The demand for external auditing: managerial share ownership, size, gearing and liquidity influences

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Abstract

Small companies with a turnover of up to £90,000 have been exempted from a compulsory audit since 1994. This paper is an investigation of why some small companies chose to continue with the audit whilst others abandoned it. The basic hypothesis of the paper is that a major reason why some small companies continue to be audited is to help control the conflict of interests among managers, shareholders, and outside creditors. Based on this analysis, the probability that a company will be audited voluntarily are predicted to increase as company size and gearing ratio increase, and to decrease as managerial share ownership and liquidity ratios increase. Univariate and multivariate tests were applied to the data of 92 small independent companies randomly selected from the Companies House CD-ROM database. The results from the two tests support the hypothesised effects of managerial share ownership, company size (turnover), and gearing ratio. There is no support for the company size (total assets) and liquidity ratio effects.

Keywords

Size Gearing and liquidity External auditing Shareholders Small firms

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