

Auditor Choice by Incorporated Societies – Why Choose a Casual Audit

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## **Abstract**

I investigate audit quality by examining 581 Incorporated Societies in New Zealand.

Incorporated Societies in New Zealand are in a unique situation as they are currently allowed to choose to be audited or not and receive assurances at any level, including from an ‘auditor’ no qualification. I run multiple regressions testing various variables as proxies for size and complexity in order to help us find out what influences the audit quality choice made by the Incorporated Society. I find results that reveal contradictory relationships between the types of assurances provided, while also having results that support prior literature. Thus, I provide new insight into the determinants of assurance at different quality levels and why entities are voluntarily audited.

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### **Attestation of Authorship**

I hereby declare that this submission is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person (except where explicitly defined in the acknowledgements), nor material which to a substantial extent has been submitted for the award of any other degree or diploma of a university or other institution of higher learning.

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Signed:

Date: 30-03-24

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## **1 Introduction**

A longstanding question in the auditing literature is why do some organizations choose a higher quality audit? This is an important question as the choice of audit quality can significantly impact the reliability and transparency of financial reporting, influencing stakeholders' trust and decision-making. Incorporated Societies (IS) are a strong setting to examine this question as currently IS are not required to receive an audit but instead may choose to receive an audit or get reviewed or neither. Furthermore, some IS may choose to receive formal assurance from a large audit firm or a chartered accountant while others may choose to receive an informal expression of assurance from an unqualified lay person (i.e. not a licensed auditor). This leads us to the question; Why do Incorporated Societies choose to receive an assurance of different quality levels?

This study intends to provide new evidence on why some organisations may choose to receive an informal audit from a lay person, which I term a casual audit. These casual audits use non-standardised language compared to an auditor's report prepared by an auditor, "the accounts have been reviewed from the information provided ... There is no reason to believe they are not accurate and complete" (Water & Environmental Care Association, 2022). Investigating this is important, as a fundamental question within auditing studies is what drives a firm to choose a better audit, this becomes more difficult to examine as audits are mandated for firms however this is where IS presents us with an interesting sector to examine as IS currently have no legal obligation to be audited, however some of these IS do so. If they choose to get an audit, they have choices about who they get to do it. Hay & Davis (2004) discuss if the IS gets an auditor, they may choose an unqualified or qualified auditor. If they are qualified, they may choose to get an individual or an auditing firm. If they choose an auditing firm, they can then choose if they want a

small firm or a large firm and if they have chosen a large firm there is the choice of getting a second-tier large firm or the Big 4 to provide the audit. The further along this choice matrix they choose to go there is a better perceived quality of the audit. One key point of interest not explored by prior literature is when an unqualified person provides the audit, and how they may still use auditing language making them accountable for the financial documentation.

IS activities do differ from those done by companies this study will look at the reasons why companies may decide to get higher levels of assurance and compare if any of these reasons are applicable to why an IS may also decide to receive higher levels of assurance. This study intends to contribute by providing an update to past literature. It is also becoming increasingly relevant with the Incorporated Societies Act 2022 (s.105) which discusses that the annual statements of certain societies will have to be audited by a qualified auditor, where the auditor will conduct the audit while complying with the applicable auditing and assurance standards. In terms of what societies will be required to get their financial statements audited, there is a lack of clarity, as in the Consultation Document it is noted that charities currently require audits if they meet certain expenditure thresholds, as such it may become compulsory for some IS to receive audits (Ministry of Business Innovation and Employment, 2022). As it is now ISs currently do not face the requirement of compulsory audits, but this may change when the IS reregisters under the new act. The Consultation Document states that small IS will be allowed to continue applying basic accounting standards to the financial statements, but those that qualify as large, total assets exceed \$66 million or revenue exceeds \$33 million in the past two financial years, will be required to have a qualified audit although there had been submissions claiming that the “thresholds were far too high for incorporated societies. The select committee agreed.” (Ministry of Business Innovation and Employment, 2022). The

more casual audit is a key point of interest as it may no longer be viable for IS as the Incorporated Societies Act 2022 will make audits compulsory for the additional societies beyond the charities that meet expenditure thresholds, as such this study will attempt to look at the quality a casual audit provides.

I test hypothesis using data collected from 581 incorporated societies, running tests using the types of assurances that the IS received as a substitute for audit quality. I test using a series of regressions consisting of our hypothesised variables that influence audit quality as independent variables. It is expected that audit quality would be related to their size, donations as a proportion of revenue, location of the IS, the number of recorded officers, profitability, the complexity of the financial statements, and the qualification of who they choose to act as their assurer. I split our audit quality proxy into its individual parts to run the regressions again which reveals that the types of formal assurances are influenced by differing variables.

The paper contributes to the literature by using the unique settings that ISs in New Zealand are in to test for audit quality using the forms of assurances received as audit quality whereas prior literature had instead used the auditor as the measure of audit quality. I do find results that share consistencies with what had been found previously by Hay & Davis (2004) with higher audit quality being associated with larger ISs.

This paper is structured such that in the next section I will look at the institutional setting of IS providing a brief background and discussion as to what they are. Then there will be a review on how companies decide on how they get audited and the underlying theories as to why they may choose to receive higher quality audits. Followed by a review on charities, currently most similar to the ISs situation, choice of assurance, then a review on how ISs chose their level of assurance. This will be followed by the development of our hypotheses,

then the presentation of our data, then the methodology I will be using, followed by the results, then the final section will conclude the paper.

## **2 Literature Review**

### *2-1 Institutional Setting.*

ISs are separate legal entities from their members, with perpetual succession and limited liability. They can engage in trading activities and vary in size and complexity. Audits of ISs are not compulsory, but financial statements must be submitted to the Registrar of Incorporated Societies, making them publicly available (Hay & Davis, 2004). Activities undertaken by an IS do differ from those done by companies, however prior literature has shown that some of the reasons for why an IS would get audited does keep in line with the logic of why a company would choose to get a higher quality audit (Hay & Davis, 2004; Kulset & Sundkvist, 2023). IS have similarities to usual corporate entities, members cannot all take part in the management and there is a separation between the ownership and control. Members act as an equivalent to the shareholders of a company and have an interest in the survival of the IS Hay & Davis, (2004). Unlike a company an IS cannot distribute their profit but like a company they also have limited liability. ISs include industry associations, trade unions, and voluntary groups formed for sports or cultural purposes (Hay & Davis, 2004). They are interesting to examine due the complete freedom they have in the auditor choice, they are required to make their financial statements publicly available, however the freedom in auditors allow them to choose to have no auditor if they do not desire to get audited. Those that decide to get audited can choose from a hierarchy of increasingly qualified auditors, someone with no qualifications, qualified accountants, chartered accountants, accounting firms and national firms (Hay & Davis, 2004).

Organizations often choose to undergo voluntary audits for various reasons. Studies (Abbott, Parker, & Peters, 2010; DeAngelo, 1981) have highlighted the motivation to enhance financial reporting quality, increase stakeholder trust, and reduce information asymmetry. Voluntary audits may also be motivated by a desire to attract investment (Myers, Myers, & Omer, 2003) and gain a competitive advantage. Voluntary audits offer several advantages to organizations. Research (Lennox, 1999; Simunic, 1984) indicates that they lead to improved financial reporting accuracy and the strengthening of internal controls. Moreover, organizations that opt for voluntary audits often report enhanced relationships with stakeholders (Turner, Mock, & Manry, 2008), and greater access to capital markets (Leuz & Verrechia, 2000)

Despite the numerous benefits, challenges exist in the context of voluntary audits. High costs are often associated with conducting voluntary audits (Knechel & Payne, 2001), which can deter smaller organizations. The potential for firms to manipulate the scope and outcomes of voluntary audits (Abbott, et al, 2016) raises concerns about their credibility and integrity.

Recent trends in voluntary audits considering that financial audits are mandated for large companies, include a growing emphasis on sustainability reporting and environmental, social, and governance (ESG) factors. Voluntary audits are increasingly used to assess and report on an organization's ESG performance and commitment to sustainable business practices (KPMG, 2020). Frameworks such as the Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB) have played significant roles in the standardization of sustainability reporting.

## *2-2 Firms Auditor Choice.*

The selection of auditors is a critical decision for companies, influencing financial reporting quality, transparency, and stakeholder trust. This report explores the factors, motivations, and implications associated with how companies decide on their auditors. The analysis is based on three prevailing theories: agency theory, signalling theory, and assurance theory.

According to Dedman, Kausar & Lennox (2014) companies would rationally choose to be audited even if there were no legal requirements within the country to make them mandatory. When deciding on getting an audit there are three prevailing theories about why a company chooses to get an audit. These three theories as to why a company would choose to receive an audit are, agency theory, signalling theory and assurance theory. Assurance, signalling, and agency theory are integral components of auditing literature. Assurance is at the core of auditing, providing stakeholders with confidence in financial information. Signalling theory explains how auditing is used by firms to communicate their commitment to transparency. Agency theory addresses conflicts of interest in auditing relationships. The synergy and integration of these concepts is crucial for a comprehensive understanding of the auditing process. Auditors provide assurance to external stakeholders, which serves as a signal to mitigate agency conflicts. The choice of auditor, audit quality, and the audit committee's effectiveness are intertwined, reflecting the interplay between assurance, signalling, and agency theory.

**Industry Expertise:** In specialized industries, companies may prefer auditors with specific industry knowledge. This expertise allows auditors to better understand sector-specific risks and challenges, improving the effectiveness of the audit (Chan, Ellen, & Phyllis, 2018).

Agency theory makes the claim that the auditor provides a governance role because of credibly certifying the financial statement as this reduces conflicts between management and the owners. Management's interest is likely to satisfy their own self-interest, which may result in the organization being harmed or the manager acting in a way that reduces the owners' benefits. When this occurs, having an independent auditor check the statements, if these actions are found the manager is then held accountable, since the manager could attempt to bias the information in the reports to satisfy their interests over the organizations (Bhattacharya & Banerjee., 2020; Yang & Simnett, 2023). Typically, agency theory is most applicable to larger companies as it is expected that there would be a greater level of separation between the ownership and control of a company when compared to smaller companies, as such the owners of larger companies would likely desire higher quality audits to ensure that the actions taken by those managing the company stay in line with the company's goals. (Yang & Simnett, 2023; Hannu Ojala, 2016). Dedman Et Al. (2014) had found results that kept in line with this theory that it was the larger companies purchasing audits. Although it has been speculated that the separation of ownership affects auditor choice, it can be hard to directly test, some studies used the size of the organisation as a proxy where some used the number of shareholders as a proxy. Dedman Et Al. (2014) had managed to find that typically companies with more directors preferred receiving an audit, likely to reduce communication and control issues. They make the claim that companies that have higher agency costs are more likely to purchase an audit.

Agency theory is a foundational concept in understanding the auditor selection process. It posits that auditors play a governance role by certifying financial statements, reducing conflicts between management and owners (Collis, 2012). Management's self-interest can sometimes diverge from the interests of the organization, potentially harming the company or its stakeholders. Auditors act as independent parties who verify the financial

statements, thereby reducing information risk, inherent risk, and control risk, consequently lowering agency costs (Bhattacharya & Banerjee, 2020). According to agency theory, auditors play a governance role by certifying financial statements, reducing conflicts between management and owners. Auditors provide independent verification and hold management accountable, reducing the agency costs associated with management's self-interest (Bhattacharya & Banerjee, 2020; Yang & Simnett, 2023). Agency Theory in auditing consists of several key components: Principal-Agent Relationship: The central premise of Agency Theory is the principal-agent relationship, where principals (shareholders) delegate authority to agents (management) to make decisions on their behalf. Auditors, as external agents, play a crucial role in providing assurance to principals regarding the actions of agents (Jensen & Meckling, 1976). Information Asymmetry: Agency Theory recognizes that agents often possess more information about the firm's operations than principals. Auditors bridge this information gap by independently verifying financial statements and providing assurance on their accuracy (DeAngelo, 1981). The auditor's role in mitigating agency conflicts is central to the effectiveness of corporate governance. The audit committee is often considered a key player in mitigating agency conflicts. Many studies have explored the effectiveness of audit committees in ensuring auditor independence and financial reporting quality (DeZoort & Salterio, 2001; Klein, 2002).

Signalling theory suggests that companies choose auditors to signal their commitment to transparency and accountability to stakeholders. Audited financial statements serve as signals of financial health and reliability, positively influencing stakeholders' perceptions (Gul, Wu, & Yang, 2013). By voluntarily undergoing an audit, companies aim to communicate their dedication to ethical financial reporting, thereby fostering trust among investors, creditors, and the public (Palmrose, 1986). In the context of auditing, signalling theory explains how companies strategically employ auditing and related activities to

communicate their financial health, transparency, and commitment to quality reporting

Signalling theory suggests that companies choose auditors to signal their commitment to transparency and accountability to stakeholders. Audited financial statements serve as signals of financial health and reliability, positively influencing stakeholders' perceptions (Gul et al., 2013). Signalling theory posits that individuals or organizations with private information signal their attributes or intentions to external parties. In auditing, firms signal their financial health, integrity, and transparency through various means, primarily the engagement of external auditors. One of the central themes in the application of signalling theory in auditing is the concept of audit quality as a signal. Firms often voluntarily hire reputable external auditors to assess their financial statements. Signalling theory also extends to the reputation and independence of auditors. Companies may select auditors with strong reputations to provide external validation of their financial statements (Francis, Maydew, & Sparks, 1999). Additionally, auditor independence is crucial in signalling the objectivity of the audit process, demonstrating a commitment to fair reporting (DeAngelo, 1981). Agency theory, which explores the conflicts of interest between different stakeholders, is closely linked to signalling theory in auditing. Firms signal their commitment to reducing agency costs by engaging in rigorous auditing practices (Klein, 2002). Signalling theory provides a valuable framework for understanding how firms use auditing and related activities to convey information to external stakeholders. Audit quality, reputation, and independence serve as key signals of a company's commitment to transparency and financial integrity. The application of signalling theory extends beyond traditional financial reporting to encompass emerging areas such as sustainability assurance. Understanding how signalling operates in the auditing context is essential for auditors, regulators, and investors as they assess the credibility and reliability of financial information. The effectiveness of a company's audit committee in ensuring auditor

independence and reporting quality also plays a significant signalling role in agency theory (DeZoort & Salterio, 2001).

Assurance theory in auditing is a fundamental concept that underpins the profession's core objective: to provide independent and reliable assessments of financial information. Assurance theory considers the auditor as an insurance provider for companies, protecting them from legal, financial, and reputational risks. Companies may choose high-quality auditors, such as those from the Big 4, to enhance their credibility and protect against potential damages (Kulset & Sundkvist, 2023). Auditors act as independent third parties who provide assurance to shareholders that the financial statements presented by management are free from material misstatement (DeAngelo, 1981). Assurance theory plays a pivotal role in enhancing the credibility of financial reporting. It provides external stakeholders, including investors, creditors, and regulatory authorities, with confidence in the accuracy and fairness of financial information. Agency theory addresses the conflicts of interest between different stakeholders involved in the auditing process, primarily the principal-agent relationship between shareholders (the principal) and management (the agent). Assurance theory in auditing consists of several key components, independence, evidence, scepticism, and materiality. Independence: Central to assurance theory is the auditor's independence. Auditors must remain free from bias, conflict of interest, and undue influence to provide objective and unbiased assessments of financial information (DeAngelo, 1981). Evidence: Assurance is built on the collection and evaluation of evidence. Auditors gather audit evidence to substantiate their opinions on the fairness of financial statements. Professional Scepticism: Assurance requires auditors to maintain a sceptical mindset, critically assessing and challenging management assertions (Hurtt, 2010). Materiality: Assurance theory acknowledges the concept of materiality, which helps auditors determine the significance of

misstatements in financial statements. Assurance engenders trust in financial markets, facilitating capital allocation decisions and economic growth (Simunic, 1980).

Financial statements that have been audited tend to be seen as being more reliable and transparent enhancing the accountability of the reports (Lennox, Wu, & Zhang, 2014). Stakeholder confidence in a company is also influenced by auditor choice, Stakeholders perceive external audits as signals of commitment to transparency and are more likely to trust audited financial information (Biddle, Hilary, & Verdi, 2009). Governance and Decision-Making: Auditor choice can influence an organization's governance structure and decision-making processes. Audit committees play a vital role in ensuring auditor independence and effectiveness (Ghosh & Moon, 2005).

Some of the factors that influence auditor choice are auditor reputation and experience, cost, industry expertise, company size, capital structure and debt covenants. Auditor reputation and experience play a pivotal role in auditor choice. Companies tend to prefer auditors with established credibility and a history of quality audit services (Collis, 2012). Reputable auditors are seen as more reliable in providing accurate and unbiased opinions on financial statements. Cost considerations, including audit fees and associated expenses, are significant factors for companies, especially for smaller organizations with limited resources. Striking a balance between audit quality and affordability is essential (Abbott & Parker, 2000). In specialized industries, companies may prioritize auditors with specific industry knowledge. This expertise allows auditors to better understand sector-specific risks and challenges, ultimately improving the effectiveness of the audit (Chan et al., 2018). Industry-specific auditors are more likely to identify industry-specific issues. The size of a company can be seen as a crucial determinant in auditor selection. Larger organizations are more likely to seek auditing services, as their volumes of transactions increase, making mistakes more likely in accounting data and financial statements (Taurigana & Clarke,

2000). Larger firms typically have more complex financial reporting requirements. The capital structure of a company may influence auditor choice. Companies with complex capital structures may desire auditors with specialized knowledge in dealing with intricate financial instruments and arrangements. Debt covenants may have specific requirements for their auditors, as they need to ensure compliance with various contractual obligations. Auditors with experience in dealing with debt covenants are often preferred (Dedman, et al 2014).

Some motivations for choosing to get audited are, agency cost reduction, transparency and stakeholder trust, as an insurance against risks. As suggested by agency theory management and ownership may have differing goals and having an auditor can mitigate the conflicts that may arise between the two parties by certifying the financial documents (Collis, 2012). When management's interests diverge from those of the organization, having an independent auditor can hold management accountable, reducing the agency costs associated with self-interested actions (Bhattacharya & Banerjee, 2020). In order to signal their commitment to transparency and improve stakeholder trust companies would get their financial statements audited, as this can serve as a signal for the financial health and reliability to their stakeholders (Gul et al., 2013), if this audit is voluntary, it can be seen as the company trying to communicate their dedication to more ethical and accurate reporting thus improving trust among the stakeholders. As shown through assurance theory the auditor can be viewed as an insurance provider for the company acting as potential protection from legal, financial and reputational risks as such Companies may choose high-quality auditors to enhance their credibility and safeguard against potential damages (Kulset & Sundkvist, 2023).

The choice of auditors significantly impacts financial reporting quality. Audited financial statements tend to be more reliable and transparent, enhancing overall

accountability (Lennox et al., 2014). Auditor oversight helps ensure that financial statements accurately represent a company's financial position. Auditor choice influences stakeholders' trust and confidence in a company. Stakeholders perceive external audits as signals of commitment to transparency and are more likely to trust audited financial information (Biddle et al., 2009). Trustworthy financial reporting can attract investors and creditors. Auditor choice can influence an organization's corporate governance structure and decision-making processes. Audit committees play a vital role in ensuring auditor independence and effectiveness (Ghosh & Moon, 2005). Effective governance practices enhance stakeholder confidence.

Big 4 audit firms are often perceived as providing higher-quality audits due to their size, reputation, and expertise (Quick et al., 2018). These firms are more incentivized to ensure audit quality as they have more to lose in terms of their reputational capital and face greater potential liabilities in the event of audit failure (Bhattacharya & Banerjee, 2020). Companies may prefer Big 4 auditors to minimize risks associated with information distribution, authority, and potential litigation (Quick et al., 2018).

### *2-3 Charities Auditor Choice.*

The decision-making process for charities in selecting auditors is influenced by various factors related to organizational dynamics, financial performance, and external monitoring needs (Tate, 2007). Tate (2007) suggests that changes in agency costs and the contracting environment within an organization can lead to alterations in the quality and selection of auditors. Auditor selection in charitable organizations is a crucial decision that impacts transparency, accountability, and the preservation of their reputation, given the importance of donations as a significant funding source. Hasseldine, Salama, & Toms (2005) indicate that

auditor expertise and industry specialization enhance audit effectiveness and credibility. Charities often prefer auditors with experience in the nonprofit sector, as they possess insights into sector specific challenges and regulatory requirements, which can safeguard their reputation and attract more funding. Kulset & Sundkvist (2023) highlight the positive relationship between being audited by an industry specialist and the future financial benefits provided to charities. Charities' complexity and debt ratio influence auditor selection, similar to public and private firms. Complexity may necessitate a higher level of audit assurance. To mitigate agency costs and potential conflicts, management can hire high-quality auditors, who can also serve as a buffer in the event of reputational damage (Kulset & Sundkvist, 2023).

Charities are subject to legal and regulatory requirements that dictate their need for audits. While large charities often must receive audits, medium and small charities have more flexibility in choosing the level of assurance they require. The legal framework and regulations play a significant role in determining the type of audit or assurance engagement charities opt for. When no specific assurance is legally required, agency theory comes into play. Charities may opt for auditors to mitigate potential bias in financial reporting by management. Auditors act as independent experts who ensure that financial documents are accurate and trustworthy. The charity sector often contains more errors in financial information than for-profit companies. Auditors can play a critical role in correcting mistakes, making recommendations for improvements, and increasing the trust in financial information. Charities must maintain this trust to attract donors and maintain their funding sources (Kulset & Sundkvist, 2023).

Donor trust is crucial for charitable organizations, and auditor choice may play a role in building and maintaining that trust. High-quality audits and auditors can act as signals of a charity's financial integrity, attracting more donations. Charities' relationships with donors,

fundholders, and the general public are essential to their survival. High-quality auditors help maintain trust by signalling the credibility of financial statements. Auditors can also serve as a scapegoat to deflect blame in case of reputation damage, further safeguarding the organization's interests (Kulset & Sundkvist, 2023). The choice of auditor can signal nonprofit credibility and stewardship, influencing donors' willingness to support the organization. Industry specialist auditors can also provide operational and fundraising advice, enhancing organizational practices. While prior research has emphasized the credibility associated with Big 4 audit firms, considering auditor specialization at the local industry level enhances understanding of the nonprofit audit market (Harris, Tate, & Zimmerman, 2019).

Not-for-profit organizations, including charities, face specific challenges due to their unique mandates and objectives. They must raise funds and attract donors while maintaining transparency and accountability. The nature of charities requires them to send credible signals about their financial stability and positive reputation to potential contributors, which can be achieved through quality audits (Kulset & Sundkvist, 2023).

Charitable organizations must carefully consider various factors when selecting auditors to ensure financial transparency, accountability, and donor trust. Kulset & Sundkvist (2023) highlights the importance of auditor specialization, legal and regulatory requirements, agency theory, and the role of auditors in error correction and trust building. These factors collectively contribute to the decision-making process, allowing charities to safeguard their reputation and secure financial support from donors. It is essential for charities to align their auditor selection with their specific needs, financial complexity, and long-term goals to thrive in the competitive landscape of the non-profit sector.

#### *2-4 Incorporated Societies Auditor Choice.*

Incorporated societies (IS) are separate legal entities from their members, their activities can vary in size and complexity and currently they are not required to receive audits as such it is interesting to look at the IS that do decide to receive audits and attempt to come to an understanding of why.

The choice of an auditor for incorporated societies follows a hierarchy of auditor quality. At each level of this hierarchy, there is an increase in observable auditor quality, reflecting different attributes and characteristics. The most basic choice is between having an audit and not having one. An audit provides a certain level of assurance and credibility to an organization's financial statements, which is essential for transparency and trust. Choosing a qualified accountant over an unqualified person represents an improvement in auditor quality. A qualified accountant has the necessary education and credentials to perform audits effectively. Opting for a chartered accountancy firm signifies another step up in auditor quality. These firms make use of professional societies of auditors, which help reduce the costs of ensuring auditor independence and competence. Larger audit firms are considered to provide a higher quality of audit. They often handle a greater number of clients and have more to lose if they fail to report a breach in a client's records, making them more reliable. Big N audit firms are perceived as providing the highest-quality audits. They possess attributes such as professional membership, large size, and strong reputations, which further reinforce their audit quality. When Hay & Davis (2004) examined the auditor choice and quality with varying levels of auditor quality they had found that the smaller the IS was the lower the audit quality was, with the IS having proportionately lower debt and salaries.

Audits are chosen to monitor and bond with external stakeholders. High agency costs, such as size, debt leverage, and managerial ownership, often indicate a need for monitoring. Selecting an auditor with a higher reputation is a way of signalling superior performance to

stakeholders. High-quality auditors can help reduce measurement errors in financial reporting. Audits are viewed as a form of insurance. External financing providers and custodians of funds may require audits to increase the chance of recovering losses or to demonstrate due care in discharging their responsibilities. In larger organizations, delegation becomes necessary, and reduced observability can lead to moral hazard and opportunism. Therefore, organizations with greater demand for control may choose higher-quality audits.

The size of an IS is a critical factor in determining auditor choice. Larger ISs are more likely to choose an audit or a higher-quality auditor to meet monitoring needs. Additionally, the cost of an audit relative to its benefits is more favourable for larger entities. Higher salaries, as a percentage of revenue, are associated with a greater demand for audits and higher-quality auditors. This is due to the need for monitoring organizations with self-interested agents, such as employees. Increased debt as a percentage of assets leads to a demand for higher-quality audits. This indicates that audits for debt-contracting purposes must be of higher quality than the minimum required. The source of income, whether from members (subscriptions and payments) or non-members (donations and grants), can influence auditor choice. Donations and grants may lead to the choice of a higher-quality auditor for signalling purposes. However, the relationship is not consistent for ISs with a higher proportion of revenue from members (Hay & Davis, 2004).

According to Hay & Davis (2004) there have been several suggested explanations for the choice of an auditor and the level of auditor quality, they are monitoring and bonding, signalling, insurance and organisational control. Although they are not required to receive an audit the IS are required to provide financial statements to the Registrar of Incorporated Societies annually. Since the employees of an IS can be self-interested, members may wish for controls to be put in place, smaller IS may have little to no employees resulting in activities being carried out by volunteers in this case it is expected that members would still

want controls to be put in place. In an IS the inner group of members would be seen as the equivalent to the board of directors, they would have an interest in providing good stewardship to the other members and hopefully attract new members. Lenders and suppliers would have an interest in the IS and their ability to repay loans. Donors would also have an interest in the IS as they would have an interest in the activities that are being taken by the IS. The Donors and lenders may have an interest in the financial documents as an insurance that their funds are being used properly. Larger ISs, with an employee hierarchy may have managers which need to exercise management control over lower-level employees. Thus, explanations for auditor choice and for choice of a higher-quality auditor that exist in previous literature could all apply to incorporated societies. (Hay & Davis, 2004)

### **3 Hypothesis**

When receiving donations, it is expected that an IS would carefully weigh various factors when selecting auditors to uphold financial transparency, accountability, and donor trust. This expectation stems from the likely desire for assurance regarding the appropriate use of donated funds. Non-member contributions are likely to prompt the IS to seek a higher standard of audit, aiming to signal performance to potential donors (Copley, Doucet, & Gaver, 1994). In line with signalling theory the auditor choice conveys their dedication to transparency and accountability. The auditing of financial statements serves as a signal of commitment to provide accurate and reliable financial information (Palmrose, 1986). Furthermore, voluntary audits can signal commitment to ethical and accurate reporting, thereby enhancing stakeholder trust and potentially bring in additional donations in the future (Gul et al., 2013). Kulset & Sundkvist (2023) had acknowledged the positive correlation between being audited by an industry specialist and the future financial benefits provided to

charities. Hay & Davis (2004) notes that higher levels of donations may lead to the engagement of higher quality auditors, to act as an insurer for the IS. Donations may prompt the choice of a higher-quality auditor for signalling purposes. Donors and lenders alike are vested in the IS's activities and have a keen interest in the integrity of its financial documents, viewing them as insurance for the proper utilization of funds.

This leads us to form the following hypothesis:

**H1:** Greater value of donations is associated with higher audit quality.

As Knechel & Payne (2001) had noted due to the cost of receiving assurance it can deter smaller entities from receiving assurances for their financial reports. Alongside smaller IS being deterred it is expected that as an IS increases in size its members would be likely to desire higher levels of assurance in order to monitor those managing the IS (Chow, 1982). This idea of receiving assurance as an action to monitor management matches agency theory and is expected to have a similar relationship as to why larger companies would receive a superior audit. Much like larger companies I expect that the larger the IS is there is an expected greater level of separation between the members and those making crucial decisions when compared to a smaller IS, therefore much like how the owners of larger companies would likely desire higher quality audits, I can reasonably expect large IS to also desire the same to ensure that the actions taken by those in management stay in line with the IS's (Yang & Simnett, 2023; Hannu Ojala, 2016). In previous literature Hay & Davis (2004) examined the auditor choice and had found that the smaller the IS was the lower the audit quality was. The size of an IS is a critical factor in determining auditor choice. Larger ISs are more likely to choose an audit or a higher-quality auditor to meet monitoring needs.

This leads us to form the following hypothesis:

**H2:** Increased size is associated with higher audit quality.

Hay & Davis (2004) had the expectation that the cost of receiving an audit would increase at a slower rate than the increase in the size of the IS.

The intricacy of financial reporting requirements often correlates with the level of audit quality required. If the entities capital structure is complex it can significantly influence auditor choice. Higher levels of complexity may necessitate auditors with specialized expertise in navigating intricate financial instruments and arrangements (Dedman et al., 2014). Entities, ranging from trading firms to charitable organizations vary in complexity affecting their auditing needs (Hay & Davis, 2004). Similarly, the complexity of charities and their debt ratios can impact auditor selection, mirroring the considerations seen in both public and private firms. Higher complexity may require a more robust level of audit assurance. (Kulset & Sundkvist, 2023). Since charities are most similar to IS I can expect similar results of higher levels of complexity being associated with higher audit quality.

This leads us to the following hypothesis:

**H3:** More complex accounts are associated with higher audit quality.

In terms of complexity, I will focus in whether the IS appears to run a shop as this makes their accounts more similar to a firm and likely more complex when compared to an IS that does not undertake this additional service.

## 4 Data and Method

In order to get a random sample of ISs for this study we got a list of all ISs from the Incorporated Societies Register, then a random number generator was used on Microsoft Excel to order the ISs. After the randomisation the data had been collected from their publicly available financial statements giving us 581 usable observations. The data has been gathered from publicly available information from the Incorporated Societies Register. A list of IS has been provided by the MBIE. The data is a random sample collected from the register. This data was collected from the financial statements provided for the year 2021, data will only be needed for one year as it is expected that there will be rigidity in an IS choice of assurance provider. The financial reports were downloaded from the Incorporated Societies Registers website, gathering the information from what the IS had stated in their reports and what they had listed on the website at the time of the report, not all reports were made available at the same time or completed at the end of the financial year, however due to the expected rigidity in assurance providers it is not expected that this discrepancy will influence the results in a meaningful manner. Auditor choice and what factors are expected to influence an IS to make their decision by following the model laid out by Hay & Davis (2004) and Kulset & Sundkvist (2023).

Typically auditing can only be carried out by a person or firm who have the appropriate levels of education and professional memberships, however for IS there are no such regulations preventing any person from engaging in the activities of an auditor. This provides the ability to examine the auditor choice for all levels of quality. An IS can choose from a hierarchy of potential auditors, they can choose to have no auditor, if they choose to have an auditor, they can choose to get someone with or without any qualifications, for those with qualifications they can choose a qualified accountant who would have the educational qualifications but may not be a chartered accountant. If someone qualified has been selected

the IS may choose to get someone with the qualifications of a chartered accountant and beyond that they may choose someone from a firm, a chartered accountancy firm comes with the brand name and is subject to the Practice Review Board of the Institute of Chartered Accountants of New Zealand having disciplinary proceedings and strict admission requirements that apply beyond being a qualified accountant. If a chartered accountancy firm is selected there is the choice between a member of the Big 4 or another firm. Auditor quality can be defined as the likelihood that the auditor will be able to both detect and report a breach in the contract to provide fair accounting information (DeAngelo 1981; Watts & Zimmerman, 1986). However, auditor quality is difficult to observe, and in order to evaluate it surrogate measures need to get used (DeAngelo 1981). Accordingly, I operationalise the examination of this variables as below.

The following variables are dummy variables testing the type of assurance provided to the IS. *Compilation* is 1 if the IS received a compilation report, otherwise it is 0. *CasRev* is 1 if the IS received a review from an unqualified individual, otherwise it is 0. *CasAud* is 1 if the IS received an audit from an unqualified individual, otherwise it is 0. *FormRev* is 1 if the IS received a review from a qualified individual, otherwise it is 0. *FormAud* is 1 if the IS received an audit from a qualified individual, otherwise it is 0. Due to the lack of observations, I will be unable to include the compilation freestyle variable as only 1% of the observations have received them.

The following variables are dummy variables testing the level of the accountant used by the IS, *Accountant* is 1 if the person providing assurance has qualifications as an accountant, otherwise it is 0. *CA* is 1 if the accountant providing assurance has qualifications as a chartered accountant, otherwise it is 0. *Firm* is 1 if the chartered accountant providing assurance works for a firm. These variables scale so it is expected that the higher the level of the accountant, such as if *Firm* was 1 all variables before it would also be 1. However, due to

the high correlation between *Accountant* and *CA* I will not be able to run the regression using both variables at once. I am unable to use the national firm variable due to the lack of observations with less than 4% of ISs using a national firm.

Our audit quality variable will be transposed by the type of assurance that the IS had received 0 if there was no assurance, 1 if they received a form of casual assurance, 2 if they received a formal review and 3 if they received a formal audit. I am using this as our proxy for quality as it can be expected that casual assurance would be better than having no assurance, formal assurance would be superior to casual assurance, and receiving an audit should be superior to receiving a review.

Then I follow Hay & Davis (2004) and examine the determinants through the following regression specified as:

$$\begin{aligned} \text{Audit quality} = & \text{LNTTLA} + \text{Don/Rev} + \text{Major Town} + \text{LNOfficers} + \text{ProfitDum} \\ & + \text{Inv/TTLA} + \text{Accountant} + \text{Firm} \end{aligned}$$

*LNTTLA* Is the natural log of total assets, this is our size proxy as this has been done by previous literature, Hay & Davis (2004) had discussed using assets as a potential size variable. I will follow suit by using the natural log of assets. Since this is the proxy, I am using for the size of an IS I will not be including total expenses, total revenue and current assets as these variables are too highly correlated with total assets, 0.748, 0.746, 0.702 respectively and significant at the 1% level, this backs up our use of assets as a proxy for size as alongside using assets Hay & Davis (2004) had looked at using revenue as the size proxy as well, finding a high collinearity seems to support this as well.

*Don/Rev* is the donations received by the IS in proportion to its total revenue, this tells us what percentage of the revenue is made up of donations.

*Major town* is a dummy variable where 0 is if it is not treated as a major town 1 where it is, I am only treating 3 towns as being applicable for this variable, these are Auckland, Wellington, and Christchurch. It is expected that the accessibility of receiving higher levels of assurance would be greater in these areas.

*LNOfficers* is the natural log of the number of officers that the IS had stated at the time of releasing their financial reports plus 1, the natural log of this variable was taken as it is not expected that having double the number of officers will be twice as good for the IS. The purpose of adding 1 to the number of officers before taking the natural log is to account for the IS that declared 0 officers at the time of providing their financial reports such that I do not lose observations by getting undefined results. If the added 1 before taking the natural log is not done, I would lose 185 observations.

*ProfitDum* is a dummy variable where 1 is if the IS had declared that they had made a profit, or 0 if they declared that they had broken even or made a loss.

*Inv/TTLA* is a measure of the complexity of the IS it is the amount of stock that the IS had in proportion to their total assets, this is a measure of the complexity of the IS as these ISs were operating a form of a shop and would therefore be expected to have more difficult accounts when compared to those that don't. However, I do lose 89 observations due to these IS declaring no assets returning an undefined result, since I am trying to determine how the complexity of the ISs accounts I will alter the variable where the undefined observations are set to 0 as these accounts would also have a value of 0 for their inventory accounts.

The *report* variable is a dummy variable that is 1 if the IS had received formal assurance and 0 if not.

## 5 Results

### 5-1 Descriptive Statistics

Table 1 provides the descriptive statistics for our key dummy variables for the 581 ISs. This is useful as it helps identify some variables which are unable to be used due to limited observations, it was identified that 159 (27.4%) of them had used a qualified *Accountant*. Of these qualified accountants 123 (21.2%) had *CA* qualifications. For the ISs 81 (13.8%) used chartered accountants that were associated with a *Firm*. Of the firms 22 (3.8%) were identified as *National Firms* which unfortunately is too few observations to be used in the models.

Of the 581 ISs 296 (51%) of them had received a form of assurance, 6 (1%) received a *Compilation Freestyle*, 89 (15.3%) received a *Compilation Report*. Too few freestyle compilations had been received as such they cannot be used in the models. 54 (9.3%) of ISs had received a *Review Freestyle*, and 40 (6.9%) had received a *Review Report*. 32 (12.9%) of ISs had received an *Audit freestyle* and 75 (35.1%) had received an *Audit Report*.

A variable is transposed from the types of assurance received in order to investigate ISs that had received formal assurances, 204 (35.1%) of the ISs had received a formal *Report*. It was found that 388 (66.8%) of the ISs had made a profit as per our *ProfDum* variable for the period of their financial reports, and 175 (30.1%) were in an identified *Major Town*.

ISs are an interesting setting containing many small firms each with varying levels of assurance including assurance provided from those that are unqualified. The data in Table 1 provides information about what level the assurance provider is and what form of assurance had been provided. 296 ISs received assurance, with 204 being noted as a form of formal assurance, however it is found that there are only 159 assurance providers that are qualified accountants. The data shows that due to the assurance provider using accounting language 45

unqualified assurers have been labelled as providing a formal assurance and as such have an increased level of responsibility.

Table 2 does the same for the remaining variables in this study. *LNTTLA* had a standard deviation of 4.48, a maximum of 17.66 and a minimum of 0. *INVofTTLA0* has a mean of 0.0094, a standard deviation of 0.05855, a maximum of 1 and a minimum of 0. *DonofRev0* has a mean of 0.1242, a median of 0, a standard deviation of 0.24142, a maximum of 1 and a minimum of 0. *LNOfficer* has a mean of 0.6581, a median of 0.6931, a standard deviation of 0.556, a minimum of 0 and a maximum of 2.89. Due to some of the ISs not identifying any officers the result of *LNOfficer* was identified as being the natural log one more than the number of identified officers such that observations did not get dropped due to an invalid result. *INVofTTLA0* and *DonofRev0* had the same issue arise, not all of the ISs had recorded assets or revenue, resulting in an invalid result for these variables, it was deemed reasonable to set the invalid results to 0 as it is true that those ISs do not have any inventory or received any donations.

### *5-2 Regression Results*

Our results Table 3 find high significance between our audit quality variable and the different levels of assurance providers both of which are seen to be significant at the .1% level, interestingly I do find a negative relationship between the firm level assurers but a positive relationship with the qualified assurers. This is unexpected as I would have expected that as the audit quality increased there would be a desire for a higher quality assurer but instead the reverse is displayed. I find that there is no significant relationship between having more officers and audit quality and the same is true for if the IS had made a profit and audit quality, the latter could be a result of ISs that are making a loss wanting to show transparency in their

actions by receiving superior levels of assurance showing the members and donors that they are making attempts to sustain the IS, while an IS that makes a large amount of profit could also desire the same transparency to show that they are not manipulating their financial statements or misusing the funds such that both ISs that make a loss and profit would both desire higher audit quality.

Denying H1 I find a negative relationship between Donations as a percentage of revenue (*DonOfRev0*) and *audit quality*, I do however find that there is not a significant relationship between these two variables. This is interesting as their prior literature had also suggested this relationship between *DonOfRev0* and audit quality, so I find results to support prior literature, but our result is insignificant. Yang & Simnett, (2023) had found that the donation to income ratio had been negatively associated with audit fees and it is suspected that the higher fees would be associated with higher audit quality. Hay & Davis (2004) also say that the national auditing firms are more likely to be involved with ISs that participate in more commercial activities as opposed to receiving their financing from donations. So, I could have reasonably expected to find this negative relationship as when *DonOfRev0* is lower it would mean the revenue received would have been more from its members and more commercial activities which could also be expected to be positively correlated with audit quality making the insignificant relationship I found between *DonOfRev0* and audit quality quite interesting to observe.

I do find supporting evidence that the size of the IS is positively related with *Audit Quality*, and in this case, I do also find that there is a significant correlation between size and audit quality, significant at the 1% level this is consistent with what I had expected to find in H2, larger ISs are associated with greater quality audits. This does also support what has been found in previous literature. the larger ISs are more inclined to voluntarily appoint auditors, with size being associated with higher quality audits. Larger ISs are subject to greater

scrutiny and monitoring, prompting members to demand audits or opt for higher-quality auditors as a means of oversight (Hay & Davis, 2004). This correlation between size and audit quality had been tested in prior literature finding similar results using other proxies of size, such as revenue, (Yang & Simnett, 2023). Therefore, the size of ISs plays a significant role in determining the level of audit quality, with larger entities tending to opt for higher-quality audits, supporting the results that have been found in prior literature. This does also follow the logic of agency theory as the larger an IS is the more likely it is that there would be a larger disconnect between the owners and those in charge of running the IS so the auditor provides a governance role certifying the financial statements to help reduce conflicts between management and owners, since the managements self-interest may diverge from the ISs interest (Collis, 2012).

Contradictory to H3 I find a negative relationship between our complexity proxy and audit quality, although this variable has an insignificant relationship with audit quality. I had expected to find a positive relationship as Simunic (1980) had found that the more complex an entity is there would be greater levels of information asymmetry and a method to mediate this issue is to receive an audit from an independent auditor, Yang & Simnet (2023) had also stated that the more complex an organisation is the more likely they will be audited by a high quality auditor.

I also tested other proxies for size to determine if there were any changes in our results, the other potential size proxies that I had available were the natural log of expenses (*LNExp*) and natural log of revenue (*LNRev*) I did not expect there to be any significant changes in the results by running these new regressions, these had been expected to also be suitable proxies for the size of an IS due to previous literature using them as well, Hay & Davis (2004) and Yang & Simnett (2023) had also used revenue as a size proxy. In Table 4 I tested using *LNRev* and size remained positive and significant at the 1% level, however

another change was found in testing this size proxy, unlike when using *LNTTLA*, *DonOfRev0* is now seen to be significant at the 10% level maintaining its negative sign, so it provides evidence for us to reject H1 while also providing support to the previous literature. In Table 5 I test using *LNExp* and the results are unchanged from our initial model. It is interesting to find the change in significance for *DonOfRev0* for only one of our size proxies so it does not appear that I have enough evidence to definitively reject H1 but does provide evidence that acts in a manner that allows us to assume that I can.

In Table 6 I change our complexity proxy to wages as a percentage of expenses (*WageOfExp*). When doing this I do find no significant changes when compared to the original model for complexity. I had initially used *InvOfTTLA* as our proxy for complexity as it implied that the IS was more commercial in nature and Hay & Davis (2004) said that a national firm was more likely to be involved with an IS of a commercial nature. So, although our initial model provides no significant evidence for H3, I do find supporting evidence for H3 if I use a different complexity proxy. I do

In Table 7 I test using *LNRev* as our size proxy and *WageOfExp* as our complexity proxy, I find that there is a significant relationship between *AudQual* and both *DonOfRev0* and *LNRev*. *DonOfRev0* is significant at the 5% level and is negative, *LNRev* is significant at the 1% level and is positive, another point of interest in Table 6 is the *ProfDum* variable becoming significant at the 5% level and having a negative relationship, this is interesting as in all other regressions I find a lack of significance with this variable. *WageOfExp* remains insignificant.

In Table 8 I test using *LNExp* as our size proxy and *WageOfExp* as our complexity proxy, I find very similar results to with the previous Table, with a significant relationship between *AudQual* and *DonOfRev0* and *LNRev*. *DonOfRev0* is significant at the 10% level and

is negative, *LNRev* is significant at the 1% level and is positive. So, I do continue to find more evidence to reject H1 when compared to our initial model, but I do lack evidence to support H3.

Table 9 swaps the *Accountant* variable for the *CA* variable and find no significant differences from the original model, which was expected due to the high collinearity between these variables.

Table 10 I change our dependent variable from audit quality to report which is a binary variable, 1 if the IS got formal assurance otherwise it is 0. This model shows interesting results compared to our initial model, first being that that our complexity variable *InvofTTLA* is significant at the 10% level, and both *Accountant* and *Firm* are positive and significant at the 1% level, this is interesting as in all previous models the *Firm* variable was surprisingly negative and significant, this is more in line with expectations that there would be a positive relationship with higher quality audits and having a firm as an assurance provider.

In Table 10 I look at if the IS received a review, either freestyle or report, here I find the same significant negative relationship between our *Firm* variable and receiving a Review as assurance, I do not see a significant relationship for *DonOfRev0*, *LNTTLA* or *InvofLNTTLA0*, but do see a significant relationship with our *Major Town* variable so it appears that when an IS receives a Review they are less likely to use an assurance provider at a firm level, this is likely to be the cause unexpected negative relationship between the *Firm* variable and audit quality. It also appears that having more access to assurance providers by being in a *Major Town* matters for an IS to get their financial statements reviewed.

Table 11 looks at if the IS received an audit, either freestyle or report, and I only see a significant relationship with *LNTTLA* and our Report variable both at the 1% level.

Table 12 looks at if the IS received a compilation report and I find that there is a significant relationship with *LNTTLA*, *Firm* and *Report*. For ISs that receive compilation reports I find that the relationship with our size proxy is negative so it implies that smaller ISs are more likely to receive a compilation report, it is surprising to see that the *Firm* variable is positive and significant especially due to the lack of formal compilation reports and the same is true for our *Report* variable which reasonably should be negatively correlated.

Overall, our models show that I can reasonably reject H1, I find strong evidence supporting H2 and find no significant correlations for H3. Our results for H1 and H2 do keep in line with prior literature that ISs with higher membership contributions as a proportion of revenue would be more likely to receive higher quality audits, since *DonOfRev0* is the proportion of revenue that is made up of donations, the closer it is to 1 the less membership contributions would be. As expected, larger ISs are expected to be more likely to receive higher quality audits.

## **7 Conclusion**

I examined ISs in New Zealand in order to allow us to discuss the level of assurance that they choose to receive due to their unique nature in how they are able to choose who audits them, from choosing no one, an unqualified person, to being able to choose a member of the Big 4. This research was intended to provide additional evidence due to the potential of the ISs unique choice in their assurance provider potentially changing in the near future. Agency theory looks at how management and ownership may have differing goals and use an auditor to mitigate potential conflicts that may arise between the two parties by certifying the financial documents (Collis, 2012). Assurance theory posits that auditors provide a level of insurance to companies, protecting them from legal, financial, and reputational risks.

Companies may choose high-quality auditors, such as those from the Big 4, to enhance their credibility and protect against potential damages (Kulset & Sundkvist, 2023). This matches a perceived reason as to why an IS would choose higher quality audits to fulfil an insurance function to protect the IS (Hay & Davis, 2004). I had not initially found evidence of whether higher levels of donations are correlated with higher quality audits but did find evidence to show the opposite when I delved further into our potential and appropriate variables, it is of interest that some proxies did not pick up on this variable while others did even though they were all reasonable proxies representing the same detail. This research does however provide supporting evidence that a larger IS would be more likely to desire higher quality audits keeping in line with what had been found previously by Hay & Davis (2004) and Yang & Simnett (2023), This followed the logic of agency theory as ISs are more likely to have a larger separation between the owners and those running the IS, the audited financial statements reduce conflicts between management and owners (Collis, 2012). I had not found supporting evidence for complexity being correlated with higher quality audits using our proposed complexity variable, which looked at if the IS was undertaking activities that were similar to those of a business although had been reasonable to assume that there would have been some form of relationship with proposed complexity variables it seems like what I had chosen may not have been the most appropriate proxies. It was interesting to see the lack of significance in our models when looking those that received an audit I find our size proxy and having a formal report being our only significant variables, whereas when looking at receiving a Review I see these same variable lose their significance, this could represent an issue with our dependent variable where increasing audit quality shifts what is relevant making it so I potentially miss an important part of the story, a future study could look into this in more detail.

The limitations of this study are primarily due to the relatively small sample size, with only 581 usable observations. Consequently, the ability to draw meaningful conclusions about National Firms is limited, as only 3.8% of the observed ISs received assurance from these firms. With a larger number of observations, more robust conclusions could be made regarding the benefits of receiving assurance from National Firms. Further limitations stem from the regression models used in the study. A probit regression would likely have been more suitable given the nature of the dependent variable; however, this approach was not feasible due to constraints with the software that was used.

This study focused exclusively on data from the year 2021, based on the assumption that there is rigidity in the choice of assurance provider for ISs. This assumption also helped to justify the fact that reports had been completed at various points throughout the year rather than at the end of the financial year. If the assumption of rigidity in the choice of assurance provider proves to be inaccurate, this could present challenges. To address this, expanding the data to include multiple years could provide insights into the consistency of assurance provider choices. While this approach may not fully resolve the issue of reports being completed at different times, it could help confirm the assumed rigidity.

Another limitation is that this study does not address the more personal benefits that receiving an audit gives to the IS. As per Carey, Knechel, & Tanewski, (2013) auditors can transfer some broad operational and business knowledge that can extend beyond the financial reporting. The auditors expertise may get shared with the IS through informal daily interactions or through formal business advisory services, as such this benefit may does not get captured by the financial reports. I did not examine the benefits of the audits beyond the financial benefits as it is difficult to examine these non-tangible benefits.

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## Appendix

Table 1

Variable Name	N	0	1
Accountant	581	72.6%	422
CA	581	78.8%	458
Firm	581	86.2%	501
National Firm	581	96.2%	559
Compilation Freestyle	581	99.0%	575
Compilation Report	581	84.7%	492
Review Freestyle	581	90.7%	527
Review Report	581	93.1%	541
Audit Freestyle	581	94.5%	549
Audit Report	581	87.1%	506
Report	581	64.9%	377
Major Town	581	69.9%	406
ProfDum	581	33.2%	193

Table 2

Variable Name	N	Mean	Median	Std Dev	Min	Max
Total Assets	581	539678.55	27344	2713390	0	46564911
LNTTLA	581	17.66	10.22	4.48	0	17.66
INVofTTLA	492	0.0111	0	0.063	0	1
INVofTTLA0	581	0.0094	0	0.05855	0	1
Total Revenue	581	158337.16	16715.66	762020.4	0	15005421
DonofRev	551	0.131	0.0007	0.246	0	1
DonofRev0	581	0.1242	0	0.24142	0	1
Officers	581	1.29	1	1.622	0	17
LNOfficer	581	0.6581	0.6931	0.556	0	2.89

Table 3

	AudQual			
	B	Std. Error	t	Sig.
(Constant)	-0.007	0.108	-0.069	0.945
DonOfRev0	-0.196	0.150	-1.303	0.193
LNTTLA	0.033	0.009	3.765	0.00***
InvofTTLA0	-0.127	0.619	-0.205	0.838
ProfDum	-0.010	0.077	-0.133	0.894
Major Town	-0.051	0.079	-0.645	0.519
LNOfficer	0.009	0.065	0.145	0.885
Accountnant	0.392	0.119	3.289	0.001***
Firm	-0.458	0.140	-3.278	0.001***

\*\*\*Significant at p < 1%

\*\*Significant at p < 5%

\*Significant at p < 10%

Table 4

	AudQual			
	B	Std. Error	t	Sig.
(Constant)	-0.3111	0.1265	-2.4596	0.014**
DonOfRev0	-0.2472	0.1476	-1.6742	0.094*
LNRev	0.07725	0.0133	5.81583	0.000***
InvofTTLA0	-0.0866	0.6086	-0.1423	0.887
ProfDum	-0.1256	0.0796	-1.5772	0.115
Major Town	-0.0328	0.0777	-0.4216	0.673
LNOfficer	-0.0139	0.0642	-0.2167	0.829
Accountnant	0.39925	0.1171	3.41049	0.000***
Firm	-0.4975	0.1378	-3.6093	0.000***

\*\*\*Significant at p < 1%

\*\*Significant at p < 5%

\*Significant at p < 10%

Table 5

	AudQual			
	B	Std. Error	t	Sig.
(Constant)	-0.2948	0.1286	-2.2928	0.022**
DonOfRev0	-0.2176	0.148	-1.4704	0.142
LNExp	0.07047	0.0128	5.503	0.000***
InvofTTLA0	-0.1519	0.6102	-0.2489	0.803
ProfDum	-0.0503	0.077	-0.653	0.514
Major Town	-0.0298	0.078	-0.3823	0.702
LNOfficer	-0.0039	0.0643	-0.0601	0.952
Accountnant	0.40795	0.1175	3.47201	0.001***
Firm	-0.4888	0.1382	-3.5375	0.000***
***Significant at p < 1%				
**Significant at p < 5%				
*Significant at p < 10%				

Table 6

	AudQual			
	B	Std. Error	t	Sig.
(Constant)	-0.045	0.117	-0.383	0.702
DonOfRev0	-0.237	0.163	-1.447	0.148
LNTTLA	0.062	0.009	6.808	0.000***
WageOfExp	0.083	0.104	0.801	0.424
ProfDum	-0.037	0.084	-0.447	0.655
Major Town	-0.047	0.086	-0.553	0.580
LNOfficer	-0.015	0.071	-0.213	0.831
Accountnant	0.932	0.116	8.027	0.000***
Firm	-0.240	0.151	-1.590	0.112
***Significant at p < 1%				
**Significant at p < 5%				
*Significant at p < 10%				

Table 7

	AudQual			
	B	Std. Error	t	Sig.
(Constant)	-0.411828	0.1367	-3.0127	0.003***
DonOfRev0	-0.321345	0.16006	-2.0077	0.045**
LNRev	0.116125	0.01379	8.41876	0.000***
WageOfExp	0.091914	0.10187	0.90224	0.367
ProfDum	-0.200472	0.08558	-2.3425	0.02**
Major Town	-0.025412	0.08426	-0.3016	0.763
LNOfficer	-0.051945	0.06935	-0.7491	0.454
Accountnant	0.924031	0.11374	8.12428	0.000***
Firm	-0.297048	0.14878	-1.9966	0.046**
***Significant at p < 1%				
**Significant at p < 5%				
*Significant at p < 10%				

Table 8

	AudQual			
	B	Std. Error	t	Sig.
(Constant)	-0.427462	0.13831	-3.0905	0.002***
DonOfRev0	-0.278183	0.16007	-1.7378	0.083*
LNExp	0.110492	0.01315	8.40294	0.000***
WageOfExp	0.127303	0.10173	1.25144	0.211
ProfDum	-0.093543	0.08277	-1.1301	0.259
Major Town	-0.018597	0.08434	-0.2205	0.826
LNOfficer	-0.035937	0.06933	-0.5184	0.604
Accountnant	0.928653	0.11371	8.1671	0.000***
Firm	-0.298653	0.14884	-2.0066	0.045**
***Significant at p < 1%				
**Significant at p < 5%				
*Significant at p < 10%				

Table 9

	<b>AudQual</b>			
	B	Std. Error	t	Sig.
(Constant)	0.013	0.108	0.121	0.903
DonOfRev0	-0.186	0.151	-1.235	0.217
LNTTLA	0.032	0.009	3.663	0.000***
InvofTTLA	-0.153	0.621	-0.246	0.806
ProfDum	-0.017	0.078	-0.221	0.825
Major Town	-0.056	0.079	-0.701	0.483
LNOfficer	0.015	0.065	0.225	0.822
CA	0.403	0.148	2.719	0.007***
Firm	-0.540	0.166	-3.249	0.001***

\*\*\*Significant at p < 1%

\*\*Significant at p < 5%

\*Significant at p < 10%

Table 10

	<b>Report</b>			
	B	Std. Error	t	Sig.
(Constant)	-0.039	0.043	-0.905	0.366
DonOfRev0	-0.033	0.060	-0.556	0.579
LNTTLA	0.027	0.003	8.179	0.000***
InvofTTLA0	0.407	0.247	1.647	0.100*
ProfDum	-0.027	0.031	-0.885	0.376
Major Town	0.005	0.032	0.165	0.869
LNOfficer	-0.020	0.026	-0.783	0.434
Accoutnant	0.498	0.043	11.608	0.000***
Firm	0.220	0.055	3.990	0.000***

\*\*\*Significant at p < 1%

\*\*Significant at p < 5%

\*Significant at p < 10%

Table 11

	<b>Review</b>			
	B	Std. Error	t	Sig.
(Constant)	0.194775	0.04339	4.48846	0.000***
DonOfRev0	-0.05081	0.06052	-0.8395	0.402
LNTTLA	0.000332	0.00355	0.09354	0.926
InvofTTLA0	0.354681	0.24942	1.42203	0.156
ProfDum	-0.0144	0.03119	-0.4616	0.645
Major Town	-0.12761	0.0318	-4.0125	0.000***
LNOfficer	-0.03645	0.0263	-1.3863	0.166
Accountnant	0.335743	0.04799	6.99648	0.000***
Firm	-0.34588	0.05638	-6.1352	0.000***
Report	-0.01517	0.04207	-0.3606	0.719
***Significant at p < 1%				
**Significant at p < 5%				
*Significant at p < 10%				

Table 12

	<b>Audit</b>			
	B	Std. Error	t	Sig.
(Constant)	-0.0287	0.04512	-0.6355	0.525
DonOfRev0	-0.0372	0.06293	-0.5915	0.554
LNTTLA	0.01303	0.00369	3.52838	0.000***
InvofTTLA0	-0.4162	0.25936	-1.6047	0.109
ProfDum	0.01908	0.03243	0.58842	0.556
Major Town	0.02182	0.03307	0.65981	0.51
LNOfficer	-0.0083	0.02735	-0.3039	0.761
Accountnant	0.05384	0.0499	1.07902	0.281
Firm	0.00318	0.05862	0.05432	0.957
report	0.20283	0.04375	0.24976	0.000***
***Significant at p < 1%				
**Significant at p < 5%				
*Significant at p < 10%				

Table 13

	Compilation			
	B	Std. Error	t	Sig.
(Constant)	0.09957	0.03773	2.6389	0.009***
DonOfRev0	0.04871	0.05262	0.92565	0.355
LNTTLA	-0.0095	0.00309	-3.0846	0.002***
InvofTTLA0	-0.2436	0.21687	-1.1232	0.262
ProfDum	-0.0049	0.02712	-0.1789	0.858
Major Town	-0.0133	0.02765	-0.482	0.630
LNOfficer	-0.0167	0.02286	-0.7291	0.466
Accoutnant	-0.013	0.04172	-0.3123	0.755
Firm	0.16062	0.04902	3.27678	0.001***
report	0.41783	0.03658	11.4216	0.000***

\*\*\*Significant at  $p < 1\%$

\*\*Significant at  $p < 5\%$

\*Significant at  $p < 10\%$