Fair Value Exposure, Changes in Fair Value and Audit Fees: Evidence from the Australian Real Estate Industry

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Abstract

This paper investigates the relationship between audit fees and both fair value exposure and changes in fair value of investment properties. The study is motivated by the limited and inconclusive evidence on the effect on audit fees of full fair value reporting for illiquid assets. Using hand-collected data from the Australian real estate industry, we find a negative (positive) association between audit fees and fair value exposure (changes in fair value of investment properties). Our findings also indicate that the use of unobservable inputs in fair value estimates for investment properties does not significantly increase audit risk and audit fees. Further, we find that audit fees are higher for firms with fair values of investment – properties estimated by external and mixed valuers – compared to firms with fair values estimated by directors alone. This study enriches the audit fee literature by documenting auditors' pricing decisions in an area that involves significant estimation and valuation risks.