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Consequences of adopting an expanded auditor's report in the United Kingdom

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Is more always better?

1. **Change:** UK FRC¹ mandated expanded auditor's report
2. **Horse Race:** First (published) large-sample archival evidence on expanded auditor's report

 Investor Reaction, Audit Fee, Audit Quality

 Finds no results

¹Financial Reporting Council



Preview of Paper

RAST
PAPER

GUTIÈREZ

Purpose of ISA 700

ISA 700: The Independent Auditor's Report on Financial Statements

Applies to: Premium-listed equity issuers on LSE Main Market

Purpose:

- Reinforce the auditor's role in the UK's *stewardship model*
- Complement corporate governance reforms and audit committee disclosure rules
- Increase **transparency** and **decision-usefulness** of the audit report

Purpose of ISA 700

ISA 700: The Independent Auditor's Report on Financial Statements

Applies to: Premium-listed equity issuers on LSE Main Market

Key Requirements Added:

1. Describe **risks of material misstatement** with greatest effect on the audit
2. Disclose **materiality thresholds** and how they were applied
3. Explain **scope of the audit** and its alignment with identified risks

SURPRISE: UK Audit Committee Report (2012 Code Revision)

Introduced by: UK Corporate Governance Code (October 2012)

Applies to: Premium-listed companies (on a *comply or explain* basis)

Key disclosures:

1. Significant financial reporting issues and how they were addressed
2. Assessment of external auditor effectiveness
3. Approach to appointing/reappointing the auditor and safeguarding independence

Report of the auditors to the members of Unilever N.V. and Unilever PLC

We have audited the accounts, which have been prepared under the historical cost convention, set out on page 66 to 112, 118 to 133 and 135 to 136. We have also audited the auditable part of the directors' remuneration report as set out on page 60.

Respective responsibilities of directors and auditors

As described on pages 63 and 64, the directors are responsible for preparing the Annual Report & Accounts and Form 20-F. This includes responsibility for preparing the accounts in accordance with applicable accounting standards. Our responsibility is to audit the accounts in accordance with applicable law, auditing standards and listing rules in the Netherlands and United Kingdom.

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with Title 9, Book 2 of the Civil Code in the Netherlands and the United Kingdom Companies Act 1985. We also report whether the auditable part of the directors' remuneration report is properly prepared in accordance with the applicable requirements in the Netherlands and the

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts and the auditable part of the directors' remuneration report are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.

Netherlands and United Kingdom opinion

In our opinion, the accounts give a true and fair view of the state of affairs of the Unilever Group, Unilever N.V. and Unilever PLC at 31 December 2002 and of the profit, total recognised gains and cash flows of the Group for the year then ended. In our opinion the accounts of the Unilever Group, and of Unilever N.V. and Unilever PLC respectively, have been properly prepared in accordance with Title 9, Book 2 of the Civil Code in the Netherlands and the United Kingdom Companies Act 1985. In our opinion, the auditable part of the directors' remuneration report has been properly prepared in accordance with the applicable requirements in the Netherlands and the United Kingdom.

6. Our determination of materiality

The scope of our audit was influenced by our application of materiality. We set quantitative thresholds and overlay qualitative considerations to help us determine the scope of our audit and the nature, timing and extent of our procedures, and in evaluating the effect of misstatements, both individually and in the aggregate, on the financial statements as a whole.

€450m (FY22: €380m) Materiality for the Group Financial Statements as a whole	What we mean A quantitative reference for the purpose of planning and performing our audit. Basis for determining materiality and judgements applied Materiality for the Group financial statements as a whole was set at €450m (FY22: €380m). This was determined with reference to a benchmark of Group's normalised PBTCO. Consistent with FY22, we determined that Group's normalised PBTCO remains the main benchmark for the Group. We consider profit before tax, excluding certain identified items, as a key indicator of performance and the basis for earnings, and therefore the primary focus of a reasonable investor. We have inspected analyst consensus data and other investor commentary for signals of alternate significant influencers of economic decisions. No revisions to our calculation methodology resulted therefrom. To reflect the Group's normalised PBTCO, we have normalised the profit before tax benchmark by excluding the one-off profit from the sale of the Suave brand and the one-off loss from the sale of Dollar Shave Club brand. Our Group materiality of €450m was determined by applying a percentage to the Group's normalised PBTCO. When using a benchmark of Group's normalised PBTCO to determine overall materiality, KPMG's approach for public interest entities considers a guideline range of up to 5% of the measure. In setting Group materiality at planning, we determined materiality using the forecast of Group's normalised PBTCO. This represents 5.06% (FY22: 4.8%) of the final Group's normalised PBTCO value. We considered the materiality amount for the financial statements as a whole and concluded that it remained appropriate. Materiality for the Parent Company financial statements as a whole was set at £295m (FY22: £296m), determined with reference to a benchmark of Parent Company total assets, of which it represents 0.4% (FY22: 0.4%).
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5. Our ability to detect irregularities, and our response

Fraud – Identifying and responding to risks of material misstatement due to fraud

Fraud risk assessment	To identify risks of material misstatement due to fraud ("fraud risks") we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. Our risk assessment procedures included: <ul style="list-style-type: none">▪ Enquiring of directors, the Audit Committee, internal audit and inspection of policy documentation as to the Group's high-level policies and procedures to prevent and detect fraud, including the internal audit function, and the Group's channel for "whistleblowing", as well as whether they have knowledge of any actual, suspected or alleged fraud.▪ Reading Board and Audit Committee minutes.▪ Considering remuneration incentive schemes and performance targets for directors.▪ Using analytical procedures to identify any unusual or unexpected relationships.▪ Using our own forensic professionals with specialised skills and knowledge to assist us in identifying the fraud risks based on discussions of the circumstances of the Group.
Risk communications	We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit. This included communication from the group to in-scope component audit teams of relevant fraud risks identified at the Group level and request to in-scope component audit teams to report to the Group audit team any instances of fraud that could give rise to a material misstatement at Group.
Fraud risks	As required by auditing standards, and taking into account possible pressures to meet performance targets, we performed procedures to address the risk of management override of controls and the risk of fraudulent revenue recognition, in particular: <ul style="list-style-type: none">▪ the risk that Group and component management may be in a position to make inappropriate accounting entries; and▪ the risk that revenue is materially overstated due to fraud through manipulation of the off-invoice rebate accrual recognised. The fraud risk in relation to revenue recognition – rebates is included as a Key Audit Matter as per item 4.1.

Report of the Audit Committee



Adrian Hennah
Chair of the Audit Committee

In addition to our reporting and control responsibilities, we focused this year on risks relating to cyber security, supply chain resilience and data privacy.

On behalf of the Audit Committee, I am pleased to present the Committee's report for the year ended 31 December 2023.

We dedicated time and resources to enhancing our understanding of the Group's continuously evolving

Report of the Audit Committee

Committee membership and attendance

	Attendance
Adrian Hennah Chair	8/8
Susan Kilsby	8/8
Judith Hartmann (member up to and including 2 May 2023)	5/5
Hein Schumacher (member up to and including 2 May 2023)	5/5
Ruby Lu (member from 3 May 2023)	3/3

The Audit Committee is comprised only of independent Non-Executive Directors with a minimum requirement of three such members. The Audit Committee was chaired by Adrian Hennah. The other Committee members are Susan Kilsby, and Ruby Lu who was appointed in July 2023 replacing Judith Hartmann who transitioned to another committee. Hein Schumacher was appointed to become CEO of Unilever as of July 2023.

The Board is satisfied that the members of the Audit Committee are competent in financial matters and have recent and relevant experience. For the purposes of the US Sarbanes-Oxley Act of 2002, Adrian Hennah is the Audit Committee's financial expert.

All relevant matters arising are brought to the attention of the Board.

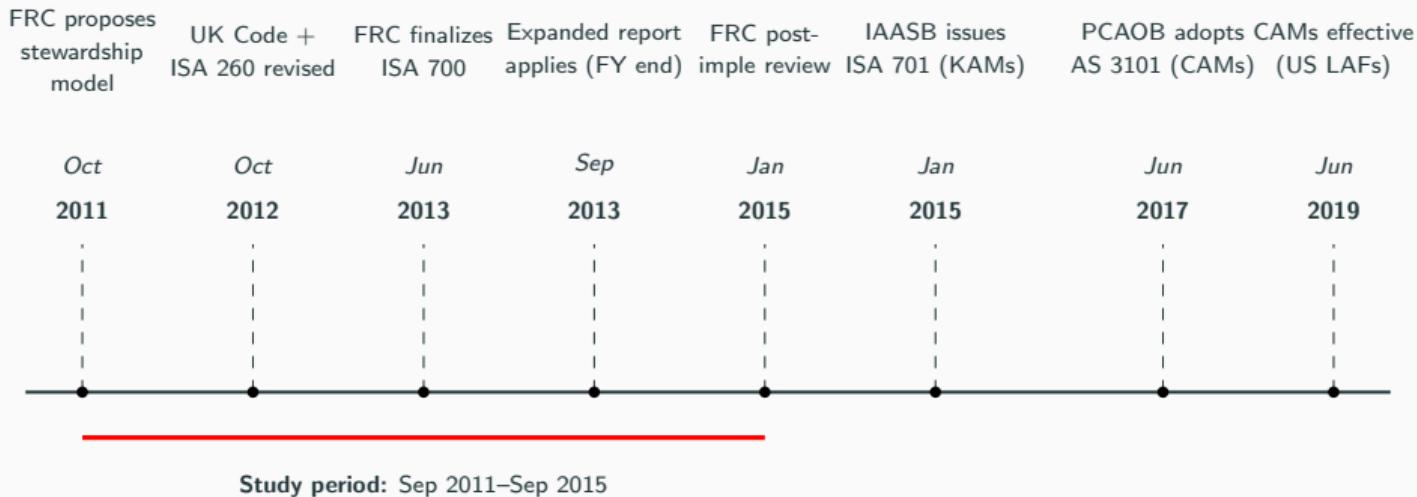
Committee Reviews

To help the Committee meet its oversight responsibilities, focused knowledge sessions are organised for committee members throughout the year. In 2023, sessions were held to review the impact of cost inflation, a review of group litigation, sustainability reporting and M&A performance and plans.

In addition, Committee members visited the local businesses in the US, Argentina, Brazil, and the Netherlands providing them with an insight into local market challenges and local risk and control management. In Brazil special focus was given to existing tax liabilities, please refer to note 19 and 20 on page 219-220. In Argentina management's approach to the challenges arising from the hyperinflationary economic context was focused on, and in the Netherlands the Committee spent time to understand the capabilities of the new R&D center co-located within the local University campus in Wageningen.

The Committee also received presentations from management and held discussions on the business's risk management

Timeline (DiD: Sep 2011–Sep 2015)



Questions asked

- Does expanded audit affect decision usefulness for equity markets?
- Does expanded audit affect audit cost?
- Does expanded audit affect audit quality?

Econometric Design

Main Difference-in-Differences Model:

$$\text{DEPVAR}_{i,t} = \beta_0 + \beta_1 \text{POST}_{i,t} + \beta_2 \text{ADOPT}_{i,t} + \beta_3 (\text{POST}_{i,t} \times \text{ADOPT}_{i,t}) + \sum_j \beta_j \text{CONTROLS}_{i,t} + \text{IndustryFE} + \varepsilon_{i,t}$$

Key Definitions:

- $\text{POST}_{i,t} = 1$ for fiscal years ending after Sept 2013
- $\text{ADOPT}_{i,t} = 1$ for premium-listed firms (treated group)
- Interaction captures treatment effect of expanded audit report

Robustness and Complementary Analyses:

- Bootstrap standard errors (1,000 replications)
- Firm fixed effects (omit $\text{ADOPT}_{i,t}$)
- Pre-post only among treated firms

Operationalization of Key Variables

- **Investor Reaction – ABRET_{i,t}:** Sum of 3-day *absolute abnormal returns* around report filing date vs LSE market.
- **Investor Reaction – ABVOL_{i,t}:** log(event-period volume / estimation-period volume), scaled by shares outstanding.
- **Audit Cost – FEES_{i,t}:** Natural log of total audit fees from financial statement notes.
- **Audit Quality – DACCR_{i,t}:** Absolute discretionary accruals from modified Jones model, scaled by avg. assets.
- **Controls – Firm Characteristics:** log(MKT), ROA, LOSS dummy, MTB, LEV
- **Controls – Audit Environment:** BIG4 dummy, GCO opinion, USLIST dummy
- **Controls – Timing/Market:** Filing delay (LAG), beta (BETA)

Cross-Sectional Test: Report Content Variation

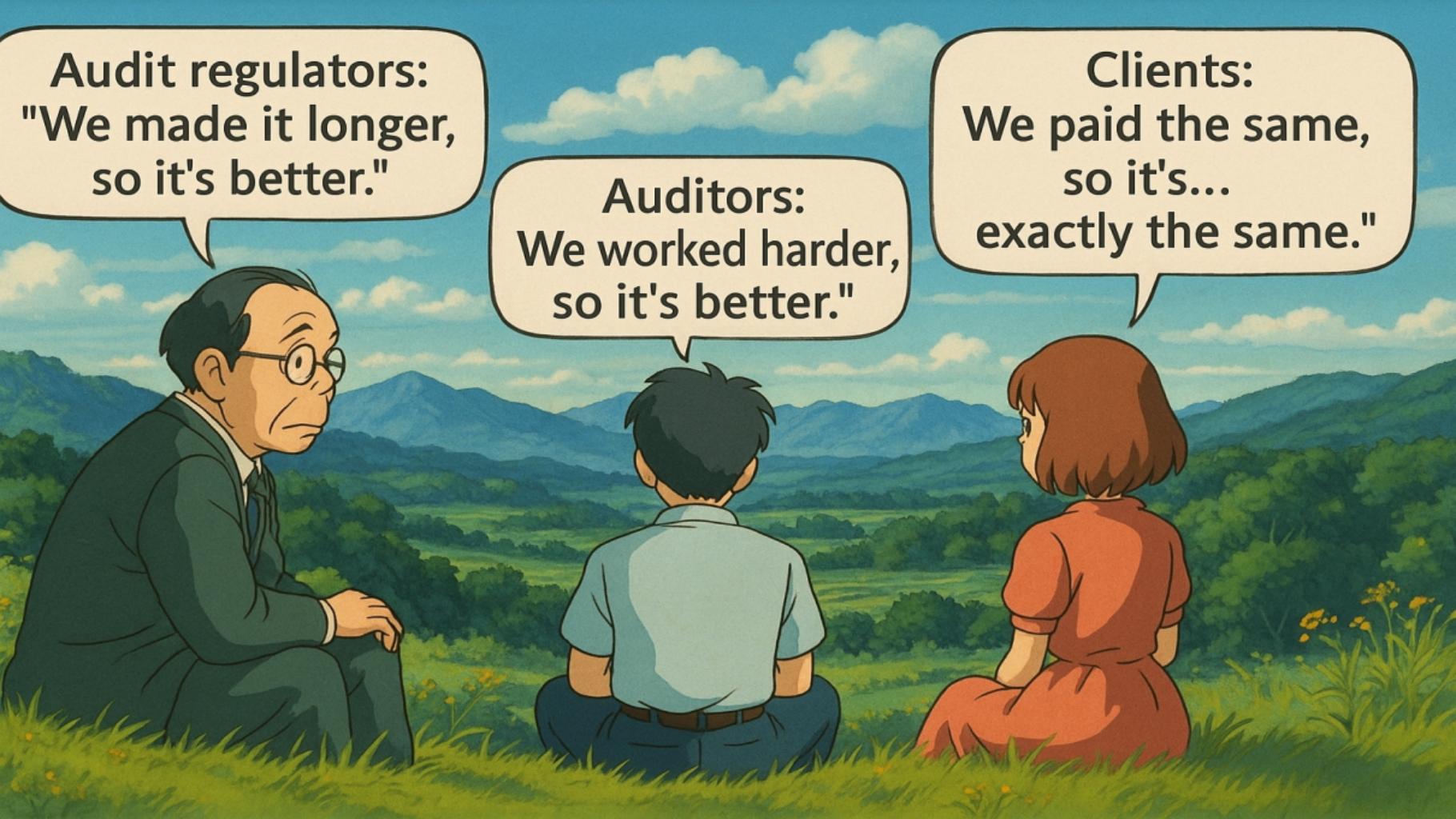
Premium Firms Only — Heterogeneity by Disclosure Features:

$$\text{DEPVAR}_{i,t} = \beta_0 + \beta_1 \text{POST}_{i,t} + \beta_2 \text{REPORT_DISCL}_{i,t} + \beta_3 (\text{POST}_{i,t} \times \text{REPORT_DISCL}_{i,t}) + \sum_j \beta_j \text{CONTROLS}_{i,t} + \text{IndustryFE} + \varepsilon_{i,t}$$

Disclosure Variables ($\text{REPORT_DISCL}_{i,t}$):

- **LENGTH:** Auditor's report word count exceeds sample median
- **NRISKS:** Number of disclosed risks exceeds median
- **NRISKSAUD:** Number of *unique* auditor-only risks (not in audit committee report) exceeds median
- **MATPERC:** Materiality as % of total assets exceeds median

Goal: Identify whether more detailed, risk-specific, or transparent audit disclosures affect investor reaction, audit fees, or audit quality differently across firms.



Audit regulators:
"We made it longer,
so it's better."

Auditors:
We worked harder,
so it's better."

Clients:
We paid the same,
so it's...
exactly the same."

Table 1 Sample selection

	LSE Main Market with premium listing	LSE AIM	DD Sample
UK companies on the LSE	728	724	
Exclude financial companies	(369)	(99)	
Exclude companies not in Thomson Reuters	(21)	(100)	
Nonfinancial companies in Thomson Reuters	338	525	
UK companies on the LSE with data available for full panel (four years around September 2013)			
Investors' reaction analyses	312	328	
Audit fees analyses	303	360	
Audit quality analyses	218	296	
Firm-year observations:			
Investors' reaction analyses	1248	1312	2560
Audit fees analyses	1212	1440	2652
Audit quality analyses	872	1184	2056

This table shows the sample selection for the analyses of investors' reaction, audit fees, and audit quality. We use company data for four years in the period surrounding the regulatory cut-off in September 2013. In our main difference-in-differences analyses, we use premium companies as the treated group and AIM market companies as a control group. In our additional cross-sectional analyses, we use premium companies only. The data used in our analyses are provided in online Appendix C.



Fig. 3 Trends in Daily Returns of FTSE100 and Total AIM Indexes

Premium Listed vs AIM Companies

Table 2 Analyses of market reaction to the filing of the expanded auditor's report

Variables	ADOPT _{it} = 0, POST _{it} = 0			ADOPT _{it} = 0, POST _{it} = 1			Diff. in Means
	Mean	Std. Dev.	Median	Mean	Std. Dev.	Median	
ABRET _{it}	0.043	0.064	0.019	0.050	0.113	0.023	0.007
ABVOL _{it}	-0.286	1.485	-0.208	-0.224	1.400	-0.175	0.062
LOGMKT _{it}	9.783	1.372	9.842	10.079	1.422	10.094	0.296***
ROA _{it}	-0.127	0.346	-0.003	-0.134	0.352	-0.008	-0.007
LOSS _{it}	0.505	0.500	1.000	0.517	0.500	1.000	0.012
MTB _{it}	2.522	4.164	1.386	2.547	3.690	1.651	0.025
LEV _{it}	0.056	0.116	0.000	0.070	0.137	0.001	0.014*
LAG _{it}	25.360	25.050	20.000	22.918	23.262	17.000	-2.442
SALEVOL _{it}	0.258	0.304	0.172	0.227	0.283	0.149	-0.031
CHNL _{it}	-0.001	0.227	0.003	0.000	0.230	0.004	0.001
BETA _{it}	0.274	0.598	0.176	0.325	0.670	0.238	0.051
ABRET_EAR _{it}	0.065	0.071	0.043	0.069	0.072	0.047	0.004
BIG _{it}	0.325	0.469	0.000	0.335	0.472	0.000	0.010
N. Obs.	656			656			1312

Decision Usefulness Test

Panel B: Difference-in-differences and pre-post analyses of abnormal returns

Variables	Dep. Var. = $\Delta BRET_{i,t}$				
	(1)	(2)	(3)	(4)	(5)
POST _{i,t}	0.006	0.006	0.009	0.001	0.001
	(1.26)	(1.28)	(1.43)	(0.79)	(0.75)
ADOPT _{i,t}	-0.003	-0.003			
	(-0.74)	(-0.78)			
POST*ADOPT _{i,t}	-0.004	-0.004	-0.004		
	(-0.88)	(-0.87)	(-0.82)		
LOGMKT _{i,t}	-0.002***	-0.002***	-0.010	-0.002***	-0.002***
	(-2.64)	(-2.81)	(-1.58)	(-3.98)	(-4.27)
ROA _{i,t}	-0.006	-0.006	-0.010	-0.008	-0.008
	(-0.61)	(-0.61)	(-0.73)	(-1.01)	(-0.67)
LOSS _{i,t}	0.003	0.003	-0.009*	0.004	0.004
	(0.74)	(0.81)	(-1.66)	(1.18)	(1.13)
MTB _{i,t}	-0.000	-0.000	-0.000	-0.000	-0.000
	(-0.29)	(-0.30)	(-0.35)	(-0.23)	(-0.18)
LEV _{i,t}	0.017*	0.017	-0.013	0.017*	0.017**
	(1.65)	(1.60)	(-0.55)	(1.82)	(2.33)

Panel C: Difference-in-differences and pre-post analyses of abnormal volume

Variables	Dep. Var. = ABVOL _{i,t}				
	(1)	(2)	(3)	(4)	(5)
POST _{i,t}	0.006	0.006	0.000	-0.068	-0.068
	(0.08)	(0.08)	(0.00)	(-1.30)	(-1.24)
ADOPT _{i,t}	-0.014	-0.014			
	(-0.14)	(-0.15)			
POST*ADOPT _{i,t}	-0.080	-0.080	-0.075		
	(-0.83)	(-0.84)	(-0.78)		
LOGMKT _{i,t}	0.090***	0.090***	0.134**	0.075***	0.075***
	(4.64)	(4.78)	(2.03)	(3.91)	(3.67)
ROA _{i,t}	0.128	0.128	-0.110	0.566**	0.566*
	(0.82)	(0.94)	(-0.45)	(2.27)	(1.69)
LOSS _{i,t}	-0.189**	-0.189**	-0.188*	-0.123	-0.123
	(-2.34)	(-2.44)	(-1.70)	(-1.04)	(-1.02)
MTB _{i,t}	0.003	0.003	-0.009	-0.001	-0.001
	(0.44)	(0.47)	(-1.11)	(-0.27)	(-0.26)
LEV _{i,t}	-0.016	-0.016	-0.455	0.193	0.193

Panel B: Difference-in-differences and pre-post analyses

Variables	Dep. Var. = FEES _{i,t}				
	(1)	(2)	(3)	(4)	(5)
POST _{i,t}	0.019	0.019	0.036**	0.000	0.000
	(1.19)	(0.76)	(2.50)	(0.00)	(0.00)
ADOPT _{i,t}	0.222***	0.222***			
	(3.76)	(5.75)			
POST*ADOPT _{i,t}	-0.012	-0.012	0.002		
	(-0.57)	(-0.29)	(0.12)		
SIZE _{i,t}	0.536***	0.536***	0.294***	0.597***	0.597***
	(31.57)	(56.82)	(9.97)	(26.98)	(47.47)
ROA _{i,t}	-0.255***	-0.255***	-0.128***	-0.362	-0.362
	(-3.59)	(-3.73)	(-2.93)	(-1.58)	(-1.58)

Audit Fee Test

Panel B: Difference-in-differences and pre-post analyses

Variables	Dep. Var. = DACCR _{i,t}				
	(1)	(2)	(3)	(4)	(5)
POST _{i,t}	0.001	0.001	-0.001	-0.000	-0.000
	(0.20)	(0.21)	(-0.19)	(-0.05)	(-0.05)
ADOPT _{i,t}	0.008	0.008			
	(1.45)	(1.55)			
POST*ADOPT _{i,t}	-0.001	-0.001	0.001		
	(-0.09)	(-0.10)	(0.19)		
SIZE _{i,t}	-0.005***	-0.005***	0.001	-0.004**	-0.004***
	(-3.81)	(-4.21)	(0.07)	(-2.56)	(-2.97)
ROA _{i,t}	-0.138***	-0.138***	-0.124***	-0.157***	-0.157***
	(-7.61)	(-7.72)	(-5.94)	(-5.33)	(-4.03)
LOSS _{i,t}	-0.009*	-0.009*	-0.010	0.004	0.004
	(-1.74)	(-1.87)	(-1.51)	(0.58)	(0.58)
MTB _{i,t}	0.000	0.000	0.000	0.001	0.001
	(0.55)	(0.62)	(0.31)	(1.31)	(1.44)
LEV _{i,t}	-0.005	-0.005	-0.058*	-0.009	-0.009
	(-0.37)	(-0.38)	(-1.73)	(-0.47)	(-0.58)

Panel B: Content of the auditor's report and investors' reaction

Variables	Dep. Var. = ABRET _{t,t}				Dep. Var. = ABVOL _{t,t}			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
POST _{i,t}	0.002 (1.08)	0.001 (0.57)	0.001 (0.74)	0.000 (0.25)	-0.161* (-1.90)	-0.096 (-1.30)	-0.092 (-1.35)	-0.143** (-2.13)
LENGTH(1/0) _{i,t}	0.003 (1.48)				-0.086 (-1.09)			
POST*LENGTH(1/0) _{i,t}	-0.002 (-0.85)				0.187* (1.79)			
NRISKS _{i,t}		0.002 (0.77)				-0.058 (-0.74)		
POST*NRISKS(1/0) _{i,t}		0.000 (0.08)				0.072 (0.76)		
NRISKSAUD(1/0) _{i,t}			0.002 (0.74)				0.038 (0.48)	
POST*NRISKSAUD(1/0) _{i,t}			-0.001 (-0.20)				0.060 (0.58)	
MATPERC(1/0) _{i,t}				0.002 (1.01)			-0.123 (-1.63)	
POST*MATPERC(1/0) _{i,t}				0.001 (0.53)			0.148 (1.44)	
Intercept	0.050*** (5.74)	0.050*** (5.65)	0.049*** (5.92)	0.049*** (5.73)	-1.101* (-1.69)	-1.158* (-1.80)	-1.147* (-1.76)	-1.105* (-1.71)
Controls	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>
Industry F.E.	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>	<i>Included</i>
N. Obs.	1248	1248	1248	1248	1248	1248	1248	1248
Adj. R ²	0.11	0.11	0.11	0.12	0.05	0.05	0.05	0.05

Robustness Test

Panel C: Content of the auditor's report and audit fees

Variables	Dep. Var. = FEES _{i,t}	(1)	(2)	(3)	(4)
POST _{i,t}	−0.001 (−0.07)	−0.015 (−0.81)	−0.010 (−0.52)	−0.020 (−1.08)	
LENGTH(1/0) _{i,t}	0.237*** (4.00)				
POST*LENGTH(1/0) _{i,t}	0.012 (0.44)				
NRISKS _{i,t}		0.175*** (2.77)			
POST*NRISKS(1/0) _{i,t}		0.044 (1.62)			
NRISKSAUD(1/0) _{i,t}			0.022 (0.39)		
POST*NRISKSAUD(1/0) _{i,t}			0.025 (0.92)		

Robustness Test

Panel D: Content of the auditor's report and audit quality

Variable	Dep. Var. = DACCR _{i,t}			
	(1)	(2)	(3)	(4)
POST _{i,t}	0.002 (0.47)	0.002 (0.40)	0.005 (1.34)	-0.004 (-0.95)
LENGTH(1/0) _{i,t}	-0.000 (-0.04)			
POST*LENGTH(1/0) _{i,t}	-0.006 (-0.88)			
NRISKS _{i,t}		0.003 (0.56)		
POST*NRISKS(1/0) _{i,t}		-0.005 (-0.73)		
NRISKSAUD(1/0) _{i,t}			0.009 (1.60)	
POST*NRISKSAUD(1/0) _{i,t}			-0.012 (-1.63)	
MATPERC(1/0) _{i,t}				-0.001 (-0.21)
POST*MATPERC(1/0) _{i,t}				0.007

Robustness Test

Robustness Tests

- **Cross-study Alignment:** Findings consistent with Lennox et al. (2017). Investors already informed; risk disclosures lack incremental value. Also align with Reid et al. (2015, 2017) on fee/quality patterns.
- **Alt. Cutoffs (75th percentile):** Mixed results; NRISKS × POST negative for accruals (\downarrow quality), but positive for fees (\uparrow effort).
- **Alt. Control Groups:** Findings robust using AIM or size/industry-matched US firms as controls.
- **Alt. Accrual Estimations:** Balance sheet method (Reid et al. 2017): Only 1st-year effect on accruals, not persistent.
- **Alt. Audit Quality Proxies:**
 - Meet/beat forecast: No effect.
 - ERCs: No effect.
- **Year-specific Effects:** No significant results using just t, or excluding t. Only fee × NRISKS effect in t+1.
- **Alt. Investor Reaction Proxies:**
 - Bid-ask spread, AVAR: No effect.
 - Alt. abnormal volume: \downarrow volume around filing.

Overall: No robust evidence of investor or audit quality effects; fee response appears most consistent.

Comparison with Reid et al. (2015, 2017)

Aspect	Reid et al.	Gutierrez et al.
Investor Reaction	Abnormal trading volume increases post-reform	No consistent effects on returns, volume, or spreads
Audit Quality	Decline in accruals, less meet/beat, stronger ERCs	Some evidence in year t only; not robust overall
Audit Fees	No fee increases post-KAM	Similar: no systematic fee rise
Sample Period	2-year window ($t, t+1$)	Broader 4-year window ($t-1$ to $t+2$) with robustness
Proxies Used	Balance sheet accruals, ERC, meet/beat	Jones-model accruals, plus ERC, meet/beat tested

RQ: Does Expanded Report Affect Decision Usefulness for Equity Markets?

Critique of the Research Framing:

- **Assumes value = reaction:** Lack of price/volume response is lack of usefulness.
- **Overlooks purpose:** Original goal was to improve transparency and trust—not necessarily trading decisions.
- **Investor relevance unclear:** Do equity markets care about audit process details?
- **Misaligned format:** Technical language may alienate lay users; few actionable insights.
- **Boilerplate overload:** Lengthy disclosures can reduce attention and comprehension.
- **AI shifts cost:** Modern tools reduce human burden, but value still depends on content quality.
- **Missed opportunity:** First-mover study could have explored broader outcomes (e.g., trust, governance, readability).

RQ: Does Expanded Report Affect Audit Fees/Quality?

Critique of the Research Framing:

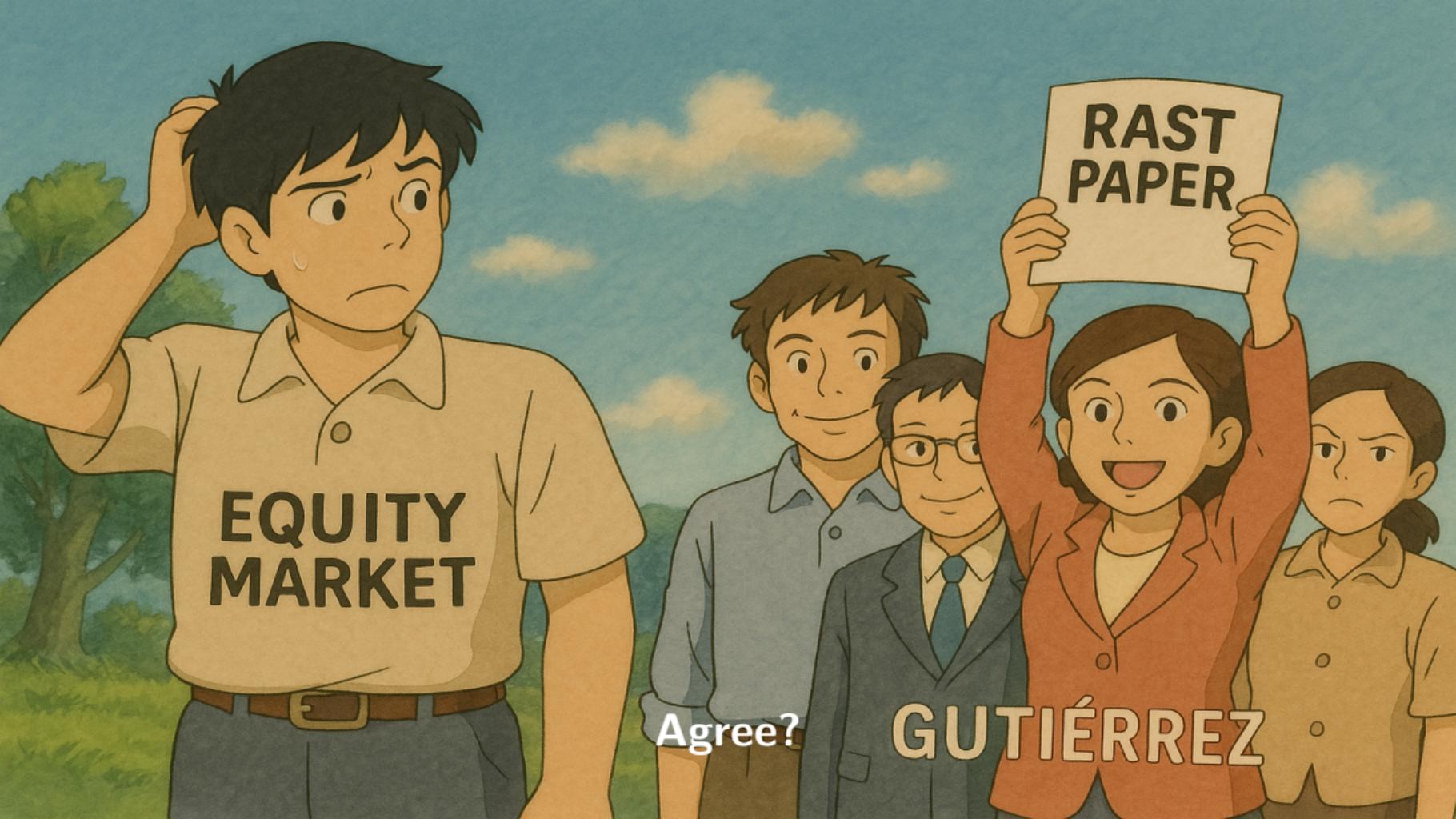
- Benefits depend on whether expanded reports
- Auditors were already sharing this information with audit committees (ISA 260); public disclosure may not materially change effort.
- When you make a burger, you let people know how you make the burger, do people care?
As long as its delicious

Theoretical Mechanism:

- *Transparency* → stronger scrutiny → higher audit effort if cost of poor quality rises.

Why This Study Was Published in RAST

- **First mover:** Archival evidence on the UK's expanded audit report before US rollout
- **User focus:** Attempts to empirically test audit report *usefulness* to investors
- **Design strength:** Exploits regulatory cutoff + AIM firms as control + DiD
- **Regulatory relevance:** Also set the front for the rollout of KAMs in 2017
- **Cost-benefit angle:** Does a regulation causing details of audit, not rigor, affect decision usefulness, and fees and quality?
- **Short horizon:** 2-year window may be too early due to resistance
- **Narrow lens:** Does not answer their own question of net social welfare
- **Unanswered question:** Is the *detail* of audit work equal to rigor? Do investors just want the *existence* of assurance?



EQUITY
MARKET

Agree?

GUTIÉRREZ

RAST
PAPER

Thank You!

For my research, visit:

hunterng.com

Questions or comments?

Email: hng@gc.cuny.edu

Thank you!

Premium vs Standard Listing on the LSE

Two categories of equity listings on the London Stock Exchange (LSE):

Criteria	Premium Listing	Standard Listing
Regulation	Must comply with UK Listing Rules and the UK Corporate Governance Code	Must meet EU/UK minimum disclosure requirements
Governance	High standards of corporate governance (comply or explain model)	Basic governance disclosures only
Issuer Type	Equity shares of trading or investment entities	Equity, GDRs, debt instruments, etc.
Eligibility for Indices	Eligible for FTSE 100/250 inclusion	Not eligible for FTSE indices
Free Float Requirement	Minimum 25% in public hands	Same 25% free float
Track Record	3 years of audited financial history (some exceptions)	Varies depending on instrument
Regulatory Burden	Higher compliance costs and scrutiny	Lighter regulatory burden

Only premium-listed companies were subject to the expanded auditor reporting (ISA 700, 2013).

Control Group: Alt Investment Market Companies & Modified Jones Model

AIM Companies as Control Group

- **AIM = Alternative Investment Market**

A sub-market of the London Stock Exchange (LSE) launched in 1995 to support smaller, growth-oriented companies.

- **Lighter Regulation**

AIM companies are subject to less stringent regulatory and disclosure requirements compared to Premium-listed firms. They are not required to comply with the UK Corporate Governance Code or the enhanced auditor reporting reforms.

- **Role in Research Design**

Used as a control group in difference-in-differences analyses to isolate the effects of the enhanced auditor's report, since they did not experience the reporting shock in 2013.

Audit Proxy Quality: Modified Jones Model

- Dependent variable: $|DACC_{i,t}|$ — absolute value of discretionary accruals
- Estimated using Jones model augmented with ROA:

$$TA_{i,t}/A_{i,t-1} = \alpha + \beta_1(1/A_{i,t-1}) + \beta_2\Delta REV_{i,t}/A_{i,t-1} + \beta_3PPE_{i,t}/A_{i,t-1} + \beta_4ROA_{i,t} + \varepsilon_{i,t}$$

- Higher $|DACC|$ indicates lower audit quality

Comparison with Reid et al. (2015, 2017)

Key Findings from Reid et al.:

- Reid (2015): Abnormal trading volume increased post-reform → suggests market reaction.
- Reid (2017): Audit quality improved:
 - ↓ Discretionary accruals
 - ↓ Meet-or-beat behavior
 - ↑ Earnings response coefficients
 - No significant increase in audit costs

Gutierrez et al. Response:

- Attempted replication using alternative design:
 - 4-year window vs. 2 years
 - DID vs. pre-post
 - More granular controls (AIM/US match)
- Using similar control vars and models: no significant effects on:
 - Investors' reaction (returns, volume)
 - Audit quality (accruals, ERCs, meet-or-beat)

Conclusion: Differences in findings attributed to time window, proxies, and sensitivity of discretionary accruals model. Gutierrez et al. confirm their null results using Reid's methods.