South Africa's audit exemption threshold: An international comparison

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DECLARATION

I, E KILIAN, declare that **South Africa's audit exemption threshold: An international comparison** is my own work and that all the sources I have used or quoted have been indicated and acknowledged by means of complete references. This dissertation has not previously been submitted by me or any other author to any other university.

Signature:

Date: 6 May 2020

PROOF OF LANGUAGE EDITING

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Kind regards

Elmarie Viljoen-Massyn

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ABSTRACT

Title: South Africa's audit exemption threshold: An international comparison

Key terms: Agency theory; Audit exemption; Australia; Brazil; Canada; Public interest; Russia; South Africa; SME; Stakeholder theory; UK; USA

Audit plays an important role in society as it keeps management honest and shareholders informed. There are many benefits to the performance of an audit. Previous research has shown that the performance of an audit in a company leads to reduced interest rates and increased confidence in its financial statements. However, the argument many have against an enforced audit on the small company is that it unnecessarily increases the costs of doing business. In many instances the shareholders are already aware of the transactions and affairs within a non-listed company without the need of an audit. The question then follows at what point should government step in and decide that an audit is needed for public interest, specifically with reference to the non-listed companies.

South Africa calculates a threshold for audit exemption by using four qualifiers, namely turnover, employees, shareholders and third party liabilities. These numbers add up to the Public Interest Score (PI score). This score determines whether a non-listed company must undergo an audit.

The research focused on audit exemption across six countries selected for the sample, namely Australia, Brazil, Canada, Russia, the UK and the USA. The aim of the study was to compare the point of audit exemption specifically for non-listed companies in these countries with that of South Africa.

The study further attempted to determine which companies are allowed to forego an audit. For this reason, the SME thresholds were also compared across the seven countries to triangulate the data gathered on these thresholds.

The study found a few similarities among the countries, for example most countries make use of revenue and employees as two of their qualifiers for audit exemption and for the SME definition. However, significant differences were found between South Africa and the other countries. These include the way in which the audit exemption threshold is calculated and the fact that South Africa is the only country which distinguishes between internally compiled financial statements and externally compiled financial statements in relation to its audit exemption threshold. Lastly, South Africa uses different qualifiers in its calculation for audit exemption than the other countries in the study.

The study further considers the role which agency theory and stakeholder theory plays in the context of a non-listed company. The study finds that there are complex interactions between the need for audit which can be explained through both the agency and the stakeholder theories.

The study concludes with recommendations to improve the audit exemption threshold in South Africa were made by taking into account the limitations of the study. One of the main recommendations made in this study is the suggestion to simplify the audit exemption threshold in South Africa to reduce the burden faced by non-listed companies.

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LIST OF ABBREVIATIONS

ABS	Australian Bureau of Statistics
ACFE	Association of Certified Fraud Examiners
ASIC	Australian Securities and Investments Commission
BDC	Business Development Bank of Canada
BER	Bureau for Economic Research
BRICS	Brazil, Russia, India, China and South Africa
CIT	Company Income Tax
CPA	Certified Public Accountants
DTC	The Davis Tax Committee
EIB	European Investment Bank
EU	European Union
FEE	Federation of European Accountants (Fédération des Experts-comptables Européens)
FSB	National Federation of Self Employed & Small Businesses Limited
GDP	Gross domestic product
FRC	Financial Reporting Council
FSB	National Federation of Self Employed & Small Businesses Limited
IBGE	Brazilian Institute for Geography and Statistics
ICAEW	Institute of Chartered Accountants in England and Wales
IFAC	International Federation of Accountants

IFC	International Finance Corporation
ILO	International Labour Organisation
IRBA	Independent Regulatory Board of Auditors
ISA	International Standard on Auditing
NAICS	North American Industry Classification System
NSBA	National Small Business Act
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics (UK)
PI score	Public Interest Score
SAICA	South African Institute for Chartered Accountants
SAIIA	South African Institute for International Affairs
SARS-NT	South African Revenue Services and National Treasury
S/A	Sociedade por Ações
SBC	Small Business Corporation
SEBRAE	Serviço Brasileiro de Apoio às Micro e Pequenas Empresas (Brazilian Service to Support Micro and Small Enterprises)
SME	Small, Micro and Medium Enterprise
SBA	USA Small Business Administration
SBEEA	Small Business, Enterprise and Employment Act of 2015
SEDA	Small Enterprise Development Agency
SDL	Skills Development Levy
Stats SA	Statistics South Africa

TBL	Triple bottom line
TIPS	Trade & Industrial Policy Strategies
UK	United Kingdom
USA	United States of America
US GAAP	United States Generally Accepted Accounting Principles
WEF	World Economic Forum

CHAPTER 1: INTRODUCTION AND BACKGROUND TO THE STUDY

1.1 Introduction

The arrival of the joint stock companies and the encouragement that this form of association received during the Industrial Revolution in England made it crucial for those in charge of a business to account reliably and clearly to the owners, that is to say, the shareholders (Puttick, 2003). The engagement of an auditor to act as agent for the shareholders became essential, and out of this grew the field of auditing as we know it today (Puttick, 2003). Audit originated from an essential need for accountability and trustworthiness.

Agency theory is often used to justify why company audits are performed (Peng, 2004). The fact that shareholders are removed from the day-to-day activities of the company creates separation of ownership and control. This phenomenon is explained by agency theory. Shareholders appoint directors to act on their behalf and increase profits and ultimately build wealth for them. When the directors meet these objectives, they themselves are rewarded in terms of financial gains. On occasion, directors may prefer to maximise their own interests by presenting misleading information to the shareholders (Jerzemowska, 2006).

The auditor is appointed as an agent to bridge the conflict of interest between the shareholders and the directors of a company. The primary function of an external audit is to provide the owners with an independent view of the company's affairs through verification of the financial statements of the company. However, many researchers have concluded that an audit provides "multi-dimensional value", which includes a different combination of benefits for each company that undergoes an audit (Knechel *et al.,* 2008).

In order to bridge the gap between shareholders and directors, and to protect the interests of investors, the initial goal of company audits was to convince participants in the capital markets that the company's financial statements provide an accurate and fair reflection of the company's performance. The audit function continued to evolve

due to the accelerated growth of world economies. In the present day, auditing has expanded beyond the basic financial statement attest function, and the auditing profession has had to adapt to more sophisticated transactions and practices (DeFond & Zhang, 2014). Moreover, concerns about the role of the auditor in various accounting scandals have resulted in renewed efforts to enhance auditor independence (Young, 2006).

Following the aforementioned, audit regulatory bodies introduced initiatives to ensure that the audit profession regains the trust of investors. These initiatives include guidance on complex transactions, for instance, ISA 545 “Auditing fair value measurements and disclosures”, ISA 240 R “The auditor’s responsibilities relating to fraud in an audit of financial statements”, corporate governance codes, and guidance on audit committees and mandatory audit firm rotation (ICAEW, 2009b; Financial Reporting Council [FRC], 2016).

As a result of the many corporate scandals in recent years, society’s demand for flawless financial statements has increased. Relevant and reliable business information fosters the flow of capital towards the most productive uses thereof (Knechel *et al*., 2007). But when information is misleading, or perceived to be unreliable, capital may flow to less productive usage and thus hinder an economy’s adaptive efficiency. The resulting cost is borne not just by those who are invested in a given security at a given time, but by society at large (Knechel *et al*., 2007). High-quality financial statement audits, therefore, serve the public interest by reducing uncertainty about the reliability of financial information (Knechel *et al*., 2007). Marx (2009) notes that audit improprieties in the past two decades have also led to an increase in auditor scrutiny by the regulators.

1.2 Audit in South Africa

1.2.1 Background

South Africa was one of the first countries in the world to introduce a formal code on corporate governance, namely the King Code (Solomon, 2010). Maroun *et al.* (2014) argue that the current audit regulations in South Africa were reflexively impacted by a “mix” of experience and knowledge gained from the strive for credibility post-apartheid,

the need to ensure fairness and the regulatory developments that occurred after the fall of Enron and Anderson in the USA, the world's largest economy.

Amid the increase in auditor scrutiny and regulations on a global scale, South Africa remained a world leader for its quality of auditing and other governance standards, as evidenced by being in the top position on the World Economic Forum (WEF) Global Competitiveness Survey for seven years in a row (IRBA, 2016). However, in the last three years, South Africa has descended to 30th place in 2017 (WEF, 2017) and even further to 55th out of 140 nations in 2018 (WEF, 2018). Although it has managed to improve its position slightly in 2019 to 49th (WEF, 2019), the country is still far behind where it once was. Not only has it lost sight of its perceived quality of audit and other governance standards, but it has also been facing a streak of company failures due to unethical practices. Tremendous accounting failures in the market include Steinhoff, whose share price dropped by 90%, wiping out almost R200 billion worth of market capitalisation (Fin24, 2019). Another example is VBS Mutual Bank. An investigation into the events concluded that the audit partner had given "an unqualified audit opinion in circumstances where he knew the financial statements were misstated" (Motau, 2018).

1.2.2 Applicable legislation in South Africa

On 1 May 2011 the regulations to the Companies Act 71 of 2008 became effective and changed the auditing landscape in South Africa for registered private companies. Previously, under the Companies Act 61 of 1973, all companies, whether private or public, had to undergo an audit. Under the new regulations, companies have to calculate their Public Interest Score (PI score) which will determine whether they will be subject to an audit, a review or nothing at all (Department of Trade and Industry, 2011). The PI score in South Africa is calculated through a combination of turnover, average employees, number of security holders, and third party liabilities (Department of Trade and Industry, 2011).

Auditors in South Africa are regulated by the Auditing Profession Act 26 of 2005. They have to register with the regulator, the Independent Regulatory Board of Auditors (IRBA), to be able to sign off on the audit reports of financial statement audits. In addition to the individual auditor rotation requirements introduced by the Companies

Act 71 of 2008, IRBA announced mandatory audit firm rotation on 1 June 2017. According to IRBA (2017), one of the reasons for the implementation of mandatory audit firm rotation is South Africa's reliance on external capital and the need to provide potential investors with credible financial information. IRBA (2017) makes it clear that it is crucial to ensure that the local profession continues to be recognised globally. Mandatory audit firm rotation applies to listed entities and public interest entities only.

1.2.3 The public interest of non-listed entities

Garner (in Black's Law Dictionary, 2009) defines "public interest" as "[t]he general welfare of the public that warrants recognition and protection or something in which the public as a whole has a stake; especially an interest that justifies government regulation." According to Cambridge Dictionary (2019), the term "public interest" is "used when talking about people's rights to know the facts about a particular situation." "Public interest" has also been defined as "the interests of third parties who rely on the opinions and advice delivered by the members of the accounting profession" (Baker, 2013).

Public interest is, therefore, some element which affects the public and could lead to government intervention to protect the public. It theoretically follows that regulation by government intends to protect the interest of the public. Thus, the requirement that certain non-listed entities must be audited is seen as being in the best interest of the public.

In South Africa, non-listed entities are typically Small, Micro and Medium Enterprises (SME) and account for an estimated 40% of GDP (SAICA, 2016). According to the SME Insight Report from the South African Institute of Chartered Accountants (SAICA, 2016), nine out of 10 new jobs will be created through SMEs by the year 2030. The nurturing of SMEs has a broad impact; for example, in Brazil, they account for 96% of employment opportunities (Rankin *et al*., 2013).

1.3 Motivation for the study and previous research

1.3.1 Previous research

For listed companies and public interest entities, audit is legally required by the majority of governments across the world. However, there are varying requirements applicable to non-listed entities. Shukarova-Savovska and Hodge (2016) refer to an increase in the number of governments across the world that do not require micro and small businesses to undergo an audit. In some instances, these companies are not even required to prepare general purpose financial statements. Governments tend to argue that a lessened regulatory burden will provide relief to these businesses and give them the opportunity to grow (Shukarova-Savovska & Hodge, 2016).

According to Collis (2010), little is known about the accounting and auditing needs of the directors of non-listed entities. Understanding the factors that play a role in the performance, growth and governance of non-listed entities is vital for economic development and success for society as a whole (Langli & Svanström, 2013). In this regard, auditors may play an imperative role as providers or verifiers of financial information and advisors to decision makers (Langli & Svanström, 2013). Contrary to the vast amount of resources focused on large corporations and the regulations implemented to keep up with global trends, little to no attention has been paid to the audit environments of non-listed entities and their changing needs.

While South Africa uses a PI score to determine whether a non-listed company must be audited or not, other countries refer to audit exemption. The literature suggests that countries across the world have unique approaches to the implementation of the audit exemption threshold for non-listed entities. A study in Hong Kong concluded that directors of small companies and the Certified Public Accountants (CPAs) who audit them agree with the requirement that an audit is mandatory for all “small companies” in Hong Kong (Chung & Narasimhan, 2001). Developed Commonwealth countries such as Australia no longer require a mandatory audit for all companies (Chan, 2012), while countries such as the USA has never had a requirement for non-listed entities to undergo an audit (Minnis & Shroff, 2017). Countries in the European Union (EU) set out thresholds which companies need to meet in order to qualify for audit exemption. This results in only the smallest of companies’ having the option of audit exemption

(Vanstraelen & Schelleman, 2017). Three tests are used in the UK to determine the audit exemption threshold. Satisfying two of the three tests means that a company is exempt from audit (UK Government, 2017). Canada also introduced audit exemption thresholds in 1994. However, Canada has only one determinant to decide whether or not an audit must take place (Haron *et al*., 2016).

While some scholars believe that the audit requirement for non-listed entities should be eliminated (Davison, 1980), others argue that the audit requirement is a "price that must be paid" by non-listed entities for their limited liability (Sherwood, 1979).

1.3.2 Shareholder and stakeholder models

The two main models of corporate governance as identified in the literature are shareholder and stakeholder models (Andreasson, 2011; West, 2006). The shareholder model argues that managers will only act in the best interest of the shareholders, that is, maximising shareholder returns, if structures have been put in place to protect the interests of the shareholders. This model is based on agency theory, and one of the structures to protect the shareholder is the external auditor (Jensen & Meckling, 1976).

The stakeholder model, in turn, argues that the organisation has support groups without whom the organisation cannot function (Freeman & Reed, 1983). Stakeholder theory postulates that, in order to maximise profits, companies need great products and services that customers want, stable relationships with suppliers that keep operations on the cutting edge, inspired employees who stand for the company mission and push the company to become better, and supportive communities to allow businesses to flourish (Freeman *et al*., 2010).

According to West (2006), South Africa's corporate structures correspond substantially with the shareholder model. He further notes that this view is dominant in the USA and generally accepted in English-speaking countries. Andreasson (2011) believes that South Africa must try to carefully balance the interests and rights of shareholders with the needs and demands of a broader range of stakeholders in society. The unique environment in which South Africa finds itself makes it seemingly impossible for one model to meet the needs of all parties.

1.4 Problem statement

From the above, the question arises whether or not the PI score is set at the right level to balance the needs of shareholders and the demands of stakeholders. On the one hand, we know that agency theory (shareholder model) influenced the origins of external audit in South Africa, mainly due to the significant influence of the UK on South Africa. On the other hand, the fact that it is called the “Public Interest” Score leads us to believe that the needs of the public (stakeholders) are being considered when the threshold for external audit exemption is calculated. However, the PI score has remained the same since its effective date in 2011, with no regard for inflation nor for the changing global landscape.

The problem statement for the study was, therefore, formulated through the following question:

- To what extent, if any, does the audit exemption threshold in South Africa differ from the audit exemption thresholds in other countries?

1.5 Objectives of the study

The following objectives were formulated for the study:

1.5.1 Primary objective

The primary objective of this study was to compare the audit exemption threshold for non-listed entities in South Africa to the audit exemption threshold for non-listed entities in other countries. The aim was to determine whether or not the South African audit exemption threshold differs significantly from that of other countries (chapter 5).

1.5.2 Secondary objective

In order to achieve the primary objective, the following secondary objectives were formulated:

- To describe the methodology to be followed in this study (chapter 2).
- To obtain an understanding of the need and history of audit (chapter 3).
- To investigate the similarities and differences in the audit exemption thresholds of selected countries across the world (chapter 4).

- To investigate the similarities and differences in the SME definition used in selected countries across the world (chapter 5).
- To determine through comparison where South Africa finds itself in relation to selected countries across the world, taking into account the underlying shareholder and stakeholder principles (chapter 6).
- To suggest recommendations for improvement of South Africa's audit exemption threshold (chapter 7).

1.6 Research design and methodology

1.6.1 Literature review

Henning *et al.* (2011) states that a literature review is essential for the contextualisation of a study. According to Mouton (2002), the literature review serves as a "map" of the terrain. A literature review recognises information which is already known in a particular area of study and which could raise awareness of areas for future research (Harvard University, 2019).

The literature review formed the foundation of this study upon which further conclusions were drawn. In previous studies the audit exemption thresholds of only two countries were compared at a time. However, no studies could be found in which South Africa's threshold was compared with that of other countries.

The following sources were consulted for the literature study:

- peer-reviewed international and South African academic articles;
- academic books;
- publications in newspapers and magazines;
- publications from government and professional bodies regarding audit, SMEs and company statistics;
- laws and regulations; and
- internet sources.

Permission to obtain information was not needed, as only publicly available sources were consulted. This study aimed to provide valuable insight for practitioners and policymakers on how South Africa's audit exemption threshold compares with that of other countries.

1.6.2 Empirical study

The study was based on a qualitative research design in which a comparison was drawn (case study) of selected countries and their audit exemption thresholds. A comparative analysis compares two or more items, which can be "two texts, two theories, two historical figures, two scientific processes, etc." (Walk, 1998). According to Mouton (2002), comparative studies are conducted to obtain a certain number of people or events to be able to "generalise" the results to a defined universe or population. The aim of such studies can be to formulate theories or provide descriptions or analysis (Creswell, 2007). A qualitative case study provides better insight into a specific phenomenon than quantitative methods (Henning *et al.*, 2011). The researcher in this study compared the similarities and differences between the audit exemption thresholds used in South Africa and the countries in the sample.

Inductive and deductive approaches stand in direct contrast (Yin, 2016). According to Ritchie *et al*. (2014):

> inductive processes involve using evidence as the genesis of a conclusion – evidence is collected first, and knowledge and theories built from this. Deductive processes use evidence in support of a conclusion – a hypothesis is first developed and evidence is then collected to confirm or reject is.

An inductive analysis was conducted in this study as the researcher identified and linked similarities, differences and recurring themes in the countries' audit exemption thresholds and their SME definitions. Knowledge was built based on the data collected. The following themes were identified to collect data and compare the countries:

1. date when audit exemption was introduced;
2. turnover threshold;
3. employee threshold;

4. asset threshold;
5. third party liabilities threshold;
6. shareholder threshold; and
7. SME threshold.

According to Patton (2015), the aim of analysing data is to understand large volumes of data, decrease the amount of information to a more usable format, identify unique patterns, and communicate the findings.

The data analysis in this study provided the following information:

- differences in determining the audit exemption between the countries;
- outliers where the trends of the rest of the countries were not followed; and
- similarities, in terms of audit exemption, between the countries.

1.6.2.1 Target population and sampling frame

We need to keep in mind that most previous auditing research was conducted from an Anglo-Saxon approach (Cooper & Robson, 2006) and that developing countries face various problems such as economic uncertainties, weak and illiquid stock markets, a weak legal system and regular government intervention (Tsamenyi *et al*., 2007). The sample in this study comprised a wide range of countries to include both developed countries and developing countries. In so doing, insight could be gained in how the audit exemption threshold is interpreted in many different countries.

The BRIC countries, an acronym for Brazil, Russia, India and China, were initially identified by Goldman *et al*. in 2001 as a group of countries which could become a significant force in the world economy by overtaking the G6 at the time (Goldman *et al*., 2003). The G7 at the time included the USA, Britain, Canada, France, Japan, Germany and Italy (The Balance, 2019). The BRIC countries formally offered an invitation to South Africa to join them in December 2010 and BRICS was formed (SAnews, 2011). For purposes of this study, selected BRICS countries were compared as they all have developing economies.

1.6.2.2 Sample method: Country selection

For the international comparison, countries were selected from across the world. The sample comprised developed countries, in which audit exemption was already implemented approximately 20 years before being implemented in South Africa, as well as developing countries which have only recently, similar to South Africa, implemented their audit exemption thresholds. The USA was selected because it has provided audit exemption to its non-listed entities since the introduction of the requirement for audited accounts of listed entities in 1933, as previously there had been no requirement for any form of audited accounts (ICAEW, 2009a). The UK (Britain at the time) first introduced an audit exemption threshold for its non-listed companies in 1994 (Collis, 2007). Canada implemented audit exemption in 1994 (Haron *et al*., 2016), followed by Australia in 1995 (Treasury, 2018a).

The sample selected from the BRICS countries included Brazil and Russia. Brazil's economy has grown tremendously, while Russia's economy is still in the early stages of development.

1.6.2.3 Data gathering and analysis of results

The first step in this study was to contextualise audit by means of a literature review. It was important to understand the need and modern-day shape of audit before researching the concept of audit exemption threshold.

The literature review on audit provided a foundation on which the comparison of the countries could be drawn, with specific reference to audit exemption and the SME thresholds. Only publicly available sources were scrutinised to gather the information needed for the comparisons, since the requirements are included in each country's laws and regulations. Upon completion of the information gathering process, a comparison was drawn between the countries according to the themes as identified in

1.6.3 Paradigmatic assumptions and perspectives

Based on the qualitative inductive approach adopted for this study, the researcher made methodological assumptions since the researcher's own experience would influence the interpretation of the raw data. The researcher processed the raw data

and identified similarities and differences through this process. The experience of the researcher contributed to the conclusions that were made.

This study was based on two main theories, namely agency theory (shareholder) and stakeholder theory (wider community). Both of these theories played a role in developing the audit landscape as we know it today (Andreasson, 2011; West, 2006).

1.7 Definition of key terms

The following definitions were used for purposes of this study:

Accounting: Accounting involves the classification and recording of monetary transactions; the presentation and interpretation of the results of those transactions in order to assess performance over a period and the financial position at any given date (CIMA Dictionary of Finance and Accounting, 2003). Ohler (1975) describes accounting as "the recording and reporting of transactions" while O'Regan (2004) defines it as "a broad term that encompasses the preparation, analysis and audit of financial information." From these definitions it is clear that the term "accounting" refers to the recording of transactions and the reporting of these results at certain dates.

Agency theory: O'Regan (2004) describes agency theory as "[t]he relationship between two parties, a principal and an agent, in which the latter represents or acts on behalf of the former". The CIMA Dictionary of Finance and Accounting (2003) describes it as "a hypothesis that attempts to explain the elements of organisational behaviour through an understanding of the relationships of principals (such as shareholders) and agents (such as company managers and accountants)". It is clear that agency theory refers to two parties and that the one party acts on behalf of the other. This acting on behalf of the other is where the tension arises, as the agent is paid to act in the best interest of the principal and not in his own best interest.

Audit: An audit can be described as "a systematic examination of the activities and status of an entity, based primarily on investigation and analysis of its systems, controls and records" (CIMA Dictionary of Finance and Accounting, 2003). Another definition is: "an official examination of a person's or organisation's accounts by an expert to verify that they are true and honest" (Longman Business English Dictionary, 2007). The product of an audit is therefore an opinion on financial statements that

provides the highest level of assurance an external auditor is allowed to offer. An audit of financial statements is further defined by ISA 200, “The overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing” (2009):

> The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with ISAs and relevant ethical requirements enables the auditor to form that opinion.

Audit opinion: An audit opinion is “[a]n indication that certain audit procedures, with known attributes based on professional pronouncements and practice, have been performed and that the financial reports of the company are credible, subject to an acceptable level of error” (Abdel-Khalik, 1993). O’Regan (2004) defines an audit opinion as:

> [a]n auditor’s conclusion on the extent to which audit evidence refutes or confirms an audit objective. Independence is considered to be central to the credibility of audit opinions, especially in the context of an external audit: An auditor’s opinion is no more than an opinion, but it must be believed to be an informed opinion honestly held.

Law (2016) defines an audit opinion as “[a]n opinion contained in an auditor’s report. It expresses a view as to whether or not the financial statements audited have been prepared consistently using appropriate accounting policies, in accordance with relevant legislation, regulations, or applicable accounting standards.”

It is therefore clear from the above that an audit opinion is a result of procedures performed by the auditor, who must be independent in order to increase credibility. An audit opinion increases the credibility of financial statements.

BRICS: This acronym stands for Brazil, Russia, India, China and South Africa, the countries identified by economists from Goldman Sachs as those that are expected to outrival the current leading economies (Goldman *et al.*, 2003).

Corporate governance: According to the Business Dictionary (2019), corporate governance is "the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with its takeholders (financiers, customers, management, employees, government, and the community)". The ICAEW (2019) defines corporate governance as the system by which companies are directed and controlled. Corporate governance, therefore, refers to what the board of a company does and how it sets the values of the company. This should be distinguished from the day-to-day operational management of the company by full-time executives (ICAEW, 2019). Siebrits (2019) explains:

> Corporate governance deals with the way in which the relationships between the governing body of an organisation, its executive managers, and its stakeholders should be structured in order to make it more likely that executive managers will serve the interests of the organisation itself, rather than their own interests.

Thus, corporate governance is a value-based guidance system that helps directors act in the best interest of the stakeholders.

Non-listed company: The major practical distinction between a private and public company is that the former may not offer its securities to the public (CIMA Dictionary of Finance and Accounting, 2003). In other words, it is a company whose shares are not openly traded and can only pass from one person to another with the agreement of other shareholders (Longman Business English Dictionary, 2007). According to Law (2016), a non-listed company is "[a]ny company that is not a public company". Non-listed companies referred to in this study are therefore any private company not listed on a stock exchange and of which the shares are not available to the general public.

SME: Small, Micro and medium (sized) enterprises are "fairly small companies that are usually based in one place and owned by one person or a small group of people" (Longman Business English Dictionary, 2007). The Organisation for Economic Co-operation and Development (OECD, 2005) defines SMEs as "non-subsidiary,

independent firms which employ fewer than a given number of employees", whereas the CIMA Dictionary of Finance and Accounting (2003) defines the term as a "[c]lassification used by policy-makers to specify which categories of enterprise are affected by regulation". SMEs are therefore uncomplicated smaller enterprises which are owned by a limited number of people.

Stakeholder: "A person or organisation with a vested interest in the successful operation of a company or organisation. A stakeholder may be an employee, customer, supplier, partner, or even the local community within which an organisation operates" (CIMA Dictionary of Finance and Accounting, 2003). The Longman Business English Dictionary (2007) defines a stakeholder as "a person who is considered to be an important part of an organisation or of society because they have responsibility within it and receive advantages from it". According to Merriam-Webster (2018), a stakeholder is "one who is involved in or affected by a course of action". Stakeholders therefore refer to a wide range of people and organisations, including employees or anyone with a vested interest in a company, anyone who is affected by the decisions taken by the company, customers, suppliers and the local community, to name but a few.

Stakeholder theory: According to O'Regan (2004), stakeholder theory contends that "an organisation's network of rights and responsibilities stretches wider than is the case suggested by the rather simplistic notions of 'agency theory'". Lin (2018), on the other hand, finds that "stakeholder theory is a theory of organizational management and business ethics that accounts for multiple constituencies impacted by business entities like employees, suppliers, local communities, creditors, and others". Another description states that it is "[a] theory which states that an entity can look after the needs of their shareholders and stakeholders simultaneously without inflicting damage to either party" (CIMA Dictionary of Finance and Accounting, 2003). Thus, stakeholder theory is wider than agency theory as it requires that a company must look after the needs of all the stakeholders and not only the shareholder as proposed in agency theory.

1.8 Chapter overview

This study is set out in the following sections:

CHAPTER 1: Introduction and background to the study

The first chapter serves as an introduction and overview of the study. The background, motivation, objectives, definitions, problem statement, research methodology and chapter overview are discussed.

CHAPTER 2: Research design and methodology

The research design and methodology selected for this study are outlined and described in detail and will address the first secondary objective namely “to describe the methodology to be followed in this study”. This chapter discusses the type of research, procedures of data collection and analysis, the population of the study, the reliability and validity of the data, the sample and sampling method, and the ethical considerations.

CHAPTER 3: The need for audit

A literature review is presented in the third chapter and contextualises the origins and development of audit over the years. In addition, the complexities of audit today are explored, specifically considering the increase in the number of stakeholders with a correlated increase in the responsibilities of the auditor thereby addressing the second secondary objective of obtaining an understanding of the history and need of audit. This chapter concludes with an overview of the current audit environment in South Africa.

CHAPTER 4: Audit exemption thresholds

In chapter 4, audit exemption thresholds for each country in the sample are explored through a comparative analysis. The comparison focuses on the similarities and differences in the audit exemption calculation of each country in the sample which addresses the third secondary objective.

CHAPTER 5: Global SME definition comparison

In order to understand the classification of the non-listed company in the selected countries, the different definitions of SMEs in each country are discussed in chapter 5. The fourth secondary objective “to investigate the similarities and differences in the SME definition used in selected countries across the world” are addressed in this chapter.

CHAPTER 6: The audit exemption threshold in South Africa compared with other countries

The comparative analysis is set out in chapter 6 thereby addressing secondary objective number five namely “to determine through comparison where South Africa finds itself in relation to selected countries across the world, taking into account the underlying shareholder and stakeholder principles.” Similarities and differences are identified among the audit exemption thresholds of the various countries and ultimately used to inform the recommendations presented in chapter 7.

CHAPTER 7: Conclusions and recommendations

In the final chapter, the researcher provides a summary of the study, concludes on the primary and secondary objectives, and makes recommendations thereby also addressing the last secondary objective.

1.9 Chapter summary

In this chapter an introduction to audit is made and the applicability thereof in business is explored. The origins of audit are looked at with special focus on the shareholder and stakeholder theories. Various corporate scandals both in South Africa and abroad has revitalised the discussion surrounding audit.

Audit exemption for private companies in South Africa is a relatively new concept, first implemented in 2011. The government of South Africa has determined that private companies above a certain threshold needs to undergo an audit. Many researchers globally have assessed the effect of increasing the audit exemption threshold in other countries. However, limited research on this matter has been conducted in South Africa even though audit exemption has been in place for the past nine years. This

chapter provided an overview of the origin of audit and the stakeholder and shareholder theories. It briefly looked at how audit has changed in South Africa since its initial implementation. The chapter further defines the research problem as “to what extent, if any, does the audit exemption threshold in South Africa differ from the audit exemption thresholds in other countries”.

An overview of the intended research design, sample size and methodology and applicable definitions was provided to answer this research problem. The chapter concludes with a breakdown of the intended research per chapter. This intended research includes a literature review of audit, the examination of the audit exemption threshold in each of the countries in the sample, the exploration of the SME definition in each of the countries in the sample, a comparison of findings and lastly the conclusions based on these findings. In chapter 2, the research design and methodology for this study will be outlined in detail, followed by the literature review on the need and history of audit in chapter 3.

CHAPTER 2: RESEARCH DESIGN AND METHODOLOGY

2.1 Introduction

Research is defined in the Cambridge Dictionary (2019) as “a detailed study of a subject, especially in order to discover new information or reach a new understanding”. In order to carry out research, the researcher needs a conceptual plan that includes suitable methodologies and methods (Adams *et al*., 2007). Moses and Knutsen (2007) explain as follows:

> One useful way to consider this relationship is to think of methods as tools; and methodologies as well-equipped toolboxes. Thus, we can expect electricians to view the world differently than carpenters. Each tradesperson relies on a different mixture of tools or approaches for solving the problem he encounters. This is a good thing: when inappropriate tools are employed, a tradesman can do great damage. Thus, we should not be surprised to find the electrician’s toolbox filled with a different set of tools than those filling the carpenter’s. On the other hand, we should not be surprised to find that the two people sometimes use the same tool.

It then follows that the researcher should carefully consider each tool that is chosen for the task to deliver a successful research report. Chapter 2 aims to describe the methodologies and methods applied in this study.

Mouton (1998) explains two broad types of strategies to be applied in a research study. A “general strategy” refers to a study of certain items as part of a larger population in order to generalise the results from the sample to the larger population (Mouton, 1998). A “contextual study” can mostly be found in the historical and cultural disciplines and aims to investigate phenomenon in an extensive manner (Mouton, 1998). The strategy in this study focused on understanding the phenomenon of audit in each of the selected countries at a given point in time. Therefore, this study can be referred to as a contextual study.

The aim of chapter 2 is to outline the approach that was followed in this study, namely a comparison. The purpose of the comparison was to find similarities and differences between the countries in the sample regarding their audit exemption threshold and definitions of SME. The outline will be set out according to the following:

- research methodology;
- research paradigm;
- research approach;
- research design;
- data collection instruments;
- population and sampling; and
- ethical considerations.

Each of the seven categories listed above will be explored in chapter 2. The secondary objectives, as mentioned in section 1.5, are the following:

- to describe the methodology that will be followed in this study (chapter 2);
- to obtain an understanding of the need and history of audit (chapter 3);
- to investigate the similarities and differences in the audit exemption thresholds in selected countries across the world (chapter 4);
- to investigate the similarities and differences in the SME definition in selected countries across the world (chapter 5);
- to determine through comparison where South Africa finds itself in relation to selected countries across the world, taking into account the underlying shareholder and stakeholder principles (chapter 6); and
- to suggest recommendations for improvement of South Africa's audit exemption threshold (chapter 7).

These objectives were achieved by means of the following procedures:

- A detailed description of the methodology was provided.
- An in-depth literature review was conducted in order to fully understand the origins of the audit environment and how it grew into the current audit setting. This literature review includes a section on the South African audit

environment, as the main aim of this study was to contextualise South Africa in comparison to other countries.

- The contextualisation of audit is presented in chapter 3.
- Chapter 4 starts with an analysis of the current available research on audit exemption and the non-listed company. This analysis forms the basis on which the remainder of chapter 4 is built, namely a literature review on the current applicable audit requirements for non-listed entities in each country in the sample.
- In chapter 5 each country's definition of SME is compared and analysed in order to better understand the non-listed entities and how they are defined in terms of size in each of the countries in the study.
- A PI score was calculated for each of the countries in the sample. The purpose was to compare the countries meaningfully with South Africa regarding audit exemption thresholds and SME definition, as well as to determine South Africa's rank among these countries. The calculations and results are discussed in chapter 6.

Based on the results and findings of the previous chapters, recommendations are proposed in chapter 7.

2.2 Research methodology

Quantitative research explores numerical data mainly through statistical analysis and with the aim to explain research problems (Yilmaz, 2013). The quantitative researcher focuses on a limited number of features in many cases, whereas the qualitative researcher focuses in depth on the similar features of a small number of cases (Ragin & Amoroso, 2011). Yilmaz (2013) states the following:

> A quantitative approach endorses the view that psychological and social phenomena have an objective reality that is independent of the subjects being studied, i.e. the knower or the researcher and the known or subjects are viewed as relatively separate and independent.

Furthermore, qualitative research emphasises words rather than the quantification of numbers (Bryman *et al.*, 2014). The qualitative researcher is more concerned with the

circumstances in which people find themselves and how they make sense of their environments (Maree *et al*., 2016). Another important feature of qualitative research is its focus on a social reality that is constantly shifting (Bryman *et al.,* 2014). Yilmaz (2013) defines qualitative research as a developing, inductive, interpretive and realistic approach to the study of society and processes in their ordinary settings to reveal in vivid terms the connotations that people attach to their understanding of the world. Yilmaz (2013) further contends that the "qualitative paradigm views the relationship between the knower and the known as inextricably connected". Henning *et al.* (2011) state that, through qualitative research, the "what", the "how" and, most importantly, the "why" are explored. The researcher is therefore not only interested in the number of times an event occurred, but also in a deeper understanding of the circumstances that had led to the event.

The aim of chapters 3 to 5 is to describe the "what", "how" and "why" of audit, audit exemption and the SME definition. In these chapters the qualitative research strategy that was employed in the study will become evident, for example, in the richness of descriptions. Chapters 4 and 5 both conclude with a table summarising the information presented in each chapter. In Chapter 6 a comparison is presented of the information from the previous chapters. The similarities and differences across all the countries in the sample are highlighted and discussed.

In the comparison between the audit exemption of the selected countries and of South Africa, the researcher found that South Africa has a unique method of calculating the point of audit exemption, or PI score. In order to draw a clearer comparison between the selected countries, the researcher calculated a hypothetical PI score for each country, presented in chapter 6. Even though numerical values were used, the ultimate aim was to draw an in-depth comparison across the limited number of countries in the study. Therefore, the overall research design of this study was qualitative in nature.

2.3 Research paradigms

2.3.1 Ontological assumptions

De Villiers and Fouché (2015) describe ontology as "the researcher's view of the world, whether from a realist perspective where an external reality exists objectively from the researcher, or from a relativist perspective where reality depends on various

circumstances and factors." Yilmaz (2013) contends that "reality is subjective and multiple" as it is observed by various different people. According to Saunders *et al.* (2017), ontology relates to the realities encountered in particular research.

The researcher in this study holds a relativist view and believes that the realities found in each country in the sample exist independent of the researcher. It was the role of the researcher to discover these realities through the research conducted in this study.

2.3.2 Epistemological assumptions

De Villiers and Fouché (2015) explain epistemology as follows:

> Ontology then translates into epistemology where the questions regarding how the researcher views knowledge are determined. This knowledge can either be based on the experience of the senses which can be observed and obtained by experiments, or be seen as multi-layered and complex where a single phenomenon can be interpreted in several ways. The outcome of the epistemology decisions determines the research paradigm in which the researcher will conduct research.

Yilmaz (2013) argues that the distance between the phenomenon being researched and the researcher must be reduced in order to obtain data that is multifaceted, comprehensive, rich and far-reaching. Bryman *et al.* (2014) contend that epistemology relates to the question of what should be regarded as knowledge within a particular field. Saunders *et al.* (2017) concur by referring to different types of knowledge within the business and management fields, ranging from textual and visual data to numerical data, from interpretations to facts and even stories and fictional accounts which can be considered appropriate.

The main point of reference for obtaining knowledge in this study was the laws and regulations of the selected countries. Since these laws are open to interpretation, the researcher could interpret them differently than intended, as countries set up their laws in unique ways. The researcher posits that various sources were consulted to obtain knowledge which in many instances creates multiple realities as the researcher sometimes needed to rely on another person's interpretation. For example, the reasons why audit exemption was initially introduced, where knowledge is obtained

from a source that is not as factual as a law the knowledge and indirectly the reality conveyed through this source might not be as accurate as a law or regulation would have been.

Epistemology comprises three main research paradigms, namely positivism, realism and interpretivism (Bryman *et al.,* 2014). According to De Villiers and Fouché (2015), only two main paradigms stand out in the literature. Each of the two paradigms will be discussed below.

2.3.2.1 Positivism

The aim of philosophical paradigms is to produce “law-like generalisations” by observing social reality in the natural sciences (Saunders *et al.*, 2017). Maree *et al*. (2016) describe positivism as a paradigm in which only the observable and objective can be used as the basis for any type of understanding. Neuman (2011), on the other hand, contends that, when positivism is applied in the social sciences, it can be described as “an organised method for combining deductive logic with precise empirical observations of individual behaviour in order to discover and confirm a set of probabilistic causal laws that can be used to predict general patterns of human activity.”

Positivism was not adopted as paradigm for the study at hand. The reason was that the study aimed to investigate the differences between laws and regulations from various countries. The study did not intend to draw “law-like generalisations” nor predict any type of human activity, but to gain a deeper understanding of each country instead.

2.3.2.2 Interpretivism

Because humans differ from the physical phenomena which are studied in the natural sciences – mainly as a result of our ability to create meaning – they cannot be studied in the same manner and with the same approach as physical phenomena (Saunders *et al.,* 2017). Saunders *et al.* (2017) further argue:

> As different people of different cultural backgrounds, under different circumstances and at different times make different meanings, and so create and

experience different social realities, interpretivists are critical of the positivist attempts to discover definite, universal “laws” that apply to everybody. Rather they believe that rich insights into humanity are lost if such complexity is reduced entirely to a series of lawlike generalisations.

Each country in this study went through a complex process to get to the point where they are now in relation to audit exemption and the SME threshold. A multitude of social interactions among role players precede the ultimate decision of whether to implement audit exemption and, if so, at what level to set the audit exemption threshold.

In most countries, a new law or regulation is released for commentary from those affected before it is implemented. In this regard, lawyers, the public at large and all affected parties drive their own agenda. For example, the majority of auditors might be worried that they would lose work if the audit exemption threshold is set too high. In contrast, government departments want to set the threshold high to help lighten the “burden” on companies. Others, like banks and tax collectors, would like all sets of financial statements to undergo an audit in order to place greater reliance on such financial statements.

The researcher aims to give more than the facts on when audit exemption was first implemented and what the current position is. Attention will also be paid to the events that have led to the countries’ current position on audit exemption; the purpose being to better understand the interactions between the parties involved.

2.3.3 Methodological assumptions

As mentioned above, a qualitative inductive approach was followed in this study. Accordingly, the researcher made some methodological assumptions since it was anticipated that her own experience would influence the interpretation of the raw data. The researcher processed the raw data and identified similarities and differences through this process. The experience of the researcher contributed to the conclusions drawn the data.

2.4 Research approach

There are three types of research approaches, according to Saunders *et al.* (2017), namely deductive, inductive and abductive approaches.

In a deductive approach, theory guides the research, as opposed to an inductive approach where the research produces a theory (Bryman *et al.,* 2014). According to Mouton (1998), a deductive inference follows the premise and is already included in the premise. By interpreting data and information, generalisable inferences can be drawn (Bryman *et al.,* 2014). Research in the natural sciences shows a preference for the deductive approach where "laws present the basis of explanation, allow the anticipation of phenomena, predict their occurrence and therefore permit them to be controlled" (Saunders *et al.*, 2017). The deductive research approach involves a search for patterns and pluralism with a minor use of numerical keys (Yilmaz, 2013). The deductive approach thus follows a pre-anticipated design, that is, the research is performed with an anticipated result in mind before it is completed. However, not all inferences made from data can be clearly connected to a theory. In some instances, the results can be better described as "interesting and illuminating findings" (Bryman *et al.,* 2014) and are perhaps then an indication of something else.

An inductive analysis starts with specific interpretations and builds towards universal patterns (Patton, 2015). The inductive approach does not start with a specific hypothesis which is tested subsequently, but with an idea which is explored through the research process (Patton, 2015). Mouton (1998) notes that when inferences go beyond the premise, it is called an inductive approach. The strength of the inductive approach is that it allows the researcher to develop insight into the subjects' interaction with one another and the world, without pre-empting the results based on a fixed set of rules (Saunders *et al.*, 2017). We can say that the inductive process helps us develop a theory by means of the exploration process.

The abductive approach starts with a surprising question/fact and then works out what a "plausible" theory could be for the occurrence of the surprising question/fact (Saunders *et al.*, 2017). This approach is in essence a combination of the deductive and inductive approaches, as it works both from a theory and towards a theory.

This study explored the audit exemption threshold and the SME definition. It aimed to understand the "why", "how" and "when" of these concepts in selected countries in order to generate recommendations for the South African environment. Therefore, the study primarily followed an inductive approach.

2.4.1 Theoretical framework

This study was based on two main theories, namely agency theory (shareholder) and stakeholder theory (wider community). Both theories played a role in developing the audit landscape as we know it today (Andreasson, 2011; West, 2006).

2.5 Research design

There are five major research designs, namely experimental, cross-sectional, longitudinal, case study and comparative designs (Bryman *et al.,* 2014). Bryman *et al.* (2014) mention that the design of a study provides the structure which eventually guides the use of a method for the study and the analysis of the data collected.

A comparative design was used in this study. According to Bryman *et al.* (2014), "[t]he advantage of any kind of comparison is that we can understand any phenomenon better if we compare it to something similar to it". An important feature of the comparative design is that it allows the differences among the various cases involved to trigger academic reflections about opposing conclusions (Bryman *et al.,* 2014). The comparative design is especially prominent in business research (Bryman *et al.,* 2014).

In this study the audit exemption threshold and SME definition of the sample of countries (refer to section 2.6 for the sample description) were compared with the aim to identify similarities and differences. In order to meaningfully compare the audit exemption threshold of the selected countries with that of South Africa, a hypothetical PI score was calculated for each country based on the rules of South Africa's calculation of the PI score. A similar approach was followed for SME definitions, where a hypothetical PI score was calculated and compared. These two sets of scores were first compared among the countries in the sample for audit on its own and then for the SME definition on its own followed by a comparison between audit and the SME

definition to gain deeper insight. The scores ultimately enabled the researcher to make recommendations based on this comparison.

2.6 Data collection instruments

The most commonly used techniques for data collections are documents or textual data, observation and interviews (Maree *et al.*, 2016). The data used in this study were in the form of documents and textual data on which secondary analysis was performed. One of the focus areas of the qualitative researcher when collecting data is to identify the commonalities between the subjects (Ragin & Amaroso, 2011). The documents which the researcher gathered to identify these commonalities were as follows:

- archival documents;
- peer-reviewed international and South African academic articles;
- academic books;
- publications in newspapers and magazines;
- government and professional bodies' publications regarding audit, SMEs and company statistics;
- laws and regulations; and
- internet sources.

As explained in paragraph 1.6.2, the comparison of the countries in this study was done according to the following seven themes:

1. date when audit exemption was introduced;
2. turnover threshold;
3. employee threshold;
4. asset threshold;
5. third party liabilities threshold;
6. shareholder threshold; and
7. SME threshold.

Theme 1 to 6 will be addressed in chapter 4 and theme 7 in chapter 5.

The trustworthiness of qualitative data is assessed according to four criteria, namely credibility, transferability, dependability and confirmability (Maree *et al.*, 2016).

2.6.1 Credibility

According to Maree *et al.* (2016), credibility pertains to whether the research is believable and consistent with reality.

2.6.2 Transferability

Transferability refers to two questions: firstly, how typical are the research participants in the manner being studied and, secondly, can the conclusions reached in this study be generalised based on the perspective of the researcher (Maree *et al.*, 2016).

2.6.3 Dependability

Maree *et al.* (2016) view dependability as being "demonstrated through the research design and its implementation." In other words, dependability can be described as the detailed account of the process that was followed and the decisions that were made to reach the conclusions of the research.

2.6.4 Confirmability

Confirmability refers to the level of researcher bias involved in the study (Maree *et al.*, 2016). In order to increase the trustworthiness of the data in this study, the researcher followed the steps listed below:

Table 2-1: Steps taken to enhance the trustworthiness of the qualitative data

Criteria	Strategy	Description
Dependability	Provide context	The main method of ensuring trustworthiness of the qualitative data in this study was to provide a proper contextualisation. A description of the core context of this study can be found in chapters 1 and 3. To enhance this context, an ongoing literature

Criteria	Strategy	Description
		review was undertook during the course of the study.
Credibility and dependability	Control for bias	The researcher needed to ensure the study was not biased and the results were not based on her expectations at the beginning of the study. This was achieved by seeking expert advice from supervisors regarding interpretations made by the researcher.
Credibility	Identify and state limitations upfront	The limitations of the study were identified and clearly described in this study.
Transferability, credibility and confirmability	Use low inference descriptors	The researcher provided accurate and detailed accounts of sources.
Transferability	Avoid generalisations	In order to gain the best possible understanding of each country's situation, the researcher avoided generalisations regarding the countries.

Source: Maree et al. *(2016) applied by the researcher*

2.7 Population and sampling

Purposeful sampling is a key concept in qualitative research (Yilmaz, 2013). The logic behind purposeful sampling lies in the selection of "information rich" cases from which a significant amount of information can be derived (Patton, 2015). This type of focused sampling in qualitative research yields better results and leads to the selection of cases that would most definitely contribute to the study (Patton, 2015). The main aim with this type of sampling is to select a small number of specific cases that will produce a wealth of information regarding the phenomenon under study (Yilmaz, 2013). According to Ragin and Amaroso (2011), the researcher obtains a deeper and enriched representation by studying the same phenomenon over multiple instances.

In this study, group characteristic sampling was performed to select the sample, as each country was chosen based on the fact that they could contribute specific information to inform and illuminate the important group patterns (Patton, 2015). The sampling method can further be described as maximum variation (heterogeneity) sampling (Patton, 2015). A wide variety of countries were chosen in this study to be analysed with regard to their audit exemption threshold and SME definition. This was done for two distinct purposes (Patton, 2015):

1. to document the diversity within each country; and
2. to identify important patterns that are common across the different countries.

There is no minimum or maximum prescription for sample sizes in general. Patton (2015) contends that, when a researcher is trying to explore a phenomenon from a larger sample size, less depth is needed to fully understand the phenomenon. The table below lists the countries selected in the sample with the reason for each selection.

Table 2-2: Countries included in the sample and the reason for inclusion

Country	Reason
Australia	Australia was chosen as a developed country that has been implementing audit exemption since 1995.
Brazil	Brazil was chosen as a developing country and a BRICS member that has implemented audit exemption recently.
Canada	Canada was chosen as a developed country that has been implementing audit exemption since 1994.
Russia	Russia was chosen as a developing country and a BRICS member that has implemented audit exemption recently.
South Africa	South Africa was chosen as the main country to research as it is the country where the research was conducted.
UK	The UK, consisting of England, Scotland, Whales (together known as Great Britain) and Northern Ireland, was chosen because the South African legal system is based on a combination of European civil law systems and English common law (SCA, 2019). The UK was also chosen since a

Country	Reason
	myriad of research has been conducted in the UK with regard to audit exemption.
USA	The USA was chosen as a developed country that has been providing audit exemption to all its non-listed entities since the introduction of audit to listed entities in 1933.

Source: Author

The sample above represents developed countries that have long been applying audit exemption (USA, UK, Australia and Canada), as well as developing countries that are in the early stages of audit exemption (South Africa, Russia and Brazil).

2.8 Ethical consideration

The North-West University granted ethical approval for this research project (NWU-00348-18-A4). Given the fact that no third parties were involved through empirical research, for example, interviews or questionnaires, there was a reduced risk of unethical conduct by the researcher. The research in this study focused on the audit exemption threshold and the SME definition in selected countries. The final threshold per country does not necessarily serve as an indicator of effectiveness of the thresholds, it is merely a score that reflects the decisions made in each country according to their needs.

A potential pitfall was research bias and the risk that the researcher would exclude articles that do not support the research. The risk was reduced since only articles were included that were deemed relevant to the field of audit exemption in non-listed entities. These articles are discussed in detail in the study and instances of disagreement between articles and the current study are pointed out.

2.9 Chapter summary

The table below provides a summary of the phases in this study and the methods employed.

Table 2-3: Summary of phases and methods employed in the study

Phase	Research design	Method	Map to results
1	Literature review	Qualitative	Chapter 3
2	Comparison	Qualitative	Chapters 4 and 6
3	Comparison	Qualitative	Chapter 5

Source: Researcher

The focus of this chapter was to outline the methodology that will be used in the study. A qualitative inductive approach was followed with an interpretivism research paradigm. The research design in this study is that of a comparison which seeks to identify similarities and differences between the countries identified in the sample. The countries were selected in this study through group characteristic sampling. These countries included, Australia, Brazil, Canada, Russia, South Africa, United Kingdom and the United States of America.

Secondary analysis was performed on documents as well as textual data in this study. Various sources were consulted to obtain the textual data which included laws, government documents, thesis, dissertations, academic articles and books to name a few.

In chapter 3, the literature review will be presented. The purpose of the literature review was to contextualise the current audit environment and the origins of audit. This contextualisation includes how the role of the auditor has evolved from the earliest centuries to the external audit function we recognise today. This chapter also contains a section on the audit environment in South Africa as it stands currently.

CHAPTER 3: THE NEED FOR AUDIT

3.1 Introduction

Since the beginning of time, doubts and uncertainties caused by human interactions and activities have led to a need for verification to minimise suspicion (Lee, 1993). Today, verification occurs daily in many different forms (Lee, 1993). Examples include checking that all items ordered have been delivered, searching customers before they leave the store to ensure they do not leave with unpaid goods, or counting money before it is accepted as payment.

In a formalised form, this type of verification has the basic structure of an audit. Lee (1993) argues that the need for an auditor is a societal one since audit helps with the conduct of human affairs and accountability in general. An audit can further be described as a societal control mechanism, as it assists in stabilising human relationships by holding individuals or organisations accountable for their actions through verification (Lee, 1993). Sherwood (1979) compares an audit with a safety belt: Even though a safety belt does not prevent all disasters, it is a necessary imperfect piece of equipment which should reduce the risk of injury to all those involved. Similarly, an audit helps to control companies to reduce the risk to all those involved in the company, whether shareholders, directors, employees or creditors (Sherwood, 1979).

This chapter explores the origins of audit and how audit was first incorporated into society. In order to compare the different countries with regard to their audit exemption thresholds, it is necessary to understand the importance of audit, where it started and how it has evolved over time.

3.2 Audit history

The term “audit” originated from the Latin word *audire* which means “to hear” (Puttick, 2003). A secondary meaning of the word “auditor” was already in use in the earliest civilisations (Puttick, 2003). In those days, an owner would appoint a steward to look after his possessions and wealth (Puttick, 2003). From time to time the steward would need to account to his master and explain which items were still in his possession,

which were sold and what was acquired (Puttick, 2003). The master would listen to his steward and ask him questions based on the information provided (Puttick, 2003). As the master was the listener, he was, therefore, the auditor and in essence the “one who satisfies himself as to the truths of the accounting of another” (Puttick, 2003).

Auditing has always been a consistent feature of structured human activity (Lee, 1993). As far back as ancient times, civilisations had their own form of auditing. For example, the Egyptians required two separate officials to record all fiscal receipts, while the Greeks imposed checking-clerks who checked public accounts of officials at the end of their terms. The Romans recognised the distinction between the person who authorises expenses and the person who handles the cash which led to an elaborate system of checks and counter-checks between the different officials (Brown, 2003).

3.2.1 Ownership structures and the need for auditing

The initial structures for the non-listed company originated from the medieval Italian *en commentate* partnership of the 12th and 13th centuries (Edwards, 1989). The underlying concept of this scheme was that a nobleman could provide capital to a reliable merchant in exchange for profit, with both parties understanding that the nobleman is only liable to the extent that he provided capital (Edwards, 1989). The use of this scheme spread to other European countries and was later codified into law by Louis XIV through the formation of *societies en commandite* (Edwards, 1989). The more removed the shareholders (noblemen) became from the day-to-day transactions as a result of these types of companies, the greater the need became for auditors to act as agents to hold managers (merchants) accountable for their work.

Mandatory audit was first introduced in Britain in 1844 for all types of companies (Competition Commission, 2011). The modern-day non-listed company took its form in 1855 when investors first obtained the benefits of limited liability ownership (Siebrits, 2019). This type of company grew over the next century and a half to such an extent that it is now viewed as the “dominant institution of our time” (Siebrits, 2019). The non-listed company was given the freedom to choose whether it wanted to have its financial statements audited when government made audit optional for them in 1856 (Competition Commission, 2011).

In the mid-19th century, a new level of separation of ownership was reached when auditing started to gather momentum in Britain due to the expanding economy and technological progress. These developments were mainly caused by massive investments needed in the railway industry (Kitchen, 1988). In turn, these changes resulted in significant expansions in the banking industry and transformation of capital markets (Kitchen, 1988). The Companies Amendment Regulations 572 of 1900 formalised the legal requirement for all limited companies to undergo an audit in Britain, where previously only certain companies were required to do so (Boockholdt, 1983).

3.2.2 The expansion of the auditor's role

The British audit requirement exerted much influence on the corporate auditor's role in the USA since the majority of the capital for railways in America was obtained through British stockholders (Boockholdt, 1983). The role of the auditor in the USA was apparent as early as the 1840s and developed through two distinct influences. Firstly, the widely dispersed geographical locations of railway companies created a need for an auditor to discover and prevent fraud by railway agents which, in turn, created the role of internal auditor (Boockholdt, 1983). Secondly, the corporations created to build railroads needed funding from shareholders, which resulted in a separation of ownership and control (Boockholdt, 1983). To address this separation, a natural role developed for a third party to verify the accounts of management (Boockholdt, 1983).

One of the earliest formal accounts by an auditor was that of William Quilter who gave evidence to the House of Lords Select Committee on Railway Audits in 1849 (Kitchen, 1988). He was mainly concerned with the importance of the "double account" system, which was later incorporated into the First Schedule of the Regulation of the Railways Act of 1868, but also provided valuable insights into audits and auditors at the time (Kitchen, 1988). For illustration purposes, an extract is provided below of questions posed to Quilter by Lord Monteagle of Brandon and Quilter's answers (Kitchen, 1988):

> 2218. In going into those accounts, is your attention simply confined to the comparison of the entry and the voucher, or is the proprietary and integrity of

each transaction looked to, as well as the actual fact of whether a certain receipt had occurred, or a certain payment had taken place?

I should not only look at the vouchers, but I should weigh the probability of the transaction itself; that is to say, if it was an invoice, I should consider whether the thing was charged at the proper price.

2219. If it was a payment, whether the payment was duly authorised?

Yes, not merely whether it was made, but whether it ought to have been made.

2220. Therefore, in exercising your functions as you describe, it is not merely a dry arithmetical duty which you perform, but it is one involving the higher powers of judgment?

Any audit, unless conducted in that way, might be done by a clerk, and as an audit would be of no value whatsoever; it would be rather a disadvantage than otherwise, because there would appear to have been an audit, when, in fact, there was none.

It is clear from the above that, as far back as two centuries ago, a significant amount of judgment was needed by auditors to perform their duties. It was not enough to merely go through the motions of checking the documents. Auditors also had to apply themselves and think about the nature of each transaction and whether or not the transaction was appropriate.

3.2.3 Evolution of audit

From the start of audit in Britain in the early 19th century until the 1960s, the auditor was responsible for preparing the accounts of about 60% of their clients. These clients were mostly family-run businesses who did not have the necessary skills to prepare a set of accounts (Matthews, 2013). The main focus of audit work at this stage was to check the postings between the different books, verify the transactions, cast columns and vouch the transactions to support. This is also when the term “ticking and bashing” was coined (Matthews, 2013). These “ticking and bashing” type audits were mainly concerned with checking and ticking every entry from invoice to the bookkeeping records. This description of audit is indeed quite different from the one given by Quilter

in 1849 in which he specifically explained that an auditor is to inspect transactions at a deeper level than mere ticking and bashing (par. 3.2.2).

The significant shift in the audit world occurred in the 1950s as a result of the changes in the accounting and reporting functions. As the accounting function changed from pure bookkeeping to a more complex form of allocating bookkeeping data, so auditors have shifted their attention from the double-entry system to compliance with generally accepted accounting principles (GAAP) (Lee, 1988).

Audit techniques became more sophisticated after the 1960s and more in line with our current understanding of an audit. Below follows a summary of these changes (Matthews, 2013):

- A decline in the preparation of the accounts from the auditor's side could be seen, especially for listed entities. Today, many countries prohibit auditors to prepare the financial statements of listed entities including South Africa.
- Auditors started testing samples instead of verifying every transaction.
- Audit evidence was obtained by testing the client's system (evidence on internal controls) by means of questionnaires and flow charts.
- The focus of testing changed from the profit and loss account to the balance sheet.
- More effort went into the interim stage testing of transactions, leaving the testing of balances for final testing.
- The norm became to follow audit programmes and manuals and to focus more on the planning of the audit.
- Permanent documentation associated with the client increased, especially the formal accumulation of working papers.
- More time was spent on giving clients advice on their business through the management letter.
- Auditors started using computers, which was by far the most significant change in the audit process.

Matthews (2013) found that the change in audit after the 1960s can be ascribed to mergers of British companies. This meant that clients could perform their accounting function since they were more professionally managed, which resulted in auditors' moving to a purer form of auditing (Matthews, 2013). The focus was shifted to the balance sheet and away from the verification of transactions in the profit and loss statement.

Around the 1980s, auditors experienced increasing pressure from clients to reduce their fees in an attempt to cut costs and remain profitable in a competitive world (Matthews, 2013). Thus, to reduce their fees, auditors began to focus on significant areas and areas with the highest risk of error.

3.2.4 Accountability

Flint (1988) argues that an audit is not limited to analysing the accounting data and providing accountability for financial affairs; it also has the value of lending credibility to the financial statements. According to Lee (1993), audit can be interpreted as a "crucial means of operationalising corporate governance and accountability", in other words, a way to control corporate behaviour in general and hold corporate managers accountable in particular.

Rubenstein (1986) identifies three categories of stakeholders to whom a company is accountable:

1. input stakeholders – employees, owners, suppliers and creditors;
2. output stakeholders – consumers, distributors and users of the company's product; and
3. environment stakeholders – the community and local and central government who influence, or are influenced by, the company's performance.

The groups to whom corporate managers are accountable have increased significantly over the last 60 years and now include input, output and environmental stakeholders, as well as the public at large (Porter, 2009). The following table summarises the change in societal norms since 1920. It shows how companies with increased power in society have become increasingly accountable to various stakeholders over time:

Table 3-1: Extension of corporate accountability

Company managers	Approximate periods			
	Pre-1920s	1920s-1960s	1960s-1990s	1990s-present
Accountable to...	Shareholders Creditors	Shareholders Creditors Investors Analysts	Shareholders Creditors Employees Suppliers Customers Investors Analysts Government (Stakeholders)	Shareholders Creditors Employees Suppliers Customers Investors Analysts Government General public (society at large)
Accountable for...	Honest, authorised use of funds	Honest, authorised, efficient and effective use of funds	Honest, authorised, efficient and effective use of funds, and socially responsible behaviour (e.g. pollution prevention)	Honest, authorised, efficient and effective use of funds, socially responsible behaviour (e.g. environmental, social and ethical), and effective corporate governance

(Source: Porter, 2009)

It is evident from the above that, as time went by, management was held more accountable, not only by a wider range of stakeholders, but also for additional items. Furthermore, not only has the subject matter for which the auditor is responsible come under scrutiny in the past 40 years, but also those towards whom the auditor has a responsibility (Lee, 1988). The changes in management's accountability had a direct impact on the auditor's role and therefore increased the complexity of an audit. Lee (1988) contends that the role of the auditor has been an ever-changing one. As the responsibilities of the auditor became clearer by defining the terms of professionalism and the skills needed to be an auditor, so did society's expectations of the auditor expand. As a result, it appears that the audit profession is always under fire (Lee, 1988).

3.2.5 Changes to accounting and their impact on the audit

Management's accountability has been influenced by the changes in the accounting domain, and these changes have had a direct impact on the role of the auditor. The focus of the modern audit is the result of the accounting process, i.e. the financial statements (Lee, 1988). It is therefore essential that attention be paid to the changes in accounting. Edwards (1989) claims that accounting did not develop along a structured path. According to Edwards (1989), the significant changes in accounting came as a result of reasonable adjustments to new circumstances and did not follow a logical pattern. He notes that the changes in accounting can be ascribed to two broad elements. The first element is an initial innovation, which is followed by the second element, namely the dispersal of new practices.

Initial innovation occurs because of an interplay of circumstances in a particular place and point of time. Examples include the result of regulation or a response to alleged needs. Changes in regulation applicable to companies have had a direct impact on the accountability of management and, therefore, the accounting function. Accounting has also changed according to the needs of the users of financial statements.

Edwards (1989) notes that the second element takes place through activities which have been described as "change agents" and "targets". One example of these changes can be seen in the "shock effect" that scandals have had on the process of accounting. Edwards emphasises that the changes that have taken place in the

accounting world are not necessarily advancements. During the 1920s, the financial reports of companies became more secretive than previously, as directors attempted to hide the effects of the general economic recession on their companies. Even though steps were taken by accountants to stop these activities, directors continued to report what they want the users to believe, instead of what actually occurred (Edwards, 1989).

With the arrival of multinational corporations, the accountability of management expanded further, as well as the complexity of audit. These corporations can have budgets far exceeding various national economies (Rossouw, 2019). This means that these corporations also have significant influence on society, which inevitably brings responsibility towards society (Rossouw, 2019). Integrated reporting and sustainability frameworks were developed as a result of the influence of these corporations on society and the environment (Rossouw, 2019).

In the early days of financial statements as we know them today, the emphasis was mainly on single reporting, which focused only on the financial statements. Then the concept of triple bottom line (TBL) reporting was introduced (Rossouw, 2019). In 1994 John Elkington (2018) coined this term, which refers to the idea that a company should produce a report that takes into account all costs associated with doing business in relation to profit, people and the planet (The Economist, 2009). According to Papmehl (2002), “a triple-bottom-line report discloses three interrelated organizational imperatives – economic prosperity, environmental integrity and social contribution”. TBL reporting was driven by many factors, including (Papmehl, 2002):

- All stakeholders of the company have “unprecedented” access to the information of the company through the use of technology.
- Certain funds allow only socially responsible companies to form part of the fund and many companies strive to become part of the fund.
- Stakeholders are demanding more comprehensive reporting for their decision making.
- Share prices perform better when a company makes use of TBL reporting.

In 2018, Elkington recalled the term TBL. He explained that, although it had a significant impact on the sustainability sector and companies moving towards a report to disclose the full cost of doing business, the original idea was much wider than this. The intention was to “provoke deeper thinking about capitalism and its future, but many early adopters understood the concept as a balancing act, adopting a trade-off mentality. Profit first, then people and planet” (Elkington, 2018). Although the vast majority of companies missed the boat, a handful did get it (Elkington, 2018). For example, Covestro, a German company, stated that the TBL concept means progress on at least two of the dimensions while the third remains unaffected (Elkington, 2018).

The last few decades saw a shift in how corporations are viewed (Rossouw, 2019). Corporations are now recognised as “moral agents with moral obligations towards society” (Rossouw, 2019). Ultimately, shareholders have a vital place in business; however, the needs of various other stakeholders have also gained standing (Rossouw, 2019). These shifts have not only changed the way we see corporations, but have also had immense consequences for the way in which they have to account for their social, economic and environmental performance (Rossouw, 2019). Consequently, accountants have been called up, due to their experience in financial accounting, to take the lead in social and environmental reporting (Rossouw, 2019). Where there are accountants, auditors will need to audit. Thus, auditors were being tasked to audit all reports including the financial reports, social reports and environmental reports (Rossouw, 2019).

Historically, audit has been understood to involve the auditing of financial statements. However, the audit function has broadened significantly to include non-financial activities and non-accounting data. Within traditional accounting, there has been pressure for change, because the traditional objectives have been changing as well (Flint, 1988).

3.3 The role and purpose of audit

Every type of business requires credible financial information in order for users to make the correct decisions. When there is doubt about the integrity of information, confidence in the business will suffer (ICAEW, 2009a). Wallace (2004) explains as follows:

> the reality is that an auditor must understand the economic entity being audited, be able to explain the information systems and technological infrastructure in which information is generated, recorded, aggregated, and interpreted, and sceptically consider the interplay of inherent, control, and detection risk factors that involve a combination of controllable and uncontrollable elements including the ingenuity of the human race.

An audit is required where there is a duty of accountability between parties. Audit is therefore used to ensure this accountability between the parties. In other words, audit is a control mechanism to monitor behaviour and performance and to secure and enforce accountability. Audit is an evolving process which responds to the changing expectations regarding the performance or conduct of the individuals or organisations where it is performed (Flint, 1988). The audit process is designed to assess compliance with predetermined norms of acceptable behaviour, which makes audit culturally, socially and politically dependent. Audit exists because the people interested in the results of an audit are unable to obtain the information themselves due to different reasons (Flint, 1988).

Since early times, financial information has been used to deceive. Furthermore, persistent conflict between management and the reporting accountant/auditor is evident throughout history (Edwards, 1989). An early example of this type of deception is Venetian traders, who kept two sets of books: one to show customers and one to show suppliers (Edwards, 1989). The absence of reliable information has, on many occasions, forced intense speculation in corporate securities, resulting in dramatic failure (Flint, 1988).

In order to fully understand audit and the need thereof, one needs to examine the interplay between fraud/misrepresentation and audit, the demand for audit, and the regulation of audit.

3.3.1 Fraud

The word “fraud” has become synonymous with Enron and the fall of one of the Big Five audit firms in 2001. Enron, a company that once was worth $60 billion in market capitalisation, went out of business as a result of one of the biggest accounting scandals in the last few decades (Prinsloo, 2019). The scandal caused both Enron

and its audit firm, Arthur Anderson, to go out of business (Prinsloo, 2019). Siebrits (2019) describes Enron as a:

> seemingly well governed company: it had a well-structured board of directors, a textbook code of ethics, its CEO proclaimed that the company was guided by sound principles, and it received clean audit reports from a respected audit firm, Arthur Andersen, etc.

Enron went bankrupt because of its size, the perceived good reputation of both the company and its auditors, and the lack of ethical conduct from the management of both the company and the audit firm (Prinsloo, 2019).

According to Prinsloo (2019), remedial action was taken after the fall of Enron in many forms, for example:

- the Sarbanes-Oxley Act and SAS 99 in the USA;
- the Auditing Profession Act 26 of 2005 in South Africa;
- the Companies Act 71 of 2008;
- the introduction and tougher implementation of codes of professional conduct by professional bodies;
- the issuing of more onerous audit standards; and
- the enforcement of harsher monitoring by the regulators of audit firms.

The Enron scandal directly led to the adoption of ISA 240 R, “The auditor’s responsibilities relating to fraud in an audit of financial statements”. This standard sets out specific requirements of the auditor. For example, the auditor must maintain professional scepticism throughout the audit, investigate deeper when the responses from those charged with governance and management are inconsistent, and discuss with team members their thoughts on where fraud might exist in the financial statements. The standard further explains that there is a higher risk of an auditor not detecting a misstatement due to fraud than detecting a misstatement due to error.

Dr Joseph T. Wells, the founder of the Association of Certified Fraud Examiners (ACFE), recognised the flaws in the attempts of businesses to prevent, detect and investigate fraud. This led him to publish the first Report to the Nation in 1996. The 2018 Report to the Nations was based on 2 690 real cases of occupational fraud from

125 countries. The aim of this report was to help businesses and fraud detectors understand “how fraud is committed, how it is detected, who commits it, and how organisations can protect themselves from it” (ACFE, 2018). In 2018, a case involving organisational fraud could cost a business R2 million (ACFE, 2018).

Fraud is divided into three main categories, namely asset misappropriation, corruption, and financial statement fraud (ACFE, 2018). The most common type of organisational fraud is asset misappropriation. This makes up 89% of the cases in the 2018 ACFE report and is also the least costly, approximately R1.7 million per case (ACFE, 2018). Corruption is the second least likely form of occupational fraud, leading to losses of about R3.8 million per case (ACFE, 2018). Financial statement fraud is the least occurring type of occupational fraud, however, the most expensive, with potential losses of approximately R12 million per case (ACFE, 2018).

Occupational fraud, in terms of the three categories mentioned above, is mainly detected through anonymous tips (40%), followed by internal audit (15%), management review (13%) and in seventh place external audit (4%) (ACFE, 2018). Even though external audit only detects occupational fraud in 4% of the cases, the presence of an external audit of financial statements reduces the median loss with 29% and the duration of fraud with 38% (ACFE, 2018). Where external audits were performed of the internal controls of financial reporting, the median loss and duration of fraud were reduced by 50% (ACFE, 2018).

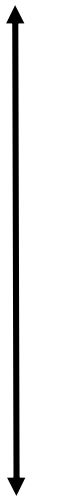
From the above, it is evident that, although auditors are neither appointed nor equipped to find all fraud in an entity, the audit plays a vital role in deterring fraud and reducing the duration of fraud within an organisation.

3.3.2 Level of assurance associated with an audit

The term “assurance” refers to the level of confidence that the users of a certain product can place on that product (CPA Australia, 2019). According to the International Framework for Assurance Engagements (IFAC, 2005), the term is best described as a “conclusion designed to enhance the degree of confidence of the intended users, other than the responsible party, about the outcome of the evaluation or measurement of a subject matter against the criteria”. Auditors provide different types of services,

each of which is associated with a different level of assurance. Figure 3-1 below illustrates the different types of assurance engagements.

Figure 3-1: Different levels of assurance associated with different services



Type of assurance	Example
Absolute assurance	A guarantee
Reasonable assurance	An audit of financial statements
Limited assurance	A review of financial statements
No assurance	Preparing financial statements on behalf of management (compilation engagement)

(Source: CPA Australia, 2019)

Figure 3-1 above clearly shows that an audit of financial statements provides the users with reasonable assurance, however, not with absolute assurance. In other words, the auditor cannot provide a guarantee to the users of the financial statements that there are no misstatements contained in the financial statements. Figure 3-1 also indicates that an audit provides more assurance than a review engagement, and that a compilation of financial statements engagement provides users with no assurance. Owing to the inherent limitations of an audit, it is impossible for the auditor to conclude that financial statements are absolutely free from material misstatements (ISA 200).

The reasons why an external audit cannot provide absolute assurance are (Jackson & Stent, 2016):

- **The nature of financial reporting:** The financial statements include estimates which are based on management's judgement. For example, judgement is applied in estimates whether a debtor will pay in the next six months; even then the outcome is not certain.
- **The nature of audit procedures:** There are many limitations inherent to audit procedures. For example, audit procedures are not designed to detect fraud,

as fraud detection is not the main aim of an audit. Also, management might withhold information from the auditor without the auditor detecting it.

- **Audit evidence is usually persuasive rather than conclusive:** Since auditors are not present when transactions take place, they are persuaded by the documents involved in such transactions. Thus, there remains the chance of false documents being presented to the auditor, or of management not telling the full truth regarding a transaction.
- **The use of sampling:** Because they cannot test every single transaction in a company due to time and money constraints, auditors test a sample of transactions. As a result, they are never 100% certain that there are no misstatements contained in the remaining balance which was not tested.
- **The inherent limitations of accounting and internal control systems:** Auditors test a sample of transactions to determine whether or not they can rely on the client's internal control systems. This sample might lead them to believe the internal controls are working when, in fact, the controls are not able to detect all errors and fraud.
- **Timeliness of financial reporting and the balance between benefit and cost:** In order to add true value, the auditor needs to report on the financial statements as soon as possible after the year end of the company. But reporting within a set time frame means that certain elements of the audit might be compromised. However, the user of the audit opinion understands this fact.
- **Other matters that affect the inherent limitations of an audit:** Many uncertainties in the financial statements cause additional difficulties and limitations for the audit. These include the presence and effect of fraud, ascertaining the level of compliance to laws and regulations, identifying and evaluating future events which might have an impact on going concern in the next 12 months, and determining with certainty that all related party transactions have been disclosed.

Owing to the inherent limitations discussed above, the work of the auditor is more focused on yielding results that are persuasive rather than conclusive (ISA 200).

3.3.3 The demand for an audit

There are four general reasons that explain the likely demand for an audit. Firstly, if the management of a company are not submitted to third party inspection, they could become careless or behave inappropriately (Knechel *et al*., 2007). Knowing that they will be subject to the scrutiny of an audit might cause management to be more cautious. Secondly, the proper evaluation of financial statements requires a certain level of expertise which the stakeholders might not possess (Knechel *et al*., 2007). This gap will be filled when the appropriate level of knowledge is applied through an audit. Thirdly, investors need financial reports to make investment decisions. The more reliable these reports are, the less risky the investment will be (Knechel *et al*., 2007). When the financial reports are reliable, the company's cost of capital is reduced. This reduction occurs as a result of the reduced risk associated with the investment. Lastly, an audit provides reasonable assurance to investors and creditors that the information is reliable, serving as a form of insurance against significant errors or fraud (Knechel *et al*., 2007).

Following on the above, a natural role develops in a company to reduce information asymmetry and questionable ethics. The auditor is seen as a trusted mediator of the information. The role of the auditor is to evaluate this information and ultimately conclude whether the information is impartial, pertinent, reliable and logical (Knechel *et al*., 2007). This role is performed by the auditor on behalf of the shareholders, thereby acting as their agent who provides them with valuable information.

3.3.4 The regulation of audit

Audit is a matter of such social importance that it is regulated by government. In the interest of public, government has the responsibility to be satisfied that auditors obey appropriate standards of knowledge, training and experience and adhere to a high level of skill (Flint, 1988). For example, in South Africa, auditors must adhere to the Auditing Profession Act 26 of 2005. Similarly, each of the countries in this study has its own set of rules and regulations applicable to auditors.

3.4 Audit landscape in South Africa

South African auditing professionals find themselves in a particularly challenging environment (Deloitte, 2019). The average CEO and CFO of a listed company in South Africa are under immense pressure from various stakeholders, such as banks and fund managers, to perform well in a sluggish economy with a poor Gross Domestic Product (GDP) of less than 1% (Deloitte, 2019). Auditors not only face challenges from clients, but also due to many other factors like the delivery of consulting services while performing the external audit, budgetary constraints accompanied with time limitations, the fact that audit partners are "sidelined" if they do not meet the revenue targets, and fee-based compensation packages (Prinsloo, 2019). These factors create a difficult environment in which the staff of audit firms have to weigh up tough choices between private and public interest while it is, in fact, their duty as auditors to look after the public interest.

In the past few years there has been an increase in large corporate scandals in South Africa, with controversies at African Bank, Steinhoff, KPMG, Tongaat Hulett and VBS Bank, to name but a few. These scandals, together with the global accounting scandals mentioned above, have placed the auditing industry in South Africa under unprecedented scrutiny. In many instances this scrutiny is certainly justified. For example, in the cases of African Bank and VBS Bank, as outlined below, audit failures clearly, and justly, contributed to the loss of trust in the industry.

3.4.1 African Bank

African Bank and its owner, African Bank Investments Ltd, collapsed in August 2014 owing more than R8 billion to investors and creditors. The reasons for the collapse were unsustainable and unsecured lending and failure to make sufficient provision for bad debts (ICAEW, 2018). The bank was saved by the South African Reserve Bank, which commissioned lawyer John Myburgh to investigate (ICAEW, 2018). In a damning report, Myburgh set out evidence of negligence and reckless behaviour by the board – particularly in relation to loans made to the financially troubled subsidiary, retail chain Ellerines, and levels of bad debt that were understated (ICAEW, 2018).

IRBA conducted a separate investigation into the role of African Bank's auditors. This led to ten charges being levelled against one of the Big Four audit firms and the two

audit partners who signed the 2013 audit report (Brown, 2018). The charges allege that the audit firm gave the bank a clean audit report even though the bank's financial statements contained misstatements about the level of loan impairment and loss provisioning (Brown, 2018). Brown (2018) quotes IRBA CEO, Bernard Agulhas: "The matter has gone to a disciplinary hearing so we believe [there are] good grounds for our charges. We believe there is a strong case for alleged misconduct that we are charging them with." Hearings were set to conclude in the matter in December 2019, however, no findings have been issued by IRBA to date (IRBA, 2019b).

3.4.2 VBS Mutual Bank

After the collapse of VBS, Advocate Terry Motau was called in by the South African Reserve Bank to conduct an investigation and report on the events which had led to the bankruptcy of VBS (Motau, 2018). Motau's report revealed that the business of VBS was indeed conducted in a fraudulent manner, which has resulted in the widespread impoverishment of the bank's depositors (Motau, 2018).

While another one of the Big Four audit firms was the auditor of VBS, the then audit partner who was responsible issued an unqualified audit opinion dated 31 July 2017 on the financial statements of the bank for the year ended 31 March 2017 (Vorster, 2019). The curator of the bank withdrew the financial statements on 16 April 2018 stating that the financial statements were no longer reliable as they contained material misstatements (Vorster, 2019). Motau further found that the audit partner who signed the fraudulent financial statements was compromised and deliberately disguised the fact that he was a beneficiary of various facilities from the bank (Motau, 2018). Motau (2018) concluded that the audit partner willingly played his part in the fraudulent scheme, knowing that the financial statements were grossly inflated and misstated.

In both matters, audit failures occurred as a result of the conduct or lack of action by the auditors and audit firms which created huge losses to the stakeholders of these companies. These and other matters mentioned above show a clear need for reform in the auditing profession in South Africa, which promisingly has begun as discussed below.

A common theme in all these matters is that trust in the profession has been lost and needs to be rebuilt. As such, auditors in South Africa are under even more pressure

than ever before. The managing partner of Deloitte South Africa (Deloitte, 2019) fully supports a:

> complete overhaul of the financial reporting ecosystem and would endorse the introduction of a separate legislation that governs all players involved, including management, those charged with governance and auditors, and establishes a "super-regulator" to regulate the entire financial reporting ecosystem, with powers to effect swift justice.

3.4.3 Latest developments in auditing in South Africa

The 2013 World Bank Report on the Observance of Standards and Codes: Accounting and Auditing (ROSC) made various suggestions to South Africa to improve its financial environment (World Bank, 2013a). These recommendations included:

- provide comprehensive arrangement for supervision of accountancy profession;
- strengthen audit quality review;
- broaden professional education and training;
- strengthen the Financial Reporting Standards Council;
- strengthen professional accountancy organisations;
- introduce limited liability partnerships for audit firms;
- make information accessible to the public; and
- strengthen small- and medium-size practitioners.

Based on these recommendations, IRBA received additional powers in the beginning of 2020 through the amendment of the Financial Matters Amendment Bill (IRBA, 2019a). The following amendments were made:

- Auditors who serve in public practice will no longer be allowed to serve on IRBA's governance structure.
- Clients are no longer allowed to fire their auditors while they are busy filing a reportable irregularity.
- The Investigating Committee now has the power to execute search and seizures and subpoena witnesses.
- There is no longer a maximum limit on fines.

- In order for the disciplinary process to go quicker, the entire process has been simplified.

These new powers granted to IRBA should help the audit profession maintain its credibility in an era where it is constantly under severe scrutiny.

The large audit firms are currently in the process of embracing new technologies in every area possible in audit (IRBA, 2019a). These technologies include artificial intelligence, robotic process automation, data analytics, cloud-based software and drone technology (IRBA, 2019a). The Fourth Industrial Revolution has brought many new challenges and opportunities for auditors, both in large and small firms. However, one of the key challenges remains the pressure on audit firms to meet profit targets in an environment which is growing more complex than ever before.

3.4.4 Corporate governance

South Africa was one of the first countries in the world to implement a corporate governance report, namely King I, shortly after the first release of the Cadbury Report in the UK in the early 1990s (Siebrits, 2019). Currently, South Africa is regarded as having one of the most advanced corporate governance thinking and practices in the world (McGregor, 2011).

There is significantly more focus on the corporate governance of a company today than in the 1980s because of the following two reasons (Siebrits, 2019):

- The degree of separation between owners and management has increased; so too has the number of stakeholders who are affected by the company. Today, the majority of employees who contribute to a retirement fund are indirectly invested in the stock market compared with earlier years when only the wealthy held investments on the stock market. The number of stakeholders increased due to the globalisation of companies, and listed entities operate over several countries with thousands of employees.
- The last 30 years have seen many corporate failures. To name a few abroad and local: WorldCom, Enron, Global Crossing, Merrill Lynch, Royal Bank of Scotland, Saambou, Leisurenet, Fidentia, VBS and Steinhoff.

The King IV report was released in 2016 and is currently the active code on corporate governance in South Africa (Siebrits, 2019). King IV focuses on a stakeholder inclusive approach, which means that all stakeholders enjoy equal rights within the organisation (IoDSA, 2016). It is further important to note that the implementation of good corporate governance will give some form of assurance, but not absolute assurance, against the failure of a company (Siebrits, 2019).

The development of corporate governance for unlisted and small and medium-sized companies is just as important as corporate governance for listed entities (McGregor, 2011). In fact, paragraph 3.10 of the Cadbury Report recommends that all companies, irrespective of their size, ensure that they are responsible for their actions and meet the spirit of the code (Cadbury Committee, 1992).

3.5 Chapter summary

Audit is important to society. The results of an audit have significant social implications since the audit of different establishments is a matter of both private and public concern. Examples of these establishments are industrial and commercial concerns, public boards, state corporations, public utilities, local and central governmental departments, and private associations for business, charitable, recreational or other purposes (Flint, 1988). The audit requirement in each type of establishment depends on many factors, ranging from the social and political philosophy to the morals of the society in which the establishment operates (Flint, 1988). Auditing has to keep up with the changing needs of the establishments it is applied to in order to meet the varying expectations of an ever-evolving society (Flint, 1988).

This chapter not only explored the history and need for audit, but also outlined how audit has evolved over the centuries. The increased complexities, coupled with an increased number of stakeholders in audit, have led to more pressures on the auditor. This, in turn, resulted in the direct correlation of sampling. The increased complexities in the auditing landscape have also led to alternative methods of auditing.

In this chapter it was shown that audit is an integral part of society that helps keep management honest and stakeholders informed. It is therefore vital to the functioning of society and business. Consequently, the investigation of audit exemption thresholds

is certainly relevant, as these thresholds will ultimately determine whether or not an audit must be conducted.

In the next chapter the researcher will report on the literature collected on the dynamics of the non-listed company and audit, and the audit exemption thresholds of each of the seven countries in the study. The chapter will conclude with a table summarising the findings.

CHAPTER 4: THE AUDIT EXEMPTION THRESHOLDS

4.1 Introduction

In the previous chapter, the importance, relevance and context of audit were established through a literature review. It was shown that audit has been present in some form or another since ancient times; initially as a result of the separation between ownership and control, and later as a result of the increase in the number and interests of stakeholders. However, this does not mean that all entities are audited or are even required to be audited. The requirements are typically determined by certain metrics or criteria, commonly referred to as an audit exemption threshold.

The aim of this chapter is to compare the external audit exemption thresholds applicable to the non-listed entities in the countries selected for the study.

Although smaller entities are essential to the economy and markets, little is known about these entities with regard to their accounting and auditing decisions and the results of these decisions (Francis *et al*., 2011). Limited research has been done on the audit of non-listed entities since these types of entities in many countries are not required to disclose their financial statements on a public platform. Thus, the audited and the non-listed cannot be compared as is the case with their listed counterparts (Minnis, 2011). Vanstraelen and Schelleman (2017) found it surprising that research on the non-listed company audit is so restricted considering that it is the non-listed entities who “dominate” in terms of their contributions to employment, capital and the economy. One of the goals of this chapter is to shed light on the current audit legislation applicable to the non-listed entities in the selected countries, thereby contributing to the limited amount of literature currently available.

Governments not only differ on whether or not they require an audit for non-listed entities, they also have different requirements when audit is present. Over time, each government decides to make changes to these requirements due to different reasons (Vanstraelen & Schelleman, 2017). A question arises as a result of the differences between non-listed on whether or not audit is needed in non-listed entities (Vanstraelen & Schelleman, 2017). Dedman *et al.* (2014) argue that many

governments implement mandatory audits because, with voluntary audits, there is a risk that not enough audits will be entered into and the country will miss out on the "elements of public good" brought on through audits. On the other hand, Shukarova-Savovska and Hodge (2016) argue that audit exemption has been implemented in many countries because it would relieve the unnecessary cost burden which falls on the small company. According to Collis *et al.* (2004), an assumption can be made from the legislation, namely that the threshold set for audit exemption is the tipping point where an audit is no longer beneficial in comparison to the costs thereof. This is known as the cost benefit tipping point.

A comparison of the audit threshold requirements of the selected countries will provide deeper insight into the auditing needs of non-listed entities and whether an audit is seen as a cost burden to these entities or a public good brought to the country.

These two contradicting arguments will be explored throughout this chapter. The aim is to clarify which countries allow their non-listed entities the freedom to choose an audit or which of the countries deem an audit as a vital component of good corporate governance in non-listed entities.

4.2 Audit and the non-listed company

According to Knechel *et al.* (2008), there are different reasons for obtaining an audit, depending on the size of the company. Smaller clients will pay for an audit as they have numerous reasons why they think an audit adds value (Shukarova-Savovska & Hodge, 2016). Irrespective of the level of fees paid, a high-quality audit is expected by management (Shukarova-Savovska & Hodge, 2016). Not only does an audit support the trustworthiness of financial statements, but these small non-listed companies value the opinion of their auditors and are willing to pay extra for honest business advice (Shukarova-Savovska & Hodge, 2016).

Collis and Jarvis (2002) claim that the operations in small and large companies differ in complexity which, in turn, reduces the internal and external risk of "moral hazard" for small companies. Examples of internal "moral hazard" are given by Carey *et al*. (2013), namely employees who might commit fraud, skimp on their responsibilities or consume the resources of the company. The less complex an entity, the fewer employees are needed, the less opportunity exists for "moral hazard". This, in turn, will

also reduce the need for audit. On the other hand, Minnis (2011) contends that non-listed entities can reduce any information asymmetry that exists and give more informative financial statements to their lenders when they subject the firm to an external audit.

4.2.1 General factors which drive the need for audit in the non-listed company

Collis *et al.* (2004) identified the main factors which predict the demand for audit, in order of significance, as follows:

- perceived benefits identified by directors;
- education of the chief director;
- size of the company;
- agency relationships between owners; and
- agency relationships between the company and lenders.

Each of these factors are discussed below.

4.2.1.1 Perceived benefits identified by directors

An audit enhances the quality of the financial statements and delivers a check on internal controls (Collis *et al.*, 2004). Management of the small company gain insight into their business through the auditors' identification of weaknesses in internal controls and their recommendations (Shukarova-Savovska & Hodge, 2016). Lastly, auditors can provide valuable business advice to small entities and serve as a mentor to these entities, thereby supporting the growth of the small business and helping it to obtain the necessary access to finance (Shukarova-Savovska & Hodge, 2016).

4.2.1.2 Education of the chief director

The likelihood that a company would voluntarily appoint an auditor increases with the education of the director in charge, irrespective of whether the director has a degree or some form of business management training (Collis *et al.*, 2004).

4.2.1.3 Size of the company

The larger the company in terms of turnover, the more likely the directors will appoint an auditor even if not legislated (Collis *et al.,* 2004).

4.2.1.4 Agency relationship between owners

In instances where the owners are not related, and in many cases where all the owners are not involved in the day-to-day management of the company, an audit is needed in light of agency conflicts (Collis *et al.,* 2004). According to Carey *et al*. (2000), there are two directly measurable characteristics which determine the demand for audit in a family business, namely the percentage of non-family management, and the share of non-family representation on the board of directors.

4.2.1.5 Agency relationship between the company and lenders

Even when an external audit is not legally required, many companies still obtain an audit in order to meet the requirements of their lenders (Collis *et al.,* 2004). Companies who subject themselves to an audit, irrespective of what the law requires, will on average get a lower interest rate, as lenders deem audited financial statements more trustworthy (Minnis, 2011). Carey *et al.* (2000) found a positive correlation between the amount of debt in a company and the demand for voluntary external audit.

4.2.2 Reasons against audit in the non-listed company

A mandatory audit for non-listed entities is not cost-effective for all companies and may not be optimal for everyone from an economic point of view (Vanstraelen & Schelleman, 2017). Shukarova-Savovska and Hodge (2016) contend that the small company audit is extremely unique and carries its own risks. Even though there are more stakeholders involved in a larger company, there is an absence of risks being mitigated in the small companies, since the internal control environments are often underdeveloped and unreliable (Shukarova-Savovska & Hodge, 2016). One of the many challenges auditors face when performing a small company audit is maintaining independence while interacting with the “owner-manager” and trying to establish a role as trusted advisor (Shukarova-Savovska & Hodge, 2016). Another challenge in auditing the non-listed company is that, in many instances, there are no or limited internal controls on which the auditor can rely. This, in turn, increases the costs of the audit (Chung & Narasimhan, 2001). Since each non-listed company is unique, it could be more prudent to offer the company a choice among different types of service. For example, a review engagement might be more appropriate for the non-listed company (Vanstraelen & Schelleman, 2017).

4.3 Previous research on audit and the non-listed company

Certain jurisdictions have performed extensive research on the need for audit in the non-listed company, for example, the UK. This research is included in the literature review as it forms the basis of understanding the dynamics between audit and the non-listed company.

Table 4-1: Previous research on audit for non-listed entities

Year	Country	Researcher(s)	Objective of research and research method	Findings
1993	USA	Abdel-Khalik	To explain why owners of small limited companies voluntarily demand external audit. A survey was sent to 31 non-listed entities, of which approximately 80% had undergone a voluntary audit in the past.	A non-listed entity voluntarily undergoes an audit: • when the company has a loss of control and needs to compensate for a longer chain of command; • when observability of subordinates' actions decreases; and • to comply with creditor-imposed constraints.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2000	Australia	Carey *et al.*	The study investigated the relationship between the demand for voluntary audit for family businesses in an environment where external audit is not required by law. A questionnaire was completed by 186 family businesses. Responses were used to assess the impact of firm characteristics linked to the cost vs. benefit of appointing an auditor.	The study found a positive correlation between the demand for external audit and the presence of non-family agents and directors. It also established that increased levels of external debts seem to result in a higher demand for external auditing. Where agency costs are high (presence of outside interests), there is a correlating demand for external audit.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2001	Hong Kong	Chung and Narasimhan	The study evaluated the perceptions of small limited companies and small audit firms, as audit was mandatory for small limited companies in Hong Kong at the time. A survey was sent to 146 small audit firms and small limited companies, of which 85 usable responses were obtained for further study.	Both the audit firms and the companies believed that the mandatory audit requirement is beneficial for them. No significant difference was found between the responses from the small companies and those from the small audit firms. Respondents also agreed that the audited financial statements provided more reliable information to the users of the financial statements.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2003	Canada	Rennie *et al.*	The researchers studied the deregulation of audit by examining archival documents and responses from a survey completed by 204 CFOs of entities affected by this deregulation.	Seventy-three percent of companies had voluntarily continued with their audits. The top three reasons were: • The lenders required an audit. • The parent company required an audit. • There was a need to provide assurance about the credibility of the financial statements to users and management. The research showed that these companies firmly believed that the benefit of an audit outweighed the cost. The only significant change that the deregulation brought was that stakeholders such as members of the public, employees, special interest groups and labour unions no longer had access to the companies' financial statements, even though almost 75% of the companies continued to make use of an audit.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2004	UK	Collis *et al.*	The study sought to determine the demand for audit in small companies in the UK. Logistic regression analysis was applied, based on a postal questionnaire sent to 2 288 directors of companies. The questionnaire consisted of 33 questions, and 385 useful responses were obtained. The companies in the sample were all considered small according to the EU maxima for audit exemption at the time.	Sixty-three percent of the respondents indicated that they would voluntarily choose to undergo an audit even if an audit was not required by law. The study also found that turnover alone could be used to determine the size of a company; however, size alone does not drive the need for an audit. Perceptions of the value of audit were found to be more important in determining whether or not to appoint an auditor than the size of the company.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2008	UK	Collis	The study investigated directors' views of accounting and auditing requirements for SMEs and draft simplification proposals. A questionnaire was sent to companies below the medium company thresholds at the time (i.e., balance sheet total of less than £12.9 million and less than 250 employees). A total of 1 294 usable responses were received from a list of 9 458 companies.	The vast majority of directors (74%) agreed that the main benefit of an audit is that it provides a check on the accounting records and systems. Two-thirds of respondents thought the benefits outweighed the costs. Out of the companies who had previously had an audit and were now exempt from audit, 54% reported no change in their total accountancy fees (referring to all fees audit and accounting). The directors of 73% of owner-managed medium companies responded that they would continue to voluntarily have an audit even if they were to fall within the exempt portion. Consistency with previous years in relation to the financial statements was a significant factor for most of these companies, as well as the directors' belief that there is value in following the same rules that apply to larger entities. The main users of the financial statements were found to be lenders (67%) and tax authorities (50%).

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2011	USA	Minnis	The study investigated the value of financial statement verification in debt financing for non-listed entities in the USA where audit is voluntary. Minnis obtained access to the data of 25 784 firm years for non-listed entities with at least two consecutive years of information. By means of descriptive statistics, three hypotheses were tested: • H1: Firms without audit bear a higher cost of debt compared to audited firms. • H2: A correlation exists between financial statement ratios and the firms' cost of debt for audited financial statements. • H3: Audited financial statements are a better predictor of cash flows for a year in advance.	Minnis made two major findings. Firstly, more weight seems to be placed on audited financial statements by lenders and, secondly, companies who subject themselves to an audit had a lower cost of debt. Evidence from this study suggests that lenders use audited financial statements "more intensely" when determining the interest rate, resulting in a decreased interest rate of 69 basis points on average. It was also found that net income and accruals are a better predictor of future cash flows in audited financial statements than in unaudited financial statements. This provides evidence for why lenders would place more reliance on audited financial statements when assessing borrowers.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2014	UK	Dedman *et al.*	The study sought to determine the demand for audit in non-listed entities. The researchers tested six hypotheses by means of descriptive statistics and a database with three years of financial information from companies, using a total of 15 013 company years: • "H1: Companies which voluntarily purchase a financial statement audit are larger, more complex, more highly leveraged with greater ownership dispersion and larger boards than companies which choose to opt out of the audit. • "H2: The demand for voluntary audit in non-listed entities does not vary with financial performance,	The most significant finding of this study was that, when audit is not required, companies do not immediately stop requesting an audit, but over time seem to move away from being audited. In 2004, 71% of the companies that were exempt from audit continued to voluntarily undergo an audit. In 2005, only 60% of these companies underwent an audit and, in 2006, this figure dropped to only 52%. • H1 was proven to be true, in that the companies that were audited had higher leverage, as well as a higher number of shareholders compared to the unaudited companies. • The results for H2 showed that audited companies had a significantly lower profit figure than unaudited companies.

Year	Country	Researcher(s)	Objective of research and research method	Findings
			the proportion of risky balance sheet items, and the company's age. • "H3: Companies are more likely to undergo a voluntary audit if they intend to raise capital in the next financial period. • "H4: Non-listed entities that purchased non-audit services from their auditor in the mandatory audit regime will be more likely to retain the audit in the voluntary audit regime. • "H5: Companies who employed a Big4 auditor, and/or paid higher audit fees in 2003, will be more likely to retain the audit after 2004."	• H3 was proven for the first time in research in this field, as findings showed that the audited companies had indeed intended to raise capital in the near future. • The data showed that companies which had purchased non assurance services in the past were more likely to continue with a voluntary audit; therefore, confirming H4. • H5 was also found to be true, namely that any company which had paid significantly higher audit fees in the past were more likely to retain the audit when it became voluntary.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2015	South Africa	Coetzee	The study investigated the impact of mandatory audit relief on the audit practice. Descriptive research was conducted to understand how mandatory audit relief has influenced practices and structures in small- and medium-sized audit firms in South Africa. This was achieved through interviews with audit practitioners, specifically sole proprietors and those in small and medium practices.	The participants all agreed on the need for audit of financial statements as this increases the credibility of the financial statements. Some participants indicated that the small company audit adds value. The majority (all except the sole practitioners) were in favour of implementing the PI score, which means auditing fewer small companies. The participants held the following strong opinions: • The implementation of audit exemption for some companies could lead to fraudulent financial statements. • The current level of 350 at which South Africa sets its PI score is too low and should be increased to 750. • The factors used to calculate the score (e.g. turnover) are not a good reflection of public interest.

Year	Country	Researcher(s)	Objective of research and research method	Findings
				• The time and effort put into an independent review are very similar to that of an audit. The study also found that none of the participants were experienced a decrease in their income streams; they did, however, experience a diversification of their income streams. This was due to a change in the types of services offered to the non-listed companies for which audit was no longer required.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2016	Malaysia	Haron *et al.*	The study investigated the perceptions of auditors in relation to audit exemption for SMEs. Individual auditors were surveyed and 79 usable responses were obtained. Three hypotheses were tested: H1: Larger audit firms will be more likely to support audit exemption. H2: Audit firms that provide non-audit services will more likely support audit exemption. H3: Short audit tenure will lead to a higher likelihood of supporting the audit exemption for SMEs.	Only H1 was proven to be true as the study found that the larger an audit firm the greater the likelihood the firm will embrace audit exemption to the small company.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2017	USA	Minnis and Shroff	The study sought to determine why non-listed entities are regulated in terms of their disclosure and audit requirements. Two surveys were conducted to obtain the views of both regulators and the non-listed entities affected by the regulations. For the first survey, 21 regulators responded from various countries at the International Forum of Accounting Standard Setters (IFASS). The second survey was sent to non-listed entities across Europe, of which 1 477 complete responses were received.	The researchers found that 95% of the regulators and 67% of the non-listed company respondents agreed that the benefits of an audit are equal or greater than the cost. From the non-listed company respondents, 65% indicated that they would continue to undergo an audit even if the regulations were removed. The findings showed that the main concern with an audit is the auditor fees, closely followed by the fact that an audit requires too much of management's time. The respondents were asked to indicate the stakeholders who would benefit from a financial statement audit. Both respondent groups mentioned tax authorities, lenders, creditors, existing shareholders, potential shareholders and government.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher (s)	Objective of research and research method	Findings
2017	UK	Vanstraelen and Schelleman	The study attempted to establish current knowledge regarding the costs and benefits of auditing non-listed entities. To this end, a literature review was conducted.	The study found that there is a diverse range of factors which drive the demand and value for an audit in non-listed entities. The study provided support for the fact that there are economic benefits to the audit of non-listed entities, for example, reduced interest rates, better credit ratings and increased access to credit. It was also found that governments can ensure quality financial reporting through mandatory auditing of the non-listed company. The literature indicated that, when audit is not mandatory, the quality of financial statements decline. The conclusion was reached that alternative services might better serve the non-listed company than an audit. The choice of undergoing a voluntary audit is driven by firm characteristics. These include the size of the firm, amount of debt of the firm, complexity, the solvency of the company, the ownership structure and the quality of the institutional environment.

Table 4-1: Previous research on audit for non-listed entities (continued)

Year	Country	Researcher(s)	Objective of research and research method	Findings
2017	Spain	Palazuelos *et al.*	The study investigated the impact, if any, of bank loan officers' perceptions of the trustworthiness of accounting information on granting credit to businesses. A survey was completed by 471 bank loan officers in Spain to compare the trustworthiness of financial information of audited companies and unaudited companies.	The study found that loan officers placed more value on audited financial statements for SMEs. This seemed to increase the probability of these companies' obtaining access to credit as opposed to unaudited companies. Another finding was that, when the financial statements of SMEs had been audited, the management of the company were automatically perceived as being honest. According to the researcher, loan officers seemed to recognise management as honest "simply because an independent external expert has evaluated their accounting information".

In paragraphs 4.3.1 to 4.3.3 an analysis is provided of the findings from the studies documented in table 4.1.

4.3.1 Audit choice

Despite a decline over time in the number of companies which voluntarily choose an audit, three years after the deregulation of audit, the majority of the companies still seem to choose to undergo an audit (Dedman *et al.*, 2014). Respondents to the studies above agreed that the value of an audit is equal or greater than its cost (Chung, & Narasimhan, 2001; Rennie *et al.*, 2003; Collis *et al.*, 2004; Collis, 2008; Coetzee, 2015; Minnis & Shroff, 2017). Various studies also indicated that, when a company is no longer legally required to undergo an audit, the majority of its directors still choose to subject the financial statements to an audit (Collis *et al.*, 2004; Collis, 2008; Minnis & Shroff, 2017).

4.3.2 Reasons for voluntary audit

Dedman *et al.*'s (2014) study not only found that the majority of companies still underwent voluntary audit, but also that companies have a greater chance of undergoing voluntary audit if:

- they have increased agency costs;
- they have more risks than the unaudited;
- they intend to raise capital in the near future;
- they purchased non assurance services from the auditor when audit was still mandatory; and
- they had a greater need for high audit assurance under the mandatory audit regime.

4.3.3 Benefits of an audit

Many benefits to the non-listed company audit were identified, including reduced interest rates, better credit ratings and more access to credit (Minnis, 2011; Palazuelos *et al.*, 2017; Vanstraelen & Schelleman, 2017). Many researchers concluded that governments should consider keeping audit mandatory for the non-listed company as it ensures accuracy of financial statements, especially if estimates are included in the financial statements (Minnis, 2011; Vanstraelen & Schelleman, 2017). These authors

then argue that there should, in fact, be no audit exemption threshold and that all companies should be audited.

When a company has their financial statements audited, lenders tend to view the management of that company as being more honest (Palazuelos *et al.*, 2017). The majority of audit practitioners in Coetzee's (2015) study felt that mandatory audit relief benefits their audit clients through reduced costs; these practitioners did not experience a reduction in fee income as they diversified their revenue streams. The audit practitioners in this South African study also proposed an increase in the PI score, which would reduce the number of companies mandated by law to undergo an audit (Coetzee, 2015). This finding coming from South African auditors, directly contrasts with the findings from studies abroad, namely that auditors advocate for more non-listed companies to undergo mandatory audit.

In the remainder of chapter 4 each country in the sample will be explored to determine when the audit requirement was introduced, followed by when audit exemption was initially introduced. The changes which occurred to audit exemption will be discussed, as well as the current audit exemption requirements of the country regarding the non-listed company.

4.4 United Kingdom

4.4.1 Background

The EU introduced an option for audit exemption in the Fourth Company Law Directive for the member states in 1994 (Collis, 2007). Subsequent to the initial introduction, the member states gradually adopted the option to implement audit exemption (Collis, 2007). At the time the UK was still part of the EU and also implemented audit exemption.

4.4.2 Introduction to UK

Mandatory audit was introduced in the UK in 1844 (Competition Commission, 2011). In 1856 government changed it to optional, only to make audit mandatory for all companies again in 1900 (Competition Commission, 2011). This requirement remained in force for the next 94 years, until 1994 when government made audit

optional through the implementation of an audit exemption threshold as recommended in the EU Fourth Directive (UK Government, 2012). The audit exemption threshold was implemented and meant that non-listed entities with a turnover of less than £0.09 million were free to choose whether or not they want an independent audit (UK Government, 2012). The initial turnover threshold was raised during the last two decades on various occasions (UK Government, 2012).

According to Collis *et al*. (2004), the use of the size criterion in the legislation implies that there is a possible link between the measures and the relative costs and benefits of the audit. The legislation also includes an assumption that the audit exemption threshold is set at the point where the costs no longer outweigh the benefits. The implementation of an audit exemption threshold in the UK was permissible under the EU Fourth Directive which gave member states the option of implementing the audit exemption thresholds (UK Government, 2006).

In order for a company to qualify for audit exemption, it first had to comply with the definition of a small company (Companies House, 2018). The small company definition was first introduced in 1992 and subsequently increased on several occasions (Companies House, 2018). The audit exemption threshold was well below the small company threshold in the first decade since the implementation of these two thresholds. Only when the two thresholds increased in 2004, did the thresholds align in terms of their numbers (Companies House, 2018). Table 4-2 below shows the different audit exemptions after each update to the audit exemption threshold.

Table 4-2: UK thresholds for audit exemptions 1994 to 2008

	1994 £ million	1997 £ million	2000 £ million	2004 £ million	2008 £ million	2016 £ million
Annual turnover	≤0.09	≤0.35	≤1.00	≤5.60	≤6.50	≤10.20
Balance sheet total	≤1.40	≤1.40	≤1.40	≤2.80	≤3.26	≤5.10
Average employees	≤50	≤50	≤50	≤50	≤50	≤50

(Source: Collis, 2008; Department for Business, Energy & Industrial Strategy, 2017a)

Following the initial introduction of audit exemption, as indicated in table 4-2 above, the first increase to the turnover threshold occurred in 1997 from £0.09 million to £0.35 million, and again in 2000 from £0.35 million to £1 million, while keeping the total assets threshold constant at £1.4 million throughout the first two increases in the turnover threshold (Collis, 2008). At this stage in 2000, government was still well below the allowed maximums instituted by the EU Fourth Directive (UK Government, 2012). The turnover threshold for audit exemption was again raised in 2004 from £1 million to £5.6 million, combined with a doubling in the balance sheet threshold to £2.8 million (Collis, 2008). This increase, described as a “seismic” event, resulted in a decrease of registered ICAEW audit firms, from 6 500 in 2002, to less than 5 000 firms in 2006 (Quick, 2006). For the first time, the turnover and total asset thresholds were the same after the increase in 2004 for both audit exemption and the small company thresholds (refer to table 2-2). The only difference remained that small companies had to comply with two of the three thresholds, of which one was less than an average of 50 employees. After complying with the small company definition, a company also had to meet both the turnover and total assets thresholds to qualify for audit exemption. In 2008 the turnover threshold was increased again to £6.5 million (UK Government, 2012) and the balance sheet total was raised to £3.26 million (Collis, 2008).

According to the UK Government (2012), there have been no major concerns as a result of the introduction of the audit exemptions. Also, companies that were close to the threshold and the “larger small companies” continued to have an audit voluntarily (UK Government, 2012). According to Warmoll (2015), it is clear that, although the regulators wanted to lessen the amount of red tape, which often stifles the innovation of start-up businesses, they may have inadvertently crippled the UK audit market.

After the latest update of the UK Companies Act of 2006 in 2016, section 382 states that, if a company satisfies any two of the following three criteria, the company qualifies as a small company and is exempted from an audit:

- an annual turnover of no more than £10.2 million;
- the aggregate of amounts shown as assets no more than £5.1 million; or
- 50 or fewer employees.

A company would still need to undergo an audit if 10% of the shareholders request an audit (Department for Business, Energy & Industrial Strategy, 2017a).

The latest change in the audit exemption threshold also meant that only two of the three criteria could be met to qualify for audit exemption, where previously all three criteria were needed to qualify (Department for Business, Energy & Industrial Strategy, 2017a). According to the UK Government (2017), the reasons for the latest increase in the thresholds were based on the results of a poll. In this poll, 400 small businesses confirmed that three out of four companies, which were subject to an audit before the latest increase in audit exemption and would be affected by the change, would benefit from the new thresholds through saving costs (UK Government, 2017). Given the fact that the UK has an estimated 5.7 million private sector businesses (FSB, 2017), a sample of 400 responses (0.07%) does not seem sufficient to conclude that these businesses would benefit from audit exemption.

Each raise of the threshold was preceded by extensive research and various public consultations by government. They considered several options and concluded in each case that the threshold should be raised. They believed that extending the audit exemption would not cause significant deterioration to the quality of financial information and that, in cases where companies need an audit to obtain finances, they would still be free to have an audit performed voluntarily (UK Government, 2012).

The UK Business Minister stated the following (Department for Business, Energy & Industrial Strategy, 2017b):

> We are committed to making the UK the best place in Europe to start and grow a business. That means supporting SMEs and removing unnecessary burdens to their growth, including by reducing regulation. By increasing the number of businesses exempt from audit, more SMEs are now able to reinvest in their businesses, increase cash flow and repay debts as a result of exemption take up.

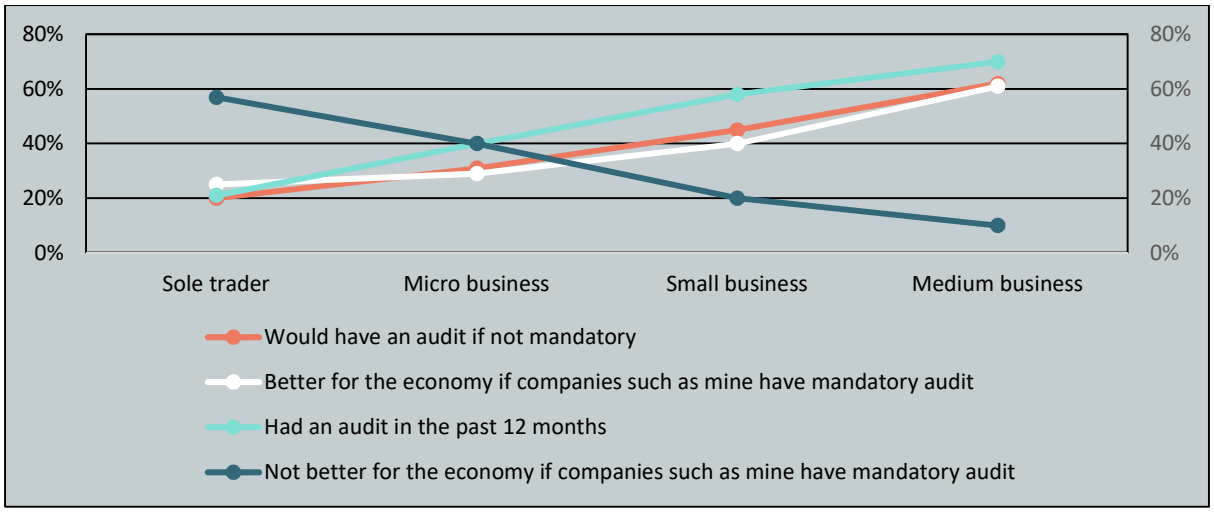
Based on the data collected, the Department for Business, Energy and Industrial Strategy (2017a) estimated that, if all companies who were entitled to the exemption took it up in the latest increase of the thresholds, it would result in an annual cost

saving of £344 million. Even though the audit exemption option is available, some companies still choose to have their accounts audited (UK Government, 2012).

ICAEW performed a study in 2014 in the UK. They obtained responses from 500 businesses, including sole traders and micro, small and medium businesses, to help them understand the needs of these types of businesses with regard to consulting and accounting. A total of 57% of the small businesses said they had undergone an audit although it was not required in terms of law, while another 30% had undergone a review. Findings of this study are in direct contrast to those of the Department for Business, Energy and Industrial Strategy (2017a), namely that small businesses still see the value in employing an auditor even when not required by law.

Figure 4-1 below shows the link between the need for an audit and the growth in the size of companies, as determined by the ICAEW (2014) survey. A significant finding of the study was the differences between companies from one sector to the next, as well as between companies of different sizes (ICAEW, 2014). ICAEW (2014) concluded that it is not helpful to formulate one single policy for all SMEs due to these significant differences. This stands in contrast with the reasons given by the UK government to explain the increase in the audit exemption threshold.

Figure 4-1: Responses regarding audit, varying by company size



(Source: ICAEW, 2014)

Figure 4-1 demonstrates that sole traders and micro businesses thought it would not benefit the entire economy if these two types of firms undergo mandatory audit. However, their attitudes changed as their firms grew in size (ICAEW, 2014). This is

consistent with previous findings, namely that, as the agency factors increase within a firm, so does the need for audit.

As of 31 December 2016, the number of registered audit firms in the UK was 6 010, which is a decrease of 17% since 31 December 2012. The number of those which are sole practitioners registered firms declined with 37% between 2003 and 2016 (FRC, 2017). Several factors contributed to this decline, of which the decrease in demand for audit played a significant role (FRC, 2017).

4.4.3 The UK compared with other EU countries

The latest 2013 Accounting Directive of the EU allowed member states to increase their limits for those entities that do not explicitly require an audit to the following thresholds (Federation of European Accountants [FEE], 2016):

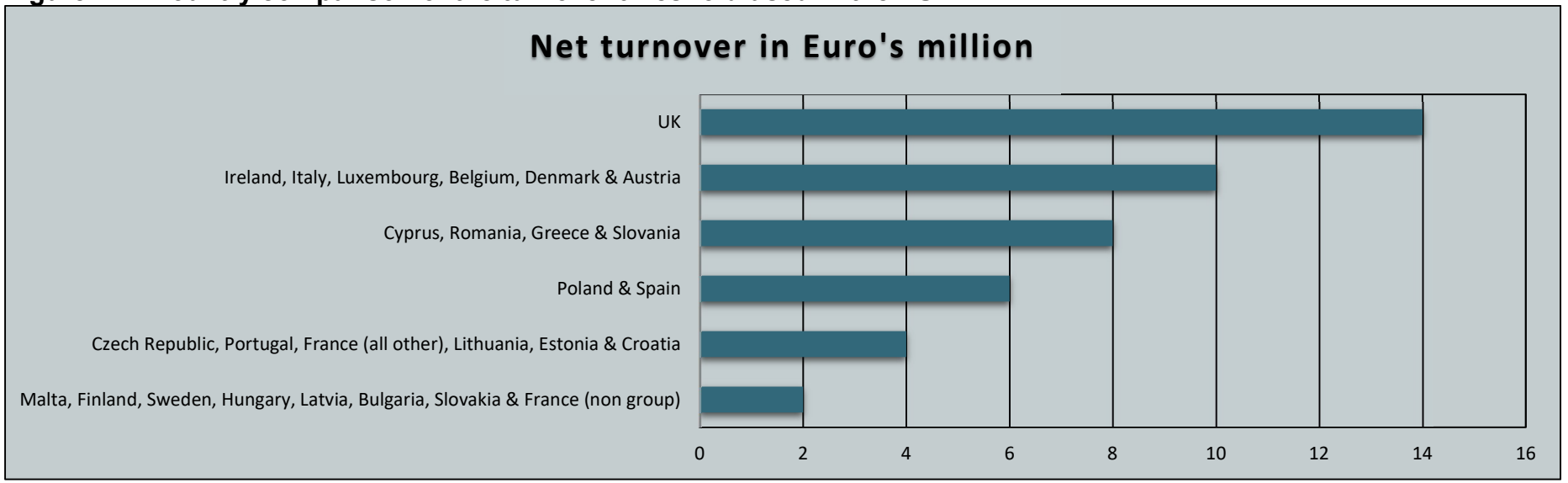
- balance sheet total equal to or less than €6 million;
- net turnover equal to or less than €12 million; or
- average number of employees equal or less than 50 during the financial year.

Member states had to incorporate their chosen thresholds, limited to a variation of 5% of the above thresholds to account for exchange rate differences. This had to be done by 20 July 2015 in order for the provisions to take effect for financial years beginning on 1 January 2016 (FEE, 2016).

According to the FEE (2019), the majority of EU countries chose not to make use of the allowed maximum thresholds, but to keep their audit exemption limit the same. The FEE (2019) saw this as a clear sign that these countries continued to recognise the public interest function of statutory audits and regard it as a value add to businesses and the economy as a whole.

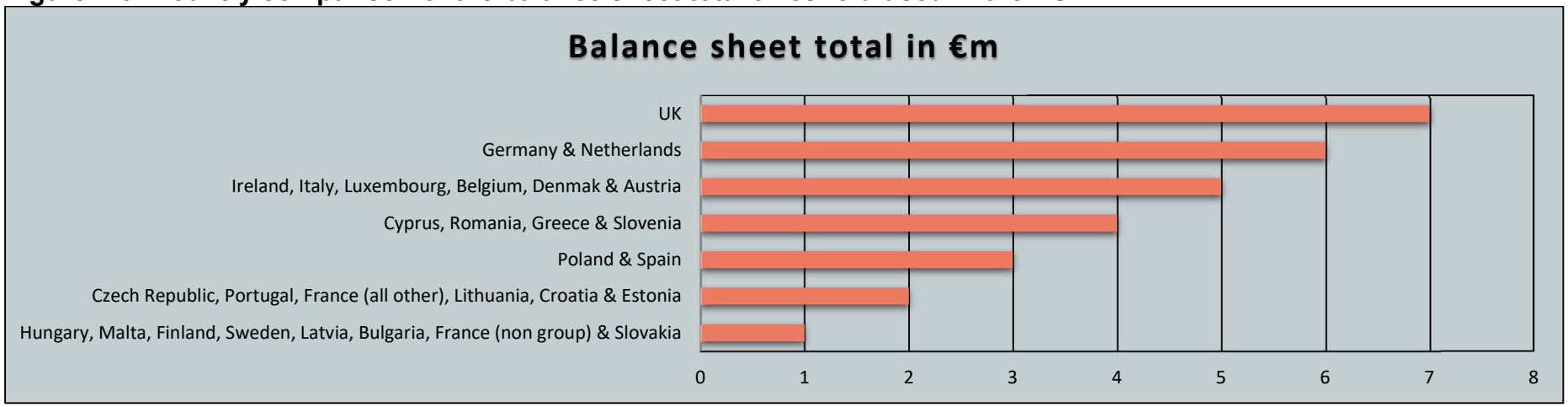
Figures 4-2, 4-3 and 4-4 below show the level at which each EU country has implemented audit exemption in terms of turnover, total assets and employees respectively.

Figure 4-2: Country comparison of the turnover threshold used in the EU



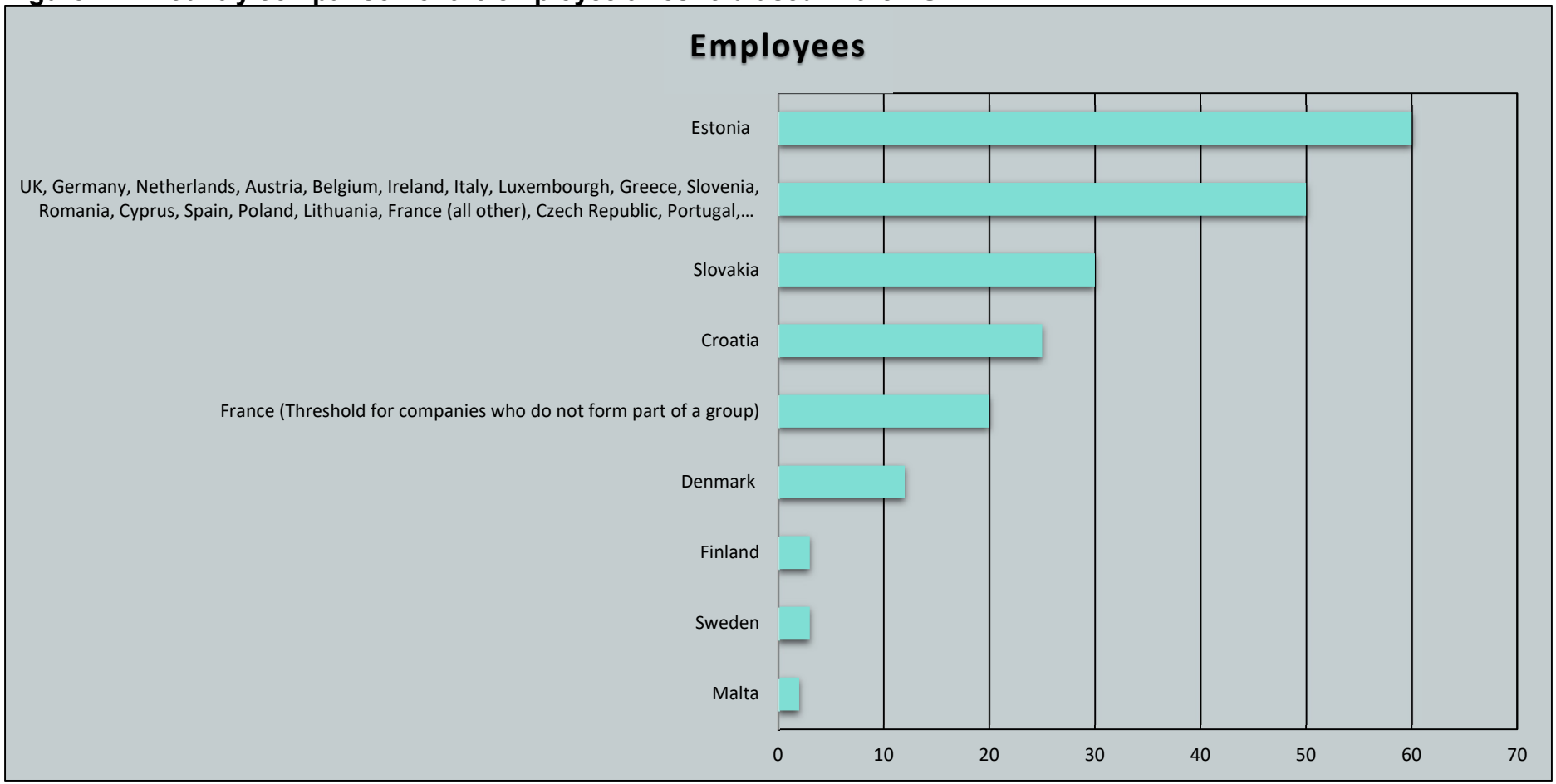
(Source: Adapted FEE, 2019)

Figure 4-3: Country comparison of the balance sheet total threshold used in the EU



(Source: Adapted FEE, 2019)

Figure 4-4: Country comparison of the employee threshold used in the EU



(Source: Adapted FEE, 2019)

Some vital observations can be made from the above three figures:

- The UK's audit exemption threshold is the highest as they have implemented the maximum allowable thresholds. Given the exchange rate differences, they are slightly over the maximum, but still within the allowable 5% variation.
- The Netherlands and Germany also implemented the allowable maximum thresholds.
- The majority of the countries in the EU implemented less than half of the allowable maximum threshold for turnover and total assets.
- The majority of the countries in the EU set their employee threshold on 50 employees.

Even when given the option to implement a high audit exemption threshold, the majority of the countries in the EU chose to not even implement half of the allowable audit exemption threshold.

4.5 United States of America

4.5.1 Introduction

Before the 1930s no US company was legally required to undergo an audit. Although the New York Stock Exchange did not require audited financial statements, more than 90% of industrial companies voluntarily underwent an audit in 1926 (Zeff, 2003). Following the stock market crash in 1929, audited financial statements became a requirement of the Exchange in 1933 (Zeff, 2003).

Audit in the USA was based on UK audits. Following the introduction of audit in the USA, most of the audit work was performed by visiting UK auditors as instructed by UK investors, since audit was already well established in the UK through statutory requirements (Moyer, 1951). However, whereas the UK had legislated audit, the USA did not share the same need since it was an expanding country with little industrial history (Moyer, 1951). Clients in the USA wanted to understand the benefits of an audit before incurring the resultant cost. The level of scrutiny applied in UK audits was found to be too costly for clients who had the freedom to choose whether they want to engage an auditor or not (Moyer, 1951). This resulted in the adoption of sampling methods to

reduce the volumes of work, which became more apparent as US businesses increased in size (Moyer, 1951).

4.5.2 Current audit requirements

The difference in need between US and UK companies led to the US' adopting an altered audit approach compared with other countries (ICAEW, 2009a). To this day, there is no statutory requirement in the USA for any public filing of audited financial statements (ICAEW, 2009a). Following the stock market crash, the only legal requirement for an audit applies to public entities who are registered with the SEC (ICAEW, 2009a). Minnis and Shroff (2017) state that, with limited exceptions, non-listed entities are not required to make their financial statements public and there is no need to undergo an audit in the USA. This is contrary to UK legislation which stipulates that companies above the threshold for audit exemption must undergo an audit and file their financial statements on a public platform. It is the discretion of the US firm to weigh the costs and benefits before voluntarily undergoing an audit (Minnis & Shroff, 2017). Currently in the USA, only non-listed companies that meet the following two criteria must disclose their financial statements publicly (Minnis & Shroff, 2017):

- assets of at least $10 million; and
- more than 2 000 individuals owning securities.

According to Lisowsky and Minnis (2018), there are US non-listed entities much larger than some listed entities which do not disclose their financial statements. There is no need for the financial statements of the majority of the medium to large non-listed entities in the USA to comply with US GAAP (United States Generally Accepted Accounting Principles). Lisowsky and Minnis's (2018) study found that almost two-thirds of the non-listed entities do not prepare audited US GAAP financial statements. They also found that the firms with external capital are more likely to produce audited US GAAP financial statements and there are still thousands of firms with dispersed capital and external debt which do not prepare audited US GAAP financial statements (Lisowsky & Minnis, 2018).

Lisowsky and Minnis's study involved the tax returns of 200 000 non-listed US entities from 2008 to 2010. They established that, in this sample, non-listed companies outnumbered public companies by 18 to one. They filtered the population to only

include companies with more than $100 million in revenue and determined that non-listed companies still outnumbered public firms three to one (Lisowsky & Minnis, 2018). This means that there is no financial information publicly available in the USA for the majority of firms in the country. Thirty-seven percent of medium to large non-listed entities choose to produce audited US GAAP financial statements (Lisowsky & Minnis, 2018). The study showed that the preparation of audited financial statements which comply with US GAAP is not necessary for non-listed entities to obtain external capital. In many instances, it seems that the smaller companies without debt produce audited US GAAP statements, whereas big firms with vast amounts of debt do not (Lisowsky & Minnis, 2018). Findings further indicated that, the younger the firms, the more likely they are to produce audited US GAAP financial statements, with a decline in the production of audited US GAAP financial statements as the firms age (Lisowsky & Minnis, 2018). In the UK it was found that companies produce audited financial statements because they have more stakeholders involved and have historically produced audited financial statements. This stands in contrast to the US finding that only younger companies undergo audit.

4.6 Australia

4.6.1 Introduction

Non-listed entities in Australia have enjoyed exemption from audit since 1995 (Treasury, 2018a) when the First Corporate Law Simplification Act introduced a classification for small companies. Section 9 of the Act sets out the following three tests:

- gross operating revenue of less than $10 million for the year;
- gross assets of less than $5 million at the end of the year; and
- fewer than 50 employees at the end of the year.

If a company does not meet at least two of the three tests, the company is classified as a large company (First Corporate Law Simplification Act, 1995). Small companies are entitled to reduced reporting requirements by meeting the criteria above (First Corporate Law Simplification Act, 1995). The reduced reporting requirements include audit exemption for small companies unless 5% of the shareholders request an audit,

or the company is specifically requested by the Australian Securities Investments Commission (ASIC) to perform an audit (First Corporate Law Simplification Act, 1995).

4.6.2 Audit exemption

The Australian Corporations Act 50 of 2001 provides for the following four definitions for companies:

1. disclosing entity, public company or registered scheme;
2. large or small proprietary companies;
3. companies limited by guarantee; and
4. registered charities.

All companies under (1) must be audited (Corporations Act of 2001). Companies registered as limited by guarantee or charities have revenue thresholds between AU$0.25 million and AU$1 million to determine whether they will undergo an audit or review (Chartered Accountants of Australia and New Zealand, 2016). Proprietary companies, on the other hand, are divided into two categories, namely large proprietary companies and small proprietary companies (Corporations Act of 2001).

From 2007 until mid-2019, the requirements for a small proprietary company were as follows (Chartered Accountants of Australia and New Zealand, 2016):

- consolidated revenue <AU$25 million;
- consolidated gross assets <AU$12.5 million; or
- company/group has less than 50 employees.

When a small company meets any two of the three requirements above, the company will be exempt from an audit (Chartered Accountants of Australia and New Zealand, 2016).

On 1 July 2019, the thresholds to distinguish between a small and a large company were increased (Treasury, 2018a). The Australian government proposed an increase to the thresholds for large companies, which means that more companies now fall into the range of small companies if they are below these thresholds (Treasury, 2018b).

The updated thresholds as at 1 July 2019 to qualify as a small company are as follows:

- AU$50 million or less in consolidated revenue;
- AU$25 million or less in consolidated gross assets; or
- 100 or less employees.

The revised thresholds are in essence double the 2007 amounts per the Corporations Act outlined above. Small companies can, however, still be required to undergo an audit by ASIC or if 5% of the shareholders request audited financial statements (Treasury, 2018b). The changes to the thresholds were made to keep up with economic growth (Treasury, 2018a). The Australian government estimated that the increase to the thresholds would save AU$81.3 million per year in regulatory costs to these companies (Treasury, 2018a). It would also result in approximately 2 200 companies that will no longer be forced to undergo an audit (Treasury, 2018a). The latest changes in the Australian thresholds are a significant deviation from previous thresholds and compared with UK thresholds.

4.7 Canada

Canada introduced the Canada Business Corporations Act in 1975 (Industry Canada, 2014). This Act introduced mandatory audit on financial statements and a disclosure provision for public companies and non-listed entities that are economically significant (Rennie *et al*., 2003). In other words, non-listed entities with revenues of more than CA$10 million or assets worth more than CA$5 million must comply with this requirement (Rennie *et al*., 2003).

Canada introduced voluntary audit in 1994 through the amendment of the Canada Business Corporations Act (Chan, 2012). This meant that, with the unanimous consent of all shareholders, large and small non-listed entities could waive an audit (Rennie *et al*., 2003). The deregulation was brought on by non-listed entities' wanting to even the playing field, since provincially registered companies were not required to file financial statements while federally registered companies were required to do so (Rennie *et al*., 2003). In essence, this meant that, if one shareholder decided that the company must undergo an audit, an audit had to take place.

According to Hayes (2010), Canada only allows audit exemption to its non-listed companies if all the shareholders in the company consent to audit exemption. If all the shareholders agree to pass a resolution and choose not to appoint an auditor, the company is exempt from an audit as per the Canada Business Corporations Act and its provincial equivalents (Industry Canada, 2014). Thus, if a shareholder who is typically not entitled to vote wants an audit to take place, he or she has the power to commit the company to an audit. In this regard, Hayes (2010) calls for more balance between the rights of minority and majority shareholders.

In Canada, a non-distributing or non-offering entity is also called a private corporation (Thomson Reuters, 2018). An offering or distributing entity is an entity that has securities listed and posted for trading on any stock exchange inside or outside Canada (Thomson Reuters, 2018).

Senkow *et al*. (2001) conducted a study on federally incorporated companies with revenues exceeding CA$10 million or assets exceeding CA$5 million. They hypothesised that the level of ownership held by a company's officers and directors is negatively associated with the likelihood of retaining an audit when deregulation occurs. These companies are entitled to forego an audit if they have the unanimous consent of all the shareholders, as mentioned above (Industry Canada, 2014). At the time of the change to the Act, many concerns were raised that most companies would discontinue their audit. However, it was found that only a relatively small proportion (about 25%) decided to discontinue their audit (Senkow *et al*., 2001).

In 1992, the Canadian Institute of Chartered Accountants lobbied against the deregulation of audit. They predicted that there would be damaging effects on public accountability and that many companies would see this deregulation as "an invitation to eliminate the audit requirement" (as cited by Rennie *et al*., 2003). However, a study by Rennie *et al.* in 2003 found that two-thirds of their 204 respondents voluntarily had still chosen to undergo an audit, even though it was no longer required by law (refer to table 3-1).

4.8 Brazil

Prior to 2007, all companies (corporations) in Brazil were required to undergo an audit (Tornovsky, 2015). The concept of "large size companies" was introduced in Brazilian

legislation by Law No. 11.638/2007 which is an amendment to the Brazilian Corporate Law. A large size company is defined as:

> a company or group of companies under the same control that had less total assets or annual gross revenues in the previous fiscal year than:
>
> (i) total assets over R$240 million, or
> (ii) annual gross revenues in excess of R$300 million.

Brazilian corporate entities are commonly organised as either Sociedade por Ações (S/A), a corporation limited by shares which can be held privately (closed corporations) or publicly (open corporations); or as a Limitada, which is a non-listed partnership (World Bank, 2013b).

A summary of the audit requirements for corporate entities in Brazil is presented in the table below (World Bank, 2013b):

Table 4-3: Summary of audit requirements in Brazil by type of entity

Type of entity		Audit requirement
Listed companies (S/A)		Yes
Non-listed companies		
S/A	SME	Not required (Entities who do not meet large entity size criteria)
	Large size	Yes (All entities with total assets >R$240m or total gross revenues >R$300m)
Limitadas	Micro and small	Not required Micro-entities: Entities with total gross revenues >R$360 thousand Small entities: Entities with total gross revenues >R$3.6m
	SME	Not required (Entities who do not meet large entity size criteria)
	Large size	Yes

Type of entity		Audit requirement
		(All entities with total assets >R$240m or total gross revenues >R$300m)
Banks and non-banking financial institutions		Yes
Insurance companies and open pension funds		Yes
Closed pension funds		Yes

(Source: World Bank, 2013b)

It is evident from table 4-3 above that a company is classified as small as long as it meets both the following two requirements:

- all entities with total assets <R$240 million; and
- total gross revenues <R$300 million.

As soon as a company has either total assets in excess of R$240 million or total gross revenues in excess of R$300 million, the company will be required to undergo an audit.

Non-listed entities are required to submit their financial statements when applying for funding at a bank. However, the banks tend not to rely heavily on these sets of financial statements in their decision on whether or not to extend credit (World Bank, 2013b). The decision to provide credit to SMEs is based on a variety of other factors such as the value of collateral, management integrity, future business possibilities and site visits (World Bank, 2013b). The main reason for not placing reliance on the financial statements is the perception in Brazil that the majority of SMEs' financial statements contain material misstatements (World Bank, 2013b). In 2010, Brazilian auditing standards were converged with the ISAs (International Standards on Auditing) issued by IFAC through the International Auditing and Assurance Standards Board (IAASB) (PWC, 2013).

4.9 Russia

Since the end of the Cold War, around 1990, Russia has been opening up its financial markets, and the Russian stock market was established (Solomon, 2010). In a way, the changes in Russia have probably been too fast and furious for their economy to keep up with (Solomon, 2010). For instance, the country's legal framework has been trying to catch up with the pace at which a market economy has been developing (Solomon, 2010). Also, the 1990s witnessed wide-scale privatisation in Russia, and the large proportion of companies that transferred from the public to the private sector caused great upheaval (Solomon, 2010). Instability in ownership rights ensued. Most companies today are characterised by an insider system whereby the company is controlled by a controlling shareholder (Solomon, 2010).

An annual audit of the financial statements of Russian entities is mandatory for (Deloitte, 2017):

- joint-stock companies;
- companies with securities traded on stock exchanges;
- banks and other credit institutions, insurance companies, credit bureaus, pension and investment funds, participants in the securities market, and stock exchanges;
- developers operating under FZ 214 (residential projects financed with pre-construction investments) – starting with the financial statements for 2017;
- companies whose annual revenue for the previous financial year exceeded RUB400 million; and
- companies whose total assets as of 31 December of the previous calendar year were valued above RUB60 million.

Starting with the financial statements for 2016, micro lenders must submit audit reports on their annual financial statements to the Central Bank of Russia (Deloitte, 2017). Publicly traded companies, banks, insurance companies, non-governmental pension funds, and companies that are more than 25% state-owned must be audited by an audit firm and not by an independent auditor alone (Deloitte, 2017).

Audits in Russia are to be performed in accordance with the ISA as issued by the IFAC and officially adopted in Russia (Deloitte, 2017). According to the regulatory requirements, auditors must inform the owners and management of audit clients of any findings related to corruption and other legal offences and of risk indicators related to such offences. If the representatives of the audit client do not take appropriate action within 90 days, the auditor must inform the relevant state authorities (Deloitte, 2017). This is similar to the section 45 requirement in the Auditing Profession Act 26 of 2005 in South Africa.

4.10 South Africa

4.10.1 Background

In 1885, ICAEW (the Institute of Chartered Accountants in England and Wales) was formed, followed by the Society of Incorporated Accountants in 1890 (Puttick, 2003). The members of these two bodies contributed significantly to the advancement of the audit profession in South Africa (Puttick, 2003). The requirement for companies to undergo an audit was introduced into legislation in South Africa for the first time in the Companies Act 46 of 1926. This requirement stated that it was mandatory for all companies in South Africa to undergo an audit, whether private or public. The Companies Act 61 of 1973 further cemented the audit requirement for all companies.

4.10.2 Current audit requirements

On 1 May 2011, the Companies Act 71 of 2008 came into effect (DTI, 2012). This Act allowed non-listed companies (private companies) to calculate their PI score and, based on this calculation, determine whether they need an audit, a review or nothing at all.

The regulations to the Companies Act 71 of 2008 came into effect at the same time as the Act itself (DTI, 2011). Regulation 26(2) to the Companies Act implemented in 2011 sets out the calculation for the PI score as follows:

- a number of points equal to the average number of employees of the company during the financial year;

- one point for every R1 million (or portion thereof) in third party liability of the company, at the financial year end;
- one point for every R1 million (or portion thereof) in turnover of the company, during the financial year;
- one point for every individual who, at the end of the financial year, is known by the company:
    - in the case of a profit company, to directly or indirectly have a beneficial interest in any of the company's issued securities; or
    - in the case of a non-profit company, to be a member of the company, or a member of an association that is a member of the company.

In terms of section 30(2A) of the Companies Act 71 of 2008, if all the directors of the company are also shareholders of the company, the company is exempted from audit and review should the company fall below the threshold for requiring an audit.

Table 4-4: Regulations to the Companies Act 71 of 2008

PI score	Implication
350 or more	Requires an audit Regulation 28(2)(c)(i)
Less than 350 and more than 100, and financial statements are internally compiled	Requires an audit Regulation 28(2)(c)(ii)
Less than 350 and more than 100, and financial statements are externally compiled	Requires a review Regulation 29(4)(a)
Less than 100	Requires a review Regulation 29(4)(b)

(Source: Department of Trade and Industry, 2011)

The table above shows that all companies with a PI score above 350 are legally obliged to undergo an audit. If the PI score is between 100 and 350, the audit requirement is dependent on who prepares the financial statements. If the financial statements are internally prepared, an audit is required. However, if the financial statements are externally compiled, a review is required. All companies with a PI score

of less than 100 only require a review, or if all the directors own the shares in the company, there is no requirement for audit or review.

4.11 Chapter summary

ICAEW (2009a) defines the global understanding of a universal audit approach as a requirement for companies to prepare financial statements for their shareholders, to have them independently audited, and to file them with a registry where anyone who might do business with the company can access them. This global phenomenon has increased pressure not only on the audit profession for more demanding accounting and auditing standards, but also on governments to reduce administrative tasks for economies to make it easier to remain competitive. One such area where governments would like to see the administrative burden reduced is accounting and auditing (ICAEW, 2009a).

This chapter focused on the audit exemption thresholds in each of the selected countries. This included a discussion of when audit exemption was introduced into each country, the level of thresholds previously set and the subsequent changes to the audit exemption threshold to reach the point they were at the time of conducting this study.

Table 4-5 below sets out the current thresholds for audit exemption in each country in the sample. These thresholds will be converted to Rand in chapter 6 for purposes of comparing the countries' thresholds.

Table 4-5: Summary of audit exemption thresholds for non-listed companies in select countries

	UK	USA	Australia	Canada	Brazil	Russia	RSA
Total revenue	<£10.2m	N/A	<AUS$25m	N/A	<R$300m	<RUB400m	<R350m
Total assets	<£5.1m	N/A	<AUS$12.5m	N/A	<R$240m	<RUB60m	N/A
Employees	<50	N/A	<50	N/A	N/A	N/A	<350
Shareholders (SH)	10%	N/A	5%	1	N/A	N/A	<350
Third party liabilities	N/A	N/A	N/A	N/A	N/A	N/A	<R350m
Qualifiers	Two of the first three or 10% of SH	N/A	Two of the first three or 5% of SH	If one SH votes for an audit, an audit must take place	Entities must have both qualifiers in place to be exempt from audit	Entities must have both qualifiers in place to be exempt from audit	Each qualifier individually or a combination of above needs to be below 350

(Source: Author)

From the table above, the significant differences are already clear among the audit exemption thresholds of the selected countries. Although the comprehensive comparison is provided in chapter 6, a few important observations can already be made here. The majority of the countries use revenue and total assets as thresholds for their audit exemption and take shareholders into account even if the latter is not directly stipulated as a threshold. Only South Africa uses third party liabilities as a threshold. Only three of the countries use employees as a threshold, namely the UK, Australia and South Africa. South Africa is also the only country in the sample which uses a combination of the thresholds to determine audit exemption. South Africa is, therefore, stricter in their application of the audit exemption threshold, seeing that a company must undergo an audit if only one of the four categories, either employees, shareholders, revenue or third party liabilities, is exceeded. This is in stark contrast with the UK and Australia where there is room for leniency among the three categories and companies only have to undergo an audit if they exceed two of the three.

The emphasis in chapter 5 will be on each country's view of an SME, with particular focus on the medium size entity. Regulators must balance the interest of the public with management's perceived burdan's of an audit in order to set standards for small companies (Collis & Jarvis, 2002). To fully compare the different sizes of non-listed companies, we need to understand how the boundaries for each size are determined. Many governments, for example of the UK, have noted that their intention is to reduce the burden for audit on SMEs in particular. The aim of chapter 5 is to define these SMEs and understand whether they fit below the thresholds as determined for audit above.

CHAPTER 5: GLOBAL SME COMPARISON

5.1 Introduction

The audit relief requirements for non-listed entities were investigated in the previous chapter. The geographical location of a non-listed company has a significant effect on the financial reporting and audit requirements of that firm (Minnis & Shroff, 2017). The majority of the countries in this study afford some form of audit exemption to their non-listed entities. Some countries, like the USA, have no requirements for non-listed entities to undergo an audit and only the very biggest of these are required to publish their financial statements. In contrast, countries like the UK require companies above certain small company thresholds to disclose their financial statements on a public platform and subject their financial statements to an audit irrespective of the costs involved (Minnis & Shroff, 2017).

The main objective of this chapter is to discuss the different definitions for SMEs adopted in each country. This is an essential step after discussing the audit exemption threshold as each country has a unique definition for SMEs, as well as a different audit exemption threshold, if any. To set a threshold for audit exemption, it needs to be clear which companies/entities are to be included or excluded from an audit.

In order to fully contextualise and understand the audit of non-listed entities for purposes of the comparison, the definition for the non-listed company as defined in each country will first be outlined and compared.

Even though micro enterprises are often referred to in conjunction with SMEs, the focus in this chapter will be on SMEs, that is, small and medium enterprises. The owners of micro enterprises are more likely to be involved in the business; therefore, there is less separation between ownership and control and, in turn, a reduced need for audit.

One of the limitations of this study was that it was impossible to compare every single piece of legislation which defines SMEs. The investigation was therefore limited to the definition in relation to statistical surveys or as defined by the statistical bodies of the

countries and two of the “most relevant” SME definitions in the legislation of each country.

5.2 SMEs defined

Small and medium enterprises are small businesses which provide opportunities for entrepreneurs, jobs for fellow citizens and gathering places for societies (Gartenstein, 2019). ICAEW (2014) notes that the majority of companies in the world are small and that these types of businesses play an essential role in the general economy by contributing to employment and innovation. They are “rooted” in the land where they started, and give back liveliness and sustenance to the communities they operate in (Gartenstein, 2019). On 6 April 2017, the United Nations (2017) adopted several resolutions to emphasise the vital role that SMEs play, especially in contributing to innovation, creativity and job creation.

Determining which businesses, small or large, create the most jobs is an age-old question. Following the loss of US manufacturing jobs to Japan in 1981, a need for 15 million jobs arose in the country (Birch, 1981). This prompted research into the question and four million entities (approximately 80% of US entities at the time) were analysed (Birch, 1981). One significant finding indicated that, over a period of eight years, 66% of jobs were created by small firms with less than 20 employees (Birch, 1981). Birch (1981) found that larger businesses [at that time] had become stagnant. The research results were used to inform state policies to support small companies and develop jobs in this way (Birch, 1981).

The OECD is a global organisation with 34 member countries. Its aim is to foster economic development and ensure that the environmental impact of growth and social development is considered at all times (Kenton, 2018). Many governments and agencies want to implement strategies and guidelines to stimulate SMEs; however, the SME space is highly complex due to the large number of ministries and government agencies involved in different countries (OECD, 2017b). According to the OECD (2017a), there is no standard worldwide definition of “SME”. Each country defines its SMEs differently in legislation, primarily since the definition of “small” and “medium” in terms of a company is defined by considering the size of a country’s economy, especially relating to the turnover and assets thresholds (OECD, 2017b).

In order to meaningfully compare the different countries, the OECD defines SMEs as follows:

- small entities (10 to 49 employees); and
- medium entities (50 to 249 employees).

The OECD (2017a) states that, since each country has a different convention for setting the SME threshold, the most appropriate measure would be to focus on employee numbers to determine the size classification of an entity.

The International Finance Corporation (IFC) is a member of the World Bank Group (IFC, 2019). The IFC works with the private sector to help developing countries and their economies and, in so doing, create more opportunities for all (IFC, 2019). One of the IFC's goals is to end extreme poverty by 2030 by developing the private sector in developing countries (IFC, 2019). SMEs account for approximately 50 to 70% of employment across global economies, and high-income economies tend to use higher thresholds than low-income economies to define their SMEs (IFC, 2019). The IFC conducted research in 2014 in which various countries' definitions of micro, small and medium enterprises were compared. The results indicated that, out of the 155 economies that participated, the most used individual threshold is the number of employees (92%), followed by turnover (49%) and then assets (36%).

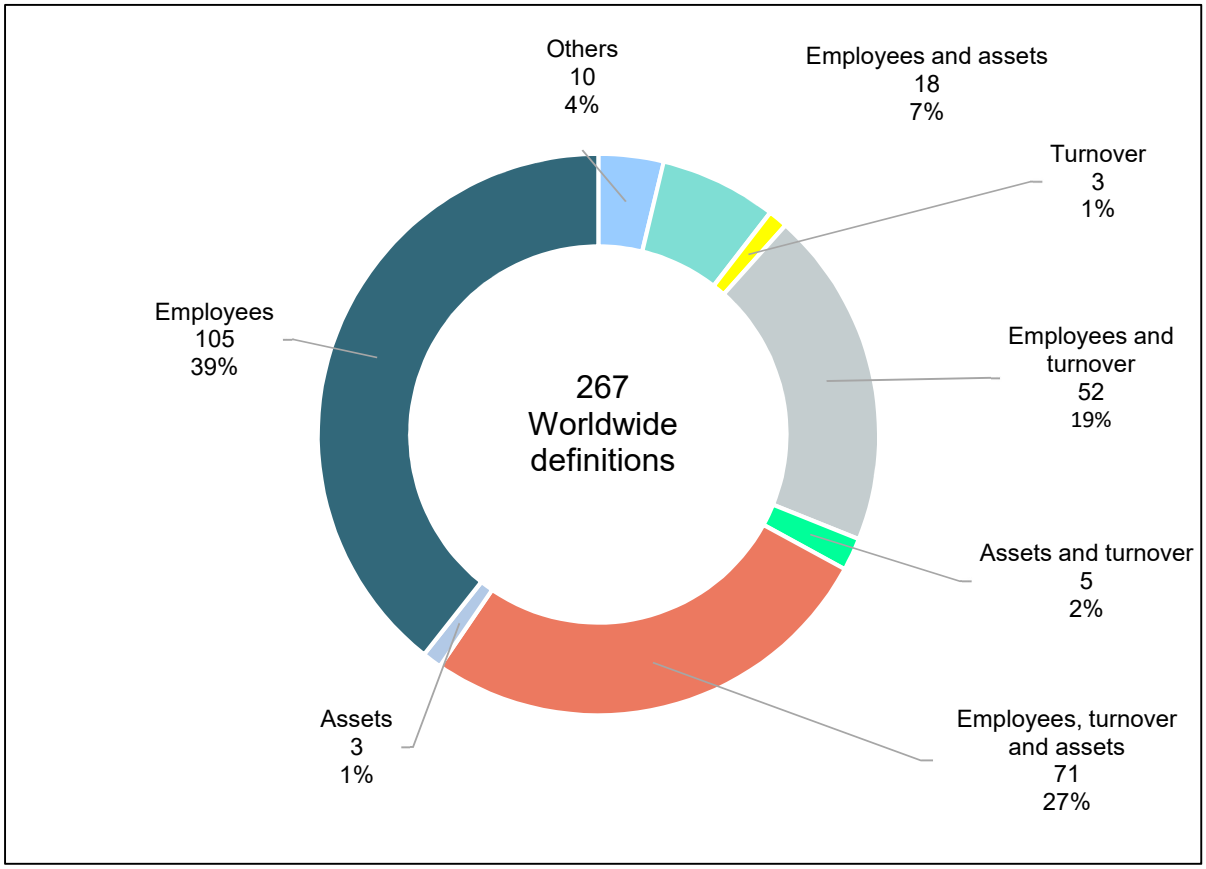
Table 5-1: Most common global average thresholds for SMEs

	Medium	Small
Employees	≤250	≤50
Turnover	US$50 to US$70m	US$1 to US$5m
Assets	US$50 to US$62m	N/A

(Source: IFC, 2014)

The table above illustrates the most used average qualifiers for SME thresholds globally (IFC, 2014). The thresholds are expressed in terms of a range in American Dollar. Figure 5-1 below shows the different combinations used in the SME definitions across countries and government sectors worldwide.

Figure 5-1: Comparison of the utilisation of variables in the SME definition



(Source: IFC, 2014)

From figure 5-1 it is evident that employees as a threshold on its own is the most commonly used qualifier for SMEs. This is followed by a combination of employees, turnover and assets, and in third place a combination of employees and turnover. A key finding of the IFC study (2014) is that different institutions apply different methods, variables and scales to set their SME thresholds. At times, even within the same country, institutions including national statistics offices, development agencies and central banks would use different thresholds and parameters in classifying an SME (IFC, 2014). Out of the 155 economies, a total of 267 definitions used by the different institutions were identified (IFC, 2014).

In this section of the chapter, the different methods for defining an SME were identified as highlighted by the IFC and the OECD. The rest of the chapter is devoted to the definition of “small” and “medium” used in the selected countries. For each country a search was done to identify the legislation which defines small and medium, as well as the institutions that have their own definition for small and medium.

5.3 United Kingdom

5.3.1 Background

The number of businesses in the UK private sector have grown with 2.2 million from 2000 to 2017 (FSB, 2017). The current 5.7 million private sector businesses (as at the start of 2017) comprise 99.9% small- or medium-sized businesses (FSB, 2017). SMEs in the UK employ 16.1 million people, comprising 60% of the entire private sector employment in the UK. These enterprises also have a turnover of £1.9 trillion annually contributing to 51% of the entire private sector turnover (FSB, 2017).

Bamford-Niles (2012) claims that, although SMEs employ millions of people in the UK and are an essential part of the UK economy, no single definition for an SME has been adopted in the UK. The Department of Business, the Research and Development Tax Relief HMRC and the Companies House each have their own definition and thresholds for SMEs (Bamford-Niles, 2012). ICAEW (2014) also stresses that there are differences between the definitions applied in official statistics and the ones used in regulations.

5.3.2 Companies House

The Companies Act of 1985 introduced lesser requirements for the financial statements of SMEs (UK Government, 1985). This Act allowed directors of these companies to deliver “modified” accounts if the company qualified as either small or medium in terms of the following thresholds (UK Government, 1985):

Table 5-2: UK small and medium company thresholds introduced in 1985

	Small	Medium
Turnover	£1.4m	£5.75m
Balance sheet total	£0.7m	£2.8m
Employees	50	250

(Source: UK Government, 1985)

Since their introduction in 1985, these thresholds have been increased on several occasions through updates to regulations (ICAEW, 2015) and the issuance of the new Companies Act in 2006 (UK Government, 2006). The latest change by government

was through the implementation of new regulations effective from 1 January 2016. These regulations increased the size thresholds for qualifying as a micro, small and medium company as follows (ICAEW, 2015; Companies Act of 2006):

Table 5-3: Latest UK small and medium company thresholds per the Companies Act of 2006

	Small	Medium
Turnover	<£10.2m	<£36m
Balance sheet total	<£5.1m	<£18m
Employees	<50	<250

(Source: ICAEW, 2015)

The Companies Act of 2006 sets out the exemptions available for SMEs regarding audit and the reports they need to file with the registrar. Even though medium companies are still required to undergo an audit, they have reduced reporting requirements. They must submit their annual accounts, a strategic report (with reduced requirements), a directors' report and an auditor's report (annexure M). The UK's adoption of the latest EU Accounting Directive into Company Law in March 2015 meant lesser reporting requirements for companies below the updated thresholds. If small companies meet any two of the three thresholds, they can choose to file abridged accounts rather than full accounts, on condition that all shareholders approve this choice (ICAEW, 2015). Small companies are also given the option in terms of the Companies Act of 2006 to forego an audit.

5.3.3 Small Business, Enterprise and Employment Act 2015

The Small Business, Enterprise and Employment Act of 2015 (SBEEA) was implemented in March 2015 and aimed to break the barriers that keep small companies from doing business in the UK. The sections applicable to small businesses set out access to information regarding applying for finance (SBEEA, 2015). Subsection 8 (SBEEA, 2015) provides an option for regulations to block or allow the charging of fees by platforms to SMEs for their service. Small companies are defined in SBEEA (2015) as any company with less than 50 employees and a turnover or total assets equal or less to the small business threshold as per the latest Companies Act.

5.3.4 Office for National Statistics

The Office for National Statistics (ONS) is the UK's statistical leg. This office publishes individual themes for a wide variety of government departments (ONS, 2017). The definition of SMEs used by the ONS (2017) when compiling different reports is as follows:

- small: 10 to 49 employees; and
- medium: 50 to 249 employees.

The only measure used in ONS surveys is the number of employees. No reference is made to turnover and total assets in determining the size of the SMEs involved in surveys.

5.3.5 Summary

The selected definitions in the UK are very similar and aligned, even though some institutions only use the number of employees as measure.

Table 5-4: Small business threshold as per different institutions and legislation in the UK

	Office for National Statistics	Companies Act of 2006	Small Business, Enterprise and Employment Act of 2015
Turnover	-	<£10.2m	<£10.2m
Assets	-	<£5.1m	<£5.1m
Employees	10 to 49	<50	<50

(Source: Author)

Table 5-4 above illustrates that the SME definitions across the legislation and institutions in the UK are consistent. The only significant difference is the fact that the Department for Business, Energy and Industrial Strategy uses only the number of employees, whereas the Companies Act of 2006 and the SBEEA use turnover, assets and number of employees.

Table 5-5: Medium company threshold as per different institutions and legislation in the UK

	Office for National Statistics	Companies Act of 2006
Turnover	-	<£36m
Assets	-	<£18m
Employees	<250	<250

(Source: Author)

The classification of medium companies in the UK is consistent with regard to the use of employee numbers. The only difference is that the Companies Act of 2006 refers to turnover and assets thresholds in addition to the employee number threshold.

5.4 United States of America

5.4.1 Background

In the USA, support for small businesses gained momentum during World War II when the need arose to provide backing for the industrial supply base. The support came in loans and other forms of help to small businesses and eventually resulted in the enactment of the Small Business Act in 1953 and the Small Business Investment Act in 1958 (Kirkwood, 2016).

The vast majority of businesses in the USA are privately owned (Minnis, 2011). They make up more than 99% of the countries' total firms and generate more than 50% of the private sector GDP in the country (Minnis, 2011). There are approximately 30 million small businesses in the USA which create 58.9 million jobs, according to the US Small Business Administration (SBA) (2018).

5.4.3 Small Business Act of 1953

The US government allocates certain government contracts specifically to small businesses, and certain "preferences" are reserved for small businesses (SBA, 2017a). According to Kirkwood (2016), two distinct programmes have contributed to the successful growth of US small businesses, namely the small business programmes and the preferential programmes. Small business programmes are seen as the help given to small businesses who want to help themselves, for example, loan

guarantees and process simplifications (Kirkwood, 2016). On the other hand, preferential small business programmes create business opportunities for small businesses by restricting larger companies to compete (Kirkwood, 2016). Both these types of programmes have been successful in redirecting a significant amount of federal public procurement dollars to small businesses (Kirkwood, 2016).

The US Congress aims to give 23% of government-wide contracts to small businesses (McVay, 2017). This goal is subdivided into smaller goals stated as a 5% contract award to small disadvantaged businesses, a 5% goal to women-owned small businesses, a 3% goal for awards to historically underutilised business zone, and a 3% goal for awards to service-disabled-veteran-owned small businesses (McVay, 2017). In 2017, government managed to exceed this goal and ended up with 23.88% of prime contracts being awarded to small businesses (SBA, 2017b). This meant that a total of $105.7 billion in contracts had been awarded to small businesses (SBA, 2017b).

Small businesses are divided according to industries, each of which have varying thresholds to determine business size. The thresholds, or industry standards, are based on the North American Industry Classification System (NAICS) (McVay, 2017). The most frequently used size standard in the manufacturing industry is 500 employees compared to the service industry where $7 million average turnover over the past three years is used as the most common size standard (McVay, 2017). A summary of these thresholds per industry is provided in table 5-6 below.

Table 5-6: Summary of thresholds per small business industry

Type of industry	Threshold
Agriculture, forestry, fishing and hunting	The majority of the industries (72%) have a threshold of $0.8m in revenue. The rest of the industries, mainly forestry, have thresholds ranging from $5.5m to $27.5m in revenue.
Mining, quarrying, and oil and gas extraction	The threshold for this sector is based mainly on the number of employees, with a range from 250 to 1 500 depending on the business. Support services for this industry have a revenue threshold of $7.5m to $38.5m.
Construction	The threshold in construction is based on revenue, with a range from $15m to $36.5m.
Transportation and warehousing	The majority of entities in this sector have a revenue threshold of between $7.5m and $37.5m. Some entities in this sector have an employee threshold of between 500 and 1 500 employees.
Real estate and rental and leasing	The majority of entities in this sector have a revenue threshold of between $7.5m and $38.5m.
Management of companies and enterprises	All entities in this sector have a revenue threshold of $20.5m.

(Source: SBA, 2017a)

The table above attests to the fact that USA regulators acknowledge the unique limits that each type of industry and enterprise have for SME classification and that one standard definition cannot be applied to all. McVay (2017) notes that, while these size standards might not seem like “small” enterprises, the reason for setting the standards this high is to allow these enterprises to grow into thriving “medium” enterprises before they forego the advantages of being a small enterprise.

5.4.3 Small Business Investment Act of 1958

The Small Business Investment Act of 1958 was implemented to:

> improve and stimulate the national economy in general and the small business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply.

The programme that was established through the Small Business Investment Act of 1958 is the Small Business Investment Company (SBIC) programme (CSR Report, 2019). The SBA does not directly invest in small businesses, but through partners with non-listed entities who qualify as SBICs to provide finance to small businesses (USA GAO, 2016). There are currently 305 SBA-licensed SBICs, all privately owned and managed, which provide small businesses with private capital that the SBIC has raised (CSR Report, 2019). Since the start of the SBIC programme, an estimated $97.6 billion has been invested in approximately 181 185 small businesses (CSR Report, 2019). The capital is provided to small businesses through purchasing shares in these businesses, making loans to them, purchasing debt securities and providing them guarantees (CSR Report, 2019).

In order to qualify for financing as a small business, the business must meet the following conditions:

- tangible net worth of less than $19.5 million; and
- an average after-tax income for the preceding two years of less than $6.5 million; or
- a business which qualifies as small, as discussed in paragraph 4.5.3.

5.4.4 US Census Bureau

The US Census Bureau (2016) publishes its statistics on business size and employment in the annual Statistics of US Businesses (SUSB) reports. The companies reported on in these reports are not classified as small, medium and large, but according to 20 employment brackets, ranging from 0 to 4, 5 to 9 up to <500 and >500 employees per firm (US Census Bureau, 2016). The annual payroll costs of the firms are also reported; however, no mention is made of the revenue or asset figures (US Census Bureau, 2016).

5.4.5 Summary

The USA, unlike any of the other countries in the sample, does not have a definition for medium enterprises, only a definition for small enterprises. The limits imposed on small enterprises can be summarised as follows:

- less than 1 500 employees; or
- less than $38.5 million in revenue; or
- less than $550 million in assets.

There are significant differences in the thresholds used in different industries, as the requirement for small businesses is industry specific and derived from the characteristics of each industry. Not only are there significant differences among the industries, but the levels for defining small businesses in the USA are much higher than in other countries. One explanation for the high thresholds in the small business definition is that the US government wants to support these businesses up to the point where they become flourishing medium-sized businesses.

5.5 Australia

5.5.1 Background

Small businesses represent approximately 97.5% of all businesses in Australia (Royal Commission, 2018). These businesses employ 4.8 million people, which accounts for 44% of the total employment in the country (Parliament of Australia, 2018). The country appointed its first Small Business and Family Enterprise Ombudsman in 2016, who believes that a growing economy needs a strong small business sector (Australian Small Business and Family Enterprise Ombudsman, 2016).

5.5.2 Australian Small Business and Family Enterprise Ombudsman Act 123 of 2015

Section 5 of the aforementioned Act defines a “small business” as follows:

> A business is a small business at a particular time in a financial year (the current year) if it has either:
>
> - fewer than 100 employees at that time; or
> - its revenue for the previous financial year is $5m or less; or
> - if there was no time in the previous financial year when the business was carried on – its revenue for the current year is $5m or less.

The Act establishes the services of an ombudsman to help and assist small and family businesses.

5.5.3 Income Tax Assessment Act 38 of 1997

Section 328 of the Australian Income Tax Assessment Act 38 of 1997 provides the tax provisions for small businesses with the aim to reduce the compliance costs applicable to these entities. A small business in terms of this Act is defined as follows:

> You are a small business entity for an income year (the current year) if:
> (a) you carry on a business in the current year; and
> (b) one or both of the following applies:

(i) you carried on a business in the income year (the previous year) before the current year and your aggregated turnover for the previous year was less than $10m;
(ii) your aggregated turnover for the current year is likely to be less than $10m.

5.5.4 Australian Bureau of Statistics (ABS)

The ABS (2001) defines small businesses as those who employ less than 20 people. Businesses are categorised for statistical purposes as follows (ABS, 2001):

- "Non-employing businesses – sole proprietorships and partnerships without employees)
- Micro businesses – businesses employing less than 5 people, including non-employing businesses
- Other small businesses – businesses employing 5 or more people, but less than 20 people
- Medium businesses – businesses employing 20 or more people, but less than 200 people."

When analysing the size and contributions of businesses in the country, the Parliament of Australia (2015) also applies the SME definition as set out by the ABS.

5.5.5 Summary

There are significant differences in the definitions used in Australian legislation for a small business. The differences are vast, even to the extent that a small business is defined in the Corporations Act in two very different ways. In the summary in table 5-7 below, the definition used in Australian legislation for small companies is as follows:

- less than 100 employees; and/or?
- annual turnover equal or less than $10 million.

Table 5-7: Summary of small business definitions used in Australia

	Australian Small Business and Family Enterprise Ombudsman Act	Income Tax Assessment Act of 1997	Australian Bureau of Statistics
Employees	<100 employees	-	>5 employees and <20 employees
Revenue	≤AU$5m	≤AU$10m	-

(Source: Author)

The only definition that could be found for medium enterprises was posed by the ABS, which states that any business with more than 20 employees is seen as a medium business.

5.6 Canada

5.6.1 Background

Canada has approximately 1.2 million businesses, of which roughly 1.1 million (97.9%) are small businesses (Industry Canada, 2016). Only 1.6% of total businesses are classified as medium ((Business Development Bank of Canada (BDC), 2019). In 2015, small businesses employed 70.5% of the total labour force in Canada (Industry Canada, 2016). The Canadian government does not favour a top-down approach. In other words, they would rather provide policy guidance to their SMEs as opposed to mandating certain requirements in law (Ancarani *et al.*, 2019). As a result, there is limited legislation in Canada relating to SMEs. In the subsequent two paragraphs, the one piece of legislation that was found will be discussed, as well as the definition as set out by the Canadian Industry Statistics agency.

5.6.2 Small Business Financing Act 36 of 1998

The Small Business Financing Act 36 of 1998 was passed as law to increase the accessibility of finance for the formation, expansion, transformation and enhancement of small businesses in Canada. This Act defines a small business as follows:

small business means a business carried on or about to be carried on in Canada for gain or profit with an estimated gross annual revenue

- (a) not exceeding CA$10 million or any prescribed lesser amount for the fiscal year of the business during which a loan is approved by a lender in respect of the business; or
- (b) in the case of a business about to be carried on, not expected at the time a loan is approved by a lender in respect of the business to exceed CA$10 million or any prescribed lesser amount for its first fiscal year that is of not less than 52 weeks' duration.

It does not include the business of farming or a business having as its principal object the furtherance of a charitable or religious purpose.

5.6.2 Industry Canada

There are varying definitions in Canada for small businesses. One such definition is posed by Industry Canada (2017) and states the following thresholds:

- a small business has 5 to 99 paid employees;
- a medium-sized business has 100 to 499 paid employees;
- a large business has 500 or more paid employees.

5.6.3 Summary

Where Industry Canada bases its definition of a small business on the number of employees, the definition as per the Small Business Financing Act 36 of 1998 is based on the gross revenue of the entity.

Table 5-8: SME definitions in Canada

	Small	Medium
Employees	1 to 99	100 to 499
Turnover	<CA$10m	N/A

(Source: Author)

In order to qualify as a small business in Canada, the entity has to have less than 100 employees or a turnover not exceeding CA$10 million. On the other hand, to qualify

as a medium business, the only requirement is having a minimum of 100 employees, but no more than 500 employees.

5.7 Brazil

5.7.1 Background

There are currently 8.5 million micro and small enterprises in Brazil, which equate to 99% of all Brazilian businesses (SEBRAE, 2019). These businesses generate approximately 52% of employment in Brazil (SEBRAE, 2019). According to the International Labour Organisation (ILO, 2014), Brazil has managed to significantly increase its number of employees in formal small businesses during the past two decades by focusing on formalising small businesses. Between 1996 and 2012, the number of employees paying social security increased from 21.7 million to 53.8 million (ILO, 2014).

In 1984, the micro enterprise statute (Estatuto da Microempresa) was the first piece of legislation on micro and small enterprises to be introduced in the country. The statute differentiated these entities in terms of their tax treatment, labour obligations and access to credit, and provided an introduction to business development services (ILO, 2014). Even the 1988 Federal Constitution of Brazil recognised the importance of micro and small enterprises and promoted preferred treatment for these companies (ILO, 2014). From 1984, the Brazilian government continued for the next 20 years to improve and increase support to micro and small enterprises (ILO, 2014). When initial efforts proved unsuccessful, government reconsidered its policies and implemented a revised growth strategy in 2000. The strategy entailed the creation of a more beneficial business environment for these entities. This led to significant improvements, for example, an increase in employment numbers and the formalisation of these businesses (ILO, 2014).

The Brazilian government also implemented a broad set of measures to support micro and small enterprises, which include policies on innovation, technology transfer, reduced taxes, simplified business set ups and many more (ILO, 2014). A crucial factor in the success of micro and small enterprises in Brazil is government's encouragement of these entities to participate in public procurement (ILO, 2014). One such initiative is the national schools' meal programme, which is run by the Ministry of Education. Fifty

million meals are served daily in Brazil, and the initiative forced municipalities to spend 30% of funds received for these meals on products from family-based farms (ILO, 2014).

5.7.2 General Law for Micro and Small Businesses (Lei Complementar 123 of 2006)

The formalisation of the micro and small enterprises industry gathered momentum with the passing of a complementary law (Lei Complementar 123 of 2006), which is known today as the General Law for Micro and Small Businesses of 2006 (ILO, 2014). The aim of this law, as stated in Article 1, is to set out the differentiated and favoured treatment of individual enterprises, especially in relation to the collection of taxes, the fulfilment of labour and security obligations and access to credit. The law introduced annual gross income thresholds to determine which companies qualify as micro and small enterprises under the law. Any company with annual gross income equal to or less than R$0.2 million is classified as a micro enterprise, and any company with annual gross income exceeding R$0.2 million and equal to, or less, than R$2.4 million is classified as a small enterprise (Lei Complementar 123 of 2006).

In 2016, the Brazilian government amended the General Law for Micro and Small Businesses and increased the thresholds applicable to micro and small enterprises as follows (Lei Complementar 155 of 2016):

Table 5-9: Thresholds as per the General Law for Micro and Small Businesses in Brazil

Enterprise type	Threshold
Micro enterprise	Annual gross income ≤ than R$0.4m
Small enterprise	Annual gross income > R$0.4m and ≤ than R$4.8m

(Source: Lei Complementar, 2016)

5.7.3 Simples Nacional

The General Law for Micro and Small Businesses also provided an upgrade to an old Simples Federal Law 9317 (ILO, 2014). The initial Simples Federal exempted businesses from having to maintain accounting ledgers, and combined five different tax laws and the employer's contribution to social security into one payment (ILO, 2014). The General Law for Micro and Small Businesses pooled eight different taxes into one single payment, thereby further reducing the bureaucratic burden relating to

tax (ILO, 2014). This portion of the General Law is referred to as Simples Nacional and became effective in July 2007 (ILO, 2014).

Table 5-10: Thresholds for Simples Nacional in Brazil

Enterprise type	Threshold
Micro enterprise	Annual gross income ≤ than R$0.4m
Small enterprise	Annual gross income > R$0.4 and ≤ than R$4.8m

(Source: Lei Complementar, 2016)

5.7.4 The Brazilian Institute for Geography and Statistics (IBGE)

The IBGE is the only institute in Brazil that uses the number of employees as a threshold for statistical purposes (Mello, 2012). All other institutions only refer to revenue as a threshold (Mello, 2012).

Table 5-11: The IBGE micro and small enterprises thresholds in Brazil

Enterprise type	Threshold
Small enterprises	Industrial operations with between 20 and 99 employees, and services employing between 10 and 49 employees
Medium enterprises	Industrial operations with between 100 and 499 employees, and services employing between 50 and 99 employees

(Source: SAIIA, 2005)

5.7.5 Summary

Brazil has managed to move towards a more unified definition for its micro and small enterprises. This can be seen in the fact that two of its legislative definitions are exactly the same. However, the IBGE definition differs significantly, as it focuses on employees as the threshold, while the laws focus on turnover.

Table 5-12: Summary of frequently used micro and small enterprises criteria in Brazil

Enterprise type	General Law for Micro and Small Businesses and Simples Nacional	IBGE
Small enterprise	Annual gross income > R$0.4m and ≤ than R$4.8m	Industrial operations 20 to 99 employees, and services employing 10 to 49 employees
Medium enterprise	N/A	Industrial operations 100 to 499 employees, and services employing 50 to 99 employees

(Source: Author)

Medium-sized entities are not defined in Brazilian legislation. Only the IBGE offers a definition. Small entities are defined in both legislation and the IBGE in terms of gross income and number of employees respectively.

5.8 Russia

5.8.1 Background

The majority of Russian entrepreneurs involved in SMEs are first generation entrepreneurs (Zavyalov *et al*., 2017). Russia has approximately 6 million SMEs which employ 16 million people in the country (World Bank, 2018). However, these SMEs only account for 25% of the total employment in Russia and 22% of GDP (World Bank, 2018). These are low percentages in comparison with other countries in the study. The European Investment Bank (EIB, 2013) found that the GDP contribution of SMEs in Russia is not only significantly lower than that of developed countries, but also unparalleled to other developing countries. In spite of the SMEs' low contribution to the Russian economy, the country has one of the lowest unemployment rates in the world. In 2018, the rate was 4.8%, which compared favourably with rates in developed countries such as the UK at 4% and USA at 3.9% in the same year (OECD, 2018). The main reason for the low unemployment rate is that Russian companies would rather reduce salaries than retrench employees during difficult times (Russia Beyond, 2019).

Entrepreneurship in Russia is a “very young phenomenon” when considering the history of the country and took on a “modern shape” only in the last two decades (Zavyalov *et al.*, 2017). Despite emerging entrepreneurship, Russia is currently placed 31st in the ease of doing business ranking, which is a significant improvement from their ranking eight years ago at 120th (World Bank, 2018). The shift in ranking is due to reforms implemented, especially reforms to improve the regulatory environment for SMEs (World Bank, 2018). Not only has the Russian president announced a decree with the goal to provide stronger support to SMEs by 2024 (World Bank, 2018), but the country also plans to double the number of SMEs by 2030 (Anevski & Temelkovska, 2017).

5.8.2 Law No. 88-FZ on State Support for Small Business in the Russian Federation of 1995

Law No. 88-FZ defines how the state will help small businesses with regard to their objectives, methods and forms, as well as how they will be regulated. The law also includes the definition and criteria for small-sized companies. Law No. 88 defines an SME as follows:

> An organisation where the share participation does not exceed 25 percent by the Russian Federation or any other voluntary and religious organisations as well as total employees less than:
>
> - 100 employees for industry and construction;
> - 80 employees for agriculture;
> - 60 employees for the scientific and technical sphere;
> - 50 employees for wholesale trade or any other activity not listed; and
> - 30 employees for retail trade and domestic services.

5.8.3 Federal Law No. 209-FZ of July 24, 2007, on developing Small and Medium Scale Entrepreneurship in the Russian Federation

Federal Law 209-FZ was introduced in 2007 and replaced Federal Law 88-FZ. Where the previous law focused only on the small company, the new law added a definition for medium enterprises. The new law not only sets out the different ways to support SMEs, but also includes an updated definition for the small company (Federal Law

209-FZ, 2008). Small and medium entities are defined as “consumer cooperatives and commercial organisations as well as natural persons” in which the aggregate stake of the Russian Federation does not exceed 25% (Federal Law 209-FZ, 2008). The total number of employees for small enterprises are limited to 101, and for medium enterprises 250. In addition, these enterprises should not exceed certain revenue thresholds for the previous calendar year as set by the Russian government (Federal Law 209-FZ, 2008).

The latest resolution was passed on 4 April 2016 (N 265) and set out a limit of RUB800 million for small enterprises and RUB2 billion for medium enterprises (Russia, 2016). These limits were doubled from the 2013 resolution for revenue thresholds set at RUB400 million and RUB1 billion for small and medium enterprises respectively (Russia, 2013).

5.8.4 Russian Federal State Statistics Service

The definition as set out by Federal Law 209-FZ of 2007 is used by the Russian Federal State Statistics Service to define small and medium enterprises (GKS, 2018). Because the same definition is used, there are less discrepancy between the reported statistical figures in the country and the actual activities in the businesses.

5.8.5 Summary

The tables below summarise the definitions currently applicable in Russia for small and medium enterprises respectively.

Table 5-13: Definition for small enterprises in Russia

Indicator	Federal Law No. 209-FZ and Federal State Statistics Service	Law No. 88-FZ of 1995
Employees	<100	<100
Turnover	<RUB800m	N/A

(Source: Author)

In order for an entity to qualify as a small enterprise, it has to meet both the requirements above, namely less than 100 employees and less than RUB800 million

in turnover. Although the employee threshold in both definitions is the same, Law No. 88-FZ does not provide a turnover threshold. The turnover threshold according to Federal Law No. 209-FZ and the Federal State Statistics Service is set at less than RUB800 million for small enterprises.

Table 5-14: Definition for medium enterprise in Russia

Indicator	Federal Law No. 209-FZ of 2007 and Federal State Statistics Service
Employees	101 to 250
Turnover	<RUB2bn

(Source: Author)

In order to qualify as a medium enterprise in Russia, an enterprise must comply with both the employee and the turnover requirements. A medium enterprise must have less than RUB2 billion in turnover and between 101 and 250 employees. Only one definition applicable to medium enterprises could be found in Russian legislation.

5.9 South Africa

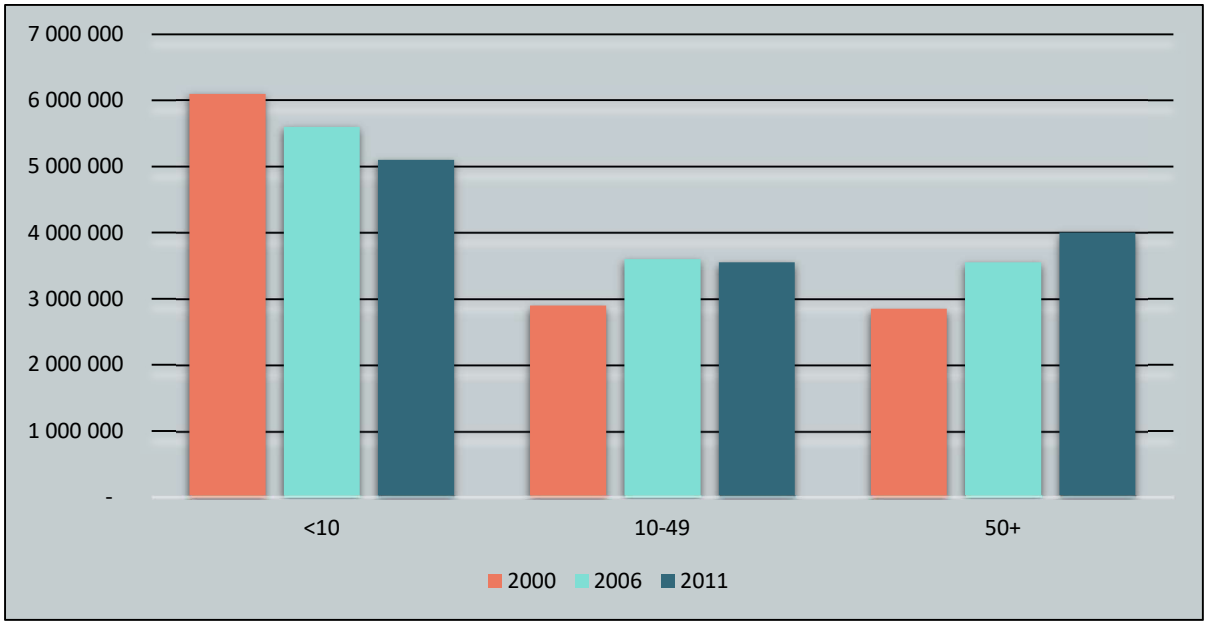
5.9.1 Background

In South Africa, SMEs employ 8.9 million people (SEDA, 2018), which accounts for 40% of the total employment in the country (Stats SA, 2018). South Africa has a total of 2 443 163 SMEs which comprise 658 719 entities in the formal sector and 1 714 233 in the informal sector (SEDA, 2018).

The National Development Plan was launched on 15 August 2012 and set out government's plans to improve the country over 18 years with specific goals for 2030 (South African Government, 2012). SMEs are seen as one of the key drivers in combating unemployment and fostering economic growth in the country (South African Government, 2012). One of these goals is that SMEs contribute towards 90% of employment (South African Government, 2012). However, from 2018, SMEs have been contributing only towards 40% of employment, as seen above. Despite the goal of increasing SME contribution to employment, a decrease in the number of people employed by SMEs has been seen, from 10.6 million in 2017 to 8.9 million in 2018 (SEDA, 2017; SEDA, 2018).

There is a vast difference in how smaller entities grow in South Africa compared to larger entities (Rankin *et al.*, 2013). Growth of SMEs is mainly expressed through the creation of jobs as opposed to larger entities where efficiencies are harnessed, and labour is thereby dispensed (Rankin *et al.*, 2013). In essence, more jobs are made available through SMEs than through larger companies. The employment opportunities presented through SMEs are a vital consideration in a country like South Africa where the unemployment rate stood at 27.1% at the end of 2018, which equates to 6.1 million unemployed persons (Stats SA, 2019b).

Figure 5-2: Number of people employed by firm size category in South Africa



(Source: Rankin et al., 2013)

The table above illustrates a decline of 1 million people employed by SMEs in entities that employ less than 10 people, from 2000 to 2011. Rankin *et al.* (2013) suggest that there was a corresponding decline in the number of entities as well. It is also evident from figure 5-2 that, even though firms which employ 10 to 49 persons grew from 2000 to 2006, a stagnation was experienced and the base shrunk slightly in the period from 2006 to 2011. This is a clear indication that SMEs are not creating employment opportunities and sustenance in South Africa when compared to the employment contributions of SMEs in other countries. In order to better understand the reasons for the lack of growth in SMEs, previous research on SMEs in South Africa is discussed below.

5.9.2 SME research in South Africa

The Small Business Institute (SBi, 2018) conducted a study using the South African Revenue Services and National Treasury (SARS-NT) dataset and the Company Income Tax (CIT) submissions over a period of six years from 2011 to 2016. The South African Revenue Services and National Treasury panel dataset, or SARS-NT dataset, "captures 'formal' firms and employment – those enterprises which are registered for tax, and employees for whom the enterprise has submitted an IRP5".

Table 5-15: Firm size and employment numbers for 2016 in South Africa

Size of business	No. of firms	Percentage of total firms	Employment numbers by firm size	Employment percentage by firm size
Micro 0 to 10 employees	176 333	66%	685 264	5%
Small 11 to 50 employees	68 494	26%	1 549 411	11%
Medium 51 to 200 employees	17 397	6%	1 628 429	12%
Large 201+ employees	5 735	2%	9 702 416	72%

(Source: SBi, 2018)

The first significant finding from table 5-15 above is that only approximately 250 000 SMEs (SBi, 2018) are registered to file tax returns. This number is significantly lower than the number of formal SMEs as reported by the Bureau for Economic Research (BER, 2016) for 2016 at 667 433 entities in the formal sector. The second finding is that, even though SMEs contribute to 98% of the total tax paying entities in the country, these entities only employ 28% of the total employees in the country (SBi, 2018). The reason for this significant difference between the findings of the two studies is that the SBi (2018) used the employee threshold to determine the size of the entity, while the BER (2016) used the turnover threshold per the National Small Business Act (NSBA). This threshold is updated by Stats SA yearly to adjust for inflation; therefore, it is reasonable to conclude that more entities will be included in the BER study. However,

this also shows the inconsistent application of the SME definition. The turnover thresholds used in the BER (2016) study are as follows:

Table 5-16: NSBA lower boundaries on enterprise sizes (adjusted by Stats SA)

Industry	Medium >R million	Small >R million	Very small >R million
Mining and quarrying	95	38	2
Manufacturing	123.5	47.5	2
Electricity, gas and water	123.5	48.5	2
Construction	57	28.5	2
Wholesale trade	304	57	2
Retail trade	180.5	42.5	2
Motor trade	180.5	42.5	2
Accommodation and catering	57	48.5	2
Transport	123.5	28.5	2
Retail estate and business services	123.5	28.5	2
Community, social and personal	57	8.5	2

(Source: Stats SA, 2015)

The BER (2016) found that the growth rate for SMEs was lower in the period 2008 to 2015 than the economic growth rate of the country. However, the contribution to Gross Value Added (GDP before taxes and subsidies) showed a positive increase over the same time. South African SMEs face a myriad of problems due to poor infrastructure, limited access to finance, labour laws and inefficient bureaucracy (BER, 2016).

In a 2005 study, SBP (a group of business environment specialists) questioned 1 800 companies, from both the formal and informal sector, regarding regulatory costs. The findings were reported in a document titled “Counting the cost of red tape for business in South Africa”. The study revealed that South African firms experience regulations, especially tax and labour regulations, as a significant constraint to their growth and ability to create more jobs (SBP, 2005). Results showed that small firms bear the most onerous burden, as their compliance cost as a percentage of turnover is the highest (SBP, 2005). Small firms have a cost percentage of 8.3%, where large firms have a 0.2% cost as a percentage of turnover (SBP, 2005). The average compliance cost per

person employed for firms with less than five employees is ten times higher than for firms with 200 to 499 employees (SBP, 2005). The reason for the high percentage in smaller firms is that certain costs are fixed and therefore borne by all firms, whether large or small. The large firms can better absorb these costs (SBP, 2005).

The above-mentioned studies indicate that a combination of problems is responsible for the lack of growth in SMEs. These problems are persistent despite the efforts being made by government to improve the growth of SMEs. In fact, the lack of growth seems to indicate that the strategies being applied are not effective. The SBi (2018) has also reviewed approximately 70 laws, strategic policies and regulation documents affecting small businesses and found that there are various interpretations of the SME definition; thus, a standard definition is lacking.

The following paragraphs focus on the inefficient bureaucracy with regard to SMEs in South Africa. A discussion will be presented on the indirect cost of compliance for these businesses. Various departments set out different requirements for SMEs in South Africa, overcomplicating the country's SME space and crippling the growth of these companies.

5.9.3 National Small Business Act 102 of 1996

The National Small Business Act 102 of 1996 replaced the Small Business Development Act 112 of 1981. The new Act established a council and a promotion agency to provide guidelines to the state for promoting small businesses in the country. The Act defines a small business as follows:

> [a small business] means a separate and distinct business entity, including co-operative enterprises and non-governmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or subsector of the economy mentioned in column 1 of the Schedule and which can be classified as a micro-, a very small, a small or a medium enterprise by satisfying the criteria mentioned in columns 3; 4 and 5 of the Schedule opposite the smallest relevant size or class as mentioned in column 2 of the Schedule.

Schedule 1 to the Act sets out the initial thresholds for the four types of SMEs to define these businesses. Each of these thresholds must be met in order to qualify as one of the businesses as per column 2. The initial employee threshold for the SME definition was set at less than 50 employees. The total turnover threshold ranged from less than R25 million in the sector for wholesale trade, commercial agents and allied services to less than R2 million in the agriculture sector. The total gross asset value ranged from less than R3.75 million at the top end of the range for the manufacturing industry to the lower end of the scale of less than R1 million in the construction and catering sector, as well as in the accommodation and other trade sector.

The employee threshold for all medium companies was set at 200, except for agriculture where the threshold was set at less than 100 employees. The total turnover threshold for medium enterprises ranged from less than R50 million in wholesale trade, commercial agents and allied services to less than R4 million in agriculture. Total assets ranged from less than R18 million in mining and quarrying to less than R4 million in agriculture.

5.9.4 National Small Business Amendment Act 26 of 2003

In 2003, the National Small Business Amendment Act of 2003 was introduced. Its main contribution was an update to the Schedule as introduced in the National Small Business Act of 1996. There were no changes to the definition of small business as introduced in the National Small Business Act of 1996, only a change in the thresholds used. When comparing the initial introduction of Schedule 1 in 1996 with the amended 2003 Schedule 1, it is clear that the number of employees in the thresholds did not change. Only the figures relating to total turnover and total gross assets were updated seven years after the initial introduction of the schedule.

5.9.5 National Small Enterprise Amendment Act 29 of 2004

The main changes in the Amendment Act of 2004 are as follows:

- The word “business” was replaced with “enterprise”.
- Provision was made for the establishment of the Small Enterprise Development Agency.
- Provision was made for advisory centres to be established within this Agency.

There were no updates to the thresholds as determined in Schedule 1 of the National Small Business Act of 1996 and as updated by the National Small Business Amendment Act 26 of 2003.

5.9.6 Revised Schedule 1 of the national definition of small enterprise in South Africa

On 12 October 2018 the Minister of Small Business Development published an amended Schedule 1 as contained in the National Small Enterprise Act of 1996, read with the National Enterprise Amendment Act of 2003 and the National Small Enterprises Act of 2004, for public commentary in Government Gazette No. 41970 (Department of Small Business Development, 2018). The proposed change to Schedule 1 included various alterations (Department of Small Business Development, 2018). Firstly, an inflationary increase on the thresholds for revenue was proposed. Secondly, the suggestion was made that the total gross asset value threshold be removed entirely from the definition, thereby defining a small company by reference only to employees and total annual turnover (Department of Small Business Development, 2018). Thirdly, the removal of the fourth size category referred to as "very small enterprise" was suggested, as research found it to be inconsistent with global best practice and of little value (Department of Small Business Development, 2018).

The Ministry of Small Business Development justified the removal of the asset threshold based on the SARS-NT dataset and the CIT data. Also, the asset threshold had caused difficulties due to complexities that arose when assets and their values were verified (Department of Small Business Development, 2018).

The updated Schedule 1 was proclaimed on 15 March 2019 in Government Gazette No. 42304 (Department of Small Business Development, 2019). Even though the Minister did not highlight it as such, another change occurred in the schedule, namely an update to employee numbers.

Table 5-17: Employee thresholds in Schedule 1 as updated

Type of enterprise	Employee numbers
Medium	51 to 250
Small	11 to 50

(Source: Department of Small Business Development, 2019)

In Schedule 1 in the 2003 amendment the employee numbers differed between the various sizes of entities and between the different industries. In the updated Schedule 1 a standard employee threshold was introduced for all industries. The updated employee thresholds align South Africa's employee threshold to the global average, the EU definition and UK thresholds.

Table 5-18: Summary of the total annual turnover threshold in the updated Schedule 1 for small enterprises in South Africa

	Total turnover
Agriculture	<R17m
Mining and quarrying	<R50m
Manufacturing	<R50m
Electricity, gas and water	<R60m
Construction	<R75m
Retail and motor trade and repair services	<R25m
Wholesale	<R80m
Catering, accommodation and other trade	<R15m
Transport, storage and communications	<R45m
Finance and business services	<R35m
Community, social and personal services	<R22m

(Source: Department of Small Business Development, 2019)

Table 5-18 above clearly shows an updated maximum total turnover for small enterprises at less than R80 million and a total turnover at the bottom end of the range as R15 million. The increases demonstrate a significant shift from the previous requirements, namely a total turnover threshold for small enterprises at a maximum of R19 million (par. 5.10.4). The thresholds per table 5-18 have increased approximately four times their original value compared to the 2003 Schedule.

Table 5-19: Summary of the total annual turnover threshold in the updated Schedule 1 for medium enterprises in South Africa

	Total turnover
Agriculture	<R35m
Mining and quarrying	<R210m
Manufacturing	<R170m

	Total turnover
Electricity, gas and water	<R180m
Construction	<R170m
Retail and motor trade and repair services	<R80m
Wholesale	<R220m
Catering, accommodation and other trade	<R40m
Transport, storage and communications	<R140m
Finance and business services	<R85m
Community, social and personal services	<R70m

(Source: Department of Small Business Development, 2019)

The previous upper end of total turnover for the wholesale sector, as turnover less than R64 million, has increased to R220 million, as per table 5-19 above. The lower end of the turnover range for agriculture is now less than R35 million.

5.9.7 SME definition used by different departments

Only some government departments have adopted the SME definition as set out in the NSBA. A summary of the definitions used by the departments is shown in the table below (Trade and Industrial Policy Strategies [TIPS], 2017).

Table 5-20: A summary of SME definitions across different legal statutes in South Africa

Type of legislation	Threshold/ exemption	Basis for defining SMEs		
		Employ-ees	Turnover	NSBA definition
Cooperatives Act 14 of 2005	Minimum 5 people to register a cooperative	-	-	-
Basic Conditions of Employment Act 75 of 1997	Applicable if more than 10 employees	Yes	-	-
Employment Equity Act 55 of 1998	Applicable if more than 50 employees	Yes	-	-
Skills Development Act 97 of 1998	R0.5m salary bill	-	Yes	-

Type of legislation	Threshold/ exemption	Basis for defining SMEs		
		Employ-ees	Turnover	NSBA definition
Broad-Based Economic Empowerment Act 53 of 2003	Exempted micro enterprise if less than R10m turnover Qualifying small enterprise if R10m but less than R50m	-	Yes	-
Sector Charters (B-BBEE)		-	Yes	-
Income Tax Act 58 of 1962	R1m turnover per annum for Turnover Tax R20m turnover for a Small Business Corporation (SBC)	-	Yes	-
Value-Added Tax Act 89 of 1991	R1m turnover threshold	-	Yes	-
National Credit Act 34 of 2005	NSBA definition	-	-	Yes
Preferential Procurement Policy Framework Act 5 of 2000	NSBA definition	-	-	Yes

(Source: TIPS, 2017)

It is justifiable that some departments would place more emphasis on one indicator, for example, tax legislation that focuses on revenue. However, the exemption mentioned in the different pieces of legislation is applied inconsistently, which causes an unnecessary burden on small enterprises (TIPS, 2017). SMEs will need to prove to each department that they are in fact an SME based on different criteria. In some cases the criteria will be met and the enterprise will be seen as small, while in other instances the same enterprise will not meet the criteria and will not be deemed an SME (TIPS, 2017).

SMEs have limited access to expert advice. Owing to complicated definitions, and different definitions being applied across departments, SME owners and personnel spend valuable time figuring out regulatory requirements instead of focusing on business. SBi (2018) found that many of these departments follow a “siloed” approach to SMEs, which means “that there is no policy or regulatory coordination, no harmonisation across laws and no coordination across government to understand the impact of its interventions”.

TIPS (2017) performed a survey on the SME definition. Results indicated that users of the definition think that the private sector was the least likely to use the NSBA definition, followed by parastatals and government departments. The majority of private sector respondents said they did not use the NSBA definition as they preferred to apply definitions as set out in other types of legislation (TIPS, 2017). Some respondents challenged the use of the NSBA’s definition because they experienced a wide variety of eligibility criteria that were unrelated to the official small business definition (TIPS, 2017). The survey also found that users of the NSBA definition commonly apply turnover and employment (27%) or turnover only (27%) to determine the class and size of the enterprise they are dealing with (TIPS, 2017).

According to TIPS (2017), the NSBA definition is out of date. International best practice is to adjust all the thresholds for inflation, and the last time that the thresholds were adjusted was 16 years ago with the amendment to the Act. Consultation with Stats SA officials suggested that the NSBA definition has been used to report on sector trends in the economy (TIPS, 2017). However, officials cautioned that the use of the Act’s thresholds require factor adjustments to more accurately distribute the different sizes of businesses in the economy – the current thresholds are too low even when adjusted for inflation (TIPS, 2017). According to international best practice, the thresholds must be updated at least every five to seven years to best reflect the circumstances of small businesses (TIPS, 2017).

According to the Davis Tax Committee (DTC, 2016), 180 000 SBCs were registered in 2002. However, in 2013, only 113 926 of these SBCs submitted a tax return, mainly due to the declining number of SBCs. These SBCs are companies with a turnover of more than R1 million and less than R20 million. These low figures might also be an indication that many SMEs are not aware of the benefits of registering a company as an SBC and reaping the benefits of the accompanying tax incentives. Another significant finding by judge Dennis Davis and his team (DTC, 2016) was that the current Skills Development Levy (SDL) threshold posed a substantial problem for SMEs, as the current system is "skewed against the SME sector". SMEs are required to contribute to SDL when the company payroll is above R0.5 million, with no real prospect of getting the same training subsidies as larger entities due to the compliance costs involved (DTC, 2016).

5.9.8 Stats SA

Stats SA (2019a) conducts quarterly surveys on financial statistics in which they report on matters ranging from industry turnover to income and expenditure items. The SME sector is included in this survey and, in order to determine the size of an enterprise, Stats SA (2019a) adjusts the industry thresholds for turnover as per Schedule 1 of the NSBA for yearly inflation.

Table 5-21: Summary of NSBA lower boundaries on enterprises sizes (adjusted by Stats SA)

Industry	Large >R million	Medium >R million	Small >R million
Mining and quarrying	527	135	54
Manufacturing	689	176	68
Electricity, gas and water	689	176	69
Construction	351	81	41
Wholesale trade	864	432	81
Retail trade	523	257	54
Motor trade	176	257	54
Accommodation and catering	176	81	69

Industry	Large >R million	Medium >R million	Small >R million
Transport	351	176	41
Retail estate and business services	351	176	41
Community, social and personal	176	81	14

(Source: Stats SA, 2019a)

The thresholds above differ from the current active thresholds as amended in 2019 by the Minister. Also, Stats SA only applies the turnover threshold and not all three thresholds when publishing any statistical results in relation to SMEs.

5.9.9 Summary

According to the London Stock Exchange Group (LSEG, 2019), there is a funding gap of approximately US$140 billion to grow SMEs in Africa. It is impossible to provide funding to SMEs without proper identification of those enterprises that comply with the SME definition. According to a paper by SBP in 2009, “South Africa lags behind other developing countries in promoting the growth and sustainability of small businesses”. A possible reason for the delay in growth in South Africa’s small business could be the regulatory burden.

In section 5.9 various definitions of “small enterprise” used within South Africa were identified. These definitions, used by government departments and in legislation, differ, in some cases significantly.

TIPS (2017) concluded in its study that simply raising the thresholds for companies to qualify as SMEs in South Africa is not enough. The definition needs to be simplified for users within government and SMEs, and be applied consistently. It seems that government has taken these recommendations to heart in its latest proposal to amend the SME definition, namely to increase the thresholds and remove the “very small” enterprise and the “asset threshold”. The removal of the asset threshold was informed mainly by the difficulty in trying to quantify this threshold for each enterprise.

The table below summarises the most prominent definitions available from Stats SA and outlined in legislation in South Africa for small enterprises.

Table 5-22: Definitions for small enterprises in South Africa

	Broad-Based Economic Empowerment Act 53 of 2003 (5.10.6)	Income Tax Act 58 of 1962 (5.10.6)	Updated NSBA thresholds (5.10.6)	Stats SA (5.10.9)
Turnover	>R10m and <R50m	<R20m	>R5m to <R80m	<R432m
Employees	-	-	>11 and <50	-

(Source: Author)

As evident from table 5-22 above, the highest threshold for small enterprises is a turnover of less than R432 million. The number of employees is rarely used as a threshold. The table below summarises the relevant definitions applicable to medium enterprises in South Africa.

Table 5-23: Definition for medium enterprises in South Africa

	Updated NSBA thresholds (5.10.6)	Stats SA (5.10.8)
Turnover	<R35m to <R220m	<R864m
Employees	>51 to <250	-

(Source: Author)

It is clear from table 5-23 above that medium enterprises are also mainly defined with regard to their turnover and, secondly, number of employees. The threshold in the Stats SA definition is significantly higher than the threshold set out in the latest NSBA schedules for turnover.

5.11 Chapter summary

Table 5-24 below represents a summary of small enterprise definitions as determined globally, as well as for each country. Each country uses a different qualifier for its SME definition. Where the UK requires an entity to meet two of the three thresholds, Australia, Canada, South Africa and Brazil require an entity to meet either the employee threshold or the turnover threshold for acquiring small entity status. The USA, on the other hand, only requires an entity to meet one of the three thresholds, and Russia requires an entity to meet both of the thresholds.

In order to compare the SME definitions used among the countries in this study, all of the highest identified definitions were summarised for the respective country's definition.

Table 5-24: Summary of SME thresholds for small companies across selected countries

	Global million	UK million	USA million	Australia million	Canada million	Brazil million	Russia million	RSA million
Employees	≤50	≤50	≤1 500	<100	<100	<100	<100	≤50
Turnover	≤$5	≤£10.2	≤$38.5	≤AUS$10	≤CAN$10	≤R$4.8	≤RUB800	≤R432
Assets	-	≤£5.1	≤$550	-	-	-	-	-
Qualifier	Either	2 of 3	1 of 3	Either	Either	Either	Both	Either

(Source: Author)

The same process as explained above was followed to determine the definitions applicable to medium enterprises. Table 5-25 below summarises the requirements for medium enterprises globally, as well as for the countries in the study where medium enterprises are defined. Medium-sized enterprises are not defined in the USA.

Table 5-25: Summary of SME thresholds for medium enterprises across selected countries

	Global million	UK million	Australia million	Canada million	Russia million	RSA million
Employees	≤250	≤250	>20	<500	<250	<250
Turnover	≤$70	≤£36	-	-	≤RUB2 000	≤R864
Assets	≤$62	≤£18	-	-	-	-
Qualifier	Either	2 of 3	1	1	Both	Either

(Source: Author)

It is evident from the table above that the UK requires an enterprise to meet two of the three size criteria in order to be seen as a medium enterprise. Russia requires an entity to have less employees and less turnover than the thresholds in order to meet the requirements as a medium enterprise. Australia and Canada only have an employee threshold. The threshold in Australia is unique, as it sets out the requirements as any entity with more than 20 employees. South Africa defines an entity as medium if it meets the turnover threshold according to Stats SA. However, according to the NSBA requirements, an entity is classified as medium if it meets both the turnover and the employee threshold, with a much lower turnover threshold than the Stats SA definition.

In this chapter, the definition for SMEs was investigated for the seven countries in the study. For each country, two legal definitions and one definition from the statistical body were obtained, except for Canada, which has limited legal definitions for SMEs. In most countries, the SME sector contributes to a significant portion of the country's economy, in some instances even 90%. Even though this sector seems to play a vital role in economies, not enough attention is being paid to defining an SME in each country. Proper definitions would help these entities acquire much-needed assistance.

The upper thresholds of each country's definitions were summarised in tables 5-24 and 5-25 for small and medium enterprises separately. From these summaries, it became clear that each country has unique requirements in relation to SMEs, whereas some similarities were also identified, especially in relation to the requirement for the number of employees.

The next step in the study was to compare the thresholds and SME definitions across the selected countries. Chapter 6 provides the comparison of the audit exemption threshold and the calculation of a hypothetical PI score based on the audit exemption thresholds for each country. This chapter also provides the comparison of the small and medium enterprise definitions, as well as a calculation of a hypothetical small company PI score. The two sets of hypothetical PI scores will be compared to ultimately give recommendations for improvements in chapter 7.

CHAPTER 6: THE AUDIT EXEMPTION THRESHOLD IN SOUTH AFRICA COMPARED TO OTHER COUNTRIES

6.1 Introduction

In chapter 4 the audit exemption threshold applied in each country in the sample was discussed and the current applicable threshold for each was determined. This was done through inspection of the relevant laws, regulations and literature emanating from professional bodies. Chapter 4 concluded with a summary of the audit exemption thresholds used in the countries, expressed in the relevant currency (in table 4-5).

In this chapter, currencies are converted to South African Rand to allow a meaningful discussion of the similarities and differences between the audit exemption thresholds in the countries. A PI score will be calculated for each country, based on the South African PI score guidelines as outlined in the regulations to the Companies Act 71 of 2008. These scores will enable the researcher to better compare the South African threshold with that of the other countries and to draw more insightful conclusions.

In the second half of chapter 6, a similar approach to the SME definition will be followed. The SME thresholds, as defined in table 5-24 for small companies and table 5-25 for medium companies, will be converted to South African Rand, after which a comparison of the similarities and differences of the thresholds will be provided.

Table 6-1 below illustrates the audit exemption thresholds converted into South African Rand using the average exchange rate (Exchange Rates, 2020) per country for 2019.

Table 6-1: **The audit exemption thresholds for selected countries in Rand rounded up to the nearest million**

	UK R million	USA R million	Australia R million	Canada R million	Brazil R million	Russia R million	RSA R million
Total revenue	<R189	N/A	<R252	N/A	<R1 100	<R90	<R350
Total assets	<R95	N/A	<R126	N/A	<R880	<R14	N/A
Employees	<50	N/A	<50	N/A	N/A	N/A	<350
Shareholders (SH)	10%	N/A	5%	1	N/A	N/A	<350
Third party liabilities	N/A	N/A	N/A	N/A	N/A	N/A	<R350
Qualifiers	Two of the first three, or 10% of SH	N/A	Two of the first three, or 5% of SH	If one SH votes for an audit, then an audit must take place	Entities must have both qualifiers in place to be exempt from audit	Entities must have both qualifiers in place to be exempt from audit	Each qualifier individually or a combination of above needs to be below 350

(Source: Author)

Table 6-1 above summarises the audit exemption requirements for each of the seven countries converted to Rand. It is evident from the above table that no two countries share exactly the same approach to their audit exemption threshold. In the sections that follow a comparison will be drawn to highlight the similarities and differences between the countries.

6.2 Audit exemption similarities between countries

The following similarities in the audit exemption threshold calculation are evident from table 6-1:

- Both the UK and Australia apply three qualifiers for audit exemption, namely total revenue, total number of employees and total assets.
- Both the UK and Australia also require a company to meet two of the three qualifiers for audit exemptions.
- Both the UK and Australia use 50 employees as one of their qualifiers for audit exemption.
- Both the UK and Australia give shareholders the power to choose an audit subject to a certain percentage requiring an audit.
- Both Brazil and Russia use two qualifiers, namely total revenue and total assets, for their audit exemption qualification. If a company has more turnover or more assets than the set thresholds, it means that the company would be subject to an audit.
- The majority of countries (five out of seven) deem total revenue an important component to determine audit exemption.
- The majority of countries (four out of seven) deem total assets a vital component to determine audit exemption.
- The majority of countries (four out of seven) take shareholders into account when determining whether the company should undergo or forego an audit.

It is clear that, even though none of the countries follow the exact same approach to their audit exemption threshold, there are many similarities between the countries.

6.3 Audit exemption differences between countries

Table 6-1 highlights the following differences between the audit exemption threshold in the selected countries:

- The majority of countries apply two to three qualifiers to calculate their exemption threshold, while South Africa uses four.
- None of the Rand values for any of the thresholds are the same or even similar.

- The USA is the only country that gives audit exemption to all small companies. Therefore, the lowest number of audits are expected to be performed in the USA for non-listed entities.
- While Canada allows for one shareholder to determine whether the enterprise wants an audit, the UK allows for 10% and Australia 5% of their shareholders. In contrast, South Africa takes into account the number of shareholders involved in the company to determine the PI score. The opinions/vote of these shareholders are not taken into account in this way in any of the other countries.
- Canada is the only country which has one qualifier, namely one shareholder who could determine whether the company must undergo an audit.
- Brazil and Russia are the only two countries that do not use the number of employees as a consideration for their audit exemption threshold calculation.
- South Africa is the only country that does not use total assets in its audit exemption calculation.
- South Africa is the only country that uses third party liabilities as one of the qualifiers in the calculation for audit exemption.
- South Africa is the only country which combines the thresholds into one calculation.

These differences highlight how the countries in the sample use their own approach to audit exemption. In the next section the PI score for each country will be calculated to allow a meaningful comparison with the South African PI score.

6.4 PI score calculation for other countries

The PI score in South Africa is a unique way of calculating the audit exemption threshold. The lower the PI score of a company, the less audits will be performed in the company. The higher the PI score, the more the audits it will undergo.

In order to further compare the countries in the sample to South Africa, the qualifiers from table 6-1 were converted to a number as per the regulations to the Companies Act 71 of 2008 and a PI score was calculated for each of the combinations for each country. Six countries were used in the comparison, namely the UK, Australia, Canada, Brazil, Russia and South Africa. The USA was left out as there is no requirement for US non-listed companies to undergo an audit.

To illustrate, the UK is taken through the process step by step. The UK has three qualifiers summarised as follows:

- Turnover £10.2 million
- Total assets £5.1 million
- Total employees 50

If a company meets any two of the three qualifiers, the company has to undergo an audit. The thresholds were converted using the average 2019 exchange rate of R18.44 (Exchange Rates, 2020) for one Pound to Rand:

- Turnover R188 079 646
- Total assets R94 039 823
- Employees 50

The regulations to the Companies Act 71 of 2008 state that one point is awarded for each R1 million (or portion thereof) in turnover and one point for R1 million (or portion thereof) in total assets. By dividing the Rand values of the thresholds above, the following points are calculated:

- Turnover 189
- Total assets 95
- Employees 50

The UK, therefore, has the following three combinations:

1. Turnover and Total assets 284 (189+94)
2. Turnover and Employees 239 (189+50)
3. Total assets and Employees 145 (95+50)

It is evident from the UK calculation that all three PI scores for the UK are lower than South Africa's PI score of 350. This means that South Africa performs fewer statutory audits than the UK. South Africa also has a threshold of 100 for when the financial statements are internally compiled by the company. This threshold does not compare well to any of the other countries, as none of them has this requirement. It is, however, included for completeness and to see how South Africa compares on the lower end of the scale.

The same approach that was followed with the UK was followed with the other countries in the sample to obtain a PI score for each. In table 6-2 below the countries are listed from the highest PI score, therefore the countries which require the least number of audits, to the lowest PI score.

Table 6-2: PI scores calculated for the countries in the study

Rank	Country	Qualifier	PI score
1	Brazil	Turnover	1 100
2	Brazil	Total assets	880
3	Australia	Turnover and Total assets	378
4	South Africa	Turnover, Employees, Shareholders and Third party debt	350
5	Australia	Turnover and Employees	302
6	UK	Turnover and Total assets	284
7	UK	Turnover and Employees	239
8	Australia	Total assets and Employees	176
9	UK	Total assets and Employees	145
10	South Africa	Turnover, Employees, Shareholders and Third party debt (Internally compiled financial statements)	100
11	Russia	Turnover	90
12	Russia	Total assets	14
13	Canada	Shareholders	1

(Source: Author)

According to table 6-2, Brazil is the country in which the lowest number of audits are performed in non-listed entities, while the highest number of audits in non-listed entities are performed in Canada. South Africa ranks third in terms of the hypothetical PI score for audit, with only Brazil and Australia ranking higher. This means that non-listed entities in only these two countries will audit less than those in South Africa. Thus, South Africa audits the third least out of the six countries in the sample. When financial statements are internally compiled, South Africa ranks fifth out of the six countries, with only Russia and Canada that audit more than South Africa. The next step is to rank the BRICS countries from the highest PI score to the lowest.

Table 6-3: BRICS countries ranked from highest to lowest PI score

Rank	Country	Qualifier	PI score
1	Brazil	Turnover	1 100
2	Brazil	Total assets	880
3	South Africa	Turnover, Employees, Shareholders and Third party debt (Externally compiled financial statements)	350
4	South Africa	Turnover, Employees, Shareholders and Third party debt (Internally compiled financial statements)	100
5	Russia	Turnover	90
6	Russia	Total assets	14

(Source: Author)

The table above illustrates that, out of the three developing countries in the study, only Russia performs more audits than South Africa. Brazil performs fewer audits than South Africa, irrespective of whether financial statements are internally or externally compiled in South Africa.

6.5 Stakeholder and agency theory

The secondary objective of chapter 6 is to compare the audit exemption threshold in relation to stakeholder and agency theory. The audit exemption threshold comparisons were completed in section 6.4.

The shareholders of a non-listed company become the outsider in their own companies as the principal becomes the insider (Gyapong & Afrifa, 2019. This separation between owner and company is the core focus of agency theory, and oftentimes the owner will engage with the auditor to act on his/her behalf. Stakeholder theory, however, adopts a much wider approach and posits that the company has a moral obligation towards all stakeholders, as well as shareholders (Freeman, 1983).

While the initial need for audit originated from owners' loss of control over their companies (agency theory), a broader need has developed in the past few decades to also take into account those affected by the company and its decisions (the stakeholders).

In comparison with the other countries in the study, South Africa takes into account more stakeholders in the calculation of audit exemption. The South African audit exemption threshold comprises four different thresholds, whereas other countries have three thresholds at most, of which only two might be used to determine audit exemption. The four different thresholds used in South Africa include employees, shareholders, the company's own revenue (i.e., customer considerations) and third party liabilities (in essence suppliers and lenders). South Africa, therefore, considers the majority of stakeholders in the public interest calculation of a company. However, South Africa does not give the minority shareholders in a non-listed company any power to choose an audit as is the case in many of the other countries in the study. South Africa, therefore, leans more towards stakeholder theory than agency theory.

6.6 SME definition comparison

The SME definitions discussed in chapter 5 will be compared in the rest of this chapter. The thresholds in foreign currency in each country are converted at the average 2019 exchange rate to get to a South African Rand value in table 6-4 below.

Table 6-4: Summary of SME thresholds for small companies across selected countries

	Global R million	UK R million	USA R million	Australia R million	Canada R million	Brazil R million	Russia R million	RSA R million
Employees	≤50	≤50	≤1 500	<100	<100	<100	<100	≤50
Turnover	≤72	≤188	≤556	≤100	≤109	≤18	≤179	≤432
Assets	-	≤94	≤7 947	-	-	-	-	-
Qualifier	Either	2 of 3	1 of 3	Either	Either	Either	Both	Either

(Source: Author)

The table above clearly shows that no two countries use similar definitions of a small company and that there are significant differences in the thresholds used across the countries. In paragraphs 6.6.1 to 6.6.3 each qualifier in the SME definition will be discussed separately as interpreted by the countries in the study.

The same process for small enterprises was followed, namely converting the foreign currencies to South African Rand to determine the definitions applicable for medium enterprises. Table 6-5 below summarises the requirements for medium enterprises globally, as well as for the countries in the study where medium enterprises are defined. Medium-sized enterprises are not defined in the USA and therefore not included below.

Table 6-5: Summary of SME thresholds for medium companies across selected countries

	Global R million	UK R million	Australia R million	Canada R million	Russia R million	RSA R million
Employees	≤250	≤250	>20	<500	<250	<250
Turnover	≤1 011	≤664	-	-	≤449	≤864
Assets	≤896	≤332	-	-	-	-
Qualifier	Either	2 of 3	1	1	Both	Either

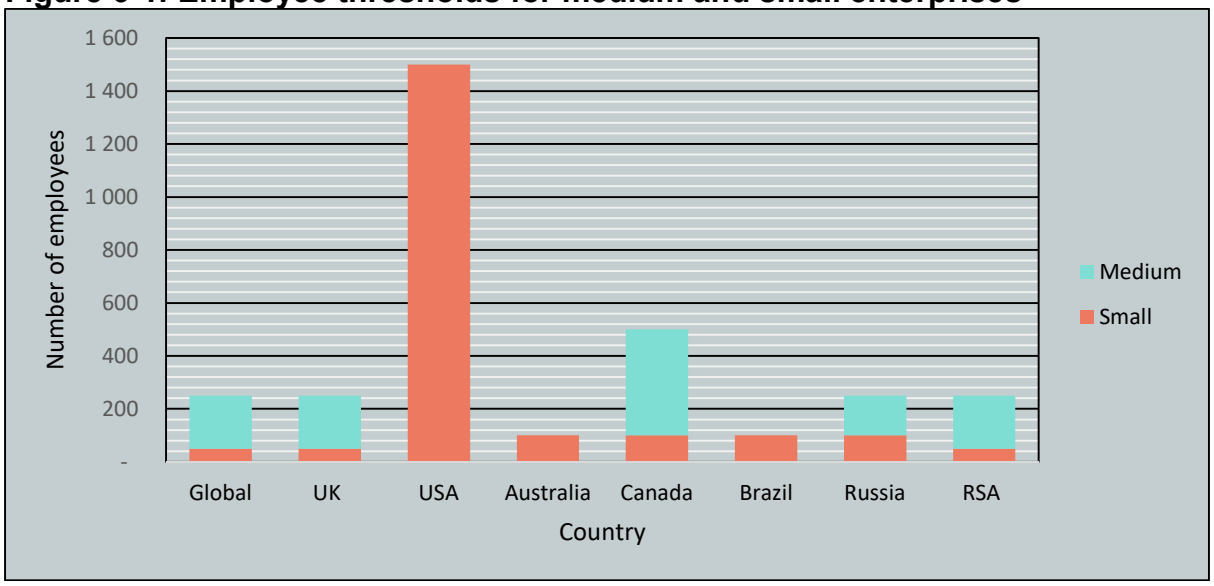
(SOURCE: Author)

It is evident from the above table that fewer countries have a definition for medium enterprise than for small enterprise. In the next paragraphs the similarities and differences will be identified and highlighted based on tables 6-4 and 6-5 above.

6.6.1 SME definition: Employee threshold comparison across countries

Figure 6-1 below compares the upper thresholds applied in each country for employees for both small and medium enterprises. The aim is not only to compare the small and medium enterprise thresholds for employees separately, but also to compare these thresholds to one another across small and medium enterprises.

Figure 6-1: Employee thresholds for medium and small enterprises



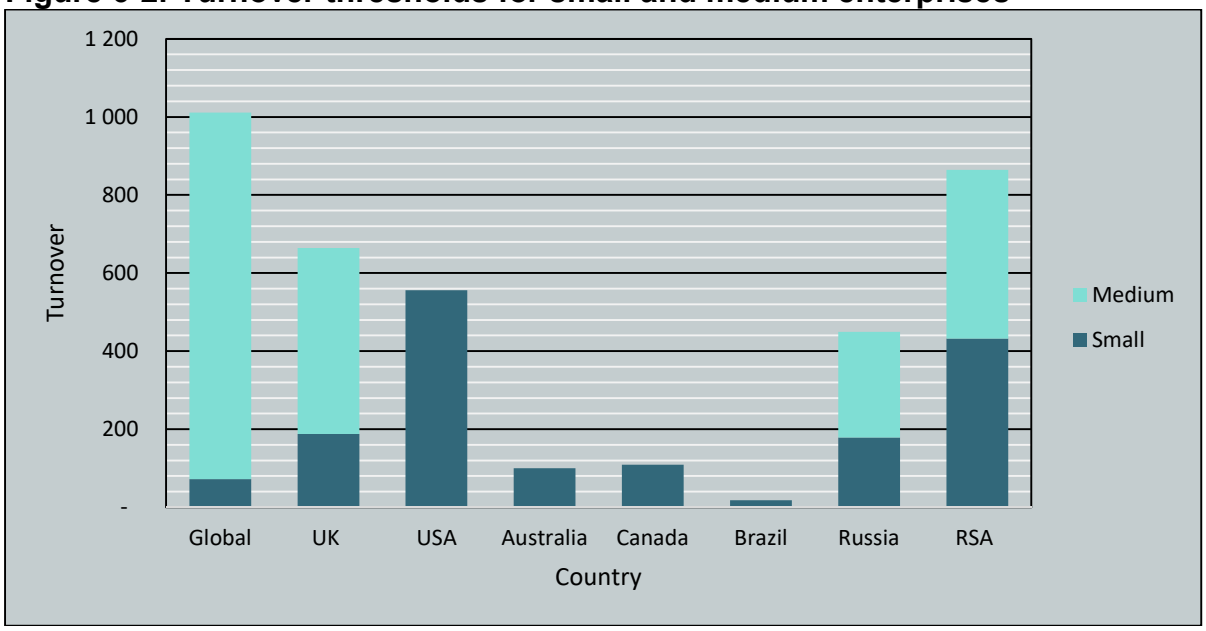
(Source: Author)

The figure above indicates that the employee threshold in the USA is significantly higher than for all the other countries in the study, as well as compared to the global average. The threshold for employees in the USA for a small enterprise is far higher than for any other country even when compared to medium enterprises. Canada has the second highest employee threshold. The UK, Russian, South African and global threshold for employees for medium enterprises is set at 250 employees. The USA and Brazil do not have a threshold for employees for medium enterprises, while Australia is the only country where the threshold for employees for medium enterprises is set above 20 employees. It is also evident from figure 6-1 that most of the countries prefer to use less than 100 employees as the qualifier for small enterprises. South Africa and the UK, on the other hand, prefer to use less than 50 employees as the qualifier for small enterprises.

6.6.2 SME definition: Turnover threshold comparison across countries

The figure below compares the turnover thresholds among the countries in the study for both small and medium enterprises. The comparison that follows aims to highlight all the similarities and differences between the countries and their turnover threshold in relation to small and medium enterprises.

Figure 6-2: Turnover thresholds for small and medium enterprises



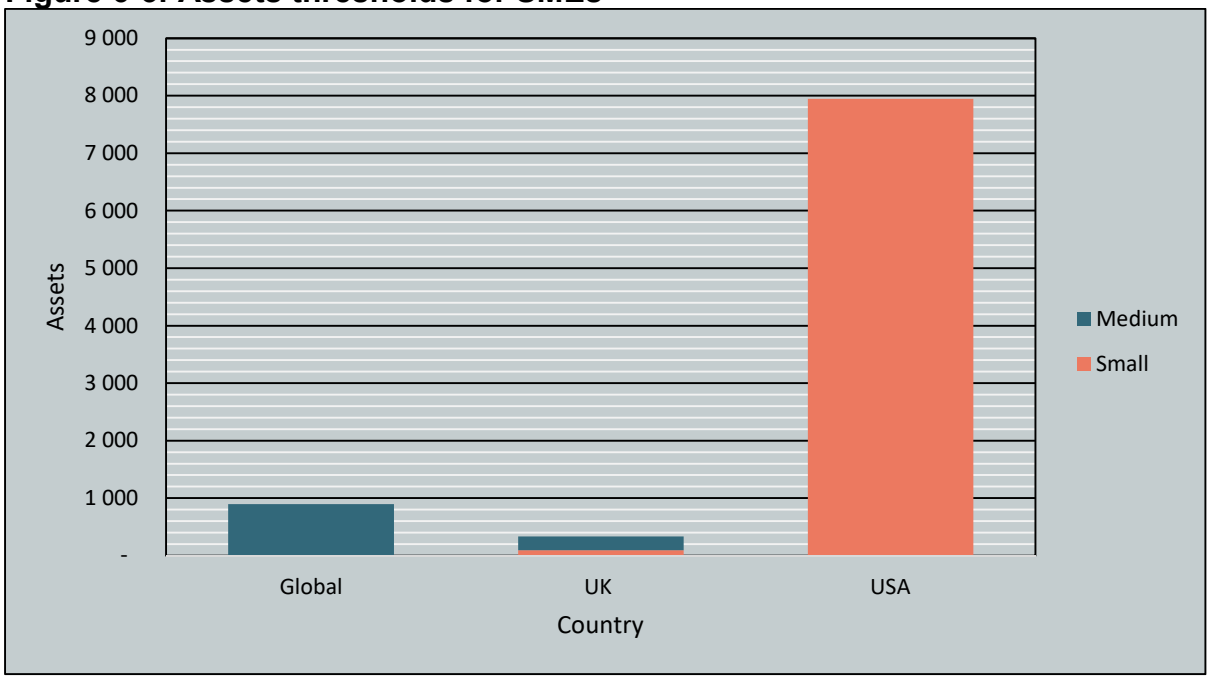
(Source: Author)

Figure 6-2 above demonstrates a considerably higher turnover threshold in the USA for small enterprises compared to other countries. The USA's threshold for small enterprises is higher than that of all the other countries for small enterprises, as well as that of Russia for medium enterprises. The majority of the countries do not have a turnover threshold for medium enterprises, that is, the USA, Australia, Canada and Brazil. South Africa has the highest threshold for medium enterprises, followed by the UK.

6.5.3 SME definition: Total assets threshold comparison across countries

The figure below shows the comparison of the total asset thresholds in the countries which define a threshold for total assets for SMEs.

Figure 6-3: Assets thresholds for SMEs



(Source: Author)

Only two countries in the study make use of total assets as a threshold. The USA has by far the highest threshold for assets for a small enterprise, even significantly higher than compared to the highest closest threshold for medium enterprises. Only the UK has a threshold for assets for medium enterprises. The fact that South Africa removed the asset threshold in the latest update to the NSBA thresholds has proven to be a wise decision seeing that the majority of countries in the sample do not make use of an asset category.

6.5.4 Summary of comparison of SME definitions

In most of the countries in the study an entity is required to meet two thresholds, while some countries require a company to meet only one of the thresholds. While the majority of the countries in the study apply an employee threshold of less than 100 for the small enterprise, South Africa's threshold is set at less than 50 employees.

The majority of the countries in this study do not have a turnover threshold for medium enterprises. South Africa has the highest turnover threshold for medium enterprises when compared to the UK and Russia, which also apply a turnover threshold for medium enterprises. When comparing its turnover threshold for small enterprises with the other countries, South Africa has the second highest threshold.

While it is important to understand the differences among the SME definitions used in the selected countries, the ultimate aim was to see how the SME definition compares to the audit exemption threshold, since the audit exemption threshold ultimately applies to SMEs.

6.7 The audit PI score vs the small entity definition

In order to fully compare the definition of a small enterprise of the sample of countries with the audit exemption threshold, a hypothetical PI score was calculated for each country based on the definition for small enterprises. Because the main focus of the study was on small enterprises, the calculation was not made for medium enterprises. For ease of comparison the hypothetical PI score based on audit exemption is referred to as “PI score audit” and the hypothetical PI score based on the small enterprise as the “PI score small”.

For a better comparison between South Africa and the other countries, a hypothetical PI score was calculated for the thresholds stipulated in legislation on small enterprises in South Africa (as set out in the latest update to the NSBA) and as updated by Stats SA with inflation. Bear in mind, however, that the NSBA requires a company to comply with both the turnover and employee requirement, where Stats SA only sets the turnover requirement.

Table 6-6 below sets out the PI score small for the countries in the sample.

Table 6-6: Summary of hypothetical PI scores based on the small enterprise definition for each country

Rank	Country and qualifiers	PI score
1	USA (total assets)	7 947
2	USA (employees)	1 500
3	USA (turnover)	556
4	South Africa (turnover, Stats SA)	432
5	UK (turnover and total assets)	282
6	Russia (turnover and employees)	279
7	UK (turnover and employees)	238
8	UK (total assets and employees)	144
9	South Africa (turnover and employees, NSBA)	130
10	Canada (turnover)	109
11	Brazil (employees), Canada (employees), Australia (employees), Australia (turnover)	100
12	Brazil (turnover)	18

(Source: Author)

Table 6-6 highlights the many inconsistencies and similarities across the countries in relation to their small enterprise definition and audit exemption threshold. A comparison of the PI score audit in table 6-2 with the PI score small in table 6-6 can be summarised as follows in table 6-7:

Table 6-7: Comparison between PI score audit and PI score small for the selected countries

Country	Findings
USA	The USA has a high PI score small of 7 947, 1 500 or 556. This is in line with our expectation based on the fact that this country does not force any of its non-listed companies to undergo an audit.
UK	The UK's PI score small and PI score audit are in line in both instances. The reason is that the UK has a uniform definition for their small companies in relation to audit exemption and other benefits granted to the small company.

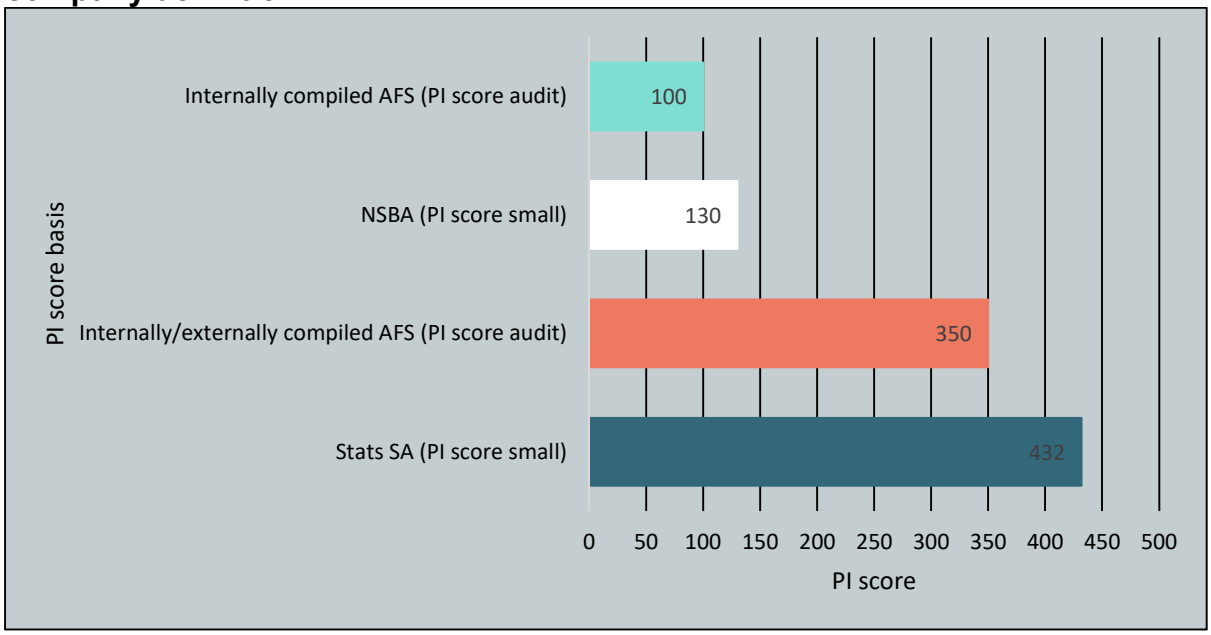
Country	Findings
Australia	While Australia has doubled its audit exemption thresholds in 2019, its SME definition has not been updated. The PI score small adds up to 100 points, while the PI score audit is either 378, 302 or 176. This leaves Australia in the same boat as Brazil, where all small companies, and some of the medium companies, are in essence exempted from audit.
Canada	In Canada, one shareholder can choose to have an audit. Therefore, this country has a PI score audit of 1. In contrast, the PI score small is 109, meaning that all small companies can choose to have an audit performed or not, depending on their shareholders.
Brazil	While Brazil has the highest PI score audit, namely 1 100 and 880, the country also has the lowest PI score small, namely 18. In other words, all Brazilian small companies are allowed to forego an audit.
Russia	At the other end of the scale lies Russia. With the third and second lowest PI score audit, Russia ranks sixth out of all the 12 scores regarding its small company requirement. This means that the smallest of companies in Russia are forced to undergo an audit when their PI score audit exceeds 14 or 90. However, these companies would still be classified as small up to the point where their PI score small would reach 279 according to legislation applicable to the small company.
South Africa	If we consider the Stats SA threshold of 432 (PI score small), which is based only on revenue, some small companies seem to be excluded from the option to forego an audit, namely all companies with a PI score small between 350 (PI score audit) and 432. An even greater cause for concern is the fact that this number includes only revenue and none of the other three qualifiers (third party liabilities, shareholders and employees). The PI score small for South Africa is based on the latest NSBA thresholds of 130, which means that all South African enterprises that have their financial statements externally compiled will be exempt from audit, as they fall below the 350 PI score audit. It must be noted that the threshold of 130 only includes revenue and employees and

Country	Findings
	does not take into account the other two qualifiers, namely third party liabilities and shareholders. If we only compare the PI score audit of 100 for companies that prepare their financial statements internally, it also means there are small companies who cannot use the audit exemption option. These are all companies above the 100 threshold and below the PI score small threshold, either 130 or 432.

(Source: Author)

Figure 6-4 below shows these differences in the calculated PI score comparison between audit and the small company definition for South Africa:

Figure 6-4: South Africa's PI score comparison between audit and the small company definition



(Source: Author)

The figure above indicates that South Africa does not afford all its small companies the option of foregoing an audit. All small companies below 350 will have the option to have their financial statements externally prepared and thereby to undergo a review. Larger small companies on the other hand with a PI score between 350 and 432 will be forced to undergo an audit.

6.8 Chapter summary

In this chapter all the data presented in chapters 4 and 5 were summarised and compared. The data were first converted to South African Rand and then compared by calculating a hypothetical PI score for both audit exemption threshold and the small company definition. The calculation of these PI scores allowed the researcher to triangulate the results of both the thresholds and the definition.

The country which grants the non-listed company the most freedom in terms of audit exemption is Brazil, followed by Australia. South Africa ranks third for non-listed companies and 10th (out of 13) for companies that have their financial statements internally compiled. Canada and Russia have the lowest PI scores in relation to audit exemption, which means they require more audits than the rest of the countries in the study.

South Africa compares well in relation to its small company threshold. The recent decision to remove the asset threshold from the definition has proven to be wise, as only two countries in the study still have an asset threshold, namely the USA and the UK. South Africa also divides the SME definition into the different sectors, in similar fashion as the USA. South Africa and the USA are the only countries to follow this approach. While South Africa and the UK maintain the same employee threshold of 50 for their small company definition, the majority of countries in the study maintain an employee threshold of 100 for their small company definition. South Africa has the second highest turnover threshold out of the countries in the study in relation to the small company definition.

After calculating a hypothetical PI score for the small enterprise definition and comparing it to the hypothetical PI score of the audit exemption, it became clear that small companies in the USA bear the lowest bureaucratic burden. These companies can choose whether they require an audit or not and they are given the space to grow into larger companies before they have to forfeit the benefits of small companies.

The UK's application of its small company definition and audit exemption is consistent, as the same classification is used. Australia and Brazil exempt all their small companies from audit, as their PI score for audit exemption is higher than their PI score for the small company definition. This means that many medium companies will

also be exempt from audit in Australia and Brazil. Russia only affords audit exemption to the smallest enterprises. Audit exemption in Canada is highly dependent on what individual shareholders want.

In South Africa, many inconsistencies where found when comparing the small company definition to the audit exemption score. The NSBA PI score small shows that all small companies are afforded the option to forego an audit. However, this definition includes only revenue and employees, which are two of the four PI score qualifiers. When we compare the PI score small based on the Stats SA definition, it seems that some small companies are excluded from the option of foregoing an audit, while bearing in mind that the Stats SA definition is only based on revenue. In other words, there might be the risk of many more entities not being afforded the option of foregoing an audit. This is a strong indication that the PI score for audit might be too low for including a large number of small companies.

The next chapter presents the conclusions and recommendations of the study based on the findings in the previous chapters.

CHAPTER 7: CONCLUSIONS AND RECOMMENDATIONS

7.1 Introduction

Arguments for more regulated audits and arguments against voluntary audits continue to pose a problem to accounting regulators and audit policymakers (Lee, 1993). There is a fine line between reducing agency costs in companies where the owner is involved in day-to-day management (ICAEW, 2006) and companies being protected against themselves due to an increased number of stakeholders. In 2018 the ACFE found that organisations with less than 100 employees incur double the losses when compared to organisations with 100 or more employees. Fraud in these small businesses occurs more easily due to the lack of internal controls, and a third of the time the fraud is perpetrated by the owner or an executive in the business (ACFE, 2018). It is clear from paragraph 3.3.1 that an audit is not an effective fraud detection tool, as it detects fraud only in 4% of the cases. It is, however, effective in reducing the losses associated with fraud and the duration of the fraud. It stands to reason that the accountability of the management of these entities should be dealt with at least on the same level of importance as listed companies. This is not to say that has all companies have to comply with the same rules. The same amount of attention should be paid to the regulatory requirements of small and medium entities as is done for listed companies.

The aim of the initial formal implementation of audit at the end of the 19th century was to protect the shareholders' investment and interest as a result of the separation of ownership and control within the entity (ICAEW, 2006b). However, in the case of many of the smaller companies, agency conflicts were reduced since the majority of shareholders began to play an active role in the management of the company (ICAEW, 2006b). Today the decision to audit or not to audit involves a myriad of stakeholders including government, shareholders, companies, trade unions, civil establishments and the media (McGregor, 2011). However, the cost to regulate an audit in order to protect the public interest may outweigh the benefits in certain instances (ICAEW, 2006b).

South Africa introduced audit exemption in 2011 through the implementation of the regulations to the Companies Act 71 of 2008. These regulations meant that companies have to calculate a PI score based on the number of employees, revenue, third party liabilities and the number of shareholders. This score indicates whether or not a company will be subjected to an audit. A PI score above 350 means that a company must undergo an audit. If a company has a PI score between 100 and 350 it must undergo an audit if its financial statements are internally prepared. If not, the company can choose to undergo a review instead. After almost a decade since the implementation of these regulations, there has been no changes to the values linked to the score.

No previous studies have compared South Africa's unique approach to audit exemption to the approach of other countries. For this reason, the research question for this study was formulated as follows: "To what extent, if any, does the audit exemption threshold in South Africa differ from the audit exemption threshold in other countries?"

In order to answer the research question, primary and secondary research objectives were formulated. This chapter will indicate how each of these objectives were addressed to ultimately answer the research questions (section 7.2). In this chapter, recommendations are also proposed to improve South Africa's audit exemption threshold, which addresses objective 6 (par. 7.2.6). Based on the findings of the study, the limitations on the research (section 7.5) and suggested areas for further research (section 7.6) will be discussed in this chapter.

7.2 Research objectives

The primary objective of this study was to compare the audit exemption threshold for non-listed entities in South Africa to the audit exemption threshold for non-listed entities in other countries. The aim was to determine whether or not the South African audit exemption threshold is significantly different to that of other countries (as indicated in chapter 1, par. 1.5.1). In order to reach the primary objective, secondary objectives were set. Each of the secondary objectives and how they were met will be discussed in paragraphs 7.2.1 to 7.2.6.

7.2.1 Describe the methodology that will be followed in this study

The first of the secondary objectives was fulfilled in chapter 2 where a detailed analysis was provided of each of the following aspects in relation to the research:

- research methodology (section 2.2);
- research paradigms (2.3);
- research approach (2.4);
- research design (2.5);
- data collection instruments (2.6);
- population and sampling (2.7); and
- ethical considerations (2.8).

The researcher applied a qualitative methodology through the use of interpretivism. The research design followed an inductive approach underpinned by the stakeholder and shareholder theories as theoretical framework. A comparative research design was followed. The secondary data used in the study are publicly available; therefore no ethical limitations were imposed on the study. Purposeful sampling was performed to select seven countries to form part of the study, namely the UK, USA, Australia, Canada, Brazil, Russia and South Africa.

7.2.2 Obtain an understanding of the need and history of audit

The second objective was addressed by conducting the literature review presented in chapter 3. Through this literature review it was determined that auditors have played an important role in society since early times. Lee (1993) concluded that the audit function has been shaped by the human need to reduce or remove doubts. Over the past 40 years, this need has extended, as management of companies have become more accountable to a wider range of stakeholders (par. 3.2.4). Consequently, the expectations on auditors have increased. Various factors played a role in defining these expectations, for example, triple bottom line reporting, multinational companies, unprecedented access to information of shareholders, and the shift in how corporations are seen (par. 3.2.5). The increase in scandals in the last few decades have also added pressure to the auditor (par. 3.2.6). Even though external audits only detect fraud in 4% of cases, they still play a vital role in reducing the losses and

duration of occupational fraud (par. 3.2.1). One cannot fully understand an audit without understanding the levels of assurance that it provides (par. 3.2.2). In paragraphs 3.3.3 and 3.3.4 the researcher discussed the demand for audit and the regulation of audit respectively, and found that audit is important to society and government.

The audit landscape in South Africa was discussed in detail in section 3.4. Emphasis was placed on recent scandals, legislative framework and the evolution of auditing standards and corporate governance in South Africa. Chapter 3 concluded with the assertion that "audit is an integral part of society which helps keep management honest and stakeholders informed".

7.2.3 Investigate the similarities and differences in the audit exemption thresholds in selected countries across the world

In chapter 4 the researcher presented an overview of previous studies on the topic, after which the audit exemption threshold was investigated for each country in the sample. Table 7-1 provides an overview of the outcomes achieved by these studies.

Table 7-1: Summary of previous studies

Researcher	Study outcome
Abdel-Khalik (1993)	Non-listed entities choose to undergo an audit where the agency costs increase or when required by creditors.
Carey *et al*. (2000)	As agency costs increase (third party interests, whether employees or lenders), the need for voluntary audit also increases.
Chung and Narasimhan (2001)	The mandatory audit requirement is beneficial for small audit firms and small companies.
Rennie *et al*. (2003)	The majority of non-listed entities voluntarily chose an audit after deregulation, due to lenders, shareholders and a need for increased credibility.
Collis *et al.* (2004)	The perceived value of an audit is a bigger drive for undergoing audit than the size of the non-listed company.

Researcher	Study outcome
Collis (2008)	The majority of respondents in the study agreed that the benefits of an audit outweigh the costs for the non-listed company.
Minnis (2011)	Audited financial statements lead to reduced interest rates, as lenders place more value on audited financial statements.
Dedman *et al.* (2014)	One year after audit had been deregulated, 71% of companies still chose to undergo an audit. By year three, this number had dropped to 52% of companies.
Coetzee (2015)	Audit practitioners agreed that an audit increases the credibility of financial statements. The practitioners also believed that the current PI score should be increased to 750.
Haron *et al.* (2016)	The larger an audit firm, the more likely the audit firm will support audit exemption for small companies.
Minnis and Shroff (2017)	Regulators and non-listed entity respondents agreed that the benefits of an audit are equal to or greater than the costs.
Vanstraelen and Schelleman (2017)	While alternative services might better serve the non-listed entity, the quality of financial statements declines when audit is made voluntary.
Palazuelos *et al.* (2017)	Loan officers seem to place more value on audited financial statements, thereby enabling SMEs to obtain finance more readily.

(Source: Author)

From these 13 studies, 62% (eight out of 13) agreed that more value can be placed on financial statements. In turn, audited financial statements lead to reduced interest rates, as can be seen in two of the studies. When agency costs increase, there is a higher likelihood that the non-listed company would voluntarily undergo an audit, as can be seen in 31% (four out of 13) of the studies.

In the remainder of chapter 4 the following aspects were identified for the seven countries in the sample:

1. the date when audit exemption was introduced;
2. turnover threshold;
3. employee threshold;
4. asset threshold;
5. third party liabilities threshold; and
6. shareholder threshold.

It was found that each country in the sample has its own approach to audit exemption. This was summarised in table 4-5, “Summary of audit exemption thresholds for non-listed companies in select countries”.

7.2.4 Investigate the similarities and differences in the SME definition in selected countries across the world

Secondary objective 4 was addressed in chapter 5 by determining the definition for small and medium enterprises in each of the countries in the sample. This was achieved by identifying at least two laws that define the SME threshold and by determining how the statistical body of each country defines its small and medium thresholds. The upper thresholds from these definitions were used to compile the small and medium thresholds, which were summarised in tables 5-24 and 5-25 respectively.

7.2.5 Determine through comparison where South Africa finds itself in relation to selected countries across the world taking into account the underlying shareholder and stakeholder principles

The fifth secondary objective was addressed in chapter 6. First, all audit exemption thresholds were converted to South African Rand, after which a hypothetical PI score was calculated for each country in the sample based on their respective determinants for audit exemption.

The comparison yielded illuminating findings as set out in table 6.4. Brazil was found to be the country with the highest PI score, meaning that Brazilian non-listed companies were allowed the most freedom to choose an audit or not. Canada was

found to be the most onerous in terms of legislating its non-listed companies. Canada had the lowest PI score, which means that the freedom to choose an audit is limited. South Africa ranked as the country with both the third highest PI score and the third lowest PI score. The reason is that South Africa is the only country that has two separate thresholds, depending on whether financial statements are internally or externally compiled.

The remainder of chapter 6 focused on the SME definition by converting the elements of the definition to Rand and comparing them across the different countries in the study.

Following on the separate comparison of the SME definition, a hypothetical PI score for the small company was calculated and compared to the hypothetical PI score for audit exemption. The purpose was to determine where the small company lies in terms of audit exemption choice (section 6.6).

Many inconsistencies were found in the comparison for South Africa. The PI score small, based on the NSBA definition, was 130, which means that all small companies can choose to have an audit provided that their financial statements are externally compiled. However, the PI score small based on the Stats SA definition of turnover alone was 432. This is highly concerning, as it means the turnover figure alone, which Stats SA deems appropriate for small companies, is higher than the upper PI score threshold for audit of 350. This is an indication that the PI score for audit should be increased to give the small companies the choice of whether they want an audit or not.

7.2.6 Suggest recommendations for improvement of South Africa's audit exemption threshold

The last secondary objective will be met through the discussion which follows. South Africa's PI score for audit exemption is set at two levels: the upper threshold is set at 350 for all companies, and the lower limit is set at 100 for companies that prepare their financial statements internally. As indicated in table 6-1, South Africa ranks as the country with the third highest PI score (for the upper threshold of 350) and as the country with the third lowest PI score (for the lower threshold of 100). Furthermore, South Africa is the only country that incorporates the number of shareholders into the actual calculation instead of giving these shareholders voting right, as is the case in

the UK, Australia and Canada. South Africa is also the only country which uses third party liabilities as one of the qualifiers in the PI score calculation. Many of the other countries use the total asset threshold of a company instead. The recommendations based on the research in this study are as follows:

- Consider simplifying the calculation as a whole by removing the distinction between internally and externally prepared financial statements. Consider adopting one approach for all companies, similar to all the countries in the sample that use an audit exemption threshold.
- In order to account for shareholders, consider the position taken in the UK and Australia where 10% or 5% of shareholders respectively can request an audit to be performed. In Canada, one shareholder has the right to request an audit.
- It could prove more meaningful to align the small company definition with the PI score, similar to the UK. This would assist in alleviating the bureaucratic burden on those in charge of small companies.
- Consider simplifying the calculation by removing the third party debt component. In 2019, the asset category of the SME threshold was removed in the NSBA and now only comprises the number of employees and turnover. Countries like Brazil and Russia only use employees and turnover to determine whether their non-listed companies require an audit.
- Instead of adding all the numbers to reach one total, consider using an approach similar to the UK or Australia where a company has to undergo an audit if it meets two of the three thresholds or three of the four thresholds.

7.3 Limitations and shortcomings of the study

The limitations and shortcomings of the study can be formulated as follows:

- Even though every effort was taken to ensure a total coverage of all important sources, this study and its findings are limited to the sources that were used.
- This study was conducted over more than one year. Thus, there is a possibility that resources are now available to shed more light on the subject than what was available when the study was conducted.
- At no point in this study was the size of the company compared to the size of the GDP of the country or brought in relation to the size of a country.

- Every relevant piece of legislation that mentions the SME definition might not have been included in this study.

7.4 Suggestions for further research

The following areas for further research are proposed:

- The question can be probed as to whether the elements of the PI score for audit truly benefit the public interest or whether other elements would be more useful.
- Focus can be placed on the review requirements of the countries in the sample, as these differ as much as the audit requirements do.
- Research can be conducted in South Africa on the opinions and views of different stakeholders and their take on the current PI score and the SME threshold, especially the views of the companies which fall just above and below the audit exemption threshold.
- A comparison can be drawn between countries that require their businesses to file financial statements on a registry which is publicly available.

7.5 Chapter summary

The main focus of this chapter was to provide an overview of the research objectives and discuss how they were achieved in this study. In paragraph 7.2.6 recommendations were made for regulators, researchers and other stakeholders on areas for improvement for the South African audit exemption threshold.

The primary objective of this study was identified in chapter 1, paragraph 1.5.1, namely to compare the audit exemption threshold for non-listed entities in South Africa to the audit exemption threshold for non-listed entities of other countries. The aim was to determine whether or not the South African audit exemption threshold differs significantly from that of other countries.

Chapter 6 presented the comparison between the audit exemption thresholds of South Africa and those of the selected countries. Similarities in the manner in which South Africa and the selected countries calculate their audit exemption thresholds were noted as follows:

- South Africa deems revenue an important aspect of the calculation, similar to four other countries in the study.
- South Africa deems the number of employees an important aspect of the calculation, similar to two other countries in the study.
- South Africa deems shareholders an important aspect of the calculation, similar to three other countries in the study.

Differences in the calculation of audit exemption thresholds between South Africa and the other countries were noted as follows:

- While the majority of countries use two to three qualifiers for audit exemption, South Africa is the only country which takes four qualifiers into consideration in the calculation.
- South Africa adds the number of shareholders into its calculation, while three of the other countries give their shareholders a say and the power to request an audit.
- South Africa is the only country with an audit exemption calculation which does not include total assets.
- South Africa is the only country that uses third party liabilities as one of the qualifiers in the calculation for audit exemption.
- South Africa is the only country that combines the thresholds into one calculation.
- South Africa is the only country to work on a scoring system, whereas the other countries simply use the number of employees as a threshold or amounts for their turnover and/or asset qualifiers.

By reaching the primary objective of this study, the research question was also answered. In chapter 1 section 1.4, the research question was outlined as: “To what extent, if any, does the audit exemption threshold in South Africa differ from the audit exemption threshold in other countries?” From the findings in this study it can be submitted that the South African audit exemption threshold differs significantly from the audit exemption thresholds of the other countries in the study.

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