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ACCOUNTING



EMPOWERING CHANGEMAKERS FOR A BETTER SOCIETY

‘DOES A HIGH-REPUTATION AUDITOR MITIGATE HORIZONTAL AGENCY COSTS OF TAX AVOIDANCE? EVIDENCE FROM PRIVATE FIRMS’

BY MARLEEN WILLEKENS – KU LEUVEN

Co-authored by Michael Kisser and John Christian Langli



ABSTRACT

We explore whether the use of a high-reputation auditor mitigates horizontal agency costs of tax avoidance associated with ownership conflicts in private firms. Using a high-reputation auditor may impact tax avoidance as follows. First, the auditor’s own reputation concerns limit client tax avoidance. Second, a high-reputation auditor also verifies information and increases transparency for outside investors. Hence, its use serves as a credible monitoring mechanism to mitigate agency costs. Ceteris paribus, this should increase tax avoidance among firms with a high-reputation auditor and which are subject to horizontal agency conflicts. Using a unique sample of Norwegian private firms from 2000 to 2016 with detailed ownership information, we provide novel evidence that the use of a high-reputation auditor mitigates horizontal agency costs of tax avoidance. These findings are robust over time and firm size and we further provide evidence suggesting that the mitigating effect of a highreputation auditor on tax avoidance is likely causal.

JEL classification: G32, M42

Keywords: Tax avoidance, horizontal agency costs, audit quality, private firms