Does Subsidiary Auditor Misalignment Explain Audit Fee Low-Balling?

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Abstract

We provide a new explanation for the initial engagement year audit fee discount documented by prior research. So-called low-balling has been interpreted by regulators and researchers as evidence of strategic audit pricing by newly appointed audit firms. However, many jurisdictions require reported group auditor fees to include the fees for audits of group subsidiaries. We predict and find that reported group auditor fees depend on the extent of involvement of the group auditor in subsidiary audits. We then observe that subsidiary auditor rotation and group auditor rotation are not perfectly synchronized. The resulting abnormal misalignment between group and subsidiary auditors explains the lower reported audit fees in initial group audit engagement years. Our results therefore suggest that the initial audit fee discount is an artifact of the reporting of group auditor fees on a consolidated basis and slow rotation of subsidiary auditors into group auditors' portfolios.

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1. Introduction

Empirical audit pricing studies have frequently found evidence that audit fees in the first year of a new engagement are lower than in other years. Researchers and regulators often describe this phenomenon as audit fee *low-balling*, interpreting the initial fee discount as evidence of strategic audit pricing behavior by newly appointed audit firms. In this paper we provide an alternative explanation for the initial fee discount, based on the observation that in many jurisdictions the fees earned for audits of subsidiary companies are included in reported group auditor fees. As a consequence, the level of misalignment between group auditors and subsidiary auditors is important in explaining reported audit fees after controlling for other audit fee determinants. We then show that the dynamics of auditor rotation within a corporate group lead to a higher than normal level of misalignment between group and subsidiary auditors in group auditor rotation years. This higher rotation year misalignment can explain the lower than normal reported audit fees in initial engagement years.

Misalignment between group auditors and auditors of subsidiaries arises for two main reasons. First, group auditors may rely on audit and assurance work performed by other audit firms (ISAAB 2020; AICPA-ASB, 2011; Hanes, 2003; Carson, Simnett, Vanstraelen, and Trompeter, 2016; Sunderland and Trompeter, 2017; Choi, Choi, and Kim, 2018; Downey and Bedard, 2019; Burke, Hoitash, and Hoitash, 2020). Second, in some jurisdictions the audit of subsidiaries is not mandatory, or exemptions from mandatory audit may be available based on size or ownership criteria. In these circumstances, some subsidiaries may be excluded from audit by agreement between the group auditor and company management, some may be audited by different audit

firms, while the audit of accounting transactions in other subsidiaries may occur through analytical review during the group audit process. We use granular data on subsidiary level auditors to construct proxies for auditor misalignment based on the fractions of subsidiaries that are audited by audit firms other than the group audit firm.

Many countries, including Italy and the United States, require companies to disclose audit fees for *all* audit work performed across a corporate group by the group auditor.[1, 2] While some companies make disaggregated disclosures detailing fees for group and subsidiary audits separately, such disclosures are voluntary. Hence, the audit fees typically captured by databases and studied by researchers include fees for audit of both subsidiaries' financial statements and parent and consolidated financial statements. However, despite its potential importance for understanding and explaining variation in audit fees across firms and over time, we are unaware of discussion of this institutional property of the data in the empirical audit pricing literature.

Although empirical audit fee models usually include the number of subsidiaries in a company as a determinant of fees designed to capture audit effort, the absence of subsidiary auditor data precludes differentiation between those subsidiaries audited by the group auditor, those audited by other audit firms and those not audited at all. We predict that the extent of misalignment between subsidiary and group auditors will be incrementally relevant in explaining cross-sectional variation in observed audit fees, after controlling for other audit fee determinants. We also predict that time varying auditor misalignment will explain time series variation in reported audit fees. Specifically,

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[1] Many countries also require disclosure of fees received by the audit firm for non-audit services or tax advisory work.
[2] In the US, disclosure requirements are described in Schedule14A (SEC). In the UK, disclosure requirements are set by the Companies Regulations 2011 (Disclosure of audit remuneration and liability limitation agreements) available at https://www.legislation.gov.uk/uksi/2011/2198/contents/made). In Italy, disclosure requirements are described in art. 149-duodecies (Regolamento emittenti n.11971/1999, available at https://www.consob.it/documents/46180/46181/regemit11971.pdf/174a3693-2650-4d20-9cb1-7c9f2a40cc78). See Section 3 for a discussion of differences among regulations.

we predict that initial year audit fees are lower because group auditors perform less subsidiary audit work in the first engagement year than in other years.

To test these predictions, we study group auditor fees reported for Italian public companies. We choose the Italian setting for four main reasons. First, prior research (e.g., Cameran, Francis, Marra, and Pettinicchio, 2015) documents significant initial fee discounts in the Italian setting of up to 16 percent. Second, audit fee disclosure regulation for Italy requires companies to report the total audit fees earned by the group auditor for all audit work, including the audits of subsidiaries. Third, we can observe financial statements and auditor identities for both public companies and for their subsidiaries because all companies are required to file financial statements, in contrast to the US setting where private company financial statements are not generally observable.[3] The accessibility of data on subsidiary auditors and subsidiary financial statements allows us to estimate the extent of misalignment between subsidiary auditors and group auditors. Fourth, group auditor rotation is mandatory for public companies in Italy. This increases the number of auditor switches and hence statistical power. Mandatory rotation also mitigates potential concerns that auditor switches are endogenous and a source of selection bias.

Using a dataset comprising all non-financial Italian public companies that are the global ultimate owners (GUO) of other companies over the period 2007-2017, we use archival data from the Orbis database supplemented by hand-collected data from company filings to identify subsidiary and parent audit firms. We then estimate the misalignment between subsidiary auditors and group auditors for each firm-year. As expected, not all subsidiaries have auditors due to exemptions from statutory audit based on absolute or relative to the group's size criteria. Based on

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[3] We could not conduct a similar study for the US because archival data on private subsidiaries is not available, to the best of our knowledge.

the subsidiaries within each group for which auditors are identifiable, on average only 27% of subsidiaries have an auditor from the same audit firm as the group auditor. However, there is considerable cross-sectional variation in the degree of misalignment. We also observe variation in the degree of within-firm misalignment around auditor rotation years. While incoming group auditors may have audited some subsidiaries in the years before they assume group audit responsibilities, more often auditor switches aligning subsidiary auditors and the group auditor occur after the initial year. Overall auditor misalignment is 2.43% higher in the initial year of a group audit engagement. The proportion of subsidiaries audited by group auditors on average increases from 25% in the initial year of audit engagements to 28% after 3 years; on an asset-weighted basis the proportion rises from 82% to 87% (from 42% to 46%) when weights are based on the assets of subsidiaries with identifiable auditors (group total assets).[4]

In audit fee regressions controlling for common determinants employed in the prior literature, we first find that audit fees are significantly negatively related to subsidiary auditor misalignment in cross-sectional tests. Next, we confirm prior research findings that reported audit fees are, on average, lower in the initial year of group auditor engagements (between 9.9% and 12.4% in our analyses) - such results have previously been interpreted as evidence of low-balling. However, we find that subsidiary auditor misalignment fully explains the initial engagement year audit fee discount. Our results suggest that when audit fees are reported as the consolidated fees earned by the group auditor, lower audit fees in the auditor rotation year are an artifact of slower rotation of subsidiary auditors into the group auditor's portfolio. Additional tests confirm that our results are insensitive to the defining of subsidiary auditor misalignment – using asset-weighted misalignment

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[4] Calculated as the sum of total assets of misaligned subsidiaries divided by the sum of total assets of all the covered subsidiaries.

proxies leads to similar conclusions. To further corroborate our findings and provide a complementary test of the strategic pricing of explanation of the initial fee discount, we also test for the presence of low-balling at the subsidiary level using hand-collected subsidiary fee data. We find that subsidiary audit fees are unrelated to group misalignment dynamics. Further, we find no evidence of low-balling at the subsidiary level either for rotations that align auditors with the group auditor or for rotations that increase misalignment.

Our paper complements a recent paper by Barua, Lennox, and Raghunandan (2020) suggesting that measurement bias in initial year audit fees can explain the audit fee low-balling phenomenon. Barua at el. (2020) argue that the initial fee discount is attributable to the predecessor auditor's likely involvement in reviews of interim financial statements issued early in the rotation year, perhaps before the incoming auditor's appointment is confirmed. The downward bias in reported audit fees of the incoming auditor is due to the effective sharing of fees for review and audit work between the predecessor auditor and the incoming auditor in the rotation year. We identify subsidiary audit as a potentially important additional channel through which sharing of audit work between predecessor auditor, incoming auditor and other audit firms also occurs. When reported audit fees include all fees earned by the incoming auditor and when the sharing of subsidiary audit work in the rotation year favors predecessor and other audit firms relative to the incoming auditor, auditor misalignment can help explain the initial year audit fee discount. We believe that auditor misalignment will be particularly relevant in countries where interim reporting is less frequent than in the US, where review of interim financial statements is not mandatory and where corporate groups and large and complex pyramidal subsidiary structures are common.

Our paper also contributes to the broader literature examining the determinants of audit fees. By showing that subsidiary auditor misalignment is an important determinant of audit fees, our

results suggest the importance of controlling for possible differences in patterns of allocation of audit work across group subsidiaries, especially when such differences may be correlated with variables of interest in the research. While the proxies for auditee complexity in audit fee models frequently include the number of subsidiaries in a group, the number of foreign subsidiaries and the number of business segments, our results indicate that significant proportions of subsidiaries are often audited by other audit firms or are not audited at all. In these circumstances the costs of group auditor effort could be quite different and have implications for deeper modelling of group auditor fees.

Finally, our paper has implications for regulators. As noted by Barua et al. (2020, p.1) US regulators including the Senate, the House of Representatives and the SEC have frequently criticized low-balling in audit fees. The belief of regulators that low-balling is a real phenomenon to be discouraged has perhaps been reinforced by the large body of academic empirical research documenting initial engagement year audit fee discounts, and by research providing theoretical models of low-balling. While our study does not rule out the existence of strategically-motivated initial audit pricing in individual engagements, it does call into question conclusions from prior research suggesting that the average audit firm discounts initial audit fees and then subsequently increases fees in later engagement years. Our paper suggests that regulators should evaluate the academic evidence carefully and understand the limited information underlying most academic literature. Our results also have implications for mandated audit fee disclosure. They suggest that aggregate audit fees earned by the group auditor convey limited information on a standalone basis and are not comparable over time. In order to interpret changes and trends in consolidated group auditor fees, and differences in audit fees across companies, financial statement users and researchers must be able to understand the scope of the audit work within a corporate group, how

that changes over time, and how it compares to other corporate groups. Aggregation of audit fees within groups can be misleading if there is insufficient transparency concerning the identity of subsidiary auditors and their audit fees. In this respect, our paper demonstrates one advantage of mandated public transparency of private company financial statements.

The remainder of our paper is organized as follows. In the next section we review the existing literature and develop our hypotheses. In Section 3, we describe the institutional setting. In Section 4, we describe the sample selection and research design. In Section 5, we discuss our results. Finally, Section 6 concludes the paper.

2. Literature Review and Hypothesis Development

The term low-balling refers to the practice of discounting initial year fees in order to attract new clients and recoup initial losses in subsequent years, leveraging on the clients' costs of switching auditors. Bidding below cost can be considered as a "competitive weapon utilized by audit firms seeking to achieve market dominance" (Chan, 1999; p. 614).

Regulators around the world are concerned that setting audit fees artificially low might lead auditors to become more susceptible to management pressure (SEC, 1978; ACIPA, 1978; NASBA, 2010, PCAOB, 2011, IESBA, 2018). In order not to lose their initial investment, auditors might be tempted to accommodate their clients' accounting choices and deliver lower quality audits.[5] Low-balling was initially theorized by De Angelo (1981) and was then empirically detected in numerous studies, making it the "most robust findings from the empirical auditing literature" (Barua et al., 2020, p.2). The empirical evidence of initial fees discounts can be traced as far back

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[5] The PCAOB specifically refers to low-balling practices as a threat to audit quality in its 2011 Concept Release (Desir, Casterlla, and Kokina, 2014).

as the 1980's(e.g., Simon and Francis;1988 and Ettredge and Greenberg,1990). Barua et al. (2020) review 34 US audit fee studies in the period 2011 – 2018, with the estimated initial year discounts ranging from 0.3% in Doogar, Sivadasan, and Solomon (2015) to 54.8 percent in Numan and Willekens, (2012). Contrary to expectations, low-balling practices apparently persist even after the enactment of the Sarbanes Oxley Act 2002 mandating greater transparency of fees earned by auditors – see e.g., Desir, Casterella, and Kokina (2014) and Cho, Kwon and Krishanan (2020). Low-balling effects have also been detected in a number of international studies. Hay et al (2006) conduct a meta-analysis of international audit fee studies over the period 1976-2003. Of the 23 studies analyzed, Hay et al. (2006) find 8 studies reporting significant initial year discounts, while a further 11 report insignificant initial year fee effects and four report positive first year premiums. Of specific relevance to this paper, Cameran et al. (2015) find that fees of incoming auditors are discounted by approximately 16 percent in Italy over the sample period 2006-2009.

The recent paper by Barua et al. (2020) challenges the interpretation of initial engagement year discounts as evidence of intentional strategic audit pricing aimed at winning new clients. They report empirical evidence that the initial year discount can arise from audit fee measurement bias. Barua et al. (2020) argue that audit fee disclosure requirements in different settings (the U.S. included), extend only to fees paid to the auditors who issue the final opinion. As auditor changes usually occur after the first fiscal quarter in the US, the fees reported by the client are lower compared to non-switching years because they exclude the cost of audit and review work conducted by the predecessor group auditor in the early part of the switch year. After controlling for this bias (aggregating audit fees paid to both predecessor and incoming auditors where both are available), Barua et al. (2020) show that low-balling effects disappear in their US sample.

We complement Barua et al.'s (2020) study by proposing another channel through which initial year discounts can appear for non-strategic reasons. Specifically, we argue that lower fees in initial years of engagement are linked to the time-varying role of the group auditor in audits of group subsidiaries. The group auditor does not usually audit every subsidiary − some components of the group are either audited by other independent auditors (component auditors) or are simply exempted from audit and therefore have no auditor (Choi et al., 2018). Prior studies on the role of group and other component auditors' dynamics on audit fees are scarce, and provide mixed evidence (Mao, Ettredge, and Stone, 2020). Carson et al. (2016) and Burke et al. (2020) show that audit firms charge higher fees when component auditors are involved in group audits, while Dee, Gunny, and Lulseged (2018) fail to find evidence of component auditors affecting audit fees. Choi et al. (2018) also show that the number of subsidiaries audited by other component auditors eventually affects group audit fees. Specifically, using a sample of Korean listed companies in the period 2005-2013, they find that in the pre-IFRS period, audit fees paid to group auditors are negatively related to the proportion of group assets (or sales) audited by other auditors. Choi et al. (2018) interpret this as evidence that group auditors strategically charge lower fees to the parent company with the intention to subsequently "win" other subsidiaries and therefore increase its clients' base. The authors also show that after IFRS adoption, group auditor audit fees charged to the parent company increase when a significant part of the subsidiaries is audited by other auditors, reflecting increased audit effort and risk associated with the involvement of other auditors. To the extent that component auditor involvement increases audit risk and fees charged by the group auditor, this will bias results against the auditor misalignment effect that we now propose.

If audit fee disclosures requirement mandate disclosure of audit fees paid to the group auditor for audit work related to both parent and group financial statements and subsidiary audits (and

total disclosed fees exclude fees paid to other component auditors) then the identity of subsidiary auditors is important in explaining group auditor fees. We expect reported group auditor fees to be higher the greater the amount of subsidiary audit work performed by the group auditor. In our empirical tests we focus on estimated *misalignment* between subsidiary auditors and the group auditor, defining a misaligned auditor as an auditor from an audit firm independent of the group auditor. We state our first hypothesis as follows:

H1: Subsidiary auditor misalignment is negatively related to group audit fees after controlling for common audit fee determinants.

The group auditor's role in audit of subsidiaries can change in the course of an audit engagement as new subsidiaries are added to or dropped from the group auditor's portfolio. Consistent with H1 we would expect such changes to affect reported audit fees. However, we predict that in years when group auditor rotation occurs, the role of subsidiary auditor misalignment will be especially important. Assume that group auditors and company management agree on a normal level of alignment between subsidiary auditors and group auditor. If subsidiary auditor assignments before group auditor rotation are at this normal level, misalignment will inevitably increase unless all subsidiaries audited in the pre-switch year by the predecessor auditor simultaneously and immediately switch to the incoming group auditor in the initial group audit engagement year. In practice we expect this to be unlikely. In some cases subsidiaries might be audited by the incoming group audit firm in the years before the group auditor switch, leading to higher total audit fees for the incoming group auditor than the predecessor auditor, all else equal. More likely, other subsidiaries might switch their auditor to the incoming group audit firm later than the group auditor switch year. If these subsidiaries were audited by the predecessor group auditor in the year, this

will show up as an initial fee discount, all else equal. We therefore formulate the following hypothesis.

H2: Group audit fees are lower in the initial engagement year because of higher subsidiary auditor misalignment in the switch year compared to other years.

In summary, when reported audit fees consolidate fees received by the group auditor for all audit work performed across a group, we predict that the level of misalignment of subsidiary audit work between the group auditor and other audit firms will be an important determinant of audit fees; and when subsidiaries are slow to switch to the incoming group auditor group, auditor fees will appear to be discounted in the initial year.

3.   Institutional Background

There are several reasons why the Italian setting is ideally suited to test our predictions concerning intra-group auditor misalignment and audit pricing. First, audit fee disclosure requirements in Italy minimize the risk of initial year audit fee measurement bias suggested by Barua et al. (2020). When the group auditor changes, Italian companies are required to disclose the total audit fees paid to both the predecessor and incoming auditors (Regolamento emittenti n.11971/1999, art. 149-duodecies, Par. 1). Therefore any initial engagement year discount detected should not be attributable to unobserved audit fees paid to the predecessor group auditor.[6] Yet despite using aggregate audit fees including both predecessor and incoming audit fees in auditor switch years, prior research has documented substantial initial year fee discounts for Italian companies of around 16 percent (Cameran et al., 2015).

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[6] In the UK there is also a requirement for separate disclosure of the fees paid to the predecessor and incoming auditor when there is an audit rotation (ICAEW 2013, TECH 14/13FRF, Question 21).

Second, audit fee disclosure regulation for Italy requires companies to report the total audit fees earned by the group auditor for all audit work, including audits of subsidiaries (Regolamento emittenti n.11971/1999, art. 149-duodecies, Par. 2), with a clear distinction between different categories of fees paid (audit, tax, assurance, other services). Similar to many other countries, there is no requirement for the companies to disclose fees paid to subsidiary auditors other than the group auditor and its network. [7, 8] However, Italy requires relatively detailed disclosures that are helpful to researchers.[9] Moreover, Italian companies are permitted to appoint component auditors different from the group auditor, while some subsidiaries might not be audited because of exemptions contained in the relevant regulations. These regulatory features result in significant cross-sectional and time series variation in auditor misalignment within corporate groups.[10]

Third, in contrast to the US setting where private company financial statements are not publicly available, we can observe financial statements and auditor identities for both public companies and for subsidiaries because both private and public companies are required to file financial statements.[11] Italian private companies must submit their financial statements to the Italian

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[7] In the US, for example, the SEC clarifies, under Schedule14A, that only the fees paid to the group auditor and its network need to be disclosed. See https://www.sec.gov/info/accountants/audindep/audinfaq.htm.

[8] Similarly, in the UK, fees paid by subsidiaries to component auditors that are different from the group auditor and its network are not required to be disclosed, although voluntary disclosure is not prohibited (ICAEW 2013, TECH 14/13FRF, Question 24).

[9] For example, in the UK fees paid to the group auditor and its network for the audit of subsidiaries are not clearly separable from fees paid for other services such as tax, internal audit, and some non-audit services allowed by the regulation (Question 19 and Question 23). https://www.icaew.com/-/media/corporate/files/technical/technical-releases/financial-reporting/tech14-13frf-disclosure-of-auditor-remuneration-updated.ashx

[10] Until 2016, subsidiaries exemptions were based on relative to the group's size criteria (Consob, regolamento emittenti n.11971, 1999 and subsequent modifications, art. 151, co.1). Specifically, a subsidiary could have been exempted if its assets were less than 2% of group assets, and its revenues were less than 5% of group revenues and, the sum of assets and revenues of exempted subsidiaries were less than 10% and 15% of group assets and revenues, respectively. With the D.lgs. 17 luglio 2016, n.135, audit exemptions rules now follow the Italian Codice Civile art. 2435-bis, which is eliminates the role of relative size. The law allows limited liability partnerships and cooperative companies to be exempted if, for at least 2 consecutive years, the following criteria are met: total assets less than 4.4 million euros, revenues less than 8.8 million euros; employees less than 50. See https://www.revisionelegale.mef.gov.it/opencms/export/mef/resources/PDF/Decreto_135_17072016_ GU16916.pdf).

[11] We could not conduct a similar study for the US because archival data on private subsidiaries is not available, to the best of our knowledge.

Business Register (Codice Civile, art. 2435), allowing us to identify subsidiaries controlled by listed entities and map group auditors' coverage.[12] The accessibility of data on subsidiary auditors and subsidiary financial statements allows us to estimate the extent of misalignment between subsidiary auditors and group auditors.

Finally, Italy introduced mandatory audit firm rotation in 1975 (and mandatory partner rotation in 2006). Mandatory audit firm rotation increases the number of auditor switches and hence statistical power. Moreover, it provides reassurance that endogeneity issues are less of a concern in our analyses, as they could be in the case of voluntary auditor rotation.

While offering these advantages, Italy also shares common characteristics of the audit environment with other developed countries, including the US and the UK. For example, Italian audit firms face restrictions on the provision of non-audit services to audit clients (Cameran, 2007). Also, auditor litigation in Italy is similar to the US and UK audit markets (Wingate, 1997).[13]

4. Research design

4.1 Group Auditor Switches and Auditor Misalignment

To test our predictions, we estimate the following panel regression (with standard errors clustered at the level of the group):

$$LN_{AF_{it}} = \beta_0 + \beta_1 MISALIGN_{it} + \beta_2 SWITCH_{it} + \beta_3 SWITCH \; x \; MISALIGN_{it} \; + \; \sum \beta_j Controls_{it}$$

$$+ \sum \beta_k FIXED \; EFFECTS(Year \; and \; Firm \; or \; Industry) + \; \varepsilon_{it} \qquad (1)$$

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[12] The Italian regulation requires private commercial companies but not partnerships to file and submit financial statements (Codice Civile, art. 2423, 2423-bis and 2217). However, art. 111 duodecies (disposizioni di attuazione del Codice Civile) extends to private partnerships the same disclosure and submission requirements if the they are owned by listed companies.

[13] See also Cameran, Prencipe, & Trombetta, 2016) who report a rate of 1.42% audit partner disciplinary actions in the period 1997-2004, very similar to the US 1.49% calculated with reference to the US market (Francis, 2004).

where *LN_AF* is the natural logarithm of the group audit fees (hand collected from the parent companies' annual reports). Our test variables of interest are as follows. *MISALIGN* captures the main effect of subsidiary-group auditor misalignment on the cross-section of audit fees. In line with hypothesis H1 we expect β_1 to be negative, i.e. subsidiary auditor misalignment to be associated with lower audit fees after controlling for other common audit fee determinants. *SWITCH* is an indicator variable with the value of one in the initial year of a group auditor's engagement, and zero otherwise. The coefficient on *SWITCH* captures the effect of audit switching on reported audit fees. We also include an interaction term *SWITCH x MISALIGN* to allow for the possibility that auditor misalignment is more important for audit fees in the initial year of engagement. Consistent with the low-balling literature, we expect the coefficient on *SWITCH* to be negative if we estimate equation (1) without controlling for auditor misalignment, i.e., after dropping *MISALIGN* and *SWITCH*MISALIGN*. However, if H2 holds and auditor misalignment explains the initial year discount, we expect β_2 to be insignificant after including the auditor misalignment terms in equation (1).

In line with prior literature, we include a comprehensive set of control variables identified as potential drivers of audit fees by the prior literature (e.g., Hay et al. 2006; , Kim et al. 2012; Carcello and Li 2013; Cameran et al., 2015; DeFond et al. 2016)). We control for the tenure of the group auditor, *TENURE*, as prior literature suggests that group audit fees tend to increase with tenure; *SIZE*, *ROA*, and *LEVERAGE* to control for scale, profitability and capital structure; *INV* and *REC* to control for operational risk; *QUICK* to control for liquidity; *N_SUB* and *FOR_SUB* to account for group complexity and associated audit effort; *CFO* and *LAG_LOSS* to account for recent financial performance; *IND_SPEC* to control for auditor industry specialization and an indicator variable *Q_OPINION* set equal to one if the auditor issues a qualified opinion. We also

include *COVERAGE*, which captures the proportion of group subsidiaries for which auditors can be identified to control for potential source of noise in the misalignment proxies. Finally we include year fixed effects and estimate the equation (1) including, alternatively, firm fixed effects or industry fixed effects.[14] Appendix A contains a detailed description of all variables.

4.2 Subsidiary Auditor Switches and Initial Fee Discounts

We also test for the presence of an initial fee discount at the subsidiary level when subsidiary audit rotation occurs. Unlike group audit fees reported by the parent company, the reported fees at the subsidiary level are not affected by misalignment dynamics as they comprise only fees paid to the subsidiary auditor. Therefore, audit rotations at the subsidiary level provide an opportunity to test for strategic audit pricing in the absence of misalignment-related measurement bias. We take advantage of our hand-collected data on the subsample of Italian subsidiaries, for which we have access to annual reports, and we estimate the following subsidiary-level panel regression (with standard errors clustered at the level of the subsidiary):

$$SUB\_LN_{AF_{it}} = \beta_0 + \beta_1 SUB\_SWITCH_{it} + \beta_2 SUB\_SWITCH_{it} x \ MISALIGN_{SUB_{it}}$$

$$+ \sum \beta_j SUB\_Controls_{it}$$

$$+ \sum \beta_k FIXED \ EFFECTS(Year \ and \ Firm \ or \ Industry) + \varepsilon_{it} \qquad (2)$$

where *SUB_LN_AF* is the natural logarithm of the subsidiary audit fees. *SUB_SWITCH* is an indicator variable that takes the value of 1 when subsidiary *i* switches its auditor and 0 otherwise. Since audit pricing strategies might depend on the "type" of switch, we also discriminate among four possible switching scenarios and re-estimate the model by substituting *SUB_SWITCH* with

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[14] Industry fixed effects are widely used in the literature when modeling audit fees (Cameran et al., 2015). However, we also estimate the model with firm fixed effects as a more conservative approach to address potential omitted factor bias (Lennox, 2014).

three dummies. A dummy for subsidiaries that were misaligned and switch to align with the parent (*MISALIGN_TO_ALIGN_SWITCH).* A dummy for subsidiaries that were aligned and switch to misalign with the parent (*ALIGN_TO_MISALIGN_SWITCH).* A dummy for subsidiaries that were misaligned and that switch and stay misaligned with the parent (*MISALIGN_TO_MISALIGN_SWITCH).* The baseline category is represented by aligned subsidiaries that switch and stay aligned with the parent. Subsidiary-level control variables are described in the Appendix and are similar to those used in the main group-level analysis.

4.3 Sample and Descriptive Statistics

The sample construction is summarized in Table 1. We establish an initial sample of 246 listed non-financial companies quoted on the Milan Stock Exchange during the period 2007-2017 from Compustat Global.[15] Then, we use historical versions of the Orbis database from Bureau Van Dijk to identify the subset of 187 companies that are at the apex of a corporate group. These companies, defined as corporate Global Ultimate Owners (GUO's), are not controlled by other companies. For each firm-year from 2007 to 2017, we identify in Orbis all subsidiaries (foreign and national) owned either directly or indirectly with at least 50.01% of the voting rights. Use of this control criterion defines a set of subsidiaries where control is unambiguous and hence where the subsidiary is relevant to the group auditor. It is likely that this criterion excludes some consolidated subsidiaries controlled with lower than 50% voting rights. To the extent that we exclude consolidated subsidiaries controlled with less than 50% voting rights we add noise to our measures of misalignment and bias results towards the null hypotheses.

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[15] Representing approximately 70% of total market capitalization during the period examined. We start from 2007 since the historical versions of Orbis Bureau van Dijk, our primary source to identify the group's consolidation perimeter, are available from 2007 onwards.

[Insert Table 1 around here]

Our initial sample comprises 1,104 parent-year observations and 34,637 subsidiary-year observations. After dropping observations with missing our final sample comprises 96 unique listed parents and 668 parent-year observations, covering 2,551 unique subsidiaries and 9,097 subsidiary-year observations.

The primary data we use comes from the Orbis database, supplemented by data hand-collected from annual reports. Orbis provides the group structure of each GUO, including the number of subsidiaries within the group and the name and identifiers for each entity. We then collect subsidiary auditor identities and financial statement data. Auditor identity information is not available for all companies, especially those located in countries without mandatory public filings by private companies; data are also sometimes missing because companies might be exempt from mandatory filing or audit due to size, ownership or materiality criteria. Hence we are unable to achieve a complete mapping of subsidiaries and their auditors for some corporate groups.

[Insert Table 2 around here]

Table 2 provides descriptive statistics for the variables included in our regression models. The mean group auditor fee disclosed by listed parents is 1.5 million Euros. To provide a sense of the relative importance of parent/group audit fees relative to total reported group auditor fees, the average value of *PARENT_FEE* is 38.52 percent of total group auditor fees; the average value of *ALIGN_FEE* indicates that the total audit fees from aligned subsidiaries where audit fees are observable is 29.97 percent of total group auditor fees. Hence on average we can reconcile approximately 66.5% of total group auditor fees to detailed fee disclosures at the parent/group and subsidiary levels.

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Around 16% of companies switch their group auditor during the sample period. Further analysis reveals that most companies switch just once in our sample period and mean auditor tenure is 4.8 years. The data are consistent with the mandatory rotation period in Italy being 12 years up to 2007 (with companies being allowed to keep existing audit engagements up to the end of the original contractual term), this subsequently being reduced to 9 years from 2008 onwards.[16] The mean value of N_SUB (= Ln(#Subsidiaries) is 2.94, implying that on average companies have nineteen subsidiaries in the corporate group. *COVERAGE* indicates that on average we can identify auditors for 46 percent of all subsidiaries, implying that approximately 54 percent of all subsidiaries in corporate groups in our sample either are not audited or have auditors whose identities cannot be traced in our data sources. Of the subsidiaries with identifiable auditors, on average 19 percent have misaligned auditors different from the group auditor (*MISALIGN*). Average asset-weighted misalignment proxies are, respectively, 16 percent based on aggregate total asset in identifiable subsidiaries (*MISALIGN_A*) and 5% based on group total assets (including assets from consolidated subsidiaries with unidentifiable auditors) (*MISALIGN_B*). This preliminary evidence suggests that audit fees for subsidiaries with misaligned auditors are a potentially material element of total group audit fees omitted from aggregate group auditor fee disclosures. If some misaligned subsidiaries subsequently switch to an auditor affiliated with the group auditor firm, these fees will then be aggregated into disclosed audit fees, which then increase for reasons unconnected to strategic audit pricing.

5. Results

5.1   Tests of Hypotheses 1 and 2

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[16] D.lgs 303/2006, art. 3 (16.d) and art.8.

Table 3, reports the patterns of change in audit fees and subsidiary auditor misalignment arranged in event time around auditor switch dates. On average audit fees fall by 5.78% in the year of group auditor change, consistent with prior studies revealing an initial year fee discount. Note that this changes does not control for changes in other audit fee determinants. Table 3 also contains preliminary analysis suggesting that subsidiary auditor misalignment is also changing around group auditor switches. The percentage of subsidiaries where auditors are identifiable and also misaligned reaches a maximum in the auditor switch year (19.41% based on the number of subsidiaries and 18.40% on a total asset-weighted basis). By the second year of audit engagements the proportions of misaligned subsidiaries have fallen to 16.46% and 13.08% respectively. Over the same period audit fees increase significantly, as would be expected if the scope of audit work by group auditors extends to more subsidiaries.

[Insert Table 3 around here]

Table 4 contains the results of our main analysis based on Equation (1). It is organized as follows: Columns 1, 2, 5 and 6 are based on year- and firm- fixed effects, while columns 3,4,7 and 8 replace firm fixed effects by industry fixed effects. Results are broadly similar for the two fixed effects designs, with the more conservative firm fixed effects results providing reassurance that we are capturing within-firm variation in audit fees as function of within-firm variation in subsidiary auditor misalignment.

Column 1 of Table 4 shows results obtained after running Equation (1) after dropping the *MISALIGN* and *SWITCH*MISALIGN* terms, i.e. without controlling for subsidiary auditor misalignment. This regression specification replicates many studies documenting an initial engagement year fee discount. The coefficient on *SWITCH* is negative and significant, the coefficient on *SWITCH* of -0.099 ($p<0.05$) indicating that after controlling for other audit fee

determinants audit fees in the initial year are on average close to ten percent lower than in other audit engagement years. Results in Columns 3, 5 and 7 provide broadly similar results confirming economically and statistically significant initial fee discounts before controlling for auditor misalignment.

In columns 2, 4, 6 and 8 of Table 4 we control for misalignment of subsidiary auditors by introducing the main *MISALIGN* effect together with an interaction term *SWITCH*MISALIGN*. The interaction term allows the effect of *MISALIGN* on group audit fees to change in auditor switch years. However, it is insignificant in three specifications and only marginally significant at the ten percent level in column 2, suggesting that the role of auditor misalignment is not specific to auditor switch years. Consistent with hypothesis H1 the coefficient on *MISALIGN* is consistently negative and significant at the 5% level or better. The coefficient estimate indicates that for a 1% increase in subsidiary auditor misalignment group audit fees fall by around 0.5% depending on the specification adopted. These results highlights that the level of misalignment between group auditors and subsidiary auditors is potentially important in explaining reported audit fees, even after controlling for other standard audit fee determinants including the number of subsidiaries.

The models in columns 2, 4, 6 and 8 including control for subsidiary auditor misalignment also reveal our main result. The initial fee discount, captured by the coefficients on *SWITCH*, are extremely sensitive to controlling for subsidiary auditor misalignment. Consistent with H2 the coefficients on *SWITCH* are all insignificant at the 5% level significant once we control for subsidiary auditor misalignment. Taken together, these results confirm our hypothesis and suggest that in the year of auditors' rotation the initial fee discount observed in the prior literature is at least partly explained by changes in group auditor's portfolio.

5.2 Subsidiary auditor switch analysis

Table 5 reports the result for our subsidiary-level analysis. We find no evidence of initial year discounts at the subsidiary level. The coefficient on *SWITCH* is insignificant in both Column 1 (controlling for firm fixed effects) and Column 3 (controlling for industry fixed effects). Moreover, no differences are found depending on the "types" of subsidiary switches (except from *MISALIGN_TO_MISALIGN_SWITCH* in Column 4). Overall, the subsidiary level evidence does not suggest within-group strategic pricing behavior by group auditors.

[Insert Table 5 around here]

5.3 Additional analyses and robustness tests

We conduct the following robustness tests relating to our main group audit fee tests:

1. We compute misalignment as the sum of total assets of misaligned subsidiaries divided by *group* total assets (replacing total assets for all the covered subsidiaries in the denominator) (*MISALIGNED_B*). Our main results (untabulated) are confirmed.

2. We include audit partner switches as an additional control. Our main results are confirmed.

6. Conclusions

In this study we provide an alternative explanation for the initial fee discount (or low-balling) phenomenon. Regulators and researchers have traditionally interpreted the initial year discount in audit fee models as evidence of strategic audit pricing behavior by newly appointed audit firms. Based on the observation that in many jurisdictions the fees earned by group auditors for subsidiary company audits are included in reported group auditor fees, we predict that the extent to which the group auditor covers audits subsidiaries within the group should affect reported audit fees. We then test whether the dynamics of auditor rotation within a corporate group lead to a higher than

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normal level of misalignment between group and subsidiary auditors in group auditor rotation years. We anticipate transitory levels of auditor misalignment around group auditor rotation if subsidiaries do not switch auditors from predecessor auditor to incoming auditor at the same time as group auditor rotation occurs.

Using a sample comprising all non-financial Italian public companies that are the global ultimate owners of other companies over the period 2007-2017, we use archival data from Orbis supplemented by hand-collected data from company filings to identify subsidiary and parent auditors. We then estimate the misalignment between subsidiary auditors and group auditors for each firm-year. Based on the subsidiaries within each group for which auditors are identifiable, we observe that on average only 27% of subsidiaries with identifiable auditors have an auditor from the same audit firm as the group auditor. We also note that the percentage of subsidiaries which are "misaligned" in terms of auditor with the parent companies reaches its peak in the rotation year (19.41 percent based on the number of subsidiaries).

In audit fee regression tests, we first establish that audit fees are significantly negatively related to subsidiary auditor misalignment in the cross-section. Next, we find that subsidiary auditor misalignment fully explains the initial engagement year audit fee discount. Our results suggest that when audit fees are reported as the consolidated fees earned by the group auditor, lower audit fees in the auditor rotation year are an artifact of lower rotation of subsidiary auditors into the group auditor's portfolio. Our findings complement the recent paper by Barua at el. (2020) which also suggests that measurement bias in initial year audit fees can explain the audit fee low-balling phenomenon.

Our paper also contributes to the broader literature on audit fees determinants. We show that subsidiary auditor misalignment is an important determinant of audit fees and recommend

controlling for possible differences In patterns of allocation of audit work across group subsidiaries, especially in studies where auditor misalignment may be correlated with variables of interest to the researcher.

We believe that our study has implications for regulators around the world who appear concerned that setting artificially low audit fees might lead auditors to become more susceptible to management pressure (SEC, 1978; ACIPA, 1978; NASBA, 2010, PCAOB, 2011, IESBA, 2018). This belief has perhaps been reinforced by the large body of academic research documenting initial engagement year audit fee discounts and providing theoretical models of low-balling. While our study reports average effects and does not completely rule out the existence of strategically-motivated initial audit pricing in individual audit engagements, it does call into question findings suggesting that audit firms systematically and strategically discount initial audit fees and then increase fees in later engagement years.

Finally, we believe our findings is relevant to the regulation of audit fees disclosure. In order to interpret changes and trends in consolidated group auditor fees, and differences in audit fees across companies, financial statement users and researchers must be able to understand the scope of the audit work within a corporate group, how that changes over time, and how it compares to other corporate groups. Aggregation of audit fees within groups can be misleading if there is insufficient transparency concerning the identity of subsidiary auditors and their audit fees. In this respect, our paper demonstrates one advantage of mandated public transparency of private company financial statements.

Variables Description

Group-level analysis:	
Variables	**Description**
AUD_FEE	Total group audit fee (EUR million) (Source: hand collected from the Group Annual Reports);
LN_AF	Natural log of group audit fees (Source: hand collected from the Group Annual Reports);
PARENT_FEE	The audit fee for parent and group audit as a proportion of total disclosed group audit fee;
ALIGN_FEE	The aggregate audit fees for aligned subsidiaries as a proportion of total disclosed group audit fee;
SWITCH	Indicator variable equal to 1 if there is a change in the group auditor and 0 otherwise (Source: hand collected from the Group Annual Reports);
MISALIGN	Percentage of subsidiaries with a different auditor than the group auditor or that are audit exempted (Source: hand collection of auditors from the Italian subsidiaries' annual reports and Orbis Bureau Van Dijk for foreign subsidiaries);
MISALIGN_A	Sum of total assets of misaligned subsidiaries divided by the sum of all the covered subsidiaries' total assets (Source: Orbis Bureau Van Dijk);
MISALIGN_B	Sum of total assets of misaligned subsidiaries divided by group total assets (Source: Orbis Bureau Van Dijk);
TENURE	Total number of years the group auditor has audited the group before a switch (Source: hand collected from the Group Annual Reports);
SIZE	Natural log of group total assets (Source: Orbis Bureau Van Dijk);
LEVERAGE	Group total debt on group total assets (Source: Orbis Bureau Van Dijk);
ROA	Group operating income before interest and taxes scaled by average group total assets (Source: Orbis Bureau Van Dijk);
INV	Group total amount of inventories scaled by group total assets (Source: Orbis Bureau Van Dijk);
REC	Group total amount of receivables scaled by group total assets (Source: Orbis Bureau Van Dijk);
QUICK	Group cash and cash equivalents on group current liabilities (Source: Orbis Bureau Van Dijk);
NSUB	Natural log of the number of subsidiaries owned with more than 50 percent of voting rights (Source: Orbis Bureau Van Dijk);

FOR_SUB	Percentage of foreign subsidiaries (Source: Orbis Bureau Van Dijk);
CFO	Group operating cash flows scaled by lagged group total assets (Source: Orbis Bureau Van Dijk);
LAG_LOSS	Dummy variable equal to 1 if there is a loss in the previous year and 0 otherwise (Source: Orbis Bureau Van Dijk);
COVERAGE	Percentage of subsidiaries over total number of subsidiaries owned with more than 50 percent of voting rights (Source: Orbis Bureau Van Dijk);
IND_SPEC	Indicator variable equal to 1 if the company is audited by an industry specialist and 0 otherwise;
Q_OPINION	Indicator variable equal to 1 if the group auditor issues a qualified opinion and 0 otherwise (Source: hand collected from Group Annual Reports);
Subsidiary-level analysis:	
SUB_LN_AF	Natural log of subsidiary audit fees (Source: hand collected from Subsidiaries Annual Reports);
SUB_SWITCH	Indicator variable equal to 1 if there is a change in the subsidiary auditor and 0 otherwise (Source: hand collected from Subsidiaries Annual Reports);
MISALIGN_TO_ALIGN_SWITCH	Indicator variable equal to 1 if there is a change in the subsidiary auditor to align with the parent auditor and the subsidiary was misaligned in the previous year 0 otherwise (Source: hand collected from Subsidiaries Annual Reports);
ALIGN_TO_MISALIGN_SWITCH	Indicator variable equal to 1 if there is a change in the subsidiary auditor to misalign with the parent auditor and the subsidiary was aligned in the previous year 0 otherwise (Source: hand collected from Subsidiaries Annual Reports);
MISALIGN_TO_MISALIGN_SWITCH	Indicator variable equal to 1 if there is a change in the subsidiary auditor to misalign with the parent auditor and the subsidiary was misaligned in the previous year 0 otherwise (Source: hand collected from Subsidiaries Annual Reports);
SUB_TENURE	Total number of years the subsidiary auditor has audited the subsidiary before a switch (Source: hand collected from the Group Annual Reports);
SUB_SIZE	Natural log of subsidiary total assets (Source: Orbis Bureau Van Dijk);
SUB_LEVERAGE	Subsidiary total debt on subsidiary total assets (Source: Orbis Bureau Van Dijk);
SUB_ROA	Subsidiary operating income before interest and taxes scaled by average subsidiary total assets (Source: Orbis Bureau Van Dijk);
SUB_INV	Subsidiary total amount of inventories scaled by subsidiary total assets (Source: Orbis Bureau Van Dijk);

SUB_REC	Subsidiary total amount of receivables scaled by subsidiary total assets (Source: Orbis Bureau Van Dijk);
SUB_QUICK	Subsidiary cash and cash equivalents on subsidiary current liabilities (Source: Orbis Bureau Van Dijk);
SUB_CFO	Subsidiary operating cash flows scaled by lagged subsidiary total assets (Source: Orbis Bureau Van Dijk);
SUB_LAG_LOSS	Dummy variable equal to 1 if the subsidiary reports a loss in the previous year and 0 otherwise (Source: Orbis Bureau Van Dijk).

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Table 1: Sample Selection

	Unique GUOs	GUO-years	Unique Subs	Subsidiary-Years
Companies listed in Milan, 2007-2017 *(Source: Compustat)*	246			
Less non-GUO listed companies *(Source: BvD-Bureau VanDijk)*	(59)			
Initial GUOs and subsidiaries sample	187	1,104	13,336	34,637
Of which:				
Italian	187	1,104	3,086	10,064
Foreign	-	-	10,250	24,573
Minus subsidiaries without auditor information	19	152	10,247	20,225
Minus GUO and subsidiary observations with missing values in other key variables	72	284	1,288	5,315
Final Sample	96	668	2,551	9,097

Table 2 - Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	p25	Median	p75
AUD_FEE (EUR million)	668	1.50	3.87	0.16	0.36	0.96
LN_AF	668	6.09	1.39	5.11	5.89	6.87
PARENT_FEE	668	0.39	0.22	0.21	0.37	0.53
ALIGN_FEE	668	0.28	0.24	0.11	0.22	0.37
SWITCH	668	0.16	0.37	0	0	0
MISALIGN	668	0.19	0.16	0.07	0.16	0.29
MISALIGN_A	668	0.16	0.26	0.004	0.06	0.18
MISALIGN_B	668	0.05	0.11	0.001	0.02	0.05
LEVERAGE	668	0.68	0.28	0.55	0.68	0.77
ROA	668	0.02	0.10	-0.004	0.04	0.07
INV	668	0.12	0.11	0.02	0.09	0.20
REC	668	0.21	0.13	0.12	0.19	0.28
QUICK	668	0.27	0.41	0.07	0.16	0.32
NSUB	668	2.94	1.23	2.08	2.83	3.61
FOR_SUB	668	0.08	0.09	0	0.05	0.13
CFO	668	0.08	0.10	0.04	0.09	0.13
LAG_LOSS	668	0.34	0.47	0	0	1
COVERAGE	668	0.46	0.25	0.25	0.42	0.64
IND_SPEC	668	0.38	0.49	0	0	1
Q_OPINION	668	0.02	0.12	0	0	0

Note: All variables are defined in Appendix A.

Table 3 - Misalignment and Average Change in Audit Fees

Year	Change in Fees (%)	Sign of Change in Fees	Misaligned Subsidiaries (%) *MISALIGN*	Sign of Change in *MISALIGN*	Asset-Weighted Misaligned Subsidiaries *MISALIGN_A*	Change in *MISALIGN_A*
-3	9.09%	+	20.83%		15.38%	
-2	9.43%	+	18.49%	-	14.80%	-
-1	1.80%	+	18.95%	+	17.91%	+
0	**-5.78%**	**-**	**19.41%**	+	**18.40%**	+
1	10.98%	+	18.14%	-	16.25%	-
2	9.89%	+	16.46%	-	13.08%	-

Table 4 - Low Balling and Auditor Misalignment

Dependent variable: LN_FEE	MISALIGNMENT = MISALIGN				MISALIGNMENT = MISALIGN_A			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SWITCH	-0.099**	-0.002	-0.124**	-0.093	-0.099**	-0.055	-0.124**	-0.100*
	(0.049)	(0.045)	(0.059)	(0.060)	(0.049)	(0.041)	(0.059)	(0.052)
MISALIGNMENT		-0.005**		-0.013***		-0.003**		-0.003***
		(0.002)		(0.002)		(0.001)		(0.001)
SWITCH*MISALIGNMENT		-0.005*		-0.001		-0.002		-0.001
		(0.003)		(0.003)		(0.002)		(0.002)
TENURE	0.027***	0.028***	0.017**	0.020***	0.027***	0.028***	0.017**	0.017**
	(0.005)	(0.005)	(0.007)	(0.007)	(0.005)	(0.005)	(0.007)	(0.007)
SIZE	0.388***	0.390***	0.396***	0.370***	0.388***	0.385***	0.396***	0.391***
	(0.082)	(0.083)	(0.035)	(0.033)	(0.082)	(0.079)	(0.035)	(0.035)
LEVERAGE	0.001	0.002	0.002	0.002*	0.001	0.002	0.002	0.002
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
ROA	0.000	-0.000	-0.005	-0.006*	0.000	0.001	-0.005	-0.006
	(0.002)	(0.002)	(0.004)	(0.003)	(0.002)	(0.002)	(0.004)	(0.004)
INV	-0.002	-0.002	-0.002	-0.003	-0.002	-0.002	-0.002	-0.003
	(0.004)	(0.005)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
REC	0.003	0.003	0.001	-0.000	0.003	0.002	0.001	0.001
	(0.005)	(0.005)	(0.003)	(0.003)	(0.005)	(0.005)	(0.003)	(0.003)
QUICK	-0.000	-0.000	-0.001*	-0.001**	-0.000	-0.000	-0.001*	-0.001*
	(0.001)	(0.001)	(0.000)	(0.000)	(0.001)	(0.001)	(0.000)	(0.000)
NSUB	0.116	0.160*	0.391***	0.448***	0.116	0.128	0.391***	0.383***
	(0.088)	(0.089)	(0.051)	(0.049)	(0.088)	(0.089)	(0.051)	(0.051)
CFO	-0.001	-0.001	-0.002	-0.003	-0.001	-0.001	-0.002	-0.002
	(0.002)	(0.002)	(0.003)	(0.002)	(0.002)	(0.002)	(0.003)	(0.002)
LAG_LOSS	0.045	0.047	0.134**	0.108*	0.045	0.047	0.134**	0.132**
	(0.038)	(0.038)	(0.057)	(0.056)	(0.038)	(0.038)	(0.057)	(0.058)
COVERAGE	-0.000	0.003*	-0.003*	0.002	-0.000	0.000	-0.003*	-0.003*
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
IND_SPEC	0.075	0.075	0.132*	0.138**	0.075	0.074	0.132*	0.139**
	(0.051)	(0.050)	(0.070)	(0.064)	(0.051)	(0.051)	(0.070)	(0.068)
FOR_SUB	-0.000	0.001	0.003	0.006*	-0.000	0.000	0.003	0.004
	(0.004)	(0.004)	(0.004)	(0.003)	(0.004)	(0.004)	(0.004)	(0.004)
Q_OPINION	-0.070	-0.103	0.203	0.168	-0.070	-0.096	0.203	0.162
	(0.126)	(0.121)	(0.175)	(0.160)	(0.126)	(0.112)	(0.175)	(0.168)
Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Firm FE	YES	YES	NO	NO	YES	YES	NO	NO
Industry FE	NO	NO	YES	YES	NO	NO	YES	YES
Observations	668	668	668	668	668	668	668	668
Adj R-squared	0.29	0.318	0.888	0.901	0.29	0.313	0.888	0.891
Number of Firms	96	96	96	96	96	96	96	96

Notes: Variables are defined in Appendix A.

Robust standard errors are in parentheses.

Significance levels are denoted as follows: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 5 - Subsidiary analysis (Italian subsidiaries)

Dependent variable: SUB_LN_FEE	(1)	(2)	(3)	(4)
SUB_SWITCH	-0.017		-0.006	
	(0.028)		(0.038)	
MISALIGN_TO_ALIGN_SWITCH		0.041		0.053
		(0.043)		(0.052)
ALIGN_TO_MISALIGN_SWITCH		0.064		0.161
		(0.117)		(0.192)
MISALIGN_TO_MISALIGN_SWITCH		-0.119		-0.212**
		(0.077)		(0.088)
SUB_TENURE	0.042***	0.043***	0.037***	0.037***
	(0.006)	(0.006)	(0.008)	(0.007)
SUB_SIZE	0.165***	0.165***	0.387***	0.384***
	(0.034)	(0.035)	(0.014)	(0.014)
SUB_LEVERAGE	0.001***	0.001***	-0.000	-0.000
	(0.000)	(0.000)	(0.001)	(0.001)
SUB_ROA	-0.002***	-0.002***	-0.003**	-0.003**
	(0.001)	(0.001)	(0.001)	(0.001)
SUB_INV	-0.004***	-0.004***	0.001	0.001
	(0.001)	(0.002)	(0.002)	(0.002)
SUB_REC	0.001	0.001	0.003***	0.003***
	(0.001)	(0.001)	(0.001)	(0.001)
SUB_QUICK	0.000	-0.000	-0.000	-0.000*
	(0.000)	(0.000)	(0.000)	(0.000)
NSUB	0.018	0.019	-0.036*	-0.030
	(0.036)	(0.035)	(0.021)	(0.020)
SUB_CFO	0.000***	0.000***	-0.000**	-0.000**
	(0.000)	(0.000)	(0.000)	(0.000)
SUB_LAG_LOSS	-0.022	-0.021	0.110**	0.103**
	(0.027)	(0.027)	(0.046)	(0.045)
SUB_IND_SPEC	0.045*	0.033	0.232***	0.211***
	(0.025)	(0.025)	(0.041)	(0.041)
SUB_Q_OPINION	-0.179***	-0.193***	0.072	0.082
	(0.068)	(0.064)	(0.189)	(0.178)
YEAR FE	YES	YES	YES	YES
SUBSIDIARY FE	YES	NO	YES	NO
INDUSTRY FE	NO	YES	NO	YES
Observations	2,998	2,998	2,998	2,998
Adj R-squared	0.11	0.12	0.59	0.59
Number of Subs	805	805	805	805

Variables are defined in Appendix A.

Robust standard errors are in parentheses.

Significance levels are denoted as follows: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$