THE MARKET FOR AUDITING SERVICES AND THE VALUE OF AUDITING AND CORPORATE GOVERNANCE IN THE NOT-FOR-PROFIT SECTOR

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Preface

This study investigates the determinants of audit fees in the not-for-profit sector for large registered charities in Australia from a sample of four years since this data began to be reported on the Australian Charities and Not-for-Profits Commission website in 2014. In addition, this report examines the role that internal audits and the establishment of audit committees, as corporate governance mechanisms, has on not-for-profit organisational performance plus the association that executive remuneration in the sector has with organisational performance. This report compliments charity register data available at the ACNC and on data.gov.au websites.

Key Points from the Research

- We provide descriptive data on audit pricing for audit services in the not-for-profit sector in Australia. Our sample comprises large registered charities registered with the Australian Charities and Not-for-Profits Commission (ACNC) from 2014-2018.
- To formally examine the impact that auditing services has on not-for-profit sector performance, we develop and test several models based on the prior research of Vermeer et al. (2009).
- From our audit fee model, we find that audit remuneration is positively associated with auditee charity size, charity's liquidity risk, financial report complexity, consolidation requirements, and Big 4/top ten auditors. In addition, audit pricing in the not-for-profit sector reflects some of the unique aspects of charitable entities' activities nature which distinguishes this sector from the for-profit sector. In general, our results support the notion that auditing is an important part of governance in not only the for-profit, but also the not-for-profit (NFP) sector.

- Interestingly, we also find a small portion of auditors perform their audit services in the not-for-profit sector in an honorary capacity, and either receive zero audit fees or donate their remuneration back to the charity.
- We find that NFPs that conduct internal audits and have established audit committees perform better when comparing their expenses to revenues and, in particular, employee expenses to revenues. These results support the view that auditing services positively contribute to a well-functioning NFP entity. We also find that executive remuneration is not related to organisational performance, as measured through cost effectiveness.

Acknowledgements

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Executive Summary

About the Report

This report provides insights into determinants of audit fees in the not-for-profit sector in Australia by examining large registered charities with the Australian Charities and Not for Profits Commission (ACNC) from a four year sample of reporting periods between 2014-2018. This report also examines the role of auditing, as a corporate governance mechanism, to improving NFP sector performance. It also examines whether executive remuneration in the sector is related to performance.

Key Findings

Our empirical evidence shows that, consistent with the for-profit sector, the size of the entity has a significant effect on audit fees. However, we also find several differences due to the unique aspects in the not-for-profit sector, such as the charity's nature, financial needs and positions, accounting rules, and the auditing environment. Furthermore, charity complexity, including a charity's liquidity risk, ratio of donors' contribution, regulatory requirements on preparing financial reports and state submissions, charity consolidated structure, and a selected range of more complicated activities operated by charities, may affect auditors' concerns on screening a charity's short-term financial health, and detecting potential audit risks, and thus affecting audit fees. We find that some of these factors do affect audit fees.

This report also provides additional empirical evidence that in the not-for-profit sector Big 4 and/or top ten audit firms are more likely to charge a premium for the provision of audit services. However, overall audit fees in the not-for-profit sector seem to be lower than in the for-profit sector. This appears to be due to a couple of reasons. First, in this sector we find a small proportion of audits where the auditors have acted in a charitable way themselves by receiving zero fees or effectively zero fees by donating the audit remuneration back to the charity. Second, we find that auditors charge less fees when the not-for-profit is involved in philanthropy or where there is a higher ratio of donations received, also indicating that the auditor is acting in a charitable way.

We also find evidence indicating that NFPs that (i) proactively conduct their own internal audits and (ii) who have established audit committees perform better than other NFPs who do not utilize this corporate governance mechanism. Specifically, we find NFPs that utilize the above two tools have lower total costs to revenues and also lower employee expenses to revenues., This signals the role that auditing tools play in improving the operational efficiency of an NFP.

Conclusions

This research provides initial evidence on audit pricing in the not-for-profit sector in Australia and the role that internal auditing, as a corporate governance mechanism, plays in driving NFP performance. The latter point provides a policy platform to encourage NFPs to consider establishing audit committees that can facilitate internal audits. NFPs that already have this embedded into their organisation can significantly reduce their operational costs relative to revenues.

Background

The not-for-profit sector in Australia is a large and significant part of the economy. According to the Australian Charities and Not for Profits Commission (ACNC), there are 72,769 registered charities in 2018[1] (ACNC Australian Charities Report 2017). The Australian not-for-profit sector contributes of approximately $146 billion to the economy which accounts for 8.5 percent of Australia's GDP in 2018 (Australian Bureau of Statistics, ABS 2018 – 2019). The sector also employs about 1.3 million people which is about 9.3 percent of overall employment in Australia (ABS Employment Statistics 2018-2019) and engages more than 3.4 million Australians volunteers. According to the Auditing and Assurance Standard Board (AASB, 2011, para.6), the growth in the not-for-profit sector has increased external parties' demand for trust and accountability in the not-for-profit sector, and transparency and accuracy in accounting and financial reporting. [2]

To respond to a growing public interest in the accountability of charities, the ACNC was established in 2012 to provide guidance, education, support and take regulatory actions when necessary. This mean that registered charities with the ACNC have had to meet certain obligations and responsibilities. Specifically, all charities must meet the ACNC's five governance standards that relate to: i) not-for-profit and working towards charitable purpose, ii) accountability to members, iii) compliance with Australian laws, iv) suitability of responsible persons, and v) duties of responsible persons. They must also report to the ACNC their financial performance and annual information statements in a true and fair manner. Furthermore, medium sized charities are required to have their financial statements either reviewed or audited while large charities' financial reports must be audited.[3]

The increase in the size of this sector and the enhanced reporting requirements have increased the demand for accountability in the not-for-profit sector. Auditing is an important part of ensuring accountability so therefore examining audit services and auditing pricing in this sector is a topic that warrants research. Simunic (1980) introduced the first model on audit

[1] This data is initially found on data.gov.au (ACNC Registered Charities, updated 16 December 2019).
[2] External parties involve regulators, government agents, donors, and beneficiaries and community.
[3] In this report we use both the terms 'not-for-profit' and 'charities' interchangeably. However, we place more focus on the 'not-for-profit' term because a number of the organizations particularly in the health and education sector have significant commercial operations and most people would not consider them to be 'charities' in the accepted definition of the term. However, it should be noted that all entities in the study are registered with the ACNC and are therefore 'charities' according to the Charity Act 2013 (Cth).

pricing in the private sector and since that time there has been extensive research on audit pricing in for-profit corporations (Palmrose, 1986; Chung and Lindsay, 1988; Ezzamel et al., 1996; Firth, 1997; Hay et al., 2006; Choi et al., 2008). The extensive research on this topic has found how certain drivers such as client size, client risk, and client complexity are associated with variations in audit fees and, also that there is consistently a premium paid for Big 4 audits. The variations in this literature show that auditing is an important part of corporate governance as it appropriately varies based on these drivers. This literature also shows that firms' choice of audit quality varies in an expected way based on several agency variables. In contrast, our understanding on audit pricing in the public sector, especially for charities, has been limited to a few studies. Beattie et al. (2001) provided first empirical findings on audit pricing where it is a voluntary choice for United Kingdom charities. Vermeer et al. (2009) and Kitching (2009) further investigate this topic using evidence from United States non-profit organisations.

In Australia, the existing literature on audit fees has predominantly focused on for-profit organisations and there has been a large amount of research performed on this topic (Francis, 1984; Francis and Stokes, 1986; Craswell, 1992; Wong, 2009). This is in part because Australia for a number of years was in a relatively unique position of being a jurisdiction that required disclosure of audit fees in the financial statements. However, in contrast there has been a paucity of research on this topic for the not-for-profit sector. This has been in part due to the lack of availability and difficulty in collecting this data. Charities and not-for-profit organisations possess unique characteristics in relation to their charitable culture, organisational structure, financial resources/positions/needs, accounting and financial reporting, type of financial statement users, and auditing environment (Tate, 2007). Therefore, by examining audit fees in this sector we can learn more about the value of the audit function and the importance of governance in this sector.

Research Design

Literature and Methodology

The literature on audit pricing in the private sector suggests that specific characteristics of auditee firms, including firm size (Simunic, 1980; Palmrose, 1986; Firth, 1997; Hay et al., 2006), financial performance (Ezzamel et al., 1996; Hay et al., 2006; Choi et al., 2008), firm financial and litigation risk (Simunic and Stein, 1996; Cobbin, 2002; Hay et al., 2006) , audit client complexity (Chan et al., 1993; O'Sullivan, 2000), have been shown to increase audit fees. This shows that these factors affect the risk of the audit and potentially result in increased audit work. In addition, prior literature shows a positive association between larger audit firms (such as Big 4 accounting firms) and higher audit fees (Palmrose, 1986; Turpen, 1990; Pong and Whittington, 1994; Ezzamel et al., 1996) of about 20 percent which implies a higher level of quality (Francis 2004). Evidence on this is also found from studies that have examined firms that are expected to require higher levels of monitoring due to higher agency costs choosing Big 4 auditors (Francis and Wilson, 1988; Francis et al. 1999).

Motivated by the initial audit pricing model on for-profit firms (Simunic, 1980), Beattie et al. (2001) develop and estimate a charity audit pricing model to capture unique characteristics of charities and the auditing environment in the not-for-profit sector in the United Kingdom. Their charity audit fee model is a function of audit fees and auditee size, auditee complexity, audit production costs, non-audit services and audit difficulties (Beattie et al., 2001). They make several contributions from their research. First, from their audit fee model they find that consistent with the for-profit sector, size, organisational complexity, and audit firm location are major determinants of the audit fee. Also, they find that the charity audit fee rate is significantly lower than the for-profit sector (approximately half).

Building on Beattie et al. (2001), Vermeer et al. (2009) include some additional variables in their model such as the need for resources, audit committee characteristics, and presence of internal auditing. Vermeer et al. (2009) use resource dependency theory (Pfeffer and Gerald, 1978) to distinguish differences in audit fees in the charities sector from the private sector and to develop the audit pricing model for charities in the United States.[4] Resource dependency

[4] This is because the traditional agency cost variables used in for-profit audit pricing studies (Hay et al. 2006) do not work in the not-for-profit sector

theory is similar but broader than agency theory and suggests that an organisations need for resources is a determinant of its decisions and actions. The source of charities' resources differs to the private sector and include donor contributions and government grants. These external parties often have different information needs and require additional audit monitoring which is associated with potential differences in additional demands on auditor monitoring and audit risk. Vermeer et al. (2009) find that auditee size, complexity, liquidity, and resource dependency are associated with audit fees. Consistent with prior research, a Big 4 premium is also observed.

Following from these prior studies, we investigate determinants of audit fees in the not-for-profit sector in Australia by modelling a regression function of audit fees on charity size, charity leverage risk, the composition of financial resources, charity nature of main activities, special financial reporting/ regulatory reporting requests, and type of auditor. This provides a contribution to prior research because the model in the Beattie et al. (2001) study includes less variables and was conducted almost twenty years ago in the UK. The Vermeer et al. (2009) study is limited to a subsample of firms because audit fee data was not disclosed at that time in the United States.

Our empirical charity audit pricing model is as follows:

$$Audit\ Fees = f\ (Charity\ Size, Charity\ Complexity, \\ Charity\ Main\ Activities, Auditor\ Premium)$$

We present both audit fees in dollar values (Audit fees) and the natural logarithm of audit fees (*Ln (Audit fees)*) to diminish potential nonlinear problems over time. We use three proxies to measure charity size, including the natural logarithm of total assets (*Ln (Total Assets)*), the natural logarithm of total revenues (*Ln (Total Revenues)*), and the natural logarithm of total expenses (*Ln (Total Expenses)*).

To capture charity complexity, we first obtain a charity's ratio of current and non-current liabilities over total liabilities (*Ratio of Non-Current Liabilities and Ratio of Current Liabilities*). In addition, we argue that a charity, which must report to specific external parties or regulatory agents, is required to have additional auditor monitoring which can increase the audit risk of the engagement. We proxy this potential complexity by identifying whether a charity is required to generate a special purpose financial report (*Special Financial Report*), and whether a charity must have their financial report submitted to the state government (*State*

Submission). Furthermore, we observe whether a charity is a consolidated entity (*Consolidation*) which is likely to increase auditee complexity in financial reporting and audit monitoring risk (Beattie et al., 2001).We also examine potential differences in the composition of a not-for-profit's need for financial resources by examining contributions of various income sources from government contributions and grants (*Ratio of Government Grants*), a charity's incomes from trading goods and services (*Ratio of Trading Income*), and donors' donations (*Ratio of Donations*).

Vermeer et al. (2009) suggest that hospitals and educational sectors are subject to greater governmental regulation and a variety of procedural and complicated checks. We therefore propose that the health sector (*Health*), and the educational and research sector (*Education*), are likely to be associated with higher audit complexity, and thus increased audit fees. We also argue that the charity's primary involvement in international activities (*International*) is likely to require potential regulated requirements and increase audit complexity.

Beattie et al. (2001) find that audit fees are lower in the not-for-profit compared to for-profit sector, indicating a charitable approach by auditors in this sector. Based on this finding, we argue that charities whose main activities are closely related to philanthropy (*Philanthropy*), are more likely to receive a fee discount from auditors and therefore we expect that there are lower audit fees for this group. The discount may be due to the social connections between the audit partners and the trustees/CEO of the charity.

Finally, we include a variable for auditor size as this has consistently been found to be associated with a significant audit fee premium in prior research (see Francis, 2004; Hay et al., 2006) by determining whether a charity has a financial report audited by the top ten audit firms (the big-four firms and other six firms KPMG, PwC, Ernst & Young, Deloitte, *Crowe Horwath, Grant Thornton, RSM Australia, Moore Stephens, Pitcher Partner, BDO*). We winsorize all variables at one percent to eliminate outliers in the sample.

Data Collection

Our sample involves all Australian registered large charities available from the ACNC for the years 2014 - 2018. We obtained the list of registered charities each year from the ACNC website. We then exclude charities with invalid or missing size information, and small and medium charities (as defined by the ACNC) from our sample due many of the financial reports containing missing information. It leaves our sample of 30,612 observations of charity-year over the four year period. In the next step, we collect data on charity annual accounting and financial performance (i.e., total assets, total revenues, total expenses, liabilities, and income resources), and other charity information (i.e, types of financial reports, state submission requirements, consolidation requirements, type of charity main activities) from the annual information statements (AIS) datasets published in the data.gov.au website. However, at the time of data collection the charity AIS for 2018 had not been published yet in this database, so we wrote a coding program and extracted 2018 financial data from each AIS which each charity submitted to the ACNC in 2018. By doing it this way, we obtained the 2018 AIS data for all charities before the ACNC releases its 2018 AIS data file in the data.gov.au website. We exclude observations with missing and incomplete financial information in the AIS over the four years. Our sample of charity annual financial information includes 30,139 valid observations from the four years of data collected (see details of how observations are excluded and the remaining sample in each of the four years in Appendix 1).

To obtain data on audit fees from our sample of charities, we first read through each of the charity's financial reports in the four years we sampled to sort out whether a charity voluntarily presents the information on audit pricing and audit firms in the financial report. We next designed and wrote programing codes to automatically collect data on i) audit pricing, and ii) to record whether a charity hired one of Big 4 audit firms (i.e., KPMG, PwC, Deloitte, Ernst and Young), or a top ten auditing firm (i.e, Big 4 and Crowe Horwath, Grant Thornton, RSM Australia, Moore Stephens, Pitcher Partner, BDO). We then present raw data on the dollar value of audit fees and generate a dummy variable which takes the value of one if a charity used a premium auditor (ie top 10 audit firms), and zero otherwise. We exclude charity-year observations with incomplete, invalid or missing information on audit pricing and audit firms. This exclusion leaves a final sample of 8,005 observations (see Appendix 1).

Analysis

Figure 1 shows a summary of main types of activities for the large registered charities in our sample. Charities' operating activities are categorised into eleven groups including: Education and Research; Health; Development and Housing; Social Services; Religion; Culture and Recreation; Philanthropic; Law, Advocacy and Politics; Environment; International Activities, and Other. The Education and Research sector and the Health sectors comprise the majority of the large not-for-profits in our sample, with 25 percent and 23 percent of the total respectively. The next largest groups relate to Development and Housing activities and Social Services, with each of these groups comprising 14 percent of our sample. Religion and Culture and Recreation both comprise about 5 percent each and Philanthropic is about 4 percent.

Figure 2 provides insight into the contribution in percentage of the most common general activities of not-for-profits in our total sample, which is more detailed than the overall main activities reported. According to the ACNC annual report, each main activity category may contain several general activities. For example, the Education and Research sector involves four general education-related activities, including primary and secondary education, higher education, research, and other education. The Health sector includes hospital services and rehabilitation, mental health and crisis intervention, aged care activities, and other health service delivery. The Social Services group consists of social services, income support and maintenance, and emergency and relief. The Philanthropy sector comprises grant-making and other philanthropic activities. The Environment sector involves animal protection and environmental activities.

In looking at the most common general activities, social services contribute the most with about 12.5 percent over the total general activities in the not-for-profit sector. Other educational activities and aged care activities account for 11.6 percent and 10.4 percent, respectively. Other major contributions belong to other health service delivery (9.4 percent) and primary and secondary education (7.3 percent).

Figure 1: Main Activities

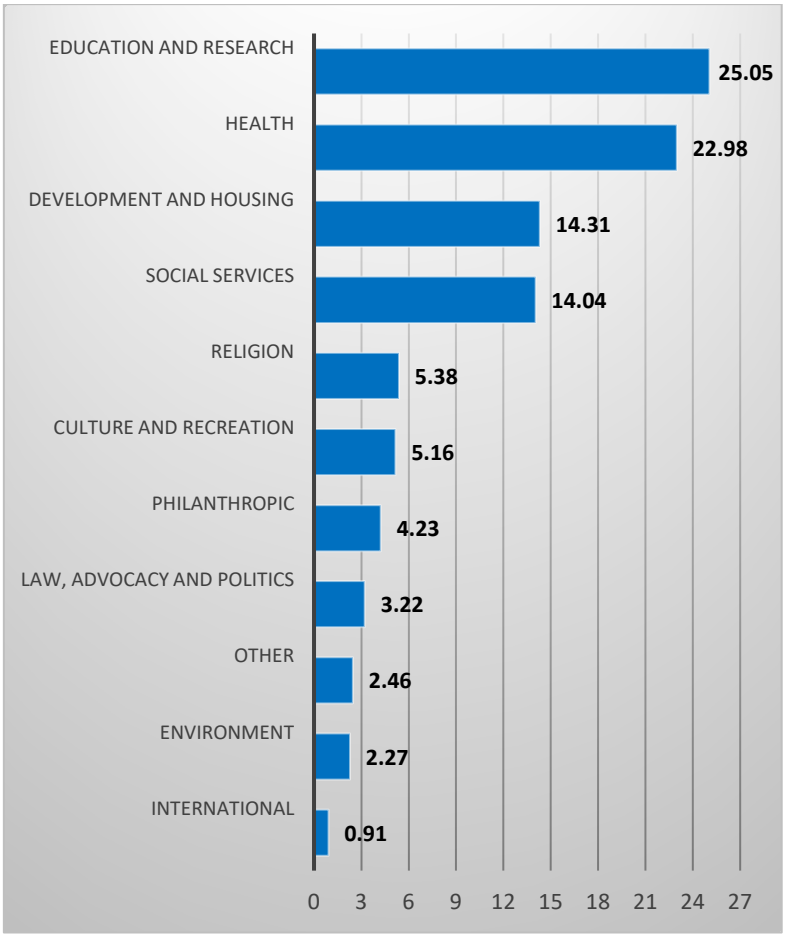


Figure 2: Most common general activities for not-for-profits in each main activity type

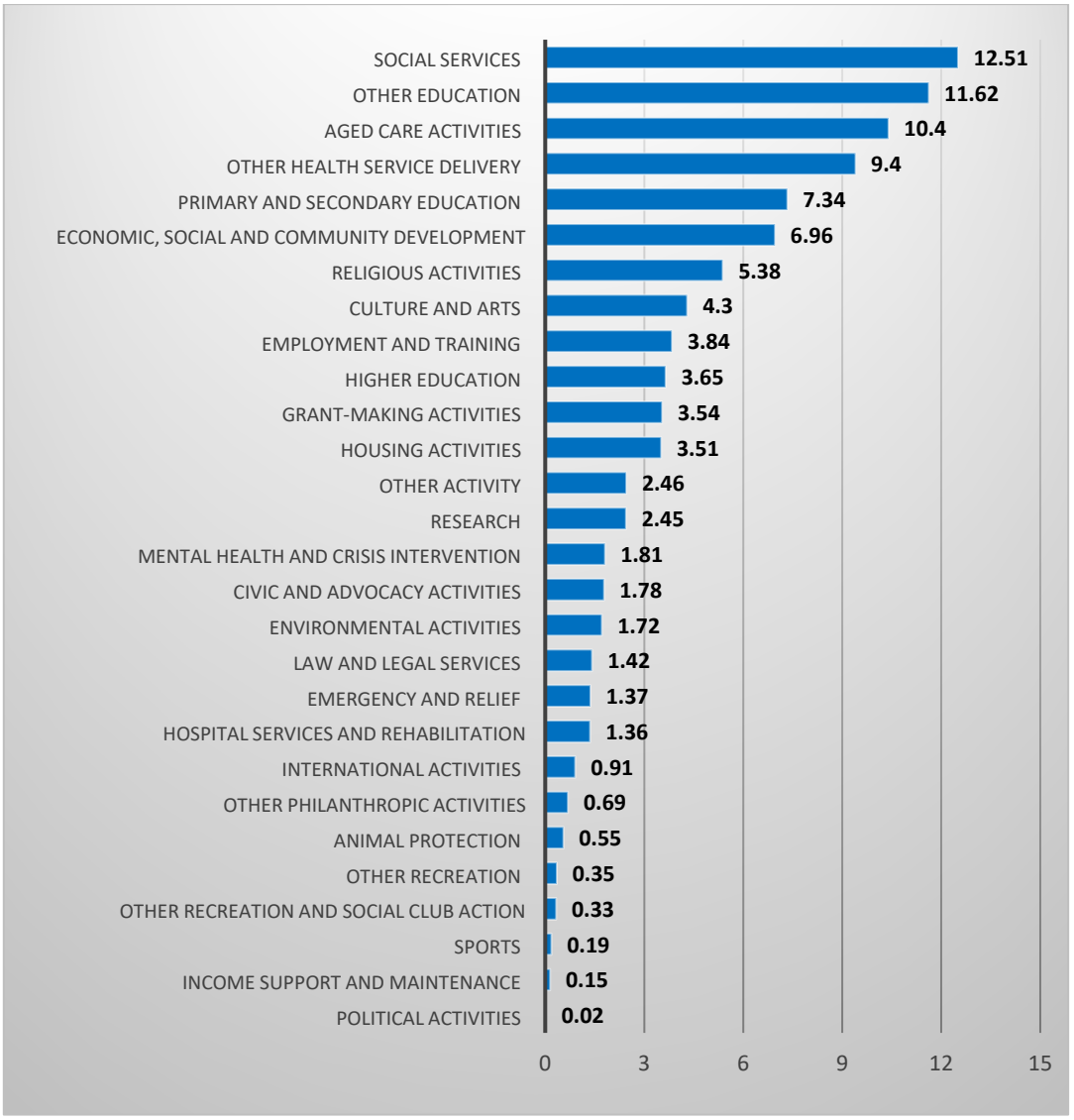


Table 1 presents the descriptive statistics of the main variables in our not-for-profit audit fee model. The mean of audit fees in our sample is around $20,500, and that is significantly less than the mean for corporate audit fees cited in various papers (see Francis, 1984; Francis and Stokes, 1986; Beattie et al., 2001; Hay et al., 2006). The maximum audit price for the sample of charities is $706,504, a minimum of zero, and a median audit price of $10,150. To minimize the impact of potential outliers and non-linear biases, we winsorize all variables and take the natural logarithms, where appropriate. The average of charities' total assets in our sample is approximately $5.34 million. Large charities in our sample contribute, on average, about $4.57 million of revenue per year with total expenses of approximately $4 million. The average non-current and current liabilities account for about 10.6 percent and 30.5 percent, respectively. The majority of financial income supporting charities in our sample comes from government grants and contributions which account for 42.2 percent of total revenue. On average, trading income from charities' activities of providing goods and services contribute about 30.6 percent. Donors' contributions account for about 12 percent of charities' income. An average of 37.3 percent of charities in our sample provide special purpose financial reports and have their financial statements submitted to a state government. Table 1 also shows that 26.6 percent of the large registered charities in our sample operate in the educational and research sector, 22 percent of charities primarily have health-related activities, a small portion of 4.5 percent of charities provide grant-making and other philanthropic activities, and around 1 percent of sample charities run mainly international activities.

In addition, Table 1 shows that on average, 14.4 percent of the large registered charities in our sample have their financial reports audited by a Big 4 audit firm and a further 13 percent use top ten firms. In a closer view, the share of KPMG in our whole sample of auditor choice, on average, is around 5.4 percent which the highest among the Big 4, while the lowest share is for a top ten firm with about 1 percent for Moore Stephens. These findings are consistent with prior evidence by Beattie et al. (2001) and Vermeer et al. (2009) that suggests not-for-profits more often choose smaller audit firms than for-profit organisations and corporate firms. This difference is certainly also significant in Australia where 37.7 percent of listed companies are audited by the Big 4 and they have 90 percent of the largest 200 companies (Carson, 2019).

Table 1: Summary and Descriptive Statistics

Variables	Mean	Median	Standard Deviation	Min	Max	Skewness	Kurtosis
AUDIT FEES							
Audit Fees	20,577	10,150	43,065	0.000	706,504	7.253	74.321
Ln (Audit Fees)	9.221	9.225	1.104	6.397	12.350	0.063	3.506
AUDITEE SIZE							
Ln (Total Assets)	15.490	15.356	1.736	0.693	20.442	0.061	5.549
Ln (Total Revenues)	15.335	15.063	1.213	13.816	19.572	1.083	4.039
Ln (Total Expenses)	15.204	14.960	1.322	9.015	19.582	0.474	4.977
AUDITEE COMPLEXITY							
Ratio of Non-Current Liabilities	0.106	0.012	2.359	0.000	154.466	65.155	4263.247
Ratio of Current Liabilities	0.305	0.212	1.076	0.000	67.412	56.727	3522.943
Ratio of Government Grants	0.422	0.424	0.373	0.000	1.000	0.138	1.417
Ratio of Trading Income	0.306	0.159	0.344	0.000	1.000	0.867	2.301
Ratio of Donations	0.120	0.002	0.264	0.000	1.000	2.310	6.984
Special Financial Report	0.373	0.000	0.484	0.000	1.000	0.523	1.274
State Submission	0.367	0.000	0.482	0.000	1.000	0.551	1.304
Consolidation	0.077	0.000	0.267	0.000	1.000	3.168	11.035
MAIN ACTIVITIES							
Education	0.266	0.000	0.442	0.000	1.000	1.062	2.127
Health	0.220	0.000	0.414	0.000	1.000	1.352	2.828
Philanthropy	0.045	0.000	0.208	0.000	1.000	4.370	20.099
International	0.010	0.000	0.097	0.000	1.000	10.094	102.888

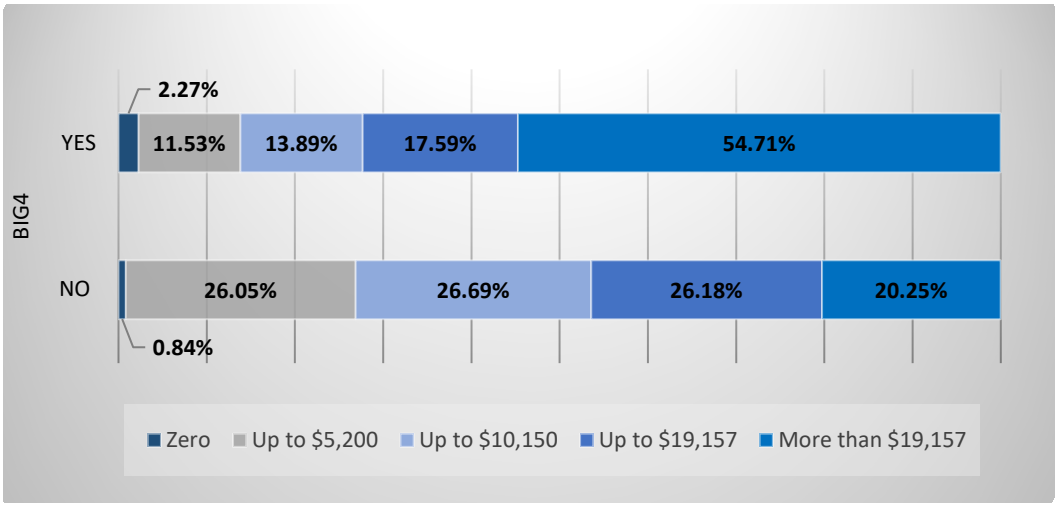
Table 1: Summary and Descriptive Statistics (cont.)

AUDITOR CHOICE							
Big 4	0.144	0.000	0.351	0.000	1.000	2.031	5.126
Top10	0.274	0.000	0.446	0.000	1.000	1.014	2.028
KPMG	0.054	0.000	0.225	0.000	1.000	3.959	16.671
PwC	0.037	0.000	0.188	0.000	1.000	4.925	25.253
Deloitte	0.037	0.000	0.188	0.000	1.000	4.925	25.253
Ernst & Young	0.036	0.000	0.186	0.000	1.000	4.996	25.959
Crowe Horwath	0.034	0.000	0.181	0.000	1.000	5.166	27.690
Grant Thornton	0.034	0.000	0.181	0.000	1.000	5.147	27.487
RSM Australia	0.016	0.000	0.125	0.000	1.000	7.762	61.251
Moore Stephens	0.009	0.000	0.094	0.000	1.000	10.496	111.167
Pitcher Partner	0.015	0.000	0.123	0.000	1.000	7.885	63.167
BDO	0.035	0.000	0.184	0.000	1.000	5.051	26.513

Figure 3 and Figure 4 demonstrate the share of audit fees by different categories of auditors. Specifically, we first sort audit fees into five groups: zero; greater than zero up to $5,200; greater than $5,200 up to $10,150; more than $10,150 up to $19,157; and more than $19,157.[5] In the next step, we calculate and compare the percentage share of each of these audit pricing groups within charities which hire a premium auditor to charities which do not.

Figure 3 presents the results when sorting audit fee groups between charities employing a Big 4 audit firm (KPMG, PwC, Deloitte, and Ernst and Young) and those hiring a non-Big 4 auditor. We observe Big 4 audit firms are more likely to act in an honorary capacity and receive no audit remuneration for their provision of audit services than non-Big 4 audit firms. Figure 3 shows that 2.3 percent of charities employing a Big 4 audit firm receive zero audit fees while non-Big 4 auditors receiving zero fees account for approximately 0.8 percent. However, a higher proportion of Big 4 audit firms (54.7 percent) charge more than $19,157 compared to non-Big 4 audit firms (20.3 percent).

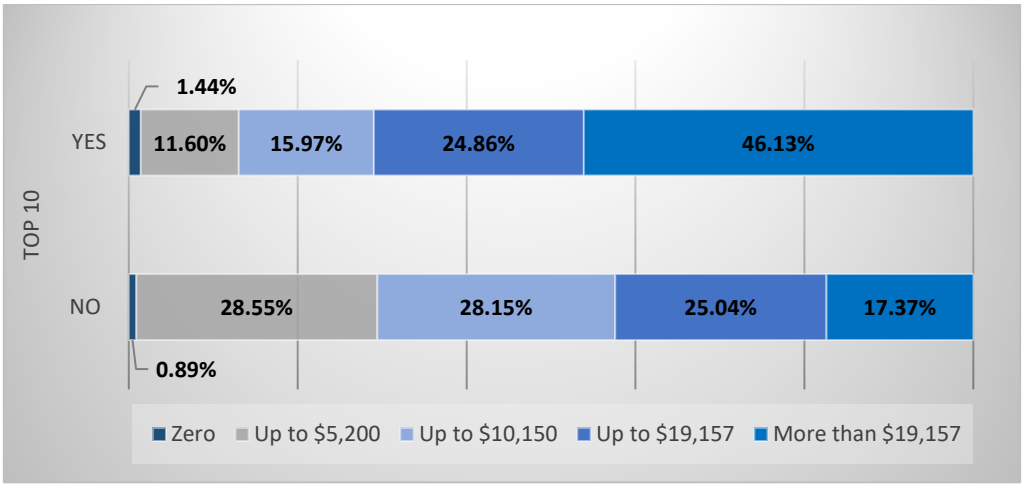
Figure 3: Audit Fees by BIG4 Audit Firms



[5] The audit fee cut-offs are sorted based on creating even groups by splitting the sample into the 25th, 50th, 75th and 100th percentiles.

In Figure 4, we obtain similar results when sorting audit fee groups between charities that employ a top ten audit firm (KPMG, PwC, Deloitte, and Ernst and Young, Crowe Horwath, Grant Thornton, RSM Australia, Moore Stephens, Pitcher Partner, and BDO) and those that hire a non-top ten audit firm. Figure 4 shows that 46.1 percent of top ten auditors charge more than $19,157 compared to 17.4 percent in this category for non-top ten auditors. In terms of other fee categories, 11.6 percent and 16 percent of top ten auditor fees vary from the range of $5200 or less, and from $10,150 or less, respectively, while the shares of these ranges in audit pricing for non-top-ten audit firms are 28.6 percent and 28.2 percent, respectively. This illustrates that the top ten auditors are on average charging higher fees for engagements, which also implies they are auditing larger clients which we explore later in this report. However, we observe a more generous behaviour in top-ten auditors than non-top ten auditors. Despite generally charging higher fees, top ten auditors do have a greater proportion of clients where they do not charge any fees (1.4 percent) compared to non-top ten audit firms (0.9 percent).

Figure 4: Audit Fees by Top 10 Audit Firms



In summary, our initial findings are consistent with prior literature on audit pricing in the private sector for for-profit organisations, suggesting that on average, Big 4 and top ten audit firms charge charities and not-for-profit entities higher fees for their audit services. We provide further analysis of this by controlling for size later in the paper.

Figure 5 illustrates the share of audit fees by sorting them by charity size from large (those charities whose total income is from 1 million to 10 million), extra-large (charities' total income from $10 million to 100 million) and extremely extra-large (charities' total income more than $100 million). The overall results not surprisingly show that audit fees are positively associated with charity size. In particular, the proportion of audit fees more than $19,157, make up the greatest propportions of 66.3 percent and 42 percent when auditing extra-large and extremely extra-large, respectively. However, fees of $19,157 or more, are less likely to occur in large charities (12.8 percent), when compared to those in extra and extremely extra-large charities (42 percent). What does seem unusual is that a lower proportion of extra-large charities pay more than $19,157 than for extra-large charities. There are also relatively more fees under $5,200 for the extremely extra-large compared to the extra-large charities.

Figure 5: Audit Fees by Charity Size

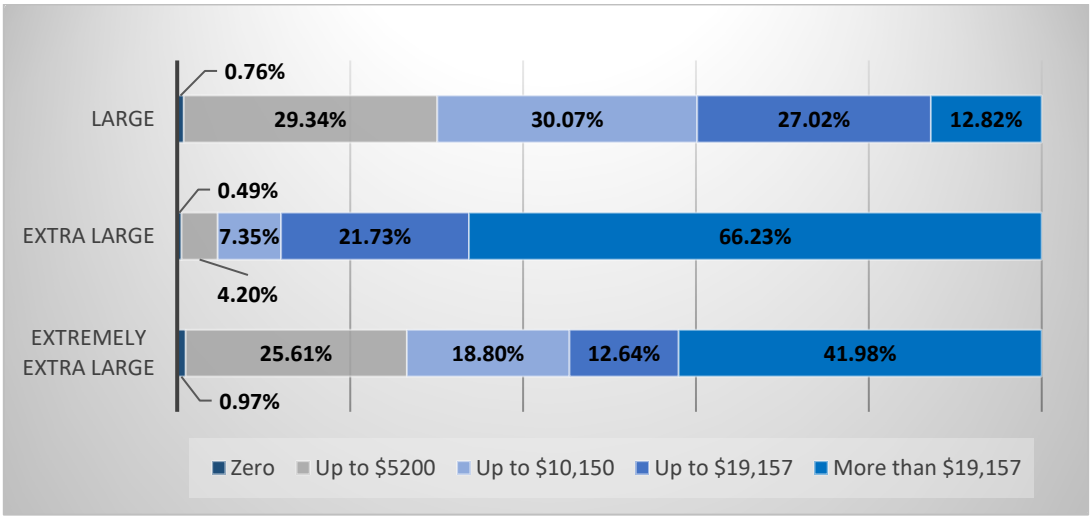


Table 2 presents univariate tests where we examine mean differences of audit fees when sorting them by: charity size (Panel A); charities liabilities (Panel B); charity sources of income (Panel C); charity selected main activities (Panel D); and auditor size (Panel E). Panel A of Table 2 shows univariate test results when we split our sample of charities based on charity size which is proxied by total assets, total revenues and total expenses. The table presents average values and mean differences in *Audit Fees* and *Ln (Audit Fees)* between charities with

high and low level of total assets, total revenues, and total expenses (split by 10th and 90th percentile of these variables for each year to examine the difference between both tails of the distribution). As expected, larger charities measured by total assets, revenues and expenses, pay a significantly higher audit fee premium than small charities.

Panel B, Table 2 presents means and difference in means of audit fees between charities with high current liabilities and those with low current liabilities (split by the 10th and 90th percentiles of ratio of charity liabilities for each year). The results show no significant mean difference audit fees by high and low current liabilities.

Furthermore, in Panel C of Table 2 we find mean differences are significantly negative when sorting audit fees in charities by a high ratio and a low ratio of government contributions. We argue that charities which rely basically on government grants and contributions, may be required to act in accordance with government regulatory compliances and rules in operating charitable activities, accounting and financial reporting. This requirement likely results in additional compliance requirements for these charities leading to the need for greater audit scrutiny, increasing audit fees. This is an important outcome to be tested empirically.

In addition, not-for-profits with higher income ratios of donations and bequests, have lower audit fees, when compared to those with lower ratios of donors' contributions (split at the 10th and 90th percentiles of the sample of donations). These types of organisations are more likely to be 'charities' in the traditional sense of the term compared to some organisations who also engage in significant 'business related' transactions. Notes in the financial report and audit remuneration data suggest that auditors who audit charitable organisation donate their audit remuneration to the charity. This amount is written down by a charity in the financial report as the charity's income from donations and bequest.

Panel D of Table 2 shows average values and mean differences in audit fees when sorting them by charity selected main activities. Specifically, we find audit fees are significantly higher (by $5,624) for charities in the educational sector compared to those in the non-educational sector. A similar conclusion is reached when comparing average values between the health-related and non-health related charities. However, Panel D, Table 2 also shows that audit fees in philanthropy-related charities, are significantly lower (by $6,793) than other organisations in the sample which may indicate a charitable approach by auditors in auditing charities with these types of activities in the not-for-profit sector.

Finally, Panel E of Table 2 shows univariate test results when we sort audit fees into two groups based on whether the charity employs a premium auditor (Big 4 and top ten audit firms). We obtain consistent and significant results that Big 4 and top ten auditors charge a higher audit fee for their services than a non-premium auditor. Specifically, audit fees for financial reports audited by a Big 4 audit firm, on average, are higher by $21,727, compared to those audited by a non-Big 4 auditor. In broadening this comparison to top ten audit firms, we find their fees are $16,444 higher than non-top ten audit firms. Overall, the findings suggest that larger and higher reputation audit firms receive an audit fee premium for auditing financial reports in the not-for-profit sector, which is consistent with research on audit fees in for-profit organisations (Francis 2004). These descriptive results are supported by our regression results in Table 3 that control for several factors and in particular, auditee size. Our conclusion is consistent with prior literature in the context of the UK voluntary sector and the US charity sector (Beattie et al., 2001; Vermeer et al., 2009).

Table 2: Univariate tests (Difference-in-mean tests where ***p<0.01, **p<0.05, *p<0.1).

Panel A: Sort by charities' size.

Sort by	**Total Assets** *(Total Assets)/ Ln (Total Assets)*					**Total Revenues** *(Total Revenues)/ Ln (Total Revenues)*					**Total Expenses** *(Total Expenses)/ Ln (Total Expenses)*				
	High		*Low*		***Difference in mean***	*High*		*Low*		***Difference in mean***	*High*		*Low*		***Difference in mean***
	Mean	*SD*	*Mean*	*SD*		*Mean*	*SD*	*Mean*	*SD*		*Mean*	*SD*	*Mean*	*SD*	
Audit Fees	55,602	59,473	14,398	21,668	41,205*** (40.00)	60,490	56,750	13,882	21,434	46,607*** (46.42)	60,882	56,583	13,802	21,294	47,080*** (47,22)
Ln (Audit Fees)	10.387	1.153	9.099	0.967	1.288*** (35.03)	10.596	1.004	9.075	0.952	1.521*** (42.62)	10.615	0.980	9.069	0.950	1.546*** (43.86)

Panel B: Sort by charity liabilities

Current Liabilities *(Ratio of Current Liabilities)*				
High		*Low*		***Difference in mean***
Mean	*SD*	*Mean*	*SD*	
17,678	25,927	18,653	31,008	-975 (-0.86)
9.278	0.994	9.221	1.066	0.057 (1.45)

Panel C: Sort by charity sources of income

Sort by	**Government Funding** *(Ratio of Government Grants)*					**Trading Income** *(Ratio of Trading Income)*					**Donations and Bequests** *(Ratio of Donations)*				
	High		*Low*		***Difference in mean***	*High*		*Low*		***Difference in mean***	*High*		*Low*		***Difference in mean***
	Mean	*SD*	*Mean*	*SD*		*Mean*	*SD*	*Mean*	*SD*		*Mean*	*SD*	*Mean*	*SD*	
Audit Fees	14,724	19,213	19,095	32,207	-4,371*** (-3.94)	17,331	30,949	18,726	31,169	-1,395 (-0.95)	13,696	26,145	19,182	31,605	-5,485*** (-4.85)
Ln (Audit Fees)	9.148	0.951	9.222	1.085	-0.074* (-1.94)	9.162	1.033	9.218	1.075	-0.055 (-1.09)	8.837	1.131	9.255	1.058	-0.418*** (-10.78)

Panel D: Sort by charities selected main activities

Sort by	**Education and Research** (*Education*)					**Health** (*Health*)					**Philanthropic** (*Philanthropic*)				
	Yes		*No*		***Difference in mean***	*Yes*		*No*		***Difference in mean***	*Yes*		*No*		***Difference in mean***
	Mean	*SD*	*Mean*	*SD*		*Mean*	*SD*	*Mean*	*SD*		*Mean*	*SD*	*Mean*	*SD*	
Audit Fees	22,946	41,138	17,322	27,217	5,624*** (7.13)	20,812	30,907	18,043	31,202	2,769*** (3.41)	12,117	21,649	18,910	31,450	-6,793*** (-3.89)
Ln (Audit Fees)	9.287	1.156	9.192	1.045	0.095*** (3.50)	9.391	1.026	9.165	1.080	0.226*** (8.10)	8.718	1.181	9.234	1.063	-0.516*** (-8.62)

Panel E: Sort by auditor size

Sort by	**Big4 Accounting Firms** (*Big4*)					**Top10 Accounting Firms** (*Top10*)				
	Yes		*No*		***Difference in mean***	*Yes*		*No*		***Difference in mean***
	Mean	*SD*	*Mean*	*SD*		*Mean*	*SD*	*Mean*	*SD*	
Audit Fees	37,379	48,180	15,651	26,263	21,727*** (22.99)	30,729	42,380	14,285	24,517	16,444*** (22.24)
Ln (Audit Fees)	9.853	1.270	9.112	1.000	0.741*** (22.76)	9.717	1.152	9.033	0.981	0.684*** (27.23)

Table 3 presents the OLS multivariate regression results for our not-for-profit audit fee model that is a function of charity size, charity complexity, main activities, and auditor size on audit fees (*Ln (Audit Fees)*). Column 1 shows a significant positive relation between audit fees (*Ln (Audit Fees)*) and all three measures of charity size (*Ln (Total Assets), Ln (Total Revenues)*, and *Ln (Total Expenses)*). The results are consistent with those in Column 4 when we examine these variables with all other variables. Particularly, the coefficients of *Ln (Audit Fees)* on *Ln (Total Assets), Ln (Total Revenues)*, and *Ln (Total Expenses)* in column 4 are associated with a 10.9%, 10.9% and 25.5% increase in audit fees when a charity' total assets, revenues and expenses increase by one percent, respectively.

In Column 2, we examine the effect of only charity complexity on audit fees. We find that audit fees (*Ln (Audit Fees)*) are negatively associated with a charity's ratio of non-current liabilities (-0.095) but positively associated with a charity's ratio of current liabilities (0.197). The results suggest that auditors may have concerns as reflected in audit fees when there are higher current liabilities, suggesting issues with the charities' short-term financial health and an increase in liquidity risk.

Columns 2 and 4 also show a significant negative association between ratio of donations and audit fees but no significant relation between ratio of government grants and trading income with audit fees. The results are consistent with our univariate results in Panel C of Table 2 that suggests that auditors are discounting their audit fees for these organisations. This would seem to be a reasonable (albeit altruistic) response by auditors because these organisations are the ones that are by their nature more charitable as there is relatively less income from commercial transactions. Consistent with these findings, Columns 2 and 4 show a significant and negative association between audit fees and philanthropy-related activities in charities.

Furthermore, Column 4 finds that when charities provide special financial reports and have financial reports submitted to state governments, audit fees are 8.6 percent and 6.7 percent lower, respectively. The results, thus imply that auditors may consider it to be a lower audit risk in a charity's financial reporting if charities comply with regulatory accounting and reporting standards from government agents, including a preparation of special financial reports and a state submission of financial statements. In addition, we find that consolidated charities pay a 31.9 percent higher audit fee, compared to non-consolidated charities because the nature of consolidation involves additional audit complexity. In our overall model in

Column 4 we find that the categories of Education and Health do not have significantly difference fees to other charities in the sample when controlling for other variables.

Column 3 presents regression results on the effect of having a premium auditor (i.e., top ten audit firms) on audit fees in the not-for-profit sector. We then replicate this regression test but incorporating premium auditor variables with all other determinants of audit fees. We find consistent results in Columns 3 – 4 that a significantly positive association between premium auditors and audit pricing in the not-for-profit sector. PwC and Deloitte audit services are 37.7 percent and 38.8 percent higher respectively than other auditors in audit pricing. KPMG's not-for-profit auditees pay 15.3 percent higher fees for audit services than non-KPMG charity auditees, which may be a factor in why they have the highest individual share of the market as shown in Table 1. Our findings provide support for prior empirical evidence that regardless private or public sector, top ten audit firms are more likely to charge premium fees for their audit services. However, audit fees in the not-for-profit sector may be lower than those in the for-profit sector (Beattie et al., 2001; Tate, 2007; Vermeer et al., 2009). The overall the descriptives provide some evidence of this. For our whole sample we find that the mean ratio of audit fees compared to total revenue is 0.5 percent. As a point of comparison, the study by Francis (2004) found that for the smallest decile of the largest 5,500 public companies in the US, the average audit fees relative to sales was 2 percent.

Table 3: Audit Fee Regression Results

Variable of interest	**AUDIT FEES** *Ln (Audit Fees)*			
	(1)	**(2)**	**(3)**	**(4)**
AUDITEE SIZE				
Ln (Total Assets)	0.087***			0.109***
	(9.91)			(9.99)
Ln (Total Revenues)	0.125***			0.109***
	(5.29)			(4.66)
Ln (Total Expenses)	0.316***			0.255***
	(15.61)			(12.20)
AUDITEE COMPLEXITY				
Ratio of Non-Current Liabilities		-0.041*		-0.095***
		(-2.31)		(-4.47)
Ratio of Current Liabilities		0.051		0.197***
		(1.27)		(3.99)
Ratio of Government Grants		-0.022		0.028
		(-0.63)		(0.87)
Ratio of Trading Income		-0.028		0.044
		(-0.52)		(0.99)
Ratio of Donations		-0.511***		-0.142**
		(-9.37)		(-3.00)
Special Financial Report		-0.216***		-0.086***
		(-9.05)		(-4.35)
State Submission		-0.248***		-0.067***
		(-10.50)		(-3.51)
Consolidation		0.824***		0.319***
		(11.62)		(6.08)
MAIN ACTIVITIES				
Education		0.069*		-0.006
		(2.44)		(-0.27)
Health		0.169***		0.020
		(6.19)		(0.91)
Philanthropy		-0.406***		-0.353***
		(-6.01)		(-5.56)
International		-0.173		-0.159
		(-1.42)		(-1.63)

AUDITOR SIZE				
KPMG			0.433***	0.153**
			(6.62)	(3.03)
PwC			0.892***	0.377***
			(11.10)	(5.91)
Deloitte			0.815***	0.388***
			(12.28)	(8.33)
Ernst & Young			0.593***	0.101
			(8.00)	(1.84)
Crowe Horwath			0.232***	0.130**
			(4.51)	(2.92)
Grant Thornton			0.623***	0.244***
			(9.10)	(3.80)
RSM Australia			0.544***	0.349***
			(6.88)	(5.37)
Moore Stephens			0.317***	0.134
			(3.38)	(1.79)
Pitcher Partner			0.606***	0.490***
			(6.34)	(6.64)
BDO			0.587***	0.231***
			(9.23)	(4.52)
CONSTANT	1.188***	9.413***	9.083***	1.976***
	(9.38)	(262.43)	(390.63)	(14.52)
Number of observations	8,050	8,027	8,611	8,005
Year fixed effects	Yes	Yes	Yes	Yes
Adjusted R^2	0.389	0.077	0.091	0.419

OLS regressions. ***p<0.01, **p<0.05, *p<0.1.

Complimentary Analysis – Auditing as a Corporate Governance Mechanism in Driving Performance

While the preceding analysis provides useful information regarding the drivers of auditing fees within the not-for-profit sector, it does not provide evidence on the value in auditing, within the NFP sector. To examine the role that auditing, in general, can serve as a corporate governance mechanism to improving NFP organizational performance, we examine whether NFPs that have established audit committees and conduct internal audits within their organization perform better than those that do not.

The Australian Charities and Not-for-profit Commission (ACNC) governance standards provide minimum standards on processes, activities, and relationships at a broad principle-based level for registered charities. However, these standards do not identify specific rules so charities must use judgment in deciding how to comply with these standards (ACNC 2021). Limited research examines the optimal formal corporate governance practices for charities with previous research focusing on ASX listed companies (eg Choe, Dey, and Mishra 2014; Abu Bakar, Khan, Mather, and Tanewski, 2020). The Principles of Good Corporate Governance and Best Practice Recommendations provide more specific principles and recommendations than the ACNC standards and provide a source of guidance for representatives of charities (ASX Corporate Governance Council, 2019).

One of the key corporate governance principles is to safeguard the integrity of information in annual reports. A recommendation for achieving this principle is the appointment of an audit committee. The audit committee advises on the quality of internal and external reporting processes and selection of the external auditor (ASX Corporate Governance Council, 2019, recommendation 4.1) and is likely to be an important mechanism in ensuring the financial governance of the charity. To empirically examine the role that auditing can have in contributing to a well-functioning NFP, we construct an econometric model that examines how four measures of NFP performance is affected by whether the organization has established an audit committee and conducts internal audits. If auditing is of value to the NFP then we should find that there is a negative association between having audit committees and conducting internal audits with the cost to revenue ratio of running the organization. After all, audits should be able to highlight inefficiencies within the organization that should enable them to improve their performance. Our model is as follows:

$$Cost\ to\ Revenue\ Ratio$$
$$= f\ (Existence\ of\ an\ Audit\ Committee\ and\ internal\ audits, Controls)$$

The first measure that we use to capture the cost to revenue ratio of the organisation is overall cost to revenues of the NFP. The second measure is employee expenses to total revenues. The third measure is administration costs to total revenues and the fourth, interest expenses to total revenues. We add several control variables to our multivariate regression that we used in our previous models, including audit fees. The results from this model are presented in table 4 below. What they reveal is that NFPs who have established audit committees and conduct internal audits are able to reduce their total cost to revenue ratio by approximately 16 percent relative to other NFPs (see column 1). Further analysis reveals that this cost-saving is primarily driven from efficiency gains made from reducing employee expenses (see column 2). This result supports the premise that auditing can play an important corporate governance role in driving organizational performance within the NFP sector.

It is also noteworthy to highlight that further analysis of the other independent control variables reveals that NFPs with less government grants, less trading income and less donations, all relative to total revenue, are also more likely to have a lower cost to revenue ratio.

Table 4: Charity Cost Effectiveness and the Role of the Internal Auditing Function

VARIABLE OF INTEREST	*Ratio of total costs to total revenues*	*Ratio of employee expenses to total revenues*	*Ratio of administration costs to total*	*Ratio of interest expenses to total*
	(1)	(2)	(3)	(4)
Independent Variables				
CHARITY COST EFFECTIVENESS				
Audit committee & internal audit	-0.159***	-0.065**	-0.048	-0.002
	(0.054)	(0.026)	(0.030)	(0.002)
Control Variables				
CHARITY FINANCIAL PERFORMANCE				
Ln (Total Expenses)	0.015	-0.001	-0.000	-0.001
	(0.025)	(0.008)	(0.013)	(0.001)
Ratio of Current Liabilities	0.095	0.027	0.039	-0.001
	(0.123)	(0.030)	(0.053)	(0.001)
Ratio of Government Grants to Total Revenue	0.309**	0.362***	0.009	-0.002
	(0.139)	(0.051)	(0.077)	(0.003)
Ratio of Trading Income to Total Revenue	0.368***	0.247***	0.159**	-0.001
	(0.132)	(0.043)	(0.073)	(0.002)
Ratio of Donations to Total Revenue	0.708*	0.122	0.275	-0.003
	(0.423)	(0.109)	(0.187)	(0.002)
Ratio of Investment to Total Revenue	0.098	-0.058	0.118	0.009
	(0.436)	(0.062)	(0.122)	(0.012)
AUDIT PREMIUM				
Top 10 audit firms	0.043	-0.025	0.050	-0.003***
	(0.158)	(0.036)	(0.067)	(0.001)
Ln (Audit Fees)	0.024	-0.009	0.029	0.001
	(0.041)	(0.014)	(0.020)	(0.001)
AUDITEE COMPLEXITY				
Special Financial Report	-0.193*	-0.075***	-0.079*	0.001
	(0.099)	(0.026)	(0.042)	(0.001)
State Submission	0.066**	0.053***	-0.018	-0.001
	(0.032)	(0.012)	(0.015)	(0.001)
Consolidation	-0.002	-0.018	0.006	0.005**
	(0.041)	(0.018)	(0.023)	(0.003)
MAIN ACTIVITIES				
Education	-0.045	0.065*	-0.089***	0.004
	(0.078)	(0.035)	(0.034)	(0.002)

Health	-0.146	-0.018	-0.081	-0.001
	(0.090)	(0.026)	(0.051)	(0.001)
Philanthropy	0.312	-0.252***	-0.213*	0.007
	(0.587)	(0.042)	(0.118)	(0.008)
International	-0.350	-0.309***	-0.355***	-0.004***
	(0.259)	(0.069)	(0.121)	(0.001)
Constant	0.749***	0.595***	0.271***	0.016
	(0.217)	(0.118)	(0.079)	(0.014)
Number of observations	7,839	7,839	7,839	7,818
Year dummies	Yes	Yes	Yes	Yes

OLS regressions. Cluster-robust standard errors are in parentheses. ***p<0.01, **p<0.05, *p<0.1.

As a final piece of analysis, we examine whether there is an association between charity cost effectiveness (i.e., the cost to revenue ratio) and executive remuneration within the NFP sector. Good corporate governance implies that there is a positive relationship between the two. Indeed, international corporate governance guidelines stress the importance of remunerating directors and senior management in a fair and responsible manner. Remunerating fairly and responsibly is another key principle and involves senior managements' remuneration being sufficiently high to recruit and retain high-quality managers. However, it also includes ensuring that senior remuneration is connected to efficiently and effectively achieving the purposes of the charity (Financial Reporting Council 2018; ASX Corporate Governance Council 2019; ACNC 2021).

To examine what the association may be within the NFP sector, we run three separate regressions for each of the three main types of charitable organisations in our sample; namely, the education, health and philanthropy sectors. We focus on how the ratio of total costs to total revenues, as an overall measure of an NFP's cost effectiveness, is related to the remuneration of *key personnel management*, which is essentially the top management team of the NFP. Table 5 reveals that there is no significant relationship between a charity's cost effectiveness and executive remuneration across each of the three main types of charitable organisations. For the sake of brevity, we do not present the regression results generated from the other three measures of cost effectiveness that we capture as the results are the same – there is no clear association between executive pay and performance in the NFP sector, at least in regards to how we measure performance. What we do find, expectedly, is that remuneration is positively related

to the size of the organisation. We also find that in the education sector, those organisations that are more reliant on donations for revenue tend to pay their management team less. The results of the impact of audit fees are mixed across the sectors, but what does stand out is that those organisations which have established an audit committee and conduct internal audits do pay their management more (for education and health NFPs). This is an interesting observation as it suggests those organisations with better corporate governance mechanisms in place reward their executives more. This could be driven by a number of factors relating to the hiring of a more experienced management team that value the auditing function within the organisation, or that it is the auditing function that encourages the hiring of executives that can command better salaries. We believe the preliminary result that we uncover is worthy of more detailed research to unpack how the auditing function is related to executive pay in the NFP sector, particularly given that remuneration in the sector does not seem to be directly related with overall organisational cost effectiveness.

Table 5: Charity Cost Effectiveness and Executive Remuneration

	KEY PERSONNEL MANAGEMENT Ln(Remuneration)		
	Education	Health	Philanthropy
Independent Variables			
CHARITY COST EFFECTIVENESS			
Ratio of total costs to total revenues	0.184	0.075	0.067
	(0.120)	(0.122)	(0.191)
Control Variables			
CHARITY FINANCIAL PERFORMANCE			
Ln (Total Revenues)	0.449***	0.329***	0.593*
	(0.065)	(0.076)	(0.324)
Ratio of Current Liabilities	-0.303	-0.118	-0.820
	(0.488)	(0.247)	(2.178)
Ratio of Government Grants to Total Revenue	-0.341	0.296	0.914
	(0.317)	(0.209)	(1.095)
Ratio of Trading Income to Total Revenue	-0.122	0.169	0.400
	(0.331)	(0.375)	(1.338)
Ratio of Donations to Total Revenue	-0.893***	-0.535	0.386
	(0.329)	(0.353)	(1.023)

Ratio of Investment to Total Revenue	-0.129	0.673	0.054
	(0.434)	(0.630)	(0.874)
AUDIT PREMIUM			
Top 10 audit firms	-0.131	-0.072	1.451*
	(0.131)	(0.167)	(0.723)
Ln (Audit Fees)	0.198**	-0.168*	-0.432
	(0.079)	(0.094)	(0.497)
Audit committee and internal audit	0.315*	0.311*	1.060
	(0.175)	(0.165)	(1.126)
AUDITEE COMPLEXITY			
Special Financial Report	-0.837	-0.512**	2.094**
	(0.523)	(0.241)	(0.919)
State Submission	0.041	0.299	-0.464
	(0.182)	(0.227)	(0.802)
Constant	4.037***	8.978***	6.158
	(0.722)	(1.259)	(4.819)
Number of observations	264	369	30
Year dummies	Yes	Yes	Yes

OLS regressions. Cluster-robust standard errors are in parentheses. ***p<0.01, **p<0.05, *p<0.1.

Concluding Remarks

This study provides new and important insights into determinants of audit fees in the not-for-profit sector in Australia. Our empirical evidence shows significantly different behaviour in audit pricing in the charity market which has unique aspects associated with charities compared to for-profit organisations, such as their: nature; financial needs and position; accounting rules; and auditing environment. Our findings suggest that audit fees in the not-for-profit sector, are positively associated with charity size, measured by a charity's total assets, total revenue and total expenses.

Furthermore, charity complexity, including a charity's liquidity risk, ratio of donors' contribution, regulatory requirement on preparing financial reports and state submission, charity consolidated structure, and a selected range of more complicated activities operated by charities, may have significant effect on auditors' concerns on screening a charity's short-term financial health and detecting potential audit risks, as we find they are associated with increasing audit fees.

This report also provides additional empirical evidence that regardless of the private or public sectors, premium auditors charge higher fees for the provision of audit services. However, audit fees in the not-for-profit sector do seem to be lower than in the private sector. Interestingly, we find that lower audit pricing may be partly explained by auditors' generosity in providing their audit services in an honorary capacity, and in either receiving zero fees, donating audit remuneration, or discounting fees for non-for-profits that rely on donations or are involved in philanthropic activities.

We also show the role that auditing can be a corporate governance mechanism to drive organizational performance in the NFP sector. Specifically, we find evidence that NFPs that establish audit committees and conduct internal audits are more likely to be cost effective than other NFPs. This supports the argument that auditing can play a constructive and useful role in driving performance in the sector. Additionally, we find that there is no clear association between executive remuneration in the NFP sector and how organisationally efficient the entity is. This indicates that there is a need to more closely examine how management are being rewarded and whether improvements in this area can be made to encourage greater performance in the sector.

In summary, the findings in this report highlight the effect of determinants of audit pricing in the not-for-profit sector, and differences in audit fees between for-profit and not-for-profit organisations. This report provides evidence that may help not-for-profits and charities' responsible persons, donors, and government agents in optimising the cost of audit pricing and audit choice. Furthermore, our research calls for more attention on the auditing environment and audit needs in the not-for-profit sector to enhance public trust and confidence in reporting, transparency, and assurance in this sector in Australia.

Appendix 1

A summary of initial sample, exclusion and final observation for each of the four years 2014 - 2018.

Initial sample of large registered charities	Details of being removed	Number of unique charities/observations of being removed	Number of unique charities/ observations remained
- 2014: 7,724 unique charities - 2015: 8,001 unique charities - 2017: 8,455 unique charities - 2018: 6,432 unique charities **Total: 30,612 observations**	Missing or invalid financial data in the annual information statements	- 2014: 0 charities - 2015: 0 charities - 2017: 7 charities - 2018: 58 charities *Total: 65 observations*	- 2014: 7,724 unique charities - 2015: 8,001 unique charities - 2017: 8,448 unique charities - 2018: 6,374 unique charities *Total: 30,547 observations*
	Missing or incomplete information on either charity main activities, consolidation, special financial reporting and state report requirement	- 2014: 82 charities - 2015: 5 charities - 2017: 166 charities - 2018: 155 charities *Total: 408 observations*	- 2014: 7,642 unique charities - 2015: 7,996 unique charities - 2017: 8,282 unique charities - 2018: 6,219 unique charities *Total: 30,139 observations*
	Missing, invalid and incomplete information audit fees and auditing firms	- 2014: 5,948 charities - 2015: 5,985 charities - 2017: 6,202 charities - 2018: 3,999 charities *Total: 22,542 observations*	- 2014: 1,694 unique charities - 2015: 2,011 unique charities - 2017: 2,080 unique charities - 2018: 2,220 unique charities **Total: 8,005 observations**

Appendix 2

Variables	Descriptions
KEY PERSONNEL MANAGEMENT	
Remuneration ($)	This variable takes dollar value to show the total accumulated annual salary of all key personnel management persons including directors and CEOs in charities. This variable is hand-collected data from charity annual financial statement and disclosure notes.
AUDIT COMMITTEE	
Audit Committee & Internal Audit	This variables is hand-collected from notes in charity annual financial statements. This variable is a dummy variable. It is equal 1 if a charity has employed either audit committee or internal audit, or both of them, and zero otherwise .
CHARITY FINANCIAL PERFORMANCE	
Ratio of Government Grants to Total Revenue	This ratio equals to total government fundings received by a charity by government divided by total revenue
Ratio of Government Grants to Total Expense	This ratio equals to total government fundings received by a charity by government divided by total expense
Ratio of Donations to Total Revenue	This ratio equals to total donations and bequests donated to a charity divided by total revenue
Ratio of Donations to Total Expense	This ratio equals to total donations and bequests donated to a charity divided by total expense
Ratio of Trading Income to Total Revenue	This ratio equals to total income from trading goods and services in a charity divided by total revenue
Ratio of Trading Income to Total Expense	This ratio equals to total income from trading goods and services in a charity divided by total expense
Ratio of Investment to Total Revenue	This ratio equals to total income from investment activities in a charity divided by total revenue
Ratio of Investment to Total Expense	This ratio equals to total income from investment activities in a charity divided by total expense
MAIN ACTIVITIES	
Education	Dummy variable equals 1 if a charity has its main business activities as schooling, education and research, and zero otherwise
Health	Dummy variable equals 1 if a charity has its main business activities as hospital services and rehabilitation, health care and services, aged care activities, and zero otherwise
Philanthropic	Dummy variable equals 1 if a charity has its main business activities as philanthropic activities, and zero otherwise

Religion	Dummy variable equals 1 if a charity has its main business activities as religious activities, and zero otherwise
Cultures and recreation	Dummy variable equals 1 if a charity has its main business activities as culture arts and reactions, and zero otherwise
Law and legal services	Dummy variable equals 1 if a charity has its main business activities as legal services and law, advocacy and civic activities and zero otherwise
Social support and development	Dummy variable equals 1 if a charity has its main business activities as economic, social and community development, income support and maintenance, social club activities, sports, emergency and relief, employment and training, and zero otherwise
International activities	Dummy variable equals 1 if a charity has its main business activities as international activities, and zero otherwise
Environmental activities	Dummy variable equals 1 if a charity has its main business activities as environmental activities and animal protection, and zero otherwise
Housing and development	Dummy variable equals 1 if a charity has its main business activities as housing activities and zero otherwise
COST EFFECTIVENESS	
Ratio of total costs to total revenues	This ratio equals to total costs divided by total revenues
Ratio of employee expenses to total revenues	This ratio equals to total employee expenses divided by total revenues
Ratio of administration costs to total revenues	This ratio equals to total other expenses and administration expenses divided by total revenues
Ratio of employee expenses to total expenses	This ratio equals to total employee expenses divided by total expenses
Ratio of administration costs to total expenses	This ratio equals to total other expenses and administration expenses divided by total expenses
Ratio of interest costs to total expenses	This ratio equals to interest expenses divided by total expenses

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