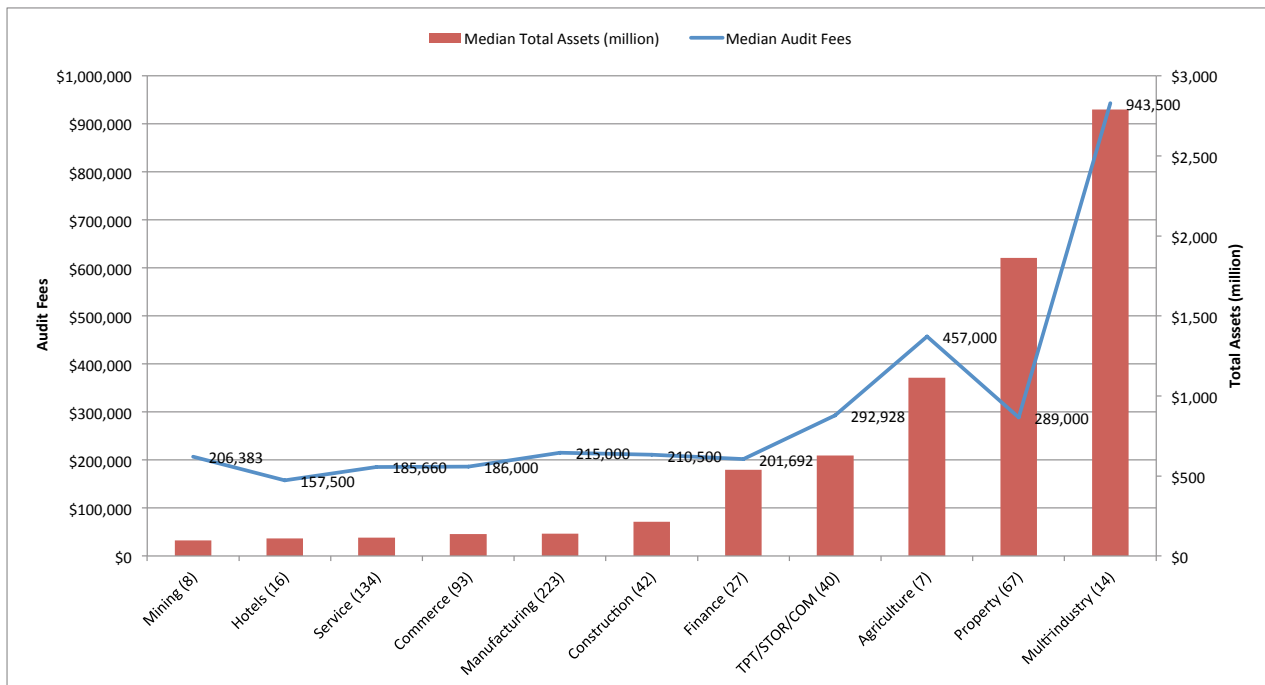


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4 AUDIT FIRM ANALYSIS

Like most developed economies, the Big Four global accountancy firms² play a dominant role in Singapore's listed company audits market. As shown in Figure 6, they controlled 64% of the market in terms of number of clients, and earned 83% of the total audit fees in 2013. It is also apparent from these statistics that the companies audited by the Big Four firms tend to be large companies that pay higher audit fees.

Among the Big Four firms (Figure 7), EY commanded the largest market share both in terms of number of clients (175) and total audit fees (\$89 million). KPMG was in second spot, with 106 listed company clients and over \$64 million in total audit fee revenue. PwC had fewer clients (62) than Deloitte & Touche (87), but earned slightly more in total audit fees; PwC earned \$45 million while Deloitte & Touche earned \$43 million.

In addition to the Big Four firms, the small and medium-sized public accounting firms also play a critical role in Singapore's accountancy sector. In our analysis, we further grouped these firms into two categories comprising the Mid Five firms (BDO, Foo Kon Tan Grant Thornton, Moore Stephens, Nexia TS, and RSM Chio Lim) which have more than 30 listed company clients each; the remaining firms are referred to as small firms.

As a group, the Mid Five firms had 181 listed company clients and earned a total audit fee of \$37 million in 2013. Within this category, BDO took the pole position with 43 clients and \$8.5 million in total audit fees. The small firms audited 61 listed companies and earned \$12 million in fees in 2013.

Figure 6 Market share

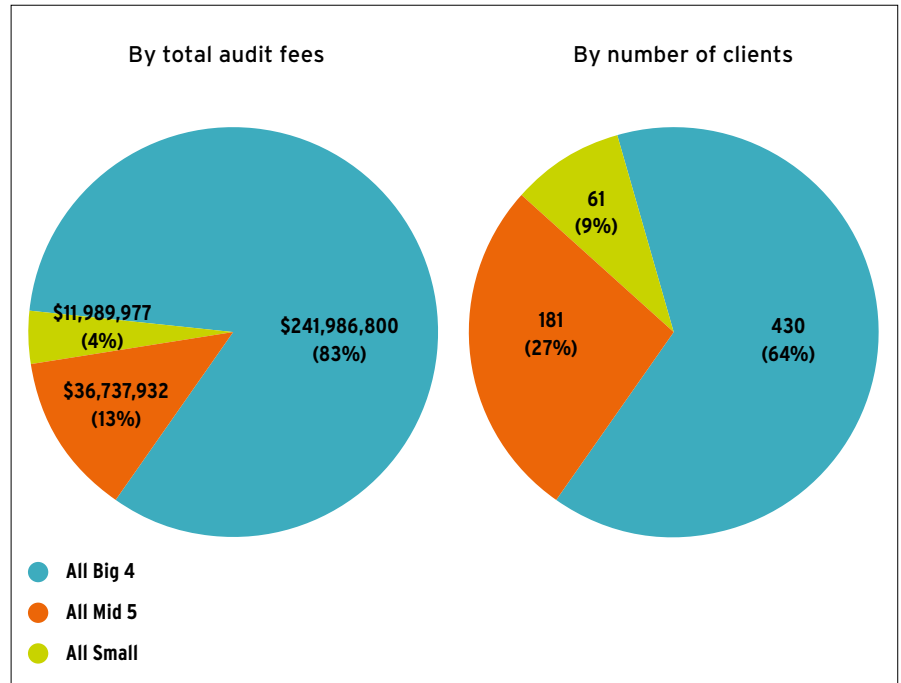
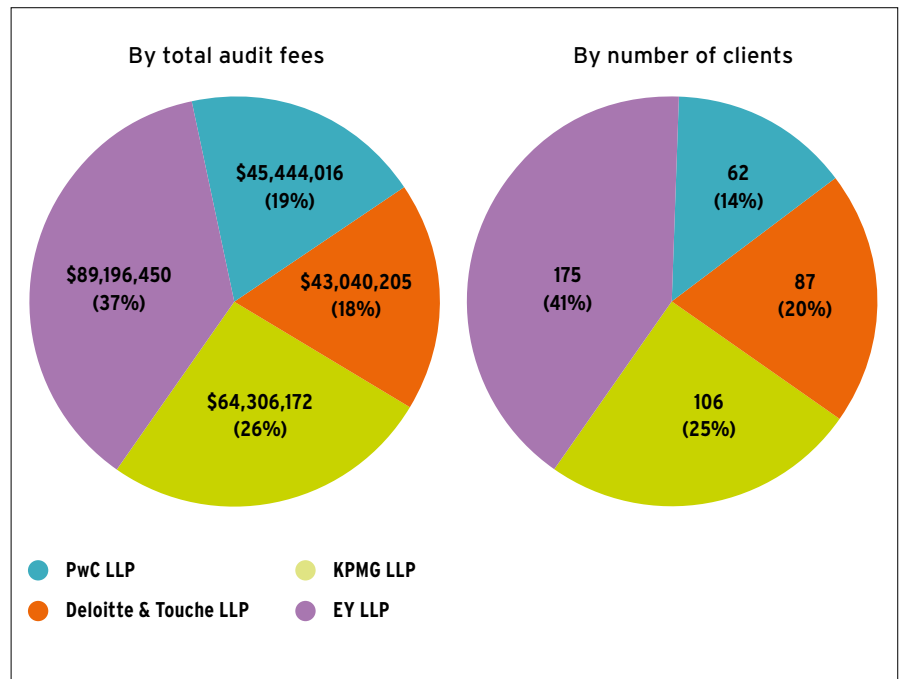


Figure 7 Big Four market share



² The Big Four global accountancy firms refer to Deloitte & Touche LLP, Ernst & Young (EY) LLP, KPMG LLP, and PricewaterhouseCoopers (PwC) LLP.

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Our data show that there was a steady increase in audit fees from 2011 to 2013, though the growth rate was lower in 2013 than 2012.

5 RECENT TRENDS IN AUDIT FEES

In our last set of analysis, we presented some information regarding the overall trend of audit fees from 2011 to 2013. To make the year-over-year comparison meaningful, we included only companies that remained listed throughout the three-year period. We also excluded companies that had year-over-year audit fee changes of \$1 million or more, because it is highly likely that these companies experienced major corporate restructuring events such as mergers and acquisitions, and are therefore not representative of companies operating under normal conditions. As a result, the sample size was reduced to 596 companies for analysis in this section.

As shown in Figure 8, the median audit fees for the overall market increased 4.7% from 2011 to 2012, and by a smaller amount of 2.1% in 2013.

This pattern is generally in line with the growth rate in the companies' total assets over the period, which reached 8.4% in 2012 before falling back to 3.0% in 2013. The lower rate of increase for audit fees in 2013 may also reflect the recent economy-wide slowdown in business cost growth. For example, according to a report by Ministry of Trade and Industry, the unit service cost index for the service sector rose by 3.5% in 2012 but the increase in 2013 was a mere 1.5%. In addition, the inflation rate was 4.6% in 2012 but decreased to 2.4% in 2013.

However, we note that the changes in audit fees could also have been driven by other factors such as the shifting landscape of competition in the audit market. These factors will be addressed in ISCA's detailed research report on audit fees, to be released in the first quarter of 2015.

CONCLUSION

Our analysis of the audit fees of SGX-listed companies reveals several important findings. First, we find that company size is a key determinant of audit fees. Larger companies tend to pay higher fees to compensate their auditors for the extra efforts. Second, there are significant variations in audit fees across industries. In addition to company size, the complexity of operation and asset composition also seem to contribute to the inter-industry audit fee difference. Third, the Big Four accounting firms are dominant players in the market, controlling over 80% of the total audit fee revenue. The five medium-sized accounting firms also play an important role, accounting for 13% of the total fees. Finally, we also provided some evidence on the recent trends in audit fees for the overall market. Our data show that there was a steady increase in audit fees from 2011 to 2013, though the growth rate was lower in 2013 than 2012. However, in the current study, we do not fully address the question of what drives the changes in audit fees – which is an area for future research. ISCA

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Figure 8 Recent trends in audit fees

