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Audit Fees Are Up; What's Interesting Is Why



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Audit costs are rising, but the latest data on audit fees raises questions about what's really driving that increase.



Whalen

Figures from Audit Analytics show the cost of a public company audit for 2,300 accelerated filers rose 3.55 percent from 2013 to 2014, after a few years of holding relatively flat. The cost rose from \$541 per million in revenue in 2013 to \$550 per million in 2014. The firm provides its cost data in relation to revenue to help gauge the figure against inflation or other reasons for growth in revenue, says Don Whalen, general counsel and director of research for Audit Analytics. "It increased 3.55 percent, which isn't very big," he says.



Franzen

In separate data compiled by the Office of Research and Analysis at the Public Company Accounting Oversight Board, the median audit cost for more than 5,800 issuers from 2013 to 2014 rose 2.92 percent, according to board

member Jeanette Franzel in a recent speech. Nearly 60 percent of companies within that population reported an increase in audit costs; 36 percent reported a decrease; and 5 percent reported no change.

When isolating companies that are subject to an audit opinion on internal control over financial reporting, the PCAOB found a higher median increase at 4.08 percent, Franzel said; 64 percent of companies reporting an increase in audit costs and 34 percent reporting a decrease. In both populations, she said, “these rates have been generally consistent over the past four years.”



DeLoach

A drive in recent years through the PCAOB’s inspection process to improve audit quality, particularly around internal control, has led some to claim that the inspection process is also pushing up costs. “They are driving auditors to increase the skepticism, to refocus and assure audits are risk-based, to not accept information from a client without evaluating whether that information is adequate and reliable,” says Jim DeLoach, managing director at consulting firm Protiviti. “All these things are driving auditors to increase the amount of work they do. That’s going to translate into audit fee increases.”

Looking into 2015, there’s no sign that auditors have yet achieved the level of work that the PCAOB wants to see, DeLoach

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Jim DeLoach, Managing Director, Protiviti

says. “The audit failure rate was just too high last year,” he says. “That’s not going to improve overnight. The audit firms are really trying to react to these increased requirements. In doing so, the clients are going to pay a higher audit bill.”



Hirth

Audit experts say plenty of other factors are driving up audit costs as well, beyond any regulatory pressure. Compensation, for example, is a key cost for audit firms, and the competition for talent in the accounting and auditing arena has picked up as the economy has improved, says Bob Hirth, chairman of COSO. Inspection results may be a driver of audit activity, “but so are new accounting pronouncements, acquisitions, new systems, as well as restatements and problems arising during the year,” he says.



Pinnell

The competition for talent is “fierce,” says Wayne Pinnell, managing partner at regional audit firm Haskell & White. “A few years ago, firms generally didn’t hire people out of school,” he says. “Now the people expected to be functioning as seasoned seniors and managers aren’t there. I would think headhunters are doing very well right now.”

Internal Company Costs



Quaadman

Tom Quaadman, vice president of the U.S. Chamber Center for Capital Markets Competitiveness, says it’s not just the rising cost of the external audit that concerns companies. “Costs are one thing, but the increased work load is another,” he says. “With the increased assurance work, there are also internal costs that companies bear as well.

Anecdotally, I've heard that the amount of time and effort are going up at a more rapid pace than the audit fees because of the internal work that has to go with it."

Sharon Virag, vice president, controller, and chief accounting officer at Aetna, says companies have worked hard as Sarbanes-Oxley compliance matured to coordinate their internal processes with external auditors' needs. "Take the analytical review of the financial statements, for example," she says. "We do it internally, and our auditors do it too. If we think it

through, we can do it in a form that they want so they don't have to redo all that underlying work. There are a lot of ways we can coordinate with the auditor to try to get that synergy in the audit."

In the past few years, however, the timing of PCAOB inspection results at the end of the year has caused changes late in the audit process, Virag says. Audit planning and procedures begin well before the end of a fiscal year, she says. "The PCAOB's cycle is not always aligned with public company audit processes, which typically start in early fall," she says.

AUDIT FEES OVER REVENUE

The table below from Audit Analytics analyzes audit fees over revenue percentage changes from year to year.

Calendar Year	Audit Fees (\$)	%	Revenue (\$)	%	Audit Fees Per \$1 Million in Revenue	% Change of Revenue From Previous Year
2002	3,758,486,166		8,027,290,684,778		468	
2003	4,471,651,278	18.97%	8,955,572,922,599	11.56%	499	6.64%
2004	6,884,177,651	53.95%	10,187,073,603,922	13.75%	676	35.34%
2005	7,445,616,534	8.16%	11,409,816,009,385	12.00%	653	-3.44%
2006	8,113,219,469	8.97%	12,738,261,938,531	11.64%	637	-2.40%
2007	8,438,767,323	4.01%	14,262,076,833,768	11.96%	592	-7.10%
2008	8,668,062,540	2.72%	14,803,242,391,554	3.79%	586	-1.04%
2009	8,262,712,205	-4.68%	13,164,941,875,678	-11.07%	628	7.19%
2010	8,124,758,431	-1.67%	14,437,112,447,463	9.66%	563	-10.33%
2011	8,448,414,258	3.98%	15,764,857,496,455	9.20%	536	-4.77%
2012	8,787,546,348	4.01%	16,549,600,084,957	4.98%	531	-0.92%
2013	9,079,993,402	7.48%	16,791,376,774,317	6.51%	541	0.91%
2014	9,333,604,957	6.21%	16,976,097,119,034	2.58%	550	3.55%

Source: Audit Analytics.

Virag says that if regulatory alerts came out more in real time, as or soon after concerns are spotted in inspections, auditors and issuers would have a better opportunity to plan and carry out the audit based on those concerns. “If they have something they want to have an impact that year, get those comments out earlier in the year,” she says.

Doug Carmichael, former chief auditor at the PCAOB now a professor at Baruch College, says he doesn’t see that as a big concern. “The PCAOB is just pointing out things they should have been doing anyway,” he says. He believes the increases seen in audit costs are not out of line with the market.

The PCAOB’s analysis of fees also sought to isolate the effect of other big corporate events that might affect the audit cost, such as a significant change in a company’s size, a big acquisition or divestment, a change in auditor, or other financial reporting problems. Franzel said the distribution of data showed a majority of issuers who reported such an event had swings in audit costs of greater than 10 percent, while a majority that did not report such an event had changes in audit costs of less than 10 percent.

“The take-away from this analysis is that the audit fee data from the past four years for all issuers, including those with ICFR opinions, show relatively stable increases in the median percentage change in fees since 2011,” Franzel said. “And when issuers do report large changes in their audit fees, it is most likely related to factors other than ICFR audit work.”