

**Audit Credibility and the Audit Purchasings Costs: A Theory and an
Experimental Investigation**

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The audit fees have been recently at issue in Japan. They are too low compared with other developed countries and bring Japanese audit firms to financial difficulties. Despite of concerns, most public companies in Japan give the cold shoulder, since they want to spare any cost other than operating ones. Some people fear that this may compromise the credibility of auditing in Japan. The aim of this paper is to examine how the different audit purchasings costs influence the behavior of investors and managers.

We build a simple signaling model. It predicts that the higher the audit purchasings cost is, the easier is it to get to the separating equilibrium, in which any manager who makes no effort no longer purchases an audit. The experiment is conducted based on this model. Three laboratory markets are made: whether auditing is unavailable or available but at two different audit purchasings costs. The audit report's accuracy is assumed to be unchanged, regardless of the purchasings costs, since the Japanese auditors are supposed to make a benevolent effort so as to maintain the audit quality.

Contrary to our prediction, investors invest less often at the high audit purchasings cost. Managers also make an effort less frequently. They try to cheat more often the investors, who turn out to be defensive and refrain from the investment. Perhaps they find too high the total incremental costs of creating trust on the part of the investors. They thus want to spare the cost of effort or audit purchase. Facing with this alternative, what they have chosen are to cut down on the former, more essential one. Their frustration unconsciously leads to a malicious act of reducing the investor's reward. That provokes retaliation.