

THE RELATIONSHIP BETWEEN INTERNAL AUDITING AND EXTERNAL AUDIT FEES: EVIDENCE FROM KUWAIT

Meshari O. Al-Hajri

Associate Professor in the Department of Accounting,
Kuwait University, Kuwait

Abstract: Although audit pricing has been one of the most studied topics in the audit literature for more than three decades now, to date, very little research has been conducted on this important issue in the Middle East Region. One important question in this line of audit research has been related to whether audit fees are influenced by the contribution of client's internal auditing (IA) to the external audit work. Much of existing research investigating this issue has been conducted in well-developed English-speaking countries, with almost no empirical evidence provided about this issue within the context of other parts of the world. The purpose of the current study is to examine this issue using data from the Kuwaiti audit market. In particular, the current study uses a sample of audit engagements performed in the Kuwaiti market, to examine whether external audit fees are influenced by the contribution of the client's internal audit function. The results show that IA contribution in the external audit work is negatively related to the amount of external audit fees.

Keywords: audit fees, internal auditing, audit markets, Kuwait.

I. INTRODUCTION

Due to the growing competition in audit markets, and the increasing complexity in the required audit procedures, one of the major challenges external audit firms have been facing in recent years is the need to be cost-efficient and at the same time preserve adequate audit quality. One way for audit firms to achieve that has been through the utilization of audit client's internal audit (IA) in the performance of the external audit work. The contribution of the client's IA department to external audit work can be beneficial not only for audit firms but also for audit clients as well. That is true since this kind of cooperation is expected to result in some synergic outcomes including high audit

quality and cost efficiency (Gramling *et al.*, 2004; Sarens, 2009). Audit clients are expected to cherish such cooperation since it can lead to reducing the cost of their external audit (Zain *et al.*, 2015). In addition, and especially in light of the recent emphasis on the promotion of effective and strong corporate governance and control, having a better understanding of how internal and external audit interact is very useful for the enhancement of integrity and reliability of corporate financial reporting (Spira and Page, 2003; Goodwin-Stewart and Kent, 2006).

The impact of IA contribution to external audit work on audit fees has been an interesting research issue for several audit researchers.

Studies in this line of audit research have typically been interested in examining whether external audit fees are influenced by the contribution of IA to the external audit work. Empirical results offered by these studies are mixed. In particular, prior research examining the IA-fees relationship has reported a negative relationship, a positive relationship, and no significant relationship between external audit fees and IA. For example, Felix *et al.* (2001) provide evidence suggesting that audit fees are reduced as a result of IA involvement in external audit. Goodwin-Stewart and Kent (2006), on the other hand, report evidence of a positive relation between external audit fees and internal audit contribution. On the other hand, both Stein *et al.* (1994) and Carey *et al.* (2000) could not find a significant relationship between audit fees and IA.

The current study aims at extending this line of audit research by examining this important yet rarely examined research issue in the context of the Kuwait audit market. Much of the existing empirical evidence about this relationship stem from developed countries' markets, with very limited research examining this issue in the context of less developed countries. Research based on data from these markets may not be applicable to other parts of the world where the market structure, firms' ownership, and the regulatory environment are quite different. The current study aims at filling this gap in the international audit literature by examining the relationship between external audit fees and IA contribution using data from the Kuwaiti audit market. Such examination seems to be warranted as it could help knowing whether empirical findings documented and conclusions drawn from prior developed markets-based studies about the IA-fees relationship prove to be relevant to a developing country's market, like the Kuwaiti market.

While similar in some aspects, the audit market in Kuwait is distinct from audit markets of developed markets in a number of different ways. First, unlike in most developed countries where the degree of regulation and official audit guidance is thorough and well-structured, rules and regulations governing the audit profession in Kuwait are still immature and underprovided. Audit pricing in Kuwait, therefore, is expected to be different from that in other markets as audit fees are expected to be influenced by the market's regulatory settings (Kim *et al.* 2012). Second, unlike in developed countries where prior related studies were conducted, there are no regulations requiring firms to disclose audit fees paid to their external audit firms. This makes the pricing of audit services in the Kuwaiti market less transparent than audit pricing in these markets where audit fees are publically known. Third, unlike in Western and well-developed audit markets, where the business environment is highly litigious, the potential for economic or reputational losses audit firms may incur as a result of audit failures is quite remote in a developing market, like the Kuwaiti market (Habib and Islam, 2007). Finally, unlike in developed markets where audit firms operate in a highly competitive environment, competition is quite insignificant in the Kuwaiti audit market. Prior research (e.g. Boone *et al.* 2012; Francis *et al.* 2013) suggests that external auditors' behavior is influenced by the level of competition in the marketplace. Hence, the reduced level of competition audit firms face in developing markets compared to that in developed markets may result in fewer incentives for audit firms to reduce their audit costs via seeking IA contribution in their external audit work. These differences between the Kuwaiti audit market and other markets where prior related studies were carried out raise the need for further

examining the relationship between audit fees and IA contribution in a setting that has not been explored before.

After controlling for some key factors related to external audit fees, the results show a negative relationship between external audit fees and IA contribution in the external audit work. The empirical evidence provided in the current study is supportive of IA as a substitute of substantive audit procedures performed to carry out the external audit work. The results provided by the current study should be of value to audit firms interested in comparing the level of their coordination with their clients' IA to that in the market. The current study's findings may also be informative to firms' audit committees when supervising the coordination between the external audit team and the firm's IA department. Empirical findings offered in the current study should also be of use to audit regulators, especially in the Kuwaiti market, for better understanding and supervision of the relationship between external auditors and their clients' IA functions.

The major contribution of this study is that it complements prior related research by carrying out an investigation of the relationship between audit fees and IA in a developing market's settings. This research endeavor, therefore, is valuable as it is, to the author's knowledge, the first to provide empirical evidence about this important research issue from the Middle Eastern region.

II. LITERATURE REVIEW

The relationship between audit fees and IA contribution has been an issue of interest for several audit researchers for the last thirty years. Understanding the interaction between internal and external auditing is important as both functions serve as monitoring mechanisms

for corporations (Stein *et al.*, 1994; Felix *et al.*, 2001; Goodwin-Stewart and Kent, 2006; Singh *et al.*, 2013). In addition, investigating the relationship between internal and external audit functions is of value as it has some economic implications for companies and external audit firms (Singh *et al.*, 2013). Empirical findings obtained about this relationship have been mixed and inconclusive, though. While results obtained by some prior studies suggest a negative relationship between audit fees and IA contribution (e.g., Felix *et al.*, 2001), evidence reported in other studies show a positive relationship (e.g., Goodwin-Stewart and Kent, 2006; Hay *et al.*, 2008).

The professional audit guidance encourages external auditors to rely on work performed by the audit client's IA function when it is of adequate quality. In particular, International Standard on Auditing 610, *Using the Work of Internal Auditors*, maintains that "the external auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan" (IFAC, p. 7). Using the work of internal auditors can be useful in conducting more efficient and effective external audit. That is true since using such a work would help lowering the cost of performing the external audit work, and enables the external audit team to make use of internal auditors' familiarity and understanding with the client's activities and operations.

The impact of external auditors' use of IA work and external audit fees has been a subject of investigation by several researchers. Existing related research reports findings revealing a positive, negative, and no relationship between using IA work and audit fees. Researchers suggesting a significant positive association between IA contribution and audit fees interpret

such a positive relationship as a demonstration of the conception that the IA function is a complementary tool that enhances the overall corporate monitoring and control (Singh *et al.*, 2013). Research suggesting a negative relationship between IA contribution and audit fees maintains that the IA function can be viewed as a substitute, at least partially, for the external audit work. This would happen as a result of (i) the reduced external audit hours resulting from internal auditors' participation in the actual conduct of the external audit work, or (ii) the reduced audit risk assessment resulting from internal auditors' knowledge and involvement in internal controls (Singh *et al.*, 2013). Research failing to report a significant relationship between IA contribution and external audit fees suggests a number of possible reasons for that¹. Firstly, there could be no causal relationship between IA and audit fees in reality. Secondly, there could be a positive relationship that is not observable as the audit firm may decide to absorb the increased audit costs for client retention reasons. Thirdly, there could be a negative relationship between IA contribution and audit fees that is not evident as the audit firm may decide not to pass the cost 'savings' on to the audit client.

Empirical auditing research has long discussed the determinants of external audit fees. Although this research has examined various factors and their potential influence on audit fees, auditee's size, complexity, and risk were conventionally thought of as the primary determinants of audit fees. The contribution of audit clients' internal auditors to external auditors' work was long believed to have the potential to reduce the costs of performing the external audit work (and consequently audit fees). Yet, only few studies have directly investigated the contribution of IA functions

as a determinant of external audit fees. Elliott and Korpi (1978) paper was among the early studies that directly investigated the clients' internal auditors' participation in the external auditor work as a determinant of audit fees. They found that the percentage reduction of the external audit work due to the participation of internal audit was significant in predicting external audit fees. Stein *et al.* (1994) is another study that explicitly examined the IA contribution as a determinant of audit fees. A dichotomous variable, with the level of IA participation represented as either "extensive" or "limited", was used to test the significance of the contribution variable in the audit fees model. The results failed to find such variable significant, probably due to the use of a dichotomous variable to capture the contribution of IA. Felix *et al.* (2001) further examined this issue using a continuous variable to measure the IA participation in the external audit work, and found this variable to be a significant determinant of external audit fees. As Felix *et al.* (1998) indicated, the main reason external auditors rely on clients' IA work when performing financial statement audits is to lower external audit costs. This suggests the presence of an inverse relationship between IA contribution and the costs of performing financial statement audits due to the cost savings external auditors retain when relying on such IA work.

Goodwin-Stewart and Kent (2006) examined the relationship between audit fees and IA using data related to Australian listed firms. In particular, using data related to a sample of 401 financial statement audits, they predicted and found evidence of significantly positive association between external audit fees and the use of client's IA. They interpreted their result as an evidence of the complementary nature of the relationship between internal and external audit as corporate monitoring mechanisms.

¹ See Singh *et al.* (2013) for further discussion.

Hay *et al.* (2008) used data related to a sample of 130 companies listed on the New Zealand Stock Exchange, and studied among other things, the relationship between audit fees and IA. Their results revealed a positive relationship between audit fees and IA. Singh *et al.* (2013) performed a further examination of the fees-IA relationship in the Australian market using data related to a sample of 272 publicly listed firms. Their results revealed a positive association between audit fees and the existence of IA function as a proxy for IA usage. Using data related to a sample of 53 audits from the Hong Kong market, Ho and Hutchinson (2010) carried out a similar investigation. Their results showed a negative relationship between audit fees and IA. More recently, Zain *et al.* (2015) recently performed similar examination in the Malaysian market, using data related to 74 listed firms. They found evidence of a significantly negative relationship between audit fees and IA contribution in external audit.

In sum, empirical findings about the relationship between audit fees and IA contribution are mixed and are still inconclusive. Moreover, it appears that much of prior related research examining this issue stem from well developed countries with only little research conducted in other parts of the world. Besides, to the author's knowledge, empirical research about this relationship is virtually nonexistent in the context of the Middle East region. Given the mixed and inconclusive empirical findings reported about the relationship between audit fees and IA contribution, this relationship remains 'anomalous' (Hay *et al.*, 2006), and, hence, further examination of this relationship seems warranted. Therefore, and as indicated earlier, the current study aims at empirically examining the relationship between audit fees and IA contribution using data from the Kuwaiti market. Such research endeavor aims at filling the shortage of empirical research on

the IA-audit fee relationship in the context of developing countries' markets.

III. RESEARCH METHODOLOGY

Sample:

To obtain data needed to test the research questions of interest, a data-gathering instrument was designed for the purpose of gathering the needed information. Audit partners/managers in six audit firms operating in the Kuwaiti market were contacted and were requested to provide some information about a random sample of 15 financial statement audits for which they have had a supervisory role. The study's initial sample consisted of observations related to 57 audit engagements (63 percent). Due to missing data, nonetheless, 22 were discarded from the analysis of the current study. Hence, the study's final sample consists of 35 audit engagements.

Model:

As indicted earlier, the main objective of the current study is to examine the impact of IA contribution on external audit fees in the Kuwaiti audit market. The following OLS regression model is used to examine the research questions of interest:

$$FEE = b_0 + b_1 IA + b_2 SIZE + b_3 LOCAT + b_4 QUICK + b_5 LEVER + b_6 ROA + b_7 NAS + b_8 BIG4 + b_9 TENURE$$

Where:

FEE : the natural log of total audit fees;

IA : External auditor's assessment of the percentage of external audit work performed by the audit client's internal audit staff.

SIZE : the natural log of the audit client's total assets;

LOCAT : the natural log of the number of audit locations visited by the audit team;

QUICK : the audit client's current assets

minus inventories to current liabilities;

LEVER : ratio of client's total long-term debt to the total Assets.

ROA : ratio of the audit client's net income to total assets.

NAS : a dummy variable, taking the value of one if the audit firm provides non-audit services to the audit client, and zero otherwise.

BIG4 : a dummy variable taking the value of one if the audit firm is EY, PWC, KPMG, or Deloitte.

TENURE: the number of years the audit client is continuously auditing the audit client.

The dependent variable in the model is the external audit fees charged by the audit firm to perform the external audit and is measured in Kuwaiti Dinar². Consistent with previous related research (e.g., Simunic, 1980; Gist, 1992; Craswell and Francis, 1999; Felix *et al.*, 2001; Whisenant *et al.*, 2003; McMeeking *et al.*, 2007; Zain *et al.*, 2015) the natural log of external audit fees is used as a measure of the dependent variable.

Control variables:

Research examining the external audit fees has typically included a set of control variables representing factors believed to have an impact on the amount of external audit fees. In general, these variables include the size of the audit client, the complexity of the audit client's activities and operations, and the amount of risk associated with the audit client. Audit client size is typically measured using the client's total assets. It is intuitive to expect that when the audit client is a large firm it would need more audit work to be performed and hence will be charged higher amounts of external fees. Such a positive relationship between audit fees and audit client size is documented in much of

the existing related empirical research (e.g., Simunic, 1980; Chan *et al.*, 1993; Craswell and Francis, 1999; DeFond *et al.*, 2000; Gonthier-Besacier and Schatt, 2007; Goodwin-Stewart and Kent, 2006; Hay *et al.*, 2008; Zain *et al.*, 2015). Due to the economies-of-scale effects, however, the relationship between audit fees and audit client size is expected to be non-linear (Gerrard *et al.*, 1994). Hence, the natural log of the audit client's total assets (SIZE) is used in the current study as a measure of audit client size.

As indicated, client complexity is also expected to be influential in determining the amount of external audit fees. That is true because more complex activities and operations would need more audit work to be performed, and consequently more fees to be charged. Much of prior audit fees research (e.g., Francis and Stokes, 1986; Che Ahmad and Houghton, 1996; Carcello *et al.*, 2002; Hay *et al.*, 2008; Zain *et al.*, 2015) report evidence of such a positive relationship between audit fees and audit client's complexity. Consistent with some prior related studies (e.g., Gist, 1992; Davis *et al.*, 1993; Chan *et al.*, 1993), the current study uses the natural log of the number of locations visited by the audit team (LOCAT) as a measure of the complexity of the audit client.

Prior audit fees research (Simunic, 1980; Chan *et al.*, 1993; Firth, 2002; Whisenant *et al.*, 2003) suggests that the amount of external audit fees is significantly influenced by the riskiness of the audited firm. Previous studies have used a number of measures of the riskiness of the audit client. Yet, audit client profitability, liquidity, and debt ratio have been among the most commonly used proxies of audit client risk. Accordingly, the current study uses three measures of audit client risk; the client's return on assets (ROA), client's quick ratio (QUICK), and client's financial leverage ratio (LEVER).

² At the time of the study, the exchange rate was: 1 Kuwaiti Dinar = 3.3 US Dollars.

While the relationship between audit fees and both client's profitability and liquidity is expected to be negative, it is expected to be positive with client's financial leverage³.

Test variable

As indicated, the current study is interesting mainly at examining whether IA contribution in the external audit work affects the amount of external audit fees. The IA variable is added to the research model to examine this research question. Similar to prior related research (Felix *et al.*, 2001), this variable is measured as external auditor's assessment of the percentage (from 0% to 100%) of external audit work performed by the client's internal audit staff. If IA contribution is positively (negatively) related to the amount of external audit fees, we would expect this variable's regression coefficient to show a positive (negative) sign.

IV. RESULTS AND ANALYSIS

Descriptive statistics:

Panel A of Table 1 demonstrates the descriptive statistics related to the study's variables. As shown, the mean total assets of the audited firms included in the sample is KD123,698,961, ranging from as low as KD301,441 to KD772,016,000. The mean of the external audit fees for the study's sample is about KD4,854. Table 1 also shows that audited firms included in the sample has a mean quick ratio of 2.48, a financial leverage of 0.25 and a mean ROA of -0.6. Panel A of Table 1 also shows that, on average, the audit firms of the sampled firms were tenured for about 2.4 years. This table also shows that, on average, internal auditors contributed in about 28 percent of the external audit work in the sample of audit engagements. Panel B of Table

1 shows some statistics about the categorical variables included in the research model. As shown from this section of Table 1, external audit firms concurrently provided non-audit services in only 11 percent of the sample of audit engagements, while providing only audit services in about 89 percent of the audit engagements. Panel B in Table 1 also shows that 40 percent of sample of audit engagements were performed by one of the Big4 audit firms, while the rest were performed by non-Big4 audit firms.

Table 2 shows the Pearson correlations among the study's independent variables. As shown in this table, the correlations among the study's independent variables are not substantially high, with the highest correlation coefficient value less than 0.60. However, and to check for any possibility of multicollinearity among the study's independent variables, the Variance Inflation Factors (VIF) were computed, and are shown in Table 3. As the results demonstrate, the highest VIF value reported equals 2.543, which is less than the critical value of 10 (Neter *et al.*, 1983). Hence, multicollinearity does not appear to be a problem in this case.

Empirical Results:

Table 3 shows the results of the audit fees regression model of the current study. As indicated, this regression model regresses the natural log of the total amount of external audit fees (FEE) on a measure of IA contribution in the external audit work (IA), in addition to proxies for client's size (SIZE), client's complexity (LOCATE), client liquidity (QUICK), client's financial leverage (LEVER), client's profitability (ROA), concurrent provision of non-audit services (NAS), external auditor's type (BIG4), and audit firm's tenure in years (TENURE). As Table 3 shows, the model is significant with F-statistic of 3.244 (p-value < .000), and R-square of about 0.54.

³ Some related studies, however, produced mixed results and conclusions about the relationship between audit fees and client's liquidity and profitability ratios.

Table 1. Descriptive statistics

A s

| <i>Panel A. Continuous Variables:</i> | N | Minimum | Maximum | Mean | S. D. |
|---------------------------------------|----|---------|-------------|-------------|-------------|
| Total Audit Fees (KD) | 35 | 1,000 | 20,000.00 | 4,854.29 | 4,601.05 |
| IA | 35 | 0.00 | 100.00 | 28.14 | 33.74 |
| Total assets (KD) | 35 | 301,441 | 772,016,000 | 123,698,961 | 198,894,416 |
| LOCAT | 35 | 1.00 | 3.00 | 1.11 | 0.40 |
| QUICK | 35 | 0.19 | 11.42 | 2.48 | 2.26 |
| LEVER | 35 | 0.00 | 0.83 | 0.25 | 0.26 |
| ROA | 35 | (26.41) | 0.77 | (0.60) | 4.49 |
| TENURE | 35 | 1.00 | 3.00 | 2.40 | 0.85 |

| <i>Panel B. Categorical Variables:</i> | Value | Frequency | % |
|--|-------|-----------|------|
| NAS | 0 | 31 | 88.6 |
| | 1 | 4 | 11.4 |
| CPA | 0 | 21 | 60 |
| | 1 | 14 | 40 |

Table 2: Pearson Correlations

| | IA | SIZE | LOCAT | QUICK | LEVER | ROA | NAS | CPA | TENURE |
|--------|----|--------|-------|--------|--------|--------|--------|--------|--------|
| IA | 1 | (0.06) | 0.09 | 0.14 | 0.19 | -0.117 | 0.02 | -0.007 | .351* |
| SIZE | | 1.00 | 0.25 | (0.08) | 0.06 | .394* | 0.259 | .526** | .392* |
| LOCAT | | | 1.00 | (0.04) | (0.10) | 0.051 | 0.154 | 0.195 | 0.214 |
| QUICK | | | | 1.00 | 0.09 | 0.145 | -0.055 | -0.073 | -0.168 |
| LEVER | | | | | 1.00 | -0.217 | 0.053 | .505** | .377* |
| ROA | | | | | | 1 | 0.063 | 0.135 | 0.075 |
| NAS | | | | | | | 1 | 0.073 | 0.043 |
| CPA | | | | | | | | 1 | .587** |
| TENURE | | | | | | | | | 1 |

* Correlation is significant at the 0.05 level (2-tailed)

** Correlation is significant at the 0.01 level (2-tailed)

shown in Table 3, the regression coefficient of the IA variable is statistically significant ($p\text{-value} < .057$), and has the expected negative sign. This result provides support to the research hypothesis that IA contribution in the external audit work would be associated with a reduction in the amount of external audit fees.

As for the other independent variables, except for the SIZE variable, the coefficients of the control variables included in the research model are statistically insignificant. In particular, the regression results show that the coefficient of the SIZE variable is statistically significant ($p\text{-value} < .006$) and has the predicted positive

Table 3. Regression Results

| FEE = $b_0 + b_1 \text{IA} + b_2 \text{SIZE} + b_3 \text{LOCAT} + b_4 \text{QUICK} + b_5 \text{LEVER} + b_6 \text{ROA} + b_7 \text{NAS} + b_8 \text{BIG4} + b_9 \text{TENURE}$ | | | | | |
|--|----------------|-----------------------|---------------------|-----------------|-------|
| Variable | Predicted Sign | Estimated Coefficient | <i>t</i> -statistic | <i>p</i> -value | VIF |
| Intercept | | 4.001 | 3.252 | 0.003 | |
| IA | - | -0.007 | -1.997 | 0.057* | 1.383 |
| SIZE | + | 0.22 | 2.985 | 0.006*** | 1.878 |
| LOCAT | + | 0.408 | 0.865 | 0.396 | 1.184 |
| QUICK | - | 0.037 | 0.728 | 0.473 | 1.188 |
| LEVER | + | 0.376 | 0.685 | 0.499 | 1.83 |
| ROA | - | -0.028 | -1.009 | 0.323 | 1.382 |
| NAS | ? | 0.507 | 1.473 | 0.153 | 1.118 |
| BIG4 | + | -0.135 | -0.402 | 0.691 | 2.543 |
| TENURE | - | 0.156 | 0.863 | 0.396 | 2.123 |

Regression summary statistics:

$n = 35$

R-square = .539

F-statistics = 3.244

***, **, * *p*-value of statistical significance at the 0.01, 0.05, and 0.10 levels, respectively.

Note:

FEE : the natural log of total audit fees;

IA : External auditor's assessment of the percentage of external audit work performed by the audit client's internal audit staff.

SIZE : the natural log of the audit client's total assets;

LOCAT : the natural log of the number of audit locations visited by the audit team;

QUICK : the audit client's current assets minus inventories to current liabilities;

LEVER : ratio of client's total long-term debt to the total Assets.

ROA : ratio of the audit client's net income to total assets.

NAS : a dummy variable, taking the value of one if the audit firm provides non-audit services to the audit client, and zero otherwise.

BIG4 : a dummy variable taking the value of one if the audit firm is EY, PWC, KPMG, or Deloitte.

TENURE : the number of years the audit client is continuously auditing the audit client.

sign. Such a result is consistent with findings of prior related empirical studies (e.g., Simunic, 1980; Chan *et al.*, 1993) suggesting that external audit fees increase as the size of the audit client increases. Contrary to expectation, however, the regression results indicate that the regression coefficient of the other control variables are insignificant. The insignificant results related to these control variables is similar to results reported in prior related research. For example, the lack of significance related to the ROA and QUICK variables can be explained in light of the opposing arguments that corporate financial characteristics such as profitability and liquidity can be viewed both as proxies of firm's risk and firm's ability to pay higher amounts of audit fees at the same time. While the risk manifestation suggests a negative relation to external audit fees, the "deep pocket" representation suggests a positive relation to audit fees.

In sum, the results reported in the current study provide empirical evidence from the Kuwaiti audit market that IA involvement in the external audit fees is associated with a reduction in external audit fees. This result is similar to findings reported in several similar studies (e.g., Felix *et al.*, 2001; Ho and Hutchinson, 2010; Zain *et al.*, 2015) and is consistent with the idea of IA as a substitute for external audits.

IV. SUMMARY AND CONCLUSION

As indicated, the main objective of the current study is to examine whether IA contribution in the external audit work is significantly related to the amount of external audit fees. Competing arguments have been offered in the audit literature about the direction of such a relation. On the one side, some audit researchers argue that IA should be looked at as a complementary function that add to the overall corporate

monitoring and control activities, suggesting a direct relationship between IA contribution to the external audit work and the amount of external audit fees. On the other hand, other audit researcher view IA contribution as a substitute to the external audit function, and therefore, expect this type of engagement to be inversely related to the amount of external audit fees. Empirical research examining the relationship between IA contribution and audit fees has produced mixed results, leaving the door open for further examination about this issue. Moreover, much of the previous empirical research examining the IA-fee relationship stems from well developed countries, with very little research examining this issue in the context of a developing country.

Using data related to a number of audit engagements performed in the Kuwaiti market, the current study performs an examination of the relationship between IA contribution to the external audit work and the amount of audit fees. This research seems to be warranted especially in light of the obvious shortage of empirical research about this issue in the context of developing countries' markets. This study, therefore, fills the gap in the international audit literature by providing empirical evidence about the IA-fees relationship from the Middle East region, namely the Kuwaiti market. The results reported in the current study provide evidence of a significant and negative relationship between IA contribution in the external audit work and the amount of external audit fees.

The current study's empirical findings have some policy implications. For example, the empirical evidence that IA contribution does substitute for some substantial audit procedures may be insightful for audit profession regulators, especially in Kuwait when establishing guidance for the relationship

between external audit teams and audit clients' IA functions. In particular, rule-making bodies can take the findings offered in this study into account when regulating the type and extent of external auditors' utilization of clients' IA staff for a better supervision of the coordination and interaction between external audit and IA teams. The empirical evidence provided in this study also calls for an increased regulatory attention to the role and functioning of corporate IA departments given their practical significance to the external audit profession.

The current study is subject to a number of worth noting limitations. First, the study's sample is relatively small. This was mainly due to the lack of any publically available

data about audit fees in Kuwait, which makes the data set used in the current study unique in some way. Hence, future similar empirical examination is needed to re-investigate the IA-fees relationship using a larger sample size, possibly when audit fees data become publically available in the Kuwaiti market. The use of the regression method given the low number of cases is inevitably another limitation of the current study. In addition, the empirical analysis of the current study is focused on the IA-fee relationship, with no implications made on the possible effect of this relationship on audit quality. Future research, therefore, should be carried out to investigate the impact of the IA contribution in the external audit work on audit quality.

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Meshari O. Al-Hajri earned his PhD in accounting from the University of Arkansas, US. He is an Associate Professor in the Department of Accounting at Kuwait University. His main research interests include audit markets, corporate governance and capital markets. Meshari Al-Hajri can be contacted at: meshari@cba.edu.kw