

**Comments of the AFAANZ Auditing and Assurance Standards Committee on Proposed International Standard on *Auditing for Audits of Financial Statements of Less Complex Entities***

Paul Coram (University of Adelaide), Yi (Dale) Fu (Deakin University), Mukesh Garg (Monash University), Noel Harding (UNSW Sydney), David Hay (University of Auckland Business School), Mohammad Jahanzeb Khan (Deakin University), Nora Muñoz-Izquierdo (CUNEF University), Ashna Prasad (Monash University), Nigar Sultana (Curtin University), Jamie Tong (University of Queensland)

Corresponding author: David Hay, [d.hay@auckland.ac.nz](mailto:d.hay@auckland.ac.nz)

The Auditing and Assurance Standards Committee is a subcommittee under the governance of the Accounting and Finance Association of Australia and New Zealand's Auditing and Assurance Special Interest Group. The views expressed represent a consensus view of the Committee, but do not necessarily reflect the individual views of every member, nor do they necessarily represent the official position of The Accounting and Finance Association of Australia and New Zealand.

# Comments of the AFAANZ Auditing and Assurance Standards Committee on Proposed International Standard on *Auditing for Audits of Financial Statements of Less Complex Entities*

## 1. Introduction - overview of comments.

The exposure draft of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ED-ISA for LCE) is an innovative approach to a widely discussed issue in auditing, namely whether the International Standards on Auditing are appropriate for less complex entities, which might include smaller entities or certain other entities. Our submission concentrates on questions which we consider research can be helpful in answering, and is supported by references to research.

Our recommendations are:

- We agree with the self-contained nature of the standard, but suggest there should be greater clarity about the difference between less complex entities under this standard and small and medium entities covered by the stand-alone International Financial Reporting Standard for Small and Medium-sized Entities (Question 1 (a))
- We agree with the title of the standard (Question 1 (b))
- We agree with not including any quantitative threshold for application of the standard (Question 3)
- The specific prohibitions on the use of the ISA standard for listed entities and entities with certain functions should be removed in sections A.7 (b) and (c) (Question 4 (a)).
- We provide a list of characteristics of complex audits that have been used in research studies, supported by references (Question 4 (b)). We suggest further guidelines.
- We suggest that the ISAs should not be the only source for standards to be applied to LCEs (question 7)
- We recommend that consideration should be given (in conjunction with IESBA) to adapting the code of ethics for auditors conducting an LCE (question 7).
- We recommend that ISA 610 (using the work of the internal auditor) should not be excluded from the standard (question 9)
- We agree with the provision of a standard audit report providing a reasonable level of assurance to financial statement users of LCEs (question 10).
- We conclude that not including KAMs is unlikely to have a negative effect on users of LCE audit reports (question 10).
- We support the audit report including a reference to the use of the LCE standard (question 10)
- We recommend extending the standards related to agreed-upon procedures to cover LCEs (question 16)
- We urge the IAASB to encourage users to participate in the development process of the ED-ISA for LCE in order to satisfy their needs and solve any possible conceptual and practical challenges to implement this regulation (question 17).

- We generally support the standard excluding group audits, but with an exception allowing group audits in cases where there are no other component auditors (questions 22 and 24)

## **2. Responses to specific questions in the IAASB proposals.**

*2.1 Question 1 a Views are sought on: The standalone nature of the proposed standard, including detailing any areas of concern in applying the proposed standard, or possible obstacles that may impair this approach?*

- We agree with the self-contained nature of the standard, but suggest there should be greater clarity about the difference between less complex entities under this standard and small and medium entities covered by the stand-alone International Financial Reporting Standard for Small and Medium-sized Entities.

In response to question 1 (a), we agree with the stand-alone “self-contained” nature of ED-ISA for LCE. Research on financial reporting standards supports our view examining the stand-alone International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs, hereinafter). Perera and Chand (2015) critically review the development and implementation process of IFRS for SMEs and find technical concerns arising when full IFRS are applied in absence of specific guidance for SMEs.

With this in mind, we recommend that ED-ISA for LCE is fully separated and self-contained from full ISAs. Nevertheless, we note that if the “self-contained” nature is maintained, more clarity on the differences between entities considered “less complex” and “small and medium-sized” is needed for users, as entities that adopted IFRS for SMEs for financial reporting purposes could be the interested users of ED-ISA for LCE.

*2.2 Question 1 b Views are sought on the title of the proposed standard.*

- We agree with the title of the standard (Question 1 (b))

We agree on the title “*International Standard on Auditing for Audits of Financial Statements of Less Complex Entities*” of the proposed standard because it includes the nomenclature “Less Complex Entities” which is consistent with the scope of the proposed standard.

We note research highlighting that users are confounded when the title of the standard is not aligned with its scope. Perera and Chand (2015) find that the title of IFRS for SMEs is confusing to users because the qualitative nature is not aligned with the definition of SMEs, which is based on the non-listed status and does not mention any size-threshold.<sup>1</sup> They also point out that the title created controversy because this is seen as having a negative effect on their reputation by some entities which do not wish to be perceived as small or medium. We are also concerned

---

<sup>1</sup> In the IFRS for SMEs, an entity is considered an SME if it does not have public accountability and publishes general purpose financial statements for external users.

that individual jurisdictions may include size-thresholds in ED-ISA for LCE, (as in the accounting regulation of SMEs), creating comparability concerns of the LCE definition.

*2.3 Question 3: Views are sought on the Authority (or scope) of ED-ISA for LCE (Part A of the proposed standard). In particular: Is the Authority as presented implementable? If not, why not?*

- We agree with not including any quantitative threshold for application of the standard (Question 3)

In response to question 3 (a), we agree on excluding any quantitative threshold on the scope of ED-ISA for LCE, such as firms' size, following prior evidence on IFRS for SMEs literature (Eierle and Haller 2009; Perera and Chand 2015).

*2.4 Question 4, Do you agree with the proposed limitations relating to the use of ED-ISA for LCE. (a) Specific prohibitions*

- The specific prohibitions on the use of the ISA standard for listed entities and entities with certain functions should be removed in sections A.7 (b) and (c) (Question 4 (a)).

We considered whether the prohibitions in ED-ISA for LCE were appropriate. We recommend that the specific prohibitions on the use of the ISA standard for listed entities and entities with certain functions should be removed in sections A.7 (b) and (c), because:

**(1) there is evidence that entities will voluntarily choose the appropriate level of assurance that suits the requirements of their financial report users**

A large body of research highlights that entities opt for high-quality accounting and auditing information to obtain access to credit and better financing conditions to SMEs (Allee and Yohn 2009; Van Caneghem and Van Campenhout 2012; Vander Bauwhede, De Meyere and Van Cauwenberge 2015; Palazuelos et al. 2020). Similar findings apply to voluntary choice of a review (Gong et al. 2021). For example, audited financial statements positively affect firms' access to financing (Brisozzo and Albanese, 2020). Minnis, M. (2011) finds that among privately held US firms, audited firms have a significantly lower cost of debt, lenders place more weight on audited financial information in setting the interest rate, and that accruals from audited financial statements are better predictors of future cash flows.

These findings provide evidence of a relevant economic benefit of financial reporting for SMEs, which is the potential to reduce information asymmetry between SMEs and their creditors through higher quality financial reporting, so that a requirement for a particular type of audit under ISAs should not be necessary.

**(2) the need for audited financial reports varies depending on other aspects of the jurisdiction such as shareholder or stakeholder orientation management practices and company characteristics**

Published research suggests that users of SMEs financial reports differ among jurisdictions (Gassen 2017). The need for audited financial reports varies depending on other aspects of the

jurisdiction such as shareholder or stakeholder orientation (Barroso et al. 2018), managers' practices (Niemi et al. 2012; Weik et al. 2018) and company's characteristics (Collis 2010; Dedman et al. 2014; Niemi et al. 2012; Weil et al. 2018).

Examining the impact of the stand-alone IFRS for SMEs using country-level interview data of 24 countries across the globe, Gassen (2017) finds that banks, tax authorities, and, to a lower degree, inside and outside shareholders, appear to be the main addressees of IFRS for SMEs, but they differ among jurisdictions. While every expert considers banks to be relevant, tax authorities are sometimes mentioned as the prime users and other times not considered at all (for example, in Australia).

Prior research also points out relevant differences in voluntary audits among jurisdictions. In a review of prior studies on this topic, Weik et al. (2018) summarize that companies opting for voluntary audit are less common in Germany (12% of their sample) than in other countries analysed in prior literature (between 26% and 80% in Australia, Canada, Denmark, Finland, and the UK). As a result, it is not appropriate to impose a particular requirement that certain entities should use ISAs across all jurisdictions when it will not be appropriate in some settings.

**(3) it is not always known when an audit is done who the financial report users will be or what information they will need.**

Handley et al. (2018) concluded that some users of SME financial statements would be satisfied with less complex reports that provide information regarding an entity's liquidity, profitability and solvency. Other users who favour reporting according to a comprehensive set of accounting standards are concerned about unspecified future needs for financial information, particularly in the event of financial distress. There is limited empirical evidence on the needs of SME financial report users (Devi and Samujh 2015; Gassen 2017). Devi and Samujh (2015) critically evaluate the development of the stand-alone standard IFRS for SMEs. Their main concern is that there was a lack of grounded studies and empirical knowledge on SME users' needs that impeded the development of the standard. Later on, as previously explained, Gassen (2017) finds, by interviewing leading accounting experts across the world, that banks, tax authorities and, to a lower degree, inside and outside shareholders, seem to be the main users of IFRS for SMEs, although differences appear among countries.

**(4) Some listed companies are considerably less complex than others.**

We recommend that section (b) be removed so that the LCE standard can be used for listed entities. Data analysis using the Australian setting shows that a very large proportion of listed entities have audits that appear to be conducted on a small scale and are not complex. Table 1 shows descriptive statistics of Australian listed companies sorted by size deciles. The lowest decile, representing the 10% of companies with the lowest fees, has mean audit fees of \$14,000. These audits are very small, but those for the next few higher deciles are not much larger – it is not until decile 7 that mean audit fees exceed \$100,000. We do not have a detailed table of New Zealand audit fees, but based on some information from earlier years it appears that the bottom decile of NZ listed companies are not as small as those in Australia and have mean audit fees of \$25,000. The top decile mean audit fee is \$1,355,000. The audit fee for the lower half of New Zealand companies by audit fee is approximately \$80,000. These data show that there are many listed companies that appear to be less complex because they have low audit fees.

**(5) We recommend that paragraph (a) remain.**

It is reasonable to acknowledge the existence of various characteristics among different jurisdictions. Minnis, M., & Shroff, N. (2017) document that private firms face differing financial disclosure and auditing regulations around the world. For example, private firms are generally neither required to disclose their financial results nor have their financial statements audited in US and Canada. By contrast, many firms with limited liability in most other countries are required to file at least some financial information publicly and are also required to have their financial statements audited.

*2.5 Question 4, Do you agree with the proposed limitations relating to the use of ED-ISA for LCE. (b) Qualitative characteristics*

- We provide a list of characteristics of complex audits that have been used in research studies, supported by references. We suggest that entities in the lower half of any complexity measure can be regarded as less complex according to that measure.

In this section we provide a list of research about auditing that considers what factors make an audit more complex, usually in order to control for differences among auditees. There is a well-established list of characteristics that have been used to control for complex audits. We also provide data on Australian companies grouped by size. We are unable to get similar data for unlisted companies. The data analysis shows that first, there are a large number of listed companies that appear to be less complex. Second, the distribution of the data suggests that a useful guideline for “less complex” is that it refers entities in the lower half of a particular complexity measure.

The most commonly used measures for firm complexity are as follows:

### **(1) Number of Subsidiaries**

The literature which uses this proxy for firm complexity suggests that a greater number of subsidiaries is an indication of diverse operations requiring broader skills in operations, accounting and auditing (Hay et al. 2006; Abbott, Parker, Peters, & Raghunandan, 2003; Carcello, Hermanson, Neal, & Riley, 2002; Davis, Ricchiute, & Trompeter, 1993; Francis, 1984; Gul, Chen, & Tsui, 2003; Simon & Francis, 1988; Simunic, 1980; Bugeja et al. 2016).

### **(2) Number of Geographic or Business Segments or SIC Codes**

The greater the number of business segments/SIC codes that a firm operates within, the more complex the firm’s operations are likely to be. This requires the firm to demonstrate task diversity expertise and knowledge across different operating activities and regulatory requirements (Davis, et al., 1993; Francis, 1984; Simunic, 1980). More recent studies use a similar approach (Abernathy, Guo, Kubick, & Masli, 2019; Ali, Boubaker, & Magnan, 2020; Bailey, Collins, & Abbott, 2018; Barroso, Ali, & Lesage, 2018; Hansen, Lisic, Seidel, & Wilkins, 2021; Pittman & Zhao, 2021; Sultana, Cahan, & Rahman, 2020).

Firms that report a high number of segments can be viewed as the most complex and complicated both from an operating and from a reporting perspective (Cohen and Lou 2012). Other studies that define complexity as number of geographical or business segments include Chakrabarty, B., Seetharaman, A., Swanson, Z., & Wang, X. (2018); André, P., Filip, A., & Moldovan, R. (2019); Cassell, C. A., Myers, L. A., Schmardebeck, R., & Zhou, J. (2018); Pinto, I., & Morais, A. I. (2019); Zhong, R. I. (2018); Hsu, H. H., Lin, C. H., & Tsao, S. M. (2018). Jaggi, B., & Tang, L. (2017) uses product lines as a proxy for firm complexity.

The greater the geographic locations across which a firm operates, the greater the likely that the operations of the firm are complexed as a result of different jurisdictional and operating conditions the firm has to adjust to and account for (Abernathy, et al., 2019; Guo et al. Wilkins, 2021; Sultana, et al., 2020). Yiu et al. (2020) also measures operational complexity as geographical diversity. What they argue is that it should be more complex and challenging for firms to deal with geographically dispersed customers across different countries.

The existence of foreign segments combines the complexity arising from domestic business segments and their diversity with operations in a foreign country thereby magnifying the difficulties in accounting and auditing transactions from such foreign segments (Bailey, et al., 2018).

### **(3) Number/Percentage of Foreign Subsidiaries**

Foreign subsidiaries essentially proxy foreign operations which, in turn, suggest a firm working across more than one jurisdiction. This requires the firm to be able to manage complexities arising from differing day-to-day operational activities and compliance with different regulatory requirements for example, accounting standards (Abbott, et al., 2003; Gul, et al., 2003; O'Sullivan, 2000; Simon & Francis, 1988). Bugeja et al. (2016) argue that multinational diversification signals greater firm complexity. They therefore use the natural logarithm of the number of foreign subsidiaries to measure geographical diversification. Other studies that use the number of foreign operations to measure business complexity include Cassell et al. (2018).

### **(4) Percentage of Foreign Assets**

Firms with foreign assets experience similar complexities to those with foreign subsidiaries; namely the need to operate outside of their home jurisdiction resulting in the need to be familiar with different operational models and compliance regimes (Carcello, et al., 2002; Simunic, 1980).

### **(5) Foreign income/sales**

The occurrence of foreign income/sales suggests that a firm operates across one national boundary and operations in another country and currency. This introduces a level of complexity which will require greater care in operational practices and accounting for such transactions by the firm (Abernathy, et al., 2019; Ali, et al., 2020; Azizan & Shailer, 2021; Barroso, et al., 2018; Hansen, et al., 2021; Kallunki, Kallunki, Niemi, & Nilsson, 2019; Pittman & Zhao, 2021).

### **(6) National and Multinational Operations**

Firms with national and multinational operations have operations that are different thus introducing complexity into their procedures as a result of changed operating conditions (Knechel & Payne, 2001).

### **(7) Auditor-related factors**

The presence of auditors at multiple locations and the number of auditor reports issued to a client also suggests variety of firm tasks evidencing more complex operations thus requiring greater auditor attention (Palmrose, 1986).

### **(8) Firm age**

Older client firms are potentially larger and have more complex operations that require more complicated disclosures (Chakrabarty, B., Seetharaman, A., Swanson, Z., & Wang, X. (2018)). However, Lisowsky, P., & Minnis, M. (2020) investigate the financial reporting choices of medium-to-large private U.S. firms, a setting that has no financial reporting mandates, and they find that firm size, ownership dispersion, external debt, and trade credit are positively associated with the choice to produce audited GAAP financial statements, while asset tangibility, firm age, and internal debt are generally negatively related to this choice.

Research in corporate governance also uses firm age as a measure of complexity. It is argued that older firms are potentially larger and have more complex operations that require more complicated disclosures (Chakrabarty, B., Seetharaman, A., Swanson, Z., & Wang, X. (2018)).

### **(9) Merger or acquisition activities**

Firms with merger and acquisition activities have more complex operations and annual reports (Chakrabarty, B., Seetharaman, A., Swanson, Z., & Wang, X. (2018)). Research in corporate governance also considers merger or acquisition activities because firms with merger and acquisition activities (MA) have more complex operations and annual reports (Chakrabarty, B., Seetharaman, A., Swanson, Z., & Wang, X. (2018)).

### **(10) Ownership structure**

Hsu, H. H., Lin, C. H., & Tsao, S. M. (2018) argues that the increased complexity of ownership configurations as a result of cross-shareholding and pyramidal share structures typically makes it difficult for minority shareholders to detect and understand the relationship between ownership and control. As such, firms are probably not LCEs if they have complicated ownership structure such as cross-shareholding and pyramidal share structures.

Similarly, Lisowsky, P., & Minnis, M. (2020) investigate the financial reporting choices of medium-to-large private U.S. firms, a setting that has no financial reporting mandates, and they find that firm size, ownership dispersion, external debt, and trade credit are positively associated with the choice to produce audited GAAP financial statements. (Jamie comment: This paper is on medium-to-large firms. However, the logic/idea can be applied to small firms. Some measures such as ownership dispersion, internal debt, trade credit etc, though not used by previous studies, may have implications for “complexity” given that they are found to be related to the demand for audited financial reports.)

### **(11) Technology-related complexity**

Min, B. S. (2018) uses two flow variables to capture technology-related complexity: R&D expenses scaled by sales and expenditure on machinery scaled by number of employees. Though not using specific measures, Darrat, A. F., Gray, S., Park, J. C., & Wu, Y. (2016) suggest that technical sophistication has implication for complexity.

### **(12) Labour intensity (number of employees)**

Operational complexity is measured as labour intensity and geographical diversity because it should be more complex and challenging for firms to manage a large number of employees in operations and to deal with geographically dispersed customers across different countries. (Yiu, L. D., Lam, H. K., Yeung, A. C., & Cheng, T. C. E. (2020))



## **Analysis of data to determine criteria for less complex entities**

We examined the audit fees of listed Australian companies to illustrate the effect of some of these factors on complexity. Audit fees depend on the inputs required to achieve effective audit outcomes and likely depend on the inputs and their associated costs (Knechel and Sharma 2012). The two important audit costs that determine audit effort and fees are hourly rates and hours spent on the audit engagement. Audit effort will, therefore, depend on the complexity of the audit client.

Since we do not have access to a complete set of variables for the audit fees model for unlisted reporting entities, we employ data for ASX-listed companies from 1995 to 2021 to provide evidence on client firm characteristics that affect audit effort and audit fees. First, we divide 25,140 firm-year observations into deciles based on audit fees. We find that firms paying high audit fees have significantly higher total assets, geographic and business segments, foreign operations and inventory and receivables. The results are consistent for both the top and bottom decile. Low audit fees paying clients (mean=\$14,000; median=\$15,000) have significantly lower total assets (mean=\$28.4m; median=\$4.18m), number of geographic segments (mean=1.305; median=1) and business segments (mean=1.001; median=1), and foreign operations (mean=0.066; median=0). We also conduct a two-sample *t*-test to test whether the means of client firm characteristics for the low and high audit fees groups are equal or not. Sample of high audit fees firms has significantly higher total assets, geographic and business segments, foreign operations and inventory and receivables. The results are consistent for both the top and bottom decile. Low audit fees firms have significantly lower total assets, the number of geographic and business segments, foreign operations and inventory and receivables. Our results are supported by regression analysis of the determinants of audit fees (details available on request).

**Table 1: Descriptive statistics for Australian listed companies by audit fee decile****Panel A: Means of descriptive statistics for Australian listed companies by audit fee decile**

Decile	No. of client -year observations	Audit fees (millions)	Total assets (millions)	Receivables - Total	Inventories - Total	Intangible Assets - Total	PPE - Total (Net)	No. Geographical segments	No. Business segments	Foreign operations	Extra ordinary items	Operating income
1	2514	0.014	28.408	2.102	2.503	9.098	5.973	1.305	1.001	0.066	0.012	0.397
2	2514	0.025	13.248	0.621	0.388	1.211	6.644	2.100	1.012	0.129	-0.061	-1.585
3	2514	0.032	18.511	0.793	0.332	1.784	10.010	2.204	1.026	0.179	0.006	-1.950
4	2514	0.040	20.819	1.119	0.599	1.514	8.459	2.469	1.025	0.235	-0.010	-3.030
5	2514	0.053	25.355	1.633	0.882	2.220	11.851	2.427	1.018	0.277	0.007	-2.514
6	2514	0.072	51.513	3.787	2.018	4.132	18.327	2.878	1.023	0.322	-0.325	-1.889
7	2514	0.104	112.574	10.236	5.878	16.334	39.017	3.274	1.025	0.385	0.232	1.230
8	2514	0.165	189.918	18.931	11.690	31.820	76.856	3.754	1.040	0.441	1.782	10.774
9	2514	0.310	433.055	42.605	34.844	77.504	165.606	5.593	1.115	0.479	0.014	23.433
10	2514	9.251	4992.820	424.426	290.918	978.600	2334.940	7.100	1.261	0.492	5.121	455.552
Full sample	25140	1.006	578.379	49.749	34.399	111.285	263.051	3.310	1.055	0.300	0.669	47.066

**Panel B: Median of descriptive statistics for Australian listed companies by audit fee decile**

Decile	No. of client -year observations	Audit fees	Total assets	Receivables - Total	Inventories - Total	Intangible Assets - Total	PPE - Total (Net)	No. Geographical segments	No. Business segments	Foreign operations	Extra ordinary items	Operating income
1	2514	0.015	4.18	0.05	0.00	0.00	0.61	1.00	1.00	0.00	0.00	-0.66
2	2514	0.025	5.33	0.07	0.00	0.00	1.51	1.00	1.00	0.00	0.00	-1.06
3	2514	0.032	7.00	0.09	0.00	0.00	2.45	1.00	1.00	0.00	0.00	-1.45
4	2514	0.040	8.95	0.14	0.00	0.00	2.17	1.00	1.00	0.00	0.00	-1.75
5	2514	0.052	12.32	0.33	0.00	0.00	2.64	1.00	1.00	0.00	0.00	-1.89
6	2514	0.072	19.05	0.80	0.00	0.00	3.20	1.00	1.00	0.00	0.00	-2.04
7	2514	0.103	37.18	2.53	0.38	0.51	5.45	1.00	1.00	0.00	0.00	-1.10
8	2514	0.162	72.52	7.50	2.18	3.19	12.94	1.00	1.00	0.00	0.00	0.80
9	2514	0.295	221.73	23.15	8.34	13.88	36.40	1.00	1.00	0.00	0.00	11.16
10	2514	0.989	1679.62	168.40	61.75	252.20	372.42	1.00	1.00	0.00	0.00	100.06
Full sample	25140	0.061	18.52	0.66	0.00	0.00	4.59	1.00	1.00	0.00	0.00	-0.94

Notes: All figures for financial data are in the Australian Dollar in millions. Geographical and business segments are counts, and foreign operations is a categorical variable, with 1 indicating the existence of foreign operation, and 0 otherwise.

*2.6 Question 7 Views are sought on the key principles used in developing ED-ISA for LCE as set out in this Section 4C. Please structure your responses as follows:*

*The approach to how ISA requirements have been incorporated into the proposed standard (see paragraphs 74-77).*

- We suggest that the ISAs should not be the only source for standards to be applied to LCEs.
- We recommend that consideration should be given (in conjunction with IESBA) to adapting the code of ethics for auditors conducting an LCE.

As noted in paragraphs 74 to 77, the approach to incorporating ISA requirements in the proposed standard was to use requirements in the ISAs as a base. We are concerned that this approach detrimentally constrains the effectiveness of the proposed standard in meeting the purposes for which it is being drafted. The approach is problematic in that the content of the proposed standard is limited to that which is already included in the suite of ISAs (that have been written and subsequently revised with a more complex entity in mind).

Research highlights that the agency relationships for which auditing reduces information asymmetry are different in private companies compared to public companies (Chen, Hope, Li and Wang 2011; Langli and Svanstrom 2014). In this regard, agency conflicts in private firms are more likely to be between majority and minority shareholders and between ownership interests and debtholders than between ownership and management (as is the case in public companies) (e.g., Carey, Simnett and Tanewski, 2000; Niskanen, Karjalainen and Niskanen, 2010; Schierstedt and Corten, 2021). Compared to publicly listed firms, private firms have fewer incentives to report high quality earnings (Ball and Shivakumar, 2005) and the cost of switching auditors for small business is relatively low (Abbott, Gunny and Zheng, 2013). Relatedly, the users of, and use for, audited financial information are different in private companies (e.g., Dedman, Kausar and Lennox, 2014).

In addition, less complex entities are more likely to be audited by a small practice (Ghosh and Lustgarten, 2006). Smaller professional practices conduct audits in smaller teams (Langli and Svanstrom, 2014), with different relationships among team members (Harding and Kim, 2021), and rely on different knowledge sharing and support networks through which to support firm and engagement level quality (Sundgren and Svanstrom, 2013). In smaller practices, threats to independence manifest themselves in different ways (Langli and Svanstrom, 2014), and threats from economic bonding may not be as significant (Hope and Langli, 2010). Importantly, reputation and litigation costs that drive positive behaviors in larger audit practices are not as salient in small to medium practices (Johnstone and Bedard, 2003; Bell Causholli and Knechel, 2015; Hardies, Vandenhoute and Breesch, 2018).

*2.7 Question 7 (continued):*

*(c) The principles in relation to professional skepticism and professional judgment, relevant ethical requirements and quality management (see paragraphs 81-84).*

- We recommend that the essential explanatory material be strengthened to remind auditors that strong and long-standing relationships, and beliefs as to management

honesty and integrity that these relationships foster, does not relieve the auditor of the need to remain skeptical.

We provide comment in response to this question under the headings of ‘Professional Skepticism’, ‘Relevant Ethical Requirements’, and ‘Quality Management’.

#### Professional Skepticism

The stronger relationship between the auditor and client management / personnel in audits of less complex entities gives rise to unique threats to the exercise of an appropriate level of skepticism that are not as significant in audits of more complex entities. The past experience that the essential explanatory material associated with paragraph 1.4.6 refers to is likely to be more salient and a greater threat than is the case when auditing more complex entities (where there are fewer opportunities to develop strong social bonds). We recommend that the essential explanatory material be strengthened to remind auditors that strong and long-standing relationships, and beliefs as to management honesty and integrity that these relationships foster, does not relieve the auditor of the need to remain skeptical. We recommend that the expression of the underlying principle of professional skepticism be strengthened.

We note literature highlighting the increased significance of social bonding in audits of private companies (and by inference, audits of less complex entities) (Langli and Svanstrom 2014). This has implications for the exercise of professional skepticism in that research has shown that objectivity can be compromised when the auditor identifies with their client (Bamber and Iyer, 2007; Stefaniak, Houston and Cornell, 2012) and when a social bond exists between the auditor and the client by way of audit firm alumni associations (Favere-Marchesi and Emby 2018). Similarly, Kadous, Leiby and Peecher (2013) find that auditors employ a trust heuristic (or rule of thumb) when evaluating advice from colleagues with whom they have a stronger social bond and do not subject the advice to critical evaluation.

#### Relevant Ethical Requirements

We recommend that the IAASB liaise with IESBA as the project progresses with a view to considering the appropriateness of Section 600 of the Code and the current restrictions on the provision of non-assurance services to less complex (owner manager) clients.

We recognize the importance of complying with a high ethical standard when performing audit (and other assurance and related services). This is the case, irrespective of the nature of the practitioner and client. However, given the objective of this project, and with reference to extant research literature, we recommend that the IAASB give greater attention to the unique independence issues that are present in audits of less complex entities and liaise with the IESBA with a view to being satisfied that current ethical requirements around the provision of non-assurance services (i.e., Section 600 of the Code) are fit for purpose and complement the application of the proposed standard. Guo, Kinory and Zhou (2021) review PCAOB disciplinary orders on small US domestic audit firms and find that concerns around auditor independence frequently arise. Small and medium audit practices tend to have closer connections to local businesses (Louis, 2005), and social bonding with owners/managers is a greater threat to independence in audits of less complex entities than is the case for larger more complex entities (Svanstrom, 2013; Langli and Svanstrom, 2014).

We also note ongoing discussion around the provision of non-assurance services by small and medium practices to their less complex (owner-manager) clients. With regard to the impact on audit quality of the provision of non-assurance services to private companies, the research is mixed. Svanstrom (2013) reports results consistent with the understanding that there are knowledge spill overs associated with the provision of non-assurance services such that audit quality is improved. Bell, Causholli and Knechel (2015), on the other hand, find that audit quality decreases with the provision of non-assurance services to privately held clients. We further note in our response to Question 9 that the performance of risk assessment in an audit of less complex entities is a challenge, and the increased knowledge (and the positive spill over effects often associated with the provision of non-assurance services) may go some way to alleviating this threat to audit quality.

### Quality Management

We recommend that the IAASB reinforces the principles of firm and engagement level quality control in an audit of a less complex entity by supplementing the material currently presented in the proposed standard to reflect important differences between small to medium practices and those larger practices for which much of the material in ISQM 1, ISQM 2 and ISA 220 is written.

With reference to quality management, we concur with the principle that those practitioners completing an engagement with reference to the proposed standard are subject to the IAASB's Quality Management standards (or national equivalents that are at least as demanding). At the same time, however, we highlight differences in the structure and organization of the small and medium practices that perform these engagements and note the need for additional essential explanatory material in Section 1 as it relates to firm quality management and Section 3 as it relates to engagement quality management.

Research highlights that auditors in small and medium practices do not have the same opportunities as auditors in larger practices to seek advice from colleagues (Langli and Svanstrom, 2014; Sundgren and Svanstrom, 2013). Small to medium practices, instead, rely on other mechanisms to compensate for this knowledge deficit (such as formal networks and insurers) (Bills, Hayne and Stein, 2018; Frank, Maksymov, Peecher and Reffett, 2021). Research further highlights that differences in the interpersonal relationships and interactions between engagement team members across large and small practices means that partners in small practices need to be especially careful in directing the work of their subordinates, or otherwise risk inappropriately influencing the audit judgments of those subordinates (Harding and Kim, 2021).

*2.8 Question 9: Please provide your views on the content of each of Parts 1 through 8 of ED-ISA for LCE, including the completeness of each part. In responding to this question, please distinguish your comments by using a subheading for each of the parts of the proposed standard.*

- We recommend that ISA 610 (using the work of the internal auditor) should not be excluded from the standard .

In our response to Question 7 above, we note our concern around the approach to developing ED-ISA for LCE, in that it is limited to circumstances already included in the extant suite of ISAs and, as a consequence, excludes the consideration of circumstances that are unique to an audit of a less complex entity. We are of the view that broadening the base from which the contents of the proposed standard is sourced (to important but unique circumstances prevailing in audits of less complex entities but not noted in the current suite of ISAs), will improve the effectiveness of the proposed standard.

#### Excluding consideration of the work of internal auditors

ED-ISA for LCE explicitly excludes requirements relating to ISA610 ‘Using the Work of Internal Auditors’. This is justified on the basis that internal auditors are most likely to be engaged in entities with higher complexity and, therefore, the requirements relating to the use of the work of the internal auditor are not relevant to audits of less complex entities.

We are concerned that this may lead to the unintended consequence of scoping entities out of the proposed standard when they engage an internal auditor (in-house or outsourced), notwithstanding that they may meet all other requirements. In circumstances where the client engages an internal auditor, the external auditor would necessarily need to ‘top-up’ their use of the standard for LCEs with reference to ISA 610. This is not permitted and would scope the engagement out of the standard, forcing the practitioner into a new engagement under the full suite of ISAs. We do not believe that this is consistent with the objectives of the proposed standard, nor in the public interest. Moreover, research suggests that the use of internal audit may be more common in less complex entities than is currently understood to be the case.

Carey, Simnett and Tanewski (2000) report that among family businesses, internal audit was more common than external audit, and that unlike the situation in listed public companies, internal auditing is seen in family businesses as a substitute rather than a complement to external audit. Indeed, when requesting an audit in a voluntary environment, the needs of less complex entities are such that internal audit services are often seen as being more appropriate. This is consistent with the understanding that significant users of the audited financial statements in private companies are the entity’s owner/managers who are seeking reliable financial information on which to make decisions (Collis, Jarvis and Skerratt, 2004).

Given the potential unintended consequences of excluding coverage of internal auditors in the proposed standard, the apparent greater use of internal audit (or similar) service in less complex entities than that recognised when justifying the exclusion of this material from the proposed standard, and the nature of internal audit relative to external audit in less complex entities, we recommend that the IAASB reconsider the exclusion of ISA 610 material from the proposed standard. We also refer the IAASB to our commentary on the appropriateness of Section 600 of the IESBA Code which limits the provision of non-assurance services to audit clients, including internal audit work

#### Part 1 – Fundamental Concepts, General Principles and Overarching Requirements

On the basis of the extant academic research, we are of the view that the coverage of material on relevant ethical requirements and firm level quality management (Section 1.2), as

well as professional skepticism (Section 1.4.5 – 1.4.6), needs to be elaborated upon in order to reflect unique but important characteristics of less complex entity audits.

While we acknowledge that responsibility for ethical standards lies with IESBA, we are concerned that extant ethical requirements, especially as they relate to the provision of non-assurance services (i.e., Section 600 of the Code), are such that they may potentially impede the realization of the public interest benefits of the proposed standard. We encourage the IAASB to liaise with IESBA with a view to considering whether, as is the case with audits of public interest entities, practitioners performing audits of less complex entities should be subject to different requirements when ensuring independence.

Consistent with research focussed on publicly listed entities (see Beardsley, Imdieke and Omer 2021 for a recent summary) the limited research addressing private companies reports mixed results as to the effect on audit quality of auditors also providing non-assurance services to their clients. Svanstrom (2013) reports that the provision of non-assurance services is positively associated with audit quality while Bell, Causholli and Knechel (2015) report that audit quality decreases with the provision of non-assurance services to privately held clients. We discuss below concerns we have with regard to risk assessment in audits of less complex entities and the provision of non-assurance services may be associated with knowledge spill overs that improve the auditor's understanding of the client and its environment. We also note research reporting that the demand for audit in a voluntary environment is positively associated with the provision of non-assurance services (Dedman, Kausar and Lennox 2014). We recommend that the IAASB liaise with IESBA with a view to being confident that Section 600 of the Code as it relates to the provision of non-assurance services to less complex clients remains fit for purpose and facilitates rather than inhibits the achievement of a high quality audit under the proposed standard.

Independent of the appropriateness of Section 600 of the IESBA Code to less complex clients, we are of the view that, given the fundamental importance of complying with ethical requirements, and unique issues impacting audits of less complex entities, reference to the ethical requirements in Section 1.2.1 warrants the addition of essential explanatory material (at present, this material is limited to reference to firm level quality management).

Less complex entities are more likely to be audited by smaller practices (Ghosh and Lustgarten 2006) and threats to independence manifest themselves in different ways when small to medium practices audit less complex entities. While social bonding and familiarity threats may be more of a concern in audits of less complex entities (e.g., Langli and Svanstrom, 2013), threats from economic bonding may be less of a concern (Hope and Langli, 2010). In addition, research highlights that the voluntary demand for audit in private companies is associated with the demand for non-assurance services (Dedman, Kausar and Lennox, 2014), putting additional pressure on practitioners to remain compliant with ethical standards. We recommend that the essential explanatory material associated with Section 1.2.1 be elaborated upon to reinforce auditors' responsibilities in this regard.

We also believe that the proposed standard can be enhanced to reinforce opportunities to improve firm level quality management in small to medium practices. Practitioners working

in small to medium practices do not have the same opportunities as auditors in large practices to seek advice from colleagues and to discuss difficult judgments. They have less access to firm training and policy manuals and cannot as easily access quality reviews (with many practices operating as sole practitioners or with a small number of partners) (Langli and Svanstrom 2014). This can impede the effective application of the proposed standard for less complex entities and even cloud judgments as to whether the proposed standard remains applicable in circumstances of increased complexity.

Challenges in managing firm level quality in a small practice are significant. In addressing these challenges, Frank, Maksymov, Peecher and Reffett (2021) report that smaller practices can benefit from the risk management knowledge of their insurers, and Bills, Hayne and Stein (2018) find that small firm membership of accounting associations and networks (AANs) can help build competencies and improve audit quality (as well as enhance market legitimacy).

With reference to this research, we recommend that the IAASB elaborate on the essential explanatory material in paragraph 1.2.1 to increase the salience of the unique challenges in small to medium practices and to reinforce the need to manage these unique threats to quality management.

Research also highlights opportunities for the proposed standard to note unique circumstances impacting the exercise of professional skepticism in an audit of a less complex entity and, in doing so, make it more likely that auditors will exercise a level of professional skepticism appropriate to the circumstances. Research notes that social bonding is a greater threat in audits of less complex entities as auditors build strong, often long term, relationships with owner-managers (Langli and Svanstrom, 2013). Research highlights that objectivity can be compromised in circumstances where the auditor identifies with the client (Bamber and Iyer, 2007; Stefaniak, Houston and Cornell, 2012) and Kadous, Leiby and Peecher (2013) suggest that auditors may be overly trusting when there is a strong social bond. We recommend that the essential explanatory material associated with paragraph 1.4.6, and in particular the material on past experience with the entity's management, be elaborated upon such that the auditor using the proposed standard is aware of the threats to the appropriate exercise of professional skepticism that they must address.

### Part 3 Engagement Quality Management

The material on engagement quality management, quite appropriately, emphasizes the direction, supervision and review of members of the engagement team. Research, however, highlights that there are differences in the relationships between members of the engagement team across large and small practices (Langli and Svanstrom, 2014; Harding and Kim 2021). Given that audits of less complex entities will often be undertaken by small to medium practices (Ghosh and Lustgarten 2006), we are of the view that the material in Part 3 could be usefully expanded to increase the salience and implications of these different relationships. Research highlights that the interpersonal relationships between members of the engagement team in small practices are such that partners may inadvertently and inappropriately influence the judgments of their subordinates when directing and supervising their work (Harding and Kim 2021). In particular, Harding and Kim (2021) find that auditor judgments are more



aligned with their superior's preference in smaller practices. We recommend that the IAASB consider elaborating on the essential explanatory material accompanying paragraph 3.2.4 such that the practitioner is cognisant of the need to avoid inappropriately influencing a subordinate's judgments through their direction, supervision and review.

#### Part 6 – Risk identification and assessment

On the basis of research highlighting that small and medium sized practices may not effectively apply risk assessment procedures as required in ISA315, we are concerned that the material included on risk identification and assessment is inadequate for the purposes of conducting this critical component of the audit process.

Van Buuren, Koch, van Nieuw Amerongen and Wright (2014) find that auditors in small and medium sized audit practices often do not apply business risk perspectives (as required in ISA315), choosing instead to follow a more historic systems or substantive approach. Subsequent work by the same authors (van Buuren, Koch, van Nieuw Amerongen and Wright 2018) finds that many auditors in small and medium practices have not embraced business risk auditing, believing it to be too complex and that previous approaches remain effective.

We recommend, therefore, that the IAASB reinforce the importance of contemporary risk assessment, based on business risk, in achieving a reasonable level of assurance by expanding on the essential explanatory material associated with Section 6.1.1, and reminding auditors of less complex entities that the contemporary approach to risk assessment is required, even in less complex entities. We also note our comments above with regard to restrictions on the provision of non-assurance services and the potential impediments that this may pose to effectively and fully understanding the client and its environment and, therefore, the effective conduct of risk assessment.

*2.9 Question 10: For Part 9, do you agree with the approach taken in ED-ISA for LCE with regard to auditor reporting requirements, including:*

- (a) The presentation, content and completeness of Part 9.*
- (b) The approach to include a specified format and content of an unmodified auditor's report as a requirement?*
- (c) The approach to providing example auditor's reports in the Reporting Supplemental Guide.*

- We agree with the provision of a standard audit report providing a reasonable level of assurance to financial statement users of LCEs (question 10).
- We conclude that not including KAMs is unlikely to have a negative effect on users of LCE audit reports (question 10).
- We support the audit report including a reference to the use of the LCE standard (question 10)

Our assessment of the proposed changes to auditor reporting in the ISA for LCE is that auditors will be required to produce an audit report that is similar to an audit report as required by ISA 700. However, there are two main differences in the ISA for LCE audit requirements:

- No KAMs are required
- The audit report will state that it was conducted under the ISA-LCE standard

We therefore present the following research to address the reporting requirements in the Proposed ISA for LCE.

- The value of a standard audit report
- What do users perceive from the standard audit report?
- How successful have the recent changes been to expand the audit report through KAMs?
- How do users perceive different levels of assurance?

### **The value of a standard audit report**

A significant amount of evidence shows that the auditor's report is an important signal to users of financial statements. Archival research has also shown that users evaluate the quality of auditing by using surrogates such as auditor size, brand, or reputation. An overall evaluation of this research concludes that the quality of auditing is high (Francis 2004). In relation to whether users determine the quality of the auditor's report through actually reading the auditor's report – it does not seem this is commonly done. Most people (including sophisticated financial statement users) have only a limited knowledge of what an auditor does and do not appear to focus much attention on the actual contents of the auditor's report.

The audit report presented in the LCE standard provides a fairly 'boilerplate' approach to reporting. Research has shown that this type of report is not well understood by users; however, from our review of the literature, that does not necessarily mean that it is not potentially the right approach for LCEs.

### **What do users perceive from the auditor's report?**

Research on the actual evaluation of unmodified auditor's reports has been mainly through behavioural research methods. Experimental research has tried to evaluate the success of some of the changes to the auditor's report to improve the communicative value and potentially reduce the expectations gap. Initial research emerged from the changes that came through to auditor's reports with SAS 58 in 1988 in the US. Studies examined potential effects on both sophisticated and unsophisticated users.

In evaluating sophisticated users, Kelly and Mohrweis (1989) examined bankers and investors perceptions of the old and 'new' auditor's reports and found that understandability was increased about the purposes of the audit. However, bankers actually perceived auditors to have less responsibility due to the expanded disclosures. Miller et al. (1993) performed an experiment with bank loan officers and found that these users better identified the new disclosures on auditors and managers roles. However, users' misperceptions regarding fraud and the scope of the audit remained unchanged.

In evaluating unsophisticated users, Hatherly et al. (1991) examined whether the new auditor's report reduced the expectations gap. In an experiment with MBA students, they found the expanded auditor's report had an effect on perceptions in most of the areas that it directly addressed. However, they also found the expanded auditor's report increased the perceptions that: *the auditor is satisfied with the financial statements, the company is free of fraud, and the audit adds credibility to the financial statements*. The authors describe this finding as a 'halo effect' since these issues were not addressed in the expanded auditor's report.<sup>2</sup> Monroe and Woodliff (1994) compared the old to the new auditor's report across a number of different user groups, including auditors. They found that the expectations gap decreased in some areas

---

<sup>2</sup> In psychology, the 'halo effect' relates to a judgement of a particular person being overly influenced by the impression of that person. In Hatherly et al. (1991) they describe the 'halo effect' where "the expanded wording [of the auditor's report] seems to generate a feeling of well-being which spills over to provide significant changes for certain other dimensions not directly addressed by the expanded wording of the report." (Hatherly et al. 1991: 315)

addressed by the wording changes, such as auditors and managers roles. However, consistent with the idea of a ‘halo effect’, the gap actually increased with the new auditor’s report in areas that are not the auditors’ responsibility, such as whether the auditor should prevent fraud and evaluate the future prospects of the company. The research evidence shows that these changes to the auditor’s report had mixed effects on users’ perceptions.

There was not much further research on the audit report until the more recent changes to the audit reporting model were proposed and in revising ISA 700 (IAASB 2005). Chong and Plugraht (2008) experimentally evaluated whether the changes reduced the expectations gap or not by examining the perceptions of shareholders and auditors. Consistent with previous research, the changes did not reduce the expectations gap, and in actual fact, there were more perception differences with the longer form report. A focus group study by Gray et al. (2011) included a variety of user groups. They found: (1) the intended communications from an unqualified auditor’s report<sup>3</sup> is not particularly clear to preparers, users and auditors; (2) users have difficulty understanding key concepts in the auditor’s report; and (3) users do not read the auditor’s report, instead just look at it to ascertain whether it is unqualified or not. A verbal protocol study of 16 financial analysts evaluating audit reports by Coram et al. (2011) found that the auditor’s report per se is deemed essential by this important group of users. Collectively, these studies denote the symbolic value of the auditor’s report and indicate that little attention is placed on the actual content of these reports.

Mock et al. (2013) performed a synthesis of research on the audit reporting model. In relation to information about the audit report content, they conclude that the average user is not interested in carefully evaluating the current audit report because it is such a standard product. They also find that expanded disclosure about the audit does little to improve this communicative value. However, consistent with an earlier review by Church et al. (2008), they conclude that audit reports have “symbolic value”, which may be partly due to the boilerplate language of the report. Changes to the auditor’s report through further expansion of the wording were again made internationally with the issuance of ISA 700 (IAASB 2005).

In summary, research on the early versions of the auditor’s report has found issues with how well different users understand what the audit report communicates. Moreover, some of the changes to the wording of the audit reports did not make much difference on this.

### **Options to expand the audit report through Key Audit Matters (KAMs)**

The other topic to consider is whether to provide an expanded audit report which is not part of the LCE ED but has been allowed through the reporting of KAMs. This option in ISA 701 was made available for listed entities for periods on or after 15 December 2016. There has been considerable research into the value of these types of disclosures leading up to and after the issuance of this new audit standard on communicating KAMs in the independent auditor’s report.

An experiment study asks the research question, *when do investors value key audit matters?*; the findings of which are very relevant to the context of LCEs audit reporting that currently excludes KAMs. Moroney et al. (2021) find that non-professional investors’ perceptions about an audit’s value and the auditor’s credibility are no different when provided with old versus new (but without any KAMs) audit report format. In investigating whether

---

<sup>3</sup> This was the accepted terminology at the time. The appropriate description for this type of audit report according to ISA 700 is ‘unmodified’ audit opinions.

KAMs inclusion affects these unsophisticated users' perceptions, the authors find that yes, it does improve perceived value and credibility but only for audits conducted by the smaller audit firms (i.e., not the Big 4). Big 4 audits are not perceived to be of any higher quality in the presence of KAMs, and the number of KAMs reported do not affect investor perceptions regarding the value and credibility of an audit by all audit providers (Big 4 and non-Big 4). The authors also find that the inclusion of KAMs detracts users' attention away from other core messages of the audit report. Another experiment examines sophisticated users (105 bank directors) perceptions and finds no material effect when the audit report is expanded to include KAMs or materiality levels (BooLaky and Quick, 2016). Materiality disclosure has been observed to be voluntarily reported in the Australian context by a single audit firm, PwC. Kend and Nguyen (2020) rationalise that the release of materiality thresholds by PwC in their audit reports may be to enhance users' understanding of KAMs if they are also made aware of auditor judgments around audit scope and materiality. Further, in investigating recent audit reform in Australia, the authors find that around 70% of Australian auditees had the same KAMs disclosed between the initial two years (2017-2018), and differences exist between client industry sectors and size in relation to KAMs reporting. Notably, the average number of KAMs reported and audit procedures undertaken per KAM vary between large and small audit practitioners, indicating differential reporting of KAMs in practice, which may be a function of firms' policies on KAMs implementation and disclosure or client-related factors.

An early archival study to look at expanding audit disclosures came from France as they have required 'justification of assessments' in audit reports since 2003. Bédard, Gonthier-Besacier, and Schatt (2019) found no significant affects from this expanded disclosure in terms of market reactions or audit outcomes. The first archival research to specifically assess the consequences of adopting the new expanded auditor's report (EAR) came out of the United Kingdom, one of the first to implement the EAR internationally. Using difference-in-differences analyses and company data over the period 2011-2015 (surrounding EAR requirements effective 30 September 2013), Gutierrez et al. (2018) does not find evidence that the new audit report format significantly affected investors' short-term reaction to the release of auditors' reports. This indicates that the EAR lacks incremental or decision-useful information beyond that provided in traditional audit reports. Lennox et al. (2021) echo this finding by utilising long-window tests to rule out any delayed investor reactions to EARs, the number and types of auditors' risk disclosures. The authors conclude that investors were aware of entity-specific financial reporting risks well before auditors disclosed these in the EARs. Overall, premium-listed UK entities lie at the high end of the size and reporting quality spectrum, whereby additional audit disclosures adds little to an already rich information environment.

Research has also examined the indirect consequences of the new reporting regime on audit quality and fees. Regarding audit quality using the absolute value of discretionary accruals as a proxy, Gutierrez et al. (2018) does not find any evidence of an impact from the EAR implementation, whereas another study does. Specifically, Reid et al. (2019) find that EAR in the UK is associated with an improvement in financial reporting quality. However, their proxies of absolute abnormal accruals, the propensity to just meet or beat analyst forecasts, and earnings response coefficients are not exclusively indicative of higher audit quality (but rather overlap with earnings quality). All three aforementioned UK studies conclude that the introduction of EAR did not significantly impact audit costs in terms of audit fees. However, higher audit fees have been observed in other jurisdictions. For example, Li et al. (2019) find that upon adopting the new audit reporting requirements in New Zealand, audit fees increased significantly by an average of NZD36800. The authors also note an

improvement in audit quality as seen by a reduction in absolute abnormal accruals. They propose three-fold reasoning for their findings. First, the theory of credence goods may explain the audit fees increase, whereby auditors act strategically to charge higher fees even though additional disclosures per se may not entail additional audit effort. Second, additional disclosures may actually require greater audit effort resulting in the observed higher audit fees. Third, since EAR requires auditors to disclose audit-specific information, they may, in fact, be pricing in potential liability costs.

Research has investigated the likely impact of expanded audit disclosures on perceived auditor liability. Employing an experimental design, Gimbar et al. (2016) manipulate US Critical Audit Matter (CAM) disclosure (i.e., no CAM, CAM related to a litigated issue, or unrelated CAM) and accounting standard precision (precise or imprecise) to gauge negligence assessment by eligible jurors. The authors find their participants to have a lower propensity to issue verdicts against the auditor when CAM is absent, and the client's accounting follows a precise accounting standard (compared to an imprecise or principles-based standard). Further, under precise standards, both related and unrelated CAMs are found to increase auditor liability. Regarding an interaction of the two factors, CAMs are found to increase auditor liability by a lesser amount under imprecise standards than precise standards; this may be because jurors perceive auditors to have a causal role and greater ability to foresee audit failures under the latter accounting treatment. In contrast, using an experimental case where accounting standards are clearly violated (i.e., fraud case), Brasel et al. (2016) find that perceived auditor liability is lower for auditors who disclose any CAMs (related or unrelated) relative to auditors stating that there were no CAMs. Another study reconciles these mixed findings by presenting experimental evidence that CAM disclosures involving measurement uncertainty have a forewarning effect. Perceived auditor responsibility is mitigated for material misstatements that are related to disclosed CAMs (Kachelmeier et al., 2020).

The main ways in which the effect of KAM disclosure has been measured is through investors' perceptions, market reactions and perceived auditor liability. Gold and Heilmann (2019) undertook a literature review of KAMs research, reporting that overall, studies provide mixed results regarding investor behaviour and market reaction to these types of additional disclosures to the audit report. Therefore, in the question of how the audit report for LCE should be communicated, the mixed research on KAMs might suggest that there is not a great benefit in requiring this sort of audit report disclosure in the audit for LCE. Particularly given the reduced size of LCEs and if full consideration is given to both the costs as well as benefits of this type of additional disclosure.

### **Different levels of assurance**

Research on the different levels of assurance that might be provided and how users might perceive this is another question that could be considered in audit reports for LCE. Most of the research that addressed this issue occurred a number of years ago when auditor review reports were first issued. Review engagements provide limited assurance compared to the standard audit. In surveying financial analysts, Pany and Smith (1982) found that analysts could not distinguish between the two different types of assurance engagements. Johnson et al. (1983) examined lenders' decision making and found that the level of assurance did not affect lending decisions. Nair and Rittenberg (1987) examined the messages conveyed by nine different forms of auditor's reports to bankers. They did find differences, but the auditors' reports were manipulated 'within subjects', which would have highlighted the differences to users. These early US studies do raise questions about how well differing levels of assurance are understood

and suggest that users have difficulties distinguishing between audit engagements and more limited engagements, such as a review.

Roebuck et al. (2000), examined whether assurance report users differ in their identified level of assurance as a result of the description of the nature of the engagement and the amount of work performed. Their sample consisted of shareholders from the Australian Shareholders Association. They found a higher level of assurance attached to historical compared to prospective reports, but no differences between the reports attempting to communicate higher versus lower levels of assurance as a result of the description of the work performed. In a monograph titled *The Determination and Communication of Levels of Assurance Other than High*, issued by the International Federation of Accountants (IFAC) in 2002, it was found that the difference between a moderate and a high level of assurance was not well understood by clients, and even less so by third parties (Maijoor et al. 2002: 111).

*2.10 Question 16: Should a separate Part on the ISA-800 series be included within ED-ISA for LCE? Please provide reasons for your response.*

- We recommend extending the standards related to agreed-upon procedures to cover LCEs (question 16)

In response to Question 16, we recommend that requirements relating to the ISA 800-series shall be included in ED-ISA for LCE. In Australia, privately entities can self-assess and then determine whether they prepare general purpose financial reports (GPFR) or special purpose financial reports (SPFR). The criterion is whether they perceive themselves as a reporting entity (AASB 1053).<sup>4</sup> Most of these companies are small to medium size businesses, and they account for more than 99 percent of businesses in Australia (Carey, Potter, and Tanewski 2014; Potter, Pinnuck, Tanewski, and Wright 2019). In other words, more than 99 percent of audits are likely to be subjected to ISA 800 which provides guidance on the audit of SPFR. Given that the ED-ISA for LCE is targeting the audit of these private sector businesses, as well as the “standalone” nature of the ED-ISA for LCE, we recommend that more clear requirements regarding how to apply the ED-ISA for LCE to audit GPFR to be included.<sup>5</sup>

In addition, Potter et al. (2019) find that companies that prepare SPFRs produce low quality and less in time financial reports. It is a concern that the financial report quality will deteriorate after the introduction of the ISA for LCE if companies do “audit standard shopping” which enables favourable audit outcomes. A similar scenario is that clients choose auditors who are willing to issue a clean audit opinion (i.e., opinion shopping) (Lennox 2000; Chan et al. 2006; Defond and Zhang 2014). Therefore, it is necessary to have clear requirements on the authority of ED-ISA for LCE for SPFR audits.

*2.11 Question 17: In your view, would ED-ISA for LCE meet the needs of users and other stakeholders for an engagement that enables the auditor to obtain reasonable assurance to express an audit opinion and for which the proposed standard has been developed? If not, why not. Please structure your comments to this question as follows:*

---

<sup>4</sup> Australia is the only country that allows such self-assessment on the application of GPFR or SPFR (Yang and Simnett 2020). However, this suggestion also applies to other jurisdictions where SPFR is allowed.

<sup>5</sup> IAASB agreed to focus on developing an auditing standard for audits of complete sets of general-purpose financial statements of LCEs first (explanatory memorandum to ED-ISA for LEC para. 150)

a. *Whether the proposed standard can, and will, be used in your jurisdiction.*

- We urge the IAASB to encourage users to participate in the development process of the ED-ISA for LCE in order to satisfy their needs and solve any possible conceptual and practical challenges to implement this regulation.

Financial reporting research provides country-level evidence on the adoption of IFRS for SMEs, which might shed some light on the potential use of ED-ISA for LCE by jurisdictions (Damak-Ayadi et al. 2020; Eierle and Haller 2009; Gassen 2017; Kaya and Koch 2015; Quagli and Paoloni 2012; Perera and Chand 2015). In summary, we feel that there will be cross-country variation in the implementation of the ED-ISA for LCE. We expand on this point below.

In a descriptive analysis by the IFRS Foundation on 166 jurisdictions (IFRS 2019), 144 jurisdictions required full IFRS for publicly accountable entities up to April 2018, including several countries that had adopted them nearly word for word as their national accounting standards, such as Australia and New Zealand. Out of the 166 jurisdictions, 86 required or permitted IFRS for SMEs, and Australia and New Zealand are not included in this sub-group. There is evidence that suggests that Australia and New Zealand are of the view that IFRS for SMEs are still complex in the recognition and measurement requirements (Devi and Samujh 2015<sup>6</sup>; Perera and Chand 2015). Australia is also of the view that coexistence of opposing IFRS recognition and measurement principles for identical circumstances harms the standards and also the practitioners. Thus, Australia and New Zealand have developed differential reporting for SMEs. Research in European countries have found that German-speaking and Latin countries show less appreciation for IFRS for SMEs with respect to Anglo-Nordic jurisdictions (Quagli and Paoloni 2012).

Damak-Ayadi et al. (2020) examine the macro-level determinants on IFRS for SMEs adoption based on the neo-institutional theory<sup>7</sup> and the economic theory of networks<sup>8</sup>. Their empirical analysis on 177 countries between 2009 and 2015, including 77 jurisdictions that adopted IFRS for SMEs, confirms that the implementation is related to law enforcement quality, culture, trading networks, economic growth, coercive isomorphism and normative isomorphism. Their results also point out that the political system, tax system and mimetic isomorphism have no effect. Consistently, Ramanna and Sletten (2014) find that network benefits increase the degree of IFRS harmonization among countries and smaller countries respond differentially higher to these benefits. In regards to ISAs implementation, there is also evidence based on the neo-institutional theory that shows that the protection of minority interests, regulatory enforcement, lenders/borrowers rights, foreign aid, prevalence of foreign ownership, educational attainment and the level of democracy are significant predictors of the harmonisation of ISAs (BooLaky and Soobaroyen 2017).

Using country-level interview data in 24 jurisdictions, Gassen (2017) finds significant cross-country differences and shows that IFRS for SMEs has provided a blueprint for national

---

<sup>6</sup> In Australia and New Zealand, SMEs do not need to prepare general purpose financial reports. Instead, they prepare special purpose financial reports in compliance with taxation regulations.

<sup>7</sup> Neo-institutional theory suggests that internationalized firms acquire more legitimacy, and organizational legitimacy establishes a connection between the firm and its environment in a socio-political context. Thus, organizations should adopt mechanisms of legitimacy even when environmental constraints exist.

<sup>8</sup> Economic theory of networks argues that countries adopt international standards when an economic partner is an adopter, considering the international regulation as a commodity or a product that could be adopted by a country.

regulatory reforms rather than becoming directly relevant to firms. In jurisdictions where there has been no discussion about the implementation, interviewees believe that their existing national regime is sufficient and better suited to cater to the national regulatory environment. In jurisdictions with non IFRS-based accounting regimes, interviewees do not desire a mandatory adoption and voluntary reduces national comparability, offering few benefits to voluntary adopters. Countries adopting the standard think that it reduces complexity by implementing a more principles-based, simplified and up-to-date financial reporting regime that remains relatively similar to IFRS (already in place). Countries that decide to use concepts from IFRS for SMEs to reform their national regimes do it for sovereignty concerns and existing regulatory consequences like taxation or dividend distribution. In jurisdictions where substantial parts of IFRS for SMEs are transformed into the national reporting regime, experts value the consistency and comparability across firm groups (public and private).

Apart from country-level adoption of IFRS for SMEs, some studies have also examined the implementation by firm- and user-level (Eierle and Haller 2009; Gassen 2017; Kaya and Koch 2015; Quagli and Paoloni 2012). Using firm-level archival data of 128 countries, Kaya and Koch (2015) show that jurisdictions not capable of developing their own local accounting regulation framework are more likely to adopt the standard, and that the likelihood of adoption increases in jurisdictions where full IFRS have been applied, reducing the financial reporting burden on SMEs. They also suggest that a reason for adopting the standard is the existence of relatively low quality of governance institutions. Additional evidence to support the under-representation of developed economies in IFRS for SMEs can also be found in Devi and Samujh (2015).

Regarding users of IFRS for SMEs, which might assimilate to those of ED-ISA for LCE, Quagli and Paoloni (2012) examine the answers to the “Questionnaire on the public consultation of the IFRS for SMEs”, and find a substantial diversity among respondents. In particular, preparers demonstrate a strong opposition to IFRS for SMEs, while users are more favourable. Later on, Gassen (2017) expands the evidence on user-level adoption of IFRS for SMEs suggesting that addressees slightly differ among jurisdictions. Banks, tax authorities, and, in a lower degree, inside and outside shareholders, appear to be the main users. However, while every expert considers banks to be relevant, tax authorities are sometimes mentioned as the prime users or not considered at all (for example, in Australia).

Finally, prior literature has critically evaluated the development and implementation of IFRS for SMEs regarding the meet of users’ needs (Devi and Samujh 2015; Perera and Chand 2015). Research suggests that the user orientation was not adequately addressed during the standard setting process. This implies that the IASB followed an indeterminate basis for simplifying full IFRS. In light of the cost-benefit considerations, SMEs may be hesitant in choosing IFRS for SMEs, if they do not clearly represent the user information needs. Thus, we urge the IAASB to encourage users to participate in the development process of the ED-ISA for LCE in order to satisfy their needs and solve any possible conceptual and practical challenges to implement this regulation.

*2.12 Question 22 The IAASB is looking for views on whether group audits should be excluded from (or included in) the scope of ED-ISA for LCE. Please provide reasons for your answer.*



*Question 24: 24. If group audits are to be included in the scope of ED-ISA for LCE, the IAASB is looking for views about how should be done (please provide reasons for your preferred option):*

- a. The IAASB establishes a proxy(ies) for complexity for when the proposed standard may be used (“Option 1 - see paragraph 169); or*
  - b. ED-ISA for LCE sets out qualitative characteristics for complexity specific to groups (Option 2 - see paragraph 176), to help users of the proposed standard to determine themselves whether a group would meet the complexity threshold.*
- We generally support the standard excluding group audits, but with an exception allowing group audits in cases where there are no other component auditors (questions 22 and 24)

In response to question 22, we recommend that group audits should not be included in the scope of ED-ISA for LCE when component auditors are materially involved in the group audit engagement. However, if component auditors are not materially involved in the group audit engagement, we cannot draw a conclusion on whether group audits shall be excluded from the scope of ED-ISA for LCE due to the lack of relevant literature. In other words, we would suggest IAASB to re-consider allowing the application of ED-ISA for LCE if component auditors are not materially involved in the group audit engagement.

Extant group audit literature uses various research methodologies such as interview, survey, and archival data analyses to investigate problems faced by auditors engaged in audits of group financial statements (Sunderland and Trompeter 2017; Downey and Bedard 2019; Downey, Obermire, and Zehms 2020; Saiewitz and Wang 2020; Downey and Westermann 2021; Carson, Simnett, Thürheimer, and Vanstraelen 2021). This line of literature finds that the challenges for group audit engagements include poor coordination and communication between group auditor and component auditors (Downey and Bedard 2019; Downey and Westermann 2021), cross-cultural differences and language barriers between group auditor and component auditors (Saiewitz and Wang 2020; Downey, Obermire, and Zehms 2020), and over reliance on component auditors (Carson et al. 2021). The theory developed by Hanes (2013) argues that these issues resulted from the geographically distribution of different audit teams. As most of these issues arise from the involvement of component auditors, we infer that group audits become complex and should be excluded from the scope of ED-ISA for LCE when component auditors are involved materially.

It is still an open question whether auditors face similar issues when audit clients are small and less complex, especially when component auditors are not materially involved. However, most of group audit studies draw their conclusions from samples of audit engagements for large listed or multinational entities. One hint provided by Carson et al. (2021) is that the involvement of component auditors increases audit quality if the principal auditor still performs a major part of audit (i.e., when less than approximately 30% of total audit fees are paid to the component auditors).<sup>9</sup> Meanwhile, this involvement of component auditors increases audit fees. Even though this study also uses a sample of multinational group audits, it implies that we probably shall not eliminate the possibility to apply ED-ISA for LCE under

---

<sup>9</sup> Burke, Hoitash, and Hoitash (2020) examine the similar question in the U.S. setting and find a consistent result.

this circumstance (i.e., when component auditors are not materially involved), because the insignificant involvement of component auditors does not make audit tasks more complex or lead to low quality audits. Instead, it increases audit quality at the cost of higher audit fees.

### **3. Comments to the New Zealand Auditing and Assurance Standards Board**

New Zealand: the NZAuASB website asks these questions:

We particularly need to know whether:

- The proposed standard should be adopted in New Zealand. Would the standard be useful for New Zealand auditors and their clients? In what context?
- New Zealand stakeholders support the proposed standard's decision framework for determining the types of entities for which the ISA for LCE is not intended.
- New Zealand auditors agree that the proposed standard is clear, understandable and practical for auditing LCEs.
- New Zealand stakeholders have concerns regarding audits conducted in accordance with the proposed ISA for LCE?

Our comments to the IAASB in part 2 are above as relevant to these questions. We recommend that

- We agree with not including any quantitative threshold for application of the standard (Question 3)
- The specific prohibitions on the use of the ISA standard for listed entities and entities with certain functions should be removed in sections A.7 (b) and (c) (Question 4 (a)).
- We provide a list of characteristics of complex audits that have been used in research studies, supported by references (Question 4 (b)). We suggest further guidelines.

## References

- Abbott, L. J., Parker, S., Peters, G. F., & Raghunandan, K. (2003). The Association between Audit Committee Characteristics and Audit Fees. *Auditing: A Journal of Practice & Theory*, 22, 17-32.
- Abdel-khalik, A.R. (1993), "Why Do Private Companies Demand Auditing? A Case for Organizational Loss of Control", *Journal of Accounting, Auditing & Finance*, Vol. 8 No. 1, pp. 31–52.
- Abernathy, J. L., Guo, F., Kubick, T. R., & Masli, A. (2019). Financial Statement Footnote Readability and Corporate Audit Outcomes. *Auditing: A Journal of Practice & Theory*, 38, 1-26.
- Ali, C. B., Boubaker, S., & Magnan, M. (2020). Auditors and the Principal-Principal Agency Conflict in Family Controlled Firms. *Auditing: A Journal of Practice & Theory*, 39, 31-55.
- Allee, K. D., & Yohn, T. L. (2009). The demand for financial statements in an unregulated environment: An examination of the production and use of financial statements by privately held small businesses. *The Accounting Review*, 84(1), 1-25.
- Altiero, E. C., Kang, Y. J., & Peecher, M. E. (2021). Motivated Perspective Taking: Why Prompting Auditors to Take an Investor's Perspective Makes Them Treat Identified Audit Differences as Less Material. *Contemporary Accounting Research*.
- André, P., Filip, A., & Moldovan, R. (2019). Diversified Firms and Analyst Earnings Forecasts: The Role of Management Guidance at the Segment Level. *Journal of International Accounting Research*, 18(3), 1-38.
- Australian Accounting Research Foundation and the Australian Accounting Standards Board (AARF/AASB), 1990, *SAC 1: Definition of the Reporting Entity*.
- Australian Accounting Standards Board (AASB), 2010, *AASB 1053: Application of Tiers of Australian Accounting Standards*.
- Azizan, S., & Shailer, G. (2021). Does Corporate Citizenship Influence Auditors' Perceptions of the Credibility of Management in Relation to Financial Reports? *European accounting review*, DOI: 10.1080/09638180.2021.1950022.
- Bailey, C., Collins, D. L., & Abbott, L. J. (2018). The Impact of Enterprise Risk Management on the Audit Process: Evidence from Audit Fees and Audit Delay. *Auditing: A Journal of Practice & Theory*, 37, 25-46.
- Barroso, R., Ali, C. B., & Lesage, C. (2018). Blockholders' Ownership and Audit Fees: The Impact of the Corporate Governance Model. *European accounting review*, 27, 149-172.
- Bédard, J., Gonthier-Besacier, N., & A. Schatt. 2019. Consequences of expanded audit reports: Evidence from the justifications of assessments in France. *Auditing: A Journal of Practice & Theory* 38 (3): 23-45.

- Boolaky, P. K., and R. Quick. 2016. Bank directors' perceptions of expanded audit reports. *International Journal of Auditing* 20:158-174.
- Boolaky, P. K., and R. Quick. 2016. Bank directors' perceptions of expanded auditor's reports. *International Journal of Auditing* 20(2): 158–174.
- Boolaky, P.K. and Soobaroyen, T. (2017), “Adoption of International Standards on Auditing (ISA): Do institutional factors matter?”, *International Journal of Auditing*, Vol. 21 No. 1, pp. 59–81.
- Brasel, K., M. Doxey, J. H. Grenier, and A. Reffett. 2016. Risk disclosure preceding negative outcomes: The effects of reporting critical audit matters on judgments of auditor liability. *The Accounting Review* 91 (5): 1345–1362.
- Briozzo, A., & Albanese, D. (2020). Voluntary audit, investment, and financing decisions in Latin American small and medium enterprises. *Journal of International Accounting, Auditing and Taxation*, 38, 100302.
- Bugeja, M., Fohn, S., & Matolcsy, Z. (2016). Determinants of the levels and changes in non-executive director compensation. *Accounting & Finance*, 56(3), 627-667.
- Burke, J.J., Hoitash, R. and Hoitash, U., 2020. The use and characteristics of foreign component auditors in US multinational audits: Insights from Form AP disclosures. *Contemporary Accounting Research*, 37(4), pp.2398-2437.
- Cahan, S. F., Jeter, D. C., & Naiker, V. (2011). Are all industry specialist auditors the same? *Auditing: A Journal of Practice & Theory*, 30(4), 191-222.
- Cairney, T. D., & Stewart, E. G. (2015). Audit fees and client industry homogeneity. *Auditing: A Journal of Practice & Theory*, 34(4), 33-57.
- Canning, M., O'Dwyer, B., & Boomsma, R. (2021). Managing the Offshoring of Audit Work: Spanning the Boundaries Between Onshore and Offshore Auditors. *AUDITING: A Journal of Practice & Theory*.
- Carcello, J. V., Hermanson, D. R., Neal, T. L., & Riley, R. A. (2002). Board Characteristics and Audit Fees. *Contemporary Accounting Research*, 19, 365-384.
- Carey, P., Potter, B. and Tanewski, G., 2014. Application of the Reporting Entity Concept in Australia. *Abacus*, 50(4), pp.460-489.
- Carson, E., Simnett, R., Thuerheimer, U., and Vanstraelen, A. 2021. Involvement of Component Auditors in Multinational Group Audits: Determinants, Audit Quality and Audit Fees. *Journal of Accounting Research* (forthcoming)
- Cassell, C. A., Myers, L. A., Schmardebeck, R., & Zhou, J. (2018). The monitoring effectiveness of co-opted audit committees. *Contemporary Accounting Research*, 35(4), 1732-1765.
- Chakrabarty, B., Seetharaman, A., Swanson, Z., & Wang, X. (2018). Management risk incentives and the readability of corporate disclosures. *Financial Management*, 47(3), 583-616.

- Chan, K.H., Lin, K.Z. and Mo, P.L.L., 2006. A political–economic analysis of auditor reporting and auditor switches. *Review of Accounting Studies*, 11(1), pp.21–48.
- Chen, K. C., and B. K. Church. 1996. Going concern opinions and the market's reaction to bankruptcy filings. *The Accounting Review* 71 (1):117-128.
- Chong, K. M., and G. Pflugrath. 2008. Do different audit report formats affect shareholders' and auditors' perceptions? *International Journal of Auditing* 12 (3): 221–241.
- Church B.K., Davis S.M., and S.A. McCracken. 2008. The auditor's reporting model: A literature overview and research synthesis. *Accounting Horizons* 22(1): 69–90.
- Collis, J. (2010). Audit exemption and the demand for voluntary audit: A comparative study of the UK and Denmark. *International Journal of Auditing*, 14(2), 211-231.
- Coram, P. J., T. J. Mock, J. L. Turner, and G. L. Gray. 2011. The communicative value of the auditor's report. *Australian Accounting Review* 58 (3):235-252.
- Coram, P.J., Mock, T., and G. Monroe. 2011. Financial analysts' evaluation of enhanced disclosure of non-financial performance indicators. *The British Accounting Review*, 43(2): 87–101.
- Cotei, C., & Farhat, J. (2017). The evolution of financing structure in US startups. *The Journal of Entrepreneurial Finance*, 19(1), 4.
- Damak-Ayadi, S., Sassi, N. and Bahri, M. (2020), “Cross-country determinants of IFRS for SMEs adoption”, *Journal of Financial Reporting and Accounting*, Vol. 18 No. 1, pp. 147–168.
- Darrat, A. F., Gray, S., Park, J. C., & Wu, Y. (2016). Corporate governance and bankruptcy risk. *Journal of Accounting, Auditing & Finance*, 31(2), 163-202.
- Davis, L. R., Ricchiute, D. N., & Trompeter, G. (1993). Audit Effort, Audit Fees and the Provision of Nonaudit Services to Audit Clients. *The Accounting Review*, 68, 35-150.
- Dedman, E. and Kausar, A. (2012), “The impact of voluntary audit on credit ratings: evidence from private UK firms”, *Accounting and Business Research*, Vol. 42 No. 4, pp. 397–418.
- Dedman, E., Kausar, A., & Lennox, C. (2014). The demand for audit in private firms: Recent large-sample evidence from the UK. *European Accounting Review*, 23(1), 1-23.
- DeFond, M. and Zhang, J., 2014. A review of archival auditing research. *Journal of Accounting and Economics*, 58(2-3), pp.275-326.
- Devi, S. and Samujh, H. (2015), “The political economy of convergence: the case of IFRS for SMEs”, *Australian Accounting Review*, Vol. 25 No. 2, pp. 124–138.
- Devi, S. S., & Samujh, R. H. (2015). The political economy of convergence: the case of IFRS for SMEs. *Australian Accounting Review*, 25(2), 124-138.
- Dobija, D., I. Cieślak, and K. Iwuć. Extended audit reporting - A insight from the auditing profession in Poland. <http://ssrn.com/abstract=2215605>.

- Downey, D. H., and J. C. Bedard. "Coordination and Communication Challenges in Global Group Audits." *Auditing: A Journal of Practice & Theory* 38 (2019): 123-148.
- Downey, D. H., Obermire, K. M., & Zehms, K. M. (2020). Toward an understanding of audit team distribution and performance quality. *Auditing: A Journal of Practice & Theory*, 39(4), 87-112.
- Downey, D.H. and Westermann, K.D., 2021. Challenging global group audits: The perspective of US group audit leads. *Contemporary Accounting Research*, 38(2), pp.1395-1433.
- Ehalaiye, D., Laswad, F., Botica Redmayne, N., Stent, W., & Cai, L. (2020). Are Financial Reports Useful? The Views of New Zealand Public Versus Private Users. *Australian Accounting Review*, 30(1), 52-64.
- Eierle, B. and Haller, A. (2009), "Does size influence the suitability of the IFRS for small and medium-sized entities?—Empirical evidence from Germany", *Accounting in Europe*, Vol. 6 No. 2, pp. 195–230.
- Farooq, M. B., & De Villiers, C. (2019). Understanding how managers institutionalise sustainability reporting: Evidence from Australia and New Zealand. *Accounting, Auditing & Accountability Journal*.
- Francis, J. 2004. What do we know about audit quality? *The British Accounting Review* 36: 345–368.
- Francis, J. R. (1984). The Effect of Audit Firm Size on Audit Prices: A Study of the Australian Market. *Journal of Accounting and Economics*, 6, 133-151.
- Francis, J.R., Khurana, I.K., Martin, X. and Pereira, R. (2008), "The role of firm-specific incentives and country factors in explaining voluntary IAS adoptions: Evidence from private firms", *European Accounting Review*, Vol. 17 No. 2, pp. 331–360.
- Gassen, J. (2017), "The effect of IFRS for SMEs on the financial reporting environment of private firms: an exploratory interview study", *Accounting and Business Research*, Vol. 47 No. 5, pp. 540–563.
- Ge, W., Koester, A., & McVay, S. (2017). Benefits and costs of Sarbanes-Oxley Section 404 (b) exemption: Evidence from small firms' internal control disclosures. *Journal of Accounting and Economics*, 63(2-3), 358-384.
- Ghicas, D. C., A. Papadaki, G. Siougle, and T. Sougiannis. 2007. The relevance of quantifiable audit qualifications in the valuation of IPOs. *Review of Accounting Studies* 13:512-550.
- Gimbar, C., B. Hansen, and M. E. Ozlanski. 2016. The effects of critical audit matter paragraphs and accounting standard precision on auditor liability. *The Accounting Review* 91 (6): 1629–1646
- Gold, A. and M. Heilmann. 2019. The consequences of disclosing key audit matters (KAMs): A review of the academic literature. *Maandblad voor Accountancy en Bedrijfseconomie* 93(1/2): 5–14.

- Gomez-Guillamon, A. D. 2003. The usefulness of the audit report in investment and financing decisions. *Managerial Auditing Journal* 18 (6/7):549-559.
- Gong, J., Krishnan, J., & Liang, Y. (2021). Securities-Based Crowdfunding by Startups: Does Auditor Attestation Matter? *The Accounting Review*.
- Gray, G., J. Turner, P. Coram, and T. Mock. 2011. Perceptions and misperceptions regarding the unqualified auditor's report by financial statement preparers, users, and auditors. *Accounting Horizons* 25 (4): 659–684.
- Guiral-Contreras, A., J. A. Gonzalo-Angulo, and W. Rodgers. 2007. Information content and recency effect of the audit report in loan rating decisions. *Accounting and Finance* 47:285-304.
- Gul, F. A., Chen, J. P., & Tsui, S. L. (2003). Discretionary Accounting Accruals, Managers' Incentives and Audit Fees. *Contemporary Accounting Research*, 20.
- Gul, F. A., Chen, J. P., & Tsui, S. L. (2003). Discretionary Accounting Accruals, Managers' Incentives and Audit Fees. *Contemporary Accounting Research*, 20.
- Gunn, J. L., Kawada, B. S., & Michas, P. N. (2019). Audit market concentration, audit fees, and audit quality: A cross-country analysis of complex audit clients. *Journal of Accounting and Public Policy*, 38(6), 1066-93.
- Guo, F., Lin, C., Maasli, A., & Wilkins, M. S. (2021). Auditor Responses to Shareholder Activism. *Contemporary Accounting Research*, 38, 63-95.
- Hanes, D. R. (2013). Geographically distributed audit work: Theoretical considerations and future directions. *Journal of Accounting Literature*, 32(1), 1-29.
- Hansen, J. C., Lisic, L. L., Seidel, T. A., & Wilkins, M. S. (2021). Audit Committee Accounting Expertise and the Mitigation of Strategic Auditor Behavior. *The Accounting Review*, 96, 289-314.
- Hatherly, D., Innes, J. and T. Brown. 1991. The expanded Audit Report – An empirical investigation. *Accounting and Business Research* 21(4): 311–319.
- Hay, D., Knechel, W., & Wong, N. (2006). Audit Fees: A Meta-Analysis of the Effect of Supply and Demand Attributes. *Contemporary Accounting Research*, 23, 141 - 191.
- Hay, D.C. and Davis, D. (2004), “The voluntary choice of an auditor of any level of quality”, *Auditing*, Vol. 23 No. 2.
- Hope, O. K., Thomas, W. B., & Vyas, D. (2017). Stakeholder demand for accounting quality and economic usefulness of accounting in US private firms. *Journal of Accounting and Public Policy*, 36(1), 1-13.
- Hsu, H. H., Lin, C. H., & Tsao, S. M. (2018). Founding family and auditor choice: evidence from Taiwan. *Corporate governance: an international review*, 26(2), 118-142.
- IFRS (2019), “Who uses IFRS standards? Analysis of the IFRS profiles for the IFRS for SMEs Standard”. Available at: <https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/#analysis-of-the-use-of-the-ifrs-for-smes-standard> (accessed October 1, 2021)

- Innes, J. B., and D. Hatherly. 1997. The expanded audit report - a research study within the development of SAS 600. *Accounting, Auditing & Accountability Journal* 10 (5):702-716.
- International Auditing and Assurance Standards Board (IAASB) 2005, ISA 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*.
- Jaggi, B., & Tang, L. (2017). Geographic location of the firm and credit rating accuracy. *Journal of Accounting, Auditing & Finance*, 32(2), 155-181.
- Johnson, D., Pany, K. and R. White. 1983. Audit reports and the loan decision: Actions and perceptions. *Auditing: A Journal of Practice and Theory* Spring: 38–51.
- Kachelmeier, S. J., Rimkus, D., Schmidt, J. J., and K. Valentine. 2020. The forewarning effects of critical audit matter disclosures involving measurement uncertainty. *Contemporary Accounting Research* 37(4): 2186–2212.
- Kallunki, J., Kallunki, J. P., Niemi, L., & Nilsson, H. (2019). IQ and Audit Quality: Do Smarter Auditors Deliver Better Audits? *Contemporary Accounting Research*, 36, 1373-1416.
- Kaya, D. and Koch, M. (2015), “Countries’ adoption of the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)—early empirical evidence”, *Accounting and Business Research*, Vol. 45 No. 1, pp. 93–120.
- Kim, J.-B., Simunic, D.A., Stein, M.T. and Yi, C.H. (2011), “Voluntary audits and the cost of debt capital for privately held firms: Korean evidence”, *Contemporary Accounting Research*, Vol. 28 No. 2, pp. 585–615.
- Knechel, R. W., & Payne, J. L. (2001). Additional Evidence on Audit Report Lag. *Auditing: A Journal of Practice & Theory*, 20.
- Knechel, W. R., & Sharma, D.S. (2012). Auditor-provided non-audit services and audit effectiveness and efficiency: Evidence from pre-and post-SOX audit report lags. *Auditing: A Journal of Practice & Theory*, 31(4), 85-114.
- Knechel, W. R., & Willekens, M. (2006). The role of risk management and governance in determining audit demand. *Journal of Business Finance & Accounting*, 33(9-10),
- Knechel, W.R., Krishnan, G. V., Pevzner, M., Shefchik, L.B. and Velury, U.K. (2013), “Audit Quality: Insights from the Academic Literature”, *Auditing: A Journal of Practice & Theory*, Vol. 32 No. Supplement 1, pp. 385–421.
- Knechel, W.R., Niemi, L. and Sundgren, S. (2008), “Determinants of Auditor Choice: Evidence from a Small Client Market”, *International Journal of Auditing*, Vol. 12 No. 1, pp. 65–88.
- Langli, J.C. and Svanstrom, T. (2014), “Audits of private companies”, in Hay, D.C., Knechel, W.R. and Willekens, M. (Eds.), *The Routledge Companion to Auditing*, Routledge, Abingdon, Oxon, UK, pp. 148–158.



- Lennox, C., 2000. Do companies successfully engage in opinion-shopping? Evidence from the UK. *Journal of Accounting and Economics*, 29(3), pp.321-337.
- Lennox, C.S. and Pittman, J.A. (2011), "Voluntary audits versus mandatory audits", *Accounting Review*, Vol. 86 No. 5, pp. 1655–1678.
- Lisowsky, P., & Minnis, M. (2020). The silent majority: Private US firms and financial reporting choices. *Journal of Accounting Research*, 58(3), 547-588.
- Litjens, R., van Buuren, J., & Vergoossen, R. (2015). Addressing Information Needs to Reduce the Audit Expectation Gap: Evidence from Dutch Bankers, Audited Companies and Auditors. *International Journal of Auditing*, 19(3), 267-281.
- McEnroe, J. E., and S. C. Martens. 2001. Auditors' and investors' perceptions of the "Expectation Gap". *Accounting Horizons* 15 (4):345-358.
- Min, B. S. (2018). Determinants of board size in an emerging market. *Journal of International Financial Management & Accounting*, 29(1), 5-29.
- Minnis, M., & Shroff, N. (2017). Why regulate private firm disclosure and auditing?. *Accounting and Business Research*, 47(5), 473-502.
- Minnis, M., & Sutherland, A. (2017). Financial statements as monitoring mechanisms: Evidence from small commercial loans. *Journal of Accounting Research*, 55(1), 197-233.
- Minutti-Meza, M. 2021. The art of conversation: The expanded audit report. *Accounting and Business Research* 51 (5):548-581.
- Mock, T. J., J. Bedard, P. J. Coram, S. M. Davis, R. Espahbodi, and R. C. Warne. 2013. The Audit Reporting Model: Current research synthesis and implications. *Auditing: A Journal of Practice & Theory* 32:323-351.
- Moroney, R., S. Phang, and X. Xiao. 2021. When do investors value Key Audit Matters? *European Accounting Review* 30 (1):63-82.
- Naynar, N. R., Ram, A. J., & Maroun, W. (2018). Expectation gap between preparers and stakeholders in integrated reporting. *Meditari Accountancy Research*.
- Niemi, L., Kinnunen, J., Ojala, H., & Troberg, P. (2012). Drivers of voluntary audit in Finland: to be or not to be audited? *Accounting and Business Research*, 42(2), 169-196.
- O'Sullivan, N. (2000). The Impact of Board Composition and Ownership on Audit Quality: Evidence from Large UK Companies. *British Accounting Review*, 32, 397-414.
- Palazuelos, E., Crespo, Á. H., & del Corte, J. M. (2020). Auditing and credit granting to SMEs: an integrative perceptual model. *Managerial Auditing Journal*, 35(1), 152-174.
- Palmrose, Z. (1986). The Effect of Nonaudit Services on the Pricing of Audit Services: Further Evidence. *Journal of Accounting Research*, 24, 405-411.

- Perera, D. and Chand, P. (2015), “Issues in the adoption of international financial reporting standards (IFRS) for small and medium-sized enterprises (SMES)”, *Advances in Accounting*, Vol. 31 No. 1, pp. 165–178.
- Pinto, I., & Morais, A. I. (2019). What matters in disclosures of key audit matters: Evidence from Europe. *Journal of International Financial Management & Accounting*, 30(2), 145-162.
- Pittman, J. A., & Zhao, Y. (2021). Auditor Responses to and Prevention of Non-Income-Increasing Misreporting: Evidence from Audit Fees and Restatements. *Auditing: A Journal of Practice & Theory*, 40, 127-153.
- Potter, B., Pinnuck, M., Tanewski, G. and Wright, S., 2019. Keeping it private: financial reporting by large proprietary companies in Australia. *Accounting & Finance*, 59(1), pp.87-113.
- Pucheta Martínez, M. C., A. V. Martínez, and M. A. García Benau. 2004. Reactions of the Spanish capital market to qualified audit reports. *European Accounting Review* 13 (4):689-711.
- Quagli, A., and Paoloni, P. (2012), “How is the IFRS for SME accepted in the European context? An analysis of the homogeneity among European countries, users and preparers in the European commission questionnaire”, *Advances in Accounting*, Vol. 28 No. 1, pp. 147–156.
- Raiborn, D.D. (1982), *Audit Problems Encountered in Small Business Engagements*, American Institute of Certified Public Accountants, New York NY., available at: [https://egrove.olemiss.edu/aicpa\\_guides/15](https://egrove.olemiss.edu/aicpa_guides/15).
- Ramanna, K. and Sletten, E. (2014), “Network effects in countries' adoption of IFRS”, *The Accounting Review*, Vol. 89 No. 4, pp. 1517–1543.
- Richardson, A. J. and Eberlein, B. (2011). Legitimizing transnational standard-setting: the case of the International Accounting Standards Board. *Journal of Business Ethics*, 98(2), 217-245.
- Saiewitz, A. and Wang, E.Y., 2020. Using cultural mindsets to reduce cross-national auditor judgment differences. *Contemporary Accounting Research*, 37(3), pp.1854-1881.
- Schneider, A., and B. K. Church. 2008. The effect of auditors' internal control opinions on loan decisions. *Journal of Accounting and Public Policy*:1-18.
- Simon, D. T., & Francis, J. R. (1988). The Effects of Auditor Change on Audit Fees: Tests of Price Cutting and Price Recovery. *The Accounting Review*, 63, 255-269.
- Simunic, D. A. (1980). The Pricing of Audit Services: Theory and Evidence. *Journal of Accounting Research*, 18.
- Sultana, N., Cahan, S. F., & Rahman, A. (2020). Do Gender Diversity Recommendations in Corporate Governance Codes Matter? Evidence from Audit Committees. *Auditing: A Journal of Practice & Theory*, 39, 173-197.

- Sunderland, D. and Trompeter, G.M., 2017. Multinational group audits: Problems faced in practice and opportunities for research. *Auditing: A Journal of Practice & Theory*, 36(3), pp.159-183.
- Van Caneghem, T., & Van Campenhout, G. (2012). Quantity and quality of information and SME financial structure. *Small Business Economics*, 39(2), 341-358.
- Vander Bauwhede, H., De Meyere, M., & Van Cauwenberge, P. (2015). Financial reporting quality and the cost of debt of SMEs. *Small Business Economics*, 45(1), 149-164.
- Vanstraelen, A. and Schelleman, C. (2017), "Auditing private companies: what do we know?", *Accounting and Business Research*, Taylor & Francis, Vol. 47 No. 5, pp. 565–584.
- Weik, A., Eierle, B., & Ojala, H. (2018). What drives voluntary audit adoption in small German companies? *International Journal of Auditing*, 22(3), 503-521.
- Willekens, M., Bauwhede, H. V., & Gaeremynck, A. (2004). Voluntary audit committee formation and practices among Belgian listed companies. *International Journal of Auditing*, 8(3), 207-222.
- Yang, Y. and Simnett, R., 2020. Financial Reporting by Charities: Why Do Some Choose to Report Under a More Extensive Reporting Framework?. *Abacus*, 56(3), pp.320-347.
- Yiu, L. D., Lam, H. K., Yeung, A. C., & Cheng, T. C. E. (2020). Enhancing the financial returns of R&D investments through operations management. *Production and Operations Management*, 29(7), 1658-1678.
- Zhong, R. I. (2018). Transparency and firm innovation. *Journal of Accounting and Economics*, 66(1), 67-93.