วารสารวิชาชีพบัญชี
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Does Economic Dependence Influence Auditor's Opinions?

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1. Introduction

Auditors are professionals who have technical competence in accounting and independence in performing audit works and reporting their opinions to the public. They are expected to reduce agency cost between shareholders (principle) and management (agent). When auditors receive audit fees from their audit clients as their compensation, a question may arise whether they compromise their independence and work for management instead of shareholders. Besides, audit fee comes from the negotiation between auditors and their audit clients and there is no specific rule from the regulatory body for quoting the audit fee. Thus, the concern that audit fee or economic dependence with clients will impair auditor's independence becomes an issue. Auditors who receive high audit fee may want to maintain such clients in their portfolio and are likely to please them. They may allow client's management to manipulate firms' earnings, override internal controls, and dominate audit process and

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opinion expression. Audit clients may ask auditors to issue unqualified or clean auditor's opinion because the stakeholders will be unaware of any problems or unsolved issues and management can maintain their performance. On the contrary, high audit fee may represent high audit quality because it implies that auditors provide premium service to their clients such as performing systematic audit procedures, identifying weakness of internal controls, and reporting the truth to stakeholders. When audit clients have uncertainties and unsolved issues, auditors have to perform additional work until they obtain sufficient and appropriate audit evidence for expressing their opinions. Thus, they can charge for high audit fee to their clients in order to maintain their audit quality and compensate with their reputation and litigation risks.

This research examines audit fees and auditor's opinion of 1,409 listed companies in Thailand from 2004 to 2008 with an attempt to provide evidence on the impact of economic dependence on auditor's independence. Interestingly, the research results show that firms with unqualified or clean auditor's opinion have lower audit fee than those with modified auditor's opinions. Modified auditor's opinions focus on clean opinion with explanation and qualified opinion. Such evidence confirms that auditors who charge high audit fees to their clients are likely and independently to issue modified auditor's report to clients in order to protect their reputation and avoid litigation risk. Another explanation may come from additional audit procedures imposing high audit costs and audit fees of firms with modified auditor's opinion. Firms with uncertainties, going concern, unsolved issues, misapplication of accounting standards, limitation of audit scopes by either circumstances or management are likely to receive modified auditor's report. Moreover, this research expects that such evidence may differ for Big 4 and non-Big 4 auditors because they may have different economic bond with audit clients. Big 4 auditors may have greater audit cost, reputation and litigation risks than non-Big 4 auditors so that they should place more conservatism and do more audit works when receiving high audit fee. In contrast, non-Big 4 auditors may want to keep clients who can pay high audit fee and are likely to issue clean auditor's report to please their clients. Further investigation reveals that both of Big 4 and non-Big 4 auditors are not influenced by high audit fees in expressing their opinion. In other words, economic dependence does not impair auditor's independence for both Big 4 and non-Big 4 auditors.

The remainder of this paper is organized as follows. Section two reviews prior literature on audit fees and audit opinion. Section three presents hypothesis development. Section four reports research design and section five provides research results. Section six concludes the paper and describes limitation of research.

2. Literature Review

The audit fee may reveal the audit quality because higher auditing practices usually require more audit time and resources and thus a higher audit fee is charged to the audit client (Moizer, 1992). The hidden inefficiency cost and excessive gain in audit fee proposal are debatable. If the audited companies can pay for high audit fee and they found their auditors as value-for-money audit, they still use the service from that auditor. Thus, audit fee could be an indirect measure of audit quality. In contrast, lower quality auditors can propose very low audit fees in order to keep clients and are so-called price-cutters. This is the practice of low-balling where the auditors set the initial audit fee at below the start-up costs in the first year of audit work (DeAngelo 1981a, 1981b) in order to win the bid from the potential client and gain the client-specific quasi-rents[1].

There is an inconclusive analysis for audit fees on the reasonable or agreeable price between auditors and audit client. Auditors have both a legal duty and professional obligations of each audit client and therefore their view on compensation of audit work is rather cheap or underpriced. In reverse, audit clients may view that their auditors have worked for them just in a short period of time in each year. Besides, audit fee is increasing every year. Thus, their view on audit fee is rather expensive or overpriced. The expectation gap on audit fee between auditors and audit client still exists in the audit market because they do not know what the real price of audit fee should be. People always prefer high quality products with a reasonable price and this agreement is difficult to be settled. One of the main reasons apart from the financial distress (Haskins and Williams, 1990) that companies would like to change auditors is the desire to get a cheaper audit (Johnson and Lys, 1990).

Apart from audit fee, when auditors collect and evaluate sufficient and appropriate audit evidences, they should express their opinion as to whether the audited financial statements are presented fairly, in all material respects in accordance with the financial reporting framework. Thus, the auditor report is the final product of the audit process that auditors use to communicate to users of the company's financial statements (Porter et al., 2003, p. 366). The auditor's report may be classified into two types: unqualified or clean report and modified reports, as mentioned in the International Standard on Auditing (ISA) 700 by the IAASB (2004). Auditors will issue an unqualified report or clean report when they consider the audited financial statements fairly present in accordance with the financial reporting framework. However, auditors will issue modified auditors' reports based on the following circumstances and materiality effect:

(1) Emphasis of matter or unqualified opinion with explanatory language. Auditors modify the auditor's report when there is a material matter arising from a going concern or uncertainty problem. They add an emphasis of matter paragraph after the opinion paragraph to highlight a matter affecting the financial statements and the addition does not affect the auditor's opinion. In other words, clean opinion still remains unchanged.

(2) Qualified opinion. Auditors express a qualified opinion when they disagree with management on the application of accounting

1 Quasi-rents represent the difference between audit fees and audit costs that an auditor will receive in the future. Normally auditor will propose a minimum initial audit fee equal to the difference between initial audit cost and the present value of the expected quasi-rent stream (Watts and Zimmerman, 1986).

policies and/or disclosure to financial statements, or management or circumstances limited their audit scope, and these matters are not so material.

(3) Disclaimer of opinion. Auditors express a disclaimer of opinion due to a very material limitation of audit scope either by client's management or by circumstances and they could not obtain sufficient appropriate audit evidence. Another reason of disclaimer of opinion comes from the uncertainty of going concern and other issues with a very material effect on financial statements.

(4) Adverse of opinion. Auditors express an adverse opinion when they significantly disagree with companies' management on the application of accounting policies and/or disclosure to financial statement.

DeAngelo (1981) defined audit quality as the joint probability that an auditor has competence to discover and independence to report a breach in the client's accounting system. The auditor's report communicates the auditor's findings to market stakeholders and gives a warning sign to the users of audited financial statements, especially modified reports. Issuing modified opinions requires auditor's objectivity and withstand client's request to issue a clean opinion because modified opinions increase costs to both the auditor and the audit client (Kida, 1980; Mutchler, 1984; Weil, 2001). Modified audit opinion can lead to adverse consequences for the client regarding stock price declines (Loudder et al. 1992; Blay and Geiger, 2001) and increase risk of business failure (Geiger et al. 1998). Auditors also have to increase professional skepticism and perform more audit procedures when they audit clients that have uncertainties, going concern, misapplication of accounting standards and inadequate disclosure.

Prior research studies examined the association between audit fee and auditor's opinions; however, the results are mixed and unanswered. DeFond et al. (2002) find no association between going concern opinions and either total fees or audit fees. Similarly, Raghunandan et al. (2003) find no significant differences between the restatement and control samples for unexpected non-audit fees, fee ratios, and total fees. Thus, economic dependence does not influence auditors in changing their opinions through restatement. Likewise, Reynolds and Francis (2000) find no evidence that auditors are more relaxed in issuing going concern reports to larger clients that pay high audit fees.

Conversely, Geiger and Rama (2003) report a significant positive association between the magnitude of audit fees and the likelihood of receiving a going-concern modified audit opinion for stressed companies. This is consistent with prior research that modified audit opinions require additional audit work and lead to higher audit fees (Barkess and Simnett, 1994; Basioudis et al., 2008; Bell et al. 2001; Francis and Simon, 1987; Palmrose, 1986; Simunic, 1980). Similarly, Reynolds and Francis (2000) find that auditors increase their independence in response to greater financial dependence. Firms, especially large firms, with auditors having the greatest financial dependence tend to report lower discretionary accruals. This is because litigation reputation risks are high for large firms. Firth (2002) reveals a positive relationship between high non-audit service fees and clean audit reports; however, he is unable to distinguish whether it is from a lack of auditor independence or clearing up uncertainties by nonaudit services.

3. Hypothesis Development

Prior research reports mixed evidence on audit fee and auditor's independence. This study attempts to answer question whether audit fee affect auditor's opinion. The high audit fee may impair auditor's independence since auditors would like to keep good relation with their clients and are likely to issue unqualified financial reports. Auditors who have economic dependence with clients may allow management to manage their earnings as reported by Frankel et al. (2002). When auditors receive low audit fee, they have less economic bond with clients because audit cost may be higher than audit fee. Thus, they are not afraid of losing such audit clients and likely to express modified opinion to financial statements when they found uncertainty or problematic issues in clients' companies. However, the high audit fee may represent audit quality because auditors have to perform their works with professional skepticism and high standards in order to protect their reputation and avoid litigation risk (Geiger and Rama, 2003). In other words, the more uncertain issues in client's firm, the more audit work to be performed, leading to higher audit fees. Besides, Herrmann et al. (2008) report that auditors' conservatism in Thailand have increased after the financial crisis due to the adoption of International Financial Reporting Standards (IFRSs) and improvements in corporate governance system. Thus, the current study expects that high audit fees represent high audit quality because auditors have to charge the premium fee when they perform more audit procedures in order to resolve issues in clients' companies. Such audit clients are likely to have going concern and/or unresolved issues and auditors are likely to express modified auditor's opinion to avoid litigation and reputation risk. Therefore, the first hypothesis is formulated as follows.

H1: Audit clients with modified financial reports pay higher audit fee than those with unqualified financial reports.

Audit quality may be affected by types of audit firm because large audit firms have more knowledge management and economic resource for developing audit staff than small audit firms. This notion is consistent with several research studies. Becker et al. (1998) report discretionary accruals in Big 6 audit clients is lower than that in non-Big 6 audit clients. Similarly, Gore et al. (2001) find that the provision of non-audit services to audit clients may impair auditor's independence in case of non-Big 5 audit clients. Thus, this research expects that audit fees or economic dependence will affect auditor's opinions in a different way for Big 4 and non-Big 4 auditors. Big 4 auditors may increase professional skepticism to protect their reputation and meet public expectation when they receive high audit fee. Therefore, Big 4 auditors will perform more audit works for problematic clients, charge for high audit fee, and issue modified report to compensate litigation and reputation risks. In other words, the more problems, the higher audit fees, and the less problems, the lower audit fees (Barkess and Simnett, 1994; Bell et al. 2001; Francis and Simon, 1987; Palmrose, 1986; Simunic, 1980). Thus, the second hypothesis is formulated as follows.

H2: Big 4 audit clients with modified financial reports pay higher audit fee than those with unqualified financial reports.

Conversely, non-Big 4 auditors may have more economic dependence with audit clients when they receive high audit fee and may be less resistant to client's management because they are likely to keep clients to maintain fee income. Thus, non-Big 4 auditors may issue clean opinion when they receive high audit fees. The third hypothesis on audit fee and audit opinions is formulated as follows.

H3: Non-big 4 audit clients with modified financial reports pay lower audit fee than those with unqualified financial reports.

4. Research Design

Secondary data analysis was performed using financial data of Thai listed companies from 2004 to 2008 obtained from Datastream. Non-financial information regarding type of auditor, auditor's opinion was collected from annual financial report and 56-1 form from the website of the Stock Exchange Commission of Thailand. The missing value variables and extreme value variables are excluded from the original sample, leading to 1,409 firm-years as reported in Table 1.

This study will apply t-test for testing mean difference between two samples (clean and modified auditors' opinions) and analysis of variance (ANOVA) for comparing means among more than two samples (clean opinion and group of modified opinions such as unqualified with explanation, qualified, and disclaimer of opinions). Bonferroni test will be conducted to find significant mean difference of pair sample groups from several groups. Pearson correlation is undertaken to report correlation between variables before further investigation.

5. Research Results

The descriptive statistics and Pearson correlation are presented in Table 2. The average audit fee is 2.42 million Baht and the highest and lowest audit fees are 24.4 million Baht and 0.065 million Baht, respectively. About 64 percent of sample companies are audited by Big 4 firms. About 65 percent and 27 percent of sample companies received unqualified opinion and unqualified opinion with explanation, respectively. Audit fee has significant positive correlation with Big 4 and Opinion. This correlation implies that firms with Big 4 auditors pay for higher audit fee than those with non-Big 4 auditors. Furthermore, firms with modified auditor's report pay for higher audit fee than those with clean auditor's report.

Table 1 Number of sampled Thai listed companies

Description	Number of companies
	Firm-years
Initial sample 2004-2008	2,270
Less Missing Data	(855)
Extreme values	(6)
Preliminary sample	1,409

Table 2 Panel A: Descriptive Statistics

Audit fee (Baht)	Min = 65,000	Max = 24,440,000	Mean = 2,419,300
No. of firms by auditor type (1,409 firms)	Big 4 = 901 (64%)	Non-big 4 = 508 (36%)	
No. of firms by opinion type (1,409 firms)	Unqualified		
Unqualified 927 (65%)	with explanation 382 (27%)	Qualified 83 (6%)	Disclaimer 17 (2%)
Panel B: Pearson Correlation			
	Audit fee	**Big 4**	**Opinion**
Audit fee	1.00		
Big 4	0.254***	1.00	
Opinion	0.122***	-0.031	1.00

Note: Significant level at *** = 1%, ** = 5%, and * = 10%

Big 4 = 1 if company is audited by Big 4 auditor, and 0 otherwise;

Opinion = type of auditor's report ranging from 0 to 4; where 0= unqualified, 1= unqualified with explanation, 2= qualified, 3= adverse of opinion, and 4= disclaimed opinion.

Table 3 Tests for Difference in Means and Medians of Audit Fees Classified by Auditors' Opinions (Million Bath)

Variables	**All Observations (n=1,409)**		
	Mean	**Median**	**Standard Deviation**
Panel A (t-test)			
1. Unqualified (clean) (n=927)	2.03	1.10	2.86
2. Modified opinion (n=482)	3.16	1.70	3.82
t-statistics = 38.81* **			
Panel B (ANOVA)			
1. Unqualified (clean) (n=927)	2.03	1.10	2.86
2. Modified opinion			
2.1 Unqualified with explanation (n= 382)	3.20	1.70	3.92
2.2 Qualified (n=83)	3.24	1.42	3.67
2.3 Disclaimer (n=17)	1.91	1.72	1.24
F-statistics = 13.84* **			

Unqualified = Unqualified audit opinion;

Unqualified with explanation = Unqualified audit opinion with explanatory language;

Qualified = Qualified audit opinion, and

Disclaimer = Disclaimed audit opinion

Note: Significant level at *** = 1%, ** = 5%, and * = 10% using the t-test and F-test

Table 3 reports difference in means and medians of audit fees classified by types of auditor's opinion. The results in Table 3 panel A shows that firms with modified opinion have higher audit fees than those with unqualified opinion and this difference is significant at 1 percent level. This result supports the first hypothesis (H1). The results in panel B describe types of modified opinion (i.e. unqualified with explanation, qualified and disclaimer of opinion) and compare them with unqualified opinion using analysis of variance (ANOVA). There is no classification for adverse of opinion due to two reasons. First, adverse of opinion represents disagreement between auditors and management in accounting policy application and/or disclosure that has a very material effect to financial statement. This case is rare in Thailand. The second reason for adverse of opinion comes from limitation of audit scope incurred by circumstances and clients' management so this type of report is unacceptable by the SEC. The results present that means and medians of audit fees for firms with unqualified auditor's report are lower than those with unqualified auditor's report with explanation and qualified auditor's report. However, firms with disclaimer of auditor's opinion show the lowest audit fees among other classifications. The result shows that there are significant differences among audit fees in each types of auditor's opinion; however, it does not report which types of opinion have influenced the results. Thus, further investigation is performed in Table 4 in order to magnify the results and indicate which pairs of opinion have significant difference.

The results in Table 4 show that means of audit fees for firms with unqualified opinion are significantly lower than those with unqualified opinion with explanation and those with qualified opinion. Unqualified opinion with explanation represents events that clients have minor implications of uncertainties and/or going concern issues and auditors have to obtain more audit evidence until they satisfy. Qualified opinion signifies situations when there is disagreement between auditor and client's management on accounting policy application, disclosure, and scope limitation by either circumstances or management. The aforementioned

Table 4 Tests for Audit Fee Difference classified by Auditors' Opinions (Million Bath)

Opinion Type	Unqualified	Unqualified with explanation	Qualification	Disclaimer
Unqualified	NA			
Unqualified with explanation	(1.16)***	NA		
Qualification	(1.21)***	0.04	NA	
Disclaimer	0.13	1.29	1.33	NA

Unqualified = Unqualified audit opinion;

Unqualified with explanation = Unqualified audit opinion with explanatory language;

Qualified = Qualified audit opinion, and

Disclaimer = Disclaimed audit opinion

Note: Significant level at *** = 1%, ** = 5%, and * = 10% using Bonferroni Test situations make auditors become more careful and they have to perform more audit procedures so that the audit fee is higher than normal situation. This result is consistent with prior studies of Barkess and Simnett, 1994; Bell et al. 2001; Francis and Simon, 1987; Palmrose, 1986; Simunic, 1980. This evidence supports the first hypothesis (H1) that audit clients with modified financial reports pay higher audit fee than those with unqualified financial reports. There is no significant difference between audit fees of firms with unqualified opinion and those with disclaimer of opinion. Firms with disclaimer of opinion may have sufficient and appropriate audit evidence on their audit issues and auditors can express their opinions without further investigation. Thus, audit fee for this type of firm is not different from that for firm with clean opinion. Furthermore, disclaimed opinion firms usually have financial problems and they are unable to pay for high audit fees.

The mean differences of audit fees among types of auditor's opinion may be influenced by size of audit firms. This study is aware of this effect so that the sample is divided into two groups: firms with Big 4 auditors and firms with non-Big 4 auditors and the result is shown in Table 5. The results are expected differently between both groups as indicated in the second and third hypothesis. As reported in Table 5, firms with Big 4 auditors show higher audit fees than those with non-Big 4 auditors in all types of auditor's opinion. Firms with modified opinion (unqualified opinion with explanation and qualified opinion) pay higher audit fees than those with unqualified opinion for both Big 4 and non-Big 4 auditors groups. Big 4 clients' firms with disclaimer of opinion show lower audit fees than those with unqualified opinion. In reverse, non-Big 4 clients' firms with disclaimer of opinion report higher audit fees than those with unqualified opinion.

Table 5 Analysis of Variance for Audit Fees classified by Auditors' Opinions and by Auditor Size (Million Bath)

Variables	Observations with Big 4 (n=901)			Observations with non-Big 4 (n=508)			Mean Difference
	Mean	Median	Σ	Mean	Median	σ	
Unqualified (Clean) (B=590, NB=337)	2.57	1.30	3.36	1.10	0.81	1.20	1.47***
Unqualified with explanation (B=261, NB=121)	3.84	2.34	4.28	1.82	1.18	2.54	2.02***
Qualified (B=41, NB=42)	4.94	3.20	4.45	1.58	1.00	1.39	3.36***
Disclaimer (B=9, NB=8)	2.36	2.29	1.19	1.41	0.71	1.15	0.95
F-statistics	11.03***			6.27***			

Unqualified = Unqualified audit opinion;
Unqualified with explanation = Unqualified audit opinion with explanatory language;
Qualified = Qualified audit opinion, and
Disclaimer = Disclaimed audit opinion
*Significant at 10% level
Note: Significant level at *** = 1%, ** = 5%, and * = 10% using the F-test

Further investigation is conducted to see which pairs of auditor's opinions have significant difference in audit fees as classified by size of auditor's firms. The results are presented in Table 6 for Big 4 group and in Table 7 for non-Big 4 group. In table 6, Big 4 clients' firms with unqualified opinion with explanation and qualified opinion significantly pay higher audit fees than those with unqualified opinion. This result support the second hypothesis (H2) indicating that Big 4 audit clients with modified financial reports pay higher audit fee than those with unqualified financial reports. Big 4 auditors have to protect their reputation and avoid litigation risk so that they perform more audit works and charge more audit fees for problematic audit clients than for normal audit clients.

As can be seen in Table 7, non-Big 4 clients' firms with unqualified opinion with explanation and with qualified opinion also pay higher audit fees than those with unqualified opinion. The results are significant at 1 and 10 percent, respectively, and rejects the third hypothesis (H3) stating that non-Big 4 audit clients with modified financial reports pay lower audit fee than those with unqualified financial reports. Thus, non-Big 4 auditors also quote high audit fees for firms that have uncertainties and/or going concern problems. The economic dependence does not affect auditor's independence for both of Big 4 and non-Big 4 auditors. However, there is no significant difference in audit fees between unqualified opinion and disclaimer of opinion.

6. Conclusion

Audit fees and auditor's opinion have been studied by many researchers to see whether economic dependence will impair auditor's independence; however, the results are inconclusive. The current research study attempts to answer this research question in Thailand by measuring audit fees in each type of opinions. Research results reveal that firms with modified auditor's opinion pay higher audit fees than those with clean auditor's opinion. The mean difference in audit fees is significant for firms with clean opinion and those with unqualified opinion with explanation and qualified opinion. This evidence implies that when audit clients have uncertainties and unresolved issues, auditors have to perform more audit works in order to obtain sufficient and appropriate audit evidence. Consequently, auditors are likely to issue modified auditor's opinion to avoid reputation and litigation risk and charge high audit fees to their clients to compensate with their additional costs. In other words, high audit fee may represent high audit quality since auditors work harder in audit engagement with uncertainties and unsolved issues. When considering the difference in audit fee by opinion types and by size of audit firms, the result is qualitatively similar to the first finding. Big 4 and non-Big 4 clients with modified opinion pay higher audit fees than those with unqualified opinion. Big 4 and non-Big 4 audit clients pay significant higher audit fees for clean opinion with explanation and qualified opinions than for clean opinion. The result shows that economic dependence or high audit fee does not impair auditor's independence for both of Big 4 and non-Big4 auditors in expressing modified opinions. Besides, high audit fee may represent greater audit effort and more audit quality. Audit fee for disclaimer of opinion is similar to that for clean

Table 6 Tests for Audit Fee Difference classified by Auditors' Opinions (Big 4) (Million Bath)

Opinion Type	Unqualified	Unqualified with explanation	Qualification	Disclaimer
Unqualified	NA			
Unqualified with explanation	(1.27)***	NA		
Qualification	(2.37)***	(1.11)*	NA	
Disclaimer	0.21	1.48	2.59*	NA

Unqualified = Unqualified audit opinion;

Unqualified with explanation = Unqualified audit opinion with explanatory language;

Qualified = Qualified audit opinion, and

Disclaimer = Disclaimed audit opinion

Note: Significant level at *** = 1%, ** = 5%, and * = 10% using the Bonferroni Test

Table 7 Tests for Audit Fee Difference classified by Auditors' Opinions (non-Big4) (Million Bath)

Opinion Type	Unqualified	Unqualified with explanation	Qualification	Disclaimer
Unqualified	NA			
Unqualified with explanation	(0.72)***	NA		
Qualification	(0.49)*	0.24	NA	
Disclaimer	(0.31)	0.41	0.17	NA

Unqualified = Unqualified audit opinion;

Unqualified with explanation = Unqualified audit opinion with explanatory language;

Qualified = Qualified audit opinion, and

Disclaimer = Disclaimed audit opinion

Note: Significant level at *** = 1%, ** = 5%, and * = 10% using the Bonferroni Test

opinion because auditors may have clear audit evidence to justify the uncertainty and/or going concern issues. Besides, audit clients in this category are usually facing financial problem so they are unable to pay high audit fees. Therefore, audit fees for disclaimer of opinion are not significantly different from those for clean opinion.

This research may suffer from two major limitations. First, clean auditor's opinion may represent client's firms without any issues or may include firms with unsolved issues and auditors cover up such issues. Auditors may receive normal or low audit fee and expect for future quasi-rents as explained by low-balling practice so that they are likely to issue clean opinion to please their clients. However, this research is unable to answer this question. Second, the exclusion of some specific firms and non-listed companies previously mentioned might reduce the statistical inference of this study to the auditing research in Thailand, since the research lacked a comprehensive view of audit fee and auditor's opinion in the country as a whole. To overcome these limitations may be an avenue for future research.

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