

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.