Audit Portfolio and Client Acceptance Decision

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Abstract

Regulatory bodies and practice-oriented research propose that client acceptance decisions are crucial to auditors' long-term financial security. Similarly, they show that auditors prefer a more homogeneous audit portfolio and tend to reject the audit of risky clients sometimes too often. In a similar vein, the accounting profession has raised concerns that audit firms are more likely to reject the audit of risky clients, e.g., start-ups, deteriorating their ability to grow creative ideas. To address such concerns, this study sheds some light on the impact of audit portfolio structure, i.e., homogeneity of audit portfolio and client risk, on client acceptance decisions and audit fees. This study shows that, in most cases, the auditor is less likely to accept a new client as the client becomes riskier, which aligns with the concern raised by the accounting profession. Surprisingly, however, under some conditions, the auditor is more likely to accept the new client as the client becomes riskier. Specifically, the relation between the client risk and the client acceptance rate could be U-shaped such that the client acceptance rate is lower for a moderately risky client than for a high-risk or a low-risk client. Perhaps more surprisingly, there exist conditions under which the auditor is more likely to accept the new client as the client becomes riskier, and if accepting such a client leads to a less homogeneous audit portfolio.

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