

The International Standard on Auditing for Less Complex Entities: A Theoretical Review and a Multi-Criteria Decision- Making Approach*

Eylül Özdarak¹
Galatasaray University

Volkan Demir²
Galatasaray University

Melik Ertuğrul³
Galatasaray University

Abstract

Our study aims to shed light on the multifaceted significance of the *International Standard on Auditing for Less Complex Entities* (ISA for LCE). After reviewing the ISA for LCE based on agency, institutional, legitimacy and stakeholder theories, we employ the Best Worst Method and aggregate results by using arithmetic, experience-weighted and geometric means to uncover the prioritization of the criteria of audit quality from auditors' perspectives. Our outcomes indicate that auditors prefer personal competencies over institutional efforts.

Keywords: Less Complex Entities, International Standards on Auditing, External Audit, MCDM

JEL Classification: M4

Daha Az Karmaşık İşletmeler için Uluslararası Denetim Standardı: Kuramsal İnceleme ve Çok Kriterli Karar Verme Yaklaşımı

Özet

Çalışmamız, *Daha Az Karmaşık İşletmeler için Uluslararası Denetim Standardının* (DAKİ UDS) çok boyutlu önemini açıklamayı amaçlamaktadır. Çalışmamızda öncelikli olarak DAKİ UDS vekalet, kurumsal, meşruiyet ve paydaş teorileri kapsamında incelenmekte, akabinde bağımsız denetçiler açısından denetim kalitesine ilişkin kriterlerin önceliklendirilmesi adına En İyi-En Kötü Yöntemi uygulanmakta ve sonuçlar aritmetik, deneyim-ağırlıklı ve geometrik ortalama yöntemleriyle birleştirilmektedir. Bulgularımız, denetçilerin kurumsal çabalardan ziyade kişisel yetkinliklerini önceliklendirdiğine işaret etmektedir.

Anahtar Kelimeler: Daha Az Karmaşık İşletme, Uluslararası Denetim Standartları, Bağımsız Denetim, Çok Kriterli Karar Verme

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¹ Galatasaray University, 34349, İstanbul, Turkey. E-mail: eozdarak@gsu.edu.tr, ORCID: 0000-0003-2504-0247

² Galatasaray University, 34349, İstanbul, Turkey. E-mail: vdemir@gsu.edu.tr, ORCID: 0000-0001-5313-2320

³ Galatasaray University, 34349, İstanbul, Turkey. E-mail: mertugrul@gsu.edu.tr, ORCID: 0000-0003-2068-2080

Introduction

As large-scale entities bear responsibility to a broad range of stakeholders due to their extensive trade networks and high activity volumes, their financial statements are periodically subject to independent audits to foster a stable trading environment. However, these entities represent only 10% of the global economy (World Bank, 2022). In contrast, although entities with simpler structures form the building blocks of the economy, they are not bound by auditing regulations due to their appeal to a narrower stakeholder group. Nevertheless, there is a significant risk that the financial statements of such entities may contain material misstatements due to error or fraud given their limited human resources, technological infrastructure, and internal control mechanisms.

The purpose of financial reporting is to maintain financial stability through the transparent disclosure of comparable and reliable information to market participants (Humphrey *et al.*, 2009). Financial reports are subject to independent audits to express an opinion on the accuracy and compliance with the relevant accounting standards in all material respects by obtaining sufficient and appropriate audit evidence through various analytical procedures (Simunic *et al.*, 2017). Audits serve to inform the public, thereby creating a positive externality and contributing to the economic welfare of society (Minnis and Shroff, 2017). Various empirical studies in the literature demonstrate that audits play a critical role in bolstering the degree of confidence in capital markets through detecting earnings management (Becker *et al.*, 1998; Chen *et al.*, 2011; Van Tendeloo and Vanstraelen, 2008; Zisis and Sorros, 2015) and enhancing the credibility of companies (Gong, 2009) which reduces the cost of capital and ultimately results in improving financial performance (Huq *et al.*, 2022; Kim *et al.*, 2011).

The International Standard on Auditing (the ISAs, henceforth), which are published by the IAASB (the Board, henceforth), determine and provide guidance on a wide array of areas related to audits of financial information. These topics include general principles and responsibilities, audit planning, risk assessment, collecting audit evidence, expression of opinion, internal control and ethical requirements to ensure coherent and high-quality audits and provide assurance to stakeholders (IAASB, 2019). Although current ISAs are tailored for all entities regardless of size, sector or nature, the Board has been receiving ever-increasing concerns about the understandability and applicability of the ISAs on entities to basic forms (IAASB, 2021) since existing ISAs cater to entities engaged in complex activities subject to international financial reporting and tax regulations.

The extant literature provides limited evidence despite the growing interests of stakeholders related to the auditing efforts of the financial statements of Less Complex Entities (LCE, henceforth). For instance, Coram *et al.* (2022) provide suggestions related to the questions in the Exposure Draft (ED, henceforth)- ISA for LCE, published in 2022 by the Board. By using the Gioia method, Haapamäki and Mäki (2023) analyze the contents of 145 comment letters submitted to the Board in order to identify the most frequent advocating and dissenting feedback from respondents regarding the ED-ISA for LCE. Lapiřkaia (2022; 2020) studies the challenges of audits of LCE focusing on provisions and reflecting on the auditing framework of LCE in Moldova. van Nieuw Amerongen *et al.* (2023) resume stakeholder opinions related to the ED- ISAs for LCE

from roundtable sessions in order to present feedback to the Board for the improvement of the standard.

The aim of this study is to conduct a comprehensive examination of the substance of the newly published ISA for LCE. Accordingly, we attempt to find answers to the following questions:

1. *Which entities qualify as LCE and what are their inherent characteristics?*
2. *How do LCE differ from SME?*
3. *What types of problems typically arise in LCE by nature that the ISA for LCE aims to address?*
4. *How have institutional changes and stakeholder expectations influenced efforts to legitimize the ISA for LCE?*
5. *How does the ISA for LCE contribute to the quality of audits?*
6. *What are the primary contributions of the ISA for LCE as viewed by auditors?*

The remainder of this study is structured as follows. The first section briefly explores the definition of LCE and the scope of the ISA for LCE. Then we delve into existing literature pertinent to auditing in the realm of LCE. Specifically, we investigate agency problems within LCE, with a focus on ownership structure, managerial composition, and the role of accounting information systems on audit quality. Then, we deliberate on the institutional efforts carried out by standard-setting bodies in formulating the ISA for LCE. After presenting the importance of stakeholder involvement and legitimacy in shaping auditing methodologies for LCE, we derive the most critical criteria for high-quality audits from the literature. By conducting the BWM with auditors and using diverse aggregation methods, we reveal the preferences of practitioners and discuss the results. Lastly, we conclude with research limitations and suggestions for further studies.

The Nature of LCE

Despite their importance, audits of LCE have received less attention than those of large-scale and publicly traded companies throughout history (Coram *et al.*, 2022). Given the lack of a distinct standard for these entities, independent audits have been conducted on a voluntary basis in accordance with the ISAs which were initiated in the early 20th century to address the necessity of auditing the financial statements of larger companies.

The objectives of the stand-alone ISA for LCE are to establish a high-quality and consistent auditing standard for the public interest, increase the reliability of financial reports, enable independent auditors to provide reasonable assurance on relevant financial statements and offer solutions to the challenges that stakeholders encounter while adapting the ISAs to LCE (IAASB, 2021 p.11).

These entities are typically characterized as any one or in combination of the following, as shown in **Table 1**.

Table 1. The nature of LCE

Qualification	Description
Business Operations and Industry	• Operating in low-risk environments with straightforward transactions • Absence of subjection to intricate laws or regulations • A limited number of business lines or revenue streams
Organizational Structure and Size	• Simple organizational structure with few reporting lines and a small management team (5 people or less)
Ownership Structure	• Straightforward ownership with a clear identification of beneficial owners and controllers
Finance Function	• Centralized finance function including financial reporting • A limited number of employees charged with financial reporting positions (5 people or less)
Information Technology (IT)	• Uncomplicated infrastructure • Mostly utilizing commercial software with limited capacity for customization (e.g. simple accounts, narrow disclosure) • Restricted access to one or two designated employees for configuration purposes • Inadequate IT controls
Financial Reporting Framework and Accounting Estimates	• A limited number of accounts in the financial statements that require the utilization of managerial know-how • Rare use of accounting estimates without complex methods, models, or assumptions

Source: IAASB (2023 pp. 16-17)

Evidently, the definition of LCE is not stipulated by any absolute numerical threshold - such as asset size, net revenue or number of employees. Rather, the Board encourages auditors to use their professional judgment when determining the applicability of the ISA for LCE to their clients, in accordance with the principle-based approach (van Nieuw Amerongen *et al.*, 2023) This enables auditors to take different circumstances into account and exercise audits based on their expertise, which eventually leads to a high level of consistency and comparability of auditing practices (Burns and Fogarty, 2010). The flexibility is expected to enhance the perceived value of audits among LCE and encourage more auditors to engage with this segment of the auditing market.

Several studies in the literature (see, among others, Burns and Fogarty, 2010; Garcia-Benau and Zorio, 2004) indicate that high-quality auditing relies on the establishment of

consistent auditing standards defining the purpose and fundamental concepts of auditing, as well as auditing procedures along with the responsibilities and ethical conduct of auditors. Since the necessity of an auditing standard stems not only from a practical standpoint but also from a variety of conceptual frameworks (Agburuga, 2019), this paper sheds light on the theoretical ground to understand the underlying principles that underpin the need for issuing the ISA for LCE for high-quality audits.

Theoretical Review

Agency Theory

Ownership structure and managerial composition

The ISA for LCE is designed to provide a level of assurance regarding the accuracy of financial statements for audits of LCE. The effective implementation of the standard hinges on the exercise of professional judgment and professional skepticism (IAASB, 2023) as these features are recognized as the core determinants of audit quality (Habiburrochman and Manifesti, 2018). The applicability of the ISA for LCE requires auditors to exercise critical assessment to make decisions regarding multiple factors, including whether a client meets the definition of an LCE, the degree of regulation in industries and the simplicity of the supply chain (IAASB, 2023). However, the use of the ISA for LCE is prohibited for listed or public interest entities (IAASB, 2023). In other words, as LCE are regarded as private entities, they are not funded through capital markets and expectedly, they are subject to a lower level of scrutiny from market participants. It can be inferred that the incentive of LCE to produce high-quality financial information is significantly lower than that of listed companies (Langli and Svanström, 2014).

Agency theory is based on the premise that principals transfer management to agents whom they delegate with the condition of protecting their interests. Jensen and Meckling (1976) assert that conflict of interest and information asymmetries arise due to the inclination toward the prioritization of personal gains including pecuniary and non-pecuniary compensations, which may lead to decisions by agents that are detrimental to principals' interests.

Since founders of LCE generally take an active role in company management instead of appointing representatives on their behalf (Hope *et al.*, 2012), a lower degree of information asymmetry stemming from the principal-agent relationship may be expected (Vanstraelen and Schelleman, 2017). However, agency problems may *still* occur in these entities despite the concentrated ownership structure (Langli and Svanström, 2014) due to information asymmetries i) between majority and minority shareholders, or ii) between entities and creditors (Minard, 2016). This disparity in oversight highlights the complexities inherent in agency relationships, as principals may encounter increased challenges in overseeing and harmonizing the interests of agents in LCE as opposed to their counterparts in publicly traded companies.

Scholars predominantly address the role of auditing in minimizing conflicts of interest and information asymmetries stemming from the principal-agent relationship (Almeida,

2014; Hashim *et al.*, 2018). The audit of financial statements is one of the agency costs that entities bear to minimize information asymmetries, managerial opportunism and other forms of conflicts of interest between parties with opposing stakes (Colbert and Jahera, 2011; Jensen and Meckling, 1976).

Auditors perform professional judgment to detect and assess the risks of material misstatement due to error and fraud (IAS 315 par. 5) to reduce agency problems arising from dynamics within and outside the entity (Langli and Svanström, 2014; Mzenzi and Gaspar, 2015). As LCE are mostly funded through debt agreements (Peek *et al.*, 2010) or commercial loans (Collis *et al.*, 2004), the audits of financial statements serve as a crucial monitoring mechanism to mitigate agency problems from the perspective of lenders. Note that the financial statements of LCE are the primary source of information used in lending decisions (Lennox and Pittman, 2011). Hence, the certification by auditors that financial statements are free from material misstatements due to error or fraud may result in a reduction in the cost of borrowing for these entities (Chow, 1982), which contributes to the tenure of human capital and advancement in innovation (Mugogo and Midala, 2020), better financial performance and ultimately global competitive power (Feng *et al.*, 2021).

Auditor independence encompassing both a state of mind and appearance, entails being unaffected by influences that might alter audit opinion and mitigating any special circumstances that may compromise independence (IFAC, 2009). It has been a subject of extensive debate in the literature, particularly after recent accounting scandals that prevailed due to close auditor-client relationships (Fontaine and Pilote, 2012). Allowing clients to exert undue influence results in the loss of auditor independence and the erosion of professional skepticism (Chiang, 2016; Ohman and Wallerstedt., 2012). Auditors tend to rely on management assertions in personal relationships without obtaining sufficient appropriate audit evidence, which ultimately results in violating the principles of objectivity (Stefaniak *et al.*, 2012), damaging professional reputation (Langli and Svanström, 2014) and deteriorating the quality of audit (Furiady and Kurnia, 2015; Qi *et al.*, 2017). Concerns about the integrity of auditors cast a negative light on the quality of auditing and undermine trust in the disclosed accounting information (Patrick *et al.*, 2017). Hence, the ISA for LCE provides direction for auditors to use their professional judgment to recognize and evaluate the risks of material misstatements in financial statements by facilitating auditors to comprehend the unique characteristics of those entities. The standard enables auditors to align with the relevant auditing procedures in areas with a greater probability of agency problems and opportunistic behavior by management, thereby ensuring their independence and professional skepticism, as well as conducting high-quality audits (IAASB, 2023).

Accounting ecosystem in LCE

As an integral component of financial management in all entities, the Accounting Information System (AIS) encompasses all processes in capturing, classifying, recording, processing and disclosing information essential to both internal and external stakeholders (Nhan *et al.*, 2023). The effectiveness of AIS has a direct impact on the quality of the financial statements, which eventually influences strategic decision-making and operational performance (Ha, 2020). Optimal utilization of AIS improves

transaction control, adaptability to dynamic environment and overall competitiveness (Monteiro *et al.*, 2021; Soudani, 2012).

The quality of information generated by AIS hinges on robust internal controls (Hla and Teru, 2015). Automating financial information production also plays a crucial role in enhancing audit quality by promptly determining and rectifying accounting errors, conducting auditing procedures, collecting audit evidence and ultimately establishing a reliable information system (Almasria, 2022). Moreover, the accuracy of AIS minimizes information asymmetries thus, increasing the reliability and transparency of managerial disclosures (Abdel-Rahim and Stevens, 2018).

Consistent with existing ISAs, the Board requires the understanding of LCE internal control system and communication with those charged with governance in cases of suspected fraud (see ISA for LCE, par. 1.8.8.) On the other hand, by taking the centralized finance function, the limited number of employees and the insufficient infrastructure into account, LCE presumably delegate the same individual(s) to be responsible for both the AIS and financial reporting. In other words, the centralized authority for the preparation of financial statements in LCE increases the risk of financial information containing material misstatements due to error or fraud as well as agency problems (Langli and Svanström, 2014). Moreover, since a few number of employees hold executive positions with extensive authority, there is a potential risk for auditors to maintain their objectivity since they regularly communicate with the same individuals (Coram *et al.*, 2022).

Overall, the resolution of agency problems associated with AIS is directly related to audit quality in LCE and necessitates a multifaceted strategy involving technological advancements, internal control enhancements, adherence to regulations, and auditor independence (Monteiro *et al.*, 2021). The ISA for LCE aims to enable auditors to uphold independence and objectivity and elevate risks related to AIS (IAASB, 2023) which, in turn, mitigates agency problems and minimizes the probability of material misstatements due to error or fraud in financial disclosures (Abdel-Rahim and Stevens, 2018).

Institutional Theory

The establishment of standards plays a pivotal role in ensuring the credibility of audits. Institutional theory suggests that standard setters are motivated to address the needs of their stakeholders and are obliged to establish a delicate balance by responding to their demands based on consistent and measurable criteria for the global acclaim of the standards (Chatham *et al.*, 2010). Institutional theory holds paramount significance in influencing the practice and progression of auditing (Josh, 2022). It offers insights into how auditing practices are not solely propelled by economic variables but are also shaped by broader institutional influences such as regulatory bodies, professional associations, and societal expectations (DiMaggio and Powell, 1983).

A much-debated question in the literature is whether the issuance of new standard(s) or the revision of existing standard(s) has widespread relevance. Previous research regarding the adoption of a new (set of) standard(s) yields mixed outcomes (Davis and Hay, 2012). The nature of auditors is risk-averse and ambiguities in auditing standards

result in pessimism and likelihood insensitivity: Auditors with a pessimist mindset tend to overstate the likelihood of the most unfavorable outcome while likelihood-insensitive auditors hold the belief that the worst scenario will occur irrespective of the precautions, leading to potential auditor negligence (Bigus, 2012). Watts and Zimmerman (1981). The latter argue that in cases where audit standards are inadequate, the auditor tends to engage in opportunistic behavior and impair independence to secure the renewal of the audit engagement which ultimately jeopardizes the quality of the audit. Hackenbrack and Nelson (1996) indicate that auditors tend to leverage the vagueness of standards to rationalize their decisions aligning with preferences and favors of their clients. All these constitute another agency problem, albeit, not between agents and principles but rather between auditors and external stakeholders (Christensen, 2010).

One of the advocates of revising existing standards, Itoh (1982), argues that developing new standards creates (i) for reporting entities, direct costs springing from information collection and publication and indirect costs stemming from unfavorable consequences arising from disclosure and (ii) for information users, costs springing from interpretation and evaluation efforts. Loyeung *et al.* (2016) find a common misuse of standards specifically in the first periods of the adoption due to the lack of experience. Audit failures increase the risk of financial statements containing material misstatements due to error or fraud and induce information asymmetry between information users and entities, leading to higher audit fees (Loyeung *et al.*, 2016). Burca *et al.* (2015) analyse the comment letters sent to the accounting authority and reveal that stakeholders are inclined to advocate amending existing standards rather than issuing new ones. Gao and Zhang (2019) assert that the effect of standardization is twofold: Standards play a crucial role in reducing potential misalignments between auditors and clients while issuing new standards eventually results in an increase in audit fees as it requires specialization with overload and constrains auditors' professional judgment.

From the standard-setters' perspective, developing standards addressing several needs is a costly endeavor and the challenges amplify on an international scale since disseminating new standard(s) and educating preparers together with users of financial information and auditors require substantial efforts (Gangolly *et al.*, 2002). Acknowledging the dichotomy, the Board implements the *Small and Medium Practices (SMPs)* initiative i) to obtain insights from stakeholders, including early-adopter entities of the ISAs, and ii) to ascertain key challenges faced by small-scale entities in adopting the ISAs (IAASB, 2013). Based on the *think simple first* approach (IAASB, 2013) the Board supports the requirement of cost-effective and easily applicable stand-alone auditing standards for the audits of LCE. The IFAC also declares its endorsement for the development of principle-based auditing standards for audits of the financial statements of LCE in order to encompass the review of year-end closing entries and the recalculation of accounting estimates which would require less tedious documentation, and to ensure the responsibility of the management of entities and those charged with governance on the financial statements (IFAC, 2018). Recognizing that the adaptation to distinct standards issued for the same type of engagement, such as audits of LCE, may potentially lead to inconsistencies in audit quality and create uncertainty for stakeholders, the Board simplified existing ISAs to develop a stand-alone standard that is easily understandable and compatible with audits of more complex entities (Haapamäki and Mäki, 2023)

Legitimacy Theory and Stakeholder Theory

Legitimacy refers to a social justification of accuracy that is contingent upon the audience and illustrates a connection between a legitimacy object (standard-setting body) and an assessing audience (preparers and users of financial statements) (Suchman, 1995). According to legitimacy theory, the dedication to adhering to social norms entails the obligation to comply with the principles of honesty, thereby serving as a crucial factor in enhancing the quality of audits (Blay *et al.*, 2019). Shoker and Sethi (1974) affirm that a standard-setter body is required to exhibit evidence of fulfilling its 'social contract', wherein its continued presence depends on achieving beneficial objectives for the broader society and offering benefits to the groups that contribute to the entity.

Accounting authorities frequently opt to communicate with interest groups in order to gain public legitimacy before, during and after releasing or revising relevant standards by using several techniques (Durocher *et al.*, 2007; Shields *et al.*, 2019). Soliciting public comment letters on standards is a frequently addressed method by standard-setters with respect to stakeholder theory (Reuter and Messner, 2015) to gauge different interest group reactions to draft standards and make necessary revisions to guarantee eventual acceptance (Tandy and Wilburn, 1992). Revising auditing standards based on stakeholder feedback permits standard-setting bodies to eliminate controversies in standards, highlight substantial themes and promote compliance with other standards (Balzarova and Catska, 2012).

Based on comment letters regarding the ED-ISA for LCE, ambiguities arising from linguistic problems e.g., length of phrases and translation errors, rule-based and coercive expressions that restrain the use of professional judgment, are the most common concerns notified to the Board (IAASB, 2019). Obscurities regarding the readability and the interpretation of standards result in deviations from the substance of standards and differentiations in professional judgment (Lin *et al.*, 2019). Pan and Patel (2018) conclude that the discrepancy between what is stated in the standards and what is implemented by the professional judgment of auditors results in both audit failures and even legal sanctions.

Furthermore, the necessity of excessive documentation procedures related to the assessment and disclosure of auditing mechanisms is appreciated (IAASB, 2019). Gray *et al.* (2011) assert that the audience of audit reports generally does not read all parts of auditor reports but tends to focus solely on the audit opinion given to the financial statements rather than how the audit is conducted. However, while auditors aim to disclose details related to the basis of the audit opinion delivered on financial statements due to legitimacy concerns, they spend overtime which inflates audit fees. Ultimately, *expectation gaps* arise between information users and the standard-setting authorities, compounded by divergence from the potential benefits aimed by standards (Gray *et al.*, 2011). Haapamäki and Mäki (2023) elucidate that auditors are required to engage in diverse ongoing professional training to comprehend and acclimate to recently issued standards, thereby upholding the quality of audits. However, Hossain *et al.* (2015) raise concerns regarding the time-consuming additional workload for auditors which indirectly leads to an increase in audit fees.

In response to feedback regarding the rule-based nature of certain standard clauses in the ED- ISA for LCE, the Board released its commitment to potential revisions that align with a principle-based approach (IAASB, 2019). Emphasizing a reliance on professional judgment for interpretation rather than a strict adherence to standard clauses, the Board aims to facilitate decision-making processes for auditors (Accountancy Europe, 2018).

Following the release of the ISA for LCE in December 2023, the Board has disseminated various guiding materials, including frequently asked questions, factsheets and explanatory presentations and upcoming webinars are announced to be held to elevate stakeholder engagement. Considering that more educational resources may be beneficial to assist independent auditors tasked with leveraging their expertise and discretion to evaluate whether a client entity qualifies as an LCE, the Board is committed to clarifying gray areas to reduce potential discrepancies (IAASB, 2023).

Research Design

Best Worst Method (BWM)

The BWM is a MCDM technique developed by Rezaei (2015) that employs ratios of the relative importance of criteria through pairwise comparisons provided by decision-makers. This method relies on two evaluation vectors: the Best criterion compared to Other criteria, and Other criteria compared to the Worst criterion. As in this study, the weights of the criteria are obtained from a linear BWM solver, which requires less data but generates more reliable and consistent outcomes than the Analytical Hierarchy Process (Moslem et al., 2020). The BWM has attracted interest in the research of auditing such as the selection of auditor (see, among others, Hammond and Amissah, 2022), the planning of audit engagement (see, among others, Li and Wang, 2024) and ethics in auditing (see, among others, Abasi *et al.*, 2023). Thus, this study uses the BWM to shed light on auditors' decision-making processes.

The steps of the BWM are as follows (Rezai, 2016):

Step 1. Identify a list of decision criteria. We consider the criteria denoted as $\{C1, C2, \dots, Cn\}$

Step 2. Determine the best (B) (most important) and the worst (W) (least important) criteria based on the opinions of the respondents

Step 3. Using a scale of 1-9 determine the preference of the B criterion overall the other criteria to form a pairwise comparison. The Best-To-Others (BO) vector is expressed as $A_b = (a_{B1}, a_{B2}, \dots, a_{Bn})$, where a_{Bi} means the preference of the B over criterion i and a_{BB} equals to 1.

Step 4. Similar to Step 3, determine the preference of all the criteria over the W criterion a_{iW} from 1 to 9 to obtain the Others-to-the-Worst (OW) vector where $A_w = (a_{1W}, a_{2W}, \dots, a_{nW})^T$, where $a_{WW} = 1$.

Step 5. Compute the optimal weights ($w1^*, w2^*, \dots, wn^*$) for all the criteria. This calculation may be obtained by use of the BWM Solver 5 Excel file. The weights of

criteria are determined to minimize the maximum absolute differences and the minimax model is obtained:

$$\begin{aligned} & \text{minimax } \left\{ \left| \frac{w_B}{w_i} - a_{Bi} \right|, \left| \frac{w_i}{w_w} - a_{wi} \right| \right\} \text{ for all } i \\ & \sum_{i=1}^n w_i = 1 \\ & w_i \geq 0 \text{ for all } i \quad \textbf{(Model 1)} \end{aligned}$$

Model (1) is transformed to the linear model as:

$$\begin{aligned} & \text{Min } \xi \\ & \text{s.t.} \\ & \left| \frac{w_B}{w_i} - a_{Bi} \right| \leq \xi \text{ for all } i \\ & \left| \frac{w_i}{w_w} - a_{wi} \right| \leq \xi \text{ for all } i \quad \textbf{(Model 2)} \\ & \sum_i w_i = 1 \\ & w_i \geq 0 \text{ for all } i \end{aligned}$$

Model (2) may be solved to obtain optimal weights (w_1^* , w_2^* , ..., w_n^*) where ξ stands for the consistency ratio which gives more reliable results as it approaches 0.

In analyzing the significance of the criteria for high-quality audits considering the need for the ISA for LCE, we employ three distinct aggregation methods -Arithmetic Mean, Experience- Weighted Mean and Geometric Mean to explore auditors' views. This multifaceted approach yields a robust evaluation of the criteria and reinforces the reliability and validity of our study.

Sample and Data Collection

To gather insights into the prioritization of the relevant criteria reflecting the need for the issuance of the ISA for LCE, we ask a group of auditors with varying levels of expertise to participate in the study. Following the study of Hammond and Amissah (2022), the sample size consists of 10 auditors, which is sufficient to capture a diverse set of perspectives. Auditors with a minimum of one year of professional experience in external auditing are included in this study. This criterion ensures that all participants possess practical exposure to the auditing processes. The diverse range of experience offers a comprehensive understanding of how different levels of expertise influence the prioritization of criteria. The data collection involves structured interviews with auditors and all responses are recorded into an Excel sheet to ensure data accuracy. The first two columns of Table 4 present the overview of the participants in this study.

Based on the theoretical review, we derive seven criteria from the literature for the high-quality audits that the ISA for LCE is aimed at addressing. The criteria comprise both procedural and outcome-focused dimensions of the audit process which are critical for ensuring the highest quality audits of LCE. Each criterion acts as a foundational element

in promoting a systematic auditing approach that is consistent with the extant literature. **Table 2** illustrates the criteria.

Table 2. List of criteria

C _i	Criteria	Reference
C1	Tailoring the ISA to the unique nature of LCE to increase relevance	(Langli and Svanström, 2014; IAASB, 2021; IAASB, 2023)
C2	Enabling auditors to maintain their independence, professional judgment and skepticism	(Burns and Fogarty, 2010; Ohman and Wallerstedt., 2012; Stefaniak <i>et al.</i> , 2012; Langli and Svanström, 2014; Mzenzi and Gaspar, 2015; Furiady and Kurnia, 2015; Chiang, 2016; Qi <i>et al.</i> , 2017; Patrick <i>et al.</i> , 2017; Habiburrochman and Manifesti, 2018; Pan and Patel, 2018; Abdel-Rahim and Stevens, 2018; Monteiro <i>et al.</i> , 2021; IAASB, 2023)
C3	Simplifying existing ISAs and providing guidance to improve understandability and applicability of the audits of LCE	(Watts and Zimmerman 1981; Bigus, 2012, Hossain <i>et al.</i> , 2015; Loyeung <i>et al.</i> , 2016; IAASB, 2021; van Nieuw Amerongen <i>et al.</i> , 2023)
C4	Expanding the range of entities subject to audits and motivating a greater number of auditors to participate through increased market coverage	(TURMOB, 2019; IAASB, 2021; IAASB, 2023)
C5	Harmonizing local auditing practices with international standards to ensure consistent and comparable audits	(Garcia-Benau and Zorio, 2004; Burns and Fogarty, 2010; Pan and Patel, 2018; IAASB, 2019; IAASB, 2023; Haapamäki and Mäki, 2023)
C6	Adapting to changes in the institutional environment and collaborating with other regulators to advance the audit profession	(Chatham <i>et al.</i> , 2010; Blay <i>et al.</i> , 2019; IAASB, 2021; Josh, 2022; Silva <i>et al.</i> , 2022)
C7	Engaging in stakeholder participation and proactively addressing criticisms following feedback to ensure continuous improvement	(Shoker and Sethi, 1974; Tandy and Wilburn, 1992; Durocher <i>et al.</i> , 2007; Balzarova and Catska, 2012; Reuter and Messner, 2015; Shields <i>et al.</i> , 2019; Blay <i>et al.</i> , 2019; IAASB, 2019; Lin <i>et al.</i> , 2019; Silva <i>et al.</i> , 2022)

Participants are asked to rate BO and OW for all the factors respectively using a 1–9 scale. **Table 3** represents the scaling rubric together with their corresponding definitions and explanations.

Table 3. Scale of the BWM

Scaling	Definition	Explanation
1	Equal importance	Two factors are equally important
3	Moderate importance	A factor is moderately favored over other
5	Strong importance	A factor is considerably favored over another
7	Very strong importance	A factor is very strongly favored over another and its dominance is demonstrated in practice
9	Extreme importance	A factor presents the highest importance

Source: Rezai (2015)

Results and Discussion

After conducting a series of discussions with participants, each expert is asked to individually identify the B and W factors among the determinants on the BWM Solver 5 tool. **Table 4** shows the weights of scaling. Each pairwise comparison is verified for consistency and all input-based consistency ratios are below the relevant thresholds. Note that all figures are rounded to the nearest decimal for readability.

Table 4. Optimal weights of criteria scaling

A _j	E _j	C1	C2	C3	C4	C5	C6	C7
A1	9	0,1752	0,3854	0,1051	0,1051	0,1051	0,0490	0,0751
A2	25	0,1682	0,4197	0,1009	0,1009	0,1009	0,0372	0,0721
A3	19	0,1171	0,3903	0,0836	0,0651	0,1952	0,0651	0,0836
A4	5	0,2020	0,1212	0,4067	0,0866	0,0673	0,0296	0,0866
A5	14	0,1135	0,4052	0,1891	0,0810	0,0630	0,0347	0,1135
A6	3	0,1823	0,1094	0,3807	0,1094	0,0781	0,0306	0,1094
A7	4	0,1823	0,1094	0,3807	0,1094	0,0781	0,0306	0,1094
A8	15	0,1608	0,3395	0,1608	0,0965	0,1608	0,0281	0,0536
A9	1	0,1505	0,0903	0,1505	0,0645	0,3632	0,1505	0,0305
A10	21	0,2712	0,3853	0,1284	0,0771	0,0523	0,0428	0,0428
TOTAL	116	1,7231	2,7557	2,0866	0,8955	1,2642	0,4983	0,7766

A_j and E_j refers to the auditor and her/his years of experience. C_i stands for the corresponding criterion.

To aggregate the preferences of auditors, we apply diverse means to enhance the reliability and robustness of our findings.

Aggregation by Arithmetic Mean

This method facilitates comparisons of preferences and reflects directly the most favorable criterion by the group. Each response contributes equally to the overall average, so that no single opinion disproportionately affects the results. This method offers a simple and straightforward approach to compare the relative importance of criteria.

The weights are aggregated as shown in the below formula and w_{ij} and n stand for the weight of C_i by respondent j and total number of respondents, respectively. The results are shown in Panel A of Table 5.

$$\overline{w_i} = \frac{\sum_{j=1}^n w_{ij}}{n}$$

C2 is assigned the highest weight ($\overline{w_2}=0,2756$), signifying that auditors perceive independence, professional judgment and skepticism as paramount factors in achieving high-quality audits in accordance with the ISA for LCE. This result underscores the critical importance of maintaining objectivity and conducting critical reasoning in audit practices regardless of the degree of expertise, which are vital for producing reliable audits.

There exists a strong inclination towards the simplification of the ISAs (**C3** with $\overline{w_3}=0,2086$) and their customization to address the distinctive needs of LCE (**C1** with $\overline{w_1}=0,1723$) reflecting a demand for practical and accessible auditing frameworks. The simplification of existing ISAs and the enhancement of their comprehensibility are identified as the second most important criterion. Auditors assert that clearer and more concise standards may improve compliance and efficacy, despite the simplicity of the nature of LCE, thereby rendering the auditing process more accessible and easier to implement.

Table 5. Criteria weights and rankings

C_i	PANEL A		PANEL B		PANEL C	
	Weight	Rank	Weight	Rank	Weight	Rank
C1	0.1723	3	0.1736	2	0.1674	3
C2	0.2756	1	0.3594	1	0.2313	1
C3	0.2087	2	0.1523	3	0.1773	2
C4	0.0896	5	0.0877	5	0.0880	5
C5	0.1264	4	0.1105	4	0.1051	4
C6	0.0498	7	0.0425	7	0.0428	7
C7	0.0777	6	0.0740	6	0.0720	6

Panels A, B and C show outcomes obtained by the arithmetic mean method, the experience-weighted mean method, and the geometric mean method, respectively. C_i stands for the corresponding criterion.

The mid-level rank of the harmonization with international standards (**C5** with $\overline{w_5}=0,1264$) highlights the importance of aligning local practices with international standards to maintain cross-border consistency for the expansion of audit market (**C4** with $\overline{w_4}=0,0896$).

Collaboration with regulators (**C6**) is ranked the lowest ($\overline{w_6}=0,0777$) among all criteria, suggesting that auditors may consider this aspect to be less immediately impactful on audit quality. While stakeholder engagement (**C7**) and regulatory collaboration are acknowledged, they are perceived as less central to the achievement of high-quality audits. This indicates a consensus that, although regulatory collaboration is beneficial, the direct implementation of the standards has greater significance.

Aggregation by Experience-Weighted Mean

The arithmetic mean method treats all respondents equally by not taking their level of experience into account. As a complementary analysis, the experience-weighted mean method genuinely leverages the profound level of professional experience to achieve robust outcomes. Experience-weighted aggregation serves to mitigate potential biases stemming from less experienced auditors who may not have encountered a broad spectrum of audit scenarios.

The weights are aggregated as shown in the below formula and w_{ij} , E_{ij} and n stand for the weight of C_i by respondent j , years of experience of respondent j and total number of respondents, respectively. The results are shown in Panel B of Table 5.

$$\overline{w_i} = \frac{\sum_{j=1}^n (E_j \cdot w_{ij})}{\sum_{j=1}^n E_j}$$

Like the first method, **C2** maintains its top priority ($\overline{w_2}=0,3594$) but at a higher weight which should be read as the experienced auditors' emphasis on maintaining objectivity and critical thinking. Furthermore, as the second-ranked criterion which acknowledges the distinctive characteristics of LCE, **C1** exhibits a slight increase in weight compared to its weight in the arithmetic mean method ($\overline{w_1}=0,1736$). The increase in the ranking of this criterion implies that seasoned auditors emphasize the significance of adapting the relevant standard on auditing to the specific nuances of LCEs, thereby facilitating more pertinent audit procedures. Additionally, streamlining existing ISAs and enhancing their comprehensibility as denoted by **C3** ($\overline{w_3}=0,15227$), albeit with slightly less preference than **C1**, is of crucial importance and underscores the consensus among seasoned auditors that the adoption of clearer standards can improve compliance and the relevance of audits for LCEs. The rankings of the other criteria remain unchanged compared to outcomes presented in Panel A of Table 5: **C5** ($\overline{w_5}=0,11049$), **C4** ($\overline{w_4}=0,0876$), **C7** ($\overline{w_7}=0,0740$) and **C6** ($\overline{w_6}=0,0425$).

Aggregation by Geometric Mean

The geometric mean method is a statistical measure for aggregating data sets with multiplicative values and a positive skew. It is defined as the n^{th} root of the product of n values, serving as a superior measure of central tendency for skewed distributions and multiplicative processes compared to the arithmetic mean (Jeuris and Vandebriel, 2013).

The geometric mean effectively minimizes the impact of extreme values or outliers, delivering a more balanced and accurate representation of central tendency. By reflecting the relative significance of criteria through their proportional contributions, it plays a significant role in the BWM. This method fosters a balanced aggregation of auditors' evaluations, ensuring that no single assessment unfairly skews the final weights. Compared to the previous two methods, it provides an optimal solution, blending the clarity of the arithmetic mean with the depth of the experience-weighted approach and eventually stands out as a robust method to aggregate weights.

The weights are aggregated as shown in the below formula and w_{ij} and n stand for the weight of C_i by respondent j and total number of respondents, respectively. The results are shown in Panel C of Table 5.

$$\bar{w}_i = \left(\prod_{j=1}^n w_{ij} \right)^{1/n}$$

With a weight of (0.2313), **C2** ranks as the top criterion consistent with all other methods despite the slight decrease in its weight compared to the experience-weighted method. This solid ranking across three approaches highlights its essential role in delivering high-quality audits, reflecting a strong consensus among auditors. Unlike the experience-weighted mean and similar to the arithmetic mean methods, **C3** ranks in second place ($\bar{w}_3 = 0,17733$), indicating that auditors believe clear and straightforward standards are crucial for effective audits. As **C1** shows a lower weight (0,1674) compared to experience-leveraged method, this result suggests a moderate but consistent preference placed by auditors. The rankings of the others remain the same with minor variations in weights ($\bar{w}_4 = 0,0878$; $\bar{w}_5 = 0,1051$; $\bar{w}_6 = 0,0428$; $\bar{w}_7 = 0,0720$).

Discussion

For an overall ranking, the second columns of each panel of Table 5 present outcomes obtained by performing three different aggregation methods.

C2 is consistently ranked the first one among all methods, indicating strong consensus maintenance of auditor independence, professional judgment and skepticism are the most crucial aspects regardless of the method used for high-quality audits under the ISA for LCE as perceived by auditors. These results are compatible with the assertions of prior studies that emphasize the pivotal impact of auditor attitudes (as in Furiady and Kurnia, 2015; Pan and Patel, 2018). In addition, the increased weight of **C2** for experience-weighted aggregation (0,3595) indicates that experienced auditors tend to prioritize auditor competencies. This may be interpreted as follows: as the degree of expertise increases, auditors bear more responsibilities and are required to navigate auditing processes. Hence, seasoned auditors are likely to encounter a diverse array of challenging scenarios during audits, which enable them to effectively assess evidence and pinpoint potential risks, ensuring the delivery of high-quality audits. This unanimity can be attributed to the Board's efforts towards a principle-based approach while revising the ISA for LCE as stated by Gao and Zhang (2019). On the other hand, this

prioritization may be linked to compliance concerns with regulations that require auditors to conduct unbiased audits to mitigate audit failures (Qi *et al.*, 2017). Such consequences lead not only to legal liabilities and deterioration of auditor credibility and professional prestige (Langli and Svanström, 2014) but also to a loss of trust in clients' financial statements (Patrick *et al.*, 2017).

The second ranking differs among all methods. The slightly lower ranking in the arithmetic and geometric means of **C1** indicates that experienced auditors, with their practical knowledge, require a comprehensive understanding of the unique characteristics of LCE for implementing context-specific auditing practices -from planning to expressing audit opinion, to address the distinct challenges faced by these entities. In contrast, less experienced auditors place more emphasis on streamlined standards on auditing with additional guidance from the standard-setter (**C3**) as Loyeung *et al.* (2016) underline. It may be interpreted as the familiarity of seasoned auditors with practical applications. By not being in line with the literature (see, Pan and Patel, 2018; Watts and Zimmerman, 1981), this finding indicates that the issue of a novel standard does not engender adaptation challenges for auditors which potentially foster inclinations toward opportunistic conduct and consequently pose a threat to diminishing audit quality.

The consistent ranking across all methods for other criteria indicates a broad agreement on their relative significance. Despite being still important for the quality of audits, they are perceived as less critical compared to the top three. The middle ranking of **C4** shows a balanced stance where auditors -irrespective of their individual experiences- clearly recognize the significance of expansion of audit coverage while this middle ranking also addresses practical limitations including resource availability and potential cost implications. While broadening the scope of audits is valuable in terms of increasing transparency and accountability, it is deemed less impactful to enhance audit quality. In addition, while harmonization of auditing standards (**C5**) fosters the consistency of audits across diverse jurisdictions and plays a crucial role for global stakeholders, it does not have perceived direct influence on the audit quality of these entities, which mostly operate locally. To say, although it is strategically important for long-term standardization as Burns and Fogarty (2010) indicated, our outcomes indicate that it is less critical for daily auditing practices.

Collaboration with regulators (**C6**) is essential for ensuring compliance, but it is considered a background mechanism for developing standards as noted by both seasoned auditors and those with less experience. Similarly, stakeholder participation and feedback (**C7**) are recognized as valuable since they reflect public viewpoints and enable the legitimacy of standards with improvements; however, the criterion is consistently ranked sixth among all methods. This suggests that both seasoned and novice auditors recognize its benefits as stated in the literature (Durocher *et al.*, 2007; Tandy and Wilburn, 1992), but are not perceived as critical as the others. Since stakeholder participation offers holistic benefits, it is regarded from practitioners' point of view as supplementary to the fundamental auditing practices and principles that have a more immediate effect on audit quality. In other words, auditors may typically adopt an outcome-driven approach and concentrate on practices that directly affect audits and uphold the integrity of financial statements.

Conclusion

Addressing the substantial global need for a stand-alone standard pertaining to the audit of simple entities, the ISA for LCE serves to foster consistency and comparability in audits on a global scale for the public interest (IAASB, 2022). This paper complements and advances the earlier research on the ED-ISA for LCE (see Coram *et al.*, 2022; Haapamäki and Mäki, 2023; Lapiřkaia 2020; Lapiřkaia 2022; van Nieuw Amerongen *et al.*, 2023) by discovering the significance of the newly released ISA for LCE from both theoretical and empirical aspects. This paper illuminates auditors' perspectives to explore the extensive necessity of the ISA for LCE for the overarching goal of achieving high-quality audits.

We point out the agency problems inherent in LCE including information asymmetry and conflicts of interest due to concentrated ownership, management pressures and proximity between auditor and client, as well as the efficiency of AIS, which considerably elevate the risk of financial misstatement due to error or fraud. Subsequently, our inquiry focuses on how the ISA for LCE may assist auditors in expressing an appropriate audit opinion while upholding their independence to use their professional judgment and skepticism, thereby increasing trust in the accuracy of financial disclosures. From the early institutional initiatives to address the auditing needs of large-scale companies to the recent efforts for the establishment of the ISA for LCE, this study highlights how strategic standard-setting processes are influenced by multiple stakeholders and regulators for the legitimacy of the standard and how these actions underscored the progression of the auditing profession.

Drawing on criteria related to audit quality in the literature, we ask auditors with different levels of experience to evaluate and prioritize seven criteria using the BWM, an MCDM method, to identify the most critical factors contributing to high-quality audits under the ISA for LCE. By employing a triangulation of weight aggregation methodologies, we aim to shed light on the topic. Our findings reveal a specific prioritization of direct auditing competencies and operational concerns over broader institutional and contextual strategies. This emphasis highlights that especially seasoned auditors attribute importance to maintaining independence, exercising professional judgment together with skepticism and streamlining standards to exercise effective audits. While regulatory collaboration and stakeholder engagement are important, they are regarded as less critical to the audit quality since they do not result in immediate outcomes compared to auditing practices in the field.

This study has several limitations. The scope of this study shall be discussed quantitatively through financial statement audits of LCEs starting from the date when the ISA for LCE standard will come into force. The paper primarily focuses on the necessity of the ISA for LCE regarding some of the key determinants of audit quality. Other determinants, such as firm-specific characteristics, audit firm reputation, client size and regulatory environment (Habiburrochman and Manifesti, 2018), may be explored by future research. Additionally, future research may concentrate on different theories to provide a deeper understanding of the ISA for LCE and incorporate a larger and more diverse sample of auditors across various jurisdictions or diverse stakeholder

groups to enhance the generalizability of outcomes. Other MCDM techniques may also be performed and offer more profound insights into the factors that drive high-quality audits.

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