

Accepted Manuscript

Title: An empirical test of SEC enforcement in the audit market

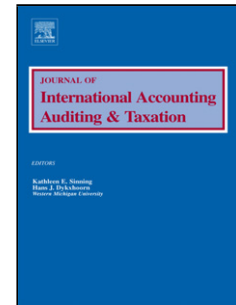
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PII: S1061-9518(17)30076-9

DOI: <https://doi.org/10.1016/j.intaccaudtax.2017.12.007>

Reference: ACCAUD 234

To appear in: *Journal of International Accounting, Auditing and Taxation*



Please cite this article as: & Leventis, Stergios., An empirical test of SEC enforcement in the audit market. *Journal of the Chinese Institute of Chemical Engineers* <https://doi.org/10.1016/j.intaccaudtax.2017.12.007>

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An empirical test of SEC enforcement in the audit market

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Abstract

This paper provides evidence that the Securities and Exchange Commission's (SEC's) enforcement policies affect audit pricing. Firms with a higher probability of enforcement by the SEC are hypothesized to experience increased pricing of audit services. According to Kedia and Rajgopal (2011), geographical proximity to SEC's offices can serve as a proxy of enforcement probability. The hypothesis of the current paper is supported by the findings that audit firms charge companies with a higher enforcement probability significantly higher audit fees. Thus, audit pricing increases when auditors perceive an enhanced audit risk for firms with greater prominence on the SEC's radar. Therefore, one can infer that the probability of SEC enforcement increases the need for shareholders to bear the costs of monitoring agents and that enforcement and audit provision are complementary devices.

Keywords: SEC, audit pricing, enforcement probability, audit market.

JEL Classification: G21, G30, G34, G38, M41.

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