



Conceptualizing an IFRS-based Criteria for Audit Exemption for Small Firms

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Author's contribution

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ABSTRACT

Criteria for audit exemption for small firms has varied greatly from country to country. Turnover-based criteria are now being combined with other parameters such as balance sheet total and number of employees in countries where mandatory audits are the norm. While some progress towards harmonization of such criteria has taken place in the EU, debate on this issue is still not widespread. At the same time, voluntary audits are also gaining ground and there has been sufficient debate in literature on the costs and benefits of such audits, particularly for small firms. Yet, the criteria for audit exemption for small firms remains disparate. This paper looks at integrating the definition of small firms under IFRS for audit exemption. Since India has moved closer to IFRS with the issuance of Revised Indian Accounting Standards (Revised Ind AS) in 2016, debate on such integration would be useful.

Keywords: Audit disclosures; audit quality; guidance for SMEs; non-audit services.

ABBREVIATIONS

BSE : Bombay Stock Exchange

FEA : Federation of European Accountants (Federation des Experts - comptables Europeens)

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<i>FRC</i>	: <i>Financial Reporting Council</i>
<i>GAAP</i>	: <i>Generally Accepted Accounting Principles</i>
<i>GAAS</i>	: <i>Generally Accepted Auditing Standards</i>
<i>ICAEW</i>	: <i>Institute of Chartered Accountants in England & Wales</i>
<i>IAASB</i>	: <i>International Auditing and Assurance Standards Board</i>
<i>IFAC</i>	: <i>International Federation of Accountants</i>
<i>IFIAR</i>	: <i>International Forum of Independent Audit Regulators</i>
<i>ISAEs</i>	: <i>International Standards on Assurance Engagements</i>
<i>ISQC</i>	: <i>International Standard on Quality Control</i>
<i>ISREs</i>	: <i>International Standards on Review Engagements</i>
<i>ISRS</i>	: <i>International Standard on Related Services</i>
<i>LLPs</i>	: <i>Limited Liability Partnerships</i>
<i>NAS</i>	: <i>Non Audit Services</i>
<i>NFRA</i>	: <i>National Financial Reporting Authority</i>
<i>NSE</i>	: <i>National Stock Exchange</i>
<i>PCAOB</i>	: <i>Public Company Accounting Oversight Board</i>
<i>PIEs</i>	: <i>Public Interest Entities</i>
<i>Revised Ind AS</i>	: <i>Revised Indian Accounting Standards</i>
<i>SA</i>	: <i>Indian Standards on Auditing</i>
<i>SIFIs</i>	: <i>Systemically Important Financial Institutions</i>
<i>SMEs</i>	: <i>Small & Medium Enterprises</i>

1. INTRODUCTION

Limited Liability Partnerships (LLPs) was a concept introduced in India in 2009. Ever since then, there has been a substantial growth in the number of organizations registered as LLPs outpacing the number of registrations as private companies. Among other benefits extended to LLPs, the audit being mandated only for LLPs having a turnover of at least Rs 40 lakhs or capital contribution of Rs 25 lakhs, has been a major attraction. This has resulted in only about 10 per cent of LLPs coming under mandatory audit. Even for such companies, the accounting standards to be followed in the preparation of financial statements have not been specified. The Revised Indian Accounting Standards (Revised Ind AS) which are aligned with IFRS to a great extent, apply to LLPs only under limited conditions. Thus, the veracity of even the audited financial statements of LLPs can be questioned in the international context. If in future, these LLPs would like to list on a stock exchange to raise capital, there can be serious hurdles if investors do not find the financial statements to be reliable and consistent. LLPs are generally governed by country-specific rules in the area of accounts and audit. Thus, such rules vary across UK, EU and the USA. Some countries have adopted the IFRS for SMEs and since LLPs can be referred to as SMEs; they would come under the ambit of these IFRS provisions. Besides, as the scope of audit widens to cover qualitative information in addition to quantitative data, audit of LLPs has now

acquired a new meaning and a new urgency as demands for at least limited purpose audits are arising from different stakeholders including lenders, suppliers, customers and joint venture partners.

In India, the Indian GAAP was the basis of all accounting until revised Indian accounting standards (Revised Ind AS) were issued in 2016. Revised Ind AS that are largely in alignment with IFRS, first applied to companies in 2015 with net worth at least equal to Rs 5 billion and in the second phase, apply to all those companies in 2017 that were not covered under the first phase beginning April 2016. This means that all companies listed on the Bombay Stock Exchange (BSE) or the National Stock Exchange (NSE), irrespective of their net worth and all unlisted companies with net worth exceeding Rs 2.5 billion or those that are associates or joint venture partners of companies that come under the ambit of Revised Ind AS will all be required to comply with the revised Ind AS. Thus, if LLPs are associates or JVs of listed companies with net worth greater than Rs 5 billion or of unlisted companies with net worth greater than Rs 2.5 billion, then revised Ind AS will apply to them (there is no net worth criteria here). However, as far as audit requirement is concerned, only those LLPs with turnover exceeding Rs 4 million or with capital contribution exceeding Rs 2.5 million come under mandatory audit (for UK, the corresponding figures are £10.2 million and £5.1 million). Further relaxation of audit is given to such LLPs if the partners of such LLPs

decide not to get their accounts audited and file a Statement of Accounts and Solvency in the specified Form 8. An analysis of accounts of some LLPs in India shows that audit fees appears mostly in notes to financial statements and that too without a break-up into different heads or accompanied with explanatory information. Godrej Vikhroli Properties LLP, though, has been a notable exception with due break-up of audit fees for audit of accounts, audit under other statutes, taxation and certification provided. For this LLP, fees payable for tax audit at Rs 187,500 in 2015 was almost as large as paid for certifications (Rs 185,000) as against Rs 310,000 paid for audit services. Such a break-up shows that the merits of limited audit or other engagements with auditors are openly recognized by LLPs and, hence, also advertised by service providers. Along with higher probability of obtaining financing and lowering of interest rates on business loans, identifying business weaknesses and prevention of fraud with improved internal control processes are also being emphasized in India by legal and financial audit service providers [15]. Risk audits and due diligence reports in mergers & acquisitions by auditors have become fairly common in India.

2. EVOLUTION OF AUDIT STANDARDS

Historically, the GAAS (generally accepted auditing standards) have been designed for all companies, irrespective of size. Nonetheless, the impact of these standards on smaller entities has continued to rise due to the widening in the scope of audit that now covers risk assessment due to the external environment and the business processes of the client company. In such circumstances, a study of the internal control procedures to detect impending risks and assess their impact on business is a crucial dimension of information that investors would like to have from the auditor. This information would help investors assess the susceptibility of client companies to any impending fraud by outsiders or insiders. Of course, for large clients, the auditor is also supposed to provide assurances on forward-looking information as well as qualitative information; for SMEs, engagement with stakeholders, understanding & utilizing new technologies and adapting audit procedures to the changing environment will be important. The sustainability standards board has helped provide metrics for the measurement of qualitative information and now covers climate-related financial disclosures, scenario analysis

and carrying out materiality tests. Both large and small firms are now employing data analytics and achieving audit objectives that typically required manual processes or sampling. This has impelled small entities to adopt formal systems and authorization procedures and benefit from enhanced credibility from audited figures.

3. LITERATURE REVIEW

3.1 Research on Demand for Voluntary Audit and Non-Audit Services

In UK, it has been seen that although audit of private companies' accounts is no more mandatory by law in all cases (mandatory only if requirement of audit is included in articles of association or shareholders demand an audit), companies are voluntarily going for audit whenever they get economic benefits of the same as documented by Dedman, et al. [9] and Lennox, C. [18]. Other studies, too, for example, Hay and David [14], Rennie, M, et al. [26], Niemi Lasse et al. [21] and Collis, J. et al. [8] have come to common conclusions that companies are more likely to purchase an audit if they have higher agency costs (measured by size of assets or sales or board size); they are riskier (have large levels of inventory or cash); they will shortly require new capital (lenders insist on audited statements); they purchase NAS (non-audit services) from the auditor; and they demonstrated a greater demand for audit assurance in the mandatory audit regime. This is despite the fact that the exemption limits for audit varied widely across countries included in the studies. Canada provided the closest example to UK as like UK, Canada, too, had dispensed with the requirement of audit for private companies with turnover greater than \$10 million or assets greater than \$5 million in 1994, though, unlike UK, they had also dispensed with the requirement of public filing of financial statements. The findings regarding the demand for audit, though, were similar. The 2010 study of Collis, Jill [6] showed that firm turnover combined with balance sheet total and average number of employees act as a surrogate for demand for voluntary audit. John Christian Langli, et al. [17] showed that there is no unanimity on the need for audit or even filing of financial statements in the case of private companies. While countries like Denmark and Sweden require all companies to audit their accounts, UK and Germany are at the other extreme with high exemption limits with firms having to take their own decisions regarding

audit based on costs and benefits of the same. Weik, A. et al. [29] found that the proportion of firms opting for voluntary audits in Germany at 12% is far lower as compared to the proportion ranging between 26% - 80% in other EU countries. In Malaysia, the study by Chan, W. Meng [3] found that although most small audit firms preferred to retain mandatory audits for small firms, other stakeholders like directors and management of small companies felt that companies which perceived benefits of audits would, in any case, continue to have their accounts audited. Vanstraelen et al. [31] found that the cost-benefit analysis for private company audits is firm-specific and mandating the audit does not seem to be cost-effective for all private companies. The study concluded that alternative services may be better for smaller private companies.

Non-audit services, generally carrying limited assurance, are of varied kinds. Some of them like reports on compliance with legal requirements to report on matters such as share issues for non-cash consideration, expenditure for grant application purposes or reports to lenders or vendors on net assets, covenant requirements, etc fall within the domain expertise of the auditor. In some services where information largely derives from audited financial information such as tax compliance or summary reports required in cases of mergers & acquisitions, auditors generally step in to perform these services. But auditors are now going beyond these areas and are engaging themselves in non-audit functions like management consultancy or human resource consultancy. The audit fees received by them also seems to be a function of the size and complexity of the client. Smaller, riskier firms, ironically, have been found to be paying less fees as opposed to the larger firms [3,4]. Quality of non-audit services in both public and private companies therefore, has been studied by many researchers. Svanstrom Tobias [28] had concluded from his research in Sweden that provision of both audit and non-audit services did not necessarily impede auditor independence. Disclosures, however, are important and the Institute of Chartered Accountants of England and Wales (ICAEW) has issued detailed guidelines on the disclosure of audit and non-audit fees, including in kind, payable to auditors & associates of auditors (after the 2011 amendment including associates or subsidiaries) in the annual reports of companies, including SMEs. Associates of auditors may be bodies

corporate or partnerships outside the country. In fact, disclosure of audit fee in case of joint ventures and joint arrangements is also encouraged, especially when such interests are substantial. In case of a change of auditor, separate disclosures of audit fees to each of the auditors must be made. Small companies, though, do not have to disclose non-audit fees. Disclosures in UK show that the non-audit fees has been climbing steadily across all sectors leading to a debate on whether this is leading to compromises on auditor independence [2]. While there have been views on both sides with regulators banning some services like outsourced internal control audit, designing of financial information systems and legal or actuarial services, there are companies like GSK whose annual reports show that have put in place a well-defined audit policy that limits the non-audit fees to 50% of the average audit fees for the preceding three years and have actually brought down the non-audit fees payable to the auditor from £5.3 million in 2014 to £3.5 million in 2016 despite rise in audit fees from £20.1 million in 2014 to £26.6 million in 2016 and further down to £1.5 in 2017 despite rise in audit and audit-related fees from £28.1 million in 2015 to £26.6 million in 2016 and £27.7 million in 2017. This policy of GSK is more stringent than the limit of 70% set by the Financial Reporting Council (FRC). Besides, GSK puts all non-audit services over £50,000 to competitive tender inviting bids from all financial services providers. Royal Dutch Shell, another British company, paid \$ 51million in 2015 for audit of parent company and its subsidiaries. The audit-related fees (fees for other services) amounted to just \$ 2 million. Similar is the case of Vodafone Ltd whose non-audit fees in 2016 stood at £1million as against £12 million of audit fees. Barclays Bank 2016 disclosed £14 million as audit fees for audit of group accounts and £27 million for other services paid to associates. Besides, as part of good corporate governance, such companies have different oversight committees like the Board Audit Committee, Board Risk committee, Board Reputation Committee, Board Nominations Committee and Board Remuneration Committee. Interestingly, the Board Audit Committee of Barclays Bank reported the distribution of time in 2016 of the Committee to different matters with 23% of time towards control issues, 19% towards business control environment, 36% towards financial results, 11% towards internal audit matters, 6% towards external audit matters and 4% towards other matters including governance and compliance. This was a big change from

2015 when 26% of the time was taken up by external audit. Aviva, on the other hand, had reported 21% of the time towards financial reporting, 22% towards financial reporting control framework and financial reporting developments, 24% towards external audit, 16% towards internal audit and controls and 17% towards others including governance, tax, treasury and dividends. Clearly, in audit matters, qualitative information is beginning to be reported and gaining importance. Instead of several limited purpose audits that may result in missed synergy benefits or limited sharing of audit resources and audit expertise, the study by Karapetrovic [16] showed that audit guidelines for integrated audit covering quality, environment and safety based on the systems approach would be preferable.

3.2 Research on Adoption of IFRS for SMEs

The issuance of IFRS for SMEs by the IASB (International Accounting Standards Board) has been a substantial movement forward towards harmonization of accounting standards for the small and medium enterprises. These standards have formalized the definition of SMEs and laid down conditions for reduced financial disclosures by SMEs. There have been similar efforts towards harmonization of audit exemption rules for SMEs in the EU. Fraser P. Nicholas [12], in his study, concluded that a single set of worldwide audit rules is needed to align national laws and standards with globalization of business and capital markets. Harmonized accounting rules have also been found by studies like that of Li, S. [19] to reduce the cost of capital as well as the cost of audit. IFRS for SMEs, therefore, have been adopted by EU and many other countries such as Malaysia, Hong-Kong, Chile, Singapore, Cambodia and South Asian countries such as Bhutan, Bangladesh, Sri Lanka and Pakistan in addition to a large number of other countries spanning Africa and Latin America. These countries have adopted these standards voluntarily with or without minor modifications to strengthen private company accounting. Ergun Ugur and Elif Ozturk [10] concluded positive perceptions of SMEs on these standards in Bosnia and Herzegovina. Strouhal, J, et al. [27] found greater benefits for users of financial statements as opposed to preparers. Besides, it has also been noted in some studies such as that by Litjens, R. [20] that while costs of adopting IFRS are clearly visible and immediate, the benefits may come in a staggered manner over a long period of time. Amongst users, too,

Atik Asuman [1] had earlier documented that firms in Turkey that had foreign partners or were export-oriented lent greater support to the adoption of IFRS for SMEs. The emphasis, of course, is on improving the quality of decisions made by stakeholders, including investors and auditors. However, SMEs that are non-publicly accountable, have also experienced difficulties due to enhanced disclosure requirements (Perera, D. et al. [23], Van and Rossouw [30]). Accountants, too, face challenges in adopting the appropriate accounting policy. In a subsequent paper, Perera, D. [22] concluded that accountants are unable to choose accounting methodologies that best reflect the economic substance when the measurement and recognition requirements are different across full IFRS and IFRS for SMEs. Together with these accounting challenges, small firms in particular, are also facing the challenge of audit quality indicators getting more and more qualitative. This adds to the cost of audit being conducted by/for them.

3.3 Research on Development of Audit Quality Indicators

Over the years, different organizations have come up with different sets of audit quality indicators even as some studies like that of Firth, M, et al. [11] have found that investors tend generally to proxy quality by the auditor's brand name reputation. Audit quality indicators have broadly been categorized into firm-level indicators and engagement-level indicators. While firm-level information can be made public, engagement-level information is more private and shared only with audit committees. Besides, some organizations have recommended a principles-based approach to select quality indicators; others have suggested a rules-based mandatory approach. New quality indicators like partner workload, industry expertise of audit personnel, investment in development of new audit methodology and tools, staff turnover, technical resources and tone at the top have generally been favoured by PCAOB (Public Company Accounting Oversight Board) of USA. Nearly 44% of audit parameters suggested by different organizations are qualitative in nature. The Federation of European Accountants (FEE) has favoured a global collaborative effort on audit quality parameters, quite akin to accounting standards. For the small and medium enterprises, special guidance has been issued by IFAC (International Federation of Accountants) pertaining to documentation,

leadership responsibilities including promoting an internal culture focused on quality, ethical requirements including professional integrity, laying down processes for resolution of all contentious issues and confidentiality of client information and use of that information only for the intended purpose, human resources, acceptance and continuance of client relationships and specific engagements including knowing when to sever relations with clients and even partners as well as engagement performance and monitoring including quality control reviews. This guide has been very popular with the small and medium enterprises and has been translated in several languages. The guide provides a set of procedures to be followed in the implementation of International Standards on Quality Control (ISQC) covering International Standards on Assurance Engagements (ISAEs) and International Standards on Related Services (ISRS). In case of audit, the auditor after gathering sufficient appropriate evidence, gives a reasonable positive assurance to investors that the financial statements fairly present the health of the company and in case of reviews, the auditors will generally give a limited assurance to investors certifying that no material misstatement has been observed in the financial statements which would have caused them to believe that the financial statements do not present a true and fair view of the company. The International Audit and Assurance Standards Board (IAASB) categorizes reasonable assurance as high assurance and limited assurance as moderate assurance. Limited assurance must, nonetheless, be of use to investors for the intended purpose as these too are dependent on sufficient inquiry and analytical procedures adopted by the practitioners. In some cases, after professional judgement, the auditor may also go into observation and/or confirmation before issuing the review report. SMEs that do not require a statutory audit may, therefore, opt for review engagements to comply with certain legal or regulatory reporting purposes. The International Standard on Review Engagements - ISRE 2400 (revised) issued in 2012 gives guidance to limited assurance by the auditor in case of reviews of historical financial statements while the International Standards on Auditing (ISAs) cover audits in which the auditor provides reasonable assurance to stakeholders. Where, however, engagements are other than audits or reviews of historical financial statements, the guidance to that effect is given by the International Standard on Assurance Engagements (ISAEs).

Historically, entities such as charities, partnerships, clubs and societies are at the forefront of requests for limited assurance as many of them do not require a statutory audit. Governments, too, may require some kind of limited assurance, before giving grants to any entity. Redmayne and Malthus in an unpublished paper [25] found that in New Zealand, while all the Big Four firms provided limited assurance mainly to companies, only 10% of the remaining did so on account of lack of demand, fear of legal liability, difficulty with lack of clarity of subject matter/criteria, lack of adequate standards or clients' inability to understand the level of assurance provided. The most common types of assurance services provided other than audits in New Zealand in 2010 were reviews of historical financial information (60% of non-audit assurance services) or reviews of prospective information (39% of non-audit assurance services). The small minority other work included probity audits, real estate trust audits, reviews of internal systems & controls, audits of sub-sets of historical financial information, export code quality audits and compliance with sector-specific regulations. In about 91% of such cases, negative assurance reporting is common, probably driven by the cost of supply. In other cases, reporting by way of prescribed formats was quite common. Bigger audit firms favour positive reporting though they commonly follow negative assurance reporting.

Pillsbury, C. [24] concluded that the middle level of assurance which may range from positive to negative is the most interesting. While positive limited assurance is generally given for agreed-upon procedures and contractual compliances in which limited substantive detailed testing is performed, negative limited assurance is prevalent mainly in case of interim reviews and financial forecasts by management. He also concluded that significant differences exist in the perceptions of bankers and auditors on limited assurance. Thus, bankers perceived interim reviews to have been issued after substantive testing, though in reality, that was not the case.

In India, non-audit services like due diligence for takeovers & mergers, valuation of brand, goodwill and other intangible assets, equity share valuation or business valuation, tax advisory services and cost, management, inventory & forensic audits are becoming quite common. Practitioners offering assurance services have to

comply with the Indian Audit Standards (SAs). These standards are in line with the standards issued by the IAASB. Nonetheless, good implementation of these standards requires framing of a robust strategy and action plan together with setting aside adequate resources for the same. Gregory [13] as early as 1978 found that the expectations from the auditors were changing very fast and that auditors were being held responsible even for limited assurances provided by them. Increased possibilities of data analytics have put pressure on reducing audit time while at the same time demands for further improving audit quality including receipt of early warning signals and forward-looking statements rather than review of historical information. Chiesa, Coughlan and Voss [4] had also suggested that auditing has to go beyond measuring and include identifying gaps between current and desired performance to develop action plans for improving performance.

As of now, an oversight body like the International Forum of Independent Audit Regulators (IFIAR) or the PCAOB regularly assesses the performance of the Big 6 audit firms (BDO International, Deloitte Touche Tohmatsu, Ernst & Young Global, Grant Thornton International, KPMG International Cooperative and PricewaterhouseCoopers International) by looking into the quality of audits conducted by them. As per the report of IFIAR issued in March 2017, 42% of audits of listed public interest entities (PIEs) and 49% of audits of systemically important financial institutions (SIFIs) had at least one inspection finding or audit deficiency which indicated lack of sufficient appropriate audit evidence supporting the opinion expressed, though it did not necessarily imply that the financial statements were also materially misstated. IFIAR further observed that high rates of deficiencies or inspection findings occurred in the critical area of firm-wide quality control which was a major source of concern. Within quality control, 49% of firms were found deficient in the areas of engagement performance, 40% in independence and ethical requirements, 31% in human resources and 28% in monitoring. The ambit of audit deficiencies or inspection findings included the Big 4 although they saw their global fee incomes rise in 2016 over the previous year. PwC remained the top performer with global fee income rising by 4% to \$35.356bn (£24.413bn), some \$156m ahead of Deloitte whose fee income increased by 3% to \$35.2bn.

4. RECOMMENDATION FOR AN IFRS GUIDE TO DEFINING SMALL FIRMS FOR AUDIT EXEMPTION

While previous studies have focussed on various audit issues such as voluntary vs mandatory audit, audit quality parameters, auditor independence, disclosure of fees from non-audit services etc., there has been little discussion on the reasons for persistence of varied audit exemption criteria despite harmonization efforts. The criteria, though, seem to suggest that any firm below a threshold revenue or capital contribution limit is a small firm and, therefore, requires exemption from statutory audit. Perhaps, it may be good to draw lessons from the International Accounting Standards Board (IASB) that has issued the International Financial Reporting Standards (IFRS). IASB defines small and medium enterprises as: i) do not have public accountability; and ii) publish general purpose financial statements for external users. Entities are deemed to have public accountability if their debt or equity instruments are traded in a public market or they hold assets in a fiduciary capacity for a broad group of outsiders (examples are usually mutual funds, insurance companies, banks, securities brokers/dealers though may include public utilities, charities and schools). Listed companies, however small, are to use full IFRS and not IFRS for SMEs. As noted by IASB, the main groups of external users of SME financial statements include banks that make loans to SMEs, vendors that sell to SMEs and use their statements to make credit and pricing decisions, credit rating agencies, customers of SMEs that use their statements to decide whether to do business with them and shareholders who are not managers of SMEs. This also shows adoption of IFRS does connote adherence to quality standards as has also been shown by researchers like Christensen et al. [5] and Collis Jill [7].

Audit exemption may be granted to such entities which qualify as SMEs under the definition given by IASB. The adoption of this rule may lead to harmonization of conditions under which audit would become mandatory; thereby dispensing with varying audit exemption limits. In consonance with IFRS, these rules would apply only to firms preparing general purpose statements. Firms preparing special purpose financial statements such as for limited assurances are permitted to provide limited disclosures and may also escape an audit. Some firms preparing special purpose financial

statements could be large firms but escape full disclosures and audit if they have not raised money from public. Therefore, discussions are still required on which companies must prepare general purpose financial statements requiring full disclosures under IFRS. In order to plug such loopholes, in Australia, by the tax legislation passed in December 2015, all companies with income greater than \$200 million as disclosed in their tax returns or companies having a consolidated income of more than \$ 1 billion have been mandated to prepare general purpose financial statements. All entities (including subsidiaries) in such a group including individuals, discretionary and unit trusts are considered as 'significant global entities' and required to prepare general purpose financial statements. In New Zealand, on the other hand, all companies with revenues exceeding \$30 million or assets exceeding \$60 million are required to prepare general purpose accounts. Before such legislation, many MNCs became eligible for special purpose accounting due to their not being publicly accountable and, thus, avoided full-scale disclosures in both these countries. Thus, both these countries, along with the requirement that these firms should not be publicly accountable, have included the size criterion in order to take care of cases of companies not issuing securities for public trading in a country's stock exchange and yet considered quite big to have a public impact.

Countries are, therefore, now mandating audit for all companies that are publicly accountable. Although public accountability is still, in most cases, defined as per IASB, it may be good to widen the definition to include all enterprises beyond a specified size measured by way of assets or revenues as also enterprises that have customers or suppliers who are publicly accountable. Hence, audit requirement will arise for all companies i) whose securities are traded on public markets; or ii) whose size exceeds specified limits; or iii) who have customers or suppliers who are publicly accountable. Companies not fulfilling any of these conditions can be categorized as SMEs not requiring audit of their accounts. The Big 4 audit firms, for example, in different countries, have large enterprises as their clients whose accounts they audit but their own accounts may not be audited or audited accounts may not be so easily available to the public. If they fall under the definition of publicly accountable firms, then they would also have to place their accounts in public domain.

The independent regulation of auditing, as opposed to self-regulation by the accounting profession, has become more acceptable since the last 15 years and today over 50 countries have set up independent audit regulators. The Financial Reporting Council of UK has broader responsibilities including securities markets oversight. The regular interaction between the independent regulators and the audit committees of companies is a healthy trend and that is why the audit committee outreach has assumed high significance in many cases. In India, so far, much discussions are taking place on the merits of an independent audit regulator that has been named as the National Financial Reporting Authority (NFRA). More and more independent regulators are joining hands to widen their scope of audit beyond their respective countries. This collaboration is also likely to help in the evolving of some uniform principles for audit of small enterprises including LLPs.

5. CONCLUSION

Audit profession, like other professions, is an evolving field. Issues that have received attention lately include establishing audit exemption limits for small or private enterprises. India has also started examining this issue in greater depth with the establishing of limited liability partnerships or LLPs in 2009 and issuance of Revised Indian Accounting Standards in 2016 that are largely in alignment with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). Although countries define small companies in different ways using different benchmarks of turnover, balance sheet total or number of employees; IFRS has a principles-based definition of a small firm; i.e. a firm that is not publicly accountable. The same principles-based definition along with other criteria dealing with size of firm as well as size of its suppliers/creditors can be used to decide which firms can be exempted from mandatory audit. This will also help strengthen the institutional framework for audit including laying down framework for audit committee reports, disclosure norms with respect to audit fees and qualitative data, making limited purpose audit reports more meaningful and establishing audit oversight bodies.

COMPETING INTERESTS

Author has declared that no competing interests exist.

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